Accounting 510; Autumn 2013
Introduction to Financial Statement Analysis
10:30am-12:20pm Monday and Wednesday
PCAR 394

Professor: Sarah McVay
Office: PCAR 549
Office Hours: By appointment
Email: smcvay@uw.edu
Web Page: canvas.uw.edu

Course Description
Over the next ten weeks we will discuss financial reporting from a user’s perspective, use a variety of tools to break apart financial reports into meaningful units for analysis, forecast financial statements, and value a firm. We will also cover the context of financial reporting to understand how GAAP rules and managerial incentives affect the quality and interpretation of financial statements.

The Course Diagram

The course is divided into 5 sections: (1) Information collection, (2) Processing Information (the role of incentives), (3) Processing Information (accounting analysis), (4) Improving Forecasting, and (5) Valuation and Decision Making. These sections will provide us the structure we need to help us become more informed users of financial information.

Course Objective
The broad objective of this course is to provide you with the knowledge and skills necessary to analyze, interpret, understand, and use publicly available financial information to make informed decisions. Specifically, this course examines the role of corporate financial reporting in financial analysis. The focus is on the analysis of public companies performed by external parties, with a particular focus on equity valuation. Tools learned will also be
useful for credit analysis, predicting financial distress, and evaluating managerial performance. The course is designed to achieve the following objectives:

- To develop skills in analyzing financial information found in annual (10-K) and quarterly (10-Q) SEC filings.
- To develop an appreciation for the usefulness and limitations of this financial information;
- To develop an understanding of, and appreciation for, fundamental financial statement analysis;
- To use the above knowledge to forecast a firm’s financials and generate an estimated value of the firm.

**Course Materials**

**Required**

**Optional**
2) (Text) *Financial Reporting & Analysis (Fifth Edition)* by Revsine, Collins, Johnson, and Mittelstaedt (McGraw-Hill Irwin, 2012). Note that this text is a resource for more complex financial accounting issues (i.e., accounting for pensions and derivatives).

Any cases or exercises not included in the course pack will be available in class or on our Canvas course web site.

⇒ If you wish to explore a topic more deeply please see me for additional information.

**Communication**

I will use canvas and UW e-mail to communicate. Please be sure you have access to Canvas (email me if not), and be sure to check your UW e-mail regularly.

**Point Distribution**

<table>
<thead>
<tr>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analyst Report</td>
</tr>
<tr>
<td>Exam I</td>
</tr>
<tr>
<td>Exam II</td>
</tr>
<tr>
<td>Professionalism and participation</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

* I consider all written work as professional writing assignments. Please proof your work.

**Analyst Report:** The purpose of the analyst report is to have you apply the various tools and techniques we cover to a publicly-traded firm of your choosing. Please fill out the “Firm Sheet” on Canvas by the end of the day **October 2**. You **may not** follow Apple, Google, Netflix or Starbucks. I suggest that you avoid banks, firms that have recently been involved in large mergers, and firms with negative equity (these will be more challenging to forecast and value).
The analyst report consists of four deliverables.

- **UNDERSTANDING YOUR FIRM:** Overview of what your firm does, and the biggest challenges it faces; a discussion of vertical and horizontal statements.
  - Due on **October 13 (Sunday).**

- **FINANCIAL STATEMENT ANALYSIS:** Calculate the core ratios for your firm and compare to industry peers, acknowledge and adjust for any GAAP-driven accounting distortions, analyze the quality of earnings.
  - Due on **October 28.**

- **FINANCIAL STATEMENT FORECASTS:** Forecast financial statements for your firm.
  - Due on **November 17 (Sunday).**

- **FIRM VALUATION:** Use the financial statement forecasts to form a valuation.
  - Due on **December 4.**

A checklist for each deliverable is available on Canvas. Please note the page limits!

- **Exam I:**
  - You will complete Exam I in class on **October 30.** Exam I will consist of several questions designed to assess your comprehension of the material we will cover in the first half of the quarter. You may bring one page of notes (front and back) to the in-class exam.

- **Exam II:**
  - You will complete Exam II as a take-home exam; it will be available at the end of our final day of class on **December 4 (Wednesday).** Exam II will consist of questions designed to assess your comprehension of the material we will cover this quarter. You can use anything you want to complete the exam (other than other people), but you must show your work…so any work done on your computer must be provided (including any formulas).

- **Professionalism and participation:** I expect you to treat this class as you would treat any professional responsibility. For example, I expect you to be on time and prepared to discuss all materials relevant to the topic of the day. Learning is an active process. Hence, your *high-quality* participation will be evaluated on a daily basis.
# COURSE OUTLINE

All materials referenced in this section are available in the coursepack unless otherwise noted.

## Section 1: Collecting Information

<table>
<thead>
<tr>
<th>Date</th>
<th>Class</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 25</td>
<td>Class 1: Introduction and framework for the course. Reading: “Information Collection” (Read after class)</td>
<td></td>
</tr>
<tr>
<td>September 30</td>
<td>Class 2: Using accounting information to understand the business. Reading: “Understanding the Business”</td>
<td></td>
</tr>
<tr>
<td>October 2</td>
<td>Class 3: Using strategy analysis to understand the business Case: “Apple and the iFad” (prepare before class, only do up to Q6)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Firm Sheet due on Canvas by end of day</td>
<td></td>
</tr>
</tbody>
</table>

## Section 2: Processing Information (the role of incentives)

<table>
<thead>
<tr>
<th>Date</th>
<th>Class</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 7</td>
<td>Class 4: Using ratio analysis to understand the business / introducing incentives Case: “Starbucks v. McDonalds” Reading: “Freakonomics - School Teachers”</td>
<td></td>
</tr>
<tr>
<td>October 9</td>
<td>Class 5: Incentives matter – compensation packages. Case: “Al Dunlap at Sunbeam” First deliverable of analyst report due on Canvas by midnight October 13</td>
<td></td>
</tr>
</tbody>
</table>

## Section 3: Processing Information (accounting analysis)

<table>
<thead>
<tr>
<th>Date</th>
<th>Class</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 14</td>
<td>Class 6: Understanding accounting disclosure versus recognition Case: “Magnet Beauty Products”</td>
<td></td>
</tr>
<tr>
<td>October 16</td>
<td>Class 7: Understanding accounting, capitalizing versus expenses Case: “CUC International”</td>
<td></td>
</tr>
<tr>
<td>October 21</td>
<td>Class 8: Understanding accounting, pensions, derivatives, and earnings management Reading: Financial Shenanigans</td>
<td></td>
</tr>
<tr>
<td>October 23</td>
<td>Class 9: Understanding accounting disclosures (Pro-forma income) Case: “Case: Compuware”</td>
<td></td>
</tr>
<tr>
<td>October 28</td>
<td>Class 10: Overflow and Exam I Q&amp;A Second deliverable of analyst report due on Canvas by the end of the day</td>
<td></td>
</tr>
<tr>
<td>October 30</td>
<td>Class 11: Exam I will assess your understanding of Sections 1-3.</td>
<td></td>
</tr>
</tbody>
</table>
## COURSE OUTLINE

All materials referenced in this section are available in the coursepack unless otherwise noted.

### Section 4: Improving Forecasting

#### November 4

**Class 12: Approaches to forecasting using historical information**

“Forecasting Financial Statements” (this is a long chapter, and can be done either before or after class)

#### November 6

**Class 13: Management Guidance (or forecasting provided by the firm)**

Case: “Google and Earnings guidance”

### Section 5: Valuation and Decision Making

#### November 11

*No Class (Veteran’s Day)*

#### November 13

**Class 14: Implementation of a detailed forecast**

Case: “Netflix: A Forecasting Case using Voluntary Disclosures”

**Third deliverable of analyst report due on Canvas by midnight November 17**

#### November 18

**Class 15: Using forecasts to construct valuation estimates**

Reading: “Using a Valuation Model to Estimate a Firm’s Stock Price”

#### November 20

**Class 16: Using forecasts and valuation estimates to inform decisions**

### 10

#### November 25

**Class 17: How accounting analysis may inform valuation and the role of third parties**

#### November 27

**Class 18: Work day**

### 11

#### December 2

**Class 19: Overflow and review**

#### December 4

**Class 20: Exam II Q&A**

**Fourth deliverable of analyst report due on Canvas by the end of the day**

---

<table>
<thead>
<tr>
<th>Date</th>
<th>Class</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 9 (Monday)</td>
<td>Exam II</td>
<td>Exam II will assess your learning of Sections 4-5.</td>
</tr>
<tr>
<td></td>
<td>Exam II</td>
<td>Take-home exam is due on Canvas by midnight.</td>
</tr>
</tbody>
</table>

---

A510 Course Syllabus