

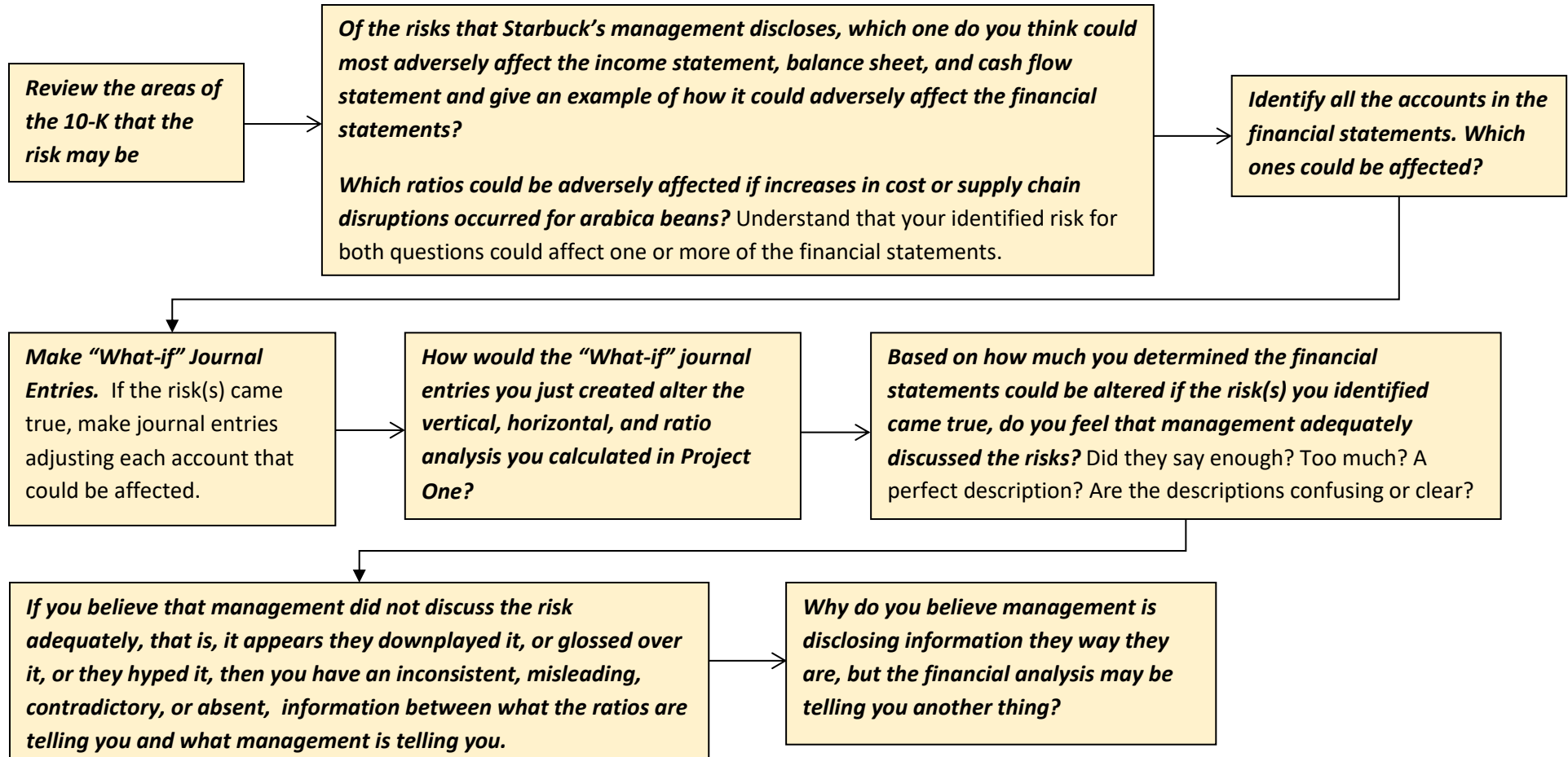
NOTE* you must be knowledgeable in accounting to fully understand this task. If you're not knowledgeable in accounting, please avoid this posting! As guessing, plagiarizing or "winging-it" may end up with the wrong answers and all answers would be reviewed!

Using the **PDF "Project Two Instructions"** complete the three requirements to analyze the **PDF "Starbucks 10-K Report 2019"**. **Requirement #1)** Read and analyze the following selected parts of the **PDF "Starbucks 10-K Report 2019"** covering all years conforming with the **Excel Sheet "Project One"** and identify a risk factor that you find of interest that could come true. **Requirement #2)** Conduct a "what-if" analysis to determine the affect the risk may have on the financials. **Requirement #3)** Answer three short essay questions.

- The spreadsheet contains multiple tabs on the bottom:
 - **IS** = Income Statement (Horizontal & Vertical Analysis)
 - **BS** = Balance Sheet (Horizontal & Vertical Analysis)
 - **CF** = Statement of Cash Flows (Horizontal & Vertical Analysis) + (Total Cash over 3yrs)
 - **Ratios** = Financial Ratios Calculations (Liquidity, Solvency, Profitability)
 - **Charts** = Horizontal/Vertical/Cash Flows/Ratios/Bar Charts (*Chart data is pulled from its designated title example chart titled "Income Statement – Horizontal Analysis" data is from the "IS" (Income Statement) tab at the bottom.*)



Project Two Process Flowchart of Tasks



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Project Two: Connecting Theory to Practice – Firm Level Risk Analysis

Project Two will help you begin the process of bridging abstract theoretical accounting information learned in the textbook to real life concrete practical events.

Project Two Objectives:

1. Examine the risk factors that Starbucks' management discloses in its Form 10-K and from an accounting perspective (as opposed to Marketing or Management). Choose one and explain its adverse affect on the financial statements using vertical, horizontal, ratio, and chart analysis developed in Project One.
2. Gain a more comprehensive understanding of a public company to make better business decisions by reading key parts of a Form 10-K, including Business, Risk Factors, Properties, Legal Proceedings, Management's Discussion and Analyses, and Index to the Notes to the Consolidated Financial Statements.
3. Understand the impacts on financial statements should a risk come to fruition using a "what-if" analysis applied to vertical, horizontal, ratio, and chart analysis on excel spreadsheets developed in Project One.
4. Identify and analyze the effects of depreciation on the financial statements at least one piece of equipment used in Starbucks.
5. Identify and recommend changes in revenue/cost structures and how it would impact any ratio developed in Project One.
6. Demonstrate good grammar, formatting, and organization.

Project Two Requirements:

1. Read and analyze the following selected parts of Starbucks' 10-Ks covering all years conforming with your spreadsheets and identify a risk factor that you find of interest that could come true.
2. Conduct a "what-if" analysis to determine the affect the risk may have on the financials.
3. Answer three short essay questions.

Requirement: 1 Read and analyze the following selected parts of Starbucks' 10-Ks.

The following areas of the 10-Ks should be your primary focus: Part 1, Items 1, 1A, 2, 3, and Part II, Items 7 and 8. Part I contains a discussion on the business model, risk factors,

properties, and legal issues. Part II contains Management's Discussion and Analyses, the financial statements and the notes to the financial statements. All these statements are referred to as *management assertions*. Parts I and II contain discussions on many types of risk that the business may be exposed to. You should read through all these areas. Once you have read through Parts I and II, you are to answer a set of questions at the end of this section of Project Two. The following narrative elaborates on each area you are to read.

Part 1, Item 1. Business

In this discussion, Starbucks discusses its business model, how it segments its financial information, and how it categorizes and earns revenue.

Part 1, Item 1A. Risk Factors

In this discussion, Starbucks discusses the risks that it has identified as material and has decided to share with the public. Although a company such as Starbucks has to disclose risks, the SEC mandates a separate section to discuss risks. However, risks can be identified by reading other areas of the Annual Report and observations of its store operations.

In 2019, Starbucks identifies the following 15 material risks:

1. Economic conditions in the U.S. and international markets could adversely affect our business and financial results.
2. Our success depends substantially on the value of our brands and failure to preserve their value, either through our actions or those of our business partners, could have a negative impact on our financial results.
3. Incidents involving food or beverage-borne illnesses, tampering, adulteration, contamination or mislabeling, whether or not accurate, as well as adverse public or medical opinions about the health effects of consuming our products, could harm our business.
4. The unauthorized access, use, theft or destruction of customer or employee personal, financial or other data or of Starbucks proprietary or confidential information that is stored in our information systems or by third parties on our behalf could impact our reputation and brand and expose us to potential liability and loss of revenues.
5. We rely heavily on information technology in our operations and growth initiatives, and any material failure, inadequacy, interruption or security failure of that technology could harm our ability to effectively operate and grow our business and could adversely affect our financial results.
6. We may not be successful in implementing important strategic initiatives or effectively managing growth, which may have an adverse impact on our business and financial results.
7. We face intense competition in each of our channels and markets, which could lead to reduced profitability.
8. We are highly dependent on the financial performance of our Americas operating segment.

9. We are increasingly dependent on the success of certain international markets in order to achieve our growth targets.
10. Increases in the cost of high-quality arabica coffee beans or other commodities or decreases in the availability of high-quality arabica coffee beans or other commodities could have an adverse impact on our business and financial results.
11. Our financial condition and results of operations are sensitive to, and may be adversely affected by, a number of factors, many of which are largely outside our control.
12. Interruption of our supply chain could affect our ability to produce or deliver our products and could negatively impact our business and profitability.
13. Failure to meet market expectations for our financial performance and fluctuations in the stock market as a whole will likely adversely affect the market price and volatility of our stock.
14. The loss of key personnel or difficulties recruiting and retaining qualified personnel could adversely impact our business and financial results.
15. Failure to comply with applicable laws and changing legal and regulatory requirements could harm our business and financial results.

Part 1, Item 2. Properties

In this discussion, Starbucks discloses select properties that it owns, providing locations, sizes and purposes. This information can help a reader understand what properties may be at risk and how Starbucks's operations could be affected if something were to happen to one or more properties.

Part 1, Item 2. Legal Proceedings

Starbucks elaborates on their legal proceedings in Item 15, Commitments and Contingencies. Many companies do the same.

Part II, Item 7. Management's Discussion and Analyses

This discussion is management's interpretation of the results of its operations. An important point to be made is that this is *management's interpretations*, not anyone else's. Management of companies tend to highlight the positive and suppress the negative. They tend to guide the discussion the way they want. In this section, you may get a better idea what risks management may find important and those they may try to minimize. For your purposes, it is filled with good information that may help you further understand the trends in the horizontal, vertical, and ratio analysis that you performed.

Part II, Item 8. Index to the Notes to the Consolidated Financial Statements

In this discussion, management further clarifies information contained in the income statement, balance sheet and statement of cash flows. Starbucks discloses eighteen notes. However, for purposes of this project we are only going to focus on notes 1, 5, 7, 8, 9, and 15. In Note 1, Summary of Significant Accounting Policies, only focus on the discussion

about the business, estimates, cash and cash equivalents, Receivables, net of Allowance for Doubtful Accounts, Property, Plant and Equipment, and Revenue Recognition. Note 5 discusses inventories in detail and will give you insight on where Starbucks get inventory and how it categorizes it. Note 7 contains Supplemental Balance Sheet Information, which discusses Property, Plant and Equipment, and Accrued Liabilities. Note 9 discusses Debt (Liabilities). In this section, Starbucks discusses in a lot of detail how it funds its operations. This discussion is involved. You may want to read it just to see how complex accounting for debt can be and the risks that Starbucks takes to pay back financing agreements. Item 15 discusses Commitments and Contingencies. What is important in this section is the legal proceedings, which is a gold mine for identifying potential risks.

Requirement #2: Conduct a “what-if” analysis.

Essay questions one and two will require you to conduct a “what-if” analysis. There are various methods to conduct a “what-if” analysis in excel and you are free to explore them. To conduct a “what-if” analysis for this deliverable, imagine the risk you identified comes true. Demonstrate through vertical, horizontal and ratio analysis how this risk could affect financial performance.

To begin this process, you need to understand what accounts could be affected if the risk you choose comes true. Let’s say that you identified a possible supply chain disruption of coffee beans because of drought in Brazil. This in fact happened and was [reported](#) in 2014. What are coffee beans to Starbucks? It is inventory. On the income statement, sold inventory is reported as cost of sales. On the balance sheet, existing coffee beans in Starbucks’s possession is reported as inventory. Lack of supply can lead to increased inventory prices. To examine the potential overall affects on the financial statements, we must look at ratios that contain cost of sales or inventory in its numerator or denominator. When looking at vertical analysis, anything that affects cost of goods sold will cause a shift in the percentage of expenses to revenues; and anything that affects inventory will reallocate the percentage mix of assets to total assets. When looking at horizontal analysis, the percentage year over year increases for both cost of sales and inventory will be affected.

Let’s take an example of a ratio that contains cost of sales, which is the gross profit margin. The gross profit margin is the gross profit/net sales. Gross profit is Net Sales – Cost of Sales. If the supply chain is disrupted and coffee bean prices rise, the cost of sales will rise when the coffee beans are used to make cups of coffee. Therefore, the gross profit will decrease. If Starbucks is net sales of coffee remains the same, the gross profit margin will decrease. There are other ratios that would be affected. When you consider a supply chain disruption as your risk, find ratios in addition to the gross profit margin and explain the affect on them.

For vertical analysis, you can discuss how the cost of sales affects the income statement by the reallocation of cost of sales to revenues and what that situation may mean. For the balance sheet, the reallocation of percentages of short-term assets may. A vertical analysis allows a user of financial information to visually see how the mix of short-term assets are affected which may impact liquidity (measuring the ability of a business to pay its short term

obligations as they become due). The more assets tied up in inventory may be problematic to companies in need of cash to pay bills.

Requirement #3 Short Essay Questions

After conducting a “what-if” analysis, you are to answer the following questions from an accounting perspective (not a marketing/management perspective) and submit an individual two to three page report.

1. Starbucks is required to disclose material risks.
 - a. Of the risks that Starbucks’ management discloses, which one do you think could most adversely affect the income statement, balance sheet, and cash flow statement and give an example of how it could adversely affect the financial statements?*
2. In the 2019 10-K, Starbucks discloses a risk that states, “Increases in the cost of high-quality arabica coffee beans or other commodities or decreases in the availability of high-quality arabica coffee beans or other commodities could have an adverse impact on our business and financial results.”
 - a. Which ratios could be adversely affected if increases in cost or supply chain disruptions occurred for arabica beans? Explain why and provide an example with hypothetical figures of at least one ratio.*
3. Compare your readings of management’s assertions and your findings of your vertical, horizontal, ratio and chart analysis. You may find that management’s discussion focuses on certain areas. They may be avoiding a discussion in other areas that you and others deem important to learn about. They may be transparent one year, and not as transparent the next year, and vice-versa. Your vertical, horizontal and/or ratio analyses may indicate one thing, but not what management is focusing on, causing what appears to be inconsistencies in how information is presented.
 - a. How do you think management interprets and informs the public of one thing, but your analyses find information that is inconsistent, misleading, contradictory, or absent, leading you to believe the reported figures on the income statement, balance sheet, cash flow statement and related disclosures reveals a side of the financial story management is not focused on? Explain to the best of your ability and include a specific example. To help you understand how to answer this question, Form 10-Ks normally follow specific patterns. It is important to read all three years (2017, 2018 and 2019) to see how management modifies its discussion from year to year. The specific narrative in each section generally does not change too much unless new disclosure requirements or*

other laws/policies/procedures are enacted. This is often a company's achilles heel. If management is telling the public a similar narrative each year, the charts should show a consistent pattern. If not, something is may not be right. Management may not accurately report what is going on, be focused on what they want to focus on, or they are issuing the wrong figures on their financials. Either way, it is an issue that must be further explored to make good business decisions.

As an example of a potential issue, let's look at a hypothetical scenario involving inventory turnover:

As you may remember, the inventory turnover ratio is a measure of how fast a company is getting rid of its inventory (through sales, obsolescence, theft, etc.). If you measure the inventory turnover ratio and it decreases slightly year over year, it generally indicates that inventories are moving slower. Imagine that you perform a ratio analysis and chart the inventory turnover ratio over six years. You notice that inventory is turning over slower. Then you compare the chart to what management asserts in its discussion and analysis. Management boasts about its improved and efficient inventory management systems and how year after year it is constantly improving. This may indicate an area of increased risk. Why? The inventory turnover data shows that inventory may be moving slower, but management claims it improved ways to control inventory. It now becomes an issue for a proactive business decision maker to delve into more deeply. The ratios are indicating one thing (through their reported figures), but management is telling everyone another (through their narrative). In this hypothetical situation, several things could be happening. Perhaps everything is fine with their inventory management system, but management is not doing a fine job of communicating the issue, or perhaps something could be drastically wrong such as production line breakdowns and management knows it but is not adequately disclosing it, or perhaps it could be that someone is stealing inventory but management does not realize it. There good be numerous reasons.

Requirement #4: Upload Document

You should target approximately one to two paragraphs for each required item. Grammar, Formatting and Organization is a skill which should be demonstrated by accountants for all work. Therefore, it is part of the grade. **Only Word files will be accepted.** Do not upload a pdf file.

members to expand their knowledge. They should credit your contribution as well, if they desire to use it. Even if you do credit work contributed by others, each paper submitted should reflect a significant work product that you created on your own.

Late submissions lose 50% credit if submitted within one week after the due date. After one week past the due date, no credit will be given. Note that this deliverable still has to be completed to advance to the next deliverable. If it is not completed, no further credit will be given for the term project.

[See Appendix A, Grading Rubric for Project Two.](#)

[See Appendix B for a Process Flowchart of Project Two.](#)

If you have further questions about Project Two, check out the [FAQ page](#) under [*Additional Questions Concerning Project Two: Company Level Risk and 10-K Analysis.*](#)

Additional Questions Concerning Project Two: Company Level Risk and 10-K Analysis

Q23: *Although teamwork was encouraged, my teammates and I were individually trying to gain as much understanding of the information as possible. We ultimately agreed that it was indeed quite a daunting task in figuring out the risks from the bounty of information. Connecting the information we gathered from the statements and deducing risk association was a bit difficult. How can it be made easier?*

A23: Project Two can be a daunting challenge. That is why you need to focus on one or two risks and do not deviate until you understand them well. The following is some more guidance if you are still stuck on what to do and how to do it - which you can apply to the deliverable three store level risk analysis as well.

Connecting risks to the financial statements becomes so much easier when you can answer the question: *“If something were to happen to Starbucks, be it good, bad or*



indifferent, what would be the effects on the financial statements, and how do they reveal itself in the vertical, horizontal and ratio analyses”?

The following is an example how this process can work. Let's say the price of coffee could suddenly rise because of a coup attempt in a country where Starbucks imports a significant amount of coffee beans. The government could become unstable. Transportation lines could be disrupted. The price of fuel could spiral out of control. So many things could happen. Then ask yourself, “From an accounting perspective, what do coffee beans represent to Starbucks”? Is it a supply, inventory, a fixed asset, a liability, an expense, etc.? Once you understand its classification, which is inventory, you need to understand how it is reported, which is a short term asset. Where is a short term asset found? It is found on the balance sheet. If the price of coffee beans rises, what happens to the balance sheet? The price paid for inventory rises. Given all else equal, the price rise would reveal itself in the horizontal and vertical analysis, as well as the current and acid-test (quick) ratios. How would increased prices affect the income statement? If Starbucks increases prices on its coffee, revenue would increase, not because the overall sales volume increases, but the cost per cup of coffee increases, often forcing price increases. Since the cost per cup of coffee increases, that means the Cost of Sales increases. How would that affect the financial statements and how would these effects reveal themselves? Theoretically, gross profit could increase, decrease or remain the same. If the cost of coffee rises 0.10 per cup, and Starbucks charges 0.10 more per cup, gross profit remains unchanged. But how would the increased cost reveal itself if gross profit does not change? All else equal, any ratio that has Revenue or Cost of Sales in it may change, so you have to examine other ratios in addition to the gross profit margin.

The price of coffee beans that I just elaborated may or may not be part of the discussion that management chooses to disclose in its risks or any other place in the 10-K. If this was the risk you chose to examine in Project Two, I would look for any discussion on price increases/decreases and understand how management is framing the discussion to see if it conforms to what you are seeing in the horizontal, vertical or ratio analysis (quickly viewed by looking at your graphs). This takes us back full circle to the question “If something were to happen to Starbucks, be it good, bad or indifferent, what would be the effects on the financial statements, and how do they reveal itself in the vertical, horizontal and ratio analyses”? But now you rephrase the question to state, “What is management saying if something were to happen to Starbucks, be it good, bad or indifferent, and does their narrative in the 10-K conform to the effects on the financial statements, and are those statements consistent with the vertical, horizontal and ratio analyses outcomes”?

Let us take another possible approach. You may be able to think in terms of the purpose of the financial statements and how their purpose may be compromised. If the purpose of the Income Statement is to report Revenues and Expenses and the ability of a company to make a profit, what events could compromise the ability of a company to make a profit? In other words, what events could diminish the company's ability to produce revenue or control expenses? If you recall from your readings, the purpose of an asset is

to produce revenue. If an asset is compromised, its revenue producing ability could be diminished. So, what events could cause assets to not produce revenue? There are many situations whereby that can occur. For example, if an item of inventory which is an asset is stolen, it can no longer produce revenue since it is no longer for sale. Normally, if a company sold inventory for cash, it would debit Cash and credit Sales Revenue. If the inventory item was stolen, that entry will never be made and therefore, a credit to Sales Revenue no longer is a possibility. When creating an income statement, that item of stolen inventory will never produce a sale. Therefore, Revenue is decreased and thus so is net income. Now that we have identified stolen inventory as a possible risk to the financial statements, when you review the 10-K, especially the risk factors, what does management discuss about inventory controls to mitigate the risk of theft of inventory? What is the effect on the liquidity ratios?

Let's examine this via the balance sheet. The purpose of the balance sheet is to report the financial condition of the company at a point in time, specifically reporting assets, liabilities and equity. A company's ability to control liabilities is a very important to an investor/creditor. If assets remain the same, the more liabilities a company incurs, the less equity it will have. The less equity a company has, the less the owner's have to a claim on assets. A problem that many public companies face is controlling the debt/assets ratio. The more debt, the more a company has to make its assets produce revenue in order to pay back liabilities. So, understanding how a company controls its debts is critical. What situations do you know of that could cause debts to rise or go out of control? These would be risks to a company. Consider the following. At a certain point, the more a company borrows, creditors will make assumptions that it is riskier to lend money to them. Creditors signal this by charging higher interest rates and impose shorter pay back periods, as well as less more restrictive terms. Some of these restrictive terms could come in the form of debt covenants which may state that if certain ratios trend negatively, it may trigger loans to be called (that is, to be paid back immediately). For instance, a debt covenant could be to maintain a current ratio of 2:1. If the company falls below it for two straight quarters, they may call the loan due. What risks could cause the current ratio to fall below the 2:1 threshold in my example? You now know the numerator and denominator components of a current ratio so you can figure it out. What is it that management discusses about its debt that may affect the balance sheet? How does management disclose it? What is the trend? What is management doing to reduce the risk of rising debt?

We could spend all day discussing potential risks to a company. Companies have dedicated staff just looking into these types of issues. How they examine risks, how they disclose them and what they choose to do about them varies from company to company. How they affect the financial statements varies from company to company. What you will probably discover is that management discusses certain risks at length and others they barely disclose anything, if at all.

When analyzing risks in Project Two, **there is no right or wrong answer**. Just your best interpretation of the situation you are analyzing to help you understand a new approach to making good, informed business decisions. As you can see from the grading

rubric, this deliverable is not graded whether or not you identified the “right” risk and analyzed it for a specific, correct answer. The grading is based more on a process of identifying risk, demonstrating how it can be tied to the financial statements from your perspective and supporting your rationale, understanding ratios in your analysis, and of course, your presentation.

It does take practice to get good at this type of analysis and you certainly may not be used to it, even for experienced accountants. In fact, several of my former students who were high level, experienced working accountants expressed that this approach was very beneficial, and they learned a lot of new things.

This exercise is not difficult. It just takes a little focus to identify a potential risk, read everything you can about it, and figure out how it affects the financial statements. The spreadsheet analysis will be extremely helpful to dissect each account. I am not expecting a full blown risk analysis. That would be many pages long. You could write a book on the risks Starbucks faces. I want no more than two pages, single spaced to discuss your findings. Keep it short and concise.

Q24: *I am still having difficulty understanding which accounts I believe could be affected by the risk I identified and how they could affect the accounts disclosed in the balance sheet, income statement, and statement of cash flows.*

A24: Using a journal entries is a practical approach to demonstrate how accounts could be affected. For example, let’s assume Starbucks identified that it could be sued for making coffee too hot. What journal entry would Starbucks make in its books if several customers actually did burn themselves and they decided to sue Starbucks? This accounting falls under the topic of contingent liabilities. If a loss event is probable and reasonably estimated, Starbucks would make a journal entry debiting an expense account and crediting a liability account. Companies have discretion in what they actually name these accounts, as long as they are expense and liability accounts. Let’s assume Starbucks debits Lawsuit Expense and credits Estimated Lawsuit Liability. Furthermore, they expect litigation in this matter to take longer than one year, so they classify the Estimated Lawsuit Liability as long term. The Lawsuit Expense has nothing to do with the cost of its inventory, therefore, it is an operational expense. The Lawsuit Expense account affects the Income Statement, and the Estimated Lawsuit Liability affects the Balance Sheet. Therefore, various ratios in a ratio analysis would be affected.

Q25: *How would your vertical, horizontal and ratio analyses be affected by a lawsuit?*

A25: Continuing the hot coffee spill lawsuit example, increasing a lawsuit expense would affect vertical analysis by altering the overall ratios of expenses to revenue. It would also affect the overall mix of operational expenses. It would only affect horizontal analysis if there are other lawsuits existing that are recorded in the books, otherwise it would be a

new account entered into the horizontal analysis. It could affect ratio analysis multiple ways.

To understand how it may affect ratios, you first need to familiarize yourself with the vast array of ratios that exist. In this course, we only focus on a relatively small amount of ratios to make this project more manageable. Once you have familiarized yourself with the ratios, you must deconstruct (break apart) the components of the numerator and denominator of each ratio. For example, let's assume that you have familiarized yourself with the long term debt to long term assets ratio (a measure of solvency). This ratio measures how much long term debt a company has relative to its long term assets. A long term debt to long term assets ratio of 1:2 means it has \$1 in long term liabilities to \$2 of available long term assets to pay that long term debt. That further means that out of all its Property, Plant and Equipment, it can pay off all its long term debt. If a company is sued and records a journal entry, its long term liabilities as well as total increase and its assets remain the same. The long term debt to long term assets ratio increases because the numerator gets larger while the denominator remains constant. When Starbucks settles the lawsuit, it lowers its long term liabilities, but its short term assets (using cash). The settlement not only will affect the long term debt to long term assets ratio, but also the current ratio. If you deconstruct the current ratio, you will see that the numerator consists of current assets and the denominator consists of current liabilities. Cash is a component of current assets, while long term liabilities are not a component of current assets. Understanding mathematical operations related to fractions would help you better understand how it may affect ratios.

Many transactions affect ratios in different ways. Depending on the user of financial information, your choice of ratio analysis can be widely affected.

Q26: *Should I select a risk that is broad or narrow in scope?*

A26: The more broad the risk, the more difficult the task to tie them to the financial statements may become. Additionally, it will be more difficult to discuss them in a concise, coherent discussion.

Here is a case in point. A few students in past classes attempted to tackle strategic or financial risk to the company and tie specific indicators in horizontal, vertical and ratio analysis. Those are among the broadest and toughest risks to tackle. You have to clearly define strategic or financial risk before you can proceed. Therefore, these broad issues are not recommended for this type of project.

The better types of risk to analyze are much more specific, occurring within strategic or financial risk. Examples include the risk of not collecting money owed on accounts receivable, or the risk of a machine that makes a specific drink (equipment) being recalled and therefore the store can no longer produce revenue on the drink, or the risk that a vendor they deal with goes out of business and therefore a supply chain in inventory disruption occurs.

As you conduct the store visitations, you have to keep in mind to identify risks that are simple and easy to understand, and could occur in any of the Starbucks store locations. Perhaps I can yet explain more specific and manageable risks to discuss through the story about the kid who starts a lemonade stand.

Let us start from the point that a little girl has started a successful lemonade stand on the corner of her street. All the kids in the neighborhood love and buy the lemonade. The girl used a secret recipe her grandmother gave her which she has sworn never to reveal. Let's say that a boy in the neighborhood is entrepreneurial and approaches her to expand the lemonade stand business to another location in the next neighborhood and split the profits. The boy saved money from his paper route and is willing to invest it to build another lemonade stand. In order to make a good business decision, the boy needs to understand the risk of investing his time and money into the business. Fortunately, the little girl took good notes of the finances of the business, documenting all sales and expenses. Her Dad the Accountant even taught her to create a balance sheet, income statement and cash flow statement.

The boy has to assess the probability that the business will continue and be profitable. He performs a risk analysis and identifies various risks of expanding the lemonade stand business. What if another kid opens up lemonade stand nearby? What happens if the price of lemons, or sugar increases? What happens if the kid has to pay another kid to operate the stand? What happens if the health department requires them to get a special lemonade stand license? What happens if a kid makes lemonade without washing their hands and someone gets sick from the product? What happens if the lemonade stand was not constructed correctly and a kid gets hurt and the parents sue the girl? More broadly, what happens if tariffs are implemented that affects the price of sugar? What if a devastating fungus hits lemons trees in the southern portion of the North America, where a significant amount of lemons grow? What happens if her Grandmother thinks she is sending an email just to her granddaughter giving her the secret recipe for the lemonade, but she accidentally sends it to someone else in the neighborhood who tells everybody (an unintentional disclosure) else in the neighborhood via a Facebook posting? Okay, some of these risks I discussed maybe a stretch from reality, but I think you get the point. Anything good or bad can happen to a business. Use your imagination and common sense what those events could be.

Once the boy can assess these risks, he will have to ask himself, if one or more of these events happen, how will affect the financial operations of the business? Can the boy use any financial tools to figure it out? Yes, he can use horizontal, vertical and ratio analysis to get a clearer picture how these events could affect the business. He can further visualize the data with charts. Let's say he is most concerned about another kid in the next neighborhood opening up a lemonade stand as a competitor. What does competition mean? If you were selling something and a competitor started selling a similar product to yours, what areas of the financial statements would it most likely impact? Probably revenue. A competitor could take away sales. If enough sales are diverted from the business to a competitor, another problem to deal with is to try to control expenses. In the lemonade stand example, if a kid opens up a competing stand nearby and sales are

drawn away, the boy will have inventory that may become stale and obsolete. Lemons and ice are perishable, and they have a cost. The boy will have to control costs by reducing the inventory and supply levels.

The steps to understanding how risks could affect the financial statements of the lemonade example can be extrapolated to a public company like Starbucks. Of course, the issues with a public company are much more complex, but the principles of analyzing are similar. You have to start with fundamental questions and use common sense to understand what management is saying to the public and how it conforms to the actual published figures in the financial statements in order to make good business decisions. Among the many benefits of the term project, this approach helps to understand this process.

When you conduct your store level visitations, let your mind wonder what could happen in that store that could also happen to several hundred or thousands of stores in the same time frame. It could be a strike upsetting the supply chain, the way they conduct their policies, the type of coffee bean used, an inefficient machine used in all stores, an ingredient in their consumable products suddenly known to cause harm, the need to refurbish furniture, etc. Those are just some of the many, many visual things I could sit in a Starbucks and think of. A strike affects inventory (revenue, assets, expenses), policies affect Human Resource and salary issues (liabilities and expenses), coffee and cocoa beans affect inventory (revenue, assets, expenses), harmful consumable products affect possible lawsuits (liabilities and expenses), refurbishing furniture (assets – particularly cash).

Other issues that are not so apparent could be the mix of inventory or whether they use LIFO or FIFO. What depreciation methods and assumptions are they using? Is a chair supposed to be depreciated over 2 years, 3 years, 5 years? Does it have any salvage value? How does the choice of a depreciation method affect the financial statements? How do they accept payment? Cash, credit, prepaid store value cards, their app? What could go wrong with these methods? How are they paying for their inventory – cash or credit. If credit, what are the terms (affects current and acid-test ratios).

Grading Rubric for Project Two			
Criteria (Each Equally Weighted at 20.00%)	Levels of Achievement		
	Unacceptable, Needs Way Too Much Work	Passable, But Still Needs Work	Good to Very Good
Of the risks that Starbuck's management discloses, explain an adverse company level affect on the I/S, B/S, and CF statements from an accounting perspective (as opposed to Marketing or Management) ¹	0.00 %	70.00 %	100.00 %
Apply ratio analysis to analyze the adverse affects of increases in cost or supply chain disruptions for arabica beans. ²	0.00 %	70.00 %	100.00 %
Identify and explain possible misleading, contradictory, or absent infromation between your analysis and management assertions. ³	0.00 %	70.00 %	100.00 %
Exhibit proper grammar, formatting, and organization. ⁴	0.00 %	70.00 %	100.00 %

[Click Here to Go back to Project Two](#)

¹ Of the risks Starbucks discloses, you must identify at least one adverse risk that is disclosed in the 10-K and connect it to a financial statement. Identifying risk is easy. What is critical for this part of the grade is to be able to explain why the risk you identified is important from an accounting perspective. Understanding financial reporting concepts, such as qualities of useful information, assumption of financial reporting, and principles in financial reporting is helpful. Our past experience is that students often identify risks to a company and then explain it as a marketing or management concept. Students in the past have discussed the quality of the coffee, or cleanliness issues of the stores. Although related, accounting, marketing and management are distinct disciplines. You have to analyze risks talking like an accountant, not a marketer or strategic manager. The first two chapters of most fundamentals or intermediate accounting textbooks explain accounting concepts.

² You are required to demonstrate an understanding a risk identified by the instructor by explaining its impact on the financial ratios you calculated in Project One.

³ Reading through the risk and other disclosures that management makes in the 10-Ks, use your analysis in Project One to connect a possible discrepancy in what management says and what is disclosed (or omitted).

⁴ The analysis should be free of grammatical errors, formatted well and organized. That is, the discussion flows well and does not appear disorganized.