

STUDY SESSION

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Financial Statement Analysis (1)

This study session covers investments in other entities (intercorporate investments), post-employment benefits, and foreign currency transactions. Intercorporate investments take the form of investments in 1) financial assets, 2) associates, 3) joint ventures, 4) business combinations, and 5) special purpose and variable interest entities. Current and new reporting standards for these investments are examined. The valuation and treatment of post-employment benefits follows, including share-based compensation (grants, options). Differences in valuation methods between defined-contribution and defined-benefit plans are described. The effect of foreign currency on a business's financials and methods to translate foreign currency from operations for consolidated financial statement reporting is examined. Analysis of financial institutions, including factors for consideration and an analysis approach (CAMELS), concludes the session.

READING ASSIGNMENTS

Reading 9	Intercorporate Investments by Susan Perry Williams, CPA, CMA, PhD
Reading 10	Employee Compensation: Post-Employment and Share-Based by Elaine Henry, PhD, CFA, and Elizabeth A. Gordon, PhD, MBA, CPA
Reading 11	Multinational Operations by Timothy S. Doupnik, PhD, and Elaine Henry, PhD, CFA
Reading 12	Analysis of Financial Institutions by Jack T. Ciesielski, CPA, CFA, and Elaine Henry, PhD, CFA

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.

LEARNING OUTCOMES**READING 9. INTERCORPORATE INVESTMENTS**

The candidate should be able to:

- a** describe the classification, measurement, and disclosure under International Financial Reporting Standards (IFRS) for 1) investments in financial assets, 2) investments in associates, 3) joint ventures, 4) business combinations, and 5) special purpose and variable interest entities;
- b** compare and contrast IFRS and US GAAP in their classification, measurement, and disclosure of investments in financial assets, investments in associates, joint ventures, business combinations, and special purpose and variable interest entities;
- c** analyze how different methods used to account for intercorporate investments affect financial statements and ratios.

READING 10. EMPLOYEE COMPENSATION: POST-EMPLOYMENT AND SHARE-BASED

The candidate should be able to:

- a** describe the types of post-employment benefit plans and implications for financial reports;
- b** explain and calculate measures of a defined benefit pension obligation (i.e., present value of the defined benefit obligation and projected benefit obligation) and net pension liability (or asset);
- c** describe the components of a company's defined benefit pension costs;
- d** explain and calculate the effect of a defined benefit plan's assumptions on the defined benefit obligation and periodic pension cost;
- e** explain and calculate how adjusting for items of pension and other post-employment benefits that are reported in the notes to the financial statements affects financial statements and ratios;
- f** interpret pension plan note disclosures including cash flow related information;
- g** explain issues associated with accounting for share-based compensation;
- h** explain how accounting for stock grants and stock options affects financial statements, and the importance of companies' assumptions in valuing these grants and options.

READING 11. MULTINATIONAL OPERATIONS

The candidate should be able to:

- a** compare and contrast presentation in (reporting) currency, functional currency, and local currency;
- b** describe foreign currency transaction exposure, including accounting for and disclosures about foreign currency transaction gains and losses;
- c** analyze how changes in exchange rates affect the translated sales of the subsidiary and parent company;

- d** compare the current rate method and the temporal method, evaluate how each affects the parent company's balance sheet and income statement, and determine which method is appropriate in various scenarios;
- e** calculate the translation effects and evaluate the translation of a subsidiary's balance sheet and income statement into the parent company's presentation currency;
- f** analyze how the current rate method and the temporal method affect financial statements and ratios;
- g** analyze how alternative translation methods for subsidiaries operating in hyper-inflationary economies affect financial statements and ratios;
- h** describe how multinational operations affect a company's effective tax rate;
- i** explain how changes in the components of sales affect the sustainability of sales growth;
- j** analyze how currency fluctuations potentially affect financial results, given a company's countries of operation.

READING 12. ANALYSIS OF FINANCIAL INSTITUTIONS

The candidate should be able to:

- a** describe how financial institutions differ from other companies;
- b** describe key aspects of financial regulations of financial institutions;
- c** explain the CAMELS (capital adequacy, asset quality, management, earnings, liquidity, and sensitivity) approach to analyzing a bank, including key ratios and its limitations;
- d** describe other factors to consider in analyzing a bank;
- e** analyze a bank based on financial statements and other factors;
- f** describe key ratios and other factors to consider in analyzing an insurance company.