

STUDY SESSION 10

FINANCIAL REPORTING AND ANALYSIS: Techniques, Applications, and International Standards Convergence

The readings in this study session discuss financial analysis techniques, financial statement analysis applications, and the international convergence of accounting standards.

The most frequently used tools and techniques to evaluate companies include common size analysis, cross-sectional analysis, trend analysis, and ratio analysis. Beyond mere knowledge of these tools, however, the analyst must recognize the implications of accounting choices on the quality of a company's reported financial results. Then the analyst can apply these financial analysis techniques to major analyst tasks including the evaluation of past and future financial performance, credit risk, and the screening of potential equity investments. The reading also discusses analyst adjustments to reported financials. Such adjustments are often needed to put companies' reported results on a comparable basis.

This study session concludes with a reading on convergence of international and U.S. accounting standards. Although there has been much progress in harmonizing accounting standards globally, as this reading discusses, there are still significant variations between generally accepted accounting principles from one country to another.

READING ASSIGNMENTS

- Reading 39** [Financial Analysis Techniques](#)
International Financial Statement Analysis, by Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, R. Elaine Henry, CFA, and Michael A. Broihahn, CFA
- Reading 40** [Financial Reporting Quality: Red Flags and Accounting Warning Signs](#)
Commercial Lending Review, by Thomas R. Robinson, CFA and Paul Munter
- Reading 41** [Accounting Shenanigans on the Cash Flow Statement](#)
The CPA Journal, by Marc A. Siegel

Reading 42 **Financial Statement Analysis: Applications**
International Financial Statement Analysis, by Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, R. Elaine Henry, CFA, and Michael A. Broihahn, CFA

Reading 43 **International Standards Convergence**
International Financial Statement Analysis, by Thomas R. Robinson, CFA, Jan Hendrik van Greuning, CFA, R. Elaine Henry, CFA, and Michael A. Broihahn, CFA

LEARNING OUTCOMES

Reading 39: Financial Analysis Techniques

- a. evaluate and compare companies using ratio analysis, common-size financial statements, and charts in financial analysis;
- b. describe the limitations of ratio analysis;
- c. calculate, classify, and interpret activity, liquidity, solvency, profitability, and valuation ratios;
- d. demonstrate how ratios are related and how to evaluate a company using a combination of different ratios;
- e. demonstrate the application of and interpret changes in the component parts of the DuPont analysis (the decomposition of return on equity);
- f. calculate and interpret the ratios used in equity analysis, credit analysis, and segment analysis;
- g. describe how the results of common-size and ratio analysis can be used to model and forecast earnings.

Reading 40: Financial Reporting Quality: Red Flags and Accounting Warning Signs

The candidate should be able to:

- a. describe incentives that might induce a company management to overreport or underreport earnings;
- b. describe activities that will result in a low quality of earnings;
- c. describe the “fraud triangle”;
- d. describe the risk factors related to incentives and pressures that may lead to fraudulent accounting;
- e. describe the risk factors related to opportunities that may lead to fraudulent accounting;
- f. describe the risk factors related to attitudes and rationalizations that may lead to fraudulent accounting;
- g. describe common accounting warning signs and methods of detecting each;
- h. describe the accounting warning signs related to the Enron accounting scandal;
- i. describe the accounting warning signs related to the Sunbeam accounting scandal.

Reading 41: Accounting Shenanigans on the Cash Flow Statement

The candidate should be able to analyze and discuss the following ways to manipulate the cash flow statement:

- ▶ stretching out payables
- ▶ financing of payables
- ▶ securitization of receivables
- ▶ using stock buybacks to offset dilution of earnings

Reading 42: Financial Statement Analysis: Applications

The candidate should be able to:

- a. evaluate a company's past financial performance and explain how a company's strategy is reflected in past financial performance;
- b. prepare a basic projection of a company's future net income and cash flow;
- c. describe the role of financial statement analysis in assessing the credit quality of a potential debt investment;
- d. discuss the use of financial statement analysis in screening for potential equity investments;
- e. determine and justify appropriate analyst adjustments to a company's financial statements to facilitate comparison with another company.

Reading 43: International Standards Convergence

The candidate should be able to:

- a. identify and explain the major international accounting standards for each asset and liability category on the balance sheet and the key differences from U.S. generally accepted accounting principles (GAAP);
- b. identify and explain the major international accounting standards for major revenue and expense categories on the income statement, and the key differences from U.S. GAAP;
- c. identify and explain the major differences between international and U.S. GAAP accounting standards concerning the treatment of interest and dividends on the cash flow statement;
- d. interpret the effect of differences between international and U.S. GAAP accounting standards on the balance sheet, income statement, and the statement of changes in equity for some commonly used financial ratios.