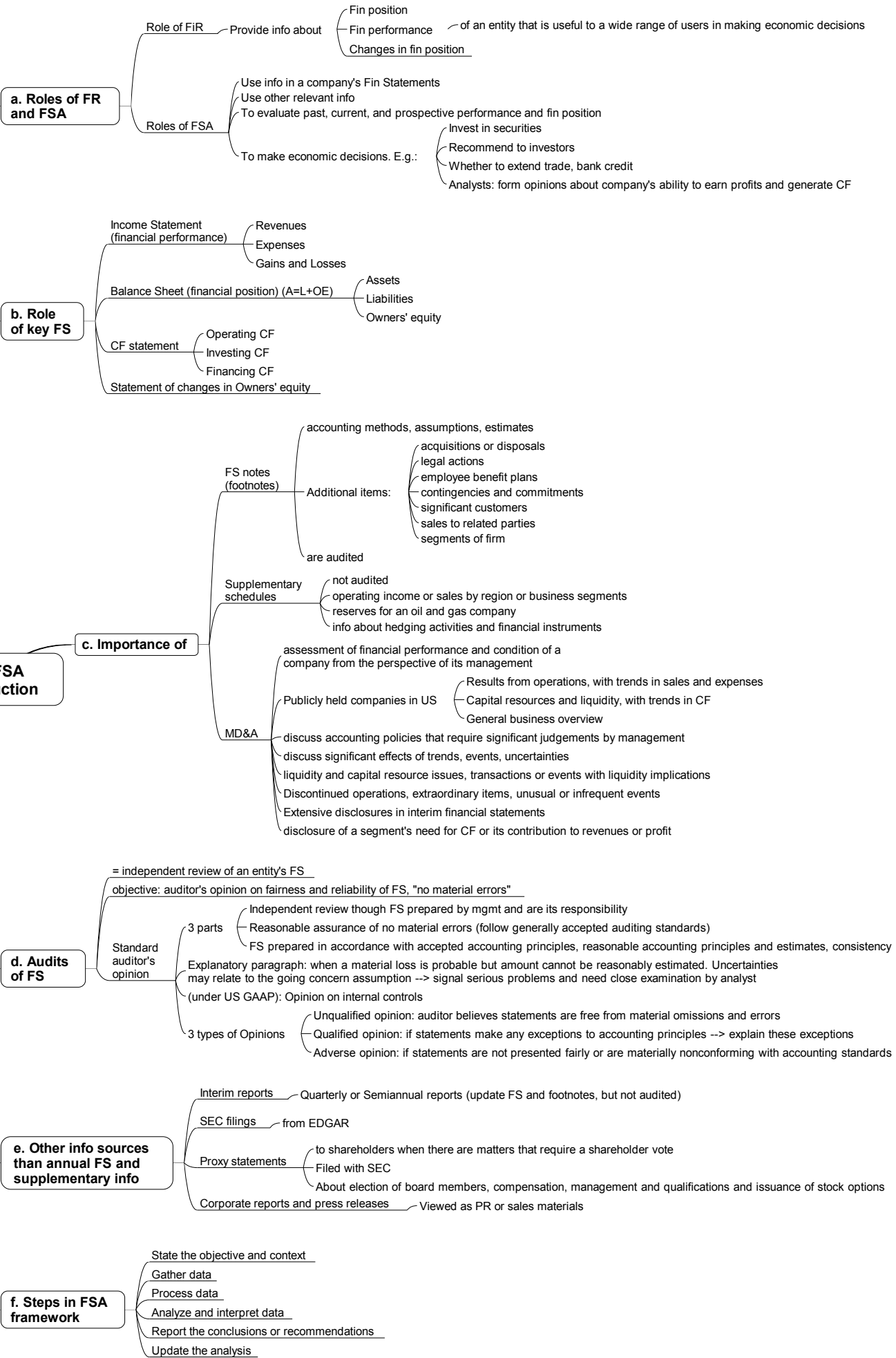


CFA LEVEL 1

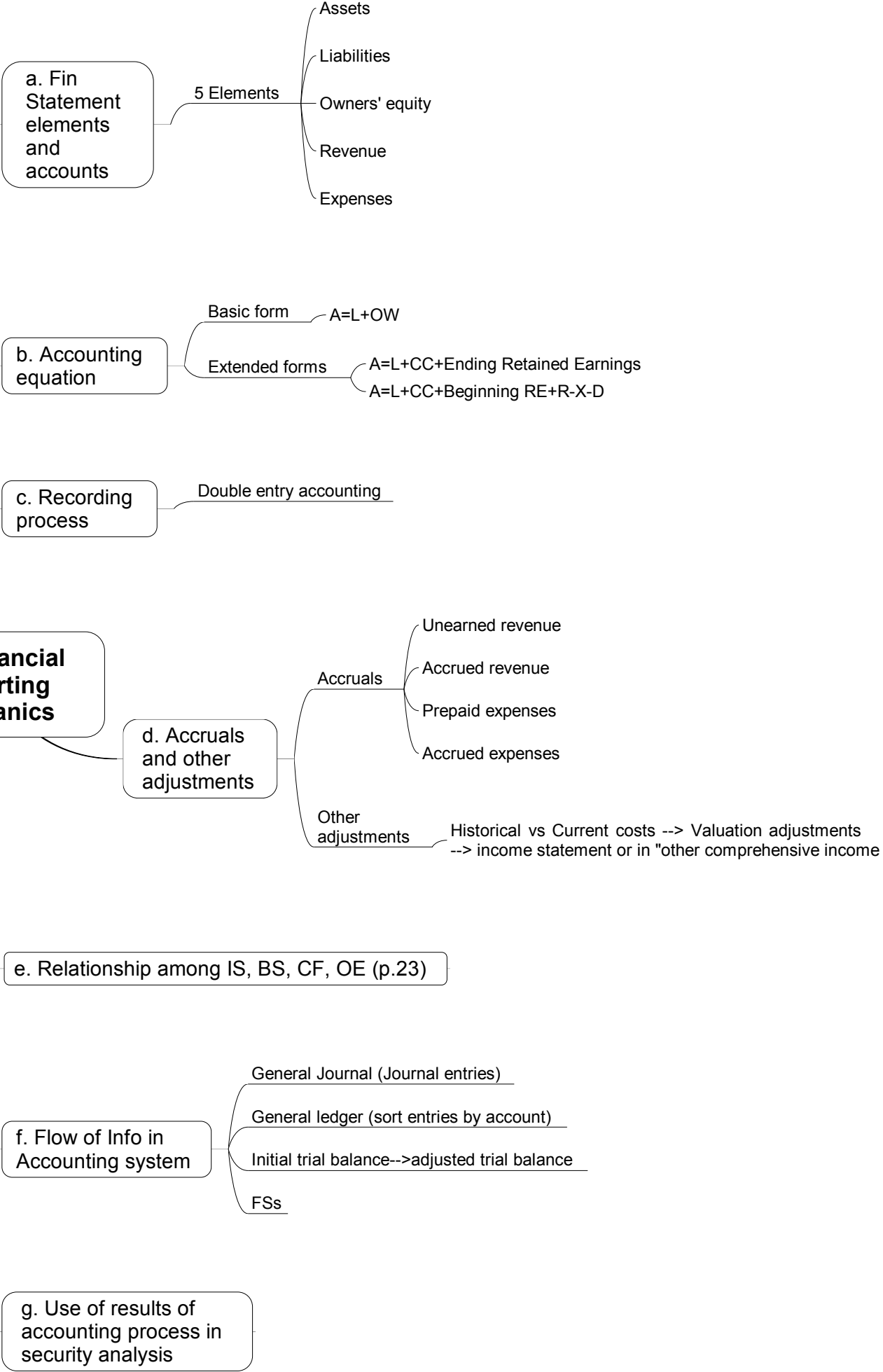
STUDY SESSION 7,8,9,10

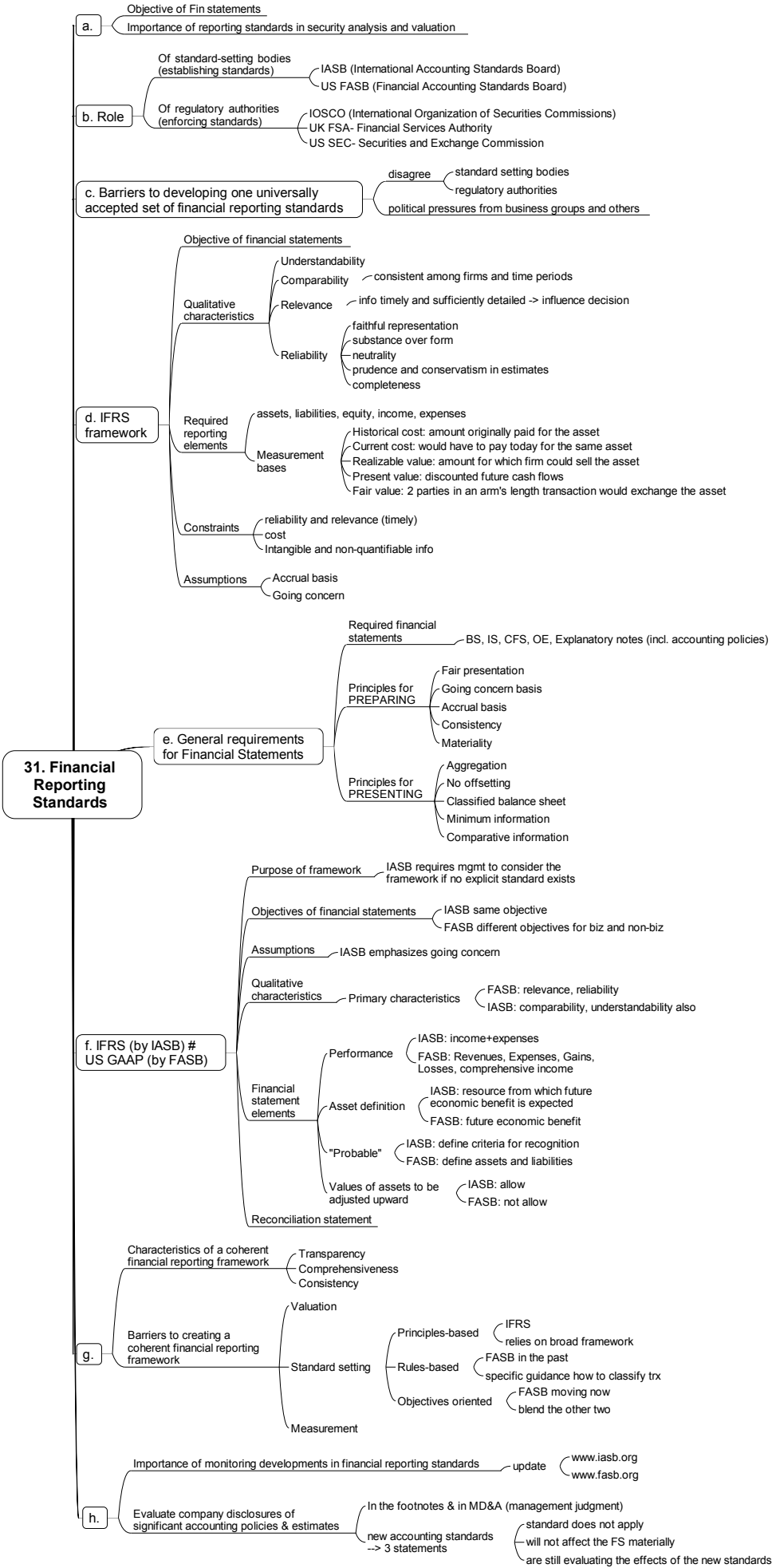
FRA

29. FSA Introduction

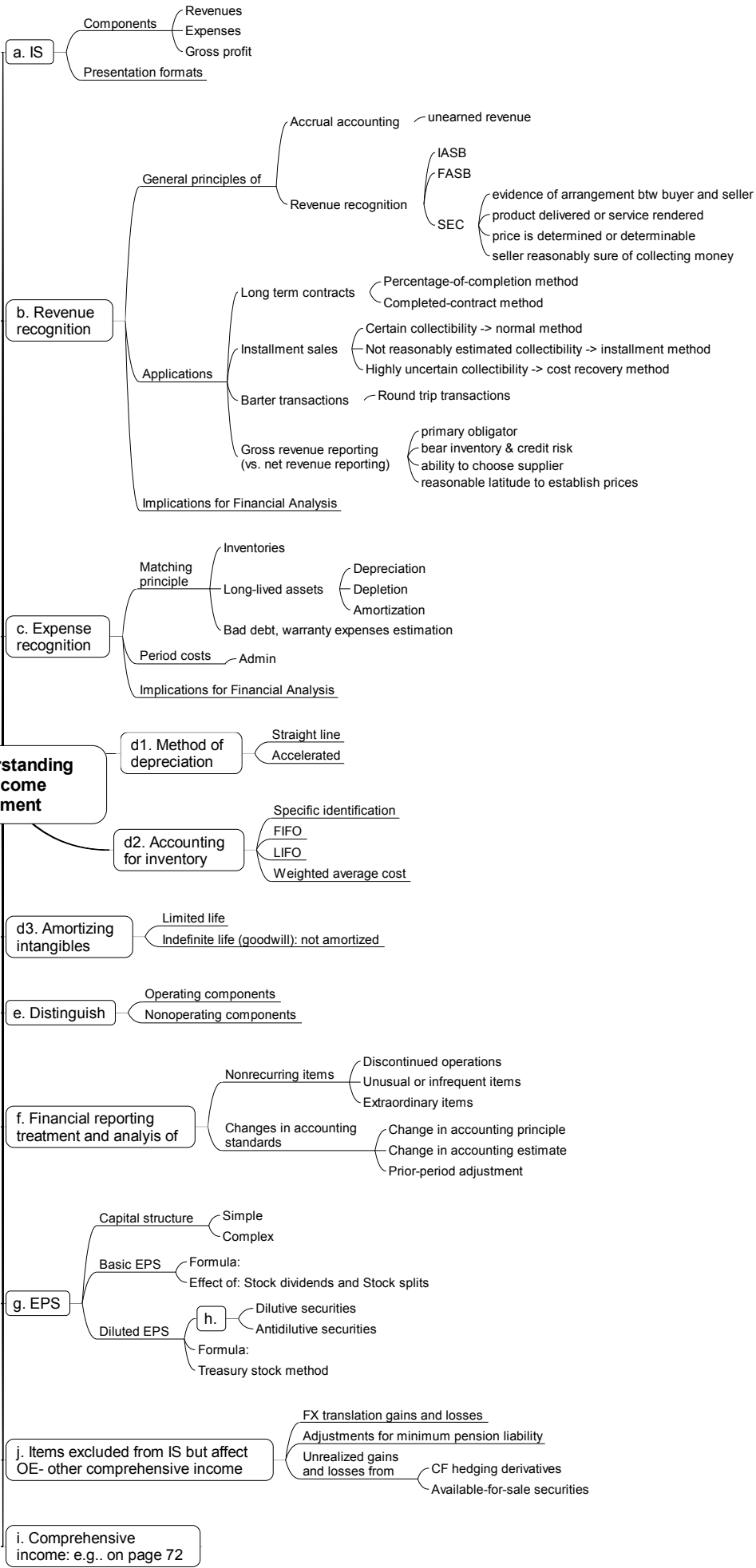


30. Financial Reporting Mechanics

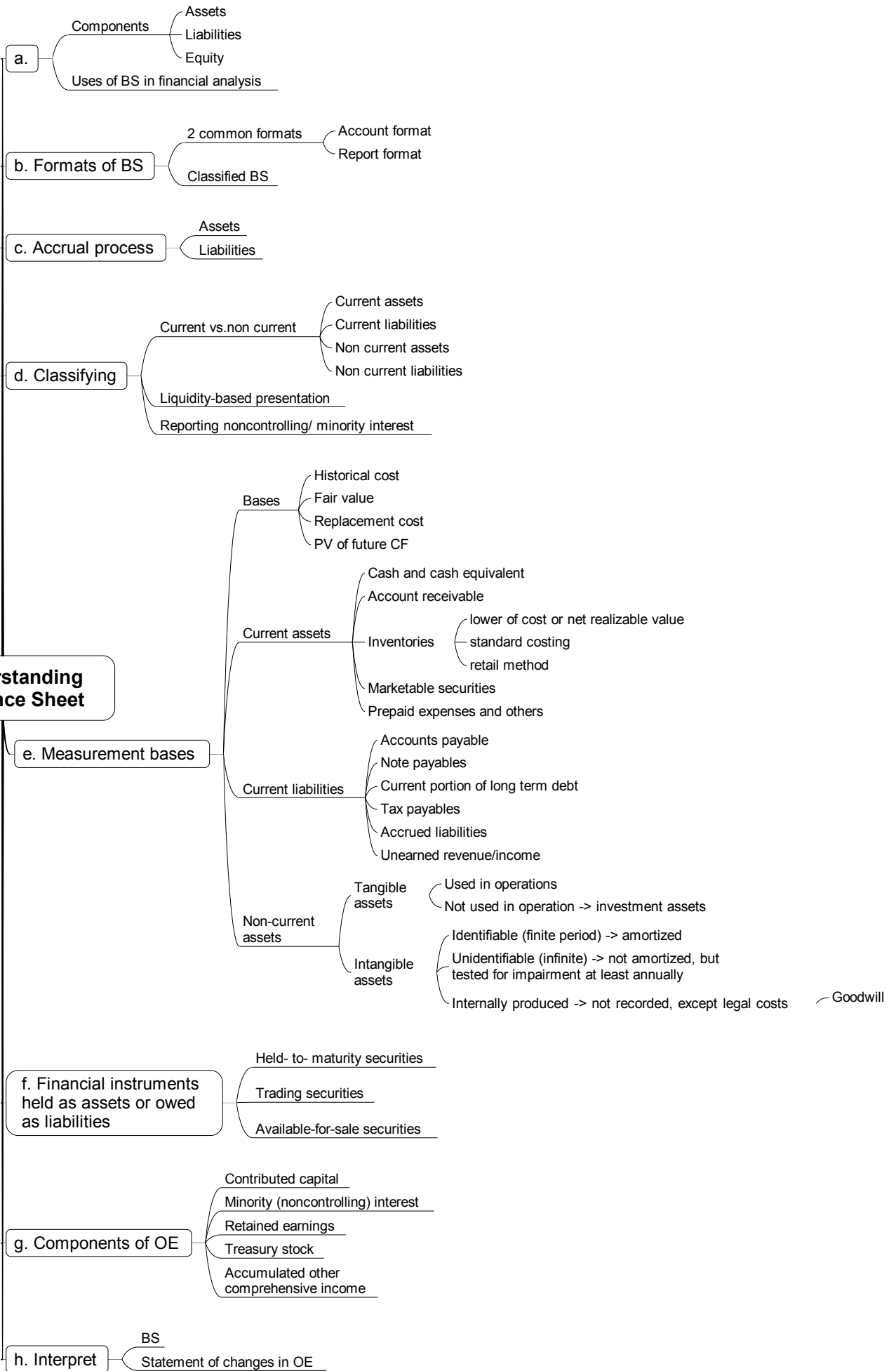


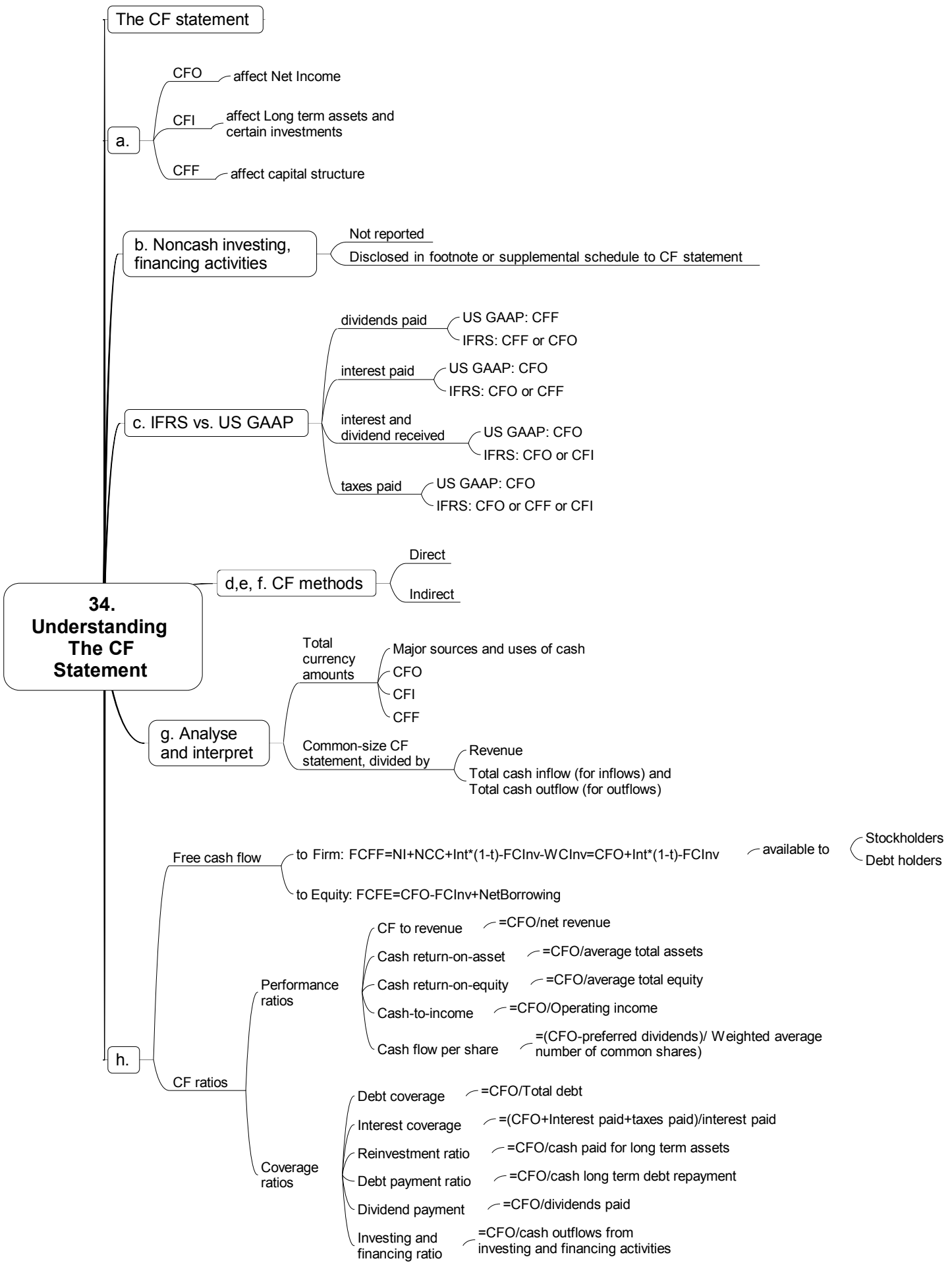


32. Understanding The Income Statement

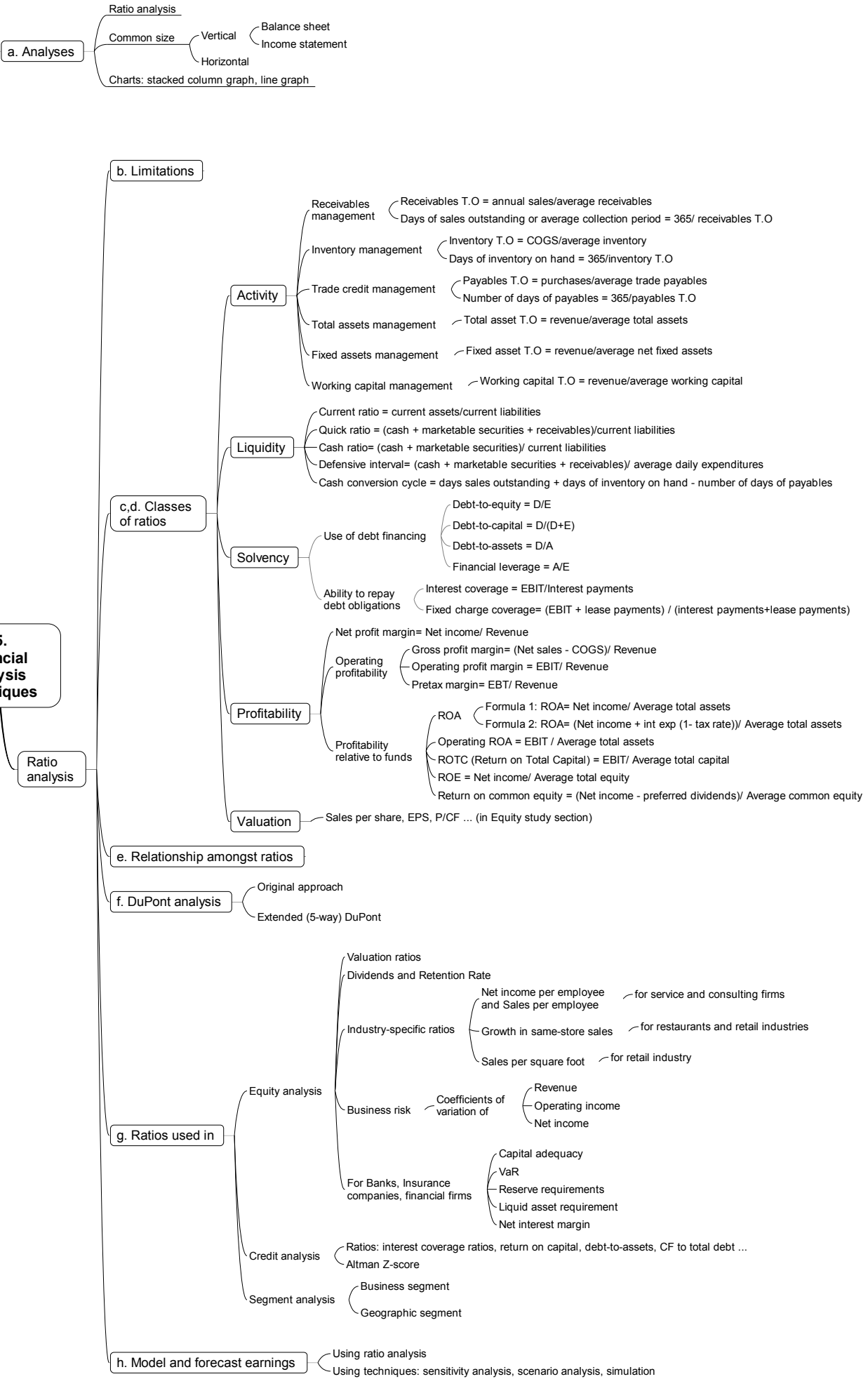


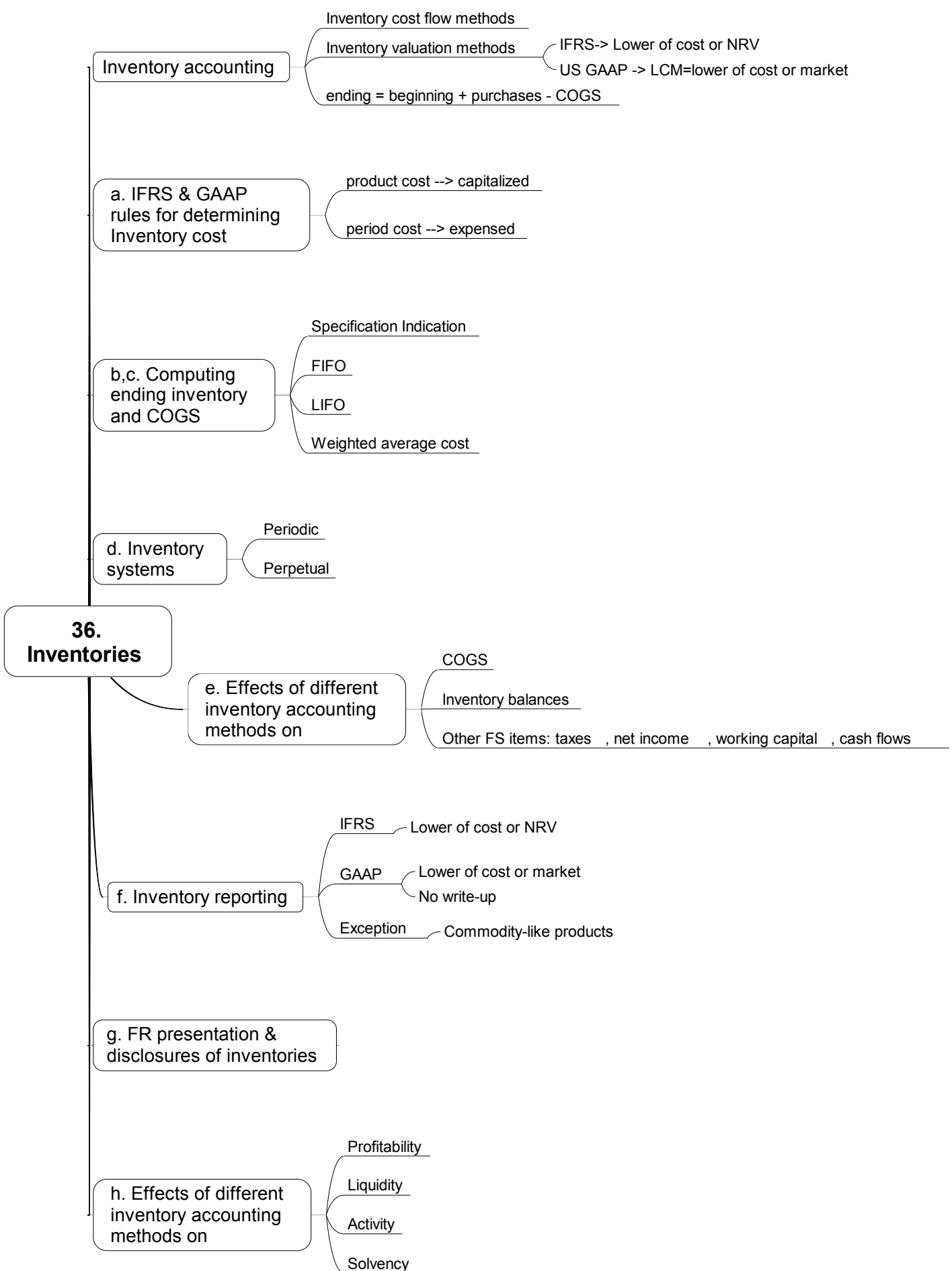
33. Understanding The Balance Sheet

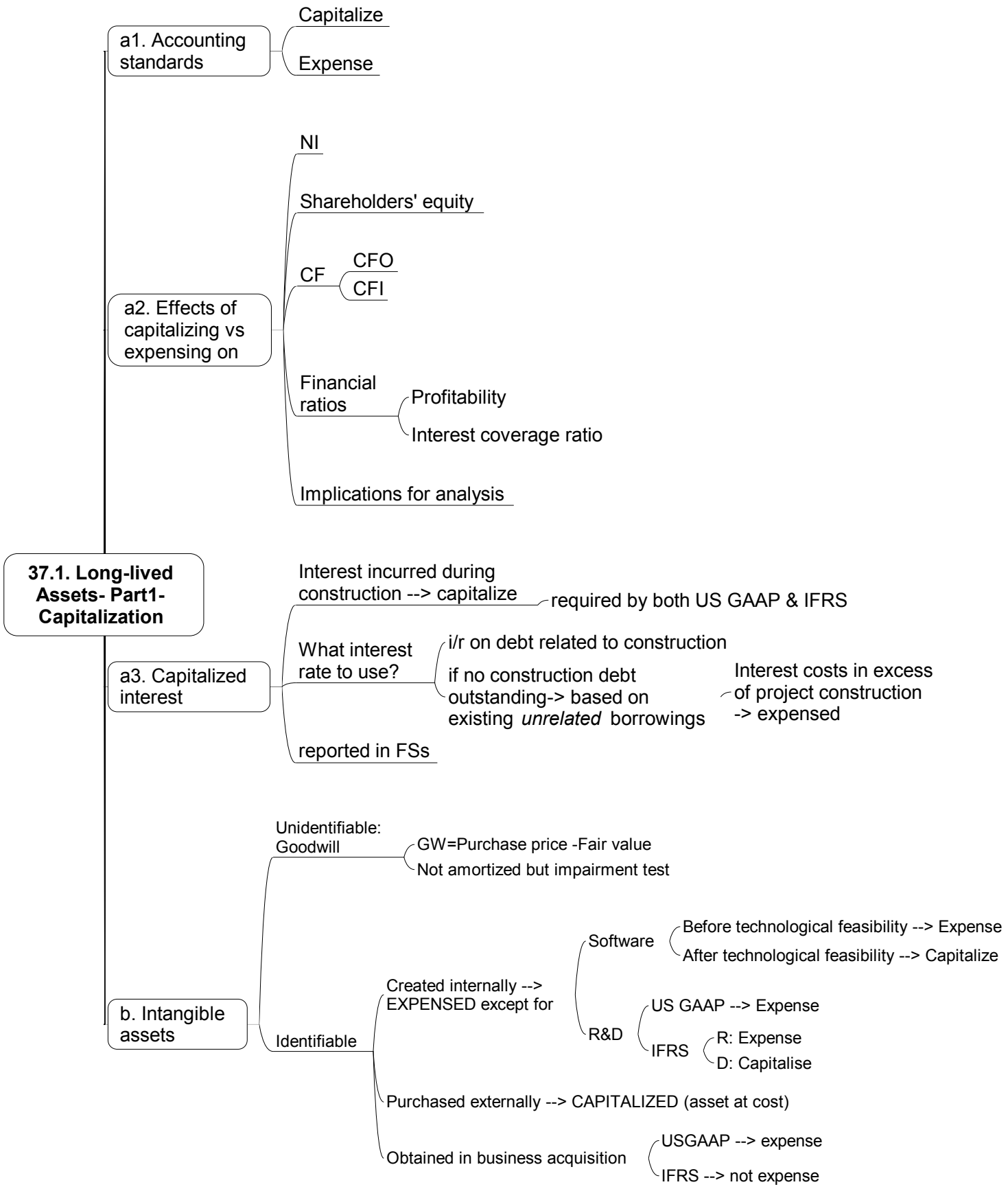




35. Financial Analysis Techniques







a1. Accounting standards

Capitalize
Expense

a2. Effects of capitalizing vs expensing on

NI
Shareholders' equity
CF
CFO
CFI
Financial ratios
Profitability
Interest coverage ratio
Implications for analysis

37.1. Long-lived Assets- Part1- Capitalization

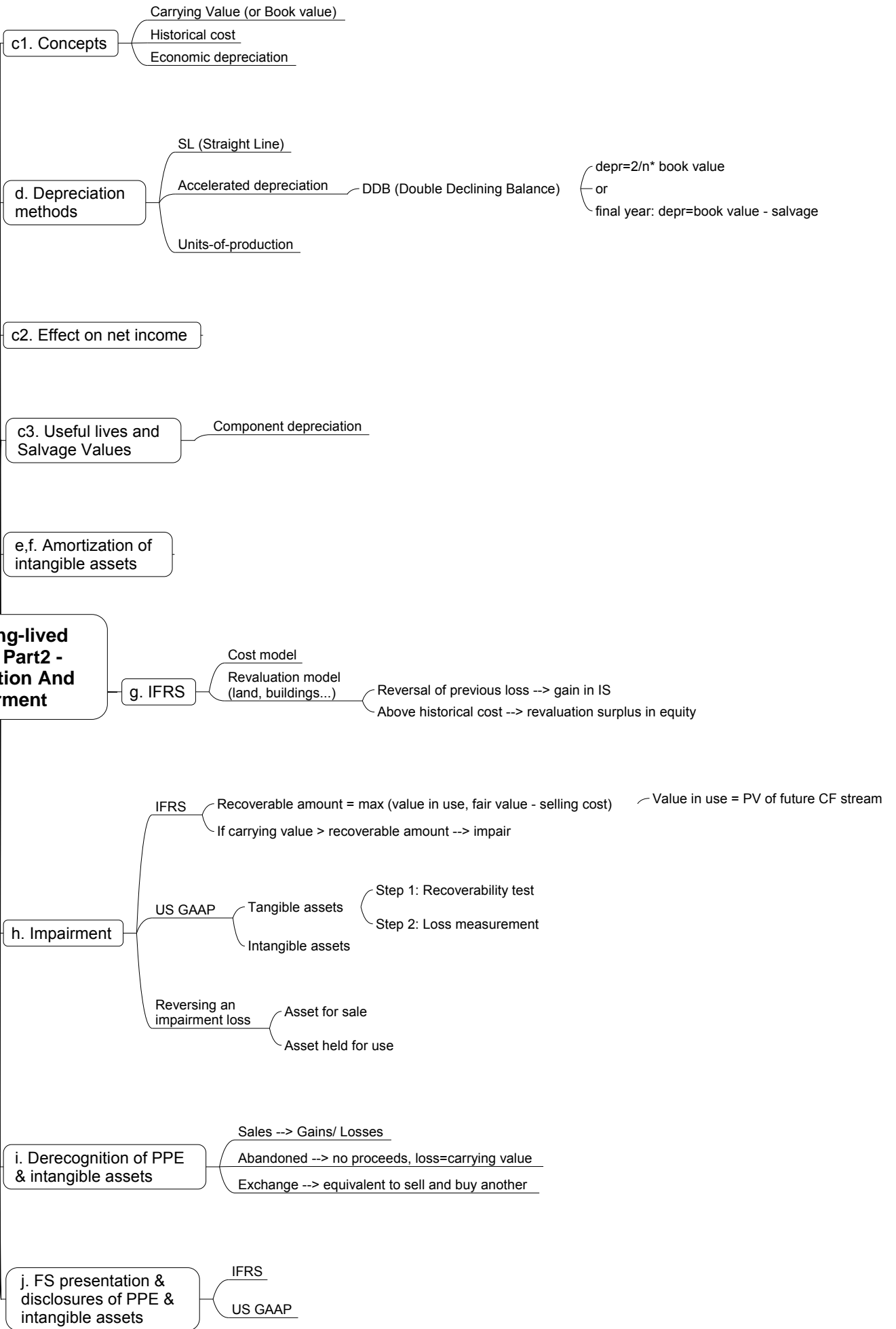
a3. Capitalized interest

Interest incurred during construction --> capitalize
required by both US GAAP & IFRS
What interest rate to use?
i/r on debt related to construction
if no construction debt outstanding --> based on existing *unrelated* borrowings
Interest costs in excess of project construction --> expensed
reported in FSs

b. Intangible assets

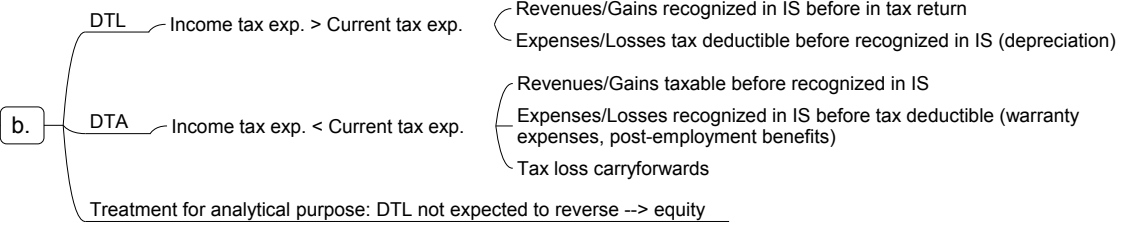
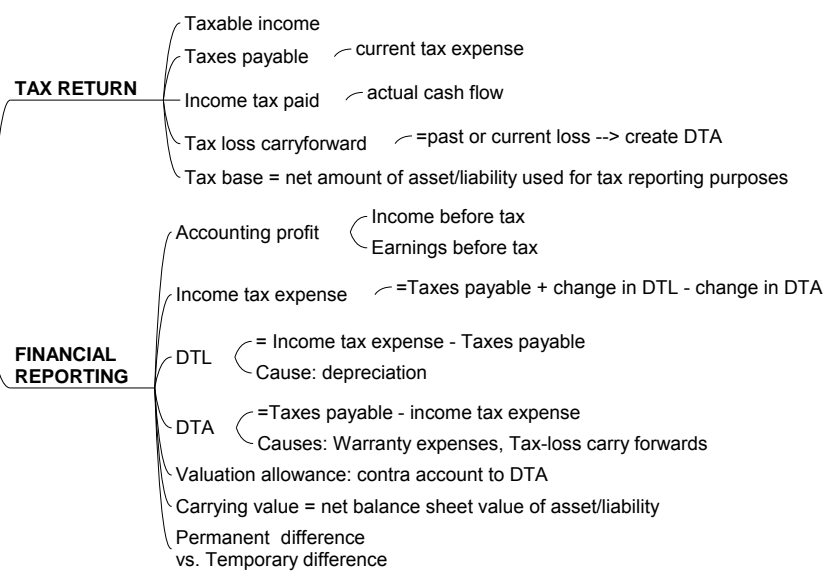
Unidentifiable: Goodwill
GW = Purchase price - Fair value
Not amortized but impairment test
Identifiable
Created internally --> EXPENSED except for
Software
Before technological feasibility --> Expense
After technological feasibility --> Capitalize
R&D
US GAAP --> Expense
IFRS
R: Expense
D: Capitalise
Purchased externally --> CAPITALIZED (asset at cost)
Obtained in business acquisition
USGAAP --> expense
IFRS --> not expense

37.2. Long-lived Assets- Part2 - Depreciation And Impairment

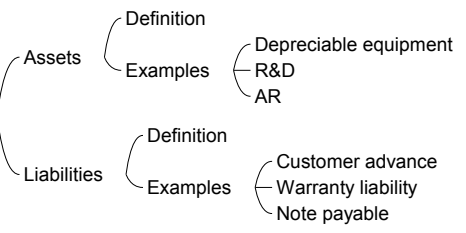


38. Income Taxes

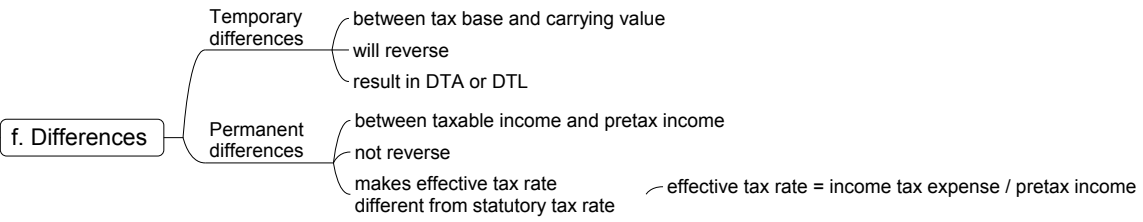
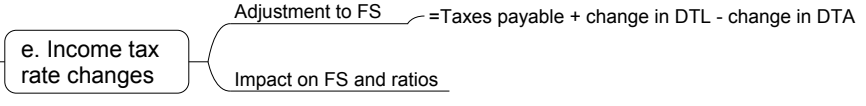
a. Terminology



c. Tax base of



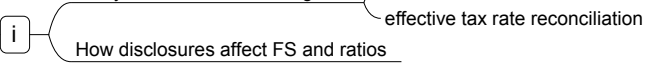
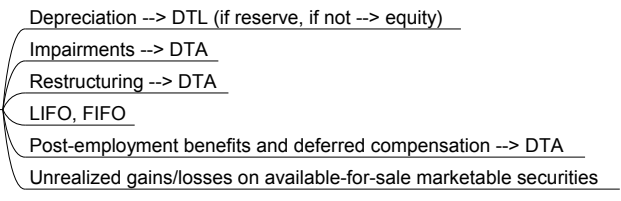
d. Calculation



g. Valuation allowance for DTA

>50% probability

h. Deferred tax items



j. IFRS vs. US GAAP (see table in Schweser)

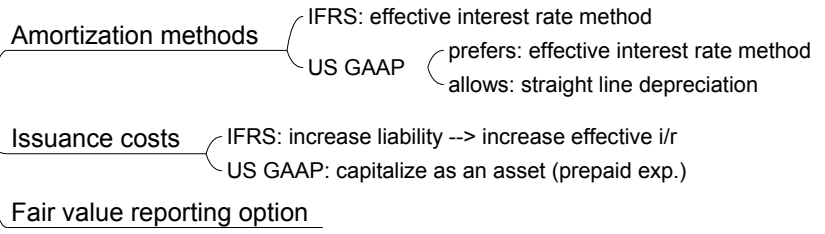
Bond terminology

a,b.
Recognition
&
measurement



**39.1.
Long-term
Liabilities-
Part1-
Financing
Liabilities**

b.

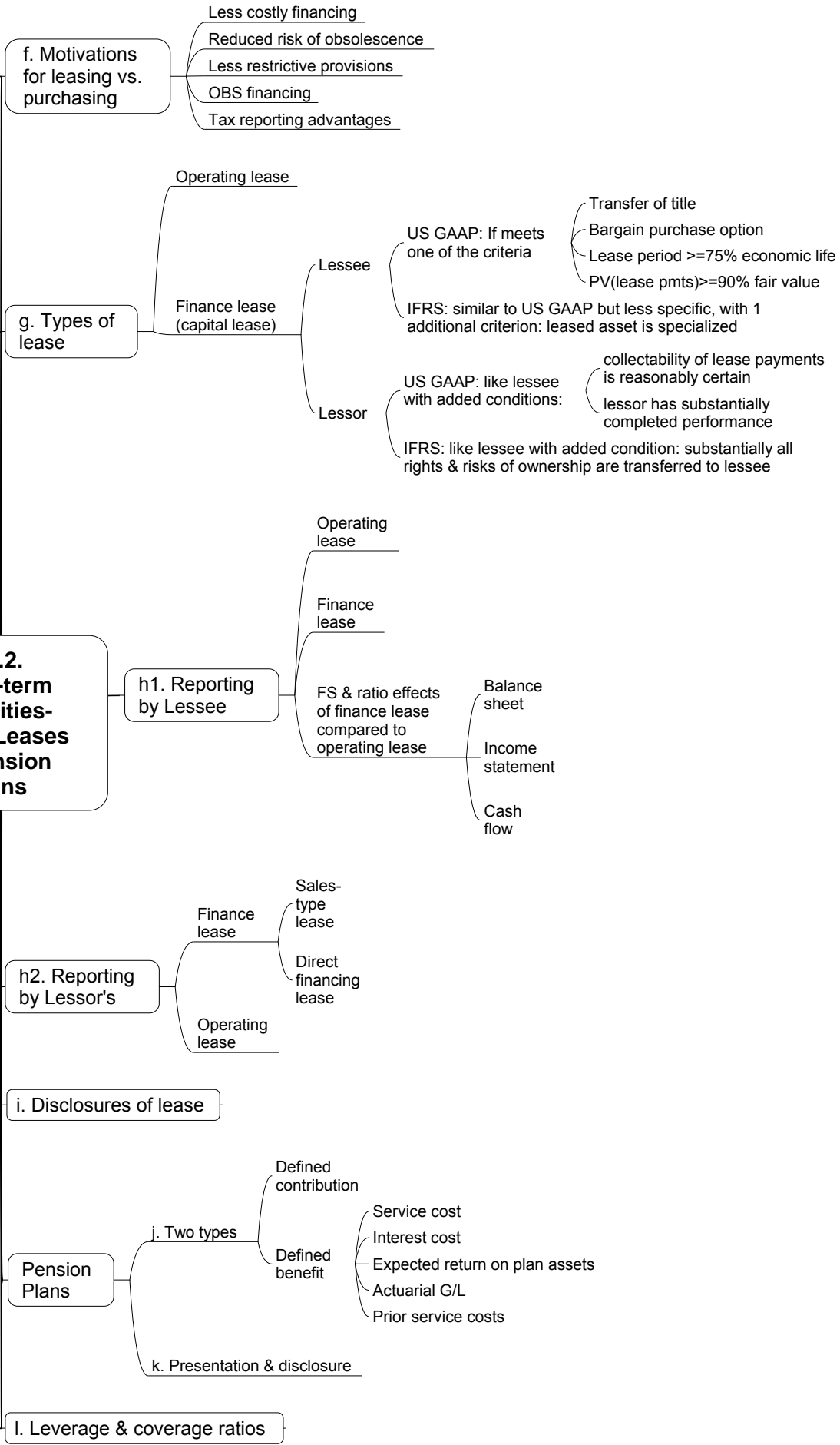


c. Derecognition of debt

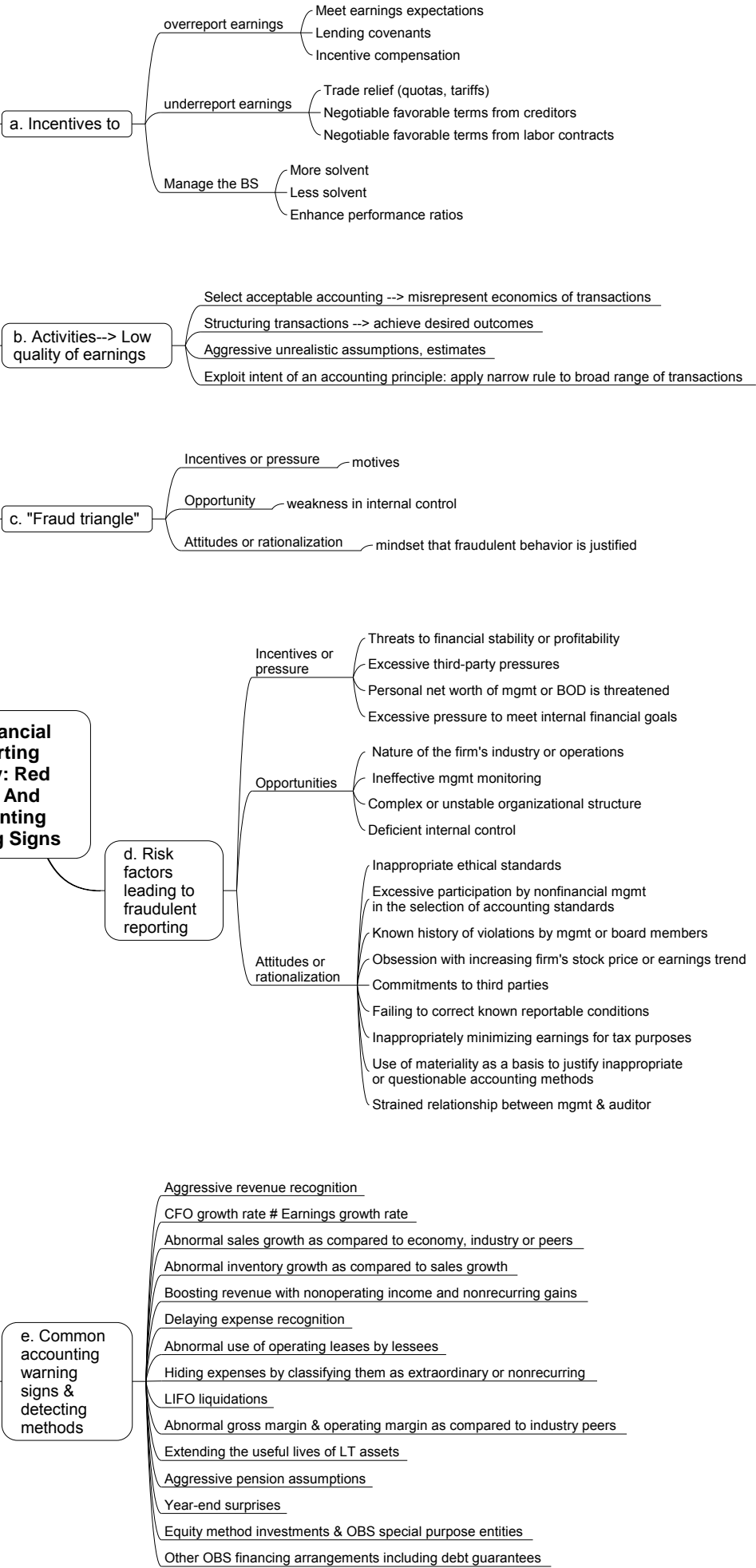
d. Debt covenants

e. Presentation and disclosures

39.2. Long-term Liabilities- Part2- Leases & Pension Plans



40. Financial Reporting Quality: Red Flags And Accounting Warning Signs



a. Incentives to

- overreport earnings
 - Meet earnings expectations
 - Lending covenants
 - Incentive compensation
- underreport earnings
 - Trade relief (quotas, tariffs)
 - Negotiable favorable terms from creditors
 - Negotiable favorable terms from labor contracts
- Manage the BS
 - More solvent
 - Less solvent
 - Enhance performance ratios

b. Activities--> Low quality of earnings

- Select acceptable accounting --> misrepresent economics of transactions
- Structuring transactions --> achieve desired outcomes
- Aggressive unrealistic assumptions, estimates
- Exploit intent of an accounting principle: apply narrow rule to broad range of transactions

c. "Fraud triangle"

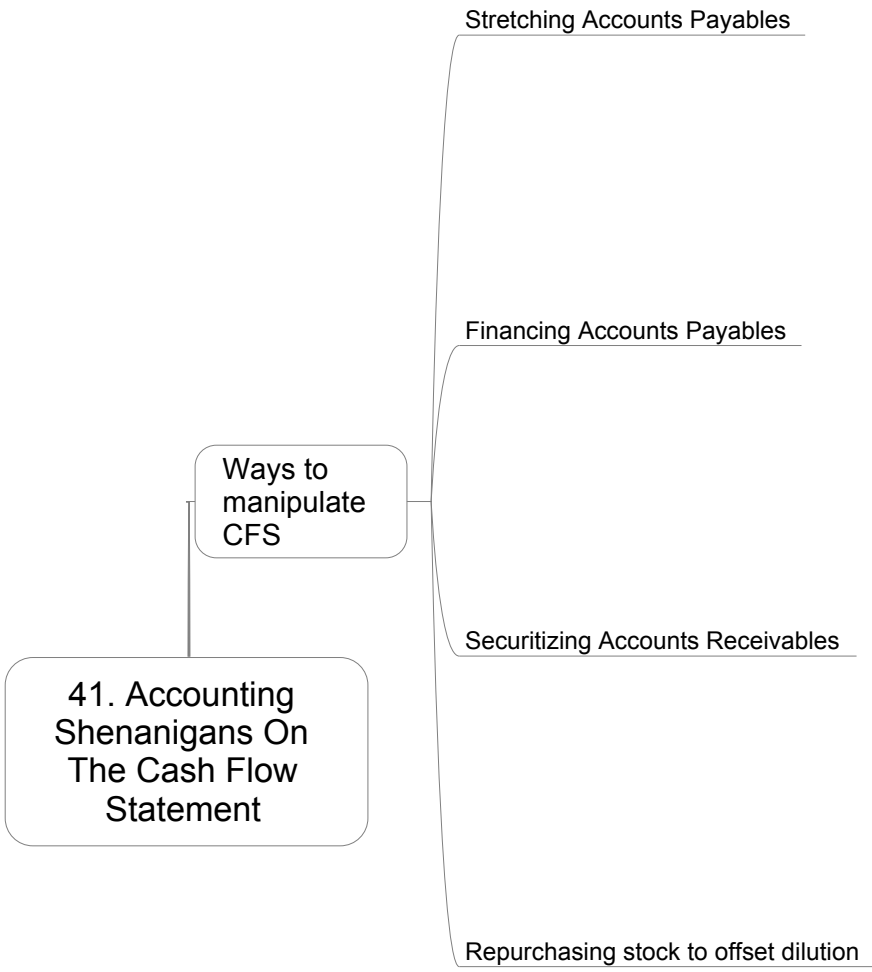
- Incentives or pressure
 - motives
- Opportunity
 - weakness in internal control
- Attitudes or rationalization
 - mindset that fraudulent behavior is justified

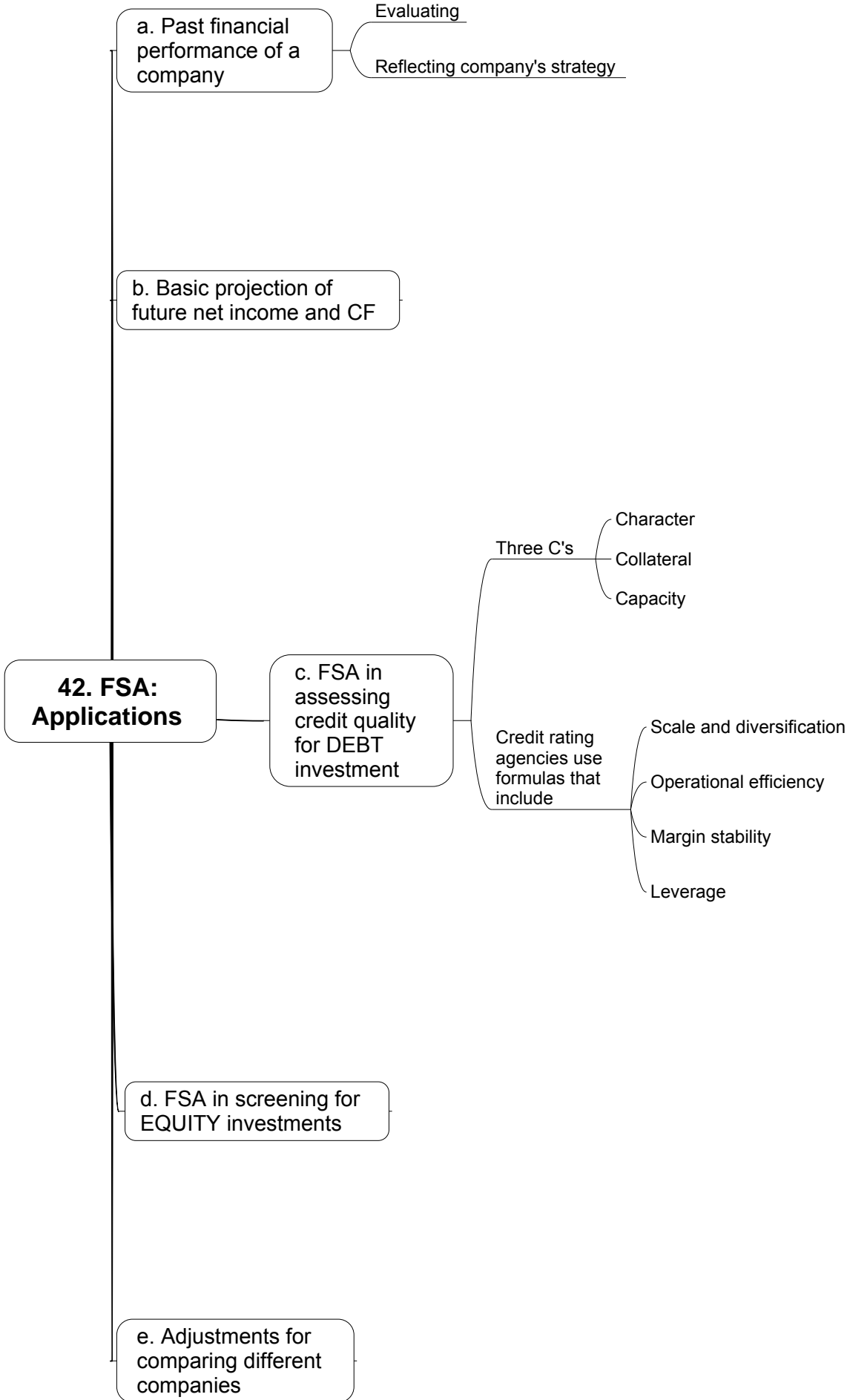
d. Risk factors leading to fraudulent reporting

- Incentives or pressure
 - Threats to financial stability or profitability
 - Excessive third-party pressures
 - Personal net worth of mgmt or BOD is threatened
 - Excessive pressure to meet internal financial goals
- Opportunities
 - Nature of the firm's industry or operations
 - Ineffective mgmt monitoring
 - Complex or unstable organizational structure
 - Deficient internal control
- Attitudes or rationalization
 - Inappropriate ethical standards
 - Excessive participation by nonfinancial mgmt in the selection of accounting standards
 - Known history of violations by mgmt or board members
 - Obsession with increasing firm's stock price or earnings trend
 - Commitments to third parties
 - Failing to correct known reportable conditions
 - Inappropriately minimizing earnings for tax purposes
 - Use of materiality as a basis to justify inappropriate or questionable accounting methods
 - Strained relationship between mgmt & auditor

e. Common accounting warning signs & detecting methods

- Aggressive revenue recognition
- CFO growth rate # Earnings growth rate
- Abnormal sales growth as compared to economy, industry or peers
- Abnormal inventory growth as compared to sales growth
- Boosting revenue with nonoperating income and nonrecurring gains
- Delaying expense recognition
- Abnormal use of operating leases by lessees
- Hiding expenses by classifying them as extraordinary or nonrecurring
- LIFO liquidations
- Abnormal gross margin & operating margin as compared to industry peers
- Extending the useful lives of LT assets
- Aggressive pension assumptions
- Year-end surprises
- Equity method investments & OBS special purpose entities
- Other OBS financing arrangements including debt guarantees





43. International Standards Convergence

a. Standards for **Asset and Liability** in Balance sheet

- Marketable investment securities
 - Held-to-maturity
 - Trading (IFRS: "held-for-trading")
 - Available-for-sale
- Inventory
- Property and Equipment
- Intercorporate investments
- Goodwill
- Identifiable intangible assets
- Provisions

b. Standards for **Revenue and Expense** in Income statement

- Construction contracts
- COGS
- Operating expenses
- Depreciation
- Interest expense
- Income taxes
- Nonrecurring items

c. Standards for **Interest and Dividends** on CF statement

d. Effects of differences