

BOSTON COLLEGE
WALLACE E. CARROLL SCHOOL OF MANAGEMENT
MA 824 Financial Statement Analysis
Summer, 2009

Prof. Billy S. Soo
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Text and Materials:

The Analysis and Use of Financial Statements, White, Sondhi & Fried (WSF), 3rd edition, Wiley, 2003 [optional]

Course notes for MA 824, Summer 2009, Prof. Billy Soo [required]

Course Description and Objectives:

Financial statements are widely used to evaluate a firm's past performance and future prospects. Effective analysis of financial statements requires a thorough understanding of a firm's business characteristics and strategy, *and* the accounting policies and procedures underlying the firm's financial statements. By carefully reviewing a firm's business and reporting strategies, an analyst can better assess the credibility of a firm's results and the likelihood of it attaining its future targets. By understanding the company's accounting policies and procedures, an analyst can better evaluate the reliability and validity of the firm's reported numbers. This dual approach towards analyzing financial statements allows the student to integrate concepts learned from accounting, economics, finance, marketing, operations and strategy, resulting in a much more thorough analyses of a firm's prospects.

The specific objectives of this course are to help you develop an understanding and the skills in the following areas: (i) identification and evaluation of business strategies and associated critical success factors and risks; (ii) assessing the appropriateness of accounting choices and disclosures given the economic realities confronting the business; (iii) using financial analysis for evaluating and projecting performance; and (iv) appreciating the potential of accounting information in the valuation of firms. Throughout the course, we will also consider and evaluate the role and incentives of company management and information intermediaries such as auditors and analysts with respect to disclosure of information.

Pedagogy:

Classes will generally consist of lectures and case discussions. New material will be introduced on lecture days. It is my expectation that you will have at least browsed through the material from the course packet and the text. Although examples illustrating the more technical topics of the material will be discussed in class, the assigned homework problems will not. To reinforce the material, however, I encourage you to practice your knowledge by working on the assigned homework. We will devote most of the case day to going over the assigned case. Everyone should come to class prepared to discuss the assigned case. In addition, we will devote some time going over the assigned Wall Street Journal article based on the previous class's lecture.

Grading:	Written Case Analyses	40%
	Class Participation:	
	Recitation	20
	Attendance	<u>10</u> 30
	Final Exam	<u>30</u>
		<u>100%</u>

Case Analyses: In groups of two to three, you should submit a typewritten analysis of each of the assigned cases. Make several copies of the report --- one for each of the group members as a reference during class discussion and one to be submitted to me at the *beginning* of class. The case analysis should respond specifically to the case questions outlined in the syllabus in a clear and concise manner. The report should be no longer than two pages of text plus three pages of exhibits if necessary (single spaced, one-inch margins, 10 point font minimum), unless otherwise indicated. To maintain these limits, it is important that you focus on answering the guide questions rather than repeating the highly descriptive text that has already been covered in the case. In answering the case questions, use only the information available at the time of the case. Specifically, do not use subsequently issued standards or rules to determine or justify your answer.

I will not accept any reports once the class has discussed the case. Thus, if everyone in your group will be unable to attend class, it is essential that someone drops off the write-up in my office or e-mails me your report *before* the case is covered in class.

Class Participation: A large component of your final grade is based on class participation. Historically, class participation has been the most significant, distinguishing factor in determining final grades. However, you should not feel intimidated by this. Past experience suggests that if you spend sufficient time in case preparation and the class environment is nurturing yet stimulating (my goal), you will want to participate. If for whatever reason you are unable to express your ideas in class, come by my office early in the course so that I can assist you in developing a strategy to overcome this shyness.

Class participation will be measured in two ways: class attendance and class recitation. By attending class, you earn a minimum amount of credit. However, your presence in class implies that you have prepared for the case and are therefore fair “game” to be called upon in class. To distinguish between students who do not show up for class and those that attend but do not participate (because they did not raise their hands or I did not call them), 10% of your grade will be based solely on class attendance. Even though the written case analyses are prepared as a group, I expect each member to be prepared to participate in class. There is an important distinction between high and low quality recitation. Class recitation is considered good if you add content by contributing new ideas or by expanding on (*not repeating*) your classmates’ contributions, or through process by raising issues that move the discussion along. Frequency without content or process does not contribute to the class (nor to your grade).

To adequately prepare for the class, you need to answer the assigned questions and be ready to introduce the case. For each case, I will randomly choose an “opener” and

expect that individual to have an introduction that (i) introduces the company; (ii) identifies the key decisions faced by the case participants; (iii) briefly outlines the alternatives to these decisions and their expected costs and benefits; and (iv) expresses the opener's preliminary opinion on these decisions. The selection of the opener is made *at the beginning of the class*. Missed opportunities adversely affect your class recitation score so try not to be absent nor late for class.

Final Exam: A final exam will be given. The exam will consist of multiple choice and open-ended Theory/Practice questions based on material covered in class and any assigned homework. If you conscientiously follow the lectures and do your homework, you should do well in the final exam. **No makeup will be given to the missed exam.**

Study Guidelines:

To maximize your learning (and grades) from the class, it is important that you spend a significant time preparing the written case summaries. Because the class discussion is based on these same case summaries, you will be effectively preparing for both requirements of the class. As part of this preparation, you should read the text and review any handouts or class lectures. For each case, carefully consider the guide questions and issues. Although the reports are written by one group, I encourage you to discuss the case with your other classmates. By "sounding out" or testing your ideas with your classmates, you will be better prepared to articulate and defend your views in class. Merely reading the case and sketching a few notes on the margins will *not* adequately prepare you for class.

In addition, it is also important for you to read the course packet and work on the assigned problems. Although the problem solutions will not be discussed in class, the exam will be primarily based on questions similar to those of the problems. If any of the material is not clear, feel free to email me for questions or to set up an appointment to see me.

Needless to say, it is a violation of the academic code of ethics to refer to case notes or solutions obtained through the internet or from people who previously have studied the case. Not only will this not help you in the final exam, it will also cheat you of the academic experience. It is the responsibility of the group to report anyone who violates this principle.

If you have a disability and will be requesting accommodations for this course, please register with either Kathy Duggan (Kathleen.duggan@bc.edu) Associate Director, Academic Support Services, the Connors Family Learning Center (learning disabilities and ADHD) or Suzy Conway (suzy.conway@bc.edu), Assistant Dean for Students with Disabilities (all other disabilities). Advance notice and appropriate documentation are required for accommodations.

Honesty & Integrity...Mutual Respect...Pursuit of Excellence...Personal Accountability

Course Schedule Quick Look

	<u>Date</u>	<u>Case Due</u>	<u>Lecture</u>	<u>WSF Chapter</u>	<u>WSF Problems</u>
	Self-study		Financial Analysis (ratios)	4 (110-149,152-154 only)	4-17, 4-19
(1)	5/27 (Wed)		Framework; Review of Financial Statements (Balance Sheet & Income Statement)	2 (28-39, 52-68 only)	2-13, 2-14
(2)	5/29 (Fri)	Harnischfeger	Revenue recognition	2 (39-52 only)	2-9, 2-17, 2-21
(3)	6/1 (Mon)	Triangle Manufactured Homes	Review of Financial Statements (Cash Flows)	3	3-2, 3-12
(4)	6/3 (Wed)		Inventories Long-term Assets: Capitalize v Expense	6 7-8	6-2, 6-10, 6-20, 6-21 7-1, 7-5, 7-9, 8-2, 8-8, 8-12, 8-14
(5)	6/5 (Fri)	Prepaid Legal	Off-Balance-sheet Activities & Investments	11 (376-386 only), 13 (455-482 only)	11-14, 11-18, 13-5, 13-6
(6)	6/8 (Mon)	Anacomp	Asset securitizations		
(7)	6/10 (Wed)		Pensions	12 (401-438 only)	12-4,12-5, 12-20
(8)	6/12 (Fri)	Harley Davidson	Deferred taxes	9 (290-314 only)	9-6, 9-9, 9-13
(9)	6/15 (Mon)	Boston Chicken	Foreign Currency	12 (438-442)	12-21
(10)	6/17 (Wed)		Foreign Currency	15 (546-574 only)	15-2, 15-3, 15-4, 15-5
(11)	6/19 (Fri)		<i>Final Exam</i>		

Pre-class

- Financial Analysis
- WSF, Chapter 4 (pp. 110-154)
- WSF, Problems 4-17, 4-19

Class 1: (5/27)

- Overview of course; Course Framework
- Review of Financial Statements – Balance Sheet and Income Statement (course packet)
- WSF, Chapters 2 (pp. 28-39, 52-68 only)
- WSF, Problems 2-13, 2-14

Class 2: (5/29)

- Case: Harnischfeger Corporation – course packet

Guide Questions:

For class discussion only: Describe Harnischfeger's business and the conditions it was facing at the time of the case.

1. Identify all accounting policy changes and accounting estimates that Harnischfeger made during 1984. Estimate the effect on the company's 1984 reported profits and cash flows. Use the following table as a format:

Policies/Estimates Changes	1984 Net income effect	EPS effect	Operating Cash flow effect	Future net income effect (one-time or recurring; + or -)
1) ...				
2) ...				
...				

If the amounts are not determinable, specify if the impact is increasing (+) or decreasing (-).

On a separate list, identify other non-recurring (accounting or otherwise) transactions that affected 1984 income.

2. What do you think are the motivations of Harnischfeger's management in making these changes to its financial reporting policies? Do you think that investors will see through these changes?

3. Assess the company's future prospects given your insights from questions 1 and 2 and the company's turnaround strategy.

- Income Statement WSJ article (course packet): “Missed Signals ...”
- Revenue Recognition (course packet)
- WSF, Chapter 2 (pp. 39-52 only)
- WSF Problems 2-9, 2-17, 2-21

Class 3: (6/1)

- Case: Triangle Manufactured Homes, Inc.

Guide Questions:

For class discussion only: Describe Triangle Manufactured Homes’ primary lines of business. What are the critical risks to its business?

1. Identify and evaluate the revenue recognition (and related) policies of Triangle Manufactured Homes. What are the key assumptions behind these policies? Do you think that these assumptions are justified (cite evidence in support of or against these assumptions)?
2. Evaluate the company’s financial and operating performance during 2006 and 2007 overall and by operating segment using key financial statement ratios.
3. Identify potential trouble spots based on the analysis in #2. Cite specific instances mentioned in the case that would validate the areas of concern.

- Revenue recognition WSJ article (course packet): “Accounting Questions Swirl ...”
- Revenue recognition Mini-cases (course packet)
- Review of Financial Statements – Statement of Cash Flows (course packet)
- WSF Chapter 3
- WSF, Problems 3-2, 3-12

Class 4: (6/3)

- Cash Flow WSJ article (course packet): “Cash Flow Never Lies ...”
- Accounting for Inventories (course packet)
- Inventories WSJ article (course packet): “Short Order: Costly Inventory Lesson ...”
- WSF Chapter 6
- WSF Problems 6-2, 6-10, 6-20, 6-21
- Analysis of Long-lived Assets (course packet)
- WSF Chapters 7 and 8
- WSF Problems 7-1, 7-5, 7-9, 8-2, 8-8, 8-12, 8-14

Class 5: (6/5)

- Case: Pre-Paid Legal Services, Inc.

Guide Questions:

For class discussion only: Describe PPLS's business.

1. How does PPLS create value for its customers? What are the critical risks in its business model? How does it manage these risks?
 2. Why do you think the company changed its commission policy in 1995? Provide both quantitative and qualitative reasons for doing so.
 3. What are the financial statement consequences of using the pre- versus post-1995 commission scheme? Evaluate in the context of membership persistence and growth.
 4. Should the company write-off the prepaid commissions as Fortune suggests? What are the financial statement consequences of doing so?
- Off-Balance-Sheet Activities and Investments (course packet)
 - WSF Chapter 11, pp. 376-386 only and chapter 13, pp. 455-482 only
 - WSF Problems 11-14, 11-18; 13-5, 13-6

Class 6: (6/8)

- Case: Anacomp

Guide Questions:

For class discussion only: Describe Anacomp's business and the challenges it faced at the time of the case.

1. Evaluate Anacomp's business new product development strategy. In particular, discuss and describe how Anacomp develops its software products. How does this differ from in-house software development? What are the risks and benefits of this strategy for Anacomp's shareholders?
2. What is the impact of the above new product development strategy on the company's financial statements compared to in-house development?
3. Evaluate the quality of Anacomp's earnings and financial condition. Provide examples from the case facts to support your assessment.

- Asset securitizations
- OBS WSJ article (course packet): “Fast Relief ...”

Class 7: (6/10):

- Pensions (course packet)
- Pensions WSJ article (course packet): “Lift’s Off: ...” and “Financial surgery ...”
- WSF Chapter 12 (pp. 401-438 only)
- WSF Problems 12-4, 12-5, 12-20

Class 8: (6/12)

- Case: Harley Davidson

Guide Questions:

For class discussion only: Describe Harley Davidson’s lines of business.

1. Why does Harley Davidson engage in securitization? What are its alternatives to securitization and how do they differ in terms of their impact on the financial statements?
2. Why are analysts concerned about Harley Davidson? Provide specific examples from the financial statements why it is a growing concern.
3. If you were Harley’s management, what changes would you make, if any, to assuage the market’s concerns?

- Deferred taxes (course packet)
- WSF Chapter 9, pp. 290-314
- WSF Problems, 9-6, 9-9, 9-13

Class 9: (6/15)

- Case: Boston Chicken

Guide Questions:

1. Assess Boston Chicken’s business strategy. What are its critical success factors and risks?

2. What are the major accounting policies that have a significant impact on the company's financial statements? What are the financial statement consequences of these policy choices? What are the key assumptions behind these policies? Are these assumptions justified given the company's strategy and prospects?

3. Assess Boston Chicken's current condition and future potential given its business strategy, accounting policies, and recent performance.

- Deferred taxes WSJ Article (course packet): "Nortel's appeal ..."
- Foreign Currency Accounting (course packet)

Class 10: (6/17):

- Foreign Currency Accounting (course packet)
- WSF Chapter 15 pp. 546-574 only
- WSF Problems 15-2, 15-3, 15-4, 15-5

Class 11: (6/19): Final exam

EVALUATION OF GROUP MEMBERS

INSTRUCTIONS: Complete the following evaluation for your entire group. Identify your group members in the column headings (you **MUST** include their names). **INCLUDE YOURSELF IN THE EVALUATION!!** Place your completed evaluation in a sealed envelope and return it **DIRECTLY** to the professor on the day of the final (May 3). Use the following categories to assign numerical scores from 0 to 10.

	Score		Score
Outstanding	10	Below Average	5 to 6
Excellent	9	Poor	3 to 4
Above Average	8	Unsatisfactory	1 to 2
Average	7	Did not participate	0

Scores for each Group Member (write a score from 0 to 10 per cell)

Evaluation Criteria	Your Name:	Name:	Name:
1. Attendance in group meetings.			
2. Contributed to group discussions.			
3. Assumed a fair share of the group work.			
4. Worked well with others.			
5. Was creative and enthusiastic.			
6. Assumed a leadership role.			
7. Contributed to the writing and editing of progress reports.			
8. Was timely in preparing work			
9. Provided quality work.			
10. Helped others in the group to learn.			
TOTAL - please add the total points for each group member (range: 0-100)			