



Rotman Commerce  
**UNIVERSITY OF TORONTO**

**COURSE OUTLINE**

**RSM 425 H1F**

**Financial Reporting and Control: Theory and Contemporary Topics**

**Fall 2018**

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<b>Instructor</b>	Professor Hai Lu
<b>Email &amp; office phone</b>	hai.lu@rotman.utoronto.ca, 416 946 0677
<b>Class Time/Location</b>	Monday 4 - 6pm, WO 20
<b>Office Hours/Location</b>	By appointment, RT 530
<b>Required Textbook</b>	William R. Scott, <i>Financial Accounting Theory</i> , Seventh Edition, PEARSON, 2015.
<b>Supplemental Reading</b>	Additional reading materials may be assigned

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**Course Prerequisites**

RSM 222H1, RSM 332H1

**Course Co-Requisite**

RSM 333H1. If you drop course RSM333H1 (the co-requisite) during the academic term, you must also drop this course. Contact Rotman Commerce Academic Program Services for academic advising if needed.

**OBJECTIVES OF THE COURSE**

This is NOT a course in which we learn how to do accounting. This is a course in which we examine accounting information critically from users' perspective. In other words, we will learn what accounting can do for us in investment and corporate control.

The course is designed for the fourth year undergraduate students. Since the course is not about specific accounting rules, it is also open to finance students and the third year students with good academic standing. Both accounting and finance students should benefit substantially from the course materials.

The primary objective of the course is to focus on contemporary topics and research to help students understand why we need accounting information in investment and corporate control and build a strong theoretical foundation on using accounting information.

The secondary objective is to improve students' analytical and critical thinking skills by exposing them to academic research and explaining basic research methodologies.

## **GRADE DETERMINATION**

Quizzes	20%
Class participation and homework	20%
Mid-term test	30%
Independent research project	30%
Total	<u>100%</u>

## **REQUIREMENTS**

### **Quizzes**

There are assigned reading materials for each session. You are asked to read the textbook chapter and any articles assigned in advance. The quizzes are designed to test your general understanding of the reading materials. There will be no make-up quizzes, but you are allowed to drop a quiz with the lowest mark.

### **Class Participation and Homework**

The primary goal of the participation portion of the grade is to reward you for your preparation and individual contributions to the learning environment. It includes but is not limit to attendance, asking and answering questions, etc. I will ask you write up and submit a case analysis, a summary of an assigned article, or some other class based question/scenario. Participation and homework will be graded for both effort and quality.

### **Term Test**

The term test will be held in class. It will be one hour and forty minutes long. It will test your understanding of the course materials covered up to the week before the midterm test. Students should be able to answer both quantitative and discussion-type questions.

### **Independent Research Project**

Students can either complete the project independently or form a group with another student. More details will be given around the time of the term test.

## **POLICY AND PROCEDURE**

### **Missed Tests and Assignments (including midterm examination)**

Students who miss a test or assignment for reasons entirely beyond their control (e.g. illness) may submit a request for special consideration. Provided that notification and documentation are

provided in a timely manner, and that the request is subsequently approved, no academic penalty will be applied.

In such cases, students must notify Rotman Commerce on the date of the missed test (or due date in the case of course work) and submit supporting documentation (e.g. [Verification of Student Illness or Injury form](#)) to the Rotman Commerce Program Office within 2 business days of the originally scheduled test or due date. Students who do not provide Rotman Commerce or the instructor with appropriate or sufficient supporting documentation will be given a grade of 0 (zero) for the missed test or course deliverable.

Note that the physician's report must establish that the patient was examined and diagnosed at the time of illness, not after the fact. Rotman Commerce will not accept a statement that merely confirms a report of illness made by the student and documented by the physician.

For students who miss the term test but follow the above procedures, a make-up exam will be offered.

### **Late Assignments**

No late assignments will be accepted. Students who, for reasons beyond their control, are unable to submit an assignment by its deadline must obtain approval from the instructor for an extension. Supporting documentation will be required as per the policy on missed tests and assignments.

### **Accessibility Needs**

The University of Toronto is committed to accessibility. If you require accommodations for a disability, or have any accessibility concerns about the course, the classroom or course materials, please contact Accessibility Services as soon as possible: [accessibility.services@utoronto.ca](mailto:accessibility.services@utoronto.ca) or <http://www.accessibility.utoronto.ca/>.

### **Academic Integrity**

Academic Integrity is a fundamental value essential to the pursuit of learning and scholarships at the University of Toronto. Participating honestly, respectfully, responsibly, and fairly in this academic community ensures that the UofT degree that you earn will continue to be valued and respected as a true signifier of a student's individual work and academic achievement. As a result, the University treats cases of academic misconduct very seriously.

*The University of Toronto's Code of Behaviour on Academic Matters*

<http://www.governingcouncil.utoronto.ca/policies/behaveac.htm> outlines the behaviours that constitute academic misconduct, the process for addressing academic offences, and the penalties that may be imposed. You are expected to be familiar with the contents of this document.

Potential offences include, but are not limited to:

In papers and assignments:

- Using someone else's ideas or words without appropriate acknowledgement.
- Submitting your own work in more than one course without the permission of the instructor.
- Making up sources or facts.
- Obtaining or providing unauthorized assistance on any assignment (this includes collaborating with others on assignments that are supposed to be completed individually).

On test and exams:

- Using or possessing any unauthorized aid, including a cell phone.
- Looking at someone else's answers.
- Misrepresenting your identity.
- Submitting an altered test for re-grading.

Misrepresentation:

- Falsifying institutional documents or grades.
- Falsifying or altering any documentation required by the University, including (but not limited to), medical notes.

All suspected cases of academic dishonesty will be investigated by following the procedures outlined in the *Code of Behaviour on Academic Matters*. If you have any questions about what is or is not permitted in the course, please do not hesitate to contact the course instructor. If you have any questions about appropriate research and citation methods, you are expected to seek out additional information from the instructor or other UofT resources such as College Writing Centres or the Academic Success Centre.

### **Email**

At times, the course instructor may decide to communicate important course information by email. As such, all UofT students are required to have a valid UTmail+ email address. You are responsible for ensuring that your UTmail+ email address is set up AND properly entered on the ROSI system. For more information please visit <http://help.ic.utoronto.ca/category/3/utmail.html>.

Forwarding your utoronto.ca email to a Hotmail, Gmail, Yahoo or other type of email account is not advisable. In some cases, messages from utoronto.ca addresses sent to Hotmail, Gmail or Yahoo accounts are filtered as junk mail, which means that important messages from your course instructor may end up in your spam or junk mail folder.

### **Quercus and the Course Page**

The online course page for this course is accessed through Quercus. To access the course page, go to [q.utoronto.ca](http://q.utoronto.ca) and log in using your UTORid and password. Once you have logged in, you will be at the Quercus Dashboard. On this page you will see all of the courses you are presently enrolled in. If you don't see the course listed here but you are properly registered for the course in ROSI, wait 48 hours.

### **Recording Lectures**

Lectures and course materials prepared by the instructor are considered by the University to be an instructor's intellectual property covered by the Canadian Copyright Act. Students wishing to record a lecture or other course material in any way are required to ask the instructor's explicit permission, and may not do so unless permission is granted (note: students who have been previously granted permission to record lectures as an accommodation for a disability are, of course, excepted). This includes tape recording, filming, photographing PowerPoint slides, Quercus materials, etc.

If permission is granted by the instructor (or via Accessibility Services), it is intended for the individual student's own study purposes and does not include permission to "publish" them in anyway. It is absolutely forbidden for a student to publish an instructor's notes to a website or sell them in any other form without formal permission.

## **CONDUCT OF CLASSES AND EXPECTATIONS**

Classes will begin at ten minutes after the hour, in accordance with university policy. Students are expected to arrive on time so as not to disrupt the class.

## Financial Reporting and Control: Theory and Contemporary Topics

### TENTATIVE COURSE OUTLINE

Class Date	Topic	Materials Covered	Self-study problems
Class 1, September 10	Overview	<ul style="list-style-type: none"> <li>• Objective of the course</li> <li>• Historical perspective of accounting</li> <li>• Complexity of financial reporting and regulations</li> <li>• Fundamental problem of financial accounting theory</li> <li>• Accounting standard setting and accounting research</li> <li>• New challenges of accounting practice (Discuss topics in course outline)</li> </ul> <p>Readings: Chapter 1</p>	
Class 2, September 17	Financial Reporting for Decision Making	<ul style="list-style-type: none"> <li>• Accounting under ideal conditions</li> <li>• Accounting under information uncertainty</li> <li>• Decision usefulness approach</li> <li>• Reaction of professional accounting bodies to decision approach</li> <li>• Decision usefulness for managers, analysts, and investors</li> </ul> <p>Readings: Chapters 2 and 3</p>	2.5, 2.6, 2.10, 2.13, 2.15, 2.18  3.3, 3.4, 3.7, 3.10, 3.12
Class 3, September 24	Efficient Securities Market and Implications	<ul style="list-style-type: none"> <li>• Efficient market hypothesis</li> <li>• Implications of efficient markets for financial reporting.</li> <li>• Informativeness of stock price and information asymmetry</li> <li>• Social significance of securities market that work well</li> <li>• A case of misleading disclosure (2002 Global Settlement Case)</li> </ul> <p>Readings: Chapter 4 Additional Readings:</p>	4-1, 4-2, 4-3, 4- 6, 4-7, 4-9

		The Ability of Earnings to Predict Future Operating Cash Flows Has Been Increasing – Not Decreasing. Myungsun Kim and William Kross, <i>Journal of Accounting Research</i> 2005, 43: 753-780.	
Class 4, October 1	Value relevance (Information-based Financial Accounting Theory)	<ul style="list-style-type: none"> <li>• Accounting theory and accounting research</li> <li>• Research methodology</li> <li>• Event studies</li> <li>• Earnings response coefficients</li> <li>• Information content of financial statement information</li> <li>• A Caveat about the “best” accounting policy</li> </ul> <p>Readings: Chapter 5 Additional Readings: Post-Earnings-Announcement Drift: Delayed Price Response or Risk Premium. Victor Bernard and Jacob Thomas. <i>Journal of Accounting Research</i> 1989, 27: 1-36.</p>	5-3, 5-7, 5-9, 5-12, 5-20.
October 8		Thanksgiving Holiday, No Class	
Class 5, October 15	Measurement-based Financial Accounting Theory	<ul style="list-style-type: none"> <li>• Accounting anomalies and behavioral finance</li> <li>• Value relevance of financial statement information</li> <li>• Valuation model</li> <li>• Measurement applications (financial statement items)</li> </ul> <p>Readings: Chapters 6 and 7 (up to 7.3) Additional Readings: Do Stock Prices Fully Reflect Information in Accruals and Cash Flows about Future Earnings? Richard Sloan. <i>The Accounting Review</i> 1996: 289-315.</p>	6-1, 6-4, 6-6, 6-13, 7-2.
Class 6, October 22	Efficient Contracting	<ul style="list-style-type: none"> <li>• Efficient contracting theory and corporate governance</li> <li>• Accounting policies for efficient contracting</li> <li>• Employee stock options</li> </ul>	8-1, 8-2, 8-4, 8-6, 8-9, 8-12, 8-14, 8-17

		Readings: Chapter 8	
Class 7, October 29	<b>Mid-Term Test : Cover the materials in Lectures 1-6</b>		
	<b>November 5-9, Reading Week, No Classes</b>		
Class 8, November 12	Conflict of Interests and Management Control	<ul style="list-style-type: none"> <li>• An overview of agency theory</li> <li>• An analysis of conflict: Agency theory and management control</li> <li>• Accounting numbers in contracting</li> <li>• Discussion on group project</li> </ul> <p>Readings: Chapter 9 (9.4-9.8) and Chapter 10 Additional Readings: Earnings quality: Evidence from the field. Dichev, Graham, Harvey, Rajgopal , <i>Journal of Accounting and Economics</i> 2013, 56: 1-33.</p>	<p>9-1, 9-2, 9-3, 9-6, 9-8, 9-9, 9-18, 9-21</p> <p>10-2, 10-3, 10-4, 10-5, 10-7, 10-9, 10-10, 10-12, 10-15, 10-18, 10-20</p>
Class 9, November 19	Applications of Agency Theory: Compensation and Cases on Behavior of Market Participants	<ul style="list-style-type: none"> <li>• Empirical compensation research</li> <li>• Motivations of earnings management</li> <li>• Empirical earnings management</li> <li>• Cases on behavior of market participants: Financial analysts, short sellers, and managers.</li> <li>• Alibaba: Corporate Governance</li> </ul> <p>Readings: Chapter 11 Wealth Transfer Effects of Analysts' Misleading Behavior. Gus De Franco, Hai Lu, and Florin Vasvari. <i>Journal of Accounting Research</i> 45: 71-110.</p>	<p>11-1, 11-2, 11-3, 11-7, 11-11, 11-13, 11-15</p>
Class 10, November 26	Information Asymmetry, Earnings	<ul style="list-style-type: none"> <li>• E-learning.</li> <li>• Information asymmetry</li> <li>• Adverse selection and moral hazard</li> <li>• Regulations</li> </ul>	<p>12-1, 12-5, 12-8, 12-9, 12-10, 12-12</p>



	Management and Regulations	<p>Readings: Chapter 12.</p> <p>Additional Assignment:</p> <p>Watch either movie and write a memo</p> <ul style="list-style-type: none"> <li>• “Enron: The Smartest Guys in the Room” (2006).</li> <li>• “<i>The Big Short</i>” (2016)</li> </ul>	
Class 11, December 3	Standard Setting and Regulations: Economics and Political Issues	<ul style="list-style-type: none"> <li>• Two Theories of Regulation</li> <li>• Conflict and Compromise</li> <li>• Information sharing and leakage through network</li> <li>• International Integration of Capital Markets</li> </ul> <p>Readings: Chapter 13</p>	13-1, 13-3, 13-8, 13-12
Class 12, December 6	Review	Monday make-up class	