ISSUES IN ACCOUNTING EDUCATION
Vol. 27, No. 2
2012
pp. 461–474

American Accounting Association
DOI: 10.2308/iace-50005

Super Electronics, Inc.: Financial Reporting of Sales Incentives and Vendor Allowances Using FASB Codification

Mahendra R. Gujarathi

ABSTRACT: Super Electronics, Inc., a specialty retailer, has recently initiated several sales incentives and has entered into a long-term purchase arrangement with a major vendor that entitles it to sliding discounts based on its level of purchases. Using FASB Accounting Standards Codification, you are to determine whether the Company's existing policies comply with Generally Accepted Accounting Principles (GAAP). You are also required to evaluate the soundness of the proposals that SE's management has made during the process of annual audit and explore plausible motivations behind them. The case provides an opportunity to examine several technical and conceptual accounting issues in a real-world setting, strengthen accounting research capabilities, understand implications of the choice of an accounting policy for performance measurement and financial statement analysis, and develop advanced critical thinking and professional judgment skills.

Keywords: FASB codification; vendor allowances; customer loyalty programs; membership fees; price protection plans.

CASE

Company Overview

Super Electronics, Inc. (SE or the Company) is a regional specialty retailer of consumer electronics, home office products, entertainment software, appliances, and related services. The Company has committed to the goals of growth and innovation ever since its incorporation in 1990. It was among the first few large retailers to sell emerging electronics items such as digital cameras, camcorders, flat-panel televisions, and GPS navigation systems to the mass market. SE provides extensive training about the new products to its sales associates so that they can make it easier for even the least technologically savvy customer to try newer electronic gadgets.

Mahendra R. Gujarathi is a Professor at Bentley University and Visiting Professor at Indian Institute of Management, Ahmedabad.

The author thanks the editor, associate editor Lori Holder-Webb, two anonymous reviewers, Professors Kam Chan, Dorothy Feldmann, Liz Keating, Kartik Raman, William Read, and Ari Yezegel for their comments and suggestions on the earlier versions of the case.

Published Online: January 2012

In the last decade, the Company has focused not only on increasing the sales of electronic products but also on capturing a significant share of the electronics installation market. SE services products purchased from its stores as well as from other retail or online outlets. The Company's reputation for large attractive stores, technical assistance for product selection, and expert installation and repair services has enabled it to achieve double-digit growth in revenues and a number of stores over the last several years. In 1999, SE launched an e-commerce site that sells a full range of the Company's products.

Performance

Compared to other firms in the specialty retailing industry, the Company has demonstrated above-average growth in sales and gross margins in the last decade. The Company's management is optimistic that this trend will continue for the foreseeable future. In fiscal 2008,[1] SE reported the highest comparable stores' sales growth[2] in the specialty electronics industry. However, preliminary results for fiscal year 2008 (ending on February 28, 2009) indicate that the Company might not be able to meet the $3.00 per share analysts' earnings estimate.

The Company's Board of Directors has placed SE's performance in the top quintile in the industry on many dimensions. Externally, too, SE's financial performance is well recognized. Moody's has assigned an investment grade rating (Aa) to the Company's bonds, and SE's stock trades at a multiple of 16 to its earnings (in comparison with the average of 12 for the industry). Analysts have attributed the high price multiple to the Company's growth prospects and the strategic direction articulated by its management.

SE's preliminary financial statements for the 2008 fiscal year are provided in Exhibit 1. They are not final; only upon further evaluation and approval by the external auditing firm will the financial statements be filed with the Securities and Exchange Commission (SEC).

Recent Initiatives

In its 2008 annual report, SE's management has reported implementation of the following new initiatives.

Customer Loyalty Program

SE initiated Super Rewards Program (SRP) in fiscal 2008 to compete with other retailers that have started customer loyalty programs. Such programs are deemed cost-effective because enticing a new customer tends to be more expensive than getting an existing customer to purchase more.[3] SE's program aims at acquiring information regarding customers' spending habits and motivates them to return often to SE for additional purchases. By tracking the frequency, amounts, and types of purchases made by the customers, the Company can design more effective sales and promotion strategies.

For an annual membership fee of $24, customers enrolled in SRP receive announcements of special sales, product coupons, and invitations to shopping events. The annual membership fee comes with a "complete satisfaction" guarantee. If a customer is not satisfied with SRP for any reason, the Company is obliged to refund the fees for the unused period of membership.

[1] The Company's fiscal year begins on March 1 and concludes at the end of February.
[2] Comparable stores sales growth is a commonly used measure in the retail industry to measure the growth in revenue from the existing stores.
[3] In the United States, it is estimated that almost 75 percent of consumers own at least one loyalty card, with over a third of all shoppers owning two or more. The popularity of customer loyalty programs is on the rise. Even luxury hotel chains such as Ritz-Carlton have added such programs recently (*Wall Street Journal* 2010).

Strategic Sourcing (Vendor Allowance)

The Company made concerted efforts in the area of strategic sourcing and aggressive sales promotion of flat-panel televisions and digital cameras. According to the 2008 annual report, the Company's procurement policies and large size enabled it to secure low prices from its vendors, which were passed on as savings to the customers. In 2008, the Company has established long-term strategic alliances with select suppliers, including one with a major vendor of flat-panel televisions. In addition, the management of the Company expects to finalize negotiations with several additional vendors in the near future.

EXHIBIT 1
Super Electronics, Inc.

EXHIBIT 1A

Super Electronics, Inc.
Statement of Financial Position

(Amounts in thousands)	**2/28/2009 (Tentative)**	**2/29/2008**
Current Assets		
Cash and cash equivalents	$57,520	$48,200
Receivables	21,960	73,920
Merchandise inventories	188,320	160,400
Other current assets	27,040	48,480
Total Current Assets	$294,840	$331,000
Property and Equipment		
Land and buildings	46,280	28,200
Leasehold improvements	83,080	61,600
Fixtures and equipment	141,000	114,600
	$270,360	$204,400
Less: accumulated depreciation	92,080	78,640
Net Property and Equipment	$178,280	$125,760
Other Assets	$61,200	$30,600
Total Assets	$534,320	$487,360
Current Liabilities		
Accounts payable	$164,026	$144,995
Accrued income taxes	20,240	22,740
Other current liabilities	37,347	55,703
Total Current Liabilities	$221,613	$223,438
Long Term Debt	$111,203	$84,594
Shareholders' Equity		
Common stock, $0.01 par value; Authorized - 50 m shares	$1,600	$1,600
Additional paid in capital	17,200	17,200
Retained earnings	182,704	160,528
Total Shareholders' Equity	201,504	179,328
Total Liabilities and Shareholders' Equity	$534,320	$487,360

(continued on next page)

American Accounting Association

EXHIBIT 1 (continued)

EXHIBIT 1B: The Effect of Truncation Bias

Super Electronics, Inc.
Statement of Operations

(Amounts in thousands except number of stores and per share data)	**Year Ended February 29 or 28**					
	2009 (Tentative)	**Percent of Sales**	**2008**	**Percent of Sales**	**2007**	**Percent of Sales**
Net sales	$1,600,920	100.00	$1,437,360	100.00	$1,273,120	100.00
Cost of sales, buying & warehousing	1,219,080	76.15	1,086,600	75.60	974,880	76.57
Gross profit	381,840	23.85	350,760	24.40	298,240	23.43
Selling, general and adm. expenses	284,400	17.76	270,800	18.84	233,280	18.32
Operating income	97,440	6.09	79,960	5.56	64,960	5.10
Interest expense	2,480	0.15	1,240	0.09	1,208	0.09
Other (loss) income	1,000	0.06	1,200	0.08	1,128	0.09
Income before income taxes	95,960	5.99	79,920	5.56	64,880	5.10
Income tax expense	38,384	2.40	31,968	2.22	25,952	2.04
Net earnings	$57,576	3.60	$47,952	3.34	$38,928	3.06
W. Avg. common shares outstanding	20,000		20,000		20,000	
Earnings per share	$2.88		$2.40		$1.95	
No. of stores open for longer than 12 months	443		407		361	

Statement of Retained Earnings (Amounts in thousands)	**2009 (Tentative)**	**2008**	**2007**
Beginning balance	$160,528	$143,488	$132,600
Net earnings	57,576	47,952	38,928
Dividends	(35,400)	(30,912)	(28,040)
Ending balance	$182,704	$160,528	$143,488

Price Protection Plan

To secure an edge over the competition, SE introduced a price protection plan for "big-ticket" items (priced at $499 and above) in fiscal 2008. If an item purchased by a customer goes on sale at SE at a lower price within 60 days of sale, the customer can present the original sales receipt and get a refund for the difference between the price paid and the new lower price.

Financial Reporting for Recent Initiatives

During the annual audit for fiscal 2008, the audit team asked SE's management about the financial transactions relating to the new initiatives of the Company and the financial reporting policies it has followed for them. A summary of this discussion is given below.

Customer Loyalty Program

The Company sold 25,000 SRP memberships per month in fiscal year 2008, resulting in proceeds of $7,200,000 (25,000 memberships × 12 months × $24 membership price) in net sales.

SRP members earn two points for each qualifying purchase of $1 of products and services of the Company. Points earned enable members to receive a certificate that can be redeemed on future purchases. SE issues a $5 certificate for every 100 points earned by a member. The certificate expires one year after issuance.

SRP members made qualifying purchases totaling $330 million during 2008. With no historical experience with point redemption, the Company recorded the entire retail value ($33 million) of the certificates issued as a reduction in sales and an increase in accrued liabilities. Customers "spent" (i.e., used) $23 million of the certificates in fiscal 2008, and $5 million of the certificates expired before February 28, 2009. When SRP certificates are used or expired, they have been recorded as a sale and a decrease in accrued liabilities.

Strategic Sourcing (Vendor Allowances)[4]

Because of the strategic sourcing initiative, the Company was able to negotiate significant allowances from a major vendor of flat-panel televisions. The vendor agreement stipulates that SE receives a 7 percent refund on all purchases if it commits to purchase at least $100 million of flat-panel televisions over a three-year period. If the purchase commitment exceeds $150 million, the vendor will give an additional 1 percent refund, making the total refund 8 percent. The vendor granted higher allowances and flexible payment terms to SE in order to lock in the multi-year purchase commitment. Obtaining such commitments has lately become challenging to vendors because of the poor economic environment in the retailing industry.

The vendor has agreed to pay SE 5 percent of the amount of the total three-year purchase commitment at the end of the first year and 1 percent at the end of the second year. In the third year, the vendor will pay the remaining amount depending on the total purchases made by SE over the three-year period. If the cumulative purchases do not meet the agreed-upon targets, SE will need to return the unearned portion of the refund to the vendor.

In 2008, the Company made a commitment to purchase at least $150 million of flat-panel televisions from the vendor. It has made purchases of $45 million in fiscal 2008, and expects to make purchases of $55 million and $60 million, in 2009 and 2010, respectively. Almost all of the $45 million of flat-panel televisions purchased from the vendor have been sold by SE during 2008. They are recorded in the statement of operations as cost of sales, buying, and warehousing. The Company has recorded the entire cash refund of $7.5 million (5 percent × $150 million) received during fiscal 2008 as sales.[5]

Price Protection Plan

SE's net sales in fiscal year 2008 included $240 million of "big-ticket" products (priced at $499 and above) covered under the price protection plan. The Company has refunded $7,000,000 in 2008 under the price protection plan and has recorded these as reductions in sales. During the coming year, the Company expects further reductions in prices of "big-ticket" products in light of the deteriorating economic conditions in the consumer electronics markets.

---

[4] Vendor allowances, widely prevalent in the retailing industry, are the amounts manufacturers or dealers pay to the retailers in exchange for a promise of guaranteed volume of purchases and for benefits such as premium shelf space or an end-of-aisle display at the retail outlets. Typically, the vendor allowance amounts are paid in advance of the purchases promised by the retailer.

[5] SE recognizes revenue when the customer takes possession of the merchandise. Although SE uses separate accounts (such as gross sales, sales discounts, sales returns, and sales allowances) to record individual transactions, net sales reported in the statement of operations represent an aggregate sum of those accounts.

Management Proposals during the Audit Process

During the process of annual audit for fiscal 2008, the senior management of the Company has proposed making the following adjustments to SE's accounts. These adjustments are *not* reflected in the preliminary financial statements given in Exhibit 1.

Unredeemed SRP Certificates

SE's management proposes to record as sales the estimated amount of SRP certificates that will not be redeemed. Management estimates that 15 percent of the remaining $5 million of outstanding certificates will not be redeemed. Thus, the expected amount of non-redemption would be $750,000.

Vendor Allowances

SE's management wants to recognize the $5.3 million difference between the total expected refund of $12.8 million (8 percent × $160 million) and the amount received from the vendor of $7.5 million (5 percent × $150 million) in fiscal 2008 as sales and as a receivable from the vendor. Management believes that such recognition is appropriate given the high likelihood that the refund will be earned; it expects total purchases over the three-year period to be $160 million, exceeding the threshold of $150 million needed to earn a refund of 8 percent.

Executive Compensation

To attract, retain, and motivate key executives, the Board of Directors of SE has approved a generous executive compensation package to its senior management. The compensation package consists of a base salary (which is not performance-based), a short-term incentive bonus plan (for achieving the specified performance targets), and long-term incentive stock option plan (to incentivize senior management for increasing shareholder value). Pertinent details of the short-term incentive bonus plan for fiscal 2008 are given in the table below:

Terms of the Short-Term Incentive Bonus Plan

Form of payment:	Cash
Maximum amount:	100% of the base salary

Bonus amount:	**Performance metric:**
25% of base salary	Annual sales growth of 11.75% or higher
25% of base salary	Annual growth in comparable store sales (open for 12 months or more) of 2.2% or higher
25% of base salary	Annual growth in income before income taxes of 25% or higher
25% of base salary	Board's subjective evaluation

Requirements

Assume that you are an audit senior assigned to SE. The audit partner has asked you to provide an analysis of the Company's existing accounting policies for the three new initiatives and an evaluation of the proposals made by SE's management during the annual audit process. You understand that management's choice of financial reporting policies is, in part, affected by a desire to comply with accounting-based debt covenants, maximize executive compensation, meet analyst forecasts, and create favorable perceptions of the capital market participants.

Your answers should provide a description of the accounting policies and an assessment of whether the policies comply with Generally Accepted Accounting Principles (GAAP). Explain your rationale and support your position with citations from the applicable authoritative pronouncements using the FASB Accounting Standards Codification, and other relevant resources, if an authoritative pronouncement is unavailable. Your answers should provide a description of the accounting policies and an assessment of whether the policies comply with Generally Accepted Accounting Principles (GAAP). Explain your rationale and support your position with citations from the applicable authoritative pronouncements using the FASB Accounting Standards Codification, and other relevant resources, if an authoritative pronouncement is unavailable. You should not cite your textbook because textbooks typically do not constitute authoritative guidance. Specifically, address the following issues.

1. Analysis of Existing Accounting Policies for the Recent Initiatives

   a. Membership fees received for the Super Rewards Program.

      i. Is it appropriate for SE to record the entire membership proceeds of $7,200,000 as revenue of fiscal 2008? If yes, why? If not, explain why and compute the amount of membership fees revenue that should be recognized in fiscal 2008. (Note: For ease of calculations, assume that each membership fee is received at the midpoint of the month and that the actual and estimated cancellations of membership are immaterial.)
      ii. Should the membership revenue be presented as sales or as other income in SE's statement of operations? If the net effect of the two alternatives on income is the same, should this matter? Why?
      iii. If the membership does not come with the "complete satisfaction" guarantee (i.e., if membership fees are non-refundable), determine the amount of membership fees revenue that SE should recognize in fiscal 2008.

   b. SRP certificates issues, used and expired.

      i. Explain whether SE's accounting for SRP certificates issued, used and expired complies with GAAP. Identify at least one other company whose accounting for customer loyalty program is similar to SE's accounting for the Super Rewards Program. Describe how that company has reported its accounting for the customer loyalty program in its annual report.
      ii. Is SE's financial reporting for the SRP certificates (issued, used and expired) the only GAAP-compliant method to account for a customer loyalty program? If not, (a) describe the alternative(s) and cite authoritative support for the alternative(s), and (b) identify at least one company that follows the alternative(s) and describe how that company reported its accounting for the customer loyalty program in its annual report.
      iii. If alternative accounting methods are acceptable per GAAP, what are some factors that will affect SE's management's choice of an accounting method? What adjustments to the statement of operations in Exhibit 1 will SE need to make if it chooses an alternative method to account for the SRP certificates issued, used and expired?

   c. Vendor allowances.

      i. Does SE's recording of the cash refund of $7.5 million from the vendor as sales of fiscal 2008 comply with GAAP? Why? Explain.

ii. Determine the amount of vendor allowance that should be recognized in fiscal 2008 and indicate where in the financial statements it should be presented. Does the presentation matter if the effect on net income is the same? Why? Explain.

d. Price protection plan.

What adjustments, if any, should be made to the statement of operations in Exhibit 1 to ensure that SE's financial reporting for the price protection plan complies with GAAP? (Note: Assume that the sales of "big-ticket" products have occurred uniformly over fiscal 2008, i.e., $20 million per month). Since this is the first year of initiating a price protection plan, SE cannot reliably estimate eventual refunds from the plan. Based on your research and interviews with SE's management, you have determined that the history of price changes on "big-ticket" items (when the price protection plan was not in use) is unavailable for the Company or the industry.

e. Effect of GAAP adjustments on statement of operations.

As an audit senior, you want to ensure that SE's existing financial reporting policies for the new initiatives are GAAP-compliant. What adjustments, if any, would you suggest to the Company's reported net sales, cost of sales, gross profit, operating income, other (loss) income, net earnings, and earnings per share? Provide your answer in the following format. Assume the average income tax rate to be 40 percent.

Adjusted Statement of Operations (in compliance with GAAP)

Item	Reported amounts	Adjustments, if any, resulting from				Adjusted amounts
		Membership fees	SRP Certificates	Vendor allowances	Price protection plan	
Net sales	$1,600,920,000					
Cost of sales	1,219,080,000					
Gross profit	381,840,000					
Selling, gen. and adm. expenses	284,400,000					
Operating income	97,440,000					
Interest expense	2,480,000					
Other (loss) income	1,000,000					
Income before income taxes	95,960,000					
Income tax expense	38,384,000					
Net earnings	$57,576,000					
W. Avg. shares outstanding	20,000,000					20,000,000
Earnings per share	$2.88					

2. Evaluation of the Proposed Audit Adjustments

a. Compute the effect of management's proposals to account for (a) unredeemed SRP certificates and (b) vendor allowances on SE's statement of operations for 2008. Specifically, compute the net sales, cost of sales, gross profit, operating income, other (loss) income, net earnings, and earnings per share that would result if the two management proposals are accepted. Present your answer in the following format. Assume the average income tax rate to be 40 percent.

Effect of Management Proposals

Item	Reported amounts	Adjustments resulting from: Unredeemed SRP Certificates	Adjustments resulting from: Vendor allowances	Proposed amounts
Net sales	$ 1,600,920,000			
Cost of sales	1,219,080,000			
Gross profit	381,840,000			
Selling, gen. and adm. expenses	284,400,000			
Operating income	97,440,000			
Interest expense	2,480,000			
Other (loss) income	1,000,000			
Income before income taxes	95,960,000			
Income tax expense	38,384,000			
Net earnings	$57,576,000			
W. Avg. shares outstanding	20,000,000			20,000,000
Earnings per share	$2.88			

b. Explain whether or not management's proposals to account for (a) unredeemed SRP certificates and (b) vendor allowances would comply with GAAP. (Note: Assume that benchmarking data or industry reports for the redemption rates of customer loyalty rewards are unavailable.)

c. If your answer in 2 (b) above is that one or both of the management proposals do not comply with GAAP, describe the appropriate accounting policy for the item(s). Compute the amounts, indicate where in the financial statements they would be presented, and specify the fiscal year in which they would be presented. (Note: Assume that the purchases of flat-panel televisions from the vendor will coincide with the management's expectation of $55 million and $60 million purchases, respectively, in 2009 and 2010.)

d. What might be plausible motivations behind the two proposals made by SE's management during the process of annual audit? Elaborate.

3. Analysis of Accounting Policies for Customer Loyalty Program—IFRS Perspective

a. Is SE's accounting treatment for the customer loyalty program (as applicable to SRP certificates issued, used and expired) consistent with International Financial Reporting Standards (IFRSs)? Why or why not? Explain your rationale and support your position with appropriate citation(s) from the applicable authoritative pronouncement(s).

b. Would an alternative method to account for customer loyalty programs be consistent with IFRS? If yes, present the journal entries to record the SRP certificates issued, used and expired under the alternative method and explain how those journal entries would be different from SE's recording of the SRP certificates issued, used and expired.

CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

Overview of the Case and Learning Objectives

Super Electronics, Inc. is a hypothetical case addressing financial reporting issues relating to vendor allowances and sales incentives such as a price protection plan and a customer loyalty program. The main learning objectives of the case are to (a) identify, interpret, and apply the U.S. authoritative accounting literature using FASB Accounting Standards Codification[6] and other relevant sources, (b) search literature to identify prevalent accounting practices on a given issue, (c) understand the importance of characterization of an item as revenue or expense even if either treatment has an identical income effect, (d) appreciate the multiple accounting treatments for real-life transactions are possible and acceptable per GAAP, (e) understand determinants in making an accounting policy choice, including managerial motivations to manage earnings for maximizing executive compensation, and appreciate the effects of such choice in performance measurement and financial statement analysis, and (f) identify, interpret, and apply the international accounting literature using the International Financial Reporting Standards[7] (IFRSs).

Each issue in the case allows instructors to discuss an accounting topic that is either not addressed in textbooks or enriches student understanding of the topic by drawing parallels with real-world situations and by requiring application rather than regurgitation of accounting standards, and by demonstrating linkages between accounting policies and management compensation.

The case helps instructors achieve many of the competencies identified by the AICPA (1999). In addition to the personal competencies (such as problem solving and communication) and functional competencies (such as understanding and applying relevant information), it helps to develop broad business competencies among students (such as critical thinking and legal/regulatory perspective).

Financial reporting of customer loyalty programs also allows instructors to incorporate International Financial Reporting Standards (IFRS) into class discussion. With SEC's roadmap for transition to IFRS and the proposed inclusion of IFRS in the CPA examination, integration of IFRS materials in the U.S. accounting curriculum is gaining attention. As observed by Thomas (2009), "Universities will need to develop strategies to incorporate international standards alongside U.S. GAAP." The Super Electronics case provides one such opportunity.

Motivations for the Case—Some Real-Life Examples

The motivations for the case development stem from several real-world instances of accounting shenanigans, earnings management, and fraud in the areas of vendor allowances, membership fees, and customer loyalty programs. To enrich class discussions and to spark student interest by

[6] FASB Codification is the single source of authoritative GAAP in the U.S. Codification will also be introduced in the CPA examination starting January 1, 2011 (*Journal of Accountancy*, 2009). A basic view of the Codification Topics is accessible free of charge at fasb.org. Academic institutions can obtain a professional view by paying a small administrative fee ($150 a year, which provides unlimited access to all faculty members and students). The professional view minimizes the time and effort needed to research and provides high-level search and retrieval functions, cross reference features, personal annotation, and dynamic linking capabilities. The FASB website contains tutorials and help pages to assist students to gain a working knowledge of the Codification and the Codification Research System. A tutorial that includes audio and animated screens to demonstrate specific features and functions of the Codification can be accessed at http://asc.fasb.org/help&analyticsAssetName=home_page_tuorials_and_help#tutorial.

[7] The IFRSs can be accessed free of charge after registering at http://www.ifrs.org/IFRSs/IFRS.htm. Unlike FASB Codification, there is no simple way to research IFRSs. A more efficient approach is to do a Google search (using the topic of interest as the search term) to obtain the reference of the pronouncement, and then get the text of the official pronouncement of the IASB website. There are also databases such as CCH's Accounting Research Manager that allow students to search IFRSs. Oftentimes, websites of international accounting firms provide useful commentaries and illustrative guidance free of charge to the academic community.

demonstrating that the issues addressed by the case are real-life issues faced by real companies, they are described below.

- Vendor allowances: Financial reporting of vendor allowances has been a continuing sore spot for years (CFO.com, November 9, 2007). Many companies including Office Depot, Albertsons, Kroger, Penn Traffic, Safeway, Fleming, K-Mart, and Staples have engaged in the front-loading of promotional allowances to meet or beat goals.[8] Correcting the recording of vendor allowances has produced huge negative effects on earning for companies. For instance, profits fell 31 percent at Safeway, 12 percent at Staples, and 6 percent at Albertson when they corrected their accounting for vendor allowances. An extreme example for inappropriate recording of vendor allowances is Royal Ahold NV, a Dutch company whose subsidiaries include Stop and Shop in the U.S. In 2001, its aggressive accounting for vendor allowances to reach earnings goals of operating units overstated Royal Ahold's earnings by approximately €215 million, about 29 percent of the actual earnings of the company for the year (Knapp and Knapp 2007).
- Accounting for membership fees: This topic presents a forum to discuss the cornerstones of revenue recognition. Several companies such as the BJ's Wholesale Club were charged by the SEC for aggressive recognition of membership fees revenue. BJ's had to record a one-time charge of over $18 million to stop recognizing revenue when the fees were received and instead recognize it when services were rendered so as to comply with the requirements of Staff Accounting Bulletin (SAB) No. 104.
- Customer loyalty programs: Customer loyalty programs are becoming common in many industries such as retailing, airlines, and restaurants. According to Mall Networks, customers hold over one billion loyalty memberships in the U.S. A discussion of the financial reporting of customer loyalty programs serves as a tool to demonstrate that—unlike textbook problems—different conceptual approaches and numerical solutions for a given accounting issue are not only possible but permissible under GAAP. Students find it very intriguing that two different accounting methods for customer loyalty programs can each be GAAP-compliant. The resulting problems of non-comparability of financial statements and challenges in evaluating management performance can be better appreciated when students experience them in a realistic context.

Financial Reporting of Sales Incentives and Earnings Management

It is fascinating for students to understand that accounting treatments are often selected or changed by the companies to manage earnings. When Best Buy started its reward zone incentive plan in 2003, it had no track record of how many of these rewards would be used and accordingly deducted all the reward zone dollars from revenues in the first quarter. But in the next quarter itself, it said it could figure out how many rewards will not be redeemed and reduced its liability. The move added two cents to its EPS, enabling it to hit analyst's forecast to the penny.

Differences in the financial reporting of customer loyalty programs hold important implications for financial analysts too. *BusinessWeek* (2005) noted that where and how the record effects of incentive programs can "distort closely watched measures such as revenues, same-store sales, and profit margins, thereby making comparisons misleading."

[8] Vendor allowances have important audit implications as well, as evidenced by Office Depot's admission of material weakness in its internal controls relating to vendor allowances and SEC's 2006 administrative proceedings against the auditors of U.S. Foodservice, Inc.

Implementation Guidance

The case can be used in a variety of financial reporting courses including intermediate accounting, accounting theory, professional research, and financial statement analysis, at the graduate or undergraduate levels. Although the case is not limited to a singular topic addressed in a specific textbook chapter, it fits better in the course in which the topic of revenue recognition is addressed. Depending on the intended learning objectives and desired scope of the case assignment, instructors can include or exclude requirement three pertaining to IFRS.

The case is best used as a collaborative project in which groups of two or three students submit written analyses of the case.[9] Subsequently, the case should be discussed in class to highlight the salient points, provide examples of real-life companies that have engaged in earnings management in the issues addressed by the case, and to indicate additional avenues for analysis. A lead time of at least two weeks is suggested before the written analyses are required, and a minimum of 50 minutes should be allowed for class discussion. While this might appear to be a significant class time that competes with coverage of other topics in a course, it helps to demonstrate that real-world issues, unlike textbook problems, do not have cut-and-dry answers. It also provides a meaningful way to introduce the meaning, motivations, and mechanics of earnings management and to expose students to FASB Codification and IFRS.

In grading the case write-ups, instructors need to address the issues of (1) identification of relevant issues, (2) identification and analysis of alternatives, computational accuracy of numbers derived, explicit statement of assumptions made, and appropriateness of rationale provided, (3) inclusion of specific recommendations and rationale behind them, (4) quality and depth of research and appropriate paraphrasing and citations, and (5) quality of writing (grammar, spelling, punctuation, sentence structure, etc.)[10]

Faculty and Student Feedback

The case was administered in six sections of an undergraduate Intermediate Accounting I course taught by three instructors and three sections of a similar course at the graduate level by another instructor. In addition, the case was used in a graduate accounting theory course by an instructor at another institution. To quote this instructor, "The Super Electronics case is a very interesting case with real-world reporting issues. The case is well written and the work requirements are clearly defined. It is also a good assignment for students to learn using the FASB Codification database. Students suggested that the case was a challenging assignment and they have learned a lot from working on it." Similar positive sentiments were expressed by each instructor who used the case assignment.

Each instructor used the case assignment as a collaborative project in which groups of three students each were asked to submit the written analyses. The suggested length of the write-up was 10 to 12 pages (excluding tables and exhibits) and the project carried 15 percent of the course grade. Several students mentioned the case as a value-added learning experience in their developmental feedback to the instructors at the end of the semester. Students, especially in the graduate classes, perceived the case assignment to be a valuable learning experience. On average, the undergraduate

[9] To save student time in inputting the case data and to enable them to focus on analysis and interpretation, an Excel file containing data in Exhibit 1 of the case can be provided to students (see the Teaching Notes for the downloadable spreadsheet). The file also contains worksheets of formats for answering requirements 1(e) and 2(a). They are automated in the sense that when the adjustment amounts are entered by the students, the resulting financial statement numbers are automatically recalculated.

[10] A handout containing guidelines for researching and citing U.S. GAAP and IFRS literature is available; see the Teaching Notes for the downloadable document.

TABLE 1

Summary of Student Feedback[a]

	Undergraduate	**Graduate**
Number of sections	6	4
Number of instructors	3	2
Number of students	121	94
Overall usefulness of the case	3.82	4.34
The case context was realistic.	4.23	4.48
The case improved my skills to identify, interpret, and apply the U.S. authoritative accounting literature using FASB Codification and other relevant sources.	4.26	4.50
The case enhanced my ability to search literature to identify prevalent accounting practice on a given issue.	4.05	4.74
The case helped me understand the importance of characterization of an item as revenue or expense even if either treatment has an identical income effect.	3.81	4.30
The case helped me appreciate that multiple accounting treatments for real-world issues (such as customer loyalty programs) are possible and acceptable per GAAP.	3.99	4.43
The case helped me understand that beyond compliance with GAAP, there are other factors (such as performance metric for bonuses) that affect accounting policy choices.	3.95	4.23
I would recommend that this case be used as a part of this course in the future.	3.69	4.24
The case assignment requires critical thinking and problem-solving skills.	4.43	4.49
The case helped me understand that in real-world situations, "the correct" answers are not always available; interpretation of information and role of assumptions is critical.	4.27	4.50
The case helped me understand some ways by which companies attempt to manage earnings.	3.98	4.27
The case enhanced my skills to identify, interpret, and apply International Financial Report Standards (IFRSs).	3.62	Not asked

[a] Scale: For usefulness question, 1 (highly useless) to 5 (very useful). For other questions, 1 (strongly disagree) to 5 (strongly agree).

students spent 10 hours, and the graduate students spent 15 hours on the case project.[11] A summary of the student feedback is presented in Table 1.

TEACHING NOTES

Teaching Notes are available only to full-member subscribers to *Issues in Accounting Education* through the American Accounting Association's electronic publications system at http://aaapubs.org/. Full-member subscribers should use their usernames and passwords for entry into the system where the Teaching Notes can be reviewed and printed. Please do not make the Teaching Notes available to students or post them on websites.

[11] This is inclusive of time for reading and analyzing the case, attending group meetings, searching the literature, and preparing and reviewing the write-up. If a formal write-up is not required, the preparation time would be significantly less.

If you are a full member of AAA with a subscription to *Issues in Accounting Education* and have any trouble accessing this material, then please contact the AAA headquarters office at info@aaahq.org or (941) 921-7747.

REFERENCES

American Institute of Certified Public Accountants (AICPA). 1999. *AICPA Core Competency Framework for Entry into the Accounting Profession*. New York, NY: AICPA.

CFO.Com. 2003. Available at: http://www.cfo.com/printable/article.cfm/3009995

CFO.Com. 2007. Available at: http://www.cfo.com/article.cfm/10122402?f=related

Journal of Accountancy. 2009. CPA exam to undergo transformation. Available at: http://www.journalofaccountancy.com/Web/20092194.htm

Knapp, M. C., and C. A. Knapp. 2007. Europe's Enron: Royal Ahold, N.V. *Issues in Accounting Education* 22 (4): 641–660.

Thomas, J. 2009. Convergence: Business and business schools prepare for IFRS. *Journal of Accountancy* 24 (3): 369–376.

Wall Street Journal. 2010. Ritz hotels bow to slump; adding a loyalty program. (September 14): B1.