

CFA 一级知识框架图

Financial Reporting and Analysis

专业来自101%的投入!

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Framework

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Framework

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R21

Financial Statement Analysis: An Introduction

The role of financial reporting and financial statement analysis

Financial Reporting	<ul style="list-style-type: none">➤ Provide information about the<ul style="list-style-type: none">● Financial position;● Financial performance;● Changes in financial position of an entity that is useful to a wide range of users <u>in making economic decisions.</u>
Financial Statements Analysis	<ul style="list-style-type: none">➤ Use relevant information in and outside a company's financial statements<ul style="list-style-type: none">● To <u>evaluate the previous, present, and future financial condition of the entity</u> for making economic decisions.



The resources used for financial statement analysis

The balance sheet	The income statement	The cash flow statement
Financial position	Financial performance	Cash inflows and outflows
At a point of time	During a period	
<ul style="list-style-type: none">➤ Assets➤ Liabilities➤ Owner's equity	<ul style="list-style-type: none">➤ Revenue➤ Expense➤ Net income	<ul style="list-style-type: none">➤ Operating cash flows➤ Investing cash flows➤ Financing cash flows
Asset = Liabilities + Owner's equity		Net cash inflow or outflow for the financial year

The resources used for financial statement analysis

Financial Notes and Supplementary Schedules★

Fiscal period; consolidation basis; accounting methods, assumptions and estimates; explanatory information about every line item on FSs.

Note disclosures include information about the following:

- Financial instruments and risks arising from financial instruments
- Commitments and contingencies
- Related-party transactions
- Subsequent events
- Business acquisitions and disposals

Management's Discussion and Analysis(MD&A)★

General contents (Publicly held companies): nature of the business, past results, material uncertainty and future outlook;
Characteristic: MD&A is a good for understanding information in the financial statements. In particular, the forward-looking disclosures in an MD&A, can be useful in projecting a company's future performance.

The resources used for financial statement analysis

IASB	<p>Provide guidance rather than set forth requirements in a standard.</p> <ul style="list-style-type: none"> ➤ <u>Nature</u> of the business ➤ Management's <u>objectives</u> and <u>strategies</u> ➤ Company's <u>significant</u> resources, risks, and relationships ➤ Results of <u>operations</u> ➤ Critical performance <u>measures</u>
SEC	<p>Requirements: Listed companies to provide MD&A and specify the content.</p> <ul style="list-style-type: none"> ➤ Favorable or unfavorable <u>trends</u> and <u>identify significant events and uncertainties</u> that affect the company's <u>liquidity, capital resources, and results of operations</u> ➤ <u>Effects of inflation, changing prices, or other material events and uncertainties</u> that may cause the <u>future operating results</u> and financial condition to <u>materially depart from</u> the current reported financial information ➤ <u>Off balance-sheet obligations</u> and <u>contractual commitments</u> ➤ <u>Critical accounting policies</u> that require <u>management to make subjective judgments</u>



The resources used for financial statement analysis

Proxy statements

- Management compensation; stock performance; potential conflict of interests
- Matters that are to be put to a vote at the company's annual (or special) meeting of shareholders

Interim reports

- Provided semiannually or quarterly
- Present the four basic financial statements and condensed notes but are not audited
- Provide updated information since the last annual period

Earnings announcements

- Followed by a conference call held by senior executives
- Describe the company's performance and answer questions posed by conference call participants

External sources

- Economy, the industry, the company, and peer (comparable) companies
- External information is helpful in assessing the company's future



Auditing and financial statement analysis framework

目的

Provide reasonable assurance that the financial statements are **fairly presented**

审计结果

内容

Unqualified (clean) opinion

- Compliance with applicable accounting standards

Qualified opinion

- Exceptions from accounting principles
- Explanations of these deviations

Adverse opinion

- Unfairly presented and contains material deviations

Disclaimer of opinion

- Limitations of financial statements hinder the auditor's ability to express an opinion

Under U.S. GAAP, the auditor **must** presents a comment on internal controls.

Auditing and financial statement analysis framework

Phase	Sources of info.	Output
1. Articulate the purpose and context of the analysis	<ul style="list-style-type: none"> ➤ Nature ➤ Needs & concern ➤ Guidelines 	<ul style="list-style-type: none"> ➤ Statement of purposes and objectives ➤ A list of specific questions ➤ Timetable & budgeted resources
2. Collect data	<ul style="list-style-type: none"> ➤ Financial data ➤ Discussion ➤ Visits 	<ul style="list-style-type: none"> ➤ Organized F/S ➤ Financial data table ➤ Complete questionnaires
3. Process data	<ul style="list-style-type: none"> ➤ Data from previous phase 	<ul style="list-style-type: none"> ➤ Adjusted F/S ➤ Common – size statements ➤ Ratios & Forecasts
4. Analyze/interpret the processed data	<ul style="list-style-type: none"> ➤ Input data ➤ Processed data 	<ul style="list-style-type: none"> ➤ Analytical results
5. Conclusions & recommendations	<ul style="list-style-type: none"> ➤ Analytical results 	<ul style="list-style-type: none"> ➤ Analytical reports ➤ Recommendation
6. Follow up	<ul style="list-style-type: none"> ➤ Periodically repeating 	<ul style="list-style-type: none"> ➤ Updated reports & recommendations



Basic concepts: accounting equation & accrual accounting

Balance sheet

Assets = liabilities + owners' equity

Owners' equity = contributed capital + retained earnings + OCI

Income statement

Net income = revenue – expense

勾稽关系

$R/E_{\text{ending}} = R/E_{\text{beginning}} + \text{net income} - \text{dividend}$

成立原因 : Double-entry accounting



Basic concepts: accounting equation & accrual accounting

Cash received in advance	Unearned revenue
Cash paid in advance	Prepaid expense
Cash received in arrears	Accrued revenue
Cash paid in arrears	Accrued expense

会计科目影响★★		Assets	Liabilities	Revenue	Expense	Equity
Unearned revenue	No revenue recognized A liability	↑	↑			
Accrued revenue	Revenue recognition An asset	↑		↑		↑
Prepaid expenses	No expense recognized An asset	Cash↓ Prepaid expenses↑				
Accrued expenses	Expenses recognition A liability		↑		↑	↓



R22

Financial Reporting Standards

Standard-setting bodies & regulatory authorities

Standard-setting bodies	FASB→U.S. GAAP IASB→IFRS
Regulatory authorities	SEC→US→知道10K,10Q, 8K FSA→UK

Reporting elements

Qualitative Characteristics

Objective

To provide useful information for making decisions about providing resources to the entity.

- **Relevance**
- **Faithful representation**
- **Comparability**
- **Verifiability**
- **Timeliness**
- **Understandability**
- **Performance:** income, expenses, capital maintenance adjustments, past cash flows
- **Financial position:** assets, liabilities, equity

Constraint

- **Cost**
(cost/benefit considerations)

Underlying assumption

- **Accrual basis**
- **Going concern**

IASB & FASB: framework, requirements and convergence

IASB general requirements

General Features

- Fair presentation
- Going concern
- Accrual basis
- Materiality and aggregation
- No offsetting
- Frequency of reporting
- Comparative information
- Consistency of presentation

Structure and Content

- Classified balance sheet
- Minimum specified information on face
- Minimum specified note disclosure
- Comparative information

Required financial statements

- Statement of financial position (B/S)
- Statement of comprehensive income (Single statement or income statement + Statement of comprehensive income)
- Statement of changes in equity
- Statement of cash flows
- Notes, summarizing accounting policies and disclosing other items
- In certain cases, statement of financial position from earliest comparative period

IASB & FASB: framework, requirements and convergence

Coherent Financial Reporting Framework

特征	<ul style="list-style-type: none"> ➤ Transparency ➤ Comprehensiveness ➤ Consistency 	难实现原因	<ul style="list-style-type: none"> ➤ Valuation ➤ Standard setting ➤ Measurement
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	IASB	FASB
Performance elements	<ul style="list-style-type: none"> ➤ Revenue ➤ Expense 	<ul style="list-style-type: none"> ➤ Revenues ➤ Expenses ➤ Gains and losses ➤ Comprehensive income
Financial position elements	<ul style="list-style-type: none"> ➤ Asset: resource from which future economic benefits are expected to flow to the entity 	<ul style="list-style-type: none"> ➤ Asset: a future economic benefit
Measurement of elements	<ul style="list-style-type: none"> ➤ Permit upward valuation 	<ul style="list-style-type: none"> ➤ Does not permit the upward valuation of most assets



R23

Understanding the I/S



Income statement format and components

NI = (revenues – operating expense) + (other income – other expense) + Gains - Losses

Operating components	<u>Net revenues from sales of goods and services</u> <u>-Cost of goods sold/Cost of service provided</u> Gross profit <u>-Other operating expenses (SG&A)</u> Operating income from continuing operations
Non-operating components	<u>+Other income and revenues</u> Recurring income before interest and taxes from continuing operations <u>-Financing costs</u>
The best indicator of future earnings	Recurring (pretax) income from continuing operations
	<u>+/- Unusual or infrequent items</u> Pretax income from continuing operations <u>- Income tax expense</u>
The line	Net income from continuing operations
Below the line	+/- Income from discontinued operations (net of tax) +/- Extraordinary items (net of tax)



Discontinued operations & extraordinary items

Non-Recurring items

Above the line (pretax)	Unusual or infrequent items	<ul style="list-style-type: none"> ➤ G/L from the sale of segments or part of a business ➤ Impairments, write-offs, write-downs, restructuring costs
	Accounting changes	<ul style="list-style-type: none"> ➤ Change in accounting estimate (prospective)
Below the line (net of tax)	Extraordinary items	<ul style="list-style-type: none"> ➤ Loss from expropriation of assets ➤ G/L from early retirement of debt ➤ Uninsured losses from natural disasters <p>IFRS prohibit. U.S. GAAP no longer include after Dec. 15, 2015.</p>
	Discontinued operations	<ul style="list-style-type: none"> ➤ 资产决定处置~实际处置期间产生的 G/L
	Accounting changes	<ul style="list-style-type: none"> ➤ Change in accounting principle (might be retrospective) ➤ Error (retrospective)

Accrual accounting & revenue recognition

Revenue

概念

- Generated from selling goods or service in routine business activities
- Net revenue = revenue - estimated returns and discounts

Revenue确认 → Delivery method

	Sale of goods	Services rendered
IFRS	<ul style="list-style-type: none"> ➤ Revenue can be measured reliably ➤ Probable inflows of economic benefits ➤ Transfer significant risks and ownership of the goods ➤ No continuing management or effective control over goods sold ➤ Relevant costs incurred can be measured reliably 	<ul style="list-style-type: none"> ➤ Revenue can be measured reliably ➤ Probable inflows of economic benefits ➤ Stage of completion can be measured reliably ➤ The costs incurred for the transaction and the costs to complete the transaction can be measured reliably

Accrual accounting & revenue recognition

Expense (具体存货处理、折旧等后续章节展开)

概念	The amounts incurred to generate revenue, such as COGS, operating expense, interest expense, etc.
Classification Method	➤ <u>By nature</u> : depreciation expenses are displayed in one account regardless of whether they come from manufacturing or administration
	➤ <u>By function</u> (cost of sales method): cost of goods sold is composed of all manufacturing costs, such as raw materials, depreciation, labor, etc.

Matching principle: expenses are recognized **in the same period** as the revenue

Accrual accounting & revenue recognition

Revenue确认 → delivery method

U.S. GAAP

- Realized or realizable
- Earned

**Guidance
from the
Securities
and
Exchange
Commission
(SEC)**

- The price is determined or determinable
- The seller is reasonably sure of collecting money
- The product has been delivered or the service has been rendered
- There is evidence of an arrangement between the buyer and seller

LT contract and installment sales

LT Contract	Reliably measure of outcome of a construction contract	U.S. GAAP	Percentage-of-completion method (POC)	➤ % of completion = (cost incurred to date)/total <u>expected cost</u>
		IFRS		➤ Revenue to date = % of completion × total revenue ➤ Profit = Revenue – cost
	Outcome of the project cannot be reliably estimated	U.S. GAAP	Completed contract method	➤ <u>Not report any income until</u> the contract is substantially finished
		IFRS	➤ Before costs are recovered, R=C. ➤ After recovery, recognize Rev. & profits.	

不同方法对财务指标影响★★	F/S	Items	POC	Completed contract
	CFS	Cash flows	Same	Same
	I/S	Income volatility	Less	Reverse
		Net income (previous years)	Greater	

LT contract and installment sales

Installment sales: a firm finances a sale, and payments are expected to be received over an extended period.

GAAP	Collectability cannot be reasonably estimated	Installment sales method (与POC类似)	<ul style="list-style-type: none"> ➤ % = cash collected / total sales price ➤ Profit = % × total expected profit ➤ Cost = revenue – profit
	Collectability is highly uncertain	Cost recovery method (similar to the completed contract method)	<ul style="list-style-type: none"> ➤ Not report any profit until the cash amounts are paid by the buyer.
IFRS	Outcome can be reliably estimated	<ul style="list-style-type: none"> ➤ Revenue attributable to the sale price (discounted PV) is recognized at the date of sale ➤ Revenue attributable to the interest component (actual payments – sale price) is recognized over time 	
	Outcome cannot be reliably estimated	<ul style="list-style-type: none"> ➤ Similar to cost recovery method. 	



Barter transactions

U.S.GAAP

- Fair value only if the firm has historically received cash payments for such goods and services and can use this historical experience to determine fair value
- Otherwise, the revenue is recorded at the carrying value of the asset surrendered

IFRS

- Fair value of revenue from similar non-barter transactions with unrelated parties

Gross vs. net reporting of revenue

Gross revenue

Gross amount of sales proceeds received from their customers

Net revenue

Net difference between sales proceeds and their cost

U.S.GAAP 要用 gross revenue 必须

- Be the primary obligor of the contract
- Independently choose its supplier
- Tolerate risks involved, including inventory risk and credit risk
- Free to determine the price



Basic EPS★★★

Basic EPS	Basic EPS = $\frac{\text{NI} - \text{Preferred dividends}}{\text{weighted average number of common shares outstanding}}$	
Weighted average number of common shares outstanding	New issue, repurchase	Weighted by time (days or months)
	Stock dividend/split	Not weighted by time, should be adjusted in a retroactive way.

Diluted EPS★★★

Diluted EPS

$$\text{Diluted EPS} = \frac{\text{adjusted income available for common shares}}{\text{weighted avg. common \& potential common shares out}}$$

$$= \frac{[NI - \text{div}_{\text{preferred}}] + [\text{div}_{\text{convertible preferred}}] + [\text{interest}_{\text{convertible debt}}](1-t)}{\text{WACSO} + [\text{shares}_{\text{conversion of conv. pfd. shares}}] + [\text{shares}_{\text{conversion of conv. debt}}] + [\text{shares}_{\text{issuable from stock opt.}}]}$$



R24

Understanding the B/S

B/S format and components

B/S作用：assess a firm's liquidity, solvency, and ability to distribute to shareholders.

Assets	
Current assets	Cash and equivalents
	Accounts receivable
	Inventory
	Prepaid expenses
	Short term investments
	Other current assets
Non current assets	Property , plant and equipment (PP&E)
	Intangible assets
	Long term investments
	Deterred tax assets
	Pension assets

流动性
下降

Liabilities	
Current liabilities	Bank overdraft
	Accounts payable
	Accrued expenses
	Unearned revenue
	Current portion of LT debt
	Current taxes payable
Long-term liabilities	Notes payable
	Bonds payable
	Financial lease obligations
	Pension liabilities
	Deferred tax liabilities



B/S format and components

Stockholders' equity

Capital	Common stock, preferred stock
Additional paid-in-capital	Capital in excess of par i.e. premium
Treasury	<ul style="list-style-type: none">➤ Stock repurchased by the issuing firm but not yet retired➤ No voting rights, no dividends
Retained earnings	$R/E_{\text{ending}} = R/E_{\text{beginning}} + \text{net income} - \text{dividend}$
Accumulated other comprehensive income	<ul style="list-style-type: none">➤ Foreign currency translation adjustment on a foreign subsidiary➤ Unrealized G/L on derivatives contracts accounted for as cash flow hedges➤ Unrealized G/L on available-for-sale securities➤ Certain costs of a company's DB plans that are not recognized in the current period➤ Revaluation gain for long-term assets (IFRS only)
Minority interest/non-controlling interest	Group accounting



Financial instruments

	Held-to-maturity	Available-for-sale	Trading securities
B/S初始计量	Amortized cost	Fair value	Fair value
期间受益→Interest	I/S	I/S	I/S
期间受益→Dividend	无→只有debt才是	I/S	I/S
期间受益→Realized G/L	I/S	I/S	I/S
期间受益 →Unrealized G/L	无，不按fair value 调整	B/S→OCI	I/S



R25

Understanding the C/F



Classification of cash flow

CF	+CF	-CF
CFO	<ul style="list-style-type: none">● Cash collected from customers● Interest received● Dividends received● Proceeds of selling trading securities	<ul style="list-style-type: none">● Cash paid to employees and suppliers● Interest paid● Dividends paid (IFRS)● Acquisition of trading securities● Cash paid for other expenses● Tax paid
CFI	<ul style="list-style-type: none">● Sales proceeds of fixed assets● Sale proceeds of debt and equity investments● Principal received from loans made to others● Dividends/interest received (IFRS)	<ul style="list-style-type: none">● Acquisition of fixed assets● Acquisition of debt & equity investments● Loans made to others● Tax paid (IFRS)
CFF	<ul style="list-style-type: none">● Principal received from debt issued● Proceeds from issuing stocks	<ul style="list-style-type: none">● Principal paid on debt● Payments to repurchase stocks● Dividends paid● Interest paid (IFRS)● Tax paid (IFRS)



Classification of cash flow★

Items	U.S.GAAP	IFRS
Interest received	CFO	CFO or CFI
Interest paid	CFO	CFO or CFF
Dividends received	CFO	CFO or CFI
Dividends paid	CFF	CFO or CFF
Taxes paid	CFO	CFO ,CFI or CFF
Bank overdrafts	CFF	Cash equivalents
Notification	Encourage direct method, but allows indirect method.	
Disclosure	➤ 鼓励采用直接法, footnotes需要披露间接法	➤ More flexibility

Cash flow 计算 ★

CFO计算		CFI计算	CFF计算
直接	间接	直接	直接



CFO calculation-direct method

Direct Method

Cash received from customers	Opening A/R + net sales – closing A/R=net sales- Δ A/R
- Cash paid to suppliers	Closing A/P - Opening A/P - purchase = - COGS – Δ Inventories + Δ A/P + Depreciation included in COGS (COGS = Opening Inventory + Purchase – Closing Inventory)
- Cash paid to employees	Opening wage payables + wage exp. – closing wage payables =-wage expense + Δ wage payables
- Interests paid	Opening interest payables + interest expense – closing interest payables=- interest expense + Δ interest payables
- Tax paid	Opening tax payables + income tax expense – closing tax payables = - income tax expense + Δ tax payables + Δ DTL – Δ DTA
= CFO	



CFO calculation-indirect method

Indirect Method

Net income	Income statement items
+ Non-cash expenses or losses	
- Non-cash revenues or gains	
+ Non-operating items (+ loss/-gain)	
-Increase in non-cash operating asset accounts (Inventory, A/R)	Balance sheet items (working capital)
+Increase in operating liability accounts (A/P)	
=CFO	

CFI calculation

Cash used in purchase of fixed assets	<ul style="list-style-type: none"> ➤ Pay attention to the movement of fixed assets ➤ Book value = carrying value = purchase cost – accumulated depreciation – impairment ➤ NBV end = NBV begin + purchase – disposal NBV - depreciation
Proceeds received from sale of fixed assets	<ul style="list-style-type: none"> ➤ Gain or loss = proceeds received – disposal NBV ➤ Gain or loss resulting from disposal of PP & E or other long term assets are NOT presented in the CFI, but in gain or loss

CFF calculation

Review long-term debt and stock	<ul style="list-style-type: none"> ➤ Issuing: +; repurchasing: -
Dividend paid	<ul style="list-style-type: none"> ➤ Dividend paid = - dividend declared + Δ dividend payables ➤ Opening R/E + net income – dividend declared = ending R/E



Cash statement analysis and ratio

Performance ratios	Coverage ratio
CFO/ revenue	CFO/total debt
CFO/ average total assets	CFO/cash paid for long- term assets
CFO/average total equity	CFO/cash long- term debt repayment
CFO/operating income	CFO/dividend paid
(CFO – preferred dividends) / weighted average number of common shares	CFO/cash outflows from investing and financing activities
	(CFO + interest paid + taxes paid) / interest paid

Free cash flow

分类	Free cash flow to firm (FCFF)
	Free cash flow to equity (FCFE)
$FCFF = NI + NCC + [Int * (1 - tax\ rate)] - FC\ Inv - WC\ Inv$	
$FCFE = CFO - FC\ Inv + Net\ borrowing$	



R26

Financial Analysis Techniques



Tools and techniques in financial analysis

Ratio analysis

Common-size analysis

Graphical analysis

Stack column graph

Line graph

Regression analysis



Financial ratios

Activity ratio

Inventory	A/R	A/P
Inventory turnover = COGS / average inventory	Receivables turnover = Net revenue / average A/R	Payables turnover = Purchase / average A/P
Average inventory processing period = 365 / inventory turnover	Average receivables collection period = 365 / receivables turnover	Average payment period = 365 / payables turnover
Operating cycle = collection period + inventory period		
Cash conversion cycle = collection period + inventory period – payment period. → 属于liquidity ratio		
Total asset turnover	Net revenue / average total assets	
Fixed asset turnover	Net revenue / average net fixed asset	
Working capital turnover	Net revenue / average WC	



Financial ratios

Liquidity ratios (a firm's ability to pay short – term debt)

Current ratio	Current assets / current liabilities
Quick ratio	(cash + marketable securities + receivable) / current liabilities =(current asset – inventories) / current liabilities
Cash ratio	(Cash + marketable securities) / current liabilities
Defensive interval	(Cash + marketable securities + receivables) / average daily expenditures
Cash conversion cycle	Days of sales outstanding + days of inventory on hand – number of days of payable

Solvency ratios (a firm's ability to pay long-term debt)

Leverage	Debt-to-equity ratio	D/E
	Debt-to-capital	D/(D+E)
	Debt-to-assets	D/A
	Financial leverage	A/E
Coverage	Interest coverage	EBIT/ interest
	Fixed charge coverage	(EBIT + lease payment)/ (interest + lease payments)

Financial ratios

Profitability ratios (a firm's ability to generate profits)

Profit / net revenue	Gross profit margin	Gross profits / net revenue
	Operating profit margin	EBIT / net revenue
	Pretax margin	EBT / net revenue
	Net profit margin	NI / net revenue
Profit / capital	ROA	$[NI + \text{interest} (1-t)] / \text{average total assets}$
	Operating return on assets	EBIT / average total assets
	Return on total capital (ROTC)	EBIT / average total capital
	ROE	NI / average total equity
	Return in common equity	$(NI - \text{preferred dividend}) / \text{average common equity}$



DuPont analysis & equity and credit analysis

ROE 来源分析 → DuPont analysis

三分解
$$ROE = \frac{\text{Net Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Asset}} \times \frac{\text{Asset}}{\text{Equity}}$$

五分解
$$ROE = \frac{\text{Net Income}}{\text{EBT}} \times \frac{\text{EBT}}{\text{EBIT}} \times \frac{\text{EBIT}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Asset}} \times \frac{\text{Asset}}{\text{Equity}}$$



DuPont analysis & equity and credit analysis

Equity analysis	基本ratio分析→Equity中还有	P/E P/CF P/B P/S
	特殊行业标准	Net income per employee Growth in same-store sales Sales per square foot
Credit analysis	Interest coverage ratio	EBIT / Interest
	Return in capital	EBIT / average total capital
	Debt – to – asset ratio	D / A
	Z- score	$Z = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$
Business risk	CV sales	Sales 标准差 / mean sales
	CV operating income	Operating income 标准差 / mean operating income
	CV net income	NI 标准差 / mean NI



R27

Inventories

Distinguish between product costs and period costs

存货的初始计量

$\text{COGS} = \text{beginning inventory} + \text{purchases} - \text{ending inventory}$ (BASE 法则)

当发生存货相关支出时

Capitalizing → 计入 B/S

- Purchase cost - trade discounts and rebates
- Conversion costs (e.g. labor and overhead)
- Other costs required to make inventory in use

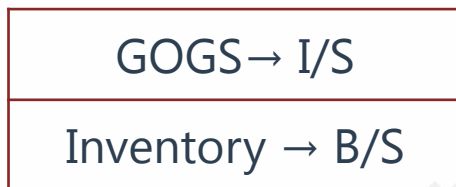
Expensing → 计入 I/S

- Abnormal waste (i.e. labor, materials, or overhead)
- Storage costs (except those required in production process)
- Administrative and selling expenses

Different inventory valuation methods

存货的期间计量

计量关键
概念



Inventory cost flow method

- Specific identification
- FIFO ★
- LIFO ★ → IFRS下不允许
- Weighted average cost



Perpetual and periodic inventory system

盘存方法（掌握影响，掌握计算期末Inventory与期间COGS）

FIFO and specific identification	Periodic perpetual system 不影响期末Inventory与COGS计量
LIFO and weighted average cost	Periodic or perpetual system 计量结果一般不同



LIFO 与 FIFO 对报表影响 ★ ★ （掌握影响→★：物价上涨&存货上升）

	LIFO	FIFO→与LIFO 反过来
COGS	Higher	Lower
Taxes	Lower	Higher
EBIT&EAT	Lower	Higher
Inventory balances	Lower	Higher
Cash flows	Higher→Tax少	Lower
Net and gross margins	Lower	Higher
Current ratios	Lower	Higher
Inventory turnover	Higher	Lower
D/A and D/E	Higher→原理：INV↓→A↓; COGS↑→NI↓→E↓	Lower

★ ★ LIFO reserve and LIFO liquidation

Inventory valuation (U.S. GAAP vs IFRS)

存货后续调整 → 减值

区别★	IFRS	Cost VS NRV (which is lower) → NRV=sales price-selling cost 减值可回转，最高到减值前
	U.S. GAAP	Cost VS market (which is lower) 不可回转 ↓判断 <ul style="list-style-type: none"> ● Replacement cost > NRV, market value=NRV ● NRV-normal profit margin < replacement cost < NRV, market value= replacement cost ● Replacement cost < NRV- normal profit margin, market value= NRV- normal profit margin

Inventory management & inventory changes

存货计量方法调整

多数情况	Retrospectively
特例	由其它方法转成LIFO时， Prospectively



R28

Long-Lived Assets



Capitalizing and expensing

花掉一笔钱	Expense	一次在I/S中处理，属CFO
	Capitalize	计入B/S资产，属CFI。之后逐年在I/S中处理

↓常见处理

Interest Capitalizing

R&D Cost

Depreciation

Impairment

Leases

Spending
Expenditure

未来有潜在收益

Yes

资本化
B/S

No

费用化
I/S

Current assets → Inventory → COGS

Non-current
assets

Tangible
assets

Depreciation

Intangible
assets

Amortization



Capitalizing and expensing ★			
Items		Capitalizing	Expensing
B/S	Shareholders' equity	Higher→ NI高 & A高	Lower
	Income variability	lower→平摊到之后每年	Higher
I/S	Net income—first year (ROA & ROE)	Higher→一次费用少	Lower
	Net income—last year (ROA & ROE)	Lower→逐年折旧费用高	Higher
CF/S	Total cash flow★	Same	Same
	CFO	Higher→支出计入CFI	Lower
	CFI	Lower→支出 CFI	Higher
Ratio	Leverage ratios (debt/equity & debt/assets)	Lower→E高	Higher
	Interest coverage (subsequent years)	Lower→EBIT小	Higher



Capitalizing and expensing

常见处理

Interest capitalizing 专指在建工程的贷款利息资本化

Items	First year	Later year
Interest expense	No impact	No impact
Net Income	↑	↓
CFO	Overstate	
CFI	Understate	
Income statement impact	No impact	建好后持有→Depreciation ↑ 建好后出售→COGS ↑
Interest coverage★	计算角度：↑ 概念角度：No impact	↓

Capitalizing and expensing

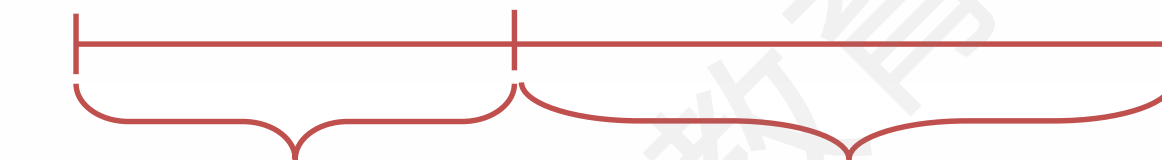
Tangible assets ★ ★

有形资产的资本化与费用化

Purchase

Ready for use

The end of useful life



Purchase price	Depreciation	Expense
Tax, freight and insurance	Repair and maintenance	
Delivery	Staff training	
Installation		Capitalize
Testing	Asset enhancement costs	

Capitalize



Intangible assets

Identifiable IA
(capitalized in B/S)

- Can be purchased separately
 - e.g. patents, trademarks, copyright purchased externally
- Some have a finite useful life and others have an indefinite useful life

Internally generated
(Expensed as incurred)

- Cannot be capitalized on B/S
 - e.g. R&D under U.S. GAAP

IA with a finite useful life—amortization over UL (SL, zero salvage value)

IA with an indefinite useful life—annual impairment test

Goodwill

Arises when one company purchases another for a price that exceeds the fair value of the net identifiable assets acquired.

Should be tested for impairment annually.

R&D Cost





Depreciation methods & amortization methods

折旧方法	计算
Straight line	$\text{Depreciation expense} = \frac{\text{cost} - \text{residual value}}{\text{useful life}}$
DDB	$\text{Depreciation expense} = \frac{2}{\text{asset life in years}} \times \text{net book value at the beginning of year X}$
Units-of-production	$\text{Depreciation expense} = \frac{\text{Original cost} - \text{salvage value}}{\text{Output units in life}} \times \text{Output units in period}$



Depreciation methods & amortization methods

折旧对财务指标影响（早期）★→ 晚期反过来

	Straight line	Accelerated (DDB)
Depreciation expense	Lower	Higher
Net income	Higher	Lower
Assets	Higher	Lower
Equity	Higher	Lower
ROA	Higher	Lower
ROE	Higher	Lower
Total asset turnover	Lower	Higher
Cash flow	Same	Same

有形资产记账方法

	IFRS	U.S. GAAP
Cost model	√	√
Revaluation model	√	×



Revaluation and derecognition of assets

准则

区别

IFRS

- Cost model & revaluation model
- Upward revaluation under IFRS will
 - Increase assets and equity → ↓ solvency ratios (D/E)
 - Increase OCI → increase comprehensive income
 - In subsequent periods, higher depreciation expense → lower NI → lower ROA and ROE

US.GAAP

- Cost model

Derecognition of assets

处置方法

做账方式

Sold

Sale proceeds - carrying value (G/L in income statement)

Abandoned

Remove carrying value from the B/S
Recognize loss in I/S

Exchanged

G/L = Fair value of the old asset/new asset - book value of the old asset



Impairment of PP&E (U.S. GAAP vs IFRS)

Cost model (基于BV) ★

准则

区别

IFRS

减值判断→一步法

- Carrying (book) value > recoverable amount→永续经营VS清算假设
 - Recoverable amount = max (fair value - selling costs , value in use)
 - Value in use = DCF value
 - Carrying (book) value = original cost – accumulated depreciation
- 减值：Asset (BV) is written-down to recoverable amount
- Reversal: loss can be reversed (最多回到减值前BV)

US.GAAP

减值判断→二步法

- Recoverability
 - Carrying (book) value > the asset's future undiscounted cash flow stream
- Loss measurement
 - 减值处理：loss = carrying value – fair value of the asset/DCF value
 - Reverse are prohibited→例外：long-lived assets held for sale



Impairment of PP&E (U.S. GAAP vs IFRS)

减值对财务指标影响

Cash flow	No effect
Assets	Decrease
DTL	Decrease
DTA	Increase
Stockholder's equity	Decrease
Current net income, ROA, ROE	Decrease
Future net income, ROA, ROE	Increase
Depreciation expense	Decrease
Future asset turnover ratios	Increase
Debt/equity ratio	Increase

Investment property

IFRS	<ul style="list-style-type: none"> ➤ A company must <u>apply one model (cost or fair value) to all of its investment property</u> ➤ To use the <u>fair value model</u>, a company must be able to <u>reliably determine</u> the property's fair value on a continuing basis. However, a company can still use cost model under the circumstances
U.S. GAAP	<ul style="list-style-type: none"> ➤ Classified investment property as normal long-lived assets

Transfer from	Transfer to	Financial statement treatment
Owner-occupied	Investment property	Treat as revaluation: recognize gain through I/S only if it reverses previous recognized loss
Inventory	Investment property	Recognize gain or loss if fair value is different from carrying amount
Investment property	Owner-occupied or inventory	Fair value of asset at date of transfer will be its cost under new classification



R29

Income Taxes



Accounting profit and taxable income

Tax reporting		Financial reporting	
Taxable income	= Taxable revenues - tax deductible expenses	Pretax income (accounting profit)	Earning before tax (EBT)
Taxes payable	= Taxable income × Tax rate Current tax expense in I/S	Income tax expense	= Current tax expense +/-deferred tax expense or income
Income tax paid = actual cash flow paid for income tax Cash outflow for tax in CFS			
Deferred tax expense/(income): relating to two B/S items Deferred tax liability (DTL) / Deferred tax asset (DTA)			

DTA & DTL产生原因 → 税务局报表与企业报表不同

Temporary and permanent differences

Temporary difference → 将来回转，只有这种才有递延所得税

Permanent difference: difference will not reverse, thus no deferred tax issues

Deferred tax assets

$$\left(\begin{array}{c} \text{Taxes} \\ \text{payable} \end{array} \right) > \left(\begin{array}{c} \text{Income tax} \\ \text{expense} \end{array} \right)$$

Deferred tax liabilities

$$\left(\begin{array}{c} \text{Taxes} \\ \text{payable} \end{array} \right) < \left(\begin{array}{c} \text{Income tax} \\ \text{expense} \end{array} \right)$$



Reversal of temporary difference



DTA & DTL

DTL

Unlikely to be reversed

Equity

To be reversed

True liability

Non-reversal/reversal is uncertain

Ignored

DTA

If <50% probability to be reversed → Valuation allowance is created

$$DTA = DTA - \left(\begin{array}{c} \text{Valuation} \\ \text{Allowance} \end{array} \right)$$

Asset ↓ & Income ↓



DTA & DTL

B/S approach★

计算DTL & DTA

Assets: accounting base - tax base

Liabilities: (-accounting base) + tax base



Positive figure x tax rate=DTL

Negative figure x tax rate=DTA

Asset角度DTA/DTL来源

Depreciable NCA

- Accounting base→original cost—accumulated accounting depreciation
- Tax base→original cost- accumulated tax depreciation

R&D

- Accounting base (expensed as incurred)→zero
- Tax base (Capitalized)→original cost-accumulated amortization

A/R

- Accounting base→invoiced amount-allowance for bad debt
- Tax base→invoiced amount (do not recognize allowance)

Financial assets

- Accounting base→fair value
- Tax base→amortized cost



DTA & DTL

Liability角度DTA/DTL来源

Customer advance

- Accounting base (accrual accounting) → unearned revenue treat as a liability
- Tax base (cash accounting) → revenue is recognized; no liability arise → zero

Warranty liability

- Accounting base (accrual accounting) → a liability is recognized for future obligation
- Tax base (cash accounting) → recognize a expense when a cash outflow incurred → zero

Financial liability

- Accounting base → fair value
- Tax base → amortized cost

Tax rate changes & effective tax rate

Tax expense 计量★ 计算

Income tax expense = current tax expense +/- deferred tax expense/income



Taxable income x Current tax rate



ΔDTL or ΔDTA



If tax rate changes

New DTA or DTL = old DTA or DTL $\times \frac{\text{new tax rate}}{\text{old tax rate}}$

Effective tax rate = $\frac{\text{income tax expense}}{\text{pre-tax income (EBT)}}$



R30

Non-Current (Long Term) Liabilities



Bond introduction and bond types

Bond type	Par	Premium	Discount
	Market rate=coupon rate	Market rate<coupon rate	Market rate>coupon rate
Interest expense (I/S)	coupon rate x face value	Coupon-amortization of premium	Coupon + amortization of premium
	Constant	Decrease	Increase
Amortized cost (B/S)	Face value	Face value + premium	Face value – discount
	Constant	Decrease as amortized	Increase as amortized
Cash paid (CFS)	CFO: coupon paid (-); CFF: face value paid (-), cash received from issuance (+)		
Analyst views		CFO understated CFF overstated	CFO overstated CFF understated

Issuance costs & fair value reporting option

U.S.GAAP

- Capitalized in deferred charge (asset)
- Amortized on a straight-line basis to the relevant expense (e.g., legal fees) over the life of the bonds

IFRS

- Subtracted as an unamortized discount from measurement of the liability, bonds payable

Both U.S.GAAP and IFRS

- Cash outflows related to bond issuance costs are included in the financing section of the statement of cash flows (usually netted against bond proceeds)

Fair value reporting option → 利率改变导致bond value改变

Bond value = a present value of future cash flows

U.S. GAAP & IFRS

- An option to report debt at its market/fair value with any gains/losses reported in the income statement
- For analysis, the market value is more appropriate

$$BV = \sum \frac{(INT + PRN)_t}{(1+R_0)^t}$$

$$MV = \sum \frac{(INT + PRN)_t}{(1+R_t)^t}$$

Derecognition of debt

概念	Redeem bonds before maturity
原因	<ul style="list-style-type: none"> ➤ Interest rates reduction ➤ Firm has generated excess cash by operation ➤ Funds from the issuance on the equity market is available
记账	A gain or loss is recognized in I/S

Debt Covenant	Affirmative covenants	Commit to do so from borrower <ul style="list-style-type: none"> ➤ Timely payments of principal and interest ➤ Target financial ratios (such as the current, debt-to-equity, and interest coverage ratios) unchanged ➤ Use collateral in working order
	Negative covenants	Commit NOT to do so from borrower <ul style="list-style-type: none"> ➤ Not to pay higher dividends or repurchase more shares ➤ Not to borrow more ➤ Not to engage in mergers and acquisitions



Classification of leases

两个参与主体	Lessee	
	Lessor	
种类	Operating lease	分类标准☆
	Finance lease (IFRS)/ capital lease (U.S.GAAP)	
For lessee		
准则	Finance lease	Operating lease
IFRS	Transfers from lessor to lessee substantially all the risks and rewards incidental to ownership of an asset. No specific condition for finance lease.	A lease other than a finance lease.
U.S. GAAP	Lessee should classify the asset as finance lease if it meet any one of the criteria below ① Transfer of ownership to the lessee ② Bargain purchase option ③ The lease term \geq <u>75%</u> useful life ④ PV of lease payments \geq <u>90%</u> fair value	A lease not meeting any of those criteria is classified as an operating lease

Classification of leases

For lessor (IFRS和US GAAP相似, 叫法不同, 这里以US GAAP为例)

Lessee 是Operating lease	Lessor 也是 Operating lease		
Lessee 是Finance lease	Lessor 是 Operating lease	不满足条件	
	Lessor 是Capital lease	满足条件	Sales-type lease Direct-finance lease



条件	➤ Be reasonably assured of cash collection
	➤ Has performed substantially under the lease



Lease accounting for lessee

会计计量 → (1). Lessee 计量 (计算)

	Financial Lease → 等同于贷款买设备	Operating lease
B/S - inception	<ul style="list-style-type: none"> ➤ Leased asset = lease liability = PV of minimal lease payment (MLP) ● MLP=future lease payment over lease term 	No effect
B/S-periodic payment	<ul style="list-style-type: none"> ➤ Leased asset → depreciation over lease term ➤ Lease liability → interest expense & principal 	No effect
I/S-periodic payment	<ul style="list-style-type: none"> ➤ Interest expense is separated from the lease payment ➤ Deprecation and interest expensed both recognized in the income statement 	Lease payment is recognized as a rental expense in I/S
CF/S	<ul style="list-style-type: none"> ➤ Principal repayment-CFF ➤ Interest expense-CFO → US.GAAP中 Int. 偿还计入 CFO 	CFO



Lease accounting for lessee

对财务数据影响

		Finance Lease	Operating Lease
B/S	Assets	Higher	Reverse
	Liabilities	Higher	
I/S	EBIT	Higher	
	Net income in early years	Lower	
	Net income in later years	Higher	
	Total net income	Same	Same
CFS	CFO	Higher	Reverse
	CFF	Lower	
	Total CF	Same	Same



Lease accounting for lessee

	Ratios	Finance Lease	Operating Lease
Early years	Current ratio (Current liab)	Lower	Reverse
	Working capital (Current liab)	Lower	
	Asset turnover (Asset)	Lower	
	ROA&ROE(Net income)	Lower	
	Debt / asset (Liab)	Lower	
	Debt / equity (Liab)	Lower	
Later year	Current ratio (Current liab)	Lower	
	Working capital (Current liab)	Lower	
	Asset turnover (Asset)	Lower	
	ROA&ROE (Net income)	Lower	
	Debt / asset (Liab)	Higher	
	Debt / equity (Liab)	Higher	

Lease accounting for lessor

概念	Capital lease	Sales-type lease	对Dealer, 有profit
		Direct financing lease	对金融机构, 无profit

概念+计算		Sales-type Lease	Direct-financing Lease
期初	I/S	<ul style="list-style-type: none"> ➤ Sales = PV of MLP (receivable) ➤ Discount rate = the interest rate implicit in the lease ➤ COS = cost of assets - PV of salvage ➤ Gross profit = sales - COS 	No profit is recognized
	B/S	Net investment in lease = PV of MLP + PV of salvage value	Net lease receivable = cost of assets
	CFS	No effect	
期末	I/S	Interest revenue = implicit interest rate × net lease receivable at the beginning of the period	
	CFS	CFO-inflow CFI-inflow	



Lease accounting for lessor

- I/S → Rental income = lease payments
- B/S → Keep the asset balance and continuously depreciate

Operating lease 与 direct financing lease 区别 ☆	Total income	→结论
	早期 direct financing lease 高	

Framework for pension plans

	DB	DC
概念	<ul style="list-style-type: none">➤ Under a defined-benefit (DB) plan, a company makes promises of future benefits to be paid to the employee during retirement➤ Benefit can be based on the employee's service years and wages at, or near, retirement	<ul style="list-style-type: none">➤ Under a defined-contribution (DC) plan, a company contributes an <u>agreed-upon (defined) amount</u> into the plan➤ Contribution can be based on: employment years, age of the worker, wages, profit of the company, or a proportion of the work's contribution

Framework for pension plans

	Plan assets	PBO	IFRS & U.S. GAAP 要求
计算 DB plan on B/S	Fair value at the end of the year = Fair value at the beginning of the year + Employer contributions + Actual return - Benefit paid to employee	PBO at the end of the year = PBO at the beginning of the year + Current service cost + Interest costs + Past service cost (plan amendments during the year) + Actuarial losses - Actuarial gains during the year - Benefit paid to employee	Funded status 计入公司 B/S Surplus → net pension asset Deficit → net pension liability
性质	Plan asset > PBO → Overfunded Plan asset < PBO → Underfunded		



Framework for pension plans

DB plan 在I/S 上计量 → 会计算 ☆

(Periodic pension costs☆☆→掌握IFRS与US.GAAP区别)

科目	计量
Current service cost	➤ The present value of benefit earned by the employees during the current period (US.GAAP 与 IFRS相同 , 都计入 I/S)
Interest cost	➤ Increase in the PBO due to the passage of time <ul style="list-style-type: none">● (IFRS: net pension liability / asset × discount rate of pension liability → net interest expense / income is recognized in P & L → asset return = liability 折现率)● (US.GAAP: PBO × discount rate → asset 与 liability 分开考虑)
Expected return on plan asset	<ul style="list-style-type: none">● (IFRS: 无这一项, 因为假设 asset return = liability 折现率, 直接体现在 net expense/income 上)● (US.GAAP: 资产有单独的 return, 折减 interest cost)

Framework for pension plans

科目	计量
Amortization of actuarial gains and losses	<ul style="list-style-type: none"> ➤ Actuarial gains and losses OCI→产生原因 <ul style="list-style-type: none"> ● An increase or decrease in the PBO from a change in actuarial ● Difference between the expected return and actual return on plan assets ➤ Amortization of actuarial gains and losses <ul style="list-style-type: none"> ● IFRS: 不摊销 ● U.S.GAAP: amortized using the corridor approach, when <ul style="list-style-type: none"> ◆ <u>Unrecognised actuarial gains and losses > 10 % × max (Defined benefit obligation, Fair value of plan assets)</u>
Amortization of past service costs	<ul style="list-style-type: none"> ➤ Past service cost→the amount by which a company's obligation relating to employee's service in prior periods changes as a result of plan amendments or plan curtailment <ul style="list-style-type: none"> ● IFRS: past service costs are recognized as an expense in P & L→不摊销 ● US.GAAP: 计入OCI→摊销



R31

Financial Reporting Quality



Financial reporting quality

The quality of financial reports → 两个评估维度

	Financial reporting quality low	Financial reporting quality high
Earnings quality high (results)	Low financial reporting quality impedes assessment of earnings quality and impedes valuation.	HIGH financial reporting quality enables assessment. HIGH financial reporting increases company value.
Earnings quality low (results)		HIGH financial reporting quality enables assessment. LOW earning quality decreases company value.



Financial reporting quality

	Aggressive	Conservative
Current period cost	Capitalizing	Expensing
Useful life for depreciable assets	Longer time	Shorter time
Salvage values	Higher	Lower
Depreciation method	Straight line	Accelerated
Recognition of impairments	Delay recognition	Early recognition
Accrual of reserves for bad debt	Less	More
Valuation allowances for DTA	Smaller	Larger

Financial reporting quality

Motivation for manipulation

Net income

Overstate NI

- Meet earning expectation
- Avoid to violate debt covenants
- Receive higher incentive compensation

Understate NI

- Obtain trade relief
- Negotiate favorable repayment term from creditors
- Negotiate favorable labor union contracts

Balance sheet

Overstate assets or understate liabilities

- Appear more solvent
 - e.g. Lower D/E ratio

Understate assets or overstate liabilities

- Enhance its performance ratios
 - e.g. Higher ROA, asset turnover ratio



Financial reporting quality

Revenue recognition

Issues	Range of problems	Warning sign
Revenue misstatement	<ul style="list-style-type: none">➤ Bring forward or delay the revenue recognition	<ul style="list-style-type: none">➤ Large changes in account associated with A/R, unearned revenue, etc. (large increases in A/R, large decreases in unearned revenue)
Accelerating revenue	<ul style="list-style-type: none">➤ Accelerate the recognition of revenue➤ Analyze cash collected from customers is a good way to detect acceleration of revenue recognition	<ul style="list-style-type: none">➤ Significant revenue without cash collection➤ Seeking for additional financing➤ Significant options vested by management➤ Maintain its track record of successively meeting analyst forecasts
Nonrecurring or non-operating item	<ul style="list-style-type: none">➤ Report the non-recurring items or non-operating gains as revenue	<ul style="list-style-type: none">➤ Temporal inconsistency in a company's definition of operating income

Financial reporting quality

Expense recognition

Issues	Range of problems	Warning sign
Understating expenses	<ul style="list-style-type: none"> ➤ Aggressive depreciation or amortization method and assumptions ➤ Un-recorder allowance for obsolete inventories 	<ul style="list-style-type: none"> ➤ Ratios of depreciation ➤ Inventory turnover ratios
Deferring expenses	<ul style="list-style-type: none"> ➤ Improper capitalization of cost which should be expensed 	<ul style="list-style-type: none"> ➤ Track growth in net non-current assets
Ordinary as nonrecurring or non-operating	<ul style="list-style-type: none"> ➤ Report the ordinary expenses or cost as non-recurring items or non operating losses 	<ul style="list-style-type: none"> ➤ Check ratio = (sales – COGS – SG&A)/ sales



Financial reporting quality

Stretching A/P	Delay payment to suppliers → CFO ↑
Financing A/P	Manage timing of CFO
Securitizing A/R	Sale A/R → CFO ↑
Repurchasing stock	Option exercise → CFF ↑ → Repurchase to offset dilution

Accounting warning signs

- Abnormal sales growth as compared to the economy, industry , or peers
- Abnormal inventory growth as compared to sales growth
- Boosting revenue with non-operating income and non-recurring gains
- Delaying expense recognition
- Abnormal use of operating leases by lessees
- Hiding expenses by classifying them as extraordinary or non-recurring
- LIFO liquidations
- Abnormal gross margin and operating margin as compared to industry peers
- Extending the useful lives of long-term assets
- Aggressive pension assumptions
- Year-end surprises
- Equity method investments and off-balance-sheet special purpose entities
- Other off-balance-sheet financing arrangements including debt guarantees



R32

Financial Statement Analysis : Applications



Financial statement analysis

Ratio analysis

A company's future income and cash flow can be projected by forecasting future sales

Credit analysis

- Character
- Covenant
- Collateral
- Capacity to pay



两家公司比较

Adjustments for Comparison

Investments in securities

When securities are classified as "financial assets measured at FV through P/L" (similar to "trading" securities in U.S. GAAP), unrealized G/L are reported in the income statement.

When securities are classified as "financial assets measured at FV through other comprehensive income" (similar to "available-for-sale" in U.S. GAAP), unrealized G/L are recognized in equity.

Inventory cost method

Companies that use the LIFO method, must also, however, disclose the value of their inventory under the FIFO method.

Off-balance-sheet financing

Off-balance-sheet financing should be considered when calculating debt ratios.



Financial statement analysis

Adjustments for comparison

Differences in depreciation	<ul style="list-style-type: none">➤ Depreciation expense affects the values of reported net income and reported net fixed assets;➤ Analysts often consider management's choices related to depreciation as a qualitative factor in evaluating the quality of a company's financial reporting;➤ In some cases, analysts may adjust reported depreciation expense for a specific analytical purpose.
Goodwill	<ul style="list-style-type: none">➤ Goodwill arises when one company purchases another for a price that exceeds the fair value of the net identifiable assets acquired;➤ Adjustments are needed on goodwill in order to improve the comparability between two firms.



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