

AN ANALYSIS OF CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE
SOCIAL RESPONSIBILITY REPORTING

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

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ABSTRACT

Anna Claire Wammack: An Analysis of Corporate Social Responsibility and Corporate Social Responsibility Reporting
(Under the direction of Professor Victoria Dickinson)

The purpose of this thesis is to present an overview of corporate social responsibility (CSR) and CSR reporting. The research done in preparation of this report was done by reviewing articles and professional reports and surveys on the topic of CSR. The report defines CSR and examines several surveys of businesses to see what the current CSR trends are. Next, government initiatives and expenditures related to CSR are described and quantified. The report continues by describing the benefits and format of CSR reporting and attestation. Other areas of business and CSR are studied such as CSR investing and consulting. Lastly, CSR is examined from global and ethical standpoints, and the unintended consequences of CSR are examined. The conclusion of this thesis is that CSR has made a place for itself in today's business world. Though there is a large debate surrounding it, businesses should be prepared to consider CSR, CSR reporting, and CSR attestation.

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Introduction

This report was written in conjunction with the Patterson School of Accountancy and the Sally McDonnell Barksdale Honors College (SMBHC) in order to fulfill the SMBHC's thesis requirement. As part of the new option created for students in both accounting and SMBHC, this report is in response to the case presented by PwC in the fall semester concerning lost government revenue due to the increase of electric vehicles. This paper will explore the topic of corporate social responsibility based on a list of questions from Dr. Dickinson.

Additional parts of the course included a speaker series where accounting firms presented our class with new and developing issues in accounting. The course provided excellent insight into areas of accounting that we had not yet covered in our other classes. Knowing of these topics will be very beneficial going into the workplace.

We also participated in two case competitions where we were given a made up business scenario and asked to come up with a solution that we presented to employees of PwC and Deloitte. The case competitions were a great way to improve my abilities of working on a team and public speaking. They also were good practice for producing and presenting this report.

I. Corporate Social Responsibility (CSR) Defined

In 1970, Milton Friedman stated the social purpose of a business is limited to the company using its resources and participating in activities designed to legally increase profits. Friedman's famous article has been summarized with the statement that the business of business is business. In today's world, Friedman's idea is challenged with the growing prevalence of companies enacting corporate social responsibility (CSR) strategies. Though CSR is a term that has been around since the 1960s and an idea that can be traced even further back in time, it is within recent years that companies have truly started to consider what CSR means for their organizations and strategies. CSR has grown rapidly in the past several years, but its benefits and permanent place in business remain matters of debate. Nonetheless, the pressure of competition has driven many companies to consider CSR in order to keep from falling behind the curve. Since CSR is a growing phenomenon, it deserves thorough consideration.

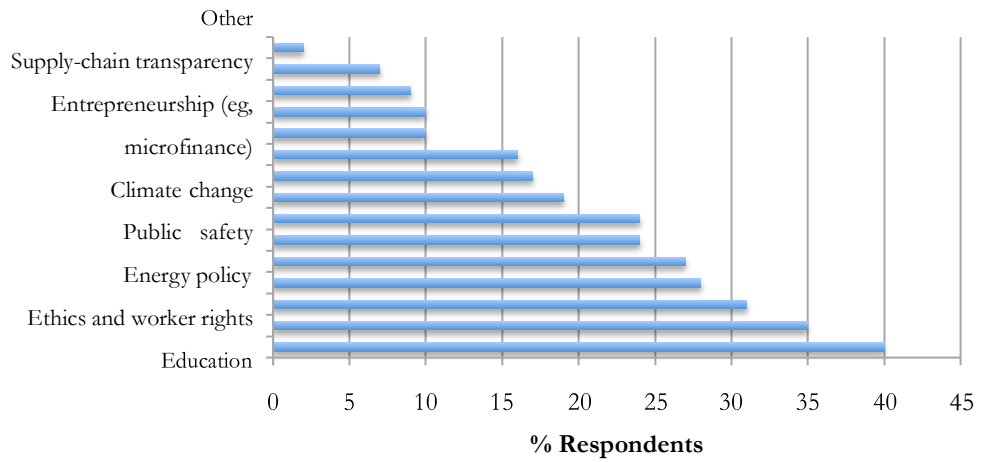
Today's world is full of messages encouraging the public to "go green" or to lessen their footprint on the world. Advertisements for "greener" substitutes for an increasing number of products are available to consumers at every turn. Additionally, companies are becoming increasingly involved in charities and more aware of the impact of their activities as a whole. All of these are just a few examples of the spreading influence of CSR in today's world.

CSR is a commonly used term, yet it is difficult to boil it down to a concrete definition. A vast amount of literature exists to examine and discuss various aspects and questions surrounding CSR, yet much of the literature comes to a similar standstill in attempting to develop a definition for CSR. This difficulty is largely due to several ambiguities surrounding CSR, as well as its multi-dimensional nature. CSR is just one term that is used to name this particular idea. Other terms such as corporate citizenship, corporate stewardship, sustainable development, the triple bottom line, and corporate responsibility generally refer to the same concept as CSR, but CSR will be used in this report for consistency. One general definition of CSR is “actions that appear to further some social good, beyond the interests of the firm and that which is required by law” (McWilliams and Siegel 117). This definition highlights that CSR actions are not actions simply taken to comply with laws and regulations—they go a step further. The World Business Council for Sustainable Development defines CSR as “the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large” (“Corporate Social Responsibility: Meeting Changing Expectations” 3). Other definitions emphasize that CSR takes different forms depending on the corporation, but it can be generalized that CSR represents a company addressing its impact beyond the functions of normal business. Companies with a CSR perspective typically strive to operate in a way that considers the interests of society and the impact of their actions on customers, suppliers, employees, shareholders, communities, and the environment (Kasipillai and Rachagan 1). Some examples of CSR

activities are practicing progressive human resource policies, developing non-animal testing procedures, recycling, reducing pollutant emissions, and supporting local businesses (McWilliams and Siegel 117). These examples show that the growth of CSR is forcing companies to look beyond Friedman's concept of solely making profits and into how their profits are actually being made.

The pressure and demand for CSR initiatives come from a variety of stakeholder groups. Several frameworks have emerged in order to categorize, rank, and report CSR initiatives. CSR Europe is a membership organization of large European companies and has its own reporting guidelines. Its guidelines examine six areas that CSR activities should be aimed toward: the workplace (employees), the market place (customers, suppliers), the environment, the community, ethics, and human rights (Moir 17). It is important to note that in order to be successful, businesses should strive to align their CSR goals with the interests of their business (Amrousy, Gavius, Katz, and Yosef 1691). Thus, CSR practices can be implemented many ways depending on the goals and interests of the particular business, so CSR can take different forms in different individual businesses. However, several areas are common amongst many companies. In 2008, the Economist Intelligence Unit conducted a survey of 566 United States-based executives. The executives were asked to identify the areas of corporate citizenship in which their company is active, and Figure 1, on the following page, shows the results.

Figure 1: COMMON AREAS OF CSR IN COMPANIES.



Source: Economist Intelligence Unit. Corporate Citizenship: Profiting from a Sustainable Business. Rep. 2008. 27.

To further examine CSR in today’s business world, it is beneficial to look at the current CSR practices of a company. Microsoft is one example of a large corporation that has given CSR a high priority. Like many other companies involved in CSR activities, Microsoft has an entire webpage dedicated to their “Corporate Citizenship”—a term interchangeable for CSR. The webpage provides stakeholders access to their various initiatives ranging from programs for youth to language technology to donations of their software. In addition, the website provides links to Microsoft’s yearly citizenship reports. Microsoft issues their own citizenship report, and they also provide their responses to the guidelines of the Global Reporting Initiative (GRI)—a leading framework for corporate sustainability reporting. Throughout their website, Microsoft presents their stance on a variety of issues, but the reports show how their actions demonstrate their commitment to the words displayed on the website. On the corporate citizenship homepage, the company states “Microsoft has an enduring commitment to working to fulfill our public responsibilities and to serving the needs of people in communities worldwide. Fundamental to this commitment is the role we serve as a responsible global corporate

citizen.” As stated earlier, CSR looks different in every company. For Microsoft, CSR “is about serving the needs of communities and fulfilling our responsibilities to the public. Our mission is to help people and businesses around the world realize their full potential.” The Microsoft Corporate Citizenship website provides detailed information about their goals and actions regarding CSR. Their website shows that Microsoft finds value in their CSR initiatives, and they have been recognized by Forbes, Ethisphere, and the Reputation Institute for their CSR reputation and business ethics. Microsoft is a leader when it comes to CSR practices and communicating them to the public, which makes it an excellent example to better understand what CSR really is.

After defining and showcasing what CSR is, the question may still remain of why does it matter? Though CSR still has its critics, even they agree that it is something that needs to be addressed and considered by companies. For the most part, stakeholders do not know the details behind CSR or why critics do not support it, so, as more companies develop their own CSR programs, expectations are rising for contemporary firms to become more than just good investments (Kristofferson, Gerrans, and Clark-Murphy 46). In short, CSR is only going to gain momentum and prevalence in the world of business, so it is becoming “what companies have to do to survive and prosper in a world where more and more of their behavior is under a microscope” (Vogel 2). Thus, modern companies can no longer afford to ignore their responsibility to society as a whole

II. The Government's Role in CSR

The United States Federal Government promotes a wide variety of initiatives that strive to further sustainability, as well as other CSR practices in businesses. First, voluntary initiatives and special programs will be listed and detailed, followed by applicable laws and executive orders, and concluded with discussion of all applicable tax deductions and credits. In addition to Federal Government initiatives, individual states have all taken CSR matters into their own hands by establishing several initiatives and programs to encourage sustainable practices and better business within each state, but, due to the large amount of such programs, these will not be individually described.

First, the Federal Green Challenge is a national initiative that was started by the U.S.'s Environmental Protection Agency (EPA). The purpose of the Federal Green Challenge is to encourage federal agencies—including the EPA—to lead by example by reducing their environmental impact. Agencies join the challenge by choosing a minimum of two out of six possible target areas—waste, electronics, purchasing, energy, water, and transportation—and commit to improving their selected areas by 5 percent per year. According to the EPA's website, there are currently 436 agencies participating in the Federal Green Challenge. The Challenge allows participating agencies to apply for awards for both overall achievement and achievement within specific target areas.

("Federal Green Challenge").

The Federal Government also sponsors the Secretary of State's Award for Corporate Excellence (ACE). Established by the State Department in 1999, the award's goal is to acknowledge the role U.S. businesses play in the global economy as good corporate citizens. The award is also meant as another way to encourage U.S. businesses to engage in CSR along with other beneficial global practices. Past winners include Cisco Systems, General Motors, Motorola, Ford Motor Company, Coca-Cola, GE, and Chevron/Texaco ("Secretary's Award for Corporate Excellence"). The CSR team in the U.S.'s Department of State's Bureau of Economics and Business Affairs manages the award. In addition to presiding over the award, the CSR team also leads "the Department's engagement with U.S. business in the promotion of responsible and ethical business practices" (Bureau of Economic, Energy, and Business Affairs 1). The team has identified several major areas in which they seek to support and guide U.S. businesses towards responsible conduct. The areas are good corporate citizenship, contribution to the growth and development of the local economy, innovation, employment and industrial relations, human rights, environmental protection, natural resources governance, transparency, anti-corruption, trade and supply chain management, intellectual property, and women's economic empowerment ("Corporate Social Responsibility").

In 2009, the U.S. EPA issued the Mandatory Reporting of Greenhouse Gases Rule—74 FR 56260—that requires large sources and suppliers within the U.S. to report their greenhouse gas data and other relevant information. The purpose of this program and required reporting is to collect accurate and timely greenhouse gas data in order to allow future policy decisions to be made with the necessary knowledge. In addition, this

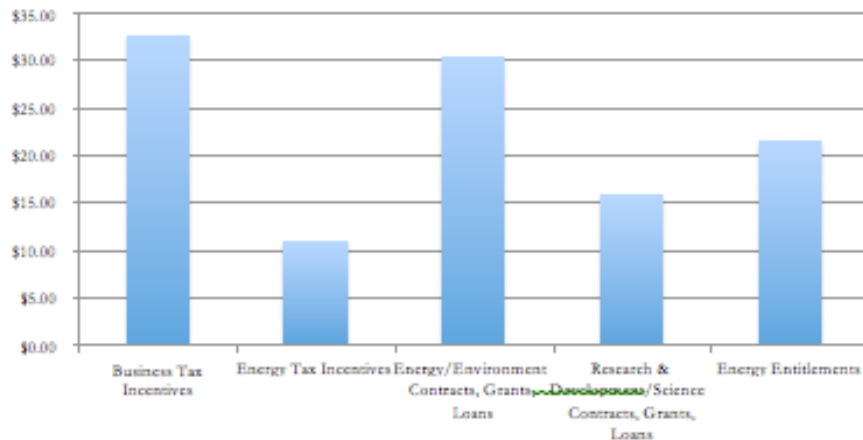
rule forces companies to be aware of their emissions—they can no longer ignore their impact on the environment. The implementation of this rule—commonly known as 40 CFR Part 98 or just Part 98—is referred to as the Greenhouse Gas Reporting Program (GHGRP). The EPA started to release the data gathered from the program to the public in 2012, so any interested party can access companies’ reported emissions. The GHGRP has substantial data regarding the amount of greenhouse gas emissions, which can be analyzed by source, industry, and type of emission. Having this information, the Federal Government can make informed decisions regarding how future policies could aid the reduction of greenhouse gas emissions. In addition, companies are required to be transparent regarding their contributions to the emissions, which could motivate them to endeavor to reduce their emissions going into the future (“Greenhouse Gas Reporting Program”). Additionally, the reported data from the GHGRP goes into an annual report that the U.S. submits to the United Nations in accordance with the Framework Convention on Climate Change. The report, which has been submitted since 1990, is called the Inventory of U.S. Greenhouse Gas Emissions and Sinks (Inventory).

Similar to the Greenhouse Gas Reporting Program, the EPA has another program called the Toxics Release Inventory (TRI). Under the TRI, facilities in different industry sectors are required to report annually the amounts of certain toxic chemicals they release or manage through recycling and treatment. The TRI program is a mandatory government program for applicable facilities in the U.S. (“Toxics Release Inventory (TRI) Program”). Like the Greenhouse Gas Reporting Program, the data collected from the TRI is available to the public through an EPA database.

The U.S. government has also enacted several laws throughout its history that venture to improve the environment and society. It is important to note that, as mentioned earlier, CSR is typically thought of going above-and- beyond what is required by legislation. Therefore, many of the laws detailed below established a minimum compliance or consideration of CSR. Many regulations have been issued throughout the years, but the ones described below are the ones that are either generally applicable or especially relevant today.

The American Recovery and Reinvestment Act of 2009, more commonly known as the Recovery Act, was enacted in February 2009 and signed into law by President Barack Obama. The Recovery Act was created in response to the Great Recession with the purposes of sustaining and creating jobs, stimulating economic activity and investing in long-term growth, and promoting accountability and transparency in government spending (H.R. 111-5). The Recovery Act planned to achieve these goals by providing tax benefits and funding to multiple entities. The total estimated expenditures for the Recovery Act was initially \$787 billion but was increased to \$840 billion (“The American Recovery and Reinvestment Act”). The total of \$840 billion includes \$290.7 billion in tax benefits, \$261.2 billion in contracts, grants, and loans, and \$264.4 billion in entitlements. Figure 2, on the following page, shows the funds endowed to CSR related expenditures.

Figure 2: CSR Related Recovery Act Expenditures



Source: “The American Recovery and Reinvestment Act.” Recovery.gov. United States Government, n.d. Web 16 Apr. 2014.

The Department of Energy (DOE) invested their \$32 million of funds in areas considered to help America’s long-term competitiveness. Thus, the DOE has or plans to invest in the areas of increasing of energy efficiency, restructuring the transportation system, doubling renewable generation, investing in smart grid infrastructure, expanding innovative research, and cleaning up our nation’s legacy nuclear waste (Department of Energy 1).

In 1972, the Clean Water Act—33 U.S.C. Section 1251 et seq.—established the basic regulations regarding water pollution in the United States. The EPA has implemented several pollution control programs, such as wastewater standards for industry and water quality standards for contaminants in surface waters. Similarly, the Resource Conservation and Recovery Act was enacted in 1976 to govern the disposal of solid waste and hazardous waste. The Clean Air Act, originally effective in 1963, was created to require the EPA to enforce regulations to protect the population from airborne contaminants that are hazardous to human health. All three of these acts have been

expanded and amended throughout the years in order to establish new regulations to react to the changing needs of the environment and society.

The Energy Policy Act of 2005 was created in order to address the growing energy problems in the U.S. The Energy Policy Act had several components including energy related tax incentives. Another act of Congress that affects the environmental aspect of CSR is the Energy Independence and Security Act of 2007. The goal of the act was “to move the United States toward greater energy independence and security, to increase the production of clean renewable fuels, promoting new emerging energy technologies, developing greater efficiency, and creating a Strategic Energy Efficiency and Renewables Reserve to invest in alternative energy, and for other purposes” (H.R. 110-6 1)

Moving away from government energy policies, the Sarbanes-Oxley Act of 2002 also sets a minimum standard for CSR practices. Different than most of the other initiatives and policies listed, the Sarbanes-Oxley Act pertains mostly to financial information. It was enacted in reaction to the Enron, WorldCom, and other accounting scandals. In order to prevent such scandals from happening again, the Sarbanes-Oxley Act increased the independence of the auditors of financial statements, as well as other standards that companies must abide by to ensure that their internal control systems are efficient and effective.

The EEO-1 Survey is a required annual filing that is mandated by the U.S. Equal Employment Opportunity Commission. Employers with federal government contracts of fifty thousand dollars or more and fifty or more employees and employers who do not have a federal government contract but have one hundred or more employees are required

to disclose data on their employees with respect to counts of employees by job category, ethnicity, race, and gender (“Revisions to the EEO-1 Report”). The EEO-1 Survey strives to push companies to have nondiscriminatory hiring policies.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was enacted to attempt to renovate the financial regulatory system. In substance, various components and provisions make the Dodd-Frank Act a lengthy and complex piece of legislation. The financial services industry was originally the target of the Dodd-Frank Act, but its expansive provisions have affected almost every entity regardless of industry. One of the many provisions relates to the topic at hand of CSR. Section 1502 of the Dodd-Frank Act describes the assessment and reporting requirements for companies that deal with conflict minerals—tin, tantalum, tungsten, and gold. Estimates have suggested that Section 1502 impacts half of all companies listed with the SEC (PwC, “Dodd-Frank Section 1502: Conflict Minerals”). The purpose of requiring companies to report on these minerals was to attempt to reduce the funding for armed groups involved in the ongoing conflict in the area that many of these minerals originate from—the Democratic Republic of the Congo (DeSmith et al.). Conflict minerals have been a topic of debate for years, and the Dodd-Frank served as the U.S. issuing its stance on the issue. That being said, the Dodd-Frank Act requires an additional form, called the Form SD, to be filed with the SEC each year. This large requirement for additional reporting aims to ensure that companies are not knowingly or unknowingly funding the violent groups responsible for many of these minerals. Though this seems to be compatible with the goals of CSR, there have been several quantitative and qualitative objections to the Dodd-Frank Act that will be examined in later sections.

In addition to these governmental policies and initiatives, two executive orders also showcase the Federal Government's stance and own CSR outlook. First, George W. Bush signed Executive Order 13423 titled "Strengthening Federal Environmental, Energy, and Transportation Management" on January 24, 2007. The executive order set forth a new set of challenging goals for agencies of the federal government. The goals include improving energy efficiency and reducing greenhouse gas emissions, extending the use of renewable energy by agencies, reducing water consumption intensity, using sustainable practices in acquiring goods and services, ensuring agencies reduce the quantities of toxic and hazardous chemicals and materials acquired, used, or disposed, establishing new agency buildings should be built according to particular sustainable standards, and several more (Exec. Order No. 13423). Each goal is given a percentage of reduction in the particular area or specific instructions for practices in federal agencies. Executive Order 13423 serves as another example of the Federal Government striving to lead by example to support CSR related practices.

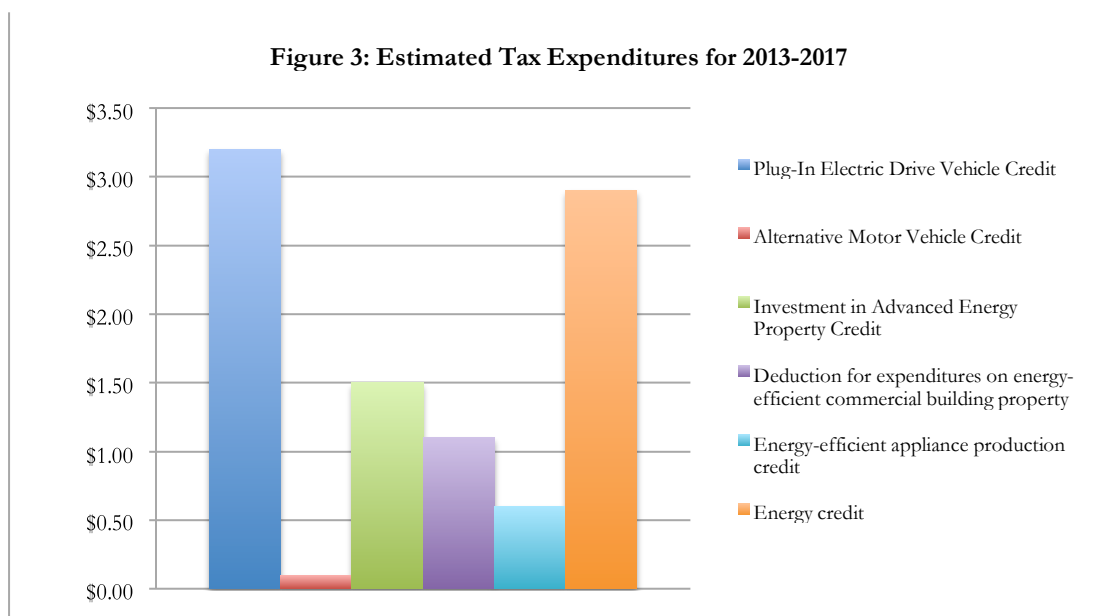
President Barack Obama signed Executive Order 13514 into effect on October 9, 2009. The executive order, titled "Federal Leadership in Environmental, Energy, and Economic Performance," expanded on the goals and requirements of Executive Order 13423. An excerpt from the executive order summarizes the goals and purpose that it is attempting to achieve by saying:

In order to create a clean energy economy that will increase our Nation's prosperity, promote energy security, protect the interests of taxpayers, and safeguard the health of our environment, the Federal Government must lead by example. It is therefore the policy of the United States that Federal agencies shall

increase energy efficiency; measure, report, and reduce their greenhouse gas emissions from direct and indirect activities...design, construct, maintain, and operate high performance sustainable buildings in sustainable locations; strengthen the vitality and livability of the communities in which Federal facilities are located; and inform Federal employees about and involve them in the achievement of these goals. (Exec. Order No. 13514).

Once more, the Federal Government strives to improve U.S. environment by requiring federal agencies to lead by examples by upholding and acting in accordance to these executive orders. Additionally, the importance of agencies being transparent in their disclosures on the progress towards these goals is emphasized in the executive order. The goal of increased transparency is, again, to set an example and allow the public to see the impact of the government.

Moving forward, the tax code provides several tax benefits for CSR related activities. Tax credits relating to CSR activities are the plug-in electric drive vehicle credit, the alternative motor vehicle credit, the manufacturer's energy efficient appliance credit, the advanced energy property investment tax credit, the solar investment tax credit, and the qualifying advanced energy manufacturing investment tax credit. Additionally, tax deductions are available for energy efficient commercial buildings, and there are several clean energy subsidies. Figure 3 shows some of the estimated tax expenditures for upcoming years.



Source: Joint Committee on Taxation. Estimates of Federal Tax Expenditures for Fiscal Years 2012-2017. Rep. no. JCS-1-13. Washington, D.C.: U.S. Government Printing Office, 2013. Print

In order to get another view of government expenditures regarding energy-related tax expenditures, Table 1, on the following page, shows multiple energy-related tax expenditures (Metcalf 2).

According to the EPA, these initiatives have the potential to greatly affect the environment. For example, the EPA states that purchasing one ton of thirty percent post-consumer recycled office paper, as compared to one ton of virgin office paper, saves approximately eight trees, 216 pounds of waste, 3,554 gallons of water, 738 pounds of greenhouse gas emissions, and 3 million BTUs of energy, which is enough to power an

average home for twelve days (“Federal Green Challenge”). Executive Order 13514 encourages federal agencies to eliminate waste through the purchase of recycled paper. With the huge size and purchasing demands of federal agencies, this would result in the listed effects being amplified to huge degrees. In addition, the EPA states that if the average worker chose to not commute two days out of the week, greenhouse gas emissions would be reduced by approximately 1,600 pounds per year (“Federal Green Challenge”). These are just a few examples of how harmful environmental effects could be lessened, or at least not increased, through some of the measures encouraged by the Federal Government.

Table 1: Energy-Related Tax Expenditures (in millions)		
	2008	2008-2012
<i>Alternative Fuels</i>		
New technology credit	960	5,530
Credit for holding clean renewable energy bonds	80	480
Other: energy facility bonds, clean-burning vehicles, fuel cell, microturbine, and solar investments	400	800
Total: Alternative Fuels	1,440	6,810
<i>Coal</i>		
Capital gains treatment on royalties on coal	170	840
Credit for investment in clean coal facilities	50	690
Partial expensing for advanced mine safety equipment	20	20
Total: Coal	240	1,550
<i>Energy Conservation</i>		
Exclusion of utility conservation subsidies	110	540
Allowance of deduction for certain energy efficient commercial building property	170	270
Credit for energy efficient improvements for new and existing homes	180	210
Total: Energy Conservation	460	1,020
<i>Oil and Gas</i>		
Excess of percentage over cost depletion, fuel	790	3,860
Expensing exploration and development costs, fuels	840	2,910
Other: alternative fuel production credit, partial expensing for new refinery investment, accelerated depreciation for certain natural gas pipelines and other investments	1,110	2,550
Total: Oil and Gas	2,740	9,320
Source: Metcalf, Gilbert E. “Using Tax Expenditures to Achieve Energy Policy Goals.” <i>American Economic Review</i> 98.2 (2008): 90-94. Print.		

III. The Smart Grid

The term smart grid refers to a new kind of electric grid to help deal with the electricity needs of the 21st century using computer-based remote control and automation. The current electric grid system dates back to the 1890s but has undergone several improvements and expansions throughout time. Today, it is made up of more than 9,200 electric generating units connected to more than 300,000 miles of transmission lines (“What Is the Smart Grid”). The smart grid aims to use new technology to move forward from the bottom up. The new smart grid system would utilize two-way communication technology between the utility and its customers. This new technology presents the opportunity for increased reliability, availability, and efficiency in the energy industry. The smart grid uses sensors, meters, and digital controls to automate, monitor, and control the two-way flow of energy. With the smart grid, power companies would be able to prevent the domino effect of power outages, restore outages faster, and obtain more accurate measures of energy usage. Large technology companies such as GE and IBM, well-known communication firms, and newly developed technology firms that focus on the creation of smart grid technology all offer smart grid services and continue to research the underlying technology.

The smart grid has several implications for businesses. Essentially, the smart grid is computerizing the transmission of electricity. Thus, it allows consumers of electricity to

obtain both the information and the tools to manage their energy usage. Rather than waiting for a monthly statement, companies can access up-to-date amounts of how much energy they are using and how much it is costing them. Therefore, companies could effectively reduce their costs and energy usage. Once completed, the smart grid could certainly help businesses with their CSR goals. However, the smart grid also comes with several additional costs and challenges that it will have to face before it becomes a widespread reality. The smart grid requires a huge transformation from the current grid system, meaning huge investments in new equipment. In order to obtain the benefits of the smart grid technologies, companies must first deal with difficult questions on when to invest in the new technology, who to partner with, and how to maximize the investment to get the most benefits for the least amount of costs (PwC 1). Many businesses strive to use less energy or cleaner energy as part of their CSR initiatives. The smart grid could help them achieve these goals by managing their energy usage and by connecting them to renewable energy sources such as solar and wind power. Businesses need to understand the full implications of engaging in the smart grid because the potential benefits cannot be obtained without encountering transitional difficulties and costs.

The new class of smart grid technology can easily be designated as a green or sustainable solution for the energy grid in the United States. Despite the possible benefits detailed above, the smart grid gives rise to several very serious concerns. First, the new-technology that the smart grid involves is particularly similar to the technology in cellular phones. Thus, the smart grid would mean that homes would be equipped with smart grid meters containing this technology on every appliance. Additionally, a dangerous

possibility surrounds the transmissions from the smart grid meters, which would give rise to constant and high exposure to high frequency transmissions (Levitt and Glendenning). Despite the concerns regarding the smart grid system, the government has invested significant funds into its development. The U.S. Federal Government chose to strive to accelerate the modernization of the country's electric grid system by providing \$4.5 billion of funding to the U.S. Department of Energy through the American Recovery and Reinvestment Act. The DOE allocated \$700 million of this amount to the Smart Grid Demonstration Program ("Audit Report"). In addition, the DOE uses its funding to provide grants to encourage the further development of smart grid technology. In 2010, the smart grid was appropriated \$10 billion by the government (Levitt and Glendenning). Though the smart grid has the potential to accelerate the world's progress toward CSR, the challenges and costs that companies face in adopting the smart grid could actually impede progress until some of these challenges and costs are decreased. Once the smart grid becomes more readily accessible, companies will be able to utilize smart grid technologies to help their CSR strategies, but, until then, the smart grid remains a risky investment. With the amount invested in smart grid technology by the U.S. government, its future will remain under a microscope going into the future.

IV. Government Initiatives Revenues vs. Expense

The Congressional Budget Office (CBO) provides nonpartisan analysis for the U.S. Congress. When legislation is proposed and enacted, they analyze the impact of the legislation on the government's revenues and expenses. The CBO's report on the American Recovery and Reinvestment Act estimated that in the period of 2009 to 2019 the government deficit would have a net increase of \$787.2 billion (Congressional Budget Office). With such a significant increase, the Recovery Act continues to generate heated debate on the effectiveness of increasing the country's debt by such a material amount. Similarly, the cost estimate reports of other energy related legislation show similar net decreases in government revenues and increases in cash outlays resulting in increases in the national deficit. Thus, the government will have to face these critics as it becomes pressured to explain how it plans on dealing with its massive debt, and the public, in addition to political opponents, will likely demand to see how the government funds have led to an improved environment.

The government's energy investment structure has already been questioned after a solar energy company, Solyndra, was awarded \$535 million in federal loans from the Recovery Act and then filed for bankruptcy less than two years after it received the government funds. The economic failure of Solyndra brought concerns about the government's investment strategy in the energy industry to the front of national news (Lott). The Solyndra bankruptcy highlights how the public, political, and business

influences have begun to question the role of government funding in the energy research and development process

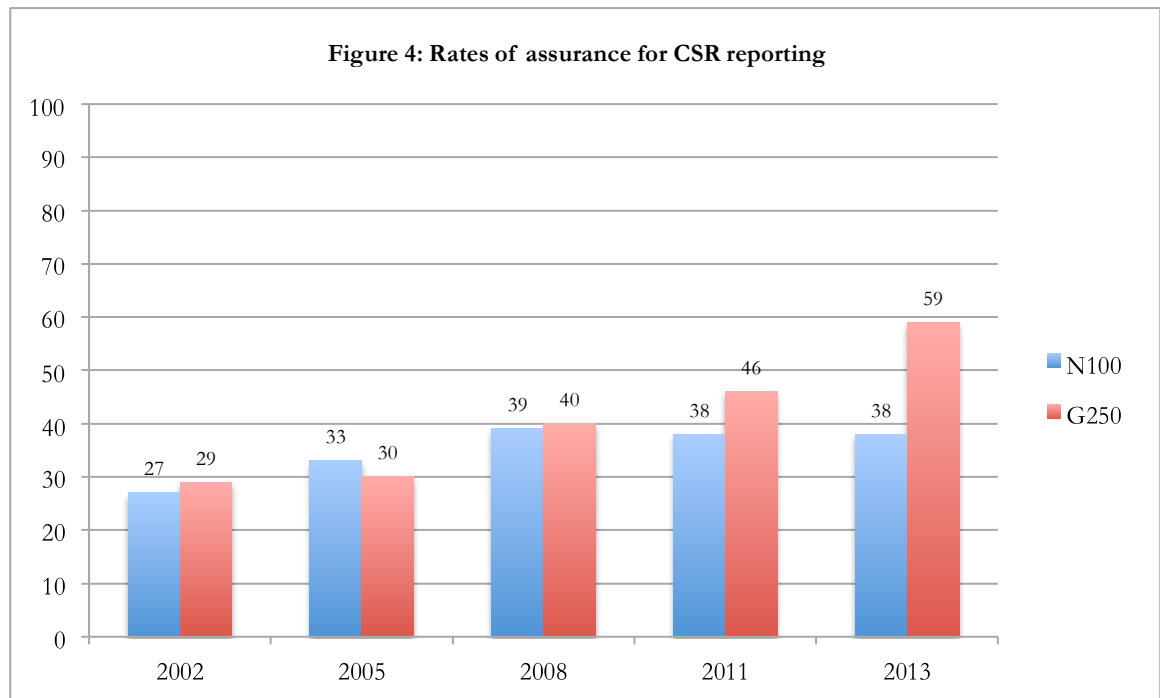
Though the initiatives, policies, and tax expenditures might have seemingly worthy intentions, several critics have questioned the plausibility of their goals. As seen in the discussion of the initiatives, several require substantial government funding, or in the case of the tax incentives, result in significant losses in government revenues. The government needs to reexamine its energy-related expenditures to see if the money being spent or lost is making progress. Further research is also needed to aid the government in identifying more efficient ways to reach these goals. Nonetheless, the initiatives and policies that have been enacted are very much influenced by the political process. Nongovernmental organizations, as well as members of political parties and lobbyists from large corporations, attempt to maintain or establish each group's own initiatives that would benefit their organization or viewpoint. The tax breaks for big oil companies serve as an example of these political influences. Big oil tax breaks, for example, are the result of huge corporations lobbying to maintain the huge tax breaks that they are currently allowed. In terms of how views on these are aligned by social demographics, further research should be conducted in order to achieve conclusive results.

V. Assurance Opportunities for CSR Reporting

As demand for companies to adopt CSR initiatives grows, another need is developing—the need for CSR information to be subject to external assurance. The amount of companies issuing stand-alone CSR reports is growing every year. In 2009, approximately 3,800 companies issued some form of CSR report, and this number is expected to rise in coming years (KPMG, “Sustainability Reporting,” 1). Traditionally, companies have reported the social and environmental effects of their activities in their annual reports, but now many companies are issuing separate reports that focus solely on their CSR efforts (Cecil 44). To show this, a 2008 survey conducted by KPMG found that 79 percent of the largest 250 companies in the world issued stand-alone CSR reports. This number showed an increase from 52 percent just three years earlier in 2005. The survey also found that 30 percent of the reports were assured in 2005, and that number grew to 40 percent in 2008 (KPMG). As these numbers show, the importance of reporting and assuring CSR information and reports is growing rapidly. As the number of sustainability and CSR reports increases, the accuracy of the information disclosed is becoming more important (GRI 5).

Assurance helps ensure that companies’ CSR data is accurate and reliable, which is important for decision-making purposes for both the company and its stakeholders. KPMG’s most recent survey on corporate responsibility reporting, which took place in

2013, shows that the number of companies seeking external assurance for their CSR reports is increasing. Figure 4 highlights that in 2013 the majority of 250 largest companies now seek external assurance.



N100 refers to the world's largest 100 companies by revenue, and G250 refers to the 250 largest companies. Source: KPMG. The KPMG Survey of Corporate Responsibility Reporting 2008. Publication. KPMG, 2008. Web.

In the CSR report, companies disclose their economic, social, and environmental impacts (GRI 5). There are several possible motivations for companies to issue stand-alone CSR reports. As stated previously, the demand for CSR reports is growing because the public is calling for increasing amounts of information. In addition, many companies see reporting as a way to improve the image or reputation of the company. By issuing a separate report on CSR activities, companies can demonstrate that their commitment to their stated initiatives is more than just a marketing maneuver. Lastly, some of the increase in CSR reports can be attributed to regulatory requirements—though the U.S. does not require CSR reporting (Adams and Zutshi 33). Overall, stakeholders are increasingly looking to CSR reports alongside financial reports in order to get a full

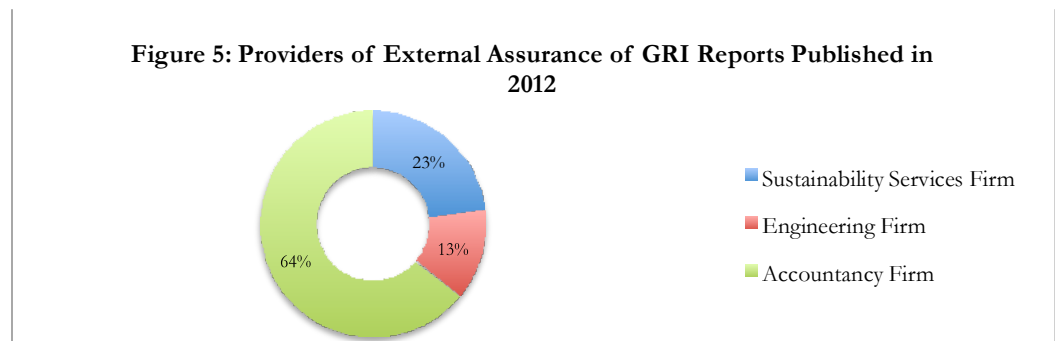
image of a company as a whole to evaluate the company's long-term viability and position.

The International Federation of Accountants (IFAC) defines an assurance engagement as one "in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria" (IFAC 16). Typically this definition is used for the assurance of financial statements, but it can also be applied to the assurance of CSR reports. The competitive nature of businesses today has resulted in the extension of assurance engagements to information other than that found in just financial statements (Pflugrath, Roebuck, and Simnett 241). Assuring financial statements is a process that is defined by accounting standards and regulations and for which accountants are well trained to perform.

The assurance of CSR reports differs from the assurance of financial statements in several ways. First, CSR reports contain a lot of nonfinancial information on a wide variety of topics. Furthermore, there is often a mix of quantitative and qualitative information in CSR reports, and the CSR reports of different companies may contain information on very different topics. Second, there is not a set of universal procedures on how to conduct an assurance engagement for a CSR report. The lack of regulation leads to a variety of CSR reports and, consequently, varied CSR assurance engagements. Though the United States has no required reporting or assurance of CSR information, there are two important organizations that have a large influence on CSR reporting practices. The Global Reporting Initiative (GRI) and AccountAbility are both international, non-profit organizations that are committed to CSR reporting (Cecil 45).

The framework established by GRI is the most widely used in the world for CSR reporting. The GRI frameworks offer guidance on what information should be included in the CSR report in conjunction with how it should be presented (Cecil 45). AccountAbility created an assurance framework to work with the GRI reporting framework in order to help auditors determine the credibility of CSR reports. What this means is that even though sustainability reporting is growing, the tools for reporting and assuring CSR information are still developing.

Who is it that assures CSR reports? Companies often hire professional accountants from large accounting firms, engineering firms, or sustainability experts to assure their CSR information. One study conducted by Pflugrath, Roebuck, and Simnett found that information assured by professional accountants was perceived to be significantly more credible than the assurance provided by sustainability experts. Looking further into this study, they found that the difference in perceived credibility was only significant in the United States and was due to the trustworthiness, expertise, and credibility of the professional accountants (Pflugrath, Roebuck, and Simnett 240). In 2012, accounting firms provided assurance for 64 percent of the assured GRI reports, as seen in Figure 5.



Source: Global Reporting Initiative. The External Assurance of Sustainability Reporting. Publication. Global Reporting Initiative, 2013. Web.

In addition to assuring CSR reports, a few other assurance opportunities are associated with CSR reporting. First, the Dodd-Frank Act, mentioned earlier, requires companies to issue additional disclosures and reports regarding their use and sources of conflict minerals. Accounting firms can offer companies several services to help with the additional burden they are facing. In order to help comply with this regulation, accounting firms can use their existing expertise and expansive resources to help companies to assess how corporations are impacted by the legislation and to provide independent attestation of the conflict minerals information and due diligence process to comply with the audit requirement of the Dodd-Frank Act.

A final assurance opportunity relating to CSR reporting is the necessity for the data collected from the Greenhouse Gas Reporting Program and Toxics Release Inventory to be assured by a third party. Thus, accounting firms could gain additional assurance business by offering clients an additional service of assuring the required reports for these two government initiatives in order to ensure compliance.

VI. Assurance Work Plan for a CSR Report

Assurance is an ongoing process, so, when a company seeks external assurance for their CSR report, they should do so prior to their reports being finished and published. The need for early engagement is due to the fact that the assurance provider should be a part of the information gathering and report preparation process (AccountAbility, “Guidance for AA1000AS” 8). Currently, external assurance remains voluntary for most countries other than France and South Africa (KPMG 2013 33). The AccountAbility AA1000 Assurance Standard is often used to guide the assurance of CSR reports to evaluate “the nature and extent of an organization’s adherence to the AccountAbility Principles” (AccountAbility, “Guidance for AA1000AS” 2). The AA1000 Principles are inclusivity, materiality, and responsiveness. Though assurance of CSR reports is not formalized and consistent universally, the AA1000AS will be used here to provide an assurance work plan for a CSR report.

Prior to accepting an AA1000AS engagement, the scope of the engagement must be determined. The scope of an AA1000AS engagement can be one of two types: Type 1 or Type 2. The organization’s behavior is examined in the context of the three previously stated principles for Type 1 engagements. Further, in Type 1 engagements, the assurer considers sustainability performance information but does not go so far to verify that information. Type 2 engagements also give conclusions on the organization’s adherence to the three principles, but Type 2 engagements go further to verify the reliability of

specific sustainability performance information (AccountAbility, “Guidance for AA1000AS” 5). Once the scope is decided, the assurer and reporting company need to make an additional decision regarding the level of assurance to be reached through the audit. The AA1000AS offers two levels of assurances: moderate and high. In addition, these two levels may be used in combination with one another. For example, specific parts of the report can be assured at a high level while the rest of the report obtains a moderate level of assurance. A report assured with a high level of assurance focuses on the reliability of the information so that stakeholders can trust that the chance of the assurer’s report containing errors is “very low but not zero” (AccountAbility, “AA1000 Assurance Standard 2008” 11). Moderately assured reports, on the other hand, focus on the plausibility of the information, and the chance of error in the assurer’s report of a moderately assured engagement is “reduced but not reduced to very low but not zero” (AccountAbility, “AA1000 Assurance Standard 2008” 11). According to KPMG’s survey (2013), 72 percent of companies that are assuring their reports opt for a limited rather than reasonable level of assurance, which, in AA1000AS terms, translates to more companies choosing a moderate level of assurance for their CSR engagements.

Once the scope and level of assurance have been reached, the assurance team should be formed. As stated earlier, the audit of CSR reports is based on similar principles to the audit of financial reports, but the information actually examined is quite different. These differences are important factors in considering the compilation of a CSR assurance team. The information included in many CSR reports requires a distinct set of competencies that should be present in the engagement team. In order for a CSR assurance team to be successful, its members should have knowledge, experience, and

skills in the following areas: auditing, the subject matter of examination, management and information systems, and external reporting and reporting standards, as well as the relevant social and political issues (AccountAbility, “Guidance for AA1000AS” 12). Looking into further detail, members should be experienced or have knowledge of providing assurance for information other than financial information, knowledge of the sector, and familiarity with the social environment of the reporting organization. In addition, the team should be aware of relevant environmental issues and technical risks, as well as any environmental, social, or employment related legislation. Lastly, the team members should be up-to-date on and familiar with the popular guidelines, such as the GRI G4 Guidelines, that companies use to format their CSR reports.

Once the team is created and both parties are ready to start the engagement, the AA1000AS requires an engagement agreement that includes objectives, responsibilities of both parties, subject matter, applicable code of conduct, scope, standards to be used, assumptions regarding reporting criteria and evidence, requirements for evidence, summary of activities including milestones, timeframes, and progress reporting requirements, assurance report and assurance statement requirements, confidentiality requirements, a declaration of independence by the assurance provider, risks and constraints, liability, fees and costs, and any special requirements relating to web-site reporting or translations (AccountAbility, “Guidance for AA1000AS” 15). Once the agreement has been reached and written, much of the planning of the engagement will be completed.

The actual execution of the engagement involves the assurance provider obtaining any necessary evidence such as financial reports, inventory reports, water usage reports,

energy consumption reports, personnel data, supplier information, and correspondence and information related to stakeholders (GRI 8). The assurance provider's access to such evidence and information is limited to the agreed-upon level and scope of the engagement as stated in the engagement agreement. Once the necessary evidence is obtained, the team would analyze all of the data and evidence within the scope of the engagement by using accepted sampling protocols and procedures. The AA1000AS recommends that tests for the quality of information consider the reliability, clarity, balance, comparability, accuracy, and timeliness of the information being examined (AccountAbility, "Guidance for AA1000AS" 18-19).

While the AA1000AS recommends that CSR reports should be tested based on the measures listed above, there are several different views on what exactly should be analyzed when assuring a CSR report. For example, KPMG has identified seven important criteria used by their analysts in assessing CSR reporting. The first component they look at consists of strategy, risk, and opportunity. The CSR report should have a clear assessment of any risks that a company faces regarding its CSR impacts and practices. Furthermore, the report should then list any actions taken in response to the identified risks. The next criteria that CSR reports can be evaluated on is materiality, which requires CSR reports to show that the company has identified the issues with the greatest potential impacts on both the company itself as well as its various stakeholders. The report should also detail how the company measured and determined materiality. Analysts should then look at the targets and indicators highlighted in the report to see if the company is using meaningful targets and performance indicators to measure and report progress. The fourth aspect that is considered is the impact on the environment of

the company's suppliers and value chain. Next, the CSR report should also identify the company's stakeholders and disclose how they engage with the stated stakeholders and respond to their feedback. The CSR report also needs to be clear on how the company's CSR activities are governed within a company. Lastly, the CSR report is assessed on how balanced the information is by looking to see if both the necessary positive and negative information is included. This last test considers the true transparency of the CSR report (KPMG, "The KPMG Survey of Corporate Responsibility Reporting 2013" 8).

An assurance engagement process concludes with the issuing of a CSR assurance statement. AA1000AS does not specify the language to be used in the statement, but it does provide requirements for the information that must be included (AccountAbility, "Guidance for AA1000AS" 26). The AA1000AS says that an assurance statement should include the following information:

Title, intended users of the assurance statement, note on roles and responsibilities..., description of the scope of the assurance engagement and its type (stating either Type 1 or Type 2), assurance standard used..., description of disclosures covered, note on criteria used, limitations (in the sustainability report, in the engagement scope or evidence gathering), description of methodology, statement on level of assurance (stating Moderate or High, or equivalent from other assurance standards), findings, conclusions concerning adherence to the AA1000AccountAbility principles (in all cases), findings and conclusions concerning the reliability of specified information (for Type 2), observations and recommendations..., note on competencies and independence of assurance

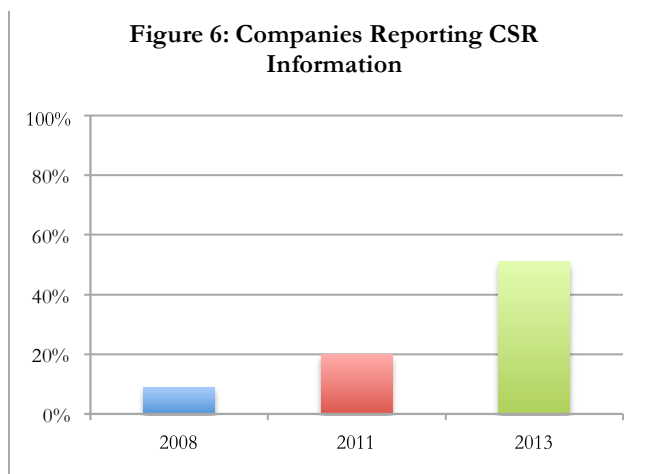
provider, name of the assurance provider, and place and date. (AccountAbility, “Guidance for AA1000AS” 26-27).

In conclusion, assurance engagements for CSR reports do not follow a clearly defined process, but there are still methods that allow assurance providers to effectively help companies by offering third-party assurance to the reports.

VII. CSR Consulting Proposal

In the United States, corporate social responsibility is not required, and the reports that are issued pertaining to CSR activities remain unregulated. With this in mind, it would be easy for executives to consider CSR reports to be a waste of time and money, but CSR reporting, like CSR itself, is becoming expected in today's world. Thus, executives should consider the possible benefits that they could achieve from issuing CSR reports before making their decision. Today's business world is incredibly different than it was as recently as ten years ago. Consumers and investors are becoming increasingly savvy and curious about the conduct of businesses. The Internet has created a gateway to an abundance of information, and the demand for nonfinancial information of companies does not seem to be declining any time soon. CSR reports partly answer this demand, and most large corporations have realized the importance of providing such information. In fact, KPMG's 2013 survey found that CSR reporting has become a standard practice. In the past, CSR and CSR reporting helped to create a competitive advantage for firms, but the majority of large companies now take part in some fashion of CSR strategy. Consequently, what used to be considered a competitive advantage is now progressively becoming a standard and anticipated part of modern business. This alone should urge companies to issue some sort of CSR report. If a firm is not capable of producing a stand-alone CSR report, they should include necessary material disclosures

as additions to their annual reports. In 2013, 93 percent of the 250 biggest companies worldwide included CSR information either in their annual reports or as stand-alone reports. According to the survey, 51 percent of reporting companies worldwide now include CSR information in their annual financial reports (KPMG, “The KPMG Survey of Corporate Responsibility Reporting 2013” 11). Though just eclipsing the 50 percent mark, the future of CSR reporting is expected to continue to increase. Integrated reporting is an issue that should be considered and watched going into the future of CSR reporting. Figure 6 shows the dramatic increase in number of corporate responsibility included in annual reports since 2008.



Source: KPMG. The KPMG Survey of Corporate Responsibility Reporting 2013. Publication. KPMG, 2013. Web.

In the past, a gap was present amongst industries that reported on CSR activities and those that did not. Today, that gap has closed for the most part with more than half of companies in all sectors reporting on CSR (KPMG, “The KPMG Survey of Corporate Responsibility Reporting 2013” 11). What this means is that regardless of industry, companies are expected to report on their CSR strategies.

Clearly, CSR reporting is in high-demand, but the costs relating to compiling and issuing the CSR reports are important to consider. The literature on the topic does not

include thorough outlines of expenditures for producing these reports. Thus, further research should be conducted in order to quantify the costs of producing and marketing CSR reports. The literature regarding CSR strategies in companies and CSR reporting is currently very inconclusive. Many researchers attempt to find relationships between CSR and financial performance or other factors, but, with diverse variables that influence these relationships, no concrete association has been found. In addition, quantifying CSR initiatives and the costs of issuing CSR reports is made difficult because CSR and CSR reports are not “one-size-fits-all.” Each company interprets CSR differently and develops their plan accordingly. Furthermore, smaller companies are less capable of enacting widespread CSR programs with thorough reports. Nevertheless, there are several common costs that result from the development and issuance of a CSR report—though the amounts of the costs would differ greatly amongst companies. Some of these costs are hiring personnel to be in charge of the company’s CSR practice, compiling the CSR report, paying an independent assurance firm to attest the report, and marketing the report and practice to the public.

Looking past the market prevalence and expectations of CSR reporting, there are several additional benefits to disclosing CSR information. First, CSR reporting can drive performance and innovation. After assessing nonfinancial dimensions and effects on their businesses, several executives noticed that new opportunities or areas of improvement were identified through the process of CSR reporting. Ute Menke of Bayer agreed with this benefit of CSR reporting, and explained the specific impact on Bayer by saying, “our climate program began with a focus on efficiency and has led to innovation in our products and services, such as our sustainable housing products. Apart from disclosing

these developments transparently, reporting also plays a role in this through its impact on internal awareness and increasing detailed and reliable data management” (KPMG, “The KPMG Survey of Corporate Responsibility Reporting 2013” 44). Another added benefit of CSR reporting is an enhanced reputation—both internally and externally. Reporting can directly influence employees by giving them a source of both pride and motivation. With added pride and motivation, companies can experience improved recruitment and retention of their employees through publishing their CSR initiatives (Adams and Zutshi 33). From an external perspective, producing a report showing the CSR actions and impacts can build credibility to stakeholders and customers. Additionally, by spending the time and money to issue the report, companies can show their commitment to CSR goes beyond a marketing strategy. However, it is important that the reports must be produced with high quality and credibility in mind in order to experience these added benefits. As stated earlier, information is easily accessible in today’s world, so, if a company were found to be guilty of not matching their actions with their words, their reputation would suffer greatly. Nevertheless, communicating CSR practices and goals can greatly help companies engage with their stakeholders in the future. Another benefit of CSR reporting is improved internal communication by enhancing internal awareness of CSR across all parts of the company (KPMG, “The KPMG Survey of Corporate Responsibility Reporting 2013” 45).

With these benefits in mind, it is clear that knowing how to brand a company’s CSR component can be an innovative and valuable business strategy. A few general recommendations in creating an effective CSR strategy are to get support from the top of the organization, get the right balance of stakeholder engagement, be transparent on

targets, create ownership, use reporting frameworks, and invest in external assurance (KPMG, “The KPMG Survey of Corporate Responsibility Reporting 2013” 41). In addition, companies should realize that the “consumer today is looking for a relationship, not just a transaction. CSR can be an effective way to build relationships that products themselves can’t” (McElhaney 35). Additionally, consistency is incredibly important with CSR reporting and branding. A simple strategic message will add value when communicated effectively to all stakeholder groups and to all employees. Thus, an effective CSR marketing strategy is to integrate the company’s CSR message into the core branding strategy. Essentially, incorporating CSR into the culture, governance, and strategy-development and decision-making processes makes a firm’s commitment to CSR obvious and help it be seen by stakeholders. Another idea to help market the company’s CSR strategy is to establish a website devoted to highlighting the various CSR practices and goals of the company. In addition, the website should include the CSR report for the company. Overall, the CSR marketing strategy depends largely on the company’s individual CSR initiatives, but the prevalence of CSR reporting in all sectors of business shows that companies not already considering the strategic advantages of CSR reporting and marketing should do so in the near future.

VIII. The Benefits of Attestation to a CSR Report

Seeking external attestation of CSR reports can provide several benefits to a company. Major accounting firms have been shown to be the major providers of independent assurance services for CSR reports. In 2012, the Global Reporting Initiative (GRI) found that 46 percent of reports listed in its Sustainability Disclosure Database claimed some form of external assurance, and accounting firms provided the assurance for 64 percent of those reports (GRI 9). With large global networks and extensive knowledge of financial and nonfinancial reporting, major accounting firms offer additional advantages in their CSR reporting services.

According to PwC's website, their experienced professionals can offer several unique services for attesting CSR reports. Their services include helping companies by identifying the information that their stakeholders require, engaging internal audits to evaluate internal controls and measures, providing independent assurance of the data included in the CSR report and information used for regulatory purposes, supporting submissions to sustainability indices, reviewing current reporting with best practices with the goal to improve beyond compliance, verifying data with environmental benchmarks and popular sustainability reporting guidelines (GRI, AA1000), aligning sustainability

objectives with the corporate strategy, and assessing how the product or service life-cycle impacts sustainability goals (PwC, “Global Sustainability & Climate Change”).

Though not required by the U.S. regulatory bodies, the services listed above can lead to significant positive effects for companies. First, voluntarily investing in independent assurance increases recognition, trust, and credibility for companies. Choosing to get an independent party to review and certify the information shows that companies are serious about their CSR practices and reporting. Therefore, stakeholders, investors, analysts, and rating agencies can make decisions based on the information included in the report with greater confidence. In addition, external assurance provides reduced risk and increased value. Reports commonly contain errors, but assurance increases the possibility of the errors being discovered and subsequently restated. Consequently, CSR reports that are not externally assured provide little to no value for the company and its stakeholders. The increased credibility of assured CSR reports reduces the risk of possible restatement or assumptions based on erroneous information, which can keep companies from having to spend unnecessary money. The next benefit of externally attested CSR reports is that companies can experience improved board and CEO level engagement. In order for CSR strategies to be effective, the top executives of the company must consider them to be a top priority. Assuring the CSR report not only shows that the executives are behind the initiatives, but it also generates and extends the interest in sustainability disclosures as part of the overall business strategy and performance. Next, companies that list externally assessed reports most likely have stronger internal reporting and management systems as a result. With the help of accounting firms, companies can ensure that their internal controls and systems are strong

and efficient. Lastly, the assurance process will improve stakeholder communication by reviewing the stakeholder engagement process and by providing a platform for dialogue with stakeholders (GRI 6-7). Overall, the many benefits of assurance should convince companies to have their CSR reports undergo independent attestation by a large accounting firm.

IX. Ethical Considerations of CSR and CSR Reporting

The term ethics typically refers to the moral principles regarding a choice or undertaking. Ethics are certainly not black and white with a clear line between what is ethical and what is unethical. Though CSR can clearly be seen as having several positive ethical effects by striving to improve the world in which businesses are operating, the motivations behind CSR and CSR reporting can give rise to an ethical dilemma. Is something deemed ethical based solely on the face value of an action or should the motivations driving the action be examined too? This question may not have an answer, but it is interesting to consider.

CSR has been described simply as “doing well by doing good.” Though no conclusive research has been reached on a definitive relationship between CSR and financial performance, the idea of doing good in order to achieve a profit seems questionable. In addition, many firms undertake CSR initiatives in order to boost their reputation or to compete in a CSR saturated market. If these forces were no longer present, would companies continue to see value in CSR? Most businesses are doing business in order to make money, so it seems that most will only engage in CSR to the extent that it will not hinder their profitability. Though CSR is not unethical, the motivations that push companies to pursue CSR are important to realize before proclaiming the ethical superiority of companies engaging in CSR.

On the other hand, it is clear the making a profit at the expense of basic human rights can never be justified. Additionally, it could be argued that knowingly harming the environment, endangering the public, or supporting firms that do so are also unethical business practices. These tenants are the reason why CSR is considered to be an ethical addition to the business world. In order to truly be as ethical as possible, businesses should not attempt to cover up a particular episode of unethical or negative behavior with a positive CSR strategy or initiative. In cases where this has been true, consumers have not reacted positively, and consumers, as well as other stakeholder groups, have become increasingly skeptical of companies for this reason. Thus, it is incredibly important for companies to be completely transparent in order to show that their CSR practices and CSR reports are truly ethical business practices and not a cover-up attempt.

X. Global Considerations of CSR

According to the compiled literature, the United States was considered, until very recently, to be lagging behind its European counterparts in terms of CSR initiatives and CSR reporting (Cecil, Economist Intelligence Unit). Recently, research has shown that U.S. corporations have closed the gap that previously existed in the number of corporations issuing reports on their CSR practices, but there are still several areas that the U.S. is behind on compared to other parts of the world. The KPMG Survey of Corporate Responsibility Reporting in 2013 showed that the U.S. had levels of reporting equal to other leading countries—an improvement from the past. Nevertheless, the survey showed that European countries remain an example to other regions in terms of the quality of their reports. Based on the rating system used in the survey, Italy, Spain, and the United Kingdom achieved the highest average scores for their companies' reports of all the countries included in the survey.

One of the big drivers of CSR reporting and the quality of CSR reports is the extent of regulation. From a regulation perspective, the U.S. does fall behind other countries, especially those in Europe. Arguments can be made both for and against regulation of CSR reports, but, regardless of attitude, it is beneficial to look at the regulations that are currently in place in other countries.

In Denmark, large companies are required to report on their CSR activities or explain in their annual reports why they do not. The French Grenelle II Act passed in 2012 requires all large companies to report annually on their CSR activities, and, in addition, it advises that companies seek external verification. The Securities Exchange Board in India requires the top one hundred listed companies to report on India's "National Voluntary Guidelines for Social, Environmental and Economic Responsibilities of Business" in their annual reports. In addition, India has a new piece of regulation called the Companies Act, which will go into effect for the 2014/2015 financial year. The Companies Act will require all registered companies to form a Board Committee on Corporate Social Responsibility, invest at least 2 percent of net profits on socially responsible projects, and explain their activities in their annual report. In Indonesia, limited liability companies and publicly listed companies are both required to report on CSR in their annual reports. Japan currently has both mandatory and voluntary guidelines for particular types of companies that require them to report on their environmental impacts.

Stock exchanges and other organizations are also enforcing new guidelines and standards to which companies must adhere. The Malaysia Stock Exchange, for example, requires listed companies to describe their CSR activities. In addition, Malaysia has a law that requires all publicly listed companies to disclose CSR information in their annual reports. Another example of a nongovernmental organization influencing CSR reporting is the Central Bank of Nigeria. In 2012, the bank issued guidelines that mandated financial services companies to establish sustainability processes and subsequently report on them. The Securities and Exchange Commission of Nigeria also recently updated their

Corporate Governance Code to recommend reporting on sustainability activities. The Singapore Stock Exchange (SGX) introduced their Sustainability Reporting Guide for listed companies along with a revised version of their Code of Corporate Governance. In addition to these initiatives that encourage CSR reporting, the Singapore government enacted the Energy Conservation Act of 2012 to require large companies to report on their energy use. Similarly, large Norwegian companies are required by the Norwegian Accounting Act to report on social, environmental, and anti- corruption activities. South Africa, which boasts a ninety-eight percent reporting rate, has the King Code of Governance Principles and King Report on Governance (King III) that require companies to publish integrated reports including their CSR performance. In addition, the Johannesburg Stock Exchange (JSE) also requires integrated reports from listed companies. Lastly, the United Kingdom's Companies Act requires both medium and large sized companies to include CSR information that is relevant to the company's performance in the annual report (KPMG, "The KPMG Survey of Corporate Responsibility Reporting 2013," 25-26).

In comparison, the regulations in the United States are much narrower in scope. The Dodd-Frank Act, detailed earlier, requires companies to issue disclosures on conflict minerals. Also explained previously, Presidential Executive Order 13514 requires federal agencies to report on CSR performance in hopes that leading by example will cause other to follow suit. In reality, CSR reporting is on the rise globally, and American companies have taken note. Their response has been to also issue CSR reports, even though they are almost completely voluntary. In order to compete globally and to gain the benefits from

CSR reporting, U.S. companies have closed the former gap in CSR reporting and have become one of the leaders in terms of percentage of CSR reports issued.

Though the U.S. government has acknowledged CSR through several initiatives and agencies, The European Commission, the executive body of the European Union (EU), has gone a step further by issuing a stated agenda regarding CSR in the EU. According to their website, the Commission’s CSR agenda for action is:

1. Enhancing the visibility of CSR and disseminating good practices
2. Improving and tracking levels of trust in business
3. Improving self- and co-regulation processes
4. Enhancing market reward for CSR
5. Improving company disclosure of social and environmental information
6. Further integrating CSR into education, training, and research
7. Emphasizing the importance of national and sub-national CSR policies
8. Better aligning European and global approaches to CSR. (European Commission, “Corporate Social Responsibility”).

In addition, the European Commission website includes a table that breaks each objective down to how the EU will go about achieving its stated goals. Table 2 shows a portion taken from the table for the first item on the agenda.

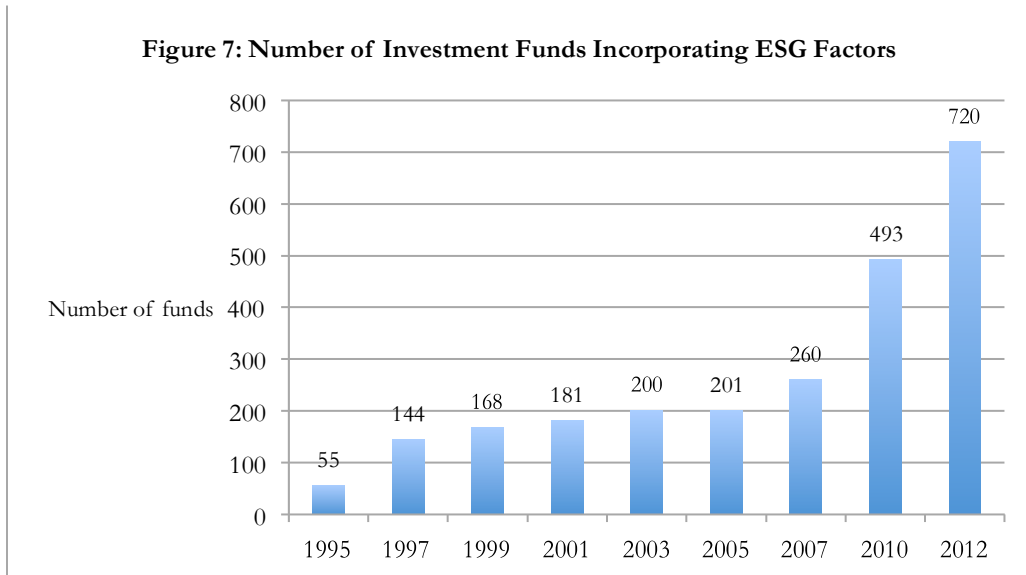
		Action	Target Date
Priority	1	Create multi-stakeholder CSR platforms in a number of industrial sectors	2013
	2	Launch annual CSR awards	2012
Other	a	Support initiative to build CSR capacity of SMEs	No date specified
	b	Dialogue with companies on issues as employability and workforce evolutions, demographic change, the needs of young people, active ageing, employee health and well-being	No date specified
	c	Cooperate with CSR Europe to review the initial results of Enterprise 2020 and help define its next steps	2012

Source: European Commission. European Commission Communication on CSR 2011: Implementation Table. Rep. European Commission, Mar. 2014.

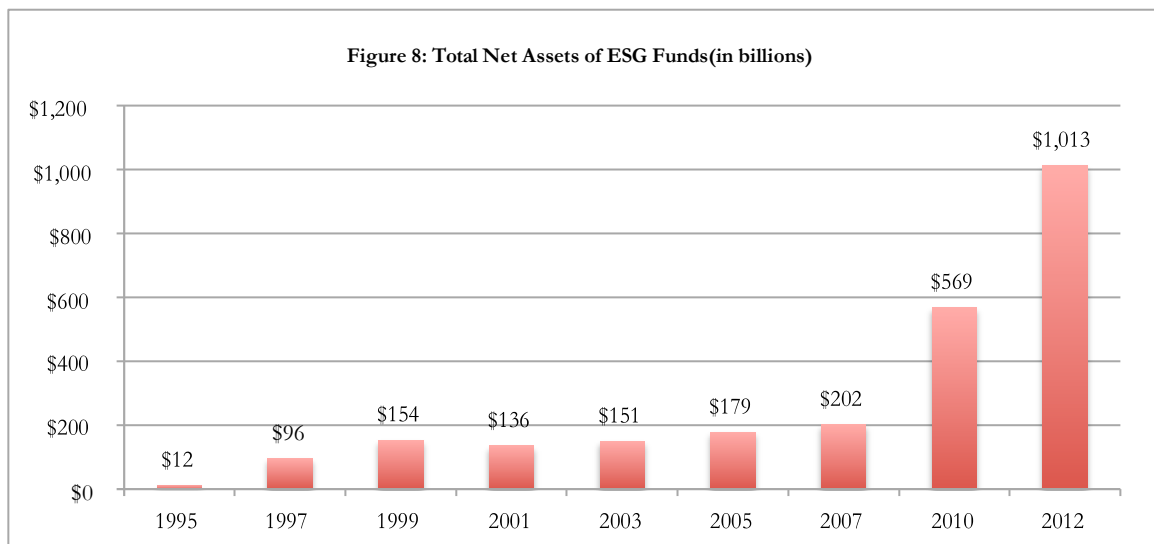
The European Union's commitment to establishing and encouraging CSR in its domain is clear through the thorough plans and clear objectives. Furthermore, the European Commission has worked with CSR Europe, which is the leading European business network for CSR. The two bodies have been able to work together to promote CSR and to put it on the agenda of EU member nations. In order for CSR to reach its full potential in the U.S., the U.S. government needs to partner and establish continued communication with business leaders and business organizations. CSR will likely become an increasingly global phenomenon due to the globalization of the business world. Consequently, governments and businesses will need to work together to develop CSR strategies that harmonize with one another to achieve the ultimate benefits that CSR can offer.

XI. Investment Benefits of CSR Practices

Many students learn on the first day of finance class that the primary responsibility of public companies is to maximize shareholder value, but recent trends have seen a growth in socially responsible investing. Socially responsible investing (SRI) is an investment strategy that considers environmental, social, and governmental (ESG) criteria when choosing investments in order to generate both financial returns and a positive social impact (US SIF). Every two years, the US SIF—The Forum for Sustainable and Responsible Investment—issues its “Report on Sustainable and Responsible Investing Trends in the U.S.” Their most recent report from 2012 showcases the huge growth in SRI in recent years. On the following page, Figure 7 shows how the number of funds that take ESG criteria into consideration has increased in recent years, while Figure 8 displays the increase of net assets held by these funds. The information in the following two graphs was taken from the US SIF’s 2012 report.



Source: US SIF. Report on Sustainable and Responsible Investing Reporting Trends in the United States 2012. Rep. The Forum of Sustainable and Responsible Development, 2012. Web.



Source: US SIF. Report on Sustainable and Responsible Investing Reporting Trends in the United States 2012. Rep. The Forum of Sustainable and Responsible Development, 2012. Web.

Investors of all types from pension funds to individual investors are increasingly beginning to invest in stocks based on ESG criteria that they believe will advance society and promote a sustainable economy. The prevalence of SRI has caused the shattering of the belief that SRI is only for certain types of firms. Companies have begun to

incorporate SRI pension funds to their company's CSR practices. Hewlett Packard, Ford, and The Gap all adopted the Domini Social Equity Fund to their 401 (k) plans, which helped to make SRI a mainstream practice (Shank, Manullang, and Hill 33). Some of the SRI funds have exclusionary screening practices where they actively do not invest in firms with negative ESG criteria. Early adopters of SRI did so by not investing in tobacco, gambling, weapons, and alcohol. Inclusionary practices, where the funds seek out organizations that operate in a certain manner, have started to have a bigger role in SRI, and these practices are expected to become more prevalent in the future (Shank, Manullang, and Hill 34). In order for pension funds and other investors to be successful in their SRI practices, they must also consider the potential for financial return as traditional investors have in the past. Thus, SRI is just an additional consideration for investors. If viewed in this manner, research has shown that there is little or no effect on portfolio returns. Though this may seem pointless without an additional return, SRI is contributing to the good of society and a more sustainable economy. In addition, research has shown that the market does add CSR into the price of stocks in the long run. While the short run may result in little or no difference in return, pension funds can achieve higher than average returns in the long run (Shank, Manullang, and Hill 44). SRI is an important consideration for pension funds because the increase in CSR and SRI recently show that both concepts are not leaving business any time soon. If trends continue into the future, they will both only continue to grow. As CSR becomes more widely known and more research is conducted, CSR components of business will likely begin have a larger effect on the pricing of stocks.

Pension funds can gain additional benefits from adding the stock of a CSR-invested company to their funds. CSR practices can help reduce company's risks in terms of sustainability and regulatory. Thus, companies are less likely to experience lawsuits or negative media attention when engaged in CSR. In addition, it has been found that analysts infer that large CSR initiatives signal that the future earnings of the firm will increase in the future and price the stocks accordingly. This inference is due to the belief that CSR is what "rich" companies do. Though this is becoming more of a misconception than a fact, pension funds are still able to capitalize off this belief by investing in companies that go above-and-beyond in their CSR endeavors (Lys, Naughton, and Wang). Similarly, the stock market has been shown to react positively to eco-friendly corporate initiatives and negatively to eco-harmful behavior (Flammer 29). Overall, SRI will likely continue to grow with CSR, and pension funds should begin to consider their own CSR practices and reputation in order to remain successful.

XII. Unintended Consequences of CSR

Though CSR has become an integral part of today's business world, companies, governments, and consumers should all be knowledgeable and attentive of some of the unintended consequences of CSR. Towards the beginning of the report, the Dodd-Frank Act was introduced. As stated earlier, the Dodd-Frank Act requires companies that deal with certain conflict minerals to issue an additional report to the SEC in order to try to reduce the trade of minerals originating from armed groups in the Democratic Republic of Congo. From an initial and high-level stance, the goals and requirements seem ethical and right; upon further consideration the Dodd-Frank Act has several unintended consequences for both the businesses and the people in the Democratic Republic of Congo. Section 1502 of the Dodd-Frank Act, which pertains to the reporting on conflict minerals, applies to nearly every publicly-traded company in the U.S., which amounts to around 6,000 companies (FSC Majority Staff 3). How is this possible? The materials that are labeled conflict minerals are used to make a large assortment of products in almost all industries. Thus, any company with contact with the listed minerals, whether in production or by supplying them to another company, must account for the origin of all of their minerals. The estimated costs of complying to Section 1502 are incredibly high. Senator Dick Durbin commissioned a study at Tulane University, and the study reported an estimated cost of \$7.93 billion to implement Section 1502 (Bayer 3). These costs

would include internal costs as well as payments to third parties for consulting, IT systems, and audit services. Section 1502 advocates justify these enormous costs by saying that they will help end the current conflict in the Democratic Republic of Congo, but, as it stands now, it is unclear how effective Section 1502 will be towards achieving that lofty goal (FSC Majority Staff 3). Additionally, Section 1502 has come under criticism due to its possible negative effects on the people living in the Democratic Republic of Congo. Since companies are required to account for the origins of their minerals, many are beginning to halt their purchases from the Democratic Republic of Congo, regardless if they are from an armed group or not. Due to the lack of organized system, companies cannot always meet the necessary requirements of Section 1502 to show that minerals from the Democratic Republic of Congo are conflict-free, even if they truly are. Thus, the people working in non-conflict mines are losing their jobs and falling into further impoverishment since mineral trading is such a huge industry in that area of the world (FSC Majority Staff 2).

In terms of CSR reporting, issuing reports on what a company spends money on or gives special attention to could give competitors an easy way to imitate what successful or highly regarded companies are doing. On the other hand, reporting could accidentally highlight areas that a company is noticeably not addressing that other companies are. In other words, CSR is likely to start to become a competitive game for companies, which could cause the costs of CSR to rise significantly. The competitive nature that CSR has developed into and will continue to become makes it difficult for some firms to compete. Smaller and medium sized businesses may not hold the necessary resources to be able to spare time or money for CSR activities. CSR programs certainly

do not exist without significant costs. In order to get the most out of CSR, companies should have a designated CSR team and executive, have a CSR marketing plan, submit a CSR report, and hire an external assurer to attest the CSR report. All of these on top of the actual CSR actions themselves could add up to a costly CSR component. These costs would likely decrease as they CSR becomes more integrated into the business model and strategy, but stakeholders will expect the CSR initiatives to be sustained and grown into the future. Companies should strive to make their CSR closely related to their original business goals and competencies so that they do not become too distracted from their core business purpose. Additionally, CSR has already become almost commonplace in today's business, so the question of its continuation if it is not longer seen as competitive advantage will be determined in the near future.

Conclusion

As the business world becomes increasingly global, demands are increasing for companies to become more transparent in their practices. With this additional transparency, companies must begin to consider the impact of their operations on society as a whole. Thus, CSR has become an up-and-coming topic and trend amongst modern businesses. Today, CSR is no longer a competitive advantage for a handful of firms. Instead, it has become a standard business practice amongst companies in all industries. Consequently, business executives should develop CSR strategies for their firms. CSR does not take the same form in every company, so executives should be careful in the adaption of their own strategies to ensure that they pursue activities that fit best for their individual needs and practices. Accompanying the widespread emergence of CSR in companies, CSR reporting has also become an expected business practice. Stakeholders are requiring increasing amounts and types of information when making their decisions for purchasing and investing in companies. The next area that will likely continue to rise in the future is the independent assurance of CSR reports.

The items explored in this report will certainly be the subjects of future research and attention in both the business and political sectors. Thus, it is important to be aware of these items to know how businesses could be impacted by future legislation or trends in these areas. Though more will be known after additional research is conducted regarding CSR, companies can no longer be passive in acknowledging the impact of their

operations on society as a whole. In closing, today's business world requires that the business of business be much more than just business.

APPENDIX A

An Analysis of Corporate Social Responsibility & Corporate Social Responsibility Reporting



ANNA CLAIRE WAMMACK
MAY 1, 2014
PWC

The Rise of CSR



- “There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits.”
 - Milton Friedman (1970)
- The business of business is now more than just business
- Increased demand for businesses to act responsibly
 - Ethical public
 - Scientific community
 - Governmental regulations and initiatives
- CSR can no longer be ignored

CSR Defined



- Difficult to define
- The World Business Council for Sustainable Development defines CSR as:
 - “the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large”
- Companies going above and beyond legal requirements to benefit the workplace, society, and the world
- CSR involves a multi-stakeholder point-of-view

CSR in Companies



- CSR is not a “one size fits all” idea
- Common areas of focus:
 - Environmental sustainability
 - Human rights
 - Governance & ethics
 - Supply chain standards
 - Education
 - Focusing on employees
 - Giving back to community

Why does CSR matter to accountants?

- Government regulations
- Opportunities to provide clients with additional services
 - Assurance
 - Consulting
- Accounting firms are businesses themselves
 - PwC “Corporate Responsibility Report”
 - PwC “Houston Corporate Responsibility Value Report”

U.S. Regulation of CSR

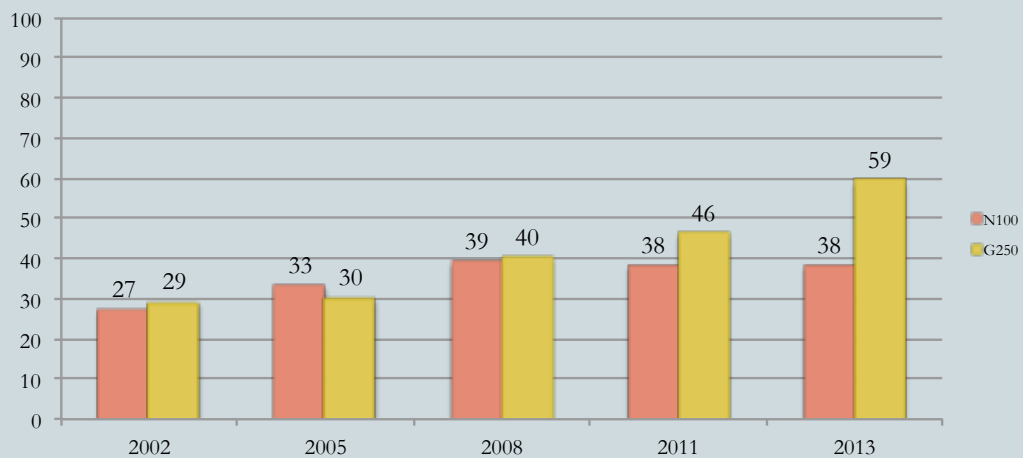
- Several initiatives and tax incentives to encourage CSR-related goals
- Governmental agencies leading by example
 - Executive Orders #13423 and 13514
- No requirements for CSR or CSR reporting
 - Section 1502 of the Dodd-Frank Wall Street Reform & Consumer Protection Act
 - Greenhouse Gas Reporting Program
 - Toxics Release Inventory

CSR Reporting

- Standard business practice
- Consumers, regulators, and investors increasingly expecting CSR information for decision-making purposes
- No uniform method for reporting
 - Global Reporting Initiative (GRI) Framework
 - AccountAbility
- Benefits of CSR reporting:
 - Increased performance and innovation
 - Enhanced reputation and credibility
 - Improved internal communication

Assurance of CSR Reports

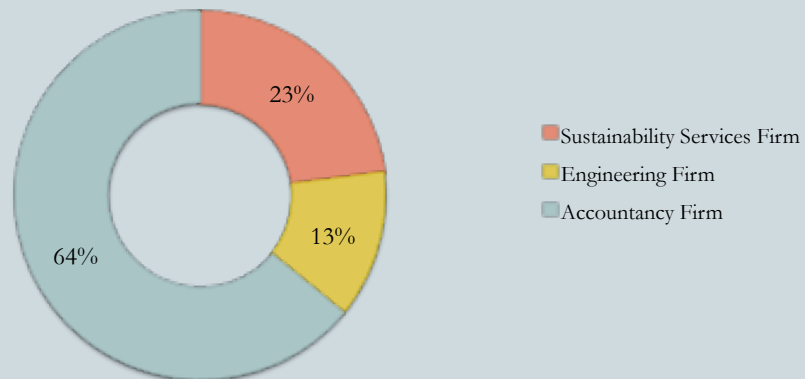
Rates of Assurance for CSR Reporting



N100 refers to the world's largest 100 companies by revenue, and G250 refers to the 250 largest companies.

Who Provides Assurance for CSR Reports?

Providers of External Assurance of GRI Reports Published in 2012



Assurance of CSR Reports

- **Unique services for the attestation of CSR reports:**
 - Identify information required by stakeholders
 - Evaluate internal controls and measures
 - Assurance of data in the report and for regulatory purposes
 - Support of submissions to sustainability indices
 - Review of current reporting with best practices to further CSR
 - Verify data with environmental benchmarks and popular reporting guide lines (GRI & AccountAbility)
 - Align sustainability objectives with corporate strategy

Assurance of CSR Reports



- **Why should companies assure their CSR reports?**
 - Increased recognition, trust, and credibility
 - Increased executive engagement
 - Reduced risk and increased value
 - Strengthened internally reporting and management systems
 - Improved stakeholder communication

Marketing CSR



- **Utilize the Internet**
 - Design a CSR portion of website and make it visible
 - Highlight CSR practices on social media
 - Post the CSR report
- **Get support from the top of the organization**
 - Make CSR a priority
- **Incorporate CSR into core branding strategy**
- **Be consistent**
- **Beware of “greenwashing”**
- **Take additional costs into consideration**

Future of CSR

- Debate still surrounds the idea of CSR
- Research is necessary to explore the financial effects of CSR on companies
 - Difficult due to ambiguous nature of CSR and large number of variables
- Regulations for CSR reporting are growing
 - Is the U.S. next?
- Government expenditures for energy-related research are being questioned
 - How will the U.S. recover lost revenue?
- Companies should consider incorporating CSR into their business strategies
 - Beware of unintended consequences

Questions?

APPENDIX B

Professional Development and Speaker Series:

PricewaterhouseCoopers, September 12

Ken Verheeck, Partner, Assurance, Houston, TX
Brent Ellis, Managing Director, Tax, Houston, TX
George Bordelon, Experienced Associate, Dallas, TX
Corey Edgar, Campus Recruiter, Dallas, TX

Summary of the case

The city of Westmead had previously relied on revenues from a tax on gas for automobiles to maintain the city's infrastructure, but the rise of electronic and fuel-efficient vehicles has caused the gas tax revenue to decrease dramatically. With one its main revenue sources dwindling, the city is in desperate need of additional revenue in order to maintain some heavy-traffic bridges into the future. In order to help solve this issue, the city asked for proposals for a revenue neutral solution to overcome this loss of revenue.

Our solution

We provided several solutions such as imposing tollbooths on roads to generate revenue to maintain the bridge and road infrastructure. This solution would allow revenue to be generated for every car that drove over the bridges or roads in need of maintenance or upkeep. Another positive element of tollbooths is that it only applies to those using the infrastructure where the revenue would be going. Another solution that we offered was a proposed tax on tires. Like the tollbooths, a tax on tires would apply to all cars, regardless of fuel efficiency.

What I learned

This case caused me to think about tax policy, which is not something that I have much background on. In addition, the PwC representatives gave good advice on how to explore possible solutions. They suggested thinking of all aspects, and they said, in this case, that political factors needed special attention. This presentation was an excellent way to begin the semester. It provided us with a real case, which was very beneficial going into the case competitions. In addition, it made us consider a topic that we have not really had classes on yet, so we had to be somewhat imaginative. Since I have yet to thoroughly cover taxes, I really enjoyed and benefitted from the feedback that we were given. After we offered our proposal, they would give us additional questions and perspectives to consider. Their feedback was valuable as we started the case competitions.

BKD, September 19

Linda Trifone, Senior Manager, Audit, Jackson, MS
Matt Glover, Senior Associate, Audit, Jackson, MS
Thad Burke, Senior Associate, Tax, Jackson, MS
Chandler Croom, Staff, Audit, Jackson, MS

Summary of the case

My group's case was about Robert, an owner of condominiums, who had one maintenance worker named Manuel. Robert's son was an auditing student, and he was able to uncover Manuel's fraud that he had committed. Ronald discovered that Manuel had been making purchases from a hardware store, getting the owner to reimburse him, and then returning the items. This allowed him to pocket the cash. In addition, Ronald found that he had reported that a toilet in one of Manuel's family member's units had been replaced 5 times in a year. In addition, the average monthly expense that Manuel recorded for repairs increased dramatically before Christmas and his vacation. Ultimately, Ronald discovered that Manuel had been committing various frauds for three years from Robert's business.

Our solution

The main problem in this case was that no one was supervising Manuel. Manuel took calls from residents, did the repairs, and purchased the necessary materials. Thus, he was able to falsify repairs and purchases in order to keep money for himself. We proposed a company account and credit card to eliminate personal money from being exchanged. In addition, hiring another worker as an office manager or receptionist would be able to verify which residents actually needed repairs. Lastly, we proposed that the reported repairs should require a site visit by a manager or someone other than the maintenance worker. Overall, Manuel's duties needed to be segregated, and he should have been more closely supervised.

What I learned

This session was very informative about fraud. I learned that fraud is different than other crimes because it is hidden. Also, 87% of fraud crimes are first time offenders, so fraudsters are not always hardened criminals. The presentation also highlighted ways to detect fraud such as behavioral red flags and looking at analytical trends. Lastly, I learned several different types of prevention methods to stop fraud before it occurs. Some of these are segregation of duties, tone at the top, education, and proper documentation. In conclusion, this presentation taught me a lot about how fraud and accounting affect one another, and by hearing a real life situation I was able to see how it would affect me on the job.

KPMG, September 26

Kirsten Hill, Managing Director, Advisory Technology Enablement, Dallas, TX
Betsy Sights, Campus Recruiting, Memphis, TN

Summary of the case

Managing stakeholders' demand is becoming increasingly important for successful decision-making within businesses. Companies may have several different types of stakeholders including investors, creditors, suppliers, consumers, politicians, and other community members. Each of these may expect different things from their relationship with the company, so it is important for relationships with stakeholders' be kept in mind while making decisions.

Our solution

The solution to managing stakeholder relationships is to identify the organization's key stakeholders through target analyses, impact charts, and priority tables. These methods will help determine a strategy for the situation. Overall, stakeholder relationships should be becoming a high priority in organizations. Businesses should strive to continuously improve the understanding of their stakeholders and the measurement tools to communicate with them. In order to truly show the priority of stakeholders, they should be taken into consideration when important decisions are being made.

What I learned

This presentation was very informative about managing stakeholders' relationships. Though this was a topic I had not specifically considered, its importance definitely shown through the presentation. Stakeholders are key to businesses, so they should without a doubt be key to the decision making process of businesses. Also, the relationship between an organization and a stakeholder should not be undervalued or forgotten. I also really appreciated Mrs. Hill and Mrs. Sights' commentary on time management. Hearing from their real life perspective on managing different aspects of life was a welcome look into my future. In addition, it was great to hear their advice on what kind of attitudes they look for in job candidates and how we should always be aware of our surroundings.

Center for Intelligence & Security Studies, October 3

Dr. Carl Jensen, Director & Associate Professor of Criminal Justice, University of Mississippi

Summary of the case

Dr. Jensen presented our class with the issue of clandestine drug records. Since selling drugs is a lucrative business, many drug dealers keep records of their sells and accounts receivable. However, these accounting records are not in the typical format of legitimate businesses. They are often difficult to read or to understand, but prosecutors can use them as key pieces of evidence in criminal cases. Often, the numbers are not written completely, or the records may be encoded in order to make it difficult to be understood by anyone other than the drug dealer.

We were presented a specific case to decode that involved numbers being replaced by letters.

Our solution

In order for records to be legally proven to be the records of an illicit drug business, there are three steps to be taken. First, they must be proved to be clandestine. Next, they need to have CLASS characteristics of account designations, dates, indications of payments, accounting terminologies, quantities, units, and prices. Last, the records should contain individual characteristics of an illicit drug business including price per unit, kilo markings, bale lists, and specific drug terminology. After examining these factors, there are five possible conclusions: the submitted documents are the records of a

(type of drug) distribution business, the submitted documents are records of an illicit drug distribution business, the submitted documents are consistent with records maintained by a drug distribution organization, no conclusion, or the submitted documents are not the records of a drug distribution business.

To decode our specific case, we realized quickly that the letters represented numbers. After identifying two of the numbers as 0 and 5, we were stuck until Dr. Jensen told us that the key was a word in Spanish with ten different letters. He then told us it was a common code using the word “murcielago.”

What I learned

I learned a lot about clandestine drug records and about how they are kept, how they are used in court cases, and how they can be decoded. Though they may be hidden in children’s books or scraps of paper, they can still be vital in drug cases. Often, the drug records can provide quantities, which determine the length of jail time.

Dixon Hughes Goodman, October 10

Chris Glenn, CIA, CFE, CISA, Risk Advisory Services and Internal Audit
Practice Leader, Memphis, TN

Summary of the case

Mr. Glenn’s presentation focused on the area of risk advisory services including IT advisory services and forensic, litigation support, and valuation services. Some of the areas that forensic, litigation support, and valuation services can aid in are commercial matters, computer forensics, fraud and forensics accounting, personal damages, domestic matters, and valuation services.

Our solution

Risk advisory services often involve checking and implementing internal controls to lessen the likelihood of perceived and unknown risks. IT is an area that has experienced huge expansions in recent years, and it is now very important for internal controls. Since many records are kept on computers, it is important for firms’ IT systems to be monitored for risk too. Though risk cannot be avoided completely, businesses certainly have a high goal of minimizing any unnecessary risk that they cannot perceive.

What I learned

This presentation was very informational about services that I had not realized were offered by accounting firms. Sometimes it is easy to limit accounting to financial statements and taxes, but accountants and their knowledge can be helpful in many situations. I also learned about several different distinctions that can be achieved in the working world such as CFE and CFA

PwC Challenge, October 14

Allen Bell, Judge, Partner and North Texas Leader, Dallas, TX
Ken Verheek, Judge, Partner, Assurance, Houston, TX
Rich Call, Judge, Assurance Sr. Manager, Houston, TX
Corey Edgar, Campus Sourcing, Dallas, TX

Summary of the case

Perpetual Energy Group has decided to focus on its sustainability strategy by developing a cornerstone for its sustainability initiative. The project they have selected as the cornerstone is the development of a biodiesel facility. Perpetual has asked us to help them communicate the value of the facility to their shareholders from environmental, social, and financial perspectives.

Our solution

Our summary of the case includes an analysis of the environmental, social, and financial perspectives, as well as a few suggestions for additional revenue. First, the key stakeholders of the environmental perspective are the general public, the scientific community, and the government. Environmentally, there are a few concerns with the production and use of biodiesel. Nitrogen oxides are a group of gases that form when fuel is burned at high temperatures, and they contribute to ground-level smog, acid rain, and visibility impairments. Additional research is needed in order to come to a conclusive answer on how biodiesel affects these emissions. In addition, there are some concerns with particular performance areas including cold climate operability, engine efficiency, and engine life. We also identified several benefits to using biodiesel. It was declared to be an advanced biofuel by the EPA meaning that it passed Tier I and Tier II health effects testing requirements of the Clean Air Act. Biodiesel helps with air quality by reducing carbon dioxide by 78.5%, carbon monoxide by 50%, and particulate matter by 30%. Biodiesel also eliminated sulfates and sulfur dioxide emissions entirely. Lastly, biodiesel takes coking oil that would otherwise be wasting in a landfill and makes it a renewable energy source. Environmentally, biodiesel is a nontoxic, biodegradable, and renewable energy source that the environmentally-consensus should welcome. Socially, we found that the biodiesel facility would promote the production of domestically produced fuel, which would lessen the dependency on foreign fossil fuels. In addition, the facility would add to the GDP of the U.S., and it would lower the costs of goods. In terms of the local community in Texas, the biodiesel project would create job opportunities and help the local farmers by providing them equipment in exchange for purchasing their crops. Our financial analysis proves that Perpetual is in an advantageous position for this project. The return on equity is 16.5%. Output is increasing at an increasing rate, and costs are increasing at decreasing rate. Eventually, these will intersect and create an economy of scale. We also provided possible revenue opportunities to fund research and development concerning the production of biodiesel. First, online donations through a subscription service could get funds by sending updates to environmentally invested individuals. A second idea is a strategic alliance with the surrounding restaurants. The West Texas Biodiesel Facility would take the leftover cooking oil, which aids in the “green” image of the restaurants, and the restaurant could offer customers an option to donate to the WTBF research and development fund. Ultimately, biodiesel is the direction of the future, so Perpetual needs to make an investment moving towards the future.

What I learned

This case taught me a lot about biodiesel, case competitions, and group projects. It was great experience getting to present a solution to judges and to answer their questions.

Though working with a group was difficult at times, it helped me realize that we do not always get to pick the people with whom we work.

Deloitte, October 17

Allen Bradley, Advisory Manager, Memphis, TN

Aaron Michael, Advisory Associate, Memphis, TN

Summary of the case

Mr. Bradley's presentation focused on Audit and Enterprise Risk Services (AERS). AERS is also called advisory, and it includes three main services areas: Business Risk, Technology Risk, and Accounting Valuation and Analytics. Advisory is an area that not many people know about, but it is similar to consulting on a short-term basis with a focus on improving the efficiency and effectiveness of operations.

Our solution

Advisory services can help businesses in many ways because they are services performed on a case-by-case basis without required reoccurrence. Advisory takes an issue and looks to find a way to ensure that the same type of issue and other possible problems do not occur in the future. Thus, they help companies install controls to make sure that the operations of the business are as efficient and effective as possible. Advisory looks at all types of internal controls including physical, technological, and operational controls. By strengthening the controls upon which the company runs, advisory services improve the performance of businesses.

What I learned

This session was very informational about advisory services and Deloitte. I had heard of advisory services, but I was unsure of how advisory differed from consulting and auditing. This presentation gave all of the similarities and differences of the three areas. In addition, the session provided great insight on Deloitte as a firm. The training programs as Deloitte University are something that seem unique to the firm, and I think attending would be a great way to become adapted to a new working environment. They also spoke on qualities that they look for in job candidates. Knowing what firms are looking for is always useful information.

Horne, October 24

Emily Parrish, Manager, Jackson, TN

Summary of the case

Ms. Parrish presented on the topic of testing journal entries for errors and fraud. Testing journal entries can be a time-consuming and looming task without certain procedures to narrow down the selection of entries to review. There are three external audit requirements for testing journal entries: (1) understand the financial reporting process and controls over journal entries, (2) identify and select journal entries and other adjustments for testing, and (3) required of individuals involved in the financial reporting process about inappropriate or unusual relating to the processing of journal entries.

Our solution

In order to test journal entries, they must be placed into a spreadsheet in Excel or other processing systems. Then, the focus needs to be narrowed concerning which entries need to be tested. Ms. Parrish suggested we consider who, when, what, why, and where of the transactions. For example, some things to search for are any entries by unauthorized employees, entries after hours or close to a holiday, entries to unauthorized or unknown accounts, entries in even dollar amounts or that do not balance, or any manual entries. In addition, programs can use Benford's Law to narrow the focus. Benford's Law suggests that there is a specific distribution of the first digits in a list of numbers. It suggests that lower digits, such as 1 and 2, will start a higher quantity of numbers in a list than 8 or 9. Once the list is narrowed, the entries need to be evaluated by finding support and verifying approval. Lastly, the process of the testing of journal entries would need to be documented for authorities.

What I learned

Testing journal entries was a process that I had not thought of before. As an accounting student, we are familiar with making journal entries, but we are not familiar with the intricate process of testing them. Once the topic was presented, I was still surprised at the large amounts of journal entries that companies have. Now I realize that it would be nearly impossible to test every single one, and I learned several tricks to narrow the focus to the most suspect entries.

Pfizer, October 31

Valerie Hall, Accounting Lead, Memphis, TN
Bradley Baker, Staff Accountant, Memphis, TN
Justin Dill, Senior Finance Lead, Memphis, TN

Summary of the case

The group from Pfizer presented on the topic of abandoned and unclaimed property. There are over one hundred types of property that states consider to be unclaimed property. Recently, states are becoming more aggressive in recognizing abandoned property as a source of non-tax revenues. Some examples of types of unclaimed property are accounts payable, payroll, and accounts receivable. The laws in place for abandoned and unclaimed property have the purpose of protecting the interests and rights of the lost owner.

Our solution

In order to decide where to report the abandoned or unclaimed property, there are a series of rules in priority order. The First Priority Rule declares that it should be reported in the state of the owner's last known address. The Second Priority Rule is the holder's state of incorporation, if the address of the owner is not known. The Third Priority Rule says that it is to be reported in the state of the holder's incorporation if the owner's address is in a foreign country. Overall, companies need to comply to the unclaimed property regulations because it is their legal responsibility. Also, they could encounter interest, penalties, and potential criminal charges if they fail to comply. Companies may be targeted by based on non-reporting, negative reporting, gaps in

recording, omission of property types, no reach-back on initial report, mergers, industry comparison, ex-employees, computer analysis, location, or newsworthy events.

What I learned

This is a topic with huge implications that I had not previously heard much about or considered. Failing to report unclaimed or abandoned property can lead to huge losses for companies that they most likely do not see coming. In addition, states can use unclaimed or abandoned property as a huge source of non-tax revenue. In fact, it is the 3rd highest source of revenue in the state of Delaware.

Deloitte FanTAXtic Competition, November 2

Summary of the case

We were presented with a proposed joint venture of two companies, Just Peachy and Tuff. Two of the owners wanted our consideration on whether it should be formed as a C Corporation or a limited liability company (LLC). Specific areas they wanted us to look into were the taxable income under each type of entity, use of initial contributions, formation, small business stock, and special allocations. In addition, a division of Just Peachy, Peach Products, wanted to expand into a new state. We had to recommend that it form as either a subsidiary or disregarded entity. In addition, they asked our recommendation on which state to choose, State A or State B. The last issues we were asked to consider were Peachy's tax provision and disclosures and corporate tax reform.

Our solution

We concluded that TuffPeach should form as a C Corporation. We chose this option based on a lower taxable income and reduced taxes on the owners. We found that at its current state TuffPeach could not qualify for the Sec. 1202 gain exclusion on small business stock. Its current aggregate gross assets equaled \$55 million, which exceeded the limit of \$50 million. We recommend that Peachy sell its land that it is holding in order to become eligible for small business stock. In regards to the state expansion, we recommended that Peach Products expand into State B as a subsidiary. We chose this option due to a lower tax liability as a subsidiary. In regards to the choice of State B, we calculated the estimated total costs of operating in both State A and State B. We found that even though the operating costs (initial property investment and wages) are greater in State B, the tax incentives, cash grant, and lower tax rate would save Peach Products \$13,062,000 over 20 years. In terms of the tax reform revision, we conclude that Peachy would need to increase their tax provision under the Worldwide Income Proposal and would need to decrease their tax provision under the Territorial Proposal.

What I learned

I learned a lot by doing this case competition. The case was very technical with a lot of calculations. Individually, I learned a lot about pros and cons of C Corporations and LLCs, qualified small business stock and calculating taxes. There were a lot of topics that I had not learned about yet, but I enjoyed getting to see what is to come.

Dr. Victoria Dickinson, November 7

Assistant Professor, The University of Mississippi, Patterson School of Accounting

Summary of the case

Dr. Dickinson presented our class with a financial statement analysis and equity valuation case on Kroger grocery stores. After numerous calculations we were able to arrive at the intrinsic value of Kroger's stock as well as the total firm value of Kroger. We did this by examining Kroger's annual report, which includes financial statements and disclosures. We also calculated several liquidity measures, which measure how much cash Kroger has and how much cash can be raised on short notice. The liquidity measures that we calculated were the current ratio and the quick ratio. In addition to liquidity measures, we also calculated solvency ratios, such as the debt-to-equity ratio and times interest earned. These solvency ratios measure a company's ability to meet its debt obligations, which is crucial for the success of a company.

Our solution

In order to forecast the value of Kroger's stock, we had to go through several steps. First, we valued Kroger's stock under the discounted cash flow model. In this model, we forecasted and discounted the firm's free cash flows for the horizon period—until the growth rate becomes stable. In addition, we calculated the forecasted and discounted free cash flow for the post-horizon period. In order to get the total value of the firm, we summed the present values of the horizon and terminal value's free cash flows. Then from the number that we calculated to be the value of the firm (\$24,118 million) we subtracted the value of the firm's debt in order to arrive at the value of the common stock. Lastly for this model, we divided this number by the number of shares outstanding to get our final calculation of the estimated stock price per share. Under the discounted cash flow model, we calculated that Kroger's stock will be priced at \$34.20. We then also calculated Kroger's estimated stock price under the residual operating income valuation model. To calculate the firm's value under this model, we took the net operating assets and added the present value of the expected residual operating income. Residual operating income is calculated by taking the net operating profit after tax and subtracting the last period's net operating assets multiplied by the weighted average cost of capital. Under this model, we calculated the total value of Kroger to be \$33,671 million, and the value of the stock is estimated to be \$47.68.

What I learned

This presentation provided us with great experience with analyzing and examining financial reports. We had to search through the document in order to find the numbers to perform the necessary calculations. Having this experience will be very useful for future internships and careers.

Ernst and Young, November 14

Jason Honeycutt, Partner—Business Tax Services, Memphis, TN
Emily Edwards, Campus Recruiters, Nashville, TN

Summary of the case

We were presented with a case concerning Asbat Pharmaceuticals. In the case, we were asked to assess Asbat's need to record a valuation allowance in order to offset its deferred tax asset created by net operating loss carry forward. We were given the loss figures for the years 2011, 2012, and 2013. In addition, we were told that Asbat is in the finishing research and development stages for a new drug that it expects to have large market value. Thus, we were provided with forecasts of income up to 2018 from Asbat's CFO.

Our solution

In order to consider the case, we were provided with the professional judgment framework. The professional judgment framework helped us consider the case carefully and to develop a high-quality solution. First, we began by considering the overarching considerations. This involved taking away any personal biases and avoiding preliminary judgments. Though these were not issues for this hypothetical case, biases and preliminary judgments could negatively affect decision processes in the real world. We then calculated the maximum error by dividing \$309,750 (the net operating loss carry forward) by \$3,500,000 (total assets) to get 8.85% of total assets. The net loss per share was forecasted to be \$5, and the pretax loss per share for 2013 was \$7.75. Next, we examined who all would be involved in this matter, and we came up with the managers, the CFO, and the board of directors. Next, the professional judgment framework urged us to maintain professional skepticism by maintaining a questioning mindset and evaluating the facts objectively. Doing so made us aware of a few questionable components of the case. First, the income forecasts could be supported by a second, outside opinion. In addition, we need to be skeptical of the expectation that the new drug will turn income around. The pharmaceutical industry has a high percent chance of failure, so putting a lot of expectation on the new drug is risky. Next, we identified the primary issue of the case as the possible need for a valuation allowance. Then, we evaluated the facts that were given in the case to solve the primary issue. The application guidance was the information on the four sources of taxable income that are considered in order to determine if a valuation allowance is required. The four sources of taxable income are taxable income in prior carryback years, future reversals of existing taxable temporary differences, tax planning strategies, and future taxable income exclusive of reversing temporary differences and carry forwards. In order to address the issue, we needed forecasts, historical information, and financial statements—especially involving the carrybacks, tax returns, and temporary differences. After considering what information we were given, we realized that the application guidance would refer in this case to the fourth source of taxable income, which is future taxable income. The outcomes that our decision could cause are that Asbat could have a loss less than what the analyst predicted or a larger loss. Though the CFO may want a small valuation account in order to beat the analyst's forecast of loss per share, we advise a full valuation allowance. This is due to the fact that all of the forecasts are assuming that the new drug will be successful without any mention of an alternative outcome. Due to the high risk of failure in the drug market, we recommend a full valuation allowance.

What I learned

This case was very educational. It focused on topics that I have not learned about yet such as deferred taxes, net operating loss carry forwards, valuation allowances, and more. Due to the complexity of the topics, it was hard for me to completely understand the case. Though the conclusion made conceptual sense to me, I was still unsure of how everything tied together. Even with preparing before class, I think I focused too much on trying to memorize the facts, rather than applying them to a real case. Nevertheless, the professional judgment framework and Mr. Honeycutt were incredibly helpful when considering the case. Having a better grasp on these topics now will definitely provide me with a solid foundation for intermediate in the spring.

Harbor View Advisors, November 21

Chris Haley, Principal, Ponte Vedra Beach, FL

Summary of the case

Mr. Haley presented with an interesting situation involving the lifecycle of an entrepreneurial venture from startup to acquisition target. Not only did he inform us of the entrepreneurial lifecycle and stages, but he also told us about the unique role of accounting in entrepreneurial ventures. First, he gave us an overview of three examples of entrepreneurial ventures at different stages and how they differ from one another. A venture is considered in its “adult” stage after it was started, grown, and sold. Ventures are classified as “teenagers” when the company is growing with a solid client base, but the venture has yet to reach maturity. Finally, an “infant” venture is one that is just getting started, and the marketing, pricing, clients, and other components are still being developed.

After giving us specific examples of each category, Mr. Haley told us about the typical lifecycle for an entrepreneurial venture. The lifecycle has six stages: idea, development, commercialization, growth, scale, and monetization. Throughout the lifecycle, entrepreneurs and their team must consider their strategy, market, business model, capital, resources, infrastructure, and control. The lifecycle begins with a good idea, but it can be difficult what qualifies as a good idea. One definition of a good idea is something that answers a problem or need. After a good idea has been thought of, it needs to be validated by finding people with knowledge on the field to which the idea is related. Even good ideas can fail due to several different factors, but the largest reason why some ideas succeed and others fail is luck. Another huge aspect in determining how good an idea is its ability to generate cash, which is the most important thing to a business. During the development stage, the business plan, strategy, capital funding structure, forecasts, customer profile, and market are all developed. In addition, the project is built or created. The development stage also involves giving the idea exposure to get people to use the product. This exposure allows for feedback from customers, investors, and professionals. The commercialization stage is when the venture begins to sell its product. During this stage, it is important to convince people that they need the product. In addition, management must strive to align their price with clients. The next stage in the lifecycle of an entrepreneurial venture is growth, and it is the most important stage in the lifecycle. It is the most important because it is the stage where businesses are likely to fail. During the growth stage, the company continues selling to a growing client

base, and it is able to keep up with demand. If a company is able to make it past the growth stage, it reaches the scale stage. During the scale stage, the company focuses on building a foundation that allows it to change in size and still operate efficiently. Ultimately, scaling is preparing the company for the unknown future, and it can be a very difficult process. Lastly, the monetization stage means the company receives cash. This can occur in three different ways. One option is that the company can be sold. A second option is that it can go public with an initial public offering—this is mostly recommended for large companies only. Lastly, the company can live off the cash flow. Which option management should choose depend on the money, time and position of the company. The value of the company is determined by what the company can negotiate with a willing buyer.

Our solution

In terms of accounting's role in the entrepreneurial lifecycle, it is very different than that of the typical role of accounting in businesses. This difference is due to the fact that entrepreneurs value growth—revenue and cash—over things that accountants value such as tax planning. They are more concerned with innovation and their ideas than small accounting issues. In entrepreneurial ventures, accountants must work with the people involved in operational planning in order to function well. This means that accountants will know the rules and the operational planners will know business. When they converse, a system of checks and balances is created. Accountants must help the rest of the people involved by keeping everybody on track and honest in order to achieve their vision. Accountants must have an objective perspective in order to be effective. Overall, accountants should focus on delivering practical business judgment by translating the accounting rules to the goals of the entrepreneur. Otherwise, accountants will be useless and ignored.

What I learned

This session was very interesting because Mr. Haley's view of accounting and accountants is very different than that of our previous presenters. After working in public accounting, attending law school, and working with entrepreneurs, Mr. Haley is not a big fan of public accounting. Though he says he sees its place, he is much happier doing other things. I enjoyed hearing a different perspective because we had previously only heard from mostly accounting firms, who obviously love accounting. Though I think want to work for a public accounting firm initially, Mr. Haley's presentation was great because he emphasized the fact accountants can do more than just working for a Big 4 firm. Ultimately, I took away that having an accounting degree actually opens many doors and provides flexibility and opportunities for many different paths.

FedEx, December 5

Janet Tarver, Manager, International Tax, Memphis, TN

Sylvia Ballard, Manager, International Tax, Memphis, TN

Summary of the case

This week we were presented with the topic of transfer pricing in the United States. Transfer pricing deals with the setting of prices for transactions between related

parties in different jurisdictions. Related parties means that they are either owned or controlled by the same interests directly or indirectly. In the context of FedEx, this could mean a foreign division of FedEx. Transfer pricing deals with many types of transactions including sales or lease transactions involving both tangible and intangible property, services, and loans. Transfer pricing is an important topic because it must be ensured that prices are set on an arm's length standard, which means that the prices set for the related party should match those that would be set for an unrelated party. The U.S. Internal Revenue Code and Related Treasury Regulations require this in section 482. Transfer pricing is an area that is monitored because transfer prices could be used to alter companies' profits and tax base in different jurisdictions. It is also important because if the standards are not followed, there are large penalties that companies can face.

Our solution

Ms. Tarver and Ms. Ballard introduced us to several different transfer pricing methods. They can be grouped into two groups: transaction-based methods and profit-based methods. The transaction-based methods are the comparable uncontrolled price (CUP) method, resale price method, and cost plus method. The profit-based methods are the comparable profits method (CPM), the transactional net margin method, the comparable profit split method, and the residual profit split method. Each method evaluated whether the pricing was truly arm's length by looking at different things such as amounts charged in a comparable uncontrolled transaction (CUP), the gross profit realized in comparable uncontrolled transaction (resale price), gross profit markup realized in comparable uncontrolled transaction (cost plus), and different profit level indicators (CPM). There is no hierarchy amongst the methods, but the comparable profits method is used the most often due to the availability of the data it requires. In each situation, it must be determined which method provides the most reliable measure of the proof to show that the prices are arm's length. After choosing a method, the reasons why the method was chosen and why the others were not must be documented. Ultimately, it is important to look at the comparability between controlled and uncontrolled transactions and the quality and completeness of underlying data and assumptions when choosing which method will provide the most reliable picture. Whichever method is chosen, good documentation is extremely important because the IRS can impose large penalties if it finds that transfer prices are not at arm's length.

What I learned

Transfer pricing is a concept that I never heard of before this class. We were presented with a very thorough run-through of it including different methods and examples. One thing that I did not think of was that the divisions of FedEx internationally must pay FedEx for things like delivery, aircrafts, royalties and intangibles, headquarter and hub charges, tracking costs, and interest. I do not think that many people realize that the foreign divisions of FedEx must pay in order to go by the same name. I thought it was very interesting and overwhelming to imagine that FedEx does business in over two hundred countries and must file tax reports with each country's version of the IRS. As Ms. Tarver and Ms. Ballard mentioned, it is nearly impossible to comply with that many sets of guidelines. They did say that their approach is mostly centered towards the guidelines of the U.S. Hearing about their stories dealing with the different international

entities was very interesting, and it was impressive to hear how well they have done in defending their cases. The entire process of transfer pricing is somewhat overwhelming once all of the different charges that are involved in the shipping and business processes were described. Nevertheless, the presentation was very informative on a subject that is crucial to businesses with many divisions both in the country and abroad.

APPENDIX C

Bold Finance

Lisa Clark
Ruhuka Didia
Anna Clare Wammack
Quanterrius Ward
Elease Williams

Key Issues

- Environmental Perspective
- Social Perspective
- Financial Perspective
- Revenue Generation
- Sustainability

Environmental Perspective

- Stakeholders
 - General Public
 - Scientific Community
 - Government
- Issues
 - Energy efficiency
 - Uncertainties in particular performance areas
- Benefits
 - Viable alternative fuel meeting the standards the Clean Air Act
 - Reported 78.5% reduction in carbon emissions
 - Use of what would otherwise be disposed cooking oil

Social Perspective

- National
 - Promotion of domestically produced fuel
 - Addition to GDP
 - A lower of the cost of goods
- Local Community
 - Create job opportunities
 - Gain favor of farmers by offering subsidies of new equipment and improvements

Financial Perspective

- ROE is 16.5%
- Output is expected to increase by 76.9% from year 1 to year 2 and by 86.7% from year 2 to year 3
- Operating costs are expected to increase by 93% from year 1 to year 2 and by 88.2% from year 2 to year 3
- At least \$2.23/gal will produce net income from operations in all three years

Revenue Opportunities

- Online donations to garner funds for R&D
 - \$10 a month per subscriber
 - A goal to reach 1 million subscribers
 - Regular online updates for subscribers as well as various prizes
- A strategic alliance with surrounding restaurants
 - WTBF gets left over cooking oil as well advertising of subscription plan
 - Customers will have option to donate \$1 to WTBF R&D with purchase of meals

Sustainability Implications

- The biofuel industry is steadily growing, currently producing over 1 billion gallons
- Relative to the market, Perpetual Energy is stable economically
- We are in an advantageous situation due to declining food prices
- With suitable funding for R&D, improvements can be implemented to solving lingering environmental issues
- The green movement has provided numerous investment opportunities including aerospace, military, and distribution

APPENDIX D

Peachy, Inc.

Joint Venture Proposal

U.S. State Expansion

Tax Provision Review and Corporate

Tax Reform

Deloitte FanTAXtic Competition – September 2, 2013

University of Mississippi – Team B

Brad Applewhite, Xinyi Long, Emily Richmond, Joseph Rebentisch, and Anna Claire Wammack

TuFFPeach JV – Entity Comparison

C Corporation

- Pros
 - Ease of raising additional capital through stocks or bonds
 - Shareholder-Owners may be considered employees for employment tax and fringe benefit purposes
- Cons
 - Subject to double taxation on corporate income
 - First year business losses trapped within corporation
 - No preferential tax treatment for capital gains

Limited Liability Company

- Pros
 - Easier and less costly to form
 - Income and losses pass through to the member's tax returns
 - Flexible structure
- Cons
 - Members subject to self-employment tax on guaranteed payments and distributions of income
 - Members may be subject to various loss limitation rules
 - Members with large amounts of passive income will pay an additional Affordable Care Act surtax

TuFFPeach JV – C Corporation Formation

- Sec. 351 – Provides for a tax free contribution for the shareholders to the corporation
- Sec. 358 – Shareholder basis in stock equal to the basis of the contributed property minus any assumed liabilities

	Gateway (5%)	Berkeley (5%)	Trimble (5%)	Funley (5%)	Peachy (40%)	TuFF (40%)
Artwork	500,000					
Cash		2,500,000	2,500,000	2,500,000	12,000,000	
Inventory					2,500,000	10,000,000
Equipment						5,000,000
Land					6,500,000	
Nonrecourse Liability					(5,000,000)	
Adj. Basis in Shares	500,000	2,500,000	2,500,000	2,500,000	16,000,000	15,000,000

TuFFPeach JV – LLC Formation

- Sec. 721 – Provides for a tax free contribution for the shareholders to the corporation
- Sec. 723 – Member’s basis in partnership interest equal to cash contributed plus basis of contributed property

	Gateway (5%)	Berkeley (5%)	Trimble (5%)	Funley (5%)	Peachy (40%)	TuFF (40%)
Artwork	500,000					
Cash		2,500,000	2,500,000	2,500,000	12,000,000	
Inventory					2,500,000	10,000,000
Equipment						5,000,000
Land					6,500,000	
Nonrecourse Liability	250,000	250,000	250,000	250,000	(3,000,000)	2,000,000
Adj. Basis in Interest	500,000	2,500,000	2,500,000	2,500,000	18,000,000	17,000,000

TuFFPeach JV – Initial Use of Contributions

- Secs. 195, 248, 709 - Start-up and Formation Costs (\$1,000,000 and \$150,000): Capitalized and amortized over 180 months
- Sec. 174 - R&D Cost (\$4,000,000): Expensed in the current year
- Development of Software (\$3,000,000): Expensed in the current year
- Sec. 168 - Acquisition of New Equipment (\$8,000,000): 50% bonus depreciation allowance in first year of \$4,000,000; the remainder is depreciated using MACRS 200% DDB, mid-year convention over a five year class life

Purchased Equipment Depreciation Schedule (MACRS)							
#	Year	Basis	%	Depreciation Expense	Accumulated Depreciation	Ending Book Value	M
1	2014	\$4,000,000	20.00%	\$800,000	\$800,000	\$3,200,000	DB
2	2015	\$4,000,000	32.00%	\$1,280,000	\$2,080,000	\$1,920,000	DB
3	2016	\$4,000,000	19.20%	\$768,000	\$2,848,000	\$1,152,000	DB
4	2017	\$4,000,000	11.52%	\$460,800	\$3,308,800	\$691,200	SL
5	2018	\$4,000,000	11.52%	\$460,800	\$3,769,600	\$230,400	SL
6	2019	\$4,000,000	5.76%	\$230,400	\$4,000,000	\$0	SL

TuFFPeach JV – C Corporation Taxable Income

TuFFPeach Taxable Income as a Corporation			
	Year 1	Year 2	Year 3
Sales	\$ 38,000,000	\$ 48,000,000	\$ 50,000,000
Cost of Goods Sold	(16,000,000)	(22,500,000)	(27,000,000)
Gross Profit	22,000,000	25,500,000	23,000,000
Dividends		-0-	1,000,000
Capital Gain Income	<u>3,500,000</u>	<u>-0-</u>	
Total Gross Income (Loss)	25,500,000	25,500,000	24,000,000
Salaries and Wages	10,000,000	10,000,000	10,000,000
Officer Compensation	2,000,000	2,000,000	2,000,000
Rent	1,000,000	1,000,000	1,000,000
Depreciation	5,800,000	2,880,000	1,728,000
Other Expenses	12,110,000	5,110,000	5,110,000
Total Expenses	<u>30,910,000</u>	<u>20,990,000</u>	<u>19,838,000</u>
Taxable Income Before Special Deductions	(5,410,000)	4,510,000	4,162,000
Special Deductions	-0-	(4,510,000)	(1,830,580)
Taxable Income	<u>(5,410,000)</u>	<u>-0-</u>	<u>2,331,420</u>
Tax Liability	\$ -0-	\$ -0-	\$ 812,647

- Contributed Machinery depreciated via MACRS 200% DDB, mid-year convention over 5 year class life
- Net Operating Loss from Year 1 is used by Year 3
- Dividend Receipt and U.S. Production Activities Deductions taken in Year 3

TuFFPeach JV – LLC Taxable Income

TuFFPeach Taxable Income as an LLC			
	Year 1	Year 2	Year 3
Sales	\$ 38,000,000	\$ 48,000,000	\$ 50,000,000
COGS	(16,000,000)	(22,500,000)	(27,000,000)
Gross Profit	22,000,000	25,500,000	23,000,000
Total Income (Loss)	22,000,000	25,500,000	23,000,000
Salaries	10,000,000	10,000,000	10,000,000
Guaranteed Payments	2,000,000	2,000,000	2,000,000
Rent	1,000,000	1,000,000	1,000,000
Depreciation	5,800,000	2,880,000	1,728,000
Other Deductions	12,110,000	5,110,000	5,110,000
Total Deductions	<u>30,910,000</u>	<u>20,990,000</u>	<u>19,838,000</u>
Ordinary Business Income (Loss)	(8,910,000)	4,510,000	3,162,000
Separately Stated Items			
Ordinary Business Income (Loss)	(8,910,000)	4,510,000	3,162,000
Guaranteed Payments	2,000,000	2,000,000	2,000,000
Qualified Dividend Income	-0-	-0-	1,000,000
Net LT Capital Gain (Loss)	500,000	-0-	-0-
Collectibles (28%) Gain (Loss)	<u>2,000,000</u>	<u>-0-</u>	<u>-0-</u>
Taxable Income	\$ (3,410,000)	\$ 6,510,000	\$ 6,162,000

- Individual Members will receive Guaranteed Payments instead of W-2 Salaries
- Contributed Machinery depreciated via MACRS 200% DDB, mid-year convention over 5 year class life
- Peachy, Inc. responsible for \$1,500,000 LT Capital Gain on the Sale of Land
- Billie Gateway responsible for a \$2,000,000 28% Rate Gain on the Sale of Artwork

TuFFPeach JV – Alternative Minimum Tax

- C Corporations
 - Sec. 55(e) – AMT inapplicable in the first year of operations
 - The AMT will apply in Year 2 as TuFFPeach would have gross receipts in excess of \$5,000,000. This does apply to TuFFPeach if it were to be listed as a C-Corporation
- LLC
 - The AMT is applied at the member level
 - As a result, the AMT will be applied separate based upon each member's distributive share of the LLC's taxable income or loss

TuFFPeach JV – Small Business Stock

- Sec. 1202 – Gain Exclusion on Certain Small Business Stock
 - Eligible Small Business must satisfy two basic requirements:
 - Be an Active, Domestic C Corporation; and
 - Aggregate gross assets of no more than \$50,000,000
 - If eligible, shareholders will be able to exclude 100% of the gain on the stock if held for five years and subject to limitations of:
 - \$10,000,000; or
 - Ten times the aggregate adjusted basis of issued small business stock and disposed of by the taxpayer
- TuFFPeach JV was capitalized with \$55,000,000 in aggregate gross assets
 - Proposed Adjustment:
 - Have Peachy, Inc. sell the encumbered land prior to contribution and contribute the \$5,000,000 in cash proceeds

TuFFPeach JV – Special Allocations LLC

- In order to have a special allocation, the allocations must have “substantial economic effect” determined as follows:
 - Allocations results in the appropriate increase or decrease in the partner’s capital account
 - Proceeds of any liquidation are distributed in accordance with positive capital balances
 - Partners must make up negative capital balance upon liquidation
 - Reasonable possibility that the allocation will substantially affect the dollar amounts to be received
- The proposed allocation cannot be performed without being unwound by the IRS
 - Proposed Suggestions:
 - Require members to contribute additional capital to maintain proportionate capital balances
 - Allocate the depreciation expense to Peachy, Inc. and the individual members and a greater portion of profits to TuFF

TuFFPeach JV – Final Recommendation

C Corporation

U.S. State Expansion – Entity Choice

Subsidiary (Separate entity)					
				State A	State B
Taxable income within state (estimated)				62,000	60,000
Tax if Subsidiary				3,720	3,000
Disregarded Entity (DRE or Branch)					
Peachy's estimated U.S. taxable income from all sources				200,000	198,000
Apportionment Factors for States A and B:					
	State A	State B	Peachy Total	State A	State B
	(Estimated)	(Estimated)	(Estimated)	Percent	Percent
Property	142,200	144,420	600,000	23.7000%	24.0700%
Payroll	76,110	77,145	400,000	19.0275%	19.2863%
Sales	580,000	580,000	1,200,000	48.3333%	48.3333%
				34.8485%	35.0057%
Apportionment of income:				69,697.08	69,311.34
Tax if Disregarded Entity (DRE)				4,181.80	3,465.57

U.S. State Expansion – State for Expansion

State A								
		Liability	Jobs	Investment	Research &		Total	Net State A
		Before	Tax	Tax	Development	Training	Tax	Tax
		Credits	Credit (1)	Credit (2)	Credit (3)	Credit (4)	Credits	Liability
Year	1	3,700	348	1,502	-	570	2,420	1,280
Year	2	3,700	-	1,850	-	-	1,850	1,850
Year	3	3,700	-	648	1,202	-	1,850	1,850
Year	4	3,700	-	-	798	-	798	2,902
Year	5	3,700	-	-	-	-	-	3,700
Year	-	3,700	-	-	-	-	-	3,700
Year	20	3,700	-	-	-	-	-	3,700
Total			348	4,000	2,000	570	6,918	

- Jobs Tax Credit – Equal \$1.20 per net new full-time equivalent job up to an offset of 50% of income tax liability when combined with the Investment Tax Credit
- Investment Tax Credit – Equal to 10% of the cost of the machinery and equipment placed in service on a qualifying manufacturing project up to an offset of 50% of income tax liability when combined with the Jobs Tax Credit
- R&D Credit – Equal to 10% of qualified R&D expenditures up to a 50% offset of 50% of income tax liability when combined with the Jobs and Investment Tax Credits
- Training Tax Credit – Equal to \$0.50 per new full-time equivalent employee trained up to 100% of income tax liability and no more

U.S. State Expansion – State for Expansion

State B						
		Liability	Jobs	Investment		Net State B
		Before	Tax	Tax	Total	Tax
		Credits	Credit (1)	Credit (2)	Credits	Liability
Year	1	3,000	1,500	1,500	3,000	-
Year	2	3,000	1,500	1,500	3,000	-
Year	3	3,000	1,500	1,200	2,700	300
Year	4	3,000	1,200	-	1,200	1,800
Year	5	3,000	-	-	-	3,000
Year	-	3,000	-	-	-	3,000
Year	20	3,000	-	-	-	3,000
Total			5,700	4,200	9,900	

- Jobs Tax Credit – Equal to \$5 per new job (full-time equivalent) created. This credit can offset 50% of a taxpayer's liability in a given tax year.
- Investment Tax Credit – Equal to 10% of the investment in machinery and equipment. This credit can offset 100% of a taxpayer's income tax liability in a given year, after considering other credits.

U.S. State Expansion – State for Expansion

State B								
		Property Investment	Wages	Property Taxes	Property Tax Abatement	State Income Tax	State Cash Grant	State B's Marginal Costs
Year 1	1	144,420	77,145	3,000	(1,500)	-	(8,500)	214,565
Year 2	2		77,145	3,000	(1,500)	-		78,645
Year 3	3		77,145	3,000	(1,500)	300		78,945
Year 4	4		77,145	3,000	(1,500)	1,800		80,445
Year 5	5		77,145	3,000	(1,500)	3,000		81,645
Year 6	6		77,145	3,000	(1,500)	3,000		81,645
Year 7	7		77,145	3,000	(1,500)	3,000		81,645
Year 8	8		77,145	3,000	(1,500)	3,000		81,645
Year 9	9		77,145	3,000	(1,500)	3,000		81,645
Year 10	10		77,145	3,000	(1,500)	3,000		81,645
Year 11	11		77,145	3,000	(1,500)	3,000		81,645
Year 12	12		77,145	3,000	(1,500)	3,000		81,645
Year 13	13		77,145	3,000	(1,500)	3,000		81,645
Year 14	14		77,145	3,000	(1,500)	3,000		81,645
Year 15	15		77,145	3,000	(1,500)	3,000		81,645
Year 16	16		77,145	3,000	-	3,000		83,145
Year 17	17		77,145	3,000	-	3,000		83,145
Year 18	18		77,145	3,000	-	3,000		83,145
Year 19	19		77,145	3,000	-	3,000		83,145
Year 20	20		77,145	3,000	-	3,000		83,145

U.S. State Expansion – State for Expansion

State A										
		Property Investment	Wages	Property Taxes	Property Tax Abatement	State Income Tax	State Cash Grant	State A's Marginal Costs	State B's Marginal Costs	State A's Costs Over State B's
Year 1	1	142,200	76,110	3,200	(1,600)	1,280	-	221,190	214,565	6,625
Year 2	2		76,110	3,200	(1,600)	1,850		79,560	78,645	915
Year 3	3		76,110	3,200	(1,600)	1,850		79,560	78,945	615
Year 4	4		76,110	3,200	(1,600)	2,902		80,612	80,445	167
Year 5	5		76,110	3,200	(1,600)	3,700		81,410	81,645	(235)
Year 6	6		76,110	3,200	(1,600)	3,700		81,410	81,645	(235)
Year 7	7		76,110	3,200	(1,600)	3,700		81,410	81,645	(235)
Year 8	8		76,110	3,200	(1,600)	3,700		81,410	81,645	(235)
Year 9	9		76,110	3,200	(1,600)	3,700		81,410	81,645	(235)
Year 10	10		76,110	3,200	(1,600)	3,700		81,410	81,645	(235)
Year 11	11		76,110	3,200	-	3,700		83,010	81,645	1,365
Year 12	12		76,110	3,200	-	3,700		83,010	81,645	1,365
Year 13	13		76,110	3,200	-	3,700		83,010	81,645	1,365
Year 14	14		76,110	3,200	-	3,700		83,010	81,645	1,365
Year 15	15		76,110	3,200	-	3,700		83,010	81,645	1,365
Year 16	16		76,110	3,200	-	3,700		83,010	83,145	(135)
Year 17	17		76,110	3,200	-	3,700		83,010	83,145	(135)
Year 18	18		76,110	3,200	-	3,700		83,010	83,145	(135)
Year 19	19		76,110	3,200	-	3,700		83,010	83,145	(135)
Year 20	20		76,110	3,200	-	3,700		83,010	83,145	(135)
									13,062	Total

Subsidiary in State B

Peachy, Inc.'s Tax Provisions and Disclosures

- Deferred Taxes in the Financial Statements
 - They arise due to temporary differences between book and taxable income.
 - Because Peachy, Inc. has a net deferred tax liability, it will pay fewer taxes in the current period but more taxes in future periods.
- Specific Deferred Tax Assets/Liabilities
 - Accrued liabilities and other reserves
 - Liabilities and other reserves are accrued for book purposes when they can be reasonably estimated and are expected to occur. These items will not be recognized in taxable income until economic performance occurs. This falls in step with the matching principle

Peachy, Inc.'s Tax Provisions and Disclosures

- Basis of capital assets and investments
 - Give rise to deferred tax assets when a reduction in the cost of the equipment acquired occurs
- Deferred Financial Revenues
 - Revenues are recognized in taxable income before they are recognized in book income. Revenues are not recognized in book income until they are realized/realizable and earned, revenues are recognized in taxable income when cash is received
- Unremitted Earnings of Foreign Subsidiaries
 - Temporary earnings of foreign subsidiaries will give rise to deferred tax liabilities because the earnings will eventually flow back into the United States economy (they are expected to be remitted)

Corporate Tax Reforms – Worldwide Income Proposal

- Provisions:
 - Statutory tax rate reduced to 25% for corporations with greater than \$10,000,000 in income
 - The 6% U.S. Production Activities Deduction is repealed
 - Depreciation deduction calculated using MACRS lives and conventions, no Bonus or Sec. 179 depreciation
 - Research activities credit is repealed
 - Deferred income included in US income ratably over four years
 - Taxed on worldwide income with no deferral for foreign profits, but the foreign tax credit remains available

Effect on Peachy, Inc.	2013
Computed Estimated Tax	\$139,407.50
State Taxes, Net of Federal Effect	6,769
Indefinitely Reinvested Foreign Earnings	-
U.S. Production Activities Deduction	-
Other Expenses	1,620
Provision for Income Taxes	<u>147,796.50</u>
Effective Tax Rate	26.5%

- Conclusion:
 - Peachy, Inc. would need to increase their tax provision under this Proposal

Corporate Tax Reforms – Worldwide Income Proposal

- Provisions:
 - Statutory tax rate reduced to 34% for corporations with greater than \$5,000,000 in income
 - The 6% U.S. Production Activities Deduction remains
 - Depreciation deduction calculated using MACRS lives but straight-line depreciation on the mid-year convention; there is no Bonus or Sec. 179 depreciation
 - Research activities remains in place but halved to 50% of the current rate
 - No longer foreign income taxed in the U.S. and the Foreign Income Tax Credit is repealed
 - Previously deferred income is subject to this foreign income exclusion

Effect on Peachy, Inc.	2013
Computed Estimated Tax	\$189,594.20
State Taxes, Net of Federal Effect	6,769
Indefinitely Reinvested Foreign Earnings	(58,950)
U.S. Production Activities Deduction	(515)
Other Expenses	1,620
Provision for Income Taxes	<u>131,998.20</u>
Effective Tax Rate	24.3%

- Conclusion:
 - Peachy, Inc. would need to decrease their tax provision under this Proposal

Conclusion

Questions?

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