

## **Financial Accounting**

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In general terms, financial accounting is the measurement of economic activity for decision-making. Financial statements are a key product of this measurement process and an important component of firms' financial reporting activities. In the past few years, financial accounting came to the forefront of the national consciousness as the stock market continued to decline amid faltering investor confidence. The crisis of confidence began with the revelation of accounting irregularities at some of the United States' largest companies. However, the implications extended well beyond the effects of individual accounting or company failures: investors seemed to lose confidence in the integrity of the financial system as a whole. The capital markets, whose relative efficiency is based largely on the timely dissemination of relevant and reliable financial information, were at risk. Clearly, the importance of understanding accounting has never been so salient.

The objective of this course is not to train you to become an accountant but rather to help you develop into an informed user of financial statement information. While financial statement users face a wide variety of decisions, they are often interested in understanding the implications of financial statement information for the future cash flows and earnings potential of a firm. We will focus on understanding the mapping between underlying economic events and financial statements, and on understanding how this mapping affects inferences about future profitability. Because annual reports are somewhat formidable, we will spend time familiarizing ourselves with how firms present the information for various accounts in the financial statements, including the footnotes. We also will discuss the role of the various institutions involved in the reporting process. By understanding the environment in which financial reporting takes place you will be in a better position to evaluate critically the disclosures made by firms in published financial statements.

The following learning objectives will be emphasized: (1) familiarity with the transactions businesses engage in, (2) fluency in accounting terminology, (3) understanding the logical structure that maps transactions into accounting numbers, (4) understanding the rationale for various accounting methods, (5) understanding the process that generates accounting standards and the complexity of this task, (6) awareness of the judgment involved and the discretion allowed in choosing accounting methods, making estimates, and disclosing information in financial statements, and (7) familiarity with the various formats used for different disclosures.

Several features of the course are used to facilitate these learning objectives. The textbook provides a conceptual foundation for the course by introducing the accounting framework and by characterizing accounting principles and alternative methods. Class time will be allocated to a combination of short lectures and discussions of the assigned materials. The

assigned cases serve as a basis of class discussion and provide a challenging test of your understanding of the topic. They are based on corporate financial statements and illustrate the issues associated with various accounting methods and the manner in which the related information is disclosed. In addition, they demonstrate the “real life” magnitude of income and balance sheet differences under alternative accounting methods, as well as a variety of financial reporting practices.

## Organizational Matters

1. **Required Text:** Horngren, C., Sundem, G., J. Elliott, and D. Philbrick, *Introduction to Financial Accounting*, 9th Edition, Prentice-Hall, 2006. The text is referred to as (T).
2. **Course Reader:** The Course Reader can be purchased at the University Bookstore. Course reader materials are organized according to the order in which they will be discussed in class. These materials include the cases and other assignments, and additional class handouts. The course reader includes additional material to be distributed during the quarter. Course reader materials are denoted (R).
3. **Course Website:** Additional course materials, including solutions for the Self-Study problems, templates for some of the assigned cases, and additional class handouts are provided on the course website.
4. **Grades** for ECON 90/190 will be based on a midterm exam, a comprehensive final exam, and hand-in homework assignments. The following weights will be used in calculating your final grade:

Midterm Exam	30%
Final Exam	55%
Homework assignments	<u>15%</u>
Total	100%

The midterm and the final exams will be closed book and closed notes, however you may bring a calculator. Although the final exam is cumulative, it will focus mainly on materials covered after the midterm. The midterm will be administered in class during the class time on the date noted below. The final will be administered during the University-appointed final exam period. The Economics department has some common syllabus elements for all courses that address exam-related issues such as disabilities etc. They can be found at [http://www-econ.stanford.edu/academics/economics\\_department\\_course\\_management.pdf](http://www-econ.stanford.edu/academics/economics_department_course_management.pdf)

Exam attendance: The midterm exam will be offered only at the time and date indicated below. If you have a scheduling conflict or are not able to take the midterm exam at that time for other reasons, you may skip the midterm exam. If you choose not to take the midterm exam you must send me an email before the beginning of the midterm exam indicating that you are not taking the midterm exam. In that case, the following weights will be used in calculating your final grade:

Final Exam	85%
Homework assignments	<u>15%</u>
Total	100%

Attendance of the final exam is mandatory (for exceptions see the Economics department's common syllabus elements).

**Homework Assignments:** Homework assignments listed in the course outline need to be submitted on the date indicated for class discussion. Your write-up of the case should be short and concise, preferably no longer than one page, and be computer generated (and not handwritten). The assignments will be graded based mostly on effort displayed. Because assignments often have several plausible answers, it is possible to receive full credit even if your answers differ from potential solutions discussed in class. You are allowed to discuss the homework assignments and prepare the assignment write-ups in groups of no more than four students. All students in the group should contribute to each homework assignment that bears their name. Students who did not contribute to the preparation of a particular homework assignment should not put their names on the write up. You may skip up to two homework assignments without any "penalty".

5. **Self-study problems:** The assigned textbook problems are intended for your use as a tool for self-study and self-assessment. They help test your understanding of the basic concepts and help you prepare for the more challenging material that will be discussed in class. They do not represent what we intend for you to learn in the course. Rather, they represent what you need to know to be able to learn the course material. We generally will not discuss the Self-Study problems during class, but you are responsible for knowing this material. You may also find that in preparing for the midterm and final exams, it is better to devote your time to the material discussed in class than to redo the textbook problems. However, you should be fully prepared to discuss the homework assignments during class time. The solution to the self-study problems will be posted on the course-website.
6. **Weekly help sessions** will be held by the course's teaching assistant Mohit Gundecha (mohitsg@stanford.edu). For up-to-date information on time and location please check the course website. Attendance at help sessions is strictly optional; these sessions are designed only to provide additional help to students who are having trouble with the basic material. That is, help sessions will provide an opportunity to ask questions about the problems and material covered in class. Neither additional material on a given topic nor new material to be discussed in future classes will be introduced in the help session. You are likely to find these sessions helpful if you have no accounting background or feel you would like to go over a given topic again. Feel free to come and go during help sessions; you are not obligated to stay for the entire session.

# Financial Accounting Autumn 2007

## Course Overview

<u>Session</u>	<u>Date</u>	<u>Topic</u>
1	Tue Sept 25	Introduction to Course and Financial Reporting
2	Thur Sept 27	Introduction to Financial Statements I
3	Tue Oct 2	Introduction to Financial Statements II
4	Thur Oct 4	Financial Statements as a Management Planning Tool
5	Tue Oct 9	Statement of Cash Flows
6	Thur Oct 11	Revenue and Expense Recognition
7	Tue Oct 16	Accounts Receivable
8	Thur Oct 18	Inventories
9	Tue Oct 23	Fixed Assets
10	Thur Oct 25	Intangible Assets
11	Tue Oct 30	Review and Catch Up
	Thur Nov 1	MIDTERM EXAM
12	Tue Nov 6	Financial Ratios
	Thur Nov 8	No class
13	Tue Nov 13	Liabilities (and introduction to NPV)
14	Thur Nov 15	Bonds
15	Tue Nov 27	Income Taxes
16	Thur Nov 29	Shareholders' Equity
17	Tue Dec 4	Accounting (out of ?) Control
18	Thur Dec 6	Final Review
	Mon Dec 10	FINAL EXAM: 3:30-6:30 p.m

# **Financial Accounting**

## **Specific Assignments (Subject to Change)**

**1: Tuesday, September 25**  
**Introduction to Course and Financial Reporting**

*Reading*

(T) Chapter 1

(R) Class Handout “The Four Primary Financial Statements”

*Self-Study*

(T) Chapter 1, Problems 1-31, 1-49

**2: Thursday, September 27**  
**Introduction to Financial Statements I**

*Reading*

(T) Chapter 2

*Self-Study*

(T) Chapter 2, Problems 2-32, 2-38, 2-46

*Assignment*

(R) Hewlett Packard

**3: Tuesday, October 2**  
**Introduction to Financial Statements II**

*Reading*

(T) Chapter 3 (pp. 90-100, skim pp. 96-100); Chapter 4 (pp. 140 – 148)

(R) Class Handout, “Double-Entry Bookkeeping”

*Self-Study*

(T) Chapter 3, Problems 3-38, 3-49; Chapter 4, Problem 4-58

*Assignment*

(R) Chemalite, Inc. Please answer the following two questions:

- a) Analyze and record Chemalite’s transactions for fiscal year 2003 (i.e., the period between 1/1/2003 and 12/31/2003); use T-accounts to record these transactions.

- b) Prepare Chemalite's financial statement for fiscal year 2003: a balance sheet for December 31, 2003 and an income statement for the year ended December 31 2003.

**4: Thursday, October 4**  
**Financial Statements as a Management Planning Tool**

*Reading*

- (T) Chapter 4 (pp. 154 – 162)
- (R) Reilly "Profit as we know it could be lost with new accounting statements"

*Assignment*

- (R) Hanson Ski Products

**NOTE:** Don't be intimidated by the sea of numbers. Most of the numbers you need to construct the balance sheets are directly given in the case. You don't need to forecast future sales, develop a schedule for collections, or re-calculate interest expense, etc. All of this has been (implicitly) done for you in the projected balance sheets, income numbers, etc. There are only a few numbers you actually need to derive.

An Excel spreadsheet with a useful format for completing the assignment is included with the case and is also available on the class web site.

**5: Tuesday, October 9**  
**Statement of Cash Flow**

*Reading*

- (T) Chapter 5
- (R) Fink, "Tuning In to Cash Flow"

*Self-study*

- (T) Chapter 5, Problems 5-41, 5-42, 5-62

*Assignment*

- (R) Statement of Cash Flows: Three Examples

**6: Thursday, October 11**  
**Revenue and Expense Recognition**

*Reading*

- (T) Chapter 6 (pp. 232-241)
- (R) Class Handout, "Accrual Adjustments"
- (R) Computer Associates International, Inc. (2004)
- (R) Forelle, "CA Pushes Out Sales Executive, Restates Revenue"
- (R) Reilly, "Apple Gets a Bruise by Blaming a \$1.99 Fee on Accounting Rule"

*Self-Study*

- (T) Chapter 6, Problems 6-34, 6-35, 6-45
- (R) Costco Companies, Inc.

*Assignment*

- (R) Microsoft's Financial Reporting Strategy  
(Assignment questions are provided in the course reader)

**7: Tuesday, October 16**  
**Accounts Receivable**

*Reading*

- (T) Chapter 6 (pp. 241-251)
- (R) Class Handout, "Basic Transactions for Receivables"
- (R) Class Handout, "Methods of Estimating Provision/Allowance for Bad Debt"
- (R) Fool.com, "Accounting for Non-Paying Customers"

*Self-Study*

- (T) Chapter 6, Problems 6-59, 6-67
- (R) Sun Microsystems

*Assignment*

- (R) Sears, Roebuck & Co.

Please send your estimate of an appropriate level for the provision/allowance for uncollectible accounts in 1999 (i.e., the numbers from question 2) by 7:00pm on Monday, October 15. Please submit this information through the class website.

**8: Thursday, October 18**  
**Inventories**

*Reading*

- (T) Chapter 7 (read pp. 278-282, 288-310; skim pp. 282-287)
- (R) Class Handout, "Accounting for Inventories"
- (R) Teaching Note "LIFO Reserve"

*Self-Study*

- (T) Chapter 7, Problems 7-56, 7-71, 7-76
- (R) Chevron Corporation

*Assignment*

- (R) Cisco Systems

**9: Tuesday, October 23**  
**Fixed Assets**

*Reading*

(T) Chapter 8 (pp. 334-357)

*Self-Study*

(T) Chapter 8, Problems 8-49, 8-58, 8-61

(R) Harley-Davidson

*Assignment*

(R) Depreciation at Delta Air Lines and Singapore Airlines

**10: Thursday, October 25**  
**Intangible Assets**

*Reading*

(T) Chapter 8 (pp. 357-362)

(R) Section on “Intangible Assets” (Kieso, Weygandt, and Warfield; John Wiley & Sons)

(R) Class Handout, “Accounting Goodwill”

*Self-Study*

(T) Chapter 8, Problems 8-54

*Assignment*

(R) BMC Software, Inc.

**11: Tuesday, October 30**  
**Review and Catch Up**

*Assignment*

(R) Midterm Exam 2006 (do not submit)

**Thursday, November 1**  
**MIDTERM EXAM**

**12: Tuesday, November 6**  
**Financial Ratios**

*Reading*

(T) Chapter 12 (pp. 534-561), Chapter 9 (pp. 415-418)

*Self-Study*

(T) Chapter 12, Problems 12-51, 12-52, 12-54

**Thursday, November 8**  
**NO CLASS**

**13: Tuesday, November 13**  
**Liabilities (and introduction to NPV)**

*Reading*

(T) Chapter 9 (pp. 418-424)

(R) Class Handout, “Basic Transactions for Bonds”

*Self-Study*

(T) Chapter 9, Problems 9-40, 9-41, 9-42

**14: Thursday, November 15**  
**Bonds**

*Reading*

(T) Chapter 9 (pp. 382-404)

(R) Tergesen, “Getting to the Bottom of a Company’s Debt”

*Self-Study*

(T) Chapter 9, Problems 9-56, 9-61, 9-74

*Assignment*

(R) MGM Mirage

**15: Tuesday, November 27**  
**Income Taxes**

*Reading*

(T) Chapter 9 (pp. 411-415)

(R) Tergesen, “How to Spot Tax Tinkering”

*Self-Study*

(T) Chapter 9, Problems 9-39, 9-72

*Assignment*

(R) Pfizer Inc.

**16: Thursday, November 29**  
**Shareholders' Equity**

*Reading*

- (T) Chapter 10
- (R) Class Handout, "Shareholders' Equity"
- (R) Lawton/Clark, "Dell to Restate 4 Years of Results"

*Self-Study*

- (T) Chapter 10, Problems 10-51, 10-57, 10-75
- (R) Yahoo! Inc.

*Assignment*

- (R) Dell Computer

**17: Tuesday, December 4**  
**Accounting (out of?) Control**

*Reading*

- (R) Patsuris, "The Corporate Scandal Sheet"
- (R) Nussbaum, "Can You Trust Anybody Anymore?"

*Self-Study*

- (T) Chapter 6, Problem 6-75; Chapter 7, Problem 7-84

*Assignment*

- (R) Tales of Audit Failures: ZZZZ Best

**18: Thursday, December 6**  
**Final Exam Review**

*Assignment*

- (R) Final Exam 2006 (do not submit)

**FINAL EXAM**

**Date: Monday, December 10, 2007**

**Time: 3:30-6:30 pm**

**Room: TBA**