

# LEONARD N. STERN SCHOOL OF BUSINESS

## NEW YORK UNIVERSITY

C10.0003

SUMMER 2007

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### COURSE OBJECTIVES

This course is designed to prepare you to interpret and analyze financial statements effectively. This course explores in greater depth financial reporting topics introduced in the core course in financial accounting and also examines additional topics not covered in that course. The viewpoint is that of the user of financial statements. However, we develop sufficient understanding of the concepts and recording procedures to enable you to interpret various disclosures in an informed manner. We discuss each financial reporting issue in terms of its effect on assessments of a firm's profitability and risk. We then apply the analytical tools and concepts in competitor analysis, credit decisions, bankruptcy prediction, and valuation. This course is designed primarily for students who expect to be intensive users of financial statements as part of their professional responsibilities.

### COURSE MATERIALS

The readings, problems, and cases for the course come from *Financial Reporting, Financial Statement Analysis, and Valuation: A Strategic Perspective*, 6<sup>th</sup> edition, by Stickney, Brown, and Wahlen. (FSA.) You will also need a copy of the General Mills Financial Statements, which can be downloaded at: <http://www.generalmills.com/corporate/investors/index.aspx>.

Go to the 2005 Annual Report and download form 10-K.

Three Internet addresses may prove useful to you at some point in the course:

- 1 Filings with the Securities and Exchange Commission: <http://www.sec.gov/>.
- 2 Pronouncement of the Financial Accounting Standards Board: <http://www.fasb.org>.
- 3 Pronouncement of the International Accounting Standards Committee: <http://www.iasc.org.uk/>. We will also be discussing current articles on the subject.

## ASSIGNMENTS

Readings, cases and/or problems are assigned for each class. You should come to class prepared to discuss your analysis of the cases and problems. Regular class participation is important to the learning process for you and your classmates. Absences from class will only be excused for emergency reasons. Let me know if you expect to miss a class.

Assignments are due at the end of the class assigned. **No late assignments will be accepted nor or emailed or faxed assignments.**

All assignments should be prepared using word processing software with type size no smaller than 12 point. During class discussions, please feel free to make changes to your solutions, but do so in a way that clearly indicates that they are the result of class discussion (e.g., using a different color of ink).

You may work in groups to discuss homework assignments. However, each person should prepare his/her own individual homework solutions to be submitted. Ideally you should work through each day's assignment on your own before discussing it with anyone. You can then make changes to your solution based on your learning in any discussion. Interpretations of the analysis should be in your own words.

Optional problems are listed for most classes. These problems generally involve similar accounting issues and analyses as the assigned cases or problems. If you have difficulty preparing the assigned cases or problems, you may wish to study the optional problems and their solutions. Alternatively, you can use the optional problems to cement your understanding of a topic once we have covered it in class.

### Financial Statement Analysis Package

A financial statement analysis package (FSAP) is available to ease the calculation of financial ratios and perform other analysis. Access FSAP and the user manual at

<http://www.thomsonedu.com/accounting/stickney/>

## GROUP PROJECT

Groups may be 3 to 4 people. Each group will choose a manufacturing or merchandising (retailing) firm to analyze, and compare it to a secondary company. The analysis should cover the relevant topics discussed during the course and will be handing in (typed) and presented toward the end of the term. You are to summarize the economics and current conditions in the industry, describe the strategies each of the firms pursue, perform a profitability and risk analysis, and assess the reasonableness of the current market price. More details will be given as the semester progresses.

## EXAMINATIONS

There will be a final examination on Thursday, **June 21<sup>st</sup>**, and a group presentation on Tuesday, **June 19<sup>th</sup>**. There will be a midterm on **May 31<sup>st</sup>**, for 1 hour and 15 minutes.

## GRADING

Grades will be based on the following weights:

Midterm	20%	May 31 <sup>st</sup>
Group Project	15%	June 19 <sup>th</sup> & 21 <sup>st</sup>
Case 1.2	} 15%	Due May 17 <sup>th</sup>
Case 3.3 & Problems 3.14 – 3.23		Due May 24 <sup>th</sup>
Wal-Mart Case 4.2		Due May 31 <sup>st</sup>
Revenue Recognition Problem 7.9		Due June 5 <sup>th</sup>
Liability Recognition Problem 8.0		Due June 12 <sup>th</sup>
Class Participation		
Final Exam	50%	June 21 <sup>st</sup>

## MAY 15<sup>TH</sup>

### Topic: Introduction to Course and Financial Statement Analysis

#### Learning Objectives:

- 1 Overview of financial reporting and financial statement analysis.
- 2 Understand most effective means of mastering course and financial statement analysis.
- 3 Discussion of General Mills Financials. Prepare problem 1.12 (p. 52 & 53).

## MAY 15<sup>TH</sup> – 17<sup>TH</sup>

### Topic: Financial Reporting Highlights

#### Learning Objectives:

- 1 Review the purpose, underlying concepts, and accounting principles related to the balance sheet, the income statement, and the statement of cash flows.
- 2 Use common size statements to make preliminary interpretations of the profitability and risk of a firm.
- 3 Review key principles that drive the preparation of financial reports.
- 4 Understand the environment in which financial reporting principles are determined, as well as the limitations presented when analyzing a firm using financial reports.

**Read:** FSA, Chapter 1,

**Hand-in:** Case 1.2 – (NIKE: Somewhere Between a Swoosh and a Slam Dunk).

Questions on Pages 78, 79, 80, 81, 82, and 84.

## MAY 23<sup>RD</sup>

### Topic: Statement of Cash Flows

#### Learning Objectives:

- 1 Understand the relation between net income and cash flow from operations for firms in various industries.
- 2 Understand the relation between cash flows from operating, investing, and financing activities for firms in various stages of their life cycles.
- 3 Prepare a statement of cash flows from balance sheet and income statement data.

**Read:** FSA, Chapter 3 General Mills Cash Flow Statement – hand in WT Grant Case 3.3 (May 25<sup>th</sup>)

**Prepare:** Problems 3.14, 3.15, 3.16, 3.17, 3.18, 3.23

## MAY 24<sup>TH</sup> – 29<sup>TH</sup>

### Topic: Profitability and Risk Analysis

#### Learning Objectives:

- 1 Analyze and interpret changes in the operating profitability of a firm using the rate of return on assets and its components, profit margin and total assets turnover.
- 2 Analyze and interpret changes in the rate of return on common shareholders' equity including the conditions when a firm uses financial leverage successfully.
- 3 Understand the importance of effective working capital management and apply analytical tools for assessing short-term liquidity risk.
- 4 Understand the benefits and risks of financial leverage and apply analytical tools for assessing long-term solvency risk.

**Read:** FSA, Chapter 4 & 5

**Prepare:** Case 4.2 Wal-Mart, Pages 272-282

**MAY 31<sup>ST</sup>**

**Topic: Data Issues in Analyzing Financial Statements**

**Learning Objectives:**

- 1 Develop an understanding of the concept of “earnings quality,” with emphasis on the sustainability, measurement and manageability of reported earnings.
- 2 Master the ability for deciding when and how to adjust reported income in order to use it in evaluating performance and in predicting future earnings of a firm.

**Read:** FSA, Chapter 6

**Prepare:** Problem 6.10

**MAY 31<sup>ST</sup>**

**MIDTERM**

**7:45PM-9:00PM**

**JUNE 5<sup>TH</sup>**

**Topics: Income Recognition, LIFO Footnote adjustments, Fixed Assets, Intangibles, Software Development Costs**

**Income Recognition**

**Learning Objectives:**

- 1 Observe the effects on the financial statements of recognizing income prior to the time of sale, at the time of sale, and subsequent to the time of sale.
- 2 Observe the time series pattern of income when firms recognize income prior to the time of sale, at the time of sale, and subsequent to the time of sale.
- 3 Review the accounting for inventories and depreciable assets.
- 4 Examine the impact on assets and net income of capitalizing and amortizing intangibles development
- 5 Identify the financial statement effects of alternative ways of organizing research and development activities and restate the income statement to a format that enhances analysis of the profitability of a technology-based firm.

**Read:** FSA, Chapter 7

**Prepare:** Problem 7.9, 7.14 a & b, 7.15 a, b, f, g

## JUNE 7<sup>TH</sup>

### Accounting for Income Taxes

#### Learning Objectives:

- 1 Understand the need for recognizing deferred income tax expense when book income differs from taxable income because of temporary differences.
- 2 Understand the conditions that give rise to deferred tax assets and deferred tax liabilities.
- 3 Use disclosures of individual deferred tax assets and deferred tax liabilities to study amounts recognized for financial and tax reporting.
- 4 Use disclosures of the effective tax rate to understand why a firm's average tax rate differs from the statutory tax rate.
- 5 Analyze the impact of income taxes on assessments of profitability.

**Read:** *FSA*, Chapter 2, Pages 97-105, & Chapter 8, Pages 575-587. General Mills Footnote 16.

**Prepare:** Problem 8.26

## JUNE 12<sup>TH</sup>

### Liability Recognition and Valuation

#### Learning Objectives:

- 1 Understand and apply the concept of an accounting liability to various transactions intended to keep debt off of the balance sheet.
- 2 Observe the importance of identifying the entity bearing the risks and enjoying the economic return when deciding liability recognition issues.

**Read:** *FSA*, Chapter 8 (pages 522 – 545)

**Prepare:** Problem 8.10

**JUNE 14<sup>TH</sup>**

**Topics: Leases/Pension and Healthcare Benefits**

**Leases**

**Learning Objectives:**

- 1 Understand the distinction between the operating lease method and the capital lease method, including the criteria for using each method and their financial statement effects.
- 2 Convert firms using the operating lease method to the capital lease method.

**Read:** FSA, Chapter 8

**Pension and Healthcare Benefits**

**Learning Objectives:**

- 1 Distinguish between the amounts that firms report on their financial statements with respect to a pension or healthcare benefit plan and to the amounts that appear on the financial statements of the pension or healthcare benefits fund and understand why the two differ.
- 2 Use pension and healthcare disclosures to measure the economic status and financial performance of a pension or a healthcare benefits plan.
- 3 Observe the role of actuarial assumptions in accounting for pensions and healthcare benefits.
- 4 Understanding reserves in the financial statements

**Read:** FSA, Chapter 8 (pages 561-575)

**Catch Up & Review**

**JUNE 19<sup>TH</sup>**

**GROUP PRESENTATIONS**

**JUNE 21<sup>ST</sup>**

**FINAL EXAM**