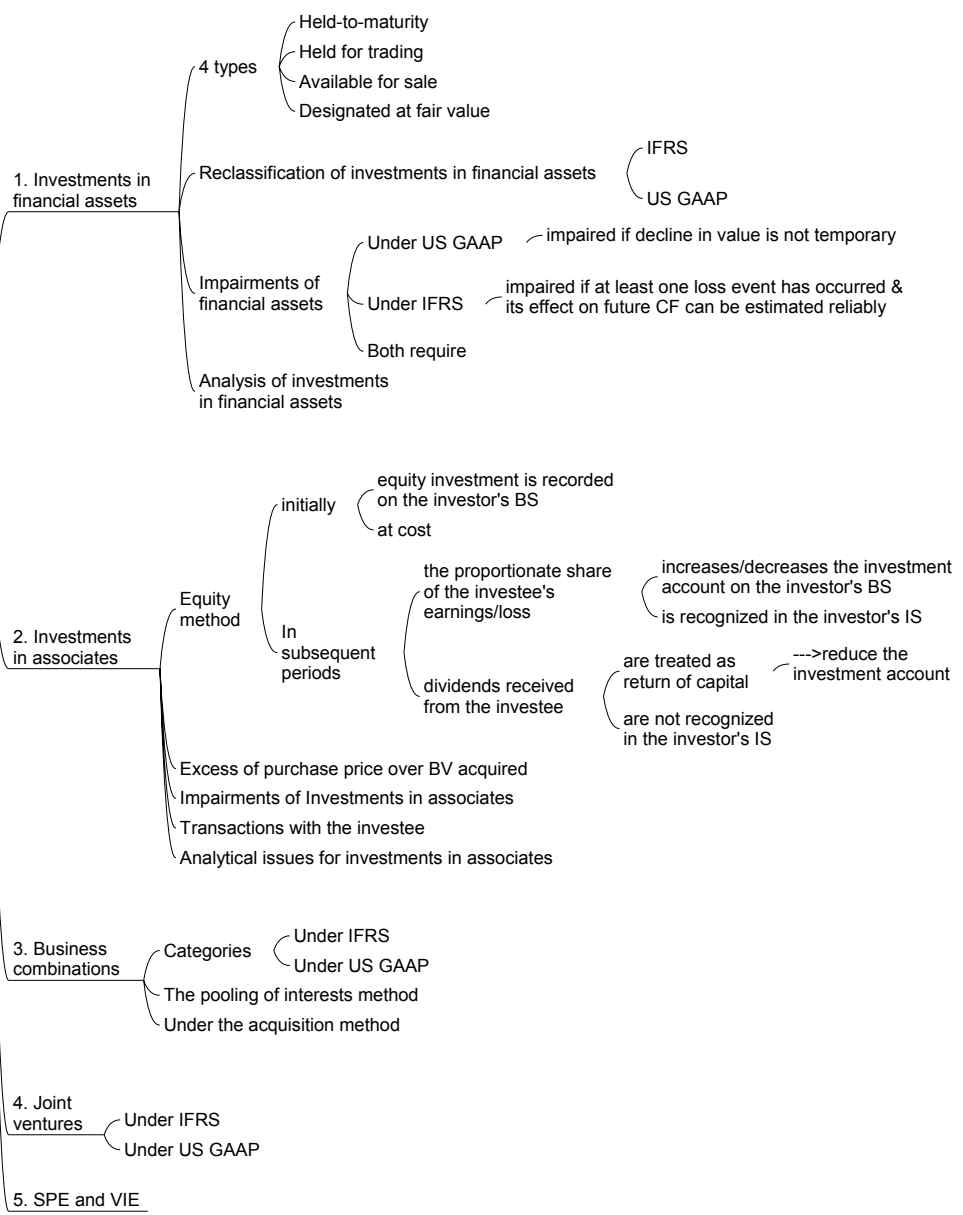


Ownership	Degree of Influence	Accounting Treatment
Less than 20% (Investments in financial assets)	No significant influence	Held-to-maturity, available-for-sale, held-for-trading, or designated at fair value (through P/L)
20%–50% (Investment in associates)	Significant influence	Equity method
More than 50% (Business combinations)	Control	Acquisition method
50% / 50% (Joint venture)	Shared control	IFRS: Proportionate consolidation preferred; U.S. GAAP: Equity method

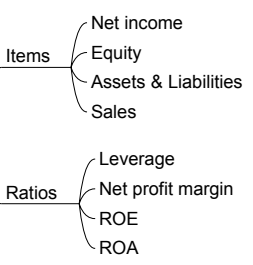
23. Intercorporate Investments

a.b. Basic corporate investment categories and reporting

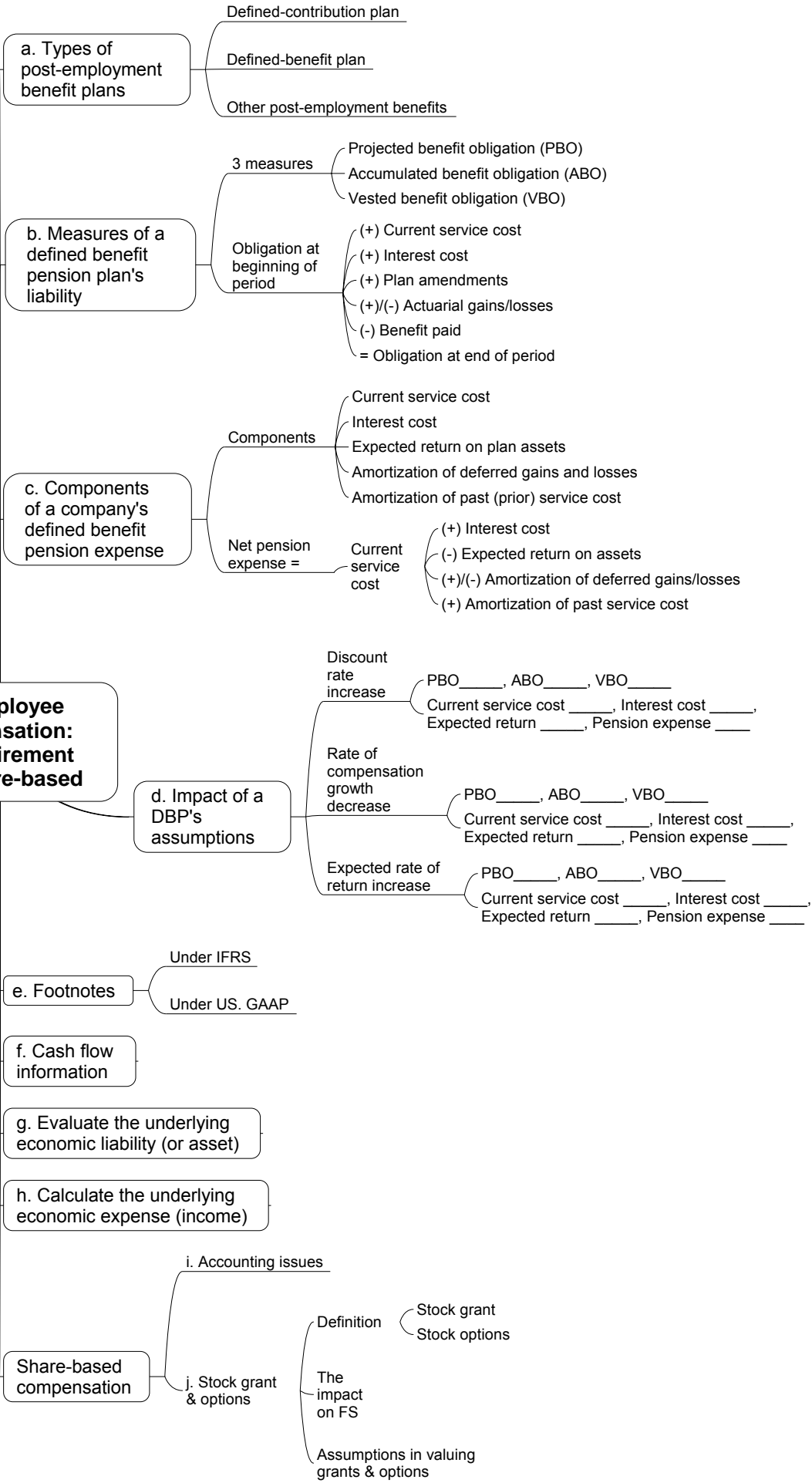
Accounting for Investments



c. Effects on financial ratios



24. Employee Compensation: Post-retirement And Share-based



a. Distinguish

- Local currency
- Functional currency
- Presentation (reporting) currency

b. Impact of changes in exchange rates on the translated sales of the subsidiary and parent company

	Foreign Subsidiary's Functional Currency	
	Foreign Currency	Parent's Presentation Currency
Translation method: Exchange rate at which financial statement items are translated from the foreign subsidiary's bookkeeping currency to the parent's presentation currency:	Current Rate Method	Temporal Method
Assets		
Monetary, e.g., cash; receivables	Current rate	Current rate
Nonmonetary		
▶ measured at current value, e.g., marketable securities; inventory measured at market under the lower of cost or market rule	Current rate	Current rate
▶ measured at historical costs, e.g., inventory measured at cost under the lower of cost or market rule; property, plant & equipment; intangible assets	Current rate	Historical rates

Liabilities		
Monetary, e.g., accounts payable; accrued expenses; long-term debt; deferred income taxes	Current rate	Current rate
Nonmonetary		
▶ measured at current value	Current rate	Current rate
▶ not measured at current value, e.g., deferred revenue	Current rate	Historical rates

Equity		
Other than retained earnings	Historical rates	Historical rates
Retained earnings	Beginning balance plus translated net income less dividends translated at historical rate	Beginning balance plus translated net income less dividends translated at historical rate
Revenues	Average rate	Average rate
Expenses		
Most expenses	Average rate	Average rate
Expenses related to assets translated at historical exchange rate, e.g., cost of goods sold; depreciation; amortization	Average rate	Historical rates
Treatment of the translation adjustment in the parent's consolidated financial statements	Accumulated as a separate component of equity	Included as gain or loss in net income

c.

If foreign currency appreciates

- All-current method
 - Net assets exposure -->
 - Net liabilities exposure -->
- Temporal method
 - Net monetary assets exposure -->
 - Net monetary liabilities exposure -->

25. Multinational Operation

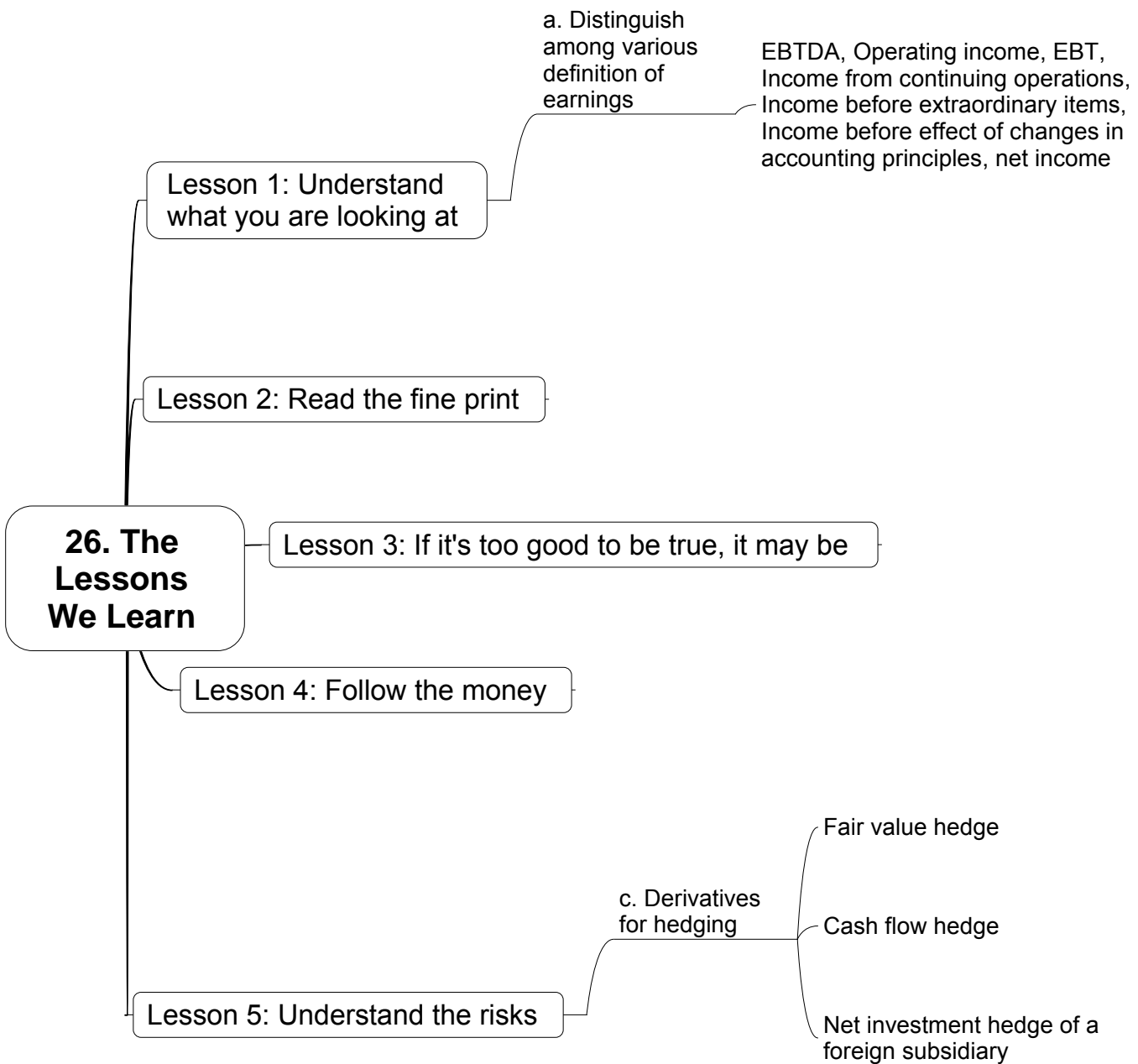
d.

- Calculate the translation effects
- Evaluate the translation of a subsidiary's BS and IS into the parent company's currency
- Analyze the differential effect of the current rate method and the temporal method on the subsidiary's financial ratios

e. Affecting the parent company's financial ratios

- Temporal method
- Current rate

f. Alternative accounting methods for subsidiaries operating in hyperinflationary economies



27. Evaluating Financial Reporting Quality

a. Contrast
 Cash-basis
 Accrual-basis
 Why accounting discretion with accrual basis?
 Revenue recognition, Depreciation estimates, Inventory cost flow, Impairment, GW, Valuation allowances for DTA, pension assumptions, stock option valuation to compute compensation expense

b. Relation between the level of accruals and the persistence of earnings

c. Opportunities and motivations for management to intervene in the external financial reporting process
 Capital markets
 Contractual provisions
 Mechanisms disciplining mgmt
 Independent audit, BoD, Certification by senior mgmt, Class action litigation, Regulators, General market scrutiny

d. Earnings quality (EQ)
 persistent & sustainable
 Measures of EQ
 NOA=
 Balance sheet approach
 Accruals =
 Accrual ratio =
 CF statement approach
 Accruals =
 Accrual ratio =

e. Mean reversion in earnings

f. Problems with quality of FS & warning signs

Revenue recognition
 Misstating revenue
 Accelerating revenue
 Misclassifying nonrecurring or nonoperating
 Detection techniques
 Large changes in A/R & UR
 Increased DSO
 Compare rev & actual cash collected
 Expense recognition
 Undestating expense
 Delaying expense
 Misclassifying expenses as nonrecurring or nonoperating
 Detection techniques
 Large changes in fixed assets & inventory
 Increased DOH
 LIFO liquidation
 Compare depreciation expense to other companies
 Core operating margin = (sales-COGS-SG&A)/ sales
 BS
 OBS financing
 Goodwill
 Techniques
 Capitalize operating leases
 Look for lack of GW impairment
 CFS
 Misclassifying CF
 Ignoring CF
 Managing CF
 Techniques
 Compare growth of operating leases with growth of asset
 Be alert for a decrease in discretionary spending, esp. near year-end

Primary purpose: identify potential outcomes, good or bad, that could affect an investment decision

<i>Step</i>	<i>Input</i>	<i>Output</i>
1. Establish the objectives	<ul style="list-style-type: none"> Perspective of the analyst (e.g., evaluating a debt/equity investment or issuing a credit rating) Needs or concerns communicated by the client or supervisor Institutional guidelines 	<ul style="list-style-type: none"> Purpose statement Specific questions to be answered Nature and content of the final report Timetable and resource budget
2. Collect data	<ul style="list-style-type: none"> Financial statements Communication with management, suppliers, customers, and competitors 	<ul style="list-style-type: none"> Organized financial information
3. Process data	<ul style="list-style-type: none"> Data from Step 2 	<ul style="list-style-type: none"> Adjusted financial statements Common-size statements Ratios Forecasts
4. Analyze data	<ul style="list-style-type: none"> Data from Steps 2 and 3 	<ul style="list-style-type: none"> Results
5. Develop and communicate conclusions	<ul style="list-style-type: none"> Results from analysis Published report guidelines 	<ul style="list-style-type: none"> Report answering questions posed in Step 1 Recommendations
6. Follow up	<ul style="list-style-type: none"> Periodically updated information 	<ul style="list-style-type: none"> Updated analysis and recommendations

Figure 1: Framework for Analysis

a.b. Framework for the analysis of FS

Focus on

- Sources of earnings & ROE
- Asset base
- Capital structure
- Capital allocation decisions
- Earnings quality & CF analysis
- Mkt value decomposition
- OBS financing
- Anticipating changes in accounting standards

28. Integration Of FS Analysis Techniques

c. Adjustments

d. Predict the impact on financial statements and ratios

e. Effects of

- BS modifications
- Earnings normalization
- CF-statement-related modifications

FRA level 2 examples

% Purchased of Subsidiary	30%
Purchased price	3

Note: PP=BV

TABLE 1:

BS before acquisition as at 1/1/2009		
	Parent	Subsidiary
Cash	20	10
A/R+Inventory	28	6
Investment in S		
Fixed assets	32	8
Total assets	80	24
Total liabilities	40	14
Common stock	28	6
Retained earnings	12	4
Minority interest		
Total Equity	40	10
Total liab.&equity	80	24

BS of Parent after acquisition as at 1/1/2009							
Equity method	Explanation		Acquisition method (purchase method/consolidation method)	Explanation		Proportionate consolidation method	Explanation
17	Pay cash to buy S		27	add up sub & pay cash		20	add up PART OF sub&pay \$
28	unchanged		34	add up sub		29.8	add up PART OF sub
3	Part of S's equity						
32	unchanged		40			34.4	add up PART OF sub
80			101			84.2	
40	unchanged		54	add up sub		44.2	add up PART OF sub
28	unchanged		28	unchanged		28	unchanged
12	unchanged		12	unchanged		12	unchanged
			7	Others' share			
40			47			40	
80			101			84.2	

TABLE 2:

IS for the year ending 31/12/2009		
	Parent	Subsidiary
Revenues	60	20
Expenses	-40	-16
Equity in income of S		
Minority interest		
Net income	20	4
Dividend	0	1
Retained earnings	20	3

IS of Parent for the year ending 31/12/2009							
Equity method	Explanation		Acquisition method (purchase method/consolidation method)	Explanation		Proportionate consolidation method	Explanation
60	unchanged		80	add up sub		66	add up PART OF sub
-40	unchanged		-56	add up sub		-44.8	add up PART OF sub
1.2	P's share						
			-2.8	Deduct others' share			
21.2			21.2			21.2	

TABLE 3:

"If-not-acquisition" BS as at 31/12/2009			Consolidated BS of Parent as at 31/12/2009					
Assumption: all year-end BS items of P & S are the same as 1/1/09, except for cash which increases by (NI-Div)	Parent	Subsidiary	Equity method	Explanation	Acquisition method (purchase method/consolidation method)	Explanation	Proportionate consolidation method	Explanation
	Cash	40	13	37.3	+RE of P +Part of Div from S	50.3	+RE of P+ Part of Div from S + all RE of S	41.2
A/R+Inventory	28	6	28		34		29.8	
Investment in S			3.9	+Part of NI of S - Part of Div from S				
Fixed assets	32	8	32		40		34.4	
Total assets	100	27	101.2		124.3		105.4	
Total liabilities	40	14	40		54		44.2	
Common stock	28	6	28		28		28	
Retained earnings	32	7	33.2	+RE of P +Part of NI of S	33.2	+RE of P +Part of NI of S	33.2	+RE of P +Part of NI of S
Minority interest					9.1	+Other's share in RE		
Total Equity	60	13	61.2		70.3		61.2	
Total liab.&equity	100	27	101.2		124.3		105.4	

FRA level 2 examples

% Purchased of Subsidiary	30%
Purchased price	7

Note: PP#BV

Full GW (100%):	7.33
Partial GW 30%:	2.20

Fair value of S:	23.33
------------------	-------

TABLE 4:

BS before acquisition as at 1/1/2009			
	Parent	Subsidiary	Fair Value of Subsi.
Cash	20	10	10
A/R+Inventory	28	6	6
Investment in S			
Goodwill			
Fixed assets	32	8	14
Total assets	80	24	30
Total liabilities	40	14	14
Common stock	28	6	
Retained earnings	12	4	
Minority interest			
Total Equity	40	10	16
Total liab.&equity	80	24	

BS of Parent after acquisition as at 1/1/2009					
Equity method	Explanation	Acquisition method Partial GW (IFRS)	Acquisition method Full GW (USGAAP & IFRS)	Pooling of interest	Explanation
13	Pay cash to buy S	23	23	30	
28		34	34	34	add up BV
4.8	Part of S's fair equity				
2.2	=PP - Part of Fair V	2.20	7.33		
32		46	46	40	add up BV
80		105.2	110.33	104	
40		54	54	54	
28		28	28	34	add up BV
12		12	12	16	add up BV
40		51.2	56.33	50	
80		105.2	110.33	104	

TABLE 5:

IS for the year ending 31/12/2009		
	Parent	Subsidiary
Revenues	60	20
Expenses	-40	-16
Share in S's income		
Additional depr.		
Equity in income of S		
Minority interest		
Net income	20	4
Dividend	0	1
Retained earnings	20	3

IS of Parent for the year ending 31/12/2009					
Equity method	Explanation	Acquisition method Partial GW (IFRS)	Acquisition method Full GW (USGAAP & IFRS)		
60		80	80		
-40		-56	-56		
1.2					
-0.6	SLD 3 years	-0.6	-0.6		
0.6					
		-2.8	-2.8		
20.6		20.6	20.6		

TABLE 6:

"If-not-acquisition" BS as at 31/12/2009		
Assumption: all year-end BS items of P & S are the same as 1/1/09, except for cash which increases by (NI-Div)	Parent	Subsidiary
	Cash	40
A/R+Inventory	28	6
Investment in S		
Goodwill		
Fixed assets	32	8
Total assets	100	27
Total liabilities	40	14
Common stock	28	6
Retained earnings	32	7
Minority interest		
Total Equity	60	13
Total liab.&equity	100	27

Consolidated BS of Parent as at 31/12/2009					
Equity method	Explanation	Acquisition method Partial GW (IFRS)	Acquisition method Full GW (USGAAP & IFRS)		
33.3					
28					
5.1	+Part of NI of S -Add Depr. - Part of Div from S				
2.2					
32					
100.6					
40					
28					
32.6	+RE of P +Part of NI of S -Add Depr.				
60.6					
100.6					

Pension exercise 1:

Payroll Professionals reported the following information in the footnotes to its financial statements:

<i>Reconciliation of Beginning and Ending PBO</i>	
Beginning PBO	\$1,250
+ Current service cost	580
+ Interest cost	70
+ Plan amendments	440
– Benefits paid	(90)
= Ending PBO	\$2,250

<i>Reconciliation of Plan Assets</i>	
Beginning fair value of plan assets	\$1,000
+ Actual return on plan assets	150
+ Employer contributions	340
– Benefits paid	(90)
= Ending fair value of plan assets	\$1,400

Expected return on plan assets is 80

Amortization of actuarial loss is 30

Amortization of prior service cost is 10

Calculate

- Net periodic benefit expense
- Economic pension expense

Pension exercise 2:

Example: Reclassifying pension expense for analytical purposes

Use the following information to reclassify the components of pension expense between operating and nonoperating items:

Partial Income Statement	
Operating profit	\$145,000
Interest expense	(12,000)
Other income	<u>2,000</u>
Income before tax	\$135,000
Other data	
Current service cost	\$7,000
Interest cost	5,000
Expected return on assets	8,000
Actual return on assets	9,500

Calculate Pension expense and make adjustments for analytical purposes.

FRA2- Multinational operations- Eg.2

U\$/LC	31/12/2008	31/12/2009
Current ex/ rate	0.5000	0.4545
Average ex/ rate		0.4762
Historical ex/ rate		0.0000
For COGS		0.4834
For Depr. Exp.		0.4878
For Fixed assets		0.4881
For accum. Depr.		0.4896
For end. inventory		0.4762
For equity		0.5000

INCOME STATEMENT 2009		All current method	Temporal method	
	LC	\$	\$	Explanation
Revenues	5,000			Average
COGS	3,300			Historical
Gross margin	1,700			
Other expenses	-400			Average
Depr. Expenses	-600			Historical
				Inc bf remeasureG/L
				Remeasurement G/L
Net Income	700			

BALANCE SHEET	31/12/2008	
	LC	All current method
		\$
Cash	100	
A/R	500	
Inventory	1,000	
Current Assets	1,600	
Fixed Assets	800	
Accum. Depr.	-100	
Net fixed assets	700	
Total assets	2,300	
Accounts payable	400	
Current debt	100	
Long term debt	1,300	
Total liabilities	1,800	
Common stock	400	
Retained earnings	100	
Total equity	500	
Total liab.& equity	2,300	

BALANCE SHEET	31/12/2009		
	LC	All current method	Temporal method
		\$	\$
			Explanation
Cash	100		Current
A/R	650		Current
Inventory	1,200		Historical
Current Assets	1,950		
Fixed Assets	1,600		Historical
Accum. Depr.	-700		Historical
Net fixed assets	900		
Total assets	2,850		
Accounts payable	500		Current
Current debt	200		Current
Long term debt	950		Current
Total liabilities	1,650		
Common stock	400		Historical
Retained earnings	800		Plug number
Total equity	1,200		
Total liab.& equity	2,850		

FRA2- Multinational operations- Eg.2

U\$/LC	31/12/2008	31/12/2009
Current ex/ rate	0.5000	0.4545
Average ex/ rate		0.4762
Historical ex/ rate		0.0000
For COGS		0.4834
For Depr. Exp.		0.4878
For Fixed assets		0.4881
For accum. Depr.		0.4896
For end. inventory		0.4762
For equity		0.5000

INCOME STATEMENT 2009		All current method	Temporal method	
	LC	\$	\$	Explanation
Revenues	5,000	2,381.00	2,381.00	Average
COGS	3,300	1,571.46	1,595.22	Historical
Gross margin	1,700	809.54	785.78	
Other expenses	-400	(190.48)	(190.48)	Average
Depr. Expenses	-600	(285.72)	(292.68)	Historical
			302.62	Inc bf remeasureG/L
			48.01	Remeasurement G/L
Net Income	700	333.34	350.63	

BALANCE SHEET	31/12/2008	
	LC	All current method \$
Cash	100	50.00
A/R	500	250.00
Inventory	1,000	500.00
Current Assets	1,600	800.00
Fixed Assets	800	400.00
Accum. Depr.	-100	(50.00)
Net fixed assets	700	350.00
Total assets	2,300	1,150.00
Accounts payable	400	200.00
Current debt	100	50.00
Long term debt	1,300	650.00
Total liabilities	1,800	900.00
Common stock	400	200.00
Retained earnings	100	50.00
Total equity	500	250.00
Total liab.& equity	2,300	1,150.00

BALANCE SHEET	31/12/2009			
	LC	All current method \$	Temporal method \$	Explanation
Cash	100	45.45	45.45	Current
A/R	650	295.43	295.43	Current
Inventory	1,200	545.40	571.44	Historical
Current Assets	1,950	886.28	912.32	
Fixed Assets	1,600	727.20	780.96	Historical
Accum. Depr.	-700	(318.15)	(342.72)	Historical
Net fixed assets	900	409.05	438.24	
Total assets	2,850	1,295.33	1,350.56	
Accounts payable	500	227.25	227.25	Current
Current debt	200	90.90	90.90	Current
Long term debt	950	431.78	431.78	Current
Total liabilities	1,650	749.93	749.93	
Common stock	400	181.80	200.00	Historical
Retained earnings	800	363.60	400.63	Plug number
Total equity	1,200	545.40	600.63	
Total liab.& equity	2,850	1,295.33	1,350.56	

FRA2- Multinational operations- Eg.3

	A	B	C	D	E
1	Adjustments for inflation under IFRS				
2					
3	Price indices				
4	Dec. 31. 2009	100			
5	Dec. 31. 2008	150			
6	Average for 2009	125			
7					
8	INCOME STATEMENT		2009	Adjustment factor	Inflation adjusted
9	Revenues		15,000		
10	Expenses		-12,000		
11	Net purchasing power G/L				
12	Net Income		<u>3,000</u>		
13					
14	BALANCE SHEET	2008	2009	Adjustment factor	Inflation adjusted
15	Cash	5,000	8,000		
16	Supplies	25,000	25,000		
17	Total assets	<u>30,000</u>	<u>33,000</u>		
18					
19	Accounts payable	20,000	20,000		
20	Common stock	10,000	10,000		
21	Retained earnings	0	3,000		
22	Total liab.& equity	<u>30,000</u>	<u>33,000</u>		