

## Financial Reporting and Analysis

### Financial Reporting Quality and Financial Statement Analysis

This study session discusses financial reporting quality and shows the application of financial statement analysis to debt and equity investments. Frequently used tools and techniques for evaluating companies include common-size analysis, cross-sectional analysis, trend analysis, and ratio analysis. Beyond mere knowledge of these tools and techniques, 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 financial analysis techniques to tasks such as the evaluation of past and future financial performance, credit risk and analysis, the screening of potential equity investments, and other job needs. The readings also explain adjustments to reported financials that analysts often make. Such adjustments are often needed to put companies' reported results on a comparable basis.

#### READING ASSIGNMENTS

- Reading 32** Financial Reporting Quality  
by Jack T. Ciesielski, Jr., CPA, CFA, Elaine Henry, PhD, CFA, and  
Thomas I. Selling, PhD, CPA
- Reading 33** Financial Statement Analysis: Applications  
by Thomas R. Robinson, PhD, CFA, Jan Hendrik van Greuning,  
DCom, CFA, Elaine Henry, PhD, CFA, and Michael A. Broihahn,  
CPA, CIA, CFA

**Note:** New rulings and/or pronouncements issued after the publication of the readings in financial reporting and analysis may cause some of the information in these readings to become dated. Candidates are expected to be familiar with the overall analytical framework contained in the study session readings, as well as the implications of alternative accounting methods for financial analysis and valuation, as provided in the assigned readings. Candidates are not responsible for changes that occur after the material was written.

**LEARNING OUTCOMES****READING 32. FINANCIAL REPORTING QUALITY**

The candidate should be able to:

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

**READING 33. 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** forecast 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** describe the use of financial statement analysis in screening for potential equity investments;
- e** explain appropriate analyst adjustments to a company's financial statements to facilitate comparison with another company.