

ACCT 742

Problems in Financial Reporting

Fall 2012 SYLLABUS

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Course Overview

Financial statements are a primary means for firms to communicate information about their performance and strategy to investors and other groups. In the wake of numerous accounting scandals, it is more important than ever for managers and investors to understand (i) the financial reporting process, (ii) what financial statements do and do not contain, and (iii) the types of discretion managers have in presenting transactions they have undertaken. This course is designed to help you become a more informed user of accounting numbers by increasing your ability to extract, interpret, and analyze information in financial statements.

We will focus on many of the biggest problem areas of financial reporting:

- Earnings per share and Alternative Measures of Performance
- Stock Options
- Fair Value and Mark to Market
- Derivatives
- Revenue Recognition
- Leases, Repo's, Convertible Debt, the Subprime Crisis, and other new rules related to debt
- Pensions
- IPO's and Acquisitions
- The Financial Reporting Environment
 - The Sarbanes-Oxley Law
 - IFRS

While this is not a course in equity valuation *per se*, equity valuation is one of the most common uses of financial statement data. Accordingly, we will examine the relation between stock prices and financial statement information. We will spend time on financial statement analysis, ratios, and forecasting.

The course assumes a solid understanding of basic financial accounting (at the level of Acct 620).

Course Materials

Bulkpack The bulk pack is available at Study.net. In addition, all of the material will be available on the eRoom for Acct 742 on Canvas.

Text: Revsine, Collins, Johnson, Mittelstaedt, *Financial Reporting and Analysis*, 5th ed., Prentice Hall, 2011. This text serves as a reference on accounting and disclosure topics. Note that the course is not a textbook-based course. Text readings provide supplementary information and information useful for preparing the problems and cases.

Canvas The course has a room on Canvas that you can log onto with your User name and Password. In addition to the Session-by-Session Assignments tab on the left, the file tab on the left also has the files organized into folders by sessions.

The Assignments tab is organized by sessions. Within each session, the relevant bulk pack material, readings, and cases are included. For some sessions, a spreadsheet will also be posted to help you with calculations.

Class Slides will be added to the Assignments as that session approaches. After class, I'll post the solutions to any cases we did.

Office Hours

Feel free to call with questions or contact me via email at the address above. E-mail is often an easier and quicker way to get your questions answered.

Grading and Course Requirements

Your grade for the course will be determined on the basis of :.

Class participation	25 %
Individually Done Case Write Ups	30 %
<u>Course Project (group)</u>	<u>45 %</u>
Total	100 %

Class Participation

The amount of learning that takes place in the course will depend on how active the class discussions are, which is dependent on the amount of preparation you do before class. Class participation will be based on your contribution to the class discussions and analyses, not simply on the amount of time you talk. If necessary, I will cold call students.

Because entering or leaving the classroom during class time is disruptive to the learning

environment, your fellow classmates and I expect that you will not do so, except in an emergency.

Please bring to each class a Name Card, with your name printed in LARGE DARK LETTERS. This will facilitate my getting to know your names and my ability to reward you for class participation.

INDIVIDUALLY DONE Case Write Ups:

Each student is required to write-up answers to 3 of the cases we will be covering in class. If you want to hand in answers to more than 3, I will count the 3 best cases. Cases must be handed in at the beginning of the class session. Cases will be graded on the basis of effort and completion along with accuracy. Cases are to be done INDIVIDUALLY. Individually means without consulting other people.

I recommend you spread your case choices across the weekends during which we'll be meeting.

Course Project:

Students are asked to form groups of up to 4. Groups should be finalized and your company choice made **by Nov 3**. The earlier you decide on a company, the more time you'll have to work on it.

Each group is expected to turn in the Course Project on the last day of class. In addition to submitting a written assignment for the project, group members will be expected to prepare a brief presentation of their findings. We will do the presentations during the last class.

Your group must identify a firm that has been the subject of an accounting controversy (alleged or real). You can use internet search engines to help you pick your firm, SEC actions, etc. Choose a firm and accounting issue you are interested in. Be sure that the issue your group tackles has a significant element of accounting judgment. Putting the wrong date on a sales contract or an option grant (i.e., backdating) is simply fraud, not an accounting judgment issue.

Please do not choose Enron, Sunbeam, Worldcom, Microstrategy, or AOL. Moreover, do not choose any firm and their accounting controversy that we will be covering in class. For example, it's perfectly ok to pick a firm that has been found to have pension accounting, but don't pick American Airlines – because that's one of the cases we'll be doing in class.

Once you have identified a firm and its accounting controversy, send me an email letting me know who and what you've selected. If I feel the firm/controversy is inappropriate, I will veto it.

There is a folder on Web Café with more information about how cases will be graded, along with some examples of cases from past years.

More details will be provided during class and on the course web page.

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Group Project Assignment

The Wharton School
Due on the last day of class - **December 15**

Please prepare a written report for the following group assignment before class on the last day of class. During class on that day, you will be expected to do a *brief* presentation of your findings (approximately 10 minutes – I'll adjust the time based on the number of groups there turns out to be).

First, find a company that has been criticized or investigated for some questionable *accounting practice*.

- Good places to search include popular press articles, analysts reports, or the SEC accounting enforcement page (<http://www.sec.gov/divisions/enforce/friactions.shtml>)
- Do *not* choose Enron, WorldCom, AOL, Sunbeam, or Microstrategy.
- Make sure that you choose a firm with questions about its accounting practices rather than a firm that has committed outright fraud. For example, a firm that ships empty boxes and books revenue is a fraud. A firm that ships actual product and books all of the revenue without any provision for bad debts has questionable accounting practices.
- Multiple groups can investigate the same company, but they *must* work *independently*!
- The degree of difficulty will be taken in account in grading your project. For example, if you investigate a firm with questionable pension accounting practices, which we will not cover in class until after the assignment is due, you will be given more slack in grading than if you investigate a simple revenue recognition issue. Thus, you are *encouraged* to investigate accounting issues that are difficult and that we haven't covered, or won't cover, in class.
 - Companies with problems that have occurred within the past 5 years will be given more credit than problems that occurred longer ago.
- You will need to find financial statements for the company. Search for the company on the SEC Edgar system (which can be accessed through the Lippincott Library page) or check out the company's web site to ensure you have access to financial statements.
- If you have any questions, please feel free to talk to me about your choice of company to investigate.

Once you have chosen a company, write a report on the company that addresses the following issues:

1. Describe the economic transaction(s) underlying the questionable accounting. Discuss the transaction in the context of the company's business and strategy (you may need to look in the company's annual report for this material).
2. Describe the accounting procedure used by the company and the accounting procedure that "should" have been used according to the critics of the accounting practice. Journal entries may be helpful here in laying out the accounting. What is the basis or justification for the company's accounting practices and for the alternative accounting practices in terms of accounting rules and concepts? How detailed or forthcoming about the accounting procedure was the company in its annual report prior to the controversy?
3. What indications were there (if any) of the problem that an astute analyst might have seen in advance?
4. Do you agree with the critics that the company's accounting practices were wrong, given your answers to the above questions? Why or why not? Note that, just because a company gets criticized for its accounting, it is not necessarily doing the wrong thing. Microsoft has been investigated by the SEC numerous times for questionable accounting practices and has been cleared every time. Are there changes to accounting or auditing standards you would recommend based on what happened?
5. If the company were to restate its financial statements using the accounting procedure that "should" have been used, what would be the effect on the a) income statement, b) balance sheet, and c) statement of cash flows? You do not have to replicate the entire statement; you just need to indicate changes (e.g., accounts receivable would increase, net income would decrease, etc.)

6. Why do you think the alleged problem occurred?
7. What were the consequences of the revelation/resolution of the problem? What happened to the firm's stock price? Did anyone get prosecuted or sent to jail? Were any fines levied? Etc.
8. Does the revelation of the company's alleged flawed accounting practices change your assessment of the company's long-run value? If so, how? If not, why not? Here I want something more substantive than the statement "value is based on cash flow, not on accounting numbers."

Hand in the following:

- A written report which addresses these issues. There is no page or word limit on your write up of this assignment, but please use 12 pt. font and at least a 1" margin on each side.
- The article, analyst report, or SEC enforcement bulletin that alerted you to the situation.
- The most recent set of financial statements issued by the company prior to the controversy.
- Any other exhibits or material to support your analysis.

Final Exam

There is no Final Exam in this course.

Grading Questionsw

All grading disputes must be appealed within *two calendar weeks* following the return of the assignment or exam (unless otherwise noted). *A request for a regrade will not be considered if it is submitted more than two week after the return of the assignment or exam (or after the specified deadline).* To have an assignment or exam regraded, you must submit the original (with no modifications) and a written description of your disagreement with the initial grade.

Preliminary Course Overview

Note that I have broken up our meetings into 1.5-hour long sessions. For example, Sessions 1 and 2 are part of a three hour long session on August 30.

<u>Session</u>	<u>Date</u>	<u>Topic</u>	<u>Problem/Case</u>
1	Thu Aug 30 9:30-11:00	Introduction	Corbomax
2	Thu Aug 30 11:00-12:30	Earnings Per Share and Alternative Measures of Performance	Ciber Inc
3	Sat Sept 1 1:00-2:30	Stock Options	Google (see Spreadsheet)
4	Sat Sept 1 2:30-4:00	Fair Values	Morgan Stanley
5	Fri Sept 28 1:30-3:00	Derivatives	American Airlines
6	Fri Sept 28 3:00-4:30	Revenue Recognition	Patten Corp (see also spreadsheet on web café)
7	Sat Nov 3 1:00-2:30	Repo's, Leases, and Leverage	Lehman Brothers
8	Sat Nov 3 2:30-4:00	Pensions and Other Post Employment Benefits (OPEB)	American Airlines
9	Fri Nov 30 9:30-11:00	Off balance sheet financing, SPE's, and VIE's	Alza
10	Fri Nov 30 11:00-12:30	Acquisitions and IPO's	Zynga
11	Sat Dec 15 9:00-10:30	Financial Reporting Post Enron: The Sarbanes Oxley Law and IFRS	No Case Assigned
12	Sat Dec 15 10:30-12:00	PROJECT PRESENTATIONS	

Two Supplemental Cases

In case you don't get three earlier ones turned in:

These can be turned in the last day of class – Dec 15

- (1) Cash Flow—Alpha and Beta AND Omega vs Epsilon (turn in both)
- (2) Income Taxes – General Motors

Preliminary Schedule of Assignments

RCJM refers to Revsine, Collins, Johnson Mittlestaedt, *Financial Reporting and Analysis*, 5th edition

Session	Date	Topic
1	Thu Aug 30 9:30-11:00	Introduction
	Read:	RCJM: Chapter 1 (skim) RCJM: Chapter 2 pp. 57-82; Chapter 3, pp. 152-164; Chapter 5, pp. 249-252, Chapter 7, pp. 396-399 Class Notes on Accounting Changes Shooting the messenger” (skim) “Revenge of the Accounting Authorities” (skim) MD&A: Revealing The Soft Numbers Increased SEC Aggressiveness in Investigations and Enforcement Actions
	Prepare:	Corbomax

2	Thurs Aug 30 11:00-12:30	Earnings Per Share and Alternative Measures of Performance
	Read:	RCJM Chapter 15 (Concentrate on 905-911) Class Notes – Dilution and Earnings Per Share Dilution of Employee Stock Options New EITF Pronouncement Aims to Close CoCo Loophole SKIM THE FOLLOWING New SEC Requirements For Pro Forma Statements and Annual Reports SEC Updates Guidance on NonGAAP Financial Measures Pro Forma Numbers Are Alive and Well Stock Options, Meet Pro Forma A Clear Look at EBITDA Profit As We Know It Could be Lost With New Accounting Statements Financial Statement Presentation – Excerpts From Current Status of Joint FASB – IASB Project
	Prepare:	Ciber, Inc

3	Sat Sept 1 1:00-2:30	Employee Stock Options
	Read:	<p>RCJM: Chapter 15, pp. 911-924</p> <p>Class Notes on Employee Stock Options , Dilution, and Notes on Earnings Per Share</p> <p>“From FASB and IASB to Managers: Don’t Stop Feeding at the Option Trough”</p> <p>“Using the Black Scholes Model”</p> <p>“How To Excel at Option Valuation”</p> <p>“Cisco’s Stock Option Valuation 2011”</p> <p>“Are TSO’s A New Trend?”</p>
	Prepare:	Google (see Excel spreadsheet on Web Cafe for Black Scholes calculation)

4	Sat Sept 1 2:30-4:00	Fair Value and Mark-to-Market
	Read:	<p>RCJM: Chapter 7, pp. 403-406</p> <p>Chapter 11, 11, pp. 611-637 (skim);</p> <p>Chapter 16, pp. 949-960 and pp. 998-999;</p> <p>Chapter 8, p. 444.</p> <p>Class Notes on Fair Value Accounting (Mark to Market)</p> <p>Proposed Accounting Standards Update: Financial Instruments</p> <p>“SEC – Fair Value Savior”</p> <p>“Fair Value Roundtable”</p> <p>“Fair Value Accounting is Alive and Well”</p> <p>“Financial Reporting and the Financial Crisis: The Case for Measuring Financial Instruments at Fair Value in Financial Statements”</p> <p>“It’s Time to Get Real About Realizations”</p> <p>“FASB’s New Draft on Values: Good News and ...”</p> <p>Historical Cost Vs Fair Value of a Bond – not allowed to be turned in</p>
	Prepare:	Morgan Stanley

5	Fri Sept 28 1:30-300	Derivatives
	Read:	<p>RCJM: Chapter 11, pp. 643-661. Class Notes On Hedging and Derivatives</p> <p>“Derivative Wars” “Southwest Hedges Curb Rising Fuel Cost” “Airlines Try To Hedge the Cost of Fuel They Buy Months in Advance” “Southwest Posts First Loss in 17 Years” Summary FAS 161 “Value at Risk” “Risk Mismanagement” (skim) “VAR – Point Counterpoint” (skim) “Lost in the Maze”</p> <p>Global Candy and solution (not allowed to be turned in) Essig Practice Problem and Solution (not allowed to be turned in)</p>
	Prepare:	American Airlines

Session	Date	Topic
6	Fri Sept 28 3:00-4:30	Revenue Recognition
	Read:	RCJM Chapter 2, pp. 61-69 RCJM Chapter 3, pp. 142—146 and pp. 149-152 RCJM Chapter 8, pp. 425-435 Class Notes on Revenue Recognition Class Notes on Rev Recognition and Collectibility of Receivables Installment Method – An Example Revenue Recognition and the Collection of Cash Accounts Receivable – Gross vs Net and the Cash Flow Statement Revenue Recognition remains accounting's 800-lb. Gorilla Rulemakers Launch Revenue Recognition Makeover Revenue Recognition – Will a Single Model Fly? New Revenue Recognition Rules – The Apple of Apple's Eye? Suits the C-Suite; New Revenue Recognition Proposals: What has changed? Gross versus Net Presentation of Revenue Hot-Air Accounting
	Prepare:	Patten (see spreadsheet on web café)

7	Sat Nov 3 1:00-2:30	Repo's, Leases, and Leverage
	Read:	RCJM: Chapter 15, pp. 924-930 Hidden in Plain Sight FASB and IASB New Project on Leases – June 2012 Fact Sheet – Economic Impacts of the Proposed Changes to Lease Accounting – Standards Highlights Of New Study Published by the Equipment and Leasing Foundation (skim) CVS - Caremark - NOT ALLOWED TO BE TURNED IN The Origins of Lehman's "Repo 105" Report Shows How, Collapsing, Lehman Hid Woes MF Global Proves Enron Era Accounting Lives On Practice Problem: Three Banks – not allowed to be turned in
	Prepare:	Lehman Brothers

8	Sat Nov 3 2:30-4:00	Pensions and Other Post Employment Benefits
	Read:	RCJM: Chapter 14 Class Notes on Pensions Displaying the Funding Status of Postretirement Plans Stock Options Yes, Pensions No Trouble Stirring in the Pension Pot Public Pensions Cook the Books Pension Accounting Change Could Make Company Profits Less Predictable Pension Accounting - An Example Pension Accounting - Solution
	Prepare:	American Airlines

9	Fri Nov 30 9:30-11:00	SPE's and Joint Ventures
	Read:	<p>RCJM: Chapter 16, pp. 980-982 SPE's: A Post "Enron" Perspective Enron and the Raptors (SKIM) Citi's \$41 Billion Issue: Should It Put CDOs On the Balance Sheet?</p> <p>"Reining In SPEs: New rules for special-purpose entities may result in bigger corporate balance sheets," "Update on consolidation of variable interest entities: changes to criteria for primary beneficiaries, definition of variable interest entity; disclosure" Summary of FAS 167 - Amendments to FASB Interpretation 46(R) China Studies Foreign IPO's</p>
	Prepare:	Alza

10	Fri Nov 30 11:00-12:30	Acquisitions and IPO's
	Read:	<p>RCJM: Chapter 10, pp. 564-571, Chapter 16. pp. 961-977 "Valuing Intangibles: A Primer" "Accounting for Acquired In Process R&D" "A Primer on Goodwill Impairment" "FASB Approves Standards to Simplify Testing Goodwill for Impairment" "Interbrand - The Top 100 Brands" "Back to Basics: Tax Merger and Acquisition Issues within the Life Sciences Industry" Notes – Financial Reporting and Disclosure Issues Related to IPO's Sample Form S-1 "The True Cost of Going Public"</p>
	Prepare:	Zynga

Session	Date	Topic
11	Sat Dec 15 9:00-10:30	Financial Reporting Post Enron - SOX and IFRS
	Read:	RCJM: Chapter 1 (skim) Brief Summary of SOX 8 Ways SOX Changed Corporate Governance IFRS: An AICPA Backgrounder FASB and IASB's Irreconcilable Differences The Future of Financial Reporting: A Market Perspective Standing on Principles The Top 10 Reasons to Fix the Conceptual Framework
	Prepare:	No Case Assigned
12	Sat Dec 15 10:30-12:00	Group Presentations