



ACCT-451 Financial Reporting and Analysis

Spring 2009 Syllabus (**SUBJECT TO CHANGE**)

Section 71: Monday 6:00 to 9:00 PM, Downtown Campus

Section 61: Tuesday and Friday 10:30 am to 12:00 pm, Evanston

Section 62: Tuesday and Friday 1:30 pm to 3:00 pm, Evanston

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Office Hours: Wednesday 3:00 to 4:00 PM, Jacobs 6223, or by appointment

Teaching assistant: Rafael Rogo, r-rogo@kellogg.northwestern.edu

Course Overview:

This course covers current practices in corporate financial reporting and fundamental issues relating to asset valuation and income determination. The emphasis is on financial statement analysis and interpretation of financial disclosures to help improve risk assessment, forecasting, and decision-making.

This is not a course about the details of GAAP, or the myriad of arcane accounting rules and procedures that comprise GAAP. The main focus is developing a set of powerful analytical tools to understand the environment in which financial reporting choices are made, what the options are, how financial data are used for various types of decisions, and how to avoid misusing financial statements. The course should be of interest not only to those responsible for preparing financial statements, but also those who will use financial statements for making decisions, including lenders, equity analysts, investment bankers, boards of directors, and others charged with monitoring or advising on corporate performance and the behavior of management.

The course utilizes a combination of lectures, case discussions and analyses, numerical exercises, and independent reading. The cases used in the course will provide an opportunity to integrate the abstract tools learned and apply them in a practical context.

Course Materials:

The cases and other course materials such as lecture slides, assignments, and selected readings are collected in a course packet that is available for purchase from the bookstore.

The required textbook for the course is “Financial Reporting and Analysis”, by Revsine, Collins, Johnson and Mittelstaedt (4rd Edition, McGraw-Hill Irwin, 2008) (referred to as “RCJM” throughout the syllabus).

Course Website:

The course syllabus and other materials, including lecture slides, class handouts, assignments and suggested solutions where available, will be placed on the course website (<http://courses.northwestern.edu>). The schedule shown on the course website will serve as the master document, and I expect you to check it every day for updates and revisions. Note that all materials on the course website are for your personal use only and may not be distributed without my prior permission.

Grading:

Course grades will be determined as follows:

		<u>Due in Week</u>
Class participation	5%	1 to 10
Flexible individual turn-in homework assignments (5 x1%)	5%	1 to 10
Inflexible Individual homework assignments (2 x 5%)	10%	3, 5
Case analyses (group) (2 cases x 10%)	20%	4, 8
Group project (group)	10%	9
Midterm exam (in-class, closed book)	25%	6
Final exam (in-class, closed book)	25%	11

Grades are designated A, B, C, D and F. An interpretation of these grades is given below:

- A: Outstanding performance in terms of the class and the standards set for the course.
- B: Commendable performance, short of the superior achievement of those given the grade of A.
- C: Competent but undistinguished performance in the attainment of course standards.
- D: Achievement acceptable for grade and credit without repeating the course. This passing grade is sufficiently below average, however, so that if consistently found in the record of a student, overall academic objectives and school standards are not being met.
- F: Failure to meet even minimum standards for the course.

All written assignments are due at or before the beginning of class on the due date.

Class participation

Class participation is an important part of the learning process, and I expect all students to participate in class discussions on a regular basis. In-class discussion of homework exercises and of cases will provide ample opportunities for all students to score highly on this component.

Flexible turn-in homework assignments

You are required to submit 5 problem sets from the 9 problem sets listed under the “Additional Practice Problems (from RCJM) in tab 4 (page 43) of the course packet. You must submit the homework within a week from the completion of topic in class. Grading will be based on the effort. You are free to discuss the

assignments with other students in the class, but you must individually submit your solutions. All assignments are due in hard copy form.

Inflexible Individual homework assignments

There will be two assignments that are required to be completed individually. You are free to discuss the assignments with other students in the class, but you must individually submit your solutions by the beginning of class on the due date. Late submission will count as zero for the purpose of calculating grades. All assignments are due in hard copy form at the beginning of class on the due date.

Cases analyses

There will be two group assignments consisting of case analyses, each of which will count for 10% of the overall course grade.

The case analyses are to be completed in groups. During our first class session, I will ask you to form study groups. Study groups may have 4 to 5 members. You are free to change groups throughout the quarter. For each case, your analysis should be centered on the question(s) asked in the assignment, and you must submit your report in hard copy form on the due date by the beginning of the class for which the case is scheduled. Late submission will result in a zero for course grade for all the group members involved.

Generally, I will expect the write-ups to identify and analyze the major problems and issues in the case as well as your specific plan(s) of action for dealing with those problems and issues, presenting carefully and logically the reasons for the proposed course of action. You should also provide numerical support and provide exhibits where appropriate. The suggested length for each write-up is between four and six pages of single-spaced text. Any reasonable number of exhibits may be attached to the write-up.

The case write-ups must be the original work of only the students in that group. By placing a student's name on the case write-up, your team is asserting that the listed team member made a substantial contribution. If a team member is unable to participate substantially in a case, his/her name should not appear as an author of the case write-up. Credit will not be awarded to students whose names are not listed in the case write-up. In addition, if you complete a case, each group member should turn in a Group Project Evaluation Form, providing an evaluation of other team members' contribution to completing the assignment. The form is included in the course packet and is also available online on the course website. The form is also due at the beginning of the class for which the case is scheduled.

You may not use any materials containing solutions or partial solutions to the case. This includes solutions prepared by current and former students at Kellogg or elsewhere. You may discuss the case only with members of your team prior to handing in the case write-up. You may not discuss case assignments with individuals who are not members of your group. Regardless of which groups members prepare the case, all students must come to class prepared to discuss the case.

Group project

The group project is also to be completed in groups. Each group will select two companies operating in similar industries and will email me the names of the two companies for my approval by week 5. Your task will be to gather, as a minimum, financial statements from the companies' most recent 10-K filings. You may supplement these with additional data from any public sources if they help you generate further insights. After analyzing these financial reports in depth, each group should be able to answer the following questions: (1) What business strategies are being pursued by each company? (2) What are the key accounting policies and estimates for each company, given their industry and business strategies? (3) Do the financial statements reflect the underlying economic reality? The assignment sheets (see Tab 11 of the course packet) will provide guidance as to the structure of the written report.

Each group will submit a written report of their findings, not to exceed six pages of single-spaced text (not including exhibits). As with the case analyses, each group member is required to submit a Group Project Peer Evaluation Form when the group turns in the written report, and late submission will result in a zero for course grade for all the group members involved.

In addition to the written report, each group will also make a presentation of their main findings and conclusions to the rest of the class. During week 9, one class session will be set aside for these presentations. You may use transparencies or other media. Each presentation will last between 5 and 10 minutes, and will be followed by another 5 minutes of questioning by the other students in the class. Students will be graded both on the quality of presentations made as well as the quality of pertinent questions asked. I will ask each student to rank the other groups' presentations on that day, and the rankings will be taken into account when determining the grade achieved by each group.

Midterm and final exams

The midterm and final exams are closed-book and are paper-based. They will be objective tests consisting of problems, short answer questions, and possibly multiple-choice and true-false questions. You may bring a non-programmable calculator and a one-page letter-sized "crib sheet" (double-sided). You may not give or receive any assistance from fellow students or any other source during the exams. Laptop computers and other data storage devices are not permitted to be used in the examination.

Copies of past exams and answer keys will be posted on the website for your practice.

All students must take the midterm and final exams at the scheduled times. In case of the Final exam alone the student affairs office will offer a schedule for early exams and I will participate in this system. All students are free to take this early exam unless not permitted by the student affairs office. Beyond this flexibility exceptions will not be made unless there are situations outside your control, such as medical or family emergencies, which cause you to miss the exam. Recruiting related conflicts are generally not considered to situations outside your control. Make-up exams will be offered at a time chosen by me. Regardless of when you take the exam, you may not discuss the exam with any other individual before the graded exams are returned. Even casual statements, such as "It was easy" or "It was hard" are not permitted.

For any graded item, you may request a re-grade within one week of receiving the graded item back. The request must be made in writing, it must be signed and dated, and you should point out the items that you would like me to consider. Note that your request is for a re-grading of the entire item, not just for the parts you highlight. Once the one week period is up, I will re-grade the item and return it. I reserve the right to re-evaluate your grade on the entire exam or assignment if you request a re-grade.

Weekly Preparation for Class:

The material to be prepared each week is detailed in the course sessions outline on pages 6 to 12. In addition to the required readings and graded assignments, you will also need to work on short numerical exercises for class discussion. These exercises are intended to illustrate a specific topic covered in the lectures, and will draw heavily from course lectures. You should familiarize yourself with the exercises assigned for each class day before coming to class, and you should prepare either a written sketch of a solution or a written account of the difficulties that prevented you from reaching a solution. I will not collect or grade answers to in-class exercises, however, I will usually cold call a student to discuss the content of his or her analysis of an exercise.

Kellogg Honor Code:

http://www.kellogg.northwestern.edu/stu_aff/policies/honorcode.htm

The student experience at Kellogg is unique because, among other reasons, students trust that their classmates will behave with honesty, integrity, and respect in all academic, professional, and social matters. Adherence to the Kellogg Honor Code plays a key role in engendering this trust. The Honor Code requires that a student not seek an unfair advantage over other students, for example, by not giving or receiving unauthorized aid during completion of academic requirements, by truthfully representing fact and self at all times, and by respecting the property and personal rights of all members of the Kellogg community. Students' willingness to abide by this Code allows faculty and students to interact with a minimum of rules, regulations, and bureaucracy, which in turn allows us to focus on creating an engaging and challenging academic environment. For each formal course requirement, I will try to be clear about my expectations and standards. If you have questions about what falls within the bounds of honorable behavior, please ask.

Kellogg Code of Classroom Etiquette; Use of Laptops, Cell Phones, and Blackberries

http://www.kellogg.northwestern.edu/stu_aff/policies/etiquette.htm

Kellogg's Code of Classroom Etiquette governs appropriate classroom behavior for the course. In particular, I expect students to be punctual arriving for class, to notify me in advance if you are going to miss a class, and not to engage in disruptive eating during class.

Laptops can be used during class time only for course-related activities, such as note-taking or working out numerical problems. Under no circumstances are students to surf the web, check e-mail, or engage in IM'ing during class time. Such disruptive activities may lead to a revision of laptop usage policy at any point during the course.

The use of cell phones or blackberries is not allowed in class. Please switch off or put on silent mode, and put them away before the start of class.

If you choose to violate any of these rules, your participation and engagement grade will suffer, and you may be asked to withdraw from the class.

Office Hours:

I will hold office hours from 3:00 to 4:00pm every Wednesday. You may also e-mail me if you have questions. I will either e-mail back or set up a telephone call depending on the complexity of the answer.

Teaching Assistant:

The teaching assistant for the course is Rafael Rogo. His email address is r-rogo@kellogg.northwestern.edu and his office is in 6217 Jacobs. You can email Rafael with your questions or arrange to meet with him if you need help with respect to any lectures, assignments, or practice problems.

CLASS SESSIONS (subject to revision)

Advance preparation: It is highly recommended that you review some introductory accounting materials, particularly for those who have not taken accounting classes recently. The following are some good review materials:

RCJM, pages 86-97 (Appendix to Chapter 2, Review of Accounting Procedures and T-Account Analysis)

RCJM, pages 199-207 (Cash Flows Versus Accrual Earnings)

Evanston Snack Shop including solution (tab 2 in course packet)

Week 1 (week beginning March 30, 2009):

Session #1: Introduction to Financial Reporting and Analysis

- Course objectives – What is this course about? Is this the right class to take right now? What are the expectations?
- Analytical framework – What is financial analysis? What analytical tools can we use? What are some important challenges when analyzing financial statements?
- Using financial ratios

Lecture: Topic 1 (tab 13 in course packet); Financial ratios (tab 3)

Read: RCJM Chapter 5 pages 235-238 and pages 248-271

[RCJM page numbers refer to the 4th Edition of “Financial Reporting and Analysis”, by Revsine, Collins, Johnson and Mittelstaedt (McGraw-Hill Irwin, 2008)]

Session #2: Organization of Information in Financial Statements

- Articulation of financial statements – How does information flow among financial statements?
- Income Statement Geography – Where do revenues, expenses, and other changes in value appear in the financial statements? Does it matter? What is the effect of changes in accounting principles?
- Sustainable Earnings: Which portions of earnings are recurring vs. nonrecurring? Operating vs. non-operating? Continuing vs. discontinued?

Lecture: Topic 2 (tab 14)

Read: RCJM Chapter 2, pages 65-85

Week 2 (week beginning April 6, 2009):

Session #3: Organization of Information in Financial Statements (continued)

- What is the effect of discontinuing operations?
- Cash Flow Statement – How is it laid out? How is it related to the income statement and to the balance sheet?
- Analysis of Cash Flows – What measures are informative? Assessing cash availability.
- Comprehensive Income – What is it? How does it affect earnings and equity?

Lecture: Topic 2 (tab 14)

Read: RCJM Chapter 4 pages 196-207; RCJ Chapter 17

In-class exercises: (1) Forecasting sustainable earnings – Tektronix Inc. (tab 15); (2) Northwest Airlines (topic 2, slides 20 to 23)

Session #4: Revenue Recognition

- When is revenue recognized?
- What amounts are recorded as revenues?

Lecture: Topic 3 (tab 16)

Read: RCJM Chapter 2 pages 57-64; RCJM Chapter 3

Week 3 (week beginning April 13, 2008):

Session #5: Revenue Recognition (continued)

- What are the various forms of sales growth?
- How can one distinguish between internally-generated growth, growth from acquisitions, and what are some techniques firms use to boost reported sales in the short term?

Submit: Individual Assignment 1 – Sara Lee Corporation (tab 5)

Lecture: Topic 3 (tab 16)

In-class exercises: (1) RCJM Case C3-1 (Smith’s Farm: Alternative bases of income determination); (2) Telxon (topic 3, slides 17 and 18); (3) Revenue Recognition for Pharmaceuticals Product Sales – aaiPharma Ind. (tab 17)

Session #6: Revenue Recognition (conclusion)

- What are the various forms of sales growth?
- How can one distinguish between internally-generated growth, growth from acquisitions, and what are some techniques firms use to boost reported sales in the short term?

Lecture: Topic 3 (tab 16)

Week 4 (week beginning April 20, 2009):

Session #7: Receivables

- Assessing the quality of receivables
- Channel stuffing – what is it? What are some financial reporting motives for channel stuffing? How to detect?
- Receivables securitizations and effect on key ratios – what are securitizations? How can they be used to misrepresent financial performance?

Lecture: Topic 4 (tab 18)

Read: RCJM Chapter 8 (skip “Imputing interest on trade notes receivable”, pages 421-425, and “Troubled debt restructuring”, pages 436-444)

Read (optional): New York Times articles: (1) Bristol-Myers Under Inquiry on Incentives for Drug Sales, (2) 2 Former Executives at Bristol-Myers Are Sued by S.E.C.

Session #8: Assessing credit risk – Amazon.com case

Submit: Group write-up for Amazon case (tab 7), individual Peer Evaluation Forms (tab 8)

In-class exercise (on receivables): Estimating stuffed sales at Bristol-Myers (topic 4, slides 19 to 21); Evaluating securitizations at Spiegel (Tab 19)

In-class discussion: Amazon.com in the Year 2000

Week 5 (week beginning April 27, 2009):

Session #9: Inventories

- Effect of inventory cost flow assumptions on gross margins
- How to identify potential distortions due to choices of inventory cost flow assumptions and how to adjust for them (in particular, converting LIFO COGS and LIFO inventories to their FIFO equivalent)

Submit: Individual assignment 2 – Flextronics International Ltd. (tab 6)

Submit: Names of two companies selected for group project

Lecture: Topic 5 (tab 20)

Read: RCJM Chapter 9 pages 476-507; Chapter 9 Appendix A (Eliminating realized holding gains from FIFO income) (pages 509-511)

Session #10: Inventories (continued)

In-class exercise: RCJM Case C9-5 (Weldotron Corporation: Strategic choice of accounting methods)

Midterm review

Week 6 (week beginning May 4, 2008):

Session #11: Midterm Examination (In-class)

Session #12: Long-Lived Assets

- Rules for intangible asset recognition – research and development, software development costs
- Capitalization of interest expenses
- Extracting value of off-balance sheet intangibles using securitizations – the Sears case

Lecture: Topic 6 (tab 21)

Read: RCJM Chapter 10 (skip “Exchanges of nonmonetary assets, pages 577-580)

In-class exercises: (1) RCJM Problems P10-8 (Determining asset impairment); (2) P10-12 (Capitalizing interest)

Week 7 (week beginning May 11, 2009):

Session #13: Income Tax Reporting

- Differences between GAAP and IRS rules when calculating profits – what are permanent and temporary differences and how are they accounted for in GAAP financial statements?
- Using tax disclosures by firms to make inferences about:
 - future earnings prospects
 - quality of earnings (aggressive or conservative income recognition in GAAP statements)
 - tax planning strategies

Lecture: Topic 7 (tab 22)

Read: RCJM Chapter 13

Session #14: Income Tax Reporting (continued)

In-class exercise: (1) Reconciling statutory and effective tax rates – Topic 7, Slide 18; (2) Analysis of Tax Footnotes – Topic 7, Slides 26 to 29; (3) (time permitting) Staples versus Office Depot (tab 24)

Week 8 (week beginning May 18, 2009):

Session #15: Assessing Reporting Quality – Sunbeam Corporation

Submit: Group write-up for Sunbeam case (tab 9), individual Peer Evaluation Forms (tab 10)

In-class discussion: Sunbeam Corporation

Short video clip on Sunbeam and Dunlap's tenure as CEO

Session #16: Leases

- Why do firms prefer reporting operating or capital leases?
- How does treatment of leases affect key ratios and how to undo any distortion?

Lecture: Topic 8 (tab 23)

Read: RCJM Chapter 12 pages 681-698; Chapter 12 Appendix "Making Balance Sheet Data Comparable by Adjusting for Off-Balance Sheet Leases" (pages 714-720)

In-class exercise: Capitalization of Leases – Office Depot Inc. and Staples Inc. (Available on Blackboard)

Week 9 (week beginning May 26, 2009): (Memorial Day make-up class is on Friday May 29)

Session #17: Group presentations of projects

Submit: Group write-up for project (tab 11), individual Peer Evaluation Forms (tab 12)

Session #18: Equity Affiliates

- Incentives for keeping affiliates off-balance sheet
- Effects on key ratios

Lecture: Topic 9 (tab 25)

Read: RCJM Chapter 16 pages 945-950

In-class exercises: (1) Coca-Cola Company (topic 9, slides 10-21); (2) RCJM Case C16-5 (Air Products: Joint ventures and off-balance sheet effects)

Week 10 (week beginning June 1, 2009):

Session #19: Wrap-up – Overall Framework for Analyzing Financial Reports

Lecture: Wrap-up (tab 26)

Session #20: Final Exam Review

Teacher and Course Evaluations to be completed at beginning of class

Scheduled FINAL EXAMINATION – week beginning June 8, 2009:

Section 81: Monday, June 8, 6:00 – 7:30 pm

Sections 61 and 62: To be announced