Accounting 6120,
I am providing the attached extra reading assignment for Chapter 6. There are 3 pages with footnotes from the latest Apple annual report. There is a 2-page Excel document containing key amounts and some analysis. You may be able to answer many (or all) of the following questions. If you need an explanation for any of these questions, I'll be glad to provide that explanation.

Let's pretend that you are (or will be) an auditor, and Apple is your client. After studying these 3 pages, can you say that you would approve these footnotes? After completing the audit, are you able to meet with management and explain these footnotes to the executives (particularly those who do not work in the finance area of the company)?
Can you explain the GAAP rules that are applied to get the information in these footnotes? Example: why does Apple not accrue a deferred income tax liability for foreign earnings not remitted to the US?

Let's pretend that you are (or will be) a tax accountant, and Apple is your corporate employer or a client of your firm.
Can you explain the tax rules that are applied in getting these amounts shown in the footnotes:

1. Amounts in the footnote containing the details of the provision for income tax,
2. Amount of deferred tax asset for deferred revenue,
3. Amount of "potential" deferred tax liability for unremitted earnings of foreign subsidiaries, and
4. Amount of unrecognized tax benefits that would, if recognized, affect the company's effective tax rate?

BIG PICTURE ITEMS (Excel file, rounded amounts)

1. Can you make the journal entry for Apple's income tax for 2016?
2. Are Apple's current year income tax payments equal to its total income tax expense for the year?
3. Apple reported pretax income of $61 billion for 2016. Using a 35% US income tax rate, we would expect US income tax expense to be $21 billion. However, income tax expense is $16 billion, and the effective tax rate is only 25.56%. Can you explain?
4. Foreign sales account for 65% of total sales. Foreign pretax earnings account for 67% of global pretax earnings. However, foreign income tax expense is only 14% of global income tax expense.
   Can you explain?
5. Apple decided to permanently invest $109 billion of its foreign earnings, outside of the United States. Apple has not accrued a deferred tax liability (of $36 billion) on this net income of $109 billion that has been reported in the GAAP statements, but has not been reported on the US tax return.
   Can you explain?
6. Apple describes a court action that requires the country of Ireland to assess additional income tax on Apple. Apple has explained that any additional assessment by Ireland would not result in an increase in global income tax. Can you explain? Is there an interesting timing issue here?
7. Apple began fiscal year 2016 with a balance of $6.9 billion in its unrecognized tax benefits account. The ending balance was $7.7 billion. Can you explain the nature of the unrecognized tax benefits account? What is the relationship between amounts in this account and amounts reported as income tax expense? Can you prepare one journal entry (for the year) to adjust the balance in the unrecognized tax benefits account, for the change in balance during the year?

Selected information: Apple Annual Report-2016

Amounts in Millions

	2016	2015
Income before provision for income taxes	61,372	72,515
Provision for income taxes	15,685	19,121
Net income	$45,687	$53,394

Income Taxes

The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets and liabilities are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.
The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement.

Provision for Income Taxes

The provision for income taxes for 2016, and 2015, consisted of the following (in millions)

	2016	2015
Federal:		
Current	$7,652	$11,730
Deferred	5,043	3,408
	12,695	15,138
State:		
Current	990	1,265
Deferred	(138)	(220)
	852	1,045
Foreign		
Current	2,105	4,744
Deferred	33	(1,806)
	2,138	2,938
Provision for income taxes	$15,685	$19,121

The foreign provision for income taxes is based on foreign pre-tax earnings of $41.1 billion and $47.6 billion in 2016 and 2015, respectively. The Company's consolidated financial statements provide for any related tax liability on undistributed earnings that the Company does not intend to be indefinitely reinvested outside the U.S. Substantially all of the Company's undistributed international earnings **intended to be indefinitely reinvested in operations outside the U.S.** were generated by subsidiaries organized in Ireland, which has a statutory tax rate of 12.5%. As of September 24, 2016, **U.S. income taxes have not been provided on a cumulative total of $109.8 billion** of such earnings. The amount of unrecognized deferred tax liability related to these temporary differences is estimated to be $35.9 billion.

As of September 24, 2016 and September 26, 2015, $216.0 billion and $186.9 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. **Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.**

The Company's effective tax rates for 2016, 2015 and 2014 differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings, a substantial portion of which was generated by subsidiaries organized in Ireland, for which **no U.S. taxes are provided when such earnings are intended to be indefinitely re-invested outside the U.S.** The lower effective tax rate in 2016 compared to 2015 was due primarily to greater R&D tax credits. The higher effective tax rate during 2015 compared to 2014 was due primarily to higher foreign taxes.

As of September 24, 2016, the Company had deferred tax assets arising from deductible temporary differences, tax losses and tax credits of $4.1 billion and deferred tax liabilities of $26.0 billion. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. The Company will continue to evaluate the realizability of deferred tax assets quarterly by assessing the need for and the amount of a valuation allowance.

In the event that the Company determines all or part of the **net deferred tax assets are not realizable** in the future, the Company will **record an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made.** In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results.

On August 30, 2016, the European Commission announced its decision that **Ireland granted state aid to the Company** by providing tax opinions in 1991 and 2007 concerning the tax allocation of profits of the Irish branches of two subsidiaries of the Company (the "State Aid Decision"). The State Aid Decision orders Ireland to calculate and **recover additional taxes from the Company** for the period June 2003 through

September 2014. Irish legislative changes, effective as of the beginning of 2015, eliminated the application of the tax opinions from that date forward. The Company believes the State Aid Decision to be without merit and intends to appeal to the General Court of the Court of Justice of the European Union... The Company believes that any **incremental Irish corporate income taxes potentially due would be creditable against U.S. taxes.**

The Company's other non-current liabilities in the Consolidated Balance Sheets consist primarily of deferred tax liabilities, gross unrecognized tax benefits and the related gross interest and penalties. **As of September 24, 2016, the Company had non-current deferred tax liabilities of $26.0 billion. Additionally, as of September 24, 2016, the Company had gross unrecognized tax benefits of $7.7 billion and an additional $1.0 billion for gross interest and penalties classified as non-current liabilities.** At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments due to uncertainties in the timing of tax audit outcomes; therefore, such amounts are not included in the above contractual obligation table.

During 2016, the Company adopted an accounting standard that simplified the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. The Company has adopted this accounting standard prospectively; accordingly, the prior period amounts in the Company's Consolidated Balance Sheets within this Annual Report on Form 10-K were not adjusted to conform to the new accounting standard. The adoption of this accounting standard was not material to the Company's consolidated financial statements.

Other Non-Current Liabilities

	2016	2015
Deferred tax liabilities	**$26,019**	**$24,062**

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35%in 2016) to income before provision for income taxes for 2016, is as follows (dollars in millions):

	2016
Computed expected tax	**$21,480**
State taxes, net of federal effect	**$553**
Indefinitely invested earnings of foreign subsidiaries	**($5,582)**
Domestic production activities deduction	**($382)**
Research and development credit, net	**($371)**
Other	**($13)**
Provision for income taxes	**$15,685**
Effective tax rate	**25.6%**

The Company's income taxes payable have been reduced by the tax benefits from employee stock plan awards. For RSUs, the Company receives an income tax benefit upon the award's vesting equal to the tax effect of the underlying stock's fair market value. The Company had net excess tax benefits from equity awards of $379 million, $748 million and $706 million in 2016, 2015 and 2014, respectively, which were reflected as increases to common stock.

As of September 24, 2016 the significant components of the Company's deferred tax assets and liabilities:

Deferred Tax Assets and Liabilities	
Basis of assets	$2,107
Deferred revenue	$1,717
Accrued liabilities and other reserves	$4,135
Deferred cost sharing	$667
Share-based compensation	$601
Other	$788
Total Deferred Tax Assets	**$10,015**
Valuation Allowance	$0
Net deferred tax assets	**$10,015**
Net deferred tax liabilities	
Unremitted earnings of foreign subsidiaries	($31,436)
Other	($485)
Total deferred tax liabilities	($31,921)
Net Deferrred Tax Assets or Liabilities	**($21,906)**

Deferred tax assets and liabilities reflect the effects of tax losses, credits and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Uncertain Tax Positions

Tax positions are evaluated in a two-step process. The Company first determines whether it is more likely than not that a tax position will be sustained upon examination. If a tax position meets the more-likely-than-not recognition threshold it is then measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company classifies gross interest and penalties and unrecognized tax benefits that are not expected to result in payment or receipt of cash within one year as non-current liabilities in the Consolidated Balance Sheets.

As of September 24, 2016, the total amount of gross unrecognized tax benefits was $7.7 billion, of which $2.8 billion, if recognized, would affect the Company's effective tax rate. As of September 26, 2015, the total amount of gross unrecognized tax benefits was $6.9 billion, of which $2.5 billion, if recognized, would affect the Company's effective tax rate.

The Company includes interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of September 24, 2016, and September 26, 2015, the total amount of gross interest and penalties accrued was $1.0 billion and $1.3 billion, respectively, which is classified as non-current liabilities in the Consolidated Balance Sheets. In connection with tax matters, the Company recognized interest and penalty expense in 2016, 2015 and 2014 of $295 million, $709 million and $40 million, respectively.

The aggregate changes in the balance of gross unrecognized tax benefits, which excludes interest and penalties, for 2016 is as follows (in millions):

Unrecognized Tax Benefits	
Beginning Balance	**$6,900**
Increases related to tax positions - prior year	$1,121
Decreases related to tax positions - prior year	($257)
Increases related to tax positions - current year	$1,578
Decreases - settlements with taxing authorities	($1,618)
Decreases - expiration of statute of limitations	$0
Ending Balance	**$7,724**
UTB that would impact effective rate	$2,800
Interest and penalties included in UTB	$1,000

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. During the fourth quarter of 2016, the Company reached a partial settlement with the U.S. Internal Revenue Service (the "IRS") on its examination of the years 2010 through 2012. In connection with this settlement, the Company recognized a tax benefit in the fourth quarter of 2016 that was not significant to its consolidated financial statements. All years prior to 2013 are closed, except for the years 2010 through 2012 relating to R&D tax credits. In addition, the Company is subject to audits by state, local and foreign tax authorities. In major states and major foreign jurisdictions, the years subsequent to 2003 generally remain open and could be subject to examination by the taxing authorities.

The Company believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. **If any issues addressed in the Company's tax audits are resolved in a manner not consistent with its expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.** Although timing of the resolution and/or closure of audits is not certain, the Company believes it is reasonably possible that its gross unrecognized tax benefits could decrease (whether by payment, release or a combination of both) in the next 12 months by up to $850 million.

The income tax benefit related to share-based compensation expense was $1.4 billion, $1.2 billion and $1.0 billion for 2016, 2015 and 2014, respectively. As of September 24, 2016, the total unrecognized compensation cost related to outstanding stock options, RSUs and restricted stock was $7.5 billion, which the Company expects to recognize over a weighted-average period of 2.6 years.

Company/Year Amounts$	Apple-2016 $Millions	
Income Tax Expense - FEDERAL		
Current Tax Expense (Benefit)	$7,652	
Deferred Tax Expense (Benefit)	$5,043	
Total Federal Tax Expense (Benefit)	**$12,695**	
Income Tax Expense - STATE		
Current Tax Expense (Benefit)	$990	
Deferred Tax Expense (Benefit)	($138)	
Total State Tax Expense (Benefit)	**$852**	
Income Tax Expense - FOREIGN		
Current Tax Expense (Benefit)	$2,105	
Deferred Tax Expense (Benefit)	$33	
Total Foreign Income Tax Expense (benefit)	**$2,138**	
Total Income Tax Expense	**$15,685**	
Total Foreign Income Tax Expense as % of total tax	**14%**	
Total deferred income tax expense (benefit)	**$4,938**	
Deferred tax expense as % of total expense	**31%**	
U.S. and Foreign Operations		
Total Revenue: U.S. and Foreign (net sales)	**$215,639**	
Foreign Sales	$140,165	
Foreign Sales Percentage	**65%**	
Pretax income (U.S. and Foreign)	**$61,372**	
Provision for income taxes	**$15,685**	
Net income: continuing oper. before minority int.	**$45,687**	
Minority interest	**$0**	
Net income from continuing operations	**$45,687**	
Effective tax rate - Computed	**25.6%**	
Foreign pre-tax earnings	$41,100	
Foreign pre-tax earnings as % of total pre-tax earn.	**67.0%**	
Reinvestment of foreign earnings-Cumulative		
Foreign earnings-perm. invested - **total amount**	$108,900	
Foreign earnings-perm. invested - **tax effect (Liab.)**	$35,900	
Balance Sheet		
Cash and cash equivalent balances	**$20,484**	
Property and equipment	**$27,010**	
Total Assets (not a total of amounts above)	**$321,686**	
Total Liabilities	$193,437	
Common Stock	$31,251	
Other Paid-in-Capital		
Retained Earnings	$96,634	
Accumulated Other comprehensive income	$634	
Shareholder's equity	$128,519	
Non-controlling interest (Minority interest)	$0	
Total equity	$128,519	
Total Liabilities and Owner Equity	**$321,686**	
Foreign Cash, Equivalent, Short-term Investments	**$216,000**	
Accrued income taxes - ending liability balance	not shown	

Company/Year Amounts$	Apple-2016 $Millions	
Cash Flow Statement Items		
Deferred Tax Provision (benefit)	$4,398	
Share based compensation expense	$4,210	
Equity awards - Excess Tax Benefit	$407	
Cash dividends paid	$12,150	
Cash paid for income taxes	$10,444	
Effective Income Tax Rate -Reconciliation		
Net income before tax	**$61,372**	
Expected income tax at statutory rate.	**$21,480**	
State taxes, net of federal effect	$553	
Foreign earnings (including amt. perm. invested)	($5,582)	
Domestic production activities deduction	($382)	
Research and development credit, net	($371)	
Non-deductible compensation		
Repatriated earnings		
Other	($13)	
Provision for income tax-sum above	$15,685	
Actual provision for income tax	**$15,685**	
Effective Tax Rate computed	**25.56%**	
Cash tax rate (basic information shown above)	**17.0%**	
Loss Carryforwards ($0, if no amount located)	$0	
Credit Carryforwards ($0, if no amount located)	$0	
Tax Effect of Loss and Credit Carryforwards	$0	
Deferred Tax Assets and Liabilities		
Losses and credit carryforwards		
Basis of assets (result of depreciation, etc.)	$2,107	
Deferred revenue	$1,717	
Unrealized losses		
Accrued liabilities and other reserves	$4,135	
Deferred cost sharing	$667	
Share-based compensation	$601	
Other	$788	
Total Deferred Tax Assets	**$10,015**	
Valuation Allowance	$0	
Net deferred tax assets	**$10,015**	
Deferred tax liabilities		
Property and equipment		
Unremitted earnings of foreign subsidiaries	($31,436)	
Inventories		
Other	($485)	
Total deferred tax liabilities	($31,921)	
Net Deferrred Tax Assets or Liabilities	**($21,906)**	
Unrecognized Tax Benefits	**2016**	
Beginning Balance	**$6,900**	
Increases related to tax positions - prior year	$1,121	
Decreases related to tax positions - prior year	($257)	
Increases related to tax positions - current year	$1,578	
Decreases - settlements with taxing authorities	($1,618)	
Decreases - expiration of statute of limitations		
Exchange rate fluctuations		
Acquisitions		
Other		
Ending Balance	**$7,724**	
Ending Balance-prior year (see above)	**$6,900**	
UTB that would impact effective rate	**$2,800**	
Interest and penalties included in UTB (End. Bal.)	**$1,000**	