

Earnings Quality and Fundamental Analysis, B7008, Fall 2017 Course Syllabus (Tentative: for Bidding)

I. CONTACT DETAILS

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II. COURSE DESCRIPTION

Financial reporting provides a window into the operational and financial workings of a company. However, translating this information into actionable insights is anything but straightforward. It requires an understanding of Generally Accepted Accounting Principles (GAAP), the quality of financial information, and the adjustments and analyses required to accurately measure and evaluate profitability, exposures, growth prospects, and value. This course is devoted to a systematic study of GAAP and earnings quality, utilizing many actual financial disclosures and cases of accounting abuses. The class also covers standard and not-so-standard financial analysis techniques, and incorporates insights from practitioner and academic research. The primary objective is to acquire a deep understanding of accounting information and how to intelligently use it in making investment, credit, and similar resource allocation decisions. Such knowledge is required of executives, consultants, bankers, analysts, investment managers, and other users of financial information. This is a case-based class. Much of our time will be spent discussing real-world cases rather than in a lecture format. The course outline below lists the specific topics we will cover.

III. ADMINISTRATION

Class Material

The course material consists of a textbook, cases, my notes on the cases and background material, and optional readings. These items cover all the course content. The optional readings elaborate on some of the analyses and are provided for those interested in research (both practitioner and academic).

All items, except the textbook, will be made available electronically before class, saved in an Acrobat version that allows for the addition of comments to the electronic documents. You may use laptops during class to help you follow the discussion, to take notes, or to add comments to the electronic documents as needed (**please use your laptop for those purposes only**).

Class Preparation

We will use the case method in the course. It is important that you read the assigned cases and think about the key issues before coming to class, so that you are prepared to contribute to the class discussion.

Performance Evaluation

Class Participation	40%
Problem Sets	20%
Individual or Group Project (Type B or A)	40%

Class Participation

I will evaluate your class participation, emphasizing the quality of your contributions to case discussions. I will use cold calling. In addition to any specific questions in the cases, please come to class prepared discuss: the general business setting, including the firm's strategy and competitive environment; an overall earnings quality analysis, key accounting policies, and a more specific red flag analysis; and how the accounting issues you identified affect your assessment of the firm's financial performance.

Problem Sets

I will give you problem sets related to 8 of the cases, selecting cases that require extra preparation. You are to turn in 4 of the 8 for credit, although preparing all of the problem sets will help you make stronger contributions to the case discussions. The problem sets you turn in will be graded for effort, not the correctness of your answers.

Individual or Group Project

The project should focus on the financial statement quality of a company that prepares financial statements under U.S. GAAP. (I recommend avoiding financial institutions.) The project should include:

- an initial assessment of the firm and its management, including a brief analysis of the firm's strategy and competitive environment;
- reformulated financial statements, separating operating from financing activities (on the income statement and balance sheet) and core/recurring operating earnings components from non-core/transitory components;
- a big-picture earnings quality analysis, including overall earnings quality ratios comparing earnings to cash flow and net operating assets to sales;
- a discussion of the firm's key accounting policies and a "red flag analysis" to identify areas of particular concern;
- an analysis of past return on sales and net operating asset turnover;
- forecasts of future: sales, return on sales, and operating asset turnover;
- a valuation of the firm's operations using the residual operating earnings model we covered in class; and
- sensitivity analysis (e.g., the growth in sales, future return on sales, future asset turnover, and/or required return needed to justify the current market price).

As a substitute for the course project, you may elect to take an individual take-home final exam or to propose an alternative individual/group project (e.g., one focused on accounting for a specific transaction, a new accounting pronouncement, academic research on a particular course topic, etc.).

IV. CONNECTION WITH THE CORE

This course builds on knowledge from the Financial Accounting (B6000) and Corporate Finance (B6300) fixed core courses. These core courses introduce students to basic financial reporting and analysis concepts. In B8008, students acquire a deep understanding of accounting information and how to intelligently use it in making investment, credit, and similar resource allocation decisions. Students should review the concepts studied in B6000 and B6300.

V. TEXT

Financial Reporting and Analysis, Revsine, Collins, Johnson, Mittelstaedt, and Soffer, 2017, 7th Edition, Mc-Graw Hill.

VI. COURSE OUTLINE

Class	Topic	Chapter	Cases (* indicates cases with problem sets: turn in 4 of 8)
1	Introduction Review	Skim: 1, 2, 4, 17	
2	Basic Financial Statement Analysis	5 Skim: 6, 7	Dollar General Bids for Family Dollar Coca-Cola: Residual Income*
3	Earnings Management Earnings Quality & Red Flags Analysis Pro-forma (non-GAAP) Reporting	Lecture	Trouble Brewing for Green Mountain Management Earnings Disclosure & Pro Forma Reporting
4	Revenue Receivables	3 8	Accounting for the iPhone New Century Financial
5	Inventories	9	First Solar Inventory Case*
6	PP&E, Intangible Assets, & Other Assets	10	PP&E Case* AOL Time Warner
7	Bonds and Derivatives Fair Value Measurements	11	Delta's Derivatives Bonds and Derivatives Case*
8	Leases	12	Leasing Decision at Magnet Beauty* Tesla
9	Income Taxes	13	Mike Mayo Takes on Citigroup Income Tax Case*
10	Pensions	14	Accounting for Pensions and Employee Benefits at Ford and Toyota Pension and OPEB Case*
11	Inter-corporate Equity Investments	16	The Coca-Cola Company* Valeant
12	Owners' Equity Review	15	

A short bio: I joined CBS in 2015. Before that, I was on the faculty of the Tepper School of Business at Carnegie Mellon University from 1992-2015, most recently as the Richard M. Cyert Professor of Economics and Management and Professor of Accounting. I worked as an academic fellow in the Chief Accountant's Office at the SEC from 2004-2005. My research interests include: earnings management, financial reporting regulation and standard setting, and incentive issues related to accounting. I have published more than 50 papers, serve on six editorial boards, and am one of the editors of *The Accounting Review*.