

Week 7 DQ 1
Due Tuesday, Day 2

Post your answer to Study Question 5.2 on p. 180 (Ch. 5). As you read your classmates' responses, consider the following scenario: If you compared two different companies that utilized two different valuation methods, how might the quality of the results differ? Also, comment on the difficulty of making comparisons between two firms that use different valuation methods.

Understanding the different inventory methods is crucial. First the person that establishes the inventory needs to determine which method to use. LIFO, or FIFO. LIFO means Last in First Out. This means that when a purchase is made, and sales are recorded the newest product is used first. So if I bought 10 combs at \$2 on December 1st, and then I buy 5 combs at \$2.50 on December 10th. When sales are made I am going to record sales using the \$2.50 until I sell through the 5 combs that were purchased on the 10th, and then the cost will go to the previous purchase price of \$2 until those 10 combs are sold through. FIFO is just the opposite. Meaning that goods are used in the order that they are received. The first items ordered, are the first items sold. Either method will pass an audit. It is important to note though that managers can't switch back and forth between the two methods. Profit will vary depending on which method is being used. Say you sold only 6 combs at \$3 each. Using the LIFO method this would equal \$3.50 profit. If you used the FIFO method, this would result in a \$6.00 profit.

Response 2

Post your answer to Study Question 5.2 on p. 180 (Ch. 5). As you read your classmates' responses, consider the following scenario: If you compared two different companies that utilized two different valuation methods, how might the quality of the results differ? Also, comment on the difficulty of making comparisons between two firms that use different valuation methods.

It is very important to understand which inventory valuation method is being used to determine the profit numbers quality. The balance sheet, statement of cash flow and income statement can be directly impacted by the valuation method that used to determine the costs of inventory. The three methods that are used are FIFO, LIFO and Average Cost. The valuation ratios can be dramatically affected depending on the inventory valuation that is being used over a long-term period; especially because prices are likely to rise. When using FIFO you can increase net

income, but then at the same time raise the amount taxes that business is obligated to pay. When using LIFO the inventory can be obsolete because they are old this will result in lower net revenue because the products pricing is higher. The Average Cost results usually fall between LIFO and FIFO. The bottom line can be affected mainly by the inventory analysis and the ratio results that are formed from that analysis. It is easier to compare companies that are in the same line of business, so I believe that quality of results would differ tremendously if different valuation methods were used. If you use LIFO that company may seem unattractive but they are performing well, as for FIFO it may look good as for profit, but may not be performing well.

DQ 2

Week 7 DQ 2
Due Thursday, Day 4

Post your answer to Study Question 5.6 on p. 180 (Ch. 5).
Discuss the consequences of poor quality reporting. What has the U.S. government done to improve the quality of reporting after recent financial scandals such as Enron?

I think that the significance is that the analysts only see this one HUGE transaction. The events that actually led up to this large transaction actually took place over a 2 year period. These items should have been written off as they occurred. Wall Street would not have known that the executives refused to write off these accounts when they should have. Wall Street only see's the one large transaction. If the company would have been more honest in their reporting they would have seen (more than likely) that there were many accounts over a two year period that should have been written off at different periods. So the analysts would not have seen a pattern of recurring write-offs. If the analysts only see the one transaction they are less likely to be able to paint an accurate picture of the financial standing of the business for investors, or potential investors. If the investors could see that there were many accounts that had to be written off maybe their investing decisions

would have been different. The regulation of the accounting field has grown by leaps and bounds since the Enron scandal. The government has implemented several agencies and regulations to ensure honesty in accounting practices. SOX is one example of an agency that has been put into place to ensure honesty in accounting. SOX implements things like internal controls, and accountability for CEO's and CFO's.

Response 2

I believe the impact and importance of this write-off event is a very big matter. It is obvious how they handled it that it was a scandal from the start. I think that everyone involved had a big role in how things played out. To me I think of the investors as a really big hit to this but also feel that audit committees have to be held responsible as well. It has been shown over many examples that audit oversights are happening to financial reporting. Although I do feel they are getting better and tighter due to conforming tightly with the GAAP requests. I feel over time the accounts receivable should have been written off in smaller increments and not all taken by \$405 million at once. Maybe that isn't correct but it would have been easier I would think to take the receivables over time.

Response 3

Wall Street should have read the footnotes and seen that the write off was for accounts receivables and should have been reported in the allowance for doubtful accounts. Every company that allow sales on credit face doubtful accounts; therefore, the write off may reoccur. The significance of this transaction is that WorldCom want to cover up the \$405 million dollars that it was unable to collect from its customers, but WorldCom wrote off a large sum of money rather recording the write-off as needed and the analyst over looked it. Depending on how the company policy is for writing off accounts, from 1998 to the 3rd quarter in 2000 is 11 quarters. If the company wrote off bad accounts quarterly it should have wrote off 36,818,181.82 per quarter. Investors would not want to continue to invest into a company that has poor collection skills, or poor management. Unusual items are simply for those items that are not recurring operating expenses. Bad debts do not fall under this category. Since the Enron and WorldCom scandals many rules and regulations have been put in place by the government such as SOX. More people are being held accountable for their actions and consequences follow poor quality reporting such as fudging the books.