

Financial Reporting and Analysis

An Introduction

The readings in this study session describe the general principles of financial reporting, underscoring the critical role of the analysis of financial reports in investment decision making.

The first reading introduces the range of information that is available to analyze the financial performance of a company, including the principal financial statements (the income statement, balance sheet, cash flow statement, and statement of changes in owners' equity), notes to those statements, and management discussion and analysis of results. A general framework for addressing most financial statement analysis tasks is also presented.

A company's financial statements are the end-products of a process for recording the business transactions of the company. The second reading illustrates this process, introducing such basic concepts as the accounting equation and accounting accruals.

The presentation of financial information to the public by a company must conform to applicable financial reporting standards based on factors such as the jurisdiction in which the information is released. The final reading in this study session explores the roles of financial reporting standard-setting bodies and regulatory authorities. The International Accounting Standards Board's conceptual framework and the movement towards global convergence of financial reporting standards are also described.

Note: New rulings and/or pronouncements issued after the publication of the readings in financial reporting and analysis may cause some of the information in these readings to become dated. Candidates are expected to be familiar with the overall analytical framework contained in the study session readings, as well as the implications of alternative accounting methods for financial analysis and valuation, as provided in the assigned readings. Candidates are not responsible for changes that occur after the material was written.

Candidates should be aware that certain ratios may be defined and calculated differently. Such differences are part of the nature of practical financial analysis. For examination purposes, when alternative ratio definitions exist and no specific definition is given in the question, candidates should use the ratio definitions emphasized in the CFA Institute copyrighted readings.

READING ASSIGNMENTS

Reading 22	Financial Statement Analysis: An Introduction by Elaine Henry, PhD, CFA, and Thomas R. Robinson, PhD, CFA
Reading 23	Financial Reporting Mechanics Thomas R. Robinson, PhD, CFA, Jan Hendrik van Greuning, DCom, CFA, Karen O'Connor Rubsam, CFA, Elaine Henry, PhD, CFA, and Michael A. Broihahn, CPA, CIA, CFA
Reading 24	Financial Reporting Standards by Elaine Henry, PhD, CFA, Jan Hendrik van Greuning, DCom, CFA, and Thomas R. Robinson, PhD, CFA

LEARNING OUTCOMES

READING 22. FINANCIAL STATEMENT ANALYSIS: AN INTRODUCTION

The candidate should be able to:

- a** describe the roles of financial reporting and financial statement analysis;
- b** describe the roles of the statement of financial position, statement of comprehensive income, statement of changes in equity, and statement of cash flows in evaluating a company's performance and financial position;
- c** describe the importance of financial statement notes and supplementary information—including disclosures of accounting policies, methods, and estimates—and management's commentary;
- d** describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls;
- e** identify and describe information sources that analysts use in financial statement analysis besides annual financial statements and supplementary information;
- f** describe the steps in the financial statement analysis framework.

READING 23. FINANCIAL REPORTING MECHANICS

The candidate should be able to:

- a** describe how business activities are classified for financial reporting purposes;
- b** explain the relationship of financial statement elements and accounts, and classify accounts into the financial statement elements;
- c** explain the accounting equation in its basic and expanded forms;
- d** describe the process of recording business transactions using an accounting system based on the accounting equation;
- e** describe the need for accruals and valuation adjustments in preparing financial statements;
- f** describe the relationships among the income statement, balance sheet, statement of cash flows, and statement of owners' equity;

- g** describe the flow of information in an accounting system;
- h** describe the use of the results of the accounting process in security analysis.

READING 24. FINANCIAL REPORTING STANDARDS

The candidate should be able to:

- a** describe the objective of financial statements and the importance of financial reporting standards in security analysis and valuation;
- b** describe roles and desirable attributes of financial reporting standard-setting bodies and regulatory authorities in establishing and enforcing reporting standards, and describe the role of the International Organization of Securities Commissions;
- c** describe the status of global convergence of accounting standards and ongoing barriers to developing one universally accepted set of financial reporting standards;
- d** describe the International Accounting Standards Board's conceptual framework, including the objective and qualitative characteristics of financial statements, required reporting elements, and constraints and assumptions in preparing financial statements;
- e** describe general requirements for financial statements under International Financial Reporting Standards (IFRS);
- f** compare key concepts of financial reporting standards under IFRS and US generally accepted accounting principles (US GAAP) reporting systems;
- g** identify characteristics of a coherent financial reporting framework and the barriers to creating such a framework;
- h** describe implications for financial analysis of differing financial reporting systems and the importance of monitoring developments in financial reporting standards;
- i** analyze company disclosures of significant accounting policies.