

Test Your Financial Literacy

Read the summary facts of a real-life case study and choose your response at the bottom of the page. The following occurred between 1998 and 2004.

- A consolidated reporting entity's Net Assets (Equity) declined \$108 million, from \$47 million to negative \$61 million, a 230% decrease.
- Consolidated liquidity, measured as Average Days' Operating Expenses divided by Cash and Marketable Securities (net of Line of Credit draws) declined 35%, from 260 days to 168 days.
- The primary entity's Net Assets declined \$11 million, from \$37 million to \$26 million (on a comparable basis), a 30% decrease.
- Included in the primary entity's \$26 million Equity is \$5 million of note and interest receivable from an unprofitable consolidating entity whose Equity balance is negative \$101 million and who owes outside investors over \$19 million in cumulative preferred dividends.
- Deferred Costs and Prepaid Expenses (consolidated) represented 15% of the primary entity's Net Assets in 1998 and now represent 179% of the entity's comparable Net Assets.
- For the first time in seven years, the primary entity funded operations by drawing on its bank Line of Credit in 2004.
- In 2003, Equity was bolstered by a "non-cash" asset sale between a consolidating entity and a related party which generated a book gain of \$5.6 million. While the deal was pending, the related party was named as a preferred provider to the primary entity's membership and their retirement plans.
- Though requested, management has not made available to its governing Council the schedule of consolidation and eliminations used to arrive at the consolidated financial statements. There have been and continue to be significant inter-company transactions with one consolidating entity that has been primarily responsible for the \$108 million decline in Net Assets.

Question: As a CPA, if you were in a fiduciary position with this entity, what should you do?

- 1. Nothing, this appears acceptable.
- 2. Wait for management to tell me what to do.
- 3. Learn more, ask questions and evaluate responses.

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