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 fact, in the wake of numerous accounting scandals and the recent financial meltdown (which accounting both helped and hindered), 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: 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), 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 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. Hence, this course is a case-based, as opposed to textbook-based course. Many of the cases are selected to illustrate that significant accounting analysis issues can arise from new organizational and technological innovations. For example, new derivative instruments, securitization vehicles, organizational forms, and intellectual property have all created challenging accounting issues.

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**

Virtually all of the material will be available in the eRoom for Acct 242 on Canvas.

**Text:** Revsine, Collins, Johnson, Mittelstaedt, Soffer - *Financial Reporting and Analysis*, 7th ed., McGraw Hill, 2018. This text serves as a reference on accounting and disclosure topics. Note that the course is not a textbook-based course. The text readings provide supplementary information and information useful for preparing the problems and cases.

**FASB Accounting Standards Codification (ASC)**

You will also have access to the Financial Accounting Standards Board’s (FASB’s) searchable accounting standards codification (ASC). The ASC is a great reference for technical accounting, although it is not necessarily the user-friendly. (It becomes friendlier with use.) To access the FASB site go to

http://www2.aaahq.org/ascLogin.cfm

The user name is AAAXXXX and the password is XXXXXXX. (to be supplied once the course starts)

**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

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. Office Hours are by appointment.

Grading and Course Requirements

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

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Class Participation</td>
<td>15 %</td>
</tr>
<tr>
<td>Quizzes (3)</td>
<td>60 %</td>
</tr>
<tr>
<td>Group Project</td>
<td>25 %</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>100 %</strong></td>
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</table>

Class Participation

In most instances, the case studies will rely heavily on verbatim excerpts from the actual financial filings (e.g., 10-K reports and 8-K press releases). For those of you who are more comfortable dealing with textbook like problems or highly polished and sanitized cases, dealing with the source material directly will prove frustrating and maddening at times. Unfortunately, that is the way it is when you leave the cloistered halls of academe.

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.

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

Do not do things in class that are disruptive to your fellow students. Examples include:

- Entering or leaving the classroom, except in an emergency.
- Eating and drinking (if it’s noisy)

I allow students to use electronic devices during class. However, do not distract other students with what you’re doing. I reserve the right to rescind this privilege.
QUizzes

There will be 3 open-book, open-notes, in-class Quizzes during the semester. The quizzes are officially “cumulative.” That is, all topics covered prior to that Quiz are fair game to be on the Quiz. However, the material on each Quiz will be heavily weighted to the material covered since the prior Quiz.

More details on the Quizzes will be provided as we get closer.

Questions and solutions from prior exams (which were longer midterm and finals, not shorter quizzes like these) 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, Quiz #2 this year that were on midterms in some prior years, finals on other prior years, or may not have been on either one.

Group Project:

The project will require your group to complete a thorough analysis of the financial statements of a company selected by you (and pre-approved by me). The company (and year(s)) examined have to have at least one interesting / contentious accounting issue that has significant consequences for the “look and feel” of the financial statements. For example, this issue can be about a business product or business practice that is new and innovative for which the accounting is unclear. Alternatively, this can be an issue about the company’s financial statements that the business press, analysts, and/or short-sellers have discussed and possibly criticized. It can be something that has been litigated or is in the process or being litigated. Or it can be on a topic your group simply feels is interesting and important.

The financial statements you focus on cannot be more than 10 years old. It’s fine if the firm is a non-US firm.

Your group must identify a firm that has been the subject of an accounting controversy (alleged or real). Your report will describe the controversy, describe the relevant accounting rules, what the company actually did, and whether the company’s accounting violates GAAP (either the letter of the law or the spirit).

Groups can be composed of up to 4 students (no exceptions). Groups may contain a mixture of students from my different sections. Group composition and topic approval must be finalized by November 1. I strongly encourage you to form your teams sooner than this and to get started on your project before this date as well. The earlier you decide on a company, the more time you’ll have to work on it, and the better your project is likely to be.

Group Projects must be turned in by 12 noon on Tuesday December 18. Ideally, someone in your group will turn in a hard copy to the accounting suite by the deadline. In addition, an electronic copy should also be sent to me via email (by that same time). Don’t use Canvas to send this – it tends to be delayed.
Details regarding the Accounting Analysis Project are provided in the Group Project assignment on Canvas.

**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.* Do not just come up to me in class or at my office with your exam and verbally explain what you want regraded.
<table>
<thead>
<tr>
<th>Session</th>
<th>Date</th>
<th>Topic</th>
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<tr>
<td>1</td>
<td>Tues Aug 28</td>
<td>Introduction</td>
<td>Barrick Gold</td>
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<td>2</td>
<td>Thurs Aug 30</td>
<td>Accounting Earnings Quality</td>
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<td>Tues Sept 4</td>
<td>Earnings and Cash Flow – Timing</td>
<td>Alpha and Beta Epsilon and Omega Groupon</td>
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<td>5</td>
<td>Tues Sept 11</td>
<td>Revenue Recognition</td>
<td>Revenue Recognition Vignettes</td>
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<td>Thurs Sept 13</td>
<td>Stock Based Compensation - Accounting</td>
<td>Intuitive Surgical- Part 1</td>
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<td>Tues Sept 18</td>
<td>Stock Based Compensation – Valuation and Incentives</td>
<td>Intuitive Surgical – Part 2 Lattice Valuation Model Netflix</td>
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<td>8</td>
<td>Thurs Sept 20</td>
<td>Earnings Per Share and Dilution</td>
<td>Ciber</td>
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<td>Tues Sept 25</td>
<td>Investments and their costs International differences</td>
<td>Land Securities</td>
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<td>10</td>
<td>Thurs Sept 27</td>
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<td>11</td>
<td>Tues Oct 2</td>
<td>Intangible Investments</td>
<td>Pfizer</td>
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<td>Thurs Oct 4</td>
<td><strong>No Class – Fall Break</strong></td>
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<td>12</td>
<td>Tues Oct 9</td>
<td>Financial Assets - Fair Value and Unrealized Gains and Losses</td>
<td>Morgan Stanley</td>
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<td>13</td>
<td>Thurs Oct 11</td>
<td>Debt and Debt Securities– Market vs Book Values</td>
<td>Royal Bank of Scotland</td>
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<td>Tues Oct 16</td>
<td>Income Taxes</td>
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<td>Detecting Aggressive Earnings Management</td>
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<td>EBITDA and Multiples-Based Valuation</td>
<td>Toys R Us</td>
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<td>Derivatives</td>
<td>Southwest Airlines</td>
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<td>Risk Disclosures</td>
<td>Southwest Airlines Walt Disney</td>
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<td>Tues Nov 6</td>
<td>Pensions and OPEB</td>
<td>Walt Disney</td>
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<td>Thurs Nov 8</td>
<td>Debt Covenants and Distress Prediction</td>
<td>Mattel</td>
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<td>22</td>
<td>Tues Nov 13</td>
<td>Consolidations</td>
<td>Coca Cola</td>
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<td>23</td>
<td>Thurs Nov 15</td>
<td>SPE’s and Variable Interest Entities</td>
<td>Alza</td>
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<td>24</td>
<td>Tues Nov 20</td>
<td>Segmental Reporting and Interim Reporting and Economic Value Added</td>
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<td>Thurs Nov 22</td>
<td><strong>No Class - Thanksgiving</strong></td>
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<td>25</td>
<td>Tues Nov 27</td>
<td>Governance and Compensation</td>
<td>Abercrombie and Fitch</td>
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<td>Tues Dec 4</td>
<td>IPO’s and Early Stage Companies</td>
<td>Zynga</td>
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<td>28</td>
<td>Thurs Dec 6</td>
<td>Course Summary</td>
<td>TBA</td>
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<td>Thurs Dec 18</td>
<td><strong>Group Projects Due – 12 Noon</strong></td>
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Preliminary Schedule of Assignments


**Session 1 Tuesday August 28 Introduction**

Read: RCJMS: Chapter 1 (skim)
- Chapter 2, pp. 47-55 and pp. 78-80
- Chapter 7, pp. 359-363 (skim)

Skim these: Enron Fast Facts
- The Rise and Fall of Enron

Prepare: Barrick Gold

**Session 2 Thursday August 30 Accounting Earnings Quality**

Read: RCJMS: Chapter 2, especially pp. 53-77;
- Chapter 5, pp. 212-216,
- Chapter 7, pp. 362-363

- The Misrepresentation of Earnings
- Notes on Structure of the Income Statement
- Notes on Accounting Changes
- Comparison of Methods

Prepare: Corbomax
**Session 3  Tuesday September 4  Earnings and Cash Flow**

Read: RCJMS: Chapter 2, pp. 47-53
Chapter 17 (this should all be review, concentrate on pp. 1019-1034).
Chapter 4, pp. 173-185

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
SEC Tells Companies to Be Careful How they Talk About Free Cash Flow

Prepare: Alpha and Beta
Epsilon and Omega
Groupon

**Session 4  Thursday September 6  Revenues Recognition I**

Read: RCJMS Chapter 3,
Chapter 8, pp. 375-384

Class Notes on Revenue Recognition and Cash Collected

Skim These: RCJMS, Chapter 3, pp. 134-136
Apple Now Sitting on $10bn of Deferred Revenue
HP’s Explanation Still Makes No Sense
How Autonomy Fooled Hewlett-Packard
Revenue Fraud

Prepare: Revco (practice problem)
Tenet Healthcare
Workday Inc
Session 5  Tuesday September 11  Revenue Recognition

Read:  RCJMS Chapter 3 (again)
       Chapter 6, esp. pp. 387-398

       Notes on Revenue Recognition
       Gross versus Net Presentation of Revenue

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

Prepare:       Revenue Recognition Vignettes
               Lehman Brothers

Session 6  Thursday September 13  Stock Based Compensation – Part 1

Read:  RCJMS:  Chapter 15, pp. 884-903
       Chapter 17, pp. 1028-1031 (again)

       Class Notes on Employee Stock Options
       Accounting for Stock Options
       Stock Options – It’s Back to the 90’s

Skim These:
       “From FASB and IASB to Managers: Don’t Stop Feeding at the Option Trough”
       “Google’s Optional Windfall”

Prepare:       Intuitive Surgical – Part 1
Session 7 Tuesday September 18 Stock Based Compensation – Part 2

Read: RCJMS: Chapter 7, pp. 343-355
       Chapter 15, pp. 884-902 (again)

Class Notes on Valuation of Employee Stock Options
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

Skim These
Are TSO’s A New Trend?

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

Session 8 Thursday September 20 Earnings Per Share and Dilution

Read: RCJMS Chapter 15, pp. 878-884
       Chapter 2, p. 78

Class Notes – Dilution and Earnings Per Share
Dilution of Employee Stock Options
Accounting for Accelerated Share Repurchase Programs

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 Problems:
Earnings Per Share Illustrations
Accelerated Share Repurchase (ASR) Illustration

Prepare: Ciber, Inc – Stock Options, Convertible Debt, and Dilution
Session 9  Tuesday September 25  Investments in Long Term Assets –
International Differences

Read:  RCJMS: Chapter 10, esp. pp. 502-511 and pp. 522-528
       Knight Frank Report - Land Securities Group

Practice Problem:  Reidl Realty Trust

Prepare:  Land Securities

Session 10  Thursday September 27  Quiz 1 – In Class
Session 11  Tuesday October 2  Intangible Assets

Read:  RCJMS: Chapter 10, pp. 511-514
Valuing Intangibles: A Primer
A Primer on Goodwill Impairment

Skim These:
In-Process R&D in Business Acquisitions”
Corporate writedowns may hit $1 trillion
Measuring the Intangible Assets of a Firm
Brand Valuation – Interbrand
The Top 100 Global Brands – 2013

Prepare:  Pfizer

Thursday October 4  No Class – Fall Break
Session 12  Tuesday October 9  Financial Securities - Fair Value – Unrealized Gains and Losses

Read:  
RCJMS:  Chapter 6, pp. 284-287  
       Chapter 16, pp. 939-947 and pp. 979-983  
       Chapter 8, p. 385-387.

Class Notes on Fair Value Accounting (Mark to Market)  
Fair Value Measurements

SEC – Fair Value Savior  
Fair Value Roundtable  
Fair Value Accounting is Alive and Well  
Financial Reporting and the Financial Crisis: The Case for Measuring Financial Instruments at Fair Value in Financial Statements

Skim These:  
It’s Time to Get Real About Realizations  
FASB’s New Draft on Values: Good News and …

Prepare:  
Morgan Stanley

Session 13  Thursday October 11  Long Term Debt – Market vs Book Values

Read:  
RCJMS:  Chapter 11, esp. pp. 561-587

Practice Problem:  
Historical Cost vs Market Value of A Bond  
Metro-Goldwyn-Mayer Inc

Prepare:  
Royal Bank of Scotland
Session 14  Tuesday October 16  Income Taxes

Read:  
  RCJMS: Chapter 13 – esp. pp. 742-747 and pp. 756-763
  Class Notes on Income Taxes
  Class Notes On Income Taxes – Advanced
  Reporting Uncertain Tax Positions

Skim:  
  Fin 48: Standing Naked Before the IRS
  Uncertainties Created by Fin 48
  Understanding Fin 48
  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:
  Accounting for Taxes: Illustrative Example and Solution

Prepare:  IBM

Session 15  Thursday October 18  Detecting Aggressive Earnings Management

Read:  TBA

Prepare:  TBA
Session 16  Tuesday October 23  EBITDA and Multiples Based Valuation

Read:  RCJMS: Chapter 10, pp. 555-562

Skim These:  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

Prepare:  Toys R Us

Session 17  Thursday October 25  Quiz 2 – In Class
Session 18  Tuesday October 30  Derivatives

Read:   RCJMS: Chapter 11, pp. 587-606
        Class Notes On Hedging and Derivatives

        Derivative Wars

Skim These:   Southwest Hedges Curb Rising Fuel Costs
              Southwest Posts First Loss in 17 Years
              Southwest Airlines Gets Burned By Fuel Hedges - Again
              Goldman Sachs’ Report on Porsche

Practice Problem:   Global Candy Company
Prepare:   Southwest Airlines

Session 19  Thursday November 1  Risk Disclosures

Read:   RCJMS: Chapter 6, pp. 587-611
        Summary FAS 161
        SEC-Market Risk Disclosures: Enhancing Comparability (concentrate on pp. 62-67)

Skim These:
        Value at Risk
        Risk Mismanagement
        VAR – Point Counterpoint
        Lost in the Maze

Prepare:   Southwest Airlines
           Cisco Systems and Microsoft
Session 20  Tuesday November 6  Pensions and OPEB

Read:  RCJMS: Chapter 14
Class Notes on Pensions

Skim These:
  Pensionphobia Strikes Again
  Pension Accounting Change Could Make Company Profits Less Predictable
  Stock Options, Yes. Pension Coffers, No
  Public Pensions Cook the Books
  Detroit Ruling Reverberates Around Country

Practice Problems:
  Pension Accounting - An Example and Solution

Prepare:  Walt Disney

Session 21  Thursday November 8  Debt Covenants and Distress Prediction

Read:  RCJMS: Chapter 7, pp. 335-343
       Chapter 6, pp. 238-254 and pp. 296-302
       Chapter 11, pp. 580-587 (again)
Class Notes on Debt Covenants

Skim These:  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 Problems:  None

Prepare:  Mattel
Session 22  Tuesday November 13  Consolidations

Read:  RCJMS: Chapter 16, pp. 952-970
       Class Notes on Business Combinations - New Rules
       Class Notes on Accounting For and Presentation of Noncontrolling Interests

Skim These:
       Mishmash Accounting
       Coke Acquires North American Unit of Bottler

Practice Problem:
       Goodwill and Noncontrolling Interests in Acquisitions Examples
       Consolidation and Equity Method Illustration

Prepare:  Coca-Cola (see spreadsheet)

Session 23  Thursday November 15  SPE’s and VIE’s

Read:  RCJMS: Chapter 11, pp. 563-564
       : Chapter 16, pp. 971 and 985-986

       Update on Consolidation of Variable Interest Entities: Changes to criteria for
       Primary Beneficiaries, definition of variable Interest entity, disclosures
       Summary of FAS 167

Skim These:
       Enron and the Raptors (SKIM)

Practice Problems:
       Expected Losses Residual Returns Example
       Find the Primary Beneficiary Example

Prepare:  Alza
Session 24  Tuesday November 20  Segmental Reporting and Interim Reporting

Read:        RCJMS: Chapter 5 Appendix
             Class Notes on Segmental Reporting
             Class Notes on EVA as a Performance Measure

Skim These:
             At last! The light at the end of the corporate performance tunnel
             Accounting Standard for Segment Reporting Mostly Working

Prepare:     Pepsico and EVA

Thursday November 22  NO CLASS – Thanksgiving
Session 25 Tuesday November 27 Governance and Compensation

Read:
- RCJMS: Chapter 7 (skim only)
- 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 26 Thursday November 29 Quiz 3 – IN CLASS
Session 27 Tuesday December 4  IPO’S and Early Stage Companies

Read:  
Act Public Before Going Public  
The True Cost of Going Public  
Groupon IPO is the Sleaze That’s Legal  
Nasdaq Listing Fees Requirements

Prepare:  
Zynga

Session 28 Tuesday December 6  Summary

Read:  
RCJMS: Chapter 1 (skim)

Brief Summary of SOX  
International Financial Reporting Standards  
FASB and IASB’s Irreconcilable Differences  
The Future of Financial Reporting: A Market Perspective  
Standing on Principles  
The Top 10 Reasons to Fix the FASB's Conceptual Framework

Prepare:  
None