

Financial Statements

Balance Sheet

- The Balance sheet of commercial bank shows the financial position (assets, liabilities, equity etc) at a given point of time usually the last day of the quarter or year
- It is also viewed as a list of financial inputs (i.e. sources of funds) and outputs (i.e. uses of funds) at a point of time

Assets in Commercial Banks

- **Cash**
- **Security holdings/ Investments**
- **Loans**
- **Miscellaneous Assets**

Cash Assets

- It includes cash and deposits due from banks
- Items include:
 - ✓ Cash in treasury or vault cash
 - ✓ Deposits with other banks
 - ✓ Cash in process of collection
 - ✓ Reserve account with Central Bank
- It is called Primary Reserves

Securities or Investments

- **Short term Securities (Liquidity Position and Secondary Reserves)**
 - ✓ Short term government securities
 - ✓ Money market securities i.e. (i) interest bearing time deposits & (ii) commercial papers
- **Securities for Investment (Income generating position of Securities)**
 - ✓ Government dated securities
 - ✓ Corporate bonds and other holdings

Investments Contd...

Trading Account Assets

- Securities purchased to provide short term profits from short term price movements
- Amount recorded in the trading account is valued in market

Government funds and Reverse Repurchase Agreement

- It is one type of loan account
- Generally overnight loan
- Government fund sold : funds come from the deposits at central bank
- Reverse Repo

Loan Accounts

- **Commercial and industrial loans**
- **Consumer loans**
- **Real estate loans**
- **Financial institution loans**
- **Priority Sector Lending**

Approaches to Bank Lending

- Liquidation Approach:

It considers the assets of the borrower as security for a loan. It implies a short-term rather than a long term view of the borrower's prospects

- Going Concern Approach:

It gives greater emphasis on the borrower's ability to repay the loan out of future cash flow rather than his ability to offer some tangible assets as security for the loan

Specific and General Reserves

- **Specific Reserves: Set aside to cover a particular loan**
- **Remaining are called General Reserves**
- **Determined by management, taxes and government regulations**

Miscellaneous Assets

- **Fixed Assets**
- **Indirect and direct investment in real estate**
- **Goodwill and other intangibles**

Liabilities of Commercial Banks

- **Deposits**
- **Borrowings from non-deposit sources**
- **Equity Capital**
- **Off-balance sheet items**

Bank Deposits

- Demand Deposits

Current Deposits: These are chequable accounts, there are no restrictions on the amount or the number of withdrawals from these accounts and does not carry any interest

Savings Deposit: Cheques can be drawn, withdrawn from an account without previous notice are restricted

- Call Deposits : they are accepted from fellow bankers and are repayable on demand. These deposits carry an interest charge

Bank Deposits Contd....

- **Time Deposits: Usually carry a fixed maturity and stipulated interest rate**
- **Recurring Deposits: Fixed amount of money deposited in an uniform interval for a stipulated fixed period and carry a stipulated interest rate**

Factors Affecting Bank Deposits

- Increase in per capita income
- Expansion of banking facilities
- Increase in banking habit
- Increase in relative rate of return on deposits
- Increase in bank credit
- Inflow of deposits for NRIs
- Growth of substitutes

Borrowings for Non Deposit Resources

- **Borrowing from money market**
- **Borrowing from Central Bank through repo operations**
- **Borrowings from other banks apart from regular money market**
- **Subordinate debts**
- **It has grown due to lesser cost**
- **These are highly volatile**

Equity Capital

- **Preferred Stock:** It gives its holder an fixed annual dividend before common shareholders receive any dividend payment. It is not tax deductible (less preferred)
- **Common Stock Outstanding**
- **Retained Earnings**

Balance Sheet Variations Across Size

- **Relative importance of balance sheet varies across the size**
- **Larger banks tend to trade securities for short-term profits than smaller banks**
- **Smaller banks hold more investment securities and loan relative to their assets**
- **Smaller banks rely more on deposits**
- **Larger banks make more use of money market instruments**

Off-Balance Sheet Items in Banking

- Unused Commitments: In this case a lender receives a fee to lend upto a certain amount of money over a defined period of time, but these funds have not yet been transferred from lender to borrower
- Standby Credit Agreements: Banks receive a fee to guarantee repayment of a loan that a customer has received from another lender
- Derivative Contracts: Future Contracts, Options, Swaps to hedge credit risk, interest rate risk and foreign exchange risk

Income Statement

- It indicates the amount of revenue received and expenses incurred over a specific period of time
- Close correlation between the balance sheet items and income statement
- Assets usually account for the majority of operating revenues and liabilities generate bank's operating expenses

Revenue and Expenditure Items

- **Interest Income:** Interest earned from loans and security investments
- **Non-Interest income:** fees, commissions etc
- **Interest expenses:** Interest on deposits, interest owed on short term borrowings in the money market, long term borrowings
- **Non- Interest Expenses:** Cost of equity capital, salary, wages, benefits paid to employees, overhead expenses, funds set aside for possible loan losses and taxes owed.

Revenue and Expenditure Items Cont...

- **Net interest income = Interest income – Interest expenses**
- **Net Income = Total Revenue – Total Expenses**
- **Pre tax Net Operating Income = Net interest income + Net Non-interest Income**
- **Pre tax Net Operating Income – Tax + Securities gains or losses + Extraordinary Income = Net Income**

Income Statement Ratios and Bank Size

- Large banks receive more income from non-interest income
- Small banks rely more on deposits than money market instruments.