一. (15%) Several years ago Compaq Computer reported a net profit of $971 million, a 24 percent increase above the previous year’s first quarter. Unfortunately, the Company’s stock price dropped by over $9 when the news reached the market.

Required: Explain why the market reacted negatively to Compaq’s news.

二. (20%) Verity is a young, fast-growing company, recognized as a leading provider of corporate knowledge retrieval solutions. Excerpts from its 2000 statement of cash flows are provided below (dollars in thousands).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>$330,100</td>
<td>$12,130</td>
<td>$(16,150)</td>
</tr>
<tr>
<td>Net cash from operations</td>
<td>8,210</td>
<td>14,867</td>
<td>8,973</td>
</tr>
<tr>
<td>Net cash from investing activities</td>
<td>(116,448)</td>
<td>(19,614)</td>
<td>2,658</td>
</tr>
<tr>
<td>Net cash from financing activities</td>
<td>107,663</td>
<td>7,063</td>
<td></td>
</tr>
<tr>
<td>Change in cash</td>
<td>(724)</td>
<td>2,402</td>
<td>2,571</td>
</tr>
</tbody>
</table>

* Change in the cash balance does not always equal the sum of cash from operations, investing, and financing due to adjustment to exchange rate changes.

Required:

1. Discuss the cash management profile of Verity across the three-year period. Where did the company get its cash, and what did it do with it?
2. Explain how the cash management profile may be representative of a young, fast-growing company.

三. (35%) The following footnotes appeared in the 1997 annual report of H&R Block:

All marketable securities as of April 30, 1997, are classified as available-for-sale. Proceeds from the sales of available-for-sale securities were $23,852, $155,170, and $299,702 during 1997, 1996, and 1995 respectively. Gross realized gains on those sales during 1997, 1996, and 1995 were $600, $1,520, and $7,014, respectively. Gross realized losses were $146, $386, and $350, respectively. At April, 1997 and 1996, the net unrealized holding gain on available-for-sale securities included in stockholder’s equity in the consolidated balance sheet was $1,326 and $1,169, respectively.

Required:

1. Describe the definitions of trading securities and available-for-sale securities, respectively.
2. Compute the change in the reported income assuming H&R Block accounted for the marketable securities as trading securities instead of available-for-sale securities.
3. Compute the cost of the securities sold during 1997.
四. (30%) In 1997, Microsoft presented to its shareholders an alternative income statement, both for the quarter ending in September and the most recent twelve months. For the quarter, the alternative income statement showed a loss of $60 million, while the main income statement showed a profit of $663 million. For the most recent twelve months, the alternative income statement showed a profit that was $0.60 per share lower than that shown by the main income statement. What accounts for the differences? Stock options. Microsoft was the first company to make a serious effort to estimate the real cost of the options that it hands out nearly to every employee. The company’s chief financial officer noted in *The New York Times*: “We do recognize that options have a cost, and this is the company’s best effort to help investors understanding the cost. It is not perfect, but options are too uncertain to lend themselves to a perfect solution.”

Required:

1. Summarizing the controversy surrounding the methods used to account for stock options.
2. Explain why some believe that stock options have a cost
3. Provide some rational for why Microsoft, rather than other companies, is seriously to communicate that cost to its shareholders.