STUDY SESSION 6

Financial Reporting and Analysis (2)

This study session focuses on evaluating financial reporting quality and applying financial analysis techniques to investment decisions. A conceptual framework for assessing the quality of a company's financial reports, including the quality of earnings, is provided. Indicators of low quality reporting, including quality of earnings, cash flow, and balance sheet are examined. The session concludes with mini cases, which demonstrate the value in applying financial statement analysis to inform practical investment decisions.

Note: Changes in accounting standards as well as new rulings and/or pronouncements issued after the publication of the readings on financial reporting and analysis may cause some of the information in these readings to become dated. Candidates are *not* responsible for anything that occurs after the readings were published. In addition, candidates are expected to be familiar with the analytical frameworks contained in the readings, as well as the implications of alternative accounting methods for financial analysis and valuation discussed in the readings. Candidates are also responsible for the content of accounting standards, but not for the actual reference numbers. Finally, candidates should be aware that certain ratios may be defined and calculated differently. When alternative ratio definitions exist and no specific definition is given, candidates should use the ratio definitions emphasized in the readings.

READING ASSIGNMENTS

Reading 18	Evaluating Quality of Financial Reports by Jack T. Ciesielski, CPA, CFA, Elaine Henry, PhD, CFA, and Thomas I. Selling, PhD, CPA
Reading 19	Integration of Financial Statement Analysis Techniques by Jack T. Ciesielski, CPA, CFA

LEARNING OUTCOMES

READING 18. EVALUATING QUALITY OF FINANCIAL REPORTS

The candidate should be able to:

a demonstrate the use of a conceptual framework for assessing the quality of a company's financial reports;

b explain potential problems that affect the quality of financial reports;

c describe how to evaluate the quality of a company's financial reports;

d evaluate the quality of a company's financial reports;

e describe the concept of sustainable (persistent) earnings;

f describe indicators of earnings quality;

g explain mean reversion in earnings and how the accruals component of earnings affects the speed of mean reversion;

h evaluate the earnings quality of a company;

i describe indicators of cash flow quality;

j evaluate the cash flow quality of a company;

k describe indicators of balance sheet quality;

l evaluate the balance sheet quality of a company;

m describe sources of information about risk.

READING 19. INTEGRATION OF FINANCIAL STATEMENT ANALYSIS TECHNIQUES

The candidate should be able to:

a demonstrate the use of a framework for the analysis of financial statements, given a particular problem, question, or purpose (e.g., valuing equity based on comparables, critiquing a credit rating, obtaining a comprehensive picture of financial leverage, evaluating the perspectives given in management's discussion of financial results);

b identify financial reporting choices and biases that affect the quality and comparability of companies' financial statements and explain how such biases may affect financial decisions;

c evaluate the quality of a company's financial data and recommend appropriate adjustments to improve quality and comparability with similar companies, including adjustments for differences in accounting standards, methods, and assumptions;

d evaluate how a given change in accounting standards, methods, or assumptions affects financial statements and ratios;

e analyze and interpret how balance sheet modifications, earnings normalization, and cash flow statement related modifications affect a company's financial statements, financial ratios, and overall financial condition.