INTERNATIONAL FINANCIAL STATEMENT ANALYSIS

Financial statement analysis consists of the following steps:

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

Accounting analysis

This begins with an evaluation of the extent to which a company’s financial statement reflect economic reality. There are three sources of distortion in financial statement:

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

Accounting analysis involves identifying and making adjustments to the financial statements where necessary.

Financial analysis

This 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 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, earns a return on invested capital is improving or deteriorating.

Prospective Analysis

This involves the combining the results of accounting analysis and financial analysis along with an analysis of business environment and company strategy to forecast future financial statements information.

Reasons to Analyse Foreign Financial Statements

1. Foreign Portfolio investment
2. International Merger and Acquisition
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

* Data Accessibility
* Language
* Terminology
* Format
* Extent of disclosure
* Timeliness
* Differences in Accounting Principles.