Because comparability is an important qualitative characteristic of accounting information, should the board accept the explanation of management? How should the information about the change in the depreciation method be displayed in the financial statements?

**Discussion Case 4-55**

### How Can My Company Have Income but No Cash?

Max Stevenson owns a local drug store. During the past few years, the economy has experienced a period of high inflation. Stevenson has had the policy of withdrawing cash from his business equal to 80% of the company's reported net income. As the business has grown, he has had a CPA prepare the company's financial statements and tax returns. The following is a summary of the company's income statement for the current year:

| | |
|---|---|
| Revenue | $565,000 |
| Cost of goods sold (drugs, etc.) | 395,000 |
| Gross profit on items sold | $170,000 |
| Operating expenses (including taxes) | 110,000 |
| Net income | $ 60,000 |

Even though the business has reported net income each year, it has experienced severe cash flow shortages. The company has had to pay higher prices for its inventory as the company has tried to maintain the same quantity and quality of its goods. For example, last year's cost of goods sold had a historical cost of $250,000 and a replacement cost of $295,000. The current year's cost of goods sold has a replacement cost of $440,000. Stevenson's personal cash outflows have also grown faster than his withdrawals from the company due to increasing personal demands.

Stevenson asks you as a financial advisor how the company can have income of $60,000 yet he and the company still have a shortage of cash.

**Discussion Case 4-56**

### When Should Revenue Be Recognized?

Stan Crowfoot is a renowned sculptor who specializes in Native American sculptures. Typically, a cast is prepared for each work to permit the multiple reproduction of the pieces. A limited number of copies are made for each sculpture, and the mold is destroyed after the number is reached. Limiting the number of pieces enhances the price, and most of the pieces have initially sold for $2,000 to $4,000. To encourage sales, Stan has a liberal return policy that permits customers to return any unwanted piece for a period of up to one year from the date of sale and receive a full refund.

Do you think Stan should recognize revenue (1) when the piece is produced and cast in bronze, (2) when the goods are delivered to the customer, or (3) when the period of return has passed? Justify your answer in terms of the FASB conceptual framework.

**Discussion Case 4-57**

### The Revenue Recognition Process

You are engaged as a consultant to Skyways Unlimited, a manufacturer of satellite dishes for television reception. Skyways sells its dishes to dealers who in turn sell them to customers. As an inducement to carry sufficient inventory, the dealers are not required to pay for the dishes until they have been sold. There is no formal provision for return of the dishes by the dealers; however, Skyways has requested returns when a dealer's sales activity is considered to be too low. Overall, returns have amounted to less than 10% of the dishes sent to dealers. No interest is charged to the dealers on their balances unless they do not remit promptly upon the sale to a customer.

At what point would you recommend that Skyways recognize the revenue from the sale of dishes to the dealers?

**Discussion Case 4-58**

### We Just Changed Our Minds

Management for Marlowe Manufacturing Company decided in 2007 to discontinue one of its unsuccessful product lines. (The product line does not meet the definition of a business component.) The planned discontinuance involved obsolete inventory, assembly lines, and packaging and advertising supplies. It was estimated that a loss of $250,000 would result from the decision, and this estimate was recorded as a restructuring charge in the 2007 income statement. In 2008, new management was appointed, and it was decided that the

**Discussion Case 5-58**

### Which Method Should We Use: The Direct or the Indirect Method?

As the assistant controller of Do-It-Right Company, you have been given the assignment to study FASB *Statement No. 95* and make recommendations on how the company should prepare its statement of cash flows. Specifically, you are to indicate which method—the direct or the indirect—should be used in reporting cash flows from operating activities. Which method do you recommend and why?

**Discussion Case 5-59**

### Some Accountant You Are!

Early in the year 2009, John Roberts, a recent graduate of Southeast State College, delivers the financial statements shown below to Laura Dennis of Dennis, Inc. After a quick review, Dennis exclaims, "What do you mean I had net income of $20,000? I borrowed $40,000 from the bank and my cash balance decreased by $2,000. I must have had a loss! Some accountant you are!" How should Mr. Roberts answer Ms. Dennis?

**Dennis, Inc.**
**Comparative Balance Sheet**
**December 31, 2008 and 2007**

| | 2008 | 2007 |
|---|---|---|
| **Assets** | | |
| Cash | $ 3,000 | $ 5,000 |
| Accounts receivable | 18,000 | 8,000 |
| Inventory | 20,000 | 15,000 |
| Equipment (at cost) | 52,000 | 20,000 |
| Accumulated depreciation | (10,000) | (5,000) |
| Total assets | $83,000 | $43,000 |
| **Liabilities and Stockholders' Equity** | | |
| Accounts payable | $ 4,000 | $ 9,000 |
| Notes payable—long-term | 40,000 | — |
| Common stock, $1 par | 2,000 | 2,000 |
| Additional paid-in capital | 18,000 | 18,000 |
| Retained earnings | 19,000 | 14,000 |
| Total liabilities and stockholders' equity | $83,000 | $43,000 |

**Dennis, Inc.**
**Combined Statement of Income and Retained Earnings**
**For the Year Ended December 31, 2008**

| | | |
|---|---|---|
| Sales | | $240,000 |
| Cost of goods sold | $150,000 | |
| Operating expenses (including depreciation of $5,000) | 70,000 | 220,000 |
| Net income | | $ 20,000 |
| Add: Retained earnings, January 1, 2008 | | 14,000 |
| Deduct: Dividends paid | | (15,000) |
| Retained earnings, December 31, 2008 | | $ 19,000 |

**Discussion Case 5-60**

### How to Generate Cash

Assume that you own and operate a small business. You have just completed your forecasts and budgets for next year and realize that you will need an infusion of $30,000 cash to get you through the year. You are reluctant to seek a partner because you do not want to dilute your control of the business. Preliminary talks with several lenders convince you that you probably won't be able to get a loan. What can you do to raise the $30,000 cash necessary to get you through the year?

**Discussion Case 5-61**

### Cash Flow per Share

In *Statement No. 95*, the FASB explicitly prohibited the reporting of "cash flow per share" in the financial statements. Cash flow per share is an amount often reported by firms outside the financial statements and is often included in financial analyses prepared by