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An Analysis of Accounting Concepts Through a Comprehensive Series of Case Studies

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AN ANALYSIS OF ACCOUNTING CONCEPTS THROUGH A COMPREHENSIVE SERIES OF CASE STUDIES

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ABSTRACT

This thesis is a compilation of 10 case studies completed under the direction of Dr. Victoria Dickinson during the ACCY 420 course over two semesters to satisfy the requirements of the Sally McDonnell Barksdale Honors College. Each case guides the study of different accounting standards. These include topics such as contingent liabilities, retirement obligations, non-GAAP financial reporting, financial statement analysis, and more. The case topics often coincided with subjects that were being covered in intermediate, audit, and tax accounting. These cases provided an opportunity to learn how to do independent accounting research in FASB codification. Each case exposed me to a more in-depth look at the topic than I had previously had in other classes. Creating the thesis significantly benefited my academic career and prepared me for a professional career.

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CASE ONE: FINANCIAL STATEMENT ANALYSIS OF STARBUCKS CORPORATION

Introduction

The purpose of the case is to practice evaluating and interpreting a set of financial statements with significant implications detailed in the statements' footnotes. Common-size financial statements are used to increase the ease of comparison between different accounting periods.

Concepts

a) Starbucks primarily makes money through brick-and-mortar stores in many different countries. Starbucks sells merchandise, food, and drinks in the stores. The firm focuses on cost leadership and convenience to sell its products through its high number of stores.

b) Income statements, balance sheets, cash flow statements, and statements of stockholders' equity are commonly prepared for external reporting. However, Starbucks Corporation prepares a consolidated statement of earnings, consolidated statement of comprehensive income, consolidated balance sheet, and consolidated statement of cash flows. Starbucks label these statements as consolidated because they include wholly owned subsidiaries and controlled investees.

c) Publicly traded corporations will always prepare financial statements periodically as they are required by the Securities and Exchange Commission to do so.

d) Company management is responsible for financial statements, but external auditors examine the financial statements prepared to determine if they are accurate. The auditor will certify that the financial statements fairly represent the position of the firm for the period. Users of the financial statements include potential investors and creditors to the firm. These users will be interested in using various financial ratios to determine the financial strength of the firm moving forward.

e) Deloitte & Touche LLP audited Starbucks Corporation's financial statements in 2013. The opinion statements are saying that Deloitte & Touche LLP has determined that the financial statements fairly represent the financial position of the firm and that effective internal control of Starbucks Corporation has been maintained has been maintained for the year ending September 29, 2013. Financial statements often take a few months after the year-end to prepare, but must be available in a timely manner to be useful for users of the statements.

Analysis

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Figure 1-1:

Common-Size Consolidated Statements of Earnings (USD $)

	Sep. 29, 2013	**Sep. 30, 2012**
Net revenues:		
Company-operated stores	79.19%	79.21%
Licensed stores	9.14%	9.10%
CPG, foodservice and other	11.67%	11.69%
Total net revenues	100.00%	100.00%
Cost of sales including occupancy costs	42.86%	43.71%
Store operating expenses	28.78%	29.46%
Other operating expenses	3.07%	3.23%
Depreciation and amortization expenses	4.17%	4.14%
General and administrative expenses	6.30%	6.02%
Litigation charge	18.70%	0.00%
Total operating expenses	103.87%	86.57%
Gain on sale of properties	0.00%	0.00%
Income from equity investees	1.69%	1.58%
Operating income	-2.19%	15.02%
Interest income and other, net	0.83%	0.71%
Interest expense	-0.19%	-0.25%
Earnings before income taxes	-1.54%	15.48%
Income taxes	-1.60%	5.07%
Net earnings including noncontrolling interests	0.06%	10.41%
Net earnings attributable to noncontrolling interest	0.00%	0.01%
Net earnings attributable to Starbucks	0.06%	10.40%

Figure 1-2:

Common-Size Consolidated Balance Sheets (USD $)	Sep. 29, 2013	Sep. 30, 2012
Current assets:		
Cash and cash equivalents	22.36%	14.46%
Short-term investments	5.71%	10.32%
Accounts receivable, net	4.87%	5.91%
Inventories	9.65%	15.10%
Prepaid expenses and other current assets	2.50%	2.39%
Deferred income taxes, net	2.41%	2.90%
Total current assets	47.51%	51.09%
Long-term investments	0.51%	1.41%
Equity and cost investments	4.31%	5.60%
Property, plant and equipment, net	27.79%	32.35%
Deferred income taxes, net	8.40%	1.18%
Other assets	1.61%	1.76%
Other intangible assets	2.39%	1.75%
Goodwill	7.49%	4.86%
TOTAL ASSETS	100.00%	100.00%
Current liabilities:		
Accounts payable	4.27%	4.84%
Accrued litigation charge	24.17%	0.00%
Accrued liabilities	11.02%	13.79%
Insurance reserves	1.55%	2.04%
Deferred revenue	5.68%	6.21%
Total current liabilities	46.69%	26.89%
Long-term debt	11.28%	6.69%
Other long-term liabilities	3.11%	4.20%
Total liabilities	61.08%	37.77%
Shareholders' equity:		
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0.01%	0.01%
Additional paid-in capital	2.45%	0.48%
Retained earnings	35.86%	61.40%
Accumulated other comprehensive income	0.58%	0.28%
Total shareholders' equity	38.90%	62.16%
Noncontrolling interests	0.02%	0.07%
Total equity	38.92%	62.23%
TOTAL LIABILITIES AND EQUITY	100.00%	100.00%

g)

ii) Starbucks Corporation's major assets include cash and cash equivalents, inventories, plant assets, deferred income taxes, and goodwill. Short-term assets account for 47.5 percent of total assets while long-term assets account for 52.5 percent. This seems appropriate for Starbucks because it is a company primarily using brick-and-mortar stores with expensive equipment.

iii) Intangible assets are assets that are not physical. Goodwill arises in an acquisition when purchase price of a company exceeds the fair value of the acquired company's total assets. Starbucks likely has intangible assets such as licenses, patents, franchises, goodwill, copyrights, or trade secrets.

iv) Starbucks is financed primarily through their retained earnings from growth in revenues as well as through outside investors purchasing common stock. 22.5 percent of total financing comes from non-owners in the form of long-term debt.

h)

i) In company-owned stores, Starbucks uses cash-basis accounting. For sales to licensed stores, revenue is recognized upon shipment. Gift cards sales are recognized when redeemed or when likelihood of redemption, based on historical data, deems redemption probability to be remote. Challenges in measuring revenue arise from the many different sources of revenue and the different recognition policies in place for the various sources. Management will need to use judgement in deciding when to recognize revenue as some of the recognition policies for licensed stores are not extremely clear.

ii) Starbucks' major expenses in 2013 included operating expenses, general & administrative expenses, and litigation charges as shown in Figure 1-1.

iii) Litigation charges were added to the Starbucks cost structure in 2013 and accounted for 18.7 percent of net revenue

iv) Starbucks recorded the litigation charge as an operating expense because it is not recurring each year. General and administrative expenses are incurred every year.

v) The company was not profitable in 2013 as their operating expenses exceeded their revenues as shown in Figure 1-1. However, the company did report a net income rather than a net loss because of negative tax paid by the government. In 2012, Starbucks was extremely profitable with revenues far exceeding expenses.

i)

i) Starbucks had net earnings of $8.8 million, while it had net cash provided by operating activities of $2.9083 billion. Calculation of net earnings comes from subtracting all expenses from revenues for a given year. Cash provided by operating activities adds back non-cash expenses and subtracts non-cash income for a year to find exactly how cash moved in operating activities for the company.

ii) Starbucks used cash of $1.152 billion to purchase property, plant, and equipment in the 2013 fiscal year.

iii) Starbucks Corporation paid $628.9 million in dividends during the 2013 fiscal year. However, the company declared dividends of $668.6 million for 2013. Starbucks will be left with $39.7 million in dividends payable in the following year.

j) GAAP requires company management to make estimates affecting various accounts. Starbucks accounts requiring the use of estimates include, but are not limited to, goodwill, fixed assets, inventories, accounts receivable, investments, and deferred income taxes. Accounts that are likely estimate free include cash and cash equivalents, prepaid expenses, intangible assets other than goodwill, accounts payable, long term debt, common stock, and retained earnings.

CASE TWO: CONTINGENT LIABILITIES RELATED TO BP OIL SPILL

Introduction

The purpose of the case is to gain a deeper understanding of accounting for contingent liabilities. Accounting for contingent warranty costs that are relatively estimable and unique contingent liabilities like those resulting from the Deepwater Horizon oil spill varies extensively. The ability to estimate the future costs associated with contingent liabilities is key in being able to recognize them on the balance sheet and expense them in the income statement.

Concepts

a) A contingent liability is a liability that may occur. The liability is contingent on a future event happening. Companies will only record a contingent liability if it meets two criteria. The liability must be both probable and estimable. Contingent liabilities should not be recorded on financial statements if their probabilities are remote or just possible. Types of contingent liabilities include potential lawsuits and product warranties. Additionally, contingent assets should never be recorded.

b) It's extremely common for products to be sold with warranties against defects, so it's important to know how to account for them on both sides of the sale. From the perspective of the buyer, the product warranty is an asset. The seller will record product warranties as current and non-current liabilities depending on the duration of the product warranty. The liability needs to be matched to the period of the sale.

c) The main judgements that management will make when accounting for contingent liabilities are estimating the probability of the loss and the related expense. Product warranties and lawsuits are extremely different in the way that the contingent liabilities are accounted for. The largest differences are that claims on product warranties, or accrued warranties, are relatively easy to estimate based on historical data and are probable, while claims from lawsuits are infrequent and vary heavily from one to another. This holds true for BP's Deepwater Horizon oil spill damage claims. Oil spills occur very rarely and the impacts are hard to measure. There is a great degree of uncertainty in the costs of the damages. How many parts will be defective? What is the estimated cost of repair per part? Every legal claim for damages against BP will vary and be a unique case.

d) BP is required to make several estimates to account for the contingencies associated with the Deepwater Horizon oil spill. BP must estimate future costs of ongoing response to the spill, remediation and assessments, research initiatives in the gulf, litigation expenses, claims center administration expenses, and estimated penalties from the Clean Water Act. The ongoing response expenses cover US Coast Guard response costs and decontamination of vessels involved in spill response. The expense is estimated using recent daily costs for this expense. The research initiative expenses include a program that studies the extent of the spill's environmental impact. BP believes all of these expenses, except the ongoing clean-up response, are not estimable until more research is finished on the spill. Therefore, BP will not be accounting for these as contingent liabilities. However, BP has established a $20 billion escrow account to satisfy all of these future costs.

CASE THREE: EQUITY METHOD AND JOINT VENTURE ACCOUNTING

Introduction

The purpose of this case is to learn more and develop a strong understanding about accounting for joint ventures and why a company might undertake a joint venture. In this case, Wendy's is involved in joint ventures with Tim Hortons Inc. and Japan. Wendy's uses the equity method to account for these joint ventures. I discover how the acquisition accounting premium arises and is amortized and possibly impaired over the life of the joint venture. I practice making year-end journal entries to account for the revenues, dividends, and amortizations arising from the joint venture with Tim Hortons Inc.

Concepts

a) Companies enter into joint venture agreements for various reasons. In a joint venture, two companies combine their resources and expertise for a common goal. A joint venture agreement between two companies can be mutually and offer many advantages. Joint ventures provide opportunities for companies to share costs and risks of a common project, access new technology or talent, and to reach new and unfamiliar markets. The joint venture between Wendy's and Tim Hortons Inc. was primarily to share wisdom and increase profits.

b) The equity method of accounting Wendy's uses in this case is a simple way of accounting for an investment in another company. To account for its initial investment with a journal entry for the cost of the investment with a debit to Equity Investments and a credit to Cash. When the investee subsequently earns income, the investor will debit Equity Investments and credit Investment Income for their share of the income. The investor's share of the income will be equal to its ownership percentage. For example, if an investor owns 50 percent of the investee, then it will claim 50 percent of the investee's income. When the investee pays dividends, the investor will debit Cash and credit Equity Investments for their share of the dividends paid.

c) When an investing company purchases shares in another company, the amount of the investment over their share of the book value of the company is split into two parts. The first half is used to write-up identifiable assets and liabilities to their fair values. This depreciation and amortization value will be accounted for on the investor's financial statements. The second half is accounted for as goodwill. Goodwill is what an investing company is willing to pay for another company over the value of its net assets. Goodwill cannot be amortized but is tested annually for impairment.

d) In 2012, Wendy's recorded its equity investment in Tim Hortons Inc. at $89.370 million and in 2011 recorded the equity investment at $91.742 million. These amounts are recorded in the investments section of the balance sheet.

e) The equity investments balance is $89.370 million at December 30, 2012 on Wendy's balance sheet. Tim Hortons Inc.'s equity balance is $70.565 million and thus Wendy's part is equal to 50 percent at $35.283 million. The difference is known as the acquisition accounting premium containing goodwill and the write-up to fair value. The acquisition accounting premium is $54.283 million in this joint venture.

f)

i) Wendy's equity method investment in Tim Hortons Inc. affected their earnings before taxes in 2012 and 2011 through their share of Tim Hortons Inc.'s earnings. The relevant journal entry is the debit to Equity Investments and credit to Investment Income for Wendy's share of Tim Hortons Inc.'s income. This amount is recorded as Investment Income, net on the Wendy's consolidated statement of operations.

ii)

Figure 3-1:

Account	Account	Debit (in thousands)	Credit (in thousands)
Equity Investments		13,688.5	
	Equity Income		13,688.5

iii) Tim Hortons Inc. records amortization on its financial statements, but Wendy's must make an entry to reflect its share. Wendy's lowers the value of its investment and reduces its income from the investment by $3.129 million.

Figure 3-2:

Account	Account	Debit (in thousands)	Credit (in thousands)
Equity Income		3,129	
	Equity Investments		3,129

iv) Wendy's received dividend payments of $15.274 million 2012 and $14.942 million in 2011 from its investment in Tim Hortons Inc.

Figure 3-3:

Account	Account	Debit (in thousands)	Credit (in thousands)
Cash		15,274	
	Equity Investments		15,274

g)

i) Equity investment income must be subtracted from net income in the cash flow statement because it is not cash-based income. Equity income of $10.551 million from Tim Hortons Inc. must be net with the loss of $1.827 million from the Japanese joint venture to arrive at the negative equity earnings cash flow adjustment of $8.724 million.

ii) Wendy's adds $15.274 million to its statement of cash flows because it is cash Wendy's received, but was not able to record as income. This amount was entirely from the joint venture with Tim Hortons Inc. The Japanese joint venture was unable to pay dividends. The original entry for the dividends received was a debit to Cash and a credit to Equity Investments.

CASE FOUR: JOHNSON & JOHNSON RETIREMENT OBLIGATIONS

Introduction

The purpose of this case is to develop a strong understanding of defined benefit obligation retirement plans and how to account for them. This case uses Johnson & Johnson's financial statements to practice this accounting. Many of the details about the pension plan are found exclusively in footnotes, but it is important to be aware of how these details impact the financial statements. Understanding how funding the plan and expensing the plan works through various actuarial assumptions is critical to grasping how pension plans work overall.

Concepts

a)

i) There are two common types of retirement plans companies use for their employees, defined benefit plans and defined contribution plans. Defined benefit plans are calculated based on the years of service of employees and the salary they earn at the time of retirement. The company bears the investment risk for the plan. The plan is not entirely based on investment returns. This means that if investment returns are low for a company's pension assets, then the company will have to put more cash into the plan to make up for the difference. The payout for employees is not based on investment returns. In a defined contribution plan, company's simply match a defined portion of an employees input into the pension plan. The payout for the employee at retirement is entirely based on the investment's returns. Johnson & Johnson uses a defined benefit plan.

ii) Retirement plan obligations are liabilities, because they are a cost incurred in current periods that will be paid in future periods. When an employee works a year in a defined benefit plan, the company's retirement plan obligation rises to reflect their defined obligation to pay that employee once he or she retires.

iii) To account for retirement plan obligations, a few assumptions must be made. The company must assume that an employee will reach vested status to claim their pension pay in the future. Assumptions must be made about the remaining service life of employees, average lifespan of employees, and average annual salary raises for employees.

b) Service costs, interest costs, actuarial gains or losses, and benefits paid to retirees all influence pension obligations. Service costs are the costs associated with the benefits earned by employees during the current period for retirement. Interest costs represent the interest accumulated on the projected benefit obligation during the current period. Actuarial gains and losses can include increases or decreases in the expected lifespan of those on the pension plan, expected service life of employees, expected retirement ages, or market changes affecting expected return on plan assets. Benefits paid to retirees decrease the projected benefit obligation and pension assets. These benefits are pension payments to retirees during the current period.

c) Actual return on pension investments, company contributions to the plan and benefits paid to retirees affect a company's pension assets. Actual return on pension investments reduces pension expense for the period and increases the pension assets balance. Company contributions to the plan decrease cash, but increase the pension assets balance.

This amount will earn interest in future periods. Benefits paid to retirees will decrease both pension assets and the projected benefit obligation.

d) Pension expense increased through a debit by the expected return on plan assets. However, pension assets are increased through a debit by the actual return on plan assets. The difference flows through an other comprehensive income gain or loss account. This is done to smooth the pension expense to a somewhat consistent amount each year. One year may have a larger than expected return, but the next may have a smaller than expected return. The gain or loss account smooths the difference over several years.

Process

f)

i) Johnson & Johnson reported a pension expense of $646 million in its 2007 income statement.

ii)

Figure 4-1:

Account	Account	Debit (in millions)	Credit (in millions)
Pension Expense		1,253	
	Projected Benefit Obligation		1,253

g)

i) The value of Johnson & Johnson's retirement plan obligation at December 31, 2007, is $12,002 million. This value represents the present value of benefits the company owes in the future as pension liabilities to current and future retirees. This number is a best estimate made by actuaries, but can easily change with amendments to prior service costs or amendments to the actuarial estimates. It is extremely unlikely the projected benefit obligation is exact.

ii) The pension-related interest cost for the year is $656 million. The average interest rate used to calculate interest cost is 5.62 percent. This number is reasonable as it is relatively close to the discount rates for Johnson & Johnson.

iii) Johnson & Johnson paid $481 million to retirees in 2007 without the use of cash. The benefits paid decreased the projected benefit obligation and plan assets.

h)

i) At December 31, 2007, the value of the retirement plan assets for Johnson & Johnson was $10,469 million. This amount represents the actual value of Johnson & Johnson has invested to support their retirement obligations. This amount is $1,533 million short of their projected benefit obligation and is therefore, underfunded.

ii) In 2006, the expected return was $701 million while the actual was $966 million. The return on plan assets for 2006 was underestimated. In 2007, the expected return was $809 million while the actual return was $743 million. The return on plan assets for 2007 was overestimated. These differences between expected and actual returns seem insignificant. General economic forces can alter the returns on investments each year. This loss in 2007 will be reflected as in increase in future pension expenses.

iii) In 2007, Johnson & Johnson and its employees contributed $379 million to its retirement plan. In 2006, they contributed $306 million to its retirement plan.

iv) Johnson & Johnson's retirement plan asset investments are held in debt and equity securities.

i) As of December 31, 2007, Johnson & Johnson's retirement plan is underfunded by $1,533 million. As of December 31, 2006, the retirement plan was underfunded by $2,122 million. This funded status appears on the balance sheet in the employee related obligations account balance.

CASE FIVE: BALANCE SHEET APPROACH VS INCOME STATEMENT APPROACH

Introduction

The purpose of this case is to practice thinking conceptually about the accounting practice. In my accounting studies thus far, I have been learning the balance sheet approach to accounting exclusively. I hadn't barely even considered the possibility of practicing accounting any other way. This case presents a good argument for considering the income statement approach was popular until the 1970s. This case argues that the balance sheet approach used today is too focused on changes in account balances and not focused enough on revenues and earnings. It calls on the reader to heavily consider the purpose of accounting and why we choose to account for things the way that we do. I've learned that it's important to match expenses to revenues properly. Management and investors make decisions based on a company's revenues and expenses. There's too little focus on recurring and reliable earnings in certain accounting situations today and the FASB and the IASB should be mindful of this when updating standards in the future. This case will surely be useful in my future career in public accounting when it comes time to make my own judgements on these situations.

Summary

There are two primary approaches to accounting, the balance sheet approach and the income statement approach. The balance sheet approach revolves around the accounting equation, assets = liabilities + equity. The focus is to determine a correct valuation of assets and liabilities. To arrive at earnings using this approach, one finds the change in assets and liabilities. On the other hand, the income statement approach looks to determine revenues and expenses first and foremost. It focuses on the revenue recognition principle and the matching principle to arrive at earnings. Balance sheet amounts are a secondary focus of the income statement approach. Until the 1970s, the income statement approach governed most of accounting. Once the FASB was created in 1973, they decided that one accounting approach should be standard for the purpose of comparability and uniformity between firms. The FASB reached the conclusion that the balance sheet approach would become the standard approach for accounting moving forward because it is the most logically sound of the two. "On the Balance Sheet-Based Model of Financial Reporting" primarily argues that the FASB and IASB's upcoming review of their conceptual framework for the purpose of increasing comparability is wrong to omit re-assessment of the structure of the balance sheet and its purpose. The paper also argues that accounting should take on a renewed focus in the income statement approach with matching expenses to revenues.

Businesses are managed around the income statement approach. They essentially advance expenses in order to earn revenue in later periods. Assets are used as intermediaries for this exchange between expenses and revenues. The goal of a firm is to generate revenues, not merely increases in assets. The assets are proposed as tools to increase revenues. Managers forecast revenues, predict matching costs, and then finally determine what assets are needed to achieve the goals. If this is true, then it makes clear sense that an accounting approach that mirrors this goal should be used. Additionally, potential investors use earnings to value a business. There are times when the balance sheet approach is appropriate for businesses. Businesses whose central purpose is to increase value of assets and call it earnings will do this. These businesses include real estate firms and marketable security investment firms. The distinction seems to boil down to whether a business is involved more frequently in operating or financing activities.

Most operating activities are better aligned with the income statement approach, whereas financing activities are better suited for the balance sheet approach.

Another argument being made against the balance sheet approach is that it isn't even a more logical or conceptually superior approach. The FASB believes the balance sheet approach is stronger because earnings are "a change in value, and one cannot define a change in value before establishing what value is." The FASB defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Future benefits, though, can really be thought of as future earnings. This leads to a circular argument from the FASB. You need to define what assets are before you can properly measure earnings, but assets are essentially defined using earnings. The two are interconnected with each other. A firm uses assets to generate earnings that increase assets. The FASB acts as if the two concepts can be separated and one can be put on a pedestal, but they cannot be separated. This leads to a framework that is weaker. Valuing intangible assets also becomes problematic and is often subjective in deciding how to measure them. In contrast, it is much easier to determine income for a firm and there is less ambiguity.

Typically, investors will value a firm based on the present value of its future earnings. The primary metric that is used is recurring earnings as they are the best predictor of future earnings. Valuing earnings based on changes in net assets gives rise to high volatility in earnings each period and is difficult for potential investors to use. Multiple studies have found that earnings volatility has substantially increased since the balance sheet approach was widely adopted. Thus, the relation between stock prices and earnings has deteriorated. This volatility is making it extremely difficult for investors that don't have much time to spare or education on valuing firms to choose wise investments.

Balance sheet accounting brings many problems to the accounting practice. First, mark-to-market accounting rules are difficult to implement when there are not reliable estimates for the market values. High volatility in this area can have significant effects on earnings. When the mark-to-market method cannot be used, firms go to the mark-to-model method. This involves too much subjectivity from management decisions with unreliable estimations or manipulation. Another issue with balance sheet accounting is that it creates a short feedback loop with significant problems. The mark-to-market method bases valuations on the market, but the market bases its valuations on the accounting valuations. This could lead to market bubbles. Financial markets don't always reflect real economic intrinsic values, but rather investors' perceptions of value.

Certainly, there must be an alternative common ground for the two approaches. This paper suggests that an alternative model should have a clear distinction between operating and financing activities. Operating activities include all activities central to regular business operations. Operating activities in this model would include what we consider as operating and investing activities today. These operating activities only serve to aid the internal activities of a firm and don't hold the same value to the rest of the market. Financing activities would include mostly cash and cash-equivalents that hold relatively the same amount to the rest of the market. In the alternative model, the income statement would have operating and financing sections. Having separate sections serves to produce some regular and recurring earnings in the operating section, while holding highly fluctuating earnings in the financing section. The balance sheet would also have the assets split into operating and financing sections. The operating assets are essentially just unexpired costs and don’t need to be adjusted to their fair value, while the financing assets could be marked to the fair value. Additionally, the alternative model would take on a renewed focus on the matching principle. Most managerial business decisions are made based on matching revenues and costs and recording revenues from operating activities should reflect this.

Current FASB and IASB releases have completely ignored the concept of matching and is drifting further from accountings roots as a measured reflection of business activities. The FASB and IASB should consider how matching should be fundamental and critical in financial reporting. Without proper matching, current efforts in relevance, faithful representation, and comparability are much less impactful.

Questions

1) How did reading this article change your current way of thinking?

This article was extremely interesting to me and had a large impact on the way that I thought about accounting. I’ve always taken accounting as a practice that cannot be changed much and that there wasn’t much reason for change. However, this article has opened my eyes to the notion that there is plenty of room for change in the practice.

From the beginning of my undergraduate career studying accounting, I’ve been studying the balance sheet approach to accounting. I wasn’t even aware that there were other approaches, let alone that in the income statement approach used to be the most prominent one practiced. I have always thought of accounting as just changes in account balances with a true balance sheet approach mindset. The thought that accounting doesn't necessarily have to approached that way is very intriguing.

It's known that part of accounting's purpose is to track business activity in a measurable and useful way. It makes sense that this should be done in a way that is reflective of how businesses actually operate. Management decisions are entirely based on balancing revenues and expenses. When deciding whether or not to take on a project, management will look at expected revenues from the project and the costs associated with achieving those revenues. If the margin on the project is higher than they could achieve through other investments, then they will accept the project, but if it is lower, they will reject. Management decisions aren't necessarily made by deciding how different account balances might change. Management's purpose is to maximize profits; therefore revenues and expenses are their primary focuses. Accounting should reflect this process as best as possible and should consider focusing on revenues and expenses first rather than balances of accounts.

Another interesting part of the article that I hadn't ever seriously considered was how mark to market rules can be problematic. I thought that they would better reflect values for potential investors. However, this article showed me that this can create a closed feedback loop. If the mark to market method values accounts based on what the market thinks they're worth and the market perceives worth of a company based on the value of those accounts, then it can create exponential growth or shrinkage. This bubble can and often does cause high volatility in the balances of mark to market accounts. The article's suggestion to separate income statements and balance sheets into operating and financing sections to confine some of the volatility away from stable accounts is enticing.

Sectioning the income statement like this would give investors a great look at recurring earnings that are subject to much less volatility. This would help with rudimentary-level investors and their ability to value firms on their recurring earnings. Highly fluctuating earnings from securities investments can make evaluating firms tricky for investors.

While I don't believe that the accounting practice needs to be overhauled to achieve the goals of this article, I do believe that the ideas presented should be considered when the FASB and the IASB make changes in the future for the accounting practice. Adding more complications that make reading financial statements more difficult for investors that aren't business savvy should be avoided.

2) How will you use this information in your future career?

I'll surely be able to use this information in many ways during my future career. While my current accounting studies don't really allow for much of my own interpretation on how to handle certain accounting situations, my future career will. Auditors are constantly interpreting accounting situations with the goal of presenting them fairly for both the firm and investors or creditors. When I reach the point in my career when must use my own interpretations in practice, I will remember the core purposes of accounting that were mentioned in this article.

When evaluating management's valuation methods for marking assets to their fair market values, I will remember how different valuation methods affect both the firm and its investors. Some firms may want to use valuation methods that are beneficial to the firm, but misleading for investors. It is important to remember the extent that subjectivity is involved when marking to market values. This bubble that is created can be dangerous to investors and creditors. Fair market value of assets can increase quickly as a result of this practice, but an also decrease just as quickly and cause losses to investors. Accounting should incorporate more valuation best on calculated estimates of real economic value created. Incorporating more use of real economic value created into valuation of accounts will shed some of the volatility seen today. This will increase the usefulness of the balance sheet to investors and increase predictability for the firm.

I'm familiar with the idea that during mergers and acquisitions, recurring earnings are used heavily throughout the process. When a firm is looking to acquire another, they will often employ an accounting firm to do financial due diligence. Part of the financial due diligence process involves finding and normalizing earnings before interest, tax, depreciation, and amortization (EBITDA). When negotiating the purchase price of the acquired firm, the acquiring firm will often use a multiple of EBITDA. The purpose of finding EBITDA is to find normal and recurring earnings to help in this valuation. Whether or not they are of this magnitude, all investments will use recurring earnings in the valuation process. While it's more feasible and sensible for a large firm to pay for this information in a large acquisition, it's not feasible for small investors to get this information. It would be extremely useful for purchasers of stock to have this normalized EBITDA. In my future career, I won't be able to provide this information to those entry-level investors, however, I will be mindful of how useful this information is when making decisions. It will be increasingly important in an audit to provide consistent and reliable information on earnings as they arrive in more complex ways. It will be a goal of mine when making judgment decisions to err on the side of providing reliable, consistent, and less volatile information.

CASE SIX: GOOGLE'S FINANCIAL STATEMENTS WITH INFORMATION ENVIRONMENT

Introduction

The purpose of this case is to study the use of non-GAAP financial measures and compare them to GAAP measures. Non-GAAP financial measures are modified income statements, balance sheets, or cash flow statements that exclude or include earnings or expenses that would otherwise be included in GAAP statements. Non-GAAP measurements are normally included in financial statements in order to show a view of the firm that, in their opinion, better shows the revenues and expenses central to business operations. They argue that these are more useful for investors and show recurring earnings. When non-GAAP measures are included, management is required to give reasons why they believe it is useful. One of the most common non-GAAP measures included is adjusted earnings before interest, tax, depreciation, and amortization (EBITDA). Some common items removed from net income to reach EBITDA are stock compensation expenses, asset impairments, merger and acquisition costs, restructuring charges, losses on debt extinguishments, changes in fair values of assets and liabilities, and gains or losses on the sales of assets (Afterman 49). This case study looks into the purpose of including non-GAAP financial measures and whether value is added in doing so.

Analysis

h)

ii) Net income under GAAP measures in 2013 was $3376 million, while net income through non-GAAP measures was $4096 million. The difference between GAAP net income and non-GAAP net income includes eliminated stock-based compensation expense, restructuring charges, income tax effects related to the stock-based compensation expense and restructuring charges, and net loss from discontinued operations. I agree with Google's adjustments in computing non-GAAP net income because it better reflects the normal income from Google's operations. Stock-based compensation expense and restructuring expenses will vary significantly each period. Removing these from the non-GAAP measured expenses will increase comparability and consistency over multiple periods. The non-GAAP income measurements better show the revenues and earnings of Google's core business and is sometimes more useful for potential investors in valuing the company.

i)

i) In 2013, Google's share price rose 58 percent from $707 to $1,120 per share. In the same year, Google's total revenues rose 19 percent from $50,175 million to $59,825 million. Its net income also rose from $10,737 million to $12,920 million for an increase of 20 percent. An increase of 19 percent in net income is exceptional and the strong increase in share price reflects that.

ii) Throughout 2013, Google's share price rose significantly faster than other firms trading on the NASDAQ exchange. In the first two quarters, Google's shares were outperforming the NASDAQ index slightly, but after third quarter earnings were released, the Google's shares were far outperforming other firms' shares on the NASDAQ exchange.

iii) The market perceived Google's January 30, 2014, press release as good news. The stock spiked shortly after the earnings were announced and the settled down to its previous growth rate in the days following. Quarter 3 and quarter 4 earnings releases were both received very positively by investors.

j)

i) Google's fourth quarter revenues were $16.9 billion, beating analyst projections of $16.8 billion. However, earnings per share were $12.01, losing to analyst projections of $12.20 per share. Despite earnings per share being lower than expected, investors were very pleased by the fourth quarter results and the share price rose four percent in after-hours trading. The share price rose partly because of revenue beating out analyst predictions, but also because of a cumulation of other factors.

ii) Investors were very happy that, days before the fourth quarter earnings release, Google announced its plans to sell Motorola to Lenovo for $2.9 billion. The Motorola smartphone unit under google had caused over $2 billion dollars in operating losses since 2012. A 31 percent increase in clicks on Google's advertisements also excited investors. Google was also a leader in developing mobile, image-based advertisements that increased cost per click. The article also cites an increase in mobile app purchases to $1.7 billion in 2013 as a reason investors reacted positively. However, there are also reasons for investors to be cautious. Google's net income for the fourth quarter of 2013 fell short of analysts' expectations and the earnings for each advertisement click Google received dropped eleven percent since the 2012 fourth quarter. Investors may also be worried about Google's 125 percent increase in capital expenditures over the last year. While this investment by Google is expected to increase future revenues, it is also massive and potentially risky. There seems to be much more upside to this investment, though.

CASE SEVEN: CITY SELECTION

Introduction

The purpose of this case is to carefully analyze two of my preferred cities to start my public accounting career and decide which of the two I would prefer. While I have already accepted an internship in Dallas for the winter of 2020, I am comparing it to New York City. New York City is where KPMG's North American Headquarters are located. It is possible that I may eventually be called to do a temporary or extended rotation in New York City after spending some time in Dallas. Analyzing Dallas will help prepare for my upcoming move to the city. I will be more knowledgeable about the city and I'll know what to expect while I'm there during my internship.

There are many different factors to consider when analyzing cities and some factors may be more important to some people than to others. Some people may be content with being indoors frequently and being surrounded by people in a dense area because they have access to great entertainment, food, and other cultural experiences that way. Others may prefer to have space away from other people and have a house rather than a multi-story apartment where they can grill or have a pool. I ultimately prefer a city that I can stay in as long as possible. For me, this means a city that is like my home, Memphis, where I can sustain a lifestyle that I am used to. I don't want culture shock that is too large for me to handle or to be too far away from my family. In this case, describe characteristics about each city's population, climate, landscape, taxes, transportation, industries, schools, crime, housing, and entertainment. I also create an operating budget for each city based on data from my analysis.

Analysis of Dallas, Texas

1. The city of Dallas has 1.34 1 million residents, but most figures will include the metropolitan area population of 7.233 million people. The Dallas-Fort Worth metroplex is massive and effectively spreads out the population. Dallas has a population density of 3,957 people per square mile.

2. Dallas, Texas, has an average annual temperature of 64.3 degrees Fahrenheit. Average temperatures in January and July are 46 degrees and 85 degrees Fahrenheit respectively. The climate is humid with extremely hot summers and mild winters.

3. Dallas is located in north Texas in the lower Great Plains. The area is very flat and is the country's largest city not on a major body of water. However, there are over 60 lakes within a 100-mile radius of the city. Because the city is spread out, there is plenty of greenery throughout.

4. Residents in Dallas are lucky to not have to pay any state or local income taxes. The state earns a lot of its revenue from taxes on energy production and is able to provide tax relief to its residents. The state sales tax rate is 8.25 percent and property tax is 0.78 percent of assessed home value. A $55,000 income will be subject to $9,607 in income taxes at an effective rate of 17.47 percent.

5. Dallas transportation hubs include Dallas/Fort Worth International Airport and Dallas Love Field. DFW airport is the largest hub for American Airlines. It is the fourth busiest airport in the world by aircraft movements and fifteenth busiest by passenger traffic. DFW airport is 27 square miles, making it larger than the island of Manhattan.

6. The largest companies in Dallas by revenue are Exxon Mobil Corporation, McKesson Corporation, AT&T Inc., Energy Transfer LP, and American Airlines Group Inc. The largest industries in Dallas are technology, financial services, and defense.

7. Dallas is home to the Parkland Memorial Hospital, the major trauma center for North Texas, and is considered one of the top 25 hospitals in the country. Dallas also includes Baylor University Medical Center ranked as one the best in the country by U.S. News & World Report. Plano and Highland Park both are consistently ranked as top city school districts in the country.

8. Thefts, burglaries, robberies, and assaults are common in Dallas. The city is above the United States average city-data.com crime index. The U.S. average is 280.6, while Dallas scores a 420.5. Neighborhoods in Dallas with the highest crime include South Dallas and Downtown Dallas.

9. The average rent in Uptown Dallas is $1,931 per month. I found two examples of apartments in the area that are representative of the market. The Alexan Henderson has one-bedroom apartments available for around $1,650 per month. It is 856 square feet and includes a pool and fitness center. Alternatively, Gables McKinney Avenue has rent near $1,865 per month for 982 square feet with a pool, small dog park, and a Whole Foods on the ground floor. I wouldn't need any roommates and there is plenty of parking available for residents.

10. Most everyone in living in Dallas will need to drive to commute. However, uptown Dallas is supposedly one of the most walkable neighborhoods in Dallas and is about a mile from Downtown. My internship will be at KPMG Plaza in Downtown. This is 0.6

miles or 13 minutes walking from Gables McKinney Avenue. If I were to drive, it would take 4 minutes.

11. Downtown Dallas and uptown Dallas are known for not having many options for grocery shopping. However, Gables McKinney Avenue has a Whole Foods on the ground floor.

12. There is a washer and dryer in every apartment at Gables McKinney Ave and this seems to be normal for most apartments in Dallas.

13. I'd like to volunteer with Big Brothers Big Sisters, because they partner volunteers with underprivileged children to provide long-lasting mentorships focused on professional development. I'd also like to work with CitySquare and Habit For Humanity to be a positive influence in my community.

14. I'm extremely excited to be able to attend Dallas Mavericks, Dallas Cowboys, and Texas Rangers games in the city. The Katy trail is a great outdoor trail that actually stretches 240 miles, but runs right into downtown Dallas and is great for running or biking. In Deep Ellum, there is a music venue called The Bomb Factory that has year-round shows with some of my favorite artists.

15. The distance from Dallas, TX, to Memphis, TN, is 450 miles. A drive by car takes about six hours and 45 minutes. My car gets about 32 miles per gallon on the highway so I could expect the drive to cost about $40 if a gallon of gas costs $2.85. Flights from American Airlines from Dallas to Memphis can often be had for about $180 and would take an hour and 25 minutes.

16. Because I would have fewer expenses living in Dallas than if I lived in New York City, I created the operating budget in Figure 7-3 with and without 401k contributions. Contributing to a 401k would allow me to avoid a few thousand dollars of taxes annually and start saving for retirement early in my career.

Figure 7-3:

Dallas Budget

	w/ 401k	w/o 401k
Monthly Income	$ 5,000	$ 5,000
Monthly 401k	$ (1,583)	$ -
Taxable Income	$ 3,417	$ 5,000
Income Tax	$ (657)	$ (924)
Net Income	$ 2,760	$ 4,076
Rent	$ (1,865)	$ (1,865)
Car Ins., Phone, Electricity, Groceries	$ (750)	$ (750)
Discretionary Income	$ 145	$ 1,461

Analysis of New York, New York

1. New York City is home to 8.623 million people, but the New York City metropolitan area has 20.3 million residents. New York City has an extremely dense population with about 26,400 people per square mile.

2. New York City has an annual average temperature of 54.91 degrees Fahrenheit. New York City's climate is somewhat regulated by the neighboring Atlantic Ocean. Average temperatures in January and July are 32.4 degrees and 76.9 degrees Fahrenheit respectively. Winters are much colder and summers are mild compared to the ones in Dallas.

3. New York City is placed at the mouth of the Hudson River feeding into the Atlantic Ocean. The city is made up mostly of islands, with Manhattan being the largest. New

York City is very dense and urban, so significant geological features are hard to come by. New York City is sometimes referred to as the "concrete jungle" because of how dense and built-up it is.

4. Residents of New York City are subject to many different federal, state, and local taxes. The state sales tax rate is 4 percent, but New York City adds a 4.875 percent tax resulting in an effective sales tax rate of 8.875 percent. The property tax rate is 1.925 percent of assessed home value. An income of $55,000 in New York City will be subject to $13,968 in income taxes at an effective rate of 25.4 percent. This is the result of a federal effective tax rate of 9.82 percent, FICA tax rate of 7.65 percent, state effective tax rate of 4.84 percent, and a New York City effective tax rate of 3.09 percent.

5. Major transportation hubs in New York City include John F. Kennedy International Airport, LaGuardia Airport, and Grand Central station. Most international flights come through JFK Airport while most domestic come through LaGuardia Airport. Grand Central Station has connection to the Amtrak connections for long-distance passenger train rides.

6. New York City's most prevalent industries are finance, international trade, healthcare, real estate, and media. New York City is often thought of as the finance capital of the world and is home to the New York Stock Exchange and the NASDAQ. New York City's five largest companies by revenue are J.P. Morgan Chase, Verizon Communications, Citigroup, Met Life, and Pfizer.

7. New York City has some of the best medical care available in the world and has 111 hospitals available in the city. Many of the country's top-ranked hospitals are located in

New York City. These include the New York-Presbyterian University Hospital of Columbia and Cornell, Hospital for Special Surgery, and the Memorial Sloan-Kettering Cancer Center. New York City's public school system is the largest in the United States. Quality of education will vary depending on location in the city, but largely the school system is good.

8. The most common crimes committed in New York City are robberies, assaults, burglaries, and thefts. However, the city is below the United States average city-data.com crime index. The U.S. average is 280.6, while New York scores a 211. The neighborhoods with the highest violent crime rates in New York City are Vinegar Hill, Downtown Brooklyn, Times Square, and the Meatpacking District.

9. Real estate is more expensive in New York City than anywhere else in the United States. Real estate in Manhattan cost an average of $1,773 per square foot, beating the second most expensive city in the country, San Francisco, by over $850 per square foot. Because renting there is extremely expensive, I expect to need a roommate to cut costs. I would like to keep the cost of rent under $2,000 per month for myself or $4,000 total for a two-bedroom apartment. I found a two-bedroom apartment in Murray Hill for $3,900 per month that includes a washer and dryer in unit. A different apartment nearby is on the market for $3,595 per month and includes outdoor patio space, but no washer or dryer. Neither apartments detail the square footage, but seem to be about 700 square feet.

10. Most people will commute via walking, biking, or the Metropolitan Transportation Authority (MTA) subway system. Because the city is so dense, most destinations will be within walking distance and a car isn't necessary. The distance from either of the

discussed apartments to Park Avenue and the KPMG offices is about one mile or 20 minutes of walking.

11. Grocery shopping in the city seems to be slightly more complex than what is common throughout most of the United States. Stores are smaller with more limited selection and most people don't drive cars. However, there are a few small grocery stores near the apartments in walking distance. Many New Yorkers will eat out for most of their meals.

12. Many New York City apartments do not include washers or dryers in the apartments. In that case, I would have to do my laundry using the community's laundry machines or take my laundry to a laundromat nearby.

13. I'd like to work with New York Cares, the Food Bank of New York City, and the New York Restoration Project. New York Cares helps to match volunteers with a wide range of volunteering opportunities that may become available from over 1,300 nonprofits. The Food Bank of New York City provides over 60 million meals every year to hungry New Yorkers. The New York Restoration Project helps to maintain 52 maintain community gardens throughout New York City.

14. I would likely attend Brooklyn Nets basketball games, go to New York Yankees baseball games, watch Broadway shows, explore Central Park, and study New York City's world-class architecture.

15. The only viable mode of traveling back home to Memphis, Tennessee, would be by plane. These round-trip flights often cost slightly over $300 and last about three hours. New York City is 1,100 miles from Memphis and it would take about 17 hours of nonstop driving to travel between the two.

16. Figure 7-6 shows an operating budget I created for living in New York City on an annual income of $60,000. I did not include 401k contributions, because I felt the budget would be too tight to plan them. In light of this, included income available for saving or investing in the final discretionary income number.

Figure 7-6:

New York City Budget

	w/o 401k
Monthly Income	$ 5,000
Monthly 401k	$ -
Taxable Income	$ 5,000
Income Tax	$ (1,330)
Net Income	$ 3,670
Rent	$ (2,000)
Phone, Electricity, Groceries/Food	$ (750)
Discretionary Income/available for saving	$ 920

17. Based on my analysis, my preferred city is Dallas, Texas. Dallas has many of the features that I value in a city. It is spread out enough for outdoor activities and has plenty of lakes nearby for fishing, boating, or watersports. Dallas is also much warmer than New York City. Being from Memphis, TN, I'm very used to the heat. Apartments in Dallas are cheaper than they are in New York City and I wouldn't necessarily need a roommate like I would in New York City. Dallas is central in the United States and therefore flights are often going to be cheaper and quicker to most domestic locations than they would be from New York. Not having to pay state income tax in Texas is also a massive bonus. Finally, Dallas is much closer to my family than New York City is.

CASE EIGHT: BREXIT

Introduction

The purpose of this case is to study the scheduled withdrawal of Great Britain from the European Union. In this case, I provide a summary of the arguments made in *Brexit: The Movie,* write on opposing views, and develop a synopsis of events this month relating to Brexit. It imperative that prudent accountants be knowledgeable about current events in the business world. They must be aware of policy changes and the effects that they bring. In the case of a British exit from the European Union, there would be massive changes to supply chains, international business contracts, trade agreements, and tax avoidance strategies. Many businesses in the United Kingdom will be looking to accounting firms for advice on how to best navigate the numerous changes affecting them. Revenues from consulting services for accounting firms have been steadily increasing in recent years as accountants are being viewed more as trusted business advisors. In order for this trend to continue, accountants must remain experts in their practices and stay knowledgeable about current events and potential regulatory changes. Brexit would bring large-scale business and economic disruption and provide a fantastic opportunity for accounting firms to further advance their consulting practices.

Analysis

Summary of *Brexit: The Movie*

During class, we watched *Brexit: The Movie*, which is a movie advocating for a British exit from the European Union. It was written and directed by Martin Durkin after it was crowdfunded with a large backing on Kickstarter. The movie was released in May 2016 ahead of the June 2016 referendum. The movie details many of the arguments for

Britain's withdrawal. Durkin argues that the European Union is undemocratic, isn't a proper representative government for British citizens, and is limiting the United Kingdom economically.

The European Union is made up of 28 member countries and creates policy governing each of them. It was established following the end of World War II in 1957 when many of these countries believed that they would be stronger together than on their own. It is made of up seven governing institutions, however, only Parliament's representatives are elected by ordinary citizens. Parliament doesn't have the power to initiate, impose, or repeal legislation. This means that the European Union's lawmaking body isn't made up of elected officials. The European Union officials creating laws has no public transparency, can impose taxes at will, has no accountability, and is antidemocratic according to Durkin.

The European Union is also not a representative government for the United Kingdom. The European Union is too large and attempts to govern too many countries. It is extremely difficult for one government to create policy that meets the needs of each country. The 28 member countries will all have specific needs that must be catered to them. Durkin argues that blanket policies from the European Union cannot effectively govern the United Kingdom.

The largest argument for a British exit from the European Union is that it would benefit the United Kingdom economically. The United Kingdom kickstarted the Industrial Revolution through its relaxed policies and fierce competition. However, during World War I, the British government imposed new state control over industries. World War II brought even more regulation and the government became unwilling to give back power by relieving some of the regulation. They were focused on protectionism and price fixing. On the other hand, Germany was in literal ruins after the Nazi party collapsed at the end of World War II. Germany then heavily deregulated its economy. The country thrived on the deregulation and had the world's third largest economy within two decades.

Regulation from the European Union is vast and complex, making starting small businesses difficult. Big businesses are more capable of adapting to new regulation. This makes competition weaker. Facing competition from growing Asian economies, the European Union has imposed tariffs, quotas, and further regulation in acts of protectionism. However, these costs ultimately fall on consumers and the cost of living in the European Union increases. The United Kingdom wants to open themselves up to free trade with other countries to boost its economy. Additionally, the United Kingdom pays the European Union $13 billion to be a member and receive benefits, but the European Union only spends about $4 billion on the United Kingdom. The United Kingdom could save the $13 billion if it left the European Union and fund its own projects.

Opposing Arguments

There has been a strong push against Britain's withdrawal from the European Union. Many claim that Brexit is a catastrophic mistake. People opposed to the United Kingdom withdrawing from the European Union argue that would weaken the country's sovereignty, security, and overall economy.

While it makes sense that leaving the European Union would give the British parliament more power over the United Kingdom's policies, some argue that it would actually reduce the country's sovereignty. Hilary Benn of the Labor Party says that, "All it would do is to weaken it by taking away our power to influence events in an ever more complex and interdependent world." The United Kingdom would also still be a member of NATO, the United Nations, and the World Trade Organization. They argue that its extremely difficult and not worthwhile to be so independent in such a globalized world ("The Pros").

One reason many Britons want to leave the European Union is for better national security and border control. However, many people argue that it would weaken national security. Many of the European Union's member countries have relatively small economies and militaries when compared to superpowers like the United States, China, and Russia. Those against Brexit argue that it is important to act as one and have a unified military to provide more leverage against superpower countries.

While there are some economists that believe leaving the European Union would be beneficial for the British economy, others believe that it would have a long-lasting and harmful impact on the British economy. "According to the IMF, a British exit from the EU would be likely to have serious consequences for both Sterling and the UK stock market, damaging investment, pensions, and the UK's balance of trade" (Rossiter). Even if the United Kingdom leaves, businesses there would still have to abide by European Union policies if they want to trade with EU countries. According to the BBC, 48 percent of the United Kingdom's exports are to EU countries. If Britain were to leave the European Union, foreign investment into the country may fall and be redirected into countries within the European Union. The European Union would develop its own financial center to rival London (Rossiter).

Timeline:

In June 2016, a referendum was held where 51.9 percent of voters in the United Kingdom voted for the withdrawal of the United Kingdom from the European Union. In March 2017, the Prime Minister, Theresa May, formally began the two-year countdown to the United Kingdom leaving the European Union. In March 2019, the Brexit countdown was delayed roughly three months. In April 2019, the United Kingdom sought a longer delay on the countdown until October 31, 2019 (Walker).

This month, October 2019, will be critical to the future of Brexit. Many things must happen for a full British exit from the United Kingdom. First, the United Kingdom and the European Union must agree on a new deal proposed by current Prime Minister, Boris Johnson. If they don’t agree on a deal, the United Kingdom must request another delay until January 31, 2020. If they do agree on a deal, the Members of Parliament must agree on the new deal. If the MP’s back the deal, Britain will exit the European Union with the new deal if there is enough time for legislation by October 31. If there is not time for legislation, the United Kingdom will decide if it wants to seek a short delay. If they don’t want a delay, it will move to a no-deal Brexit or a vote of no confidence. If they do seek a short delay and the EU agrees, there will be a Brexit with the new deal. If they seek a short delay and the EU does not agree, there could be a no-deal Brexit or a vote of no confidence (Barnes).

CASE NINE: ANALYSIS OF FEDEX

Introduction

The purpose of this case is to thoroughly analyze a company's 10-K. A 10-K is an annual report filed by all publicly traded companies that describes their financial performance. The 10-K includes financial statements prepared by the company's management that are audited by public accounting firms. These statements include an income statement, balance sheet, and a statement of cash flows. The income statement is a summary of a company's revenues and expenses during a particular year. The balance sheet is a summary of a company's assets, liabilities, and stockholders' equity at a point in time. The statement of cash flows describes a company's cash inflows and outflows during the year. In addition to the financial statements, a 10-K also includes an explanation of the company's operations, risks the company is facing, and accounting methods. It is important to study these statements as an accounting student, because a large portion of public accounting firms' revenues come from public company audits. They audit the financial statements to provide reasonable assurance that they are free from material misstatement. If students are hired into an audit position at a public accounting firm, it will be imperative that they're familiar with the structure of the 10-K, the financial statements within it, and the nature of the business described in the 10-K. In this case, I research FedEx Corporation through its 10-K. I provide an overview of the company, the accounts on its balance sheet, the various revenues and expenses it has, its customers, and its suppliers.

Analysis

1. FedEx provides many different courier and logistics services through many different independently operating subsidiary companies under the FedEx brand. FedEx's largest

profit drivers are its FedEx Express, FedEx Ground, and FedEx Freight services. The parent company's headquarters are located in Memphis, Tennessee, but operates globally. Most of its revenue comes from North America and Europe. Their fiscal year-end is May 31. FedEx doesn't detail why they've chosen this year-end date, but it's likely due to the holiday busy season (FedEx Corporation 4).

2. Ernst & Young LLP's Memphis, Tennessee, office audits FedEx's financial statements and internal controls.

3. Assets are resources owned by a company that have future value. They are organized on the balance sheet as current assets and long-term assets. Cash and Cash Equivalents are cash accounts and marketable securities that can be very quickly converted to cash. Receivables are funds that customers that owe FedEx in the short-term less the allowance that FedEx estimates won't be collectible. Spare parts, supplies, and fuel are reported at weighted-average cost less an allowance for obsolete parts. Prepaid expenses are expenses such as utilities, rent, or insurance that FedEx has paid for in a period before it is due. Property, Plant, & Equipment are long-term assets including land, warehouses, package handling equipment, hangars, planes, and trucks. Buildings and equipment are depreciated over their estimated useful lives. Goodwill is generated during an acquisition and is the excess of the purchase price over the fair value of net assets of the acquired business. Goodwill is tested annually for impairment. Liabilities are amounts a company is obligated to pay and are broken down on the balance sheet into current and long-term liabilities. Current portion of long-term debt is the amount of long-term obligations that are due this year. Accrued salaries and employee benefits are obligations to employees that the company has not paid. Accounts payable are short-term obligations a company

has to its suppliers for something it has already purchased. Accrued expenses are expenses that a company has recognized or incurred but has not yet paid for. Long-term debt includes obligations a company has greater than one year in the future. Deferred income taxes are taxes a company owes in the future. Pension obligations represent the amount a company owes its employees for their retirement benefits. Self-insurance accruals are amounts that a company has insured for itself. Deferred lease obligations are payments a company owes in the future on leases. Deferred gains are gains on sales of aircraft or other property that have been deferred and are amortized over time. Common stockholders' investment represents the portion of the company that is owned by investors. The common stock account is the par value of all of the stocks sold multiplied by the number of shares outstanding. Additional paid-in capital represents additional value investors paid over the par value of the stock. Retained earnings are accumulated net income minus dividends to shareholders. Accumulated other comprehensive losses are losses from irregular activities by the company. The treasury stock account represents the cost of the shares that a company has bought back from investors (FedEx Corporation 100).

4. FedEx serves many different customer bases through its different subsidiary companies. FedEx Express provides United States and international shipping services for delivery of packages and freight. FedEx Ground is a leading provider of business and residential ground package delivery services. FedEx Freight ships larger packages or small freight for businesses. FedEx Services provides general sales, marketing, information technology, communications, customer service, billing and collection, and technical support services to companies. FedEx Office services are offered through

physical, customer-facing stores. It provides access to printing and shipping expertise for ordinary people and small businesses. FedEx Logistics helps large corporations seamlessly navigate their global trade logistics challenges. For many of FedEx's contracts, there is only a single performance obligation. That performance obligation is often to transport a package and FedEx would recognize revenue once the package is delivered. For more complex contracts seen in FedEx Freight and FedEx Logistics, they will recognize the revenue proportionally throughout the completion of the contract. For these contracts, revenue is recognized as control transfers over time. FedEx uses a cost-to-cost method for measuring progress on the control transfer over time, so their revenues are recognized proportionally with the costs they incur based on total expected costs to completion (FedEx Corporation 106). $22.1 billion of FedEx's total $69.7 billion in revenues come from regions outside of the United States (FedEx Corporation 134).

5. FedEx's largest suppliers are truck manufacturers, plane manufacturers, and fuel suppliers. FedEx doesn't list their specific suppliers. FedEx purchases many different trucks from various manufacturers. Most of FedEx's planes come from Boeing or Airbus. "FedEx Express purchases jet fuel from various suppliers under contracts that vary…" (FedEx Corporation 10). FedEx does not list any of its truck or jet fuel suppliers. FedEx's cost of goods sold includes salaries and employee benefits, purchased transportation, rentals and landing fees, fuel, and maintenance.

6. Other operating expenses include depreciation and amortization, business realignment costs, and miscellaneous other operating expenses. Depreciation and amortization are expenses brought on by FedEx's large number of trucks and planes essential to its business operations. They represent the loss in value over time that these assets face.

Business realignment costs are from FedEx's new voluntary employee buyout program for staff positions. FedEx is looking to reduce its number of employees and is providing severance packages to those that are willing to leave. The other miscellaneous operating expenses come from outside service contracts, professional fees, insurance, and uniforms (FedEx Corporation 51).

7. Revenues have increased 15.5 percent from $60.3 billion in 2017 to $69.7 billion in 2019. Operating expenses have increased 17 percent from $55.7 billion in 2017 to $65.2 billion in 2019. There were no extraordinary changes to revenues or operating expenses as they saw growth that is typical for well-established businesses. However, 2019 saw large retirement plan expenses for FedEx. They paid $3.3 billion in mark-to-market adjustments, whereas they normally see income of around $0.5 billion (FedEx Corporation 102).

8. Net income for FedEx in 2019 was $0.54 billion. FedEx's cash provided by operating activities was $5.61 billion. The main differences come from depreciation and amortization, because they aren't cash expenses, and the massive mark-to-market retirement plan adjustments (FedEx Corporation 104).

9. Balance sheet accounts that contain estimates or judgements include allowance for doubtful accounts, depreciation and amortization, retirement plan balances, and self-insurance accruals.

CASE TEN: ECONOMIC INEQUALITY

Introduction

During lecture, we watched "Thomas Sowell on the Myths of Economic Inequality" from the Hoover Institution. It's a roughly one-hour long discussion and interview with Thomas Sowell conducted by Peter Robinson. They discuss Sowell's educational background, economic inequality, different philosophical views, affirmative action, and many other subtopics. However, each topic came down to a way of thinking that has been pushed aside in recent years. Thomas Sowell analyzes and thinks about everything based on evidence and results. Popular culture currently dictates that that political leaders focus on ideals that may not be completely realistic. These idealistic policies often don't pan out as well as planned and produce lackluster results. Thomas Sowell provides a breath of fresh air in this interview with his evidence-based thoughts on economic inequality.

Analysis

The interview starts with Peter Robinson and Thomas Sowell discussing Sowell's upbringing and educational background to not only establish ethos for those unfamiliar with Sowell, but also to show how different educational experiences guided his current beliefs. Thomas Sowell earned his Bachelor of Arts degree in economics from Harvard University, his Master's degree from Columbia, and Doctor of Philosophy degree from the University of Chicago. During his time working for the United States Department of Labor, Sowell began to reject his prior Marxist beliefs. He learned first-hand about the bureaucracy of government institutions and it pushed him into a constrained philosophical view.

In his book, “A Conflict of Visions,” Sowell discusses two fundamental philosophical views and the assumptions that they accept. The first view he calls the constrained vision. The constrained vision relies on processes, rather than the will of people. Those that accept the constrained vision feel that they are constrained by reality, rely on processes, and believe that solutions require trade-offs. The unconstrained vision relies on the idea that good things happen naturally. Those that accept the unconstrained vision believe that there are ideal solutions to problems and compromise isn’t acceptable, but is part of the process in finding an ideal solution.

The U.S. Department of Labor taught him that the “government is not simply the personification of the national interest. Government institutions have their own institutional interests.” These experiences fueled his work as an economist throughout his career. Many people today abide by the unconstrained vision, but don’t necessarily understand the implicit assumptions come with it. Idealistic beliefs from the unconstrained vision are hard to deny morally, and they’re easily pushed onto people through popular culture. The policies that arise from unrealistic ideals often only result in increased bureaucracy and unimpressive results.

Sometimes these policies can even do the opposite of what they aim to do. Regarding the increased backing for socialism in U.S. popular culture, Sowell points to Venezuela. Many people believe socialism is the future for an advanced society, but fail to look at past results of socialism. Venezuela is an oil rich country, but people are starving and there have been protests every day because of it. Sowell also believes that a successful welfare state isn’t possible in a democratic country unless there was a welfare state vision in its foundation. The assumptions accompanying welfare states bring a lot of trouble. People in the United States were much poorer in the first half of the 20^{th} century, but after welfare was introduced and things were supposed to be better, crime only skyrocketed. The increase in wealth only followed past trends.

People today rely too much on institutions to step in to improve their lives. Sowell's constrained vision says that people shouldn't rely on the government. Everything comes down to hard work and people should be rewarded for it. It's been popular in the 2020 Democratic Party presidential debates to criticize people for earning large amounts of money from their successful businesses. Egalitarianism as a concept is a good thing, but it has been misconstrued today to mean resenting other peoples' good fortune.

Popular culture today pushes idealistic beliefs and policies strongly onto people today, despite the fact that they may not work in reality. Sowell's evidence-based thoughts on economic inequality in his interview with Peter Robinson were highly informative and a great example of how we should be approaching complex societal issues in the future.

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