9

Financial Reporting and Analysis

Financial Reporting Quality and Financial Statement Analysis

This study session introduces the concept of financial reporting quality. The session examines the financial reporting quality differences that may exist between companies and the means for identifying them. Warning signs of poor or low quality reporting are covered. The application of financial analysis techniques to evaluate a company's past and projected performance, assess credit risk, and screen for potential equity investments follows. Common adjustments to reported financials to facilitate cross-company comparisons conclude the session.

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.