ACCOUNTING AND FINANCE FOR LAWYERS
Fall 2018

Instructor: Simon B. Jawitz
Classroom: TUES 4:10-6:00PM
Time: TUES 4:10-6:00PM
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Course Objectives and Outline: This course is designed to give law students the knowledge, tools, insights and confidence they need to work effectively in any one of a myriad of business, financial or commercial settings. We will begin with the history and purpose of corporations and other business entities. Students will study about how corporations are created and organized, the respective roles of boards of directors, management and shareholders and how conflicts arise and may be resolved. We will focus on corporate governance and best practices as well as the nature and limits of fiduciary and other legal obligations. Considerable time will then be spent learning how to read and understand financial statements of both public and private companies. This is not delving into technical and arcane accounting rules but learning how the principal financial statements are related to each other and tell the story of a business, its operations and financial condition. This is always eye opening and often exciting. Thereafter, we will learn the most basic tools of financial analysis—including the time value of money and discounted cash flow analysis—and how they are used to value everything from bonds to investment projects and ultimately entire businesses. We will look in some detail at the finance of real estate and see how both legal and financial analyses are crucial to success in the field. Throughout the term students will explore in some depth the concepts of risk and return and learn the fundamentals and key drivers of financial analysis. Real world examples will constantly be used to illustrate these concepts as we develop them throughout the semester.
Quantitative analysis will be a core skill used throughout the course. However, no background in statistics, calculus or other advanced mathematical theory or practice is required. Each topic will be presented in an accessible manner and ALL students will be able to understand and master the skills taught in the course.

**Introduction.**
We will begin with an overview of the materials to be covered in the course. In order to understand how the materials will fit together and to appreciate the goals for the semester, we will ask a simple question: Using just our common sense, intuition and general knowledge what would we want to know about Apple Computer in order to make an assessment of its value? We will see that there is nothing magical or mystical about financial thinking. The goal for the course is to achieve meaningful insights that are logical, understandable and intuitive.

**The Corporate Enterprise and Corporate Governance.**
Corporations have been called “one of the most fundamental institutions of the modern era.” We will study how and why the corporate form of enterprise was created and the extraordinary impact it has had on almost every aspect of our lives. We will learn about how corporations are created and organized, the respective roles and duties of boards of directors, management and shareholders and how conflicts arise and may be resolved. We will look at evolving standards of corporate governance and the role that shareholder activism has played in forcing corporate executives and boards to be more focused on “shareholder value.” Particular attention will be paid to conflicts between shareholders and management that arise in the context of takeovers. Issues involving corporate governance are in the news on a weekly basis. This will provide tremendous opportunity to explore these issues throughout the term of our course.

**Capitalization—Financing the Corporate Enterprise.**
We will then turn our attention to the capitalization of corporations and explore the various tools that are used by corporations to raise capital—common equity, preferred stock and debt. What are the characteristics of each, how do they compare and how are they combined to create a workable capital structure? We will also review and analyze a “typical”
term sheet for a Series A Round of venture capital for insights into capital structure and to gain some appreciation of the process of early-stage financing for a start-up company.

**Understanding Financial Statements.**
Next we will jump into the world of accounting. Unlike traditional accounting courses that focus on the details of debits and credits, journal entries and the like, we will approach accounting from the vantage point of accounting statements and what they tell us about the history and financial condition of a company. This is actually an exciting endeavor, as an understanding of the balance sheet, income statement and statement of cash flows brings to life the workings of a company. Moreover, it is fundamental to any effort to value a business. We will review the structure and content of a company’s annual report and report on Form 10-K so students will gain some practical experience in looking for and finding important information. Finally, we will also learn how to interpret some of the most important financial ratios so that trends can be identified, companies compared and crucial insights gleaned.

**The Time Value of Money—Future and Present Values.**
At this point in the course we will need to “sharpen our pencils” a bit. The time value of money and in particular the concepts of future value and present value need to be fully understood and students need to learn how to do basic computations. These financial concepts will be explored and through a logical progression of exercises students will become comfortable and indeed confident in their ability to compute the present value of future cash streams. No student in the class will be unable to master this material!

**Measuring Risk and Return—Bonds and Loans.**
We will begin our study of risk and return by looking at these concepts in the world of loans and bonds. What risks do creditors take when they purchase bonds or make loans? How do we measure credit risk and interest rate risk? In connection with interest rate risk we will take a very brief look at the basic tools used by investors to measure risk. What is the term structure of interest rates? Regarding credit risk we will review the most important analytical tools used by credit analysts
and also look at the role of covenants and other structural techniques used to mitigate credit exposure. Finally, we will consider a term sheet for a bank working capital facility to better understand how smaller companies borrow and how commercial lenders protect themselves in extending credit to this segment of the market.

**Capital Investment Decisions.**
We will now begin the process of building the tools necessary to understand the valuation of companies. We start by looking at how companies make capital investment decisions and how they apply financial evaluation to decisions such as whether to expand into a new product line or refurbish older equipment. At the heart of this analysis is the concept of net present value.

**The Finance of Real Estate.**
Focusing on the financing of real estate investments makes sense for several reasons. First, it is a great way to reinforce some of the basic concepts we have already looked at such as PV, perpetuities as well as accounting basics. Second, it provides an easy way into the world of valuing financial assets without many of the complications you encounter in “corporate” finance. Third, we can see the value of leverage and study the differences between before and after-tax analyses. Finally, many of us will be involved with real estate either in our professional capacities as attorneys or as private investors. Understanding some basics will pay dividends in many respects.

**From Projects to Firms.**
We then begin to apply these same principles to valuing a business in its entirety. Beginning with the basic dividend discount model and the somewhat more elaborate Gordon Growth model, we will start to understand the assumptions, logic and shortcomings of valuing a business enterprise on the basis of discounting anticipated future cash flows.

**The Discounted Cash Flow Valuation Model.**
While there are many ways that valuation is done by bankers, business consultants and corporate executives, we will focus primarily on the discounted cash flow method of valuation. What is the theory
underlying its use? What are the necessary inputs? How do I determine reasonable sales and net income projections for a company?

**The Cost of Equity Capital.**
This will certainly be the most difficult concept of the course largely because it is built on premises that are non-intuitive (or perhaps counter intuitive) and rests on principles that are the subject of ongoing and vigorous debate. Nevertheless, by the end of our sessions students will have a firm grasp of the basics and hopefully insights that will be of broad applicability.

**Understanding How All the Pieces Fit Together.**
At this point we will endeavor to consolidate our understanding of accounting, free cash flow, growth and the cost of capital. We will also look at several issues related to valuation including cash on the balance sheet and employee stock options. This will be a time to test our knowledge, reinforce insights and eliminate confusion.

**Is that Stock Cheap at a P/E Ratio of 10X?**
While a DCF valuation is explicitly or implicitly at the heart of almost every valuation, bankers and corporate executives frequently talk in terms of P/E ratios and other similar measures. Popular discussions of companies in the press and elsewhere almost always use this jargon. What does it mean? What is relative valuation? We will study one or two of the most commonly used multiples and gain some practical insights into their proper use.

**Investing on Steroids—Leverage and Financial Risk.**
What is leverage and why is it being talked about almost everyday? We will explore the relationship among leverage (i.e. the use of debt in the capital structure), return and risk. We will also look at the role of leverage in our financial system generally and the risks that it creates.

**How do Companies Create Value for Shareholders?**
We will begin our wrap up by looking back at all of the insights we have gained and asking the simple question—how do companies create value for shareholders? While the specifics may be complex and as varied as the thousands of different business lines that companies pursue, the
basic rules are surprisingly simple. It all comes down to one or two very simple ideas.

**An Introduction to Options.**
As we end the course, we will very briefly explore the world of options. By this point in the course all students will understand that in almost all areas of business and finance risk and uncertainty diminish value or require higher expected returns as compensation. But in the world of options investors look for and embrace uncertainty and it increases the value of positions. Why is this true? We will look at and dissect the most widely used model for option pricing in a manner accessible to all students in the class. We will also look at how many business decisions can be better understood and evaluated by identifying options that are implicit in various courses of action.

The objectives of this course are to instill a basic understanding of the most important principles of business, accounting and finance, stress the importance of ethics and proper decision making and most importantly to encourage students to think critically and creatively.

**Course Requirements:**

**Attendance:** Class attendance will be essential in order to master the materials that we cover and also in order to make class sessions meaningful and rewarding for fellow students. Please come to class!

**Participation:** Class sessions will combine lecture and discussion but the key to success will be robust participation by all. I will expect all students to come to class having read and thought about any materials assigned for that class. Students are encouraged to ask and answer questions and offer opinions and insights.

**Required Reading:** There will be no textbook for the course. There will be written materials provided for each topic covered. A package containing all of the materials that I will use in class can be obtained in the copy center. These materials will also be available in
different formats on our TWEN site for the course. In addition, I will recommend additional readings

**Final:** There will be a take-home final exam administered after completion of the course. The final will cover all of the materials covered but topics of particular importance will be identified in advance.

**“TWEN” (The West Education Network):** I have set up a course page for this class on TWEN. TWEN gives me a quick way to reach all of you with any announcements, Syllabus changes, handout materials, interesting links, etc. It also gives me a way to extend class discussion beyond the classroom hours. *You must register for this course on TWEN.*

**Expected Student Workload:** The American Bar Association requires that you spend at least four hours per week outside of class studying for this 2-credit course. This is an average amount of time required for out of class work per week over the course of the semester. The time you will spend throughout the semester preparing for class as well as studying for and taking the final exam will satisfy (and likely exceed) that time commitment. This is in addition to the two hours of class time.