

## 7. Understanding Financial Statements

R. Prasanth Kumar

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### UNDERSTANDING FINANCIAL STATEMENTS

#### Introduction

Sometimes, finance is not about money. Rather to create curiosity to answer the following questions:

- How it will take a customer to buy your product?
- How much cash flow you need reach milestone?
- How much to be spent on marketing to generate revenues?
- How to manage day today business?
- How is your firm?
- How was your firm?
- How will be your firm?

#### Finance is an Art

- Art of understanding business numbers
- Art of Revenue & Cost Structure
- Art of making Business Plan
- Art of Decisions Making

#### Financial Statements

- What does your company own, and what does it owes to others?
- What are its sources of revenue, and how has it spent its money?
- How much profit has it made?
- What is the state of your firm's financial health?

This session will help you answer these questions by discussing three essential financial statements: Income statement (Profit & Loss Account), Balance Sheet and Cash flow statement. The FS are essential documents of business to assess the performance of business and identify the areas for interventions. The stakeholders are interested at different financial information of your firm.

## 2. Income Statement

Whether the products / services that a company provides are profitable? Profit creates sovereign criterion of the enterprise, Right on the money, Charts its own course and Run the way u want. If stops being profitable, your stakeholder poke their nose, unlikely to get succeed. Make accurate business forecasts and projections by developing a projected income statement, (profit and loss account), as a planning and management tool that will help control business operations; develop a preview of income amount generated (monthly and annually).

**2.1 Profit:** It is the amount left over after all expenses are subtracted from sales revenue. The basic types of profits are Gross Profit, Operating Profit, and Net Profit.

**2.2 Gross Profit:** It is sales minus cost of goods / service sold, leftover after meeting direct cost. It should sufficient to cover operating cost.

**2.3 Operating Profit:** It is Gross profit minus operating expenses, profit made from the running the firm. It also called EBIT (Earnings Before Interest and Taxes).

**2.4 Net Profit:** It is operating profit minus financial cost and taxes; the surplus is given to owner.

### Exhibit 1 Income Statement of Agi Limited for the period ended 31 March 2020

	Particulars	Amount
I	Revenue From Operations	
II	Other Income	
III	Total Income (I+II)	
IV	EXPENSES	
	Cost of materials consumed	
	Purchases of Stock-in-Trade	
	Changes in inventories of finished goods, Stock-in -Trade and work-in-progress	
	Employee benefits expense	
	Finance costs	
	Depreciation and amortization expense	
	Other expenses	
	Total expenses (IV)	
V	Profit/(loss) before exceptional items and	

	tax (I- IV)	
VI	Exceptional Items	
VII	Profit/(loss) before tax (V-VI)	
VIII	Tax expense: (1) Current tax (2) Deferred tax	
IX	Profit (Loss) for the period from continuing operations (VII-VIII)	
X	Profit/(loss) from discontinued operations	
XI	Tax expense of discontinued operations	
XII	Profit/(loss) from Discontinued operations (after tax) (X-XI)	
XIII	Profit/(loss) for the period (IX+XII)	
XIV	Other Comprehensive Income	
	A (i) Items that will not be reclassified to profit or loss	
	(ii) Income tax relating to items that will not be reclassified to profit or loss	
	B (i) Items that will be reclassified to profit or loss	
	(ii) Income tax relating to items that will be reclassified to profit or loss	
XV	Total Comprehensive Income for the period (XIII+XIV)(Comprising Profit (Loss) and Other Comprehensive Income for the period)	
XVI	Earnings per equity share (for continuing operation):	
	(1) Basic	
	(2) Diluted	
XVII	Earnings per equity share (for discontinued operation):	
	(1) Basic	
	(2) Diluted	
XVIII	Earnings per equity share(for discontinued & continuing operations)	
	(1) Basic	
	(2) Diluted	

### Information from Income Statement

- Product / Service Revenues
- Cost of Goods Sold

- Gross Profit
- Selling, General & Administrative Costs
- Operating Income
- Other Income
- Other Expenses
- Income tax expense
- Income from continuing operations
- Net income
- Extraordinary items

### 3. Balance Sheet

It's like our whole body health check up! In the same fashion firms do check their financial position through balance sheet at a given point of time, monthly, quarterly or annually.

It describes the assets controlled by the business and how those assets financed with funds. The basic equation of balance sheet as follows:

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

#### 3.1 Components of Balance Sheet

- **Current Assets** - Assets that either cash now or will become cash within the next 12 months. Examples are Deposits in bank accounts, accounts receivable, bills receivables, inventories, etc.
- **Fixed Assets** - The things your firm owns for the purpose of generating income. Examples are buildings, vehicles, equipment, furniture, computers, etc.
- **Other Assets** - The things your firm owns that do not fit in the above two categories. Examples are patents, copyrights, utility deposits, etc.
- **Current Liabilities** - Amounts your firm owes that must be paid within the next twelve months. Examples are trade accounts payable, sales and payroll taxes, income taxes and the next 12 payments for your notes and mortgages.
- **Long-term Liabilities** - Amounts your firm owes that will be paid after the next 12 months. These are usually confined to all payments on your notes and mortgages due after the next 12 months.
- **Capital (Owner's Equity)** - The investment made by the owner, less any drawings for personal use, plus all accumulated earnings of the company since inception.

**Exhibit 2 Balance Sheet of Agi Limited as at 31 March 2020**

Particulars	Amount
<b>(1) ASSETS</b>	
<b>Non-current assets</b>	
(a) Property, Plant and Equipment	
(b) Investment Property	
(c) Other Intangible assets	
(d) Financial Assets	
(i) Investments	
(ii) Trade receivables	
(iii) Loans	
(iv) Others (to be specified)	
(e) Deferred tax assets (net)	
(f) Other non-current assets	
<b>(2) Current assets</b>	
(a) Inventories	
(b) Financial Assets	
(i) Investments	
(ii) Trade receivables	
(iii) Cash and cash equivalents	
(iv) Bank balances other than (iii) above	4607472
(v) Loans	
(vi) Others (to be specified)	
(c) Current Tax Assets (Net)	
(d) Other current assets	
<b>Total Assets</b>	
<b>EQUITY AND LIABILITIES</b>	
<b>Equity</b>	
(a) Equity Share capital	
(b) Other Equity	
<b>LIABILITIES</b>	
<b>Non-current liabilities</b>	
(a) Financial Liabilities	
(i) Borrowings	
(ii) Trade payables	
(iii) Other financial liabilities (other than those specified in item (b), to be specified)	
(b) Provisions	
(c) Deferred tax liabilities (Net)	
(d) Other non-current liabilities	
<b>Current liabilities</b>	
(a) Financial Liabilities	
(i) Borrowings	
(ii) Trade payables	

(iii) Other financial liabilities (other than those specified in item (c))	
(b) Other current liabilities	
(c) Provisions	
(d) Current Tax Liabilities (Net)	
<b>Total Equity and Liabilities</b>	

### Information from Balance Sheet

- Assets = Liabilities + Equity
- Balance (Value) of Assets
- Balances (Value) Liabilities (Any loan against asset?)
- Growth of Equity
- Funding Advice
- Liquidity (Working Capital)
- Debt Solvency

### 4. Cash flow Statement

The cash flow statement provides information about the firm's sources and uses of cash during accounting period. It helps to know the whether the firm has sufficient cash in hand to run the business. The firm needs enough cash to purchase inventory, pay its expenses and clearing its loans. Investors, in particular, want to know how much, why and how cash was generated or used.

#### 4.1 Components of Cash Flow Statement

- **Operating Activities:** The principal revenue-generating activities of an organization and other activities that are not investing or financing; any cash flows from current assets and current liabilities
- **Investing Activities:** Any cash flows from the acquisition and disposal of long-term assets and other investments not included in cash equivalents
- **Financing Activities:** Any cash flows that result in changes in the size and composition of the contributed equity capital or borrowings of the entity (i.e., bonds, stock, dividends)

**Exhibit 3 Cash Flow Statement of Agi Limited for the year ended 31st March, 2020**

Particulars	31st March, 2020	31st March, 2019
<b>Cash Flow from Operating Activities</b>		
<b>Net Profit Before Tax</b>		
Adjustment for :		
Depreciation & Amortization		
Extra Ordinary Items		
Interest / Dividend Income		
(Profit) / Loss on sale on Fixed Assets		
Financial Costs		
<b>Operating Profit before Working Capital Changes</b>		
<i>Adjustment for :-</i>		
(Increase) / Decrease in Inventories		
(Increase) / Decrease in Trade Receivables		
Increase / (Decrease) in Trade Payables		
Increase / (Decrease) in Short Term Provisions		
Increase / (Decrease) in Other current liabilities		
(Increase) / Decrease in Other Non Current Assets		
Increase / (Decrease) in Other long term liabilities		
(Increase) / Decrease in short term loans & Advances		
(Increase) / Decrease in other Current Assets		
<b>Cash Generated from Operations</b>		
Direct Taxes Paid		
<b>Net cash from / (used in) operating activities (A)</b>		
<b>Cash Flow From Investing Activities</b>		
Purchase of Fixed Assets (Incl CWIP)		
Sale of Fixed Assets		
Profit / (Loss) on sale of Fixed Assets		
Other non Current Investments		
Purchase / Sale of Investments		
Interest / Dividend Income		
<b>Net cash from/ (used in) Investing activities (B)</b>		
<b>Cash Flow From Financing Activities</b>		
Proceeds From issue of share capital (including Premium)		
Proceeds From issue of Debenture capital (including Premium)		
Share Application Money		
Increase/ (Decrease) in Long Term Borrowing		
Increase/Decrease in Long Term Loans & Advances		
Increase/ (Decrease) in Short Term borrowing		

Financial Costs		
<b>Net cash from/(used in) financing activities (C)</b>		
<b>Net (Decrease)/Increase in cash and Cash Equivalents (A+B+C)</b>		
Cash and cash equivalents at beginnings of year		
<b>Cash and cash equivalents at end of year</b>		

**Information from Cash flow statement**

- Actual Cash Position
- How much Cash comes in?
- How much Cash goes out?
- How much Cash at the end?

**Disclaimer**

This reading is not designed to be your only guide to understand financial statements. A much wider range of resources is available to you, and I strongly recommend you make use of them.