CFA LEVEL I STUDY SHEET · TOPIC 4

Financial Statement Analysis

Chartered Financial Analyst (CFA®) Program Level I exam

11–14% of the exam · 12 learning modules · 2027 curriculum

Financial Statement Analysis covers how companies report revenue, expenses, assets, liabilities, cash flows and taxes under IFRS and US GAAP, and how an analyst adjusts and interprets those numbers. Level I questions mix short calculations (EPS, cash flows, inventory, deferred tax, ratios) with recognition rules and the effect of a reporting choice on the statements and ratios.

You should be able to: You should be able to compute EPS, cash flows, inventory costs, impairments, deferred taxes and key ratios, and explain how a reporting choice changes the statements.

Every learning module: the key point and the trap

FSA.1 The analyst's framework and information sources

The analysis framework has six steps: set the purpose and context, collect data, process data, analyse and interpret, develop and communicate conclusions, follow up.

Trap: Management's commentary is generally not audited; only the financial statements and notes carry the audit opinion.

FSA.2 Revenue, expenses and earnings per share

IFRS 15 and ASC 606 use five steps: identify the contract, identify the performance obligations, set the price, allocate it, recognise revenue when or as each obligation is satisfied.

Trap: Diluted EPS can never be above basic EPS; a security that would raise it is antidilutive and excluded.

FSA.3 Reading the balance sheet

Purchased intangibles are recorded at cost; internally generated ones are mostly expensed; in an acquisition, identifiable intangibles are recorded at fair value.

Trap: Debt in solvency ratios means interest-bearing obligations, not all liabilities.

FSA.4 Building the cash flow statement

Cash flows are split into operating, investing and financing activities; the net change reconciles opening and closing cash on the balance sheet.

Trap: Signs on working capital changes are the common error: a rise in an asset is a deduction, a rise in a liability an addition.

FSA.5 Interpreting cash flows and free cash flow

Read the cash flow statement for the main sources and uses of cash, and whether operations fund investment and dividends over time.

Trap: Interest is added back to FCFF after tax, not in full.

FSA.6 Inventory measurement and cost flows

IFRS measures inventory at the lower of cost and net realisable value; write-downs are reversed if value recovers, but never above cost.

Trap: Under IFRS a write-down can be reversed, but only up to the original cost.

FSA.7 Intangibles, impairment and asset disposals

Purchased intangibles are recorded at cost; internally developed ones are expensed except IFRS development costs that meet the criteria; in a business combination identifiable intangibles are recorded at fair value.

Trap: Recoverable amount is the higher of the two measures, not the lower.

FSA.8 Leases, pensions and share-based pay

IFRS 16 lessees recognise a right-of-use asset and a lease liability for almost all leases, then depreciation and interest; short-term and low-value leases may be exempt.

Trap: Under IFRS 16 the principal part of each payment is a financing outflow, which raises operating cash flow relative to a US GAAP operating lease.

FSA.9 Deferred taxes and tax rates

Accounting profit is before tax under the reporting standards; taxable income is under tax rules; taxes payable are the tax on taxable income; income tax expense = taxes payable + change in DTL − change in DTA.

Trap: Apply the tax rate to the temporary difference, not to a year's depreciation charge.

FSA.10 Judging the quality of reported numbers

Reporting quality is about whether the statements are useful and faithful; earnings quality is about whether results are sustainable and adequate.

Trap: Conservative accounting is not high-quality accounting; it is biased in the other direction and can flatter later periods.

FSA.11 Ratios, DuPont and comparative analysis

Tools: ratios, common-size analysis (vertical and horizontal), trend analysis, graphs and comparison with peers; ratios depend on accounting choices and need context.

Trap: A rising ROE driven only by leverage carries more risk than one driven by margin or turnover.

FSA.12 Forecasting with pro forma models

A sales-based pro forma model forecasts revenue first, then costs, working capital and capital spending as ratios or drivers of revenue.

Trap: Starting from last year's number and adjusting too little is anchoring, not caution.

Key terms

Weighted average shares: Shares outstanding weighted by the fraction of the period each was outstanding.

Antidilutive: A potential share that would raise EPS if included, so it is left out of diluted EPS.

Recoverable amount: Under IFRS, the higher of fair value less costs of disposal and value in use.

Net realisable value: Estimated selling price less the costs to complete and sell.

LIFO reserve: The difference between inventory at FIFO and at LIFO (US GAAP).

Temporary difference: A gap between an item's carrying amount and its tax base that will reverse.

Free cash flow to the firm: Cash available to all capital providers after operating costs and investment.

Free cash flow to equity: Cash available to shareholders after investment and debt flows.

Right-of-use asset: A lessee's asset representing its right to use a leased item.

Channel stuffing: Pushing excess goods onto customers to pull revenue into the current period.

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