

Rutgers School of Business
Financial Statement Analysis (FSA)
Accounting 565
Fall 2008

Instructor: Prof. Sungsoo Kim
Office: Room 333A BSB
Phone: (856) 225-6584
Fax : (856) 225-6231
E-mail: sungsoo@crab.rutgers.edu
Office Hour: 3:00-4:30pm. Tuesday, Thursday or by appointment
Class meeting: 6:00 – 8:40 p.m. Tuesdays @BSB116

Required Materials:

“**Financial Statement Analysis and Security Valuation**”, by Stephen Penman, McGraw Hill Irwin (3rd ed.)

Regular Reading of The Wall Street Journal, Forbes, Business Week, Fortune etc.

Course Description & Objectives: This course is designed to prepare you to interpret and analyze financial statements for tasks involving credit and security analyses, lending and investment decision, and other decisions that must rely on financial data. This course, therefore, explores in greater depth financial reporting topics from the perspective of financial statement users. We develop sufficient understanding of the concepts and recording procedures to enable you to interpret various disclosures in an informed manner. We discuss each financial reporting issue in terms of its effect on assessments of a firm’s profitability and risk. We then apply analytical tools and concepts in competitor analysis, credit and investment decision, bankruptcy prediction, and valuation.

Class Activities: *Short cases (and/or reading assignments) will be provided by the Instructor on selected topics.* Please come to class prepared to discuss your analysis of the cases and problems. Regular class participation is important to the learning process for you and your classmates. Absences from class will affect your participation grade.

Assignments: Assignments are due at the end of the class assigned. No late assignments are accepted, nor are faxed or e-mailed assignments. During class discussions, please feel free to make changes to your solutions (or write-up), but do so in a way that clearly indicates that they are the results of class discussion (e.g., using a different color of ink).

You may work in groups to discuss homework assignments. However, each person should prepare his/her own individual homework solutions to be submitted. Ideally you should work through each day’s assignment on your own before discussing it with anyone. You can then make changes to your solution based on your learning in any discussion. *Interpretations of the analysis should be in your own words.*

Course Structure: The course is organized into three parts:

- Part One: Overview of financial statement analysis. This section emphasizes understanding business activities – planning, financing, investing and operating. It describes strategies underlying business activities and their effect on the financial statements, and it discusses the objectives of analysis. Important tools and techniques in analyzing and interpreting financial statements are illustrated.
- Part Two: Accounting Analysis. This section describes the accounting measurement and reporting practices underlying financial statements. Presentation is organized around financing (liabilities and equity), investing (assets), and operating (income and cash flow) activities
- Part Three: Financial Analysis. In this section, the processes and methods of financial statement analysis are examined. The objectives of users and the analytical tools and techniques for meeting those objectives are emphasized. This section demonstrates how analysis tools and techniques enhance users’ decisions – including company valuation and lending decisions. It also shows how financial statement analysis reduces uncertainty and strengthens confidence in making timely business decisions.

Semester Project: Please refer to the below.

Grading policy: The course grade for each student will be determined based on the following activities:

Class participation	10%
Midterm	30%
Homework assignments	20%
Presentation	10%
Final project (to be submitted last day of class)	<u>30%</u>
Total	100%

Related Web Addresses

Filings with the Securities and Exchange Commission:

www.sec.gov (click on “Edgar Data Base”)

Pronouncement of the Financial Accounting Standards Board(FASB):

www.fasb.org

Pronouncement of the International Accounting Standards Committee

www.iasc.org.uk

Professional Announcements and membership info for CPAs:

www.aicpa.org

Financial Data and current business news:

www.hoovers.com (for about 10,000 companies financial and nonfinancial info)

www.disclosure.com,

www.fortune.com,

www.cnnfn.com

Schedule of class activities for FSA

Week		Chapter	Topic	Homework Assignment	Due Date
1	Sep 2	Ch 1-2	Introduction to Investing and to the Financial Statements		
2	Sep 9	Ch 3	Choosing a Technology: Method of comparables Asset-based Valuation Screening Analysis Pro Forma Analysis	E2-10,11,12	
3	Sep 16	Ch 4	Dividend Discount Analysis Discounted cash flow Analysis Contrasting Cash accounting with Accrual Accounting	E3-13,16,17,18	
4	Sep 23	Ch 5	Pricing Book Values	E4-6,8,12,17	
5	Sep 30	Ch. 6	Pricing Earnings	E5-3,8,10,14,15	1-page Outline on Project
6	Oct 7	Ch 8	Analysis of the Statement of Shareholders Equity	E6-11,12,13,14	
7	Oct 14	Ch 7	Midterm I (Chs. 1-5) Operating and Financing Activities and the analysis of Balance Sheet and Income Statements	E8-8,9,10,11	
8	Oct 21	Ch 9	Balance Sheet and Income Statements	E7-4,5,6	2-page writeup on Proj.
9	Oct 28	Ch 11	Profitability analysis	E9-7,8,9,10	
10	Nov 4	Ch 12	Analysis of Sustainable Earnings and Growth	E11-4,6,7	
11	Nov 11	Ch. 10	Analysis of Cash flow Statement	E12-11,12,14	
12	Nov 18	Ch. 13	Pro forma Analysis for operating and financing activities: enterprise valuation and leverage	E10-7,8,9	
	Nov 25	Thanksgiving			
13	Dec 4	Ch.14	Simple Forecasting and Valuation	E13-8,10,15,16	
14	Dec 11		Presentation Term Project due	E14-10,12,13,14	Term Project

Term Project

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Required:

Download a copy of the 2007 Annual Report of companies of your choices (whose stocks are publicly traded) from one of the industries listed below. Analyze the financial statements in detail, focusing on the analysis questions below. You may use external corroborating data or information if such data/information aids you in your analysis.

INDUSTRY	SIC CODE
1. Food & Kindred Products	2000 – 2111
2. Chemical & Allied Products	2830 – 2836
3. Heavy Machinery & Equipment	3500 – 3569
4. Computers	3570 – 3779, 3670 – 3679
5. Transportation	4000 – 4899
6. Electric & Gas Utilities	4911 or 4931
7. Insurance & Real Estate	6500 – 6999
8. Computer Services (network, programming, internet, etc.)	7370 – 7379

Purpose of the Project:

The purpose of the term project is to apply financial analysis and valuation concepts, tools, and techniques to an issue or situation of particular interest to you. You should organize yourself into teams of two students for the project. In addition to preparing a written report, each team should be prepared to present its project in class.

The term project will give you the opportunity to study, in depth, the implications of a specific accounting issue/controversy, a financial transaction (such as a management buyout, a merger, or acquisition), a particular circumstance (such as financial distress), a single firm or an industry. It will also give you the opportunity to develop your research, report writing, and presentation skills. Your project should evidence detailed analysis of financial statement data, including footnotes.

Your report will be improved if you apply the concepts, tools, and techniques of analysis developed in the course (such as a discussion of accounting issues and choices, and financial analysis, forecasting, and valuation techniques). *The project should also include some form of "benchmarking," that is, a comparison to similar circumstances or firms.*

The written part of your project should be no more than 20 pages (double-spaced, word processing font no smaller than 12-point, one-inch margins all around), including tables, graphs, appendices, and references. Also include any supporting financial statements and articles (these do not count as part of the 20-page maximum length).

Structure of the Project

The following are some approaches you might consider. Other forms are possible, but we should discuss your ideas before you try a project that differs radically from all of the suggested approaches.

1. Specific Accounting Issue/Controversy

Select a particular accounting issue/controversy, which has been in the news recently (e.g., accounting for start-up costs and intangibles by internet companies, the write-off of purchased R&D, the management of earnings.) Identify four or five firms that have been involved in or have utilized this particular accounting practice. Analyze the firms' performances with and without the utilization of the specific accounting practice. How does the choice of this accounting practice affect the ability to evaluate the performance of the firms? What would you recommend?

2. Case Study of One Firm

Select a firm in which you have a particular interest. Analyze this firm's performance relative to its past performance and relative to the performance of other firms in its industry. Is the performance improving/declining? To what would you attribute the changes? What recommendations would you have to improve the performance further? Given current stock prices, would you recommend a buy/hold/sell strategy? Why?

3. Case Study of One Transaction

Choose a transaction that particularly interests you, such as an initial public offering, management buyout, acquisition, merger, or divestiture. Analyze the price at which the transaction occurred. Was the price "fair" to all interested parties? Was the transaction desirable (based on publicly available information at the time and financial data for comparable firms)? Did the transaction turn out well?

4. Case Study of One Circumstance

Choose a firm that is in a particular circumstance that interests you, such as financial distress, alleged poor management, alleged fraudulent reporting, or strong competitive pressures to restructure. Compare the firm's financial performance to its own past performance and that of "comparable" firms. Recommend a course of action for management and/or investors to pursue. For firms in financial distress, you should document the symptoms of distress that your analysis uncovers, and comment on the firm's ability to survive.

5. Valuation of One Firm:

Choose a firm and try to assign a valuation based on the financial statement information. Excel spreadsheet template will be provided by the instructor. You need to make a number of assumptions in this exercise, but the instructor will be available for consultation if you choose to do this option.

Project Development Schedule-

1. Tuesday, Sep 30, 2008 - one-page description of the project is due.
2. Tuesday, Oct 21, 2008 - A two-page outline presenting the characteristics of the accounting issue/controversy, transaction, circumstance, firm, or industry is due. The two-page outline should also indicate significant progress in any business strategy and accounting/financial analysis relevant for your study.
3. Wednesday, Dec 11, 2008 - The final paper is due by the last class.

Tip: Describe any industry specific accounting problems and practices. Tabulate and compare the accounting methods chosen by your firms in their most recent financial statements. How do these choices affect the ability to make comparisons among firms? Compare the most important financial ratios for your set of firms. How is this comparison affected by your firms' accounting choices? What do these ratios suggest about firm strategies within the industry? If you were making stock recommendations, would you recommend buy/hold/sell on any of these firms? Why, or why not?

You should support your analytical inferences with figures/computations, making valid or reasonable assumptions as necessary. Your analysis should explore (in depth) the risks, accounting and/or market returns, strengths, opportunities, uncertainties, threats, etc., that face the company