Columbia Business School

Earnings Quality and Fundamental Analysis
B8008, Fall 2023
Preliminary Course Syllabus

I. CONTACT DETAILS

Professor: Jonathan Glover
Office: Kravis 521
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.

The course starts with a short review of financial reporting and then focuses on various modules of fundamental analysis, including earnings quality, performance evaluation, risk assessment, forecasting, and valuation. The remaining class meetings are devoted to a deeper dive into the reporting and analysis of key transactions (e.g., business combinations, leasing) and financial statement line items (e.g., revenue, income taxes). 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**).

Cases

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

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

Class Participation
I will evaluate your class participation throughout the course, emphasizing case discussions.

Problem Sets
The best 4 (of 5) of your problem set grades will be included in your final grade. 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 adjustments you made in your assessment of core/recurring operating earnings to the adjustments made by management in their presentation of non-GAAP earnings,
- basic financial statement analysis (including a DuPont decomposition of return on net operating assets), a discussion about the consistency of your financial statement analysis with your initial assessment of the firm's competitive environment, and possible explanations for any inconsistencies,
- 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),
- a broader assessment of the firm's earnings quality, including any adjustments you find helpful in making the firm's reported numbers more consistent across time and/or more comparable to peer firms' reported numbers,
- forecasts of future performance (over no more than a 10-year horizon) and an explanation for your assumptions, including how you incorporated the previous steps of the assignment, and
- an ReOI-based equity valuation.

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 own analysis rather than relying on the analysis of others. Alternatively, conduct a contemporaneous analysis of any company. In selecting a company, you might look for circumstances that makes it particularly interesting to assess the company's earnings quality (e.g., a company with a high short interest).

IV. CONNECTION WITH THE CORE

Financial Accounting (B6000) is a pre-requisite. If you have not taken B6000 but have taken another course on financial accounting or have other experience with financial statements that you think prepares you to take this course, please email me with details to request permission to enroll. The course also builds on knowledge from Corporate Finance (B6300). 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.

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

Class	Topic	Optional Text Chapter	Cases
1	Introduction	Skim:	
2	Review and Preview	1,2,4	
3	Earnings Quality	5	
4	Non-GAAP Reporting		Valeant Pharmaceuticals
5	Financial Statement Analysis	6	
6	continued		Dollar General Bids for Family Dollar
7	Forecasting	7	
8	Valuation		Coca-Cola
9	Earnings Management		
10	Red Flag Analysis		Trouble Brewing for Green Mountain
11	Revenue	3	
12	continued		Muddy Waters vs. eHealth
13	Receivables and Bad Debts	9	New Century Financial
14	Inventories	10	First Solar
15	Property, Plant, and Equipment	11	
16	Intangible and Other Assets		AOL Time Warner
17	Financial Instruments & Liabilities	12	
18	Leases	13	Accounting for Leases at American Airlines
19	Income Taxes	14	
20	Pensions	15	FedEx Pension Accounting
21	Inter-corporate Equity Investments	17	Fair Value Accounting at Berkshire Hathaway
22	Business Combinations		
23	Owners' Equity	16	
24	Stock-Based Compensation		Stock-Based Compensation at Twitter