

FINANCIAL ACCOUNTING AND REPORTING

FALL 2017

COR1-GB.1306.03, KMEC 2-70 (Wed., 9:00-11:50am)

COR1-GB.1306.05, KMEC 2-70 (Wed., 1:30-4:20pm)

COR1-GB.1306.06, KMEC 2-70 (Mon., 1:30-4:20pm)

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Office Hours: Make appointment by email.

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 four 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. Liabilities: understanding net present value
9. Liabilities: bonds, pricing them, and their accounting
10. Liabilities: contingent liabilities
11. Liabilities: operating and capital leases
12. Equity items: stock and employee stock options
13. Current (short-term) assets: Accounts receivables, and allowance for doubtful accounts
14. Current (short-term) assets: Inventory, excess and obsolete inventory
15. Non-current (long-term) assets: Property, plant & equipment, intangible assets, and their impairment charges
16. Analysis of return measures of operating performance (ROA, ROE)
17. Basic stock valuation (relative multiples, DCF model)

Textbook: Libby, Libby and Hodge, *Financial Accounting, 9th Edition*. This textbook is optional for this course. It 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.

As a guideline for what to focus on in the textbook readings and what to skip, see “Suggested Textbook Chapter Readings” later in this syllabus.

Lecture Slides: Most lectures will use the aid of PowerPoint slides, which will be given to you in a booklet. 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 operating performance and financial standing 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 will be posted to NYU Classes after the assignments have been graded.

Quizzes: There will be several 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. All exam questions are based on actual financial statements from a publicly-traded company, and the questions can resemble questions from homework, lectures, and even prior exams. 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.

Grading: Your grade will be based on 10% homework, 20% first exam, 25% second exam, 40% final exam, and 5% classroom etiquette.

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 10%. For example, if you earn 208 out of 200 homework points, then you get $(200/200)*10\%=10\%$, not $(208/200)*10\%=10.4\%$.

As a guideline for how my teaching assistants grade homework assignments and how I personally grade exams, see "Rubric on Grading" at the end of this syllabus.

Optional individual presentations: During the last class meeting, individuals have the option of giving a short (5 minutes or less) oral presentation about a company's financials. The intent is to provide you with an opportunity to use what you've learned in this course to evaluate a company's past and predict its future. This is an open-ended voluntary assignment, and you can present whatever you think is most interesting or important about a company. But as a general guideline, it would be good to give a brief overview of the company's business model, highlights from the income statement (e.g., revenue growth, margin trends), balance sheet, and cash flow statement. Also, it would be informative to an investor to mention the company's current valuation metrics and predict future valuation. PowerPoint slides or hand-outs are optional. While the "learning by doing" aspect of this assignment should be valuable enough for anyone trying to get good at financial analysis, anyone who makes a good presentation will receive 5

extra credit points added to their exam #1 or exam #2 score. If you intend to make a presentation, you must let me know by email several days before the last class meeting. If you choose not to make a presentation, you don't need to do anything.

Classroom etiquette (C.E.) will be fully explained during the first class meeting, but in general, it is *not* the same as class participation. C.E. 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 your smartphone or other electronic device during lecture will result in a zero C.E. score and lower your overall grade.

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 classroom etiquette. 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 C.E. score.

If you must miss a class and want to avoid an absence, you may attend another block's class covering the same material. If you do so, you must notify me in advance by email. For example, if you must miss your normal Wednesday 9-11:50am class, then you may instead attend the Wednesday 1:30-4:20pm class (or vice versa). The course schedule near the end of this syllabus shows when each week's material is covered for each block. If you attend another block's class, let me know (by saying hello to me during class) and you will not receive an absence for that week.

Finally, if you cannot make up an absence but want to view a recording of the class, you must email me to request a link to the recording. Viewing a recording does not make up for an absence.

Distribution of Grading: The Stern policy for Core MBA courses is 25-35% A's and A-'s; 50-70% B's, and 5-15% C's.

Teaching Assistants: I have several teaching assistants whose primary responsibility is to grade homework assignments; they do not grade nor assist in the preparation of exams. They will also likely conduct one review session prior to each exam.

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 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 for more information.

Small Group Lunches: This is completely voluntary. I am treating for lunch once a week for up to 6 students at a time to chat in an informal setting. We go to the NYU Torch Club, which is two blocks from Stern (18 Waverly Place). To sign up, go to NYU Classes and click on the lunch signup link on the left side of the screen. It will open a Google Docs Excel file, where you can write your name for a specific date.

A word of caution: as a first year MBA student, you will be EXTREMELY busy with clubs and recruiting activities during lunch time. So do not simply put your name down just to reserve a spot in the distant future. Be sure that your schedule is open before you sign up. If, however, you sign up and later realize that you cannot attend, then you must remove your name from the slot ASAP (at least 24 hours ahead of your scheduled slot) so that someone else may sign up. “No shows” are considered a mark against classroom etiquette.

If all slots are filled, then put your name on the waitlist. I will send emails occasionally to people on the waitlist to see if they can make last-minute openings.

Suggested Textbook Chapter Readings

Textbook: Financial Accounting, Libby, Libby, and Hodge (9th 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, CP1-3.

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 later 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 52 is important to know (for my class and in general). After page 52, 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 69) 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, M2-12, E2-2, E2-4, E2-9, E2-20, CP2-1, CP2-2, CP2-3.

Chapter 3 – More about the Income Statement

Everything up to page 115, which is about the income statement, you should know well. You must be able to understand a company's income statement. After page 115, 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. You must know profit margin (page 127) and other

types of margin metrics for this course. 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 179) 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. Total Asset Turnover (page 185) is another metric you should know about. 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 metrics Gross Profit Percentage (page 244) and Return on Assets (ROA, page 250) are really important. 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 298; 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. Become familiar with the Receivables Turnover Ratio and Average Collection Period (page 296). 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 350; 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 (pages 349-350) 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 (page 392) 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, $SE=A-L$). An important metric discussed in this chapter is the A/P turnover and days (page 462). 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. The Times Interest Earned ratio (page 516) and the Debt-to-Equity ratio (page 526) are important. 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 (page

559); know it like the back of your hand. Investors also use the Dividend Yield (page 563) to evaluate stocks. 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 – 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, M12-1, M12-2, E12-1, E12-3, E12-7, E12-10, E12-16, CP12-1, CP12-2, CP12-3.

Chapter 13 – 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 through Q13, M13-1 through M13-10, CP13-1, CP13-2, CP13-3.

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TENTATIVE COURSE SCHEDULE*

Class #	Blocks #3 & 5	Block #6	Lecture Topic	Textbook Reading	Due**	Exams
1	09/06/17	09/11/17	Introduction & Overview	Chapters 1 & 5		
2	09/13/17	09/18/17	Recording Transactions	Chapters 2, 3, 4	Homework #1	
3	09/20/17	09/25/17	Recording Transactions	Chapters 2, 3, 4	Homework #2	
4	09/27/17	10/02/17	First Half: Exam #1 Second Half: Fraud		Homework #3	Exam #1
5	10/04/17	10/16/17	Cash Flows Parts 1 & 2	Chapter 12 & Pages 290, 343, 454	Homework #4	
6	10/11/17	10/23/17	Margins, EPS, NPV	Pages 122, 238, 549		
7	10/18/17	10/30/17	Bonds Part 1 & 2	Chapter 9 & 10	Homework #5	
8	10/25/17	11/06/17	First Half: Exam #2 Second Half: Stockholder's Equity		Homework #6	Exam #2
9	11/01/17	11/13/17	Stockholder's Equity Accounts Receivables	Chapters 11, 6	Homework #7	
10	11/08/17	11/20/17	Inventory, PP&E	Chapters 7 & 8		
11	11/15/17	11/27/17	Return Analysis & Valuation		Homework #8	
12	11/29/17	12/04/17	Exam #3			Exam #3
13	12/06/17	12/11/17	Optional individual presentations			

* Subject to slight changes based on the pace of class discussions.

** Homeworks due at the start of class.

Rubric for grading

For homework, the teaching assistants will use the following guidelines to award points for each question:

- 1) The name of the student must be included at the top of the printout.
- 2) Numerical answers must be correct and in the preferred format (% symbol, # of decimals, etc). For example, although 0.2513 and 25.13% are mathematically the same value, the conventional and preferred format to express growth rates, return rates, and margin calculations is with the percent symbol (%) and one or two decimals (XX.XX%).
- 3) Dollar answers must be correct and in an unambiguous format. For example, if a company expresses amounts in units of thousands of dollars, then the correct format will be "\$1,345 (thousands)" or "\$1,345 (in thousands)." Without the "(thousands)" or "(in thousands)" label, an answer of just "\$1,345" or "1,345" will not receive full credit. In addition, an answer of "\$1,345,000" is also not correct because you do not know that the last three digits are zeros (they could be all ones or twos), so do not add unnecessary zeros.
- 4) Changes in numerical and dollar answers must be quantified. For example, if a return measure changed from 10.0% in one year to 9.0% in the following year, then one must state that the return measure decreased by 1.0% or "1 percentage point" or "100 basis points" or some other quantifiable description. It is not sufficient to state that the return measure "decreased a little."
- 5) Qualitative answers should be concise yet sufficiently informative to answer the question. The grader has full discretion to deem an answer to be too vague or uninformative to receive full credit.
- 6) Homework assignments may be typed and printed or hand-written. For hand-written work, the grader must be able to read your writing for you to receive full credit.

For exams, I will use the following guidelines to award points for each question:

- 1) Every point mentioned for grading homework assignment will apply for grading exams.
- 2) For exam #1, you will record a series of economic transactions (financing, investing, and operating transactions) using hand-written journal entries (JEs). JEs must conform to the conventional practice in which debits are written to the left and credits are indented to the right.
- 3) For exam #1, you will prepare an income statement (I/S). First, the name of the company and time period for which the operating results apply must be labelled at the top of the I/S. Second, the I/S must conform to the conventional practice in which each expense is placed in the proper section and the profit subtotals of gross profit and operating profit are shown, along with the final net income.
- 4) For exam #1, you will prepare a balance sheet (B/S). First, the name of the company and date for which the accounts apply must be labelled at the top of the B/S. Second, the B/S must conform to the conventional practice in which assets are listed first, then liabilities, then equity. Third, current assets must be listed before non-current assets, current liabilities must be listed before non-current liabilities, and direct equity investments must be listed before retained earnings. Finally, total assets, total liabilities, total equity, and total liabilities and equity must be shown.
- 5) For all exams, when interpreting what a financial ratio, measure, or metric (or a change in the metric) indicates about a company, the ideal answer addresses the economic and/or business implications for the company. It is not sufficient to merely state the relative mathematical movements of the numerator and denominator. For example, an answer of "the costs increased more than the sales" is not a sufficient answer to receive full credit.
- 6) If there is a question about a particular item or account, and the company happens to not have or not show that item or account on its financial statements, then the correct answer should be something like "none," "not shown," or "this company does not show that item or account." For example, not all companies have or show inventory on their balance sheets. It is incorrect to assume an amount where none is shown.