



**NIGERIAN INSTITUTE OF  
QUANTITY SURVEYORS**

*The professional construction cost managers.*

**WEBINAR SERIES ON ACCOUNTING AND FINANCE  
FOR NON-FINANCIAL MANAGERS:**

**UNDERSTANDING FINANCIAL STATEMENTS AND  
RATIO ANALYSIS  
BY**

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# What are Financial Statements?

Financial statements are written records that convey the business activities and the financial performance of a company.

Financial statements are a collection of summary-level reports about an organization's financial results, financial position and cash flows.

Financial statements are often audited by government agencies, accountants, firms, etc. to ensure accuracy and for tax, financing, or investing purposes.

# Uses of Financial Statements

- To determine the ability of a business to generate cash, the sources and uses of that cash.
- To determine whether a business has the capability to pay back its debts.
- To track financial results on a trend line to spot any looming profitability issues.
- To derive financial ratios from the statements that can indicate the condition of the business.
- To investigate the details of certain business transactions, as outlined in the disclosures that accompany the statements.
- To use as the basis for an annual report, which is distributed to a company's investors and the investment community.

# Content of IFRS Financial Statements

## IFRS FINANCIAL STATEMENTS

The complete set of IFRS financial statements is as follows:

- A statement of financial position as at the end of the accounting period.
- A statement of comprehensive income.
- A statement of changes in equity.
- A statement of cash flows.
- Notes to the financial statement that summarize the company's significant accounting policies, break down the information contained within the primary financial statements and show other disclosures required under IFRS/IAS.

# Content of IFRS Financial Statements (Old and Current Nomenclature)

Traditional	IFRS
Balance sheet	Statement of financial Position
Cash flow statement	Statement of cash flows
Debtors / creditors	Receivables / payables
Fixed assets	Non-current assets

# Content of IFRS Financial Statements (Old and Current Nomenclature)

Traditional	IFRS
Minority interest	Non- controlling interest
Movement on reserves	Changes in equity
Profit & loss account	Statement of comprehensive income/ Income statement
Stock	Inventories
Turnover	Revenue

# Content of IFRS Financial Statements

## STATEMENT OF FINANCIAL POSITION

The Statement of Financial Position is a snapshot of the financial state of a company at any one point in time. As a minimum, it should include the line items that present the following amounts:

- Property, plant & equipment
- Investment property
- Intangible assets

# Content of IFRS Financial Statements

## STATEMENT OF FINANCIAL POSITION

- Financial asset, (excluding amount shown under trade & other receivables, cash & cash equivalents investments and investment accounted for using the equity method).
- Investments accounted for using equity method
- Biological assets
- Inventories
- Trade and other receivables
- Cash and cash equivalents

# Content of IFRS Financial Statements

## STATEMENT OF FINANCIAL POSITION

- Total of asset classified as held for sale
- Trade and other payable
- Provisions
- Financial liabilities (excluding amount shown under trades & other payables and provisions)

# Content of IFRS Financial Statements

## STATEMENT OF FINANCIAL POSITION

- Liabilities and assets for current tax
- Deferred tax liabilities and deferred tax assets
- Liabilities included in disposal groups classified as held for sale
- Non- controlling interest presented within equity
- Issued capital and reserves attributable to the owners of the parent

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF FINANCIAL POSITION

<b>M &amp; O Consult</b>		
Statement of Financial Position as at 31 December, 2022		
	<b>2022 N(000)</b>	<b>2021 N(000)</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Available for sale investments	2,000	1,000
Investments in associates	4,000	3,000
Other intangible assets	3,000	2,000
Goodwill	5,000	3,000
Property, plant and equipment	8,000	10,000
	<b>22,000</b>	<b>19,000</b>

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF FINANCIAL POSITION

<b>M &amp; O Consult</b>		
<b>Statement of Financial Position as at 31 December, 2022</b>		
	<b>2022 N(000)</b>	<b>2021 N(000)</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	5,000	2,000
Loans and Advances	7,000	6,000
Other receivables	2,000	1,000
Inventories	4,000	5,000
	<b>18,000</b>	<b>14,000</b>
<b>Total assets</b>	<b>40,000</b>	<b>33,000</b>

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF FINANCIAL POSITION

<b>M &amp; O Consult</b>		
<b>Statement of Financial Position as at 31 December, 2022</b>		
	<b>2022 N(000)</b>	<b>2021 N(000)</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity attributable to equity holders</b>		
Share capital	10,000	10,000
Statutory Reserves	10,000	8,500
Retained earnings	<u>4,600</u>	<u>1,000</u>
Shareholders Fund/Equity	<b>24,600</b>	<b>19,500</b>
Preferential Capital(Redeemable)	<u>3,000</u>	<u>3,000</u>
<b>Total Capital</b>	<b>27,600</b>	<b>22,500</b>

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF FINANCIAL POSITION

<b>M &amp; O Consult</b>		
<b>Statement of Financial Position as at 31 December, 2022</b>		
	<b>2022 N(000)</b>	<b>2021 N(000)</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Non-current liabilities</b>		
Debenture	3,000	3,000
Deferred Tax	2,000	1,500
Other long term liabilities	4,000	3,000
<b>Total non-current liabilities</b>	<b>9,000</b>	<b>7,500</b>

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF FINANCIAL POSITION

<b>M &amp; O Consult</b>		
<b>Statement of Financial Position as at 31 December, 2022</b>		
	<b>2022 N(000)</b>	<b>2021 N(000)</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Current liabilities</b>		
Trade and other payables	1,500	1,000
Short term borrowing	1,000	1,000
Current tax payable	5,00	7,00
Provisions	4,00	3,00
Total current liabilities	<b>3,400</b>	<b>3,000</b>
Total liabilities	<b>12,400</b>	<b>10,500</b>
Total equity and liabilities	<b>40,000</b>	<b>33,000</b>

**M & O Consult**

# RELEVANT RATIO ANALYSIS

# Solvency ratios

Solvency ratios measure a company's ability to meet its longer-term obligations. Analysis of solvency ratios provides insight on a company's capital structure as well as the level of financial leverage a firm is using.

Some solvency ratios allow investors to see whether a firm has adequate cash flows to consistently pay interest payments and other fixed charges. If a company does not have enough cash flows, the firm is most likely overburdened with debt and bondholders may force the company into default.

# Debt-to-Assets ratio

The debt-to-assets ratio is the most basic solvency ratio, measuring the percentage of a company's total assets that is financed by debt.

The ratio is calculated by dividing total liabilities by total assets. A high number means the firm is using a larger amount of financial leverage, which increases its financial risk in the form of fixed interest payments.

# Assets /Liabilities ratio

$$= \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

$$2022 = \frac{\text{₦}12,400}{40,000} = 31\%$$

$$2021 = \frac{\text{₦}10,000}{33,000} = 30.0\%$$

This means that in 2022, 31% of the firm's assets are financed with debt. In 2021, the debt ratio is 30%. In 2022, the business is using more equity financing than debt financing to operate the company.

# Debt-to-equity ratio

The debt-to-equity ratio measures the amount of debt capital a firm uses compared to the amount of equity capital it uses. A ratio of 1.00 indicates that the firm uses the same amount of debt as equity and means that creditors have claim to all assets, leaving nothing for shareholders in the event of a theoretical liquidation.

For our example, total debt used in the numerator includes short- and long-term interest-bearing debt. This ratio can also be calculated using only long-term debt in the numerator

# Debt-to-Capital ratio

The debt-to-capital ratio is very similar, measuring the amount of a company's total capital (liabilities plus equity) that is provided by debt (interest-bearing notes and short- and long-term debt).

Once again, a high ratio means high financial leverage and risk. Although financial leverage creates additional financial risk by increased fixed interest payments, the main benefit to using debt is that it does not dilute ownership.

In theory, earnings are split among fewer owners, creating higher earnings per share. However, the increased financial risk of higher leverage may hold the company to stricter debt covenants. These covenants could restrict the company's growth opportunities and ability to pay or raise dividends.

# Liquidity Ratios

- ▶ Does your enterprise have enough cash on an ongoing basis to meet its operational obligations? This is an important indication of financial health.

# Working Capital

**= Current Assets – Current Liabilities**

- ▶ WC is a measure of cash flow and should always be a positive number. It measures the amount of capital invested in resources that are subject to quick turnover. Lenders often use this number to evaluate your ability to weather hard times. Many lenders will require that a certain level of WC be maintained.
- ▶ This is also known as Net Current Asset

# Current ratio/Working capital ratio

- ▶ Total Current Assets
- ▶ Total Current Liabilities

$$2022 = \frac{\text{₦18,000}}{\text{₦3,400}} = 5.29$$

For 2022, take the Total Current Assets and divide them by the Total Current Liabilities. You will have: Current Ratio of 5.29. This means that the company can pay for its current liabilities 5.29 times over.

Practice calculating the current ratio for 2021. A quick analysis of the current ratio will tell you that the company's liquidity has gotten just a little bit better between 2022 and 2021 since it rose from X to 5.29. This ratio is also known as working capital ratio.

# The Quick ratio(Acid test)

**Quick Ratio:** In order to calculate the quick ratio, take the Total Current Assets for 2022 and subtract the Inventory.

Divide the result by Total Current Liabilities. You will have:

$$\text{Quick Ratio} = \frac{(\text{N}18,000 - \text{N}4,000)}{\text{N}3,400} = \underline{4.12}$$

# What does it tell you?

- ▶ Measures your ability to meet short term obligations with short term assets., a useful indicator of cash flow in the near future
- ▶ A social enterprise needs to ensure that it can pay its salaries, bills and expenses on time. Failure to pay loans on time may limit your future access to credit and therefore your ability to leverage operations and growth.

# What does it tell you?

- ▶ A ratio less than 1 may indicate liquidity issues. A very high current ratio may mean there is excess cash that should possibly be invested elsewhere in the business or that there is too much inventory. Most believe that a ratio between 1.2 and 2.0 is sufficient
- ▶ The one problem with the current ratio is that it does not take into account the timing of cash flows. For example, you may have to pay most of your short term obligations in the next week though inventory on hand will not be sold for another three weeks or account receivable collections are slow.

# What does it tell you?

- ▶ A more stringent liquidity test that indicates if a firm has enough short-term assets (without selling inventory) to cover its immediate liabilities.
- ▶ This is often referred to as the “acid test” because it only looks at the company’s most liquid assets only (excludes inventory) that can be quickly converted to cash).
- ▶ A ratio of 1:1 means that a social enterprise can pay its bills without having to sell inventory.

# Content of IFRS Financial Statements

## STATEMENT OF COMPREHENSIVE INCOME

The statement of comprehensive income shows the trading/financial performance of the company during the accounting period. The statement can be divided into two separate statements:

- Income statement itself
- Other Comprehensive Income

# Content of IFRS Financial Statements

## STATEMENT OF COMPREHENSIVE INCOME

A second statement starting with profit (or loss) for the year from continuing operations and then disclosing the separate components of other comprehensive income which may be any gains or losses you take directly to the equity section of the statement of financial position i.e. gain on revaluation of property plant & equipment or actual gains from defined benefit pension plan.

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF COMPREHENSIVE INCOME

M & O Consult		
Statement of Comprehensive Income for the year ended 31 December, 2022		
	2022 N(000)	2021 N(000)
Income from consultancy	10,000	6,000
Commissions	4,000	3,000
Other Incomes	<u>1,000</u>	<u>1,000</u>
	<u>15,000</u>	<u>10,000</u>
Overheads	(3,500)	(2,000)
Depreciation	(2,000)	(2,000)
Provisions	(500)	(500)
Finance costs	(3,000)	(2,500)
Profit before tax	<u>9,000</u>	<u>7,000</u>

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# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF COMPREHENSIVE INCOME

<b>M &amp; O Consult</b>		
Statement of Comprehensive Income for the year ended 31 December, 2022		
	2022 N	2021 N
Profit before tax	9,000	7,000
Income tax expense	(450)	(350)
Profit for the year from continuing operations	8,550	6,650
Loss for the year from discontinued operations	(X)	(X)
Profit for the year	8,550	6,650
Other comprehensive income	2,000	2,000
Income tax relating to other comprehensive income	(200)	(200)
Total comprehensive income for the year	<u>10,350</u>	<u>8,450</u>

# Illustration on M&O Consult

	₱
▶ Consulting Income	10,000
▶ Less cost of consulting	<u>2,000</u>
▶ Gross Profit/Income	8,000
▶ Less admin and overhead	<u>2,500</u>
▶ Operating Profit	5,500
▶ Less interest and taxes	<u>3,000</u>
▶ Net Income/Profit	<u><u>2,500</u></u>

# Profitability Ratios

- ▶ Profitability ratios are arguably the most widely used ratios in investment analysis. These ratios include the ubiquitous “margin” ratios, such as gross, operating and net profit margins. These ratios measure the firm’s ability to earn an adequate return. When analyzing a company’s margins, it is always prudent to compare them against those of the industry and its close competitors.
- ▶ Margins will vary among industries. Companies operating in industries where products are mostly “commodities” (products easily replicated by other firms) will typically have low margins. Industries that offer unique products with high barriers to entry generally have high margins. In addition, companies may hold key competitive advantages leading to increased margins.

# Gross profit margin

Gross profit margin is simply gross income (revenue less cost of goods sold) divided by net revenue. The ratio reflects pricing decisions and product costs. The 80% gross margin for the company in our illustration shows that 80% of revenues generated by the firm are used to pay for the cost of goods sold.

For most firms, gross profit margin will suffer as competition increases. If a company has a higher gross profit margin than is typical of its industry, it likely holds a competitive advantage in quality, perception or branding, enabling the firm to charge more for its products. Alternatively, the firm may also hold a competitive advantage in product costs due to efficient production techniques or economies of scale.

Keep in mind that if a company is a first mover and has high enough margins, competitors will look for ways to enter the marketplace, which typically forces margins downward.

# Operating profit margin

Operating profit margin is calculated by dividing operating income (gross income less operating expenses) by net revenue. The operating margin in illustration above is 55%, which suggests that for every ₦1 of revenues generated, ₦0.55 is left after deducting cost of goods sold and operational expenses.

Operating expenses include costs such as administrative overhead and other costs that cannot be attributed to single product units.

Operating margin examines the relationship between sales and management-controlled costs. Increasing operating margin is generally seen as a good sign, but investors should simply be looking for strong, consistent operating margins

# Net profit margin

- ▶ Net profit margin compares a company's net income to its net revenue. This ratio is calculated by dividing net income, by net revenue. It measures a firm's ability to translate sales into earnings for shareholders. Once again, investors should look for companies with strong and consistent net profit margins.
- ▶ In our illustration, the net profit margin of 25% suggests that for every ₦1 of revenue generated by the firm, ₦0.25 is created for the shareholders/Partners of M&O Consult.

# ROA and ROE

- ▶ Two other profitability ratios are also widely used—return on assets (ROA) and return on equity (ROE).
- ▶ Return on assets is calculated as net income divided by total assets. It is a measure of how efficiently a firm utilizes its assets. A high ratio means that the company is able to efficiently generate earnings using its assets.

$$\text{ROA} = \frac{\text{Profit Before Interest \& Tax (PBIT)}}{\text{Total Assets}}$$

$$\text{ROE} = \frac{\text{Profit After Tax (PAT)}}{\text{Equity}}$$

# ROA and ROE

While return on assets measures net income, which is return to equity holders, against total assets, which can be financed by debt and equity, return on equity measures net income less preferred dividends against total stockholder's equity.

This ratio measures the level of income attributed to shareholders against the investment that shareholders put into the firm. It takes into account the amount of debt, or financial leverage, a firm uses.

# ROA and ROE

Financial leverage magnifies the impact of earnings on ROE in both good and bad years.

If there are large discrepancies between the return on assets and return on equity, the firm may be incorporating a large amount of debt. In that case, it is prudent to closely examine the liquidity and solvency ratios.

# Conclusion

Ratio analysis is a form of fundamental analysis that links together the three financial statements commonly produced by corporations.

Ratios provide useful figures that are comparable across industries and sectors. Using financial ratios, investors can develop a feel for a company's attractiveness based on its competitive position, financial strength and profitability

# Content of IFRS Financial Statements

## **STATEMENT OF CHANGES IN EQUITY**

This statement shows the capital invested by the shareholders and profit earned from ordinary activities and the amount retained by the company.

Other matters that affect statement of changes in equity includes revaluation gains on item of property plant and equipment or actuarial gain from defined benefit pension plan which are not reported directly through the income statement as profits or losses.

# Content of IFRS Financial Statements

## STATEMENT OF CHANGES IN EQUITY

For owner-managed business, the only items that may affect the statement of changes in equity are the resulting profit or loss that is transferred to retained earnings and any dividends that the directors may have taken in their capacity as shareholders.

# Content of IFRS Financial Statements

## TYPICAL STATEMENT OF CHANGES IN EQUITY

Statement of Changes in Equity for the year ended 31 December 2022	Share capital	Statutory reserves	Retained earnings	Revaluation reserve	Total
Balance at 1 January 2022	X	X	X	X	X
Dividends			(X)		(X)
Issue of Shares	X				X
Total Comprehensive income for the year			(X)	X	X
Gain/loss on revaluation of non-currents				X	X
Transfers to Statutory reserves		X	(x)		
Balance at 31 December 2022	X	X	X	X	X

# Content of IFRS Financial Statements

## STATEMENT OF CASH FLOWS

More businesses fail because of cash flow issues than because they can't achieve a profit, which is why the first basic standard to get to grips with is Statement of Cash flows. Of course, for the banker, the statement of cash flows is *sine qua non* amongst financial statements in risk analysis.

All companies, whether small or big, reporting under IFRS are mandated to prepare statement of cash flows.

# Content of IFRS Financial Statements

## STATEMENT OF CASH FLOWS

Financial statements are prepared using the accruals basis of accounting. The accrual concept allows users of the financial statements to understand the viability (profits) or otherwise (loss) and the financial position of the company at the end of the accounting period.

An organization prepares the statement of cash flows so that users of the accounts can see how the organization has generated and spent its cash.

# Content of IFRS Financial Statements

## **IMPORTANCE OF THE STATEMENT OF CASH FLOWS**

The statement of cash flows can reveal things in the financial statements that may not be apparent due to the accrual concept. Statement of cash flows is the only primary financial statement that you prepare on a cash (receipts and payments) basis.

It quickly shows the liquidity or otherwise of the company which may not be disclosed by other primary financial statements. Negative operating cash flows signal that danger is ahead of an organization despite its profitability.

# Content of IFRS Financial Statements

## **UNDERSTANDING STATEMENT OF CASH FLOWS**

The IAS that guides the preparation of the statement of cash flows is IAS 7. There are two methods to choose from: direct method and indirect method. Indirect method is considered easier.

The standard encourages companies to use the direct method but only on the grounds that it provides information that is not available under the indirect method which may be useful in estimating future cash flow.

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

The standard prescribes that statement of cash flows be split into three sections and in the following order:

- **Operating activities:**  
The day-to-day revenue-producing activities that are not investing or financing activities.
- **Investing activities:** Those activities that involve the acquisition and disposal of long term assets.
- **Financing activities:** Those activities that change the equity and borrowing composition of the company.

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

To prepare statement of cash flow you will need the following:

- The statement of comprehensive income for the current year
- The statement of financial position for both the current year and the previous financial year.

The Cash Flow Statement is prepared mainly to show how the opening cash balance turned into the closing cash balance.

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

### Calculating cash flow from operating activities

Under the indirect method you need to reconcile the operating profit to the net cash inflow from operating activities.

Adjust profit from operations for non-cash items included in the income statement e.g. depreciation and loss on disposal of non-current assets since they are not cash transactions.

Compare current year's inventory, receivables and payables to the previous year figures to arrive at decrease or increase in working capital.

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

### Considering investing activities

Investing activities are cash spent or received from buying new non-current assets or selling a non-current asset like property, plant and equipment; income from investment such as dividend received, interest received will also form part of the investing activities.

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

### Focusing on financing activities

This is determining how much you have raised and spent in the year on activities like bank loans, issue of share, etc.

### Balancing the figure

This is done by deducting the cash and cash equivalents (short-term, highly liquid investments) at the beginning of the year from the cash and cash equivalents at the end of the year. The result should be equal to the net increase (decrease) in cash and cash equivalent resulting from operating, investing and financing activities.

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

Example of direct method		
	2022	2021
	N'000	N'000
<b>Operating activities</b>		
Received from customers	7,046	6,665
Payment to customers	(4,742)	(4,426)
Payments to and on behalf of employees	(928)	(783)
Other payments	(567)	(547)
Net cash inflow from operating activities	<b>809</b>	<b>909</b>

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

Example of indirect method		
	2022	2021
	N'000	N'000
Operating Profit	940	897
Adjustments for:		
Depreciation	160	151
Loss on sale of non-current assets	100	110
Profit on sale of non-current assets	<u>(50)</u>	=
Cash flow from operating activities before changes in working capital	<u>1,150</u>	<u>1,158</u>

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

Example of indirect method		
	2022	2021
	N'000	N'000
<b>Cash flow from operating activities before changes in working capital</b>	1,150	1,158
Decrease in inventory	130	110
Increase in Loans & other receivables	(80)	(119)
Cash generated from operations	1320	1224
Interest paid	(75)	(95)
Tax Paid	(234)	(190)
<b>Net cash inflow from operating activities</b>	<b>1,011</b>	<b>939</b>

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

Example of indirect method		
	2022	2021
	N'000	N'000
Net cash inflow from operating activities	<u>1,150</u>	<u>1,158</u>
<b>Investing Activities:</b>		
Proceeds from disposal of non-current assets	430	214
Purchase of property, plant and equipment	(3,150)	(2,280)
Net cash used in investing activities	(2,730)	(2,066)

# Content of IFRS Financial Statements

## UNDERSTANDING STATEMENT OF CASH FLOWS

Example of indirect method		
	2022	2021
	N'000	N'000
<b>Financing activities:</b>		
Net Loans raised	1,260	720
Proceeds from share issues	3,850	2,180
Dividends paid	(800)	(540)
Net cash used in/from financing activities	<u>4,310</u>	<u>2,360</u>
Net increase/(decrease) in cash and cash equivalents	2,730	1,452
<b>Cash and cash equivalents at beginning of the year</b>	<b>2,432</b>	<b>980</b>
<b>Cash and cash equivalents at beginning of the year</b>	<b>5,162</b>	<b>2,432</b>

# Content of IFRS Financial Statements

## ACCOUNTING POLICIES

IFRS is a principle based framework and it is important that all preparers of financial statements stick to those principles.

An organization must select suitable accounting policies that are in line with IFRS principles. IFRS provides guidance on accounting policies as contained in **IAS 8 Accounting policies, changes in accounting estimates and errors**.

It is required of an organization to select accounting policies appropriate to its individual circumstances. Some accounting policies are critical and also require disclosure e.g. revenue recognition.

# THANK YOU FOR YOUR ATTENTION



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