

MULTIPLE NEEDS AND SINGULAR OFFERINGS: FINANCIAL STATEMENT ANALYSIS AT A CROSSROADS

Kurt Jesswein, Sam Houston State University

ABSTRACT

Accounting is often referred to as “the language of business” because it is how financial information about business entities is reported to various parties both inside and outside the organization. Therefore, the analysis of financial statements that are derived from the accounting process can be of paramount importance to understanding the operations of business entities. Developing the skill set that is necessary to successfully analyze financial statements can provide a significant advantage to students entering the world of finance and accounting. Yet there does not appear to be a singular text or set of materials that covers the broad spectrum of analytical tools in sufficient depth to provide a singular source to help in developing that skill set. We examine the state of financial statement analysis as it is currently situated in the ivory-towered world of academia and look at where it could or should move in the future.

INTRODUCTION

Accounting is often referred to as “the language of business” because it is how financial information about business entities is reported to various parties both inside and outside the organization. The process of assessing and analyzing accounting information (i.e., the company’s financial statements) is of paramount importance to understanding the key components of a company’s profitability and the risks that it takes on to generate that profitability.

The methods and tools used to conduct analyses of financial statements are dictated by the specific needs of the individual or organization conducting the analysis. Although there can be many varied approaches to financial statement analysis, such analysis tends to fall into one of three groupings: those concerned with the overall well-being (i.e., strength and weaknesses) of the organization such as management within the organization, those concerned with the organization’s ability to repay debts such as external creditors of the organization, and those concerned with the ability of the company to generate additional value through its operations such as investors or potential investors in the organization.

The ability to analyze financial statements is a skill that can be taught to many but which will only be mastered by those with sufficient practical experience and those who possess the gift of being able to decipher the true meaning among the many mixed signals that accompany such an undertaking. While the “art” of financial statement analysis is something that cannot be readily taught, the “science” of financial statement analysis can be and is in both the academic and professional realms. In the professional realm various organizations provide learning resources specific to their fields. For example, one can train in credit analysis through

coursework offered by organizations such as the Risk Management Association (RMA) and American Bankers Associations (ABA). Or one can be trained in investment analysis through organizations such as the American Association of Individual Investors (AAII) or the CFA Institute.

In the academic realm many colleges and universities offer specific courses in financial statement analysis. Surprisingly, given the importance placed in the private sector on performing credit and investment analysis and in evaluating the operational efficiencies of organizations through analyzing financial statements, there have been few studies on how financial statement analysis is approached within academia and none in many years, the most recent being Koehn & Hallam, 1999. This paper reviews the “state” of financial statement analysis as it is currently being offered within the academic realm at U.S. colleges and universities with a critical look at where it may need to go in the future.

RESEARCH DIRECTION

Each of the primary textbook publishers offers textbooks covering various aspects of financial statement reporting and analysis. From Wiley, we have Drake & Fabozzi (2012), Fridson & Alvarez (2011), and Robinson, Henry, Pirie, Broihahn & Cope (2012). From Cengage we get Gibson (2013), Healy & Krishna (2013), and Wahlen, Baginski & Bradshaw (2011). McGraw-Hill offers Lundholm & Sloan (2013), Penman (2013), Revsine, Collins, Johnson & Mittlestaedt (2013), Subramanyam & Wild (2009), and White, Sondhi & Fried (2003). Prentice-Hall has Orniston & Fraser (2013). Lesser known publishers such as Cambridge Business Publisher also produce text such as Easton, McAnally, Sommers & Zhang (2013). Given the plethora of offerings each textbook has obvious advantages and disadvantages or strengths and weaknesses relative to the other texts that may be based on the unique perspective of the individual making the comparisons.

The casual review of these textbooks produces a list of key similarities and differences. These include a matter of perspective (accounting information producer versus accounting information user), the ease or level of difficulty, and the breadth and depth of coverage. Some Orniston and Fraser) are relatively light reads, while others are almost encyclopedic (White, Sondhi & Fried). Although many of them profess otherwise, most of the texts assume either a high level of familiarity with the underlying accounting methodology or at least assume that the readers can readily grasp the accounting topics. Many address a broad array of uses of financial statement information, from assessments of a company’s overall financial strengths and weaknesses to more focused examinations associated with investment or credit analysis. We argue that although credit analysis is addressed in each of the texts the topic is not covered with sufficient rigor to provide students with the tools to be successful in their careers. Not belittling the other purposes of financial statement analysis, it is in the credit area that many students will begin their careers. Particularly at the vast majority of schools that do not make up the upper tier of research institutions, graduates will more likely find themselves working in positions involving a great deal of credit analysis, whether it is in the financial services area or within the commercial world dealing of trade credit and related matters.

The full paper examines the topical and theoretical approaches that permeate the many textbooks in the field. It also examines a large sample of college curricula and associated course syllabi to see how the topic is being addressed by business schools in the 21st century. Suggested changes to the pedagogy of financial statement analysis are made in the hope of making the courses academically rigorous yet also addressing the practical importance of the subject matter.

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