
TABLE OF CONTENTS

PART ONE: READING BETWEEN THE LINES	1
Chapter 1: The Adversarial Nature of Financial Reporting	3
The Purpose of Financial Reporting	4
The Flaws in the Reasoning	7
Small Profits and Big Baths	10
Maximizing Growth Expectations	12
Downplaying Contingencies	18
The Importance of Being Skeptical	19
Conclusion	23
Chapter 1: Test Your Knowledge	25
Chapter 1: Solutions and Suggested Responses	27
PART TWO: THE BASIC FINANCIAL STATEMENTS	29
Chapter 2: The Balance Sheet	31
The Value Problem	32
Comparability Problems in the Valuation of Financial Assets	33
Instantaneous Wipeout of Value	35
How Good Is Goodwill?	37
Losing Value the Old-Fashioned Way	40
True Equity Is Elusive	41
Book Value May Overstate Reality	42
Pros and Cons of a Market-Based Equity Figure	44
The Common Form Balance Sheet	46
Conclusion	46
Chapter 2: Test Your Knowledge	49
Chapter 2: Solutions and Suggested Responses	51
Chapter 3: The Income Statement	53
Making the Numbers Talk	53
How Real Are the Numbers?	57
Conclusion	75
Chapter 3: Test Your Knowledge	77
Chapter 3: Solutions and Suggested Responses	79
Chapter 4: The Statement of Cash Flows	81
The Cash Flow Statement and the Leveraged Buyout	83
Analytical Applications	88
In Defense of Slack	103
Conclusion	104
Chapter 4: Test Your Knowledge	107
Chapter 4: Solutions and Suggested Responses	109

PART THREE: A CLOSER LOOK AT PROFITS	111
Chapter 5: What Is Profit?	113
Bona Fide Profits Versus Accounting Profits	113
Which Costs Count?	115
Conclusion	118
Chapter 5: Test Your Knowledge	121
Chapter 5: Solutions and Suggested Responses	123
Chapter 6: Revenue Recognition	125
Making It Up at Gowex	125
Globo's Foreseen Fall From Grace	128
Channel-Stuffing in the Drug Business	131
A Second Take on Earnings	134
Making the Numbers at M/A-Com	136
Astray on Layaway	138
Recognizing Membership Fees	139
A Potpourri of Liberal Revenue Recognition Techniques	141
Fattening Earnings with Empty Calories	143
Tardy Disclosure at Halliburton	147
Managing Earnings with Rainy Day Reserves	150
Fudging the Numbers: A Systematic Problem	152
Conclusion	155
Chapter 6: Test Your Knowledge	157
Chapter 6: Solutions and Suggested Responses	159
Chapter 7: Expense Recognition	163
Diamond Foods's Movable Expenses	163
Nortel's Deferred Profit Plan	166
Grasping for Earnings at General Motors	170
Time-Shifting at Freddie Mac	172
Conclusion	173
Chapter 7: Test Your Knowledge	175
Chapter 7: Solutions and Suggested Responses	177
Chapter 8: The Applications and Limitations of EBITDA	179
EBIT, EBITDA, and Total Enterprise Value	179
The Role of EBITDA in Credit Analysis	184
Abusing EBITDA	187
A More Comprehensive Cash Flow Measure	188
Working Capital Adds Punch to Cash Flow Analysis	191
Conclusion	192
Chapter 8: Test Your Knowledge	195
Chapter 8: Solutions and Suggested Responses	197

Chapter 9: The Reliability of Disclosure and Audits	199
Where Was the Cash?	200
Sloppiness Can Be a Red Flag	203
How Manipulation Evades Detection	206
Systematic Problems in Auditing	207
Conclusion	211
Chapter 9: Test Your Knowledge	213
Chapter 9: Solutions and Suggested Responses	215
Chapter 10: Mergers-and-Acquisitions Accounting	217
Goodwill Goes Bad	218
Double Trouble	219
Conclusion	222
Chapter 10: Test Your Knowledge	223
Chapter 10: Solutions and Suggested Responses	225
Chapter 11: Is Fraud Detectable?	227
Telltale Signs of Manipulation	228
Fraudsters Know Few Limits	230
Enron: A Media Sensation	231
HealthSouth's Excruciating Ordeal	237
Milk and Other Liquid Assets	243
Trouble Was Brewing at Luckin	246
Conclusion	248
Chapter 11: Test Your Knowledge	249
Chapter 11: Solutions and Suggested Responses	253
PART FOUR: FORECASTS AND SECURITY ANALYSIS	257
Chapter 12: Forecasting Financial Statements	259
A Typical One-Year Projection	259
Sensitivity Analysis with Projected Financial Statements	270
Projecting Financial Flexibility	275
Pro Forma Financial Statements	278
Multiyear Projections	282
Conclusion	293
Chapter 12: Test Your Knowledge	295
Chapter 12: Solutions and Suggested Responses	297
Chapter 13: Credit Analysis	299
Balance Sheet Ratios	300
Income Statement Ratios	307
Statement of Cash Flows Ratios	311
Combination Ratios	313
Relating Ratios to Credit Risk	319
Conclusion	332

Chapter 13: Test Your Knowledge	335
Chapter 13: Solutions and Suggested Responses	337
Chapter 14: Equity Analysis	339
The Dividend Discount Model	340
The Price-Earnings Ratio	345
The Du Pont Formula	354
Valuation Through Restructuring Potential	356
Advanced Equity Analysis	362
Conclusion	364
Chapter 14: Test Your Knowledge	365
Chapter 14: Solutions and Suggested Responses	367
Glossary	369
Index	384
Final Exam Copy	391