Chapter 1, 2

AN INTRODUCTION TO FINANCIAL STATEMENT ANALYSIS

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CFA Institute

LEARNING OUTCOMES

- describe the roles of financial reporting and financial statement analysis;
- describe the importance of financial statement notes and supplementary information—including disclosures of accounting policies, methods, and estimates—and management's commentary;
- describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls;
- identify and describe information sources that analysts use in financial statement analysis besides annual financial statements and supplementary information;
- describe the steps in the financial statement analysis framework.
- describe the objective of financial reporting and the importance of financial reporting standards in security analysis and valuation;
- describe the International Accounting Standards Board's conceptual framework, including qualitative characteristics of financial reports, constraints on financial reports, and required reporting elements;
- describe general requirements for financial statements under International Financial Reporting Standards (IFRS);

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CONTENTS

1. Roles of Financial Reporting and Financial Statement Analysis
2. Primary Financial Statements and Other Information Sources
3. Financial Statement Analysis Framework
4. The Objective of Financial Reporting
5. The International Financial Reporting Standards Framework
6. Comparison of IFRS with Alternative Reporting Systems

global standard
IFRS , USGAAP

THE ROLES OF FINANCIAL REPORTING AND FINANCIAL STATEMENT ANALYSIS

- **The role of financial statements:** to provide information about a company's performance, financial position, and changes in financial position that is useful for decision making. for investor
- Financial information: financial statements and other reports (auditor's report, risk disclosure, executive compensation, management's discussion and analysis (MD&A), etc.

US firms' reports have

- **The role of financial statement analysis**: to use financial information to evaluate the past, current, and potential performance and financial position of a company for decision making
  - (e.g. evaluate merger and acquisition, assign bond rating, value a security and make recommendation, etc.)

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PRIMARY FINANCIAL STATEMENTS AND OTHER INFORMATION SOURCES

Financial Statements and Supplementary Information

- Statement of Financial Position
- Statement of Comprehensive Income
- Statement of Changes in Equity
- Statement of Cash Flows
- Notes
- MD&A
- Auditor’s Reports

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10k means annual report in US

or note to financial statement

ACCOMPANYING NOTES

- The notes (also sometimes referred to as footnotes) that accompany the four financial statements are required and form an integral part of the statements.
- Notes include information on:
  - Significant accounting choices (policies, methods, and estimates). e.g. whether firm chooses FIFO, LIFO, or weighted average
  - Explanatory detail about line items on the face of the financial statements.
  - Other disclosures, such as commitments and contingencies.
- Based on notes disclosures, analysts can understand whether accounting choices are similar for the companies being compared. If the policies differ, an analyst can often make necessary adjustments so that the financial statement data used are more comparable.

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MANAGEMENT COMMENTARY OR MD&A

A narrative report that provides a context within which to interpret the financial position, financial performance, and cash flows of an entity.

Provides explanations of the amounts in the financial statements.

Provides information on a company's prospects. e.g. future strategy

Provides management with an opportunity to explain its objectives and its strategies for achieving those objectives.

- Information in MD&A is typically unaudited.

Contain forward-looking information

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CONTENTS OF *MANAGEMENT COMMENTARY*

MD&A

The IFRS practice statement *Management Commentary* states that the management commentary should include information that is essential to an understanding of:

1) the nature of the business;
2) management's objectives and its strategies for meeting those objectives;
3) the entity's most significant resources, risks, and relationships;
4) the results of operations and prospects; and
5) the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

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CONTENTS OF *MANAGEMENT COMMENTARY*

Includes all in IFRS

In the United States, the SEC requires listed companies to provide an MD&A and specifies the content.

- Management must highlight any favorable or unfavorable trends and identify significant events and uncertainties that affect the company's liquidity, capital resources, and results of operations.
- Management must provide information about the effect of inflation, changing prices, or other material events and uncertainties that may cause the future operating performance and financial position to materially depart from the current financial information.
- Management must provide information about off-balance-sheet obligations about contractual commitments.

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MD&A: APPLE (2021-10K)

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and accompanying notes included in Part II, Item 8 of this Form 10-K. This section of this Form 10-K generally discusses 2021 and 2020 items and year-to-year comparisons between 2021 and 2020. Discussions of 2019 items and year-to-year comparisons between 2020 and 2019 are not included in this Form 10-K, and can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of the Company's Annual Report on Form 10-K for the fiscal year ended September 26, 2020.

Fiscal Year Highlights

COVID-19 Update

The COVID-19 pandemic has had, and continues to have, a significant impact around the world, prompting governments and businesses to take unprecedented measures, such as restrictions on travel and business operations, temporary closures of businesses, and quarantine and shelter-in-place orders. The COVID-19 pandemic has at times significantly curtailed global economic activity and caused significant volatility and disruption in global financial markets. The COVID-19 pandemic and the measures taken by many countries in response have affected and could in the future materially impact the Company's business, results of operations and financial condition, as well as the price of the Company's stock.

During 2021, aspects of the Company's business continued to be affected by the COVID-19 pandemic, with many of the Company's retail stores, as well as channel partner points of sale, temporarily closed at various times, and a significant number of the Company's employees working remotely. The Company has reopened all of its retail stores and substantially all of its other facilities, subject to operating restrictions to protect public health and the health and safety of employees and customers, and it continues to work on safely reopening the remainder of its facilities, subject to local rules and regulations. During the fourth quarter of 2021, certain of the Company's component suppliers and logistical service providers experienced disruptions, resulting in supply shortages that affected sales worldwide. Similar disruptions could occur in the future.

The extent of the continuing impact of the COVID-19 pandemic on the Company's operational and financial performance is uncertain and will depend on many factors outside the Company's control, including the timing, extent, trajectory and duration of the pandemic, the emergence of new variants, the development, availability, distribution and effectiveness of vaccines and treatments, the imposition of protective public safety measures, and the impact of the pandemic on the global economy and demand for consumer products. Refer to Part I, Item 1A of this Form 10-K under the heading "Risk Factors" for more information.

Fiscal 2021 Highlights financial performance of this year

Total net sales increased 33% or $91.3 billion during 2021 compared to 2020, driven by growth in all Products and Services categories. Year-over-year net sales during 2021 also grew in each of the Company's reportable segments.

significant event

In April 2021, the Company announced an increase to its current share repurchase program authorization from $225 billion to $315 billion and raised its quarterly dividend from $0.205 to $0.22 per share beginning in May 2021. During 2021, the Company repurchased $85.5 billion of its common stock and paid dividends and dividend equivalents of $14.5 billion.

AUDITOR'S REPORTS

verify the number
↳ reasonable, not 100% verify

- Financial statements presented in companies' annual reports are generally required to be audited (examined) by an independent accounting firm in accordance with specified auditing standards.
- An audit report is a written opinion on the financial statements prepared by the independent auditor.
- Objectives of the independent auditor in conducting an audit:

not absolute / 100% from error / fraud

  - To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement (whether due to fraud or error), enabling the auditor to opine on whether the statements are prepared in accordance with applicable financial reporting framework.
  - To report on the financial statements.

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RESPONSIBILITIES OF AUDITORS AND MANAGEMENT(1)

- Responsibilities of auditor:
  - Express an opinion on the financial statements.
  - Plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
  - Because of the nature of audit evidence and the characteristics of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected.
  - Not responsible for planning and performing the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are NOT MATERIAL to the financial statements are detected.

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RESPONSIBILITIES OF AUDITORS AND MANAGEMENT(2)

- Responsibilities of management:
  - The management is responsible for the financial statement.
  - Adopt sound accounting policies and establish and maintain internal control that will initiate, record, process, and report transactions (including events and conditions) consistent with management's assertions embodied in the financial statements.
  - The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management.
    - The auditor's knowledge of these matters and internal control is *limited to that acquired through the audit*.
  - The fair presentation of financial statements in conformity with generally accepted accounting principles is an implicit and integral part of management's responsibility.
    - The independent auditor *may make suggestions* about the form or content of the financial statements or draft them, in whole or in part, based on information from management during the performance of the audit.

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TYPES OF AUDITOR'S REPORTS

very good

Unqualified audit opinion: "Clean" or "Unmodified" opinion. States that the financial statements give a "true and fair view" (international) or are "fairly presented" (international and U.S.) in accordance with applicable accounting standards. This opinion is the one that analysts would like to see in a financial report.

Other types of opinions:

in general, FS is fairly presented but | OK!

- *Qualified* audit opinion: One in which there is some scope limitation or exception to accounting standards. Exceptions are described in the audit report with additional explanatory paragraphs so that the analyst can determine the importance of the exception.

very bad, FS cannot be trusted

- *Adverse* audit opinion: Issued when an auditor determines that the financial statements materially depart from accounting standards and are not fairly presented. Generally, an analyst would not bother analyzing these statements.

cannot gather enough info to issue an opinion

- *Disclaimer of opinion*: Issued when the auditors are unable to issue an opinion for some reason, such as a scope limitation. uncertainties (going concern) ⇒ number in FS may be wronged
- Key Audit Matters and Critical Audit Matters are included in the report for certain entities.

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PARTIAL AUDITOR'S REPORT: APPLE

auditor's recommendation, that is sent to the firm, may not affect FS
↓
still clean report

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Apple Inc.

clean report

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Apple Inc. as of September 25, 2021 and September 26, 2020, the related consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended September 25, 2021, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of Apple Inc. at September 25, 2021 and September 26, 2020, and the results of its operations and its cash flows for each of the three years in the period ended September 25, 2021, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the "PCAOB"), Apple Inc.'s internal control over financial reporting as of September 25, 2021, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated October 28, 2021 expressed an unqualified opinion thereon.

Basis for Opinion

, not auditor's responsibility

These financial statements are the responsibility of Apple Inc.'s management. Our responsibility is to express an opinion on Apple Inc.'s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to Apple Inc. in accordance with the U.S. federal securities laws and the applicable rules and regulations of the U.S. Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the account or disclosure to which it relates.

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PARTIAL AUDITOR'S REPORT: THAI AIRWAYS

REPORT OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

TO THE PLAN ADMINISTRATOR
THAI AIRWAYS INTERNATIONAL PUBLIC COMPANY LIMITED

Disclaimer of Opinion debt restructuring

We were engaged to audit the consolidated financial statements of Thai Airways International Public Company Limited and its subsidiaries (the "Group") and the separate financial statements of Thai Airways International Public Company Limited (the "Company") which comprise the consolidated and separate statements of financial position as at December 31, 2021, and the related consolidated and separate statements of profit or loss and other comprehensive income, changes in shareholders' equity and cash flows for the year then ended, and notes to the consolidated and separate financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying consolidated and separate financial statements. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated and separate financial statements.

Basis for Disclaimer of Opinion reason why auditor cannot express opinion

As we considered the conditions of uncertainty that had impact to the Group's and the Company's operations as follows:

1. Lack of financial liquidity

   As disclosed in Note 1 to the financial statements regarding the financial position of the Group and the Company, as at December 31, 2021, the Group had significant current liabilities in excess of current assets by Baht 22,552 million and had capital deficiency of Baht 71,250 million in the consolidated financial statements, and the Company had current liabilities in excess of current assets by Baht 19,375 million and had capital deficiency of Baht 66,658 million in the separate financial statements. The Group and the Company had incurred losses from operations since year 2013 which resulted in capital deficiency and lack of financial liquidity.

   In the second quarter of year 2020, the Company was under the Automatic Stay status according to the Order to accept the rehabilitation petition of the Central Bankruptcy Court on May 27, 2020. As a result, the Company has triggered the event of default of outstanding liabilities and has not paid liabilities when due, including trade account payables, short-term borrowings, long-term borrowings, debentures and lease liabilities. Subsequently, on June 15, 2021, the Central Bankruptcy Court issued an Order approving the rehabilitation plan (see No. 3 of Basis for Disclaimer of Opinion). The Company is currently in the process of implementing the rehabilitation plan.

2. Effect of Coronavirus Disease 2019 Pandemic to operations of the Group

   As disclosed in Note 1 to the financial statements, the Coronavirus disease 2019 ("COVID-19") pandemic has affected in an economic slowdown impacting most businesses and industries, especially aviation industry. Since March 23, 2020 and March 25, 2020, Thai Smile Airways Company Limited, a subsidiary, and the Company temporarily suspended domestic and international flight operations, respectively. However, Thai Smile Airways Company Limited resumed some domestic flight services in June 2020 and reviewed the frequency of flight service to increase and reduce the number of flight to be consistent with the demand, including launching new domestic routes. Since August 2020, the Company resumed some international flight services, including chartered flights but not yet operated as normal. Subsequently from July 21, 2021 to August 3, 2021, Thai Smile Airways Company Limited temporarily suspended all domestic flight operations due to the new wave of COVID-19 pandemic. However, Thai Smile Airways Company Limited has since resumed to serve both domestic and international flight in accordance with each country Government's measures to control the spread of COVID-19.

3. Entering into the rehabilitation process

   As disclosed in Note 5 to the financial statements, on May 26, 2020, the Company submitted a petition to enter into a business rehabilitation process and propose the rehabilitation planners to the Central Bankruptcy Court under the Bankruptcy Act B.E. 2483. On May 27, 2020, the Central Bankruptcy Court issued an Order to accept the rehabilitation petition of the Company. On September 14, 2020, the Central Bankruptcy Court granted the Company's business rehabilitation petition and appointed the Planners as nominated by the Company, resulting to the Company entered into the rehabilitation process. On March 2, 2021, the Planners submitted the rehabilitation plan to the Official Receiver. On May 19, 2021, the creditors' meeting passed a resolution in accordance with Section 90/46 of the Bankruptcy Act B.E. 2483.

   Subsequently, on June 15, 2021, the Central Bankruptcy Court issued an Order approving the rehabilitation plan and plan amendment petitions as per the resolution of the creditors' meeting on May 19, 2021, including the approval of the nominated Plan Administrator. The essential parts of the business rehabilitation plan are capital restructuring, debt repayment of each class of the creditors, and the completion of the business rehabilitation plan. The Company is currently in the process of implementing the rehabilitation plan. However, completion of the rehabilitation plan depends on the ability to implement the plan, and must meet all conditions as specified in the rehabilitation plan.

The aforementioned conditions disclosed in No.1 to No.3. have impact on and are inter-related reflecting in the material uncertainty to the ability to continue as going concern of the Group and the Company which may affect the valuation of significant assets and liabilities in the consolidated and separate financial statements for the year ended December 31, 2021.

hire auditor to get clean report ⇒ change auditor until they get good report

DO FIRMS ENGAGE IN OPINION-SHOPPING?

Case 1 : firm with modified report will switch if prob of switching auditor and still get modified report < stay the same to get better report

Case 2 : firm with clean report will switch if prob of " " "

Partial results

Table 4

Heteroscedastic probit models of audit reporting and auditor switching (z-statistics in parentheses)[a]

	Audit reporting		Auditor switching		
	Eq. (1)		Eq. (2a)	Eq. (2b)	Eq. (3)
	(1)	(2)	(3)	(4)	(5)
Opinion-shopping					
$\hat{Q}_{it}^{q1*} - \hat{Q}_{it}^{q0*}$	–	–	–	-0.52 (-4.61)**	–
$\Pr(\hat{Q}_{it}^{q1} = 1) - \Pr(\hat{Q}_{it}^{q0} = 1)$	–	–	-1.64 (-4.24)**	–	–
Prior reports					
Q_{it-1}	1.64 (13.59)**	1.73 (13.66)**	–	–	0.66 (4.63)**

The company would have received modified reports more often if they had made opposite switch decision. (Because the company switched the auditor, it received lower modified reports than what it should have been)

Lennox, C., 2000. Do companies successfully engage in opinion-shopping? Evidence from the UK. *Journal of accounting and economics*, *29*(3), pp.321-337.

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INTERNAL CONTROL SYSTEM

- The internal control system is the company's internal system that is designed, among other things, to ensure that the company's process for generating financial reports is sound.
- Some countries (e.g., the United States) require an additional audit opinion on the company's internal control systems.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Apple Inc.

Opinion on Internal Control Over Financial Reporting

We have audited Apple Inc.'s internal control over financial reporting as of September 25, 2021, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the "COSO criteria"). In our opinion, Apple Inc. maintained, in all material respects, effective internal control over financial reporting as of September 25, 2021, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the "PCAOB"), the consolidated balance sheets of Apple Inc. as of September 25, 2021 and September 26, 2020, the related consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended September 25, 2021, and the related notes and our report dated October 28, 2021 expressed an unqualified opinion thereon.

auditor will report firm's weakness under internal control weakness

Basis for Opinion

Apple Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Apple Inc.'s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to Apple Inc. in accordance with the U.S. federal securities laws and the applicable rules and regulations of the U.S. Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

San Jose, California
October 28, 2021

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DEBT CONTRACTING AND INTERNAL CONTROL WEAKNESS REPORTS

if firm fail to comply this, creditor can cancel debt agreement

condition of debt agreement

internal control weakness

$$Financial\ Covenants = \alpha + \beta_1\ Uncorrected + \beta_2\ Corrected + \beta_3\ Institutional\ Investor + \beta_4 Revolver + \beta_5\ Interest\ Rate + \beta_6\ Secured + \beta_7\ Loan\ Size + \beta_8\ Maturity + \beta_9\ Credit\ Rating + \beta_{10}\ Number\ Lenders + \beta_{11}\ PP\ Indicator + \beta_{12}\ Firm\ Size + \beta_{13}\ Profitability + \beta_{14}\ Leverage + \varepsilon$$

Partial results

TABLE 3

Financial Covenants as a Function of Financial Reporting Quality

	Financial Covenants ← The number of financial covenants		
Parameter	Predicted Sign	(1)	(2)
Uncorrected ← 1 if loan is issued during uncorrected period	−	−0.362***	−0.468***
		(0.00)	(0.00)
Corrected ← 1 if loan is issued during corrected perio	−/?	−0.500***	−0.683***
		(0.00)	(0.00)
Uncorrected ∗ Relationship Lender			0.220
			(0.27)
Corrected ∗ Relationship Lender			0.283
			(0.12)
Relationship Lender			−0.069
			(0.50)

Lenders decrease the use of financial covenants when a firm experiances material internal control weaknesses. Lenders continues to distrust such covenents even after the internal control weaknesses are corrected.

- Costello, A.M. and WITTENBERG-MOERMAN*, R.E.G.I.N.A., 2011. The impact of financial reporting quality on debt contracting: Evidence from internal control weakness reports. *Journal of Accounting Research*, *49*(1), pp.97-136.

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INFORMATION SOURCES BESIDES ANNUAL FINANCIAL STATEMENTS

หนังสือมอบฉันทะ

- Annual report or proxy statement: Management compensation and governance information
- Interim reports: (Unaudited) financial statements with updated information on a company's performance and financial position since the last annual period
- Press releases, particularly earnings announcements, and conference calls
- Presentations to analysts → intermediary who spread firm's info & news to public
- External data sources for information on:
  - the economy
  - the industry
  - the company and peer (comparable) companies
- Regulatory context, where applicable
- Direct experience of the company's products and services

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FINANCIAL STATEMENT ANALYSIS FRAMEWORK

Phase
1. Articulate the Purpose and Context of the Analysis
2. Collect Data
3. Process Data
4. Analyze/Interpret the Processed Data
5. Develop and Communicate Conclusions and Recommendations
6. Follow-Up e.g. change recommendation from buy to hold as the firm may face lawsuit

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THE OBJECTIVE OF FINANCIAL REPORTING

- To provide financial information about the reporting entity that is useful to users in making decisions about providing resources to the reporting entity, where those decisions relate to equity and debt instruments, or loans and other forms of credit.

- Investors: Buy, sell, or hold.
- Lenders and other creditors:
  - Lend or not
  - Amount and terms

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FINANCIAL REPORTING USE IN SECURITY ANALYSIS AND VALUATION

- Decisions by investors to buy, sell, or hold securities depends on expectations about returns (dividend yield and price appreciation).
- Expectations about returns depend on prospects for an entity's future cash flows, and assessing those prospects requires information about an entity's:
  - resources,
  - claims on resources, and
  - use of the resources by management and board.

mkt cap

not present the value of firm ; FS show only historical performance of firm

- Financial reports are not designed to show the value of a reporting entity; they provide information to help users estimate the value of the reporting entity.
- Financial reports do not and cannot provide all the information needed by investors and creditors. Other pertinent information must be obtained from other sources.

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IMPORTANCE OF FINANCIAL REPORTING STANDARDS IN SECURITY ANALYSIS AND VALUATION

There's prob to loss in lawsuit → firm must record liability

- Complexity involved in setting standards reflects the complexity of the underlying economic reality.
- Complexity and uncertainty create the need for judgment by preparers.
- Judgment can vary among preparers, so standards are needed to achieve consistency.
- Even though standards limit the range of acceptable approaches, preparers still must make judgments and use estimates.
- By understanding how and when standards require judgments and estimates that can affect reported numbers, an analyst can make better use of the information.

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STANDARD-SETTING BODIES AND FINANCIAL REPORTING STANDARDS

- The International Accounting Standards Board (IASB) sets IFRS (International Financial Reporting Standards).

- The U.S. Financial Accounting Standards Board (FASB) sets U.S. GAAP (generally accepted accounting principles).

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CONTINUING DEVELOPMENTS IN FINANCIAL REPORTING STANDARDS

- Although many countries have adopted IFRS, not all countries have done so.
- As more countries adopt IFRS, the need to consider other financial reporting systems will reduce.
- Financial reporting standards (both IFRS and home-country GAAP) continue to evolve for various reasons, including
  - Changes in economic activity (new types of products and transactions),
  - Improvements to existing standards, and
  - Convergence between international and home-country standards.
- An analyst needs to understand whether and how differences in financial reporting standards affect comparability in cross-sectional analysis.

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SOME KEY DIFFERENCES BETWEEN US GAAP VS IFRS

Basis for Comparison	US GAAP	IFRS
Developed by	Financial Accounting Standard Board (FASB)	International Accounting Standard Board (IASB)
Based on	Rules	Principles
Inventory valuation	FIFO, LIFO, and Weighted Average Method	FIFO and Weighted Average Method
Extraordinary items	Shown below (at the bottom of the income statement)	Not segregated in the income statement
Development cost capture value of asset in different aspects	Treated as an expense e.g. R&D is too uncertainty → just record it as expense	Capitalized, only if certain conditions are satisfied
Reversal of Inventory	Prohibited → once it goes down → cannot revise it	Permissible, if specified conditions are met

Source: https://keydifferences.com/difference-between-gaap-and-ifrs.html.

GLOBAL CONVERGENCE OF ACCOUNTING STANDARDS: DIFFERENCES REMAIN

- Different reporting systems are used in different countries.
- For example, despite convergence efforts, differences remain between U.S. GAAP and IFRS.

Inventory

- IFRS does not allow for the use of the LIFO (last in, first out) costing methodology for inventory, which is permitted under U.S. GAAP.
- In the United States, the Internal Revenue Service (IRS) has conformity provisions such that certain methods of accounting are allowed for income tax purposes only if the entity also uses that method for financial reporting purposes. LIFO is one such method subject to conformity provisions.
- Thus, without a change in IRS rules, eliminating LIFO from U.S. GAAP would, in effect, eliminate its use for tax purposes as well.

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GLOBAL CONVERGENCE OF ACCOUNTING STANDARDS: DIFFERENCES REMAIN

- Despite convergence efforts, differences remain between U.S. GAAP and IFRS.

Measurement of Certain Asset Classes (optionality permitted under IFRS)

- Under IFRS, certain assets (e.g., capitalized acquired intangibles and property, plant, and equipment) are initially recognized at cost. For subsequent measurement, entities have a choice:
  - to continue with a cost model or
  - To revalue the assets within each class to fair market value (less any subsequent accumulated amortization or depreciation).
- U.S. GAAP does not permit use of a revaluation model.

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GLOBAL CONVERGENCE OF ACCOUNTING STANDARDS: DIFFERENCES REMAIN

- Despite convergence efforts, differences remain between U.S. GAAP and IFRS.

Impairment (property, plant, and equipment; inventory; and intangible assets)

- The IFRS models allow for reversals of impairments up to a certain amount if there is an indication that an impairment loss has decreased
- U.S. GAAP does not allow reversals of impairments.
- The SEC staff believes that the distinction could result in differences in the timing and extent of recognized impairment losses.
- Therefore, U.S. issuers could experience greater income statement volatility if the IFRS models were incorporated (flowing from recoveries of values previously written down).

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GLOBAL CONVERGENCE OF ACCOUNTING STANDARDS: DIFFERENCES REMAIN

- Despite convergence efforts, differences remain between U.S. GAAP and IFRS.

Certain Non-financial Liabilities

- The recognition of certain non-financial liabilities (e.g., contingencies and environmental liabilities) is governed by the probability that a liability has been incurred under both U.S. GAAP and IFRS. However, U.S. GAAP and IFRS differ in their definitions of what is "probable."
- For example, the definition of **probable** for contingencies is
  - For IFRS, "more likely than not to occur."
  - For U.S. GAAP, "the future event or events are likely to occur."
- "Likely" is considered to be a higher threshold than "more likely than not," meaning U.S. GAAP has a higher recognition threshold than does IFRS.
- Therefore, a liability will often be recognized earlier under IFRS than under U.S. GAAP.

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→ as asset (future benefit)
goodwill ; you pay to buy a company more that what it cost

IFRS *CONCEPTUAL FRAMEWORK*

Constraint

- Cost (cost/benefit considerations)

Underlying Assumption

- Accrual Basis
- Going Concern

*Materiality is an aspect of relevance.

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IFRS *CONCEPTUAL FRAMEWORK*: OBJECTIVE OF FINANCIAL REPORTING

- At the core of the *Conceptual Framework* is the objective to provide financial information that is useful to current and potential providers of resources in making decisions.
- All other aspects of the framework flow from that central objective.

*Materiality is an aspect of relevance.

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IFRS *CONCEPTUAL FRAMEWORK*: FUNDAMENTAL QUALITATIVE CHARACTERISTICS

Two **fundamental** qualitative characteristics that make financial information useful:

1. *Relevance*: Information that could potentially make a difference in users' decisions.
2. *Faithful representation*: Information that faithfully represents an economic phenomenon that it purports to represent. It is ideally:
   - complete,
   - neutral, and
   - free from error.

*Materiality is an aspect of relevance.

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IFRS *CONCEPTUAL FRAMEWORK*: ENHANCING QUALITATIVE CHARACTERISTICS

- Four **enhancing** qualitative characteristics that make financial information useful:

  e.g. firm should use straight line consistently to be able to compare current FS with the previous one.

  You should be able to compare FS

  - *Comparability*: Companies record and report information in a similar manner.
  - *Verifiability*: Independent people using the same methods arrive at similar conclusions.
  - *Timeliness*: Information is available before it loses its relevance.
  - *Understandability*: Reasonably informed users should be able to comprehend the information.

  not too complex

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IFRS *CONCEPTUAL FRAMEWORK*: CONSTRAINTS AND ASSUMPTIONS

Constraint: The benefits of information should exceed the costs of providing it.

Underlying assumptions:

not use cash basis

- *Accrual basis*: Financial statements should reflect transactions in the period when they actually occur, not necessarily when cash movements occur.
- *Going concern*: Assumption that the company will continue in business for the foreseeable future.

/will survive

  - Inventory: sell in a normal period or sell all due to store closure

value

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GENERAL FEATURES OF FINANCIAL STATEMENTS

- Fair presentation
- Going concern
- Accrual basis
- Materiality and aggregation
- No offsetting cannot offset, should show both side of transaction
- Frequency of reporting
- Comparative information
- Consistency

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1. Which of the followings is incorrect about management discussion and analysis (MD&A)

- ○ contain forward-looking information
- ○ explains the companies' current performance
- ○ explain the companies' objectives and strategies to achieve those objectives
- ● audited by an auditor

2. The assumption that the effects of transactions and other events are recognized when they occur, not when the cash flows occur, is called:

- ● accrual basis
- ○ going concern
- ○ cash basis
- ○ liquidation

3. Neutrality of information in the financial statements most closely contributes to which qualitative characteristic?

- ○ Verifiability.
- ● Faithful representation.
- ○ Understandability.
- ○ Relevance.

4. Management's responsibilities include:

- ○ Adopting appropriate accounting policies
- ○ Maintaining good internal controls
- ○ Presenting a true and fair view of financial statements
- ● All of the above

5. Accompanying notes do not contain:

- ○ Accounting policies
- ○ Commitments and contingencies disclosure
- ○ Effect of new accounting standard adoption
- ● Risk disclosure

6. Which phase in the financial statement analysis framework is most likely to involve producing updated reports and recommendations?

- ○ Analyze/interpret the processed data.
- ○ Process Data.
- ● Follow-up.
- ○ Develop and communicate conclusions and recommendations.

7. The role of financial statement analysis is best described as:

7. The role of financial statement analysis is best described as:

- ○ providing information useful for making investment decisions.
- ● evaluating a company for the purpose of making economic decisions.
- ○ using financial reports prepared by analysts to make economic decisions.
- ○ assisting investors form an expectation of a company's future performance.

8. Auditor's responsibilities include

- ● expressing an opinion on the financial statements
- ○ providing an absolute assurance that the financial statements contain misstatements
- ○ detecting frauds
- ○ all of the above

9. International financial reporting standards are currently developed by which entity?

- ○ The IFRS Foundation.
- ○ The Financial Accounting Standards Board.
- ○ The International Organization of Securities Commissions.
- ● The International Accounting Standards Board.

10. According to the Conceptual Framework for Financial Reporting, which of the following is not an enhancing qualitative characteristic of information in financial statements?

22:32 อ. 22 ส.ค. 78%

Homework1 (2604647_1/2023.Group)

- ○ all of the above

9. International financial reporting standards are currently developed by which entity?

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- ○ The International Organization of Securities Commissions.
- ● The International Accounting Standards Board.

10. According to the Conceptual Framework for Financial Reporting, which of the following is not an enhancing qualitative characteristic of information in financial statements?

- ○ Comparability.
- ● Accuracy.
- ○ Timeliness.
- ○ Understandability.

ส่ง

เนื้อหานี้ถูกสร้างขึ้นโดยเจ้าของฟอร์ม ข้อมูลที่คุณส่งจะถูกส่งไปยังเจ้าของฟอร์ม Microsoft จะไม่รับผิดชอบต่อความเป็นส่วนตัวหรือแนวทางปฏิบัติด้านความปลอดภัยของลูกค้า รวมถึงของเจ้าของฟอร์มนี้ อย่าให้รหัสผ่านของคุณ

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