

# Interpretation of Financial Statements

**MODULE SPECIFICATION**

<b>1. Title</b>	<b>Interpretation of Financial Statements</b>	
<b>2. Start date</b>	2016	
<b>3. Level of module</b>	Level 5 FHEQ	
<b>4. Number of credits</b>	30 Credits	ECTS Value
		15
<b>5. Status</b>	<ul style="list-style-type: none"> <li>• Compulsory</li> </ul>	
<b>6. Recommended prior modules</b>	<ul style="list-style-type: none"> <li>• Financial Services: The Commercial Environment</li> <li>• Debt and Equity Investment and Valuation</li> </ul>	
<b>7. Programmes of study to which module contributes</b>	<ul style="list-style-type: none"> <li>• BSc (Hons) in Finance, Investment and Risk</li> </ul>	
<b>8. Campus / Partner</b>	N / A	
<b>9. Syllabus overview</b>	<p>This module builds on previous studies to provide a more detailed insight into evaluating the fundamentals of a company and evaluating its performance by analysing financial statements.</p> <p>Although financial statements contain a myriad of financial information they also provide a valuable insight into organisations risk appetite and strategic direction along with other information such as director remuneration, director shareholdings, mission statements and also an organisation’s commitment to sustainability. This module aims to synthesise all the information contained in a set of financial accounts to enable students to interpret company performance and form an investment decision.</p> <p>The module will start by summarising the key concepts in investing and valuation along with exploring the contents of financial reports and accounts. Students will evaluate the information contained in financial statements and how this information can be analysed to gain a detailed insight into the business. As part of this process students will also investigate the key users of financial statements and the need for companies to effectively communicate with them.</p> <p>Students will then move onto explore the fundamental concepts in the construction of the key financial statements. As part of this journey students investigate the composition of the Balance Sheet, Income Statement, Statement of Shareholders Equity and Cash Flow Statement. This will be done with a clear emphasis on the use of this information to make investment decisions using complex analysis and ratios.</p> <p>Having developed a good grounding in the composition of the financial statements, students will then move onto the detailed interpretation and analysis of the key financial statements. This will include both qualitative and quantitative analysis as well as learning how to benchmark performance against an organisation’s peers.</p> <p>Students will then develop a toolkit for forecasting financial statements and the integration of analyst forecasts into the establishment of forward looking analysis. These forecasts will then be developed into forming detailed valuation analysis such as prospective price earnings ratios, Price to book, net asset values and other such valuation techniques.</p> <p>The final part of the module will develop students awareness of the risks which companies face and how these can be identified through the detailed analysis of financial</p>	

statements. This will include establishing the quality of the financial statements produced by organisations and the long-term sustainability of their business models. Finally students will contrast academic models against concepts such as the margin of safety.

Overall this module will undertake a comprehensive investigation of how financial statements can be interpreted in order to make investment decisions and value a range of companies.

**10. Intended subject specific learning outcomes and, as appropriate, their relationship to programme learning outcomes**

On completion of this module, students will be able to:

- a) critically evaluate the contents, role(s) and purpose(s) of financial statements in meeting the information needs of stakeholder groups and helping form investment decisions;
- b) undertake complex quantitative and qualitative analysis of corporate performance using information sourced from financial statements.
- c) prepare financial forecasts and forward looking valuations for investment purposes, whilst evaluating the methodological limitations of such approaches; and
- d) utilise annual reports and accounts to evaluate the risks which organisations face and the impact this has on their valuation.

These intended module learning outcomes contribute to the following programme learning outcomes:

- BSc (Hons) in Finance, Investment and Risk: A2, A3 and A5.

**11. Intended generic learning outcomes and, as appropriate, their relationship to programme learning outcomes**

On completion of this module students, will be able to demonstrate achievement of the following generic learning outcomes:

1. Critical thinking skills.
2. Ability to learn through reflection on practice and experience.
3. Ability to work with complex material.
4. Ability to analyse problems and identify appropriate solutions.
5. Ability to work and study independently and utilise resources effectively.
6. Communication and report writing skills.

These intended generic learning outcomes contribute to the following programme learning outcomes:

- BSc (Hons) in Finance, Investment and Risk: B–D.

## 12. Learning and teaching

### A. Learning hours

For a module of study worth 30 credits, the total expected study hours are 300 (ie ten hours per credit). The contact hours will depend upon the student's mode of study.

### B. Tuition support

#### Distance learning

Distance learning allows students to study independently within a clear framework, but at a pace that suits their personal circumstances and study needs. Over their course of study (24 weeks), students will be provided with comprehensive learning materials, study guides and will be assigned to a subject specialist academic tutor to support their studies. Distance learners will have regular contact with The London Institute of Banking & Finance lecturer and further practical support is available from The London Institute of Banking & Finance Student Services.

#### Flexible learning

Flexible learning allows distance learners to opt for three face-to-face workshops of approximately six hours each, evenly spread at appointed dates in each session (24 weeks).

#### Full-time students

Full-time students will study on a semester basis supported by their module lecturer. The weekly timetable will be advised at the start of the programme.

### C. Learning materials and learning outcomes

The learning and teaching strategy is designed to ensure that the students achieve the learning outcomes by the end of the module. The learning and teaching methods include formal lecture and tutorial (full-time), online learning support from an appointed lecturer (distance / flexible learning), private study of text and other supporting materials, a formal assignment, informal exercises, (both individual and group-based), and pooling of experience and knowledge through class / forum and individual discussion. The assessment strategy is designed to achieve a balance between testing the student's skills of knowledge recall and understanding, and those of research and application.

### D. Reading

Students will be provided with a core text or equivalent, as detailed below, but will also be expected to read and research the recommended reading on the course website. Lecturers may also recommend additional reading throughout the module.

#### Essential reading

- Penman, S. (2012) *Financial statement analysis and security valuation*. 5th edn. McGraw-Hill.

#### Further reading

- Cohen, A., Pinto, J. E., Henry, E. and Robinson, T. R. (2010) *Equity asset valuation* (CFA Institute Investment Series). John Wiley & Sons Ltd.
- Fridson, M. and Alvarez, F. (2011) *Financial statement analysis: A practitioners guide*. Wiley Finance.

#### Journals

- Journal of Accounting Research
- International Review of Financial Analysis
- Financial Analysts Journal
- Journal of Finance

#### Websites

- International Financial Reporting Standards: [www.ifrs.org](http://www.ifrs.org)
- Financial Accounting Standards Board: [www.fasb.org](http://www.fasb.org)
- Annual Report Service: [www.annualreportsservice.com](http://www.annualreportsservice.com)
- Bloomberg: [www.bloomberg.com](http://www.bloomberg.com)

Each student will have access to the Virtual Learning Environment (VLE) and to *KnowledgeBank* learning resources (an electronic library service). A list of further readings relating to the syllabus and summative assignment can be found on the VLE.

It should be noted that due to the rapidly changing environment that encapsulates the financial services sector, the reading list above is indicative only. It is subject to review and update at the discretion of the module team. An up-to-date reading list is made available to students at the start of the module.

### 13. Assessment

Component	Duration / Length	Weighting
<b>Component 1</b> Summative assignment	4,000 words including quotations and in-text citations	50%
<b>Component 2</b> Examination	Two hours (plus 15 minutes' preparation time)	50%

#### Component 1: Summative assignment

This component will contribute 50% of the overall assessment and will be based upon the submission of one assignment (maximum 4,000 words including quotations and in-text citations) at the end of the course but prior to the examination. The assignment will focus on the analysis of financial statements and / or establishing valuations and financial forecasts with a view to forming an investment recommendation. Feedback will be provided on this component via detailed written feedback. The pass mark for this component is 40%.

#### Component 2: Examination

This component will contribute 50% of the overall assessment. A variety of question styles and approaches may be included in the examination. Questions might require responses that involve both discursive and quantitative elements. Students will typically be required to explore and compare specific aspects of an issue or to apply their technical abilities and understanding to, for example, solve a problem or provide a recommendation.

The question paper will be structured as follows:

- **Section A:** is a compulsory section, which carries 30 marks over a number of sub questions. It will assess core knowledge testing both quantitative and qualitative aspects of the module through the use of an un-seen case study.
- **Section B:** Two optional 10-mark questions from a choice of three.

The pass mark for this component is 40%.

Time allowed: 2 hours (plus 15 minutes' preparation time).

A scientific calculator may be used but it must not be programmable, nor have a wireless-communications capability, nor be capable of storing textual information. It must also not require a mains electricity supply. Calculators with any further functions are not allowed in the examination room.

At regular intervals during the course of study, students will be expected to submit formative assignments. These assignments will take the form of developmental learning activities towards the assessed assignment and unseen examination components and will be integrated within the study plan. They will provide students both with opportunities to reinforce their learning as they progress through the course of study and the opportunity to prepare for both the summative assignment and unseen examination.

Whilst these formative assignments will not contribute to the overall assessment, students are strongly advised to take the opportunity to complete them, as feedback will be provided from their lecturer on their progress through the course of study.

Students should be aware of the regulations governing the award of credit and the arrangements for compensation, condonement and the capping of marks. Students should also be aware of the regulations relating to the resitting of assessment components and / or the retaking of modules. This information is contained within The London Institute of Banking & Finance's General and Academic Regulations for Students sections 7, 8 and 9.

#### Module Grading

A student's module performance grade is determined by their overall weighted average percentage score in accordance with the following:

Pass	40%	-	59%
Merit	60%	-	69%
Distinction	70%	-	100%

## **14. Syllabus**

### **1. The role and purpose of financial statements and investment basics**

In this part of the syllabus students will explore the purpose of financial statements along with the contents of annual reports and accounts. The focus will be on developing skills and knowledge to enable students to evaluate the information to aid investment decision making. The main contents of this section will include:

- Who are the users of financial statements along with identifying other interested stakeholders.
- The key contents and publication details of annual reports and accounts.
- A detailed investigation into purpose and contents of the main financial statements, namely the Income Statement, Balance Sheet, Statement of Shareholders Equity and the Cash Flow Statement.
- How to interpret qualitative commentaries in sections such as the strategic review and chairman's statement.
- Investigating content in the 'Notes to the account' section of the annual reports and accounts.
- A broad overview of key reporting requirements.
- The importance of stock valuation.

## **2. Corporate Performance Analysis**

This section will focus on the analysis and interpretation of financial statements and the other components of the annual report and accounts. Detailed analysis will be undertaken to establish the current financial position of the company and its strategic direction. The main contents of this section will include:

- Developing a detailed understanding of the business and its strategic direction from the annual reports and accounts.
- Analysing the Statement of Shareholders Equity.
- Detailed evaluation of the Statement of Financial Position.
- Using a range of ratios and other analytical tools to analyse the Income Statement.
- Undertaking a comprehensive evaluation of Cash Flow Statement to aid investment decision making.
- Peer analysis and benchmarking.

## **3. Valuation analysis**

This section will develop the knowledge acquired from syllabus sections 1 and 2 and will investigate key valuation techniques. Students will also critically evaluate these techniques to ensure they develop a clear understanding of the assumptions and limitations. The main contents of this section will include:

- Price to book ratios.
- Price earning and prospective price earnings ratios.
- Developing sales and profit forecast models.
- Valuation models and their limitations.
- The role of financial analysts.
- Sector specific factors such as cyclicalities, capital investment requirements and long-term prospects.

## **4. Forecasting**

This section will develop students ability to produce financial forecasts using a variety of methods and then to evaluate the results in the context of current valuations. The main contents of this section will include:

- Macro-Economic Analysis.
- Growth sustainability.
- Stock screening analysis.
- Sensitivity analysis.
- Financial statement forecasting.
- Comparing forecasts to actual and evaluating variances.

## **5. Risk evaluation and valuation**

This section will evaluate the key risks which can be identified from the financial statements. The impact of these risks on valuation will then be analysed and additional valuation methodologies presented. This section will conclude by contrasting some of the academic valuation models and concepts to those used by leading analysts and fund managers. The main contents of this section will include:

- Key risks analysis and measures.
- Amended valuation techniques such as a value at risk valuation.
- Explore the concept of a margin of safety proposed by Benjamin Graham.
- Risk diversification.
- Investors required rate of return and associated models.