Accounting 327 – Spring 2017
Financial Statement Analysis

Professor
Jeffrey L. Johanns, CPA, CGMA

E-Mail
jeffrey.johanns@mccombs.utexas.edu

Twitter:
@JohannsAudit

Office
GSB 5.126G

Office Hours
Tuesday/Thursday 10 – 11:30 am, or by appointment

Phone
(512) 750-0565 (Cell)

Course Web Page
via Canvas

Teaching Assistants
Yue Wang/Javier Garcia

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

Although we will review some accounting concepts, 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 interpret and manipulate financial statements.

Materials

Required text:
- Financial Statement Analysis & Valuation 4e, by Easton, McAnally, Sommers and Zhang

Optional texts:
- Regular readings of The Wall Street Journal, Barron’s, Business Week, Fortune, etc.

Course Requirements and Grading
Your grade in the course will be determined as follows:

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Exams</td>
<td>50%</td>
</tr>
<tr>
<td>Stock Pitch</td>
<td>25%</td>
</tr>
<tr>
<td>Homework Assignments</td>
<td>15%</td>
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<tr>
<td>Class Participation</td>
<td>10%</td>
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</tbody>
</table>

100%
The historical distribution of grades has been roughly as follows: 30% A’s, 60-65% B’s, 5%-10% below B. Plus/Minus grading applies to this course.

Description of Course 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 Thursday, March 2, 2017 from 6:30-8:30 pm and will cover material from class sessions 1-12. The second exam is tentatively scheduled for Thursday, April 13, 2017 from 6:30-8:30 pm and will cover material from class sessions 13-23. 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 will be posted to Canvas 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 Canvas on the Tuesday 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, 2 if your effort appears to be unreasonably low and 4 if you made a reasonable attempt to answer all of the questions. There are 19 assignments in total, but I only count your 15 best scores. In other words, you are allowed up to 4 free passes. (Note that everyone must complete Assignment 5 and it cannot be dropped from your cumulative homework score.) Assignments should be submitted electronically through Canvas. 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.

Class Participation
While I don’t take formal attendance each class, regular attendance is expected, and necessary for your success in this class. Class participation goes far beyond attendance. A high level of participation requires regular contributions in class – in the form of (a) asking questions; (b) answering questions; and (c) engaging other students in professional debate. Simply showing up in class and office hours will not result in a high grade for participation. I typically place students in one of three or four “buckets” at the end of the semester for determining their participation grade. If you want to know where you stand on participation during the semester, it is your responsibility to ask me.
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. 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) prospective analysis (i.e., valuation).

1. **Business strategy analysis (Session 3)**
   - The purpose of business strategy analysis is to assess the profit potential of the firm at a qualitative level. This step involves industry and competitive analysis.

2. **Accounting analysis. (Sessions 4-12)**
   - The purpose of accounting analysis is to develop an understanding of whether a firm’s accounting captures its true underlying economic condition. This step involves identifying areas of accounting flexibility and evaluating the appropriateness of accounting policies and estimates.

3. **Financial analysis (Sessions 13-17)**
   - 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.

4. **Prospective analysis (Sessions 18-23)**
   - 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 lectures, textbook examples and questions, discussion questions, and examples and questions derived from current events. We will use the financial statements of Whole Foods Market (WFM) to reinforce the concepts learned in class. There will also be a “real-time” aspect to the class, as we will analyze breaking news for WFM.
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 Canvas.

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 disservice. Those students around the offending students face additional distraction because fellow students cannot benefit from the insights of the students who are not engaged. In addition, faculty office hours are spent going over class material with students who chose not to pay attention, rather than 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 of a phone 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 (http://deanofstudents.utexas.edu/sjs/) or the General Information Catalog Sec. 11-402 (http://catalog.utexas.edu/general-information/appendices/appendix-c/student-discipline-and-conduct/) 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 and registration documentation (e.g., downloadable forms, including guidelines for documentation, accommodation request letters, and releases of information are available online at http://ddce.utexas.edu/disability/. Please do not hesitate to contact SSD via phone (512) 471-6259, videophone (512) 410-6644, or e-mail ssd@austin.utexas.edu, 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

A student who misses classes or other required activities, including examinations, for the observance of a religious holy day should inform the instructor as far in advance of the absence as possible, so that arrangements can be made to complete an assignment 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.
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<th>Session</th>
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<th>2017 Topic</th>
<th>Readings</th>
<th>Assignment</th>
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<td>Tue</td>
<td>Course Introduction/Capital Markets</td>
<td>Syllabus/Slides for Session 1</td>
<td></td>
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<tr>
<td>2</td>
<td>19-Jan</td>
<td>Thu</td>
<td>Framework for FSA/Strategy Analysis</td>
<td>Slides – Sessions 2 and 3</td>
<td>Discussion Q’s in Slides/Note card</td>
</tr>
<tr>
<td>3</td>
<td>24-Jan</td>
<td>Tue</td>
<td>Framework for FSA/Strategy Analysis</td>
<td>Slides – Sessions 2 and 3</td>
<td>Discussion Questions in Slides</td>
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<td>4</td>
<td>26-Jan</td>
<td>Thu</td>
<td>Review of Bus Activities and Fin Statements</td>
<td>Module 2, L01, L02, L03, L04</td>
<td>2-40, 2-47, 2-48</td>
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<td>5</td>
<td>31-Jan</td>
<td>Tue</td>
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<td>Module 5, L01, L02</td>
<td>5-30, 5-36</td>
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<tr>
<td>6</td>
<td>2-Feb</td>
<td>Thu</td>
<td>Income Statement: Income Taxes</td>
<td>Module 5, L03, L05</td>
<td>5-26, 5-42</td>
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<td>7</td>
<td>7-Feb</td>
<td>Tue</td>
<td>Earnings per share and accounting quality</td>
<td>Module 5, L05, L06</td>
<td>5-19, 5-38</td>
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<td>8</td>
<td>9-Feb</td>
<td>Thu</td>
<td>Group Exercise</td>
<td>Assignment 5</td>
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<td>9</td>
<td>14-Feb</td>
<td>Tue</td>
<td>Balance Sheet: Assets</td>
<td>Module 6, L01, L02, L03</td>
<td>6-24, 6-28, 6-31</td>
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<td>10</td>
<td>16-Feb</td>
<td>Thu</td>
<td>Balance Sheet: Liabilities &amp; Owners’ Equity</td>
<td>Module 7, L01, L02 and Module 8, L01, L02</td>
<td>7-17, 7-23, 8-24</td>
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<tr>
<td>11</td>
<td>21-Feb</td>
<td>Tue</td>
<td>Cash Flow Statement</td>
<td>Appendix B, L02, L03, L04, L05</td>
<td>B-28, B-34</td>
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<tr>
<td>12</td>
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<td>Thu</td>
<td>Cash Flow Statement</td>
<td>Appendix B1</td>
<td>B-44</td>
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<tr>
<td>13</td>
<td>28-Feb</td>
<td>Tue</td>
<td>Profitability Analysis and Interpretation</td>
<td>Module 3, L01, L02</td>
<td>3-26, 3-35, 3-40</td>
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<tr>
<td>14</td>
<td>2-Mar</td>
<td>Thu</td>
<td>Exam Thursday evening</td>
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<tr>
<td>15</td>
<td>7-Mar</td>
<td>Tue</td>
<td>Profitability Analysis and Interpretation</td>
<td>Module 3, L04</td>
<td>3-47</td>
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<tr>
<td>16</td>
<td>9-Mar</td>
<td>Thu</td>
<td>Common Size Statements &amp; Credit Analysis</td>
<td>Module 4, L03</td>
<td>4-23, 4-26</td>
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<tr>
<td>14-Mar</td>
<td>Tue</td>
<td>SPRING BREAK</td>
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<tr>
<td>16-Mar</td>
<td>Thu</td>
<td>SPRING BREAK</td>
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<tr>
<td>17</td>
<td>21-Mar</td>
<td>Tue</td>
<td>Off-Balance Sheet Financing (Leases)</td>
<td>Module 10, L01</td>
<td>10-11, 10-20</td>
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<td>18</td>
<td>23-Mar</td>
<td>Thu</td>
<td>Forecasting Financial Statements</td>
<td>Module 11, L01, L02, L06</td>
<td>11-11, 11-29</td>
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<tr>
<td>19</td>
<td>28-Mar</td>
<td>Tue</td>
<td>Forecasting Financial Statements</td>
<td>Module 11, L03, L04, L05</td>
<td>11-20, 11-21</td>
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<tr>
<td>20</td>
<td>30-Mar</td>
<td>Thu</td>
<td>Cost of Capital and Valuation Basics</td>
<td>Module 12, L01, L02, L03, L04</td>
<td>12-39, 12-46</td>
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<tr>
<td>21</td>
<td>4-April</td>
<td>Tue</td>
<td>Cost of Capital and Valuation Basics</td>
<td>Module 12, L05, L06</td>
<td>12-41, 12-43</td>
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<td>22</td>
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<td>Thu</td>
<td>Cash Flow Based Valuation</td>
<td>Module 13, L01, L02</td>
<td>13-10, 13-11</td>
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<td>23</td>
<td>11-April</td>
<td>Tue</td>
<td>Market Based Valuation</td>
<td>Module 15, L03, L04</td>
<td>15-28, 15-41</td>
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<tr>
<td>24</td>
<td>13-April</td>
<td>Thu</td>
<td>Exam Thursday evening</td>
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<tr>
<td>25</td>
<td>18-April</td>
<td>Tue</td>
<td>Writing tips/Group Project Meeting</td>
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<td>26</td>
<td>20-April</td>
<td>Thu</td>
<td>Stock pitch</td>
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<tr>
<td>27</td>
<td>25-April</td>
<td>Tue</td>
<td>Stock pitch</td>
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<tr>
<td>28</td>
<td>27-April</td>
<td>Thu</td>
<td>Stock pitch</td>
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<tr>
<td>29</td>
<td>2-May</td>
<td>Tue</td>
<td>Stock pitch</td>
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<tr>
<td>30</td>
<td>4-May</td>
<td>Thu</td>
<td>Make-up day</td>
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* Schedule may be amended by Canvas announcements.
Financial Statement Analysis Course Overview

Skills developed in class

• Shorter term skills
  - Knowledge of GAAP (e.g., 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?