CHAPTERS 10 AND 11: PROPERTY, PLANT, AND EQUIPMENT (10 POINTS)

**Earnings Management Case**

Background: Earnings management is a serious issue in the financial reporting world. Public accountants and company employees are often pressured to meet certain earnings targets. The following case is from your text and discusses how the accounting for property and equipment can be used to manage the bottom line.

Required*:* Read the case below and answer the following questions.

Jerry Prior, Beeler Corporation’s controller is concerned that net income may be lower this year. He is afraid upper-level management might recommend cost reductions by laying off accounting staff, including him.

Prior knows that depreciation is a major expense for Beeler. The company currently uses the double-declining balance method for both financial reporting and tax purposes, and he’s thinking of selling equipment that, given its age, is primarily used when there are periodic spikes in demand. The equipment has a carrying value of $2,000,000 and a fair value of $2,180,000. The gain on the sale would be reported in the income statement, but he doesn’t want to highlight this method of increasing income. He thinks, “Why don’t I increase the estimated useful lives and the salvage values? That will decrease depreciation expense and require less extensive disclosure, since the changes are accounted for prospectively. I may be able to save my job and those of my staff.”

1. Who are the stakeholders in this situation?
2. What are the ethical issues involved?
3. What should Prior do?

**Financial Statement Impacts**

Background: ABC Co recently spent $1,200,000 to acquire a piece of equipment. The accounting staff is unsure how to properly classify and record the purchase. One employee argues that future benefits of the equipment are unknown beyond the current year and that the expenditure should be expensed completely on the current year income statement. Another employee argues that the expenditure will benefit the current year plus two additional years and should be capitalized as a depreciable asset, depreciating it to a $0 salvage value using straight-line over a 3 year time period.

Required: Using the template provided on Blackboard, show the financial statement impacts of these two alternatives over the three year period. Ignore income taxes. You will not need to use all lines in the template.