

STUDY SESSION

6

Financial Reporting and Analysis

Quality of Financial Reports and Financial Statement Analysis

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.

READING ASSIGNMENTS

Reading 19	Evaluating Quality of Financial Reports by Jack T. Ciesielski, Jr., CPA, CFA, Elaine Henry, PhD, CFA, and Thomas I. Selling, PhD, CPA
Reading 20	Integration of Financial Statement Analysis Techniques by Jack T. Ciesielski, Jr., CPA, CFA

LEARNING OUTCOMES

READING 19. 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;

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.

- 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 20. 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.