

Harnischfeger corp essay



**ASSIGN
BUSTER**

1. Identify all the accounting policy changes and accounting estimates that Harnischfeger made during 1984. Estimate as accurately as possible the effect of these on the company's 1984 reported profits.

1. Products purchased from Kobe Steel were included in net sales, as opposed to only reporting the gross margin on Kobe equipment. These net sales amounted to \$28 million in 1984, although the amount was insignificant on net income.

2. Financial statements of some foreign subsidiaries (fiscal July 31) were included, thus increasing sales amount by 3 months (August –October), at \$5. 4 million.

3. Depreciation expenses of plants, machinery and equipment using straight-line method, instead of accelerated methods as used previously. The reduced depreciation expense increased 1984 income by \$11 million.

4. Estimated depreciation lives on certain plants and equipment, as well as residual values on certain machinery, were changed, increasing net income by \$3. 2 million.

5. Liquidation of LIFO inventory increased net income by \$2. 4 million before tax.

6. Pension plan was restructured to change minimum pension benefit, capturing \$39. 3 million in remaining plan assets, to be amortized to income over 10 years. Coupled with changes in the assumed investment rate (increased to 9%), pension expense was reduced by \$4 million.

2. What do you think are the motives of Harnischfeger's management in making changes in its financial reporting policies? Do you think investors will see through these changes?

1. The management wants to more accurately report the performance and situation of the firm, for example including purchases from Kobe in net sales.

2. Since most changes are positive, management might be looking to boost stock prices before the new public offering in order to raise more capital. (\$150 million to pay debt)

3. Maintain certain performance levels to avoid defaulting on new covenants of restructured loans, so as to maintain credit worthiness and credit lines.

4. New management wants to perform up to expectations and targets of company's shareholders.

5. Improve performance so as to improve compensation benefits and wages which were reduced and frozen in 1983.

Given all changes pertain to accounting, the investor must firstly, carefully looked through the financial report, and secondly, have some basic knowledge and understanding of financial statements to be able to understand any impacts. The average investor might thus be unable to 'see through' the changes made and recognize their impact. The analysts however may be easily able to understand the changes and impacts when evaluating for their recommendation. Since most changes do not affect long term performance and cash flow, it may be difficult for investors to predict future impact.

3. Assess the company's future prospects, given your insights from questions 1 and 2 and the information in the case about the company's turnaround strategy.

The turnaround strategy included 4 elements –changes in top management, cost reductions, reorientation of business and lastly debt restructuring and recapitalization. All 4 have seemed to be successful, with the new management implementing measures that helped turn the company around rapidly. Reorientation allowed it to focus on higher value and faster growth sectors, and cost reduction was successful in increasing profit levels. Financing was sound and investor confidence allowed smooth recapitalizations, helping to clear of remaining debt.

From question 1 it can be seen that most of the impact on profit seems to be short term, with some changes even having insignificant impact. Thus accounting changes seem to be mostly irrelevant to the improved performance of the company. From question 2, management might have certain vested interests (compensation), and might be under pressure to improve and maintain performance (eg loan covenants). However, compensation policies and loans might have been modified to avoid improvements purely due to accounting changes, thus all motives might revolve around the aim to improve performance legally. Given these information, the company's future prospects seem positive.