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N.B. Shamuratova [1], V. Alibekova [2], G. Amalbekova [3]

Kokshetau University named after A. Myrzakhmetov, Kokshetau;
Taraz State University named after M.H. Dulati, Taraz;
Information and Media Communication Center

FINANCIAL ANALYSIS AND ITS DEFINITION

Abstract. This article is devoted to explanation of financial analysis as a concept, including its methodology and all topics related to this problematics. The findings will subsequently be used for the creation of the actual financial analysis of the selected company. Where financial analysis is determined, explains various approaches to this problem, identifies individual users of financial analysis, as well as sources of information for its creation. It also describes the methodology of a specific approach to financial analysis. Thus, the main attention is paid to the explanation and interpretation of all individual indicators and possible procedures in their formation. The article also contains information about the main characteristics of the selected company and industry and gives the reader an idea of how this company works. Based on the presented financial statements for the past five years, the company will be subjected to analysis of all the indicators explained in the methodological part of the article, and based on correctly interpreted results, conclusions and potential recommendations will be presented. For this purpose, part of the indicators used in financial analysis will be compared with the average values in the industry in which the company operates. This will provide a wider range in which this particular analysis can be used.

Keywords: Financial analysis, Financial health, Absolute indicators, Differential indicators Ratiometric indicators Indicator systems.

Financial analysis can be characterized as a systematic tool for monitoring the financial condition of the company on the base of the analysis of information that are primarily to find in the financial statements of the company. However, financial analysis is not only a sort of statistical assessment of the current situation, but it is also reflective of the past management and to some extent it can also predict the future financial conditions.

In business sphere, where due to the economic environment many unexpected changes occur, financial analysis represents for many a very useful, for others absolutely vital instrument to regulate corporate planning, to which the finances are obviously inseparably connected. Long story short, whoever creates the financial analysis (be it of one's own business or e.g. of potential business partners) acquires additional information and thus also a certain amount of benefits with it. (Fabozzi, Peterson Drake, & Habegger, 2003).

The purpose of financial analysis is to provide its user with the information in such form, on the base of which he can more easily decide about further plans for functioning of his business or generally about his intentions with the company that is being assessed. As already mentioned, the source of such information is the financial statements. While they provide the information about management of the company, they rather have the character of hard data. It is only the processing with financial analysis, during which the financial statements data is mutually compared, that transforms it in a form with much higher informational value. The hard data is then displayed in required context that can assess the so called financial health of the company.

As a financial health is considered a satisfactory financial situation of the company, meaning the company is able to achieve required appreciation of the invested capital, with regard to the risks the company is willing to take. Financial health is therefore generally determined by the profitability. The higher it is the better situation and better financial health it means. At the same time, however, it is necessary to secure long-term liquidity that derives from good cash flow. Together with the profitability, it can ensure stable and long-term operation. (Synek, 2010)

Various approaches to financial analysis

Financial analysis can be seen from different perspectives. In terms of its extent, there are three basic types that differ in the content. The narrowest conception is regarded as an analysis of finance in a true sense of the word. It is purely an investigation and analysis of the financial statements. The wider option adds to the output an evaluation process. In addition of the data from accounting, the most extensive option includes other financial and nonfinancial sources of information about the company and its environment. Generally speaking, the more extensive option we choose the more precisely we are able to predict future development. On the other hand, we expose ourselves to a higher risk of subjectivity. (Higgins, 2012)

As for the approach to the financial analysis, there are two basic types; the first is technical or quantitative analysis and the second is called fundamental or qualitative, while both of these have its pros and cons and it is therefore recommended to combine these approaches. (Higgins, 2012)

Technical analysis applies its final conclusions on the base of mathematical and statistical methods, through which the investigated data can be quantitatively compared and thus later assessed and evaluated from the qualitative point of view. Generally, the creation of technical analysis proceeds as follows. The first thing to do is to characterize the environment. That means the required data is gathered, then, on the base of the investigated subject, the relevant indicators are chosen, the applicability of the indicators is verified and the comparable entities are selected. The next thing on the list is to select the most suitable method, which is followed by primary data processing. Finally, after appropriate processing, the data is evaluated on the base of selected criteria. Methods that are used for technical analysis are: absolute indicators analysis, differential indicators analysis, ratiometric indicators analysis and indicator systems analysis. Technical analysis will be the main focus of this thesis during the investigation of the selected company in the following chapters. (Higgins, 2012)

Fundamental analysis (or qualitative analysis), in contrast to technical analysis, does not use numerical methods and algorithmic procedures, but leans on the relation between economic and noneconomic phenomena that have direct or indirect impacts on the company. The foundation of fundamental analysis is the identification of environment and the impacts of the macroeconomic and microeconomic environment on the company, in regard to its set goals and the stage of its life. This method is based rather on a verbal evaluation resulting from the experience and the opinion of the expert who carries out the analysis. The methods used forfundamental analysis are e.g. SWOT analysis, critical factors method, BCG matrix, Argenti's A-score, portfolio analysis and more. (Higgins, 2012)

Users of financial analysis

The final documents created on the base of analysing the financial statements can be handy for a variety of subjects. These subjects are generally divided into external and internal users. According to their particular interest, each of these subjects prefers more or less different information. (Sedláček, 2007)

When assessing the company, the external users of financial analysis can utilize the mandatory publications of financial statements or other publicly accessible sources. Compared to the internal users, they usually have a limited amount of information. The investors, banks, creditors, business partners, competitors and government are considered as external users. (Sedláček, 2007)

The investors include shareholders, partners and other persons that own or are considering ownership of a certain stake in the company. Above all, the potential investors benefit from the results of financial analysis in order to find out the possible return on their investment and related risks. They also use the information in terms of control, when they are interested in the previous management of the business, which include its stability and perspective (also of the possible investment) and the size of profit shares payments. (Sedláček, 2007)

Banks and creditors are primarily interested in the creditworthiness and liquidity so they can properly assess the ability of the company to meet its obligations. Based on these factors, the creditor makes his decision of granting or rejecting a loan or under what terms. They also evaluate the return on the potential project, of which the client requires financing. (Sedláček, 2007)

By **business partners** we mean both suppliers and customers. While the suppliers are like the banks and creditors interested in liquidity and solvency to establish a long-term smooth relationship, the customers are rather interested in the financial stability of the company and the ability to meet its obligations. (Sedláček, 2007)

The competitors mostly care about the comparison with their own business results. The numbers they are particularly interested in are the amount of sales, profitability, profit margin, solvency or inventory turnover period, which may possibly inspire them or let them discover mistakes in their own actions. (Sedláček, 2007)

Above all, **the government** uses the results of financial analyses to publish the statistical data for the whole industry. They also provide a way to check the taxes payments or drawing grants. The analyses can also serve as a base for the application of fiscal and monetary politics. (Sedláček, 2007)

Compared to external users, the internal users have the advantage of having access to much more detailed financial or nonfinancial types of information. Aside from the mandatory published financial statements, they have access to detailed data of the financial, managerial and intercompany accounting including the calculations, plans, strategies etc. Financial analyses for the company's own use are usually carried out by the company's departments, auditors or rating agencies. Internal users include managers, employees and unions. (Sedláček, 2007)

Managers use the results of financial analyses for establishing an appropriate future financial strategy. Specifically, this includes the amount and structure of the assets, sources of financing, allocation of available resources, profit distribution, decisions about future business goals or business valuation. The results also serve as a certain self-reflection and an indicator of the correctness of managerial decisions. (Sedláček, 2007)

Employees and unions are primarily interested in the wages and social conditions, as well as long-term jobs preservation. They therefore mainly concentrate on the overall stability and profitability of the company, within the results of financial analyses. (Sedláček, 2007)

Sources of information for financial analysis

Given that the financial analysis is based directly on the financial or nonfinancial statements, the quality of the output strongly depends – besides correct execution – on the quality of the information sources. In case these sources lacked quality and complexity, they would not be able to provide sufficient informational value and the results of the financial analysis could be therefore distorted and provide the user with false information about the financial health of the company and related problems. (Grünwald & Holečková, 2007)

As a source of information, the financial statements can be divided into two basic groups, into financial statements and intercompany financial statements.

Financial statements are considered to be external statements, for they present publicly accessible information that the company is under certain circumstances obliged to publish annually. This type of statements provides information to all; it is primarily intended for the external users though. They provide information about the asset portfolio and its financing, generating and managing of profit or loss and an overview of the cash flows of the company. They can be considered as the fundamental data for the financial analysis. (Synek, 2010)

On the other hand, the **intercompany or internal statements** does not have any form, which is set by the law so it's up to the companies to decide about the form this data will have according to their needs. Generally, these statements are useful, because they are created in a narrower timeframe and this more frequent and more detailed classification leads to more accurate results with lesser risks of deviation from reality. (Synek, 2010)

The balance sheet is a basic financial statement with assets on one side, liabilities on the other, while the balance between those two must always be preserved. To a certain moment they together show the state of the assets, sources of its financing and the financial situation given by the profit and its distribution. When analysing the balance sheet, we're not only interested in the structure of assets and liabilities and the development of the balance, but also in the relations between the individual items. There is one drawback, when analysing the balance sheet and that is that the items are reported in historical values, which can distort the analysis, for there is no consideration of the time value of the money or the current value of assets and liabilities in the balance sheet. (Růčková, 2015)

Chart 1: Balance sheet

ASSETS	LIABILITIES & EQUITY
RECEIVABLES FOR	EQUITY
SUBSCRIBEDCAPITAL	
FIXED ASSETS	Share capital
Intangible fixed assets	Capital funds
Tangible fixed assets	Reserve funds, indivisible fund and other funds from profit
Non-current financial assets	Retained earnings Profit or loss for the current period
CURRENT ASSETS	LIABILITIES
Inventories	Reserves
Long-term receivables	Long-term liabilities
Short-term receivables	Short-term liabilities
Current financial assets	Bank loans and borrowings
OTHER ASSETS	OTHER LIABILITIES

Source: of own making according to (Pelák, 2009)

Profit and loss account or income statement shows expenses and income for a period, which makes them flow quantities. Similarly to the balance sheet, this statement is also a vital part of the financial statement. The purpose of this account – apart from displaying income and expenses – is to show profit or loss, that is why the analyst always wants to know what individual items influenced the final profit (when the income exceeds the expenses) or loss (vice versa). We recognize three subtypes – operating, financial and extraordinary profit or loss. These partial results together give the final profit or loss for the current period. (Pelák, 2009)

Operating profit or loss includes items that represent main part of the business. It includes sales of products, goods and services, from which the operating expenses are subtracted. According the Czech accounting standards, the operating profit or loss comprises of:

+ Sales of goods
- Cost of goods sold
= GROSS MARGIN + Production
- Purchased consumables and services
= ADDED VALUE
- Staff costs
- Taxes and charges
- Depreciation of tangible and intangible fixed assets
+ Sales of fixed assets and material - Net book value of fixed assets and material sold
- Change in reserves and provisions relating to operating activities and complex deferred expenses
+ Other operating income - Other operating expenses
+ Transfer of operating income - Transfer of operating expenses
= OPERATING PROFIT OR LOSS (Kislingerová & kol., Manažerské finance, 2010)

Financial profit or loss consists of expenses and income mostly related to speculative securities, shares and interest on loans. It comprises of these accounts:

+ Proceeds from the sale of securities and investments - Cost of securities and investments sold
+ Income from non-current financial assets
+ Income from current financial assets
- Costs of financial assets
+ Income from the revaluation of securities and derivatives - Costs of the revaluation of securities and derivatives
- Change in reserves and provisions relating to financial activities
+ Interest income
- Interest expenses
+ Other financial income - Other financial expenses
+ Transfer of financial expenses - Transfer of financial income

= FINANCIAL PROFIT OR LOSS (Kislingerová & kol., Manažerské finance, 2010)

The sum of operating and financial profit or loss makes after subtracting the income tax on ordinary activities the **profit or loss from ordinary activities**. (Kislingerová & Hnilica, Finanční analýza - krok z krokem, 2008)

Since January 1 2006, the extraordinary profit is not recognized due to an amendment of the accounting methods and the original accounts became parts of other accounts. (Königová, 2016)

Until then, the **extraordinary profit or loss** consisting of random transactions was found out from these accounts:

\+ Extraordinary income - Extraordinary expenses

\- Income tax on extraordinary activities

= EXTRAORDINARY PROFIT OR LOSS (Růčková, 2015)

The sum of profit or loss from ordinary and extraordinary activities makes **profit or loss for the current period.**

For the purposes of financial analysis, there is a term net profit, which is identical with the profit or loss for the current period. There is also profit or loss before tax that is also reported in the profit and loss account. Other versions of profit are also used, modified by certain items. These profits or losses and their mutual relationships are displayed in following table: (Schnaiberg, n.d.)

Chart 2: Profit or loss types

			EBITDA		
		EBIT			Depreciation
	EBT			Interest	
EAT		Tax			
Net profit, P. or L					

Profit before tax, Profit or loss
Profit before tax and interest, Operating profit or loss
Profit before tax, interest and depreciation
Source: (Schnaiberg, n.d.)

The cash flow statement shows the flows of intake and expenditure of funds, unlike the profit or loss account, which displays income and expenses. It is then obvious that income does not necessarily mean intake and expense does not have to mean expenditure. We often encounter situation when the business is profitable, but does not have any funds to pay its obligations with. Cash flow statement informs the user about the amount of generated funds and how they were handled with. Compared to the income statement, the cash flow statement has the advantage of not including depreciation, which gives many ways to approach them and thus influence the profit or loss without any impact on the amount of funds. The same as for depreciation goes for accruals. (Pelák, 2009)

Based on the way it is compiled, cash flow statement has two forms. **Direct method** means that the increases and decreases of cash are recorded during the appropriate period. When you use the **indirect method**, total cash flow is summed from partial calculations of operating cash flow, cash flow from investing activities and cash flow from financing activities. The starting point for operating cash flow is profit or loss, to or from which are then added or subtracted item differences from the start and the end of the current period (i.e. changes). It is typically a change of provisions (depreciation values), inventories, receivables, payables, reserves and accruals, while a general rule says that the asset accounts increases and liability accounts decreases are added and vice versa. The same goes for cash flow from investing activities, which is the result of fixed assets changes, and cash flow from financing activities, which is given by long-term loans and credits changes. (Vachtová, 2013)

Н.Б. Шамуратова[1], В. Әлібекова[2], Г. Амалбекова[3]

А.Мырзахметов атындағы Көкшетау университеті, Көкшетау;
М.Х. Тараз мемлекеттік университеті Дулати, Тараз;
Ақпараттық және медиа коммуникациялар орталығы, Тараз

ҚАРЖЫЛЫҚ ТАЛДАУ ЖӘНЕ ОНЫҢ АНЫҚТАМАСЫ

Аннотация. Бұл мақала қаржылық талдауды тұжырымдама ретінде, оның әдістемесі мен осы мәселеге қатысты барлық тақырыптарды түсіндіруге арналған. Нәтижелер кейіннен таңдалған компанияның нақты қаржылық талдауын жасау үшін қолданылады. Қаржылық талдау анықталған жерде осы мәселеге қатысты әр түрлі тәсілдерді түсіндіреді, қаржылық талдаудың жеке пайдаланушыларын, сонымен қатар оны құру үшін ақпарат көздерін анықтайды. Онда сонымен қатар қаржылық талдаудың нақты тәсілінің әдістемесі сипатталған. Осылайша, барлық жеке индикаторларды және оларды қалыптастырудағы мүмкін процедураларды түсіндіруге және түсіндіруге басты назар аударылады. Мақалада сонымен қатар таңдалған компания мен саланың негізгі сипаттамалары туралы ақпарат бар және оқырманға компанияның қалай жұмыс істейтіні туралы түсінік беріледі. Соңғы бес жылдағы ұсынылған қаржылық есептілік негізінде компания мақаланың әдістемелік бөлімінде түсіндірілген барлық көрсеткіштерге талдау жүргізеді және дұрыс түсіндірілген нәтижелерге, қорытындыларға және ықтимал ұсыныстарға сүйене отырып ұсынылады. Осы мақсатта қаржылық талдау кезінде қолданылатын көрсеткіштердің бір бөлігі компания қызмет ететін саладағы орташа мәндермен салыстырылады. Бұл нақты талдауды қолдануға болатын кең ауқымды қамтамасыз етеді.

Түйінді сөздер: Қаржылық талдау, қаржылық жағдай, абсолютті көрсеткіштер, дифференциалды көрсеткіштер, коэффициенттік көрсеткіштер, индикаторлық жүйелер.

Н.Б. Шамуратова[1], В. Алибекова[2], Г. Амальбекова[3]

Кокшетауский университет им. А. Мырзахметова, Кокшетау;
Таразский государственный университет им. М.Х. Дулати, Тараз;
Информационно-Медиа Коммуникационный Центр, Тараз

ФИНАНСОВЫЙ АНАЛИЗ И ЕГО ОПРЕДЕЛЕНИЕ

Аннотация. Эта статья посвящен объяснению финансового анализа как концепции, включая его методологию и все темы, связанные с этой проблематикой. Результаты будут впоследствии использованы для создания фактического финансового анализа выбранной компании. Где определяется финансовый анализ, разъясняет различные подходы к этой проблеме, определяет отдельных пользователей финансового анализа, а также источники информации для его создания. Так же описывает методологию конкретного подхода к финансовому анализу. Таким образом, основное внимание уделяется объяснению и интерпретации всех отдельных показателей и возможных процедур при их формировании. Так же статья содержит информацию об основных характеристиках выбранной компании и отрасли и дает читателю представление о том, как работает эта компания. На основе предоставленной финансовой отчетности за последние пять лет компания будет подвергнута анализу всех показателей, объясненных в методологической части статьи, и на основе правильно интерпретированных результатов будут представлены выводы и потенциальные рекомендации. Для этой цели часть показателей, используемых в финансовом анализе, будет сравниваться с показателями средних значений в отрасли, в которой работает компания. Это обеспечит более широкий диапазон, в котором этот конкретный анализ может использоваться.

Ключевые слова: Финансовый анализ, финансовое здоровье, абсолютные показатели, дифференциальные показатели, ратиометрические показатели, индикаторные системы.

Information about authors:

Shamuratova Nazgul Balabaevna - I.O. Associate Professor, Candidate of Economic Sciences, Kokshetau University named after Abay Myrzakhmetov, Definition of research methods, study of domestic and foreign literature, resumes and conclusions, Naza_1@mail.ru, https://orcid.org/0000-0002-8566-0758

Alibekova Vilnara - Doctor PhD, Senior Lecturer, Taraz State University named after M.Kh. Dulati, Taraz, Research work, information gathering, generalization, article writing, vilnara70@mail.ru, https://orcid.org/0000-0001-9577-476X

Amalbekova Gulmira - Director, Candidate of Economic Sciences, Information and Media Communication Center, Research, bay-70@mail.ru, https://orcid.org/0000-0001-9622-6263

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