

ACCT 742
Problems in Financial Reporting
Fall 2005 SYLLABUS -- Preliminary

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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:

- The Financial Reporting Environment Post Enron
 - The Sarbanes-Oxley Law
- Earnings Quality and Alternative “Measures” Earnings
 - GAAP, Pro Forma, Core, EBITDA, etc
- Cash Flow Statement – Interpretation and Classifications of Items
- Revenue Recognition
- Fair Value and Mark to Market
- Derivatives
- Stock Options
- Intangible Assets
- Pensions
- Consolidation of Debt and “Off Balance Sheet” Debt
- Special Purpose Entities and Control
- Segmental Reporting
- Interim 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 examine the relation between stock prices and financial statement information. We will also study the use of financial ratio, forecasting financial statement data (income statement, balance sheet and cash flow statement), and models of distress prediction.

The course assumes a solid understanding of basic financial accounting (at the level of Acct 620/621).

Course Materials

Bulkpack The bulk pack is available at Wharton Reprographics. In addition, much of the material (particularly, notes and non-Harvard cases) will be available on the eRoom for Acct 742 on Web Cafe.

Text: Revsine, Collins, Johnson, *Financial Reporting and Analysis*, 3rd ed., Prentice Hall, 2004. 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.

In-class handouts: Occasionally, supplemental material will be distributed in class. You will be billed for these handouts by the university at the end of the semester. Note that any lecture slides will not be distributed in class. Please download these prior to class.

Web Café The course has a room on Web Café that you can log onto with your User name and Password. Within the Course Material folder, there is a folder for each class session, as well as one for the syllabus and the final exam. Inside the folder for a given class session, you will see three subfolders:

Course Pack Material: This includes notes, problems, cases, and readings that were included in the course 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 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. 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 will be announced.

Grading and Course Requirements

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

Class participation (individual)	20 %
Midterm Exam #1	25 %
Midterm Exam #2	25%
Final Exam (individual)	<u>30 %</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.

Final Exam

Midterm Exam 1 will cover material from Sessions 1-9.
Midterm Exam 2 will cover material from Sessions 10-18

The midterm and final exams will be take home exams. **You must work on the exam individually.** You are not permitted to discuss the exam with anyone else, including other students, former students, or people in the real world. However, you are permitted to use any written resource, such as your notes, the textbook, information on the company you find on the web, etc.

You will have approximately one week to do each of the first two midterms. The final exam is a take home that will be distributed during final exam week. You will have up to 72 HOURS to work on the exam, and you can choose which 72 hour period during final exam week to work on it.

More details on this exam will be provided as the time gets closer.

Sample questions and solutions will be available from Web Café.

Grading Disputes

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

<u>Session</u>	<u>Date</u>	<u>Topic</u>	<u>Problem/Case</u>
1	Wed Sept 7	Financial Reporting Post Enron	Enron
2	Mon Sept 12	Financial Reporting Post Enron - II	Enron
3	Wed Sept 14	Ratios and Forecasting	Gap
4	Mon Sept 19	Accounting Based Valuation	Gap
5	Wed Sept 21	Accounting Changes and Nonrecurring Items	Corbomax
6	Mon Sept 26	Alternative Measures of Earnings	Cisco Systems
7	Wed Sept 28	Cash Flow Statement	Statement of Cash Flow Classification
8	Mon Oct 3	Revenue Recognition and Uncollectibles	Patten
9	Wed Oct 5	Revenue Recognition – Gross versus Net and Multiple Deliverables	Merck; Yahoo vs Google
10	Mon Oct 10	Securitization	H&R Block
11	Wed Oct 12	Fair Value Accounting	Historical Cost Vs Fair Value of a Bond; Astoria Financial
	Wed Oct 12	TAKE HOME EXAM 1 DUE	
12	Wed Oct 19	Derivatives	Global Candy Company
13	Mon Oct 24	NO CLASS	
14	Wed Oct 26	Derivatives and Risk Disclosures	Sun Microsystems
15	Mon Oct 31	Stock Options and Dilution in EPS	Peoplesoft
16	Wed Nov 2	Stock Options and Valuation	TBA
17	Mon Nov 7	Intangible Assets	Gillette
18	Wed Nov 9	Intangible Assets II	
19	Mon Nov 14	Convertible Debt	MGM
20	Wed Nov 16	NO CLASS - TAKE HOME Exam Number 2 DUE	
21	Mon Nov 21	Pensions and OPEB	Vulcan Materials
22	Wed Nov 23	Consolidations	Coca-Cola
23	Mon Nov 28	SPE's and Joint Ventures	Alza ,
24	Wed Nov 30	Segmental Reporting	Pepsi
25	Mon Dec 5	Risk Analysis and Prediction	Sun Microsystems
26	Wed Dec 7	Interim Reporting	McKinley

FINAL EXAM WEEK is from December 14 to December 21

Preliminary Schedule of Assignments

RCJ: refers to Revsine, Collins, Johnson, *Financial Reporting and Analysis*, 2nd ed.

Session	Date	Topic
1	Wed Sept 7	The Financial Reporting Environment Post Enron
	Read:	<p>Skim all of these – concentrate on the Batson excerpts</p> <p>“Timeline of key events in the Enron affair”</p> <p>“Timeline of the key events leading to Andersen’s demise”</p> <p>“Analysis: Pyrrhic Victory for Arthur Andersen arrives too late,” Finance Week</p> <p>“Reversed and Reprimanded – Arthur Andersen,” The Economist</p> <p>“Banks Face More Enron Pain” Financial News Online</p> <p>“CIBC to pay \$2.4 Billion to Settle Enron Investor Suit,” The Globe and Mail</p> <p>“Enron Press Release –Third Quarter Earnings– October 16, 2001</p> <p>“Excerpts from Enron Financial Statements – 2000”</p> <p>“Excerpts from Report of Neal Batson, Court-Appointed Examiner”</p>
	Prepare:	Enron: What did Enron do to manipulate the appearance of their financial performance and financial condition? Why did they do these things?
2	Mon Sept 12	Financial Reporting Post Enron – II
	Read:	<p>Class Notes on The Role of Auditors and Accounting Standards in the Financial Reporting Environment</p> <p>“Two Years later: A recap of the Sarbanes-Oxley Act of 2002 and Related SEC Rulemaking”</p> <p>“Sarbox 404 Costs 63 Percent Higher Than Expected”</p> <p>“Reform’s Heavy Load Burdened by Sarbanes-Oxley, small companies mull staying (or going) private</p> <p>"The Greedy Bunch," Fortune, Sept 2, 2002</p> <p>"CFO's Feel Pressure to Lie," Boston Globe</p> <p>"Unaccountable in Washington," New York Times,.</p> <p>" No Excuses For Enron's Board," Business Week,</p> <p>“Former Enron Directors Will Pay \$13 Million,” CFO.com</p> <p>“Former WorldCom Directors Pony Up \$18 Million,” CFO.com</p> <p>“Over Before It Started,” The New York Times</p> <p>“Ruining Andersen’s Demise and the Loss of Audit Competition,” Financial Executive</p> <p>“Auditors: Too Few to Fail,” The New York Times</p> <p>“Excerpts from – Final Report of Neal Batson, Court-Appointed Examiner” (skim only)</p>
	Prepare:	Enron: What went wrong at Enron? Discuss the roles of management, the board of directors, the auditor, the financial

		accounting rule making process, analysts, investment banking firms, and Congress. What features of the Sarbanes-Oxley law do you think will be most effective?
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3	Wed Sept 14	Ratios and Forecasting
	Read:	RCJ: Chapter 5 and Appendix B of Chapter 6 Class Notes on Financial Statement Analysis, Ratios, and Forecasting Stickney, Chapter 10, Pro Forma Financial Statements [CP]
	Prepare:	The Gap (part 1) [CP] (see spreadsheet on Course Web Page)
4	Mon Sept 19	Accounting Based Valuation
	Read:	RCJ: Chapter 6 (skip pp. 298-300) and Appendix A of Chapter 6 Class Notes on Accounting Based Valuation “versus” Dividend Discount Models [CP] Example Problem on Accounting Based Valuation [CP]
	Prepare:	The Gap (part 2) [CP]
5	Wed Sept 21	Accounting Changes and Nonrecurring Items
	Read:	RCJ: Chapter 2 pp. 41-70, ; Chapter 5, pp. 126-137 Class Notes on Accounting Changes [CP] Class Notes on Comparison of Change in Accounting Method Using Retroactive with Restatement Method versus Cumulative Catch Up Method (web page)
	Prepare:	Corbomax [CP]
6	Mon Sept 26	Alternative Definitions of Earnings
	Read:	RCJ, Chapters 1 and 2 (Skim both) Class Notes on Alternative Definitions of Earnings Measures of corporate earnings: What number is best? Standard and Poors – Core Earnings "FEI Offers Caution on S&P Framework, July 1, 2002. "Out, by \$100 billion - How Pro Forma Accounting Boosts Profits," The Economist, February 23, 2002. SEC Orders New Disclosures on Company Earnings "Pro Forma" in Earnings Reports? As If" "Cisco Unveils Grisly Details of \$2.25 Billion Write-off," Zdnet News, May 8, 2001.
	Prepare:	Cisco Systems [CP]

7	Wed Sept 28	Cash Flow Statement
		<p>RCJ: Chapter 17 RCJ: Chapter 4, pp. 174-185 RCJ: Chapter 6, page 301</p> <p>Class Notes on Cash Flow Statement</p> <p>"Cash Flow? It Isn't Always What it Seems," Wall Street Journal, May 8, 2002 "Days May Be Numbered for EBITDA Numbers," Wall Street Journal, July 5, 2002. [CP] "Disconnected: Inside WorldCom's Unearthing Of a Vast Accounting Scandal," The Wall Street Journal, June 27, 2002 "WorldCom Files for Bankruptcy --- Debt, Scandal Overwhelm; Operations Set to Continue During a Reorganization." The Wall Street Journal, July 22, 2002 "WorldCom Revision Tops \$7 Billion --- Internal Review Unearths Additional Improper Items; Year 2000 Is to Be Restated," The Wall Street Journal, August 9, 2002 "MCI Shareholders Jump the Payout Line," Business Week, May 20, 2003</p>
		Statement of Cash Flow Classification WorldCom
	Prepare	

8	Mon Oct 3	Revenue Recognition
	Read:	RCJ Chapter 3 (especially pp. 117—125) RCJ Chapter 8, pp. 383-395 Class Notes on Revenue Recognition Installment Method – An Example Revenue Recognition and the Collection of Cash “Hot Air Accounting,” Forbes, May 5, 1997, pp. 114-115.
	Prepare:	Patten Corp. (see spreadsheet on course web page)
9	Wed Oct 5	Revenue Recognition and Uncollectibles
	Read:	RCJ Chapter 2, pp. 45-51 SAB 101's requirements for revenue recognition ...And the Revenue Games People (Like Enron) Play: Got Energy Trading Contracts? You Read it Here First (Sort of): The Gross truth about energy revenues Final EITF Consensus on Multiple Deliverables Revenue recognition: It doesn't really concern you, or does it? Big EDS Charge Illustrates Impact of New Accounting Rule
	Prepare:	Yahoo versus Google Merck

10	Mon Oct 10	Securitized
	Read:	<p>RCJ: Chapter 8: pp. 396-405</p> <p>Class Notes on Transfers of Financial Assets [CP]</p> <p>Examples of Securitization [CP]</p> <p>“Warning: Credit Crunch; Regulators want \$1 trillion or more of hidden corporate debt moved into plain view. The reform could stifle the credit-driven economy,” Forbes Magazine, August 12, 2002 (Web page)</p> <p>H&R Block Articles</p> <p>H&R Block’s Mortgage-Lending Business Could be Taxing Update: H&R Block shares fall on mortgage business worries</p> <p>H&R Block Subsidiary’s Sale Expected to Increase</p> <p>Taxing Questions at H&R Block</p> <p>H&R Block Unit Sells \$1.2 Billion Mortgage ABS</p> <p>H&R Block Keeping Mortgage Cash Cow Close to Home</p>
	Prepare:	H&R Block
11	Wed Oct 12	Fair Value Accounting
	Read:	<p>RCJ: Chapter 11, pp. 563-579; Chapter 16, pp. 885-891</p> <p>Class Notes on Accounting for Investments in Debt Securities and “Small” Equity Investments</p> <p>“Shining a Light on Companies Accounts” The Economist, 08/18/2001</p> <p>“Freddie Mac's Shuffling Games,” Dow Jones News Service, 27 June 2003</p>
	Prepare:	<p>Historical Cost Vs Fair Value of a Bond</p> <p>Astoria Financial (see spreadsheet on course web page)</p>

WEDNESDAY – OCTOBER 10 – MIDTERM EXAM #1 DUE @ 3:00 PM

MONDAY – OCTOBER 17 – NO CLASS – FALL BREAK

12	Wed Oct 19	Derivatives
	Read:	RCJ: Chapter 11, pp 585604 Class Notes On Hedging and Derivatives EDS Isn't Alone in Betting on a Rising Stock How EDS Rolled Dice -- and Lost --- Effort to Prevent Option Grants From Diluting Per-Share Profit Backfires When Stock Plummets
	Prepare:	Global Candy Company

13	Mon Oct 24	NO CLASS
14	Wed Oct 26	Derivatives and Risk Disclosures
	Read:	TBA
	Prepare:	Sun Microsystems

15	Mon Oct 31	Stock Options and Dilution in Earnings Per Share
	Read:	RCJ: Chapter 15, pp. 836-854 Class Notes on Employee Stock Options , Dilution, and Notes on Earnings Per Share “Intel’s option policy clouds accounting reform debate” “A New Year’s stock option resolution” “Foreign Firms to Expense Options” “Clock Ticks on Tech Lobbyists” “Accounting for Stock Options”
	Prepare:	Peoplesoft
16	Wed Nov 2	Valuation of Employee Stock Options
	Read:	"Deciding Value of Stock Options May Be Tricky --- Lack of Universal Method For Determining Amount Poses Dilemma for Firms," The Wall Street Journal Europe, August 7, 2002. "The Best Way of Valuing Options," Business Week, July 30, 2002 "Pinning Down The Value of a Stock Option" “How to Ante Up” “New Valuation Model could dampen the controversy over expensing employee stock options”

		<p>“Two Microsoft VP’s to get \$7.5 million for Underwater Options”</p> <p>“Protect Your Net Worth from Stock Options Meltdown”</p>
	Prepare:	Valuing an Employee Stock Option (see spreadsheet on course web page)TBA

17	Mon Nov 7	Intangible Assets
	Read:	<p>RCJ: Chapter 10, pp. 520-527</p> <p>“Valuing Intangibles: A Primer”</p> <p>“Corporate writedowns may hit \$1 trillion”</p> <p>“Accounting Rule Targets Goodwill; Companies must tell realistic value”</p> <p>“Street Strategist Goodwill, The Intangible”</p> <p>“The Top 100 Brands”</p> <p>Disclosures from Sun Microsystems</p>
	Prepare:	The Gillette Company

18	Wed Nov 9	Intangible Assets
	Read:	TBA
	Prepare:	The Gillette Company

19	Mon Nov 14	Convertible Debt
	Read:	RCJ: Chapter 15, pp. 854-859 Kirk Kerkorian's Personal Money Machine, <i>Business Week</i> , Nov. 2, 1974 [CP]
	Prepare:	Accounting for Convertible Debentures – Example Problem [CP] Metro-Goldwyn-Mayer [CP]
20	WED NOV 16	NO CLASS – MIDTERM #2 DUE @ 3 PM
21	Wed Nov 21	Pensions and OPEB
	Read:	RCJ Chapter 14 Class Notes on Pensions “S&P 500 Pension Analysis Shows Market Decline Continues to Erode Pensions.” PR Newswire, 24 April 2003 “I hope I die before I get old – Pensions,” Financial Times, 28 May 2003 "GM Balance Sheets Aren't As Clear as Company Claims" "The New Pinch From Pensions: Companies Must Pour Millions into Retiree Plans After Betting on Stocks" "Pensions, Pension Interest, and Standard & Poors Core Earnings" “Companies Face Big Changes In How The Estimate Pensions” Pension Accounting - An Example “San Diego Faces Turbulent Times” “Another Credit Downgrade Announced”
	Prepare:	Vulcan Materials

22	Wed Nov 23	Intercorporate Investments and Consolidation
	Read:	RCJ: Chapter 16, pp. 891-909 Class Notes on Intercorporate Investmensts – Equity Method Mishmash Accounting The Equity Method: An Example Consolidation vs the Equity Method
	Prepare:	Coca-Cola (also see spreadsheet from Course Web Page)
23	Mon Nov 28	SPE's and Joint Ventures
	Read:	“From SPE's to VIE's” “Reining In SPEs: New rules for special-purpose entities may result in bigger corporate balance sheets,” CFO Magazine [CP]
	Prepare:	Alza Corporation
24	Wed Nov 30	Segmental Reporting and EVA
	Read:	Class Notes on Segmental Reporting (SFAS 131) [CP] TBA
	Prepare:	Pepsico Inc and Economic Value Added (B) [CP]
25	Mon Dec 5	Risk Analysis and Prediction
	Read:	RCJ: Chapter 6, pp. 298-300 "A Yardstick for Corporate Risk Current measures of a company's health--and its ability to handle adversity--are inadequate. Here's what we need to know," Business Week, August 26, 2002. [CP] Penman: Chapter 21, The Analysis of Credit Risk [CP] Excerpts from Moody's Default Ratings Models Analysis of Default Risk: Fruit of the Loom
	Prepare:	Sun Microsystems [CP]

26	Mon Dec 7	Interim Financial Reports
	Read:	Class Notes on Interim Reporting Requirements [CP]
	Prepare:	McKinley International [CP] Predicting Quarterly EPS (web)
		FINAL EXAM (Open Book - Open Notes) You can pick it up anytime beginning the first day of Final Exams Week and you have 72 hours to turn it in. All exams must be turned in by 3 pm on the last day of final exams week.