

FIN-409 Analysis of Financial Statements

Cr Hrs: 3.0

Course Description

This course is designed to enhance students' acumen for extracting and interpreting information in financial statements. Synthesizing this information will develop students' skills in assessing the relationship between the accounting report and the underlying economic viability of the firm. In this respect, this course draws from Accounting, Finance and Economics. Students will develop tools to interpret financial statement information for use by investors, creditors, employees, regulatory agencies and other stakeholders. This course is designed to improve analytical ability by using an accounting report as part of an overall assessment of the firm's strategy and how that strategy corresponds to its stated objectives.

Course Objectives

Ultimately the objective of financial statement analysis is to examine the relationship between information in financial statements and the measurement of a firm's value.

There are three basic themes:

- a) Filtering to and extracting relevant information in statement footnotes.
- b) Deciphering hidden but critical information relative to firm value.
- c) Exploring and applying different methods of valuation.

Learning Outcomes

This course aims to provide students with the ability to:

- Understand an overview of financial statements
- Perform financial analysis
- Calculate profitability analysis
- Evaluate the quality of earnings
- Quantify and interpret cash flow analysis, asset analysis, liability analysis, and equity valuation analysis.
- Discuss horizontal/vertical analysis and their purpose
- Select and apply appropriate methods of valuation

Required Course Material

The textbooks for this course is:

Analysis of Financial Statements (AFS)

Author: Charles Gibson

Edition: (12th Edition)

ISBN: 81-315-1684-9

Publisher: Cengage Learning

Financial Reporting, Financial Statement Analysis, and Valuation: *A Strategic Perspective* (FRFSAV)

CHAPTERS: 1, 10, 11, 12, 13, 14

Authors: James M. Wahlen, Stephen P. Baginski, Mark T. Bradshaw

Edition: (7th Edition)

ISBN: 0-324-78942-4

Publisher: Cengage Learning

A financial calculator is required.

In addition, following reference book can also be useful:

Supplemental readings may also be used from academic and business journals.

The articles used for this course are:

Reading financial sections of newspapers and/or periodicals is encouraged.

The cases used are:

Assigned as required.

Additional suggested chapters are:

Assigned as required.

Course Content (Weekly)

Weekly breakdown is given below

Week	Topics
1	Reading (FRFSAV) Chapter 1 Reading (AFS) Chapter 1 (p.10-18) Overview of Financial Statement Analysis Identify the Industry Economic Characteristics <ul style="list-style-type: none">Tools for Studying Industry Economics Identify the Company Strategies

	<p>Assess the Quality of the Financial Statements</p> <p>Analyze Profitability and Risk</p> <p>Prepare Forecasted Financial Statements</p> <p>Value the Firm</p> <p>Role of Financial Statement Analysis in an Efficient Capital Market</p> <p>The Association between Earnings and Share Prices</p> <p>Sources of Financial Statement Information</p> <p>TRADITIONAL ASSUMPTIONS OF THE ACCOUNTING MODEL (AFS)</p> <ul style="list-style-type: none"> ○ Business Entity <ul style="list-style-type: none"> • Going Concern or Continuity • Time Period • Monetary Unit • Historical Cost • Conservatism • Realization • Matching • Consistency • Full Disclosure • Materiality • Industry Practices • Transaction Approach • Cash Basis • Accrual Basis
2	<p>Reading (AFS) Chapter 2</p> <p>Introduction to Financial Statements and Other Financial Reporting Topics</p> <p>FORMS OF BUSINESS ENTITIES</p> <p>THE FINANCIAL STATEMENTS</p> <ul style="list-style-type: none"> ○ Balance Sheet (Statement of Financial Position) ○ Statement of Stockholders' Equity (Reconciliation of Stockholders' Equity Accounts) ○ Income Statement (Statement of Earnings) ○ Statement of Cash Flows (Statement of Inflows and Outflows of

	<p>Cash)</p> <ul style="list-style-type: none"> ○ Notes <p>THE ACCOUNTING CYCLE</p> <ul style="list-style-type: none"> ○ Recording Transactions ○ Recording Adjusting Entries ○ Preparing the Financial Statements <p>AUDITOR'S OPINION</p> <ul style="list-style-type: none"> ○ Auditor's Report on the Firm's Internal Controls <ul style="list-style-type: none"> • Report of Management on Internal Control over Financial Reporting <p>MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS</p> <p>THE SEC'S INTEGRATED DISCLOSURE SYSTEM</p> <p>THE EFFICIENT MARKET HYPOTHESIS</p> <p>ETHICS</p> <ul style="list-style-type: none"> ○ SEC Requirements—Code of Ethics <p>HARMONIZATION OF INTERNATIONAL ACCOUNTING STANDARDS</p> <p>CONSOLIDATED STATEMENTS</p> <p>ACCOUNTING FOR BUSINESS COMBINATIONS</p>
3	<p>Reading (AFS) Chapter 3</p> <p>Balance Sheet</p> <p>BASIC ELEMENTS OF THE BALANCE SHEET</p> <ul style="list-style-type: none"> • Assets • Liabilities • Stockholders' Equity • Quasi-Reorganization • Accumulated Other Comprehensive Income • Employee Stock Ownership Plans (ESOPs) • Treasury Stock • Stockholders' Equity in Unincorporated Firms ○ International Consolidated Balance Sheet (IFRS)
4	<p>Reading (AFS): Chapter 4</p> <p>Income Statement</p> <p>BASIC ELEMENTS OF THE INCOME STATEMENT</p> <ul style="list-style-type: none"> • Net Sales (Revenues)

	<ul style="list-style-type: none"> • Cost of Goods Sold (Cost of Sales) • Other Operating Revenue • Operating Expenses • Other Income or Expense <p>SPECIAL INCOME STATEMENT ITEMS</p> <ul style="list-style-type: none"> • Unusual or Infrequent Item Disclosed Separately • Equity in Earnings of Nonconsolidated Subsidiaries <p>INCOME TAXES RELATED TO OPERATIONS</p> <ul style="list-style-type: none"> ○ Discontinued Operations ○ Extraordinary Items ○ Cumulative Effect of Change in Accounting Principle ○ Net Income—Non-controlling ○ Interest (previously minority share of earnings) <p>EARNINGS PER SHARE</p> <p>RETAINED EARNINGS</p> <p>DIVIDENDS AND STOCK SPLITS</p> <p>LEGALITY OF DISTRIBUTIONS TO STOCKHOLDERS</p> <p>COMPREHENSIVE INCOME</p> <p>INTERNATIONAL CONSOLIDATED INCOME STATEMENT (IFRS)</p>
5	<p>Reading (AFS) Chapter 5</p> <p>Basics of Analysis</p> <p>RATIO ANALYSIS</p> <p>COMMON-SIZE ANALYSIS (VERTICAL AND HORIZONTAL)</p> <p>YEAR-TO-YEAR CHANGE ANALYSIS</p> <p>FINANCIAL STATEMENT VARIATION BY TYPE OF INDUSTRY</p> <p>REVIEW OF DESCRIPTIVE INFORMATION</p> <p>COMPARISONS</p> <ul style="list-style-type: none"> ○ Trend Analysis ○ Standard Industrial Classification (SIC) Manual ○ North American Industry Classification System (NAICS) ○ Industry Averages and Comparison with Competitors ○ Caution in Using Industry Averages <p>RELATIVE SIZE OF FIRM</p>
6	<p>Reading (AFS) Chapter 6</p>

	<p>Liquidity of Short-Term Assets; Related Debt-Paying Ability</p> <p>CURRENT ASSETS</p> <p>CURRENT LIABILITIES</p> <p>THE OPERATING CYCLE</p> <ul style="list-style-type: none"> • Cash • Marketable Securities • Receivables • Inventories • Prepayments • Other Current Assets • Current Liabilities <p>CURRENT ASSETS COMPARED WITH CURRENT LIABILITIES</p> <ul style="list-style-type: none"> • Working Capital • Current Ratio • Acid-Test Ratio (Quick Ratio) • Cash Ratio <p>OTHER LIQUIDITY CONSIDERATIONS</p> <ul style="list-style-type: none"> ○ Sales to Working Capital (Working Capital Turnover) ○ Liquidity Considerations
7	<p>Reading (AFS) Chapter 7</p> <p>Long-Term Debt-Paying Ability</p> <p>INCOME STATEMENT CONSIDERATION WHEN DETERMINING LONG-TERM DEBT-PAYING ABILITY</p> <ul style="list-style-type: none"> ○ Times Interest Earned ○ Fixed Charge Coverage <p>BALANCE SHEET CONSIDERATION WHEN DETERMINING LONG-TERM DEBT-PAYING ABILITY</p> <ul style="list-style-type: none"> ○ Debt Ratio ○ Debt/Equity Ratio ○ Debt to Tangible Net Worth Ratio ○ Other Long-Term Debt-Paying Ability Ratios <p>SPECIAL ITEMS THAT INFLUENCE A FIRM'S LONG-TERM DEBT-PAYING ABILITY</p> <ul style="list-style-type: none"> ○ Long-Term Assets versus Long-Term Debt

	<ul style="list-style-type: none"> ○ Long-Term Leasing ○ Pension Plans ○ Postretirement Benefits Other than Pensions <p>JOINT VENTURES</p> <ul style="list-style-type: none"> ○ Contingencies ○ Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk ○ Disclosures about Fair Value of Financial Instruments
8	<p>Reading (AFS) Chapter 8</p> <p>Profitability</p> <p>PROFITABILITY MEASURES</p> <ul style="list-style-type: none"> ○ Net Profit Margin ○ Total Asset Turnover ○ Return on Assets ○ DuPont Analysis ○ Return on Assets ○ Interpretation Through DuPont Analysis ○ Variation in Computation of DuPont Ratios Considering Only Operating Accounts ○ Operating Income Margin ○ Operating Asset Turnover ○ Return on Operating Assets ○ Sales to Fixed Assets ○ Return on Investment (ROI) ○ Return on Total Equity ○ Return on Common Equity ○ The Relationship Between Profitability Ratios ○ Gross Profit Margin <p>TRENDS IN PROFITABILITY</p> <p>SEGMENT REPORTING</p> <p>REVENUES BY MAJOR PRODUCT LINES</p> <p>GAINS AND LOSSES FROM PRIOR PERIOD ADJUSTMENTS</p> <p>COMPREHENSIVE INCOME</p> <p>PRO-FORMA FINANCIAL INFORMATION</p>

	<p>INTERIM REPORTS</p> <p>Exam Review</p>
9	<p>Wrap-up week</p> <p>Exam Review</p>
10	<p><u>Mid-Term Examination</u></p>
11	<p>Reading (AFS) Chapter 9</p> <p>For the Investor</p> <p>LEVERAGE AND ITS EFFECTS ON EARNINGS</p> <ul style="list-style-type: none"> ○ Definition of Financial Leverage and Magnification Effects ○ Computing the Degree of Financial Leverage ○ Summary of Financial Leverage <p>EARNINGS PER COMMON SHARE</p> <p>PRICE/EARNINGS RATIO</p> <p>PERCENTAGE OF EARNINGS RETAINED</p> <p>DIVIDEND PAYOUT</p> <p>DIVIDEND YIELD</p> <p>BOOK VALUE PER SHARE</p> <p>STOCK OPTIONS (STOCK-BASED COMPENSATION)</p> <p>RESTRICTED STOCK</p> <p>STOCK APPRECIATION RIGHTS</p>
12	<p>Reading (AFS) Chapter 10: Statement of Cash Flows</p> <p>BASIC ELEMENTS OF THE STATEMENT OF CASH FLOWS</p> <p>FINANCIAL RATIOS AND THE STATEMENT OF CASH FLOWS</p> <ul style="list-style-type: none"> ○ Operating Cash Flow/Current Maturities of Long-Term Debt and Current Notes Payable ○ Operating Cash Flow/Total Debt ○ Operating Cash Flow per Share ○ Operating Cash Flow/Cash Dividends <p>ALTERNATIVE CASH FLOW</p> <p>PROCEDURES FOR DEVELOPMENT OF THE STATEMENT OF CASHFLOWS</p>
13	<p>Reading (FRFSAV) Chapter 10</p>

	Forecasting Financial Statements Introduction to Forecasting Preparing Financial Statement Forecasts Step 1: Projecting Sales and Other Revenues Step 2: Projecting Operating Expenses Step 3: Projecting Operating Assets and Liabilities on the Balance Sheet Step 4: Projecting Financial Assets, Financial Leverage, Common Equity Capital, and Financial Income Items Step 5: Projecting Nonrecurring Items, Provisions for Income Tax, and Changes in Retained Earnings Step 6: Balancing the Balance Sheet Step 7: Projecting the Statement of Cash Flows Analyzing Projected Financial Statements Sensitivity Analysis and Reactions to Announcements
14	Reading (FRFSAV) Chapter 11 Risk-Adjusted Expected Rates of Return and the Dividends Valuation Approach Introduction and Overview Equivalence among Dividends, Cash Flows, and Earnings Valuation Risk-Adjusted Expected Rates of Return Rationale for Dividends-Based Valuation The Dividends Valuation Model Implementing the Dividends Valuation Model
15	Reading (FRFSAV) Chapter 12 Valuation: Cash-Flow-Based Approaches Introduction and Overview Rationale for Cash-Flow-Based Valuation Free-Cash-Flows-Based Valuation Concepts Measuring Periodic Free Cash Flows Cash-Flow-Based Valuation Models Evaluation of the Free Cash Flows Valuation Method

16	<p>Reading (FRFSAV) Chapter 13</p> <p>Valuation: Earnings-Based Approaches</p> <p>Introduction and Overview</p> <p>Rationale for Earnings-Based Valuation</p> <p>Earnings-Based Valuation: Practical Advantages and Concerns</p> <p>Theoretical and Conceptual Foundations for Residual Income Valuation</p> <p>Residual Income Valuation Model with Finite Horizon Earnings Forecasts and Continuing Value</p> <p>Residual Income Model Implementation Issues</p> <p>Consistency in Residual Income, Dividends, and Free Cash Flow Value Estimates</p>
17	<p>Reading (FRFSAV) Chapter 14</p> <p>Valuation: Market-Based Approaches</p> <p>Introduction and Overview</p> <p>Market Multiples of Accounting Numbers</p> <p>Market-to-Book and Value-to-Book</p> <p>Price-Earnings and Value-Earnings Ratios</p> <p>Price Differentials</p> <p>Reverse Engineering</p>
18	<p><u>Final Examination</u></p>