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A Course Survey of Financial Statement Analysis

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ABSTRACT: This study reports survey results of the pervasiveness and attributes of Financial Statement Analysis (FSA) as both an undergraduate- and graduate-level course. The paper may be of interest to departments considering adding an FSA course to the curriculum. Demographic data of survey participants is provided as well as information regarding motivations for offering the course, classroom materials, instructional methods and topic analysis. The paper also includes descriptions of model assignments and teaching innovations.

INTRODUCTION

The purpose of this research is to provide descriptive information regarding Financial Statement Analysis (FSA) as a course offering. Data were gathered from surveys of accounting departments regarding their current and proposed offerings of FSA. This information may be of interest to accounting departments as they deliberate whether FSA should be added to the curriculum. Schools already offering FSA may use the survey results to evaluate topical coverage and instructional methodologies currently employed in the course.

The broadened 150-hour accounting curriculum makes considering new accounting courses a necessity. Prober and Sherman (1988) argue that FSA is a valuable topic and deserving of coverage in the 150-hour curriculum. They cite evidence that academics have in the past placed less importance on FSA as a topic for study than have practitioners. While Prober and Sherman (1988) encourage expanded coverage of FSA topics in existing accounting courses,

this research examines FSA as a stand-alone course.

The Sponsors' Education Task Force report, *Perspectives on Education: Capabilities for Success in the Accounting Profession* (1989, 12), challenges educators to re-engineer the accounting curriculum, stating that:

emphasis should be placed not only on the presentation of relevant material, but also on the compounding of learning by appropriate combination across course and departmental lines.

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When knowledge and skills learned early in the university experience are expanded on in work at a later stage, the students' experience is reinforced and enriched.

In addition, the AECC (1990, 308) asserts that students need the skills to "solve unstructured problems in unfamiliar settings and to exercise judgment based on comprehension of an unfocused set of facts." Analysis of syllabi returned in the surveys provides examples of the ability of the FSA course to address these challenges. Students are given projects to build on skills learned in prerequisite classes and to arrive at decisions and recommendations supported by their own analytical work.

FSA can be added to the accounting curriculum as part of the 150-hour degree. Given its relevance to finance and other majors, FSA as an accounting course also provides an opportunity to service other business school departments. Further, the course is suitable for both undergraduate and graduate credit.

This article explains the research method, followed by analysis of survey responses. Data reported include respondents' demographic data, motivations for electing to offer/not offer FSA, topical content of FSA courses currently being taught and information on instructional methods and materials.

RESEARCH METHOD

A survey instrument was prepared to gather data about FSA as a course offering in the United States and Canada. Respondents indicated whether their institution offered FSA, along with reasons for offering or not offering the course. Those indicating that FSA was a current

course offering were asked to return a copy of the class syllabus along with the survey.

The questionnaire was sent to institutions that were most likely to have the program resources to support the FSA course. It was therefore sent to all schools listed in the *Accounting Faculty Directory* (Hasselback 1996) with five or more faculty at the rank of assistant professor or above. This filtering process produced a total of 362 schools, 342 in the United States and 20 in Canada.

A total of 163 surveys were returned, for a response rate of 45 percent.¹ Sixty-three respondents indicated that an FSA course was being offered at their institution. Of the schools offering FSA courses, 40 returned the class syllabus as requested. Upon telephone follow-up, four more schools returned the desired syllabus. Thus, 70 percent of syllabi for existing FSA courses were studied.

ANALYSIS

Demographics and Course Election

Eighty percent of the surveys received came from public institutions. The majority of respondents (78 percent) represent AACSB accredited business schools. Nearly half of the schools with undergraduate accounting program accreditation offer FSA, while the majority of those schools without accounting accreditation (58.7 percent) do not offer FSA. Schools with the smallest number of accounting full-time equivalent staff appear to be

¹ This response rate closely resembles Prober and Sherman's (1988) 45.6 percent response to a survey investigating how financial statement analysis is incorporated into existing accounting courses.

severely constrained in their ability to support FSA.

Motivations for Course Offering and Course Tenure

Student demand (by undergraduates and M.B.A.s) is the driver behind offering the FSA course in 32 percent of the responses. Other motivations cited more than once include skill-building for accounting and finance students, faculty interest/expertise, desire to service finance departments and M.B.A. programs, and fulfillment of CFA program requirements.

For schools proposing to offer FSA, student demand again appears to be the primary motivation, representing 32 percent of the responses. Another important consideration (21 percent) is the addition of the FSA course to help meet the 150-hour requirement.

The most common reason for not offering FSA is the opinion that the course content of FSA is adequately covered by other courses in the curriculum (36 percent). Curriculum constraints (18 percent), lack of student demand (20 percent) and lack of staff resources (10 percent) are also heavily cited motivations. It is interesting that student demand factors heavily into both sides of the course election decision.

Most schools that offer FSA have made the adoption decision fairly recently. Seventy-five percent of the schools reported that the course has been offered for ten years or less. The majority of schools state that the course has been offered for five years or less. Only one school reports that the course has been a part of the curriculum for more than 20 years. The data reflect that FSA has been a

significant part of accounting curriculum revisions during the last five years.

Course Prerequisites, Target Student Populations and Departmental Responsibility

In supplying prerequisite data for FSA, survey respondents overwhelmingly agree that Principles of Financial Accounting is a necessary prerequisite for the course. There is also strong support for Principles of Managerial Accounting and Corporate Finance as a prerequisite. Respondents show less agreement on whether Intermediate Accounting I and II should serve as prerequisites. With one exception, schools that require Intermediate I as a prerequisite also require Intermediate II. However, the majority of schools do not require Intermediate Accounting before students enroll in FSA. The schools proposing FSA also do not appear inclined to require Intermediate Accounting as a course prerequisite. The prerequisite data are consistent with the view that schools may service finance majors by offering FSA to teach interpretive skills involving accounting information. Such a class may be relevant for many more majors than the Intermediate Accounting sequence, which often assumes a more technical, preparer focus.

Schools that currently offer FSA to undergraduate students seem to target finance majors more than accounting majors. Approximately half of schools currently offering FSA do not allow accounting undergraduates to take the course as an accounting elective (26/54). Schools proposing the course also favor disallowing undergraduate accounting students access to the course as an accounting elective.

With respect to graduate students, the majority of schools make the course available to those specializing in either accounting or finance. Schools proposing to offer FSA intend to allow graduate-level access to both accounting and finance majors. The majority of schools teach, or propose to teach, FSA in the accounting department.

Topical Coverage

This analysis of FSA instruction addresses topics across 40 categories.

Certain key topics in table 1 show broad support, as they are covered by the majority of schools (50 percent or more). Coverage of fundamental analysis concepts² was almost universal, with 97 percent of syllabi acknowledging this topic. Other prevalent topics are cash flows,

² Fundamental analysis concepts include introduction to financial statements, the economic environment, the financial accounting process, sources of financial information and the need for financial statement analysis.

TABLE 1
Topical Coverage for Financial Statement Analysis
(n=38)

Topical Area	Frequency	%	Topical Area	Frequency	%
Fundamental			Analysis of		
Concepts	37	97.4	Special Industries	9	23.7
Cash Flows	27	71.1	Supply of Information	9	23.7
Debt Financing	23	60.5	Demand for Information	8	21.1
Valuation	23	60.5	Revenue Recognition	8	21.1
Ratios/Other Tools			Liquidity	8	21.1
for Analysis	22	57.9	Return on Investment	8	21.1
Profitability	19	50.0	<i>Pro Forma</i>		
Risk			Financial Statements	7	18.4
Considerations	18	47.4	Corporate Restructuring	6	15.8
Long-Lived Assets	16	42.1	Market Efficiency	6	15.8
Inventories	15	39.5	Inflation Accounting	5	13.2
Earnings/Quality			Contingencies	5	13.2
of Earnings	15	39.5	Empirical		
Income Taxes	15	39.5	Research	5	13.2
Financial Reporting			Segment Reporting	5	13.2
Strategies/Disclosure			Audit Report/		
Issues	14	36.8	Auditors' Risk Analysis	4	10.5
Pensions/			Asset Utilization	4	10.5
Postretirement Benefits	13	34.2	Distress Analysis	4	10.5
Intercorporate			Statistical Analysis—		
Investments	13	34.2	Time Series and/or		
Business Combinations	11	28.9	Cross-Sectional	3	7.9
Leases	11	28.9	Foreign Accounting		
Multinational			Standards	2	5.3
Issues	11	28.9	Management Evaluation	2	5.3
Off-Balance Sheet			No topics provided	6	
Issues/Hedging	11	28.9			
Forecasting	10	26.3			
Income Statements	10	26.3			
Balance Sheets	9	23.7			

debt financing, valuation, ratios and profitability analysis.

Topics receiving less than 50 percent coverage are arguably less broad and are chosen at the discretion of the instructor. These choices may reflect the instructor's interest and expertise, current events, reliance on the text, overall departmental curriculum requirements, or topics of current empirical research. The current business climate makes quality of earnings, multinational issues, off-balance sheet financing and financial reporting strategies/disclosures issues timely additions to course syllabi, while choices to cover topics such as return on investment, asset utilization and inflation accounting appear from the syllabi analysis to be textbook-dependent decisions. Some instructors seem to adopt a financial statement emphasis in order to provide coverage of the most important influences on the balance sheet (long-lived assets, income taxes, inventories, leases, pensions, business combinations and contingencies) and income statement (revenue recognition and segment reporting).

Instruction, Grading and Texts

Tables 2 and 3 report the frequency, relative use and grading profile of various instructional methods in FSA classrooms. A large majority (88 percent) of those surveyed rely on examinations, constituting, on average, 42 percent of the student's grade. The nature of FSA is highly conducive to casework. Correspondingly, roughly 60 percent of the respondents utilize written casework, with slightly more emphasis on individual casework than team casework. Written casework accounts, on average, for 23 percent of the student's performance.

Twenty-eight percent of those surveyed require oral team presentations of casework, while only 7 percent require individual presentations. Students' presentation performances assume the least importance, comprising only 6.5 percent of the student's grade. Other instructional modes include outside readings (42 percent) and a culminating term paper or project (30 percent). Basis for grading also includes homework problems (12 percent of grade) and class participation (9 percent of grade).

TABLE 2
Instructional Modes for Financial Statement Analysis
(n =43)

<u>Instructional Mode</u>	<u>Frequency</u>	<u>%</u>
Exams	38	88.4
Individual casework	26	60.5
Team casework	25	58.1
Homework problems	25	58.1
Outside readings	18	41.8
Term project/paper	13	30.2
Team presentations	12	27.9
Individual presentations	3	7.0
Class requirements not outlined on syllabus	1	

TABLE 3
Basis of Grading for Financial Statement Analysis
 (n =40)

Category	Frequency	%	Average % of Grade
Exams	34	85.0	41.6
Written cases	31	77.5	23.0
Homework problems	20	50.0	12.0
Term projects/papers	16	40.0	9.7
Class participation	23	57.5	9.1
Oral presentations	16	40.0	6.5
Syllabus did not provide basis for grading	4		

All schools returning syllabi for analysis require a textbook. The texts authored by Stickney (1996) and White et al. (1994) were each used by 12 schools. The Gibson (1995) text was used by seven responders and Bernstein's (1993) text by four. Nine other texts were each used by one school.³

Resources and Innovations

We conclude with a section noting several course management topics that might be of interest to current and potential instructors of an FSA course. Analysis of syllabi yields a list of resources and periodicals commonly used, as shown in exhibit 1. In addition to the technology of the databases in exhibit 1, four syllabi required the use of spreadsheets throughout the term for ease of ratio generation and *pro forma* financial statement preparation.

Several instructors plan the FSA course according to an alternating schedule of lecture and seminar days for case and problem discussion. For case discussion, one instructor assigns each case to two groups. One group is asked to present the case highlights to the class for 20 minutes. The other group critiques the presentation for ten minutes. At the end of

class, each group hands in its written analysis, not exceeding eight pages of double-spaced typed text. Casework is presented by students in six out of 30 class sessions. Cases used are textbook cases. For case preparation, another instructor requires students to prepare a one-page typed summary of the key elements and conclusions for 14 cases covered during the term. (This instructor permits a one-page numerical support attachment for some cases.) The purpose of the one-page summary is to address key issues.

Not all syllabi reviewed provide details of project assignments. With respect to projects for undergraduates, numerous syllabi provide project details similar to the following three.

Undergraduate Project Description A

Students spend the first four weeks of the quarter in a thorough analysis of one company, involving common-sizing, decomposition analysis, ratio construction and analysis,

³ The sample results of textbook usage may not accurately reflect the current market. There have been new books and substantially revised textbook offerings since the survey was conducted. See bibliographic references for the four textbooks referenced in the text.

EXHIBIT 1
Resources, References and Services

Outside Resources

Compustat C-D (individual company disclosure)
 Dialog (a dialog distributor allowing access to hundreds of databases)
 Disclosure (an information system for financial disclosure of individual companies)
 Dow Jones News Retrieval Service

Edgar Database-Internet (for SEC filings by companies)
 FARS (A CD Rom system for researching GAAP issues)

Investment Services

Moody's
 Robert Morris Associates *Annual Financial Statement Studies*
 Standard & Poors
 Value Line

Reference Books and Periodicals

Any Financial Accounting Intermediate Text
Accounting Horizons
Business Week
Forbes
 GAAP Guide (several are published)
Wall Street Journal

and searching for relevant information. Then students independently prepare four additional company report papers where one "company" is the university attended by the students.

Undergraduate Project Description B

A team of three to four students prepares a written report and oral presentation of a comparative analysis of the informativeness of the annual reports of four companies from one industry. The project focus is on the evaluation of the quality of information provided in the annual report. Required:

- (1) brief background discussion of accounting and reporting issues related to the industry;
- (2) description of the contents of the annual reports and voluntary disclosures provided;
- (3) assessment of the apparent motivations for the contents of the annual reports;

- (4) an analysis of financial position and condition, and expected future profitability of the company.

Students are allowed five pages of text discussion for each of the four companies.

Undergraduate Project Description C

Groups of two students prepare a comprehensive five-year analysis of two companies in the same industry. Students are required to use Compustat and annual reports from companies. They perform a comprehensive financial analysis, emphasizing the degree of informative disclosure in the financial statements. Then they compare and contrast the informativeness of the annual reports of the two companies. Finally, they discuss the effects of alternative accounting principles on the analysis. The final work consists of 15 pages of text, exclusive of exhibits.

The following three innovative projects were found on syllabi for graduate students.

Graduate Project Description A⁴ Integrated Company Project: Serial Parts

First Part

- Evaluate industrial and economic factors affecting the firm
- Make a comprehensive ratio and quantitative analysis of financial/operating considerations
- Assess firm's quality of earnings and make an overall assessment of the four functions of management (production, investing, marketing and financing).

Second Part

- Predict for two years ahead economic factors affecting the company
- Predict product mix and foreign/domestic mix of revenues, operating profits and identifiable assets. Forecast, line-by-line, three major financial statements for the next three years. Prepare an accompanying MD&A for the next two years and strengths, weaknesses, opportunities and threats analysis of the firm.

Third Part

- Select a target company as a merger and acquisition company for the firm
- Identify strategic goals of company and identify variables the target firm should possess
- Discuss strategic advantages of the merger and provide a set of *pro forma* financial statements for post-merger firm.

Graduate Project Description B

A comparative analysis of three companies in the same or similar industries but from three different countries, one of which is the United States. Use current financial statements and other information to assess differences in accounting policies

used by the companies and the effects of those policies on ratios and performance.

Graduate Project Description C

Project 1: Collect brokerage house reports on a company from three large brokerage houses. Write a report summarizing the reasons why the analyst chose a buy, hold or sell recommendation.

Project 2: Make a credit analysis of a company and three competitor firms in the same industry. Include credit ratings offered by Moody's, Standard & Poor's, and the computation of the Altman Z-Score, the Value Line safety rank and the times-series and cross-sectional comparisons of financial ratios.

LIMITATIONS AND DIRECTIONS FOR FUTURE RESEARCH

The survey design and responses received precluded answering several questions raised in the review process. These issues may offer guidance and direction for those undertaking further work in this area. For example, researchers may want to explore specifically why students demand this course. Such explorations might address whether the demand for offering FSA is affected by geographic area or the economics of the area. Future research could also investigate more directly the possible impact of the 150-hour requirement on the choice to offer FSA. It should be noted here that the current survey instrument did not explore why

⁴ The projects are quoted with permission of the professors employing them: Graduate Project A (Richard E. Baker, Northern Illinois University); Graduate Project B (Morris McInnes, Suffolk University); Graduate Project C (Scott E. Stickel, LaSalle University).

schools choose to offer the course at the graduate or undergraduate level. Additionally, further research could focus on a broader sample of small and private schools. Finally, educators would likely be interested in the impact of various instructional approaches on the development of students' analytical skills as well as how the course specifically synthesizes knowledge learned in previous courses.

SUMMARY

This research investigates the prevalence of Financial Statement Analysis (FSA) as a course offering, motivations for offering or not offering the course, as well as the nature and content of the course. The findings are based on the analysis of survey respondents and interpretation of course syllabi returned by survey participants.

Several reasons exist for investigating the offering of FSA. The

impending 150-hour requirement should allow accounting programs room to offer more accounting electives. FSA is an attractive prospect for addition to accounting curricula, given the analytical skills it builds in students, the ability to reinforce and synthesize knowledge gained in prerequisite courses, and the natural forum it provides for students to improve their oral presentation and analytical writing skills. FSA also provides accounting departments with the potential to service finance departments and M.B.A. programs.

This study may be helpful to those proposing FSA by offering insight into topics covered in the courses as currently taught, prerequisites demanded, target populations and instructional information on classroom methods, textbook adoptions and bases for grading.

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