Yelubayeva Zhuldyz, d.e.s., Professor
Lebekov Aidar
«Finance», 1-year Master student
EI «Almaty Management University»
Almaty, the Republic of Kazakhstan

FINANCIAL STATEMENT ANALYSIS PREVIEW

Records and data that show the financial activities of a business, an individual or any other company. Financial statements are meant to present the financial information of the entity in question as clearly and concisely as possible for both the entity and for readers. Financial statements for businesses usually include: income statements, balance sheet, statements of retained earnings and cash flows, as well as other possible statements [1].

The role of financial statements is a summarizing all operating activities of chosen enterprise or company for the proceeding period. At the end of a period usually it's a year financial statements, or quarter bases data, which are prepared and report on investing and financing activities.

Balance sheet – one of five main components of accounting reports [2]. According to the international rules of financial statements, the balance contains data on assets, obligations and own capital [3]. The balance sheet characterizes a property and financial condition of the organization in a monetary assessment for reporting date.

According to IFRS the balance consists of three parts: assets, obligations and capital [2]. Generally articles of balance by tradition follow one after another as liquidity though there are exceptions [4]. The main property of balance consists that total assets are always equal to the sum of obligations and own capital. Assets show, what means are used by the organization [1], and obligations and own capital show who provided these means and in what size [2]. All resources, which are possessed by the enterprise, can be provided either owners (capital), or creditors (obligation). Therefore the sum of requirements of creditors together with requirements of owners has to be equal to the sum of assets [5]. It is also caused by that at reflection of operations on accounts in balance the principle of double record is observed.

Submission of the current information on property of an economic entity in the form of the balance sheet is one of fundamental methods of accounting. The balance sheet doesn't reflect the movement of means and facts of implementation of concrete economic operations, but shows a financial condition of an economic entity at a given time. The essence of balance (as method) consists that data on the cost of property of an economic entity for the interesting date are grouped definitely, allowing to carry out the financial analysis and to receive forecasts for the future [5].

The main rule of accounting equation (also known as the balance sheet identity), the basis of whole accounting system:

$$\text{Assets} = \text{Liabilities} + \text{Equity} \qquad (1)$$

Assets is the part of the balance sheet (left side) reflecting structure and cost of property of the organization for a certain date.

Assets – it is the resources controlled by the company as a result of last events from which the company expects an economic benefit in the future (this treatment contains in the principles of IFRS). They have also divided into two groups: current (short-term) and non-current (long-term) assets. Current (short-term) assets are expected to be converted to cash or used in operations within one year of operating cycle, and never longer. For example: cash, cash and cash equivalence, inventory, account receivables etc. The assets withdrawn from economic circulation, but reflected in accounting belong to non-current assets. For example: fixed assets, intangible assets, long-term investments, long-term securities etc. [6].

All assets is a resources for investment, which are expected to generate future earnings through operating activities.

Liabilities it is the debt of the organization arising from events of last periods which settlement will lead to leaving of the resources containing an economic benefit. Always on the left side of balance sheet. Liabilities are separated into two groups: current (short-term) and non-current (long-term) liabilities. Current (short-term) liabilities are obligations the company is expected to settle within one year of operating cycle, and never longer. For example: interest payable, tax, utilities, account payables, rent etc. Non-current (long-term) liabilities all other obligations which aren't getting under definition short-term. For example: long-term debts, differed taxes etc. [6].

Equity is a set of the property used for receiving profit. The direction of assets to the sphere of production or rendering services for the purpose of generation of profit is called also capital investments or just investments.

The independent term the equity in modern accounting isn't used, but there is a number of close indicators of the financial analysis. For example, own capital – is a difference between the cost of assets of the company and the sum of its obligations. Usually this size is formed at the expense of the authorized capital (a contribution of owners of the company), the additional capital (revaluation of property, the issue income), retained earnings and reserves (which are formed of profit).

In most cases equity include shareholders, retained earnings, funding or contributed by owners [6].

The formula:

$$\text{The working capital} = \text{Current assets} - \text{Short-term obligations} \qquad (2)$$

Other way to receive just the same value:

Working capital = (Own capital + Long-term obligations) – Non-current assets (3)

Where:

The working capital – the size of the capital, which is available for the organization for financing of its current activity (i.e. acquisitions of current assets during normally production cycle) [6].

Management of the working capital consists in control of its size so that it was optimum. The optimum is understood as such size of the working capital which, on the one hand, allows the enterprise of a message normal uninterrupted operating activities, with another – isn't inflated to such an extent that freezes, brings considerable means of the organization out of a turn [7].

Income statement (Profit and Loss Statement) – reports the entities financial performance in terms of net profit or loss over a specified period. Reflects the income and expenses of the company for a certain period of time. The net profit and net losses are calculated by subtraction of expenses from the income. Income statement (Profit and Loss Statement) is consist of the following two things:

- income: what the business has earned over a period (e.g. sales revenue, dividend income, etc);
- expense: the cost incurred by the business over a period (e.g. salaries and wages, depreciation, rental charges, etc) [8].

Unlike Balance where data are provided as of a certain date, the Profit and loss report contains indicators for a certain period the accruing result since the beginning of year (usually, for the 1st quarter, half-year, 9 months, year).

Structure of the Profit and loss report.

The report consists of a set of indicators, which in the sum yield total financial result – net profit or a loss. The main indicators of activity of the organization go at the very beginning of the report is a revenue, cost of sales, business and management expenses – all this makes financial result (profit or a loss) from sales, i.e. from primary activity of the organization for the sake of which it also was created.

Further, there are indicators of other income and expenses, such as interest receivable and payment, the other income and expenses, which in the sum with the results received earlier from sales I make an indicator "Profit (loss) to the taxation". After from this indicator subtract income tax and will add change postponed tax, assets, and obligations, the total financial result – net profit or a loss for the period turns out.

The total cumulative income – the change in the capital during the period as a result of operations and other events which isn't change as a result of operations with owners in their quality of owners.

The total cumulative income includes all components of profit or a loss and the other cumulative income.

The other cumulative income include the income item and an expense (including adjustments concerning reclassification) which aren't recognized as a part of profit or a loss as demand that or allow others IFRS.

The enterprise has to recognize all articles of the income and resolve an exception of components of the other cumulative income, which satisfy to definition of the Concept, from structure of profit or a loss.

Elements of the other cumulative income contain adjustments on reclassification.

Components of Income statement:

- revenue;
- cost of good sales;
- other income;
- other expenses;
- taxes;
- profit and total comprehensive income for the year.

Revenue- the money or material values received by legal entity as a result of any activity for a certain period of time.

Cost of sales represents the cost of goods sold or services rendered during an accounting period. Hence, for a retailer, cost of sales will be the sum of inventory at the start of the period and purchases during the period minus any closing inventory.

Other income consists of income earned from activities that are not related to the company's main business activities. For instance, other income of an entity that manufactures electronic appliances may include:

1. Gain on disposal of fixed assets.
2. Interest income on bank deposits.
3. Exchange gain on translation of a foreign currency bank account.
4. Distribution cost includes expenses incurred in delivering goods from the business premises to customers.

Administrative expenses generally comprise of costs relating to the management and support functions within an organization that are not directly involved in the production and supply of goods and services offered by the entity.

Examples of administrative expenses include:

- wages cost;
- professional and law charges;
- depreciation and amortization of buildings;
- rent costs of offices used for management, administration purposes.

Cost of functions like departments not directly involved in production HR department, such as finance department, and administration department.

Other costs (expenses). This is essentially a residual category in which any expenses that are not suitably classifiable elsewhere are included.

Finance charges sometimes comprise of interest expense on loans and debentures.

The effect of present value adjustments of discounted provisions are also included in finance charges (e.g. unwinding of discount on provision for decommissioning cost).

Taxes – corporate or income tax.

Income tax expense recognized during a specific period is generally comparable of the three things:

- short-term period's evaluated tax charge;
- important period tax adjustments;
- deferred tax costs.

Important period financial information is presented alongside short-term period financial results to facilitate comparison of performance over a whole period.

It is therefore important that prior period comparative figures presented in the income statement relate to a similar period.

For example, if an organization is preparing income statement for the six months ending 31 December 2015, comparative figures of prior period should relate to the six months ending 31 December 2014 [9].

An income statement measure a company financial performance between balance sheet days. It is an overall view of the operating activities of a company. As it was written before, the income statement shows detail information of revenues, expenses, gains and losses of entity for specific period. The earnings or net income- is a bottom line, which illustrates the profitability of the entity.

The net income reflects return on equity holders for the time period under consideration, while in the same time, the line items of the statement detail how net income are determined. Net income approximately the growth or falling in equity before considering contributions to and distribution to equity holders. For income to identify and measure change in equity, it is need to be a slightly different term of income, it is named as comprehensive income.

Gross profit or gross margin- is one of the income statement indicator of profitability, it is the differences between sales and cost of revenues, that means extent, which company is able to cover and pay of its products, services and etc. This meanings is not especially suitable for services and technology companies where production cost are takes a little part of total cost.

Differences between sales and operating expenses – Earnings from operations. In addition, it is often exclude interest cost and taxes.

Represent earnings from continuing operations before the provisions for income tax or corporate tax – Earnings before tax.

Earnings before extraordinary items and discount operations or Earning from continuing operations – is income from an entity's ongoing business after interests and taxes.

The accrual method is a method of the account and recognition of the income and expenses according to which results of economic operations admit upon their commission irrespective of the actual time of receipt and payment of money, related (by analogy with the principles of definition of the income and expenses at an assumption of temporary definiteness of the facts of economic activity).

Statement of cash flow – the report of the company on sources of money and their use in this temporary period. This report directly or indirectly reflects monetary receipts of the company with classification by the main sources and its monetary payments with classification by the main directions of use during the period [10]. The report gives an overall picture of production results, short-term liquidity, long-term solvency and allows to carry out the financial analysis of the company with bigger ease [11].

Nowadays all national and international developers of standards of financial statements came to a conclusion about importance of disclosure of information on sources and the directions of use of money by the companies, the report on cash flow became part of a package of financial statements.

By drawing up the report divide inflow and outflow of cash on production (operational or current), financial and investment activity of the company:

- operating activities – a primary activity, and also the other activity creating receipt and an expenditure of funds of the company (except for financial and investment activity).
- investment activity – a kind of activity, connected with acquisition, creation and sale of non-current assets (fixed assets, intangible assets) and the other investments which aren't included in definition of money and their equivalents.
- financial activity – a kind of activity which leads to changes in the size and structure of the capital and borrowed funds of the company. As a rule, such activity is connected with attraction and return of the credits necessary for financing of operating and investment activities [16].

This classification is intended in order that users of the reporting could estimate impact of these three activities on a financial position of the company and size of its money. Cash flows carry to cash flow from activity of the company, operational, financial, investment depending on character.

The same operation can lead to emergence of cash flows which will be classified differently. For example, the same operation can be classified both operational, and financial activity.

Table 1. Classification of cash flows by kinds of activity*

Activity:	Inflows	Outflows
Operating	-receipts from sale of goods and rendering of services; -receipts of rent payments for providing the rights, remunerations, commission; -receipts and payments of insurance companies for insurance premiums, claims.	-payments to suppliers of goods and services; -payments of a salary to workers; -payments of income tax, except the taxes relating to financial or investment activity.
Investment	-receipts from sale of fixed assets, intangible assets and other non-current assets; -receipts from sale of shares of other companies, and also shares in the joint companies; -receipts in repayment of the loans granted other parties.	- payments for acquisition of fixed assets, intangible assets and other non-current assets; - payments for stock acquisition or debt tools of other companies, and also shares in the joint companies; crediting of other parties.
Financial	-receipts from issue of shares or release of other share tools; -receipts from issue of bonds, bills, mortgages, loans, and also from other financial instruments.	-payments to owners at repayment or repayment of shares of the company; -payments in repayment of loans; -payments by the tenant in repayment of the obligation for financial rent.

*Note – complied by author on the basis of the source [11]

Repayment of a percentage loan provides as payment of percent, and the main amount of debt. If the loan is repaid in a monetary form (unlike clearing or a natural form), it is reflected in the report on cash flow, thus payment of percent can be classified as operating activities, and payment of a principal debt — as financial.

By providing the report on cash flow according to IFRS (IAS) of 7 companies have to open information on structure of money and their equivalents. At identification of money equivalents various classifications therefore the company has to open information on the accounting policies defining structure of money and their equivalents can be applied.

There are two methods of drawing up the report on cash flow. Council for IFRS considers a question of, whether it is necessary to make obligatory to application a direct or indirect method for preparation of the report on cash flow. In October, 2008 Council for IFRS published the document "The Preliminary Point of View on Providing Financial Statements". It was supposed to introduce the requirement about preparation of the report on cash flow according to a direct method . The majority didn't support adoption of the document. Now the majority of the companies avoid use of a direct method and use indirect [12].

The indirect method consists in establishment of differences between the indicator of net profit (loss) of the reporting period created on a method of charge and presented in the profit and loss report and the indicator of pure money on operating activities (an increment of money and their equivalents for the period) calculated on a cash method on the basis of data of the balance sheet (a difference between money for the end and the beginning of the reporting period).

Drawing up the report on cash flow by an indirect method most is suitable for the companies which are keeping account on IFRS by method of transformation and not having opportunity to automate this process enough. By means of an indirect method the report on cash flow can be made on the basis of the profit and loss report, the balance sheet for the beginning and for the end of the reporting period, and also some additional data on streams which are usually used at transformation of the reporting. Data from accounting systems on real cash flows aren't required, and also it isn't required to any automation of the reporting. This method allows to show accurately, what monetary contents every line of the profit and loss report has.

References:

1. Financial Statements Definition. Available from internet: http //www.investopedia.com/terms/f/-financialstatements.asp# ixzz3zgGYgG4s
2. *Бакаев А. С.* Бухгалтерские термины и определения. – М.: Бухгалтерский учёт, 2002. – Р. 160.
3. *Еверчев И. В.* МСФО. 1000 примеров применения. – М.: Рид Групп, 2011. – С. 53. – Р. 992. – ISBN 978-5-4252-0230-7.
4. *Daniels Mortimer.* Corporation Financial Statements. – New York: New York: Arno Press, 1980. – P. 13-14.
5. Williams Jan R. Financial & Managerial Accounting. – McGraw-Hill Irwin, 2008. – P. 40. – ISBN 9780072996500.
6. *John J. Wild, K.R. Subramanyam, Robert F.* Halsey Financial statement analysis. – McGraw-Hill, 2013. – 19 p.
7. Working capital. Available from internet:http//www.audit-it.ru/finanaliz/terms/liquidity/working-capital.html
8. Income Statement. Profit & Loss Account. Available from internet: http//accountingsimplified.com/-financial/statements/ income-statement-profit-and-loss.html
9. Income statement analysis. Available from internet:http//accounting-simplified.com/financial/-statements/income-statement-profit-and-loss.html#sthash.ZCubXeBl.dpuf
10. *Helfert Erich A.* The Nature of Financial Statements: The Cash Flow Statement//Financial Analysis – Tools and Techniques – A Guide for Managers. – McGraw-Hill, 2001. – P. 42.
11. Watanabe, Izumi. – The evolution of Income Accounting in Eighteenth and Nineteenth Century Britain. – 57. – Осака: Osaka University of Economics, 2007. – С.27-30. – (5). – 2000 экз. – ISBN 978-5-904522-50-6.