FASTER
ICT – Financial and Accounting Seminars Targeting European Regions

WP3

E-modules & Educational Products

Module 6

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Module 6: Financial Statement Analysis

Financial statement analysis

- analysis of FS: includes transformation of the accounting information in more useful information based on which investment decisions could be made
- 2 types of users of accounting information:

- internal users
- external users

- common goal of these two types of users: evaluation of *the past and the current financial position of a company, the current performance and the future expectations and risks*

Information for Analysis

- most of the users (especially the external ones): rely fully on the **general-purpose financial statements:**

- Income Statement (or Statement of Comprehensive Income)

- Balance sheet (or the Statement of Financial Position)

- Statement of Stockholders' Equity

- Cash Flows Statement

- notes of these statements

Standards for Comparisons – Benchmarks

- analysis of FS: not enough for assessment of the company's performance and position
- results of analysis: compared with some standards (benchmarks):

- intracompany standards
- intercompany standards
- industrial standards

Tools of Analysis

- **horizontal analysis:** consists of comparison of the financial statements items across time;
- **vertical analysis (component percentages)**: represents a comparison of the financial statements items to a base amount
- **ratio analysis:** measurement of key relations between financial statement items

Tools of Analysis

- **ratio analysis:**

- following main groups of ratios could be used:

  - *Liquidity and efficiency*
  - *Solvency group*
  - *Profitability*
  - *Market test*

Cash Flows Statement

- information about the cash receipts, cash payments & net generated cash flow during the reporting period
- statement is prepared on the cash basis not on the accrual basis as the other statements
- based on the CF analysis, internal and external users can determine:

- the ability of an entity to generate future cash flows;

Cash Flows Statement

- the ability of an entity to pay dividends and to meet its obligations;

- the reason why there is a difference between the net income and the net generated cash flow during the period;

- how much money is generated or spent from/for investing and financing activities of an entity;

- the flexibility and liquidity of an entity.

Structure of the Cash Flows Statement

- CFS: represents all the generated cash flows and all the spent money classified according to the three types of activities that are part from the whole business activity of each entity:
- operating,
- Investing,
- financing

Cash Flows from Operating activities

- include all the transactions that in general produce the main revenues of the entity

- cash receipts from sale of goods / rendering services;

- cash receipts from royalties, fees, commissions and other revenue;

- cash payments to suppliers of goods and service;

- cash payments to employees.

Cash Flows from Investing activities

- involve cash flows used for acquisition and disposal of long term assets, for making and collecting loans, for acquiring and disposal of debt and equity instruments

examples:

- cash payments to acquire fixed assets

- cash receipts from disposal of fixed assets

- cash payments to acquire shares, warrants or debt instruments of other enterprises and interest in joint ventures

- cash receipt from disposal of above investments

Cash Flows from Financing Activities

- involve activities that result in changes in size and composition of owners capital and borrowing of the organization examples:

- sale of share
- buy back of shares
- redemption of preference shares
- issue / redemption of debentures
- long term loan / payment thereof
- dividend / interest paid

Methods of preparation of CF Statement

- 2 methods used for preparation of the Cash Flows Statement – direct and indirect
- ***indirect method*:** calculation of CF of operating activity starts from the *net income* (or the income before taxes) which is *adjusted* with all incomes/losses coming from the other two activities (investing and financing); all the non-cash expenses or revenues; all the changes in the inventories, accounts receivables, accounts payable, deferred taxes etc.

Methods of preparation of CF Statement

- ***direct method*:** calculation of the net cash flow of operating activity represents exactly paid and received cash flows

Comparison between indirect and direct method

- ***Operating Activity – Indirect Method***

Net Income

+ Depreciation expenses (noncash expenses)

+ Losses from sale of assets

- Gains from sale of assets

- increases in current assets

+ decreases in current assets

+ increases in current liabilities

- decreases in current liabilities

= Net cash from operating activities

Comparison between indirect and direct method

- ***Operating Activity – Direct Method***

Net Income

- \+ Cash Received from Customers
- \- Cash paid for inventory
- \- Cash paid for operating expenses
- \- Cash paid for income taxes
- \- Cash paid for interest
- \+ Cash received from dividends and interest
- **= Net cash from operating activities**

Thank you for attention