

Accounting 327 – Fall 2011
Financial Statement Analysis

Professor	Michael Clement
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Office Hours	Monday and Wednesday 1:00 – 3:00 and by appointment
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Course Web Page	via Blackboard
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Course Objectives

- To learn a framework for making business decisions using financial statement information
- To practice applying the framework, primarily from the perspective of an equity investor
- To practice communicating our decisions using written and oral communication skills

We will review some accounting concepts, but the primary objective of the course is **NOT** to improve your understanding of Generally Accepted Accounting Principles (GAAP). Instead the goal is to improve your ability to manipulate and interpret financial statements.

Materials

Required text:

- *Financial Statement Analysis* (McGraw-Hill custom text ISBN 97811121260627) available at the University Co-Op
- Course reader: supplemental readings packet available at the GSB Copy Center

Optional texts:

- *Business Analysis & Valuation Using Financial Statements 4e*, by Palepu and Healy (Thomson-Southwestern)
- Regular readings of *The Wall Street Journal*, *Forbes*, *Business Week*, *Fortune*, etc.

Course Requirements and Grading

Your grade in the course will be determined as follows:

exams	50%
stock pitch	25%
homework	15%
class participation	10%
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	100%
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The historical distribution of grades has been *roughly* as follows: 35% As, 60% Bs, 5% below B. Plus/Minus grading applies to this course.

Description of Requirements

Exams

There will be two **outside-of-class exams**. Each exam will be worth 25% of your course grade. The first exam is tentatively scheduled for **Tuesday, October 11, 2011** from **7:00-9:00 pm** and will cover material from class sessions 1-12. The second exam is tentatively scheduled for **Monday, November 14, 2011** from **7:00-9:00 pm** and will cover material from class sessions 15-22. Please notify me immediately if you have a conflict with either of these dates.

Stock Pitch

Each student will be part of a 3-4 person team that is responsible for analyzing two stocks in the same industry. Each team will write a report and make a short “stock pitch” presentation to convince the class which of the two stocks is a better investment. More details about stock pitch have been posted to Blackboard in the course documents section.

Homework Assignments

The primary objective of homework assignments is to help you review the lecture material before attending class. Written assignments will be posted on Blackboard on the Wednesday prior to their due dates. The assignments will be a combination of computational problems and cases. Assignments will be graded based on an **effort** basis. You will receive 0 if you did not hand in the assignment, 1 if your effort appears to be unreasonably low and 2 if you made a reasonable attempt to answer **all** of the questions. There are 18 assignments in total, but you are only required to submit 14 of them. In other words, you are allowed 4 free passes. Assignments should be submitted electronically through Blackboard using Microsoft Office 2003 or 2007. I do not accept late homework.

For most assignments you can work in groups, but **each person should turn in his or her own solution. Failure to turn in your own work could result in a zero score for that assignment.** For some assignments you may be required to work individually. Each assignment will clearly state whether or not group work is permitted.

A word on class participation

Class participation is graded daily on a -1, 0, 1, 2 basis. Students who detract from the class discussion will receive a -1 for the day; students who do not participate will receive a 0; students who participate will receive a 1; and students who make a strong contribution will receive a 2.

I view class participation as both an opportunity and a responsibility. Class participation provides an opportunity for students to practice important career skills in a low cost environment. Among other skills, these include the ability to express and defend one's ideas. (Remember, we may challenge ideas, but we will not challenge people. Rude classroom behavior will result in a reduction in class participation points.) The cost of not developing these skills will increase as your career progresses (e.g., lost promotions). Class participation is also a responsibility because students who attend a top business school expect to learn from the viewpoints of their classmates. Non-participating students do not provide their classmates with this important benefit. I therefore reserve the right to "cold call" students who are not participating in class discussions. My intent is not to embarrass you; rather it is to help you get involved in the discussion where your classmates can benefit from your ideas.

Course Structure

During the semester we will learn a framework for business analysis and valuation. The steps in the framework include: (1) business strategy analysis (2) accounting analysis (3) financial analysis and (4) valuation, or prospective analysis. The purpose of business strategy analysis is to assess the profit potential of the firm at a qualitative level. This involves industry and competitive analysis. The purpose of accounting analysis is to develop an understanding of whether a firm's accounting captures its true underlying economic condition. This involves identifying accounting flexibility and evaluating the appropriateness of accounting policies and estimates. The purpose of financial analysis is to assess the firm's historical financial performance in the context of its stated goals and strategy. Tools used for financial analysis include ratio analysis, cash flow analysis, and common size financial statements. The purpose of prospective analysis is to forecast the firm's future. Tools used for prospective analysis include forecasts of financial statements and valuation models.

The course will be taught using a combination of examples, discussion questions, cases and homework problems. We will learn new concepts using Southwest Airlines (LUV) as our example company and we will gain greater insights to the concepts by using discussion questions and homework problems. There will also be a "**real-time**" aspect to the class, as we will analyze breaking news for LUV.

I have attached a tentative schedule of class meetings to the end of this document. It is possible that we may have to **periodically revise the schedule**. Should significant revisions be required, I will post a revised schedule on Blackboard. I will also post a "plan for the week" to Blackboard that will outline what we plan to cover that week.

McCombs Classroom Professionalism Policy

The highest professional standards are expected of all members of the McCombs community. The collective class reputation and the value of the McCombs experience hinges on the execution of this policy. Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects. The McCombs classroom experience is enhanced when:

- **Students arrive on time.** On time arrival ensures that classes are able to start and finish at the scheduled time. On time arrival shows respect for both fellow students and faculty and it enhances learning by reducing avoidable distractions.
- **Students display their name cards.** This permits fellow students and faculty to learn names, enhancing opportunities for community building and evaluation of in-class contributions.
- **Students minimize unscheduled personal breaks.** The learning environment improves when disruptions are limited.
- **Students are fully prepared for each class.** Much of the learning at McCombs takes place during classroom discussions. When students are not prepared they cannot contribute to the overall learning process. This affects not only the individual, but their peers who count on them, as well.
- **Students attend the class section to which they are registered.** Learning is enhanced when class sizes are optimized. Limits are set to ensure a quality experience. When section hopping takes place some classes become too large and it becomes difficult to contribute. When they are too small, the breadth of experience and opinion suffers.
- **Students respect the views and opinions of their colleagues.** Disagreement and debate are encouraged. Intolerance for the views of others is unacceptable.
- **Laptops are closed and put away.** When students are surfing the web, responding to e-mail, instant messaging each other, and otherwise not devoting their full attention to the topic at hand they are doing themselves and their peers a major disservice. Those around them face additional distraction. Fellow students cannot benefit from the insights of the students who are not engaged. Faculty office hours are spent going over class material with students who chose not to pay attention, rather than truly adding value by helping students who want a better understanding of the material or want to explore the issues in more depth. Students with real needs may not be able to obtain adequate help if faculty time is spent repeating what was said in class. There are often cases where learning is enhanced by the use of laptops in class. Faculty will let you know when it is appropriate to use them. In such cases, professional behavior is exhibited when misuse does not take place.
- **Phones and wireless devices are turned off.** We've all heard the annoying ringing in the middle of a meeting. Not only is it not professional, it cuts off the flow of discussion when the search for the offender begins. When a true need to communicate with someone outside of class exists (e.g., for some medical need) please inform the professor prior to class.

Academic Dishonesty

The McCombs School of Business has no tolerance for acts of scholastic dishonesty. Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Because dishonesty harms the individual, all students, and the integrity of the University, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> or the General Information Catalog to access the official University policies and procedures on scholastic dishonesty. If the application of that Policy Statement to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification.

Students with Disabilities

Upon request, the University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. Services for Students with Disabilities (SSD) is housed in the Office of the Dean of Students, located on the fourth floor of the Student Services Building. Information on how to register, downloadable forms, including guidelines for documentation, accommodation request letters, and releases of information are available online at <http://deanofstudents.utexas.edu/ssd/index.php>. Please do not hesitate to contact SSD at (512) 471-6259, VP: (512) 232-2937 or via e-mail if you have any questions.

Class Web Sites and Student Privacy

Password-protected class sites will be available for all accredited courses taught at The University. Syllabi, handouts, assignments and other resources are types of information that may be available within these sites. Site activities could include exchanging e-mail, engaging in class discussions and chats, and exchanging files. In addition, class e-mail rosters will be a component of the sites. Students who do not want their names included in these electronic class rosters must restrict their directory information by notifying the Office of the Registrar in the Main Building, Room 1. For information on restricting directory information see: <http://www.utexas.edu/student/registrar/catalogs/gi02-03/app/appc09.html>.

Quantitative Reasoning Flag

This course carries the Quantitative Reasoning flag. Quantitative Reasoning courses are designed to equip you with skills that are necessary for understanding the types of quantitative arguments you will regularly encounter in your adult and professional life. You should therefore expect a

substantial portion of your grade to come from your use of quantitative skills to analyze real-world problems.

Tentative Schedule of Classes (as of 8/24/11)*

Session	Date	Day	Topic	Readings	Deliverables (pg#)
1	24-Aug	Wed	Course introduction	Chapter 1	
2	29-Aug	Mon	Review of Financial Accounting/Campus Products	Campus Products	Assignment 1
3	31-Aug	Wed	Business strategy analysis	LUV 2010 annual report	Assignment 2
4	7-Sep	Wed	Accounting Analysis and accounting overview	LUV 2010 annual report	Assignment 3
5	12-Sep	Mon	Accounting Analysis: income taxes	R Chapter 13: pgs 31-55	C13-2, C13-3 (96, 97)
6	14-Sep	Wed	Accounting Analysis: analytical framework	R Chapter 2: pgs 139-151, Chapter 5: pgs 451-461	E2-2, P2-5 (151, 161)
7	19-Sep	Mon	Accounting Analysis: assets	R Chapter 2: pgs 103-115, Chapter 10: pgs 177-198, 205-208	C2-2, P10-6 (173, 224)
8	21-Sep	Wed	Accounting Analysis: derivatives	R Chapter 11: pgs 269-286	P11-10, P11-22 (301, 308)
9	26-Sep	Mon	Accounting Analysis: leases	R Chapter12: pgs 319-338	E12-4, P12-14 (361, 369)
10	28-Sep	Wed	Accounting Analysis: stock-based compensation	R Chapter 15: pgs 397-410	E15-16, C15-1 (420, 429)
11	3-Oct	Mon	Accounting Analysis: earnings per share	R Chapter 15: pgs 391-397	E15-13, E15-15 (419, 420)
12	5-Oct	Wed	Accounting Analysis wrap-up		
13	10-Oct	Mon	Catch-up Day (exam Tuesday evening)		
14	12-Oct	Wed	No class (exam compensation day)		
15	17-Oct	Mon	Financial Analysis: cash flow statement	R Chapter 17: pgs 501-529	E17-2, P17-5 (536, 545)
16	19-Oct	Wed	Financial Analysis: profitability analysis	R Chapter 5: pgs 437-464	E5-10, P5-11 (484, 490)
17	24-Oct	Mon	Financial Analysis: risk analysis	R Chapter 5: pgs 464-476	E5-5, P5-3 (483, 486)
18	26-Oct	Wed	Prospective Analysis: Valex		
19	31-Oct	Mon	Prospective Analysis overview	L Chapter 7: pgs 629-641, R Chapter 6: pgs 605-611	E6-3, P6-4 (612, 615)
20	2-Nov	Wed	Valuation: DDM and DCF-based approaches	L Chapter 10: pgs 658-660, R Chapter 6: pgs 567-572	E6-1 (612)
21	7-Nov	Mon	Valuation: Earnings-based approaches	L Chapter 10: pgs 649-658, R Chapter 6: pgs 572-579, 598-605	E6-2, P6-7 (612, 617)
22	9-Nov	Wed	Valuation: Market-based approaches	R Chapter 6: pgs 581-588	E6-4, E6-5 (612, 612)
23	14-Nov	Mon	Catch-up Day (exam in evening)		
24	16-Nov	Wed	Credit Analysis	R Chapter 5: pgs 477-480, R Chapter 6: pgs 590-598	E6-8 (613)
25	21-Nov	Mon	Course Wrap-up	To be determined	
26	23-Nov	Wed	No class (exam compensation day)		
27	28-Nov	Mon	Stock pitch		stock pitch presentation
28	30-Nov	Wed	Stock pitch		stock pitch presentation

*Schedule may be amended by “plan for the week” e-mails

FSA Course Overview

Skills developed in class

- **Shorter term Skills**
 - Knowledge of GAAP (i.e., how does the accounting for stock options work?)
- **Longer term Skills**
 - A framework for analyzing financial statements
 - Judgment (e.g., how do I decide where to allocate effort?)
 - Analytical skills (e.g., how do I determine the source of recent performance?)
 - Manipulation skills (e.g., how do I adjust the financial statements to reflect different accounting choices?)

The PHB Framework

