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, and valuation. This course is designed primarily for participants who expect to be active users of financial statements as part of their professional responsibilities.

Required Course Materials

The readings, problems, and cases for the course come from:


Additional Sources

The following web sites may prove useful to you at some point in the course:


Assignments

Readings, cases and/or problems are assigned for most classes. 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 affect your class participation grade.
If collected, assignments are due at the end of the class assigned. No late assignments are accepted, nor are faxed or e-mailed assignments.

All assignments should be prepared using word processing software with type size no smaller that 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.

Examinations

There will be two examinations given in the course. Missing an exam is a serious problem. Moreover, no make-up exams are given, with the weight attached to the missed exam assigned to the other exam. The exams will be given in class and are open book and notes.

Grading

Grades will be based on the following weights:

First Examination (31 May)……… 33 1/3 %

Second Examination (14 June)…… 33 1/3 %

Class Participation, Problem and Case Preparation (including Problem 10.16 which definitely will be collected on 26 June) ………… 33 1/3 %

Total…………………………. 100.0 %
TOPICS AND ASSIGNMENTS

Class 1  - 15 May 2006
Topics:
  Introduction to Course and Financial Statement Analysis
  Initial Review of PepsiCo Financial Statements and Notes
Learning Objectives:
  1. Overview of financial reporting and financial statement analysis.
  2. Understand most effective means of mastering course and financial statement analysis.
  3. Review the purpose, underlying concepts, and accounting principles related to the balance sheet, the income statement, and the statement of cash flows.
Read: FRSA, Chapter 1
Review: FRSA, PepsiCo Financial Statements and Notes (Appendices A and B).
Prepare: FRSA, Problem 1.12

Class 2  - 17 May 2006
Topics:
  Financial Reporting Highlights and Introduction to Cash Flows
  In-Depth Review of PepsiCo Financial Statements and Notes
Learning Objectives:
  1. Review key principles that drive the preparation of financial reports.
  2. Understand the environment in which financial reporting principles are determined, as well as the limitations presented when analyzing a firm using financial reports.
Read: FRSA, Chapters 1 and 3
Prepare: FRSA, Case 1.2 (Nike) and Problem 7.9 (Chapter 7 not needed to complete the problem)

Class 3  - 22 May 2006
Topic:
  Income Flows Versus Cash Flows: Key Relationships in the Dynamics of a Business
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: FRSA, Chapter 3
Prepare: FRSA, Problem 3.19; Problem 3.21; and Problem 3.22
Class 4 - 24 May 2006

Topic: Profitability and Risk Analysis

Learning Objectives:
1. 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. 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.
3. Analyze and interpret changes in the rate of return on common shareholders’ equity including the conditions when a firm uses financial leverage successfully.
4. Understand the importance of effective working capital management and apply analytical tools for assessing short-term liquidity risk.
5. Understand the benefits and risks of financial leverage and apply analytical tools for assessing long-term solvency risk.

Read: FRSA, Chapters 4-5
Prepare: FRSA, Problem 4.20; and Problem 5.12

Class 5 – 31 May 2006

1. First half of class: Examination - In-class exam, open book and open notes (exam covers Chapters 1, 3, 4, and 5)

2. Second half of class: Topic - Deferred Income Taxes (Chapter 2)

Learning Objectives:
1. Discuss the link between the valuation of assets and liabilities on the balance sheet and the measurement of income.
2. Understand the need for recognizing deferred income tax expense when book income differs from taxable income because of temporary differences.
3. Understand the conditions that give rise to deferred tax assets and deferred tax liabilities.
4. Use disclosures of individual deferred tax assets and deferred tax liabilities to study amounts recognized for financial and tax reporting.
5. Use disclosures of the effective tax rate to understand why a firm’s average tax rate differs from the statutory tax rate.

Read: FRSA, Chapter 2 (pages 97-105)
Prepare: FRSA, Problem 2.12
Class 6 - 5 June 2006

Topic:
Revenue Recognition and Related Expenses

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 accounting for intangible assets

Read:  FRSA, Chapter 7
Prepare:  FRSA, Problem 7.11; Problem 7.12; and Case 7.2 (parts b. to h.)

Classes 7 and 8 - 7 and 12 June 2006

Topic:
Liability Recognition and Related Expenses

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.
3. 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.
4. Convert firms using the operating lease method to the capital lease method.
5. Analyze the long-term solvency risk of a firm with and without capitalization of operating leases.
6. Pensions and post-retirement health care benefits

Read:  FRSA, Chapter 8
Prepare:  FRSA, Problem 8.10; and Problem 8.15 (7 June)
          FRSA, Question & Exercise 8.6; and Problem 8.21 (12 June)

Classes 9 - 14 June 2006

Examination (6-8pm) - in-class exam, open book and notes (exam is cumulative, but emphasizes materials addressed in class from Chapters 7 and 8).  Note that class will end at 8pm on this day.
Classes 10 and 11 – 19 and 21 June 2006

**Topic:**

Intercorporate Entities and related topics

**Learning Objectives:**

1. Understand the purchase method for accounting for a corporate acquisition, and its on-going effects on the financial statements.
2. Observe the interaction between legal, accounting, tax, and financing factors in structuring a corporate acquisition.
3. Understand the general principles for translating financial statements of foreign subsidiaries.

**Read:** *FRSA*, Chapter 9

**Prepare:** *FRSA*, Problem 9.10; Problem 9.11 (19 June)

*FRSA*, Question & Exercise 9.4; Problem 9.19 (part a. only); and Problem 9.20 (part a. only) (21 June)

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Class 12 – 26 June 2006

**Topic:**

Forecasting Pro Forma Financial Statements

**Learning Objectives:**

1. Review the relations between items on the balance sheet, income statement, and statement of cash flows that require internal consistency when preparing pro forma financial statements.
2. Design pro forma statements as support for adding a new product line, starting a new business, divesting of current businesses, etc.

**Read:** *FRSA*, Chapter 10

**Prepare:** *FRSA*, Problem 10.16 (this assignment will be collected at the end of class)