

ADVANCED FINANCIAL REPORTING AND ANALYSIS – BUS 610 –

Dr. Jan Barton
Goizueta Business School – Emory University
Spring 2006

Office: GBS 460
Office hours: 2:30–4:00 pm (except Fridays)
Class: GBS 201, TTh 10:00–11:15 am

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Course description and objectives

Despite extensive regulation, managers have much discretion in implementing measurement, recognition and disclosure rules when reporting their firms' performance. Managers can also reveal additional information voluntarily, leaving them to some extent free to make decisions about its quality and credibility. These choices emerge from the complex interactions that managers have with investors, regulators, auditors, analysts, competitors, etc. Why and how managers make all these choices and what effects their choices have are difficult questions to answer. The one thing we do know for sure is that information in corporate financial reports tends to be noisy and biased.

This course focuses on the analysis of managers' financial reporting and disclosure strategies, and the effects of such strategies on firms' equity values and contracts. We will examine various institutional settings and economic contexts in which managers make financial reporting and disclosure choices, paying close attention to the quality and credibility of the information disclosed. The course should help you continue developing hands-on financial statement analysis skills in a variety of business decision contexts. The course's specific objectives are:

1. **To increase your awareness of the role of financial reporting information in valuation and contracting.** Throughout the course, you will be exposed to theories and evidence of how information contained in financial statements and supplementary disclosures affects market values of corporate securities and contracts between the firm and its stakeholders.
2. **To build on the knowledge you gained from BUS 512, *Financial Accounting*, to evaluate the extent to which a firm's financial reports and disclosures capture its underlying business reality.** We will discuss and assess the degree of reporting flexibility available to managers, the incentives behind managers' accounting and disclosure choices, and the quality and impact of the information contained in the financial reports and disclosures.
3. **To practice the techniques learned in BUS 514, *Financial Statement Analysis*, for analyzing financial reports.** We will discuss and practice techniques for analyzing business strategies, financial reporting and disclosure policies, financial performance, forecasts and fundamental values.
4. **To continue exposing you to various decision contexts and “real-world” accounting data from firms in a variety of industries.** Through case studies, we will discuss specific decision contexts that you are likely to encounter in the business world. In each context, we will focus on the goal of the analysis, select the relevant analytic techniques, and apply them to the financial statements of U.S. or foreign companies in diverse industries, including in the not-for-profit sector.
5. **To provide you with additional opportunities to develop your communication and interpersonal skills.** You will discuss techniques and applications with other class participants, make managerial decisions independently and in teams, and communicate your decisions orally and in writing.

This syllabus describes a tentative plan to achieve the course's objectives. However, keep in mind that we may have to revise it during the semester to successfully meet the course's objectives.

Course requirements

The course will require probably 8–10 hours of class preparation each week. You should spend most of this time analyzing the issues raised in each case.

To help you achieve the objectives of the course, your grade will be based on:

| | |
|---|-----------|
| • Class participation | 40% |
| • Four case write-ups completed in groups | 40 |
| • <u>Two case write-up completed individually</u> | <u>20</u> |
| | 100% |

CLASS PARTICIPATION

Class participation (either during class time or on the course's FirstClass conference) is important because it enhances everyone's learning experience. You should strive to be a contributing and valuable member of the class. Feel free to ask questions about issues that you or your peers are unclear, contribute your ideas and insights, offer examples, challenge my and your peers' assumptions and analyses, and raise interesting directions for class discussion. The emphasis of your class participation should be on the quality of your contribution, not on the duration of your "air time." Your peers will evaluate the quality of your class participation; however, I retain the right to adjust final class participation grades.

CASE WRITEUPS

I will post specific instructions for each case writeup on the course's FirstClass conference approximately one week before its due date. The "group" case writeups should be completed in groups of no more than three students. Each group member will receive the same grade, so choose your group carefully to enhance productivity and skill transfer. All writeups are evaluated in terms of content, technical analysis and presentation. The latter includes grammar, coherence and brevity. Pages should be word-processed (11 or 12pt., 1.5" margins, no less than 1.5 spacing), stapled in the top left corner (i.e., no paper clips or covers), and numbered. *Documents turned in should not exceed page limits stated in the instructions.*

Miscellaneous matters

- Prerequisites: BUS 514 (Financial Statement Analysis).
- You are expected to attend and participate in all class sessions.
- Announcements, syllabus revisions and miscellaneous course materials will be posted to the class conference on FirstClass. You are responsible for accessing this information timely.
- I will accept late assignments at my discretion.
- You are expected to abide to the GBS Honor Code. I will report suspected violations of the Code to the Honor Council.
- The text required for the course is:

The Analysis and Use of Financial Statements, by White, Sondhi and Fried (Wiley, 2003, 3rd edition): ISBN 0–471–37594–2.

- I highly recommended these texts on financial statement analysis and valuation:

Financial Reporting and Statement Analysis: A Strategic Perspective, by Stickney, Brown and Wahlen (Thomson Southwestern, 2004, 5th edition): ISBN 0-324-18638-X.

Business Analysis & Valuation Using Financial Statements, by Palepu, Bernard and Healy (Southwestern, 2004, 3rd edition): ISBN 0-324-11984-5.

Financial Statement Analysis and Security Valuation, by Penman (McGraw-Hill Irwin, 2004, 2nd edition): ISBN 0-07-253317-X.

Equity Valuation and Analysis with eVal, by Lundholm and Sloan (McGraw-Hill, 2003): ISBN 0-07-282021-7.

Financial Reporting and Analysis, by Revsine, Collins and Johnson (Pearson Prentice Hall, 2005): ISBN 0-13-143021-1.

Valuation: Measuring and Managing the Value of Companies, by Koller, Goedhart and Wessels (Wiley, 2005): ISBN 0-471-70218-8.

Course Content

| Part | Class | Topic |
|--|--------------|---|
| 1. INTRODUCTION | | |
| | 1 | Introduction |
| 2. REVENUE AND EXPENSE RECOGNITION | | |
| | 2 | Revenue and expense recognition |
| | 3 | Complex issues in revenue recognition |
| | 4 | Recurring vs. nonrecurring items |
| 3. ASSETS | | |
| | 5 | Accounts receivable |
| | 6 | Inventories |
| | 9 | Investment property |
| | 10 | Long-lived fixed assets |
| | 11 | Intangible assets |
| 4. LIABILITIES AND EQUITY | | |
| | 12 | Deferred income taxes |
| | 13 | Pensions and other post-employment benefits |
| | 14 | Financing liabilities |
| | 15 | Leases |
| | 16 | Special purpose entities |
| | 17 | Financial distress and troubled debt restructuring. |
| | 18 | Shareholders' equity |
| | 22 | Financial derivatives and hedging |
| 5. INTERCOMPANY TRANSACTIONS | | |
| | 19 | Business combinations |
| | 20 | Equity-method investments |
| | 21 | Multinational operations |
| 6. NOT-FOR-PROFIT AND GOVERNMENTAL ENTITIES | | |
| | 23 | Not-for-profit organizations |
| | 24 | Governmental entities |

Detailed Class Schedule

| Class/date | Topic/Assignments |
|-------------------|--|
| 1—Tue. 1/31 | Introduction |
| Topics: | Course format, requirements and expectations. Framework for analyzing financial statements. |
| Readings: | WSF skim Chs. 1, 3, 4, 5, 17, 18 |
| 2—Thu. 2/12 | Revenue and expense recognition |
| Topics: | Revenue recognition and expense matching principles. Objectivity and conservatism in financial reporting. |
| Readings: | WSF Ch. 2 (pp. 28–52). |
| Case: | Homearnings Reverse Mortgage Group (A) (HBS No. 9–194–098). |
| 3—Tue. 2/7 | Complex issued in revenue recognition |
| Topics: | Revenue recognition rules under SEC Staff Accounting Bulletin No. 101. |
| Readings: | WSF Ch. 2 (pp. 28–52) |
| Case: | Boston Automation Systems, Inc. (HBS No. 9–103–041). |
| 4—Thu. 2/9 | Recurring vs. nonrecurring items |
| Topics: | Time-series properties of accounting numbers. Persistence vs. predictability. Valuation and contracting implications of recurring vs. nonrecurring earnings. |
| Readings: | WSF Ch. 2 (pp. 52–61). |
| Case: | Warnaco Group, Inc. (A) (HBS No. 9–101–068). |
| 5—Tue. 2/14 | Accounts receivable |
| Topics: | Accounts receivable. Allowance for uncollectible accounts. Transfers of receivables with and without recourse. Deferred revenue. Sales-type leases. |
| Readings: | WSF Ch. 11 (pp. 378–381). |
| Case: | Sensormatic Electronics Corporation – 1995 (HBS No. 9–197–041). |
| 6—Thu. 2/16 | Inventories |
| Topics: | Inventory definition, capitalization and valuation. |
| Readings: | WSF Ch. 6. |
| Case: | Kings Mountain Distillery, Inc. (HBS No. 9–197–042). |
| 7—Tue. 2/21 | No class |
| 8—Thu. 2/23 | No class |
| 9—Tue. 2/28 | Investment property |
| Topics: | Investments. Measurement bases. International Financial Reporting Standards. |
| Readings: | WSF Chs. 1 (pp.11–14), 2(pp. 61–65), 13(pp. 454–466). |
| Case: | Land Securities Group (A): Choosing cost or fair value on adoption of IFRS (HBS No. 9–105–014). |

Detailed Class Schedule (cont'd)

| Class/date | Topic/Assignments |
|-------------------|---|
| 10—Thu. 3/2 | Long-lived fixed assets |
| Topics: | Capitalization, depreciation and impairment of long-lived fixed assets. Regulatory accounting. Stranded costs. |
| Readings: | WSF Chs. 7, 8. |
| Case: | Atlantic Energy/Delmarva Power & Light (A) (HBS No. 9–298–034). |
| 11—Tue. 3/7 | Intangible assets |
| Topics: | Valuation and financial reporting of intangible assets. Brand equity. |
| Readings: | WSF Ch. 7 (pp. 235–240). |
| Case: | Habitat for Humanity International: Brand valuation (HBS No. 9–503–101). |
| 12—Thu. 3/9 | Deferred income taxes |
| Topics: | Financial reporting and analysis of deferred income tax assets, liabilities and expense. |
| Readings: | WSF Ch. 9. |
| Case: | Deferred taxes and the valuation allowance at Lucent Technologies, Inc. (A) (HBS No. 9–103–064). |
| Tue. 3/14 | No class—Spring break |
| Thu. 3/16 | No class—Spring break |
| 13—Tue. 3/21 | Pensions and other post-employment benefits |
| Topics: | Financial reporting and analysis of defined contribution and defined benefit pension plans. |
| Readings: | WSF Ch. 12. |
| Case: | General Motors U.S. pension funds (HBS No. 9–206–001). |
| 14—Thu. 3/23 | Financing liabilities |
| Topics: | Financial reporting and analysis of long-term debt. |
| Readings: | WSF Ch. 10 (pp. 322–347). |
| Case: | Kidder, Peabody & Co.: Creating elusive profits (HBS No. 9–197–038). |
| 15—Tue. 3/28 | Leases |
| Topics: | Financial reporting and analysis of operating, capital and synthetic leases. Off-balance-sheet financing. Special purpose entities. |
| Readings: | WSF Ch. 11. |
| Case: | Financing PPL Corporation's growth strategy (HBS No. 9–202–045). |
| 16—Thu. 3/30 | Special purpose entities |
| Topics: | Special purpose entities. Asset securitization. |
| Readings: | WSF 11. |
| Case: | Harley-Davidson, Inc. Motorcycle manufacturer or financing company? (HBS No. 9–105–027). |

Detailed Class Schedule (cont'd)

| Class/date | Topic/Assignments |
|-------------------|--|
| 17—Tue. 4/4 | Financial distress and troubled debt restructuring. Topics: Financial distress. Bankruptcy reorganization. Financial reporting of troubled debt. Fresh-start accounting. Readings: WSF Chs. 10 (pp. 347–355), 18. Case: Flagstar Companies, Inc. (HBS No. 9–299–038). |
| 18—Thu. 4/6 | Shareholders' equity Topics: Debt vs. equity. Shareholders' equity. Treasury stock. Stock dividends and splits. Convertible securities. Dirty surplus. Case: DoubleClick, Inc. (HBS No. 9–103–016). |
| 19—Tue. 4/11 | Business combinations Topics: Pooling vs. purchase accounting. Goodwill. Readings: WSF Ch. 14. Case: Keane's acquisition of Metro Information Services (A) (HBS No. 9–103–042). |
| 20—Thu. 4/13 | Equity-method investments Topics: Investment in equity securities. Partial consolidation. Readings: WSF Ch. 13 (pp. 466–484). Case: The Coca-Cola Company (A) (HBS No. 9–100–001). |
| 21—Tue. 4/18 | Multinational operations Topics: Foreign currency transactions and translations. Readings: WSF Chs. 13 (pp. 484–492), 15. Case: Farmington Industries, Inc.: Managing currency exposure risk (HBS No. 9–104–053). |
| 22—Thu. 4/20 | Financial derivatives and hedging Topics: Financial reporting and analysis of financial derivatives and hedging transactions. Market risk disclosures. International accounting standards. Readings: WSF Ch. 16. Case: The IAS 39 "carve out": How the European Union hedged its exposure to the international standard on derivatives and hedging (Stanford GSB No. A–191). |
| 23—Tue. 4/25 | Not-for-profit organizations Topics: Financial reporting and analysis of not-for-profit organizations. Case: Stanford University: Implementing FASB Statements 116 and 117 (Stanford GSB No. A–184). |
| 24—Thu. 4/27 | Governmental entities Topics: Financial reporting and analysis of governmental entities. Case: The City of New York (HBS No. 9–198–030). |