This course studies the construction, evaluation, and interpretation of the principal components of corporations’ financial reports: the balance sheet, the income statement, and the statement of cash flows, along with these statements’ supplementary notes. Much of the class will be devoted to understanding how individual transactions affect these principal financial statements. The course also contains a brief introduction to financial statement analysis. We will learn some aspects of how and when a firm’s financial reports accurately reflect its earnings-related activities.

The course also examines some of the ways in which managers’ accounting decisions affect published financial statements. There is often sufficient discretion in how firms record and/or structure transactions so as to affect the appearance of a firm’s financial statements. As examples, by judiciously (a) choosing among financial methods (e.g., choosing between LIFO versus FIFO), (b) making estimates (e.g., forecasting warranty costs), and/or (c) structuring transactions (e.g., engaging in off-balance-sheet financing), a manager may be able to affect dramatically a financial statement’s appearance. We will study examples of firms using this latitude to achieve various objectives (e.g., avoid financial distress, potentially influence litigation outcomes, etc.). We will also study how information in the notes to the statements allows the savvy financial statement reader to undo some of the cosmetic effects associated with these choices.

Much of the course is devoted to learning how to account for basic transactions. Why? For two reasons: first, because a manager does not understand a transaction unless he/she knows how to account for it. Second, a manager does not know how to interpret a firm’s financial statements unless he/she knows how the transactions of the firm can affect its financial statement’s appearance. By the end of the course, you should obtain a mastery of how many common business transactions are recorded in financial accounting, and also the ability to interpret the fundamental components of firms’ financial statements.
Text

Required: Weil, Schipper, and Francis Financial Accounting: An Introduction to Concepts, Methods, and Uses 14th edition (henceforth abbreviated “WSF”). This is the newest edition. No other edition of this book should be acquired, as the text has changed over time (accounting standards change!), as have the problems in the text.

(This is a great textbook, but it has one deficiency: in attempting to be all things to all students, it contains the accounting rules used both under U.S. GAAP and under IFRS (international financial reporting standards), the latter sometimes also called “IASB” (International Accounting Standards Board) GAAP. Although there are broad similarities between U.S. GAAP and IFRS, there are occasional differences. I believe that financial accounting is fairly difficult to learn even when dealing with just one set of accounting standards, and consequently, that it is undesirable to try to learn financial accounting under two distinct sets of accounting standards. Accordingly, throughout this class, you are only responsible for accounting under U.S. GAAP.)

Canvas Site

My use of the Canvas website will be limited to: 1. posting the case packet for the course (which consists solely of sample quizzes and sample exams from prior iterations of the class); and 2. lecture notes and handouts distributed in each class. If you miss a class, you can find the lecture notes related to that class on the Canvas site. (I will not bring an inventory of previously handed out lecture notes with me to class.) A word of caution: in my view, obtaining a copy of the lecture notes without attending class is a poor substitute for attending class, as the lecture notes do not contain all of the material discussed in class related to the lectures (but see comments about Attendance on page 7 below).

Readings and Assignments

Assignments in the course outline below are from WSF unless otherwise noted. In the course outline, “Ch. 9,” for example, refers to Chapter 9 from WSF. Also, note that “1-18, 1-19” refers to problems 18 and 19 from Chapter 1 of WSF. (Note in particular that 1-18 does not mean problems 1 through 18.)

You are expected to do the assigned reading and problems prior to class. Assigned problems, other than the financial statement journal (discussed below), are NOT to be turned in for course credit. The fact that the assignments are not to be turned in does not lessen their importance: if you don’t do the assigned problems when they are due, the class discussion will lose some of its import, and it will be more difficult for you to prepare for the final exam (or quizzes). Copies of the solutions manual to WSF are sold along with the text to give you the opportunity to try additional problems and check your solutions.

Contemporary readings from the financial press, and from the recently available financial statements, will be distributed in class as the quarter progresses.
**Pace and Class Format**

This course covers an incredible amount of material over a quarter. Ideally, if I could control the schedule for this course, I would cover the material over fifteen weeks rather than over ten weeks. But, since I am restricted to the schedule imposed by Kellogg’s quarterly format, this forces the class to have what is, overall, a fast pace.

Given the in-class time constraints, and given the overall volume of the material in the class to be covered, you should recognize that it is not possible, in principle, for me to discuss every topic of importance in class. This is particularly true for some topics covered later in the quarter. Consequently, the in-class discussion should be viewed as a guide to cover the major conceptual points, but it cannot cover all that merits learning in the course. This is typical of graduate classes at leading business schools: you bear ultimate responsibility for learning the material; I am responsible for giving you as organized, as clear, and as informative a presentation of introductory financial accounting as class time allows.

A typical class will involve me lecturing on material assigned for that class, and providing illustrations of the concepts discussed in class using “live” financial statements, and concluding - in our third through ninth class meeting – with a brief quiz at the end of class. On some days – but not all - I will review a representative problem or two from the assigned homework for that class. You can use the solutions manual to check your answers to assigned problems we don’t review in class. (One warning about the solutions manual: use it sparingly! If you look at the solutions manual before you attempt a problem on your own, you may fool yourself into believing that you could have solved the problem when you really do not have a mastery of the material related to the problem.)

The class is scheduled for 6PM to 9PM. We will take a fifteen minute break around 7:30PM. On those evenings we have quizzes, the quiz typically will be administered at 8:45PM and it will be designed to be completed in 15 minutes (but see below). On those evenings where there is no quiz (the first, second, and tenth classes, I will generally teach right up until 9PM. Please plan your post-class transportation accordingly.

One difficulty that sometimes arises in this course is cross-student heterogeneity: particularly in the first half of the course, there tends to be wide disparities among students’ financial accounting backgrounds. As a consequence, some students may ask interesting, sophisticated questions the answers to which require somewhat advanced accounting knowledge. While I am happy to entertain such questions, on occasion, I may defer answering them until after class, or later in the course, so as to not disrupt the flow (or level) of the classroom discussion. Please do not be offended if, on occasion, I defer or decline addressing such questions.

A final issue regarding classroom operation: based on surveys of graduating Kellogg students, there seems to be an appreciation by students of “cold-calling” in class. This is an effective device to ensure that students are prepared and maintaining an active interest in the class. I will do a limited amount of cold-calling in class every time we meet in response to this demonstrated student demand.
Grading

Grading will be based entirely on the following weighting scheme:

Course Preterm  
Financial Statement Journal  
Quizzes and final exam (based on the formula: Max{.4 x (average of the best four of 7 quizzes) + .6 x Final, Final}  

Exam and Quizzes

Starting with the third week of the class, there will be a quiz at the end of every class meeting, designed to last approximately 10 – 15 minutes (with one exception – see below). Even though the typical quiz is designed to take at most 15 minutes to complete, I will allow all students to spend up to one half hour completing a quiz, by distributing the quiz at 8:45PM and requiring students to stop working on the quiz at 9:15PM. These quizzes are not designed to test one’s ability to work under time pressure: if you find it difficult to complete a quiz in the allotted time, this is not an indication of the difficulty of the quiz; it is an indication that you have not acquired sufficient mastery of the material being studied.

The quiz on the statement of cash flows is an exception to the preceding: it will be designed to take no more than one-half hour to complete, but I will allot forty-five minutes of time (from 8:30PM to 9:15PM) for its completion.

The material covered in the quizzes will lag the material covered in class by one week – so that you will NOT be quizzed on material that is first covered in class the same week the quiz is administered.

There will be an in-class final exam.

As the grading formula above indicates, the quiz component of your grade will be based on the best four of seven quizzes – unless the final exam component of your grade is better than your quiz component - in which case, your performance on the quizzes will have no influence on your course grade. The final exam, and all quizzes, will be in class. In some previous iterations of the class, I used a midterm in place of the weekly quizzes. Since you may find the sample midterm questions useful when preparing for the quizzes, I have included past sample midterms, along with past sample finals, in the case packet.

One of the truly excellent features – in fact, maybe the best feature -- of the WSF text is the broad array of problems it contains. In order to exploit this feature of WSF, I make the following promise: when taking into account all the questions on the quizzes and the final exam together, at least fifty percent of all the questions will be essentially the same as, apart from minor changes in wording or arithmetic detail, as some question that appears at the end of the chapters of the text we will cover. (Note carefully the phrasing of the preceding statement: these questions may not be the same as the assigned problems listed in the course outline below: they may be any problems from the relevant chapters.) Thus, any student willing to work hard enough to cover all of the problems
at the end of all of the assigned chapters will be assured that he/she has seen at least fifty percent of the questions on all the quizzes and the final exam before sitting down to take the quizzes or the final exam. I believe that this promise – which, obviously, is intended to motivate you to work on more than just the assigned problems - will facilitate your learning financial accounting, since you will learn more the more accounting problems you do.

The ground rules for taking the quizzes and final exam are the following: all quizzes and the final exam will be closed book, closed notes, with no study aids (e.g., no “cheat sheets”). While you can use a simple calculator, you are prohibited from using any device that permits wireless communication – thus, laptops, cell phones, pdas that have wireless capabilities, etc., are prohibited. I recommend that you buy a cheap calculator (i.e., one that is capable of doing basic arithmetic calculations).

What do you do if you cannot attend class in a week for which a quiz is administered? Nothing special. I have purposefully designed the quiz component of the grade so that if you miss one, two, or even three class sessions, there are no consequences for you (regarding the quiz component of the grade), since the quiz component of grades is based on the best four out of seven quizzes. If you miss more than three such classes, then there are potential consequences associated with not taking four or more quizzes, of course – unless you do sufficiently well on the final exam. I think this is appropriate: I don’t think you can consider yourself fully engaged in the course if you miss more than three classes.

Problems

The problems listed in the course outline below address the principal areas of financial accounting that I wish you to emphasize. They illustrate issues, techniques, and ideas that you must understand. However, I recommend that you attempt more problems than just those assigned, particularly for material you find difficult. There are both direct and indirect benefits from doing so: the direct benefits are that your quiz/exam performance will improve. The indirect (and more important to me) benefit is that you will learn more. For problems that you find difficult, there are usually other similar problems, juxtaposed next to the assigned problems, that will give you additional opportunities to test your understanding of the material.

Financial Reporting Journal

Notwithstanding all the rules underlying the preparation of financial statements, there is an amazing amount of diversity across firms’ financial presentations. Initially, this diversity is disorienting: not all the financial statements you see in practice conform to the presentations that appear in our, or any other, textbook. As managers, you must grow accustomed to the variations in these presentations to be effective. The way to do that is to examine as many statements as possible. To encourage your financial statement exploration, I want you to construct a financial reporting “journal” in which you record what you regard as interesting observations concerning four (4) financial reports involving companies other than those whose financial statements are discussed in class. It suffices to have one typed, double-spaced page of commentary per company. You have considerable discretion regarding the contents of your commentary. It can consist of comments about unusual accounting practices, unusual financial statement presentations, puzzling
notes, auditors’ opinions, trends in a firm’s financial data, MD&A discussion, etc. The important thing is to expand the scope of the financial statements you are acquainted with. Your financial reporting journal is due on the same day as the final exam, and is to be prepared individually by each student.

**Honor Code/Classroom Etiquette**

The Kellogg Honor Code applies at all times in this course, as does the Kellogg code of classroom etiquette (except as noted in the first class meeting). These documents are appended to this course outline.

*Additions to/Emphasis added to the Code of Classroom Etiquette:*

Barring an emergency situation – which you must alert me to before class - cell phones, laptops, blackberries, etc. and the like must be turned off before class begins, and remain off throughout class. I prefer, but do not insist, that laptops not be used either. If you want to use a laptop, please sit at the back of the classroom.

No hats are to be worn in class, other than those for religious purposes.

Each of cell phones, PDAs, computers, or any other wireless technology is forbidden from use during the exam or any of the quizzes: as noted above, I recommend that students buy a (cheap) calculator to perform arithmetic computations during the exam/quizzes, or else plan on doing arithmetic computations manually.

Do not be late for class: I intend to show up on time. So should you.

**What to bring to class**

- **Name tags** It will be very helpful to me, and perhaps your fellow classmates as well, if you would bring your name tags to each class.

- **Textbook** At various points in several classes, we will make reference to the textbook. Please bring the textbook to class every class meeting.

- **Annual Reports** I will distribute CVS’s most recent annual report in our first meeting. We will make regular use of it. Bring it to class.

- **Previous Week’s Lecture Notes** Not all the material I would like to cover from week to week necessarily fits perfectly into a three hour lecture format. Consequently, to anticipate the possibility that we might continue to study material in one week that was assigned for the previous week, it is desirable for you to bring the previous week’s lecture notes to class.

- **Yourself?** I think the best way to learn the material in this course is to study it on your own through reading the text and packet materials, doing the assigned problems and some supplementary problems, and then attending the lectures--so as to get my “take” on the material. But, I realize that not all students learn best by attending lectures. Accordingly, I leave it to your discretion as to whether you attend the
lectures. There are two restrictions, though, if you do not attend class regularly: 1. you may not ask me questions outside of class regarding the lectures you miss; 2. you should not fill out a TCE form.

You might think it inconsistent to have weekly quizzes (beginning with the third week of class) and optional class attendance. I do not view it that way: as you can see for yourself by inspecting the formula for how class grades are determined, if you can absorb the material on your own so that you do well on the final exam, you will suffer NO penalty for not having taken the weekly quizzes.
Course Outline

Week 1  Introduction

Week 2  Start Balance Sheet Procedures
Read: Ch. 1, Ch. 2
Prepare: 1-18, 1-19, 1-20, 1-33, 1-40, 2-10, 2-12
No Quiz

Week 3  Finish Balance Sheet Procedures
Read: Ch. 3, Ch. 4 through page 124
Prepare: 3-12, 3-13, 3-14, 3-15, 3-16, 3-21, 3-24, 3-28, 3-34, 4-14, 4-18, 4-23, 4-24
First Quiz

Week 4  Income Measurement
Read: Ch. 5
Prepare: 5-11, 5-13, 5-21, 5-28, 5-30, 1-42 (this is not a typo)
Second Quiz

Week 5  Statement of Cash Flows
Read: Ch. 6
Prepare: 6-14, 6-15, 6-19, 6-21, 6-25, 6-26, 6-31, 6-33, 6-34, 6-44
Third Quiz

Week 6  Financial Statement Analysis; Revenue Recognition and Accounting for Receivables
Read: Ch. 7 (skip appendix); Ch. 8
Prepare: 7-15, 7-16, 7-23, 7-27, 7-30 (“Ratio Detective”), 8-13, 8-14, 8-22, 8-23, 8-27, 8-46
Fourth Quiz

Week 7  Working Capital; Long-lived and Intangible Assets; and Present Value Computations
Read: Ch. 9 (only: pp. 327-328; bottom of p. 335 to bottom of p. 341, pp. 347-354); Ch. 10; Appendix (pp. 707-719)
Prepare: 9-17, 9-25, 9-27, 9-36, 10-14, 10-20, 10-21, 10-31, present value problems A-30, A-32 (in Appendix)
Fifth Quiz
Week 8  Introduction to Liabilities  
Read:  Ch. 11; start Ch. 12 (pp. 465-469)  
Sixth Quiz  

Week 9  Liabilities II; Start Accounting for Investments* (see note below)  
Read: Finish Ch. 12 (only pp. 479-487); start Accounting for Investments Ch. 13 (pp. 505-517)  
Seventh (and last) Quiz  

Week 10  More Accounting for Investments* (see note below)  
Read: Ch. 14  
Prepare: 14-18, 14-20, 14-24, 14-29, 14-30,  
No Quiz  

Optional  Saturday Review Session 10:00AM (Classroom TBA)  
Prepare: Review Sample Final Exam  

Week 11  Final Exam (in class, regular time)  
Financial Reporting Journal Due  

*In some iterations of the class in the past, I have lagged behind the course outline at this point. If this happens in the present class, I will let you know how the schedule and assignments will be adjusted. In any event, you can be assured that the final exam will cover no topics that we have not discussed in class.
The Kellogg Honor Code

All students enrolled in a course offered by the Kellogg School of Management agree to abide by the Kellogg Honor Code.

The Kellogg Honor Code governs student conduct pertaining to all academic, placement and extracurricular activities associated with the Kellogg School of Management. Each student agrees:

1. Not to seek an unfair advantage over other students, including but not limited to giving or receiving unauthorized aid during completion of academic requirements

2. To truthfully represent fact and self at all times

3. To respect the property and personal rights of all members of the Kellogg community

4. To uphold the Kellogg Honor Code by reporting all material violations, and by fully cooperating with and protecting confidentiality of any Honor Code proceedings.

All Kellogg students are also expected to adhere to all policies and requirements of Northwestern University and to abide by all applicable laws and regulations.

The Honor Code Philosophy Statement

The students of the Kellogg School of Management regard honesty and integrity as qualities essential to the practice and profession of management. The purpose of the Kellogg Honor Code is to promote these qualities so that each student can fully develop his or her individual potential. Upon admission, each student makes an agreement with his or her fellow students to abide by the Kellogg Honor Code. Students who violate the Kellogg Honor Code violate this agreement and must accept the sanction imposed by the Kellogg community.

The Kellogg Honor Code is administered by students and is based on the concept of self-government. The efficacy of such a student-administered honor code is dependent upon a high degree of dedication to the ideals of honesty, integrity and equal opportunity reflected by the code. The Kellogg Honor Code requires that each student act with integrity in all Kellogg activities and that each student hold his or her peers to the same standard. In agreeing to abide by the code, the Kellogg students also agree to report suspected violations. By not tolerating lapses in honesty and integrity, the Kellogg community affirms the importance of these values.

The intent of the Kellogg Honor Code is to express the ethical standards of the Kellogg community. It does not attempt to be a list of rules and sanctions.
Classroom Etiquette

The Kellogg Code of Classroom Etiquette has been established to assist student and faculty alike to foster appreciation for a classroom environment that enhances the learning experience for all students. Attention to the code will add value to the course by creating a more meaningful and constructive discussion.

Students, therefore, are expected to demonstrate classroom etiquette based on the following principles:

I. Attendance:

i. Students are expected to attend every class throughout the term. When unable to attend, the student should notify the professor in advance.

ii. Attendance is compulsory at the first class session. Failure to attend will result in your exclusion from the class if a waiting list exists. Wait listed students are eligible only if they attend the first class session.

II. Punctuality

Students are expected to arrive for class on time so that the professor may start and end the class according to schedule. Students more than five minutes late are subject to guidelines established by a class vote during the first session.

III. Exiting and Entering

Students are expected to remain in the classroom for the duration of the class. If a student must depart early due to unavoidable circumstances, the student should inform the instructor before class. Leaving and re-entering the class is not permitted except in the event of an emergency.

V. Disruptive Behavior

Students should demonstrate respect for the professor and fellow students during the class period. Students, therefore, should refrain from distracting behavior such as disruptive eating, using laptops to surf the Web or check e-mail and holding side conversations.

VI. Respect the Facilities

Students are expected to help maintain the appearance of the classroom. After class students should discard all trash.
In essence, the Code emphasizes respectful behavior in the classroom that contributes to the enhancement of the learning experience at Kellogg.