**16/SMS02/030**

  **INTERNATIONAL FINANCIAL STATEMENT ANALYSIS**

Financial statement analysis is a part of business analysis. Business analysis is the evaluation of a company’s business environment, strategies, financial position and performance to be able to make decisions concerning that company. Financial statements are an important source of information for conducting business analysis.

Financial statement analysis consist of the following steps

1. Accounting analysis
2. Financial analysis
3. Prospective analysis

**Accounting Analysis**

Accounting analysis 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:

1. Accounting standards that are inconsistent with economic reality
2. Estimation errors made by managers in applying accounting standards
3. 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.

**Financial Analysis**

It is conducted through the use of ratios calculated from financial statements. Financial Analysis involves the use of adjusted financial statement information to conduct:

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

**Prospective Analysis**

It 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 to Analyse Foreign Financial Statements**

1. Foreign Portfolio Investment
2. International Mergers and Acquisitions
3. Making credit decisions about foreign customers.

**Potential Problems in Analysing Foreign Financial Statements**

1. Data Accessibility
2. Language
3. Terminology
4. Format
5. Extent of Disclosure