Earnings Quality and Fundamental Analysis, B7008, Fall 2019
Course Syllabus (Tentative: for Bidding)

I. CONTACT DETAILS
Professor: Jonathan Glover
Office: 605B
Phone: 212-854-1911
Email: jg3463@gsb.columbia.edu
Office hours: After class or by appointment

TA: Kunjue (Quinn) Wang
Email: KWang21@gsb.columbia.edu

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 adjustments and analyses used to more accurately assess 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. Studying these cases of accounting abuses will help you improve your ability to “read between the lines.” 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
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 Attendance and Quizzes 15%
Class Participation 30%
Problem Sets 20%
Individual or Group Project (Type B or A) 35%

Class Attendance, Participation, and Quizzes
I will take attendance and administer quizzes using Poll Everywhere. I will also evaluate your class participation, emphasizing the quality of your contributions to case and problem set discussions. I will use a mix of cold calling and asking for volunteers. In addition to any questions in the cases and problem sets, please come to class prepared to discuss: the general business setting, including the firm’s competitive environment; an overall earnings quality analysis and a more specific red flag analysis, focusing on those accounting choices that are most relevant; and how the accounting issues you identified affect your assessment of the firm’s financial performance.

Problem Sets
You are to turn in 4 (of 5) problem sets. They are individual assignments and will be graded for effort.

Individual or Group Project
Select a public company that prepares financial statements under U.S. GAAP. Avoid financial institutions, since their accounting is specialized. Provide an analysis and discussion of:
• the firm’s competitive environment;
• naive equity valuations (without making adjustments to the financial statements) based on: (i) asset value, (ii) earnings power value, and (iii) full value (including growth).
• whether your valuations (in particular, the difference between asset value and earnings power value) are consistent with your assessment of the firm’s competitive environment;
• reformulated financial statements, separating operating from financing activities (on the income statement and balance sheet) and recurring (core) operating earnings components from transitory (non-core) components;
• a big-picture earnings quality analysis (cash flows vs. accruals, total asset turnover, etc.);
• the relationship between the firm’s depreciation and amortization charges and its related capital expenditures (including your assessment of maintenance capex);
• the firm’s non-core/transitory operating earnings components such as asset write-downs and your assessment of how often such charges are likely to recur (use a 10-year history);
• the firm’s most important accounting choices (other than those discussed above);
• a more-detailed red flag analysis, focusing on the key accounting choices you identified above;
• an overall assessment of the firm’s earnings quality (summarize your earnings quality analysis);
• equity valuations that incorporate your earnings quality analysis: (i) asset value (based on your best guess of replacement costs, including the replacement cost of identifiable assets not reported on the firm’s balance sheet such as advertising and R&D but excluding goodwill), (ii) earnings power (with earnings quality adjustments), and (iii) full value (including growth); and
• an overall assessment of the stock as an investment opportunity.
• Optional (extra credit): If the company provides non-GAAP measures to its investors, provide your assessment of the quality of the firm’s non-GAAP reporting.
I would like to have at least one meeting with your group about your project as you are working on it. Your individual project grade will be based primarily on the project itself but will also incorporate feedback your group provides on your contribution to the project. The maximum group size is 3.

IV. CONNECTION WITH THE CORE

This course builds on knowledge from the Financial Accounting (B5000) and Corporate Finance (B5300) fixed core courses. These core courses introduce students to basic financial reporting and analysis concepts. In B7008, 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 B5000 and B5300.

V. TEXT


VI. COURSE OUTLINE

<table>
<thead>
<tr>
<th>Topic</th>
<th>Chapter</th>
<th>Cases and Problem Sets (turn in 4 of 5 Problem Sets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Introduction Review and Preview</td>
<td>Skim: 1, 2, 4, 17</td>
<td></td>
</tr>
<tr>
<td>2 Value Investing &amp; Financial Statement Analysis</td>
<td>5</td>
<td>Dollar General Bids for Family Dollar</td>
</tr>
<tr>
<td>3 Earnings Management Earnings Quality &amp; Red Flags</td>
<td>Skim: 6,7</td>
<td>Trouble Brewing for Green Mountain</td>
</tr>
<tr>
<td>4 Non-GAAP Reporting Revenue</td>
<td>3</td>
<td>Financial Statement Analysis Problem Set Accounting for the iPhone</td>
</tr>
<tr>
<td>5 Receivables Inventories</td>
<td>8, 9</td>
<td>New Century Financial First Solar</td>
</tr>
<tr>
<td>6 Property, Plant, and Equipment Intangible and Other Assets</td>
<td>10</td>
<td>Revenue and Receivables Problem Set AOL Time Warner</td>
</tr>
<tr>
<td>7 Bonds Derivatives</td>
<td>11</td>
<td>Delta’s Derivatives</td>
</tr>
<tr>
<td>8 Fair Value Measurements Leases</td>
<td>12</td>
<td>Inventory, PPE, and Other Assets Problem Set Microsoft’s Leases</td>
</tr>
<tr>
<td>9 Income Taxes Pensions</td>
<td>13, 14</td>
<td>Mike Mayo Takes on Citigroup</td>
</tr>
<tr>
<td>10 Pensions Inter-corporate Equity Investments</td>
<td>14, 16</td>
<td>Ford’s Pensions Bonds, Derivatives, and Leases Problem Set</td>
</tr>
<tr>
<td>11 Business Combinations</td>
<td>16</td>
<td>Coca-Cola: Accounting for Investments in Bottlers Valeant</td>
</tr>
<tr>
<td>12 Owners’ Equity Review</td>
<td>15</td>
<td>Income Taxes, Pensions, and Inter-corporate Equity Investments Problem Set</td>
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A short bio: I joined the faculty of Columbia Business School in 2015 as the James L. Dohr Professor of Accounting and am serving a 3-year term (2019-2022) as chair of the Accounting Division. Before joining Columbia, 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.