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An Analysis of the Fundamentals and Professional Applications of Financial Accounting

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AN ANALYSIS OF THE FUNDAMENTALS AND PROFESSIONAL APPLICATIONS OF FINANCIAL ACCOUNTING

by
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Abstract

AN ANALYSIS OF THE FUNDAMENTALS AND PROFESSIONAL APPLICATIONS OF FINANCIAL ACCOUNTING

(Under the direction of Dr. Victoria Dickinson)

This work is a series of case studies examining key theoretical concepts in financial accounting and their professional applications. Each case study focuses on a different significant accounting topic that, when considered together, create a single, complete analysis of items and events that are represented within financial accounting practices. This is achieved through analysis of financial statements, the accompanying notes to the financial statements, and information gathered from relevant press releases. Additionally, this work examines professional elements of the accounting field. The research and analysis conducted within this work was completed in conjunction with formal accounting education courses which helped to strengthen the theoretical concepts presented within the courses as well as within this work. The combined effect was a deeper and more thorough understanding of financial accounting practices and theory. Therefore, this work also serves as an educational piece for interested readers desiring a more in-depth understanding of financial accounting topics.

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Case 1: A Tale of Two Cities

Introduction

The purpose of this case is to analyze two cities that could potentially serve as my place of residence someday. These cities are analyzed from every aspect, financial feasibility, enjoyability, safety, professional development and opportunity, and impacts on not only my life as it is now but my life and decisions I will likely have to make in the future. This case pushed me to answer questions that I had not anticipated having to consider at this stage in my life. It seems like these types of decisions are far away until they are right around the corner. So often, it is the lack of preparation and time taken to consider these questions that causes us to make poor decisions when the time comes to address them. Through this case, I was able to learn not only about my values when it comes to making very real-world practical decisions about my future, but also the importance of being able to be honest with yourself, particularly in regard to the future that you are building. I learned that while the emotional approach to making these kinds of decisions, the approach that might tell you to go with the choice that seems the most "fun" or "different and exciting", can be tempting on the surface, when you are forced to live life every day in the environment created by those decisions, the rational problems created by the emotional approach can become abundantly clear. For example, lack of financial feasibility and the ability to have a satisfying work-life balance and even potentially begin a family in the city you choose to start your career path in are all very steadying questions that this case taught me are key to ask. We must take mature approaches to solving the problems that are going to affect out maturing lives. Without considering these sometimes unpleasant elements, we can be lead to make the wrong decision for ourselves and those who are impacted by our lives, and the first step in making those decisions is deciding where we will work and spend our time trying to build ourselves as professionals and successes in the worlds we have chosen to enter.

a. What is the population?

The city of Memphis, TN is home to 650,618 people, according to a population estimate (United States Census Bureau, n.d., table 1). Comparatively, New York City has a population of 8,398,748 (United States Census Bureau, n.d., table 1). The effect on general living conditions created by these vastly different populations can be most easily understood by an analysis of the relative sizes of these two cities. Memphis has a size of 324 square miles (City of Memphis, n.d., para. 1). New York City is slightly smaller in size, with an area of 305 square miles (Lankevich, n.d., para. 1). This means that Memphis accommodates an average of 775 people per square kilometer while New York City must accommodate an average of 10,631 people per square kilometer. While this obviously makes New York City the more crowded city, the effects of this higher density population per square kilometer of city area are also observed in the landscape of the two cities. While Memphis has maintained a more flat landscape as far as architectural structures are concerned, New York City has been forced to build upward and make use of air space to accommodate its much higher population, setting the two cities in distinct physical contrast.

While I enjoy visiting larger cities, my life has been spent in small cities that are not nearly as populous as New York City. I enjoy cities that are populous enough to allow you to meet new people while still being small enough that you can see people you know when you go out for activities outside of work. A place as populous as New York City might be overwhelming for me at first, but I am confident that time would help me to adjust to the new surroundings.

b. Describe the climate and seasonal fluctuations. Are you accustomed to living in this weather? If not, describe some challenges from this climate.

The weather in Memphis tends to mirror that of most Southern cities, with long, hot summers and shorter, more mild winters. Temperatures in the winters tend to hover around 34 degrees Fahrenheit and typically are not accompanied by snow (Weather Spark, n.d., para. 4). Summers can venture into more extreme temperatures, averaging around 91 degrees Fahrenheit (Weather Spark, n.d., para. 3). The largest amounts of rain fall typically occur from February 27th to July 29th (Weather Spark, n.d., para. 11). Overall, Memphis has a relatively moderate climate. The greatest potential for extremes can be seen in the summer months, when it is possible for abnormally high temperatures to occur depending on annual patterns.

New York City, however, has a more extreme seasonal weather profile than that of Memphis. Due to its location in the Northern-most area of the country, New York City experiences extreme winters that typically last from October to April and can present temperatures as low as 26 degrees Fahrenheit (Best Places, n.d.a, para 12). New York City also experiences frequent snowfall from the month of December to the month of April (Best Places, n.d.a, graph 10). New York City has an average of 25 inches of snow per year (Best Places, n.d.a, para. 18).

I have lived in the south for my entire life, so I am far more familiar with the climate of Memphis. The more intense summers and precipitation primarily in the form of rain is nearly identical to that of Mississippi, where I am from. I am most accustomed to living life in these conditions. While I enjoy the thought of snow, my life experiences have not given me the knowledge necessary to properly deal with the challenging circumstances that snow can create. For example, I have never driven in snowy conditions. This would create special challenges for me if I were to choose to live in New York City, a place that receives nearly 25 times the amount of snow that I am familiar with. Because of my lack of familiarity with the problems that the intense New York City winters may present, I feel that I am best suited for a climate more like that of Memphis.

c. Describe the city's topography, scenery, and other geographic or geological features of the area in which the city is located.

Memphis is located on the banks of the Mississippi River and possesses geographical characteristics more like that of a rolling countryside. The river serves as one of Memphis's most beautiful elements of scenery. Figure 1 shows the Mississippi River brightly lit by the city lights of Memphis. While there may be a lack of mountainous terrain or beachy shoreline, it is clear that the city has learned how to best work in harmony with its natural assets to provide beautiful scenery.

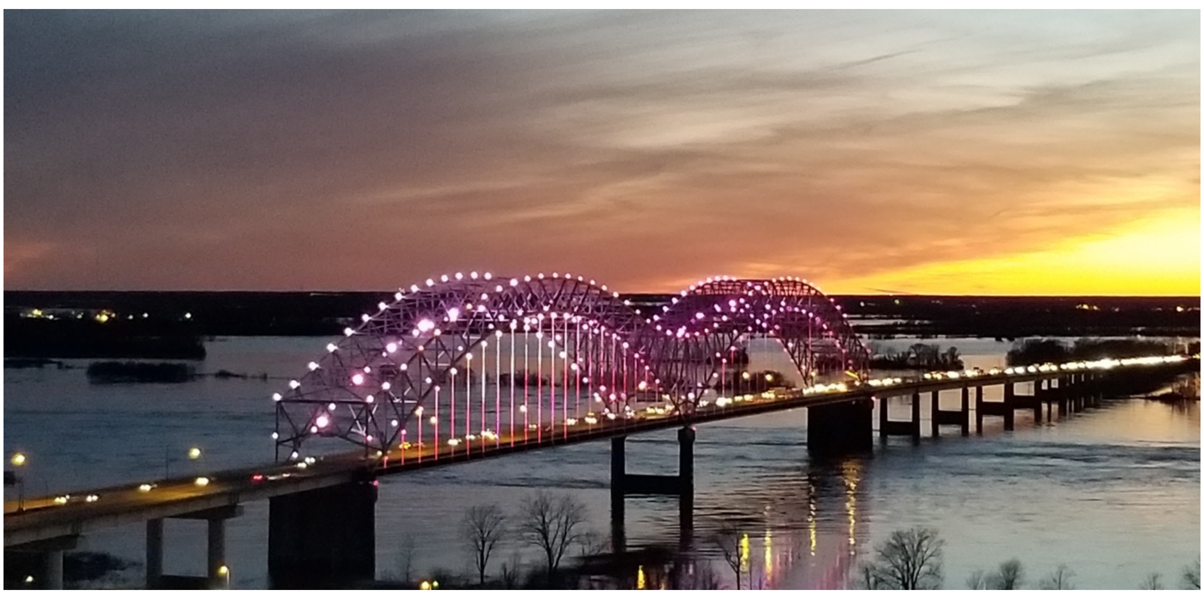


Figure 1: City of Memphis

New York City is located at the mouth of the Hudson River. Its geography is highly segmented, creating five distinct areas known as boroughs. This segmentation is largely due to the river formations that serve as boundaries for some of the segments. New York City also includes an island, Staten Island to be exact, within its territory. Because of the high prevalence of city-scape in New York City, there is a large presence of parks in an attempt to preserve a sense of nature in what would otherwise be an all-concrete landscape. New York City has taken this as an opportunity, showcase nature at its most beautiful. Figure 2 shows one such park, Central Park, which is nestled in the middle of New York City buildings.

Figure 2: Central Park

Source: Moreton, S. (2010). *Central park skyline* [Photograph]. Flickr. https://www.flickr.com/photos/47001638@N08/4716735492/in/photolist-Zmsqi6-7XJoL-dtvME1-8bNv8J-dtvMqW-7HmRF6-9frS1-7HqMiu-7HmRvK-7HmRAt-27R7F7J-7HqMoQ-7HqMkh-7HqMcj-6pR4CX-dtvNnq-dyjJN8-615FCc-5fkt6v-eCkQpB-9eLaLJ-ihgTU-actFnz-d2Q1vW-NSn85x-uTfKoo-2q69QT-2hYM7nh-7goXpA-ihgTY-ihgTW-ihgU2-ihgTZ-ihgU1-85UUQD-28XfLTk-divdvu-aNYR4T-diveMT-divdEC-GfW2oG-4vt7Y4-LEbQbF-85Y4Nw-a7d5sz-ff4kyA-JKDwaA-34f2Tc-7ZYDKo-dtqbs2/. CC BY 2.0.

d. What are the individual tax rates within the city (e.g. consider federal, state, and local income tax, property tax, and any other taxes you'd be likely to pay. Quantify what this means based on a starting salary of approximately $55,000 per year)?

Memphis is located in Tennessee, which does not impose a state income tax on its residents. The federal income tax still applies at a marginal rate of twenty two percent for a single individual generating $55,000 per year in income. This means that roughly $8,000 in federal income taxes will come out of my paycheck. There are also no local income taxes. The current property tax there is $7.24 per $100 of assessed value (Greater Memphis Chamber, n.d.a, tab 1). Sales tax in

Memphis is approximately 9.25 percent (Greater Memphis Chamber, n.d.a, tab 3). Food is taxed at four percent (Greater Memphis Chamber, n.d.a, tab 6).

In New York City, state income tax is levied on residents. For a $55,000 annual salary, a rate of 6.33 percent would apply (Bell, 2019, para. 2). Federal income taxes will apply in the same way that they would in Memphis, and New York City also collects a local income tax. The combined result of these taxes would be an income tax payment of roughly $14,000 out of my paycheck. The remainder would be used towards the property tax of 21.167 percent (New York City Department of Finance, n.d.b para. 2). The sales tax is 8.875 percent (New York City Department of Finance, n.d.a, table 1).

Overall, it is clear that it is infinitely more cost effective to reside in Memphis than it is to live in New York City. Before any payments are even made for necessities such as food, electricity, water, or rent, income taxes alone would have reduced my paycheck to only $41,000 for the year. That leaves me feeling uncomfortable. Not only would I prefer to have the higher standard of living that Memphis provides at a lower cost, I am also appreciative of the fact that there would be some potential to save some of my paycheck for future needs.

e. What transportation hubs are in the city?

While Memphis is a far more modest transportation hub than New York City, it includes the essentials for convenience. Memphis is home to Memphis International Airport, meaning that flights are easily accessible and don't require driving to another city to access. Memphis also has a trolley system that offers convenient and whimsical transportation options around the city area. Memphis is also home to a number of bus stations. New York City has massive transportation hubs including a number of large airports such as JFK International Airport. A common mode of transportation in New York City is the subway system that operates beneath the city. This serves as a main mode of transportation for many native New Yorkers who must commute to work each day. This subway system serves the need that cars typically serve for most city-dwellers. Due to the parking fees charged in New York City, it is more cost effective for many to use the subway system instead of owning a personal car. In addition, New York City also has train and bus stations that service both tourists and those who live in the city. While it would seem that transportation in New York City would be more convenient, I think that Memphis allows for more control over transportation methods used by individuals. I find Memphis more desirable in this respect.

f. What are the city's most prevalent industries? What are the city's five largest companies?

Memphis is a growing industrial landscape that possesses a large variety of industries. Because of its unique location, Memphis is considered a logistics hub of America, so it is no surprise that transportation, including distribution and logistics, is in the top most prevalent industries in Memphis. Memphis also has strong manufacturing presence and a decent healthcare presence. One of the largest manufacturing companies there, International Paper, is headquartered in Memphis (Greater Memphis Chamber, n.d.b, tab 2). The four other largest companies in Memphis are FedEx, AutoZone, ServiceMaster, and Mueller Industries (Greater Memphis Chamber, n.d.b, table 1). The idea of having access to such a wide variety of industries and the array of experiences they could offer is an exciting prospect. I would not enjoy an environment that was overrun by one single industry and lacked a variety of engagement opportunities to learn from.

New York City's largest industries include financial services, healthcare, and professional and technical services (Ross, 2019). This makes sense due to New York's status as a booming financial capital in the country. Some of the largest companies in New York City are IBM, Pepsi Co., J.P. Morgan Chase & Co., Citi, and Verizon (Axelson, 2019, list 1). While New York City also presents the variety that Memphis does, it lacks the manufacturing presence that I am attracted to. I believe in placing yourself where your skills will be most useful, and with my minor being Manufacturing Engineering, I would prefer an area that will allow me to utilize and grow my knowledge in a way that will be most helpful to my employer.

g. Describe the quality of the city's healthcare. Describe the quality of the city's school districts. Would your children attend public or private school?

Memphis has a quality healthcare environment. It is the home of the University of Tennessee Health Science Center as well as St. Jude Children's Research Hospital. Memphis is also home to many hospitals as well as Le Bonheur Children's Hospital. The school districts of Memphis include the Bartlett City School District and the Shelby County School District (Great! Schools.org, n.d.). Offering the typical public schools, no information on particularly good performance was mentioned for any one of these public schools. Memphis also offers some private school options.

New York City has attempted to provide guaranteed free health care to all of its citizens. While this may impact the future state of the city, it has not yet been achieved. New York City has sixty-two hospitals within its limits, more than many entire states have (Becker's Hospital Review, 2015, list 1).

This makes sense considering the large number of people living there. New York City has the largest public-school system in the United States, educating over 1.1 million students each year (Jones, 2018, section 10). These students are taught in more than 1,800 public schools present in the city (Jones, 2018, section 10). It seems that these two cities are fairly equally matched in these two areas. While New York is clearly a much larger scale than Memphis in these areas, performance between the two cities seems to be equal. If I were to have children in the future, whether or not they attended public or private school would most likely depend on where I lived.

h. What types of crime are common within the city and where are the locations within the city to avoid?

According to statistics, assault, theft, and burglary are the most commonly perpetrated crimes in Memphis (BestPlaces, n.d.b, para. 1). Memphis is typically considered to be a high-crime city, with crime rankings of 85.7 and 81.1 for violent crime and property crime respectively (BestPlaces, n.d.b, para. 1). For reference, the national averages in these two fields are 22.7 and 35.4, respectively (BestPlaces, n.d.b, para. 1). While this may seem shockingly dangerous, these numbers are impacted mostly by crimes in very localized areas. Parts of the city to avoid include the neighborhoods of Shelby Forest-Frayser, Parkway Village-Oakhaven, Downtown, White Haven-Coro Lake, and Berclair-Highland Heights (Sparkes, 2020).

While New York City has higher raw numbers of the same crimes as Memphis, due to the much larger number of residents there, the crime rate per person is significantly lower. Dangerous neighborhoods of New York City include Hunts Point, Fort Greene, downtown Brooklyn, and Vinegar Hill in Brooklyn (AddressReport, 2015).

i. Based on where you see yourself living for the first three years, how much rent do you expect to pay? Back up this assertion with sample properties from each location (including pictures). Describe the square footage, amenities, need for a roommate, availability of parking, etc.

I would hope to pay not more than nine hundred dollars a month in rent. This may seem unrealistically low, but I also hope to live with a roommate for the first three years. From my research, this seems like a reasonable rent for an apartment in Memphis. Figure 3 shows one such apartment in Memphis. This apartment is available for 900 to 1,000 dollars per month (Apartments.com, n.d., table 1). This apartment comes with a clothing care center, a kitchen, and a pool, and two bathrooms (Apartments.com, n.d., list 1). The apartment is roughly 1,500 square feet (Apartments.com, n.d., table 1).

Figure 3: Memphis Apartment

Source: Apartments.com. (n.d.). *The Roxbury* [Image]. https://www.apartments.com/the-roxbury-memphis-tn/hhkqlw2/

I truly cannot fathom the rent that is necessary to live in a New York City apartment. Some research has indicated that it would be nearly impossible to live moderately comfortably in an apartment in New York City for less than 3,000 dollars of rent each month. Figure 4 shows a two-bedroom, one-bathroom apartment in New York City.

It includes a washer and dryer in the apartment building but not in the apartment, a kitchen, and no furnishings (Bond Real Estate, n.d. para. 1). The rent for this apartment is 2,959 dollars per month (Bond Real Estate, n.d., para. 1). Although the square footage was not mentioned with this particular apartment, other such apartments for similar rent amounts on the market were around 650 square feet.

This indicates that it is much more difficult to live comfortably in New York City for the same money that would allow someone to live lavishly in the city of Memphis, and I am more inclined toward Memphis for that reason.

Figure 4: New York City Apartment

Source: Bond Real Estate. (n.d.). *East 92nd street* [Image]. https://www.bondnewyork.com/upper-east-side/apartment-for-rent/east-92nd-street/1253911

j. What is the typical mode of commuting? Based on your answers identified in the prior question, what are your likely commuting times?

The typical mode of commuting in Memphis is driving a personal vehicle to work. While traffic during commutes is typically nowhere near that of larger cities, traffic can be a factor in commute times. The average commute time for Memphis residents is 21.4 minutes (DataUSA, n.d., section 1). The typical mode of commuting in New York City is public transportation (Manskar, 2019). While this system is fairly efficient, those who use it still experience an average commute of forty-three minutes, making their commute double that of Memphis residents on average (Manskar, 2019, para. 2). Even with the convenience of the subway system, I prefer the flexibility and security of being able to drive my own vehicle to work. The fact that Memphis has both a shorter average commute time and is more compatible with commuting in personal vehicles makes it the more attractive option in my opinion.

k. Where will you do your grocery shopping?

I am a major proponent of organic and farm-fresh foods. I try to limit my diet to include only these items. Because Kroger is prevalent in most places, much of my shopping would be done there, however, in Memphis particularly, I would absolutely take advantage of the Whole Foods Market and any other farmers' markets that the city offered. I would also shop at New York City green markets (farmers' markets). In addition to these farmers' markets, I would imagine that there are also a host of international-type small markets that offer items necessary to make cuisines from around the world. As long as I have access to fresh produce, I would be content with either of these options.

l. How will you do your laundry?

In cities such as Memphis, there is more of an expectation that homes, and even some apartments will come furnished with a washing machine and dryer for clothes. Even in apartment buildings, if the washing machine and dryer are not located in each individual apartment, there may be a community wash room located in the apartment building. Access to these items is generally convenient. In cities such as New York, however, it is not unreasonable to expect to have to transport laundry from an apartment or home to a local laundromat because it is normal for apartments and homes in the city to not be furnished with these items (DiValentino, n.d.). This also means that washing clothes requires payments for use of the washing machine and dryer with each load of laundry cleaned. In my opinion, it is more cost-effective and time-efficient to have a washing machine and dryer located in your own living space as Memphis typically has them.

m. Name at least three civic, religious, or charitable organizations you would like to be active in for each city.

I would love to be active in the Memphis Child Advocacy Center, which is a center meant to help children who have suffered abuse learn to lead normal, happy lives again. They are involved in helping children recover from abuse they have suffered (Memphis Child Advocacy Center, n.d.). During this process, they also educate parents and others on how to prevent child abuse (Memphis Child Advocacy Center, n.d.). I would also like to be involved with the First United Methodist Church in Memphis. I have grown up attending this church, and I would like to maintain my connection with it as I grow older. I would also like to be involved with the Mid-South Food Bank in Memphis. They gather and distribute food to children so that they will not have to go without a meal, and that is a cause very near to my heart (Mid-South Food Bank, n.d.).

In New York City, I would also like to be involved in the First United Methodist Church. In addition, I would like to be involved with the Children's Aid Society. They function as an all-encompassing source of aid for children who are in need or at risk, providing services such as after-school activities and health services (Children's Aid, n.d.). Essentially, anything that a child may need but would be unable to provide for themselves, the Children's Aid Society steps in to fill that role. Finally, I would also like to be a part of the New York Food Bank. Poverty is particularly visible in places such as New York City, and with all of the luxury and glamor that encompasses the city constantly, I think it can be easy to forget the people who live surrounded by these things every day but have nothing. I would like to play a part in helping them meet the necessities of everyday life.

n. What are the sports, entertainment, or recreational activities that you would be most likely to engage in within the city?

In Memphis, I would absolutely attend Memphis Grizzlies basketball games and baseball games at the stadium. I am also a music fan, and the numerous music festivals Memphis hosts each year would certainly fill a large portion of my time. I would also attend many concerts at the FedEx Forum and probably spend a good deal of time at the many museums Memphis has. That is one of my favorite past-times. New York City has no shortage of museums either, and I would absolutely visit the Metropolitan Museum of Art multiple times if I were to live there. If I could afford it, I would also frequent the many theaters there to watch plays and musicals, hopefully even Broadway. I would also like to visit the boardwalks there, as New York City has many of them. I would also enjoy attending basketball games and baseball games.

o. What are the modes of traveling back to your hometown from this city? What is the average cost you'd incur for each trip back home? How long will it take you to reach your home?

From Memphis to my home in Mississippi, it is most reasonable and convenient to drive. The drive takes a total of one hour and thirty minutes and, depending on gas prices, usually costs somewhere between thirty and forty dollars. From New York City, the most reasonable mode of transportation to my home would be to first fly from New York to the Memphis airport, and then either drive or be driven from there to my home. While prices for round-trip airfare from New York City to Memphis vary widely, it would most likely be difficult to make this trip for less than three hundred dollars. This does not take into consideration the thirty dollars of additional traveling costs to drive from Memphis to my home. Taking into consideration all of the additional travel necessary for air travel, the total amount of time for this trip would be somewhere in the range of six hours. It is obviously far more convenient and more cost-effective to travel from Memphis to my home than it is to travel from New York City to my home.

p. Based on your findings, develop a model monthly operating budget for each city for Year 2, assuming that with bonuses for being a high performer, your annual salary is $60,000.

Figure 5 shows two budgets that represent what I think my estimated costs would be for living in the two cities indicated in each budget's title.

Y2 Budget 1: Memphis	
Income:	$60,000
Less	
Taxes:	(15,000)
Utilities:	(2,000)
Rent:	(6,500)
Necessities:	(18,200)
Other:	(5,000)
Remaining:	$13,300

Y2 Budget 2: New York City	
Income:	$60,000
Less	
Taxes:	(21,000)
Utilities:	(2,000)
Rent:	(12,000)
Necessities:	(18,200)
Other:	(5,000)
Remaining:	$1,800

Figure 5: Forecasted Budgets: Memphis vs. New York City

q. Determine which one is your preferred city and why.

Memphis is my preferred city. Starting out as a young professional, I have always believed that it is wise to save as much money as possible. That would be a difficult goal to achieve if I were to live in New York City. With the high cost of living associated with this city, it would nearly consume my entire salary just to fulfill my basic needs of life. As the budgets above show, I would barely be able to cover my everyday basic costs, let alone have money for any unexpected problems, such as car repairs, illness, or injury. Memphis is also a city that seems to possess the feeling of a city without being overwhelming like New York. While it is large enough that it is not boring, Memphis is also a place where it is possible to go out and see people you know. It is a place that has the ability to feel like home when you need it to feel like home and like a vacation when you need it to feel like a vacation. It offers stability and the chance to begin saving for a potential family in the future if you a young adult just entering the working world. That is a rare and valuable opportunity that I do not feel should be passed up.

Case 2: Views on Brexit and Its Implications

Introduction

The goal of this case study is to thoroughly describe, from multiple viewpoints, one of the most influential historical happenings of our lifetime, Brexit. Brexit is the name given to the decision of the United Kingdom to exit the European Union. The European Union is a political, economic union of 28 countries that are primarily located in Europe. These countries agreed to create this union because they believed that it would benefit their respective economies and offer them more trade opportunities with the other member countries. Over time, however, the United Kingdom has begun to question the necessity of being a part of the European Union, and some British citizens even feel that the United Kingdom's membership is harming its economy and the well-being of the people. In addition to the lack of economic necessity, these citizens also point out the political shortcomings that membership in the union has caused the United Kingdom, questioning the nature and appropriateness of the European Union's political presence there. This is detailed further in the first view presented in the following case analysis.

In addition to the impact that Brexit will have on citizens when it happens, it will also have extreme implications for the activities of the international business world. These implications must not go unrecognized by members of the accounting field, as they will have impacts on the approaches used to service clients that are a part of the international business world. This case also draws attention to the consequences of Brexit in this context.

Through this case I have learned the importance of staying informed about international occurrences to all accountants' ability to execute their jobs, not only those working internationally. This case has enhanced my appreciation for the complexity of knowledge that accountants are responsible for maintaining and continually updating about both domestic and foreign happenings in order to best serve clients. In the international landscape that is today's business world, geographical separation is meaningless, and accountants must take it upon themselves to stay educated on the events taking place everywhere, or risk losing the ability to function as a source of value to clients.

A Summary of *Brexit: The Movie*

The following is a summary of *Brexit: The Movie* (2016). It should be noted that while this video was obtained from the channel Brexit: The Movie on YouTube and is included in the reference list for this case as such, the video was originally written and directed by Martin Durkin.

This source presents an interesting view on Brexit, one heavily focused on the perspectives of the citizens of the United Kingdom, and gives a highly internal and personal approach to discussing this historical event. This movie begins by addressing Brexit from a political standpoint. It was suggested that the opportunity for the people to vote on whether or not the United Kingdom should leave the European Union was really a chance to answer the question of how much the people value democracy. According to this source, for a democracy to function, a certain element is critical; that element is transparency. From the viewpoint of the people, the European Union lacks transparency. Yet, it still exists as the major governing power over the British people. This is one of the reasons that, in 2016, the British people were given the option to vote on whether or not they should leave the European Union. This opportunity was not taken lightly. Most of the people realized its major importance as being almost certainly the last chance that they would receive in their lifetime to vote on exiting. This vote yielded the results that the majority of people wanted to exit (Brexit: The Movie, 2016).

The first reason for this desire of the people to exit is that they are not happy with the political landscape that has been created as a result of being a part of the European Union. The people do not feel that they are being given the opportunity to influence the decisions that their government is making. This sentiment is not without reason. The people of the United Kingdom have been effectively cut off from the activities of the law makers that give final approval on the policies that will affect their everyday lives. While the British people are able to elect members of Parliament, these members are not actually the ones that have the power to vote on and pass laws. The real power in this respect lies with the European Union officials. While this already indicates a lack of democracy, the situation is worsened by the fact that the people have no way of giving their input on the potential policies that the European Union officials debate over enacting. Even worse, the only people that are allowed to know what is said during these debates are the officials themselves. This information is not required to be disclosed to the public. Finally, once these laws are voted on and passed by officials, the British people have no defined way of repealing them, leaving them at the mercy of policy-makers. Compared to the history of what the British people wanted their government to be when they decided long ago that they would not allow their government to tax them, or pass regulations, without their consent, the present-day situation seems far from what they initially intended (Brexit: The Movie, 2016).

Another element that is needed for a democracy is that the people should know who has the power. The European Union makes it nearly impossible for the people to have this seemingly basic knowledge. The European Union has such a large number of committees, groups, and officials, all scattered in different locations, that there is an almost intentional lack of clarity as to exactly who does what jobs. A survey of people taken at random on the streets of a city under this government's control indicated that none of the people could identify officials of the European Union governmental body. The immense complexity of this body does not make it possible for the average citizen to know who has power over their lives (Brexit: The Movie, 2016).

The combined effect of the European Union lacking the above two elements of transparency and the people's ability to know who has power over them leads to an absence of another critical element in a democracy, accountability. If the people do not know who is making the policies and decisions or how and why they are making the decisions they make, how can there be accountability? This has led to further problems such as an overabundance of laws and poor and possibly dishonest management of funds. For instance, officials in the European Union are able to set their own salaries, typically setting them inappropriately high. In addition to this higher pay, they also receive lower taxes on their earnings than the average citizen. Finally, all of these benefits are in addition to their already generous allowances that they receive as part of their positions in government. Another example of the inappropriate use of taxpayer dollars occurs when the European Union takes this money and gives large "donations" to charities and universities of significant size in exchange for their support, essentially buying the groups' support with taxpayer-provided money. The European Union rationalizes this by saying that such organizations as charities and universities benefit the people and supporting them financially is actually an investment for the people. What they do not mention is that for every pound of European Union money that is given for such endeavors, the people must pay 2.3 pounds in taxes. All of this is done under the understanding among officials that their jobs are basically ensured and there is no way that they will be voted out by the people (Brexit: The Movie, 2016).

Considering all of these problems associated with the European Union's power presence in Britain, it makes sense to wonder why an exit has not already occurred. One reason is that the

British government continues to uphold their stance that membership in the European Union is important for the British economy to thrive and that it provides the United Kingdom with more influence in Europe. The trade understandings British has access to as a member of the European Union and their ability to exert influence are presented as being worth more than the benefits would be if they were to exit. However, this assertion is called into question under consideration of some evidence. The video first looks at the impact that membership in the union has had on local industries. The fishing industry is one that has been most heavily influenced by the United Kingdom's membership in the European Union. This industry was once thriving in towns such as North Shields in England due to the waters in these areas being so rich with fish, with 14,000 tons of fish being landed in the small town alone. When Britain joined the common market as part of its membership in the European Union, it lost control of its fishing grounds, with rights to these waters going to other member nations. This has caused such devastation for the fishing industry that the government has begun paying fisherman, who have made their livelihoods off of fishing for years, to destroy and burn their boats because the industry cannot sustain so many participants. This indicates that perhaps Britain’s presence in the European Union does not provide it with as much influence as the government claims (Brexit: The Movie, 2016).

Additional evidence leads to the conclusion that in addition to not providing Britain with greater influence, membership in the European Union is also totally unnecessary for the British economy to thrive. In fact, this membership may be a hindrance for the economy. One reason for this is that the European Union has created too many laws for new business startups to succeed. This has resulted in larger companies taking over the market because they can afford to comply with the numerous regulations while smaller companies cannot. This has reduced competition and harmed the overall economy. The European Union has also instituted regulations such as tariffs and quotas against foreign manufacturers and producers and instead focused on pouring resources into more domestic businesses that are failing on their own in order to keep them afloat. This has also served to reduce competition, stifling growth and the innovative spirit that typically pushes economies forward (Brexit: The Movie, 2016).

The final piece of evidence suggesting that Britain's membership in the European Union is not required for its economic success can be observed through a comparison of Britain with a country that is not a member of the European Union and is highly successful, Switzerland. Switzerland has maintained its independence from the European Union and has managed to become one of the most successful economic entities in the world. A comparison with Britain shows that Switzerland has lower taxes, better household incomes, higher export levels, and a stronger GDP. Because it is one of the least regulated economies in the world, competition is free to develop naturally. In addition, the people control the politicians in Switzerland, protecting the current state of low regulations and ensuring that they always have a voice in their laws. Switzerland's success proves that membership in the European Union is not a necessity in order to thrive economically. In fact, it is not even required that a nation be a member of the European Union in order to trade with it or have trade deals in order to trade goods. The European Union actually has fewer trade deals than most of the rest of the world. This serves as strong evidence that Britain could not only survive an exit but event flourish economically as a result (Brexit: The Movie, 2016).

a. Alternative Views on Brexit

Since 2016 when Brexit was voted on by the people of the United Kingdom, the press and other sources have presented a multitude of different views on the topic. Some presented it as being a mistake for the United Kingdom, others presented it positively, some presented it from a more removed, factual standpoint, while others chose to focus more on the opinions of the people and how it would impact them. *Brexit: The Movie* uses a combination of more personal and factual information that functioned to show support for Brexit.

Not everyone shares this purely supporting view of Brexit, however. One publication presented a totally negative view of Brexit, titling their article, “Economically Speaking, Brexit is a Bad Idea Every Way You Look at It”. This article by Eshe Nelson (2018) states that exit from the European Union will leave the economy of Britain smaller than it would be if it did not exit. According to the article, this is the view of the UK Treasury and the Bank of England as well. The UK Treasury reported that if Brexit were to occur, the economy of the United Kingdom would decrease by 3.9 percent in the first 15 years compared with staying in the European Union (Nelson, 2018, para. 5). They also stated that under the worst-case scenario of exiting without a deal in place allowing the United Kingdom to trade under the rules of the World Trade Organization, the economy could suffer a 9.3 percent reduction (Nelson, 2018, para. 6).

The article also states that the Bank of England offered assessments on the future state of the United Kingdom should Brexit occur. Their predictions were also less than encouraging. They determined through their method of assessment that if Brexit were to occur, the GDP of the United Kingdom would decrease by 1.25 to 3.75 percent by the end of 2023 (Nelson, 2018, para. 9). In what they call the worst situation of no trade agreements with the European Union at the time of exit, those values increase to a 10 percent decline in GDP (Nelson, 2018, para. 10). In addition, the article states that there have already been economic costs incurred simply because of the people’s vote to exit in 2016; these costs include the United Kingdom’s economic growth being among the slowest of the members of the Group of Seven, which is estimated to be two percent less than it would be had the vote yielded the opposite result (Nelson, 2018, para. 13). In addition, that article states that household incomes have grown by only an insignificant amount since the vote took place (Nelson, 2018). The article concludes by stating that while these assessments are discouraging, Brexit has been a purely political project from the beginning, and the economic impact has not been of great concern throughout the process (Nelson, 2018).

Other sources present yet another view of Brexit, stating that it was a reaction to the worries of the people about the influx of immigrants in their country. One Washington Post article titled, "Immigration Worries Drove the Brexit Vote. Then Attitudes Changed" (2018) by Karla Adam and William Booth suggests that the real reason the people voted for Brexit in 2016 was because they were experiencing feelings of anxiety over the immigration of foreigners from other European Union member nations into the United Kingdom. As a part of the European Union, Britain complied with the right of free movement of citizens of European Union nations between countries. This resulted in a large amount of foreigners moving into the United Kingdom, which the article claims made those already residing in the United Kingdom nervous (Adam & Booth, 2018). The exit of the United Kingdom from the European Union would give them the independence to set more strict guidelines for the number of foreigners that may enter the country and from what income level and country they are allowed to come from (Adam & Booth, 2018). This is in sharp contrast to the view of Brexit presented in *Brexit: The Movie*. Instead of presenting Brexit as something the people of the United Kingdom support because of a sense of nationalism and recognition that membership in the European Union is becoming a hindrance on their success, this view presents Brexit as a fear-driven response in attempt to stop an entirely separate issue in an indirect way (Adam & Booth, 2018).

b. Implications for the Accountant in the Future Business World

If Brexit takes place at any point in the future, the implications that it will have on the international business landscape will be vast. As professionals servicing clients that function within this landscape, it is critical that accountants be involved in the developments of Brexit. The first impact that Brexit would have on accountants across the world would be the requirement it would place on them to educate themselves quickly and thoroughly on a large and complex new set of policies and business consequences resulting from the United Kingdom no longer operating under European Union rules. The task of accurately understanding how Britain and the rest of the world will interpret and implement these new regulations to impact businesses would need to be completed as soon as possible and may make accountants with some knowledge of international law or at least a background in law more valuable to firms.

After understanding the basic policies and regulations, the next step would be to establish how these new pieces of legislature would impact business decisions. This area would be less definite and require a great deal of forward thinking, as with any major change in the policies of a nation. Much of the implications for business would be determined by whether or not the United Kingdom could obtain trade deals upon their exit and with what countries these trade deals would be established.

As far as which clients would be most impacted by the changes resulting from Brexit, manufacturing clients would probably especially have an interest in these changes. Because they will impact the regulatory landscape surrounding purchasing, receiving, and transporting goods, these clients may have something to gain from either obtaining raw materials from or transporting their products to the United Kingdom. In addition, they may also stand to benefit from locating plants there if regulations that previously hindered company growth decrease.

Without the above considerations, it would not be possible for accountants to provide maximum value to their clients. Companies depend on accountants to possess the knowledge necessary to offer meaningful advice that provides value to the client by helping them make the best business decisions. Without first being educated on the regulations monitoring the business world, considering how those regulations impact business in general, and then considering how specific clients can best utilize those regulations to maximize their success, accountants cannot provide their intended functions, and they no longer serve as an asset to the client. Therefore, it is critical that, if Brexit happens, accountants move quickly to understand its impact on how they will advise clients.

c. Looking Forward in October 2019

October 31st, 2019, has been set as the date by which the United Kingdom and the European Union will come to an approved agreement on the terms of Brexit and Brexit will be executed (Brexit: Where do we stand?, n.d.). If no agreement is reached by this date, then it will still be possible for Brexit to occur without a deal present between the United Kingdom and European Union, referred to as a no-deal Brexit (Brexit: Where do we stand?, n.d.). Another consideration that the United Kingdom and the European Union need to consider and ratify before Brexit takes place is the logistical element of this shift. If Brexit occurs overnight with no regulations addressing the acceptance and release of goods at ports or airports, there may be long delays or large amounts of traffic created at these establishments. If no deal is reached, then the United Kingdom has agreed to exit the European Union on May 31st, 2019, at midnight (Brexit: Where do we stand?, n.d.).

If a deal is reached on or prior to October 31st, 2019, then a transition period will be instituted that will last until roughly December 31st, 2020, during which time the European Union rules currently in place will continue to apply (Brexit: Where do we stand?, n.d.). This will allow for some of the aforementioned logistical issues and any other remaining problems caused by the change to be addressed. This transition period may be extended by two years. In summary, October, 2019, is the month that will determine which of the two potential futures the United Kingdom will be facing and which of the two potential scenarios the rest of the world will have to determine how to handle (Brexit: Where do we stand?, n.d.).

Case 3: International Paper Annual Report Analysis

Introduction

The purpose of this case was to offer students a chance to analyze in depth the 10-K report (annual report) for the fiscal year of 2018 of one of the United States' most successful companies, International Paper. International Paper is a manufacturer of paper and packaging products. Their business spans on an international scale, and they have managed to establish their name as one of the ladders in paper production and packaging. As a publicly traded entity, International Paper is required to file annual reports with the Securities and Exchange Commission (SEC). These reports include the set of financial statements for the company and the auditor's report on those financial statements and internal controls, which serve as assurance to the users of the financial statements that they are free from material error. Their annual report offers several complexities associated with such a large, broadly-reaching company, including consolidated revenues reported by both operating segment, and geographic market region, the presence of unique assets such as forestlands, and reporting on the impacts of foreign currency translation to U.S. currency.

The value of performing this analysis of International Paper's annual report is includes several elements. First, for students intending to pursue a career in the professional accounting world, familiarity with such filings with the SEC is critical. These reports serve as the most comprehensive and trust-worthy source for gaining a financial understanding of a company's business. Gaining such an understanding is crucial not only for investors but also for the public accountants that have obtained the company as a client. For an accountant to perform their job to the best of their abilities, a thorough understanding of the client is a necessity, whether the accounting services are concerned with the tax, audit, or advising elements of the client. Familiarity with these rich information sources will provide a distinct advantage to students transitioning into their professional careers by preparing them for what their profession will require of them.

a. What is the nature of your company's business? Based on what you read in the company's Annual Report, how do they generate profit? Where is it headquartered? Where do they do business? What is their fiscal year-end? If this date differs from the calendar year-end, why did they choose it?

International Paper is a paper and packaging company with operations in North America, Europe, Latin America, North Africa, India and Russia (International Paper, 2018, p. 45). According to the 2018 annual report, they manufacture paper and packaging products at their own plants and are vertically integrated to some degree, owning many of their own forestlands as a source of raw materials for product production. According to the annual report, International Paper stated that, "substantially all of our businesses have experienced, and are likely to continue to experience, cycles relating to available industry capacity and general economic conditions" (International Paper, 2018, p. 1). International Paper's vision is, "To be among the most successful, sustainable and responsible companies in the world", and their mission is "to improve people's lives, the planet and the company's performance by transforming renewable resources into products people depend on every day" (International Paper, n.d., para. 5-6).

The company reports profits in three operating separate segments, Industrial Packaging, Global Cellulose Fibers, and Printing Papers (International Paper, 2018). Of course, at the root of International Paper's profit-making method is their ability to create products and sell them to their customers for a price that is greater than the cost of producing the product. The annual report indicates the following sources of generated profit for the three aforementioned segments: Industrial Packaging's profits were higher than in 2017 due to "higher average sales price realizations, net of mix, higher sales volumes, and lower input costs… partially offset by higher operating costs and higher maintenance outage costs" (International Paper, 2018, p. 20). Global Cellulose Fibers' operating profit was more favorable versus 2017, "as the benefits of higher average sales price realizations and improved mix were partially offset by lower sales volumes, higher input costs, higher maintenance outage costs and higher operating costs" (International Paper, 2018, p. 20). Printing Papers' profits represented an increase in operating profits from 2017 because, "benefits from higher average sales price realizations, net of mix, were partially offset by lower sales volumes, higher input costs, higher maintenance outage costs and higher operating costs" (International Paper, 2018, p. 20).

International Paper is headquartered in Memphis, Tennessee. This was most likely a strategic decision. Memphis has been dubbed the logistical hub of America. This allows for better distribution of International Paper's finished goods as well as inward transportation of materials for production from suppliers.

International Paper conducts business on an international scale. As mentioned, their markets include North America, Europe, Latin America, North Africa, India, and Russia (International Paper, 2018 p.45). International Paper has a fiscal year-end of December 31st, meaning that their fiscal year-end falls on the calendar year-end (International Paper, 2018, p. 38).

b. Who are your company's auditors? Name the firm and city.

International Paper's auditors are Deloitte & Touche LLP, and their office is located in Memphis, Tennessee (International Paper, 2018, p. 38). This is highly convenient considering that International Paper's headquarters is located in Memphis, Tennessee. Deloitte has been the auditor of International Paper since the year 2002 (International Paper, 2018, p. 38).

c. Describe each asset on your company's balance sheet. Determine any relevant accounting policies related to these accounts. Now do the same for liabilities and equity accounts.

Assets

Cash and Temporary Investments -

Cash is the most liquid of all assets and is the most prominent value-bearing medium typically given in an exchange. International Paper's temporary investments are defined as having an original maturity of three months or less and are treated as cash equivalents, stated at cost, which approximates market value (International Paper, 2018, p. 55).

Accounts and Notes Receivable –

Receivables are financial assets that are rights to payment held against customers and others for provided items of value. They indicate an unfulfilled obligation that a customer has to pay money to International Paper, and International Paper records this as an asset because it is a promise of cash that they have some expectation of receiving at a future date. For International Paper, this could mean paper products purchased on credit by customers that the company is waiting to receive cash for. Notes Receivable are supported by a promissory note, which is a written promise to pay a specific sum of money at a certain date in the future. These notes also create an obligation for the borrower to pay interest to International Paper.

Contract Assets –

A contract asset is an entity's right to payment for goods provided to a customer when payment is contingent upon a future occurrence. In that way, it is like a receivable. Contract assets are created when International Paper has already fulfilled its obligation to a customer, but the customer's payment is contingent upon some future event taking place.

Inventories -

Inventories are asset items that International Paper holds for sale in their normal course of business. These items may be manufactured by International Paper or purchased from outside vendors. It also includes the goods that will be used in the production of goods to be sold. For International Paper, "inventories are valued at the lower of cost or market value and include all costs directly associated with manufacturing products: materials, labor and manufacturing overhead" (International Paper, 2018, p. 46). In the U.S., raw materials and finished pulp and paper products costs are determined via last-in, first-out (LIFO) method, and other inventories are valued using first-in, first-out (FIFO) or average cost methods (International Paper, 2018, p. 46).

Assets Held for Sale –

Held for sale assets are long-lived assets that International Paper intents to dispose of via sale in the future. The annual report of International Paper does not provide much detail regarding these assets.

Other Current Assets –

Other current assets (OCA) is a category of items of value that a company possesses that may be converted to cash within a year or a business period. These assets may also be thought of as those that do not fit into another specific asset account designation.

Plants Property and Equipment –

Property, plant, and equipment (PP&E) represents physical assets that are expected to be held for a long-term period by a firm. Such fixed assets would include land, buildings, and machinery.

According to the annual report, plants, properties, and equipment are recorded on the books at their individual costs, and their values are composed of historical cost less accumulated depreciation, which is an estimated method of expensing the cost of the asset over time so that the expenses associated with the purchase of the asset are recorded in the same periods that the asset generates revenues (International Paper, 2018). Periodic expensing of the "expenditures for betterments" are capitalized, which means that they are recorded as assets, not expenses (International Paper, 2018, p. 46). However, normal repairs and maintenance on the property, plant, and equipment assets are expensed as they occur (International Paper, 2018, p. 46). According to the annual report, the units-of-production method of depreciation is the estimation method used for pulp and paper mills of International Paper, and the straight-line method of estimating periodic depreciation expense is used for other plants and equipment (International Paper, 2018, p. 46).

Forestlands –

This is an asset highly specific to International Paper and companies like them. It represents land that is owned by the company which has forests on it. The trees on this land act as a source of raw materials for International Paper, allowing them to manufacture their products.

Investments –

The investments account is stated to include investments in securities such as bonds, common stock, or long-term notes (International Paper, 2018). The annual report also indicates that this account often includes non-consolidated subsidiaries, which are companies that International Paper has some share of ownership in, or affiliated companies (International Paper, 2018).

Financial Assets of Special Purpose entities -

A special purpose entity is a separate entity that acts to back up the company by holding its own assets apart from those of International Paper. International Paper had several actions that were considered a part of special purpose entities. The annual report indicated that this account also included timber installment notes that were used as collateral for borrowings from third parties (International Paper, 2018).

Goodwill –

Goodwill is an intangible asset that is defined as the excess of the purchase price paid for a company over the fair values of the company's identifiable net assets (assets less liabilities, or equity). According to this definition, goodwill may only arise from the purchase of one company by another. International Paper assesses its goodwill to determine if it has been impaired (International Paper, 2018). The term impaired means that goodwill's carrying value on the books of International Paper exceeds its fair value.

Deferred Charges and other assets -

A deferred charge is a long-term prepaid expense. These prepaid expenses are considered assets because they indicate the right of International Paper to the future benefits provided by their purchase. These benefits will be used by International Paper in the future. In International Paper's balance sheet deferred income tax assets are recorded in the accompanying consolidated balance sheet under the captions "Deferred charges and other assets" (International Paper, 2018, p. 61).

Liabilities

Notes payable and current maturities of long-term debt -

This account is money borrowed by the company that is due at a date that falls within a year from the date of the financial statements. When money is borrowed by a company via a note payable, it is borrowed with a set interest rate. This acts as the price that International Paper pays to borrow the money through the note.

Accounts payable –

This account is composed of money owed by International Paper to other entities for services or products that International Paper has already received from those entities. Typically, these liabilities are to be paid within a set number of days after reception of the goods or services.

Accrued payroll and benefits –

This liability represents money that has been earned by International Paper's employees but has not been paid to them yet. It is designated as a liability because International Paper is obligated to pay their employees from the moment that the work is done to the time paychecks are distributed for that work.

Liabilities held for sale –

These items are the same basic concept as assets held for sale, simply switched to involved liabilities instead. Liabilities are deemed to be held for sale if it is likely that they will be sold in the future rather than held for use.

Other accrued liabilities –

Accrued liabilities are items that reflect expenses that have not yet been paid or logged under accounts payable during an accounting period. Any accrued current liabilities not already represented in the "Accrued payroll and benefits" account will be recorded here as well. In addition, this account also includes any guarantees that International Paper may have provided entities with which they have done business. The annual report states,

> In connection with sales of businesses, property, equipment, forestlands and other assets, International Paper commonly makes representations and warranties relating to such businesses or assets, and may agree to indemnify buyers with respect to tax and environmental liabilities, breaches of representations and warranties, and other matters. Where liabilities for such matters are determined to be probable and subject to reasonable estimation, accrued liabilities are recorded at the time of sale as a cost of the transaction. (International Paper, 2018, p. 62)

Nonrecourse Financial Liabilities of Special Purpose Entities –

Non-recourse debt is a kind of loan that is secured by collateral. If the borrower is not able to pay off their debt, the entity that is owed can collect the collateral as substitute for payment of the debt by the borrower. This is to protect the entity lending the money.

Deferred Income Taxes –

Deferred income tax is a liability recorded on a balance sheet resulting from a difference in income recognition between tax laws and International Paper's accounting methods. This account exists because there is a difference in the way that International Paper calculates their own taxable income for internal purposes and the way that prevailing tax laws require them to calculate it. The annual report addressed this by stating,

> International Paper uses the asset and liability method of accounting for income taxes whereby deferred income taxes are recorded for the future tax consequences attributable to differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets and liabilities are re-measured to reflect new tax rates in the periods rate changes are enacted (International Paper, 2018, p. 46).

Pension Benefit Obligation –

A pension benefit obligation is the present value of retirement benefits earned by employees. It is considered a liability by International Paper because they will have to provide those benefits to their employees in their future times of retirement. The amount of this obligation is determined by actuarial estimates and predictions, based on a number of assumptions, including the following: estimated future pay raises, estimated employee mortality rates, and estimated interest costs (International Paper, 2018).

Postretirement and Postemployment Benefit Obligation –

Post-retirement benefits are for people who have served or worked to achieve a lifetime benefit for themselves from International Paper. This is one form of retirement pension that is paid to the employees in their retirement years. These include benefits such as medical plans and life insurance (International Paper, 2018).

Other Liabilities –

This account includes any long-term debt incurred by International Paper that is not recorded in any of the other long-term debt accounts.

Commitments and Contingent Liabilities –

This account includes obligations that International Paper has agreed to be responsible for over a future period of time. The annual report stated that this account includes such items as lease agreements that International Paper is bound by and also environmental liabilities that may have to be fulfilled by International Paper at some later date (International Paper, 2018).

Equity

Common stock $1 par value –

Common stock is capital stock of International Paper that is issued to shareholders. These shares are securities that function as shares of ownership of International Paper. The $1 par value distinction is an arbitrarily set value that is used to value the common stock account on the company's balance sheet and also informs financial statement users of how many shares of common stock are issued.

Paid-in capital –

This account is used as a storage account for any amount paid by shareholders for their shares of stock that was over the par value of the stock. For instance, if a shareholder purchased five shares of $1 par value common stock but paid $15 for the shares, then $10 would be recorded in the paid-in capital account. This is a means of keeping common stock separately recorded at par value but also accounting for any extra value paid for by shareholders.

Retained earnings –

Retained earnings is composed of net income generated by International Paper that they decide to keep within the company. This is reduced by any dividends paid to shareholders and may also be used to fund needed business endeavors in the future. However, any net income that is retained adds to the value of the business and is therefore recorded in the equity section of the balance sheet.

Accumulated other comprehensive loss –

This account contains any losses generated by translation of foreign currency (International Paper, 2018). The annual report stated, **"**Balance sheets of international operations are translated into U.S. dollars at year-end exchange rates, while statements of operations are translated at average rates", and then continued and stated, "Adjustments resulting from financial statement translations are included as cumulative translation adjustments in Accumulated other comprehensive loss" (International Paper, 2018, p. 47).

d. Describe your company's customer base - who are they and how do they use your company's products or services. Describe your company's specific sources of revenue and their revenue recognition policies. How much revenue comes from outside of the U.S.?

International Paper's customer base includes large office supply stores that purchase items such as uncoated printing paper in bulk purchases for retail sale to customers in their store locations. The uncoated paper may also used by International Paper's customers to be turned into envelopes, tablets, business forms and file folders (International Paper, 2018, p. 23). In addition, customers of International Paper's coated papers include office supply stores and also customers in the production of marketing materials such as brochures, pamphlets, greeting cards, books, annual reports and direct mail (International Paper, 2018, p. 23). International Paper's products in their industrial packaging segment are purchased by a variety of customers including manufacturers who box their products in-house, packaging companies, and shipping companies such as online stores and other such online shopping platforms that must ship their products (International Paper, 2018). In addition, customers in the food production industry also purchase products from the industrial packaging segment (International Paper, 2018). They use the products of International Paper as packaging for their food items to be sold in grocery stores. International Paper's cellulose fibers are purchased by customers in the hygiene product production industries. They are used to manufacture absorbent items such as absorbent hygiene products and tissues (International Paper, 2018). An exact list providing the names of customers of International Paper is not provided, most likely due to the desire to keep this list private from competitors.

International Paper identifies their segments as sources of revenues. According to page 4 of the Annual Performance Summary section of the annual report, Industrial Packaging accounts for 69 percent of International Paper's revenues, making it the largest segment provider of revenues (International Paper, 2018). Also on page 4 of the Annual Performance Summary section of the annual report, it is stated that the segment that is the second largest producer of revenues is Papers, which accounts for 19 percent of total revenues, and the third largest producer of revenues is the Global Cellulose Fibers segment (International Paper, 2018). International Paper recognizes revenue, "when the customer takes title to the goods and assumes the risks and rewards for the goods" (International Paper, 2018, p. 45). International Paper (2018) also stated that for customized goods where International Paper has a right to payment for the goods, revenue is recognized over time, generally as the goods are produced. International Paper offers early payment discounts to customers (p. 45). The Company estimates the expected cash discounts and other customer refunds based on historical experience with customers to record reductions in revenue accordingly (International Paper, 2018, p. 45). Computations from disaggregated revenue values show that of the total revenue recognized by International Paper, approximately 24.5 percent comes from outside of the U.S (International Paper, 2018, p. 49).

e. Describe your company's suppliers - who are they and what products or services do they provide to your company? What types of costs are included in your company's COGS?

Suppliers of International Paper include chemical suppliers, transportation suppliers, and suppliers in the forestry and wood products industries (CSIMarket.com, n.d.). Chemical suppliers likely supply International Paper with chemical agents necessary for the production process of their paper products. Chemicals are necessary to process certain raw materials, such as wood pulp, in the production of many different paper products made by International Paper. The costs of these chemicals would be included in the Cost of Goods Sold (COGS) of International Paper on their income statement because they are a part of the production process. Any other costs incurred to obtain elements necessary in the production process of their goods would be included in the COGS of International Paper. This includes also the products of suppliers in the forestry and wood products industries. Although International Paper has somewhat vertically integrated and owns a large amount of forestlands, they still require the products of forestry and wood products suppliers in order to make their products (CSIMarket.com, n.d.). These suppliers may supply such items as wood for pulp to make paper. Additionally, suppliers of transportation would also be included in International Paper's list of suppliers (CSIMarket.com, n.d.). They are necessary to transport goods to International Paper, which results in a freight-in cost. Freight-in costs are included in COGS as well. International Paper does not publish a list of their suppliers by name. This is most likely an effort to keep this information from their competitors, as it could damage International Paper's ability to conduct future business with their suppliers and to maintain any beneficial contracts or future contract deals with suppliers.

f. Describe each category of other operating expenses on the income statement - how do these expenses help generate revenue?

Selling and administrative expenses are the expenses associated with structuring the company and guiding it as well as selling the product. These expenses help generate revenue-driving product sales and ensure that production is properly overseen. Depreciation, amortization, and cost of timber harvested is all depreciation and amortization expenses and the cost of timber harvested, which is the cost to harvest the timber from the land International Paper owns. It helps generate revenue by providing raw materials to International Paper. Depreciation and Amortization are tied directly to assets that are used in operations to help International Paper generate revenue. Distribution expenses are the expenses attributable to distributing International Paper's products to consumers. These expenses help generate revenue by transporting products to complete sales obligations. Litigation settlement is another expense listed on the income statement. This arises when a company is involved in legal proceedings for which they incur expenses related to defending themselves or protecting themselves. In this case, this expense may not be directly tied to revenue production in any way other than that it allows the business to continue to function normally and legally, which allows continuation of revenue generation.

g. How have revenues and expenses changed over the past three years? Can you find any articles in the business press to support what you're seeing in the financial statements?

Revenues and expenses have remained fairly stable over the past three years (International Paper, 2018). There has been a reasonable and stable growth in sales of International Paper, and, as one would expect, the cost of goods sold has also increased with the increase in sales from 2016 to 2018 (International Paper, 2018). This makes sense because as more product is sold, more expenses associated with producing product are recorded as cost of goods sold. The numbers found here indicate that International Paper is performing well and is experiencing a healthy, steady growth from a revenue perspective. Observations of the popular business press also supported this conclusion, indicating that International Paper is focusing on growth where it matters. This would explain the stable revenue stream and lack of indications of poor performance.

h. Compare your company's net income to their cash flows from operations. What accounts for the difference?

In comparison to International Paper's net income reported in the financial statements, which shows consistent growth from 2016 to 2018, the cash flows statement is less stable and showed a decline in cash flow from 2017 to 2018 (International Paper, 2018). The cash flows for all three years, however, were all positive, which is a positive indication of the performance of the company (International Paper, 2018). The largest discrepancy occurred in 2018, in which net income from continuing operations was $1,672 million and cash flows showed a positive $589 (International Paper, 2018, p. 40-43). These differences are created by the factoring out of non-cash items that are accounted for in the periods indicated above. For example, if an expense that was recognized in a period was not represented by an actual cash outflow, then it is factored out of the net income value by adding it back. One example of such an expense is depreciation, which is not a cash outflow but rather a systematic expensing of a cash outflow that may have occurred many years prior. In the case of International Paper, it appears that the largest factors that impacted the cash flow for the year 2018 were cash outflows for reduction of debt and investments in capital projects (International Paper, 2018).

i. Which accounts on your company's balance sheet contain estimates or judgements?

Pension benefit obligation contains actuarial estimates and judgements as noted previously (International Paper, 2018). Accounts receivable will also be subject to some estimation as companies must determine which receivables will likely never be collected. This estimate is called allowance for doubtful accounts, and it serves to reduce the value of the expected receivables that will be collected. Plant, property, and equipment are recorded on the balance sheet at their net values, which indicates that they are subject to the effects of an estimate of depreciation expense. Goodwill is also subject to some judgement as it must be assessed for impairment on an annual basis and written down to its impaired value if impairment exists. The contingent liabilities account may also include some estimates or judgements if International Paper estimates how much of the environmental liabilities they may have to pay in the future or how much of their guarantees they will have to fulfill to customers.

Case 4: A Discussion of Dr. Thomas Sowell's View of Economics

Introduction

The purpose of this case is to discuss the views of Dr. Thomas Sowell, an American economist, author, and professor from Harlem in New York. Particularly, this discussion will focus on a video in which Dr. Sowell discusses his views on economic inequality, the state of economics today, social implications of certain beliefs and practices of current-day society in the United States and globally, and how his views on economics have changed over the course of his life and career. Dr. Sowell has had a drastic change in his views on economics from the time that he was a young man to the present day (HooverInstitution, 2018). The evolution of his position has been impacted greatly by his life experiences and research in the field of economics. Although he began as a devoted Marxist, he has since altered his position to be far more conservative (HooverInstitution, 2018). One thing that is particularly apparent about Dr. Sowell's methodology for developing and communicating his ideas and beliefs regarding not only economics, but also current social issues is his constant devotion to the use of facts and evidence to draw his conclusions. This was particularly refreshing, considering the nature of the topics discussed in the video. In the current societal environment, Dr. Sowell's ideas may not be considered the most popular, however, his ability to support his statements with factual evidence was not only refreshing, but enlightening as well.

Through this case, I have learned the value of evidence and fact in not only allowing oneself to discover the truth, but also in sharing those findings with others in a powerful and meaningful way. Whether or not someone agrees with Dr. Sowell, it cannot be argued that his ideas and findings are without merit because of his extensive effort spent analyzing facts and information to draw his conclusions. Looking to the future, I feel that this applies directly to my future career in accounting. As an auditor, my job will be to gather evidence and search for the truth through facts and analysis. Seeing the power of this effort through Dr. Sowell's testimony has reassured me not only of the value of the field that I am entering but has also helped strengthen the mindset that I will need to be successful as an auditor.

Summary of *Thomas Sowell on the Myths of Economic Inequality*

The following is a summary of the video *Thomas Sowell on the Myths of Economic Inequality* (2018) by the HooverInstitution channel on YouTube.

Dr. Sowell began by describing his life and beliefs growing up as an African American boy in Harlem. He said that as early as 16 years of age, he was a devoted Marxist. He stated that from his experiences growing up in Harlem, seeing the distinct differences between the affluent upper class and the poor neighborhoods of New York, he turned to the ideas of Marxism, which essentially states that the rich became rich through taking from the poor. When he was 18 years old, Dr. Sowell states that he joined the Marines and that he then returned to school after his time in the military. It was during his time as a graduate student, that his Marxist views on economics and social norms first began to change. He recalled that there was a certain research project that he undertook while working at the labor department which caused him to come across a study that stated that when a certain foreign country passed minimum wage laws, employment rates fell drastically in the sugar cane industry of that country. The study gave two potential reasons for this trend, stating that it could either be because the minimum wage laws were pricing the workers out of jobs and that sugar cane farms could not afford to pay them, or that the wage law had been passed at a time when a hurricane had come through the country and killed all of the sugar cane, leaving no work for the workers. So, Dr. Sowell stated that he saw clearly that if he could get data on the amount of sugar cane standing in the field for that year from the agricultural department, then he could determine if the labor reduction was due to the wages or due to the hurricane removing all of the sugar cane from the fields. He attempted to gather data on the amount of sugar cane in the fields but could never get a reply from the office that could provide this data (HooverInstitution, 2018).

After this experience, Dr. Sowell states that he began to look at things differently. He began to realize the bias and agendas associated with so many proposed ideas of the time. He states that he began to realize that a basic flaw of the way that people think today is that they cannot move past the fictitious notion that good things simply happen, but bad things must be someone's fault. He said that it was through his analysis of evidence and increasing intellectual status, he moved away from Marxism (HooverInstitution, 2018).

Dr. Sowell supports that social visions have made it possible for people to totally disregard factual evidence. If the conclusion proposed by factual evidence does not fit with the social vision of a person, they have been permitted to completely deny the evidence and still be accepted. This trend has become pervasive throughout society today. He gave the example of Socialism, recalling that it is a great idea in theory, but if you examine the factual evidence, every time that socialism has been implemented in a nation, it has failed. The facts here are undeniable, yet there are still people who view it as the solution to all economic problems. He also applied this logic to other topics with more of a social implication including education, affirmative action, reparations, and even current political topics, ending the video by saying that factual evidence, as well as logic are the tests of theories that should be given consideration in order to gain an understanding of the truth (HooverInstitution, 2018).

Case 5: Starbucks Corporation – Understanding Financial Statements

Introduction

This analysis pertains to the case, "Starbucks Corporation- Understanding Financial Statements". This case focused on the utilization of financial statements to provide understanding about the financial position and activities of Starbucks Corporation in the fiscal year ended September 29, 2013. This was also meant to provide a deeper understanding of the financial statements. Through information provided by the company's balance sheet, income statement, statement of stockholder's equity, statement of cash flows, and statement of comprehensive income, it was possible to analyze characteristics of Starbucks Corporation such as how it is financed, trends in its financial performance, and its treatment of methods of operation.

This case taught me the immense usefulness of the financial statements, both individually and when used in conjunction with one another and also what elements of the financial statements are important to monitor to guage the financial health of a company. This case also made clear the importance of the accompanying notes to the fianancial statemtns. These notes often are the key descriptive element that ties real-world events to what is exhibited in the financial statements. While the financial statements disclose the financial state of a company, the notes to the financial statements are key to understanding how that state came to be. They are also a key part of undertstanding the business of a fiscal entity.

Concepts

***Please note that all non-specified amounts mentioned in this case are in millions of dollars. All information discussed herein was provided within the case materials unless otherwise cited.**

a. What is the nature of Starbucks' business? That is, based on what you know about the company and on the accompanying financial statements, how does Starbucks make money?

Starbucks Company is a retail and wholesale company that produces and sells consumable and non-consumable products directly to consumers as well as to other retailers. They also license their trademarks as a means of generating revenue.

b. What financial statements are commonly prepared for external reporting purposes? What titles does Starbucks give these statements? What does "consolidated" mean?

Financial statements that are commonly prepared for external reporting purposes include the balance sheet, income statement, statement of stockholder's equity, statement of cash flows, and the statement of comprehensive income. Starbucks titles these, "Consolidated Balance Sheets", "Consolidated Statements of Earnings", "Consolidated Statements of Equity", "Consolidated Statements of Cash Flows", and "Consolidated Statements of Comprehensive Income", respectively. "Consolidated" means all of the subsidiaries of Starbucks are combined into that single statement.

c. How often do publicly traded corporations typically prepare financial statements for external reporting purposes?

Publicly traded corporations typically prepare financial statements for external reporting purposes quarterly.

d. Who is responsible for the financial statements? Discuss the potential users of the Starbucks financial statements and the type of information they are likely interested in.

Financial statements are the responsibility of both the company's internal employees and the external firm that is entrusted with monitoring the financial statements for accuracy. Current investors of Starbucks as well as potential investors are two of the primary users of financial statement information. They would be looking for indicators of the financial health of the company, that the health is sustainable, and that growth is a focus of the company along with maximizing value for shareholders.

e. Who are Starbucks' external auditors? Describe the two "opinion" letters that Starbucks received in 2013. In your own words, what do these opinions mean? Why are both opinions dated several months after Starbucks' year-end?

Starbucks' external auditors are Deloitte & Touche LLP, located in the city of Seattle, Washington. The two opinion letters that Starbucks received essentially inform Starbucks that their financial statements have been audited and found to be a fair representation of the company's financial position. Therefore, they received an unqualified opinion. This means that their statements upheld the standards set forward by GAAP and that they are accurate and fair. The letters to management at Starbucks were to inform the management that their internal controls and methods of accounting were appropriate. This indicates the difference between the two letters. One was in regards to the financial statements, and the other was in regards to the internal controls. At the point when these letters were sent, the audit would have been complete and the financial statements published.

Analysis

g. In reference to Starbucks' balance sheet for fiscal 2013

i. Demonstrate that the accounting equation holds for Starbucks. Recall that the accounting equation is: Assets = Liabilities + Equity.

According to the balance sheet for the year ended September 29, 2013, Starbucks Corporation possessed total assets of $11,516.7 million, which is equal to the sum of the company's total liabilities of $7034.4 million and equity of $4,482.3 million. This shows that the accounting equation, Assets = Liabilities + Equity, is upheld. This is represented mathematically by the following:

$$\$11{,}516.7 = \$7034.4 + \$4482.3$$

$$\$11{,}516.7 = \$11{,}516.7$$

ii. What are Starbucks' major assets? Calculate the proportion of short-term and long-term assets for 2013. Does this seem appropriate for a company such as Starbucks?

Based on the percentages in Table 1, Starbucks' major assets include property, plant, and equipment, cash and cash equivalents, and inventories. These assets represent the largest percentages of the total assets of Starbucks Corporation. The proportion of short-term and long-term assets is as follows:

Short-term assets: $5,471.4 /$11,516.7 = 47.51%

Long-term assets: $6,045.3/$11,516.7 = 52.49%

Table 1: Starbucks Corporation Common-size Balance Sheet

Consolidated Balance Sheets (USD $)	Sep. 29, 2013	Sep. 30, 2012	Sep. 29, 2013	Sep. 30, 2012
In Millions, unless otherwise specified				
Current assets:	'	'		
Cash and cash equivalents	$2,575.70	$1,188.60	22.36%	14.46%
Short-term investments	658.1	848.4	5.71%	10.32%
Accounts receivable, net	561.4	485.9	4.87%	5.91%
Inventories	1,111.20	1,241.50	9.65%	15.10%
Prepaid expenses and other current assets	287.7	196.5	2.50%	2.39%
Deferred income taxes, net	277.3	238.7	2.41%	2.90%
Total current assets	5,471.40	4,199.60	47.51%	51.09%
Long-term investments	58.3	116	0.51%	1.41%
Equity and cost investments	496.5	459.9	4.31%	5.60%
Property, plant and equipment, net	3,200.50	2,658.90	27.79%	32.35%
Deferred income taxes, net	967	97.3	8.40%	1.18%
Other assets	185.3	144.7	1.61%	1.76%
Other intangible assets	274.8	143.7	2.39%	1.75%
Goodwill	862.9	399.1	7.49%	4.86%
TOTAL ASSETS	11,516.70	8,219.20	100.00%	100.00%
Current liabilities:	'	'		
Accounts payable	491.7	398.1	4.27%	4.84%
Accrued litigation charge	2,784.10	0	24.17%	0.00%
Accrued liabilities	1,269.30	1,133.80	11.02%	13.79%
Insurance reserves	178.5	167.7	1.55%	2.04%
Deferred revenue	653.7	510.2	5.68%	6.21%
Total current liabilities	5,377.30	2,209.80	46.69%	26.89%
Long-term debt	1,299.40	549.6	11.28%	6.69%
Other long-term liabilities	357.7	345.3	3.11%	4.20%
Total liabilities	7,034.40	3,104.70	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	0.8	0.7	0.01%	0.01%
Additional paid-in capital	282.1	39.4	2.45%	0.48%
Retained earnings	4,130.30	5,046.20	35.86%	61.40%
Accumulated other comprehensive income	67	22.7	0.58%	0.28%
Total shareholders' equity	4,480.20	5,109	38.90%	62.16%
Noncontrolling interests	2.1	5.5	0.02%	0.07%
Total equity	4,482.30	5,114.50	38.92%	62.23%
TOTAL LIABILITIES AND EQUITY	$11,516.70	$8,219.20	100.00%	100.00%

iii. In general, what are intangible assets? What is goodwill? What specific intangible assets might Starbucks have?

Intangible assets are assets that lack physical substance. Intangible assets may include such items as patents, copyrights, goodwill, and trademarks. Goodwill is an intangible asset that results from one company purchasing another company. The purchaser in the transaction records goodwill as the amount of cost incurred in the transaction less the fair value of the net identifiable assets that are purchased. This represents benefits that the purchaser is obtaining that are not specifically identified upon the date of purchase. Starbucks also possesses intangible assets including trademarks, trade names, copyrights, contract-based patents, and trade secrets. These are mentioned in the notes to the financial statements regarding, "Other Intangible Assets". They may also possess intangible assets that are less easily identifiable such as their human capital.

iv. How is Starbucks financed? What proportion of total financing comes from non-owners?

Starbucks is financed through the sale of its common stock and through debt securities. On September 29, 2013, Starbucks had a debt to equity ratio (total liabilities/total stockholder's equity) of 1.57, which is 2.58 times its debt-to-equity ratio of .61 at the end of the previous fiscal year. Further analysis shows that on September 29, 2013, the amounts of both current liabilities and long-term debt more than doubled compared to the previous fiscal year, while total stockholder's equity decreased by 12 percent. This indicates a large increase in the use of debt by Starbucks to finance its growth. However, it may be worth noting that the amount of total liabilities listed on the balance sheet as of September 29, 2013, was strongly impacted by litigation expense incurred that year. This was responsible for 40 percent of the total liabilities amount. Other comprehensive income listed on the balance sheet as of September 29, 2013, is $67 million, indicating that .58 percent of total financing is from non-owner sources.

h. In reference to Starbucks' statement of earnings for fiscal 2013 (the year ended September 29, 2013) and to the common-size income statement developed in part f, above

i. Review the revenue recognition policies of Starbucks discussed in Note 1 (Summary of Significant Accounting Policies). Does Starbucks record revenue when they receive cash from their customers (cash-basis accounting) or do they follow a different rubric (for example, accrual accounting)? How does Starbucks record revenue on stored value cards (i.e., gift cards)? What challenges in measuring revenue do you observe? That is, are there any significant judgments management needs to make in recording sales revenues at Starbucks?

Starbucks uses accrual accounting for recognizing revenue. For licensed stores, revenue from sales is recognized at the point of shipment, depending on specifications in the contract pertaining to the sale. For company-operated stores, revenues are recognized at the point of sale. Revenue from sales of items such as ready-to-consume drinks and packaged coffees and teas are typically recognized when the product is received by the customer. For stored value cards, revenue is recognized when the gift card is redeemed or when redemption of the card can be considered highly remote based on historical experience. This would present a challenge for Starbucks because although data gathered from past experiences would offer some guidance in determining if redemption was remote, there would still be an element of judgement required here. If redemption is deemed to be remote and revenue is recognized, but the card-holder then redeems the card, this could lead to difficulties in recording revenue.

ii. What are Starbucks' major expenses?

Store operating expenses and cost of sales are overwhelmingly Starbucks' largest expenses. Store operating expenses were 28.78 percent of total net revenues and cost of sales was 42.86 percent of total net revenues for the fiscal year ended September 29, 2013. Store operating expenses and cost of sales were responsible for 69 percent of total operating expenses. Store operating expenses would include all costs necessary to run the physical store locations and maintain them. Costs of sales would include all sales necessary to sell products. Costs of the food and beverage items to sell as well as labor expenses are also considerable expenses. This information is exhibited in Table 2.

iii. Were there any significant changes in the cost structure during the most recent year?

There has been little change in the cost structure during the most recent year. However, one notable change is that Starbucks reported litigation charges for the year, which was not a charge they reported in the previous two years.

iv. In fiscal 2013, Starbucks separately reported a litigation charge and included it in operating income. Why didn't the company just include this amount within the line item for general and administrative expenses? Why is it an operating expense?

The amount for litigation charge was most likely listed separately for full disclosure purposes, to ensure that readers of the financial statements could identify the cause of the increase in expenses for that fiscal year and have a more accurate understanding of Starbucks' financial position. Additionally, the separation of litigation charge form general and administrative expenses allows for more meaningful trends to be observed. Litigation is an operating expense because it does pertain to the operations of the business, but it is not a recurring expense. The source of the litigation charge would have been legal expenses incurred by Starbucks to obtain legal representation. These legal expenses could have been incurred from Starbuck's payment for representation in any legal proceedings such as for defense against claims in a lawsuit against the company or in any other proceedings in court that Starbucks was a part of and must pay in some way.

Table 2: Starbucks Corporation Common-size Income Statement

Consolidated Statements Of Earnings (USD $)	12 Months Ended					
In Millions, except Per Share data, unless otherwise specified	**Sep. 29, 2013**	**Sep. 30, 2012**	**Oct. 02, 2011**	**Sep. 29, 2013**	**Sep. 30, 2012**	**Oct. 02, 2011**
Net revenues:	'	'	'			
Company-operated stores	$11,793.20	$10,534.50	$9,632.40	79.19%	79.21%	82.33%
Licensed stores	1,360.50	1,210.30	1,007.50	9.14%	9.10%	8.61%
CPG, foodservice and other	1,738.50	1,554.70	1,060.50	11.67%	11.69%	9.06%
Total net revenues	14,892.20	13,299.50	11,700.40	100.00%	100.00%	100.00%
Cost of sales including occupancy costs	6,382.30	5,813.30	4,915.50	42.86%	43.71%	42.01%
Store operating expenses	4,286.10	3,918.10	3,594.90	28.78%	29.46%	30.72%
Other operating expenses	457.2	429.9	392.8	3.07%	3.23%	3.36%
Depreciation and amortization expenses	621.4	550.3	523.3	4.17%	4.14%	4.47%
General and administrative expenses	937.9	801.2	749.3	6.30%	6.02%	6.40%
Litigation charge	2,784.10	0	0	18.70%	0.00%	0.00%
Total operating expenses	15,469	11,512.80	10,175.80	103.87%	86.57%	86.97%
Gain on sale of properties	0	0	30.2	0.00%	0.00%	0.26%
Income from equity investees	251.4	210.7	173.7	1.69%	1.58%	1.48%
Operating income	-325.4	1,997.40	1,728.50	-2.19%	15.02%	14.77%
Interest income and other, net	123.6	94.4	115.9	0.83%	0.71%	0.99%
Interest expense	-28.1	-32.7	-33.3	-0.19%	-0.25%	-0.28%
Earnings before income taxes	-229.9	2,059.10	1,811.10	-1.54%	15.48%	15.48%
Income taxes	-238.7	674.4	563.1	-1.60%	5.07%	4.81%
Net earnings including noncontrolling interests	8.8	1,384.70	1,248	0.06%	10.41%	10.67%
Net earnings attributable to noncontrolling interest	0.5	0.9	2.3	0.00%	0.01%	0.02%
Net earnings attributable to Starbucks	$8.30	$1,383.80	$1,245.70	0.06%	10.40%	10.65%
Earnings per share - basic	$0.01	$1.83	$1.66	0.00%	0.01%	0.01%
Earnings per share - diluted	$0.01	$1.79	$1.62	0.00%	0.01%	0.01%
Weighted average shares outstanding:	'	'	'			
Basic	749.3	754.4	748.3	5.03%	5.67%	6.40%
Diluted	762.3	773	769.7	5.12%	5.81%	6.58%
Cash dividends declared per share	$0.89	$0.72	$0.56	0.01%	0.01%	0.00%

v. Was the company profitable during 2013? During 2012? Explain your definition of "profitable."

Starbucks was profitable during 2012, having earnings before income taxes of $2,059.1 million. In 2013, the company was not profitable, suffering a loss of $229.9 million. My definition of profitable is that a company's total expenses sum to less than their total revenues.

i. In reference to Starbucks' fiscal 2013 statement of cash flows

i. Compare Starbucks' net earnings to net cash provided by operating activities and explain the difference.

Starbucks' net earnings for the fiscal year 2013 totaled $8.3 million, and the cash provided by operating activities totaled $2,908.3 million. Cash provided by operating activities was greater than net earnings by $2,900.0 million. Cash provided by operating activities describes the actual amount of physical cash inflow for Starbucks during the 2013 fiscal year from the normal activities of the business. Net earnings is a combination of both cash and non-cash items and their impact on the financial position of the company. This includes such non-cash items as depreciation and amortization expense and gains or losses as well as litigation accrual. Their impact is represented in net earnings.

ii. How much cash did Starbucks use for expenditures for property, plant and equipment during fiscal 2013?

During the fiscal year of 2013, Starbucks used $1,151.2 million for expenditures for property, plant, and equipment.

iii. What amount of dividends did Starbucks pay during the year? How does this amount compare to the amount of dividends declared as shown in the statement of equity?

T-account analysis can be used to determine these amounts as follows. Figure 6 shows t-accounts that are stated in millions of dollars.

Retained Earnings	
255.6	5,046.20
668.6	8.3
	4130.3

Dividends Payable	
	668.6
628.9	
	39.7

Figure 6: Starbucks Dividends T-accounts

Figure 6 shows that although Starbucks declared $668.6 million in dividends during the fiscal year 2013, they only paid $628.9 million of them, resulting in a remaining balance of $39.7 million in the dividends payable account. This amount will impact retained earnings in the fiscal period during which it was declared.

j. Several notes to the financial statements refer to the use of "estimates." Which accounts on Starbucks' balance sheet require estimates? List as many accounts as you can. Are any accounts estimate-free?

Accounts on Starbucks' balance sheet that require estimates include accounts receivable, net, inventories, property, plant, and equipment, net, goodwill, long-term debt, other intangible assets, amounts associated with gift cards and warranties, and insurance reserves. Any accounts that are affected by accrual accounting methods, involve market or fair value amounts, or that are impacted by a systematic method writing off their balances are impacted by estimates. Therefore, no, there are no accounts that are estimate free.

Case 6: BP p.l.c - Contingencies

Introduction

This analysis pertains to the case, "BP p.l.c - Contingencies". This case focused on the methods of estimation of contingencies, the method of recording contingencies, and scenarios that would lead to contingent liabilities or assets. It was also meant to emphasize the contingencies that may arise for a company in the wake of a disaster. These contingencies primarily included lawsuits from multiple sources and for multiple causes that would each need to be analyzed and independently estimated and determined to be probable or improbable. This would require not only the input of legal counsel but also the professional judgement of an accountant. The BP Deepwater Horizon oil spill scenario was used to examine these many contingencies.

This case taught me the importance of accountants' knowledge of the legal system and its implications on the financial information of companies. Understanding how this information impacts the probability of certain future events occurring and incorporating that into financial decisions and estimations is critical to producing representationally faithful financial information. This case emphasizes that accountants are responsible not only for having a complete and in-depth understanding of the company they work for, but also a well-rounded understanding of how external events can work hand-in-hand with accounting practice. In my opinion, this is a significant part of what makes accountancy both a fascinating and impressive profession. The skills necessary to perform this profession go well beyond simply the technical skills associated with the accounting system itself. This case functions as a strong example of this point.

Concepts

***Please note that any non-specified amounts mentioned in this case are in millions of dollars. All information discussed herein was provided within the case materials unless otherwise cited.**

a. What is a contingent liability? Explain, in your own words, when a company would record a contingent liability (i.e. a contingent loss) on its books. List some types of contingent liabilities. Do companies ever record contingent assets (i.e. contingent gains)?

A contingent liability is a possible future obligation that may or may not arise based on the occurrence or non-occurrence of a future event. In order for a company to record a contingent liability, the amount of the liability must be estimable, and it must be determined to be probable. Examples of contingent liabilities include litigations and warranty costs. No, a company does not record contingent assets. This would not be a conservative approach to financial reporting and may present a misleadingly positive image of the company's financial position. However, they may be mentioned in the notes to the financial statements.

b. Product warranties are a common contingent liability. Consider a piece of equipment such as a telescopic joint, which BP purchases from GE Oil and Gas. The telescopic joint compensates for heave and offset on drilling vessels and is sold with a two-year warranty against defects. From BP's perspective as the purchaser of the telescopic joint, what is a product warranty? From the perspective of GE Oil and Gas, the manufacturer of the telescopic joint, what is a warranty?

From BP's perspective, the product warranty would be a contingent asset. From the perspective of the manufacturer, the product warranty would be a contingent liability that would need to be recorded in the period with the sale.

c. What judgments does management need to make to account for contingent liabilities in general and accrued warranty costs in particular? How does a claim for damages resulting from the Deepwater Horizon oil spill differ from a warranty claim on a piece of equipment such as a telescopic joint?

Management would need to use judgement to estimate the amount of the warranty liability they expect to be responsible for. They would also need to use judgement to determine if it is probable that they will be held responsible for this obligation in the future. If so, they may record the contingent liability. For warranty costs specifically, management must also use judgement to determine how much of the liability and expense related to the warranty should be recognized each period. A claim for damages resulting from the Deepwater Horizon oil spill would be more difficult to estimate than those for a warranty claim due to the broad scope of reasons for the liabilities that may arise. In addition, these liabilities would be to numerous different entities, not just to a single entity as a product warranty claim would be. It may also be more difficult for BP to estimate these claims because it is not something they have consistent experience with handling. Since a warranty claim is likely something a company would have prior experience with, it would be easier for them to estimate this amount. A warranty claim would also be limited in amount to an extent because the work that would need to be done to the product or even replacement costs could safely be estimated to fall within a certain range of amounts. In essence, a warranty claim would have far fewer variables in estimation than a claim arising from a disaster such as the Deepwater Horizon oil spill.

d. Describe some of the estimates that BP must make to account for the contingencies associated with the Deepwater Horizon oil spill. By way of comparison, the Exxon Valdez oil spill took place on March 24, 1989. Litigation continues as of early 2011.

The BP Deepwater Horizon oil spill created numerous contingent liabilities from the many lawsuits it sparked. These lawsuits came from a number of different sources, including businesses and individuals that suffered loss of profits and income due to the spill, families of the

BP employees who were killed in the explosion that began the spill, environmental agencies, suits for property damage, suits for health problems caused by the chemicals used in the cleanup efforts, and even BP shareholder suits (Goguen, 2015). In considering and attempting to estimate these contingent liabilities, members in charge of BP's finances would have to work closely with legal staff and use both their legal and financial knowledge to estimate what claims would most likely result in payment from BP and in what amount the payments would be.

The largest financial impact the Deepwater Horizon oil spill caused to entities outside of BP was to businesses and individuals whose financial success was directly tied to the coastal areas where they were located. Such businesses included the commercial fishing industry (Goguen, 2015). The oil spill also severely impacted the tourism industry in the coastal areas, which are typically popular vacationing spots for tourists but were avoided due to the presence of the oil. This caused a great deal of harm to many different businesses that typically depend on tourism for a large portion of their annual income. Such businesses included hotels and resorts in coastal areas, rental properties, businesses existing as tourist attractions, charter boat services, and many others (Goguen, 2015). These businesses were able to sue for lost profits directly caused by the BP oil spill (Goguen, 2015). As an auditor, it could be safely determined that these claims would be considered probable and could certainly be estimable.

Families of BP employees that were killed or injured in the explosion that began the oil spill also had solid grounds to file suit against BP (Goguen, 2015). These claims could be considered probable and estimable, using information from prior court rulings in similar suits. As the investigation into the cause of the explosions progressed, it was found that it was the result of weaknesses in concrete cores being used to seal oil wells on the ocean floor (Broder, 2011).

These findings only gave further grounds to those who filed lawsuits on behalf of their killed or injured family members.

The environmental impact the oil spill had was enormous, harming coastlines, wildlife, and wetlands (Goguen, 2015). The harm done to these areas prompted lawsuits that needed to be estimated (Goguen, 2015). It also prompted the probability of payment of government-imposed fines by BP for the damage done to the environment (Goguen, 2015). These also would need to be estimated.

Individuals and business owners also had grounds to sue for property damage resulting from the oil spillage (Goguen, 2015). These damages were primarily to properties located on the coastline where the physical oil had direct contact with the property. Property damages were also caused by the chemicals used in the cleanup efforts after the spill had occurred (Goguen, 2015).

BP would also need to estimate any suits resulting from the cleanup efforts which involved harsh chemicals. These chemicals as well as the oil itself contributed to health issues for local residents of the areas directly impacted by the spill (Goguen, 2015). These suits would be considered probable and estimable.

Finally, it would not be unreasonable for BP to anticipate potential suits from their stockholders as their stock prices fell drastically due the incident that could have been avoided and was determined to be primarily due to poor decisions on the part of BP (Goguen, 2015). At the very least it would be reasonable to estimate the negative impacts on BP’s stocks and total equity due to this disaster.

As an accountant, it would be reasonable to determine which of these cases would result in losses by determining which could prove that their damages were caused directly by the BP oil spill. This may be done by researching decisions made in courts in similar cases in history and how they were settled and the methods of proof used to show that the oil spill had been a direct cause of damages in those cases. It may also be worth noting that BP was not the only party involved in this disaster. The companies Transocean, rig owner; Halliburton, well contractor; and Cameron International, the manufacturer of one of the defective parts in the spill, were also involved (Goguen, 2015, para. 11). It may be necessary to estimate what portion of the claim value should be their responsibility. The Justice Department could also sue BP for environmental crimes (Broder, 2011). It may be necessary to estimate these claims. Additionally, it would be necessary for an accountant to consider the likelihood that investigations would determine BP's negligence played a role in the disaster. If negligence is proven, then this could impact estimations of claims that will result in payments by BP, making it reasonable for accountants' contingency estimates to be larger. Negligence could be proven by investigations looking into the safety policies of both BP and their processes for vetting which manufacturers and third-party companies they used in their operations and also by obtaining internal communications from BP to scan for anything incriminating regarding negligence.

Case 7: The Wendy's Company – Equity Method Investments

Introduction

This analysis pertains to the case, "The Wendy's Company – Equity Method Investments". This case focused on the utilization of the equity method of recording equity investments. Specifically, this case used the scenerio of a joint-venture between two companies to analyze this method and the implications it has on the financial statements. This case was meant to provide a deeper understanding about why companies enter into joint-ventures, the equity method of recording equity investments, and using that understanding to identify related items on Wendy's financial statements and interpret their meanings. This case gave me a much greater understanding of the process of recording an investment when a company purchases ownership in another company. Before this case, the only element of this process that I had any exposure to was the concept of goodwill. This case taught me that the excess of purchase price over the book value of an investee's net assets is not always all recorded as goodwill. It also forced me to mentally connect the entries required under the equity method of accounting for an investment to resulting items on a company's financial statements. In addition, this case showed me for the first time how critical notes to the financial statements can be to gaining useful information. This case will help me in my future career by providing me with an example of a real-world application and presentation of a common financial statement item. It is important for my comfort with such items to grow in order to allow me to handle them to the best of my abilities once I reach my professional career. Having such in-depth exposure that goes beyond what may be possible to provide in a textbook is truly a valuable opportunity which accounting students at any level can benefit from.

Concepts

***Please note that all non-specified amounts mentioned in this case are in thousands of dollars. All information discussed herein was provided within the case materials unless otherwise cited.**

a. In general, why do companies enter into joint-venture agreements?

Joint ventures offer an alternative to a business acquisition or merger. Companies enter into joint ventures for the advantages they offer. These advantages include access to resources of the other firm such as human capital, knowledge, or technology, increased profits if the joint venture is successful, more flexibility vs. a merger or acquisition, the ability of participating companies to maintain control over their businesses, and the ability to share risk.

b. Consistent with U.S. GAAP, Wendy's uses the equity method to account for its joint venture in TimWen. Briefly explain this accounting method. In your answer, be sure to comment on how the investing company accounts for its initial investment and any subsequent income and dividend activity of its investee.

According to GAAP, the equity method of accounting for equity investments must be used by an investor when they possess significant influence over the company in which they have invested. Under the equity method, the investor records the initial investment at its cost, by debiting the "Equity Investments" account and crediting the "Cash" account. The investor is then required to adjust this amount every period based on changes in the net assets of the company they have invested in. Specifically, this means the following: If the investee reports net income for a particular period, the investor increases the carrying value of the investment and records income in an amount equal to the net income of the investee for that period multiplied by the percentage of ownership the investor possesses. If the investee reports a net loss for the period, the investor decreases the carrying value of the investment and records an investment loss in the amount of the net loss for the period multiplied by the percentage of ownership the investor possesses. If the investee pays out a dividend, this is treated as a decrease in the value of the investment, and the investor increases cash and decreases the carrying value of the investment by the amount of the dividend multiplied by the percentage of ownership the investor possesses. No entries are ever made to mark the investment to fair value under the equity method. This approach is used due to the implications created by the significant influence the investor holds over the investee in the relationship. This relationship indicates that the investor should recognize that net income earned by the investee increases the value of the investor's investment, and dividends being paid out and net losses by the investee decreases the value of the investor's investment in the company. If the investor did not possess significant influence over the investee, then it would be appropriate to use another accounting treatment for the investment other than the equity method.

c. When a company purchases shares (ownership) in another company, the investment amount may exceed their share of the book value of the underlying net assets of the investee. How does the investing company account for this excess amount under the equity method?

The excess amount is known as an acquisition accounting premium and should be distinguished into two separate pieces for accounting purposes. One portion of the excess amount should be separately recorded as goodwill, if any exists. Goodwill is an intangible asset. By definition, it is the excess of the amount paid for a company's assets over the value of the net identifiable assets of the company that is purchased. Goodwill represents items of value that an investor believes they are obtaining by investing in another company but that may not be recorded on the books of the investee. These items might include such assets as human capital. The portion of the excess that is distinguished as goodwill should be recorded as such on the investor's books. Once recorded, goodwill is not amortized but is tested annually for impairment. The other portion of the excess amount not considered goodwill is called a write-up. The write-up is allocated to the assets and liabilities of the investee by the investor in order to adjust their book values to fair market value. This process does not affect the book values of the investee's liabilities and assets on the investee's actual books. Therefore, the amount that is allocated to assets is not depreciated by the investee because, again, in reality it does not exist on the books of the investee. The investor, however, makes an annual charge to record depreciation and amortization on the written up values within the equity investment account.

Analysis

d. Consider the information in Note 8. What amount did Wendy's include on its 2012 and 2011 balance sheets for their equity method investments? Where does this appear on Wendy's consolidated balance sheet?

For their equity investment in TimWen, Wendy's included $91,742 on their balance sheet in 2011 and $89,370 on their balance sheet in 2012. A second equity investment Wendy's has listed on their balance sheet represents a joint venture Wendy's is involved in with a company in Japan. This equity investment included $77 on their balance sheet in 2011 and -$1,750, representing a loss, on their balance sheet in 2012. All of this appears in the "Investments" account on Wendy's balance sheet with the exception of the effects of the negative balance in the investment account for the Japan joint venture in 2012. This amount was included in the "Other Liabilities" account on the balance sheet in 2012.

e. Using information in Note 8, compare the amount recorded for Wendy's investment in TimWen at December 30, 2012 with Wendy's 50% share of TimWen's equity at December 30, 2012. What accounts for the difference between these two amounts?

The amount recorded for Wendy's investment in TimWen at December 30, 2012, was $89,370. From the information given in Note 8, however, it can be determined that Wendy's 50 percent share of TimWen's equity at December 30, 2012, was $35,283. This information was determined using the 2012 year-end balance of "Parent's equity" given in Note 8 of $70,565, which represents 100 percent of TimWen's equity for the year 2012. Because Wendy's has a 50 percent ownership stake in TimWen, 50 percent of the total equity of TimWen belongs to Wendy's. This yields a total of $35,283 as Wendy's share of TimWen's equity at December 30, 2012. Wendy's recorded $89,370 for their investment in TimWen and had a share of TimWen's equity equal to $35,283 at December 30, 2012, showing a $54,087 difference between the two amounts. This difference represents the acquisition accounting premium, as mentioned in the response to question c, or the excess of purchase price paid by Wendy's over the value recorded for net assets on TimWen's books.

f. Consider the information disclosed in Note 8 regarding Wendy's investment in the TimWen Joint Venture.

i. How did Wendy's equity method investment in TimWen affect their earnings before taxes in 2012 and 2011? Where does this appear in Wendy's consolidated statements of operations?

In 2011, Wendy's equity method investment in TimWen resulted in $10,571 of equity income for Wendy's, increasing their earnings before taxes. In 2012, the same situation occurred in the amount of $10,551. This is included in "Other operating expense, net" on Wendy's consolidated statements of operations.

ii. Prepare the journal entry to record Wendy's share of TimWen's 2012 earnings.

Equity Investment	13,680	
Equity Income		13,680

iii. What is the amount of the amortization of the purchase price adjustments in 2012? Prepare the journal entry to record the amortization of the purchase price adjustments for 2012.

The amount of the amortization of the purchase price adjustment in 2012 is $3,129. This can be found in Note 8 in "Amortization of purchase price adjustments". The journal entry to record amortization of the purchase price adjustments for 2012 is below.

Equity Income	3,129		
	Equity Investment		3,129

iv. What amount of dividends did Wendy's receive from the TimWen joint venture in 2012 and 2011? Prepare the journal entry to record the receipt of dividends from TimWen for 2012.

Wendy's received from the TimWen joint venture dividends of $15,274 and $14,942 in 2012 and 2011, respectively. The journal entry to record the receipt of dividends from TimWen in 2012 is below.

Cash	15,274		
	Equity Investment		15,274

g. Consider the information in the statement of cash flows.

i. The operating activities section of the statement of cash flows reports a negative adjustment for "Equity in earnings in joint ventures, net" of $8,724 in 2012. Reconcile this amount to the information disclosed in Note 8. Explain why a negative adjustment is made to arrive at net cash from operating activities.

The amount of $8,724 is the net amount of the equity earnings from investments for 2012. This number includes $10,551 of equity in earnings for the period from the TimWen investment and $1,827 of equity in losses for the period from the Japan investment, which net to $8,724. These values can be found in Note 8 of the financial statements. Because this equity in earnings from equity investments is considered income, it increases net income for the period. This element of net income, however, does not involve the actual exchange of cash. Therefore, it does not represent an actual cash inflow and must be subtracted in order to not misleadingly appear to be an actual inflow of cash on the cash flows statement.

ii. The operating section also reports a positive adjustment for "Distributions received from joint venture" of $15,274 in 2012. Reconcile this amount to the information disclosed in Note 8. Explain why a positive adjustment is made to arrive at net cash from operating activities.

This amount of $15,274 is equal to the actual amount of dividends paid to Wendy's by TimWen during 2012. This amount can be found in Note 8 to the financial statements listed as "Distributions received". A positive adjustment is made to arrive at net cash from operating activities because the receipt of dividends by Wendy's did involve an actual receipt of cash. This can be observed in the general journal entry to record the receipt of dividends shown below. Therefore, it must be treated as an actual inflow of cash and added to the cash from operating activities.

Cash	XXX	
Equity Investment		XXX

Case 8: Johnson & Johnson – Retirement Obligations

Introduction

This analysis pertains to the case, "Johnson & Johnson – Retirement Obligations". Its primary purpose is to assess pension obligation plans including the different types of plans, the assumptions that are involved in creating them, how they are accounted for in the financial statements, and the different activities that impact the pension obligations of employers. This case is also meant to inform readers about how a pension plan works from a financial standpoint and to explain the different entities involved in creating, distributing, and maintaining the funds necessary for a pension plan.

This case taught me exactly how the pension plan is utilized in practice. It also helped me to see first-hand the financial implications pension plans can have for companies. Most importantly, this case helped me to understand exactly how pension plans are presented on companies' financial statements. While much of the information pertaining to pension plans can be found on the face of the financial statements themselves, a great deal of the most relevant information for this financial statement item is located within the notes to the financial statements. Possibly the most important learning opportunity of this case was its emphasis on the value of the notes to the financial statements and how to use these notes in conjunction with the financial statements to understand the full picture of a company's financial position. Moving forward in my career, these skills will undoubtedly be valuable to me as I work with companies' financial statements.

Concepts

***Please note that all non-specified amounts mentioned in this case are in millions of dollars. All information discussed herein was provided within the case materials unless otherwise cited.**

a. There are two general types of retirement (i.e. pension) plans—defined benefit plans and defined contribution plans.

i. How do these two types of plans differ? Which type does Johnson & Johnson have?

A defined benefit plan details the benefits that an employee will receive upon their retirement. It does not set a specified formula or amount that the employer must contribute to the plan every period. As long as the employer contributes enough over time that the end benefit is the amount that was detailed in the pension plan, it does not matter how much they contribute each period. A defined contribution plan details the amounts that an employer will contribute to the fund each period. This is usually based on a formula, and as long as the employer makes their promised contributions to the plan each period, they have fulfilled their obligation. The end benefit is not set at a certain amount. Johnson & Johnson has both defined contribution and defined benefit plans.

ii. Explain why retirement plan obligations are liabilities.

They are liabilities because they represent an obligation that the employer owes to provide contributions in the form of money to a pension fund so that the pension fund may invest and properly manage those monetary contributions and then pay employees the amount of retirement money that was agreed upon in the employee's pension agreement contract. If the employer does not contribute enough money to the pension fund entity for the fund to pay the contractually defined amount of employees' pension plans, then the employer is still seen as the responsible party for providing the funds, not the pension fund. This is the same whether the plan is a defined benefit or a defined contribution plan.

iii. List some of the assumptions that are necessary in order to account for retirement plan obligations.

Many of the assumptions that go into pension accounting are known as actuarial assumptions. An actuary is a professional that is trained to assign probabilities to future events. Financial plans, such as pension plans, are created based on the probabilities of these future events. Actuarial assumptions pertaining to a retirement plan obligation would include assumptions about how long employees will live, employee turnover rates, interest rates, earning rates, future salaries, and frequency of early retirement.

iv. Figure 7 is a flow chart representing the flow of cash between the entities involved in a pension plan. The arrows indicate the direction of cash flows. Because the employee can contribute to the pension fund as well as receive benefit payments from it, an arrow in both directions was included between these two entities.

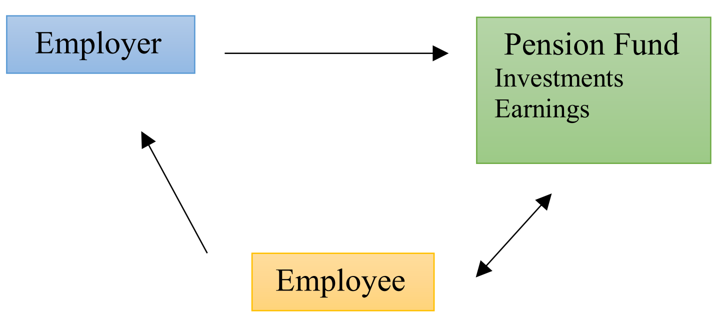


Figure 7: Flowchart of Pension Process

b. In general, companies' pension obligations are influenced each year by four main types of activities: service cost, interest cost, actuarial gains or losses, and benefits paid to retirees. Explain each of the four activities in your own words.

Service cost is the increase in the projected benefit obligation due to employees rendering their services during the current year. In other words, it is the addition to the cost of the pension for the employer because of an additional year of employees' services. As with any other liability that is to be paid over time, the pension obligation accrues interest. This interest is added to the cost of the pension liability and is known as interest cost. Actuarial gains or losses are those gains, reductions in the pension obligation, or losses, increases in the pension obligation, that result due to changes in the actuarial assumptions used to create the plan. Benefits paid to retirees involves the pension fund actually distributing cash payments to retired employees of the employer. Service cost and interest cost increase the pension obligation, benefits paid decreases the pension obligation, and actuarial gains or losses may do either.

c. In general, companies' pension assets are influenced each year by three main types of activities: actual return on pension investments, company contributions to the plan, and benefits paid to retirees. Explain each of the three items in your own words.

Actual return on pension investments refers to the return that the pension fund earns from investing the contributions from the employer. This differs from the expected return on pension investments, which is calculated based on an expected rate, not the actual rate, of return and the beginning balance of pension assets for the period. Company contributions to the plan are the cash payments that the employer pays to the pension fund. The company expects the fund to invest these payments wisely and earn a return on them to pay benefits to retiring employees. Benefits paid to retirees are the actual distributions of cash payments to retired employees of the employer.

d. In general, companies' pension expense and pension plan assets both have a "return on plan assets" component. How do the two returns differ? Explain the rationale for this difference.

The pension expense is calculated using the expected return on plan assets, not the actual return on plan assets. This is calculated using an expected rate of return provided by an actuary. The pension expense for the company is therefore reduced by the amount of the expected return on plan assets. The pension plan assets, however, are impacted by the actual return on plan assets, which increases the plan assets. This is the true amount of return that the investments of the pension fund generated during the period, not an expected or estimated amount. This method was adopted in order to reduce the effects that the potentially volatile actual return may have on pension expense for the employer and, consequently, on the net income of the employer. By using a less volatile expected rate of return and including the difference between the expected and the actual rate of return as a gain or loss and holding it as a component of other comprehensive income, the volatility impacting net income is reduced.

Process

f. Consider Johnson & Johnson's pension expense detailed on page 61 of the company's annual report. Note that the company uses the term "net periodic benefit cost" to refer to pension expense.

i. How much pension expense did Johnson & Johnson report on its 2007 income statement?

In 2007 Johnson & Johnson reported $646 million of pension expense on its income statement.

ii. Prepare the journal entry to record the service cost and interest cost portion of the 2007 pension expense.

Pension Expense	1,253	
Projected Benefit Obligation		1,253

g. Consider Johnson & Johnson's retirement plan obligation, that is, the pension liability, as detailed on page 62 of the company's annual report.

i. What is the value at December 31, 2007, of the company's retirement plan obligation? What does this value represent? How reliable is this number?

The value of the company's retirement plan obligation at December 31, 2007 was $12,002. This value represents the money that the company currently owes and will have to pay to fund the pension fund in order for employees to receive their benefits upon retirement. This number is somewhat reliable; however, it may change if actuarial assumptions change.

ii. What is the pension-related interest cost for the year? Compute the average interest rate the company must have used to calculate interest cost during 2007. Does this rate seem reasonable? Explain.

The pension-related interest cost for the year was $656 million. The average interest rate the company must have used was 5.62 percent. This can be found by dividing the interest cost for the year by the beginning projected benefit obligation of $11,674. Yes, when compared to the average interest rate of international benefit plans of 5.5 percent and the average interest rate of U.S. benefit plans of 6.5 percent, Johnson & Johnson's interest rate seems reasonable.

iii. What amount of pension benefits were paid to retirees during the year? Did Johnson and Johnson pay cash for these benefits? How do the benefits paid affect the retirement plan obligation and the retirement plan assets?

During the year, $481 million of pension benefits were paid to retirees. No, Johnson & Johnson did not pay cash for these benefits. The pension fund pays these benefits, not Johnson & Johnson. The payment of benefits decreases the retirement plan obligation and also decrease the plan assets.

h. Consider Johnson & Johnson' retirement plan assets that is, the pension plan asset, as detailed on page 62 of the company's annual report.

i. What is the value at December 31, 2007, of the retirement plan assets held by Johnson & Johnson's retirement plan? What "value" is this?

The value of the retirement plan assets held by Johnson & Johnson's retirement plan is $10,469 million. This is the value of the cash, investments, and earnings that the pension fund entity has accumulated. These assets do not belong to the employer and are not recorded as assets on the employer's books.

ii. Compare the amount of the expected return on plan assets to the amount of the actual return during 2006 and 2007. Are these differences significant? In your opinion, which return better reflects the economics of the company's pension expense?

The actual return on plan assets during 2006 was $966 million, and the expected return was $701 million. The actual return on plan assets during 2007 was $743 million, and the expected return on plan assets was $809 million. These differences are significant. This shows that in 2006, there was an unexpected gain because the actual return was greater than expected, but in 2007, there was an unexpected loss because the actual return was less than expected. It also shows a large decrease in the return that the plan assets were able to generate from one year to the next, indicating a potential negative economic trend or that the pension fund is not managing their funds well. I think that the actual return better reflects the economics of the company's pension expense because this amount shows the real impact that the economy has on how much the employer must pay for their pension plan.

iii. How much did Johnson & Johnson and their employees contribute to the retirement plan during 2007? How does that compare to contributions in 2006?

During 2007, the total contributions to the retirement plan from Johnson & Johnson and their employees was $379 million, with $317 coming from the company and the other $62 coming from plan participants. These values were higher for both parties than in 2006, with company contributions increasing by approximately 24 percent and employee contributions increasing by approximately 32 percent.

iv. What types of investments are in Johnson & Johnson's retirement plan assets?

Johnson & Johnson's retirement plan assets include debt and equity securities.

i. Is the company's retirement plan under funded or over funded at December 31, 2007? At December 31, 2006? Where does this funded status appear on the company's balance sheet?

The company's retirement plan is underfunded by $1,533 at December 31, 2007 and also at December 31, 2006 by $2,122. This funded status appears in the notes five and thirteen and are listed as "Employee related obligations" under non-current liabilities.

Case 9: A Discussion of On the Balance Sheet-Based Model of Financial Reporting

Introduction

The goal of this case study analysis was to present a different perspective of financial accounting than the typical case study and academic lesson in order to allow readers to analyze elements of financial accounting on the system level as opposed to the detailed entry level or even the financial statement level. This case was also meant to introduce the considerations that must be debated and analyzed when changes must be made to the conceptual framework. This case also encourages readers to apply those considerations on a personal level and consider the impact that such potential changes could have on the professional lives of many people. This case prompted me to consider accounting from a system level. As a student, learning often requires me to focus on details and learn individual processes in order to gain understanding, but these are very small components of a much grander system. It was a vastly different experience considering accounting from this perspective. From this case, I learned how intensely difficult it is to set standards and revise them in order to try and best represent financial information. I believe that this is due to the extreme complexity of the system of financial accounting, however, I also think that this complexity is what makes financial accounting so fascinating. I was happy to learn about a current issue in the world of accounting that could have very real consequences for me as I progress through my professional life. This case also pointed out to me some potential flaws with the methods of financial accounting that are currently used that I never would have questioned before. Having the opportunity to see how certain methods are questioned is often the best way for me to learn how to think critically about a subject, and I think that was the result here. This case was also meant to challenge readers to consider how the information presented in the paper could be relevant to scenarios in future careers.

Summary of *On the Balance Sheet-Based Model of Financial Reporting*

The following is a summary of the paper *On the Balance Sheet-Based Model of Financial Reporting* (2007) by Ilia D. Dichev and Stephen Penman published by the Center for Excellence in Accounting and Security Analysis of Columbia Business School. The full citation for this item may be found in the case reference list.

The paper *On the Balance Sheet-Based Model of Financial Reporting* discusses the current efforts of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to re-assess their conceptual frameworks, which currently differ from one another. This review was prompted by the Boards' desire to eventually bring together the two main systems of accounting in order to create a single, cohesive system of accounting standards to be used around the world. The paper points out that the two Boards recognize that this goal is not feasible without their agreement on a conceptual foundation. However, the authors argue that this re-consideration is lacking because it does not incorporate a review of the balance-sheet orientation of the framework and that this could lead to an outcome that is harmful to accounting as a whole. Furthermore, the authors present the argument that the income-statement approach to financial accounting is a more accurate basis for accounting than the balance-sheet approach and that if the Boards ignore this element in their reassessment, it will likely lead to faulty accounting, regardless of what other positive characteristics the rest of the resulting financial reporting model might have (Dichev & Penman, 2007).

The argument begins with an explanation of the balance sheet and the income statement approaches to accounting. The balance sheet-based approach considers placing correct values on assets and liabilities as financial reporting's main objective and treats the determination of other accounting variables as less important and as if they are byproducts of other valuations. Therefore, the balance sheet-based approach suggests that income statement amounts, particularly earnings, is controlled by decisions and items on the balance sheet.

Essentially, this view dictates that earnings is just the change in net assets (assets less liabilities) for a period and that earnings is therefore dictated by correctly deducing the values of assets and liabilities for an entity. Alternatively, the income statement approach treats proper deduction of revenues, expenses, and earnings as the objective of financial reporting, meaning that the focus is placed on correct timing and size of revenues and expenses. This results in balance sheet items being seen as peripheral. The objective of accounting itself is to properly reflect accruals, which report accurately the timing of revenues and the expenses connected to those revenues. The authors state that the balance sheet accounts are primarily the residual of such matching, making assets and liabilities the result of accruals. The authors suggest that this can be better understood by considering that accounts receivable, which is an asset on the balance sheet, comes to exist because revenue is recorded before the actual receipt of a payment (Dichev & Penman, 2007).

In the past, the income statement view was more widely used in accounting, and it was not until the 1970's that the balance sheet view gained prominence with the creation and establishment of the FASB as the official authority for creating standards in the United States. The FASB chose the balance sheet approach primarily because they felt it was conceptually better than the income statement approach. Their reasoning was that if earnings is based on a change in value, then there must be a definition for value before earnings can be determined, which led to the conclusion that it was reasonable for assets and liabilities to be deduced before earnings, indicating that the balance sheet approach as being correct. Additionally, the FASB reasoned that use of the income statement approach may not be sound on a conceptual level because of its reliance on the imprecise, potentially unspecific matching principle and because it indirectly gives rise to less dependable values of assets and liabilities. Ever since this change, efforts have been made to strengthen the balance sheet approach through the establishment of reformed rules and the progression towards incorporating a more complete balance sheet approach, such as with the implementation of "fair value" accounting, which uses market prices as a basis for accounting. Today the balance sheet approach is the primary accounting approach around the world, with both the IASB and the FASB being committed to this approach. The paper states that in 2006, the FASB issued Preliminary Views, a document which presented support of the balance sheet approach and a decreasing view of the importance of earnings (Dichev & Penman, 2007).

The authors state that the changes indicated in this document reveal a need to present a critique of the balance sheet-based model of financial reporting and to, through this critique, exhibit why it will be harmful for the two Boards to conduct their re-consideration without incorporating a re-assessment of the balance-sheet orientation of the conceptual framework.

The authors argue that the balance sheet approach to accounting is flawed for four reasons. Firstly, the balance sheet approach goes against how most entities operate, create value, and are managed. The majority of firms attempt to generate revenue through the process of advancing expenses. Most assets, therefore, simply serve as tools that are used in company operations and do not have much value outside of the operations. Instead of being entities that accumulate and grow assets and then measure earnings based on the growth of the assets, companies generate earnings by giving up or altering their assets in some way. The balance sheet, by contrast, gives the impression that there is continually a supply of assets when in reality the assets exist because of the endless using and changing of assets to generate earnings. The authors assert that this idea can be exemplified by using the example of companies that operate one project at a time. In these scenarios the company can only generate value if they make sure that the revenues generated by a project is more than the costs associated with that project (the advanced expense required to perform the project) to create an acceptable margin. This point does not only apply to companies that operate one project at a time, as the majority of firms have both continual and project-based business. This is also relative to the time over which the business operations are being considered, as even a business endeavor with smaller, internal subunits can be considered an individual project when the time horizon over which it is observed increases. Even the whole firm is a one-time project when it is examined over its lifetime. When the firm is finished, all of the assets it was in possession of are disposed of in some way, and the only enduring consequence that the firm leaves behind, according to the paper, is the amount of revenues, expenses, and earnings it generated. Considering that assets are a peripheral element to firms' advancing expenses to generate revenue, it stands to reason that accounting would go along with this operation method; This supports that the income statement approach is the more realistic approach (Dichev & Penman, 2007).

The income statement approach more accurately reflects the operations of wealth creation, which is critical as this is traced by the system of accounting. The authors also assert that the fact that managers run their businesses by an income statement approach, using predictions of sales and expenses to make decisions, is further evidence that the income statement approach is superior to the balance sheet approach. The authors state that when considering whether or not to undertake new projects, managers would consider first the total costs associated with the endeavor, the resulting revenue, and if there will be large enough earnings to go through with the project. They would not consider accumulations of assets themselves in a new project as the origin of value from the project. To go along with this theme, the authors also mention that the principal users of the financial statements, investors, also use income statement information to make decisions. Even financial analysts will create some form of forecasted income statement when evaluating a company (Dichev & Penman, 2007).

To summarize this point, the authors state that the problem with balance sheet accounting discussed here is that it treats assets as cells of held value that are strictly separate from the actual activities and actions of the firm, removing focus from firm operations, where firm value is actually created. The income statement approach, however, does concentrate on the operations of a firm and the idea that the value of a firm is the product of employing resources (assets) to conduct business and generate earnings. The value of a firm's assets come from their use, not from their holding or disposal. This idea was supported in the paper by analyzing the ratio of Property, Plant, and Equipment (PPE) sales to depreciation and also to the level of PPE that firms held. In these observations, sales of PPE, which represent assets for external purposes, was found to be significantly less than depreciation or level of PPE, which represent assets for internal purposes, totaling only small percentages respectively. This not only challenges the accuracy of accounting for PPE at fair value, as fair value is not relevant for the vast majoring of PPE and can cause more earnings volatility, but also shows that sales and market values of PPE are secondary to the firm and that the business is more concerned with the use of PPE within the business. Accounting for these assets needs to accurately represent this. The income statement approach is therefore appropriate for the accounting of such assets for nearly all firms (Dichev & Penman, 2007).

The second reason that the authors presented is the lack of clarity regarding what makes the balance sheet approach conceptually better than the income statement approach. The FASB believes in and supports the conceptual superiority of the balance sheet approach because, according to Dichev and Penman (2007), "earnings is a change in value, and one cannot define a change in value before establishing what value is, and that leads to asset and balance sheet-based accounting" (p. 15). However, the authors address that the definition of an asset is a probable future economic benefit, where benefits in truth indicates net benefits, meaning that the FASB employs circular reasoning here, stating that in order to define earnings, assets must be defined first, but they then define assets in terms of earnings. In reality, if there is income, there must be an asset that is responsible for generating it. This means that the conceptual superiority of the balance sheet approach has not been firmly established. It may even be possible to say that the idea of income is conceptually superior as income is a widely clear concept while assets are not. This issue has grown with the increase in intangible assets, which have a derived value. Furthermore, income is used to derive this value (Dichev & Penman, 2007).

The third reason given by Dichev and Penman (2007) is that, "Balance sheet accounting is likely a major contributor to the substantial temporal decline in the forward-looking usefulness of earnings" (p. 16). Investors use earnings for evaluating investments. The degree of usefulness of earnings to an investor is based on the continuity and predictive quality of the earnings, and the view that promotes these types of earnings is the income statement view. According to the balance sheet approach, earnings is the same as changes in net assets, indicating a poor degree of continuity and predictive quality. This is worsened by the volatility injected into earnings by the mark-to-market accounting supported under the balance sheet approach. Dichev and Penman (2007) stated that, "comparable earnings volatility has more than doubled" over a 40-year period, and earnings persistence has decreased (p.17). Therefore, the balance sheet approach leads to earnings that investors do not view as useful. Due to the utilization of the balance sheet method, there has also been a weakening in the relationship between stock prices and earnings. The authors include that research has already begun to show that the balance sheet approach has caused a reduction in the predictive quality of earnings. If earnings becomes a meaningless number for predictive information, there are a number of negative consequences that would follow including that the value of accounting itself may be put in danger, investors may begin to use more non-GAAP sources for their information, and there may be an increase between sophisticated and unsophisticated investors due to the ability of sophisticated investors to expend more resources to obtain useful earnings information than unsophisticated investors, widening the gap between the two (Dichev & Penman, 2007).

Finally, the fourth reason mentioned by Dichev and Penman (2007) is that, "There are substantial problems with applying the balance sheet-based model of accounting in practice" (p.18). This can be most evidently seen in the excessive estimates and judgments involved in the balance sheet approach. This can lead to inaccurate representations of financial information; the authors give the example of the Enron scandal. In addition to this issue, another consideration is that balance sheet-based accounting, "creates a feedback loop between financial markets and the real economy, and may possibly lead to or exacerbate market bubbles" (Dichev & Penman, 2007, p. 19). This is due to the resulting unsafe degree of confidence in the accuracy of market prices. The paper asserts that accounting should instead realize that the real economy is different from the financial market realm, which involves informed guesses about values. Failure to exhibit the real economic actions of a firm can diminish the usefulness of accounting (Dichev & Penman, 2007).

The author ends the paper by providing some proposed solutions for an improved conceptual framework. The alternative model for a framework should include understandable differentiations between operating and financing activities. Operating activities should be defined as the activities involving assets that mainly function to increase internal activities of the business and that have little value as individual value cells. Financing activities, however, are assets and liabilities that can be distinguished from the business and have values not reliant on the wealth of the firm. In addition to this, operating and financing assets and activities should be evident in the financial statement. This is key to being able to identify earnings from operating activities, which are very continuous and predictive, and those from financing activities, which do not possess such qualities. This would make statements more useful to those using them. The balance sheet should also make this distinction and separate assets from operating and financing activities due to their differences. One such possible designation scheme would be value-in-use versus value-in-exchange assets, typically operating and financing respectively. The second feature would be emphasis on the matching and revenue recognition principles. This could help the accounting reflect the economics of the company. The paper argues that revenue recognition and matching should be the basis for operating activity accounting (Dichev & Penman, 2007).

2) How did reading this paper change your current way of thinking?

Before reading this paper, I was beginning to understand that accounting is more than just many individual, distantly related calculations and methods that had been chosen by a group of standard setters for different, specific situations. I was beginning to see it more as an incredibly large, complex, and interconnected system with components that somehow seem to work together and function to provide an effective, accurate, and meaningful method of recording financial information. To me, this was an amazing realization because this system of accounting for financial transactions was created to accomplish an extremely difficult task of keeping record of every transaction an economic entity takes part in. Not only does it accomplish this huge task, but it also goes a step further and provides us with information that allows us to place values on the economic entities themselves, to value businesses. To me, this is what makes accounting so impressive and unbelievably valuable. Not only is it valuable to the business itself for internal purposes, but it is valuable to those outside of the company who want to understand what the company is worth and what the company will most likely be worth in the future so that they can invest their money wisely and enter into a mutually beneficial relationship. This not only plays a part in the prosperity of those involved directly in the relationship but also plays a part in driving the overall economy.

It was my belief before reading this paper that the greatest importance of presenting accurate and useful financial statements as accountants was in the value that they provide to investors. After reading the paper, I think that this has been affirmed even more for me, however, I realize now that the financial statement information may not be as useful as I thought it was in its current and potential future methods of presentation. The paper made a point several times to discuss the usefulness of earnings to investors. It genuinely concerned me that the usefulness of earnings to investors appears to be going down according to research findings. Because this is the most important reason for creating and issuing financial statements, in my opinion, I think that something needs to be done about the current method of accounting that is leading to these problems. I wonder if accountants would be seen as less valuable should the financial statements become less useful to investors. The paper did make me wonder if companies will begin to no longer see accountants as the providers of value that they are now. I think that the FASB should consider this when making their decisions. While the problem may not be too large to ignore currently, it could become that way at an increasing rate should they continue to push for the strictly balance sheet approach to financial accounting.

This paper also made me realize that accounting has more flaws than I realized before reading the paper. I think that as a student, it can be easy to accept what you are told when you are studying a subject and not question it, but as I read this paper, ideas and questions were presented to me that made me wonder why I had never stopped to ask the same questions I was reading. Because of this, one of the biggest impacts that reading this paper had on my way of thinking was to prompt me to make a conscious effort to look for the connections between pieces of information when they are not obvious. This paper made it clear that those pieces of information can be influential to very important decisions.

Finally, this paper made me think about the very basis of accounting in an entirely new way. I had never considered that earnings under the current method of accounting is treated more as a product of assets and liabilities rather than as its own entity, but after reading that information and considering it, I realized that with what I currently know, I feel it is true. I also understand why it is rational to value some assets at fair value but not others depending on how they are used in the company. This made me wonder why we capitalize PPE at fair value. If the PPE is going to be used entirely for operating purposes, I can understand why it may not be logical to value it at what it could sell for. Furthermore, I have never considered that there could be two "views" of accounting, one based on assets, and one based on earnings. I think that this is going to change the way that I learn accounting going forward because I now have two different views to which I can compare new information that I learn.

3) How will you use this information in your future career? Be thoughtful and creative about the situations you will encounter where this paper will affect your beliefs and the way you carry out your future job.

In my future career, I think that this information will allow me to better understand financial statements and their relationship to the true performance of a company. I also think that if the standards change as the paper suggests and become even more extremely balance sheet-based, then I will have an understanding and ability to learn the changes more quickly than my fellow co-workers because of this exposure to these ideas.

Should I ever be given the ability to comment on a document issued by the FASB for feedback, such as the Preliminary Views, in my future, I think that the information I read in the paper would help me prepare for that task. I also think that after reading the paper I would be more likely to have developed my own opinion on the topic and would be more comfortable speaking out about it after understanding that the FASB fully supports a basis that, from the paper, I do not know that I would be willing to totally support.

I also believe that if I am ever able to fill a consulting role for a company or individual, the information I learned in this case will allow me to better serve as their consultant because, if the changes actually take place sometime in the future, I would already have a basic understanding of the changes and be able to advise my clients as effectively as possible and educate them on the changes as quickly as possible.

I may also be able to help better explain the actual performance of economic entities to potential and present investors should the quality of earnings for investor decisions continue to decrease. Because I believe this to be one of the most important uses of financial statements and of the work that accountants do, I think that this would be an element of my job that I would take the most pride in. As indicated in the paper, the usefulness and quality of earnings has an impact not only on individual businesses and investors but also on the state of the economy as a whole. I believe it would become the role of accountants to bridge the gap that would be created between what investors need to know and what the financial statements provide.

Finally, I think that if the changes mentioned in the paper are carried out, then audits will also change to become more focused on the balance sheet and have less focus on the income statement. I think this because if assets and liabilities become more strictly the things from which revenues, expenses, and earnings are derived, then it would make sense to first ensure that a company's assets and liabilities are correct. Knowing the information from this case will allow me to be more aware of the benefits and the downsides of using this approach to audits.

Case 10: Google Inc. – Earnings Announcements and Information Environment

Introduction

This case focuses on the company Google regarding the information that they include on their financial statements, its usefulness to investors, Google's relationship with investors and the effects that their relationships have on stock price, and Google's use of press releases to influence investors. The general idea of this case is how Google uses multiple tools such as non-GAAP measures and press releases to indicate to its investors how the company is actually performing. The recurring theme seems to be Google's desire to ensure that they are sharing as much relevant information with their investors as possible because uncertainty would create risk, an undesirable outcome in the eyes of investors. Google accomplishes this primarily through the presentation of non-GAAP financial measures for investor consideration. These measures are meant to provide investors with an understanding of the core business operations of Google that is as strong as possible. While these non-GAAP financial measures may be calculated in different ways depending on the company that is using them, they must always be accompanied by a reconciliation showing how the non-GAAP financial measure compares to the most comparable GAAP financial measure. This is also helpful for investors, as it provides a way for them to determine if the non-GAAP financial measure is actually calculated in a way that makes it useful. This is meant to help investors make the best decisions possible when deciding where to invest their resources, and research has indicated that the use of non-GAAP measures has provided investors with better indications of future cash flows and earnings. This case also discusses how Google utilizes press releases to keep investors informed on information that may not necessarily be available on the financial statements. This information can include rationalizations for activities in the company that caused certain numbers to behave the way they have as well as information on steps that the company is taking to combat any general trends occurring at the time that may affect the company's business in either a negative or positive manner. This case taught me not only about the existence and usefulness of non-GAAP financial statements, but also where to look to determine if these measures have been calculated in a reasonable and responsible way. This case made me aware not only of the pros of non-GAAP financial measures, but also of the potential cons of their use, which allowed me to more accurately judge their usefulness. In addition, this case taught me the importance that accountants play in the role of information creator and disseminator. In a large way, companies depend on accountants to provide them with the information that is critical to give to investors and allows investors to feel comfortable investing their resources in the company. This is critical to the success of a company. I had also never considered the role that accountants serve when it comes to press releases and the role that press releases play in investor decisions. It is the responsibility of the accountant to ensure that these press releases provide information that is useful in a timely manner and that any financial results that require additional explanation are given said explanation in a thorough and accurate way in press releases. If this is not accomplished, the consequences can manifest themselves in very real ways for the company, affecting investor relations and stock prices. This was not an element of the profession that I had considered before, and having this knowledge will certainly impact my ability to better fulfill the requirements of my future profession.

Summary of "Non-GAAP Performance Measures: Virtue or Vice?"

The following is a summary of the article "Non-GAAP Performance Measures: Virtue or Vice?" by Allen Afterman (2015) on non-GAAP financial measures is provided.

A non-GAAP performance financial measure is, by definition, a number that represents a company's historical or future financial performance, position, or cash flows, that excludes amounts otherwise included or includes amounts otherwise excluded from the comparable U.S. GAAP measure. Typically, if a company decides to disclose a non-GAAP financial measure, it is required that company also include the most similar GAAP measure. Non-GAAP financial measures included in an SEC filing must also be accompanied by an explanation of why management believes them to be useful. While the non-GAAP measures presented varies depending on the company, some examples include earnings before interest and taxes and earnings before interest, taxes, depreciation, and amortization. Non-GAAP financial measures are growing in popularity, and the companies that choose to present them do so because they believe that the measures provide investors a better understanding and view of the company's core operations. Additional pros and cons of non-GAAP financial measures have been presented, including cons such as the idea that such measures are used in an attempt to present a better picture of the company when GAAP measures provide negative information. However, there is evidence that non-GAAP earnings are a better predictor of future earnings and cash flows (Afterman, 2015).

With the increasing use of non-GAAP measures, regulations have been increasingly put into place to ensure that their use does not corrupt the information communicated to investors and other users of the financial information. One of the most frequently used non-GAAP measures is earnings before interest, taxes, depreciation, and amortization. This is most often calculated by adding or subtracting such factors as stock compensation, asset impairment charges and write-offs, restructuring charges, and other such special items. There is a great level of flexibility that management has in computing and choosing non-GAAP measures to present (Afterman, 2015). One issue afflicting non-GAAP financial measures is their lack of comparability to those of other companies. The reason for this is because of the great flexibility management has in calculating their respective non-GAAP financial measures. Not only might some companies choose to present different non-GAAP measures than other similar companies, but they may calculate the measures differently as well, making them not useful for comparison. However, it is agreed that the explanations, reconciliations, and reasoning that is required to be presented with non-GAAP financial measures increases their value. It is also suggested that the reliability and credibility of non-GAAP financial measures would be increased if they were given uniform, designated names. Finally, the article ends by stating that the future in regard to non-GAAP financial measures involves further investigation of and attempts to make non-GAAP financial measures as useful as possible. Members of the FASB have also expressed belief that GAAP in combination with non-GAAP financial measures is a powerful analytical tool in understanding a company's business (Afterman, 2015).

Analysis

***Please note that all non-specified amounts mentioned in this case are in millions of dollars. All information discussed herein was provided within the case materials unless otherwise cited.**

h. Read the excerpts of the press release titled "Google Announces Fourth Quarter and Fiscal Year 2013 Results" and review Google's operating performance reported in the statements of income accompanying the press release

ii. The press release includes information about non-GAAP financial measures for the fourth quarter of 2013. Consider the table that reconciles GAAP measures to the non-GAAP measures. What explains the difference between GAAP net income and the non-GAAP equivalent? Do you agree with each of Google's adjustments in computing non-GAAP earnings? Why or why not?

Google has followed the increasing trend within the financial world and provides non-GAAP financial measures for consideration by its investors and use by its management. One of the non-GAAP financial measures that Google chooses to present is non-GAAP net income. This measure is defined by Google as, "net income excluding expenses related to Stock-Based Compensation (SBC) and, as applicable, other special items less the related tax effects, as well as net income (loss) from discontinued operations." The difference between GAAP net income and non-GAAP net income is the result of the adjustments made to "Income from operations" to arrive at non-GAAP net income as presented in the reconciliation Google provides of non-GAAP and comparable GAAP measures. The adjustments begin with adding back the SBC expense and deducting the income tax effects related to it in order to eliminate them. Restructuring and related charges are also added back, and their tax effects are deducted in order to eliminate them. These items are both listed in the article as some of the most frequent adjustments made by companies when creating their non-GAAP measures. Finally, net loss from discontinued operations is added back to eliminate its effects. These adjustments are made in order to provide a clearer picture of the recurring core business operating results. Google management believes this non-GAAP measure is useful because it allows investors to compare Google's recurring core business operating results over multiple periods.

I agree with the adjustments Google makes to arrive at non-GAAP net income because I think that they accomplish Google's goal of removing those elements of net income that do not necessarily represent recurring events or events that relate to the daily operations of the company. By excluding non-cash charges such as SBC and also discrete cash charges that are infrequent or relate to restructuring activities instead of operating activities, I believe that Google is able to arrive at a number that can be useful for investors because it gives a clearer understanding of their business activities. In addition, by removing the effects of a loss from discontinued operations, Google is able to indicate what the performance of only continuing operations was for the period. This is of value to both present and potential investors because it indicates the performance that Google is able to achieve through its more sustainable activities, meaning that this performance is more likely to persist into the future. However, one potential improvement could be considered when observing the treatment of stock compensation expense, which is recurring and is also an operating expense. Simply because it is often excluded, it may not be the most reasonable treatment of this item.

i. Use the attached stock-market charts for Google for the period January 1, 2013, through February 14, 2014, to answer the following questions. These adjustments are not made when calculating GAAP net income.

i. Compare Google's fiscal 2013 earnings performance with the movement in Google's stock price over 2013.

The graph indicates that the general trend of the stock price of Google was increasing for the year of 2013. After the first quarter earnings were released, the stock price begins a general trend of increasing through roughly the middle of May. This indicated a positive response to the earnings announcement from Google. After the second quarter earnings were announced, the stock price began a slight general trend of decreasing, however, this period between the second and third quarterly earnings announcements seems to be fairly stable, with stock prices neither increasing drastically nor decreasing drastically. At the time of the announcement of the third quarter earnings, however, there is an extremely steep upward movement in the trend line of Google's stock price. This could indicate the belief of investors that Google had an extremely good year. It may also indicate that the demand for Google's stock increased among investors because of their earnings for the quarter or the expectation of good future performance. This expectation is what non-GAAP financial measures are meant to influence and does have a real impact on the success of a company. After the third quarter, stock prices begin a strong upward trend, decreasing immediately before the announcement of the fourth quarter earnings, peaking upwards briefly after the announcement of the fourth quarter earnings, but then falling again and slowly starting to increase again. This may indicate that investors expected strong earnings performance from Google for the fourth quarter, but the actual performance was not quite as strong as anticipated.

ii. Compare Google's 2013 stock price performance with the performance of the broader set of firms trading on the NASDAQ exchange (that is, the NASDAQ index).

For most of the 2013 fiscal year, Google's stock prices were outperforming those of the broader set of firms trading on the NASDQ exchange. This is particularly true from the time after Google's announcement of its third quarter earnings. This graph particularly points out the increase in Google's stock prices after the release of their third quarter earnings, leading me to believe that their financial performance for that period was exceptional. There were, however, times within the 2013 fiscal year where Google's stock price fell below or was consistent with the NASDAQ index. These times include approximately mid-January, where there was a brief drop in Google's stock price, and from mid-September to mid-October, where the Google stock price and the NASDAQ index were approximately the same. This would indicate that the stock prices of Google were normally affected by the state of the overall economy at the time, as were all of the other companies trading on the NASDAQ exchange. Google did, however, experience events related to their performance that had an impact on their stock prices at certain points in time where the general trend in Google's stock price varied significantly from the NASDAQ index.

iii. Based on the stock market chart, did the market perceive the earnings news in Google's press release dated January 30, 2014, as "good news" or "bad news"? Note: the press release was made available after the close of trading for the day.

The stock market chart indicates that the market perceived the information in the press release as good news. This would account for the beginning of the increasing stock price shown in the chart. The information in this press release must have given investors the idea that Google had the capability and likelihood of exhibiting positive performance in the future. This perception by investors would lead to increased demand for Google's stock, causing the price of the stock to increase. Had the press release been perceived as bad news, the reaction would have been the opposite; investors would have had less demand for Google's stock, and the price of the stock would have decreased if investors believed that the press release indicated that Google would not experience future success. This is the first reference to and indication of the power that press releases hold in regard to the success of publicly-traded companies. Press releases can play a role in the perception that investors have of the company.

j. Read the Wall Street Journal article from January 30, 2014 titled "Google Reports Higher Profit."

i. According to the article, how did Google's fourth quarter revenue and earnings compare to the consensus analyst forecasts at the time of the earnings press release? Are these relations consistent with the positive stock market reaction following the press release?

According to the article, Google's fourth quarter revenue was $16.9 billion. This was just slightly higher than the prediction of $16.8 billion that analysts had made for the period. This outcome can be attributed to the 17 percent growth that Google's core advertising business to $14.1 billion during the period. The result of this revenue growth was increased excitement among investors, and Google's share price increased four percent in after-hours trading and finished the day trading at $1,135.39, nearly a three percent increase. Analysts had predicted that earnings would be higher than the actual results of the fourth quarter. Net income of $3.38 billion, or $9.90 per share, was considered disappointing while the analysts had predicted that the earnings per share for the period would be $12.20.

The positive reaction of the market to the press release is not necessarily consistent with the fact that the actual earnings for the period for Google were lower than predicted, but it is consistent with the increase in revenues as well as the overall message of the press release. The press release was essentially created to inform investors that Google is doing well and succeeding and that the source of its success is especially reassuring and positive for investors as it indicates that investors' fears that Google may begin to experience negative effects due to a shift in Internet usage to mobile devices from desktops are not being fulfilled. This press release was meant to restore confidence in investors of Google, and it appeared to accomplish this.

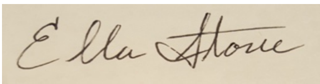
ii. What other factors does the article discuss that might contribute to the market's positive reaction to the earnings press release? Are there any factors that might cause investors to be concerned about Google's recent performance?

The article also discusses, as mentioned above, that not only is the increase in revenues itself a positive sign for investors, but the cause of this increase is also in itself a positive sign. The increase in revenues is due to the strong performance of Google's core advertising business. The press release states that this performance was driven by a 31 percent increase in clicks on the company's advertisements, and overall growth of advertisements indicates that advertisers are spending more and more on online advertising and abandoning other forms of traditional media. This is a positive trend in Google's view, and although there is a shift to more mobile platforms by Internet users, Google is still expected to continue to prosper. In addition, Google is taking steps to improve its results for phones, coming up with new forms of advertising such as image-based ads. These ads in particular have proven to be successful. Product listing ads are also proving to be useful for users and showing promising results for Google. The increased interest these ads have prompted from advertisers has resulted in Google's ability to charge higher prices for such ads, and while the cost per click on product ads increased by 80 percent in the fourth quarter from the previous year, the higher costs did not result in any decrease in advertiser's return on investment. This allowed Google to generate high revenue from their advertising. In addition, app sales through the Google Play store on Android smartphones served as a key reason for strength in Goggle's 'other' revenue line. Analysts were also pleased by the sale of Motorola to Lenovo, as selling that business eliminated a potential distraction for Google and boosted Google's bottom line. Google is also making promising investments to build computers and data centers that increase speed of delivery of content to users. With all of these positive signs Google is experiencing the benefits with their shares trading at an amount 31 times that of 2013 earnings.

The only factor that I could see investors being concerned about would be the disappointing net income and earnings per share for the period. The article also states that the average amount that Google receives from each click is on the decline and dropped 11 percent when compared to the fourth quarter of the previous year. This has been a result of the smaller screens that have been part of the trend towards mobile device usage for Internet access. The smaller screens cause advertisers to pay less for ads than when they are featured on laptops, creating the 11 percent decline in per-click amount. While this shift to mobile does not seem to be seen as an issue for investors in 2014, if Google does not continue to come up with new, innovative ways of displaying ads, then this could become a problem for Google's financial performance in the future.

"On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this work."

Signed:



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