

# FINANCIAL STATEMENT ANALYSIS

## Course Description

The class examines the tools used for analyzing industries, accounting methods, financial performance, forecasting methods and valuations of the firm. We will also be paying special attention to nonrecurring items, restructurings, current and fixed assets, intangibles, pensions and contingencies.

## Course Requirements and Credits

Course Requirements : Managerial Accounting & Controlling  
Financial Management  
Course Credit Hours : 3 hours  
Total ECTS Credits : 6 credits

## Target Audience

Graduate students. Profile course.

## Learning Objectives

The course explores in depth the concepts and recording procedures of accounting, thus enabling you to interpret accounting reporting and analyze data provided in financial statements. The class will also examine the analytical tools and concepts in competitor analysis, credit decisions, bankruptcy prediction, and valuation. Alongside the in-depth ratios that will be used, you will learn the importance of the accounting methods, and the limitations of the accounting rules.

## Text and Materials Required

- Financial Statement Analysis: A Global Perspective, Thomas R. Robinson, Paul Munter, Julia Grant, ISBN: 0130601217, April 2003, Prentice Hall.
- Financial Statement Analysis Workbook: Step-by-Step Exercises and Tests to help you Master Financial Statement Analysis, Martin Fridson, Fernando Alvarez, ISBN: 0471409189, July 2002, Publisher: Wiley, John & Sons, Inc., Edition Number: 3.

### **Suggested further readings:**

- Financial Reporting and Statement Analysis: A Strategic Perspective, by Clyde Stickney and Paul Brown, Dryden Press (Harcourt Brace), 1998, ISBN: 0030238110
- Financial Statement Analysis with S&P package, John J. Wild, Leopold Bernstein, K. R. Subramanyam, ISBN: 0072508086, May 2001, Publisher: McGraw-Hill Companies, Edition Number: 7
- Financial Statement Analysis: A Practitioner's Guide, Martin S. Fridson, Fernando Alvarez, ISBN: 0471409154, March 2002, Publisher: Wiley, John & Sons, Incorporated, Edition Nr: 3.
- Financial Statement Analysis and Security Valuation by Stephen H. Penman (McGraw-Hill Irwin 2003), ISBN: 007253317X

- ❑ Business Analysis & Valuation Using Financial Statements, by Krishna Palepu, Victor Bernard and Paul Healy, Southwestern College Publishing, Cincinnati, ISBN: 0324020023
- ❑ Damodaran on Valuation by Aswath Damodaran, John Wiley & Sons, New York, 1994, ISBN: 0471108979
- ❑ <http://www.aasb.com> - the AASB Accounting Standards
- ❑ <http://sec.freeedgar.com> – free access to all SEC filings
- ❑ <http://www.fasb.org> – changes brought by the Financial Accounting Standards Board
- ❑ <http://www.iasc.org.uk> – changes brought by the International Accounting Standards Committee.

## Course Outline

### **Introduction**

#### ***The principles of financial reporting***

- ❑ Key principles of reporting, the company environment and limitations of accounting reporting principles.
- ❑ The Income statement and the cash flow of the company. Revenue Recognition, Nonrecurring Items. Cash Flow Analysis
- ❑ The Balance sheet. Types of assets and groups of liabilities. Special items.
- ❑ The statement of cash flows. Cash and non cash items. Building a cash flow.
- ❑ The income statement special items, extraordinary items, discontinued operations, restructurings and deferred taxes.

#### ***Accounting Topics***

- ❑ Financial Accounting. Measuring Business Income. Financial Reporting and Analysis. Short-Term Financial Assets. Inventories. Current Liabilities and the Time Value of Money. Long-Term Assets. Long-Term Liabilities. Contributed Capital. The Corporate Income Statement and the Statement of Stockholders' Equity. The Statement of Cash Flows
- ❑ Receivables, inventory, plant and equipment, advertising and research & development. Leases, stock-based compensation, pensions and other post-retirement employee benefits (OPEB), contingencies. Goodwill, consolidations, minority interest and international accounting standards.

#### ***The cash flow***

- ❑ Framework for Financial Statement Analysis. Accounting Income and Assets: The Accrual Concept. The Cash Flow Statement. Analysis of Cash Flows. Uses of Cash Flows in financial analysis. Accruals, Cash Flows & earnings quality. Cash Flows Classification issues
- ❑ Net income and cash flows from operating, investing, and financing activities. The nature of earnings. Data Issues in Analyzing Financial Statements earnings quality, sustainability, measurement and manageability of reported earnings. Adjustments to reported income or evaluation and forecasting purposes.

#### ***Profitability and Risk Analysis***

- ❑ Operating income analysis, rates of return, discount rates, effective working capital management and short-term liquidity risk.
- ❑ The role of financial leverage and long-term solvency risk. Revenue Recognition

- Income and its patterns prior to the time of sale, at the time of sale, and subsequent to the time of sale.
- Accounting for Income Taxes.
- Deferred income taxes, deferred tax assets and deferred tax liabilities. Impact of taxes profitability.
- Fixed and Intangible Assets. Accounting for inventories and depreciable assets. Impact on assets and net income of capitalizing and amortizing intangibles. R & D activities and reporting formats for enhancing analysis.
- Liability Recognition. Accounting liability and the transactions intended to keep debt off of the balance sheet. Liability recognition issues.
- Leases and Pension Liabilities. Operating lease vs. capital lease method. Conversions. The long-term solvency risk of a firm with and without capitalization of operating leases. Reporting of pension or healthcare benefit plans and differences of disclosure.
- Analysis of Disclosures & Intercorporate Investments. Off balance sheet items. Segment Data. Related party transactions. Corporate combinations
- Adjusting financial data for Analysis. Adjustments to the balance sheet. Adjustments to reported income. Cash Flow adjustments. Adjustments for comparability
- Financial analysis for equity valuation. Residual Income (EBO) model. The EVA /EBO link. DCF models. Dividend imputation issues and impact on equity valuation.
- Corporate Acquisitions. Purchase method vs pooling of interest method for an acquisition, Legal, accounting, tax, and financing issues in acquisitions.
- Foreign Currency Translation. The all-current translation method and the monetary-nonmonetary translation method. Applications and effects.
- Pro Forma Financial Statements.
- Financial Ratios and Earnings per Share. Analysis of Financial Statements. Dilutive Securities and Earnings per Share. Income & Earnings Per Share. Accrual concept of income. Calculation of EPS. Controversy over options & EPS. Estimating sustainable earnings
- Traditional Ratio Analysis. Financial analysis in credit assessment. Institutional arrangements for reviewing large volumes of transactions
- Traditional Ratio Analysis. Common size financial statements. Ratio categories. Trend analysis. Integrated (DuPont) analysis
- Industry Analysis. Problems in analyzing financial reports for companies in different industries
- Introduction to forecasting
- Par, book, market, intrinsic, liquidation values. Estimating core earnings, strategic analysis and statistical estimation
- Forecasting financial statements
- Percent of sales approach
- CAPX/depreciation approaches
- Financing schedules
- Projecting free cash flow from pro forma statements
- Exit multiples and terminal value Forecasting. Methods of forecasting. Reformulating I/S and B/S. Estimating core earnings, strategic analysis and statistical estimation
- Quality of Accounting. Conservatism, hidden reserves, revenue recognition, expense estimation and value creation
- Final exam

## Methodology

The class comprises of two distinct components – lecture part and exercise part. One aims at giving the theoretical background necessary for dealing

with the financial topics raised and the other covers the practical application of these in the decision making process of the company. Continuous evaluations through tests will be used to enhance the understanding of each topic.

### Grading Policies

Presence:	10%
Participation:	20%
Presentations:	20%
Quizzes:	15%
Mid Term Exam:	15%
Final Exam:	20%

### Contact Information

Swiss Management Center  
School of Graduate Studies  
Baarerstrasse 112  
CH-6302 Zug  
Switzerland