EMBEDDING A GROUP PROJECT INTO INTERMEDIATE ACCOUNTING TO TEACH THE ETHICS OF EARNINGS MANAGEMENT

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Abstract

We propose a novel pedagogic design to integrate teaching earnings management and accounting ethics at the undergraduate level. Earnings management is an extensive topic related to almost every topic in collegiate accounting education. Generally Accepted Accounting Principles (GAAP) give accountants discretion to exercise professional judgment on how to report earnings. The ethicality of earnings management has its profound pedagogical challenges. This flexibility exposes many ethical dimensions for professional training. The interaction of earnings management and accounting ethics offers a particular perspective to design a course project module to integrate the detection of earnings management schema and its ethicality. We follow the accounting ethics pedagogic framework (Apostolou

& Schleifer, 2013) to demonstrate and validate our course design: (1) assess the need to embed the ethicality of earnings management in the curriculum; (2) articulate learning objectives; (3) identify the nature of the content; (4) select suitable delivery modes; and (5) conduct learning assessment. The paper has three contributions to accounting ethics education. First, the proposed course module offers a solution to relieve the limited space in the curriculum to train accounting ethics. Second, the ethicality of earnings management can act as a bridge to integrating ethical accounting decision-making and professional judgment. Third, the course design offers a virtual platform to engage the instructor and students in exploring the boundary of positive and fraudulent earnings management.

1. THE NECESSITY OF INCLUDING THE ETHICAL IMPLICATIONS OF EARNINGS MANAGEMENT IN THE CURRICULUM

Teaching ethics has attracted the interest of academicians and practitioners alike. Several scholars have tackled ethics instruction issues in accounting education (see Armstrong, 1993a, 1993b; Awasthi & Staehelin, 1995; Dow et al., 2018; Miller et al., 2020). Many authorities require the covering of ethics in the accounting curriculum (e.g., National Association of State Boards of Accountancy (NASBA, 2005, 2007; AECC, 1990). Accounting professionalism requires ethical principles in its decision-making and professional judgment. Accrediting bodies, such as the Association to Advance Collegiate Schools of Business (AACSB), require an accounting curriculum that covers ethics and seeks documentation during accreditation reviews (AACSB, 2004, 2022). The American Accounting Association Project on Professionalism and Ethics provides case studies on professional ethics for accountants. In its quest to further promote ethical principles and

best practices among its members, the American Institute of Certified Public Accountants (AICPA) has transitioned from a code-emphasizing rule to one favoring a principles-based approach (Spalding & Lawrie, 2019). Exposing accounting students to this new conceptual framework may help the students learn the underlying principles informing the rules. Also, State Boards of Accountancy in the USA may require an ethics course or ethics topics as a prerequisite for taking professional licensure examinations.

The post-Enron era also increased educators' willingness to teach accounting ethics to enhance future accountants' professionalism. For example, Blanthorne et al. (2007) reported that 90 percent of deans at AACSB business schools chose to integrate ethics coverage into courses. In accounting, 81.7 percent of accounting faculty responding to the survey report teaching ethics in at least some accounting courses. Thus, both schools and faculty are comfortable with ethics courses or embedding course modules. Vidaver-Cohen (2004) demonstrates that both formal (i.e., the AACSB accreditation) and informal authority (i.e., the demands from faculty and students) have a common interest in accounting ethics education.

Earnings management (EM) has been a hot topic in accounting and auditing research for several decades. This paper uses McKee's (2005, p. 1) definition that describes EM as "reasonable and legal management decision-making and reporting intended to achieve stable and predictable financial results." We consider that EM reflects a conscious judgment by management to smooth earnings over time. The nature of this accounting concept has profound ethicality. It needs necessary ethical training to enhance students' professional judgment. As Nelson et al. (2003) demonstrated, this concept needs to comprise three angles: (1) EM is consistent with GAAP, and (2) EM is not easy to derive its mechanism from GAAP, but (3) EM is also obviously incompatible with GAAP. There is no clear-cut boundary between earnings management and fraudulent manipulation. Accounting ethics

training can enhance the understanding of earnings management in a complicated business context.

However, educators' response to the call has been generally limited. There are three challenges for accounting education to add enough ethics courses (or even embed ethics course modules into accounting courses): (1) limited space in the curriculum, (2) inadequate instructional resources, and (3) a lack of qualified faculty members with enough formal training (Blanthorne et al. 2007; Mintz 1995).

The proposed design offers a solution to meet the needs of accounting ethics education and relieve the three challenges. First, the integration of earnings management and its ethicality lends itself to flexible time and can be executed outside the classroom. The designed course module can be embedded in many high-level accounting courses, like intermediate accounting, auditing, fraud detection, and cost accounting. Second, faculty and students are familiar with earnings management, so this topic can enhance students' interest and engagement. Earnings management offers a robust theoretical framework to map accounting ethics and professional judgment.

2. COURSE DESIGN OBJECTIVES

An overall course design objective is to activate students' ethical awareness and form a professional basis for the eventual goal of ethical behavior (Massey & Hise, 2009). The course module design is to improve students' professional judgment. We expect to enhance the students' ethical decision-making skills, especially using ethical principles to report and communicate a company's earnings. Prior literature shows that a heightened moral sensitivity can foster a positive ethical climate and work climate to support ethical action (Schminke et al., 2007; Massey & Hise, 2009). Accordingly, we identified increasing students' ethical perception as the course's primary objective. The reason to select the ethicality of earnings management is that this topic is often covered in the accounting curriculum, so it arguably can heighten ethical perception.

The broad learning objectives for the course module include the following: (1) improve students' ethical motivation and engagement and increase ethical sensitivity; (2) attain ethical knowledge and develop ethical awareness facing specific accounting decision-making; (3) develop ethical or moral reasoning when preparing and communicating accounting information; and (4) improve ethical decision-making or judgment with the perspectives of various stakeholders.

3. THE COURSE MODULE CONTENT DESIGN – INTEGRATE THE ETHICALITY OF EARNINGS MANAGEMENT INTO A THREE-STAGE GROUP PROJECT

In this section, we discuss how the course objective discussed above leads to the development of the course contents. The design purported for this course module is to integrate and introduce the four primary ethical dimensions of accounting measurements to students. The first ethical dimension is the professional code of conduct with accounting measurement (Hise & Massey, 2010). Students need to know all regulations for each accounting measurement in earnings management. The second dimension is discretion and its consequence. The relevant consequence can help students foster the necessary consciousness of the ethicality of accounting measurement and its reporting (Cohen et al., 2000). The third dimension is the professionalism and philosophical morality of earnings management. We follow Bebeau & Thoma (1999) to construct an "intermediate concept" to connect accounting measurement decision-making and moral education. The fourth dimension is the review of the impact on other stakeholders on related accounting measurement and earning management decision-making.

3.1. Professional Code of Earnings Management and its Ethicality

The ethicality of EM exists because there is no clear boundary between "bad" and "good" EM. Given the examples in the

literature concerning EM practices, McKee (2005, p. 35) asks about "the line between ethical and unethical EM," and he assumes the boundary is unclear. "It is a question we must all answer for ourselves using our ethical values." On the one hand, deliberate earnings manipulation is viewed as self-serving, misleading, and perhaps fraudulent. On the other hand, US GAAP offers managerial discretion in reporting decisions. This discretion is believed to be used to achieve earnings objectives and has a "positive" intention to protect the interests of shareholders (Hamilton et al., 2018).

The "bad" EM is undertaken to hide actual operating performance and mislead information users; the "good" EM is used to manage the business strategically to add value for stakeholders. The only difference is the management intent when making accounting-related decisions. This discretion offers space to discuss and explore the depth of the ethicality of EM from a variety of stakeholder viewpoints. The conservative approach from regulators pays more attention to the point that hiding real information misleads the investing public. However, Hamilton et al. (2018) state that "others regard the discretion inherent in reported earnings as a valuable tool that can be used to incorporate management's private information and company-specific circumstances into accounting transactions."

Fischer & Rosenzweig (1995, p. 440) believes that "following the law and explicit business policies is not and cannot be a sufficient guarantee that one's behavior is ethical." Salcedo-Albarar et al. (2009) go further in this argument, maintaining that some rules and professional regulations may be considered social perversions, and breaking those rules may improve social welfare. Regulation is one fundamental dimension of the ethicality of EM. Students' ethical understandings also demand many other dimensions.

3.2. The Discretion of Earnings Management and its Consequences

The second dimension of EM ethicality is that consequences matter. If GAAP offers discretion that allows a company to decide

whether to expense or capitalize costs for future projects, students need to assess the potential consequences of the action (Cohen et al., 2000). The instructor should activate student debate about the cases in the group project. The discussion can cover whether harm is a criterion for the probity of a behavior (Gaa 1994). It also requires assessing whether there is a relationship between the perception of harm and the willingness to act (Jones 1991). The issues in each case in the course project can be interpreted from different philosophical perspectives, including virtue ethics (MacIntyre 1984; Pincoffs 1986), stages of moral development (Kohlberg 1984; Rest 1986), and the dimensions of moral judgment and utilitarianism (Cohen et al. 1993b).

3.3. An Intermediate Concept for the Philosophical Morality of Earnings Management

One learning objective is to train students' ethical sensitivity in accounting decision-making, especially in accounting measurement. Spitzer (2005) reports that ethical decision-making needs reflection as an ethical reasoning foundation. Reflection has been recognized as a practical methodology for inclusion in accounting ethics education (Mintz 2006, Rest 1986), especially in upper-level accounting courses (Burns 2006). When we want to improve students' ethics consciousness, the course project needs to design a series of reflective writing assignments to activate students' mindsets to explore the potential discretionary space. The course arranges one topic in each module in intermediate accounting chapters. These reflective assignments require students to understand where the discretion accountants have for each accounting treatment regulated by GAAP and accounting applies. As a result, the first key element in delivering the material in our course is that students are required to engage in reflection exercises. These reflection skills can be developed by integrating specific accounting techniques and enriching students' understanding of the big picture.

As Rest and Narva'ez (1994, 216) note, promoting "questioning, inquiring, and openness to evidence and argument

educational experiences" can improve ethics. We included a discussion forum to let students raise questions and review others' responses. The discussion ensures that student interchanges will be interactive (e.g., Massey & Hise, 2009; Loeb 1998; Rest 1986) and open (e.g., Delaney & Coe 2008; Rest & Narva'ez 1994).

Guffey et al. (2009) emphasized that group discussions produced significantly better results. These statistically significant results suggest that group discussions in the learning process effectively influence ethical judgments and perceptions and develop students' professionalism. Thus, we designed the ethics course module using a three-stage group project as the platform for necessary group discussion and debate.

Apostolou et al. (2015) identified a profile for instructional cases where "an actual or hypothetical set of information followed by a set of questions or activities" encourage students to understand the complexities of a topic or topics (p. 70). Beets (1993, p. 59) found that role-playing enhanced students' understanding of professional ethics. Mintz (1995, P. 247) argued that case analysis, role-playing, and collaborative learning are pedagogical techniques one can use to teach virtue to accounting students. Thus, in the last stage of the course project, we created a hypothetical case to let students take roles from different stakeholders' perspectives to walk through these cases.

We followed Bebeau & Thoma (1999) to use "intermediate concepts" to connect theoretical ethical models and professional codes of conduct in the group project. Hise & Massey (2010) demonstrated that the connection between the theoretical model and professional code could improve delivery effectiveness. The literature documented many EM schemas, e.g., Belski et al. (2008) documented three treatment levels of earnings manipulation: (1) accounting method change, (2) accounting estimate change, and (3) operating change. The study found that the intent of earnings management matters (Belski et al., 2008). Managers engaging in earnings management deemed opportunistic or selfish were considered more unethical (or less ethical) than earnings management behavior aimed at increasing firm contracting

efficiency. In addition, the method of manipulation was also important. Accounting estimate change was considered the least ethical, followed by economic operating decisions. Changes in accounting methods were considered the least unethical. In the design of the group project, we set up a series of business scenarios and let these EM schemas be exposed to students' decisional options. Students are guided to understand the relationship between each decision-making and possible earnings impact. This arrangement can increase students' ethical practice to identify "five internal goods: (1) honesty; (2) concern for the economic status of others (stewardship or accountability); (3) sensitivity to the value of cooperation and conflict; (4) the communicative character of accounting; and (5) dissemination of economic information" (Mintz, 1995).

One significant challenge in designing the content is to reflect and arrange the mentioned ethicality of earnings management. The first arrangement is to activate students' awareness of the intent of utilizing discretion from three perspectives. First, we arranged an in-depth discussion about the conceptual understanding of fair value and the difference between fair value and carrying value. In addition, the second phase topic was about the motivations of earnings management. Students could discuss and understand that managers' compensation is one primary incentive that can lead to earnings management, even fraudulent manipulation. Finally, the project requires that students state arguments to support their option selection for each business scenario in project phase three. Students are required to add an analysis of the intention of the accounting policy choice.

The second arrangement lets students be exposed to moral reasoning and rank the ethicality of the three treatment levels of earnings manipulation: accounting method change, estimate change, or operating change (Belski et al., 2008). Three business transactions are related to accounting methodology change, two others are related to accounting estimate change, and three others are related to operating change. We expected students to rank and select decisional options from the least unethical to the ethical level.

3.2. Review of Impact on Other Stakeholders

Prior research in psychology and accounting shows that students can effectively learn about essential types of earnings management by first developing a knowledge framework with examples. Nelson et al. (2003) documented specific approaches used by managers when they attempt to manage earnings. Their evidence includes 515 earnings-management attempts identified and characterized by 253 auditors from Big 5 firms. These documented approaches and schemas act as the knowledge framework to activate students' sensitivity to related EM ethicality.

The hypothetical case (see Appendix) in the designed group project uses these results as a reference to create these simulated ten business scenarios. The scenarios embedded two categories of decisional options and actions. The first categorization is about the decisional attempts according to whether they primarily involved expense recognition, revenue recognition, issues unique to business combinations, and other issues. We selected this broad categorization because it captures an essential first-level difference between attempts. Revenues and expenses differ fundamentally in the accounting principles being applied. Business combinations are one-time decisions that often involve special incentives, income effects, and balance sheet effects. The second categorization is about accounting manipulations or operating manipulations. Accounting manipulation involves altering the recording of existing accounting transactions, and these actions involve departures from GAAP. Operating manipulation relates to the timing of year-end transactions and operating decisions to report revenues and expenses in the desired accounting period. Managers decide to accelerate/ delay the undertaking of an operating activity to move revenues/ expenses from one accounting period to another.

We expect the designed course module can activate students' ethical sensitivity and consciousness in selecting decisional options and ranking the ethicality of each decision. The categorization of the simulated business scenarios can help to assess which level of understanding students can achieve. We can observe students'

ethical judgment from their project reports. For example, accounting estimate change was considered the least ethical, followed by economic operating decisions. Changes in accounting methods were considered the least unethical (Belski et al., 2008). Students' arguments used to support their accounting treatment selections can provide evidence for instructors to explore and continuously improve ethics education in accounting courses.

4. TEACHING DELIVERY MODES

As discussed in the previous section, this research wants to use an embedded course project to ease the limited space in the curriculum and inadequate instructional resource challenges (Blanthorne et al. 2007; Mintz 1995) in accounting ethics education. The designed course module offers flexibility in combining classroom teaching contents with a three-stage course project to permeate accounting ethics in a high-level undergraduate accounting course. We hold three principles to deliver the designed course module: (1) Considering the classroom as a community and utilizing active learning techniques (Dellaportas, 2006); (2) Developing the simulated business scenarios with documented earnings management schemas; (3) Complying with step-by-step engagement principles.

We embed the three phases into each chapter covering the whole semester to permeate ethical thinking into each chapter. This embedment arrangement avoids occupying curriculum space and lecture time. Prior research in psychology and accounting suggests that people can best learn about important types of earnings management by first developing a knowledge framework with individual examples. Thus, we select three discussion topics that offer background knowledge of earnings management. The first phase is to discuss Fair value and its working mechanism. The second phase discusses the relationship between managers' compensation and earnings manipulation. The third phase requires developing an integrated solution for ten simulated business scenarios. The first two topics are background knowledge related to

decision-making and ethical implications in the fourth phase. The third stage is the core task of this course project.

We emphasize the process of interactive exchange with students and the collaborative activities that can activate ethical judgment with moral problem-solving in a simulated contextual case. With the well-mapped course stages, we can frequently inspire the four ethical dimensions and speed up students' natural development of moral judgment. We require that all decision-making and professional judgment result from group work. The collaborative learning opportunities serve to activate ethical thinking in these courses. We initiate a discussion forum in the Canvas platform and encourage students to use Zoom or Teams to have more vivid and timely interactions for these discussion topics.

Students must submit a report to demonstrate their accounting judgment and explain all related accounting regulations for each simulated business scenario. The report also requires students to demonstrate the argument to support or reject their selection for their accounting judgment. In the argument, students need to state the ethical implications if they believe some options have ethical issues. Students have about three weeks to discuss and prepare for the fourth stage task.

5. REFLECTION REPORT OF THE LEARNING ASSESSMENT

We executed the group project course module in intermediate financial accounting II (ACCT 312) for two semesters (one online and one face-to-face section each semester). The four learning objectives discussed above can be well achieved. The difference between the online and face-to-face sections is subtle partly because most discussions did not happen in class. The three-stage group project offers a platform to work as a glue that can integrate accounting domain technical skills and ethics education to achieve the goal of "seeing trees and forests." The topics and questions are real-world oriented and provide pragmatic perspectives to engage students and activate students' interests and increase ethical sensitivity. Group discussions significantly

developed ethical awareness and improved students' moral reasoning. The project encouraged students to consider ethical decision-making from the perspectives of various stakeholders. These extended angles enhance students' understanding of the communications of financial reporting on earnings. Three takeaways should be signified in this course design.

First, the well-designed group project avoids using lecture curriculum space. It is embedded in the course module, but it can be reflected everywhere in every chapter and every homework question. This flexibility and extensibility add pedagogic benefits to other high-level accounting courses, like auditing, fraud detection, and advanced financial accounting. Here are some selected comments from the students.

"The discussion of the group project makes my accounting knowledge alive, not boring numbers anymore."

"The viewpoints and perspectives learned from the group project changed my understanding of what accounting numbers really mean."

"I began to like accounting; there could be interesting stories behind each accounting number."

Second, the real-world questions-oriented group project enhanced students' engagement in the course. Students have a clear awareness that the project is related to career competency. The discussion not only adds to their accounting skills but also inspires their learning of the following accounting knowledge. The course set up a discussion forum in Canvas for each project phase; students were also encouraged to use Zoom or Teams (both Zoom and Teams are embedded into Canvas). The enthusiasm to participate in the discussions was high. 100% of the students participated in at least one of the three discussions, and 91.7% participated in all three discussions. The topics and project arrangement got praise from students. We selected some comments as follows.

"Accounting numbers are arguable; I began to like this career."

"Fraudulent activities are so close to earning management, and I must have the awareness to understand where the boundary is."

Third, students can have strong and seamless reflections on accounting ethics in earnings management. At the end of the semester, students can have a strong understanding of the four dimensions of the ethicality of earnings management. This understanding can be reflected in the Phase three project report. Students can actively research and understand which regulations are related to each business scenario, and they can clearly understand the potential discretions and consequences of each accounting treatment. We achieved the goal that students can successfully make moral reasoning and rank the ethicality of the three treatment levels of earnings manipulation: accounting method change, estimate change, or operating change (Belski et al., 2008). For example, 71% of the students rejected the accounting options using operating changes to achieve the targeted earnings goal, and the remaining students also made arguments that the operating change was because of another strategic plan, not the intention of boosting earnings in the short term. These arguments show that students already have been trained with ethical awareness and sensitivity.

They also can extend these concepts into some other related courses. Several students clearly argued with the concept of "materiality," which is a concept in auditing. In one discussion for transaction 10 (see Appendix 1), one student wanted to use the schema "sell a building and leaseback for continuous use." The reason is that this is a strategic plan. The intention is not just for a short-term earnings boost. But another student argued with the auditing concept of "materiality." No matter which intentions are held for this business transaction, the amount is "material" and potentially violates related regulations.

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APPENDIX: THE DESCRIPTION OF THE COURSE PROJECT

1. Objective

The ACCT 312 group project trains students' professional judgment skills and extends their professional perspective by discussing some debatable accounting topics and actual finance and accounting-related events. The group project helps develop a bird's eye viewpoint. It is also beneficial for students to have a deeper understanding of GAAP and how the regulations work. The assignment encourages and requires teamwork in its preparation. The questions often have no one-fits-all answer, and students must support their opinions with robust arguments. Thus, it is essential to develop arguments with the knowledge they learned in their accounting classes.

2. Team member and coordinator selection

Students could self-select group members for the group project. But if some students were selected after the third week of the semester, the instructor randomly placed them into a group with available seats. Students could learn who was in their group by checking the list provided in the assignment and on the discussion board. Each group needed to vote for a coordinator; volunteers were highly encouraged. Each group was required to post the coordinator’s name to the professor by the fourth week of the semester.

The coordinator needed to develop a team charter with group members to guide the group's teamwork. The team charter often included the following typical elements. (1) How are the distinct roles and responsibilities distributed equitably among the team? (2) What norms/expectations should be established for meetings (frequency, attendance, timeliness)? (3) What communication tools will be used for discussing and collaborating? (4) How to plan amid conflicting opinions? (5) How do we hold individual members accountable for the norms that were established collectively?

The Canvas discussion board was highly recommended for the group to host asynchronous communication. Each group could also use other synchronous platforms, like Zoom, Teams, etc.

3. The group project had three independent phases.

3.1. ACCT 312 Group Project Phase 1: Fair Value and Its Working Mechanism.

Fair value and carrying value (historical value-based measurement) are the two primary accounting measurements. According to GAAP, many investments use fair value as the measurement basis, but intangible assets use carrying value. This measurement difference is significant between investment accounting and intangible asset accounting. This essay from the Harvard Business Review highlights this difference[1]and demonstrates why GAAP requires the fair value to measure investment, but it only permits the use of historic-based carrying value to measure intangible assets. Each student needed to draft a 500-word essay to illustrate the difference. The solution needed to provide the following information (but not limited to): (1) the definition and the primary features of these two measurements; (2) the precondition that fair value can be used as a robust accounting measurement; (3) some specific situations where fair value is not appropriate.

3.2. ACCT 312 Group Project Phase 2: Managers' Compensation and Earnings Manipulation.

Stock-based compensation plans theoretically align the interests of the employees with company performance. Many public companies developed different share-based compensation plans to engage employees' dedication to their companies' development. However, some critics point out that the share-based compensation arrangement could "distort the quality" of a company's earnings and "make them look stronger than they are." Some studies found that

[1] https://hbr.org/2013/03/why-fair-value-is-the-rule

managers are more likely to manipulate strong earnings when they want to cash out their stocks or options.

The article that was included in the directions given to students found that firm performance and CEO tenure interacted with out-of-the-money options and ownership to influence CEO earnings manipulation behaviors (Zhang, X. et al., 2008). Students were told they could skip the part on methodology and analysis because it is hard for undergraduate students to understand statistical analysis. But it was necessary to understand the introduction, assumption, and result.

Students were instructed to read the essay "CEOs on the Edge: Earnings Manipulation and Stock-based Incentive Misalignment (Zhang, X. et al., 2008)[2] and to write an essay of more than 400 words to answer the following two questions: (1) some studies show that stock-based compensation plans could distort companies' earnings quality. Please explain how this compensation plan can have the potential to distort companies' earnings quality with what you learned from ACCT 312; (2) Please propose some suggestions about how companies can avoid this potential distortion.

3.3. Group Project Phase 3: Accounting Discretion and Earnings Management.

The discretion allowed by Generally Accepted Accounting Principles (GAAP) enables managers to exercise judgment in preparing financial statements. Managers can exercise discretion to report smooth earnings over time and shift earnings between financial periods. Firms benefit from the reporting of smooth earnings because of the higher valuation they can obtain for their shares and lower equity cost. Both GAAP and the SEC have been applying regulations to prevent managers from misrepresenting their firm's earnings prospects to investors. However, earnings smoothing and earning management still exist in practice, and some of these activities may, in some cases, be illegal.

[2] https://journals.aom.org/doi/abs/10.5465/AMJ.2008.31767230

The group project wanted students to understand the big picture of financial statements and how professional accounting judgment can impact net income, especially EPS. This group project required using the knowledge gained in ACCT 312 to deal with ten transactions and, by doing so, to achieve an EPS higher than five dollars per share for the hypothetical company. In other words, one can imagine the case under the condition where the boss requires someone to try to take advantage of any available discretion to achieve the targeted goal, a five dollars EPS. But students also needed to ensure that their solutions complied with all regulations.

In summary, the group project could not receive a full score if (1) the solution did not achieve the $5 EPS or (2) the solution violated GAAP or other regulations. This assignment was a group project, which required students to discuss possible solutions with their group. Students were not required to provide arguments to explain why or how they chose their solution.

3.3.1. Case Background Introduction Given to Students.

The projected company is ValueVehicle (VV), a hypothetical electrical vehicle manufacturer. VV is a publicly listed company and is required to comply with all regulations from the SEC and GAAP. Each group is the accounting department, and they are responsible for disclosing financial information to the SEC and the public.

3.3.2. Company basic financial information.

VV (formerly ValueVehicle, Inc.) is an American electric vehicle and clean energy company based in Fayetteville, North Carolina. VV's current products include electric cars (the Model 100, Model 101, and Model 102). VV was founded in July 2008. After 12 years in the market, VV earned its fame as the electric passenger car manufacturer, with a market share of 14% of the plug-in segment and 21% of the battery-electric part.

VV started its IPO in 2012 and became a public company, and it has 2 million outstanding shares. The stock market price was

$100 per share on December 1, 2021. The primary financial statutes (on December 1, 2021) are illustrated as follows:

Total assets: $2 billion. Current assets: $50 million (including finished products inventory of $30 million). Long-term liability: $50 million. Current liability: $10 million. Common stock: $10 million (VV has no dilutive shares, bonds, or preferred shares).

The profit target in 2021 is to earn $10 million in net income, which also means that the targeted EPS is $5 per share. By November 30, 2021, VV has achieved $8 million in net income (after tax and interest). To achieve the targeted goal, VV needs to have a two-million-dollar net income (after tax and interest deduction, the income tax rate is 21%) in the last month of 2021. The transactions of this month are illustrated as follows. Each team is required to record the transactions in December 2021 based on their professional judgment.

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3.3.3. Requirements

Please recognize the following detailed transactions and complete the journal entries. Each team must make the necessary argument if the journal entries have several options.

1. From December 1 through December 20, VV has had 1.2 million dollars in transactions with a gross margin of 40%.

2. Dealer X planned to sign a $1 million sales contract with VV in February 2022 (the gross margin is projected as 40% based on the current product information). Recently, dealer X discussed an alternative they can sign the contract before December 31, 2021. The condition is that VV can offer a 20% discount on the sales price.

VV can choose to provide the discount in December 2021 or reject this contract and wait for the deal in February 2022. The company has enough inventory to ship to the dealer if they sign the contract in December 2021. The dilemma for the decision is the balance of the unfair contract discount and early revenue recognition.

3. Dealer Y proposed to sign a $1 million sales contract with VV before December 31, 2021, with two conditions: (1) Dealer Y can return the cars unconditionally if they cannot sell the cars before June 2022. (2) VV needs to offer a 10% discount on the sales price. The gross margin is projected as 40% based on the current product price (without the 10% discount). There is no publicly available information about how many cars Dealer Y can sell by June 2022. The representative of dealer Y predicts that 10% of the cars cannot be sold by June 2022. VV can choose to offer the contract or reject this deal.

4. On December 1, 2021, the accounting department received the latest report from the Pilot Automation System department. The report claims that a new wireless operating system has achieved technological feasibility. VV spent $800,000 on this system in 2021. The technological feasibility judgment is based on the company's own engineering expert group. There is no official technical criterion currently available for technological feasibility. The original goal for this Pilot Automation System is a patent, but the management is now considering this system as internally developed software. VV spends $300,000 this month after passing the technological feasibility. Based on the given information, each team must determine whether this system is a patent or software and decide to capitalize the $300,000 (the capitalization can be amortized within ten years) or record it as an R&D expense.

5. On December 10, the team checked and found that VV had four debt investments in the market. The category and the fair value are listed in Table 1. The CEO suggests re-categorizing these investments and recognizing some gains and losses. Please make decisions and explain the reasons for them.

Table 1: The list of the company's four investments

Company	Amount	Marketing Value (12/10/21)	Category	Maturity Date
Company A	$1 M	$1.2 million	Held-to-maturity	June 2023
Company B	$1 M	$1.3 million	Held-to-maturity	June 2023
Company C	$1 M	$0.8 million	Trading security	July 2023
Company D	$1 M	$0.9 million	Available-for-sale security	May 2023

6. VV bought $20 million in equity securities from J Company. The investment is 19% of the voting common stock of the J Company, but the CFO of the J company is selected from VV. VV has an impact on the J Company's decision-making. VV uses an equity approach to record this investment. The balance of the J company investment in December 2021 is $20 million. Some managers argue that the impact is not significant and want to change the accounting approach to use fair value and recognize the investment gains. The J Company had zero net income in 2021, but its stock price has increased to $21.4 million. Does your team agree with the change and recognize the $1.4 million gains? Please clarify the reasons for this judgment.

7. On December 22, the accounting team is required to make a financing decision for the 2022 annual budget. VV has a $5 million budget shortage that needs financing. Your team has three options available for obtaining the $5 million. First, VV can borrow money from a local bank with a 12% annual interest. Second, sell $5 million in treasury stock. Third, initiate $5 million in non-participatory preferred stocks with a 12% dividend rate. Please select one option and clarify the reasons.

8. VV initiates a one million dollar stock-based compensatory plan for the C-level managers. Your team must select

from two alternatives: the first is to use compensatory stock options; the second is to use a restricted stock plan. What is your team's preference, and explain why it chose this selection?

9. The administrative and selling expenses in December 2021 are $300,000. Please include the eight businesses above and compute net income and EPS. Remember to pay income tax on the December income (the tax rate is 21%).

10. If the net income from the computation above is less than $2 million, you cannot meet the market expectation. Your team is required to explore workable solutions to help achieve this goal. Please propose one potential accounting-related business activity to meet your goal. The proposed solution needs to comply with the official regulations from GAAP, SEC, etc. Please explain the proposed transaction and present the journal entry for your transaction. Here is one possible example of how you may achieve your goal. A financial consultant advises selling one building to your business partners. Then the company can lease it back for the following three years. The building's original value is $3 million, and the current value is $2 million (the depreciation is $1 million). The fair value of the fixed assets is $2.9 million. The lease can be an operating lease for three years, and each year from 2021 is $0.3 million. The sale can add $0.9 million in gains to the 2020 annual net income.