Accounting 242 / 742
Fall 2020   SYLLABUS – Preliminary

Note: The syllabus will be updated as the semester goes along

Professor Richard Lambert   Office: 1307 SH-DH
lambertr@wharton.upenn.edu   Phone: 898-7782

Course Delivery

Due to the extraordinary circumstances stemming from the global pandemic, this course (like virtually all courses) will be taught online. The delivery will be synchronous, i.e., "delivered live" during the normal class time period. The sessions will also be recorded and available for later viewing.

Course Overview

Financial statements are a primary means for firms to communicate information about their performance and strategy to investors and other groups. Financial data is employed in a multitude of analytical research and decision-making contexts such as equity valuation, bankruptcy prediction, acquisition decisions, and managerial performance assessments. In order for the data to be used effectively, however, the nature of the data itself must be understood.

In this course, students learn how to analyze firm's financial statements and related disclosures to strengthen students' ability to assess the firm's strategy and valuation. We emphasize (i) the links between financial statement data and the underlying economics of the firms (economic activities and their financial consequences), (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.

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 focus on two of the most important issues in valuation: information related to profitability (or cash flow) and information related to risk. In the former case, we will talk about the properties of alternative performance measures (like accounting net income, free cash flow, EBITDA, EVA), and we'll also talk about empirical evidence on how these measures relate to values and forecasting future financial statement data (like future cash flows). In the latter case, we look at assessing the capital structure, especially hard to measure aspects of a firm's liabilities or debt.   We will also study the use of financial ratios in assessing performance and in models of distress prediction.

To meet the course objectives, we will rely extensively on case studies involving the financial disclosures of actual companies. We will also make use of spreadsheet models and larger data sets (often obtained from WRDS) to conduct larger-scale analysis.

The course assumes a solid understanding of basic financial accounting (at the level of Accounting 101). A course in finance (discounted cash flow models, weighted average cost of capital, option pricing models), will also be helpful, but not required. Some exposure to probability and statistics will also be helpful.

Course Materials

Text: Wahlen, Baginski, and Bradshaw, *Financial Reporting, Financial Statement Analysis and Valuation: A Strategic Perspective*, 9th Edition, Cengage, 2018. The text is required.

Canvas: Additional material (slides, solutions, spreadsheets, outside readings) are available on the Canvas site associated with the course.

More about Canvas

The course has a site on Canvas. The ASSIGNMENTS folder provides links to the notes, readings, cases, etc. for each class session. Within the FILES folder is all the Course Material. There is a sub-folder for each class session, as well as one for the syllabus and the exams. Inside the folder for a given class session, you will see three or four subfolders:

Notes and Readings:	This includes notes, problems, cases, and readings that were included in the bulk pack.
Pre Class Material:	New readings, problems, and cases (ones not included in the course pack) are contained here. This folder will also have any spreadsheets available to help work the problems and cases. Finally, this folder will contain power point slides that will be constitute the outline of what we'll cover in class that day. Many students find that printing out the slides before class helps them follow along better. Two to three slides per page is a good compromise between not using up too much paper and having room to jot down notes.
Solutions and Post Class Material:	This is where I'll post solutions, corrections, etc

Office Hours

This semester, my office hours will be held "virtually." I'll announce office hours later. In the meantime, if you want to discuss things, we can set up a time via Zoom or Blue Jeans.

We'll use the discussion boards on Canvas to ask and answer questions as well.

E-mail is the easiest and quickest way to get your questions answered.

Grading and Course Requirements

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

Class Participation	10 %
Homework Assignments (best 4 of 5)	48%
Small Projects (2)	42%
Total	100 %

Notes:

For MBA students: The usual requirement that the average grade be no greater than 3.33 (B+) does not apply this semester. Also, no LT's will be given.

For Undergraduates: There is no required or recommended distribution. I expect that the average GPA will be above 3.5 (this has been true in the past). But that depends on how well you do!

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. Good participation can be through asking good questions, answering questions, and adding helpful "anecdotes" or "experiences" related to the topics we're talking about in class. Class participation grades are based on what you add to the learning experience of the entire class. Simply talking a lot, or asking "too many" questions does not add to others' learning experience, and will not be rewarded.

Given the unprecedented circumstances this fall, we have to re-think what good participation means. It's hard to have participation be as active or as fluid in a large virtual meeting. Therefore, you should expect the following:

- If necessary, I will be cold calling people during class discussions.
- I'll be regularly using PollEverywhere to conduct polls – being in class and participating in them will count.
- Discussion Boards on Canvas are another way to participate.

Homework Assignments / Quizzes

Homework assignments (Quizzes) are to be done individually. They are "take home," and are, of course, therefore open book and open notes. Each one will be similar in spirit to the practice problems and cases we do each day. Each homework assignment focuses on a small number of the topics we will have covered (often just one). While they are not computationally intensive, there will be some computations!

There will be (typically) a 48-hour window of time when you can choose to take each homework assignment. One you start it, you'll have 90 minutes to turn in your answers. The assignments will be done via the Canvas "Quiz" feature. You'll turn in your answers electronically; no hard copies are accepted.

They should take roughly 30-60 minutes each, depending on how much of the material you have to "learn from scratch" when you start the assignment (because you hadn't been keeping up!) Therefore, the 90-minute time limit should not be a binding constraint.

Think of the assignments collectively as being equivalent to two exams, with the problems being done at separate dates instead of all packed into bigger, longer exams.

Questions and solutions from prior quizzes and exams (some of which were much longer quizzes) will be available on Canvas. Please be aware that the sequence of topics is not always the same from semester to semester. Therefore, it is possible that there are topics we are covering on, say, Homework #1, this year that were on a different quiz number in prior years, or may not have been on either one.

Homework #1	Due:	Wednesday September 23
Homework #2	Due:	Wednesday October 7
Homework #3	Due:	Wednesday October 21
Homework #4	Due:	Wednesday November 18
Homework #5	Due:	Wednesday December 2

Projects

There will be 2 Projects during the semester. THEY ARE TO BE DONE INDIVIDUALLY – NOT IN GROUPS. An electronic copy of your project is to be sent to me by the due date.

Projects will involve more extensive analysis than Homework problems. Calculations will probably be done using spreadsheets rather than "by hand." You'll be given financial statement data from MULTIPLE companies, and you'll be asked to analyze and compare them. Some of the data will be from the financial statements of the companies and some will be from WRDS. You will not have to collect any data yourself (other than extract it from the financial statements provided).

The project topics and due dates are as follows:

Project 1: Monday November 9   Calculation, analysis and interpretation of different measures of Cash Flow and Free Cash Flow for Companies

Project 2: Friday December 18   Calculation, Analysis and Interpretation of Valuation Multiples and Accounting Based Valuation for Companies

Re-Grading Requests

All re-grading requests must be made 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 weeks after the return of the assignment or exam (or after the specified deadline).* **To have an assignment or exam re-graded, you must submit the original (with no modifications) and a written description of your disagreement with the initial grade**.

Preliminary Course Outline

Session	Date	Topic	Problem/Case
1	Wed Sept 2	Introduction	Allergan, Barrick Gold
2	Wed Sept 9	Financial Statement Decompositions and Re-packaging	Oracle, Vulcan Part 1
3	Mon Sept 14	Earnings Per Share and Dilution	Ciber
4	Wed Sept 16	Cash Flow Statement	Alpha and Beta Epsilon and Omega
5	Mon Sept 21	Free Cash Flow	Oracle, Which Measure of FCF Works, FCF With a Terminal Value
6	Wed Sept 23	Forecasting and Dynamic Relationships **Homework # 1 Due**	Walmart
		OPERATING ACTIVITIES	
7	Mon Sept 28	Revenue Recognition 1	Revenue Recognition Vignettes
8	Wed Sept 30	Revenue Recognition 2	Tenet Healthcare Workday Inc
9	Mon Oct 5	Margins and Segments	Vulcan, Procter and Gamble
10	Wed Oct 7	Income Taxes **Homework # 2 Due**	Alphabet
		INVESTING ACTIVITIES	
11	Mon Oct 12	CAPEX and Depreciation	Land Securities
12	Wed Oct 14	Investments in Intangibles	Pfizer
13	Mon Oct 19	Acquisitions and Noncontrolling Interests	Coke, Alza
14	Wed Oct 21	EBITDA and Multiples Based Valuation **Homework #3 Due**	Toys R Us, Vega Valuation
15	Mon Oct 26	EVA and Accounting Based Valuation	TBA
		FINANCIAL ASSETS AND CLAIMS	
16	Wed Oct 28	Investments in Financial Assets	Berkshire Hathaway
17	Mon Nov 2	Long Term Debt – Book Value & Mkt Value	Royal Bank of Scotland Delta Energy
18	Wed Nov 4	Convertible Debt and Leases	Intel, CVS
19	Mon Nov 9	**NO CLASS - Project 1 Due – Free Cash Flow**	
20	Wed Nov 11	Pensions	Walt Disney
21	Mon Nov 16	Stock Options	Intuitive Surgical, Netflix
22	Wed Nov 18	Derivatives **Homework # 4 Due**	Southwest Airlines
23	Mon Nov 23	Risk Factors	Southwest Airlines Walt Disney
	Wed Nov 25	**NO CLASS – Thanksgiving Break**	
24	Mon Nov 30	Bankruptcy Prediction Models	TBA
25	Wed Dec 2	Detecting Earnings Management **Homework # 5 Due**	Who Is Unusual?
26	Mon Dec 7	Compensation and Governance	Abercrombie and Fitch
27	Wed Dec 9	Summary	TBA
	Fri Dec 18	**Project 3 Due – Multiples and Accounting Based Valuation**	

Preliminary Schedule of Assignments

WBB refers to Wahlen, Baginkski, Bradshaw *Financial Reporting, Financial Statement Analysis, and Valuation*, 9th edition

Session 1   Wednesday September 2   Introduction

Read: WBB Skim Chapter 1 and 2 (skip the section on Income Taxes for now)
                        Chapter 4, pp. 199-201
                        Chapter 6, pp. 366-374

                Notes on the Structure of the Income Statement
                Buffett Accounting "Nightmare" Fuels First Loss in Nine Years
                Five Financial Reporting Issues to Consider As a Consequence of Covid-19

Practice: Problem 1-7, 1-8, Problem 2-20

Prepare: Allergan
                Barrick Gold

Session 2   Wednesday September 9   Decomposing and Repackaging Financial Statements

Read: WBB   Chapter 2 (skip the section on income taxes)
                        Chapter 4, pp. 204-212
                        Chapter 5, pp. 283-293

                Mathematics Linking ROE and ROA

Practice: Problem 2-12,
                Problem 4-5, 4-9, 4-13, 5-2
                Procter and Gamble

Prepare: Problem 4-15
                Vulcan
                Oracle

Session 3   Monday September 14   EPS and Dilution

Read: WBB   Chapter 4, pp. 192-195
                      Chapter 7, pp. 435-439 (skim – we'll revisit this later)
                      Chapter 7, pp. 453-457 (skim – we'll revisit this later)

                      Class Notes – Dilution and Earnings Per Share
                      Dilution of Employee Stock Options

Skim These
                      New EITF Pronouncement Aims to Close CoCo Loophole
                      Ciber Declares it will Settle at least 30% of its Convertible Debt in Cash Helps
                            Mitigate FASB Stance
                      Ciber's Money Where Its Mouth Is
                      Move Over CoCo's: Net Shares Will Do

Practice: Problem 4-12
                      Problem 7-10
                      Salesforce

Prepare: Ciber, Inc – Stock Options, Convertible Debt, and Dilution

Session 4   Wednesday September 16   Cash Flow Statement

Read: WBB, Chapter 3
                      Class Notes on Earnings and Cash Flow
                      Class Notes on Cash Flow Statement

Skim These: Cash Flow? It Isn't Always What it Seems
                      Testimony of Richard Roach on Enron Prepays

Practice: Problem 3-4, 3-6, 3-9, 3-12, 3-14
                      Problem 7-4
                      SalesForce

Prepare: Problem 3-22
                      Alpha and Beta
                      Epsilon and Omega

Session 5   Monday September 21 Free Cash Flow

Read: WBB, Chapter 12
               SEC Tells Companies to Be Careful How they Talk About Free Cash Flow

Practice: Problem 12-3, 12-4, 12-5, Problem 12-6, Problem 12-11
               Free Cash Flow to All - Illustrations

Prepare: Which FCF Measure Works For What?
               FCF With Terminal (Continuing) Value Assumptions
               Oracle

Session 6   Wednesday September 23 Forecasting Financial Statements

Read: WBB, Chapter 10

Practice: Problem 10-1, 10-9, 10-11

Prepare: WBB Case 10-1 (Walmart)
               Financial Statement Projections

Wednesday, September 23 – Homework Assignment # 1 Due

Session 7   Monday September 28   Revenue Recognition

Read: WBB Chapter 6, pp. 577-592

                   Notes on Revenue Recognition
                   Gross versus Net Presentation of Revenue

Skim: Accounting Change Cuts Groupon's Revenue
                   Report Shows How, Collapsing, Lehman Hid Woes

Practice: Chapter 6, Problem 6-1, 6-2, 6-3
                   Sigma Corp

Prepare: Revenue Recognition Vignettes

Session 8 Wednesday September 30   Revenue and Cash

Read: WBB   Chapter 9, pp. 592-601 (only skim the LIFO-FIFO material)
                         Management Discussion & Analysis for Starbucks, pp. 1-20 (on Canvas)

                   Class Notes on Revenue Recognition and Cash Collected

Skim These: Apple Now Sitting on $10bn of Deferred Revenue
                   Revenue Fraud

Practice: Problem 3-10, 3-11
                   Psi Co.

Prepare: Tenet Healthcare
                   Workday Inc

Session 9   Monday October 5   Margins and Segments

Read: WBB   Chapter 4, pp. 213-239
                       Chapter 9, pp. 592-601
                       Appendix B - Management Discussion & Analysis for Starbucks, pp. 1-20
                       (this is on Canvas)
                 Segment Disclosures – Investors' Perspectives

Practice: Problem 4-15, Case 4.1 Walmart

Prepare: Vulcan Part 2
                 Procter and Gamble

Session 10   Wednesday Oct 7   Income Taxes

Read: WBB   Chapter 2, pp. 94-105
                       Chapter 9, pp. 602-609

                 Class Notes on Income Taxes
                 Class Notes On Income Taxes – Advanced
                 Reporting Uncertain Tax Positions
                 Lost in Translation: Detecting Tax Shelter Activity in Financial Statements
                 How Apple Sidesteps Billions in Taxes
                 Apple's Response on its Tax Practices

Practice: Problem 2-9, 2-10, 2-19
                 Caterpillar

Prepare: Alphabet

> ## Wednesday, October 7 – Homework Assignment # 2 Due

Session 11   Monday October 12   Capital Investments and Depreciation

Read: WBB   Chapter 8, pp. 497-512; skim pp. 529-537, pp. 540-544
                        Knight Frank Report - Land Securities Group

Practice: Problem 8-17,
                        Reidl Realty Trust
                        Economic Depreciation

Prepare: Land Securities

Session 12   Wedneday October 14   Intangibles

Read: WBB   Chapter 8, pp. 513-518

                        Valuing Intangibles: A Primer

Skim: TBA

Practice: Problem 8-4
                        Prior Exam Problem

Prepare: Pfizer

Session 13   Monday October 19   Acquistions and Noncontrolling Interests

Read: WBB   Chapter 8, pp. 526-549

Skim: TBA

Practice: Problem 8-11, 8-12, 8-19, 8-20
                Devon Energy

Prepare: Coca Cola
                Alza

Session 14 Wedneday October 21   EBITDA and Multiples Based Valuation

Read: Chapter 6, pp. 385-386
                Chapter 14

Skim: A Clear Look at EBITDA
                Six Letters That Should Spell Danger To Investors
                The Top 10 Limitations of EBITDA

                Toys R Us to Close All 800 of its US Stores

Practice: Problem 14-3, 14-8
                Enterprise Value to EBITDA

Prepare: Toys R Us

Wednesday, October 21 – Homework Assignment # 3 Due

Session 15   Monday October 26   EVA and Accounting Based Valuation

Read: WBB   Chapter 13

               Class Notes on Accounting Based Valuation
               Class Notes on Valuation with Finite Horizon Models

Practice: Problem 13-6, 13-10, 13-11, 13-13
               Accounting based valuation problem
               Spring 2018 Quiz 1 practice problem

Prepare: TBA

Session 16   Wednesday October 28 Financial Assets

Read: WBB   Chapter 8, pp. 519-528,
                         Chapter 2, pp. 80-84 (again)
               Class Notes on Fair Value Accounting (Mark to Market)

               Financial Reporting and the Financial Crisis: The Case for Measuring Financial
                    Instruments at Fair Value in Financial Statements

Skim: It's Time to Get Real About Realizations…

Practice: Problem 2-8
               Prior Exam Problem

Prepare: Berkshire Hathaway

               ———

Session 17   Monday November 2   Long Term Debt – Book Value and
**   Market Value**

Read: WBB   Chapter 7, pp. 446-457
                      Chapter 3, pp. 357-366 (skim)

Practice: Problem 7-5
                Historical Cost vs Market Value of A Bond

Prepare: Problem 6-4
                Royal Bank of Scotland
                Delta (From Quiz 4 Spring 2018)

Session 18   Wednesday November 4   Convertible Debt and Leases

Read: WBB   Chapter 7, pp. 446-457
                      Chapter 3, pp. 357-366 (skim)

Practice: Problem 7-5

Prepare: Problem 6-4
                Intel
                CVS

Session 19   Monday November 9   No Class – Project # 1 Due

<div style="border:1px solid black; text-align:center;">

Monday October 5
No Class

Project # 1 Due
Cash Flow and Free Cash Flow Analysis

</div>

Projects Are To be done INDIVIDUALLY

Session 20   Wedneday November 11 Pensions and OPEB

Read:	WBB Chapter 9, pp. 609-620
	Class Notes on Pensions
	New Presentation of Pension Expense
Skim:	Pensionphobia Strikes Again
	Pension Accounting Change Could Make Company Profits Less Predictable
	Stock Options, Yes. Pension Coffers, No
Practice:	Problem 9-11, 9-12
	Pension Accounting - An Example and Solution
	Devon Energy
Prepare:	Walt Disney

Session 21   Monday November 16   Stock Based Compensation

Read: WBB   Chapter 7, pp. 435-441

                Class Notes on Employee Stock Options
                Class Notes on Valuation of Employee Stock Options
                Accounting for Stock Options
                Stock Options – It's Back to the 90's
                The Best Way of Valuing Options,
                New Valuation Model could dampen the controversy over expensing employee
                        stock options

                Deciding Value of Stock Options May Be Tricky --- Lack of Universal Method
                        For Determining Amount Poses Dilemma for Firms,
                Using the Black Scholes Model
                How To Excel at Option Valuation

Practice: Problem 7-14,
                LinkedIn, Xata

Prepare: Intuitive Surgical – Part 1 and 2 (see Spreadsheet on Canvas)
                Lattice Valuation Model
                Netflix

Session 22 Wednesday November 18   Hedging and Risk Disclosures

Read: WBB   Chapter 5, pp. 278-283
                        Chapter 7, pp. 467-473
                Class Notes On Hedging and Derivatives
                Chapter 7 Appendix A (On Canvas) – just the part on Derivatives – skim
                Chapter 9 Appendix A (On Canvas) – just the part on Derivatives -- skim

Skim These: Southwest Hedges Curb Rising Fuel Costs
                Southwest Posts First Loss in 17 Years
                Southwest Airlines Gets Burned By Fuel Hedges - Again

Practice: Global Candy Company

Prepare: Southwest Airlines

Wednesday, November 18 – Homework Assignment # 4 Due

Session 23   Monday November 23   Hedging and Risk Disclosures

Read: WBB   Chapter 5, pp. 278-283
                         Chapter 7, pp. 467-473
                   Class Notes On Hedging and Derivatives
                   Chapter 7 Appendix A (On Canvas) – just the part on Derivatives – skim
                   Chapter 9 Appendix A (On Canvas) – just the part on Derivatives -- skim

                   SEC-Market Risk Disclosures: Enhancing Comparability (concentrate on pp. 62-
                         67)

Skim These: Value at Risk
                   Risk Mismanagement
                   VAR – Point Counterpoint

Practice: Cisco and Microsoft

Prepare: Southwest Airlines
                   Walt Disney

Wednesday November 25   NO CLASS – Thanksgiving Break

Session 24   Monday November 30   Debt Covenants and Distress Prediction

Read: Chapter 5, especially pp. 301-316
                Chapter 6, pp. 363-365
                Chapter 6 Appendix (On Canvas) – skim
                Class Notes on Debt Covenants

Skim: Financial Contracting: A Survey of Empirical Research and Future Directions
                Teva Debt Downgraded on Covenant Amendment
                Mattel: Toys R Us, Amended Debt Covenants, What does it all Mean?
                Sears "Going Concern" Warning is New Accounting Rules First Test

Practice: Problem 5-16

Prepare: Mattel

Session 25   Wednesday December 2 Detecting Earnings Management

Read: WBB, Chapter 6, pp. 349-357, pp. 379-392
                Discretionary Accrual Models\Critical Accounting Policies

Skim: SEC Enforcement Actions Update

Practice: Problem 6-8

Prepare: Problem 6-22
                Problem 6-23
                Critical Accounting Policies
                Who is the Most Unusual?

Wednesday, December 2 – Homework Assignment # 5 Due

Session 26 Monday December 7   Compensation and Governance

Read: WBB - TBA
               ISS US Summary Voting Guidelines
               The SEC New Compensation Disclosure Rules
               SEC Adopts Rules for Say on Pay
               Companies Say No Way to Say on Pay

Prepare: Abercrombie and Fitch

Session 27   Wednesday December 9   Summary

Skim: Brief Summary of SOX
               FASB and IASB's Irreconcilable Differences
               The Future of Financial Reporting: A Market Perspective

Prepare: None

Friday December 18
Project # 3 Due
Multiples Based and Accounting Based Valuation

Project are to be done Individually