

Financial Statement Analysis

LEARNING OUTCOMES

Introduction to Financial Statement Analysis

The candidate should be able to:

- describe the steps in the financial statement analysis framework
- describe the roles of financial statement analysis
- describe the importance of regulatory filings, financial statement notes and supplementary information, management's commentary, and audit reports
- describe implications for financial analysis of alternative financial reporting systems and the importance of monitoring developments in financial reporting standards
- describe information sources that analysts use in financial statement analysis besides annual and interim financial reports

Analyzing Income Statements

The candidate should be able to:

- describe general principles of revenue recognition, specific revenue recognition applications, and implications of revenue recognition choices for financial analysis
- describe general principles of expense recognition, specific expense recognition applications, implications of expense recognition choices for financial analysis and contrast costs that are capitalized versus those that are expensed in the period in which they are incurred
- describe the financial reporting treatment and analysis of non-recurring items (including discontinued operations, unusual or infrequent items) and changes in accounting policies

- describe how earnings per share is calculated and calculate and interpret a company's basic and diluted earnings per share for companies with simple and complex capital structures including those with antidilutive securities
- evaluate a company's financial performance using common-size income statements and financial ratios based on the income statement

Analyzing Balance Sheets

The candidate should be able to:

- explain the financial reporting and disclosures related to intangible assets
- explain the financial reporting and disclosures related to goodwill
- explain the financial reporting and disclosures related to financial instruments
- explain the financial reporting and disclosures related to non-current liabilities
- calculate and interpret common-size balance sheets and related financial ratios

Analyzing Statements of Cash Flows I

The candidate should be able to:

- describe how the cash flow statement is linked to the income statement and the balance sheet
- describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data
- demonstrate the conversion of cash flows from the indirect to direct method
- contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Analyzing Statements of Cash Flows II

The candidate should be able to:

- analyze and interpret both reported and common-size cash flow statements
- calculate and interpret free cash flow to the firm, free cash flow to equity, and performance and coverage cash flow ratios

Analysis of Inventories

The candidate should be able to:

- describe the measurement of inventory at the lower of cost and net realisable value and its implications for financial statements and ratios
- calculate and explain how inflation and deflation of inventory costs affect the financial statements and ratios of companies that use different inventory valuation methods
- describe the presentation and disclosures relating to inventories and explain issues that analysts should consider when examining a company's inventory disclosures and other sources of information

Analysis of Long-Term Assets

The candidate should be able to:

- compare the financial reporting of the following types of intangible assets: purchased, internally developed, and acquired in a business combination
- explain and evaluate how impairment and derecognition of property, plant, and equipment and intangible assets affect the financial statements and ratios
- analyze and interpret financial statement disclosures regarding property, plant, and equipment and intangible assets

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Topics in Long-Term Liabilities and Equity

The candidate should be able to:

- explain the financial reporting of leases from the perspectives of lessors and lessees
- explain the financial reporting of defined contribution, defined benefit, and stock-based compensation plans
- describe the financial statement presentation of and disclosures relating to long-term liabilities and share-based compensation

Analysis of Income Taxes

The candidate should be able to:

- contrast accounting profit, taxable income, taxes payable, and income tax expense and temporary versus permanent differences between accounting profit and taxable income
- explain how deferred tax liabilities and assets are created and the factors that determine how a company's deferred tax liabilities and assets should be treated for the purposes of financial analysis
- calculate, interpret, and contrast an issuer's effective tax rate, statutory tax rate, and cash tax rate
- analyze disclosures relating to deferred tax items and the effective tax rate reconciliation and explain how information included in these disclosures affects a company's financial statements and financial ratios

Financial Reporting Quality

The candidate should be able to:

- compare financial reporting quality with the quality of reported results (including quality of earnings, cash flow, and balance sheet items)
- describe a spectrum for assessing financial reporting quality
- explain the difference between conservative and aggressive accounting
- describe motivations that might cause management to issue financial reports that are not high quality and conditions that are conducive to issuing low-quality, or even fraudulent, financial reports
- describe mechanisms that discipline financial reporting quality and the potential limitations of those mechanisms
- describe presentation choices, including non-GAAP measures, that could be used to influence an analyst's opinion
- describe accounting methods (choices and estimates) that could be used to manage earnings, cash flow, and balance sheet items
- describe accounting warning signs and methods for detecting manipulation of information in financial reports

Financial Analysis Techniques

The candidate should be able to:

- describe tools and techniques used in financial analysis, including their uses and limitations
- calculate and interpret activity, liquidity, solvency, and profitability ratios
- describe relationships among ratios and evaluate a company using ratio analysis
- demonstrate the application of DuPont analysis of return on equity and calculate and interpret effects of changes in its components
- describe the uses of industry-specific ratios used in financial analysis
- describe how ratio analysis and other techniques can be used to model and forecast earnings

Introduction to Financial Statement Modeling

The candidate should be able to:

- demonstrate the development of a sales-based pro forma company model
- explain how behavioral factors affect analyst forecasts and recommend remedial actions for analyst biases
- explain how the competitive position of a company based on a Porter's five forces analysis affects prices and costs
- explain how to forecast industry and company sales and costs when they are subject to price inflation or deflation
- explain considerations in the choice of an explicit forecast horizon and an analyst's choices in developing projections beyond the short-term forecast horizon