Selected information from the financial statements of Dell Company follows:

Dell Company
CURRENT ASSETS SECTION OF BALANCE SHEETS
(in thousands of dollars)

	DECEMBER 31 1997	DECEMBER 31 1996
Cash	$ 7,000	$ 7,200
Marketable securities at cost, which approximates market	26,000	22,000
Accounts receivable, net of allowance for doubtful accounts	210,000	190,000
Inventories	252,000	308,000
Prepaid expenses	5,000	4,800
Total current assets	$500,000	$532,000

STATEMENTS OF INCOME
(in thousands of dollars)

	YEAR ENDED DECEMBER 31 1997	YEAR ENDED DECEMBER 31 1996
Net sales	$ 1,200,000	$1,000,000
Costs and expenses:		
Cost of goods sold	$ 960,000	$ 800,000
Selling, general, and administrative expenses	147,000	120,000
Other, net	24,000	18,300
Total costs and expenses	$(1,131,000)	$ (938,300)
Income from continuing operations before income taxes	$ 69,000	$ 61,700
Income taxes	(26,900)	(25,300)
Income from continuing operations	$ 42,100	$ 36,400
Cumulative effect of change in estimates of salvage values of property, plant, and equipment, less applicable income taxes of $1,500,000	—	(3,000)
Net income	$ 42,100	$ 33,400
Earnings per share of common stock:		
Income from continuing operations	$4.21	$3.64
Cumulative effect of change in estimates of salvage values of property, plant, and equipment, less applicable income taxes	—	(.30)
Net income	$4.21	$3.34

Selected information from the summary of significant accounting policies in the notes to the financial statements of the Dell Company is as follows:

Inventories: Inventories are stated at the lower of cost (FIFO) or market.

Deferred income taxes: Deferred income taxes arise from timing differences when profits or expenses are included in taxable income on the income tax return later or earlier than they are included in the statement of income. Such timing differences relate principally to depreciation. A provision for deferred income taxes of $6,700,000 in 1997 and $6,300,000 in 1996 is included in the statements of income in "Other, net."

Selected information from other notes to the financial statements of the Dell Company is as follows:

Inventories: Inventories are comprised of the following:

	DECEMBER 31 1997	DECEMBER 31 1996
	(thousands of dollars)	
Finished goods	$176,000	$215,000
Goods in process	13,000	14,000
Raw materials	63,000	79,000
	$252,000	$308,000

Inventories at December 31, 1997 were reduced from a cost of $292,000,000 to a market value of $252,000,000 under the direct inventory reduction method. The cost of inventories at December 31, 1996 approximated their market value.

Accounting change: During the third quarter of 1996 Dell Company revised earlier estimates of salvage values for its property, plant, and equipment. This change in accounting reduced the 1996 net income by $3,000,000 ($0.30 per share).

REQUIRED

1. Are inventories and the related cost of goods sold presented appropriately? Explain why or why not. If the presentation is not appropriate, specify the appropriate presentation and explain why.
2. a) What are the components of the quick (acid-test) ratio?
   b) How should the quick ratio be used?
3. Is the provision for deferred income taxes presented appropriately? Explain why or why not. If the presentation is not appropriate, specify the appropriate presentation and explain why.
4. Is the accounting change presented appropriately? Explain why or why not. If the presentation is not appropriate, specify the appropriate presentation and explain why. Assume that the accounting change did not involve deferred income taxes.

(25%)

二、

In 1969, the Accounting Principles Board issued APB Opinion No. 15, "Earnings per Share". APB Opinion No. 15 required that EPS be reported and prescribed how these amounts would be computed and disclosed. APB Opinion No. 15 defined a simple capital structure for which it prescribed a single EPS presentation, and a complex capital structure for which it prescribed a dual EPS presentation. APB Opinion No. 15 has been amended several times by statement of the Financial Accounting Standard since 1969. Recently, FASB statement No. 128, "Earnings per Share" supersedes APB Opinion No. 15 and the related Interpretations of Opinion 15.

Instructions

(a) Explain why the existence of convertible securities and other financing instruments necessitated the reporting requirements for EPS prescribed by *APB Opinion No. 15*.

(b) Much of the effort involved in reporting EPS concerns the identification of common stock equivalents.
   1. In addition to convertible securities that meet the yield test for common stock equivalence, what other items are considered common stock equivalents?
   2. Describe the circumstances under which a convertible security that meets the yield test for common stock equivalence would not be assumed to be converted in the computation of EPS.

(c) *Statement of Financial Accounting Standards No. 55*, "Determining Whether a Convertible Security Is a Common Stock Equivalent," which was adopted in 1982, changed the test for common stock equivalence from, "a cash yield of less than 66⅔ percent of the then current bank prime interest rate" as prescribed in *APB Opinion No. 15*, to "a cash yield of less than 66⅔ percent of the then current average Aa corporate bond yield." Explain the reason for this change.

(d) *Statement of Financial Accounting Standards No. 85*, "Yield Test for Determining Whether a Convertible Security is a Common Stock Equivalent," which was adopted in 1985, changed the test for common stock equivalence from the "cash yield test" as prescribed in *APB Opinion No. 15* and continued in *Statement of Financial Accounting Standards No. 55*, to the "effective yield test." Explain the reason for this change.

(e) List the main requirements prescribed by SFAS No. 128, which changed those prescribed by APB Opinion No. 15. Explain the reason for this change.

(25%)

三、 Balboa Manufacturing Company, a California corporation listed on the Pacific Coast Stock Exchange, budgeted activities for 1996 as follows:

	Amount	Units
Net sales	$9,000,000	1,000,000
Cost of goods sold	5,400,000	
Gross margin	$3,600,000	
Selling, general, and administrative expenses	2,100,000	
Operating income	$1,500,000	
Nonoperating revenues and expenses	-0-	
Income before income taxes	$1,500,000	
Estimated income taxes (current and deferred)	600,000	
Net income	$ 900,000	
Earnings per share of common stock	$9.00	

Balboa has operated profitably for many years and has experienced a seasonal pattern of sales volume and production similar to those below forecasted for 1996. Sales volume is expected to follow a quarterly pattern of 10%, 20%, 35%, 35%, respectively, because of the seasonality of the industry. Also, owing to production and storage capacity limitations, it is expected that production will follow a pattern of 20%, 25%, 30%, 25%, per quarter, respectively.

At the conclusion of the first quarter of 1996, Vasco DeGamo, the controller of Balboa, has prepared and issued the following interim report for public release:

	Amount	Units
Net sales	$ 900,000	100,000
Cost of goods sold	540,000	100,000
Gross margin	$ 360,000	
Selling, general, and administrative expenses	412,500	
Operating loss	$ (52,500)	
Loss from warehouse fire	(262,500)	
Loss before income taxes	$(315,000)	
Estimated income taxes	-0-	
Net loss	$(315,000)	
Loss per share of common stock	$(3.15)	

The following additional information is available for the first quarter just completed, but was not included in the public information released:

1. Assume that the warehouse fire loss met the conditions of an extraordinary loss. The warehouse had an undepreciated cost of $480,000; $217,500 was recovered from insurance on the warehouse. No other gains or losses are anticipated this year from similar events or transactions, and Balboa had no similar losses in preceding years; thus, the full loss will be deductible as an ordinary loss for income tax purposes.
2. The company uses a standard cost system in which standards are set at currently attainable levels on an annual basis. At the end of the first quarter there was underapplied fixed factory overhead (volume variance) of $75,000 that was treated as an asset at the end of the quarter. Production during the quarter was 200,000 units, of which 100,000 were sold.
3. The selling, general, and administrative expenses were budgeted on a basis of $1,350,000 fixed expenses for the year plus 75¢ variable expenses per unit of sales.
4. The effective income tax rate, for federal and state taxes combined, is expected to average 40% of earnings before income taxes during 1996. There are no permanent differences between pretax accounting earnings and taxable income.
5. Earnings per share were computed on the basis of 100,000 shares of capital stock outstanding. Balboa has only one class of stock issued, no long-term debt outstanding, and no stock option plan.

Instructions

(a) Without reference to the specific situation described above, what are the standards of disclosure for interim financial data (published interim financial reports) for publicly traded companies? Explain.
(b) Identify the weaknesses in form and content of Balboa's interim report without reference to the additional information. Explain.
(c) For each of the five items of additional information, indicate the preferable treatment for each item for interim reporting purposes and explain why that treatment is preferable.

(25%)

四

"Why me?" thought Alan Burke. "My first day on the job at the bank and instead of getting a company with a nice single set of financial statements, I get five separate sets of statements that supposedly fit together."

Alan Burke had just started as a new credit analyst for the First National Bank of Audelin, having just completed an MBA degree with a major in finance at the local university. From the loan officer responsible for this client, Alan learned the following information about each of the four companies associated with UFS Corporation and about the UFS Corporation itself.

UFS CORPORATION

The UFS Corporation was a manufacturing company whose principal products were microwave ovens, refrigerators, and conventional ovens. The company had had a long history (over 50 years) of selling high-quality, high-priced home appliances; however, recent reductions in the prices of competitor products had forced UFS to consider ways to provide assistance to its customers to help them buy its products. As a consequence, UFS had started its own finance subsidiary, the UFS Acceptance Corporation, to assist customers in the financing of their purchases.

UFS Corporation was also associated with three other companies. It held an 80 percent interest in Scrub-All, a company that made automatic dishwashers. UFS had purchased this interest in Scrub-All because the company's product line complemented its own, and the products were of a quality that UFS would have had difficulty duplicating. Further, to ensure a steady supply of chrome parts for its appliances, UFS had obtained a 10 percent interest in the common stock of Acme Chrome Company. Well over 50 percent of Acme's sales were attributed to purchases by UFS and Scrub-All. Also, in order to compete in the low-end market for various appliances, UFS Corporation formed a joint venture with Whirlwind Products Co. for the production of such appliances.

UFS ACCEPTANCE CORPORATION

Created nearly five years ago, the UFS Acceptance Corporation was a wholly owned subsidiary that purchased consumer notes from its parent, the UFS Corporation. UFS Acceptance borrowed funds from several banking institutions on a medium- and long-term basis, and used the margins between the short-term interest rates on the consumer notes and the rates on its medium- and long-term liabilities to cover its overhead costs. The parent company guaranteed all of the borrowings of UFS Acceptance Corporation.

SCRUB-ALL COMPANY

With an ownership interest of 80 percent of the common stock of Scrub-All, UFS Corporation controlled the tactical and strategic policies of the Scrub-All Company through an interlocking board of directors. Scrub-All, like UFS, sold its consumer notes to UFS Acceptance Corporation. The family that originally started Scrub-All still holds a 20 percent ownership interest in the common stock of the company.

ACME CHROME COMPANY

In order to guarantee a steady supply of chrome parts and that a company would work with the engineers of UFS in the design of new parts, UFS had purchased a 10 percent interest in Acme Chrome Company. Over the years, a strong relationship had developed between UFS and Acme. For example, Acme scheduled the production runs of its other customers around the production needs of UFS and Scrub-All.

SPOTLESS APPLIANCE CO.

Both UFS Corporation and Whirlwind Products Co. contributed half of the funds necessary to start Spotless Appliance Co. Spotless Appliance Co. makes low-end priced appliance models, which are sold under the Spotless trade name or are labeled with various department store names. The board of directors of Spotless Appliance Co. consists of an equal number of members voted in by each of UFS Corporation and Whirlwind Products Co. and three members from outside either of the respective companies. Any debt of Spotless is guaranteed by both UFS Corporation and Whirlwind Products Co.

Mike Hussis, the loan officer responsible for UFS, provided Alan with the financial statements of the five companies (Exhibits 1–5) and asked him to answer some basic credit review questions concerning an expansion loan application that had been received from the parent company. Before Alan could complete the credit review, he identified the following questions that needed to be addressed in order to understand the relationship between the various companies.

EXHIBIT 1

UFS CORPORATION
Consolidated Balance Sheet
December 31, 1988

Assets	
Current assets	$ 87,500,000
Notes receivable	58,000,000
Investment in stock of Spotless Appliance at equity (50%)	1,750,000
Investment in stock of Acme Chrome Company (10%) at cost	5,000,000
Other assets	101,500,000
Goodwill	3,800,000
Total assets	$257,550,000
Liabilities and Stockholders' Equity	
Current liabilities	$ 81,500,000
Long-term liabilities	102,100,000
Minority interest	7,500,000
Common stock	15,000,000
Retained earnings	51,450,000
Total liabilities and stockholders' equity	$257,550,000

EXHIBIT 2

UFS ACCEPTANCE CORPORATION
Balance Sheet
December 31, 1988

Assets	
Current assets	$ 8,000,000
Notes receivable	58,000,000
Other assets	6,500,000
Total assets	$72,500,000
Liabilities and Stockholders' Equity	
Current liabilities*	$ 5,000,000
Long-term debt	47,100,000
Common stock ($1 par)	10,000,000
Retained earnings	10,400,000
Total liabilities and equities	$72,500,000

* $3,000,000 of the current liabilities is a promissory note to UFS Corporation. UFS Corporation accounts for this as a long-term receivable in Other Assets.

EXHIBIT 3

SCRUB-ALL COMPANY
Balance Sheet
December 31, 1988

Assets	
Current assets	$16,400,000
Other assets	52,600,000
Total assets	$69,000,000
Liabilities and Stockholders' Equity	
Current liabilities	$13,350,000
Long-term liabilities	18,150,000
Common stock	12,000,000
Retained earnings	25,500,000
Total liabilities and stockholders' equity	$69,000,000

EXHIBIT 4

ACME CHROME COMPANY
Balance Sheet
December 31, 1988

Assets	
Current assets	$14,750,000
Other assets	36,250,000
Total assets	$51,000,000
Liabilities and Stockholders' Equity	
Current liabilities	$ 5,000,000
Long-term liabilities	15,000,000
Capital stock	18,750,000
Retained earnings	12,250,000
Total liabilities and stockholders' equity	$51,000,000

EXHIBIT 5

SPOTLESS APPLIANCE COMPANY
Balance Sheet
December 31, 1988

Assets	
Current assets	$ 8,500,000
Other assets	16,000,000
Total assets	$24,500,000
Liabilities and Stockholders' Equity	
Current liabilities	$ 3,000,000
Long-term debt	18,000,000
Common stock ($1 par)	6,000,000
Retained earnings	(2,500,000)
Total liabilities and equities	$24,500,000

QUESTIONS

1. Why are investments in Acme Chrome and Spotless Appliance Co. shown on the balance sheet, while the investments in Scrub-All and UFS Acceptance Corporation are omitted?
2. What is meant by the carrying value "at equity" for the investment in Spotless Appliance Co.?
3. Why is the investment in Acme Chrome Company shown "at cost"?
4. Explain the "goodwill" account. What other name is sometimes used instead of goodwill and to what company is this account related?
5. What is meant by "minority interest" and to what company is this account related? Is this a liability or an equity account?
6. What are UFS Corporation's current ratio, debt-to-equity ratio, and debt-to-asset ratio? Are these ratios at an acceptable level?
7. How would the balance sheet of UFS Corporation appear if Spotless Appliance Co. were consolidated? Would you recommend consolidation for Spotless? Can an argument be made for consolidating Acme Chrome Company?
8. How does the balance sheet of the parent company appear without any of the subsidiaries consolidated? Would you use this statement to make your credit decision?

(25%)