

***[DRAFT AS OF OCTOBER 12, 2009]***

**ACCOUNTING ISSUES FOR LAWYERS  
LAWS 6281  
Spring 2010  
Professor Wayne M. Gazur**

**Required Materials:**

David R. Herwitz & Matthew J. Barrett, ACCOUNTING FOR LAWYERS, CONCISE FOURTH EDITION (Foundation Press 2006), ISBN 978-1-59941-040-1.

**No Accountants! Students with Prior Accounting Training Cannot Enroll:**

This is a course in accounting fundamentals for attorneys. Students who have three (3) or more credit hours of college or graduate study accounting courses should not take the course (use your law school time to greater benefit).

**Objectives of the Course:**

Accounting is the language of business, and attorneys are advisors to businesses as well as being business persons themselves. Accounting issues arise in a number of contexts, including: (1) determining taxable income and deductions (indeed, the federal income tax return forms for business entities such as Form 1120 (corporations) and Form 1065 (partnerships and LLCs) are arranged as an income statement, a balance sheet, and a reconciliation of owners' equity); (2) "forensic" accounting in an embezzlement, financial fraud, or bankruptcy matter; (3) enforcement of criminal sanctions against financial crimes such as embezzlement and financial fraud (i.e., prosecutors and defense counsel need to know a little about these concepts); (4) requirements under lending covenants and security agreements; (5) business buy-sell agreements, particularly clauses that set the price; (6) dissolution of marriage, particularly where business assets are involved; (7) corporate distributions (legality under state corporate law); (8) interpreting limited liability company and partnership agreements; (9) securities law litigation involving misstatements of financial results; (10) commercial leases where a tenant must prove gross sales or maintain a certain level of net worth; (11) representations and warranties in purchases and sales of businesses; (12) cost amounts in construction contracts; (13) the application of financial ratio analysis in investment and lending assessments of businesses; (14) business reports, such as for corporate franchise taxes, that impose taxes on assets, on capital, or other measures; and (15) acquainting you with accounting so that, hopefully, your law firm's bookkeeper will not embezzle or otherwise fleece you.

A search of the Westlaw "Forms All" database using the phrase "generally accepted accounting principles" if it appeared somewhere in the document, reported 1,639 results (site visited on October 12, 2009). When some legal issue turns on a quantification of expenditures, profits, assets, or liabilities, the drafter's instinct is to tie the valuation to generally accepted accounting principles, or "GAAP." One objective of the course is to learn about some of those principles. But, an equally important objective is to gain an appreciation of the uncertain,

malleable nature of those principles.

The aim of this course is not to transform you into an accountant in a semester, even if that were possible. Rather, the objectives of the course are: (a) to acquaint you with the mechanics of basic bookkeeping—these terms and concepts will be yours for a lifetime; (b) to review several accounting concepts and principles that are of particular relevance to attorneys; (c) to examine certain applied situations where accounting rules play a legal role; and (d) to have some fun doing this.

**Grading:**

There will be a 3-hour written final examination that may include short-answer problems, essays, or multiple-choice answer problems. Reference materials during the examination are limited to your copy of the casebook (annotated as you wish), any instructor required/purchased/distributed materials, prints of any materials posted on TWEN, any notes or outlines that you prepare, and a calculator. Class attendance and performance may also affect up to five (5) percent of the final grade in the course, provided that notwithstanding such adjustment, I reserve the right to apply the Law School 20% rule (denying ability to take the final exam—with the obvious consequences) in extreme cases of poor attendance.

Campus policy regarding religious observances requires that faculty make every effort to reasonably and fairly deal with all students who, because of religious obligations, have conflicts with scheduled exams, assignments or required attendance. Please email me in advance of such absences (a day or so in advance) so that I know why you are absent.

**Optional Paper:**

If there are fewer than thirty-five (35) students enrolled in the course, the Law School rules require that I offer an optional writing project. If the enrollment is below 35 students, then the optional paper, if a student so chooses, would supplant fifteen (15) of the final examination points, such that the final examination would be worth eighty (80) points. The optional paper requires a written analysis, typewritten, not to exceed 15 pages, double-spaced, of an issue relevant to the course. The optional paper would be due by 5 PM, Friday, April 9, 2010. Please provide me with advance notice of your interest in this option by March 1, 2010, so that I can prepare a formal problem memorandum. The optional paper may consist of a current topic or the solution of an extended bookkeeping problem.

**Office Hours:**

My office is 403 at the Law School. My telephone number is (303) 492-7013, and my e-mail address is Wayne.Gazur@colorado.edu. My spring office hours are: Tuesdays and Thursdays 2:30-3 PM; or by appointment. I will post material from time to time on The West Education Network (“TWEN”) at [lawschool.westlaw.com](http://lawschool.westlaw.com) so please register for the course on TWEN.

## Assignments:

**It is important that you complete the assigned problems for discussion in class.**

**First Day of Class (January 12, 2010)** Read pages v-xiv of the preface to the textbook. The Enron list of lessons is a bit misleading, as it suggests that accounting is important only for public corporations, but the information is nevertheless valuable. Read the “Objectives of the Course” heading above for other contexts. Read pages c-1 through c-5 of the textbook’s appendix. Then read, but don’t study in great depth, the Starbucks 10-K in the appendix, focusing on the composition of the four basic financial statements at pp. 40-43 (earnings statement (aka income statement), balance sheet, statement of cash flows (on p. 109), and statement of shareholders’ equity). If you were a financial analyst trying to analyze Starbucks’ potential as an investment, what would you focus on? If you were a lender, what would you focus on? Can you find the explanation of what is considered “cost of sales” versus “store operating expenses”? Although for convenience we will use the 10-K in the book this time, one can access all of the Starbucks (and other reporting companies) filings (for free) on the Securities and Exchange Commission’s easy-to-use EDGAR database, at <http://www.sec.gov/edgar.shtml>.

## CHAPTER I--INTRODUCTION TO FINANCIAL STATEMENTS, BOOKKEEPING, AND ACCRUAL ACCOUNTING

### 1. (January 14, 2010) The Balance Sheet and Double-Entry Bookkeeping; “T Accounts”; the Accounting Equation

Read pp. 1-26; do Problem 1.1B (to aid in checking your work, the balance sheet columns should each total \$19,900). Read Problem 1.1A. Assume you are a potential creditor considering a loan to E. Tutt, Esq. What asset(s) are omitted from the balance sheet?

Every action has an opposite, equal reaction in accounting (sounds like something from physics class). An expenditure must be matched by a source of funding. Revenue must be matched by an increase to some asset, and so forth. There are therefore two sides to every transaction. This action/matching reaction concept is the basis of double-entry bookkeeping. The “debits” (left side of the T) for a transaction must always equal the “credits” (right side of the T) for a transaction. Which account balances (i.e., assets or liabilities) are reported as debits or credits is simply a matter of accepted convention, not a rule of nature. Based on my long experience with accounting (I had a childhood fascination with this material, passed the CPA Exam in 1976, and spent some time at Arthur Andersen & Co.), I recommend that you always first compose a transaction as a general journal entry (see p. 21) before posting it to the T-accounts; it helps you to determine which accounts are involved and whether the context of each adjustment is a debit or a credit. Although we are using “pen and ink” paper bookkeeping, these principles are the basis of popular small business PC and Mac-based electronic accounting software products such as QuickBooks and Peachtree (which cost approximately

\$200-\$400, but perform the functions of a 6-figure priced custom mainframe system from the 1970s).

2. (January 19, 2010) The Income Statement

Read pp. 26-38; do Problem 1.2B (to aid in checking your work, the income statement should show \$440 in net income and the balance sheet columns should each total \$11,640). The closing process is a little confusing upon the first encounter. This is an area where it is particularly important to actually perform the steps, as in Problem 1.2B. Question: Do you believe that the \$3,000 ascribed to Mr. Stief's Library reflects economic reality? A trial balance, six-column worksheet helps in closing the income and expense accounts to the balance sheet; we address that in the next assignment.

A bookkeeping shortcut—if a total of some numbers is “off” by a multiple of 9, there likely is a transposition error in posting the numbers. E.g.,  $15 + 26 + 32 = 73$ ;  $51 + 26 + 32 = 109$ ; the difference of 36 arising from the transposition of the 1 and the 5 is a multiple of 9.

3. (January 21, 2010) The Trial Balance and Six-Column Worksheet; Statement of Changes in Owner's Equity

Read pp. 39-42; do Problem 1.3A (assuming that the accounts receivable are current assets and the accounts payable and notes payable are current liabilities, please prepare a classified balance sheet); Read pp. 43-50. Look at the Starbucks 10-K again on pages 42 and 43 of the textbook appendix. Let's not get caught up in the adjustments, but do see that the Statement of Shareholders' Equity can be somewhat involved.

4. (January 26, 2010) Partnership and LLC Accounting; Introduction to Accrual Accounting

In the prior assignment the textbook explained the capital account concept for partnerships (and LLCs). I have posted two sample LLC agreements on TWEN (they are highly simplified for educational purposes—do not use them for any other purposes). Read those agreements, getting a sense of how profits and losses are applied to the capital accounts, as well as capital contributions. You will find that the federal income tax consequences (and the attendant boilerplate) have taken center stage, which, unfortunately, is very common for partnership and LLC agreements. Then read pp. 50-58. Fair value accounting is a continuously-emerging issue brought into focus by the recent financial difficulties of financial institutions (we will address that later with respect to investments). With respect to the “going concern” assumption raised on p. 54, go to EDGAR and read the fourth paragraph of the accountants' opinion (and note 1 to the financial statements) with respect to the Crocs, Inc. (ticker: CROX) fiscal-year 2008 report.

5. (January 28, 2010) Deferral of Expenses: Capitalized Costs and Depreciation

Read pp. 58-64, 537-562; do Problems 9.1 A & 9.5B. We address the expense

deferral rules later in the course and the concomitant problems of income manipulation.

6. (February 2, 2010) Deferral of Income and Accrual of Expenses and Income  
Read pp. 64-73; do Problem 1.4B.
7. (February 4, 2010) Income Tax Accounting and Bookkeeping Problem  
Read pp. 73-88; do Problem 1.5B(a) (to aid in checking your work, the income statement should show \$3,245 in net income and the balance sheet columns should each total \$124,125).
8. (February 9, 2010) Inventory Accounting  
Read pp. 89-96; 491-535; do Problem 8.2B.
9. (February 11, 2010) Comprehensive Bookkeeping Problem  
Read pp. 96-103; do Problem 1.6A.
10. (February 16, 2010) Statement of Cash Flows; Consolidated Financial Statements  
Read pp. 103-112; 112-119.

***Goodbye to bookkeeping!***

## **CHAPTER II--THE DEVELOPMENT OF ACCOUNTING PRINCIPLES AND AUDITING STANDARDS**

11. (February 18, 2010) Generally Accepted Accounting Principles; International Financial Accounting Standards; GAAP Hierarchy Read pp. 121-149; do Problems 2.1 A & 2.1B.
12. (February 23, 2010) Independence; The Audit Process, including Internal Control and the Establishment of Generally Accepted Auditing Standards Read pp. 149-168. Do Problem 2.2B.
13. (February 25, 2010) The Expectation Gap; Audit Reports; Alternatives to Audits; Sources of Authority; Accountants Legal Liability Read pp.168-204. One of the audit procedures that directly impacts a business lawyer is responding to auditors' requests for information regarding pending litigation and other contingent liabilities. The nuanced dance between the auditor and attorney (which balances financial disclosure with litigation confidences) is examined later in Chapter VII.

## **CHAPTER III--THE TIME VALUE OF MONEY**

14. (March 2, 2010) Introduction to the Time Value of Money Read pp. 205-225; do Problems 3.1A-3.4A.

15. (March 4, 2010) Time Value of Money (continued) Do Problems 3.4B-3.6B.

#### **CHAPTER IV--INTRODUCTION TO FINANCIAL STATEMENT ANALYSIS AND FINANCIAL RATIOS**

16. (March 9, 2010) Introduction to Financial Statement Analysis and the Balance Sheet  
Read pp. 229-246; do Problems 4.1 & 4.2.

17. (March 10, 2010) The Measurement of Income; Pro Forma Metrics and  
Comprehensive Income Read pp. 246-270; do Problems 4.3A, 4.3B, & 4.3C.

18. (March 16, 2010) Ratio Analysis; The Statement of Cash Flows; Management's  
Discussion and Analysis Read pp. 270-289. Read Section 4 of the loan agreement found  
at OHFT § 25:13 in the Westlaw Forms-All library, as well as Sections 4.6 & 6.3 of the  
loan agreement at ADVSBF § 13:17 in the same library.

#### **CHAPTER V--LEGAL ISSUES INVOLVING SHAREHOLDERS' EQUITY AND THE BALANCE SHEET**

19. (March 18, 2010) Statutory Restrictions and the GAAP Interface; Drafting Legal  
Documents Containing Accounting Terminology and Concepts Read pp. 291-307; do  
Problems 5.1A & 5.1C; Read pp. 307-316. Read the buy-sell agreement found at  
ADVSBF § 21:5 in the Westlaw Forms-All library. Can you find an indirect reference  
to the ability of the corporation to make the redemption payments?

### *Spring Break!*

#### **CHAPTER VI--REVENUE RECOGNITION AND ISSUES INVOLVING THE INCOME STATEMENT**

20. (March 30, 2010) Introduction to Revenue Recognition; Expenses Read pp. 317-337;  
do Problems 6.1B, 6.1C, 6.1D, & 6.5.

21. (April 1, 2010) Exchange Transaction Requirement; Deferred Payments Read pp.  
337-376; do Problem 6.2.

22. (April 6, 2010) Investments Read pp. 376-393. The continuing mark-to-market  
controversy lives here. Do Problem 6.6B (p. 418).

23. (April 8, 2010) More Income Recognition Issues Read pp. 393-417. Do Problem

6.6A.

24. (April 13, 2010) Accrual of Expenses and Losses; Drafting and Negotiating Contracts Containing Accounting Concepts and Terminology; Intangibles and Big Bath Read pp. 419-438; do Problem 6.9A; 569-591; do Problems 9.8 & 9.10A.

## **CHAPTER VII--CONTINGENCIES**

25. (April 15, 2010) Contingencies; FAS #5 Read pp. 439-470; do Problem 7.1 (consider the perspectives of management, outside counsel, the independent auditor, a lender, shareholders, plaintiff's counsel, and the SEC (assuming that X Corp. was a registrant)).
26. (April 20, 2010) Auditor Requests for Information Read pp. 471-490; do Problem 7.3.
27. (April 22, 2010) Last Day of Class; Review Session.