

Earnings Quality and Fundamental Analysis

B8008, Spring 2023

Course Syllabus

I. CONTACT DETAILS

Professor: Jonathan Glover
Office: Kravis 531
Email: jg3463@gsb.columbia.edu
Office hours: After class or by appointment

TA: Rongchen Li
Email: rli25@gsb.columbia.edu

II. COURSE DESCRIPTION

Financial reporting provides a window into the operational and financial workings of a company. However, translating this information into actionable insights is anything but straightforward. It requires an understanding of: Generally Accepted Accounting Principles (GAAP), the quality of financial information, and adjustments and analyses used to assess profitability, risk, growth, and value.

This course starts with a review of financial reporting and then focuses on various modules of fundamental analysis, including earnings quality, performance evaluation, risk assessment, forecasting, and valuation. Most of the course is devoted to a deeper dive into the reporting and analysis of selected transactions, line items from the financial statements (e.g., leases, income taxes, pensions, and business combinations), and related footnote disclosures. We will also cover non-GAAP/pro-forma reporting.

This is a case-based class. Much of our time will be spent discussing real-world cases rather than in a lecture format. We will study many actual financial disclosures and cases of accounting abuses. Studying financial disclosures will help you better understand the underlying assumptions and accounting choices the firm made in arriving at its accounting numbers. This information can be used to make earnings quality adjustments to the accounting numbers to make them more consistent across time or more comparable across companies. Studying cases of accounting abuses will help you improve your ability to “read between the lines” and develop a set of red flags to look for in analyzing financial statements. The class also incorporates insights from practitioner and academic research.

III. ADMINISTRATION

Class Material

The course material consists of cases, my notes on the cases and background material, an optional textbook, and optional readings. These items cover all the course content. The optional readings elaborate on some of the analyses and are provided for those interested in research (both practitioner and academic). You may use laptops during class to help you follow the discussion, to take notes, or to add comments to the electronic documents as needed (**please use your laptop for those purposes only**).

Class Preparation

It is important that you read the assigned cases and think about the key issues before coming to class, so that you are prepared to contribute to the class discussion.

Performance Evaluation

Attendance	10%
Class Participation	30%
Problem Sets	20%
Individual or Group Project (Type B or A)	40%

Attendance and Class Participation

I will take attendance using Poll Everywhere. I will also evaluate your class participation, emphasizing the quality of your contributions to case and problem set discussions.

Problem Sets

The best 4 (of 6) of your problem set grades will be included in your final grade. These are individual assignments. You may discuss the problem sets with other students, but the work you turn in should be your own.

Individual or Group (of 4 or less) Final Project

Your final project should provide:

- an initial assessment of a firm and its management, including a brief analysis of the firm's strategy and competitive environment,
- reformulated financial statements, separating operating from financing activities (on the income statement and balance sheet) and core/recurring operating earnings components from non-core/transitory components,
- an analysis of the quality of the firm's non-GAAP reporting if it provides such numbers (including comparing the company's analysis to your reformulated financial statements),
- financial statement analysis and a "simple valuation" before any earnings quality adjustments,
- earnings quality adjustments you think are needed to make the firm's reported numbers more consistent across time and/or more comparable to another firm in the same industry,
- a big-picture "red flag analysis" (cash flows vs. accruals, total asset turnover, tax vs. financial statement income, etc.),
- a more detailed red flag analysis to identify areas of particular concern (focus your analysis on the firm's most important accounting method choices and estimates),
- forecasts of future performance (over no more than a 10-year horizon) and an explanation for the assumptions you made including the role of your reformulated financial statements, earnings quality adjustments, and red flag analysis in shaping your forecasts, and
- an ReOI-based equity valuation of the firm.

Pick a company that prepares financial statements under US GAAP. Financial institutions have specialized accounting, so I suggest avoiding them. You may pick a company with earnings quality problems that were later publicly revealed and conduct an analysis of the company during the periods the earnings quality problems occurred. In this case, try to conduct your analysis without the benefit of hindsight. Alternatively, you may conduct a contemporaneous analysis of any company. I also allow students to design their own final projects (e.g., a survey of academic research on a particular course topic). If you would like to design your own project, please submit a brief proposal to me by email by March 15.

IV. CONNECTION WITH THE CORE

This course builds on knowledge from the Financial Accounting (B6000) and Corporate Finance (B6300) fixed core courses. These core courses introduce students to basic financial reporting and analysis concepts. In B8008, students acquire a deep understanding of accounting information and how to intelligently use it in making investment, credit, and similar resource allocation decisions. Students should review the concepts studied in B6000 and B6300.

V. TEXT (optional)

Financial Reporting and Analysis, by Revsine, Collins, Johnson, Mittelstaedt, and Soffer, 2020, 8th Edition. I also recommend Financial Shenanigans by Schilit, Perler, and Engelhart, 4th Edition.

VI. COURSE OUTLINE

Week	Topic	Optional Text Chapter	Cases and Problem Sets (turn in 4 of 6 Problem Sets)
1	Introduction Review and Preview	Skim: 1,2,4	
2	Earnings Quality Non-GAAP Reporting	5	Valeant Pharmaceuticals
3	Financial Statement Analysis	6	Dollar General Bids for Family Dollar
4	Forecasting and Valuation	7	
5	Earnings Management Red Flag Analysis		Trouble Brewing for Green Mountain
6	Revenue	3	Accounting for the iPhone Financial Statement Analysis Problem Set
7	Receivables and Bad Debts Inventories	9 10	New Century Financial First Solar
8	Property, Plant, and Equipment Intangible and Other Assets	11	Revenue and Receivables Problem Set AOL Time Warner
9	Financial Instruments & Liabilities Leases	12 13	Delta's Derivatives Microsoft's Leases Inventory, PPE, and Intangibles Problem Set
10	Income Taxes Pensions	14 15	Mike Mayo Takes on Citigroup Ford's Pensions Financial Instruments and Leases Problem Set
11	Inter-corporate Equity Investments Business Combinations	17	Coca-Cola Income Taxes and Pensions Problem Set
12	Owners' Equity Review	16	Inter-corporate Equity Investments and Business Combinations Problem Set