Course summary

15.511 Corporate Accounting

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Professor SP Kothari
Sloan School of Management
Massachusetts Institute of Technology

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Course summary

- Accounting – Mapping of actions and events into financial statements
  - (Economic) Principles governing the accounting mapping: Objectivity, conservatism, revenue recognition, and matching
- But the mapping is incomplete and asymmetric (for good reasons, of course)
- Hence, firms supplement financial information with disclosures in
  - MD&A section
  - Footnotes
  - Management forecasts
  - Q&A at conference calls

Where do we go from each topic from the course?

- Financial statements and basic bookkeeping
  - Bookkeeping: Necessary evil!
  - Ability to interpret financial statement information is essential for decision making
    - Balance sheet
      - What are the assets and liabilities when buying another firm?
      - Tangible, intangible, on- and off-balance sheet
      - What is the investment being made in a project, department, firm, or a target? What appears on paper is just a starting point.

Where do we go from each topic from the course?

- Financial statements and basic bookkeeping
  - Income statement
    - Assessing operating performance
    - Is it sustainable? Is it believable? Is the revenue recognized optimistically? Conservatively?
  - Cash flow statement
    - Is the wedge between income and operating cash flow worrisome?
    - Projections: What are the cash needs going forward? For working capital and for fixed asset investments? Where will the financing come from?
    - In an M&A context, valuation is on the basis of cash flows

Where do we go from each topic from the course?

- Revenue recognition
  - Revenues is the engine that drives a firm
  - Revenue growth signals where the firm is headed, so everyone focuses on it
    - Incentive to inflate it
      - Single biggest source of fraud and manipulation
      - High bang for the buck: Every dollar of invented revenue increases pre-tax income by a dollar
      - Enhances revenue growth and all of the operating efficiency ratios
  - Revenue recognition practices vary with industry, so get to know the business

Where do we go from each topic from the course?

- Inventories
  - Lower of cost of market
  - Determinant of COGS
    - Combined with revenues, profitability depends on COGS
    - Incentive to overstate inventory
      - Overstatement increases income and improves the balance sheet
      - Reversal in the following period: Payback time!

Where do we go from each topic from the course?

- Depreciation
  - Accounting is quite mechanical!
  - No cash flow effect of changing accounting
  - Why do we care?
    - Depreciation cost is crucial from the standpoint of making investment decisions
    - An important component of total cost, so serves as one of the inputs into pricing and other decisions

Where do we go from each topic from the course?

- Liabilities
  - Fixed obligations
  - Increases the risk of residual claimholders, shareholders
  - Present value calculations are needed to determine long-term liabilities
  - On- and off-balance sheet liabilities
    - Pension liabilities
    - Enron, Freddie Mac and other spectacular cases where off-balance sheet liabilities from derivative positions have caused havoc

Where do we go from here?

- Course focused almost entirely on analyzing a given set of actions and events
- More interesting to think about
  - How to create opportunities? How to choose from among alternative opportunities and action choices?
  - How to finance the alternative action choices? Market them? Operationalize them? Organize them? Incentivize employees to take desirable actions? …………
    - Obviously, too interesting to be a part of this course!