Mail: banishagupta2099@gmail.com
Website: https://iibf.info/iibfLearning

ANALYSIS OF FINANCIAL STATEMENTS

📌 Why Financial Statements Matter in Banking?

Whenever a bank considers a **loan proposal**, apart from **integrity 🏅 and due diligence** 🔍 on the borrower, it has a **keen interest** in knowing the **financial health** 💰 of the borrower. The **financial statements (FS)** 📝 act as the **backbone** 🏗 of any credit proposal.

☑ Key Benefits of Financial Statements for Banks & Lenders

🏦 BankingPerspective	🔍 Purpose
📈 **Assessing Financial Health**	Understanding the borrower's liquidity, solvency & profitability
📊 **Risk Evaluation**	Helps determine whether lending is safe or risky
📅 **Loan Repayment Capacity**	Checks the cash flow & ability to pay EMIs
📉 **Trend Analysis**	Compares past & present financial performance

🏦 BankingPerspective	🔍 Purpose
📌 Compliance Check	Ensures the borrower adheres to legal norms

📌 **Ratio analysis** 📊 helps in understanding whether a business has improved or deteriorated **over time** ⏳ and allows comparison with industry peers.

🏦 Challenges in Financial Statement Analysis

Understanding financial indicators isn't easy! 🤯

It requires:

☑ **Deep Business Knowledge** – To interpret reports correctly 📜

☑ **Cross-Verification** – To ensure the accuracy of reported numbers 🧐

☑ **Compliance Check** – To prevent frauds & misrepresentation 🕵

📌 Key Parameters Checked by Banks

🔎 Parameter	📌 Purpose
💵 Liquidity	Can the business pay short-term debts?
📊 Solvency	Will the company survive long-term?

🔎 Parameter	📌 Purpose
💰 **Profitability**	Is the business making enough profit?
🏗 **Viability**	Can it generate future income?
⚠️ **Risk Analysis**	How risky is the lending decision?

📜 Types of Financial Statements (As per Companies Act, 2013) 🏛

According to **Section 2(40)** of the **Companies Act, 2013**, financial statements include:

📄 **Financial Statement**	📌 **Purpose**
🏦 **Balance Sheet**	Shows assets, liabilities & net worth
📈 **Profit & Loss Account**	Shows income vs. expenses & profit/loss
💸 **Cash Flow Statement**	Tracks cash inflows & outflows
📊 **Statement of Changes in Equity**	Shows changes in shareholders' equity
📑 **Explanatory Notes**	Additional financial disclosures

📌 **Exceptions:** 🚨 **One Person Company (OPC), Small Company & Dormant Company** may not require a **cash flow statement**.

💡 Why Do Banks Still Analyze Financial Statements After Audit?

📌 The **management** prepares financial statements, while auditors only **opine on their accuracy**.

📌 Banks must **verify the genuineness** ✅ before fresh sanctioning, renewal, or reviewing accounts.

📌 **Cross-verification with MCA website** 🌐 ensures authenticity.

🔍 Genuineness Checks Include:

✅ **Verification**	🔍 **Process**
🏢 **Audited Financials vs. MCA Website**	Compare uploaded financials with the Ministry of Corporate Affairs (MCA) records.
📩 **Independent Confirmation**	Obtain confirmation from CA firms via email/fax.
🆔 **UDIN (Unique Document Identification Number)**	ICAI ensures documents are verified.
🔄 **Cross-checking with Statutory Returns**	Match P&L & Balance Sheet with regulatory filings.

📌 Key Reports in Financial Statements Analysis

📌 1. Directors' Report 📜

👉 A crucial document that includes:

✔ Financial results & performance summary 📈

✔ Future plans & upcoming investments 🚀

✔ Dividend declared 💸

✔ Compliance with accounting standards 📄

✔ Disclosure of risks & internal controls ⚠️

📌 2. Auditors' Report 🕵️

👉 The **auditor's opinion** on financial statements, focusing on:

✔ **True & Fair View** – Are the numbers accurate?

✔ **Fraud Safeguards** 🚨 – Any red flags?

✔ **Material Misstatements** ❌ – Any hidden liabilities?

📜 Basic Concepts & Standards in Financial Statements 🏦

📌 9.4 Basic Concepts Used in the Preparation of Financial Statements

Financial statements are prepared following key **accounting principles** 📚 to ensure accuracy, transparency, and consistency in financial reporting.

🔢 Important Accounting Concepts

🔢 Concept	📌 Explanation	🌍 Real-Life Example
🏦 **Accrual Concept**	Revenue & expenses are recorded when **earned/incurred**, not when cash is received/paid.	A company records revenue when goods are **delivered**, even if the customer pays after 30 days.
🔁 **Consistency Concept**	The same accounting methods should be followed across periods.	If a company uses **FIFO for inventory valuation**, it should continue in the next year.
🏗 **Going Concern Concept**	Assumes that the business will **continue operations** in the foreseeable future.	A factory **undergoing expansion** follows this concept in its statements.
⚖️ **Prudence Concept**	Cautious approach to recognizing **profits & losses**.	A company **writes off doubtful debts** even if collection is possible.

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🔢 Concept	📌 Explanation	🌍 Real-Life Example
🔄 Separate Entity Concept	Business & owner are **separate entities** in accounting.	The owner's **personal expenses** are not included in business financials.
💰 Money Measurement Concept	Only transactions **measured in money** are recorded.	The manager **reputation** of a company is not recorded in financials.
💱 Stable Monetary Unit Concept	The currency used for accounting must remain **consistent**.	A company in India reports **all transactions in INR**, not switching to USD.
🏷️ Cost Concept	Assets are recorded at their **purchase cost**, not market value.	A factory purchased for ₹50 crore is recorded at that cost, even if its value rises to ₹60 crore.
➕➖ Dual Aspect Concept	Every transaction affects **two accounts** (Debit = Credit).	When a loan is taken, **Cash (Asset) increases**, and **Loan Payable (Liability) increases**.
📅 Accounting Period Concept	Financial transactions are recorded in **fixed time frames**.	A company's **financial year is April-March** for annual reporting.

🔢 **Concept**	📌 **Explanation**	🌍 **Real-Life Example**
✅ **Realization Concept**	Revenue is recorded **only when goods/services are delivered**.	A contractor records **revenue after completing construction**, not at contract signing.
🔄 **Matching Concept**	Expenses must be recorded **in the same period** as related revenue.	Depreciation expense is allocated **yearly over the asset's life**.
🔍 **Full Disclosure Concept**	All relevant financial details must be disclosed.	A company discloses **pending legal cases** in the notes to accounts.

📌 9.5 Accounting Standards (AS) 📖

📌 What are Accounting Standards?

📄 Accounting Standards (AS) are **guidelines and rules** set for the **recognition, measurement, classification, and disclosure** of financial transactions.

📃 Key Features of Accounting Standards

✅ Ensure **uniformity** in financial reporting.

✅ Reduce **accounting alternatives** to improve **comparability**.

✅ Provide **reliable information** for decision-making.

✅ Facilitate **global integration** of financial statements.

🏢 Who Issues Accounting Standards in India?

📌 The **Institute of Chartered Accountants of India (ICAI)** formed the **Accounting Standards Board (ASB) in 1977** to:

📍 Consider the **business environment** & **legal framework**.

📍 Formulate & synchronize **diverse accounting policies**.

📍 Integrate **International Financial Reporting Standards (IFRS)** with Indian laws.

🌍 International Financial Reporting Standards (IFRS) 🌏

📌 IFRS is a set of **global accounting standards** developed by the **International Accounting Standards Board (IASB)**. It is used worldwide for consistent financial reporting.

📌 India's Version of IFRS: Ind AS

India adopted **IFRS-based accounting standards** called **Indian Accounting Standards (Ind AS)**.

📜 **Ind AS Applicability Mandatory for:**

- **All listed companies** 📈
- **Unlisted companies** with a **net worth of ₹250 crore+**
- **Holding, subsidiary, associate, and joint venture companies**

🏭 **Case Study: Satyam Scam (2009) – Lack of Accounting Standards Compliance**

Satyam Computers, once a top IT company, **manipulated its financial statements** to show higher profits. The company **inflated revenue & assets**, leading to **investor losses of over $2 billion**.

🚨 **How was it caught?**

🔍 **Auditors & regulators cross-verified financials** using AS principles.

📊 Inconsistencies in **cash flow statements & profit margins** exposed the fraud.

⚖️ The **CEO confessed**, leading to **legal actions & corporate reforms** in India.

◇ **Lesson:** Compliance with **Accounting Standards (AS) & IFRS** ensures **transparency & investor trust**!

📜 9.6 Legal Position Regarding Financial Statements 🏦

📌 (a) Format of Financial Statements

📄 The **Companies Act, 2013** prescribes **specific formats** for the **Balance Sheet & Profit & Loss Account**, except for :

✔ **Insurance Companies** 🏢

✔ **Banking Companies** 🏦

✔ **Electricity Companies** ⚡

✔ **Companies governed by sector-specific laws** 📜

📜 Key Legal Provisions for Financial Statements

✅ Financial statements **must give a true & fair view** of the company's state of affairs.

✅ **Compliance with Accounting Standards (AS)** 📄 under **Section 133** is mandatory.

✅ **Schedule III** defines different formats for different company classes.

✅ **Exceptions** 🚨 – Banking, Insurance & Electricity companies follow their own prescribed formats.

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✅ If statements **deviate from AS**, companies **must disclose the deviation, reasons, and financial effects**.

📊 Format of the Balance Sheet

PART—I
Form of Balance Sheet
(Name of Company.... Balance Sheet as at....)

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
1	2	3	4
I. EQUITY AND LIABILITIES			
(1) Share holder's Funds			
(a) Share capital			
(b) Reserves and surplus			
(c) Money received against share warrants			
(2) Share application money pending allotment			
(3) Non-Current Liabilities			
(a) Long-term borrowings			
(b) Deferred tax Liabilities (Net)			
(c) Other Long-term Liabilities			
(d) Long-term provisions			
(4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade Payables			
(c) Other Current Liabilities			
(d) Short-term Provisions			
Total			
II. ASSETS			
(1) Non-current Assets			
(a) Fixed Assets			
(i) Tangible Assets			
(ii) Intangible Assets			
(iii) Capital Work-in-progress			
(iv) Intangible Assets under Development			
(b) Non-current Investments			
(c) Deferred Tax Assets (Net)			
(d) Long-term Loan and Advances			
(e) Other Non-Current Assets			
(2) Current Assets			
(a) Current Investments			
(b) Inventories			
(c) Trade Receivables			
(d) Cash and Cash Equivalents			
(e) Short-term Loans and Advances			
(f) Other-current Assets			
Total			

Format of the Profit & Loss Statement

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
	1	2	3	4
I	Revenue from operations		xxx	xxx
II	Other income		xxx	xxx
	Changes in inventories of finished goods work-in-progress and Stock-in-Trade Employee benefits expense Finance costs Depreciation and amortization expense Other expenses Total expenses		Xxx xxx	Xxx Xxx
V	Profit before exceptional and extraordinary items and tax (III - IV)		xxx	xxx
VI	Exceptional items		xxx	xxx
VII	Profit before extraordinary items and tax (V - VI)		xxx	xxx
VIII	Extraordinary items		xxx	xxx
IX	Profit before tax (VII- VIII)		xxx	xxx
X	Tax expense: (1) Current tax (2) Deferred tax		 Xxx Xxx	 Xxx Xxx
XI	Profit (Loss) for the period from continuing operations (VII-VIII)		xxx	xxx
XII	Profit/(loss) from discontinuing operations		xxx	xxx
XIII	Tax expense of discontinuing operations		xxx	xxx
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)		xxx	xxx
XV	Profit (Loss) for the period (XI + XIV)		xxx	xxx
XVI	Earnings per equity share: (1) Basic (2) Diluted		 Xxx xxx	 Xxx xxx

📌 (b) Accounting Period 📅

📌 **As per the Income Tax Act & Companies Act, 2013:**

✔ **April 1st – March 31st** is the financial year.

✔ If a company is **incorporated after January 1st**, its first financial year **ends on March 31st of the next year**.

✔ **Uniform Accounting Period** ensures **compliance & consistency** across companies.

📌 (c) Financial Statements for Incomplete Projects / No Activity 🚧

📌 **Even if no business activity occurs, companies must prepare financial statements!**

✅ **Mandatory even if:**

✔ **No transactions occurred** 📉

✔ The project is **under development** 🏗

✔ The company is **dormant but registered** 📜

🚀 **Why?**

✔ Ensures **legal compliance** 📑

✔ Provides **investor & lender transparency** 👀

✔ Maintains **financial records for future use** 📋

📌 💥 Real-Life Example: Importance of Financial Statement Formats

🏭 Case Study: Vijay Mallya & Kingfisher Airlines 🏦

What Happened?

✔ Kingfisher Airlines' **balance sheet showed huge losses** 📉, but the company continued taking loans!

✔ **Auditors reported discrepancies** in financial statements.

✔ Banks **failed to verify financial reports**, leading to **₹9,000 crore bad loans** 🚨.

✔ **Strict financial regulations & audits** could have **prevented fraud!**

📜 9.7 Balance Sheet 🏦

📌 What is a Balance Sheet?

📊 The **Balance Sheet** is a **financial statement** that shows the **assets (what a company owns) and liabilities (what a company owes) at a specific point in time**.

🔹 It acts as a **snapshot** 📸 of a company's **financial position** on a given date.

🔹 Unlike the **Profit & Loss Statement**, which covers a **period**, the Balance Sheet represents **one specific moment in time** ⏳ .

📌 Key Features:

✅ Usually prepared **at the end of an accounting period** (March 31st for Indian companies).

✅ Indicates the **specific date** it is prepared for.

✅ Helps investors, creditors, and regulators understand the **financial health** of a business.

📌 General Instructions for Preparing a Balance Sheet 📑

◇ Classification of Assets & Liabilities

🏦 **Type**	✅ **Criteria**
🏢 **Current Assets**	Expected to be converted into cash **within 12 months**
🏗 **Non-Current Assets**	Held **for long-term use** (beyond 12 months)
💰 **Current Liabilities**	Due **within 12 months**

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🏦 **Type**	✅ **Criteria**
⚖️ **Non-Current Liabilities**	Not due for **at least 12 months**

📃 How to Classify Assets?

☑️ **Current Assets**:

✔️ Expected to be realized within **12 months** 📅

✔️ Includes **cash, inventory, trade receivables, and short-term loans**

☑️ **Non-Current Assets**:

✔️ Held for **long-term use** beyond **12 months**

✔️ Includes **property, plant & equipment, long-term investments, patents, trademarks**

📌 **Example of Asset Classification**	🏢 **Current Asset**	🏗️ **Non-Current Asset**
Cash in Hand 💵	✅	❌
Machinery 🏭	❌	✅
Inventory 📦	✅	❌
Trademark 🏷️	❌	✅

📃 How to Classify Liabilities?

☑ **Current Liabilities**:

✔ Due within **12 months** 📅

✔ Includes **trade payables, short-term borrowings, taxes payable**

☑ **Non-Current Liabilities:**

✔ Payable **after 12 months**

✔ Includes **long-term borrowings, deferred tax liabilities**

📌 **Example of Liability Classification**	💰 **Current Liability**	⚖️ **Non-Current Liability**
Bank Loan (Repayable in 5 years) 🏦	❌	✅
Trade Payables 📄	✅	❌
Employee Benefits (Long-Term) 👥	❌	✅

📌 H. Short-Term Provisions 📝

🔹 These are **liabilities expected to be settled within a year**.

☑ **Classification:**

✔ (a) **Provision for Employee Benefits** 👥 – Example: Bonus, Leave Encashment

✔ (b) **Other Provisions** 📜 – Example: Tax Provisions, Warranty Claims

📌 **Example:** A company sets aside ₹5 lakh for employee **annual bonuses**, which is recorded under **short-term provisions**.

ANALYSIS OF FINANCIAL STATEMENTS

📌 I. Tangible Assets 🏗

Tangible assets are **physical assets** that a company owns and uses for business operations.

✅ **Classification:**

✔ (a) **Land** 🌍

✔ (b) **Buildings** 🏢

✔ (c) **Plant & Equipment** 🏭

✔ (d) **Furniture & Fixtures** 🛋

✔ (e) **Vehicles** 🚗

✔ (f) **Office Equipment** 🖥

📌 J. Intangible Assets 💡

Intangible assets are **non-physical assets** with economic value.

✅ **Classification:**

✔ (a) **Goodwill** 🤝

✔ (b) **Brands/Trademarks™**

✔ (c) **Computer Software** 💻

✔ (d) **Mining Rights** ⛏️

✔ (e) **Copyrights & Patents** 📚

✔ (f) **Recipes, Designs, & Prototypes** 🧪

✔ (g) **Licenses & Franchise Agreements** 📄

📌 K. Non-Current Investments 📊

Long-term investments held for generating future returns.

✅ **Classification:**

✔ **Trade Investments** 📈 (Investments in subsidiary/associate companies)

✔ **Other Investments** 💵 (Government securities, Bonds, Shares)

📌 L. Long-Term Loans & Advances 🏦

These are **amounts given by a company** that are **expected to be recovered beyond 12 months**.

✅ **Classification:**

✔️ (a) **Capital Advances** 🏗️ (For property or equipment purchase)

✔️ (b) **Loans & Advances to Related Parties** 🤝

✔️ (c) **Other Long-Term Advances** 💰

✅ **Sub-classification:**

✔️ **Secured, Considered Good** ✅

✔️ **Unsecured, Considered Good** 💼

✔️ **Doubtful** ❌

📌 M. Other Non-Current Assets 🏢

✅ **Classification:**

✔️ (a) **Security Deposits** 💳 (Example: Rent deposits)

✔️ (b) **Long-Term Trade Receivables** 📜

✔️ (c) **Other Assets (Specify)** 🏦

📌 N. Current Investments 💹

Short-term investments expected to be **converted into cash within a year**.

📌 **Example:** A company **buys short-term mutual funds** to park excess cash.

📌 O. Inventories 📦

✅ **Classification:**

✔ (a) **Raw Materials** 🏭

✔ (b) **Work-in-Progress** 🔄

✔ (c) **Finished Goods** 📦

✔ (d) **Stock-in-Trade** 🏬

✔ (e) **Stores & Spares** ⚙️

✔ (f) **Loose Tools** 🔧

📌 P. Trade Receivables 💳

Amounts due from customers for goods or services provided.

📌 **Example:** A company sells goods worth ₹10 lakh to a client **on credit**, recorded as **Trade Receivables**.

📌 Q. Cash & Cash Equivalents 💵

✅ **Classification:**

✔ (a) **Bank Balances** 🏦

✔ (b) **Cheques & Drafts on Hand** 📝

✔ (c) **Cash on Hand** 💰

📌 R. Short-Term Loans & Advances 💳

Short-term loans & advances refer to **amounts given by a company** that are expected to be **recovered within 12 months**.

✅ **Classification:**

✔ **(a) Loans & Advances to Related Parties** 🤝 – Example: Loans to subsidiaries or directors

✔ **(b) Other Short-Term Advances** 💰 – Example: Advances for business expenses

✅ **Sub-classification:**

✔ **Secured, Considered Good** ✅

✔ **Unsecured, Considered Good** 💼

✔ **Doubtful** ❌

📌 S. Other Current Assets 🔍

📜 This category includes **current assets that do not fit into other standard classifications**.

📌 **Examples:**

✔ **Prepaid Expenses** 📅 – Rent or insurance paid in advance

✔ **Accrued Income** 💵 – Interest earned but not yet received

✔ **Advance Tax Payments** ⚖ – Tax paid in advance but not yet adjusted

📌 T. Contingent Liabilities & Commitments ⚠

These represent **potential liabilities & commitments** that may **arise in the future** but are **not yet recorded in financial statements**.

🔹 **(i) Contingent Liabilities** – Possible financial obligations in certain situations

🔍 Contingent Liability Type	📌 Description
Claims Not Acknowledged as Debt ⚖	Legal claims pending against the company
Guarantees 🏦	Bank guarantees given for subsidiaries or third parties

🔷 (ii) Commitments – Future financial obligations

📍 Commitment Type	📌 Description
Unexecuted Contracts 📄	Contracts yet to be completed
Uncalled Liability on Shares 📈	Outstanding payments on partly paid shares
Other Financial Commitments 📊	Pending investments, lease agreements

📌 U. Dividend Disclosure 💰

✔ Companies must **disclose the amount of dividends proposed** to be distributed to:

- **Equity shareholders** 📈
- **Preference shareholders** 💼

✔ **Arrears of fixed cumulative dividends** on preference shares must also be disclosed separately.

📜 9.8 Profit & Loss Account (Statement of Income & Expenditure) 📊

📌 What is a Profit & Loss (P&L) Account?

📄 The **Profit & Loss Account (P&L)** is a **financial statement** that summarizes a company's **income and expenses** for a specific **accounting period** (e.g., April 1 – March 31).

- 🔹 It shows **whether a business made a profit or a loss** 💰 📉.
- 🔹 Every P&L statement **must specify the period** for which it is prepared.
- 🔹 It helps in **assessing financial performance**, **tax calculations**, and **business decision-making**.

📌 General Instructions for Preparing a P&L Statement

1️⃣ Revenue (Income) 💰

Revenue represents the **income generated from business operations**.

◇ **(A) For Non-Finance Companies** 🏭

✔️ Revenue from operations must be disclosed **separately** as:

✅ **(a) Sale of Products** 🏷️ – Example: A manufacturing company's revenue from selling goods.

✅ **(b) Sale of Services** 📄 – Example: A consulting firm's revenue from providing services.

✅ **(c) Other Operating Revenues** 💼 – Example: Rental income from business properties.

🔸 (B) For Finance Companies 🏦

Finance companies have different revenue components:

✅ **(a) Interest Income** 💵 – Revenue from lending activities (e.g., banks, NBFCs).

✅ **(b) Other Financial Services** 📊 – Investment advisory fees, brokerage, or commission income.

📌 2️ Finance Costs 💳

Finance costs include **expenses related to borrowing money** or financial transactions.

✅ **(a) Interest Expense** 💰 – Interest paid on loans, bonds, or overdrafts.

✅ **(b) Other Borrowing Costs** 💼 – Loan processing fees, commitment charges.

✅ **(c) Foreign Exchange Gain/Loss** 💱 – Net impact of currency transactions on loans.

📌 3️⃣ Other Income 🏦

Income **not directly related** to the company's core business activities.

✅ **(a) Interest Income 💵** – Earned from bank deposits or lending (for non-finance companies).

✅ **(b) Dividend Income 📈** – Received from investments in shares.

✅ **(c) Net Gain/Loss on Sale of Investments 📊** – Profit or loss from selling stocks, bonds, or assets.

✅ **(d) Other Non-Operating Income 🏢** – Example: Rental income from company-owned buildings.

📌 4️⃣ Additional Information (Notes to Accounts) 📜

Companies **must disclose additional financial details** in the **Notes to Accounts**, such as:

✅ **Breakdown of major expenses** (e.g., advertising, legal fees).

✅ **Breakdown of major income sources** (e.g., government grants, investment income).

✅ **Details of one-time or exceptional items** (e.g., litigation settlements).

📃 9.9 Cash Flow Statement (CFS) 💰

📌 What is a Cash Flow Statement?

📊 The **Cash Flow Statement (CFS)** tracks the **movement of cash & cash equivalents** within a business over a **specific period**. It shows how a company's **cash balance changes** from the **beginning to the end of the period**.

🔹 CFS provides insights into a company's **financial strength, liquidity, and ability to generate cash**.

🔹 It helps assess whether a business can **meet short-term obligations** and finance future growth.

📌 Key Insights from CFS

✅ Reveals **profitability vs. actual cash flow** 📈

✅ Shows how a company **manages its cash resources** 💰

✅ Helps in understanding **financial sustainability** 🔍

📌 Components of Cash Flow Statement 🏦

A Cash Flow Statement is divided into **three sections**:

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1 Operating Cash Flow (OCF) 💼

✔️ **Cash generated from core business operations**.

✔️ Should be **positive** for a business to remain **solvent**.

2 Investing Cash Flow (ICF) 📉

✔️ **Cash used for acquiring/selling assets** or **long-term investments**.

✔️ **Does NOT** include debt or capital financing.

3 Financing Cash Flow (FCF) 📊

✔️ **Cash transactions related to funding, capital, & debt**.

✔️ Shows how a company **raises money** through **loans or equity** and how much is paid back.

📌 **Example:** A company **issues new shares** (cash inflow) or **pays dividends** (cash outflow).

📌 Uses of the Cash Flow Statement 📋

✅ Understanding Business Liquidity 💳 **– Evaluates if a company has enough cash to pay liabilities.**

✅ Operational Efficiency 📊 **– Assesses how well cash is managed compared to past years.**

✅ Assessing Financial Stability ⚖️ **– Helps banks/lenders check if the business can repay loans.**

📌 Methods of Preparing a Cash Flow Statement

1 Direct Method 📊 (Preferred Globally)

✔ Converts **each item** in the **income statement** into **cash receipts or payments**.

📌 **Example:**

- Revenue from Sales **₹50 crore** → Cash Received **₹48 crore**
- Purchases of Materials **₹30 crore** → Cash Paid **₹28 crore**

2 Indirect Method 📈 (Used in India IN)

✔ Starts with **Profit Before Tax (PBT)** from the **Profit & Loss Statement**.

✔ Adjusts for **non-cash items & working capital changes**.

📌 Steps to Calculate Indirect Cash Flow

1 **Begin with Profit Before Tax (PBT)**

2 **Add Back Non-Cash Expenses** (Depreciation, Amortization)

3 **Subtract Non-Operating Income** (Investment gains, dividends)

4 **Adjust for Working Capital Changes:**

- **Deduct Increase in Current Assets** (excluding cash)
- **Add Increase in Current Liabilities**

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5 **Deduct Taxes Paid**

6 **Arrive at Net Cash Flow from Operating Activities**

📌 **Example:** If a company reports ₹10 crore profit but has **₹3 crore depreciation and ₹2 crore increase in inventory**, the adjusted cash flow will be:

₹10 crore + ₹3 crore - ₹2 crore = ₹11 crore cash inflow.

FORMAT FOR PREPARATION OF CASH FLOW STATEMENT

Particulars	Amount	Amount
(A) Cash Flow from operating activities		
Net Profit Before Interest and Tax		
Adjustment for		
Depreciation		
Good will written off		
Loss on sale fixed assets		
Preliminary expense		
Operating profit working capital changes		
Increase in current assets		
Decrease in current assets		
Increase in current liabilities		
Decrease in current liabilities		
Cash generated from Operating activities		
Cash used in operating activities		
(B)Cash Flow from investing activities		
Purchase of fixed assets		
Sale or disposal of fixed assets		
Purchase of securities (in case of non-financial companies)		

Sale of securities (in case of non-financial companies) Loans and advances made to third parties Repayments received from loans and advances made to third parties. **Cash generated from Investing activities** **Cash used in investing activities** **(C) Cash Flow from Financing activities** Issue of shares Issue of debentures, bonds Loan taken from bank Redemption of debentures Buy-back of equity shares Repayment of borrowings Dividends on both equity and preference shares Interest on debentures and loans **Cash generated from Financing activities** **Cash used in Financing activities** **Net Increase in Cash and cash equivalents** **Opening Balance Cash and cash equivalents** **Closing Balance Cash and cash equivalents**		

🏭 Case Study: Jet Airways – Bankruptcy Due to Poor Cash Flow

🚨

📉 What Happened?

Mail: banishagupta2099@gmail.com
Website: https://iibf.info/iibfLearning

✔ Jet Airways had **high revenue & profits**, but **poor cash flow**.

✔ The company **failed to generate enough cash** to cover loan repayments & salaries.

✔ Over ₹8,500 crore in debt caused **bankruptcy & shutdown in 2019**.

✔ Investors & creditors suffered **huge financial losses** 💰 .

📌 **Lesson:** A company can be **profitable on paper but still fail** due to **poor cash flow management**! ✅ 📊

📃 9.10 Projected Financial Statements & Analysis of Financial Statements by Bankers 🏦

📌 9.10 Projected Financial Statements 📊

📑 **Actual financial statements** provide insights into a company's past performance, but **for bank credit assessment**, it is necessary to **anticipate future financial conditions**.

🔸 **Projected Financial Statements (PFS)** help:

✔ Assess the **working capital needs** of a business 💰

✔ Estimate the **future financial position** 📈

✔ Determine the **loan repayment capacity** of a borrower 🏦

◇ Why Projected Financial Statements are Important?

✅ **For Working Capital Needs** 📊 – Past financials are insufficient; future projections are necessary.

✅ **For New Businesses** 🚀 – No historical data exists, so projections are based on industry trends.

✅ **For Loan Disbursement & Repayment** 📜 – Helps banks structure loans based on expected cash flows.

✅ **For Expansion Plans** 🏗 – Ensures a project is **financially viable before funding is approved**.

📌 9.11 Purpose of Financial Statement Analysis by Bankers

📊 **Financial statement analysis** helps banks assess a borrower's **creditworthiness & financial stability** before approving a loan.
Different stakeholders analyze financial statements for **different purposes**:

📌 **Stakeholder**	🔍 **Focus Area**
📈 **Stock Market Investors**	Earnings Per Share (EPS) & profitability
🏛 **Tax Authorities**	Compliance & turnover details

📌 Stakeholder	🔍 Focus Area
📜 Government Regulators	Accounting policies & financial transparency
🏦 Bankers & Lenders	Credit risk, debt repayment ability & fund utilization

📌 Key Areas of Financial Analysis by Banks

1 Assessment of Performance & Financial Position 📊

✅ **Analyzes business growth trends & profitability** 📈

✅ **Evaluates leverage (Debt/Equity ratio) & financial health** 💰

📌 **Example:** A business with **consistent profits & low debt** is a **low-risk borrower**.

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2 Projection of Future Performance 🚀

✅ Past performance helps **forecast future earnings**.

✅ Evaluates **growth prospects & stability**.

3 Detecting Financial Red Flags 🚨

✅ **Identifies financial deterioration before it becomes a problem**.

✅ **Red flag indicators** include:

- Continuous **decline in profitability** 📉

- High **loan defaults** or **overdue payments** ⚠️
- Poor **working capital management** 🏦

4 Assessing Credit Requirements 🏦

✅ Helps banks **determine the right loan amount**.

✅ Prevents **over-financing (excess funds) or under-financing (insufficient funds)**.

5 Examining Funds Flow 💵

✅ Ensures that **borrowed funds are used for their intended purpose**.

✅ Detects **misuse of short-term funds for long-term investments**.

6 Cross-Checking Financial Statements ☑️

✅ **Verifies submitted financials with the actual balance sheet**.

✅ **Ensures no manipulation of stock, receivables, or payables**.

📌 Limitations of Financial Analysis 🚨

Though financial analysis **helps banks assess creditworthiness**, it has **certain limitations**:

⚠️ Limitation	🔍 Issue
📈 **Doesn't Consider Inflation**	Prices change, but past data is used for evaluation.
🏢 **Window Dressing of Accounts**	Companies may manipulate financials to appear stronger.
📜 **Accounting Policy Changes**	Different firms use different accounting rules.
⏳ **Historical Data-Based**	Focuses on past data, which may not reflect future trends.
💰 **Only Monetary Information**	Non-financial factors (e.g., brand reputation) are ignored.

📃 9.12 Rearranging Financial Statements for Analysis 🏦

📌 Why Rearranging Financial Statements is Important?

It refers to the process of **reorganizing or reformatting the information in financial statements** to make it more useful for analysis, decision-making, or specific reporting needs.

📊 To **assess a borrower's creditworthiness**, banks **rearrange financial statements**. This helps in **identifying trends, risks, and financial viability**.

📌 **Key Reasons for Rearranging Financial Statements:**

✔ **Evaluates financial stability** 📉 📈

✔ **Identifies risks & red flags** 🚨

✔ **Assesses working capital needs** 💰

✔ **Determines loan repayment ability** 🏦

✔ **Ensures correct fund utilization** ✅