

9-2002

## ACCT 615.01: Accounting Theory

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ACCT 615 - Fall 2002

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NOTE: Office hours may change sometimes

<u>Date</u>	<u>Reading</u>	<u>Assignment</u>
Sept. 3	---	Introduction
5	1(4-12), 3	A. (Accounting Theory) B. (History)
10	4, and pages 45-48	C. (Regulation)
12	5(136-157)*	D. (GAAP)
17	7	E. (Conceptual Framework)
19	APB #22, 8***, 6(194-200)	F. (Disclosure) G. (Useful Information)
24	9	H. (Uniformity and Disclosure)
26	11**, 10(330-335)	I. (Income Statement)
Oct. 1	---	CATCHUP - CLASS WILL BE HELD
3	EXAM I	Individual test and group test (DOUBLE CLASS)
8	FAS #130, FAS #7	J. (Comprehensive Income) K. (Dev. Stage Cos.)
10	<b>No Class, but D &amp; B Due in Beed's office by noon</b>	
15	10(360-368, 376-378)	L. (Stockholder's Equity)
17	---	CATCHUP - CLASS WILL BE HELD
22	13****, Appendix 1/A*****	M. (Price Changes)
24	---	CATCHUP - CLASS WILL BE HELD & (656 exam)
29	17*****	N. (Leases)
31	---	CATCHUP - CLASS WILL BE HELD
Nov. 5	HOLIDAY	---
7	FAS #131, FAS #34	O. (Segment Reporting) P. (Interest Capitalization)
12	EXAM II	Individual test and group test (DOUBLE CLASS)
14	<b>No Class, work on finalizing your term papers</b>	
19	Packet Readings <b>AND</b> <b>Homework Qsts and Term Papers Due (with copies for all)</b>	LC Q. (Internat'l Harmonization) R. (Env. Liabilities)
21	Packet Readings	LC S. (Stock Options) T. (Enron, etc.)
26	Packet Readings	U. (Derivatives)
28	HOLIDAY	---
Dec. 3	<b>No Class - Complete Work on Powerpoint Presentations</b>	
5	<b>No Class - Complete Work on Powerpoint Presentations</b>	
Dec. 10	Two Papers (HO Homework)	V. (Int'l Harm.) W. (Env. Liabilities)
12	Two Papers (HO Homework)	X. (Stock Options) Y. (Enron, etc.)
<b>Final Week EXAM III (Monday, December 17 from 10:10-11:30)</b>		

LC = count on a longer class these days

- \* **Do pay attention to the equations at the end of this chapter. They are theoretical equations, not mathematical equations.**
- \*\* **SKIP - section on Future Events on pgs. 399-402 and Comprehensive Income on pgs. 404-405 and Specialized Subjects on pgs. 415-419.**
- \*\*\* **SKIP - section from top of 254- section on bottom of 259.**
- \*\*\*\* **SKIP - section on Income Systems on pgs. 484-498 and Special Problems on pgs. 501-509 .**
- \*\*\*\*\* **Ignore the exhibits per se. Concentrate on the concepts of each attribute being discussed.**
- \*\*\*\*\* **SKIP - section on evolution on pgs. 650-middle of 652 and APB #7 and #27 on pgs. 658-659.**

- Appendices are not included in assignments unless so indicated.

**School of Business Mission Statement:** The faculty and staff of The School of Business Administration at The University of Montana-Missoula are committed to excellence in innovative experiential learning and professional growth through research and service.

**HOMEWORK:**

Homework points are based on homework turned in and credit received as a percent of total points received on all homework collected. For example, if you get credit for 80% of the homework, you will get 80 points (100 X 80%.) No late homework will be accepted except for unusual circumstances that I determine are appropriate on an individual basis. **HOMEWORK MUST BE TYPED AND SPELLCHECKED.** It can be single-spaced or double-spaced.

**POINTS:** Your grade will consist mainly of the following points:

EXAM I (individual and group exam)	. 120	There are no makeup exams due to the group nature of the exams.
EXAM II (individual and group exam)	. 120	
EXAM III (individual exam only)	100	
HOMEWORK	100	
DESC. AND BIBLIOG.	30	
TERM PAPER	100	
Personal Opinion - term paper	10	
PEER GROUP EVALUATION (D & B)	10 (By individuals)	
PEER GROUP EVALUATION (PAPER)	10 (By individuals)	
PEER GROUP EVALUATION (PRESENTATION)	10 (By individuals)	
5 GROUP HOMEWORK QSTS & ANSWERS	30	
Class Presentation Ranking and Evaluation	50 (By classmates and guests)	
Class Paper Ranking	<u>10</u> (By individuals)	
Total points possible	700	

**There is no such thing as a late description and bibliography or a late term paper.**

Whatever your group has done by the required deadline on each is what I will grade. Substantial points are lost if either is turned in incomplete, however. Your group is responsible for these assignments as a group and **no** excuses regarding "whose fault it is" if the assignment is late will be accepted. A term paper will not be accepted if the description and bibliography was not turned in by the required deadline.

**ASSIGNMENT MATERIAL:**

Wolk, Harry I., Michael G. Tearney, and James L. Dodd (2001), *Accounting Theory*, (Fifth Edition, South-Western Publishing Company)

**The following materials may be found in Beed's office:**

- APB #22 and FAS #7, 34, 130, 131
- Intermediate Text pages on stock options plus two Wall Street Journal articles
- Intermediate Text pages on derivatives
- Article on environmental liabilities from The CPA Journal.
- Three short articles on international issues. One is from Strategic Finance and the other two are from the Wall Street Journal.
- Three short articles on Enron, etc. They are from Strategic Finance, Business Week, and the Wall Street Journal.

Group papers will be used as homework assignments for the last two class days. Group term papers will also be the basis for the professional presentations.

### **Group Presentation Ground Rules:**

- You will use powerpoint to present your material.
- You will dress in professional attire.
- The presentation must cover the material in your term paper, but you may add other material also.
- Each person must give approximately an equal part of the presentation, but it must flow. It must be evident that you built and worked on the presentation together and that each person did not just take one part and then the whole was pasted together. Each of you needs to work on building the powerpoint – this 'skill' is expected in 'real life.' All of you will use it during your part of the presentation. Someone else will not 'run' it for you. You are ready to present when it is clear that all of you could give any part of the presentation. In other words, you are not prepared only to give 'your' small part of the talk.
- Practice is a must.
- Presentations need to be at least 30-60 minutes in length. You may not exceed 60 minutes. Make sure you are presenting new material as you progress – do not be repetitive.
- Questions and answers will follow. All of you will answer questions and I will expect all of you to be able to answer questions over all of the talk, not just the section you presented. You must know the material that everyone presented. It is a group paper and a group presentation.
- Fancy powerpoint items (such as shooting stars, music, info entering from all directions) is O.K. but is not required. Remember, the medium must be used to increase the quality of the material. Fancy presentation with little or no content is a bomb.
- Handout material is acceptable, but not required. And, again, it should be clear that it improves the presentation and isn't just wasted paper.
- Since other faculty and accounting professionals from the area will be invited to all presentations, you must begin the presentation by introducing yourselves.
- All in attendance, 615 students and visitors, will complete an evaluation form after each presentation.

### **Homework Assignment Material and Homework Questions**

On Nov. 19, your group will make available a copy of your term paper for each member of the class and for Beed. As a group, you will compose and hand out five homework questions covering your paper. They are also due on Nov. 19. The correct answers and where they could be found in your paper will be compiled on a separate sheet and given to Beed to be used to grade the homework handed in by the class. (**Read Beed's questions on your topic first and do not repeat them.**) These questions will be graded for quality and material coverage. All group members will receive the same grade for these questions. Homework answers will not be shared with class members in other groups. **A GROUP DOES NOT DO THEIR OWN HOMEWORK FOR THEIR OWN TOPIC. EVERYONE MUST DO BEED'S HOMEWORK ON ALL TOPICS, including their own, HOWEVER.**

## ASSIGNMENTS

### A. (Chapter 1)

1. When you registered for this class, what did you think the material in the class would cover? In, other words, what did you envision Accounting Theory to be?
2. Accounting policies are derived from three main sources. Name and briefly describe the role each source plays in the policy-making process.
3. In your own words, define what objectivity means in accounting.

### B. (Chapter 3)

**BOOK QUESTIONS:** 9, 19

1. Why was there a lack of uniformity in accounting practices between companies before the 1920s?
2. Who were the main users of financial reports before the 1920s, what types of information did they want, and why did they want it?
3. Since the SEC first allowed the accounting profession to put out accounting rules, how many groups have done this? Name the groups and the time periods during which each put out rules. Name at least one reason why each of the first two groups was dissolved and replaced by another group.

**EXTRA – Book Question 5**

4. What part did the Wheat Committee play in changing accounting rule-making?
5. What are some of the current complaints about the FASB?
6. What is the EITF and what role does it play in accounting rule-making?
7. What is the Business Roundtable and what part does it try to play in accounting rule-making?

### C. (Chapter 4)

**BOOK QUESTIONS:** 1, 2, 18

1. It is said that the FASB uses due process. What is due process in financial accounting?
2. What is the most surprising thing you learned in this chapter? Why was it surprising to you?
3. In your own words, what is agency theory and how does it relate to financial accounting?

**EXTRA – Book Questions 7, 8**

4. The authors state that all companies, even those with "bad" news, have an incentive to disclose their news. Why?
5. Will improved financial reporting eliminate fraud and business failure? Why or why not?
6. In general, what types of accounting policies do auditors oppose? Why?

### D. (Chapter 5)

1. Of all the principles and postulates listed on pages 136-157, which one do you believe is the most useful today? Why? (This is not in the book. Give your own thoughtful answer.)
2. Of all the principles and postulates listed on pages 136-157, which one do you think is the most dangerous or troublesome to the accounting profession today? Why? (This is not in the book. Give your own thoughtful answer.)
3. When the entity theory (page 152) was first proposed, creditors became worried. Why? (Think about this. The answer is only found indirectly in the book.)
4. The residual equity theory is applied to the earnings per share rule in accounting. How? (The answer is not directly in this book or your intermediate book. Think about this and give a thoughtful answer.)

**EXTRA**

5. What is an interim statement and why have they become popular?
6. Why is materiality in accounting a hard concept to define and use?

E. (Chapter 7)

BOOK QUESTION: 2

1. Do the authors of the text seem to believe that economic consequences should be the main characteristic the FASB considers when setting standards? If so, why? If not, what is the main characteristic?
2. Do you believe that the FASB should make economic consequences play a major role in standard setting? Why?
3. Reread the information in Chapter 4 regarding due process. Compare the concept of due process with the concept of neutrality as they relate to accounting policy setting. (Do not just define each concept. Compare them to each other as they relate to accounting policy setting.)
4. Briefly state the main idea behind each of the six concepts of the Conceptual Framework Project.
5. Do you believe that the FASB relies more heavily on relevance or reliability in setting standards? Give your opinion, but carefully back it up with at least two examples from intermediate accounting to justify your opinion.

**EXTRA**

Book Question 3

6. Briefly define the three aspects of relevance.
7. Briefly define the three aspects of reliability.

F. (APB #22)

1. Why did the APB put out this ruling?
2. What information in general did the APB require be disclosed? (Do not give a list of specifics.)
3. Where exactly should the information be disclosed?

G. (Chapter 8 and Chapter 6)

BOOK – QUESTION FROM Chapter 8: 11

1. Why does the accounting profession publish one type of financial statement for everyone when there are a lot of user groups other than investors?
2. What is the efficient markets hypothesis and what are its three forms? How does this relate to accounting?
3. What is portfolio theory? Why might this theory be helpful?

**EXTRA**

Book Questions from Chapter 8: 1, 2

H. (Chapter 9)

1. What is a "safe harbor" provision and why would the accounting profession like more of these provisions?
2. What is competitive disadvantage with regard to financial statements? How does it relate to the disclosure concept?
3. What is the difference between finite uniformity, rigid uniformity, and flexibility? Give an example of each.
4. What is a relevant circumstance in financial accounting? Define and give an example.

**EXTRA**

BOOK QUESTIONS: 7, 17, 18

5. What is information overload in accounting? Why can it be a problem?

I. (Chapter 11 and part of Chapter 10)

1. Differentiate between the asset/liability vs. revenue/expense approach of measuring income. (Do not just define each. What is the difference?) Which has been the traditional approach?
2. What are the three hierarchies of the matching principle and how is each applied or used in accounting?
3. Differentiate between the current operating vs. all-inclusive income concepts. (Do not just define each.) Which method is used today?
4. The following categories of items are found on financial statements. They are listed in alphabetical order here. Put each one in the proper order in which it would be found on the income statement. If a listed item is not found on the income statement, give a detailed explanation regarding where it would be found on a set of financial statements. Assume a multiple-step format. You may need to use your intermediate book to help you.  
Change in principle      Discontinued operations      Prior period adjustment  
Earnings per share      Extraordinary items      "Other" revenues and expenses  
Operating cash flow      Operating income

**EXTRA**

5. What is a summary indicator in accounting? Give four examples of a summary indicator.
6. What is income smoothing? Why might management want to smooth income?
7. Differentiate between articulated and nonarticulated financial statements.

J. (FAS #130)

1. What does this standard cover and what does it not cover with regard to comprehensive income?
2. What is the purpose of reporting comprehensive income?
3. Under existing accounting standards what items will be included in "other comprehensive income?"
4. FASB allowed three formats for reporting comprehensive income. What are they? Which is the one the FASB likes the least?
5. How should tax effects be displayed according to this standard?

K. (FAS #7)

1. Define development stage company.
2. Development stage companies wanted different reporting standards for themselves. Why do you think they wanted different standards? (The answer is not directly in the reading. Give a good answer of your own.)
3. Did the FASB allow a different set of rules for development stage companies? Give a reason for your answer.
4. List several activities in which development stage companies are involved.

L. (Chapter 10)

**BOOK QUESTION: 18**

1. According to the book, there are three components of owners' equity. Name and describe each.
2. Technically, the recipients of a stock dividend do not receive anything of value. Why not? (Carefully explain what you mean in your answer. Do not just give some definitions.)
3. Define operating cycle and then indicate how it is used for classification purposes on the balance sheet.

**EXTRA**

**Book Question 15**

4. What is the difference between shares issued and shares outstanding?

Give the proper entries for each of the following. The entries are not in your book. Honestly see how you do before looking them up. Test yourself. Hint: You covered these entries in principles and intermediate accounting. (See next page for the entries.)

**In all cases, assume the par value of the stock is \$100 and the stock originally sold for \$110.**

**5-7 each require two entries.**

5. Declare and pay a \$40 cash dividend.
6. Declare and pay a small stock dividend. Assume market value is \$130.
7. Declare and pay a large stock dividend. Assume market value is \$130.

For 8-10, use the single-transaction approach. (Cost method.)

8. Buy treasury stock at \$116.
9. Sell the treasury stock for \$123.
10. Sell the treasury stock for \$112.

For 11-14, use the two-transaction approach. (Par value method.)

11. Sell the stock originally.
12. Buy treasury stock at \$112.
13. Buy treasury stock at \$104.
14. Sell the treasury stock at \$115.

**M. (Chapter 13 and Appendix 1-A)**

BOOK QUESTIONS IN Chapter 13: 3, 11 (Compute the gains or losses. Some are losses.)

1. If historical cost is price-level adjusted, does it give current value information? Why or why not?
2. The book states that an asset should be sold if  $PV < NRV$ . Why is that true?
3. Distinguish between a purchasing power gain/loss vs. a holding gain/loss. (Do not give an example. Answer the question.)
4. Distinguish between a monetary holding gain/loss vs. a real holding gain/loss. (Do not give an example. Answer the question.)
5. Do you believe that you would find it easier to explain price-level adjusted financial statements or current value financial statements to your nonbusiness friends? Give a thoughtful, reasonable answer.
6. Forget the book information. In your opinion, do you believe financial statements should continue to use historical cost or switch to current value? Give a thoughtful explanation for your answer.

**EXTRA**

7. Three reasons were given in support of historical cost. Give them.
8. What is the difference between a specific price index and a general price index?

**N. (Chapter 17)**

BOOK QUESTIONS: 7, 11

1. The concept of substance over form is quite apparent in the lease standard. How? Be specific.
2. According to FAS #13, what is the one, overriding concept that the FASB used to determine whether a lease should be capitalized? (Do not give any of the four capitalization criteria.)
3. What is the basic difference between a sales-type lease and a direct financing lease? (Do not give examples.)
4. Land leases have slightly different rules to follow than do other lease assets. What is the difference and why is land treated differently?
5. Sometimes a leased asset is amortized/depreciated over its useful life and sometimes over the lease term. How is the proper method determined?
6. The FASB required lessees to use the lower of two prescribed interest rates to calculate the present value of the minimum lease payments to record the entry for the asset and the liability in a capital lease. What did that rule do to the amount to be recorded? (This answer is not directly given in the book. Think about it and then answer.)

**EXTRA – see next page**

Book Questions 6, 8, 13

7. What is off-balance sheet financing with regard to leases?
8. What are lease executory costs and how are they accounted for in a capital lease?
9. What is included in minimum lease payments in a capital lease?

O. (FAS #131)

1. Why did the FASB put out this standard?
2. Before the quantitative threshold tests can be run, a company has to know how many segments it has in order to run tests on them. How are the number of segments originally determined (even before any test is run?)
3. How should a company handle a segment that has never met any quantitative thresholds in previous years, but does this year?
4. What is required on interim reports?
5. After a company determines the number of significant segments it has according to the FASB guidelines, it must then apply upper and lower-limit guidelines to determine if it has too few or too many segments. What are these upper and lower-limit guidelines and how are they applied?
6. Many companies were severely opposed to the first standard on this topic (FAS #14.) Why do you think this was the case? (Think of a good answer of your own.)

**EXTRA**

7. In general, what types of qualitative information must a company report about its significant segments?
8. How should companies report segments that are determined not to be significant according to the FASB guidelines?

P. (FAS #34)

1. What does it mean to "capitalize" an expense? (The answer is not in the reading. You know this, but if you can't remember, look it up.)
2. What is the limit on how much interest can be capitalized in one period?
3. Capitalization of interest can continue only while three conditions are being met. What are the three conditions?
4. If interest can be capitalized, what rate should be used?
5. The SEC seemed to be against capitalization of interest. But, after this standard came out, the SEC dropped its previous ruling. Why do you think the SEC did this? Is it because the FASB standard followed the SEC ruling? (The answer is not in the reading or in any of your other textbooks. Give a good, thoughtful answer of your own.)
6. According to GAAP, interest has always been accrued as incurred and was not capitalized. Why did the idea of capitalizing interest come up? (The answer is in the *standard here and there*, but think about this and give some logical reason of your own.)

Q. (Packet readings on international issues)

1. What was IASC's original role in 1973? What is its role/goal today?
2. What are the two major relatively recent events that created a stronger need for international accounting standards?
3. What are the three concerns that have hindered progress of IASC?
4. What is the NYSE's opinion regarding use of international standards to list on U.S. exchanges? Why?
5. So far, what do US companies think about allowing international companies the right to use IASC standards to trade on US stock exchanges?
6. What is the main difference between GAAP-based standards versus IAS-based standards?

**EXTRA**

7. So far, what does the SEC think with regard to the use of international standards to list on U.S. exchanges? Why?
8. Who is Harvey Pitt and what is his opinion about U.S. versus international standards?
9. What is the G4+1? What is its role/goal?

R. (Packet article on Environmental issues)

1. Why is the accounting profession considering this topic?
2. List the four basic types of environmental liability. Briefly state how each would be quantified.
3. In general, what have accounting rules required with regard to disclosing environmental information?
4. In your opinion, after reading this article, what would be the major incentive for a company to act in an environmentally responsible manner?

**EXTRA**

5. What four factors drive the trend toward accrual of cleanup liabilities?
6. Even though this article is from 1993, do you think it is still relevant today? Why or why not?

S. (Packet readings on Stock Options)

1. Define stock option and discuss each of its components.
2. Describe the intrinsic value method under APB #25.
3. Currently, how could a company set up a stock option plan so that it will not have to record an expense?
4. Describe the fair value method proposed by the FASB.
5. Summarize the short WSJ article by Golub. What is his opinion?
6. Summarize the short WSJ article by Bartley. What is his opinion?

**EXTRA**

5. Discuss the difference between authorization date, grant date, exercise date and expiration date with regard to stock options.

T. (Packet readings on Enron, etc.)

1. List the five groups that Alfred King blames for the recent debacle at Enron. How does he believe that each share part of the blame?
2. New employees were instrumental in Enron's demise according to the Business Week article. How was this so?
3. List at least two other instances of how the Enron "environment was ripe for abuse" in the Business Week article.
4. Summarize the WSJ article.

U. (Packet reading on derivatives)

1. What is a derivative?
2. Why did derivatives used to have off balance sheet risk?
3. What is a hedge? Briefly define the two types of hedging activities.
4. What is a notional amount with regard to derivatives?

**EXTRA**

5. There are four types of risk that derivatives can help manage. Name and summarize each. (Do not just directly copy out of the article.)
6. Name and briefly summarize the four most common types of derivatives.

V. Term Paper homework questions on International Harmonization

W. Term paper homework questions on Environmental Liabilities

X. Term paper homework questions on Stock Options

Y. Term paper homework questions on Enron and related issues.

## TERM PAPER TOPICS

1. International Standard Harmonization
2. Environmental Liabilities
3. Stock Option Accounting
4. Enron, Worldcom, etc. What happened?

Cover the following in your paper:

- History
- Problem and what caused it
- What has been done or is currently being done by the accounting profession with regard to your topic
- Are other groups involved? If so, who, what, and why?
- What is the current status of the topic?
- What are future options or possibilities regarding your topic?

REMINDER: \* Your paper will be read and graded by Beed and the entire class.  
The final term paper grade will be based on a combined evaluation.  
\* The presentation will be graded based on evaluations of those in attendance.

Rank your group's topic preference in order of preference.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

Give group members' names.

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1. Many groups believe that one set of international standards is desired due to the growth of international markets, multinational companies, and international investors and creditors.
2. Environmental liabilities is probably the hottest emerging challenge facing accountants and companies today.
3. Stock options was by far the most controversial issue the FASB dealt with to date. It resulted in a new standard (FAS #123) which did not quite replace the old rule (APB #25.)
4. The recent problems with Enron and WorldCom and other companies have greatly affected the accounting profession.