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ASSIGNMENT: SUMMARY OF THE NOTE ON 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 with respect to that company. Business analysis is conducted using relevant information available about a company, this information is provided by financial statements.

Financial statement analysis consists of the following steps:

ACCOUNTING ANALYSIS

This begins with an evaluation of the extent to which a company’s financial statements reflect economic reality. Accounting analysis involves identifying distortions in financial statements and making adjustments to the financial statements where possible.

There are three common sources of distortion in financial statements:

1. Accounting standards that are inconsistent with economic.
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.

FINANCIAL ANALYSIS

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.

Financial analysis is usually conducted through the use of ratios calculated from the financial statements.

PROSPECTIVE ANALYSIS

This type of analysis 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. Preparing forecasted future financial statements 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 ANALYSE 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