An Analysis of Accounting Services and Relevant Economic Factors

Lauren Huffstatler
Emma Yates
Jacobi Scruggs
Kolby Husted

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AN ANALYSIS OF ACCOUNTING SERVICES AND RELEVANT ECONOMIC FACTORS

by
Lauren Huffstatler

A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements of the Sally McDonnell Barksdale Honors College.

Oxford, Mississippi
May 2024

Approved by

Advisor: Dr. Victoria Dickinson

Reader: Dean W. Mark Wilder
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The Operational Risk Assessment, ESG and Cybersecurity Risk Assessment, Audit Risk and Planning, and Tax Planning cases included in this thesis were completed by myself and my group members: Emma Yates, Jacobi Scruggs, and Kolby Husted.
ABSTRACT

LAUREN HUFFSTATLER: An Analysis of Accounting Services and Relevant Economic Factors

(Under the direction of Dr. Victoria Dickinson)

This thesis consists of a collection of six case studies completed during the fall and spring semesters of Honors Accountancy 420 under the guidance and direction of Dr. Victoria Dickinson. These case studies represent an analysis of financial accounting and current economic events relevant to the profession. During the fall semester, Dr. Dickinson formed groups of students to complete four case studies relating to an assigned company. My group was assigned FB Financial Corporation, and we evaluated the company in the areas of risk assessment, audit and risk planning, and tax planning. At the end of the semester, we presented our findings to a panel of accounting professionals, which served as the defense of this thesis. During the spring semester, Dr. Dickinson assigned us relevant economic topics to analyze and respond to. The completion of this thesis has expanded my knowledge of financial accounting and encouraged me to think critically about the economy’s effects on the accounting profession.
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CHAPTER I: CASE 1—OPERATIONAL RISK ASSESSMENT

This Week’s Findings

Our task for the week was to research FB Financial Corporation to examine and gain an understanding of the organizational structure of the business and assess current risks. Through our research of inflation, interest rates, energy prices, supply chain, political climate, and global unrest, we realized that a significant threat to the business is the state of the global economy. Specifically, we found inflation to be one of the biggest concerns for FB Financial Corporation. Rising interest rates and supply chain issues are two major factors in the current state of inflation. Our research demonstrated that government leaders have continually increased interest rates in an attempt to combat inflation (“Higher Interest Rates”). Additionally, political and global unrest has caused imported items to be less accessible and more expensive, fueling supply chain shortages (Schmelzer and Glunz).

This was a challenging yet beneficial case. In order to determine what potential risks FB Financial Corporation may be facing, we had to consider the structure and organization of the company. This required quite a bit of research, as we were not originally familiar with this company. Similarly, the banking and finance industry is not an industry we have much experience learning about. Up to this point, our financial accounting classes have most thoroughly discussed manufacturing companies. We learned that the banking and finance industry has many unique complexities. The many economic risks that a bank may currently face are very complex as well. To determine which factors may impact the banking industry, it was
necessary for us to learn about how the industry operates. As a result of our research on the banking and finance industry, we feel much more knowledgeable about the business organization of banks and what factors have an effect on their financial state.

About the Company

FB Financial Corp is a financial holding company operating through its subsidiary, FirstBank. First Bank has two segments—Banking and Mortgage. The Banking division focuses on providing traditional banking services to corporations and the average consumer. The Mortgage division offers mortgage loans to residential home buyers and loan services to government agencies. Headquartered in Nashville, TN, FirstBank provides its services to clients in Tennessee, Alabama, Kentucky, and Georgia. It offers 82 full-service branches and 16 smaller community branches (“FB Financial Corp”). FB Financial’s local banks include First Bank, FirstBank Mortgage, FirstBank Mortgage Partners, Consumer Direct Mortgage, Farmers Bank of Lynchburg, Farmers State Bank, The Ayers Foundation, American City Bank, Franklin Synergy Bank, Clayton Bank, FB Bank, Northwest, and FNB in Nashville. Having assets totaling over $12 billion, FirstBank ranks highly among national and local banks—top five percent nationally and top 15 among Middle Tennessee banks. FB Financial has multiple levels of authority. The top of their organizational structure begins with a CEO/President and Senior Management Team. Members of this team are assigned to an array of roles throughout the company. Below Senior Management is the Board of Directors. These directors oversee different regions and sectors of FirstBank. Their goal is to keep vision and core values at the forefront of all duties. Next are the Market Presidents. The Market Presidents are stationed throughout the Southeast around where certain bank branches are located. They are placed in these areas to make decisions about the market in their area and decisions regarding their teams and local customers (“About Us”).
In recent years, the COVID–19 pandemic has had a large effect on the global supply chain, creating product shortages and increasing inflation and interest rates. One market that has been particularly affected is the housing market. The housing market has seen significant increases in prices, while inventory has been quite low. With home prices and mortgage rates steadily increasing, it is now more expensive than ever to buy a home. Similarly, those looking to build a home may be forced to pay a premium on supplies and wait months for inventory to arrive. Subsequently, many prospective homebuyers have decided to put their searches on pause and hold off on buying a home (“New Home Construction Up”). This lack of inventory and buyers is a direct threat to mortgage lenders, including FB Financial Corporation. In May of 2022, FirstBank decided to permanently close a delivery channel of its mortgage division,
ConsumerDirect, due to a lack of market inventory (Castroverde). With no end in sight to supply chain shortages and rising inflation, the state of the housing market is a direct threat to FB Financial Corporation, specifically the Mortgage division of FirstBank.

Though FB Financial only serves certain parts of the United States, recent global unrest has played a part in the rise in inflation and interest rates as well. Historically, global unrest has been known to negatively affect the economy. Recent conflict in Russia and Ukraine has influenced rising energy costs and fueled inflation (Schmelzer and Glunz). To combat the increasing inflation, Chairman of the Federal Reserve, Jerome Powell, recently raised interest rates for the fourth time in 2022. As banks are forced to raise their rates, their customers feel the effects. Banks have increased the cost of borrowing money, which affects mortgage loans, auto loans, and even credit card rates. By making borrowing money more costly, The Federal Reserve hopes to encourage Americans to spend less money (“Higher Interest Rates”). As spending falls, so does demand. For banks, consumers borrowing less money is far from ideal. Banks make money from the interest they charge their customers, but with fewer people borrowing, revenues may take a hit.

The current economic state may have an effect on both FirstBank’s mortgage and banking segments. Supply chain issues, increasing interest rates, and a strained housing market are a threat to revenues for FB Financial Corporation. The looming threat of a recession should be of concern to the company as well. Though it has no control over such economic factors, FB Financial should plan accordingly for how to respond and withstand a potential negative impact on its business.
CHAPTER II: CASE 2—ESG AND CYBERSECURITY RISK ASSESSMENT

This Week’s Findings

Our task for the week was to research the roles that Environmental, Social, and Governance (ESG) and cybersecurity play in the field of accounting and their respective risks. Through our research, we discovered the potential for growth that ESG brings to the field of accounting and the downsides that come with its development. ESG introduces an array of new responsibilities and regulations for companies to follow, and these companies will look to public accounting firms to help them do so. While presenting itself as a promising new opportunity, ESG metrics are historically unregulated, which may present firms with some difficulty. We applied our knowledge of ESG to understand the effects these regulations may have on FB Financial Corporation and FirstBank and suggest how they should respond.

Additionally, we researched the increasing importance of cybersecurity, specifically for the banking and finance industry. Cybersecurity attacks are extremely common in the financial services industry. This week, we examined how FB Financial Corporation and FirstBank have responded to breaches in cybersecurity in the past and how they should prepare for them in the future. As technology advances, companies will be able to better position themselves for cyber-attacks, but those committing the breaches will benefit also. Companies, especially those in the banking and financial industry, must take action to ensure that they are not only protecting themselves but their customers as well.
The research we conducted this week demonstrates how companies must be ever-evolving to adapt to changes in society and technology. We learned that as we step into the workforce, we will be the ones to invent and implement these changes. Even though ESG and cybersecurity seem unrelated to public accounting firms, these issues will heavily affect their clients. We now feel more prepared and informed about how these topics will impact our field.

**What is ESG?**

ESG can be defined as the consideration of environmental, social, and governance factors in companies’ financial decisions. As the world becomes more environmentally and socially conscientious, consumers want to know that companies are making decisions in the best interest of the world. Societal implications and profits should now coexist as the primary objectives of companies.

![Figure 2: ESG](image)

ESG and Public Accounting

With the increasing importance of ESG, new opportunities within the profession of public accounting have emerged. In countries around the world, providing ESG data is mandatory by the government and this data is often generated by audit and assurance firms. ESG regulations are still developing in the United States, but as they continue to evolve, there is an opportunity for public accounting firms to capitalize on these new requirements. In the years to come, firms will be able to offer advising services and provide firms with ESG disclosures to comply with new standards. The Big 4 and other companies have already begun to seek out specialists, including accountants, to provide audit, advisory, and consulting services to clients looking to generate ESG data (Dennis; Kenan-Flagler). As ESG is becoming increasingly important, the time for firms to act is now to create new divisions specifically for providing ESG services. According to Susan S. Coffey, CPA and CGMA CEO, “Environmental, social, and governance (ESG) reporting is the most consequential expansion of business information since Great Depression-era reforms led to our capital markets’ reliance on audited financial statements. That might sound like hyperbole, but it’s not — and it’s imperative CPA firms grasp this and take steps to secure their place in providing ESG advisory and assurance services” (Coffey). Though ESG appears to offer new opportunities to the field of accounting, ESG data is often unreliable and very subjective. MSCI, the world’s biggest ESG rating company, provides scores to measure how well a company's goals and practices align with ESG standards. The method that MSCI uses to create these scores is completely unregulated and has been proven to be inconsistent. Public accounting firms must learn to navigate such a subjective industry to ensure they provide useful, standardized, and reliable data (Hussain). Additionally, the firms themselves
will need to comply with these standards. Firms will have to adjust their priorities to place ESG alongside profits as a primary objective.

The Challenges and Risks of ESG

Because ESG is such a new concept, many companies are struggling with its implementation. One main challenge for companies is following the ESG guidelines and standards put in place by the International Sustainability Standards Board. Failure to comply with the International Sustainability Standards Board can result in penalties and investigations, which in turn creates uncertainty amongst stakeholders. In the case of FB Financial, a major challenge in measuring ESG is the fact that it is simply a small banking service. Unlike other companies in the same industry such as J.P. Morgan, Renasant Bank, and Wells Fargo, FB Financial may not have enough data, which is vital to calculating ESG. Though this may be true, “ESG progress can be measured, though. What’s important to remember is that these measurements are often not as clear-cut. They require a deeper level of analysis and an appreciation that there are much more moving parts to the concept than one figure can show” (Byrne). Because of this, FB Financial and its finance professionals can decide which measurement basis should be used for measuring ESG. This is done mostly by evaluating the framework to be implemented for the company. In an article by EMBA Pro, one suggestion on the basis of the framework for sustainability was for FB Financial to begin using the Triple Bottom Line concept for its ESG calculation. The Triple Bottom Line concept consists of three different components: People, Profits, and Planet. As of now, FB Financial fulfills these three
requirements, but to better improve its ESG score it should consider having separate funding for more sustainable and environmental projects. This could add value and increase profits for the company.

While this is a good suggestion for the company and its customers, FB Financial also needs to consider the possible risks of ESG. Certain economic risks that arise for the company include the percentage of stakeholders decreasing because of poor ESG implementation within the company, and the reliability of the information being questioned in response to stakeholders finding out that the ESG of a company has not been verified by a third party. “ESG ratings impact profitability - regardless of what industry your company is in. People like to know that the companies they interact with and buy from are companies that do good in the world” (Goodreads). In terms of the country as a whole, the company does not have a tremendous effect as it mainly only serves the southeastern region of the United States. However, it seems ESG may only increase in importance for companies. In order to satisfy investors and comply with ISSB standards, FB Financial should be proactive and plan for how it should address ESG reporting.

World Economic Forum

The goal of the World Economic Forum is to establish a worldwide precedent for ESG reporting. “As investor interest in environmental, social, and governance (ESG) issues grows, there is widespread support for a global standard on sustainability reporting” (“ESG Could”). As ESG becomes a larger factor throughout the corporate world, it is important for there to be standards that allow comparisons to occur across businesses and industries; therefore, the World Economic Forum decided that more trustworthy and useful ESG data was necessary (“ESG Could”). This data needs to be more reliable because of how quickly ESG standards are growing.
Even though the ESG rating is not yet a perfect system, it is becoming more common around the world; therefore, it is important that there is a precedent and standard for how these ratings are evaluated. One aspect of the World Economic Forum’s stance on ESG is their addition of the financial component to the equation. “There is wide support for a global standard on sustainability reporting and in making a stronger connection between the “F” of financials and ESG – “FESG”. The overwhelming majority of investors (89%) surveyed for the most recent EY Global Institutional Investor Survey said they would like the reporting of ESG performance, measured against a set of globally consistent standards, to become a mandatory requirement” (“ESG Could”). Including financials in ESG makes it a more favorable metric, especially for banks like FB Financial Corp. Outside of financials, a large part of ESG is sustainability. According to the World Economic Forum, there are two investor groups the sustainability realm intends to serve: “those focused on financial risk – that is, those who seek material information related to the financial impact on a company of sustainability-related factor, and those focused on social impact – that is, those who seek information about the company’s impact on its external surroundings (including on people, communities, the environment, and society)” (“ESG Could”).
This chart is intended to show in depth what is involved in trusted, decision-useful, sustainability information. It displays the people, departments, and types of information that combine to form information for investors that is reliable. The Forum involves meetings of businesses and leaders to discuss potential solutions for current concerns, allowing it to influence globally.
Blackrock understands that “climate risk is investment risk” (“ESG Integration”). The company believes that it is important to create a team specifically for ESG to understand the best way to please the public. This is important because Blackrock makes its income off of investments. “Our approach to ESG integration focuses on identifying financially material sustainability insights – those that we believe may impact the financial performance of clients’ portfolios - and including those insights into the broader mix of traditional financial information used to manage those portfolios” (“ESG Integration”). Blackrock plans to approach ESG by deciding the best ways to serve its customers through ESG criteria. Vanguard is taking a similar approach by advising and offering investments in ESG-aligned funds. Through these investments, Vanguard believes that it can grasp a broader millennial audience (“ESG Strategies”). These factors affect FB Financial because of the impact of sustainability measures on the banking industry. In banking, it is very important to have the support of investors. Many investors will be very interested in sustainability measures because of their prevalence in the news. Sustainability and economic efforts are important in the world today; therefore, it is important for FB Financial to show that sustainability is important to it as well. If FB Financial does not express the importance of sustainability to its company, it may risk losing some investor support.

**Actions FB Financial Should Take**

With the rise in popularity of ESG, there is also an increase in regulation to ensure that reporting is done correctly and fairly. New regulations now require the rating agencies to report how they are conducting their ratings. This report will assist banks with knowing which companies are promoting sustainable initiatives. “It will enable banks to more effectively fund companies and projects that promote a sustainable future. They’ll have a clearer understanding of
their corporate customers’ commitment to sustainability” (Silva). An increase in regulations will assist banks with knowing how they can increase their ESG. Because of the increase in the topic of sustainability throughout the news recently, “It is clearly in the best interest of the industry to address ESG from a risk perspective as much as from a desire to align better with the social forces pushing for change” (Silva). Banking is an interesting industry because banks service consumers differently than other industries. Their satisfaction ratings are based on the happiness of their customers; therefore, a bank taking a stance in the sustainability conversation could benefit them greatly.

Because FB Financial is not an extremely large company, we could not find anything specific about what they should do to respond to ESG; however, we gathered information on what other banks have done to create suggestions for the company. Currently, FB Financial has low exposure to many ESG issues. We think FB Financial could present itself as a frontrunner in the implementation of ESG standards to gain the support of new customers and investors. To do so, it should involve itself in more sustainability projects. Also, the company should consider creating a procurement team that specializes in ESG. By adding a team responsible for ESG, FB Financial can strategize the best way to advance its implementation of ESG.

Cybersecurity

As the internet expands and advances, shifts in the cybersecurity landscape become more prevalent and difficult to navigate. The banking industry, with data from millions of people and businesses, is liable to be targeted by cyber-attacks and is therefore responsible for cyber-attack
prevention and response. As these attacks become more sophisticated and frequent, prevention has become an increasing problem for the industry with ransomware attacks increasing “by a whopping 1318%” (Duncan). Through ransomware and other malware designed to attack financial institutions’ assets, billions have been stolen from banks and depositors. Prevention should be of top priority to protect customer data and prevent financial losses. Cyber-attacks put banks at risk for fines or penalties from the Federal Deposit Insurance Corporation (FDIC)—an independent government agency that protects depositors against losses of their deposits at insured banks—and threatens their reputation among consumers.

FirstBank has acknowledged and acted upon cybersecurity practices in its own business. The corporation has a foundation of ransomware protection on online servers and databases in place with validation steps and activity monitoring. Online banking procedures from the website, app, and its own database are all monitored with alerts and protection steps active for defense. Card security helplines and informative web links on preventing fraud are all available on FirstBank’s website. On October 23, 2020, despite the foundation of cybersecurity in place, FirstBank reported a breach of their servers from hackers trying to steal customers' data. An early detection and quick response allowed FirstBank to shut down servers, limiting and then stopping the hackers. This incident was a reminder for FB Financial that even good cybersecurity is always at risk in the evolving world of hacking and malware. Though FB Financial has continued to advance its cybersecurity, it still has room for improvement. Blockchain integration could further FirstBank’s ability to control and secure data transactions that are more anonymous. Expansion and investment into strong security solutions in all aspects of the online business—from the banking app to its own online databases—would only be beneficial for the corporation and its customers. FirstBank faces immense problems and risks in the cybersecurity sector, but with good
security foundations, quick response, and a dedication to continuous improvement, it has a chance to succeed in the ever-changing online world.
This Week’s Findings

Our goal this week was to investigate FB Financial Corporation’s most recent 10-K to choose three high-audit-risk accounts to further analyze. Through investigation of the balance sheet, income statement, and other financial statements included in the 10-K, we were able to easily identify multiple accounts that we believe to be high-risk. Determining which three of those accounts contained the highest potential risk proved to be more difficult. When examining FB Financial Corporation’s income statement to determine how it generates revenue, we found that interest income totals about 63 percent of total revenue. Because it is the largest revenue account, we determined that it should be included in our selection of risky accounts. On the balance sheet, we observed very high totals for assets and liabilities. Of total assets, we found that loans net of allowances for credit losses accounted for 59 percent, with a valuation of nearly $7.5 billion. We believe the number of loans made to thousands of customers in many different areas and the associated allowance account make the loan account risky. Similarly, we observed customer deposits to be a dominant liability account. Total deposits are valued at over $10 billion and comprise 97% of total liabilities. The deposits are accounted for in multiple types of customer accounts, including non-interest-bearing and brokered. Because of the number and variety of customer deposit accounts, we believe that this account could be easily manipulated to reduce total liabilities, making it risky.
After choosing our three high-audit-risk accounts, we further researched the accounts, analyzing internal controls that could mitigate misstatement risk, such as proper authorization of accounts and adequate documentation. Each account has unique risks and therefore requires different internal controls and substantive tests by auditors. We also researched how the use of data analytics may assist in audit procedures related to risky accounts. Through this week’s research, we were able to obtain a deeper understanding of audit processes for FB Financial Corporation—and banks in general—and what characteristics auditors may look for when identifying high-risk accounts.

Interest Income

Interest income accounts for about 63 percent of FB Financial Corporation’s total revenue in 2021. Much of this income relates to interest and fees on loans from the banking department. With interest income being the biggest stream of revenue for FB Financial Corporation, it is imperative that the amount reported on financial statements is accurate for investors. If this amount is overstated, investors may be misled into believing that the company is generating more revenue than it actually is, potentially leading to lawsuits, fines, or penalties. If the amount is understated, investors may not get an accurate representation of the company’s ability to produce revenue and choose not to invest. To ensure that income is reported accurately, FB Financial Corporation should utilize internal controls such as keeping adequate records and documentation and performing independent checks on performance. Keeping adequate records and documentation can be used to support items listed on the financial statements and prove their accuracy. This can prevent the interest income account from being overstated and verify the occurrence of transactions reporting revenue. Independent checks may also be used to ensure that all revenue is accounted for and not understated. By having one employee check the work of
another who recorded a transaction, any inaccuracies or misstatements of revenue can be caught. This can also help to confirm that all revenue is being recorded correctly and none is withheld by employees.

**Substantive Tests by The Auditor for Interest Income**

Auditors are often hired to prove the accuracy of financial statements, and they do so by performing substantive tests to locate misstatements. Auditors use audit sampling by taking a sample of transactions to test for accuracy. Tests of details are used on accounts that have a high risk of misstatement by using documentation to prove a transaction actually occurred and that it was recorded correctly. To confirm that interest revenue is not overstated, auditors may compare the transactions reported to their supporting documents to guarantee that reported revenue is accurate. Doing so allows auditors to prove that balances provided on the financial statements are not materially misstated (Bory).

Performing substantive tests manually is time-consuming. By using technology such as robotic process automation to perform testing, auditing processes become much more efficient, and auditors can test whole datasets instead of just samples. Robotic process automation—also known as RPA—can be used in a multitude of ways to simplify the work of auditors. According to Ken Tysiak, Editorial Director of the *Journal of Accountancy*, “...Automation is useful for auditors (and preparers) when dealing with large volumes of contracts that contain data needed to perform accounting under FASB's new revenue recognition and lease accounting standards” (Tysiak). RPA is especially helpful for auditing revenue accounts. Where human judgment is not required, RPA can perform internal control tests and tests of details to streamline the audit process. File transfer protocol sites are used for the secure exchange of documents between a client and auditor, and from there, auditors can search for supporting documentation and issue
alerts if transactions do not match up. This technology is not a replacement for auditors, but its use can allow auditors to dedicate their time to examining the errors or inaccuracies found by the RPA system instead of performing tasks that do not require their expertise (Rozario and Miklos).

Loans and Allowances for Credit Losses

Loans provide the means for banks to lend out money and receive interest income over time, which accounts for a majority of FB Financial’s revenue. Loans is a receivable account connected with Allowance for Credit Losses that after net calculations, represents 59 percent of total assets. FB Financial Corporation relies on the repayment of and interest provided by loans to prevent losses and generate revenue. The Allowance for Credit Losses estimates the amount of loans that will not be repaid; estimating this value correctly each year is essential to reporting the valuation of the loans account correctly. Due to the importance of this account, it is necessary that proper internal controls are in place and substantive tests are performed to decrease risk.

Proper authorization of loans and the estimation of allowance for credit losses are key to mitigating the risk of this asset account. With FB Financial Corporation being a regional bank across the southeast, those issuing loans may utilize a larger amount of discretion. When a customer comes to FB Financial Corporation, they meet with a loan officer of that state/region whose job is to review their “financial history and assess whether (they) qualify” for the loans. They also assign interest rates and handle parts of the recording and paperwork process (Assurance Financial). FB Financial should follow strict guidelines for the evaluation of creditors and issuance of loans to prevent credit losses and receive adequate returns. Keeping these guidelines and assessments for loans consistent throughout the company is just as important as the loss protection these guidelines enact, as they are only enacted through the responsible management of employees. Proper issuance of loans reduces risk by ensuring that
consistent, correct, and smart loan investments are made to consumers with good credit. If banks continuously disperse cash without receiving much return on investment, they may cease to operate because of a lack of cash flows. A decrease in cash flows makes it difficult for banks to have cash readily available for customers and their own operating activities.

**Internal Controls Related to Loans**

Maintaining adequate documents and records is a crucial internal control for FB Financial Corporation to be able to evaluate credit limits for its customers. Specific factors that need to be considered when establishing credit limits are credit score, annual income, payment history, and debt-to-income ratio. The consequences of lending to high-risk borrowers can be detrimental to banks, especially smaller banks like FB Financial Corporation. An article by Asurity states that one type of fraud related directly to mortgage fraud is income fraud, which takes place when a borrower purposely misrepresents their amount of income, falsely resulting in an increased credit limit. To mitigate the likelihood of mortgage fraud, lenders should verify the existence of employers, check stubs, and the work history of borrowers. Doing so allows banks such as FB Financial Corporation to reduce borrowers’ credit risk and therefore lower their allowance accounts.

To increase efficiency, it would be helpful for FB Financial to have an automated system to help implement these controls. A type of automated robotic process that would be useful in this case would be a loan management information system, as it would cover more transactions in less time. Like a human employee of a bank, a loan management information system performs duties such as collecting and verifying information about loan applicants, their trustworthiness, and their credibility (Podmurnyi). However, a loan management information system results in increased benefits such as eliminating human error, saving time, and automated reporting.
Having such a system in place would allow FB Financial to decrease the credit risk of its borrowers overall.

**Deposits**

The last account we chose to research was the deposits account. As a bank, it is very important to report customer deposits correctly on the financial statements, as they represent a majority of total liabilities. In FB Financial’s case, deposits account for around 97% of liabilities. If liabilities are overstated, the financial position of the company may appear weaker than it is. Perhaps more importantly, an understatement of liabilities may make the company appear stronger to investors and falsely convince them to invest. Management may be tempted to manipulate this account to increase the company’s stockholder’s equity, which we believe makes it a risky account. Due to the account’s risk, proper controls and audit procedures should be in place to ensure that this account is not materially misstated.

**Internal Controls to Mitigate Risk for Deposits**

One way to mitigate the risk of misstating the deposits account is through a combination of segregation of duties and independent checks. In addition, bank reconciliations and proof of receipts are extremely important to ensure correct balances. The receipt of funds and reconciliations of accounts are both considered incompatible duties meaning the same person cannot perform the action and check it. “Segregation of duties is a key internal control intended to minimize the occurrence of errors or fraud by ensuring that no employee has the ability to both perpetrate and conceal errors or fraud in the normal course of their duties” (“Office of Internal Audit”). The depositing process may seem simple, but it requires more controls than one may think. The process begins when the cash is received. With segregation of duties
implemented, one employee should receive the cash, another employee should record the cash, and a final employee should reconcile the account. This process includes both of our identified internal controls. Bank reconciliations are very important because they ensure that the book balances match the bank balances. It is important that this process also includes segregation of duties. “Cash collections must be reconciled on a daily basis to the cash register/point of sale system to ensure the completeness of receipts. On a monthly basis, an employee who does not collect funds must reconcile deposit tickets to general ledger accounts to ensure that all amounts were properly deposited and reconcile general ledger balances to bank records to ensure that deposits were appropriately credited by the bank” (“Office of Internal Audit”). These reconciliations will be an additional check of the deposits that were collected because if the amount is recorded incorrectly, the bank reconciliation will not balance. One step that could decrease the chance of an incorrect balance being reported would be the collection of cash receipts (“Internal Controls”). Ensuring that two receipts are printed for each deposit transaction would increase the reliability of the deposits because both members of the transaction would have proof it occurred. By utilizing segregation of duties and bank reconciliations, FB Financial could create an internal control system that would decrease the likelihood of a misstatement of the balance of the deposits account.

**Substantive Tests by the Auditor for Deposits**

Because of the importance of deposits for FB Financial, it is imperative that auditors can confirm the reliability of the account’s balance. One substantive test that the auditor could run would be a confirmation of receipts. An auditor could take the bank’s copies of the deposit receipts and check those against the balances. This would be very tedious, but it would be a thorough way to confirm that the amount deposited was the amount recorded in the books.
Robotic processes could be used greatly to enhance this test. A system could be created that requires the input of the deposit amount and date into the computer. Once the receipts are printed, a picture of the bank's receipt copy would be scanned into the computer system. Once the scan is in the computer, it would be attached to the original input. Therefore, when the auditor checks the receipts against the transactions, everything is digital, and it is much easier to confirm the balances. Additionally, the robotic process would not allow one to enter an input and a receipt that are out of balance, which would decrease clerical errors.
CHAPTER IV: CASE 4—TAX PLANNING

This Week’s Findings

Our main task for this week was to find different ways to minimize the tax payments of our company, FirstBank, with the consideration of corporate tax credits in the industry of banking. In addition, we also had to consider the upcoming midterm elections and their potential implications on tax policy. After much research, we discovered that FirstBank is a community bank and not a national bank, preventing FirstBank from benefiting from tax credits mainly offered to national banks. While FirstBank has the capability to register as a national bank and claim tax credits, doing so would go against its values of serving its communities to the best of its abilities. To uphold these values, a proposed solution that we found would be for FirstBank to further expand into Kentucky through the process of apportionment. The reason for this is that Kentucky has the lowest corporate income tax rate amongst FirstBank’s states of operations which also consist of Tennessee, Alabama, and Georgia.

With apportionment in mind, we discovered that Kentucky could result in FirstBank paying less in taxes if done correctly. While doing this does not provide an instant reduction in taxes, a reduction in taxes paid can result over time. To prove this, we analyzed FirstBank’s current 10-K to consider different factors such as revenue and total deposits to make calculations related to different tax rates among states, FirstBank’s numerous locations, and the populations of states that FirstBank serves. After performing these calculations, we then considered the
upcoming midterm elections and the different effects they may have on tax policy. We determined that this is crucial information as it could have an impact on whether business entities such as FirstBank pay more or less taxes because of different viewpoints and ideas amongst possible elected candidates and their identified political parties.

In all, this was a challenging yet rewarding assignment. We had to utilize all of our knowledge of FirstBank to be able to come up with the best possible solution to decrease its tax liability. This could be done in many ways, so creating a solution specific to FirstBank was key instead of giving a general recommendation. We were required to extensively research tax policy and the company’s financial statements to come up with a recommendation that made sense logically for the company while keeping the restrictions of tax policy in mind. We then calculated the estimated potential tax savings for FirstBank if it were to implement our suggestion.

**Tax Credits for National Banks**

The federal government provides many opportunities for national banks to receive tax credits through programs that promote community development and energy conservation. A bank is classified as a national bank if it is chartered through and monitored by the Office of the Comptroller of the Currency, which is a bureau of the U.S. Department of the Treasury. Some of these credits include Public Welfare Investments, The Low-Income Housing Tax Credit (LIHTC), New Markets Tax Credits (NMTC), Opportunity Zones, and Renewable Energy Tax Credits. Public Welfare Investments, LIHTC, and NMTC allow national banks or federal savings associations to invest in underserved or underdeveloped areas to foster economic growth and create affordable housing. Renewable Energy Tax Credits encourage investment in renewable energy sources (Office of the Comptroller of the Currency).
However, FirstBank, the subsidiary of FB Financial Corporation, is not a national bank, and it is primarily regulated by the Federal Deposit Insurance Corporation. While it is possible for FirstBank to file an application with the Office of the Comptroller of the Currency for a charter to become a national bank, that does not reflect FirstBank’s core values. FirstBank prides itself on being a community bank, providing quality service to its local communities. On its website, FirstBank describes its values by explaining, “Over three decades FirstBank’s assets grew to be in the billions, but FirstBank never compromised their vision. In 2001, we expanded our brand of authentic local banking into the state’s most iconic cities, from Nashville to Memphis. FirstBank has made small town life our business culture empowering local market presidents and managers to make real decisions locally. You can walk into any branch and find a welcoming smile and willingness to help. You will know instantly you’re not just a customer. You’re part of the FirstBank family” ("About Us"). Though FirstBank could see great financial benefits from becoming a national bank, that decision would not make sense for its mission. Instead, FirstBank should exercise other strategies to minimize its tax liability.

Our Solution

Because of FirstBank’s core values, switching to a national bank is not an option. Our solution for FirstBank is to further expand into Kentucky. FirstBank should add additional branches in Kentucky because of apportionment, which is “the assignment of a portion of a corporation’s income to a particular state for the purposes of determining the corporation’s income tax in that state” (Cstewart). This is different from allocation because allocation only covers non-business income. Apportionment covers business income, and it helps determine how much tax should be collected. FirstBank has locations in Tennessee, Alabama, Georgia, and Kentucky ("About Us"). Of the four states FirstBank is currently located in, Kentucky has the
lowest corporate income tax rate at five percent. By focusing on future expansion in Kentucky, FirstBank has the ability to lower its total corporate income taxes in the future. This would not decrease taxes immediately, but over time, less of FirstBank’s income would be going directly to taxes. According to FirstBank’s 2021 10-K, only about six percent of total deposits lie within its Kentucky branches. Increasing the number of branches would additionally increase the share of deposits that are in Kentucky. Through an increase in deposits, a larger share of FirstBank’s income would be recognized in the calculation of the apportionment income tax rate. The state tax apportionment is calculated by arranging percentages of a company’s payroll, property, and revenue allocated to each state, and then weighted together to get an appropriate tax rate. FB Financial Corporation currently has a federal and blended state income tax rate of 26.06 percent according to the most recent 10-K. Our solution to decrease this tax rate would include not only increasing deposits in their Kentucky branches, but a complete further expansion into Kentucky, increasing payroll, property owned, and revenue growth to continue to drive down the apportionment income tax rate. Nashville, Tennessee, the current headquarters, provides a great central location for FB Financial Corporation’s business and relations in the Southeast region, but it does not provide the same lower corporate tax benefits that Kentucky does (five percent compared to 6.5 percent). Being a bordering state to Tennessee, Kentucky also provides increased opportunities for business in the Southeast region that FB Financial Corporation already operates in.

**Numerical Tax Savings**

Because of the large number of FB Financial Community Banks, it is difficult to calculate the amount of revenue generated by each branch. We decided the best way to predict how our solution would decrease tax payments was to compute FB Financial’s revenue per
capita for each area in which there are currently branches. Since FB Financial has multiple branches across Tennessee including in small towns and metropolitan areas, we decided it was most accurate to use Tennessee’s entire state population. To find the total number of customers in all the areas where there are currently FB Financial branches, we added together the populations of Tennessee, Birmingham, Huntsville, and Bowling Green. The sum of these populations is 8.761 million. To find the income before taxes, we analyzed the Income Statement on the 10-K. According to the 10-K, income before taxes in 2021 was $243.051 million. Once we had this information, we calculated the income per capita to be $27.74.

If FB Financial expanded into Louisville, we would predict an increase in income based on the per capita income rate that was previously calculated. According to Statista, the population of the Louisville Metropolitan Area is 1.285 million (Korhonen). Multiplying Louisville’s population by the income per capita rate provides for an increase in income of $35.646 million.

If FB Financial Corporation’s income in each state is directly related to the number of branches in that state, it will currently have a blended state tax rate of 4.99 percent. By expanding the total number of branches by 20 percent in Kentucky, 19 branches would be added. This increase in income in Kentucky would then change the blended state tax rate to 4.68 percent. By applying those rates to FB Financial Corporation’s current income, a savings of $753,458 can be calculated. By assuming that income and the number of branches in each state are positively correlated, we can predict that an increase in operations in Kentucky will increase the total revenue generated in the state. Therefore, the blended state tax rate would decrease due to Kentucky having the lowest corporate tax rate at five percent.
The Midterm Elections

With the ideal solution of having FirstBank remain a community bank while expanding in Kentucky, today’s politics can still influence how community banks operate. One main factor related to these operations is the upcoming 2022 midterm elections. As part of his Build Back Better agenda, President Joe Biden wants banks to provide basic information about each customer’s account to the Internal Revenue Service to reduce the number of wealthy individuals who avoid paying taxes (Center for American Progress). While this may aid in Biden’s vision of reducing the number of tax evaders, implementing this would be detrimental to community banks such as FirstBank because of the finite amount of resources. This is exceedingly crucial as this would lessen the number of resources available to expand FirstBank in Kentucky. “Smaller financial institutions will face onerous compliance costs. Ultimately, everyday families and businesses experience a loss of personal privacy, higher checking account fees, lower yields on savings, and fewer free services as a result” (The Heritage Foundation). Doing this goes against FirstBank’s customer values which may result in fewer customers and less revenue. Also, to combat the current rise of inflation among consumers, Biden alongside the Consumer Financial Protection Bureau aspires to eliminate unnecessary bank charges such as overdraft fees and depositor fees resulting from bounced checks (Banking Dive). This can also result in less revenue for FirstBank which may make it difficult to establish more branches in Kentucky. On the other hand, if the Republican party were to win the midterm elections, businesses such as FirstBank may see a decrease in corporate taxes (Schaeffer and Cuevas). This could provide FirstBank with the additional capital needed to expand in Kentucky, as well as an overall decrease in tax liability.
CHAPTER V: BANK FAILURES

Introduction

For this week’s case, I was asked to research the recent liquidity crisis and failure of banks in the United States, specifically Silicon Valley Bank. Upon conducting my research, I was asked to consider the implications these events may have on the economy, my future career, and current accounting and auditing standards.

Silicon Valley Bank is a medium-sized bank in the Bay Area of California. The bank primarily served the tech industry, start-up companies, and venture capitalists (Ziady). Within recent years, SVB has experienced massive growth simultaneously with the tech industry (Ziady). Since 2019, its assets and deposits nearly tripled (Ziady). SVB heavily invested in U.S. government bonds when interest rates were extremely low. As the Federal Reserve has continued to raise interest rates, the value of SVB’s bonds took a huge hit, forcing it to sell them off at a loss (Ziady). When this was announced, the bank’s customers rushed to withdraw their money, creating a run on the bank. Further panic ensued when SVB officers sold off all their stock and paid out huge bonuses to themselves. This bank run caused stock prices to plummet, and the bank was seized by the Federal Deposit Insurance Corporation. The FDIC announced it plans to make all depositors whole, but investors in the bank appear to be out of luck.

The question that remains is, “How was this not prevented?” Looking back, there were many red flags, but those are certainly easier to see after the fact. Many question whether audit
standards should be reformed due to the involvement of securities in the meltdown. The FDIC’s decision to make depositors whole has also drawn criticism. For myself, I have to consider how these events will potentially affect the economy and my career as I prepare to enter the workforce.

**Economic and Monetary Response**

Since the COVID-19 pandemic, inflation has skyrocketed in the U.S. To combat this, the Federal Reserve has steadily raised interest rates to slow down the economy and plans to continue doing so. High interest rates discourage borrowing and spending, which should decrease the amount of money circulating in the economy. According to the Quantity Theory of Money, changes in price levels are directly related to the supply of money in the economy (Folger). So, based on this theory, raising interest rates should help lower inflation levels. However, as we have seen from the recent banking crises, there may be some problems with this method. Skyrocketing interest rates caused the value of Silicon Valley Bank’s investment bonds to sink. Its bonds were yielding very low returns compared to more recently issued bonds, making them worth less than what they paid for them. It's clear that simply raising interest rates may not be a fool-proof way to fight inflation.

According to Milton Friedman, “There is one and only one basic cause of inflation: too high a rate of growth in the quantity of money…These days, that cause is produced in Washington, proximately, by the Federal Reserve System, which determines what happens to the quantity of money; ultimately, by the political and other pressures impinging on the System, of which the most important are the pressures to create money in order to pay for exploding Federal spending…” (Ireland). It is no secret that the U.S. is in a huge budget deficit. But instead of decreasing spending, it continues to operate with a deficit, year after year. In the last 50 years,
the government has experienced a budget surplus only five times (U.S. Department of the Treasury). The government’s solution to the deficit is to simply print more money, which appears to be the root cause of rising inflation in the U.S. It seems evident to me that the government needs to cut its budget. If we do not have the money to spend, we should not be spending it. When the government decides to print more money and just raise interest rates in response, U.S. consumers are the most affected. The cost of borrowing affects consumers’ ability to buy homes and cars and pay off their credit card bills. I find it unfair that consumers are paying the price for the government’s mistakes.

I am very aware that cutting the federal spending budget is easier said than done, but I believe it is now unavoidable. It is the responsibility of Congress to pass the federal spending budget each year, meaning it should also be their responsibility to keep the budget as balanced as possible. Each year, Congress rushes to pass a budget just to avoid a government “shutdown,” giving insufficient consideration to the details of what they are passing. For anything to change, I believe that it is imperative that Americans educate themselves and hold their representatives in Congress responsible. I think Americans have to remember that at the end of the day, we choose who represents us and decides how to spend our tax dollars.

Audit and Accounting Response

Just two weeks before the failure of Silicon Valley Bank, KPMG signed its audit report with no mention of the bank’s held-to-maturity securities (Weil and Eaglesham). By just looking at SVB’s balance sheet, it appeared the bank had a considerable amount of assets. However,
what appeared on the balance sheet was very misleading to investors. Because these securities had a much lower yield than the current market yield, they were actually not worth what they were valued at on the balance sheet.

As a result of SVB’s failure, I think audit standards should be updated to have stricter guidelines for the reporting of HTM securities. Especially since interest rates are supposed to keep rising, the value of SVB’s securities would have kept going down. I find it very misleading to investors that companies do not have to disclose that at no time in the near future will their investments be worth what they are valued at on the balance sheet. Just because companies intend to hold their securities until maturity does not mean they will, which is what happened with SVB. It ran into a liquidity crisis and was forced to sell off its bonds at a loss for quick cash. Since at any time this could happen, I think investors should be aware of the market value of a company’s held-to-maturity securities when it seems clear they are impaired.

Potential Impacts on My Future Career

The recent banking crisis has been an eye-opening event to me in terms of how important monetary policy is in the U.S. Before this assignment, I had limited knowledge about macroeconomics, but I had not considered how large of a role the government is currently playing in the state of the economy. I knew that more money circulating meant higher inflation, but I was not aware that the increase in the money supply was to fund the massive federal spending budget. Now knowing this, I will think differently about how the federal government is choosing to spend money. I am not against government programs, but it seems that the U.S. simply cannot afford to keep funding them at the rate it does. If no changes are made, I find it hard to believe that my generation will not be harshly impacted as we begin our careers. I am thankful to be getting a degree in a profession with great job stability, but I worry about my
ability to have the same economic opportunities as my parents or grandparents. I am concerned that I will have less opportunity and freedom to make changes in my career. As an entry-level employee, I also worry about the threat of layoffs. For the sake of my generation, I believe it’s imperative that my peers and I continue to educate ourselves and pay close attention to who we are voting into Congress.
CHAPTER VI: FINANCIAL CRISIS HISTORY

Introduction

For this week’s case, I was asked to watch Inside Job, a documentary about the 2008 financial crisis, and read “The Great American Bubble Machine,” an article by Matt Taibbi detailing Goldman Sachs’ involvement in market manipulations. I was then encouraged to consider how these materials affected my trust in the government and financial institutions and my beliefs about my role and society. From this, I was able to draw parallels between the political landscape of 2008 and today.

Before this case, I had a general understanding of the 2008 financial crisis. I knew that the housing bubble was caused by predatory lending and bad loan underwriting. What I did not know was that these loans were being packaged into AAA-rated securities and that the government essentially paved the way for the crisis by deregulating the financial industry (Ferguson et al.). I was unaware that the world’s largest financial firms lobbied the federal government to make their fraudulent trading activities legal (Ferguson et al.). I was most shocked to learn that the individuals responsible for the crisis faced virtually no consequences and even kept their positions of power (Ferguson et al.). Similarly, I was completely unaware of the involvement of Goldman Sachs specifically in the 2008 failure and all other past market manipulations (Taibbi).
This research was a very eye-opening experience for me in terms of the motives of the American government and financial institutions. I now have a deeper understanding of why it is so important that financial institutions be strictly regulated. This case was yet another reminder that the government does not have Americans’ best interests in mind. Going forward, I plan to pay much closer attention to policies regarding financial institutions and those that create them. As a result of this case, I have come to appreciate the regulations followed by the accounting industry and realize how important my future profession is to the economy.

**Trust in Government and Institutions**

I think one of the few things most Americans can agree on is their lack of trust in the government, for one reason or another. The 2008 economic crisis is one reason why. Those who know enough about the crisis are aware that our government and its cohorts with financial institutions are to blame. The federal government’s involvement in the 2008 meltdown proved that its loyalty does not lie with the American people but with Wall Street. The deregulation of financial institutions in the U.S. gave these institutions the green light to partake in fraudulent trading activities at the expense of the American people (Ferguson et al.). This deregulation allowed the rich to get richer while tanking the world economy (Ferguson et al.). This corruption is not specific to one administration or party either—it is systemic. The government gets away with this deregulation by disguising it as “free market economics.” It has sold this lie to the American people that it will relinquish control of economic activity when really it is involved in every aspect of it. By pretending to stay out of Americans’ economic business, the government lets the greed of corporations take over, and those in power get to benefit the most. This is just one reason I find it very difficult to have any faith or trust in America’s government or financial
institutions. Personally, I have learned that if the government says it is going to do something that sounds too good to be true, it probably is, and it almost definitely has an ulterior motive.

My Role in Society

Learning the details of the 2008 crisis encouraged me to rethink my role as a U.S. citizen. As Americans, it is our job to hold the government accountable. I believe our government has been able to get away with its corruption for so long because we do not hold it responsible. I have realized I need to pay closer attention to the government’s activities and use that information to make more informed voting decisions. However, it does feel discouraging knowing that as just one person my vote cannot make substantial change. I think it is imperative that Americans as a whole take a closer look at our government’s actions, educate ourselves, and vote accordingly. If we do not hold our government accountable, nothing will ever change.

I have always had an interest in governmental and forensic accounting, and I hope that at some point in my career, I can take advantage of this interest and use my profession as a way to create the change I want to see. Researching this financial crisis made me realize that I may want to go into the financial services service line when I start my career in public accounting. I was assigned a financial services client for last semester’s comprehensive case, and after continuing to research the financial industry, I think it will be an industry that I seriously consider.

Political Parallels Between 2008 and Today

A large political parallel that I see between 2008 and today is an absence of governmental action. In 2008, the government did nearly nothing to prevent the financial crisis and has appeared to learn little as a result of it (Ferguson et al.). The executives of the financial institutions that caused the economic meltdown were not punished, but instead many of them
were appointed governmental roles and retained their power (Ferguson et al.). Today, our society and government are so polarized that they are ineffective at doing almost anything. Since no one can agree, the government simply does nothing. Additionally, Americans repeatedly vote the same people into office, knowing they have accomplished little to nothing during their time there. This can be seen when it comes to gun control or passing an effective federal spending budget. In my opinion, this describes insanity, which can be defined as doing the same thing over and over and expecting a different result each time. Though today’s society is much more divided than that of 2008, the financial crisis can be used as a clear example of the effects of inaction. I think that the U.S. must come to understand that it is only hurting itself by being so divided.
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