

# Intermediate Accounting 2

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This assignment analyzes the performance of four retail stores (companies) among the various aspects of the financial statements for: Costco, PriceSmart, Macy and Wal-Mart in the field of Retail business.

## ***Comparison of Companies / Costco, PriceSmart, Macy & Wal-Mart***

### ***1. Business of each company:***

#### *Costco:*

A very unique Big Box Store, which aims to provide lower prices but in bulks. Costco, unlike its competitor's aims to provide its products to customers with large families. They also only sell to their customers who have membership and surcharges do apply to those who are not.

Costco stores are designed in a way that on a sunny day the lights are usually off mainly because of the sun light provided by the infrastructure, thus helping in the overhead cost reduction. In addition Costco does not carry multiple brands of the same products, and are usually grouped under its native brand Kirkland, thus; also decrease the overheads and increase the revenues as well. Such unique touches to their overall system makes Costco not only stand alone as a business but it impacts the society and environment, and also give its competitors a great competition; and great savings for the customers.

#### *PriceSmart:*

A similar big box store like Costco with the same ideas and Goals, but it just operates in Caribbean and Central America. It has expanded its business further but only makes a tiny percent on the Royalty part of it. It also reduces its costs by having a House Brand and providing its products in Bulks.

Since it operates in many different regions PriceSmart has to follow different regional laws especially Accounting related, so it has a dedicated team in different regions to be able to file taxes and also to take care of the employees' wages as well.

#### *Macy's:*

Opened in 1843, as a Dry goods store, now known to be one of the biggest stores in the World, one of the mid-range to upscale departmental stores in the United States of America. Macy is also another retail store that provides competitive price in the products it sells. It aims to provide the top brands in a single store without the high margin in the prices. It sells various products ranging from dry goods to bed and bathing, Jewelry and Accessories. Its involvement and keeping up to date with the various trends has earned it its name.

#### *Wal-Mart:*

Wal-Mart operates in a category which it found itself, and is today renowned for its leadership in its role, which would be to provide all the needs under the same roof, for a very competitive low price. The company runs large discount department stores and warehouses throughout the world. It strives to provide all the necessary needs for its customers as a one stop at a very competitive price. Although Wal-Mart is a publicly traded company it is still a family operated business as the Family owns 48% stake in the business. It operates under 55 different names in 15 different countries.

**2. Long-Term Financial Liabilities:**

a. Amount of Long-Term Liabilities:

<b>Long-Term Liabilities</b>	
Companies	Value (\$)
<b>Costco</b>	1,253 (in millions) <sup>1</sup>
<b>PriceSmart</b>	60,451 (in thousands) <sup>2</sup>
<b>Macy</b>	6,655 (in millions) <sup>3</sup>
<b>Wal-Mart</b>	44,070 (in millions) <sup>4</sup>

b. Types of Debts:

Companies	Types of Debts	Value of each Debt (\$)
<b>Costco</b> (in millions)	<ul style="list-style-type: none"> <li>• Senior notes</li> <li>• Promissory notes</li> <li>• Term-Loan</li> <li>• Zero-Coupon convertible sub-ordinated notes</li> <li>• Miscellaneous<sup>5</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Senior Notes: <b>1,997</b> (900 due in March 2012 – excluded from the amount above, Balance due March 2017)</li> <li>• Promissory Notes: <b>85</b></li> <li>• Term-Loan: <b>39</b></li> <li>• Zero-Coupon convertible sub-ordinated notes: <b>31</b></li> <li>• Miscellaneous: <b>1</b></li> </ul>
<b>PriceSmart</b> (in thousands)	<ul style="list-style-type: none"> <li>• Notes Payables<sup>6</sup></li> </ul>	<ul style="list-style-type: none"> <li>• <b>60,451</b> (excludes rent and income taxes)</li> </ul>
<b>Macy</b> (in millions)	<ul style="list-style-type: none"> <li>• Senior notes</li> <li>• Senior debentures</li> <li>• Amortizing debenture<sup>7</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Senior notes: <b>3,092</b></li> <li>• Senior debentures: <b>3,276</b></li> <li>• Amortizing debenture: <b>18</b></li> </ul>
<b>Wal-Mart</b> (in millions)	<ul style="list-style-type: none"> <li>• Unsecured debts</li> <li>• Other debts<sup>8</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Unsecured debts: <b>44,060</b> <ul style="list-style-type: none"> <li>○ Fixed: 42,889</li> <li>○ Variable: 1,771</li> </ul> </li> <li>• Other debts: <b>1,202</b></li> </ul>

<sup>1</sup> Costco Financial Report, pg. 46

<sup>2</sup> PriceSmart Financial Report, pg. 29

<sup>3</sup> Macy Financial Report pg. F-5

<sup>4</sup> Wal-Mart Financial Report pg. 33

<sup>5</sup> Costco Financial Report, pg. 65

<sup>6</sup> PriceSmart Financial Report, pg. 53

<sup>7</sup> Macy Financial Report pg. F-17

<sup>8</sup> Wal-Mart Financial Report pg. 44

<u>Companies</u>	<u>Maturity of Long-Term Liabilities</u>	
<b>Costco</b> (in millions)	2012	\$900
	2013	0
	2014	0
	2015	0
	2016	0
	2017	1,253
	Total	<b>2,153</b>
	Less:	
	due within one year	900
	<b><u>\$1,253<sup>9</sup></u></b>	
<b>PriceSmart</b> (in thousands)	2011	\$7,771
	2012	7,298
	2013	12,298
	2014	14,213
	2015	23,495
	2016	3,147
	Total	<b>68,222</b>
	Less:	
	due within one year	7,771
	<b><u>\$60,451<sup>10</sup></u></b>	
<b>Macy</b> (in millions)	2013	\$121
	2014	461
	2015	718
	2016	1,105
	2017	306
	2018-2042	3,693
	Total	<b>6,404</b>
	Premium on acquired Debt	216
	Capital Lease	43
	<b><u>\$6,663<sup>11</sup></u></b>	
<b>Wal-Mart</b> (in millions)	2013	\$1,975
	2014	5,168
	2015	3,927
	2016	4,750
	2017	1,130
	2018-2042	28,912

<sup>9</sup> Costco Financial Report, pg. 67

<sup>10</sup> PriceSmart Financial Report, pg. 55

<sup>11</sup> Macy Financial Report pg. F-18

	Total	<b>45,862</b>
	Less:	
	due within one year	1,975
		<u>43,887</u>
	Derivative Fair Value Adjustments	183
	Revised Total	<b><u>\$60,451</u></b> <sup>12</sup>

**Senior Notes:** in case of bankruptcy the senior debt holders such as the banks will be repaid first before any other debt holders.

**Promissory Notes (Notes Payable):** referred to as note payable, in which the payer will pay the determined amount on a fixed or determinable amount of time or on the demand of the payee.

**Term-Loan:** loans that are offered by banks to small business so that the business can run its monthly operations.

**Senior Debenture:** a debenture is a document that either creates debt or acknowledges it. In a large corporation it is a term used to borrow medium to long-term loans.

**Unsecured Debts:** it is collateral and is backed up by an asset i.e. the lender can seize the collateral or asset if need be.

**Zero-Coupon Convertible:** zero-coupons are the most volatile due to no interest payments to hold the bond and as a result investors demand a higher yield to hold them. The convertible pay a lower yield because the investors are willing to pay a premium for its convertible feature; as a result, they off-set each other.

**Amortizing Debenture:** debentures in which the total annual payment (principal and interest) is approximately equal throughout the life.

*c. Existence of Covenants related to Debt:*

*i. Costco:*

Costco has no covenants.

*ii. PriceSmart<sup>13</sup>:*

PriceSmart has covenants in the amount of \$47.5 million as of August 31, 2011. These covenants relate to loans in Trinidad, Barbados, Panama, El Salvador, Honduras and Columbia.

As of August 31, 2011 the company is in compliance with respect to these covenants.

*iii. Macy<sup>14</sup>:*

Macy's covenants consist of lease covenants and are in compliance as of January 31, 2012.

<sup>12</sup> Wal-Mart Financial Report, pg. 44

<sup>13</sup> PriceSmart Financial Report, pg. 22

<sup>14</sup> Macy Financial Report, pg. F-14

iv. *Wal-Mart*<sup>15</sup>:

Wal-Mart's covenants mainly are comprise of secured debts and long-term leases. As of January 31, 2012, they are not withdrawn and mature at various times between June 2012 – June 2016.

The company is in compliance as of January 31, 2011.

**3. Deferred Income Tax Liability:**

a. Amount of Deferred Income Tax Liability:

<b>Deferred Income Tax Liability</b>	
<u>Companies</u>	<u>Value (\$)</u>
<b>Costco</b> <sup>16</sup>	885 (in millions – includes other liabilities)
<b>PriceSmart</b> <sup>17</sup>	1,888 (in thousands)
<b>Macy</b> <sup>18</sup>	1,141 (in millions)
<b>Wal-Mart</b> <sup>19</sup>	7,862 (in millions – includes other liabilities)

b. Taxable Temporary Difference:

i. *Costco*<sup>20</sup>:

The components of a deferred tax assets and liabilities (in millions) are as follows:

	<b>2011</b>	<b>2010</b>
Equity compensation	\$89	\$112
Deferred income/membership fees	134	118
Accrued liabilities and reserves	429	392
Other	32	35
Total deferred tax assets	<u>684</u>	<u>657</u>
Property and equipment	494	414
Merchandise inventories	164	170
Total deferred tax liabilities	<u>658</u>	<u>584</u>
<b>Net deferred tax assets</b>	<b><u>\$26</u></b>	<b><u>\$73</u></b>

The increase in deferred tax liabilities of \$74 is due to increase in Property, Plant and equipment and the decrease of \$6 is due to the decrease in Merchandise inventories.

<sup>15</sup> Wal-Mart Financial Report, pg. 43

<sup>16</sup> Costco Financial Report, pg. 46

<sup>17</sup> PriceSmart Financial Report, pg. 29

<sup>18</sup> Macy's Financial Report, pg. F-5

<sup>19</sup> Wal-Mart Financial Report, pg. 33

<sup>20</sup> Costco Financial Report, pg. 73

The increase in deferred tax assets is due to increase in deferred income/membership fees and accrued liabilities and reserves, a net increase of \$53 and the decrease is due to the decrease in equity compensation and other, a net decrease of \$26.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (in millions) is as follows:

	2011	2010
Gross unrecognized tax benefit at beginning of year	\$83	\$80
Gross increases—current year tax positions	21	29
Gross increases—tax positions in prior years	10	4
Gross decreases—tax positions in prior years	(6)	(1)
Settlements	(1)	(27)
Lapse of statute of limitations	(1)	(2)
<b>Gross unrecognized tax benefit at end of year</b>	<b><u>\$106</u></b>	<b><u>\$83</u></b>

The above schedule shows how the taxable temporary difference of \$23 is attained.

ii. *PriceSmart*<sup>21</sup>:

The components of deferred tax assets (in thousands) are as follows:

	2011	2010
U.S. net operating loss carry forward	\$8,953	\$9,688
U.S. capital loss carry forward	4,318	4,318
U.S. timing differences and AMT credits	294	1,787
Deferred compensation	683	921
Foreign tax credits	<u>3,569</u>	<u>4,944</u>
Foreign deferred taxes	15,421	14,264
Total deferred tax assets	28,290	35,922
U.S. valuation allowance	(8)	(8,350)
Foreign valuation allowance	(7,661)	(7,296)
<b>Net deferred tax assets</b>	<b><u>\$21,251</u></b>	<b><u>\$20,276</u></b>

As of August 31, 2011 and 2010, the Company had deferred tax liabilities of \$2.4 million and \$1.6 million, respectively; hence a taxable temporary difference of \$800,000.

The Company evaluated its deferred tax assets and liabilities and determined that a valuation allowance is necessary for certain foreign deferred tax asset balances, primarily because of the

<sup>21</sup> PriceSmart Financial Report, pg. 50 - 51

existence of significant negative objective evidence, such as the fact that certain subsidiaries are in a cumulative loss position for the past three years, and the determination that certain net operating loss carry-forward periods are not sufficient to realize the related deferred tax assets.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (in thousands) is as follows:

	2011	2010
Balance at beginning of fiscal year	\$13,165	\$13,851
Additions based on tax positions related to the current tax year	1,130	429
Reductions for tax positions of prior years	-	(166)
Settlements	(643)	(21)
Expiration of the statute of limitations for the assessment of taxes	<u>(574)</u>	<u>(478)</u>
<b>Balance at end of fiscal year</b>	<b><u>\$13,528</u></b>	<b><u>\$13,615</u></b>

The above schedule shows how the taxable temporary difference of \$87 is attained. The taxable temporary difference could also be the result of income taxes associated with uncertain tax benefits. As of August 31, 2011, the liability for income taxes associated with uncertain tax benefits was \$13.5 million and can be reduced by \$11.6 million of tax benefits associated with state income taxes and other timing adjustments which are recorded as deferred income taxes. The net amount of \$1.9 million, if recognized, would favorably affect PriceSmart's financial statements and favorably affect the company's effective income tax rate.

*iii. Macy<sup>22</sup>:*

The components of a deferred tax assets and liabilities (in millions) are as follows:

	2012	2011
<b>Deferred Tax Assets:</b>		
Post-employment and postretirement benefits	\$559	\$473
Accrued liabilities accounted for on a cash basis for tax purposes	227	195
Long-term debt	109	117
Unrecognized state tax benefits and accrued interest	77	91
State operating loss carry forwards	<u>52</u>	<u>61</u>
Other	155	144
Valuation allowance	<u>(34)</u>	<u>(35)</u>
<b>Total deferred tax assets</b>	<b><u>1,145</u></b>	<b><u>1,046</u></b>
<b>Deferred tax liabilities:</b>		
Excess of book basis over tax basis of property and equipment	(1,733)	(1,793)

<sup>22</sup> Macy Financial Report, pg. F-22

Merchandise inventories	(531)	(483)
Intangible assets	(195)	(162)
Other	(235)	(217)
Total deferred tax liabilities	(2,694)	(2,655)
<b>Net deferred tax liability</b>	<b><u>\$(1,594)</u></b>	<b><u>\$(1,609)</u></b>

The valuation allowance at January 28, 2012 relates to net deferred tax assets for state net operating loss carry forwards. The net change in the valuation allowance amounted to a decrease of \$1 million for 2011. As of January 28, 2012, the Company had no federal net operating loss carry forwards and state net operating loss carry forwards of approximately \$1,079 million, which will expire between 2012 and 2031.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (in millions) is as follows:

	2012	2011
Balance, beginning of period	\$205	\$207
Additions based on tax positions related to the current year	23	19
Additions for tax positions of prior years	-	-
Reductions for tax positions of prior years	(21)	(8)
Settlements	(15)	(4)
Statute expirations	(13)	(9)
<b>Balance, end of period</b>	<b><u>\$179</u></b>	<b><u>\$205</u></b>

As of January 28, 2012 and January 29, 2011, the amount of unrecognized tax benefits, net of deferred tax assets, that, if recognized would affect the effective income tax rate, was \$116 million and \$133 million, respectively. This explains the taxable temporary difference of \$26 in the above schedule.

*iv. Wal-Mart<sup>23</sup>:*

The components of a deferred tax assets and liabilities (in millions) are as follows:

	2012	2011
Deferred Tax Assets:		
Loss and tax credit carry forwards	\$2,996	\$2,968
Accrued liabilities	\$2,949	\$3,532
Share-based compensation	376	332
Other	1,029	708

<sup>23</sup> Wal-Mart Financial Report pg. 48

Total deferred tax assets	<u>7,350</u>	<u>7,540</u>
Valuation Allowance	(2,528)	(2,899)
Deferred tax assets, net of valuation allowance	<u>\$4,822</u>	<u>\$4,641</u>
Deferred tax liabilities:		
Property and equipment	5,891	4,848
Inventories	1,627	1,014
Other	409	474
Total deferred tax liabilities	<u>7,927</u>	<u>6,336</u>
<b>Net deferred tax liabilities</b>	<b><u>\$3,105</u></b>	<b><u>\$1,695</u></b>

As of January 31, 2012, the Company has provided a valuation allowance of approximately \$2,528 million on deferred tax assets associated primarily with net operating loss carry forwards for which management has determined it is more likely than not that the deferred tax asset will not be realized.

The \$371 million net change in the valuation allowance during fiscal 2012 related to releases arising from the use of net operating and capital loss carry forwards, changes in judgment regarding the future ability to use net operating and capital loss carry forwards, increases from certain net operating losses arising in fiscal 2012, decreases due to operating and capital loss expirations and fluctuations in currency exchange rates.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (in millions) is as follows:

	<b>2012</b>	<b>2011</b>
Unrecognized tax benefit beginning of year	\$795	\$1,019
Increases related to prior year tax positions	87	101
Decreases related to prior year tax positions	(162)	(61)
Increases related to current year tax positions	56	199
Settlements during the period	(161)	(453)
Lapse in statutes of limitations	(4)	(10)
<b>Unrecognized tax benefit end of year</b>	<b><u>\$611</u></b>	<b><u>\$795</u></b>

As of January 31, 2012 and 2011, the amount of unrecognized tax benefits related to continuing operations was \$611 million and \$795 million, respectively, of which, the amount of unrecognized tax benefits that would affect the Wal-Mart's effective tax rate is \$520 million and \$687 million for January 31, 2012 and 2011, respectively.

The above schedule and explanation show how the taxable temporary difference of \$184 million was acquired.

**4. Defined Benefit Pension Plans:**

*a. Discount rate:*

*i. Costco:*

No discount rate is given and cannot be calculated because no defined value of the defined benefit obligation plan is provided.

*ii. PriceSmart<sup>24</sup>:*

A discount rate of 5% is used to calculate the present value of the defined benefit obligation.

*iii. Macy<sup>25</sup>:*

A discount rate of 4.65% is used to calculate the present value of the defined benefit obligation.

*iv. Wal-Mart<sup>26</sup>:*

A discount rate of 6% is used to calculate the present value of the defined benefit obligation.

All the companies' discount rates are close to each other with the exception of Costco which has the lowest discount rate of all.

*b. Funded Status of Company's Pension Plan and Liability (Asset):*

<b><i>Funded Status of Company's Pension Plan &amp; Liability (Asset):</i></b>		
<b><u>Companies</u></b>	<b><u>Funded Status</u></b>	<b><u>Asset (Liability)</u></b>
<b>Costco<sup>27</sup> (in millions)</b>	From 2012 and thereafter \$43 million	\$31 and (9)
<b>PriceSmart<sup>28</sup> (in thousands)</b>	No funding will be made this year all is recorded under deferred income taxes and other liabilities	\$91 and \$273 (unrealized expense)
<b>Macy<sup>29</sup> (in millions)</b>	Underfunded – by \$389 million (Obligation of \$3,458 million and plan assets value of \$3,069 million)	\$(389)
<b>Wal-Mart<sup>30</sup> (in millions)</b>	Underfunded - \$339 million (United Kingdom), 325 million (Japan)	\$(664)

*c. Difference due to IFRS:*

There will not be any material difference when the IFRS pension plan is implemented in 2013; as it is mainly changing the way the accounts are represented and removing them from income statement to the balance sheet.

<sup>24</sup> PriceSmart Financial Statement, pg. 45

<sup>25</sup> Macy's Financial Report, pg. F-25

<sup>26</sup> Wal-Mart Financial Report, pg. 50

<sup>27</sup> Costco Financial Report, pg. 33

<sup>28</sup> PriceSmart Financial Report, pg. 45

<sup>29</sup> Macy's Financial Report, pg. F-24

<sup>30</sup> Wal-Mart Financial Report, pg. 51

5. Ratios / Current, Cash Debt Coverage & Debt:

<i>Ratios</i>			
<u>Companies</u>	<u>Current Ratio</u>	<u>Cash Debt Coverage Ratio</u>	<u>Debt Ratio</u>
<b>Costco</b> (in millions)	1.138 ≈ 1.14	0.2075 ≈ 0.21 = 21%	0.53
<b>PriceSmart</b> (in thousands)	1.342 ≈ 1.34	0.4346 ≈ 0.43 = 43%	0.43
<b>Macy</b> (in millions)	1.40	0.1244 ≈ 0.12 = 12%	0.73
<b>Wal-Mart</b> (in millions)	0.882 ≈ 0.88	0.1691 ≈ 0.17 = 17%	0.608 ≈ 0.61

<i>Calculations of Ratios</i>			
<u>Companies</u>	<u>Current Ratio</u>	<u>Cash Debt Coverage Ratio</u>	<u>Debt Ratio</u>
<b>Costco</b> <sup>31</sup> (in millions)	13,706 / 12,050	$(3,198 - 389) / ((14,188 + 12,885)/2)$	14,188 / 26,761
<b>PriceSmart</b> <sup>32</sup> (in thousands)	292,777 / 218,227	$(75,599 - 17,934) / ((288,490) + 236,522)/2)$	288,490/664,328
<b>Macy</b> <sup>33</sup> (in millions)	8,777 / 6,263	$(2,093 - 148) / ((16,162 + 15,101)/2)$	$(22,095 - 5,933) / 22,095$
<b>Wal-Mart</b> <sup>34</sup> (in millions)	54,975 / 62,300	$(24,255 - 5,048) / ((117,645 + 109,535)/2)$	$(193,406 - 75,761) / 193,406$

Current Ratio:

This is a ratio that is used to measure the liquidity of a company's ability to pay short-term obligations. It is also known as Liquidity ratio, Cash Asset Ratio and Cash Ratio.

It is calculated by dividing the Current Assets by Current Liabilities (Current Ratio = Current Assets / Current Liabilities).

According to the calculations above for Current Ratio, Macy has the best performance.

Cash Debt Coverage Ratio:

This is ratio is used to analyze the company's ability to be able to pay for its debts through cash generated from operating activities instead of using the assets in operations to liquidate.

<sup>31</sup> Costco Financial Report, pgs. 46 & 49

<sup>32</sup> Price Smart Financial Report, pgs. 29 & 32

<sup>33</sup> Macy's Financial Report pgs. F-5 & F-7

<sup>34</sup> Wal-Mart Financial Report pgs. 33 & 35

It is calculated by taking away dividends from Cash flow from operations and divided by the average liabilities (Cash Debt Coverage Ratio = (Cash flow from operations – Dividends) / Average Liabilities).

A debt coverage ratio below 1 means the company cannot currently pay off all its debts. A debt coverage ratio close to 0 could be a warning that the company is in very poor financial condition. Any debt coverage ratios above 1 show that the company could pay back all of its debts.

Based on the calculations above PriceSmart looks to be in the best condition to be able to pay of its debts, compared to others as all the other companies ratios are more close to 0 than 1.

#### Debt Ratio:

This is a ratio that indicates the relativity of company's assets to its liabilities. It gives an idea of a company's leverage along with the potential risks that the company might face in terms of its debt load.

It is calculated by dividing the total debts by the total assets (Debt Ratio = Total Debt / Total Assets). If the debt ratio is below 0.5, it usually means that the assets are financed through equity and if greater than 0.5 then the assets are financed by debts.

Based on the calculations above none of the companies are highly leveraged as they all are below 1. PriceSmart seems to have its assets finance through equity while others through debt; which makes PriceSmart's performance to be the best based on the debt ratio.

Based on the calculations above of all the three ratios PriceSmart has the best performance overall. This is because its current Ratio of 1.34 is a good indication of its ability to pay off short-term obligations with cash easily. The Cash Debt Coverage Ratio of 0.43 is not the best but it's not bad either and again shows that it is able to pay off its debts via cash. The Debt ratio of 0.43 is also a good indication of its debt to asset ratio. All these ratios being in a good standing further proves that PriceSmart's assets are most likely financed from equity instead of debts.