

Handout 7

Bon Voyage

Travel-R-Us, Inc. (Travel) is a publicly-traded company with annual revenue of \$370 million and a fiscal year ending May 31. Amelia Emerson, the Controller and a CPA, requests advice from your accounting firm about a problem she is facing in her company. Travel owns and operates three cruise ships serving Alaska, the Mediterranean, and the Bahamas. In addition, Travel has another division that provides vacation land tours in Europe and the United States.

The company's cruise line revenues are seasonal. The cruise ship tourism industry is highly competitive and capital intensive. During peak business periods, Travel's revenues have been substantially reduced in the past by adverse weather conditions, equipment failure, and the cost of fuel. The economy and high energy costs have impacted Travel's cruise line profits. For the last two years, Travel has operated at a loss.

In the current fiscal year, one of Travel's ships, the Rialto, was severely damaged by a hurricane during a voyage to the Bahamas in early September. Travel is a self-insured company. Rather than incur the cost to repair the Rialto, Travel has decided to sell off the cruise line division at a gain and totally cease operations in that industry. The cruise line division will be sold to Admiral Cruise Line within the next twelve months. The Rialto part of the sale will result in a loss. But the sale of the division will result in an overall gain. For the year, the division will have a loss from operations. The capital raised from the sale of the cruise line division will be used to expand Travel's land tour operations.

Amelia's problem arises over how to report the sale of the cruise ships and cruise line division. In a meeting she had with the CEO and CFO, the CEO wanted to report the total gain from the sale of the ships and the other net assets as part of normal operations. "No need to separate the profit on the financials and confuse the shareholders," he said. "Just bury it with our other revenue – no different than merely selling off some assets."

The CFO partly disagreed and believed that it would be more advantageous for the company to report the Rialto separately as an extraordinary loss. However, the CFO totally agreed with the CEO that the gain from the sale of the other assets should be buried in revenue because the shareholders and financial analysts would believe that the increase in earnings from the gain would be ongoing, and that the Rialto loss would be perceived as only a one-time occurrence not to be repeated in the future. "It was the blasted weather conditions that led us to make the decision to sell the Rialto and get out of the cruise line business. We don't want to bury the loss in operations, only the gain," the CFO said. "Combining the gain with our other revenue will also make it possible for us to meet our earnings target and thereby get our performance bonuses," he added with a maniacal grin.

Amelia said nothing at the meeting, but disagrees with both executives. Amelia thinks she knows how to report the sale, but wants you to provide her with your recommendation. Amelia was only recently hired as the Controller of Travel, and her position there is still somewhat tenuous. She doesn't want to rock the boat unnecessarily if she is wrong. But on the other hand, she doesn't want to become involved with misleading the public.

Required:

Prepare a letter (not a memo) addressed to Amelia Emerson at 1555 North Cruise Avenue, Palm Beach, FL 33480, advising her about how to report the damage to the Rialto and the sale of the ships and cruise line division. You must support your advice by citing any applicable accounting standards. You are not required to include a reference page until your final draft is submitted in ACCT 351COM. Limit your letter to only one page (single spaced with double space between paragraphs) and one-inch margins. Create your own letterhead for the accounting firm you represent. The date should be placed no less than one-half inch below the letterhead (or 1.5 inches from the top of the page).

In your letter, also include a very brief discussion regarding how you would advise Amelia about the ethical aspects of this situation. You might want to look at Rule 102 (AICPA Code of Professional Conduct).

To cite and reference Rule 102, CSUN's Professor Chris Jones prepared the following summary:

Reference

American Institute of Certified Public Accountants (AICPA). (2011, November 30). *AICPA Code of Professional Conduct—Current and Historical Revisions. ET Section 102—Integrity and Objectivity*. Retrieved from http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_102.aspx

The ethics code is only updated intermittently. Therefore, you do not need to indicate the date in the retrieval portion of the reference.

Rule 102 is not part of U.S. GAAP and, as such, is not available through the FASB Accounting Standards Codification (ASC). Instead, you must access this ethical code of conduct through the AICPA website. The reference is formatted similar to the FASB Codification except for the dates. The AICPA has published a latest revision date which is what would be used for the date portion of the reference. (You must go to the table of contents of the Code of Professional Conduct to see the date - <http://www.aicpa.org/RESEARCH/STANDARDS/CODEOFCONDUCT/Pages/default.aspx>).

In-text Citation

To refer to the entire rule rather than individual paragraphs or subparagraphs and assuming no other AICPA references, use the following:

(AICPA, 2011)

To refer to an individual paragraph in Rule 102 (such as “subordination of judgment by a member”), use the following:

(AICPA, 2011, ET Section 102.05)

Remember, textbooks are not recognized as authoritative sources in accounting research. Therefore, don't use your textbook as support for your recommendation.