

**FINANCIAL ACCOUNTING AND REPORTING**

FALL 2013

COR1-GB.1306.02, KMEC 2-70 (Wed., 9:00-11:50am)

COR1-GB.1306.04, KMEC 3-55 (Wed., 1:30-4:20pm)

COR1-GB.1306.06, KMEC 3-55 (Mon., 1:30-4:20pm)

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**Office Hours:** Mondays 10:00-11:30am; Thursdays 10:00-11:30am  
Or by appointment.

**Overview:** My objective in this course is to teach you how to read, understand, and analyze the financial statements and information disclosures of most publicly-traded companies. At the very beginning of the course, you will also learn how to *prepare* very basic financial statements. This course is intended for students with no previous exposure to financial accounting. Importantly, I take an external user's perspective, as opposed to an accountant or internal user's perspective. External users include investors, creditors, customers, suppliers, government regulators, and business school students. A solid understanding of the fundamentals covered in this course will enable you to do well in more advanced finance and accounting courses, as well as interview intelligently for jobs in finance, consulting, and general management.

This course begins with the basic concepts of accounting. We begin by looking at the main financial statements: balance sheet, income statement, statement of cash flows, and statement of stockholders' equity. Particular attention is paid to how these four statements relate to each other and how they provide information about the financial health of a company. We then cover specific items from the financial statements and apply tools of analysis whenever possible.

The lecture examples, homework assignments, and exams are based on very recent financial information released by companies making headlines in today's news. You will learn by analyzing firms' recent earnings announcements, listening to management conference calls with analysts, and understanding the concerns of users of firms' financial accounting information.

**Topics Covered:** My plan is to cover the following topics in order. Keep in mind that some topics require only half a lecture to cover while other, more difficult topics require several lectures to cover.

1. The purpose of financial statements and its users
2. Accrual basis of accounting
3. How to record economic transactions (by hand)
4. How to prepare and present financial statements (by hand)
5. Cash flow analysis
6. Working capital analysis
7. Margin analysis
8. Net present value computations
9. Pricing and accounting for bonds
10. Contingent liabilities
11. Operating and capital leases
12. Stock and employee stock options
13. Net sales, accounts receivables, and bad debt
14. Inventory accounting, excess and obsolete inventory
15. Property, plant & equipment, intangible assets, impairment charges
16. Return analysis
17. Basic stock valuation

**Textbook:** Libby, Libby and Short, *Financial Accounting, 7<sup>th</sup> Edition*. The textbook covers the basic material in the course, including background information, accounting rules and conventions. I find that this textbook has a good balance of topics covered while deferring more complicated topics to more advanced textbooks. Unfortunately, there are typos in the textbook, which I have collected over the past several years (see the end of the assigned chapter readings for a list). Any material that I assign from the textbook is fair game for exams.

**Lecture Slides:** Most lectures will use the aid of Powerpoint slides, which will be given to you in a booklet. Just like with the textbook material, any material included in the slides is fair game for exams.

**Homework:** There will be two types of homework assignments: textbook and non-textbook. I hand pick textbook problems that I think are useful to practice and that reinforce basic accounting proficiency, but they will not be submitted or graded. Answers to these textbook problems will be provided on NYU Classes and I will not be going over them in class.

Conversely, non-textbook homework assignments will be submitted and graded. These assignments are integral aspects of this course. The types of analyses you perform during these assignments are very similar to what you would be expected to do on an exam and in a real-world task such as assessing the health and performance of a company and valuing its stock. They typically require you to gather information about a company (from the company or SEC website), carefully read over financial statements, possibly listen to a conference call, and conduct the analyses that we discuss in class. Students who do not complete the assignments inevitably perform worse on exams than students who do.

You must submit a hardcopy of your completed homework at the beginning of class on the date due; late homework will either receive a partial deduction in points, or depending on the lateness, not be accepted at all. Solutions to textbook and non-textbook homework will be posted to NYU Classes.

**Quizzes:** There will be many quizzes given in class over the course of the semester, none of which will be handed in or graded. The purpose of these quizzes is for YOU to find out whether you understand the material and are able to perform the accounting and finance computations discussed in lecture in a timely manner.

**Exams:** There will be three exams, two during the semester and one during finals. All exam questions are based on actual financial statements from a publicly-traded company, and the questions can resemble questions from homework (textbook and non-textbook), lectures, and even prior exams. Prior exams will be made available for your practice.

All exams are closed book, but you are allowed one sheet of notes (normal 8.5" x 11" size, front and back, typed or hand-written). You also need a calculator (simple, financial, or scientific). Finally, past students have found it much easier to take my exams when they use a highlighter to highlight important line items on a firm's financial statements.

You can consider the first two exams to be "mid-terms" and the last exam to be the "final." If you miss one of the mid-terms, there will be no makeup exam. Instead, more weight will be applied to the other mid-term. There will be no makeup for the final exam. If you miss the final, then you will receive a zero for that exam.

**Grading:** Your grade will be based on 15% homework, 15% first exam, 20% second exam, 40% final exam, and 10% class professionalism.

Note: Some homework assignments include extra credit, so it is possible that you can earn "more than 100%" on homework assignments over the course of the semester. However, the most that homework will count towards your grade is 15%. For example, if you earn 208 out of 200 homework points, then you get  $(200/200)*15\%=15\%$ , not  $(208/200)*15\%=15.6\%$ . There will no extra credit on exams.

Class professionalism will be fully explained during the first class meeting, but in general, it is *not* the same as class participation. Professionalism means taking the course seriously and avoiding behaviors that are disruptive to me and the class. For example, though I know that some of you are accustomed to taking notes on your laptops, laptop use in this class is not allowed. Other electronic devices including iPads, tablets, smartphones, Blackberries, etc. are also not permitted during lectures and exams. Using electronic devices during class will lower your professionalism score. Also, attendance is one element of class professionalism (see policy on attendance below). In past semesters, differences in class professionalism scores among students made big differences in the final grades.

**Attendance:** Attending lecture is very important for understanding all the material; students who miss several classes inevitably perform worse than students who make it to every class.

Accordingly, attendance is one element of class professionalism. However, since full-time MBA students must sometimes miss class for various reasons, my policy is to allow **two** absences (out of the 13 weekly class meetings) without penalty. You may miss class for interviews, travel, sickness, or religious holidays. You do not need to email me in advance nor provide me a doctor's note. Starting with a **third** absence, however, there will be deductions to your class professionalism score.

**Code of Conduct:** As a student at Stern, you are expected to conduct yourself as a business professional. The Stern School does not tolerate cheating, nor does your future employer. Please know that the penalty for cheating is an automatic grade of F for the course and appearance before the Student Disciplinary Committee. I am very strict on this issue. I will do what I can to help you learn the material in this course. All I ask is that you do not cheat yourself, your fellow classmates or the Stern School. Please see [www.stern.nyu.edu/uc/codeofconduct](http://www.stern.nyu.edu/uc/codeofconduct) for more information.

**Students with Disabilities:** If you have a disability that you feel may affect your class performance, please let me know early in the semester so that arrangements can be made, in consultation with the Henry and Lucy Moses Center for Students with Disabilities, to accommodate your needs. Please see [www.nyu.edu/csd](http://www.nyu.edu/csd) for more information.

**Small Group Lunches:** This is completely voluntary. I am treating for lunch once a week for up to 5 students at a time to chat in an informal setting. We go on Mondays to the Torch Club, which is two blocks from Stern (18 Waverly Place). To sign up, open the Google Docs Excel file (link below) and write your name into a date and time slot (the file should save automatically). If later you find out that you are unable to attend, you must remove your name from the slot ASAP so that someone else may sign up. "No shows" are considered a mark against class professionalism.

<https://docs.google.com/spreadsheets/cc?key=0AlaP-yZcplpodFN6ejdwZ2VDZFozMFg4a01YUW5Mc1E&usp=sharing>

## Suggested Textbook Chapter Readings

**Textbook: Financial Accounting, Libby, Libby, and Short (7<sup>th</sup> Edition)**

### **Chapter 1 – Introduction to the Four Financial Statements**

Read the whole chapter. Pay particular attention to the discussion of the four main financial statements and how they relate to each other. The chapter's material is about defining terms and where to find specific information—things you should know in general. By the end of the course, this stuff should be second nature to you. In future chapters, you will need to know how to use this stuff to analyze companies. Supplement A is also useful background knowledge. Supplement B is only useful if you want to go into the accounting profession. In terms of end-of-the-chapter questions, exercises and problems, I find the following useful to know: Q2, Q3, Q4, Q8, Q9, Q13, Q14, Q17, Q18, M1-1, M1-2, E1-2, E1-3, E1-9, CP1-1, CP1-2, CP-3.

*I expect you to be able to find information on a set of financial statements (similar to the three CP problems at the end of EVERY CHAPTER) on an exam fairly easily and then be able to use that information to answer a question about the company's performance. If you can find the information for American Eagle Outfitters (appendix B) and Urban Outfitters (appendix C), then you should be able to do so for any company I use for an exam. All the ratio analysis metrics discussed in the chapters (plus others I discuss in class) are fair game for an exam.*

### **Chapter 2 – More about the Balance Sheet**

The material up to page 51 is important to know (for my class and in general). After page 51, the “transaction analysis” stuff is important to future accountants, CPAs and auditors. But it is difficult to memorize the rules if you don't use it every day. If you will not be a future accountant, we still need to go through it one time so that it is not completely foreign to you when it is mentioned in your future accounting classes (e.g., financial statement analysis). As you read through, at least be able to follow the transactions and keep in mind that everything is done so that the balance sheet remains balanced at all times. Journal entries and T-accounts are a part of this necessity. The current ratio (page 68) is one of many commonly-used performance metrics that you should know if you work in business and finance in the future. I suggest: M2-3, M2-6, M2-7, M2-11, E2-2, E2-4, E2-9, E2-20, CP2-1, CP2-2, CP3-3.

### **Chapter 3 – More about the Income Statement**

Everything up to page 113, which is about the income statement, you should know well. You must be able to understand a company's income statement. After page 113, again with the transaction analysis, try to follow it the best you can. The purpose is so that you understand the inner workings of how the income statement was prepared, even though your primary objective is to read and analyze the income statement. Total Asset Turnover (page 127) is another metric

you should know about. I suggest: Q4, Q5, Q6, Q7, Q8, Q9, Q10, Q11, Q12, Q13, M3-3, M3-4, M3-5, M3-6, M3-11, E3-3, E3-4, CP3-1, CP3-2, CP3-3.

#### **Chapter 4 – Accruals and Deferrals**

The material on accruals and deferrals of revenues and expenses (up to page 176) you should know about because they affect actual revenues and expenses—the key items you read on an income statement. For example, analysts generally like high amounts of deferred revenue (all else equal) on the balance sheet because that usually leads to high actual revenue in future income statements. Again, if you will not be a “preparer of financial statements” in the future, you can just follow the material on preparation and “closing the books” from a cursory perspective. You must know profit margin (page 182) and other types of margin metrics for this course. I suggest: Q5, Q8, Q9, M4-2, M4-3, E4-6, E4-14, CP4-1, CP4-2, CP4-3.

#### **Chapter 5 – Key Players, Reporting & Disclosure**

This chapter is actually a continuation of chapter 1, and it is all important. It extends the discussion of the key players, the communication process, and how the four financial statements are related. This chapter steps back from the detailed transaction analysis of chapters 2, 3 and 4, and it really is for the “users of financial statements.” Read the whole chapter because you may become one of the key players in the future. The metric ROA is really important (page 250). I suggest Q1 through Q7, E5-1, E5-2, E5-3, E5-4, E5-8, E5-9, E5-17, E5-18, CP5-1, CP5-2, CP5-3.

#### **Chapter 6 – Revenues, Accounts Receivable, and Cash**

Read up to page 295; we will not cover the material after that. Since a company’s revenue is such a focus for investors and analysis, and is usually the first number mentioned, you must be well aware of revenue rules. Knowing accounts receivables is also important. The metrics used in the chapter, gross margin, A/R turnover and days A/R, are primary tools of investors and analysts. I suggest: Q2, Q9, Q10, M6-1, M6-4, E6-7, E6-8, E6-16, E6-20, P6-1, CP6-1, CP6-2, CP6-3.

#### **Chapter 7 – Inventory**

Read up to page 349; we will not cover the material after that. Keep in mind that not all companies have inventory, like a services company, but most do. You must be aware of the methods of inventory accounting (average cost, FIFO, and LIFO) and how each method affects the financial statements. The inventory management metrics, Inventory Turnover and Days (page 347), are important. I suggest: Q4, Q5, Q6, Q9, M7-5, E7-2, E7-5, E7-13, E7-15, CP7-1, CP7-2, CP7-3.

## **Chapter 8 – Property, Plant & Equipment (PP&E), Depreciation**

Read the whole chapter, but when it comes to methods of depreciation, we will focus on straight-line. As with inventory, keep in mind that some companies have very little PP&E, like web-based companies. For companies that do require lots of PP&E, it is important to know how it is depreciated, written off, and disposed of in terms of dollar amounts because that affects the financial statements considerably. The Fixed Asset Turnover metric is a more detailed metric than the Total Asset Turnover discussed in chapter 3. I will not cover natural resources, so you may skip that part. Intangible assets are important to know, particular for companies with very little PP&E (again those web-based companies). I suggest Q8, Q12, Q13, Q14, Q15, Q16, M8-3, M8-4, M8-7, M8-9, E8-2, E8-3, E8-9, CP8-1, CP8-2, CP8-3.

## **Chapter 9 – Liabilities**

Read the whole chapter. There is a lot of material in this chapter because there are so many different types of liabilities. Knowing about all the different types of liabilities is important because owner's equity is derived after all liabilities are deducted from a firm's assets ( $A=L+SE$ , thus,  $SE=A-L$ ). Important metrics discussed in this chapter are quick ratio, A/P turnover and days. There is also the most basic finance concept discussed in this chapter, which is present value calculation. You should and must know how to computer present values using your calculator and pencil/paper, and not rely on the PV Tables in the back of the book. I suggest: Q1, Q8, Q12, Q14, M9-3, M9-4, M9-7, E9-1, E9-19, E9-22, CP9-1, CP9-2, CP9-3.

## **Chapter 10 – Bonds**

The whole chapter is important, but bond math is hard and there are entire courses at Stern dedicated to it. For our purposes, understand that issuing bonds is an important method for companies to raise capital, so they must report all the details of the principal and interest involved on their financial statements. Bonds are often issued at a discount or premium because interest rates move constantly, and on the day the bond is issued to the market, the interest rate will not be exactly the same as what is printed/promised on the bond. When we compute interest expense, we will only discuss the effective interest amortization method, so ignore the straight-line amortization method. When bonds are retired early (companies buy them back before they mature), there can be an accounting gain or loss, even though cash is used (i.e., cash leaves the company) to buy back the bonds. I suggest: Q1, Q3, Q4, Q5, Q8, M10-1, M10-2, M10-4, M10-9, M10-10, E10-1, E10-6, CP10-1, CP10-2, CP10-3.

## **Chapter 11 – Owner's Equity**

A short chapter, but it's all about stocks, which is what most people (investors and employees) care about. Stock represents legal ownership of a company, and there are different varieties with subtle differences. Earnings Per Share (EPS) is the most watched financial measure ever; know

it like the back of your hand. I suggest: Q4, Q6, Q7, Q9, Q11, Q13, Q16, M11-1, M11-4, M11-6, M11-7, M11-9, E11-1, E11-4, E11-13, E11-17, CP11-1, CP11-2, CP11-3.

## **Chapter 12 – Inter-Corporate Investments**

TBD

## **Chapter 13 – Cash Flow Statement**

Another short chapter, but it is arguable the most important chapter in the book, so I will cover this material much earlier. We focus only on the indirect method. I suggest: Q1, Q2, Q4, Q5, Q6, Q7, Q10, Q11, M13-1, M13-2, E13-1, E13-3, E13-7, E13-10, E13-16, CP13-1, CP13-2, CP13-3.

## **Chapter 14 – Financial Statement Analysis**

A summary of all the accounting-based ratios discussed in the prior chapters, plus some new ones based on market price. I strongly suggest you do the following in your preparation for the final exam: Q1-Q13, M14-1 through M14-10, CP14-1, CP14-2, CP14-3.

## **Known Typos and Errors**

Chapter 1, Page 23, demonstration case, Accounts payable should be \$19,282.

Chapter 3, Page 121, T-tables should read “+ Prepaid Insurance (A) –”, and Accounts Receivable credit should be “(-A)”

Chapter 3, Page 156, Problem CP3-1, #2 shows incorrect solution.

Chapter 5, Page 274, Problem CP5-1, #6 shows incorrect solution.

Chapter 10, Page 523, “Loss on bond call (+Loss, -SE)” and the 20,000 amount should be left justified (no left indents).