**Q#1**

**As a financial analyst we always consider IAS as very important accord for decision making, while considering the concept please briefly introduce following IAS how they are important for us,** [**IAS 2**](http://www.iasplus.com/standard/ias02.htm)**Inventories,** [**IAS 7**](http://www.iasplus.com/standard/ias07.htm)**Statement of Cash Flows, IAS 38 Accounting for Research and Development Activities,** [**IAS 18**](http://www.iasplus.com/standard/ias18.htm)**Revenue.**

Ans: **IMPORTANCE OF IAS 2 INVENTORIES:**

The importance of IAS 2 is to prescribe the accounting treatment for inventories. It provides guidance for determining the cost of inventories and for subsequently recognizing an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

**IMPORTANCE OF IAS 7 STATEMENT OF CASH FLOWS:**

The importance of IAS 7 is to require the presentation of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows, which classifies cash flows during the period according to operating, investing, and financing activities.

**IMPORTANCE OF IAS 38 Accounting for Research and Development Activities:**

The objective of IAS 38 is to prescribe the accounting treatment for research and development activities. Research and development investments are foundation for generating new knowledge through basic research

**IMPORTANCE OF IAS 18 REVENUE:**

The objective of IAS 18 is to prescribe the accounting treatment for revenue arising from certain types of transactions and events.

IAS 18 *Revenue* outlines the accounting requirements for when to recognize revenue from the sale of goods, rendering of services, and for interest, royalties and dividends. Revenue is measured at the fair value of the consideration received or receivable and recognized when prescribed conditions are met, which depend on the nature of the revenue.

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Q#2

International financial recording slandered are always playing vital role in financial analysis. Introduce the importance and concept of IFRS and explain how the following IFRS deals with different financial elements, [IFRS 10](http://www.iasplus.com/standard/ifrs10.htm) Consolidated Financial Statements, [IFRS 13](http://www.iasplus.com/standard/ifrs13.htm) Fair Value Measurement.

Ans: **CONCEPT AND IMPORTANCE OF IFRS:**

International Financial Reporting Standards (IFRS) set common rules so that financial statements can be consistent, transparent and comparable around the world. IFRS are issued by the International Accounting Standards Board (IASB). They specify how companies must maintain and report their accounts, defining types of transactions and other events with financial impact. IFRS were established to create a common accounting language, so that businesses and their financial statements can be consistent and reliable from company to company and country to country.

IFRS Standards bring **transparency**by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.

IFRS Standards strengthen **accountability**by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Our Standards provide information that is needed to hold management to account. As a source of globally comparable information, IFRS Standards are also of vital importance to regulators around the world.

And IFRS Standards contribute to economic **efficiency**by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs.

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| **IFRS 10** | ***Consolidated Financial Statements*** |
| **Overview** | Sets out the requirements for determining whether an entity (a parent) controls another entity (a subsidiary). |
| **Control** | An investor controls an investee when it has power over the investee, exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the returns.  An investor has power when it has existing rights that give it the current ability to direct the relevant activities of the investee—the activities that significantly affect the investee’s returns. |
| **Consolidated financial statements** | When a parent-subsidiary relationship exists, consolidated financial statements are required. These are financial statements of a group (parent and subsidiaries) presented as those of a single economic entity.  There are two exceptions to this requirement. If, on acquisition, a subsidiary meets the criteria to be classified as held for sale in accordance with IFRS 5, it is accounted for under that Standard. The other exception is for investment entities. |
| **Investment entities** | An entity that obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and measures and evaluates the performance of substantially all of its investments on a fair value basis is an investment entity.  An investment entity does not consolidate its subsidiaries. Instead it measures the investment at fair value through profit or loss in accordance with IFRS 9. |
| **Consolidation procedures** | Intragroup balances, transactions, income and expenses are eliminated.  All entities in the group use the same accounting policies and, if practicable, the same reporting date.  Non-controlling interests (NCI) are reported in equity separately from the equity of the owners of the parent. Total comprehensive income is allocated between NCI and the owners of the parent even if this results in the NCI having a deficit balance. |
| **Changes in the ownership interest** | A change in the ownership interest of a subsidiary, when control is retained, is accounted for as an equity transaction and no gain or loss is recognised.  Partial disposal of an investment in a subsidiary that results in loss of control triggers remeasurement of the residual holding to fair value at the date control is lost. Any difference between fair value and carrying amount is a gain or loss on the disposal, recognized in profit or loss. |

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| **IFRS 13** | ***Fair Value Measurement*** | |
| **Overview** | Defines fair value and provides guidance, how to estimate it and the required disclosures about fair value measurements. | |
| IFRS 13 applies when another Standard requires or permits fair value measurements or disclosures about fair value measurements (and measurements such as fair value less costs to sell) but does not stipulate which items should be measured or disclosed at fair value. | | | |
| Fair value | | Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.  A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants, under current market conditions. | |
| Fair value hierarchy | | When an entity estimates fair value, the estimate is classified on the basis of the nature of the inputs the entity has used.  Level 1 inputs are quoted prices in active markets for identical assets and liabilities that the entity can access at the measurement date.  Level 2 inputs are those other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and interest rates and yield curves observable at commonly quoted intervals.  Level 3 inputs are unobservable for the asset or liability. Examples include an entity using its own data to forecast the cash flows of a cash-generating unit (CGU) or estimating future volatility on the basis of historical volatility.  Entities are required to use valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. However, the objective of estimating the exit price at the measurement date remains the same regardless of the extent to which unobservable inputs are used. | |
| Disclosure | | The disclosures depend on the nature of the fair value measurement (e.g. whether it is recognised in the financial statements or merely disclosed) and the level in which it is classified.  The disclosure requirements are most extensive when level 3 inputs are used, including sensitivity analysis. | |

**Q#3**

**While going for any financial analysis, financial statements are considered as important elements. Please explain the importance of four basic financial statements in financial analysis, income statement, balance sheet, statement of retains earning & statement of cash flow.**

Ans: **INCOME STATEMENT:**

The income statement is one of the most important financial statements because of its indication of profits, its timely reporting, and its classification of revenues and expenses.

An income statement is important because it offers a recent picture of the company's revenues and expenses and overall profitability. Managers and investors can use this information to make financial decisions.

The income statement is important because it clearly states whether a company is making a profit. The total revenues and expenses of a company are listed on its income statement. Subtracting the expenses from revenues provides the total profit during the given accounting period, usually a year or a quarter of a year. A company must consistently be making a long-term profit for it to be considered a good investment choice. This information can only be found on the income statement.

**BALANCE SHEET:**

Balance sheet analysis can reveal a lot of important information about a company’s performance. Importance of balance sheet is listed below:

* It is an important tool used by the investors, creditors and other stakeholders to understand the financial health of an entity.
* The growth of an organization can be known by comparing the balance sheet of different years.
* It is an essential document required to be submitted to the bank to obtain a business loan.
* Stakeholders can understand the business performance and liquidity position of the entity.
* Ability to undertake expansion projects and meet unforeseen expenses can be determined by analyzing a company’s balance sheet
* If the company is funding its operations with profit or debt can be known.

**STATEMENT OF RETAINS EARNING:**

**Importance to Shareholders**

The retained earnings statement is important to shareholders because it indicates how much equity they collectively hold in the company. The retained earnings are, essentially, the total amount of money that shareholders are entitled to -- though they can only receive the money when a dividend is paid out at the discretion of the board of directors. By dividing the retained earnings by the number of outstanding shares, shareholders can calculate how much money one share entitles them to.

**Importance to Board**

The retained earnings statement tells the board of directors how much money they have to either invest in the firm or redistribute to shareholders. The board of directors is responsible to shareholders and must ultimately make a decision in their interest. They may either use the money to invest further in the firm or they can convert the retained earnings into a dividend that is paid out to shareholders.

**Importance to Investors**

Potential investors will look carefully at the retained earnings statements for the firms that they are considering investing in. They will look not only at the most recent retained earnings statement but at statements over time. This can give investors a sense of how much money they can reasonably expect to earn from their investments.

**Importance to Creditors**

Creditors will look at a variety of performance measures, including retained earnings, before issuing credit to a business. High retained earnings indicate that the firm is profitable and should have few problems repaying its debts. Low or nil retained earnings indicate that the firm may have problems repaying its loans; creditors may, therefore, choose not to extend credit to these businesses or they may charge a higher rate of interest to compensate for the risk.

**STATEMENT OF CASH FLOW:**

Cash Flow Statement is particularly useful in short-term planning. In order to meet the various obligations, a firm needs sufficient amount of cash (e.g. payment for expenses, purchase of fixed assets, payments for dividend and taxes, etc.).

**Helps to make Cash Forecast:**

Cash Flow Statement, no doubt, helps the management to make a cash forecast for the near future. A projected Cash Flow Statement helps the management about the cash position which is the basis for all operations and, thus, the management sees light relating to cash position, viz. how much cash is needed for a specific purpose, sources of internal and external issues, etc.

**Helps the Internal Management:**

It helps the internal management to determine the financial policy to be adopted in future since it supplies information relating to funds, e.g. taking decision about the replacement of fixed assets or repayment of long-term liabilities, etc.

**Reveals the Cash Position:**

It is a significant pointer about the movement of cash, i.e. whether there is any increase in cash or decrease in cash and the reasons thereof which helps the management. Moreover, it explains the reasons for small cash balance even though there is sufficient profit, or vice versa. Besides, the management can compare the original forecast with the actual one in order to understand the trend of movement of cash and the variation therefore.

**Reveals the result of Cash Planning:**

How far and to what extent the cash planning becomes successful is revealed by the analysis of Cash Flow Statement. The same is possible by making a comparison between the projected Cash Flow Statement/Cash Budget and the actual one—and the measures to be taken accordingly.

**Q#4**

Financial statement analysis is very important for any business activity while considering any financial decision making. Keeping in view the concept for financial statement analysis, please explain the different techniques that we use to adopt for doing *Liquidity Analysis* and *Activity Analysis* with its calculation formulas.

Ans: **Liquidity analysis**:

Liquidity ratios are an important class of financial metrics used to determine a debtor's ability to pay off current debt obligations without raising external capital. Liquidity ratios measure a company's ability to pay debt obligations.

Liquidity is the ability to convert assets into cash quickly and cheaply. Liquidity ratios are most useful when they are used in comparative form. This analysis may be internal or external.

For example, internal analysis regarding liquidity ratios involves using multiple accounting periods that are reported using the same accounting methods. Comparing previous time periods to current operations allows analysts to track changes in the business. In general, a higher liquidity ratio shows a company is more liquid and has better coverage of outstanding debts.

Alternatively, external analysis involves comparing the liquidity ratios of one company to another or an entire industry. This information is useful to compare the company's strategic positioning in relation to its competitors when establishing benchmark goals. Liquidity ratio analysis may not be as effective when looking across industries as various businesses require different financing structures. Liquidity ratio analysis is less effective for comparing businesses of different sizes in different geographical locations.

Current ratio= current assets/current liabilities

***Activity Analysis:***

The activity analysis is sometimes called the management efficiency analysis or economic activity analysis. It includes the assessment of the productivity (turnover) of assets and capital used by the company. Productivity analysis is based on the ratios relating the achieved results on sales (or costs of obtaining them) to the levels of assets and capital used in the company. The group of these ratios allows assessing the efficiency of assets management, which affects both the financial liquidity and long-term profitability.

Meaning of Activity Analysis • Activity ratios are financial analysis tools used to gauge the ability of a business to convert various asset, liability and capital accounts into cash or sales. The faster a business is able to convert its assets into cash or sales, the more efficient it runs. Activity ratios become more meaningful when compared to industry-average activity ratios. Different industries have different industry-average activity ratios and pitting your ratios against those of peer businesses allows you to know if your ratios are better or worse.

*Total Asset Turnover = Net Sales ÷ Average Total Assets*