Financial Statement Analysis: C10.0003  
Spring 2005 – Mondays and Wednesdays 9:30 A.M. – 10:45 A.M.

Professor April Klein  
K-MEC 10-93  
E-mail: aklein@stern.nyu.edu  
OFFICE HOURS:  
Monday & Wednesday  
12:30 P.M. – 1:30 P.M. and  
by appointment

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. This course is designed primarily for students who expect to be intensive users of financial statements as part of their professional responsibilities.

The pre-requisites for this course are the core course in financial accounting and the core course in managerial accounting.

Course Materials  
- The readings, problems, and cases for the course come from Financial Reporting and Statement Analysis: A Strategic Perspective, 5th edition, by Clyde Stickney, Paul R. Brown, and James Wahlen.

- We will also be using the Apple Computer 10-K filing during the class. For a pdf printable and downloadable file, go to:  
  http://www.snl.com/Interactive/IR/4004205/2004_10K.pdf  (There is an underscore between 2004 and 10K)

- Please bring both to class as we will be using them throughout the semester.

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

2. Pronouncements of the Financial Accounting Standards Board:  
   http://www.fasb.org
3. Pronouncements of the International Accounting Standards Committee:  
   http://www.iasc.org.uk

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.

• Ten percent of your grade will be based on “class preparation.” You can receive these points either from actively discussing the cases and problems in class or handing in the assignment at the end of the class. No late assignments will be accepted nor will I accept e-mailed or faxed assignments.

• All assignments should be prepared using word processing software with type size no smaller than 12 point. You can include tables or spreadsheets as well, as long as they are carefully labeled and defined. 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.

• Additional assignments either will be discussed in class or are extra problems for your benefit. I will tell you the assignments that will be discussed in class prior to that class.

Financial Statement Analysis Package
A financial statement analysis package (FSAP) is available to ease the calculation of financial ratios and perform other analyses. Access FSAP and the user manual at http://www.swlearning.com

Group Project
You will self-select yourselves into groups of 5 in class on February 7. Each group will choose an industry to analyze, for example, fast food or women’s clothes. Each person in the group will choose his/her own firm in the industry. Your group will present orally an industry analysis at the end of the term using the firms in your industry. The analysis should cover the relevant topics discussed during the course. You are to summarize the economics and current conditions in the industry, describe the strategies each of the firm pursues, perform a profitability and risk analysis, and assess the reasonableness of the current market prices. The oral presentation will be accompanied by either your power point slides or a 5-10 page report. Each person will attach a 1-2 page analysis of his/her firm including tables and graphics – attached to that put the firm’s most recent annual report.
More details of the project will be given as the semester progresses.

**Timetable**
- Select group of 5 in class: February 7
- Select industry and firms: February 14
- Get annual report: March 21
- Project due: End of term

**Examinations**
There will be two examinations: one on March 2 and the other on the final exam date as fixed by Stern.

**Grading**
Grading will be based on the following weights:

<table>
<thead>
<tr>
<th>Component</th>
<th>Weight</th>
</tr>
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<tbody>
<tr>
<td>Class Preparation</td>
<td>10%</td>
</tr>
<tr>
<td>Exam 1</td>
<td>30%</td>
</tr>
<tr>
<td>Oral Presentation/Industry Report</td>
<td>15%</td>
</tr>
<tr>
<td>Firm Analysis</td>
<td>5%</td>
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<tr>
<td>Exam 2</td>
<td>40%</td>
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**Blackboard**
I will be using Blackboard to post notes, the syllabus, and to communicate with you throughout the term. If you have any questions as to how to use Blackboard, please see me after class.
Syllabus

January 19  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

For next class (not a hand-in): Read through the Apple Computer 10-K report. You won’t understand everything, but using the report and other outside information, tell me the type of company Apple is, how they make money, who their customer base is, and what their strategic advantages are, if any. In particular, look through the MD&A (starting on page 23) and tell me what, if anything about Apple, surprised you.

January 24 & 26  Financial Reporting Highlights

Read: Chapter 1
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

Preparation Hand-In: Case 1.1 (NIKE): Note, the questions are on pages 62, 64, 69 and 70
1/24: Hand-in questions relating to Balance Sheet and Income Statement
1/26: Hand-in remaining questions

January 31 & February 2 & February 7  Statement of Cash Flows

February 7: Select groups for project

Read: Chapter 3
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.

1/31: We will go over problem 3.10 in class. Not a hand-in.
2/2: Prepare: Problems 3.1 – 3.6 In your preparation, tell me the type of company each firm is (manufacturing, merchandising or service), whether it is a cyclical or non-cyclical company, and what in the SCF tells you about what is going on with each company.

2/7: Preparation Hand-In: Case 3.1 (W.T. Grant)

February 9 & 14 & 16 & 23 Profitability and Risk Analysis

February 14: Select industry and firm for group project

Read: Chapters 4 & 5 (note: skip pages 296-298)
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 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

Note: in doing these problems, you may find the FSAP package to be useful.

2/9: We will go over problems 4.1-4.4 in class. Not a hand-in.
2/14: We will go over problems 4.9, 5.1, 4.10, 5.2 in class. Not a hand-in.
2/23: Preparation Hand-Ins: Case 4.1 (Wal-Mart) and Case 4.2 (Gap & Limited)

February 28 & March 2 Data Issues in Analyzing Financial Statements

Read: Chapter 6
Learning Objectives:
1. Develop an understanding of the concept of “earnings quality” with emphasis on 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

2/28: We will go over problem 6.1 in class. Not a hand-in.
3/2: Preparation Hand-In: Problem 6.4

March 7
Exam 1

March 9 & 21 & 23
Income Recognition, LIFO Footnote Adjustments, Fixed Assets, Intangibles

March 21: Bring in annual report for company in group project

Read: Chapter 7
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.

Prepare: Problem 7.1, 7.6 (Parts A&B)

March 28 & 30
Accounting for Income Taxes

Read: Chapter 2, Pages 84-93; Chapter 8, Pages 580-594 : Do problem 7.7
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 the disclosures of individual 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

Prepare: Problem 8.17

April 4 & 6 Liability Recognition and Valuation

Read: Chapter 8, Pages 519-534
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

Prepare: Problem 8.1

April 11 & 13 Leases

Read: Chapter 8, Pages 534-546
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

Prepare: Problem 8.4

April 18 Pension and Healthcare Benefits

Read: Chapter 8, Pages 564-580
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
April 20  Catch up and Preparation for Group Presentations

April 25, 27, & May 2  Group Presentations

TBA  Exam 2