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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.

📌 2️⃣ 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**.

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🔹 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**:

1 Operating Cash Flow (OCF) 💼

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

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

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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**

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?

✔ 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
📜 Government Regulators	Accounting policies & financial transparency
🏦 Bankers & Lenders	Credit risk, debt repayment ability & fund utilization

📌 Key Areas of Financial Analysis by Banksz

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**.

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** ✅