SS9 Financial Report and Analysis

Friday, July 23, 2021

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# READING 29. FINANCIAL REPORTING QUALITY

1. Distinguish between financial reporting quality and quality of reported results (including quality of earnings, cash flow, and balance sheet items)

* Financial **reporting quality**: characteristics of firm's financial statements. **Quality** of reported results: level and sustainability of earnings, cash flows, BS.

1. Describe a spectrum for assessing financial reporting quality

* Quality of FS and quality of earnings, from high to low: GAAP compliance and decision useful & sustainable and adequate earnings; compliance but low quality earnings; compliance but low earnings and bias reporting of choices/estimates; compliance but earnings are managed; not compliant but numbers are real; NO.

1. Distinguish between conservative and aggressive accounting

* **Biased accounting** choices under GAAP: **conservative** to decrease reported earnings and financial position, **aggressive** to increase earnings and improve.

1. Describe motivations that might cause management to issue financial reports that are not high quality
2. Describe conditions that are conducive to issuing low-quality, or even fraudulent, financial reports

* Motivation(as D above), opportunities, **rationalizations**(justify of a choice)

1. Describe mechanisms that discipline financial reporting quality and the potential limitations of those mechanisms

* Regulation, auditing[but firms select and pay auditors limit effectiveness of discipline reporting quality], internal control, private contracts.

1. Describe presentation choices, including non-GAAP measures, that could be used to influence an analyst’s opinion
2. Describe accounting methods (choices and estimates) that could be used to manage earnings, cash flow, and balance sheet items

* Revenue recognition of FOB(free-on-board) shipping point > FOB destination, accelerating ship (channel stuffing), bill-n-hold transactions
* Estimates of reserves for uncollectible accounts or warranty expenses
* Valuation allowances on deferred tax assets
* Depreciation methods: useful lives, salvage values, recognition of impairments
* Inventory cost flow methods; other cash flow effects of stretching payables
* Capitalization of expenses
* Related-party transactions

1. Describe accounting warning signs and methods for detecting manipulation of information in financial reports

* Bill-and-hold, barter, or related-party transactions
* Fourth-quarter earnings pattern not caused by seasonality

7. Under IFRS, a firm that presents a nonstandard financial measure is least likely required to:

A. provide the same measure for at least two prior periods.

**B**. explain the reasons for presenting the nonstandard measure.

C. reconcile the nonstandard measure to a comparable standard measure.

* IFRS require a firm that presents a nonstandard financial measure to reconcile that measure to an IFRS measure and explain why the firm believes the nonstandard measure is relevant to users of the financial statements. Presenting the nonstandard measure for prior periods is not a requirement. (LOS 31.g)

2. A potential warning sign that a firm is engaging in channel stuffing is an unusual increase in the firm’s:

**A**. receivables turnover. B. days of sales outstanding. C. number of days of payables.

* 

4. Which of the following stock screens is most likely to identify stocks with high earnings growth rates?

A. Dividend payout ratio greater than 30%.

**B**. Price to cash flow per share ratio less than 12.

C. Book value to market value ratio less than 25%.

* Firms with high growth rates will tend to have high market values to book value of equity. Low price to cash flow (P/CF, P/BV, P/E) ratios would tend to identify value stocks rather than growth stocks. Screening for high dividend payout ratios would tend to identify mature firms with relatively few growth opportunities.

# READING 30. APPLICATIONS OF FINANCIAL STATEMENT ANALYSIS

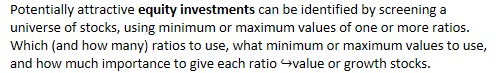
1. Evaluate a company’s past financial performance and explain how a company’s strategy is reflected in past financial performance

* Accumulated “War chest” referring to large cash balances support acquisitions.

1. Forecast a company’s future net income and cash flow
2. Describe the role of financial statement analysis in assessing the credit quality of a potential debt investment

* Credit risk consist of financial and business risk; credit analyst cares more about cash flows & solvency to pay back debts rather than accrual income.

1. Describe the use of financial statement analysis in screening for potential equity investments

* 
* Backtesting refers to using a specific set of criteria to screen historical data to determine how portfolios based on those criteria would have performed, survivorship bias, data-mining bias, and look-ahead bias.

1. Explain appropriate analyst adjustments to a company’s financial statements to facilitate comparison with another company

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