

# Preface

*In the present days, the most burning issue in the Indian economy is about the day by day increase in non-performing assets (NPAs) of banks, increase in bad loans and a large number of frauds reported every day by the banks relating to a loan given. As a result, the Indian banking industry is witnessing a turmoil. The Government has come up with various measures like induction of the Insolvency and Bankruptcy Code, Prompt Corrective Action (PCA), setting up of reconstruction firm etc. for faster resolution of stressed assets. Even the International Monetary Fund (IMF) in its recent bi-weekly news conference has asked the Government of India to address the ongoing crises in the Indian banking sector to support investment and inclusive growth agenda.*

*The issue of bad loans and loan fraud in Indian banking system has reached an alarming level, and therefore, is a cause of concern for everyone - Government, Regulators, Banks, Investors, Shareholders and even every citizen of India, as it is the public money which is going into bad loans.*

*This book is not for whom to be blamed, but there is a center piece of documents - "Balance Sheet", which is always relied upon by the banks for any amount of loan provided or to be provided. I have always considered the balance sheet like a horoscope, if one knows how to read and analyse it, then probably addressing the various early warning signs available in such accounts could have helped to a great extent in reducing NPAs and loan fraud.*



*Dr. Raghuram Rajan, former Governor of the Reserve Bank of India highlighted six key reasons for the recent spurt in non-performing assets (NPAs) and bad loans of banks in a note (May 2016) to the Public Accounts Committee (PAC) of the Parliamentary Panel. The reasons he marked include:*

- 1. Domestic and global slowdown*
- 2. Delays in statutory and other approvals, especially for projects under implementation*
- 3. Aggressive lending practices during the upturn, as evidenced by high corporate leverage*
- 4. Laxity in credit risk appraisal and loan monitoring in banks.*
- 5. Lack of appraisal skills for such projects that need specialized skills, resulting in acceptance of inflated cost and aggressive projections*
- 6. Wilful default, loan frauds and corruption in some cases.*

*Out of these six reasons, this book deals extensively with the last three (reasons numbered 4, 5 and 6 above) and shows how they can be mitigated through proper analysis of financial statements.*

*By reading between the lines of financial statements and by correlating relevant information with proper analysis, the true financial history of any entity can be revealed. Accountants already know this, but where they differ are in their varying degree of skills and wisdom derived from experience.*

*This book shows its readers how to hone their skills to a sharpness needed to dissect financial statements with surgical precision, so that the future of any loan provided can be ascertained and as a result, the quality of the assets of the bank can be improved by reducing bad loans and frauds.*

*On the basis of proper analysis and understanding of the facts of each case, any fraud, diversion of funds, the genuineness of investment, sustainability of sales, quality of profit, end use of the funds, corporate governance practice, quality of disclosure, or quality of audit etc. can be ascertained. How to combine all these factors has been explained in this book, so as to improve the skills for analysis of financial statements and credit risk appraisal.*

*Every action or inaction of the management is visible from financial statements. That is why heavy reliance has been placed on the financial*



*statements, since Kautilya's time. Kautilya's Arthashastra was written about 2,400 years ago. The Arthashastra is not only of historical interest but is one of the world's oldest manuals on the economic administration of a State. While dealing with accounts (i.e. balance sheet) in the Arthashastra, Kautilya states:*

*"All accounts shall be maintained in the proper form and legibly written without corrections (overwriting). Failure to do so shall be a punishable offence".*

*(Verse - 2.7.35)*

*While dealing with financial reporting (i.e. disclosure of information), in Arthashastra, it has been stated about the submitter of the report:*

*"He shall have so thorough a knowledge of the receipts and disbursements from the city and from, the countryside that, when questioned, he shall not falter in giving details of the income, expenditure and net balance for (accounts relating to) a period of even a hundred years".*

*(Verse - 2.5.22)*

*What has been stated in the Arthashastra, 2,400 years ago, holds good even today. The maintenance of proper accounts and the requirement of disclosing full information in the balance sheet is not new but they exist since Kautilya's time. What has changed is the level of complexity of business in a wired and globalized world (with interconnected and interdependent economies) where financial transactions can take place almost at the speed of thought. Consequently, there has been an accompanying increase in the level of complexity in financial statements and accounting.*

*The complexity in accounting, however, has become debilitating in many aspects as the relevant laws in India have not kept pace with changes in economic development, thus creating an imbalance between complex businesses (requiring complex accounting) and laws relating to accounts and audit.*

*As a result, entities have started to use creative accounting that meets the benchmarks of outdated laws and has begun using the loopholes in both ethical and unethical manners to suit their objectives. Diversion of funds, fudging books of account, misrepresenting sales and profit have become rampant. Relevant disclosures are often found missing or improper. Walls*



*raised in corporate governance and deterioration in the quality of audit have added fuel to the fire.*

*In this book, all sincere efforts have been taken to unlock these mysteries and tricks by explaining how to analyse the various details provided in the financial statements, so as to detect what has been disclosed or not.*

*The overall objective of this book is to explain step by step, how to read the balance sheet beyond what is visible on the surface; how to analyse the information and how to correlate the various details available - so as to find out the strengths, early warning signs, frauds, creative accounting, genuineness of various items, hidden secrets etc.*

*The 36 years of my practice as a Chartered Accountant, research analyst and fraud investigator has improved my skills for analysis of financial statements. But it was Mr. Pratip Chaudhuri, former Chairman of State Bank of India, who invited me in 2012 to share my experience and knowledge of analysing balance sheets with his senior officers. Since then, I have not looked back and have imparted numerous training to the various banks on credit and analysis of financial statement. These training and interaction with the participants have also helped in sharpening my knowledge. The overwhelming response of the training and my commitment to the cause of improvement in the quality of assets of the bank by reducing NPAs and frauds has prompted me to pen down this book for those who see accounting as both a science and an art that keeps the heart of commerce beating without any falter.*

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