

Acct 743 (243)
Accounting for Mergers, Acquisitions, and Complex Financial Structures
Autumn Semester 2010

General Course Information

Aut disce aut discede (either learn or depart)

Instructor

Robert E. Verrecchia
1322 Steinberg Hall - Dietrich Hall
Office Hours: by prior appointment
e-mail: verrecchia@wharton.upenn.edu

Registration

Acct 743 (243) serves as The Wharton School's advanced accounting class for both its graduate and undergraduate programs; being an "advanced" class, the material in this course is unavoidably difficult. Thus, students are strongly *discouraged* from registering for Acct 743 (243) unless they satisfy four criteria.

1. A student believes that he or she has achieved already a high level of proficiency in accounting, as demonstrated by having either received a top grade in his or her prior accounting preparation (e.g., nothing less than a grade of "A-" in any prior accounting class) or earned the equivalent of an accounting concentration in an accredited undergraduate business curriculum;
2. A student anticipates having sufficient time during the semester to handle a course with a heavy work load, which as a practical matter means that he or she has either already accepted a job offer or anticipates spending relatively little time in the recruiting process during the semester;
3. A student perceives that intellectually he or she is easily in the top 15% of his or her respective academic programs (e.g., Wharton MBA program; Wharton undergraduate program; Penn Law; etc.); and
4. A student is comfortable with material that is rigorous and quantitatively challenging, such as mathematics, engineering, computer science, etc.

For example, in the Autumn Semester of 2009 a total of *only* 73 Acct 743 registrants (or an average of 24 students per section) successfully completed Acct 743. A student is discouraged from registering for Acct 743 (243) if he or she anticipates *any* problem with performing at a high level.

In addition, Acct 243 registrants are required to have *completed* successfully one of either Acct 201 or 202 *before* registering for Acct 243. Failure to have done so shall result in a student being dropped from the roster (the transcripts of all Acct 243 registrants shall be screened to ensure this policy is followed).

If a student has any doubt as to whether Acct 743 (243) is an appropriate class based on his or her personal circumstances, do not register!

Class Objectives

The objective of this course is to discuss and understand the accounting that underlies merger, acquisition, and investment activities among firms, and how these activities result in complex financial structures. Key topics include the acquisition method for business combinations, the equity method for investments, the preparation and interpretation of consolidated financial statements, tax implications of mergers and acquisitions, earnings-per-share considerations, the accounting implications of intercompany transactions, the accounting implications of non-domestic investments, etc. For a more detailed listing of individual topics, look below under "Topics" in the **Schedule of Assignments**.

This class pursues its objective in three ways. First, we analyze in detail the accounting that underlies each topic using the material found in any standard, advanced accounting textbook as a pedagogical guide for relevant issues. Second, through various lecture materials, cases, and exercises, we highlight and expand on these topics. Finally, we examine the financial statements of publicly traded companies to illustrate the application of these issues. The primary objective of the class is to become proficient in preparing and analyzing the financial statements of firms that merge and acquire other firms as part of their normal course of operations. Toward that goal, we attempt to

understand the historical context and contemporary thought that has led to the promulgation of current accounting pronouncements on this topic.

This course is recommended to students who intend to work in the financial services area, broadly defined. Specifically, the course is recommended for students who, in their careers, anticipate that they will be required either to prepare pro forma consolidated statements for *prospective* acquisitions, or analyze the consolidated statements of *existing* complex financial structures.

Course Materials

A four volume set of course materials is available from Study.Net: Volume I, Volume II, Volume III (Exercises), and Volume IV (Suggested Solutions). These materials are also available in PDF format on the class website (in Wharton web café).

Supplementary Course Materials

Along with course materials of lecture notes, readings, cases, and exercises, students are encouraged to purchase a recent edition of *Advanced Accounting*, Floyd A. Beams, Joseph H. Anthony, Robin P. Clement, and Suzanne H. Lowensohn (Pearson-Prentice Hall, NJ). Currently the 10th edition of *Advanced Accounting*, Floyd A. Beams, *et al.* is available (ISBN number ISBN-10: 0-13-603397-0).

Academic Calendar

The University academic calendar shall be adhered to faithfully. Note that Fall Term Break on the University calendar is October 9-12. This means that there shall be no class on Tuesday, October 12.

Class Policies and Procedures

New Class Policies and Special Procedures

New policy on dropping Acct 743. Acct 743 registrants only have until the end of the 5th lecture to elect to drop Acct 743 (effectively, only until 3 pm on September 23): all Acct 743 registrants who are registered for Acct 743 after that date shall be put in the Acct 743 grading pool at the end of the semester and receive a final grade, including the possibility of a failing grade. *There are no exceptions to this policy!*

New policy for classroom demeanor. In addition to a long-standing ban on consuming food in the classroom (see “Zero-tolerance policy on class decorum,” below), henceforth all text messaging, or other use of cell (mobile) phones, is strictly prohibited. *This policy shall be strictly enforced!* Students shall be directed to disable their phones *before* the start of each class.

Standard Class Policies and Procedures

Zero-tolerance policy on attendance at lectures. Starting with the 4th class (on September 21), and continuing through until the 19th class (on November 16) class attendance shall be taken at the *start* of each class. Specifically, a seating chart shall be determined based on students’ seating preferences as of the end of 3rd class (on September 16). It should be unnecessary to state that students shall *only* be assigned seats in the section for which they are registered. Between the 4th class and the 19th class, and excluding the quiz dates, there are 13 lectures. Failure to be counted as present at the *start* of 9 of 13 lectures shall result in a student being dropped from the class (i.e., a student shall receive a “withdrawal” on his or her transcript). This allows each student 4 absences/tardy attendances (ATAs). Note that the 4 ATAs are inclusive of *all* rationales for missing class, such as illness, travel, interviews, prior commitments, etc. *There are no exceptions to this policy!*

ATAs shall be carefully recorded at the start of each class so as to establish the necessary documentation in the event a student disputes whether he or she has exceeded his or her ATAs. Carefully note that a student shall be dropped from the class at *my* discretion (based on having exceeded his or her allotment of ATAs), not at a *student’s* discretion.

Requiring that a student attend 9 of 13 lectures is tantamount to a 70% attendance level. If a student cannot meet this threshold of attendance, he or she is well advised to seek out an alternative elective.

If *occasionally* during the semester a student has a conflict with the section for which he or she has registered, a student may attend one of the other sections and register his or her attendance on the seating chart for that day (and thus avoid an ATA). Students are strictly prohibited, however, from registering for one section and attending another.

Zero-tolerance policy on class decorum. All classes start promptly. In addition, so as to cultivate the best pedagogical environment, food shall be prohibited from the classroom; students are permitted, however, to take one beverage to class.

Seating charts. Each student shall have an assigned seat in the section in which he or she has registered. The seating chart shall be determined based on students' preferences as of the end of the 3rd class (September 16).

Grading

Quizzes. Each quiz is closed-book, closed-notes, and individual product; "cheat-sheets" or other summaries of class material shall be strictly prohibited! Students shall be afforded the entire 80-minute class period to complete a quiz. Each quiz shall be graded based on 50 points. There is no final exam or quiz in the regularly scheduled final exam period.

Zero-tolerance policy on attendance at quizzes. Students are required to attend scheduled quizzes in the sections for which they are registered: *there are no "make-up" quizzes.*¹

Conflicts that result in missing a quiz shall be categorized as follows. A "Class A" conflict is something tantamount to a medical emergency. In the event of a medical emergency that incapacitates a student at the time of a scheduled quiz, and for which a student has documentation, that quiz shall be ignored and the student shall be graded exclusively based on his or her performance on the other four quizzes. In effect, a student's cumulative performance on the other four quizzes shall be grossed up by 25%. A "Class B" conflict is something tantamount to an unforeseen conflict with another academic obligation. In the event that a student has a conflict of this nature, in place of the missing quiz the *lowest* score among the four other quizzes a student takes shall be substituted. A "Class C" conflict is anything deemed avoidable or frivolous. In this event a student shall be assigned a score of zero for that quiz.

I am the sole arbiter of the appropriate categorization of a conflict.

A student must take *at least* four quizzes to receive credit for the class!

Grade distribution. Grade distribution shall be determined as follows. First, all Acct 743 registrants will be put in a single pool; the pool is subject to a fixed and immutable grade distribution whose mean cannot exceed 3.33. *The current electronic grading system employed by the MBA Office will not allow grades to be submitted electronically if they fail this criterion!* Second, all Acct 243 registrants shall be put in second pool; the grade distribution for the pool shall be determined based on performance relative to the Acct 743 pool (whose mean cannot exceed 3.33). Consider the following illustration. In a class with 5 students the 1st, 2nd, and 4th best students by rank are Acct 743 registrants; the 3rd and 5th best students are Acct 243 students. I assign the 1st, 2nd, and 4th best students grades of A, B+, and B-; these grades average to 3.33. Thus, the 3rd best Acct 243 registrant must receive a grade no higher than B+ and no lower than B-; the 5th best Acct 243 registrant must receive a grade no higher than B- (and as low as I deem appropriate).

No class credit shall be given to any student whose performance on the five scheduled quizzes is more than two standard deviations below the cumulative mean of all students in all sections. There are no exceptions to this policy!

¹ Conflicts that arise from religious holidays on quiz dates shall be accommodated by providing a student with the opportunity to take a quiz the day *before* the regularly scheduled quiz date.

Re-grades. *Requests to re-grade quizzes are strongly discouraged!* If a student has a valid inquiry about how a quiz was graded, he or she should contact the grader by e-mail at mvance@wharton.upenn.edu, and then drop off his or her quiz with the grader by putting it in the mailbox of **M. Vance** in the Accounting Suite (1300 SH-DH). If it appears that a student is making persistent, and frivolous, re-grading requests, he or she shall be prohibited from making additional requests and this behavior shall factor into the student's CD&P-adjustment (see below).

Prior years' quizzes. Virtually every variation on every quiz from prior years has been converted into an exercise in this year's assignments. This accounts for the surfeit of exercises in the course materials.

This year's quizzes. Quiz answers and summary performance statistics shall be posted on the class website (in the Wharton web café) as soon as the grading has been completed.

Cases and exercises. Cases refer to problem assignments that employ real firms and real financial data, while exercises refer to problem assignments that involve fictitious firms and fictitious financial data. Quiz material shall be based primarily on the latter; nonetheless, students are responsible for presenting and discussing the former in class. Cases include excerpted data from a firm's 10-K, 10-Q, or annual report as part of the case assignment; these data should be adequate for completing the case. As cases primarily involve ferreting out information in the excerpted data, or opining on the nature of a firm's disclosure, no suggested solutions shall be provided. Suggested solutions to all exercises, however, shall be provided in Volume IV (Suggested Solutions).

Classroom demeanor and participation (CD&P). A student shall be sanctioned for poor classroom demeanor and participation (CD&P) through a reduction in his or her cumulative performance; this shall be referred to as a student's "CD&P-adjustment." A student's CD&P-adjustment shall be influenced by two factors. The first factor is class demeanor, which is defined as class attendance and prompt arrival at class when a student attends. Students who arrive after class begins at the regularly scheduled class time, or fail to attend at all, shall be sanctioned through their CD&P-adjustment (and those students who exceed their allotted ATAs shall be dropped entirely from the class). The second factor is class participation. During class students are expected to participate in class discussions. Students who are unprepared to participate shall be sanctioned through their CD&P-adjustment. The default for the CD&P-adjustment is 0: that is, a student who attends class regularly and participates in class shall be subject to no adjustment to his or her cumulative performance on the five quizzes. Alternatively, students who exhibit poor class demeanor and fail to participate shall be subject to an adjustment in a range between 0 and minus 50 points.

Cumulative point total. A student's cumulative point total shall be based on a student's cumulative performance in the five quizzes (which represents a total of 250 pts.), *less* the CD&P-adjustment (which ranges between 0 and minus 50 pts.).

Class credit. I reserve the right to deny class credit to any student whose performance I deem inadequate.

Assignments

Schedule of Assignments

The schedule of assignments begins on the next page. In this schedule, note that "rev" is an abbreviation for material authored by Robert E. Verrecchia.

Topics & Class Dates	Lectures, Readings, & Cases	Exercises
Pre-term Preparation		PSS #1 (Review of Financial Statement Preparation)
Recent Developments in M&A Accounting Sept. 9 Class #1	Recent Developments in M&A Accounting, rev AmerisourceBergen (Merger Disclosure) AOL Time Warner (Goodwill Impairment) JDS Uniphase (Goodwill Impairment) Alcan (Merger Adjustments & Goodwill Disclosure)	Plastic & Synthetic (Merger) Pandemonium & Serenity (Computing Goodwill)
Balance Sheet Considerations in Mergers Sept. 14 Class #2	Balance Sheet Considerations in Mergers, rev Intel (In-Process R&D) Yahoo! (Goodwill Allocations) USA Interactive (Intangible Assets vs. Goodwill)	Purloin & Steal (Business Combinations) Pumpkin & Squash (Business Combinations) Pistil & Stem (Business Combinations)
Tax Considerations in Mergers Sept. 16 Class #3	Tax Considerations in Mergers, rev Spanish Step; European Telecoms, <i>The Economist</i> , 2005 Babcock and Wilcox (Taxable vs. Nontaxable Goodwill) United Retail Group, Inc. (Taxable vs. Nontaxable Goodwill)	PSS #2 (Tax Considerations)
Investments Sept. 21 Class #4	Investments, rev General Motors (Investments)	Police & Siren (Consolidated Balance Sheet) Poem & Sonnet (Equity Investments) Port & Sauternes (Equity Method) PSS #3 & #4 (Financial Statement Preparation w/ Investments)

Topic & Class Dates	Lectures, Readings, & Cases	Exercises
Consolidated Investments Sept. 23 Class #5 <i>Final opportunity for Acct 743 registrants to drop!</i>	Consolidated Investments, rev A Once-Sweet Bottling Plan Turns Sour for Coke, New York Times, 1999 Anheuser Busch, et al. (Subsidiary Investments)	Polka-Cola & Syrup (Consolidation) Politburo & Senate (Consolidation) Pepper & Salt (Bargain Purchase) Pilot & Stewardess (Bargain Purchase) Pasta & Salad (Equity Investments) PSS #5 & #6 (Consolidation w/ Multiple Investments) PSS #7 (Multiple Investments with Depreciable Asset Step-up)
Working Paper Adjustments Sept. 28 Class #6	Working Paper Adjustments, rev Comcast & Disney (Prospective Merger) Lyondell Chemicals (Consolidation Issues), Josh Lewis (WG '06) Disney (Off Balance Sheet Investments)	Porcupine & Skunk (Working Paper Adjustments) Polygamous & Single (Working Paper Adjustments) Plethora & Surfeit (Cost Data and Intra Financial Reporting Period Acquisitions)
Sept. 30 Class #7	Quiz #1	
Intercompany Transactions – Inventories Oct. 5 Class #8	Intercompany Transactions - Inventory, rev Stater Bros Holdings Inc (Unconsolidated Affiliate) Alcan & Novelis (Spin-off with unrealized, intercompany profits)	Push & Shove (Intercompany Inventory Transactions) Patio & Solarium (Intercompany Inventory Transactions) Pebble & Stone (Intercompany Inventory Transactions) Python & Snake (Consolidation w/ Cost Data) Python & Snake Revisited (Consolidation w/ Cost Data) Petunia & Sunflower (Intercompany Inventory Transactions) Parsley & Sage (Intercompany Inventory Transactions) Port & Starboard (Consolidation w/ Cost Data)

Topics & Class Dates	Lectures, Readings, & Cases	Exercises
Preferred Stock, EPS, Consolidated EPS Oct. 7 Class #9	Preferred Stock, Earnings Per Share (EPS), and EPS Considerations in Business Combinations, rev eBay (Expensing Employee Stock Options)	MLV (EPS) O'Lanahan Trick-n'-Prank Company (EPS) Principal & Student (Consolidated EPS) Porpoise & Squid (Consolidated EPS)
No Class! Oct. 12	Fall Term Break	
Oct. 14 Class #10	Quiz #2	
Corporate Liquidations, Reorganizations, and Leveraged Buyouts Oct. 19 Class #11	<i>Fresh-Start Accounting: What Is the Implication on Reported Earnings of Companies Emerging from Chapter 11?</i> , Soo Kim (WG '06), 2006 Leveraged Buyouts, rev Enron Capitalism, etc. MFN Financial Corporation (Reorganization) MFN Financial Corporation's 1999 10-K & 2000 10-K (These will be posted on the class website in Wharton web café as the documents: MFN - 10K-1999.pdf and MFN - 10K-2000.pdf)	
Intercompany Transactions - Depreciable and Non-depreciable Assets Oct. 21 Class #12	Intercompany Transactions - Nondepreciable Assets, rev Intercompany Transactions - Depreciable Assets, rev	Prostrate & Supine (Intercompany Land Transactions) Prometheus & Sisyphus (Consolidations w/ Intercompany Transactions) Paranoid & Schizophrenic (Consolidations w/ Intercompany Transactions) Peregrine & Stork (Consolidation w/ Intercompany Transactions)

Topics & Class Dates	Lectures, Readings, & Cases	Exercises
Intercompany Transactions -Debt Oct. 26 Class #13	Intercompany Transactions - Debt, rev	Pusillanimous & Strong (Intercompany Debt) Prince & Squire (Intercompany Debt) Popeye & Sweatpea (Intercompany Debt) Plato & Socrates (Consolidations w/ Intercompany Transactions)
Interpreting Consolidated Data Oct. 28 Class #14	---	Putrid & Stinky (Interpreting Consolidated Statements) Pluto & Saturn (Interpreting Consolidated Statements)
Nov. 2 Class #15	Review Session to Prepare for Quiz #3	
Nov. 4 Class #16	Quiz #3	
Changes in Stock Ownership Nov. 9 Class #17	<i>Changes in Stock Ownership</i> , Katherine Daly (WG '09), 2009 IMS Health Inc (SAB 51 Gains) Pharmacia & Monsanto (Consolidated Subsidiaries) Nextel Communications, Inc. (Deconsolidation Gains)	Pin & Stripe (SAB 51 Gains) Parasite & Sycophant (Changes in Ownership)
Complex Affiliations Nov. 11 Class #18	Complex Affiliations, rev	Parteehardee (Cross Holdings) Parteehardee Revisited (Cross Holdings w/ Goodwill Impairment) Pond, Stream, & Spring (Consolidation w/ Cross Holdings) Polygraph & Subsidiaries (Complex Affiliations)

Topics & Class Dates	Lectures, Readings, & Cases	Exercises
Capstone Cases Nov. 16 Class #19	<i>Beams, et al.</i> , Chapters 5-7 (Review)	Pampas & Steppe (Consolidations w/ Data Flaws) Pencil & Sharpener (Consolidations w/ Data Flaws) Precipitous & Slow (Consolidation w/ Data Flaws) Pliable & Supple (Interpreting Consolidated Data)
Nov. 18 Class #20	Quiz #4	
Foreign Currency Translations Nov. 23 Class #21	Foreign Currency Translations, rev Amazon.com (Translating Intercompany Loans) Amazon (Translating Intercompany Loans), Peter Kim (WG '05)	Puccini & Strauss (Translation) Prague & Sarajevo (Translation) Paris & Seine (Translation) Porto & Santiago de Compestela (Translation) Providence Corporation (Translation)
Nov. 25 No Class!	Thanksgiving Break	
Topics & Class Dates	Lectures, Readings, & Cases	Exercises
Foreign Currency Remeasurements Nov. 30 Class #22	Foreign Currency Remeasurements, rev	Postage & Stamp (Remeasurement) Pyongyang & Seoul (Remeasurement) Philadelphia Corporation (Remeasurement)
Dec. 2 Class #23	Review Session to Prepare for Quiz #5	
Dec. 7 Class #24	Quiz #5	
Dec. 9 Class #25	Turn in team assignment (No Class!)	