

Andrews University
School of Business
Department of Accounting, Economics, and Finance

Course Outline
Portland, December 9-20, 2007

Course Title: ACCT620, Financial Statement Analysis

Instructor: Ann Gibson, PhD
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Textbooks: Stice, Earl K. & Stice, James D. (2006), *Financial Accounting Reporting and Analysis*, 7th edition. Thomson/Southwestern

Mulford, Charles W. & Comiskey, Eugene E. (2002), *The Financial Numbers Game: Detecting Creative Accounting Practices*. John Wiley & Sons.

Course Description:

The recent corporate accountability crises have focused the world's attention on what accounting reports can do and what they cannot do. Accounting failures at Enron, World Com, and numerous other firms have led to extensive reforms in the U.S. Probably the most notable of these reforms is the Sarbanes-Oxley Act (2002), which includes many accounting and disclosure changes. Throughout these crises, what was surprising was the lack of understanding of GAAP and basic accounting issues by many boards of directors and Wall Street analysts. Through this course you will gain a better understanding of some of the issues relating to analyzing financial statements.

The course will explore both underlying theory and practical applications of financial reporting and analysis, including providing an understanding of alternative accounting measurements, determining ways to better communicate financial performance and financial position to users and emphasizing techniques for analyzing financial reports. The course highlights the importance of financial statements as an information source for creditors and investors and will address different forms of financial analysis based on financial report information. We will also discuss earnings management and fraudulent financial reporting. Accounting is the "language of business" and with the knowledge gained from this course, you will be able to read, interpret and critically evaluate the published financial disclosures firms make. The primary focus of this course is on accountability of publicly-traded enterprises. However, the topics covered will be of assistance in financial decision-making and analysis for all types of business organizations.

Course Objectives:

The objectives of the course are to:

1. Assist the student in developing the skills necessary to interpret and use financial statement information effectively for decision-making. Specifically the student will:

- a. Interpret and evaluate the corporate balance sheet, income statement, stockholders' equity statement, and cash flow statement, with applications to financial statements of other business organizations.
- b. Be able to interpret the results of such financial analysis and evaluate a firm's liquidity, solvency, effectiveness, and profitability.
- c. Utilize library and internet resources such as EDGAR, Lexis-Nexis/Disclosure, etc. to research financial information about publicly traded corporations.
- d. Communicate research results in a professional manner.
- e. Appreciate the influence of and necessity for ethics in financial reporting.

Class Expectations Before Class Begins on December 9:

I. Read Chapter 7, which is a review of the accounting cycle (analyzing transactions, preparing journal entries, posting to the ledger, adjusting and closing entries). Do Exercise 7-7, Exercise 7-8, and Exercise 7-10 and **email your answers to these exercises to me by November 16**. The purpose of this assignment is for you to review basic accounting principles and for me to be assured that you remember what you learned in your first accounting course.

II. Do the attached "bridge test" and **mail your answers to me by November 16**. Again, the purpose of this assignment is for you to review basic accounting principles and for me to be assured that you remember what you learned in your first accounting course.

You may use any books or notes in doing these two assignments, but **do not discuss these assignments or the bridge test with others**. The purpose of this assignment is to determine the level of **your current accounting knowledge**. I will grade the exercises and the bridge test as soon as I receive them. If I find that you have made a number of errors (i.e., score less than 90% on this combination of assignments), you will be asked to do additional review problems to bring your accounting knowledge up-to-speed for the graduate course.

III. Choose which Ethical Dilemma (see below) you wish to present to the class and email your choice to the instructor (gibson@andrews.edu).

IV. Choose a company for your Financial Analysis Project. The class members need to select different companies. Given all the possible companies to select, it is unlikely that you will duplicate a classmate's choice. However, if you do, the person notifying me first of their choice will have preference for that company. Email your choice to gibson@andrews.edu

Course Procedures:

1. **Ethical Dilemmas.** On the attached assignment schedule, 7 ethical dilemmas are assigned.. We will discuss the first one—on Monday night, December 10 (“Dodging a Loan Covenant Violation”) and the last one—on Thursday night, December 20 (“Fear of Reporting Under U.S. GAAP”) together (and the teacher will lead the discussion). Each class member (6 of you) will be asked to choose one of the remaining ethical dilemmas and do a short presentation (15 minutes) on the ethical dilemma to the class. In the presentation, the ethical issues and the accounting issues should be clearly identified. The presenter should be prepared to answer questions from the class and lead the discussion of the issue. Any questions posed in the case should be answered during the presentation.

Please email me your choice of the ethical dilemma you wish to present. The ethical dilemmas will be assigned on a “first come/first serve” basis, determined by the time of your email to me.

All students are expected to read the ethical dilemma for the day and come to class prepared to enter into the discussion. No written work is expected for the ethical dilemma assignment, **EXCEPT** for the individual doing the presentation. That individual will be expected to submit a written analysis of the dilemma. Thus—over the two week period, each student will submit written work on ONE ethical dilemma of their choice—the same one they presented. Other class members’ participation in the discussion will be part of their class participation grade.

2. **Business Memos** (December 12 and 17). These are individual assignments to hand in. Students are expected to prepare their hand-in work as if the work was being presented to management. The business memos should be prepared in a professional business style and should be addressed to the individual identified in the case.

3. **After-class financial analysis project.** See attached sheet of instructions for the financial analysis project. This project is due **no later than** January 14, 2008. It should be emailed, as a MS Word attachment, to the instructor (gibson@andrews.edu). The subject line of the email should be “Portland ACCT620 Project Report”.

4. **Mid-term Examination.** The mid-term examination will consist of multiple-choice and essay questions. There will be no final examination.

5. **Other Requirements:**

a. *Attendance.* Class attendance is critical to fully understanding the concepts and applications discussed in this class, and is expected of all students. Andrews University policies regarding class attendance apply. Specifically, class absences greater than 10% of the total course appointments may result in a failing grade. (AU Bulletin page 28). Please make proper arrangements with the instructor for any absences which may be excused, such as absences due to serious illness, death in the family, etc.

b. *Academic honesty.* Academic honesty is expected and academic dishonesty of any type will not be tolerated. This includes, but is not limited to, plagiarism (copying other’s work as your own—in part or total—without the appropriate citations) and copying others’ responses

during examinations. Please refer to the Andrews University bulletin, page 28, for the University policy on academic integrity.

c. *Deadlines.* Serious management scholars know that the real world of business is not very forgiving; therefore deadlines **MUST** be met. Any exception to this rule can only be made at the discretion of the instructor. Penalties may apply for late submissions.

d. *Preparation of assignments/reports.* Written reports should be prepared professionally. They will be evaluated in terms of grammatical structure, content flow, neatness, and readability.

Grading and Evaluation:

Your grade will be calculated as follows:

Class Participation	25 pts
Pre-class accounting refresher work	75 pts
Ethical Dilemma Presentation (1)	25 pts
Ethical Dilemma Paper (1)	25 pts
Two Business Memos	50 pts
Financial Analysis Project	150 pts
Mid-term Exam	<u>100 pts</u>
Total	450 pts

The grade distribution will be prepared according to the following scale:

A	94-100%	C+	74-78%
A-	90-93%	C	67-73%
B+	86-89%	C-	60-66%
B	82-85%	D	55-59%
B-	79-81%	F	0 - 54%

ACCT620 - Financial Analysis Project

As a business professional you will frequently use financial reports in decision making. As a manager you may use financial statements to assess the performance of your business or to evaluate the financial performance of your contract suppliers. Individuals use financial statements to select and evaluate companies in their personal investment portfolios. This project will help you to become more familiar with the information that can be garnered from financial reports and assist you in using that information to improve decision-making.

Directions:

Select a **publicly traded company with published audited financial statements and reports**. Do not select a foreign firm. Likewise, this project is not suited for not-for-profit or governmental type organizations because you must have data availability to do this project. If you are having difficulty deciding on a company, consider the following suggestions as possibilities: Walgreens, Sears, McDonalds, Abbot, GAP, Cisco, Merck, Target, Whirlpool, General Electric, Wal-Mart, Nike, Best Buy.

Prepare an analysis of the company you have selected. The most common sources of information will be the financial statements, notes to the financial statements and the auditor's reports for the most recent three fiscal years. (It may be that your company will have only two years of financial reports available. However, if you can locate a company with three years of financial data, that will make your analysis both easier and stronger).

Financial reports are available on the web from a variety of sources. The best sources are from the "investor relations" or "about the company" pages of the company's website. You can get financial statements (10-K report) from the SEC website: <http://www.sec.gov>.

Your report should be prepared so that it has a professional look and substantive content. The report is due on **January 14, 2008**. The report should provide a cover page which gives the name of the company for which you are doing the financial analysis, the course name and acronym and your name, along with the date submitted. For all analysis, except ratios, document the sources for your information using references. Do not cut and paste from the financial statements for this project. Please use your own words for the analysis of the company.

The maximum length of the report, including cover page, tables, and graphs, is **20 pages**. The case should be type-written, 12-point font with 1-inch margins. The ratios and other quantitative analysis should be displayed in tables or worksheets and properly labeled. Copies of the financial statements used (including notes—but not the management analysis) must be attached as an appendix (which does not count in the 20 pages).

The financial analysis should be organized as follows and answer the following questions:

Section I: Company Profile.

a. History of the Company. This portion should be no longer than two pages. The history would include points such as significant events (i.e., financial landmarks; mergers/acquisitions;

prosecutions); how the company has changed since its inception; persons that loom large in the company's history (and may have formed the company's culture); any other events of interest. Remember—it is possible that corporate life began before incorporation.

- b. Briefly describe the nature of the Company's business(es)—i.e., how/where/when do they make money?
- c. Summarize in no more than one page the latest news (2007) from the financial press about your Company. (This summary is not to be a bulleted list of articles, but rather a report of current events, especially those that can have an effect on company profits, stock price, creditors and other interested parties, or anything else of importance).
- d. Where is the company headquartered? What is the company's fiscal year end date? Who are the auditors and where are they located? Have the auditors changed in the last 3 years? If so, why?
- e. What time period does the auditor's report cover? What specific matters, if any, does the auditor's report bring to the attention of the reader? Discuss why any of these matters are included in the report. What language does the auditor use to indicate whether the financial statements were a fair representation of the company's financial condition?

Section II: Financial Analysis.

- a. Prepare a comprehensive quantitative financial analysis of the financial statements of your selected Company. Include in your analysis common-sizing; ratio analysis for profitability, efficiency, short-term liquidity, and leverage analysis. Be careful to sort through the data sufficiently to present a concise, readable report.
- b. What explanations did management give in the annual report for the changes in revenues and profits over the last two/three years? Did the Company grow? If so, how did the Company finance growth? If the Company did not grow, what plans does management have for the future to turn the Company around?
- c. Do you consider the Company's accounting methods liberal or conservative? Are there off-balance sheet items? If so, what? Are there related party transactions? If so, what?

Section III: The Competition.

Who is your Company's primary competitor? (Or you may decide they have two or three primary competitors). Compare your Company and its competitor on the following ratios for the most recent year: profit margin; return on assets; return on equity; current ratio; long-term debt-to-equity. Provide a brief assessment of the differences between your firm and its competitor and discuss which firm appears to be stronger financially. Substantiate your answer.

Section IV. The Recommendation

Based on your analysis, would you recommend investing in your Company? Provide substantive evidence for your recommendations. Be careful to write a compelling essay. You must do more than merely repeat the ratios or say your Company is the best choice. The point of this section is to convince me! Include in your decision a discussion of your Company's strengths and weaknesses and how they compare to their competitors and their industry. What do you consider to be their prospects for the future? Why?

ACCT620
Detailed Course Schedule

Sunday, December 9 a.m. Introduction to the course

This class will provide a general introduction to the course and will serve as a review to the key elements of financial reporting. We will review the pre-assignment exercises from Chapter 7 in the Stice book and go over the Bridge test.

Additional Reading: Mulford & Comiskey, Chapters 1-3 (pages 1-88)

Sunday, December 9 p.m. U.S. Financial Reporting Framework: What do law, politics, and capital markets have to do with accounting?

This class will discuss the financial reporting framework by examining the key players in the U.S. (Stice, chapter 1 & 2). We will explicitly consider the incentives CFOs face when preparing financial statements (Stice, chapter 8), as well as examine recent assessments of the costs and benefits of Sarbanes-Oxley legislation.

Additional Reading: CFO articles (July 1, August 1, September 1, 2007)
Journal of Accountancy articles (2002 and 2003)
Mulford & Comiskey, Chapters 4-5 (pages 93-158)

Monday, December 10 Methods of Valuation: Is it Better for Information to be Reliable or Relevant?

Accountants have wrestled with two methods of valuation for decades: historical cost and fair value. This class will provide a general understanding of these methods of valuation and will consider the advantages and limitations of each (a continuation of Stice, chapter 2).

Ethical Dilemma: "Dodging a Loan Covenant Violation" - page 71

Tuesday, December 11. The Accrual Concept: Why are Some Items of Value Reflected as Assets on the Balance Sheet, and Others are Not?

This class will examine the accrual concept and its impact on the balance sheet (Stice, chapter 4 and 10). We will consider the impact the different accounting choices on Inventory and the effect of management estimates on asset valuations of Inventory. These concepts can also be applied to Accounts Receivable. We will also look at the format and components of a classified balance sheet.

Additional Reading: Mulford & Comiskey, Chapter 8 (pages 237-275)

Ethical Dilemma: "Is It Alright to "Manage" the Balance Sheet?" - page 173

Recommended Assignment: Exercise 4-10 and Exercise 4-11

Wednesday, December 12 The Accrual Concept: If Economic Income is the Best

Performance
Measure, Why is it Not Reflected on the Income Statement?

This class will examine the accrual concept of income and compare the notion of economic income with accounting income (Stice, chapter 5, 9). We will describe the criteria for revenue and expense recognition in the U.S., the impact on reported earnings, and the implications for financial analysis. The focus will be on U.S. GAAP. We will also look at the format and components of an income statement.

Additional Reading: Mulford & Comiskey, Chapter 6 (pages 159-196) and Chapter 9 (pages 279-

313)

Ethical Dilemma: "How Flexible Is Accounting Judgment?" - page 422

Business Memo: Why Did We Manage Earnings? - page 372

Recommended Assignment: Exercise 5-13 and Exercise 5-14

Thursday, December 13 What happened to the cash?

This class will examine the Statement of Cash Flows (Stice, chapter 6). We will compare the format used by most publicly traded companies and an alternative format that provides superior information. We will distinguish among operating, investing, and financing cash flows.

Additional Reading: Mulford & Comiskey, Chapter 11 (pages 345-377)

Ethical Dilemma: "Is the Price Right?" - page 286

Recommended Assignment: Exercise 6-13 and Exercise 6-14

Sunday, December 16 a.m. Midterm test over basic accounting concepts, assumptions, and constraints; the accounting revenue cycle, the financial statements. (Chapters 1, 2, 4, 5, 6, 8, 9, 10)

Sunday, December 16 p.m. Financial Analysis: Short-term Solvency; Operating Efficiency And Profitability

This class will focus on financial analysis tools by examining the key metrics to measure short-term solvency, operating efficiency, and profitability. Special attention will be paid to the examination of receivables and inventories. (Stice, chapter 3)

Additional Reading: Mulford & Comiskey, Chapter 10 (pages 317-341)

Recommended Assignment: Problem 3-21 and Problem 3-27

Monday, December 17 Financial Analysis: Major Asset Acquisitions

This class will focus on the company's major asset acquisitions—specifically property, plant and equipment acquisition and disposal. We will also discuss depreciation methods, the role they play with respect to tax planning, and the problems of distinguishing between capitalization and expensing expenditures during the life of the long-lived assets. (Stice, chapter 12)

Additional Reading: Mulford & Comiskey, Chapter 7 (pages 201-233)

Ethical Dilemma: “Profit Manipulation During Labor Negotiations” - page 584

Business Memo: Dumping Costs Into a Landfill - page 583

Tuesday, December 18 Financial Analysis: The Borrowing Question

This class will focus on the company's liabilities and will consider the ability of a company to generate sufficient cash flow to repay any borrowing plus interest. Specific liability areas to be considered: pensions (Stice, Chapter 11); leases (Stice, Chapter 14); and bonds (Stice, Chapter 14).

Ethical Dilemma: “Hiding An Obligation by Calling It A Lease” - page 698

Wednesday, December 19 Financial Analysis: Stock can be both bought and sold

This class will focus on stock transactions, both from an investment opportunity (Stice, Chapter 13) and from a method of financing (Stice, Chapter 15). Equity items that bypass the income statement will also be discussed.

Ethical Dilemma: “Reclassifying Securities for Gain” - page 639

Thursday, December 20 Why Does Worldwide Accounting Diversity Cause Problems for Capital Market Participants?

This class will examine the significant changes in accounting standards worldwide and the convergence of US GAAP on International Accounting Standards. We will also consider the implications these changes have for both U.S. and international capital markets. (Stice, chapter 16)

Ethical Dilemma: “Fear of Reporting Under U.S. GAAP” - page 792