Accounting 327 – Fall 2012
Financial Statement Analysis

Professor
Michael Clement

Office
CBA 4M.234

Office Hours
Monday and Wednesday 1:00 – 3:00 and by appointment

Phone
(512) 471-0332

E-Mail
michael.clement@mccombs.utexas.edu

Course Web Page
via Blackboard

Teaching Assistant
Brent Lao (brent.lao@phd.mccombs.utexas.edu)

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:
- 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:

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>exams</td>
<td>50%</td>
</tr>
<tr>
<td>stock pitch</td>
<td>25%</td>
</tr>
<tr>
<td>homework</td>
<td>15%</td>
</tr>
<tr>
<td>class participation</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
The historical distribution of grades has been roughly as follows: 30% As, 65% 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 16, 2012** from **7:00-9:00 pm** and will cover material from class sessions 1-12. The second exam is tentatively scheduled for **Monday, November 19, 2012** 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. 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

**Accommodations for Religious Holidays**

By UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious holy day. If you must miss a class, an examination, a work assignment, or a project in order to observe a religious holy day, you will be given an opportunity to complete the missed work within a reasonable time after the absence.

**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 8/29/12)*

<table>
<thead>
<tr>
<th>Session</th>
<th>Date</th>
<th>Day</th>
<th>Topic</th>
<th>Readings (page numbers are in gray boxes in text)</th>
<th>Deliverables (pg#)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>29-Aug</td>
<td>Wed</td>
<td>Course introduction</td>
<td>R Chapter 1</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>5-Sep</td>
<td>Wed</td>
<td>Review of Financial Accounting/Campus Products</td>
<td>Campus Products</td>
<td>Assignment 1</td>
</tr>
<tr>
<td>3</td>
<td>10-Sep</td>
<td>Mon</td>
<td>Business strategy analysis</td>
<td>LUV 2010 annual report</td>
<td>Assignment 2</td>
</tr>
<tr>
<td>4</td>
<td>12-Sep</td>
<td>Wed</td>
<td>Accounting Analysis and accounting overview</td>
<td>LUV 2010 annual report</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>17-Sep</td>
<td>Mon</td>
<td>Accounting Analysis: income taxes</td>
<td>R Chapter 13: pgs 31-55</td>
<td>C13-2, C13-3 (96, 97)</td>
</tr>
<tr>
<td>6</td>
<td>19-Sep</td>
<td>Wed</td>
<td>Accounting Analysis: analytical framework</td>
<td>R Chapter 2: pgs 139-151, R Chapter 5: pgs 451-461</td>
<td>E2-2, P2-5 (151, 161)</td>
</tr>
<tr>
<td>7</td>
<td>24-Sep</td>
<td>Mon</td>
<td>Accounting Analysis: assets</td>
<td>R Chapter 2: pgs 103-115, R Chapter 10: pgs 177-198, 205-208</td>
<td>C2-2, P10-6 (173, 224)</td>
</tr>
<tr>
<td>8</td>
<td>26-Sep</td>
<td>Wed</td>
<td>Accounting Analysis: derivatives</td>
<td>R Chapter 11: pgs 269-286</td>
<td>P11-10, P11-22 (301, 308)</td>
</tr>
<tr>
<td>9</td>
<td>1-Oct</td>
<td>Mon</td>
<td>Accounting Analysis: leases</td>
<td>R Chapter 12: pgs 319-338</td>
<td>E12-4, P12-14 (361, 369)</td>
</tr>
<tr>
<td>12</td>
<td>10-Oct</td>
<td>Wed</td>
<td>Accounting Analysis wrap-up</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>15-Oct</td>
<td>Mon</td>
<td>Catch-up Day (exam Tuesday evening)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>17-Oct</td>
<td>Wed</td>
<td>No class (exam compensation day)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>31-Oct</td>
<td>Wed</td>
<td>Prospective Analysis: Valex</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>5-Nov</td>
<td>Mon</td>
<td>Prospective Analysis overview</td>
<td>L Chapter 7: pgs 629-641, R Chapter 6: pgs 605-611</td>
<td>E6-3, P6-4 (612, 615)</td>
</tr>
<tr>
<td>23</td>
<td>19-Nov</td>
<td>Mon</td>
<td>Catch-up Day (exam in evening)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>21-Nov</td>
<td>Wed</td>
<td>Credit Analysis</td>
<td>R Chapter 5: pgs 477-480, R Chapter 6: pgs 590-598</td>
<td>E6-8 (613)</td>
</tr>
<tr>
<td>25</td>
<td>26-Nov</td>
<td>Mon</td>
<td>Course Wrap-up</td>
<td>To be determined</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>28-Nov</td>
<td>Wed</td>
<td>No class (exam compensation day)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>3-Dec</td>
<td>Mon</td>
<td>Stock pitch</td>
<td></td>
<td>stock pitch presentation</td>
</tr>
<tr>
<td>28</td>
<td>5-Dec</td>
<td>Wed</td>
<td>Stock pitch</td>
<td></td>
<td>stock pitch presentation</td>
</tr>
</tbody>
</table>

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

- Industry/Strategy Analysis
  - What is the competitive landscape?
  - How does the company make money?
  - What are the critical success factors?

- Accounting Analysis
  - Do earnings reflect economic reality?
  - Where are the major areas of accounting flexibility?
  - How are critical success factors measured in financial statements?

- Financial Analysis
  - Is performance sustainable?
  - What is company’s past financial performance?
  - How has company performed relative to critical success factors?

- Prospective Analysis
  - What is the company’s future?
  - What is the company worth?
  - What are predictions for critical success factors?