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 ASSIGNMENT

INTERNATIONAL FINANCIAL STATEMENT ANALYSIS

Business analysis is the evaluation of a company’s business environment, strategies, financial position, and performance to be able to make decisions with respect to that company. Whether to extend credit to a company or to invest in a company’s equity securities are important decisions based on business analysis. Business analysis is conducted using relevant information available about a company. Financial statements are an important source of information for conducting business analysis.

Financial statement analysis consists of the following steps:

i. Accounting analysis;

ii. Financial analysis; and

iii. Prospective analysis.

Accounting analysisbegins 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:

i. Accounting standards that are inconsistent with economic reality (a rule that requires all research and development costs to be expensed immediately with no possibility of recognizing an asset is an example).

ii. Estimation errors made by managers in applying accounting standards (the estimation of the cost of pension and other postretirement benefits is an example).

iii. The intentional manipulation of financial statements by managers; often referred to as earnings management (the intentional overstatement of an accrued restructuring charge is an example).

Financial Analysisinvolves the use of adjusted financial statement information to conduct:

i. Cash flow analysis: the analysis of how a company generates and uses cash.

ii. Profitability analysis: with a focus on return on invested capital.

iii. Risk analysis: including an evaluation of liquidity and solvency to assess a company’s ability to meet its obligations.

Prospective Analysisinvolves 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 is a very important part of business analysis because decisions made today about a company are based on forecasts of the company’s future prospects.

Reasons to Analyze Foreign Financial Statements

i. Foreign Portfolio Investment

ii. International Mergers and Acquisitions

iii. Making credit decisions about foreign customers.

iv. Evaluating the financial health of foreign suppliers

Potential Problems in Analyzing Foreign Financial Statements

Some of the potential problems that may arise in analyzing foreign financial statements include:

i. Data Accessibility

ii. Language

iii. Terminology

iv. Format

v. Extent of Disclosure

vi. Timeliness

vii. Differences in Accounting Principles