

	Course	AIM 6344 Financial Statement Analysis Sections 001
	Professor	Umit G. Gurun, Phd.
	Term	Spring 2015
	Time &Location	Section 001: Mon & Wed : 11:30am-12:45pm/ JSOM 11.206

Professor's Contact Information

Office Location	4.813
Email Address	Please use umit.gurun@utdallas.edu to reach me. I will not use Elearning email.
Office Hours	<p>Wednesday 9:30-11:15 or by appointment.</p> <p>I am available to discuss issues of concern to you on an individual basis either after class or in my office. Please email umit.gurun@utdallas.edu (do not use email in Elearning) to make an appointment for an office visit. So that I can be better prepared for your visit, please give me a general idea of the topic you'd like to discuss. I typically schedule 15 minute appointments; if you believe you will require more time, request a longer appointment. I'm happy to respond by email, but please keep the emails short. Long philosophical discussions and questions like "what do you think of issue X?" are best handled in person.</p>

General Course Information

Pre-requisites, Co-requisites, & other restrictions	<p>The quantitative aspects of the course will require only elementary computational skills; however a calculator and/or some spreadsheet knowledge will be required. I assume that you are familiar with basic finance/accounting concepts (such as definitions of debit/credit, balance sheet/income statement etc.) and have introduction level of accounting knowledge.</p>
Course Description, Objectives & Outcomes	<p>The purpose of this course is to provide students the opportunity to develop skills and understanding of the integration of strategy, accounting, economics and finance. This course provides you with a framework for business analysis and valuation using financial statement data, this framework applies to a variety of business decisions. You can develop the following <i>skills</i>:</p> <ol style="list-style-type: none"> (1) extract relevant information from financial statements and other disclosures to see the underlying business activities and strategy, (2) assess firm performance and risk, (3) assess managerial strategic motives in reporting financial information and ways to adjust for such motives, (4) forecast firm future performance, (5) value the firm or project. <p>The focus is on integrating key concepts from accounting, economics, finance, and strategy areas and applying them to financial decision-making. Skill development requires effort on your part.</p> <p>The course is useful for students planning for careers in investment or commercial banking, corporate management, venture capital, security analysis, credit analysis, consulting, or public accounting.</p> <p>This course uses a small amount of lecture based on readings and discussion/analysis of business cases. To master the skills offered by this course you must come to class fully prepared each day. For days involving lecture, you are expected to have read the required readings and given some thought to their content. The textbook is an excellent source. More importantly, you must contribute to your development – primarily through application with the cases. For days involving case discussion, you are expected to have fully prepared the case for discussion. Full preparation of the case means that you have read the case carefully, perhaps several times, and conducted the relevant financial analysis in detail. Further, you should be prepared to make a recommendation for the decision at hand and be able to support your recommendation with data and analysis. If you are unwilling to make a commitment to preparation/participation at a high level and consistently follow through on it throughout the entire semester, then DO NOT TAKE THIS CLASS. By the end of the course students should have answers to the following questions:</p> <ul style="list-style-type: none"> • How are fundamental values (or "intrinsic values") estimated? • How is "value created for shareholders" identified? • How does one pull apart the financial statements to get at the relevant information for valuing equities? • What is the relevance of cash-flows? Of earnings? Of book values? • How does profitability tie into valuation? • What is growth? How does one analyze growth? • How does one analyze the quality of financial reports? • How does one deal with the accounting methods used in financial statements?

Required Texts & Materials	"Financial Statement Analysis & Valuation" by Peter Easton, Mary Lea McAnally, Patricia Fairfield, Xiao-Jun Zhang, and Robert Halsey. 3rd edition (ISBN:978-1618530097)
Suggested Texts & Reading Materials	<p>For those of you asking additional resources:</p> <p>Penman, S., Financial Statement Analysis and Security Valuation, 2007</p> <p>Stickney C., Brown P, and J Wahlen. <i>Financial Reporting and Statement Analysis: A Strategic Perspective</i>, Dryden Press, 5th Edition, 2004.</p> <p>White G, Sondhi A and Fried D, <i>The Analysis and Use of Financial Statements</i>, Wiley, 3rd Edition, 2003.</p> <p>Benjamin Graham, <i>The Intelligent Investor</i>, 4th ed. (New York: Harper & Rowe, 1973)</p> <p>Benjamin Graham, David Dodd, and Sidney Cottle, <i>Security Analysis: Principles And Technique</i>, 4th ed. (New York: McGraw-Hill, 1962)</p> <p>Lawrence Cunningham, <i>The Essays of Warren Buffet: Lessons for Corporate America</i>, (Cardozo Law Review, New York, 1997)</p> <p>Burton Malkiel, <i>A Random Walk Down Wall Street</i>, 7th ed. (New York, Norton, 2000)</p> <p>Andrei Shleifer, <i>Inefficient Markets</i> (Oxford University Press, 2000)</p> <p>Robert Shiller, <i>Irrational Exuberance</i> (Princeton University Press, 2000)</p>
Other Material	Each week on Thursday, I will post a message to the discussion board on Elearning that outlines the following week's material and assignments. This document will include questions that we will focus on and other related material.

Course Policies

Grading (credit) Criteria	<p>Grade distribution:</p> <table data-bbox="354 1192 950 1281"> <tr> <td>Exam (37.5% each x 2)</td> <td>75 %</td> </tr> <tr> <td>Pop Quizzes (25/X % each)</td> <td>25 %</td> </tr> <tr> <td>Class Participation (bonus)</td> <td>5 %</td> </tr> </table> <p>Pop Quizzes: I will give several pop quizzes during the semester. The objective of these quizzes to ensure that you read the case and follow the class discussion. If I give X quizzes, each quiz will contribute 25/X% to your final grade.</p> <p>Exams: I will give 2 (two) exams –see course outline for the dates of these exams. The exams will contain multiple choice questions from materials that will be covered in class.</p> <p>Overall grading policy: Your grade will be determined by your rank in class after <u>all</u> grades are given.</p> <p>Participation: I am a strong advocate of students developing their ability to process and articulate their thoughts. To that end, I strongly encourage you to contribute to the class discussion. Quality is more important than quantity. Contribution means identifying issues, providing insights and solutions to problems, assisting classmates etc. Experience suggests that preparation often facilitates contribution! I will select people to contribute – demonstrating you are unprepared will negatively impact your contribution grade, similarly being absent without advance notice will as well. Supporting your position is more valuable than having a position! You don't have to agree with me, or any of your class mates, but you do have to support your opinions. Many of the concepts used in the class may not be new to you or they may be a different way to look at what you already know. The real value then is to apply what you know or learn in the class. The participation point is a bonus credit and will ONLY be given to a few individuals (maximum 5) in class.</p> <p>Preparation to class: I realize that many of you have competing interests for your time, accordingly occasional class absences are expected but I also expect to be notified of such absences in advance. Failure to do so may result in a lower grade.</p>	Exam (37.5% each x 2)	75 %	Pop Quizzes (25/X % each)	25 %	Class Participation (bonus)	5 %
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Class Participation (bonus)	5 %						
Make-up Exam, Pop Quizzes	There will be no makeups . Students with anticipated absences (such as a documented university sponsored event) should contact me one week prior to the absence. Pop quiz dates will not be announced. If you miss a pop quiz and						

& Case assignments submissions	believe that there is a good reason for the absence, you should bring documentation (such a doctor's report) to support your case.
Extra Credit	None – no exceptions.
Objections to Grades	I will try to release case/assignment grades within one week of exam/quiz. I will consider only the written objections to your grade within one week of grade release.
Rules Regarding Classroom	Electronics are allowed as long as usage of these electronics does not bother your friends or me. Please turn off your cell phones and please stay away from non-class material (social networking sites) during the lectures. Please try to be quiet if you come to classroom late/leave early.
Student Conduct and Discipline	<p>The University of Texas System and The University of Texas at Dallas have rules and regulations for the orderly and efficient conduct of their business. It is the responsibility of each student and each student organization to be knowledgeable about the rules and regulations which govern student conduct and activities. General information on student conduct and discipline is contained in the UTD publication, <i>A to Z Guide</i>, which is provided to all registered students each academic year.</p> <p>The University of Texas at Dallas administers student discipline within the procedures of recognized and established due process. Procedures are defined and described in the <i>Rules and Regulations, Board of Regents, The University of Texas System, Part 1, Chapter VI, Section 3</i>, and in Title V, Rules on Student Services and Activities of the university's <i>Handbook of Operating Procedures</i>. Copies of these rules and regulations are available to students in the Office of the Dean of Students, where staff members are available to assist students in interpreting the rules and regulations (SU 1.602, 972/883-6391).</p> <p>A student at the university neither loses the rights nor escapes the responsibilities of citizenship. He or she is expected to obey federal, state, and local laws as well as the Regents' Rules, university regulations, and administrative rules. Students are subject to discipline for violating the standards of conduct whether such conduct takes place on or off campus, or whether civil or criminal penalties are also imposed for such conduct.</p>
Academic Integrity	The faculty expects from its students a high level of responsibility and academic honesty. Because the value of an academic degree depends upon the absolute integrity of the work done by the student for that degree, it is imperative that a student demonstrates a high standard of individual honor in his or her scholastic work. Scholastic dishonesty includes, but is not limited to, statements, acts or omissions related to applications for enrollment or the award of a degree, and/or the submission as one's own work or material that is not one's own. As a general rule, scholastic dishonesty involves one of the following acts: cheating, plagiarism, collusion and/or falsifying academic records. Students suspected of academic dishonesty are subject to disciplinary proceedings. Plagiarism, especially from the web, from portions of papers for other classes, and from any other source is unacceptable and will be dealt with under the university's policy on plagiarism (see general catalog for details). This course will use the resources of turnitin.com, which searches the web for possible plagiarism and is over 90% effective.
Email Use	The University of Texas at Dallas recognizes the value and efficiency of communication between faculty/staff and students through electronic mail. At the same time, email raises some issues concerning security and the identity of each individual in an email exchange. The university encourages all official student email correspondence be sent only to a student's U.T. Dallas email address and that faculty and staff consider email from students official only if it originates from a UTD student account. This allows the university to maintain a high degree of confidence in the identity of all individual corresponding and the security of the transmitted information. UTD furnishes each student with a free email account that is to be used in all communication with university personnel. The Department of Information Resources at U.T. Dallas provides a method for students to have their U.T. Dallas mail forwarded to other accounts.
Withdrawal from Class	The administration of this institution has set deadlines for withdrawal of any college-level courses. These dates and times are published in that semester's course catalog. Administration procedures must be followed. It is the student's responsibility to handle withdrawal requirements from any class. In other words, I cannot drop or withdraw any student. You must do the proper paperwork to ensure that you will not receive a final grade of "F" in a course if you choose not to attend the class once you are enrolled.
Student Grievance Procedures	<p>Procedures for student grievances are found in Title V, Rules on Student Services and Activities, of the university's <i>Handbook of Operating Procedures</i>.</p> <p>In attempting to resolve any student grievance regarding grades, evaluations, or other fulfillments of academic responsibility, it is the obligation of the student first to make a serious effort to resolve the matter with the instructor, supervisor, administrator, or committee with whom the grievance originates (hereafter called "the respondent"). Individual faculty members retain primary responsibility for assigning grades and evaluations. If the matter cannot be resolved at that level, the grievance must be submitted in writing to the respondent with a copy of the respondent's School Dean. If the matter is not resolved by the written response provided by the respondent, the student may submit a written appeal to the School Dean. If the grievance is not resolved by the School Dean's decision, the student may make a written appeal to the Dean of Graduate or Undergraduate Education, and the dean will appoint and convene an Academic Appeals Panel. The decision of the Academic Appeals Panel is final. The results of the academic appeals process will be distributed to all involved parties.</p> <p>Copies of these rules and regulations are available to students in the Office of the Dean of Students, where staff members are available to assist students in interpreting the rules and regulations.</p>
Incomplete Grades	As per university policy, incomplete grades will be granted only for work unavoidably missed at the semester's end and only if 70% of the course work has been completed. An incomplete grade must be resolved within eight (8) weeks from the first day of the subsequent long semester. If the required work to complete the course and to remove

	<p>the incomplete grade is not submitted by the specified deadline, the incomplete grade is changed automatically to a grade of F.</p>
<p>Disability Services</p>	<p>The goal of Disability Services is to provide students with disabilities educational opportunities equal to those of their non-disabled peers. Disability Services is located in room 1.610 in the Student Union. Office hours are Monday and Thursday, 8:30 a.m. to 6:30 p.m.; Tuesday and Wednesday, 8:30 a.m. to 7:30 p.m.; and Friday, 8:30 a.m. to 5:30 p.m.</p> <p>The contact information for the Office of Disability Services is: The University of Texas at Dallas, SU 22 PO Box 830688 Richardson, Texas 75083-0688 (972) 883-2098 (voice or TTY)</p> <p>Essentially, the law requires that colleges and universities make those reasonable adjustments necessary to eliminate discrimination on the basis of disability. For example, it may be necessary to remove classroom prohibitions against tape recorders or animals (in the case of dog guides) for students who are blind. Occasionally an assignment requirement may be substituted (for example, a research paper versus an oral presentation for a student who is hearing impaired). Classes enrolled students with mobility impairments may have to be rescheduled in accessible facilities. The college or university may need to provide special services such as registration, note-taking, or mobility assistance. It is the student's responsibility to notify his or her professors of the need for such an accommodation. Disability Services provides students with letters to present to faculty members to verify that the student has a disability and needs accommodations. Individuals requiring special accommodation should contact the professor after class or during office hours.</p>
<p>Religious Holy Days</p>	<p>The University of Texas at Dallas will excuse a student from class or other required activities for the travel to and observance of a religious holy day for a religion whose places of worship are exempt from property tax under Section 11.20, Tax Code, Texas Code Annotated. The student is encouraged to notify the instructor or activity sponsor as soon as possible regarding the absence, preferably in advance of the assignment. The student, so excused, will be allowed to take the exam or complete the assignment within a reasonable time after the absence: a period equal to the length of the absence, up to a maximum of one week. A student who notifies the instructor and completes any missed exam or assignment may not be penalized for the absence. A student who fails to complete the exam or assignment within the prescribed period may receive a failing grade for that exam or assignment. If a student or an instructor disagrees about the nature of the absence [i.e., for the purpose of observing a religious holy day] or if there is similar disagreement about whether the student has been given a reasonable time to complete any missed assignments or examinations, either the student or the instructor may request a ruling from the chief executive officer of the institution, or his or her designee. The chief executive officer or designee must take into account the legislative intent of TEC 51.911(b), and the student and instructor will abide by the decision of the chief executive officer or designee.</p>
<p>Off-Campus Instruction and Course Activities</p>	<p>Off-campus, out-of-state, and foreign instruction and activities are subject to state law and University policies and procedures regarding travel and risk-related activities. Information regarding these rules and regulations may be found at http://www.utdallas.edu/BusinessAffairs/Travel_Risk_Activities.htm. Additional information is available from the office of the school dean.</p>

Course Outline:

Below outline is tentative. Any change to course outline will be announced in class and/or Elearning. An updated version of the course outline will be put on Elearning if any change occurs.

These descriptions and timelines are subject to change at the discretion of the Professor.

Please note the exam dates are March 9 and April 29.

Week	Monday	Wednesday	Material
0	12-Jan	14-Jan	Module 0: Course details, overview
1	No class- MLK Day	21-Jan	Module 1:Framework for Analysis and Valuation
2	26-Jan	28-Jan	Module 2: Overview of Business Activities
3	2-Feb	4-Feb	Module 3:Profitability Analysis and Interpretation
4	9-Feb	11-Feb	Module 4:Credit Risk Analysis and Interpretation
5	16-Feb	18-Feb	Module 5:Revenue Recognition and Operating Income
6	23-Feb	25-Feb	Module 6:Asset Recognition and Operating Assets
7	2-Mar	4-Mar	Module 7:Liability Recognition and Non-owner Financing
8	9-Mar	11-Mar	Exam 1 (on Monday)/ Module 8 (on Wednesday)
9	23-Mar	25-Mar	Module 8:Equity Recognition and Owner Financing
10	30-Mar	1-Apr	Module 9:Inter-corporate Entities
11	6-Apr	8-Apr	Module 10:Off- Balance Sheet Financing
12	13-Apr	15-Apr	Module 11/12:Forecasting Financial Statements
13	20-Apr	22-Apr	Module 13:Cash Flow Based Valuation
14	27-Apr	29-Apr	Module 14/15:Operating Income Based Valuation
15	4-May	6-May	Module 15 and Review
16	27-Apr	29-Apr	Exam 2 (on Wednesday)

Accounting Magic Using Generally Accepted Accounting Principles

	<u>Company A</u>	<u>Adjustments</u>	<u>Company B</u>
Sales Revenue ^a	25,000	1,000	26,000
Other income:			
Equity/Cost Method Affiliates ^b	<u>1,500</u>	<u>(250)</u>	<u>1,250</u>
Total Revenues	<u>26,500</u>	<u>750</u>	<u>27,250</u>
Costs and Expenses:			
Cost of Goods sold	15,000		15,000
SG&A	3,550		3,550
LIFO Effect ^c	900	(900)	
Depreciation ^d	1,000	(400)	600
Amortization Expense ^e	400	(250)	150
Exploration Costs ^f	1,200	(550)	650
Pension Costs ^g	750	(200)	550
Other Post-employment costs ^h	300	(200)	100
Asset Impairments ⁱ	300	(300)	
Compensation:			
Base Salaries	400		400
Bonuses ^j	<u>200</u>	<u>(200)</u>	
Total Costs/Expenses	<u>24,000</u>	<u>(3,000)</u>	<u>21,000</u>
Pretax Income	2,500		6,250
Tax Expense ^k	525		1,837.5
Net Income	1,975		4,412.5
Per share on 1000 shares	<u>1.975</u>		<u>4.4125</u>

^a Revenue Recognition Methods

Firms have considerable latitude concerning when they recognize revenue. For example, variations can occur because of differences in estimates of the degree and cost of completion in long-term construction contracts where the percentage-of-completion method is used, in revenue recognition of installment sales, and in the use of sales-type or direct-financing leases where operating leases should be used by the lessor. The impact of different revenue recognition is \$1,000 more in income recognized by company B. We assume this amount has not yet been received in cash; however, deferred taxes must be reported.

^b Equity/Cost Method Affiliates

Company A owns 20% or more of the voting common stock in another company. Its proportionate share of the earnings of this investment, \$1500, is reported as a component of other income. It is assumed that Company A has received dividends of \$1250 from the investment. Company B owns less than the 20% threshold and cannot use the equity method. Under the cost method, it reports as other income, the \$1250 received as dividends, but it does not report the additional \$250 that would have been recorded under the equity method. This is the one instance where Company A or B are slightly different. It is included because it's an important difference between companies.

The investment in other companies also affects taxes. Eighty percent of dividends received from other corporations are tax-exempt. Thus, Company A recognizes a tax expense and liability for 20% of the \$1250 received in dividends. Assuming a 35% corporate tax rate the tax liability is \$87.50 or $[0.20 \times \$1250 \times 0.35]$. Company B recognizes the same tax expense and liability on the \$1250 received as dividends. However, deferred taxes must be recorded on the additional \$250 recorded by Company A. Company A may assume that it will receive this amount as dividends or capital gains in the future. We use the latter because it is more conservative. Company A records an additional tax expense and deferred taxes payable.

Since for corporations that tax is payable on the full amount of the capital gain, the tax is \$87.50 or $[0.35 \times 250]$.

Note: Companies may assume either indefinite reinvestment of undistributed earnings [\$250 in this case] or that these earnings will be received in a tax-free liquidation. Both assumptions would allow the company to record the \$250 as income without any tax impact. This election is available only for companies with more than a 50% ownership share.

^c LIFO Effect

Company A uses the LIFO inventory valuation method and Company B uses FIFO. In periods of increasing prices and stable or increasing inventories, LIFO firms will report higher cost of goods sold. The difference between FIFO and LIFO Cost of Goods Sold is the LIFO effect, \$900 in this case.

^d Depreciation

Company A uses accelerated depreciation methods with shorter lives, whereas Company B uses straight-line depreciation with longer lives.

^e Amortization Expense

Company B amortizes goodwill, patents, and copyrights over the maximum periods allowed, whereas Company A uses shorter lives.

^f Exploration Costs

Company B capitalizes all exploration costs, whereas Company A expenses dry-hole costs.

^g Pension costs

The difference in pension costs, \$200 lower for Company B, is due to difference in assumptions of discount rates, assumed rates of return on assets, and different allocation to expense of the difference between actual results and actuarial assumptions.

^h Other Post-employment Contracts

Costs of health-care and life insurance benefits promised to employees are recognized as incurred by Company B. Current accounting does not require accrual of these costs (as in pensions). However, Company A has recorded current costs and accrued future costs. The values we used may understate the true differences, because studies have reported accrued amounts of as much as 20-30 times the periodic cost.

^i Asset Impairments

Accounting guidelines for the timing and measurement of impairments (loss in value) to long-lived assets are at best vague and inconsistently applied. Firms also have considerable discretion with respect to reporting impairments to the carrying values or receivables, marketable securities, and investments in affiliates. Here, Company A has recognized loss due to impairment, whereas Company B has not yet done so.

^j Compensation

Company B uses stock options for bonuses, whereas Company A pays them in cash.

^k Tax

For both companies that tax is the tax on the difference between sales revenue and total costs plus the tax on other income. Assuming a 35% corporate tax rate for Company A is $0.35 (25,000 - 24,000) + 87.50 + 87.50 = \525 the tax for Company B is $0.35 (26,000 - 21,000) + 87.50$