



California Polytechnic State University
Accounting 322--Intermediate Accounting II—Spring 2010

INSTRUCTOR INFORMATION

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COURSE OBJECTIVE

The overall objective of this course is to enhance your understanding of:

- Accountants' role in providing financial accounting information,
- Theories and processes underlying that information and
- The relevance of that information to various user groups.

The presumption is that you will likely pursue a career in accounting, that you are in charge of developing that career, and your goal is to be a vital member of the management and decision making team in a public accounting firm, private industry, government or a not-for-profit organization. Although the development of your technical skills is critical, it is not the only skill necessary for you to be successful. Interpersonal skills, analytical and problem solving skills and written and oral communication skills are critical success factors and will be emphasized.

With respect to BUS 322 specifically, the focus will be on the following:

- Build on the foundation of accounting knowledge, research and thought processes gained in BUS 321.
- Gain in-depth knowledge of the underlying economic impact of specific, complex transactions.
- Understand the conceptual basis of the accounting and reporting for these transactions.
- Develop an understanding of the mechanical aspects of accounting for the transactions in line with the underlying concepts.
- Learn how to interpret corporate financial reports, primarily from the perspective of an investor

Topic coverage is shown on attached lecture and homework schedule.

PREREQUISITES

Completion of BUS 321 with a minimum grade of C-. If you have not met this requirement, please discuss your situation with me immediately following the first class meeting.

LEARNING OBJECTIVES

The role of financial accounting is to communicate information that supports business decision-making. Without understanding how decision makers use accounting information, it is difficult to fully understand financial accounting issues or, more importantly, to critically evaluate accounting method alternatives. Keep this perspective in mind as you study each topic. To assist you, in each class we will cover real world cases, which offer insights into how the information discussed in the chapters affect decisions made by investors, creditors, managers, and others. Also, avoid memorizing. A true understanding of **how** a particular procedure is applied demands a clear understanding of **why** it is applied. As you learn procedures presented in the text, be sure to make sure you understand **why** those procedures applied.

The successful student will:

- (1) Acquire an understanding of the basic concepts and principles underlying financial accounting measurement and reporting practices.
- (2) Develop the critical thinking skills needed to analyze and comprehend the nature and consequences of economic events which are the subject matter of accounting.
- (3) Gain an appreciation for the behavioral and economic consequences of accounting and reporting alternatives, including ethical considerations.
- (4) Cultivate the communication skills essential to the financial reporting process.

CLASS POLICIES

Organization of the Lectures:

We meet for four hours each week. I will lecture for the majority of the class, but I will also give you problems in lecture to work on. During that time I will serve as a freelance consultant for you. So this part of the lecture will constitute the “learning-by-doing” component of our course. Active involvement with the course material inside and outside of class is one of the keys to mastering this subject. I would encourage you to adopt Cal Poly’s 25-35 study approach. The grade for class participation will be based on the quality of your contributions to the in-class discussions. You also can earn class participation points by sending e-mails to me with good observations about the material and by calling my attention to articles in the business press that apply course concepts.

Academic Integrity

The Orfalea College of Business expects all its students to learn, respect, and practice integrity. All acts of dishonesty are unacceptable. The college’s policy on academic integrity will be adhered to the Campus Administrative Manual (CAM) (Section 684).

Resources:

Intermediate Accounting, 5th ed.; Spiceland, Sepe, Nelson, Tomassini; McGraw Hill, 2009. **Please bring your text to class.**

Course syllabus, class notes, solutions etc. will be available on Blackboard. Students are expected to download the class notes and other materials from Blackboard in a timely manner. Please access Blackboard from: <http://my.calpoly.edu> using your Cal Poly username and password.

Grading

Grades will be allocated as follows:

Professional conduct/ in-class contribution (non-negotiable)	5%
Presentation (15%) and Problems (5%)	20%
<u>2 Mid-terms (20% each) and final exam (35%)</u>	<u>75%</u>
Total	100%

Your final grade will be based on a weighted average of your scores on the elements listed in the above table.

This class uses the relative scale based on a normal distribution. I prefer this method because it assigns grades based on your actual performance as a class, as opposed to the absolute scale, which uses an abstract and arbitrary standard.

In the **absolute scale** method, your score is compared to a pre-determined scale, such as A=90-100%; B=80-89%; C=70-79%; etc. This evaluates you based on a pre-determined set of criteria.

In the **relative scale** your score is evaluated by comparing it to other scores in the class. Thus the relevant issue is not your percent score but your **percentile** score.

A **percentile** score measures where your grade falls compared to other grades in the class. For example, a score of 85th percentile means your score is higher than 85% of the class, and lower than 15% of the class. A score of 85th percentile is **not** the same as an 85%.

Since this class uses the relative scale, the grading scale uses percentile scores rather than percent scores. The grading scale for this class is:

Grade	Percentile (not percent)	Percent of class	
A	90 —100	23%	Mean + 1.5 σ
A-	78 – 89.9999		Mean + 0.8 σ
B+	67 – 77.9999	40%	Mean +0.5 σ
B	50 – 66.999		Mean
B-	37 – 49.9999		Mean - 0.4 σ
C+	30 –36.999	24%	Mean – 0.6 σ
C	25 – 29.999		Mean – 0.75 σ
C-	13 – 24.999		Mean – 1.1 σ
D	3—12.9999	10%	
F	0—2.9999	3%	

The probable median GPA for the class, which is the same as the 50th percentile, is 2.86 (B/B-).

If you have a dispute with a grade, you must submit your original exam and a written explanation of the dispute within one week of receiving the exam back. I will re-grade the entire exam and will change the score to zero if the exam has been tampered with.

Class participation will decide marginal cases and I will give negative class participation points for coming to office hours without having attempted to understand the material.

Class involvement:

The goal is for students to be continuously involved. An “absentee” student will not be successful in this course. My goal is to add value each class session.

Class time:

I will start promptly at ten minutes after the hour. Please arrive at class prior to ten minutes past the hour. Late arrivals to class are disruptive. As a courtesy to me, and your colleagues, please make every attempt to arrive before class begins. Sometimes this is unavoidable, but **frequent late arrival is unprofessional** and inconsiderate behavior. If there is a unique situation that will result in arriving late frequently, please discuss it with me at the beginning of the semester.

Services for Students with Disabilities:

If you think you need an accommodation for a disability, please let me know at your earliest convenience. Some aspects of the course, the in-class activities, and the way I teach may be modified to facilitate your participation and progress. As soon as you make me aware of your needs, we can work with the Disability Resource Center (Student Services Bldg 124, phone 756-1395) to help us determine appropriate accommodations. I will treat information you provide as private and confidential.

ROLE OF ASSIGNMENTS**Reading**

The reading assignments are designed to provide a foundation and a basis for your understanding of the issues involved. The classroom activities will build on that foundation to enhance your understanding and comprehension of the critical factors that need to be considered in dealing with those issues. Therefore, if you do not read the assigned materials **in advance** or do not dedicate sufficient time to them you will not be prepared for the classroom experience.

Class Discussion

You will notice that various assignments are included in the Class Schedule for discussion in class. These assignments, which will not be collected and graded, will help you develop a foundation for understanding the topic. Given the emphasis in the classroom on the conceptual issues and their application, your participation is critical. You are responsible for asking penetrating questions, not those that could be readily answered by reading the textbook, for providing well conceived alternatives to those proposed in the literature or by your colleagues, by challenging me and your colleagues to support their positions. These types of activities stimulate thinking, develop your analytical and problem solving skills and create a learning experience that is exciting and memorable.

In-class presentation and case study*Guidelines for the presentation:*

- ❖ Please use PowerPoint slides and bring handouts for your classmates.
- ❖ Please restrict your presentation to 15 minutes. This means no more than 4-5 slides.
- ❖ The first slide should cover the controversy surrounding your topic. The next two slides should discuss the pros and cons of various accounting treatments. The final two slides should discuss the current measurement in US-GAAP and highlight the importance of estimates and potential areas where management discretion is required.
- ❖ Each student will have to present at least one slide. Hence, you will work in groups of five.

Grading of the presentation:

- ❖ You will be graded on along the following rubric. Since this is an accounting class the grading will heavily weigh on subject knowledge as opposed to oral communication.
- ❖ The presentation will be 10% of your final grade.

Evaluating Presentations	D	C	B	A
Organization	Audience cannot understand presentation because there is no sequence of information.	Audience has difficulty following presentation because students jump around.	Students present information in logical sequence which audience can follow.	Students present information in logical, interesting sequence which audience can follow.

Subject Knowledge	Students do not have grasp of information; students cannot answer questions about subject.	Students are uncomfortable with information and are able to answer only rudimentary questions.	Students are at ease with expected answers to all questions, but fail to elaborate.	Students demonstrate full knowledge (more than required) by answering all class questions with explanations and elaboration.
Graphics	Students use superfluous graphics or no graphics	Students occasionally use graphics that rarely support text and presentation.	Students' graphics relate to text and presentation.	Students' graphics explain and reinforce screen text and presentation.
Mechanics	Students' presentation has four or more spelling errors and/or grammatical errors.	Presentation has three misspellings and/or grammatical errors.	Presentation has no more than two misspellings and/or grammatical errors.	Presentation has no misspellings or grammatical errors.

Topics for in-class presentation (please look at the syllabus for the date of your presentation).

1. Shareholders' Equity: Shareholder value accounting. Transactions below or above intrinsic value (*I WILL DO THIS IN THE FIRST CLASS TO GIVE YOU AN IDEA WHAT I EXPECT*)

Shareholder value accounting (SVA) is accounting that reports faithfully to the shareholders. It's a form of accounting that has as its primary goal reporting to the shareholders about what their earnings are and what their assets and liabilities are. GAAP accounting keeps track of the assets and liabilities of the firm, rather than those of the shareholders. If a firm borrows by writing a claim on the shareholders' equity, GAAP doesn't record that. If a firm pays off a loan by issuing stock at less than market value, GAAP doesn't record that as a loss to the shareholders. GAAP doesn't have the shareholders' interests at heart.

2. Employee stock options. Pros and Cons of expensing stock options.

In recent years, CEO compensation has become a "hot button" issue due to the widening gap between executive pay and that of rank and file workers as well as the larger percentage of performance-related pay in the form of stock option grants. The debate over whether or not to expense options centers on their value. Fundamental accounting requires that expenses be matched with the revenues they generate. No one argues with the theory that options, if they are part of compensation, should be expensed when earned by employees (vested). But how to determine the value to be expensed is open to debate.

3. Earnings-per-share. Financial Crisis' flawed metrics

While everyone is looking for reasons why this nation is in a financial mess, let me toss another one into the ring. We're in this situation because we've focused almost exclusively on the income statement and ignored the balance sheet. An income statement indicates how revenues are transformed into net income, or profits after taking expenses into account. The balance sheet lays out the assets deployed in the operations to generate the revenues that drive profits. The critical factor for any firm's success is its profitability, i.e., how much

profit is the firm making relative to the amount of assets that have been deployed. Almost no one looks at profitability — we focus on raw profits instead, to our detriment.

4. Cash Flow: Is cash really king in valuations, or do earnings trump it all? Cash flow vs. accrual accounting

About five years ago, as investors licked their wounds in the wake of the Enron and WorldCom scandals, analysts clamored for financial measures beyond earnings that might paint a truer picture of a company's intrinsic value. Earnings, many argued, could be more easily inflated than other financial variables. At the time, as had happened cyclically many times before, institutional investors rallied around cash flow from operations as perhaps the best sign of a company's future cash flows and, by extension, its likely stock price. Because cash flow, unlike earnings, excludes relatively arbitrary items like depreciation and amortization, the logic went, cash flow might be a closer proxy of a company's value. Earnings in some high-profile scandals had proved fallible, since companies could fudge the numbers. Forecasts of other variables, including dividends, might also more perfectly signal a company's value, some thought.

5. Investments: Who said accounting wasn't fair? Fair value vs. historical cost accounting.

As the U.S. savings and loan crisis that rocked the financial and real estate markets some 15 years ago came to an end, accountants strove to understand just what had gone wrong. A key problem, many experts suggested, lay with the methods used to value assets and liabilities on balance sheets. At the time, the dominant valuation approach was *historical-cost accounting*. This method reports the original amount paid or received for assets and liabilities on a company's balance sheet, as well as earnings generated by the assets and liabilities on the income statement. Banks and savings and loan institutions used historical-cost accounting to report the value of loans and core deposits on their balance sheets, and equity analysts valued these firms from their earnings. But historical costs are not current values; if interest rates change, the value of deposits and loans also change, and this change forecasts the firm's ability to generate earnings. Just as declines in the market value of mortgages in today's subprime mortgage market indicate potential investment losses, so too the change in the value of loans relative to deposits of savings and loans 15 years ago would have indicated losses. While those losses eventually would have been reported in earnings, market values sound the distress signal a little earlier. In light of the savings and loan failures, many experts argued for a switch to *fair-value accounting* — marking assets and liabilities on the balance sheet to their market value. Regulators, including the U.S. Financial Accounting Standards Board and the International Accounting Standards Board, are moving steadily in this direction. Fair value is defined by these bodies as the price at which a firm could sell an asset (or the price it would have to pay to be relieved of a liability).

6. Intangible assets: Valuing intangible assets. Capitalizing vs. expensing.

In the ensuing shift away from manufacturing, a firm's assets are increasingly in its entrepreneurial ideas, brands and research and development. Distribution systems have replaced delivery trucks as the main source of value. A firm can book these so-called intangible assets to the balance sheet if it has acquired them on the open market. Copyrights and patents, or even laboratory equipment for R&D, for example, are frequently brought onto the balance sheet at the price they were acquired for, their so-called historical cost. But the lion's share of intangibles cannot be assigned market prices; without clear market information, there is no sound basis on which to determine value. Accountants have resisted booking intangibles to the balance sheet largely because doing so runs counter to the principle of conservatism, an axiom of accounting practice. Conservatism says that speculation should not come into the accounts — and intangibles are speculative. But critics have charged that accounting, by failing to provide a method for valuing and booking intangibles, has not kept up with the changing pace of business

7. Revenue recognition: Now, later or never. Accounting Conservatism

The issues that bear upon the details of how, when and in what amount revenue should be recognized are broad and extremely deep. When it comes to identifying transactions where revenue recognition exists, there are plenty of issues and rules governing the proper accounting treatment auditors and accountants should follow. Given the struggling economy and the pressure from shareholders to deliver favorable performance numbers, issuers might try to shed the best possible light on revenue but at the expense of accuracy. The objective of the revenue recognition project is to clarify the principles for recognizing revenue and to create a joint revenue recognition standard for US GAAP and IFRSs that companies can apply consistently across various industries and transactions

8. Hedge your bets. Hedge your bets. The reporting of gains and losses.

The accounting profession, with its emphasis on historical transactions, has traditionally paid little attention to risk. “When you drive a car,” “you can’t just look in the rearview mirror. Sometimes you have to look ahead. And accounting is not well suited for that. It seems logical to assume that accountants would want to take advantage of a new accounting rule that suppresses earnings volatility. But when it comes to accounting for hedging activity, some CFOs would rather risk volatility than designate derivative instruments as hedges for accounting purposes. A conceptual question in accounting for derivatives is: Should gains and losses on a hedge instrument be recorded as they occur, or should they be recorded to coincide with (match) we income effects of the item being hedged?

Problems

Background and Purpose: The primary objective of this assignment is to begin to integrate the many concepts we have studied and to give an opportunity to apply our intermediate accounting to more challenging issues. You will present the problems after the in-class presentation to the class.

Exams

Exams will be designed to assess whether you have grasped the materials to date and are able to apply the knowledge comprehensively. The exams will emphasize technical competence and critical thinking ability and will include application-oriented problems.

You may use a reference sheet on the exams. The reference sheet must follow the guidelines:

- one sheet, one sided
- it must be original work, it can not be photocopied.
- the sheet may not include a list of the solutions to the homework
- the reference sheet must be turned in with the exam.

Many past students have told me that the process of preparing the reference sheet is more valuable for exam success than the use of the sheet during the exam.

Homework Assignments

Homework assignments should be completed when you arrive for class. I encourage you to use Excel wherever it seems appropriate since that tool will prove invaluable in your professional life. I will attempt to cover all homework assignments in class. Copies of the solutions will be available on Blackboard after the homework is covered in class.

NOTE TO THE STUDENTS:

This class is manageable and most students get out of it what they put in. If you are in to the course you will enjoy it (enjoy accounting, it is possible). My goal is for the students to leave this class with long term finance/accounting analytical skills.

If you have chosen to protect your Directory Information (which includes name and email), it is important you communicate this to your instructor prior to or on the first day of class. This course uses Blackboard tools that will display students' full names and email addresses.

COURSE OUTLINE:

The attached outline shows the topics covered, the homework assignments for each class and the exam schedules. All of the homework is optional but highly recommended. It is virtually impossible to learn the material without practicing it. I have listed in-class cases with the chapter reading assignments. We will cover these in class so please read them prior to class and be prepared to answer the questions.

TENTAIVE¹ CLASS SCHEDULE (ALL CLASSES HELD IN 03-209 2-4pm

Week	Date	Reading	Topic	Homework*
1	30 Mar		Course Overview	
	1 Apr	Ch. 18 pp. 946-950	Presentation and Analysis of Equity Presentation: Shareholder value accounting. Transactions below or above intrinsic value Problem: 18-6	E18.1, E 18.2, E18.8, E18.11
2	6 Apr	Ch. 18 pp. 954-955	Shareholder Equity (Earned Capital) Problem 18-9, 18-10	E18.14, E18.15, E18.17
	8 Apr	Ch. 19 pp. 1002-1011 Appendix 19A	Share-based Compensation Presentation: Pros and Cons of expensing stock options Problem: 19-2, 19-3	E19.1, E19.5, E.19.7
3	13 Apr	Ch. 19 pp. 1012-1019	Earnings per Share Presentation: Financial Crisis' Flawed Metrics Problem: 19-9, P19-10	E19.11, E19.15
	15 Apr		Review/ Catch-Up	

Week	Date	Reading	Topic	Homework*
4	20 Apr		MIDTERM #1, WEEKS 1 -3	
	22 Apr	Handout	Earnings Quality	
5	27 Apr	Ch. 21 pp.1108-1139	Statement of Cash Flow's Presentation: Is cash really king in valuations, or do earnings trump it all? Cash flow vs. accrual accounting Problem: 21-1, 21-10	E21.1, prepare a cash flow statement
	29 Apr	Ch. 21 pp. 1139-1146	Statement of Cash Flow's	
6	4 May	Ch. 10 pp. 503-510	Intangible Assets/ R&D Presentation: Valuing intangible assets. Capitalizing vs. expensing. Problem: 10-4, 10-11	
	6 May	Ch. 11 pp. 545-546; 553-558	Intangible Assets/ Impairment	E10.24, E11.23
7	11 May	Appendix A pp. 1185	Derivatives Presentation: Hedge your bets. The reporting of gains and losses. Problem: P A-1	E A-2, E A-4
	13 May	Appendix A pp. 1185	Derivatives Review/ Catch-Up	
8	18 May		MIDTERM #2, WEEKS 4 -7	
	20 May		FURLOUGH DAY	
9	25 May	Ch. 12 pp.586-596	Investments Presentation: Who said accounting wasn't fair? Fair value vs. historical cost accounting. Problem: 12-4, 12-7	

Week	Date	Reading	Topic	Homework*
	27 May	Ch. 12 pp.602-608	Investments	
10	1 Jun	Ch. 5 pp.226-236	Revenue Recognition Presentation: Now, Later or Never. Accounting Conservatism Problem: P5-1, 5-2	
	3 Jun	pp.238-252	Revenue Recognition	

¹ I call it tentative, as I reserve the right to change what we cover based on how efficiently we are progressing. Homework is due on the next day of class. For example, homework 1 (assigned on April, 1th is due on April, 6th; or homework 2 (assigned on April, 6th is due on April, 8th)