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**INTERNATIONAL FINANCIAL STATEMENT ANALYSIS**

Financial statement analysis is one of the processes involved in the evaluation of a company’s business environment, strategies, financial position, and performance to be able to make decisions with respect to that company. It concisists of the following steps:

1. **Accounting analysis:** This begins with an evaluation of the extent to which a company’s financial statements reflect economic reality. There are three common sources of distortion in financial statements:

* Accounting standards that are inconsistent with economic reality.
* Estimation errors made by managers in applying accounting.
* The intentional manipulation of financial statements by managers; often referred to as earnings management.

Accounting analysis involves identifying distortions in financial statements and making adjustments to the financial statements where possible.

1. **Financial analysis:** This involves the use of adjusted financial statement information to conduct:

* Cash flow analysis: the analysis of how a company generates and uses cash.
* Profitability analysis: with a focus on return on invested capital.
* Risk analysis: including an evaluation of liquidity and solvency to assess a company’s ability to meet its obligations.

Much of financial analysis is conducted through the use of ratios calculated from the financial statements. Financial ratios are compared within a company over time to determine whether the company’s ability to generate cash flows, earn a return on invested capital, and so on, is improving or deteriorating. Ratios also are compared across companies operating in the same industry to evaluate companies relative to their peers.

1. **Prospective analysis:** This involves combining the results of accounting analysis and financial analysis, along with an analysis of the business environment and company strategy, to forecast future financial statement information, especially cash flows and income.

**Reasons for Analysing Foreign Financial Statements**

* 1. Foreign Portfolio Investment
  2. International Mergers and Acquisitions
  3. Making credit decisions about foreign customers.
  4. Evaluating the financial health of foreign suppliers.
  5. Benchmarking against global competitors.

**Potential Problems in Analysing Foreign Financial Statements**

1. Data Accessibility
2. Language
3. Terminology
4. Format
5. Extent of Disclosure
6. Timeliness
7. Differences in Accounting Principles