

Financial Statement Analysis

Introduction to Financial Statement Analysis



Exam Focus

- Purpose of financial statement analysis
- Sources of regulated information
- The audit report
- Differences between U.S. GAAP and IFRS

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Scope of Financial Statement Analysis

Financial reports

Other information

Evaluate:
Past, present, and future
Performance (I/S)
Position (B/S)
Financial flexibility (cash flow)

Investment, credit, and other economic decisions

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Regulated Sources of Information

- Accounting standards
 - U.S. GAAP
 - IFRS (International Financial Reporting Standards)
- Securities regulation
 - IOSCO
 - U.S. Securities and Exchange Commission
 - European Commission:
 - European Securities Commission (ESC)
 - European Securities and Market Authority (ESMA)

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Footnotes

- Footnotes = additional information on the amounts presented in the primary financial statements
- Basis of presentation
- Information on accounting policies, methods, and estimates
- Other disclosures
 - Segment reporting
 - Acquisitions and disposals
 - Financial instruments and risks
 - Post balance sheet events
 - Related party transactions

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Management Discussion and Analysis (MD&A)

- IASB and IFRS Practice Statement
 1. Nature of the business
 2. Management's objectives and strategies
 3. Significant resources, risks, and relationships
 4. Results of operations
 5. Critical performance measures
- Should include favorable and unfavorable trends and events impacting:
 - Liquidity
 - Capital resource
 - Operating results

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The Audit Report

Independent review of company's financial statements; unqualified report offers **reasonable assurance** that financial statements are free of material errors

Audit opinion

- Unqualified: "unmodified" or "clean" opinion
- Modified {
 Qualified: exceptions to accounting principles
 Adverse: statements not presented fairly
 Disclaimer of opinion: unable to form an opinion

Must provide opinion on company's **internal controls** under U.S. GAAP

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Audit Report

Standard auditor's opinion

1. Responsibility of **management** to **prepare accounts**; **independence** of **auditors**
2. Properly **prepared** in accordance with **relevant GAAP**; **reasonable assurance** that the statements are free from **material misstatement**
3. Accounting **principles** and **estimates** chosen are **reasonable**

Key (critical) audit matters

Highlights accounting choices requiring significant judgments or estimates, how significant transactions were accounted for, and choices the auditor believes have a significant likelihood of being misstated

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Key Differences: IFRS & U.S. GAAP

Difference	U.S. GAAP	IFRS
Based on	Rules	Principles
Interest paid	CFO	CFO or CFF
Interest received	CFO	CFO or CFI
Inventory	LIFO allowed	LIFO prohibited
Development costs	Expensed	Potentially capitalized
Reversal of inventory writedown	Prohibited	Allowed

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