

Problems in Financial Reporting

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Course Objectives

Accounting 742 is designed to increase your ability to extract and interpret information in financial statements. We will focus on developing your accounting analysis skills, as well as your ability to utilize those skills in assessing a firm's underlying business strategy and underlying economic performance. For example, after taking this course, you should be able to use the disclosures in a firm's financial report to determine its accounting policy for a particular type of transaction and be able to determine how that policy choice affects its primary financial statements. Given your understanding of the drivers of the statements, you should be able to assess what, if anything, those statements communicate about the firm's strategy and economic performance.

In an effort to satisfy the course objective, you will often be asked to struggle with real financial statement disclosures. Such activities are hard because accountants are not inherently gifted communicators, which is why they are accountants as opposed to journalists, speechwriters, novelists, or screenwriters. Furthermore, accountants must write with legal concerns in mind, which generally does not favor compelling, concise, and explicit narratives. By engaging in these difficult accounting analysis "workouts," however, you will develop valuable accounting research and reasoning capabilities.

Class Materials

GAAP Guide (Optional Reference Book)

Note that a GAAP Guide is a reference and should be used accordingly. In general, the GAAP Guide provides a good overview of technical accounting by topic area as well as references to the Accounting Standards Codification (ASC). For each topic area/class session I have referenced some relevant pages of the GAAP Guide in the [course schedule](#) .




FASB Accounting Standards Codification (ASC)

You will also have access to the Financial Accounting Standards Board's (FASB's) searchable accounting standards codification. To access the FASB site go to: <http://aaahq.org/ascLogin.cfm>. The University of Pennsylvania user name is AAA51620 and password is SrQ1C47. This username and password is effective for just this academic year and access is granted for academic use only. Using this resource is much more challenging than using the GAAP Guide.

Canvas

Course materials will be on the Canvas by class session. You should prepare/review/read any material labeled **Prepare Before Class** prior to class. The **In Class** label is for any illustrative problems we will do in class as well as the slides for the class. If you have trouble keeping up when we work through the illustrative problems in real time, you should take a look at these problems prior to class. The class slides will be posted shortly before class so you should plan on accessing these materials the evening before or the morning of class. The **Post Class** label pertains to any materials distributed during class, notes for the case discussed, additional instructor slides, and suggested solutions for any illustrative problems completed during class. These materials will be made available at the end of the day that the class session is held.

Study Groups

Individuals must form groups of 4 to 5 individuals (no less than 4 and no more than 5 – no exceptions) for the purposes of preparing cases and a course project. Groups must be formed prior to the class meeting on September 19, which is when the first group case assignment will be discussed. Once your group is formed, please register your group by emailing courseware@wharton.upenn.edu, and your group will be assigned a number as well as a letter designation – A, B, or C – which determines your group's case assignments. You can see the cases assignments for each group letter viewing the [case summary](#) . If you do not find a group, you will be assigned to a group.

Grading

Your final grade will be determined as follows.

- Class Participation 10%
- Case Write-- ups (preassigned group 5 out of 8) 25%
- Project 25%
- Final Exam 40%


A minimum grade of 50% on the Final Exam is a necessary condition for passing the course. Hence, your group cannot carry you through the course.

Participation, Cases, Project, Exam

Class Participation

I expect you to come to class prepared to work. I will generally try to call on students who volunteer, but will cold call if volunteers are not forthcoming or the same few students do all of the volunteering. Note that if you never speak in class during the term, this component of your grade will be a zero.

Cases

Each group is required to prepare 5 of 8 cases during the term, and may prepare more cases if you wish to do so. Your group's eight cases can be identified after your group is assigned a letter designation A, B, or C by looking at the [case summary](#) . In addition, for each class session assignment link below, I have identified the group(s) having a case assignment for that session.

Your case grade will be based upon the best 5 cases submitted by your group. Your group should strive to satisfy the case requirements – *no more and no less*. Your grades on the cases will range from 1 to 5 and will be a function of the thoughtfulness of your analysis approach/presentation/answers, as opposed to whether or not you figured out the “right” answer.

Your case write-up must be submitted on Canvas by 8:00 AM on the day they are discussed in class. Only .doc, .docx, or .pdf are allowed.

If your group is not assigned a case for a given session, you are still expected to read and think about the case prior to attending the class session.

Project

Each group will be required to prepare an accounting analysis project. Details regarding the assignment are provided in the [Accounting Analysis Project Assignment](#).

Final Exam



There will be a final take home exam, which will be available on Canvas on Wednesday, December 14 at 10:00 AM and must be submitted on Canvas by 4:00 PM on Tuesday, December 20. More logistical details regarding the exam will be forthcoming as the semester passes.

The exam will be a comprehensive exam in the sense that you are responsible for all topic areas covered. In addition, you may be asked about material that relates conceptually to what we have covered. You may not discuss (very broadly defined) the exam with any other individuals except for me. You can use any written reference resources including your notes, GAAP guides, textbooks, and material regarding the company in question on the web.

Instructor Availability

My office is in 1321 SHDH and my email address is pef@wharton.upenn.edu. Office hours are by appointment. Please contact me in advance to make an appointment. You are also welcome to stop by to see me at any time. If you stop by and I have other commitments, I will be happy to make an appointment with you for later in the day.

Hard Copies of Class Schedule

A copy of the class schedule may be downloaded or viewed by clicking [here](#)  . For each class session, the class schedule contains a listing of the topic(s), suggested reading, in-class problem(s), case(s) covered, and the group(s) assigned to the case(s) covered. This information, as well as the associated files, can all be accessed by opening the assignment link for each session below.

Accounting 742: Problems in Financial Reporting
Fall 2011
Case Summary

| Date | Topic | Case | Groups Hand-in |
|---------|---|-------------------------------------|--------------------------------------|
| W 9/7 | Introduction Accounting for Income Taxes | Symphony Pharmaceuticals MDC | |
| M 9/12 | Reverse Engineering Financial Statements | Pretend Corporation | |
| W 9/14 | Impairments and Restructuring Charges | Impairment & Restructuring at Cisco | |
| M 9/19 | Cash Flows and Ratio Analysis | Wired Wanda's | A |
| W 9/21 | Revenue Recognition | Boston Chicken | B |
| M 9/26 | Accounting Changes/Revenue Recognition | Computer Associates | C |
| W 9/28 | Revenue Recognition – Gross vs. Net | Merck | A |
| M 10/3 | Revenue Recognition and Receivables | Patten | B |
| W 10/5 | Subprime Crisis and Securitizations | New Century Financial | C |
| M 10/10 | No Class: Fall Break | | |
| W 10/12 | R&D Entities | Alza | A |
| M 10/17 | Intangibles | Shaw Group | B |
| W 10/19 | Long-Lived Assets: Int'l Differences | Land Securities Group | C |
| M 10/24 | Fair Value Accounting | Morgan Stanley | A |
| W 10/26 | Derivatives | American Airlines | B |
| M 10/31 | Long-term Debt: Market vs. Book | Royal Bank of Scotland | C |
| W 11/2 | Repos and Leverage | Lehman Brothers | A |
| M 11/7 | Leases | Whole Foods and IBM | B Whole Foods C IBM |
| W 11/9 | Contingent Liabilities | Intel | A |
| M 11/14 | Pensions and OPEB | CF&I Steel | B |
| W 11/16 | Stock Based Compensation and Dilution | Cisco | C |
| M 11/21 | Intercompany Investments | | |
| W 11/24 | No Class: Projects Due | | |
| M 11/28 | Intercompany Investments | The Coca-Cola Company | A |
| W 11/30 | Variable Interest Entities | Citigroup | B |
| M 12/5 | Foreign Currency Translation | Eyepass Worldwide | C |
| W 12/7 | Course Wrap | Nobel Instruments | ABC |

Accounting 742: Problems in Financial Reporting
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Class Schedule

Session 1: Wednesday 9/7

Topics: Introduction
Accounting for Income Taxes – Some Review and Some New

Reading: GAAP Guide 15.03 to 15.27 and 15.32 to 15.33
Accounting for Taxes Overview

Prepare Before Class: Symphony Pharmaceuticals (read and think only)
MDC (read and think only)

Session 2: Monday 9/12

Topics: Accounting for Income Taxes – Some Review and Some New
Reverse Engineering Financial Statements

Reading: GAAP Guide 15.03 to 15.27 and 15.32 to 15.33
Accounting for Taxes Overview

Prepare Before Class: Pretend Corporation

Session 3: Wednesday 9/14

Topics: Earnings Quality

Reading: GAAP Guide 3.41 to 3.52

Prepare Before Class: Impairment and Restructuring at Cisco

Prepare During Class: Generic Corporation Income Statement

Session 4: Monday 9/19

Topics: Cash Flows and Ratio Analysis

Reading: GAAP Guide 3.41 to 3.52
Statement of Cash Flows Preparation Teaching Note (alternative to GAAP Guide)
Dupont Analysis Teaching Note

Prepare Before Class: **Wired Wanda's (Group A)**

Session 5: Wednesday 9/21

Topics: Revenue Recognition – Franchises

Reading: GAAP Guide 19.26 to 19.33

Prepare Before Class: **Boston Chicken (Group B)**

Session 6: Monday 9/26

Topics: Accounting Changes
Revenue Recognition

Reading: GAAP 2.02 to 2.13

Prepare Before Class: **Computer Associates (Group C)**

Session 7: Wednesday 9/28

Topics: Revenue Recognition – Gross vs. Net

Prepare before class: **Merck (Group A)**

Session 8: Monday 10/3

Topics: Revenue Recognition and Receivables

Reading: GAAP Guide 19.107 to 19.113 and 19.121 to 19.124

Prepare before class: **Patten (Group B)**

Session 9: Wednesday 10/5

Topics: Subprime Crisis and Securitization

Reading: GAAP Guide 3.13 to 3.17 and 17.23 to 17.30

Prepare Before Class: **New Century Financial (Group C)**

Monday 10/10: Fall Break ☺

Session 10: Wednesday 10/12

Topics: R&D Arrangements

Reading: GAAP Guide 1.09 to 1.13, 2.37, and 12.25 to 12.26
Brief Teaching Note on R&D Arrangements (Alternative to GAAP Guide)

Prepare Before Class: **Alza (Group A)**

Session 11: Monday 10/17

Topics: Intangibles

Reading: GAAP Guide Chapter 11 (particularly 11.09 to 11.12), 3.73 to 3.81, 2.13 to 2.16

Prepare Before Class: **The Shaw Group (Group B)**

Session 12: Wednesday 10/19

Topics: Long-Lived Assets: International Differences
Reading: GAAP Guide 3.35 to 3.41 Chapter 18 (particularly 18.08 to 18.11)
Prepare Before Class: **Land Securities Group (Group C)**

Session 13: Monday 10/24

Topics: Fair Value Accounting
Reading: GAAP Guide Chapter 10 and 4.09 to 4.22
Prepare Before Class: **Morgan Stanley (Group A)**

Session 14: Wednesday 10/26

Topics: Derivatives
Reading: GAAP Guide Chapter 17 (particularly 17.01 to 17.22) and 18.18
Prepare Before Class: **American Airlines (Group B)**

Session 15: Monday 10/31

Topics: Long Term Debt – Market vs. Book
Reading: GAAP Guide Chapter 4 and Chapter 10
Prepare Before Class: **Royal Bank of Scotland (Group C)**

Session 16: Wednesday 11/2

Topics: Repos and Leverage
Reading: GAAP Guide Chapter 17 (particularly 17.2 to 17.25)
Prepare Before Class: **Lehman Brothers (Group A)**

Session 17: Monday 11/7

Topics: Leases
Reading: GAAP Guide Chapter 13
Prepare Before Class: **Whole Foods (Group B)**
IBM (Group C)

Session 18: Wednesday 11/9

Topics: Contingent Liabilities
Reading: GAAP Guide 4.22 to 4.26 and 8.12 to 8.14
Prepare Before Class: **Intel (Group A)**

Session 19: Monday 11/14

Topics: Pensions and OPEB
Reading: GAAP Guide Chapter 14
Prepare Before Class: **Musselman Steel (Group B)**

Session 20: Wednesday 11/16

Topics: Stock Based Compensation and Dilution
Reading: GAAP Guide 1.12 to 1.34
Prepare Before Class: **Cisco (Group C)**

Session 21: Monday 11/21

Topics: Intercorporate Investments – Control and Significant Influence
Reading: GAAP Guide 11.01 to 11.12 and 12.03 to 12.19
Prepare During Class: Consolidation and Equity Method Illustration

Wednesday 11/23: No Class – Group Project Due

Session 22: Monday 11/28

Topic: Intercorporate Investments – Control and Significant Influence
Reading: GAAP Guide 11.01 to 11.12, 12.03 to 12.19, and 12.25 to 12.26
Prepare Before Class: **The Coca-Cola Company (Group A)**

Session 23: Wednesday 11/30

Topic: Variable Interest Entities
Reading: GAAP Guide 12.34 to 12.41
Prepare Before Class: **Citigroup (Group B)**

Session 24: Monday 12/5

Topic: Foreign Currency Translation
Reading: GAAP Guide Chapter 16
Prepare before class: **Eyepass Worldwide (Group C)**

Session 25: Wednesday 12/7

Topic: Course Wrap
Reading: None
Prepare before class: **Nobel Instruments (Groups A, B, and C)**

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Accounting Analysis Project

Your group must submit an accounting analysis report for a firm whose accounting practices have been or are controversial. You can identify a firm with an accounting controversy by searching business press articles/blogs, reports by financial analysts, the SEC accounting enforcement [website](#), or the enforcement pages of other relevant regulatory agencies. Companies that are not based in the US are fine. You should not select Enron, Worldcom, Sunbeam, Microstrategy, AOL, or any of the companies and associated controversies that are considered in the cases we will cover in the course. Multiple groups can report on the same controversy, but each group must work independently.

Once you believe you have identified a firm and associated controversy, you should email me to obtain approval to proceed. Your email should include a very brief statement regarding the accounting issue(s) involved, which could merely be a copy of the article that led you to the company. If I believe the issues are inappropriate, too trivial, or too complex, I will not give my approval. For example, a company that committed a blatant fraud by booking revenue for mythical shipments to mythical customers will most likely be deemed too trivial and not be approved. (Remember that a good controversy is one in which there is no obvious consensus as to the appropriate accounting treatment.) Once you have received approval, you can do your research and prepare the report.

Your group's report should clearly describe the economics of the transaction associated with the controversial accounting, how the transaction in question relates to the firm's business strategy, how the company has accounted for the transactions in question, and the nature of the accounting controversy, including any alternative practices that have been held up as superior to the company's practices. Your descriptions should be quantitative and qualitative. Hence, you should provide a specific quantitative assessment of the financial statement impact of the company's accounting practices relative to the alternative practice(s) in addition to describing the impacts in general. For example, if the company restated its financial statements to reflect the alternative practice(s), how would the statements differ? Finally, you should also describe the consequences of the accounting controversy. For example, was anyone sacked and/or successfully prosecuted?

In addition to describing the transaction, the associated accounting, and the consequences of the controversy, your report should also opine on the following questions to the extent they are pertinent to your case: (1) Were/are the critics of the company's accounting practices correct? If so, why and what alternative accounting is correct? If not, why are the critics incorrect? (2) What factors led the company to adopt the controversial practices? (3) What factors led external parties to question those practices? (4) Prior to the accounting controversy entering into the public eye, were there indicators that should have alerted a sophisticated financial statement user of the potential accounting issue? (5) Should the existence of the controversy, once analyzed and understood, alter perceptions of the company's long-term outlook? For example, should future cash flow forecasts be affected by the fact that the controversy arose in the first place?

The report should be printed with 12-point font and have 1" margins. There is no page limit. With that said, length in and of itself will not be rewarded and conciseness will be rewarded. In addition to your report and any supplementary tables/graphs/appendices to the report, you should also provide me with the most recent set of financial statements issued prior to the controversy, and the article/blog/report that identified the controversy for your group.

The report will be graded for clarity, completeness, conciseness, and creativity. The degree of difficulty will also be taken into consideration when your report is graded. For example, a report that addresses a relatively straight-forward aggressive revenue recognition practice will receive little slack, whereas a report that considers some complex financial transactions will receive much more slack. The degree of difficulty consideration is intended to provide you an incentive to delve into a challenging accounting issue that has not been covered in class. Finally, reports that consider controversies arising in the past five years will receive more credit than reports regarding controversies that occurred more than five years ago.

If you have any questions regarding the project, please feel free to contact me.