

# Financial Reporting and Analysis

- **Financial Statement Analysis: An Introduction**
- Financial Reporting Standards
- Understanding Income Statements
- Understanding Balance Sheets
- Understanding Cash Flow Statements
- Financial Analysis Techniques
- Inventories
- Long-Lived Assets
- Income Taxes
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## LOS Describe the roles of financial reporting and financial statement analysis

- **Financial reporting** provides information on a company's performance, its financial position as well as changes in its financial position.
  - Usually takes the form of interim financial statements, audited financial statements, management discussion and analysis, and additional disclosures as required by regulators.
- **Financial statement analysis** can be used to determine if a company is profitable, adequately capitalized, and able to meet its long and short-term obligations.
  - Allows analysts to form estimates or expectations of a company's future performance and financial position.

**LOS** Describe roles of the statement of financial position, statement of comprehensive income, statement of changes in equity, and statement of cash flows in evaluating a company's performance and financial position

## What's the purpose of financial statements?

1. **Statement of financial position** discloses resources that a company has control over (assets), obligations to its lenders & other creditors (liabilities) and the excess of the assets over the liabilities (Owner's equity).

$$\textit{Assets} = \textit{Liabilities} + \textit{Owner's Equity}$$

2. **Statement of comprehensive income** informs how much revenue a company has generated versus the expenses incurred to generate the profit or loss made over the specified period of time.

$$\textit{Net Income} = \textit{Revenue} + \textit{Other Income} - \textit{Expenses}$$

**LOS** Describe roles of the statement of financial position, statement of comprehensive income, statement of changes in equity, and statement of cash flows in evaluating a company's performance and financial position

3. **Statement of changes in equity** provides information on the increase or decrease in owners' investments in a company over time.
4. **Statement of cash flows** discloses a company's sources and uses of cash.
  - Cash flow information is classified into:
    - a) **Operating cash flows:** These are cash flows that arise from daily operations of a company and which determine net income.
    - b) **Cash flows from investing activities:** Acquisition and disposal of long-term assets.
    - c) **Cash flows from financing activities:** obtaining or repaying capital to be used in the company.

**LOS Describe the importance of financial statement notes and supplementary information—including disclosures of accounting policies, methods, and estimates—and management’s commentary**

## **Are financial statement notes important?**

- They provide important disclosures such as the basis of preparation, the reporting currency, and the accounting policies, methods, and estimates that have been used in preparing the financial statements.
- **Supplementary information** on financial risks, contingencies, operating segments’ performances, and related party transactions assist analysts in arriving at expectations on a company’s future performance.
- **The management’s commentary** provides information on a company’s results of operations, planned capital expenditure, and future outlook.

**LOS Describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls**

**There are two main objectives of audits of financial statements:**

1. To obtain reasonable assurance whether financial statements as a whole are free from material misstatement.
  - An independent auditor expresses an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
2. To report on the financial statements in accordance with the auditor's findings as required by the International auditing Standards.

**LOS Describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls**

**Types of audit reports:**

- a) Unqualified audit opinion:** Used to indicate that the financial statements are fairly presented in accordance with the accounting standards
- b) Qualified audit opinion:** Expressed when there is some amount of limitation to the scope of the audit or when there is an exception to the accounting standards
- c) Adverse audit opinion:** Expressed when an independent auditor has determined that the financial statements materially depart from accounting standards and are not fairly presented.
- d) Disclaimer of opinion:** Indicates that the auditor is unable to issue an audit opinion for one reason or another.

# LOS Describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls

## From Nike's 2017 Form 10-K:

### Report of Independent Registered Public Accounting Firm

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To the Board of Directors and Shareholders of NIKE, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of NIKE, Inc. and its subsidiaries as of May 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 2017 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of May 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 8. Our responsibility is to express opinions on these financial statements, on the financial statement schedule and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. Our audit of internal control over

financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/S/ PRICEWATERHOUSECOOPERS LLP  
Portland, Oregon  
July 20, 2017



# **LOS Describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls**

## **Importance of effective internal controls**

- Effective Internal Controls ensure a sound process for financial reporting in a company.
- The Sarbanes–Oxley Act of the United States requires public traded companies to demonstrate that their internal controls are effective.
  - The act requires management to take responsibility for the effectiveness of internal controls and have supporting evidence for the evaluation as well as provide a report on the internal controls.

# LOS Describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls

## From Nike's 2017 Form 10-K:

### ITEM 8. Financial Statements and Supplementary Data

Management of NIKE, Inc. is responsible for the information and representations contained in this report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and include certain amounts based on our best estimates and judgments. Other financial information in this report is consistent with these financial statements.

Our accounting systems include controls designed to reasonably assure assets are safeguarded from unauthorized use or disposition and provide for the preparation of financial statements in conformity with U.S. GAAP. These systems are supplemented by the selection and training of qualified financial personnel and an organizational structure providing for appropriate segregation of duties.

An internal Corporate Audit department reviews the results of its work with the Audit Committee of the Board of Directors, presently comprised of four outside, independent directors. The Audit Committee is responsible for the appointment of the independent registered public accounting firm and reviews, with the independent registered public accounting firm, management and the internal audit staff, the scope and the results of the annual audit, the effectiveness of the accounting control system and other matters relating to the financial affairs of NIKE as the Audit Committee deems appropriate. The independent registered public accounting firm and the internal auditors have full access to the Audit Committee, with and without the presence of management, to discuss any appropriate matters.

## LOs Identify and describe information sources that analysts use in financial statement analysis besides annual financial statements and supplementary information

### Besides financial statements, what else do analysts use?

- i. **Interim financial reports:** produced on a semiannual or quarterly basis, depending on regulatory requirements.
  - The reports are not audited and provide basic financial statements since the last audited period.
- ii. **Company websites,** press releases and in-conference calls held by a company with analysts and investors.
- iii. **Periodic earnings announcements:** a form of press release usually occurring well before a company files its formal financial statements.

## **LOS Describe the steps in the financial statement analysis framework**

- i. Articulating the purpose and context of the analysis:** Gives the approach, tools, data sources, and the format in which the final report will be made.
- ii. Input data collection**
- iii. Processing of data:** Using selected analytical tools
- iv. Analyzing the processed data:** Once processed, the output data from step 3 is interpreted to support a conclusion or recommendation.
- v. Developing and communicating conclusions and recommendations:** The analyst gives a feedback on the conclusion and recommendation derived from the analysis in an appropriate format.
- vi. Follow up:** Periodic reviews in order to determine if the initial conclusions and recommendations still hold true.

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