

Course summary

15.511 Corporate Accounting

Summer 2004

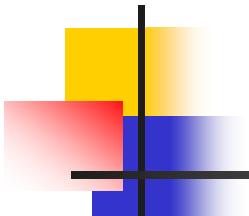
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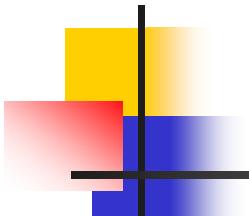
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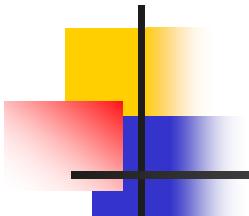
Course summary

- Accounting – Mapping of actions and events into financial statements
 - (Economic) Principles governing the accounting mapping: Objectivity, conservatism, revenue recognition, and matching
- But the mapping is incomplete and asymmetric (for good reasons, of course)
- Hence, firms supplement financial information with disclosures in
 - MD&A section
 - Footnotes
 - Management forecasts
 - Q&A at conference calls



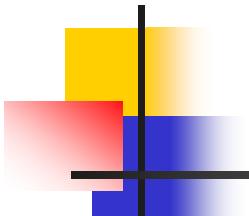
Where do we go from each topic from the course?

- Financial statements and basic bookkeeping
 - Bookkeeping: Necessary evil!
 - Ability to interpret financial statement information is essential for decision making
 - Balance sheet
 - What are the assets and liabilities when buying another firm?
 - Tangible, intangible, on- and off-balance sheet
 - What is the investment being made in a project, department, firm, or a target? What appears on paper is just a starting point.



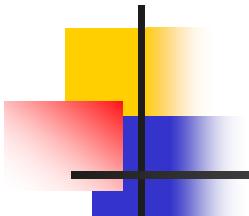
Where do we go from each topic from the course?

- Financial statements and basic bookkeeping
 - Income statement
 - Assessing operating performance
 - Is it sustainable? Is it believable? Is the revenue recognized optimistically? Conservatively?
 - Cash flow statement
 - Is the wedge between income and operating cash flow worrisome?
 - Projections: What are the cash needs going forward? For working capital and for fixed asset investments? Where will the financing come from?
 - In an M&A context, valuation is on the basis of cash flows



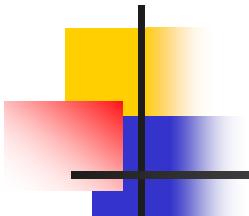
Where do we go from each topic from the course?

- Revenue recognition
 - Revenues is the engine that drives a firm
 - Revenue growth signals where the firm is headed, so everyone focuses on it
 - Incentive to inflate it
 - Single biggest source of fraud and manipulation
 - High bang for the buck: Every dollar of invented revenue increases pre-tax income by a dollar
 - Enhances revenue growth and all of the operating efficiency ratios
 - Revenue recognition practices vary with industry, so get to know the business



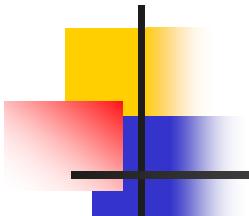
Where do we go from each topic from the course?

- Inventories
 - Lower of cost or market
 - Determinant of COGS
 - Combined with revenues, profitability depends on COGS
 - Incentive to overstate inventory
 - Overstatement increases income and improves the balance sheet
 - Reversal in the following period: Payback time!



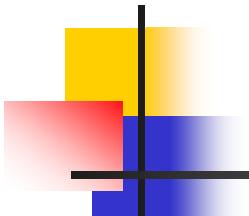
Where do we go from each topic from the course?

- Depreciation
 - Accounting is quite mechanical!
 - No cash flow effect of changing accounting
 - Why do we care?
 - Depreciation cost is crucial from the standpoint of making investment decisions
 - An important component of total cost, so serves as one of the inputs into pricing and other decisions



Where do we go from each topic from the course?

- Liabilities
 - Fixed obligations
 - Increases the risk of residual claimholders, shareholders
 - Present value calculations are needed to determine long-term liabilities
 - On- and off-balance sheet liabilities
 - Pension liabilities
 - Enron, Freddie Mac and other spectacular cases where off-balance sheet liabilities from derivative positions have caused havoc



Where do we go from here?

- Course focused almost entirely on analyzing a given set of actions and events
- More interesting to think about
 - How to create opportunities? How to choose from among alternative opportunities and action choices?
 - How to finance the alternative action choices? Market them? Operationalize them? Organize them? Incentivize employees to take desirable actions?
 - Obviously, too interesting to be a part of this course!