You must know these!

KNOWVATION

CONCEPTS & TERMINOLOGIES IN FINANCE

BUSINESS AWARENESS-4

(JBIMS MHRD, XAT, TISS-MAT, TISS-NET, CMAT, SSC, IIFT, BANKS)

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ASSETS & Its TYPES

- An asset is anything which contains economic value and can be converted into cash for future benefits.
- **Personal assets** include cash, savings account, bonds, land, car, etc.
- **Business assets** can include machines, property, raw materials & inventory.
- Business assets are of two types:

1. **Current Assets:** Current Assets are assets that can be converted into cash within one fiscal year. Ex. Inventory, short-term bonds, cash, etc.
2. **Fixed or Non-Current Assets:** These assets have a life of more than one year. Ex. equipment, property, patents and copyrights, etc.

LIABILITY & Its TYPES

- A liability is something a person or company owes, usually a sum of money.
- Liabilities are also of two types:

Current liabilities: Debts payable within one year.

Ex. Monthly EMI, college fees, etc.

Long-term or Non-Current liabilities: Debts payable over a longer period.

Ex. 5 year loan taken by infrastructure company.

EQUITY

- In financial management, equity is defined as the value attributable to the owners of a business or an individual.
- Example to understand.

House worth ₹10 lacs.

=

Loan of ₹7 lacs.

+

Own pocket ₹3 lacs.

- This is the **Fundamental accounting equation** and is very intuitive.

BALANCE SHEET

- A balance sheet is a financial statement which reports a company's assets, liabilities and shareholders' equity at a specific point in time.
- It is called 'balance sheet' because the fundamental accounting equation must be balanced every time.

Assets = Liabilities + Shareholders' Equity

Balance Sheet Example:

Example Company
Balance Sheet
December 31, 2019

ASSETS		LIABILITIES	
Current assets		Current liabilities	
Cash	$ 2,100	Notes payable	$ 5,000
Petty cash	100	Accounts payable	35,900
Temporary investments	10,000	Wages payable	8,500
Accounts receivable - net	40,500	Interest payable	2,900
Inventory	31,000	Taxes payable	6,100
Supplies	3,800	Warranty liability	1,100
Prepaid insurance	1,500	Unearned revenues	1,500
Total current assets	89,000	Total current liabilities	61,000
Investments	36,000	Long-term liabilities	
		Notes payable	20,000
Property, plant & equipment		Bonds payable	400,000
Land	5,500	Total long-term liabilities	420,000
Land improvements	6,500		
Buildings	180,000		
Equipment	201,000	Total liabilities	481,000
Less: accum depreciation	(56,000)		
Prop, plant & equip - net	337,000		
Intangible assets		STOCKHOLDERS' EQUITY	
Goodwill	105,000	Common stock	110,000
Trade names	200,000	Retained earnings	220,000
Total intangible assets	305,000	Accum other comprehensive income	9,000
		Less: Treasury stock	(50,000)
Other assets	3,000	Total stockholders' equity	289,000
Total assets	$ 770,000	Total liabilities & stockholders' equity	$ 770,000

The notes to the sample balance sheet have been omitted.

Source: accountingcoach.com

INCOME STATEMENT

- Income or Profit & Loss statement, as the name suggests, is a financial statement that summarizes the revenues, cost, expenses and profit incurred during a specified period, usually a fiscal quarter or year.

P&L Statement Example:

Profit and Loss Statement

Business Name

Time Period

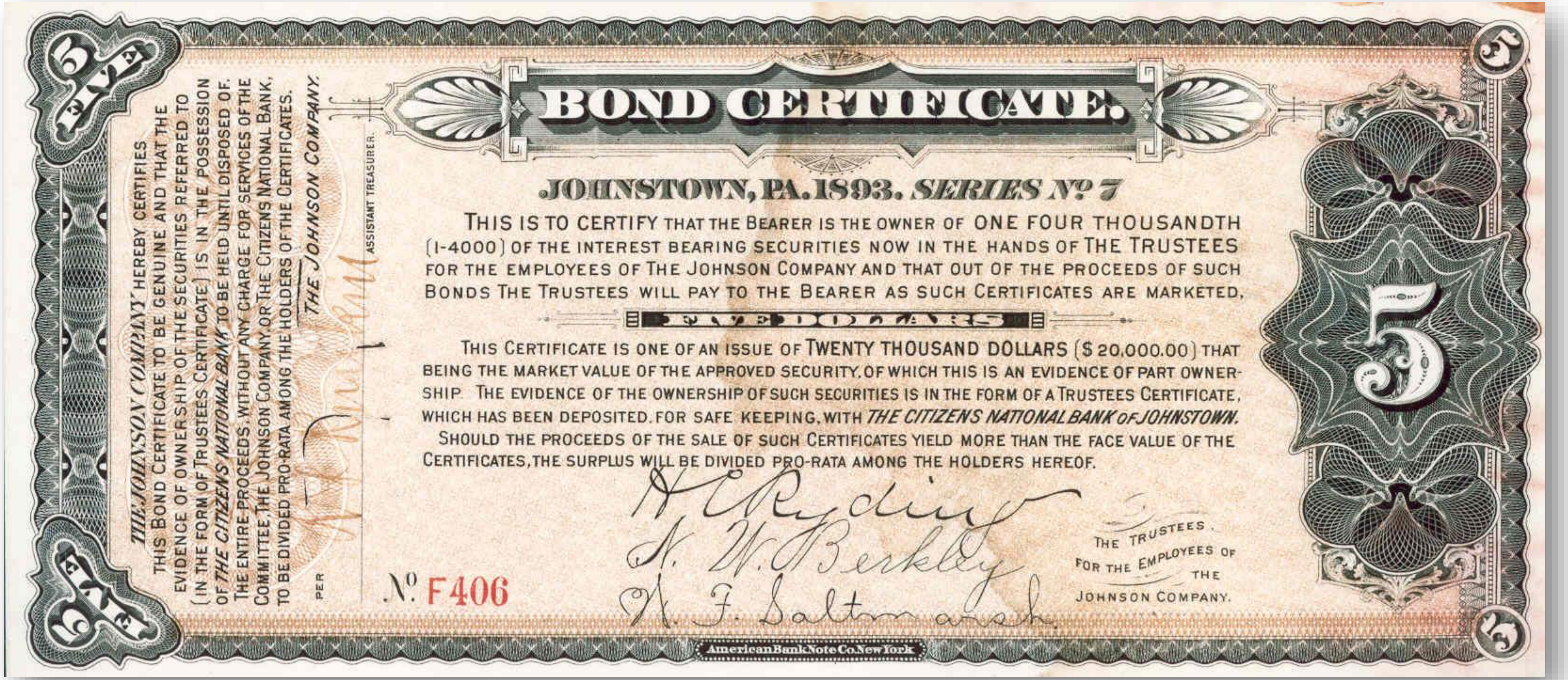
Income		
	Gross sales	$1,100,000
	Less: Returns	$100,000
	Net Sales	**$1,000,000**
Cost of Goods Sold		
	Materials	$200,000
	Service labor	$400,000
	Total Cost of Goods Sold	**$600,000**
Gross Profit		**$400,000**
Expenses		
	Advertising	$200,000
	Depreciation	$20,000
	Insurance	$30,000
	Professional Fees	$10,000
	Office Expenses	$40,000
	Total Expenses	**$300,000**
Net Operating Profit		**$100,000**

Source: digital.com

BONDS

- Bonds are simply loans made by investors to big corporates or governments for a fixed duration of time.
- When companies or other entities need to raise money to finance new or ongoing projects, they may issue bonds.
- Bonds are commonly referred to as fixed income securities because they provide periodic income payments at a predetermined fixed interest rate.
- On maturity, the lender also gets his principal amount back.

The Johnson Company $5 Bond Example:



Source: digital.com

NPAs (Non Performing Assets)

- If a loan is not repaid (either principal or interest) for a period of 90 days, it is termed as an NPA.
- Banks further classify NPAs further as:

1. **Substandard assets:** Assets which has remained NPA for a period less than or equal to 12 months.
2. **Doubtful assets:** An asset would be classified as doubtful if it has remained in the substandard category for a period of more than12 months.
3. **Loss assets:** Loss asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted and needs to be fully written off.

NII (Net Interest Income)

- NII is the difference between the interest income a bank earns from its lending activities and the interest it pays to depositors.

Net interest income = Interest earned - Interest paid

- NII is the major source of income for banks.

- Other sources of income for bank:

Demand drafts & lockers, Advisory services to corporates, Trading income, Commission via selling other (non-bank) financial products.

MUTUAL FUNDS

- Mutual Fund is a pool of money collected from a number of investors and is managed by a professional fund manager.
- The fund manager invests the same in equities, bonds, and other securities.
- The income/gains generated from this collective investment is distributed proportionately amongst the investors after deducting applicable expenses and levies.
- Just like a stock has a trading price in share market, in similar manner, mutual funds has a per-share market value called **NAV (Net asset value).**
- It is the price at which investors buy ("bid price") fund shares from a fund company and sell them ("redemption price") to a fund company.

RISK & ITS TYPES

- Risk is the probability that financial loss will occur.
- A financial institution faces the following typical types of risks:

1. **Credit risk:** This is the risk of default by a borrower.
2. **Liquidity risk:** This is the risk of not having cash when it is needed.
3. **Operational risk:** This is the risk of loss occurring from inefficiency in a bank's people, process and systems.
4. **Regulatory risk:** This refers to the risk of loss if a Financial Institution does not comply with the regulations needed by a country's regulator.
5. **Market risk:** Also called systematic risk is the risk that affects the financial market as a whole. Ex. changes in interest rates, exchange rates, geo-political tensions, or recession.

Assignment!

Read the basics of:

1. Cash flow statement
2. Hedge funds
3. Debentures and derivatives
4. NBFCs

Thanks a lot for watching!

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