



Indiana CPA Society
Ethics Case Study
Fall 2002

Background Information

You are the Audit engagement executives for your firm's new client, Yahoo!, the US Internet business and consumer services company. During the planning of the audit, you review the financial statements from previous years and notice that the company is accounting for its stock compensation expense using the intrinsic value method. As a result, the reported net income is over 900 percent greater than the pro-forma income disclosed in the footnotes. This issue has received much deserved attention in recent months, so you note the situation as a possible audit risk factor and discuss it with the audit committee.

As a result, Yahoo!'s finance committee asks for your opinion on the presentation and disclosure of the stock options. You will need to use your experience and judgment as a CPA to determine, including ethical considerations, which manner of reporting the stock compensation would you recommend to the Board. The CFO and CEO would prefer to disclose in the footnotes, while the audit and finance committees would prefer to expense the options.

Attached you will find the annual report for your new client; use this and any other resources necessary and available to you to complete the case.

Required Documentation & Analysis

1. Keeping in mind recent events, including the Enron/Andersen scandal and the recent adoption of the Sarbanes-Oxley bill, give your recommendation to the Yahoo! audit and finance committees as to which method they should implement.
 - a. Which would you consider to be the most ethical for you as the auditor accepting the engagement and why?
 - b. Which method best reflects the economic performance of the company?
 - c. Which method is in the best interests of the investors and other third parties who read the financial statements and related foot notes?
2. Provide a detailed analysis of the alternatives available, including financial statements and notes showing the effects of the alternatives.
 - a. Address the difficulties and shortcomings in reporting each method as well as the benefits.
3. In the event of an oral presentation, be prepared to address questions for both sides of the argument keeping the following in mind:
 - a. Investors' confidence and reactions
 - b. Effects on net earnings
 - c. Industry standards and trends
 - d. Accuracy of accounting estimates

- e. Auditor's responsibility to the client as well as the public

Case Format & Guidelines

The written case has no minimum or maximum page restrictions, so long as the above requirements have all been addressed. Each case should, however, contain a 2-5 page executive summary and any exhibits you plan to use to support your recommendation to the audit and finance committees.