

# UNIVERSITY OF KARACHI

## ANALYSIS OF FINANCIAL STATEMENT

BS – VII

**Course Title : ANALYSIS OF FINANCIAL STATEMENT**

**Course Number : BA (H) – 633**

**Credit Hours: 03**

### **1. Overview of Financial Reporting and Financial Statement Analysis**

- Overview of Financial Statement Analysis
- Identify the Industry Economic Characteristics
- Tools for Studying Industry Economics
- Value Chain Analysis
- Porter's Five Forces Classification
- Economic Attributes Framework
- Identify the Company Strategy
- Framework for Strategy Analysis
- Assess the Quality of the Financial Statements
- Balance Sheet – Measuring Financial Position
- Income Statement – Measuring Operating Performance
- Statement of Cash Flows
- Summary of Financial Statements and Notes
- Analyze Profitability and Risk
- Tools of Profitability and Risk Analysis
- Value the Firm
- Role of Financial Statement Analysis in an Efficient Capital Market

### **2. Asset and Liability Valuation and Income Measurement**

- Asset and Liability Valuation
- Historical Value: Acquisition Cost
- Historical Value: Adjusted Acquisition Cost
- Historical Value: Present Value of Cash Flows Using
- Historical Interest Rates
- Current Values: Current replacement Cost
- Current Values: Net Realizable Value

- Current Values: Present Value of Cash Flows
- Using Current Interest rates
- GAAP Valuations
- Income Recognition
- Treatment 1: Value Changes Recognized on the Balance Sheet and Income Statement When realized

### **3. Income Flows Versus Cash Flows**

- Key Relationships in the Dynamic of a Business
- Income Flows, Cash Flows and Life Cycle relations
- Net Income and Cash Flow from Operations
- Investing and Financing Activities
- Illustrations of Cash Flow Relations
- Preparing the Statement of Cash Flows
- Algebraic Formulation
- Classifying Changes in Balance Sheet Accounts
- Illustration of the Preparation Procedure

### **4. Profitability Analysis**

- Profitability Analysis
- Rate of Return on Assets
- Disaggregating ROA
- Economic and Strategic Factors in the Interpretation of ROA
- Analyzing the Profit margin for ROA
- Analyzing Total Assets Turnover
- Supplementing ROAs in Profitability Analysis
- Rate of Return on Common Shareholders' Equity
- Earnings Per Common Share
- Calculating EPS
- Criticisms of EPS
- Interpreting Financial Statement Ratios
- Comparisons with Corresponding Ratios of Earlier Periods
- Comparisons with Corresponding Ratios of Other Firms

### **5. Risk Analysis**

- Framework for Risk Analysis
- Analyzing Short-term Liquidity Risk
- Analyzing Long-term Solvency Risk
- Analyzing Credit Risk
- Analyzing Bankruptcy Risk

- The Bankruptcy Process
- Models of Bankruptcy Prediction
- Synthesis of Bankruptcy Prediction research
- Market Equity Beta Risk
- Financial reporting manipulation Risk
- Motivation for Earnings Manipulation
- Empirical Research on Earnings Manipulation
- Application of Beneish's Model to Sunbeam Corporation
- Summary of Income manipulation Risk

## **6. Quality of Accounting Information and Adjustments to Reported Financial Statement Data**

- Accounting Quality
- High Quality Reflects Economic Information Content
- High Quality Signals Earnings Persistence Over Time
- Discontinued Operations
- Extraordinary Items
- Changes in Accounting Principles
- Items of Other Comprehensive Income
- Impairment Losses on Long-lived Assets
- Restricting and Other Charges
- Changes in Estimates
- Gains and Losses from Peripheral Activities
- Restated Financial Statement Data
- Account Classification Difference
- Financial reporting Worldwide
- Warnings Management
- Accounting for Fixed Assets
- Fixed Asset Valuation
- Depreciable Life
- Depreciation Method
- Impairment of Fixed Assets
- Persistent Earnings and Fixed Asset Reporting
- Accounting for Intangible Assets
- Accounting for Research and Development Costs
- Accounting for Software Development Costs
- Accounting for Goodwill
- Persistent Earnings and Intangible Asset Reporting
- Valuing Intangibles – Is it Possible?

## **7. Liability Recognition and Related Expenses**

- Principles of Liability Recognition
- Principles of Liability Valuation
- Application of Criteria for Liability Recognition
- Controversial Issues in Liability recognition
- Issuance of Hybrid Securities
- Off-Balance-Sheet Financing Arrangements Leases
- Operating Lease Method
- Capital Lease Method
- Choosing the Accounting Method Effects on Lessor
- Lease Accounting for tax Purposes
- Converting Operating Leases to Capital Leases
- Impact of Accounting for Operating Leases as Capital Leases
- Derivative Instruments
- Nature and Use of Derivative Instruments
- Accounting for Derivatives

## **8. Forecasting Pro-Forma Financial Statements**

- Overview
- Introduction to Forecasting
- Preparing Pro-Forma Financial Statements
- General Forecasting Principles
- Six-Step Forecasting Game Plan
- Practical Tips for Implementing the Six-Step Game Plan
- Using FSAP to Prepare Pro-Forma Financial Statements
- Project Sales and Other revenues
- Projecting Sales
- Projecting Other revenues
- Project Operating Expenses
- Project the Assets on the Balance Sheet
- Project Liabilities and Shareholders' Equity
- Project Interest Expense, Interest Income, Income Tax Expense, and the Change in Retained Earnings
- Closing the Loops: Solving for Co-Determined Variables
- Projecting the Statement of Cash Flows
- Shortcut Approaches to Forecasting
- Analyzing Pro-Forma Financial Statements
- Sensitivity Analysis and Reactions to Announcements Summary

## **9. Foundations of Ratios and Financial Analysis**

- Purpose and Use of Ratios
- Ratios: Cautionary Notes

- Common-Size Statements
- Discussion of Ratio by Category
  - i. Activity Analysis
  - ii. Liquidity Analysis
  - iii. Long term Debt and Solvency Analysis
- Ratios: An Integrated Analysis
  - i. Analysis of Firm Performance
  - ii. Economics Characteristics and Strategies
  - iii. Classification and Partitioning of Ratios
  - iv. Ratios: Pattern of Disclosure, Definition and Use

## **10. Empirical Research: Implication for Financial Statement Analysis**

- The Classical Approach
- Market Based Research
- Efficient Market Theory
- Modern Portfolio Theory
- Test of the Mechanistic Hypothesis versus the EMH
- The Ball and Brown Study
- Information Content Studies
- The Relationship b/w Earning and Stocks Return
- Market Based Research-Current Status
- Market Anomalies
- Positive Accounting Research
- Disclosure and Regulatory Requirements
- Agency Theory
- Direction of Current Research
- Ball and Brown Revisited-Back to the Future
- Implication for Financial Statements Analysis

## **11. Analysis of Inventories**

- Inventory and Cost of Goods Sold: Basic Relationships
- Scenario 1: Stable Prices
- Scenario 2: rising Prices
- Comparison of Information Provide by Alternative Method
- Balance Sheet Information: Inventory Accounts
- Income Statements Information: Cost of Goods Sold
- LIFO Versus FIFO: Income, Cash Flow and Working Capital Effects
- Adjustment from LIFO to FIFO

- Adjustment of Inventory Balances
- Adjustment of Cost of Goods Sold
- Adjustment of Income to Current Cost Income
- Financial Ratios: FIFO Versus LIFO
- Profitability: Gross Profit Margin
- Liquidity: Working Capital
- Activity: Inventory Turn Over
- Solvency: Debt to Equity
- LIFO: Reporting and Measurement Issues
- Initial Adoption or Change to LIFO
- LIFO Liquidation
- Declining Prices
- LIFO and Interim Reporting
- LIFO Inventory Method

## **12. Analysis of Long Lived Assets**

- Acquiring the Asset: The Capitalization Decision
- Conceptual Issues
- Financial Statement Effects
- Need for Analytic Adjustments
- Valuation Implications
- Other Valuation and Economic Consequences

## **13. Analysis of Income Taxes**

- Accounting for Income Taxes
- Basic Issues
- Deferred taxes: Alternative Approaches

## **14. Analysis of Financing Liabilities**

- Balance Sheets Debt
- Current Liabilities
- Long Term Debt
- Debt with Equity Features
- Effect of Changes in Interest Rates
- Retirement of Debt Prior to Maturity

## **RECOMMENDED BOOKS:**

1. White, Sondhi, Fried: The Analysis and Use of Financial Statements
2. Stickney, Brown, Wahlen: Financial Reporting and Statement Analysis 5th Edition
3. Charles H. Gibson: Financial Reporting Analysis 10th Edition