

Micro Detect Corporation was sued for securities fraud. It was alleged that the company deliberately overstated income by failing to appropriately recognize losses on its trading securities. Following is the transcript of the testimony given by one of Micro Detect's expert witnesses, Professor Winston, in response to questioning by the company's attorney. Examine the testimony, and determine if any statement made by the professor is patently untrue. Develop a list of questions that an attorney for the plaintiff would want to use to cross examine the professor. Non-GAAP statements in the following testimony may be assumed to be correct; focus only on the assertions about accounting methods.

Question:

Professor, did Micro Detect realize a loss on its trading securities during the time period in question?

Answer:

Absolutely not. The company continues to hold the securities that have declined in value. Realization would only occur when the securities are sold. Micro Detect has never sold any securities at less than their cost.

Question:

Would you mind telling the jury how these so-called "trading securities" should be accounted for?

Answer:

Unsold trading securities should be valued at fair value, you know, and this is exactly what the company did.

Question:

So, then, it is your testimony that the assets in question were correctly valued?

Answer:

Yes.

Question:

Now, I suspect that on cross-examination, the plaintiff's attorney is going to try to make a big deal about how the company kept the balance sheet in balance, so to speak. Let's go ahead and anticipate their questioning and try to clarify now. Please explain to the jury the process that Micro Detect used to keep the balance sheet in balance.

Answer:

OK. When assets go down, something else must go down to offset, or keep the books in balance. There is an equation: $\text{assets} = \text{liabilities} + \text{equity}$. In this case, the company decreased equity to offset the decreased trading security value.

Question:

I see, so the company correctly valued assets and total equity.

Answer:

Yes.

Question:

And this decrease in equity, can you tell the jury more about how the company recorded that?

Answer:

Equity sometimes contains an account known as "accumulated other comprehensive income." There are various alternative mechanisms for reporting this account, and its changes. One approach is to directly increase or decrease the account, as was done at Micro Detect.

Question:

So, equity was decreased directly, and the company's income was not impacted?

Answer:

Right, the profession uses a "current operating approach" to measuring income. Things that are not related to day-to-day operations go directly to equity.

Question:

And, so, "accumulated other comprehensive income" is used to record these types of transactions and events that are not otherwise considered to be part of the company's ongoing earnings?

Answer:

Right.
