



Rotman Commerce UNIVERSITY OF TORONTO

COURSE OUTLINE

RSM 425H1S

Financial Reporting and Control: Theory and Contemporary Topics Winter 2015

Instructor	Professor Hai Lu
Email & office phone	hai.lu@rotman.utoronto.ca , 416-946-0677
Class Time/Location	Thursday 12-2, WO 35
Office Hours/Location	Thursday 2:00-3:00pm, RT 530, or by Appointment
Teaching Assistant	Barbara Su, Email: Barbara.Su12@Rotman.Utoronto.Ca
Required Textbook	William R. Scott, <i>Financial Accounting Theory</i> , Seventh Edition, PEARSON, 2015.
Supplemental Reading	Additional reading materials (See the listed articles for each session)

Course Pre-requisites:
RSM 222H1, RSM 332H1

Course Co-requisite:
RSM 333H1

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 the latest research findings 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.

Each topic involves substantial reading. You will find you understand accounting better and know what accounting can do for our business after studying these materials. The course is also very helpful if students plan to pursue graduate studies in the future. Reading requirement is demanding, but I will guide you through the process.

GRADE DETERMINATION

Quiz	20%
Class participation and homework	15%
Mid-term test	35%
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 articles assigned in advance. Starting from the third week, you will have a small quiz or a homework assignment almost each week. The quizzes are designed to test your general understanding of the reading materials. There are five quizzes in total. There will be no make-up quizzes, but you are allowed to drop a quiz with the lowest mark. The remaining four quizzes account for 20% of course mark.

Class Participation and Homework

The primary goal of the individual participation portion of the grade (3%) 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 or a summary of an academic article assigned. Homework accounts for 12% course mark and will be graded by quality.

Term Test

The term test will be held in class on February 26. It will be one hour and forty minutes long.

Research Project

Student can either complete the project independently or form a group with another student.

The research project has to be related to the topics covered in class. You are expected to review the related literature, highlight research questions, and use data/analyses to justify your answers

in your final research report. More details will be given before the term test. The assignment is due in hard copy in class on April 2.

POLICY AND PROCEDURE

Missed Tests and Assignments (including midterm examinations)

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 **48 hours** 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: disability.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 the following procedures outlined in the *Code of Behaviour on Academic Matters*. If you have any question 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.

Blackboard and the Course Page

The online course page for this course is accessed through Blackboard. To access the course page, go to the UofT Portal login at <https://portal.utoronto.ca/> and log in using your UTORid and password. Once you have logged in, look for the My Courses module where you'll find the link to all your course websites. If you don't see the course listed here but you are properly registered for the course in ROSI, wait 48 hours. If the course does not appear, go to the Information Commons Help Desk in Robarts Library, 1st floor, for help, or explore the Portal Information and Help at www.portalinfo.utoronto.ca/students and review the Frequently Asked Questions.

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, Blackboard 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.

Theory of Financial Reporting and Control: Contemporary Topics

TENTATIVE COURSE OUTLINE

Class Date	Topic	Materials Covered	HW/Quiz
Class 1, January 8	Overview	<ul style="list-style-type: none"> • Objective of the course • Historical perspective of accounting • Complexity of financial reporting and regulations • Fundamental problem of financial accounting theory • Accounting standard setting and accounting research • New challenges of accounting practice (Discuss topics in course outline) <p><i>Readings: Chapter 1 of Textbook</i></p>	
Class 2, January 15	Financial Reporting for Decision Making	<ul style="list-style-type: none"> • Accounting under ideal conditions • Accounting under information uncertainty • Decision usefulness approach • Reaction of professional accounting bodies to decision approach • Decision usefulness for managers, analysts, and investors <p><i>Readings: Chapters 2 and 3 of textbook.</i></p> <p><i>Additional Readings:</i></p> <ol style="list-style-type: none"> 1) CPA Canada Handbook Part 1: The conceptual framework for financial reporting (Available at Rotman BIC online). 2) FASB Statement of Financial Accounting Concepts No. 2 - Qualitative Characteristics of Accounting Information (Figure 1 and related discussions). (www.fasb.org/pdf/aop_CON2.pdf). 3) 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 3, January 22	Efficient Securities Market and Implications	<ul style="list-style-type: none"> • Efficient market hypothesis • Implications of efficient markets for financial reporting • Informativeness of stock price and information asymmetry • Social significance of securities market that work well • A case of misleading disclosure (2002 Global Settlement Case) <p><i>Readings: Chapter 4 of textbook.</i> <i>Additional Readings:</i></p> <ol style="list-style-type: none"> 1) Understanding Asset Prices - Scientific Background on 2013 Nobel Prize in Economics, Royal Swedish Academy of Science. 2) Market Efficiency and Accounting Research: A Discussion of ‘Capital Market Research in Accounting’ by S.P. Kothari. Charles Lee. <i>Journal of Accounting and Economics</i> 2001, 31: 233-253. 3) Wealth Transfer Effects of Analysts’ Misleading Behavior. Gus De Franco, Hai Lu, and Florin Vasvari. <i>Journal of Accounting Research</i> 45: 71-110. 	Quiz 1
Class 4, January 29	Information-based Financial Accounting Theory	<ul style="list-style-type: none"> • Accounting theory and accounting research • Research methodology • Event studies (Ball and Brown 1968) • Earnings response coefficients • Information content of financial statement information • A Caveat about the “best” accounting policy <p><i>Readings: Chapter 5 of textbook</i> <i>Additional Readings:</i></p> <ol style="list-style-type: none"> 1) Empirical Evaluation of Accounting Income Numbers. Ray Ball and Philip Brown. <i>Journal of Accounting Research</i> 1968, 6: 159-178. 2) The Supraview of Return Predictive Signals. Jeremiah Green, John Hand, and Frank Zhang. <i>Review of Accounting Studies</i> 2013: 692-730. 	Quiz 2 Distribute HW1: HBS case - Sky Air Inc.
Class 5, February 5	Measurement-based Financial Accounting	<ul style="list-style-type: none"> • Efficient securities market: Revisit • Accounting anomalies and behavioral finance • Value relevance of financial statement information 	HW1 Due

	Theory	<ul style="list-style-type: none"> • Valuation model • Measurement applications (financial statement items) <p><i>Readings: Chapters 6 and 7 of textbook.</i> <i>Additional Readings:</i></p> <ol style="list-style-type: none"> 1) Including Estimates of the Future in Today's Financial Statements. Mary Barth. <i>Accounting Horizons</i> 2006: 271-285. 2) How Can Accounting Researchers Become More Innovative? Sudipta Basu. <i>Accounting Horizon</i> 2012: 851-870. 	
Class 6, February 12	Positive Accounting Theory (PAT) & Data Analysis	<ul style="list-style-type: none"> • Outline of Positive Accounting Theory • Three hypotheses of PAT (bonus plan, debt covenant, and political cost hypothesis) • Accounting choice and empirical PAT research • How to extract financial accounting and stock market information from WRDS (Introduction for preparing group project) <p><i>Readings: Chapter 8 of textbook.</i> <i>Additional Readings</i></p> <ol style="list-style-type: none"> 1) The Role of Accounting Theory, Chapter 1 of Watts and Zimmerman's Book "Positive Accounting Theory" 2) Positive Accounting Theory: A Ten Year perspective. Ross Watts and Jerold Zimmerman, <i>The Accounting Review</i> 1990.131-156. 	<p>Quiz 3</p> <p>Distribute the problem set for preparing for Mid-term.</p>
	February 17-20, Reading Week, No Classes		
Class 7, February 26	Mid-Term Test : Cover the materials in Lectures 1-6		
Class 8, March 5	Conflict of Interests and Management Control	<ul style="list-style-type: none"> • An overview of agency theory • An analysis of conflict: Agency theory and management control • Accounting numbers in contracting • Discussion on group project 	Distribute HW2: Alibaba Goes Public

		<p><i>Readings: Chapter 9 (9.4-9.10) and Chapter 10 of textbook.</i></p> <p><i>Additional Readings:</i></p> <ol style="list-style-type: none"> 1) Are CEOs Overpaid? Marcel Cote, <i>CA Magazine</i> 2007 November. 2) Executive Equity Compensation and Incentives: A Survey. John Core, Wayne Guay, and David Larcker, 2003. <i>FRBNY Economic Policy Review</i>, April: 27-50. 3) The Economics of Conflicts of Interest in Financial Institutions. Hamid Mehran and Rene Stulz. <i>Journal of Financial Economics</i> 2007, 85: 267-296. <p><i>Lecture 8 will also cover the requirements of group project and discussions on data preparation.</i></p>	
Class 9, March 12	<p>Applications of Agency Theory:</p> <p>Cases on Behavior of Analysts, Short Sellers, and Managers</p>	<ul style="list-style-type: none"> • Empirical compensation research • Motivations of earnings management • Empirical earnings management • Cases on behavior of market participants: Financial analysts, short sellers, and managers. • Alibaba: Corporate Governance <p><i>Readings: Chapter 11 of textbook.</i></p> <p><i>Additional Readings:</i></p> <ol style="list-style-type: none"> 1) Undermining Staying Power: The Role of Unhelpful Management Theories. Roger Martin, <i>Rotman Magazine</i>, Spring 2009. 2) How Are Earnings Managed? Example from Auditors. Mark Nelson, John Elliott, and Robin Tarpley. <i>Accounting Horizons</i> 2003. 17: 17-35 3) Academic Articles supporting the findings presented in in-class slides. 	HW2(Alibaba) Due
Class 10, March 19	Financial Frauds, Social Responsibility, and Social Media	<ul style="list-style-type: none"> • Information asymmetry • Cases of misrepresentation of financial statements. • Regulations • Social Media <p><i>Readings:</i></p>	Quiz 4

		<p>1) Screening of the documentary <i>Enron: The Smartest Guys in the Room</i>.</p> <p>2) The Market for ‘Lemons’: Quality, Uncertainty and the Market Mechanism. George Akerlof, <i>Quarterly Journal of Economics</i> 1970, 84: 488-500.</p> <p>3) The Market for “Lemons”: A Study of Quality Uncertainty and the Market Mechanism for Chinese Firms Listed in the US. Randolph Beatty, Hai Lu, and Wei Luo, <i>working paper</i>, 2014.</p>	
Class 11, March 26	New Challenges on Information Sharing: Social Network	<ul style="list-style-type: none"> • Regulation Fair Disclosures • Expert network and insider trading • Information sharing and leakage through network • Network and private equity in emerging market. <p><i>Readings:</i></p> <p>1) Final Rule: Selective Disclosure and Insider Trading. <i>Securities and Exchange Commission</i>. http://www.sec.gov/rules/final/33-7881.htm</p> <p>2) Expert Network, Galleon’s Web, <i>Wall Street Journal Online</i>. Insider Case Lands Big Catch, June 15, 2012. <i>Wall Street Journal</i>. The Man Who Wired Silicon Valley, December 30, 2009. <i>Wall Street Journal</i>.</p> <p>3) The small world of investing: Board connections and mutual fund returns. Lauren Cohen, Andrea Frazzini, and Christopher Malloy, <i>Journal of Political Economy</i> 2008. 116 (5): 951-979.</p>	Quiz 5
Class 12, April 2	Discussions on Research Project and Review	<p>Comment on sample student research projects and review what we have learned. Summarize key points on <u>What Accounting Can Do For You: Investment, Corporate Control,...</u> Accounting is More Than Just Book Keeping.</p>	Group Research Project Due