Financial Statements and their Reporting Ability for Management

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ABSTRAKT

Účetní závěrka hraje významnou roli v rozhodovacím procesu každého podnikatelského subjektu. Z výsledků finanční analýzy management získává informace , které jsou důležité pro budoucí rozhodování. Práce se zabývá finanční analýzou účetních výkazů společnosti Gobi Corporation v Mongolsku s cílem zjištění vypovídací schopnosti jednotlivých finančních ukazatelů. Práce se skládá z teoretické a analytické části. Teoretická část popisuje základní pojmy z účetní závěrky a metody finanční analýzy. Analytická část se zabývá finanční analýzou účetních výkazů společnosti Gobi Corporation v období 2005 - 2008 a v závěru práce jsou uvedena doporučení, která vedou ke zlepšení finanční situace podniku.

Klíčová slova: účetní závěrky, účetní metody, poměr analýza, absolutní ukazatele, vypovídací schopnost, rozhodnutí managementu.

ABSTRACT

Financial statements play an important role in the decision making process of each enterprise. The results of financial analysis, management obtains the information that is important for future decisions. This work deals with the financial analysis of financial statements of the Gobi Corporation in Mongolia to identify explanatory power of financial ratios.

The thesis consists of theory and analysis parts. Theoretical part outlines the underlying concepts of financial statements and the methods. The analytical part deals with the financial analysis of financial statements of the Gobi Corporation during the period 2005 - 2008 and the conclusion of the thesis presents recommendations that will lead to improved financial situation.

Keywords: financial statements, financial methods, ratio analysis, absolute indicators, reporting ability, management decision.

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DECLARATION OF ORIGINALITY

I hereby declare that the work presented in this thesis is my own and certify that any secondary material used has been acknowledged in the text and listed in the bibliography.

May 5, 2010

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INTRODUCTION

In order to make a profit and maximize value in today's challenging business world, sound financial decisions are required. For this reason financial statements and their reporting are valuable management tools. Management needs to have enough accurate information about the financial situation of the company over the last few years in order to make appropriate, profitable decisions. Especially if the industry in which the firm operates is relatively competitive, analyzing and comparing financial statements with not only other firms but also within the company itself becomes significant.

A highly competitive industry in Mongolia is cashmere processing. Mongolia is the second largest cashmere producer in the world behind China. Over the past decades the industry has been growing quickly and a number of firms have been established. Since 1981 the Gobi Corporation has played a major role in the Mongolian market as well as exporting its products successfully to over thirty other countries. The firm's successful history and healthy financial situation made it an apt choice for analysis in this bachelor's thesis. The firm's annual reports from the last four reporting years, 2005-2008, will be analyzed to determine how the figures contained therein can be used effectively by management in future decision making. The thesis consists of theoretical and practical parts. The theoretical part concerns terms and concepts used in financial statements, while the practical part provides the financial position and analysis of Gobi Corporation based on annual reports. Finally, recommendations will be made as to how to improve Gobi Corporation's financial management system.

I. THEORY

1 FINANCIAL STATEMENTS

Several thousand years ago, individuals started merchandising activities in the sense that they exchanged what they have by what they do not have. Firstly the trading was in the form of barter. But when development went further and beyond the local area, the primitive form of financial recording began. These financial recordings played in a major role for lending and borrowing process, as lenders wanted to inspect whether the borrower is capable of paying the loan. At the same time, these financial records could have helped them to see how their own enterprise is working and decide what actions to take in the future. All of these reasons brought the necessity of financial statements, for managers to make the financial decisions, and for shareholders to check the overall financial performance of the firm.

Nowadays, the detailed financial statements are highly reliable information source for investors, shareholders, and managers etc, as background information for decision making. Because financial statements report what has actually happened to assets, earnings and dividends over the past few years, indicating the firm's performance, problems, and prospects. Regardless of the specialization, a manager with the skill of interpreting and evaluating financial statements is highly preferable in today's competitive business environment.

There are four basic financial statements:

1. The balance sheet
2. The income statement
3. The statement of cash flows
4. The statement of retained earnings.

However the statements are interconnected, each statement has its own specific information. In the following subchapters, financial statements will be explained in detail.

1.1 The balance sheet

Balance Sheet is a financial statement that summarizes a company's assets, liabilities and shareholders' equity at particular date. These three balance sheet segments give

investors an idea to what the company owns and owes, as well as the amount invested by the shareholders (Balance Sheet n.d.). Therefore it is a record of
The basic relationship is:

Assets = Liabilities + Stockholders' equity

Assets are things that a company owns that have value. This typically means they can either be sold or used by the company to make products or provide services that can be sold (Beginners' Guide to Financial Statements n.d.). Management has bigger influence on assets. Management must make decisions about cash versus marketable securities, credit versus cash sales, whether to make or buy commodities, whether to purchase or lease items, the types of business in which to engage and so on (Ross, Westerfield and Jaffe 2008, 21).

Liabilities are amounts of money that a company owes to others. This can include all kinds of obligations, like money borrowed from a bank to launch a new product, rent for use of a building, money owed to suppliers for materials, payroll a company owes to its employees, environmental cleanup costs, or taxes owed to the government (Beginners' Guide to Financial Statements n.d.). Liabilities are divided into short-term (current) and long-term (non-current) liabilities.

Equity is the ownership's interests in the company. The ownership equity is the residual interest in assets that remains after deducting liabilities (Fraser and Ormiston 2001, 69). There are two main sources for stockholder's equity. i.e. the money invested in the company and the retained earnings that are added.

1.2 The income statement

The income statement measures the company's financial performance over a specific period of time. The basic equation of income is:

Revenue – Expenses = Income (Ross, Westerfield and Jaffe 2008, 24)

The income statement starts with revenues, followed by expenses and at the bottom there is a net income (net loss). The operations section reports the firm's revenues and expenses from principal operations. One number of particular importance is earnings before interest and taxes (EBIT), which summarizes earnings before taxes and financing costs. Among other things, non-operating section of the income statement includes all financing costs, such as interest expense. Usually a second section reports as a separate item the amount of taxes levied on income (Ross, Westerfield and Jaffe 2008, 24).

There are two basic common formats and considerable variation in the degree of detail presented, i.e. Multiple-step format and the single-step format.

Multiple-step format distinguishes several profit measures – gross profit, operating profit, and earnings before income tax.

The single-step version groups all items of revenue together, then deducts all categories of expense to arrive at a figure for net income (Fraser and Ormiston 2001, 92).

During an accounting period there might be certain items must be disclosed separately on the income statement due to their importance. These are discontinued operations, extraordinary transactions, and the cumulative effect of changes in accounting principles (Fraser and Ormiston 2001, 93).

Discontinued operations. The operation is resulted from when a firm sells major portion of its business. The results of continuing operations are shown separately from the operating results of the discontinued portion of the business. Any gain or loss o the disposal is also disclosed separately (Fraser and Ormiston 2001, 93).

Extraordinary gains and losses. These are items that meet two criteria: unusual in nature and not expected to recur in the foreseeable future, considering the firm’s operating environment (Fraser and Ormiston 2001, 93).

The cumulative effect of a change in accounting principle. It occurs when a firm changes an accounting policy, for example, from depreciation to the straight-line method.

1.3 The statement of cash flows

The statement is important by explaining the change in accounting cash and equivalents (Ross, Westerfield and Jaffe 2008, 29). There are changes of cash generated from operating activities, investing activities and financing activities. The statement of cash flow allows investors to understand how a company's operations are running, where its money is coming from, and how it is being spent (Heakal n.d.). The main purpose of the statement of cash flow stands not only with the detailed information about company's cash receipts and cash payments during a period, but also with informing about an entity's operating, investing, and financing activities.

- **Operating activities** include the cash effects of transactions that create revenues and expenses.
- **Investing activities** involve the acquisition and long-term or non-current assets, such as long-term investments, property, plant, equipment, and intangible assets (Norton and Porter 2010, 75).
- **Financing activities** result from the issuance and repayment, or retirement of long-term liabilities and capital stock and the payment of dividends (Norton and Porter 2010, 75).

Cash flows from operating activities represent the cash generated internally. In contrast, investing and financing activities provide cash from external sources (Fraser and Ormiston 2001, 125). There are two methods for calculating and representing the cash flow from operating activities; i.e. direct and indirect.

Indirect method shows cash collection from customers, interest and dividends collected, other operating cash receipts, cash paid to suppliers and employees, interest paid, taxes paid, and other operating cash payments (Fraser and Ormiston 2001, 125).

Direct method starts with net income and adjusts for deferrals; accruals; non-cash items, such as depreciation and amortization; and non-operating items, such as gains and losses on assets sales (Fraser and Ormiston 2001, 125).

In addition, this financial statement is highly effective due to its importance of reporting ability of the causes of changes in cash. Management can evaluate certain activities and understand what is happening to a company's most liquid resource – its cash. Based on the data, investors and other users can predict of the amounts, timing and uncertainty of future cash flows. Another useful fact about the statement of cash flow is that employees, creditors, and stockholders can examine the company's ability to pay salaries and dividends. If company does not have appropriate cash, there will be failure to meet all these obligations.

1.4 The statement of retained earnings

A statement reporting how much of the firm's earnings were retained in the business rather than paid out in dividends (Brigham and Houston 2004, 42). The statement of retained earnings is built on the basis of information from Income Statement and contributes information to Balance Sheet.

The word 'Retained earnings' is representing a claim against assets. The main purpose of retaining earnings is to expand the business itself. As explained in Brigham, changes in retained earnings occur because common stockholders allow the firm to reinvest funds that otherwise could be distributed as dividends (Brigham and Houston 2004, 42). Thus retained earnings do not indicate the cash the firm has; it only indicates that the dividends the firm had to pay were less than the earnings.

1.5 Objective of financial statements reporting

The users of financial information are the main reason financial statements are prepared (Norton and Porter 2010, 55). The most probably the stockholders might be the most important users of the financials statements. Concurrently company's management takes responsibility in front of the stockholders, being entrusted a part of stockholders' wealth. Thus management should make wise decision based on financial statements.
The primary objective of financial reporting is to provide economic information to permit users of the information to make informed decisions (Norton and Porter 2010, 55). Users include both the internal, especially management, and external users. Management is in charge of running the company, this it is required to be well informed in order to take further action, based on the past facts.

1.6 Users of financial statements

The information provided by financial statements is used to make predictions which can influence the users' decisions. The users of financial statements may be divided into external and internal groups. The external users do not have the direct involvement within the organization, while internal users do.

1.6.1 Internal users

Managers/ Owners. The main goal of managers using financial statements is to make better financial decisions which intend to increase the market value of the shareholders' equity. Financial statements help managers to identify from where the firm makes the most of its earning, where attention is needed and what financial activities should be taken in the further.

This group demands financial statement in order to interpret contracts that have provisions based on the financial information. When preparing a contract with other entities, management needs to work with contractual terms arisen from financial statement variables.

Employees. The job of employee is secured by the profitable and continued operations of the firm. Therefore the firm's financial information attracts employees to discuss promotion, salary hike and to keep track of the viability of their pension plan.

1.6.2 External users

Shareholders, Investors and Security Analysts. This is major recipients of the financial statements. The main purpose of their demand is to decide about the company shares, and timing of the purchase or the sale of those shares (Financial analysis revised: Users and Suppliers of Financial Statements Information n.d.). In most case their decisions involve the investment focus. Investors' main point of interest concerns the profitability of the firm - the ability of the firm to earn more profits. This group of users attempt to predict future dividends and changes in the markets price of company's common stock (Hermanson 1987, 779). The earning influences both dividends and price changes. In order to predict company's future earning, investors analyze the past earnings record.

Creditors and Other Suppliers. Creditors pay attention to the relationship between assets and liabilities. If assets exceed the liabilities, the company will be considered solvent. Therefore it is logical to sum; the greater the assets than liabilities, the more solvent the company. This leads to have positive impression from stockholders' in term of equity, increasing the probability of investing and lending decision.

Government and Regulatory Agents. Government institutions are interested in whether the firm paid accurate payment of tax. Another point the government may want to interfere is that if the firm is working in scope of legal forms as well as labor laws, e.g. wage payments and employee benefit.

Customers. One of the most precious assets for the firm is its customers. The relationship between customer and firm can stay up many years. Customers might use financial statements to have secure relationship.

1.7 Management decision making

Prior to define how management uses financial statements in their decision making, it is better to define management itself. Management is the process of coordinating work activities so that they are completed efficiently and effectively with and through other people (Robbin and Coutler 2002, 7). The word ‘process’ is the where attention should be concerned, representing management activities, i.e. planning, organizing, leading, and controlling. In general management process is ongoing decisions and activities. Once the decision made by management affects entire organizational area, it must be carefully done. Therefore it is considered comprehensive process, not just a simple act of choosing among alternatives (Robbin and Coutler 2002). According to Drury, there are seven stages of decision making process. The first five stages represent the decision-making or the planning process. The final two stages represent the control process, which is the process of measuring and correcting actual performance to ensure that the alternatives that are chosen and the plans for implementing them are carried out (Drury 2004, 8).

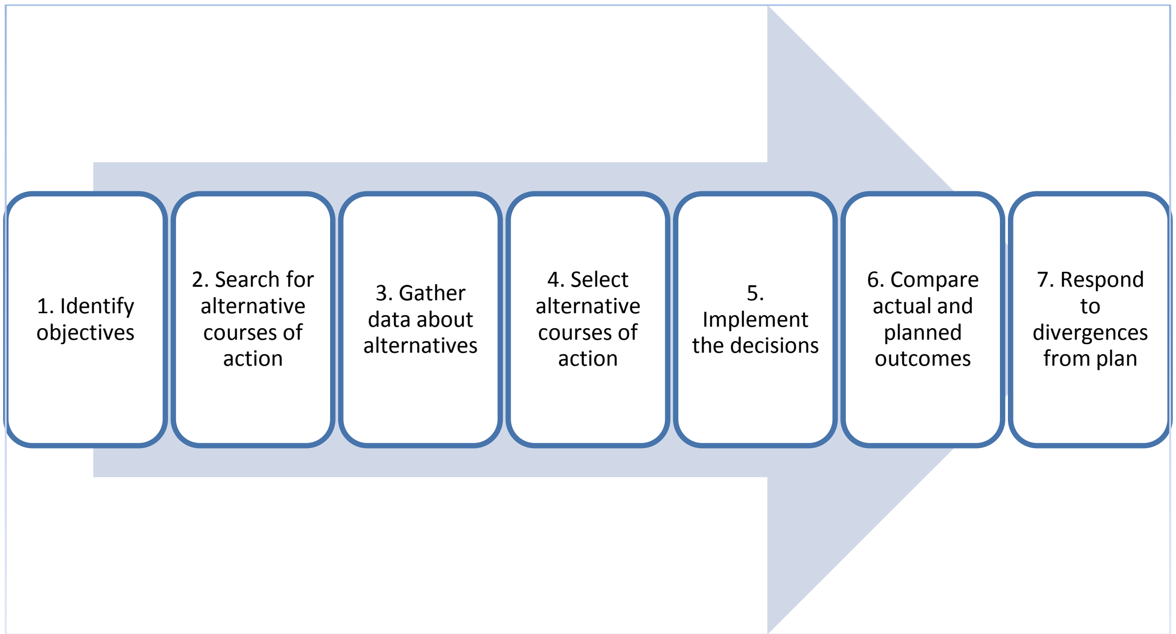

Figure 1. The decision-making, planning and control process

Indentifying objectives. Prior to any decision making, there must be motive that stimulates to make certain decision. As a basic rule, firms seek to maximize profits for the owners of the firm or, more precisely, the maximization of shareholders' wealth (Drury 2004, 8). During the profit maximization, maximization of overall economic welfare also rises. In brief, it means firms seek to maximize the value of future net cash inflows.

The search for alternative courses of action. If the company management concentrates only on present activities or performance, it will be probable to encounter the risk of insufficient cash flows to survive in the future. It is essential for a company to search for alternative courses of action concerning future opportunities;

1. Developing new products for sale in existing markets
2. Developing new products for new markets
3. Developing new markets for existing products (Drury 2004, 11)

Gather data about alternatives. When potential areas of activity are identified, management should assess the potential growth rate of the activities, the ability of the company to establish adequate market shares, and the cash flows for each alternative activity (Drury 2004, 10). There are long-run or strategic decisions and short-term or operating decisions. As usually strategic decisions are the concern of top management and they have profound effect on the firm's future position and it is thus essential that adequate data are gathered about the firm's capabilities and the environment in which it operates

(Drury 2004, 10). In contrast, operating decisions are the concern of lower-level management and deal with the present situation of firm.

Select appropriate alternative courses of action. After considering several alternative courses of action, management selects the one with better benefits is chosen. But there might be some complications due to the difference between short-term and long-term cash flows.

Implementation of the decisions. Once alternative courses of action have been selected, they should be implemented as part of the budgeting process. The budget is a financial plan for implementing the various decisions that management has made (Drury 2004, 11).

Comparing actual and planned outcomes and responding to divergences from plan. The managerial function of control consists of the measurement, reporting and subsequent correction of performance in an attempt to ensure that the firm's objectives and plans are achieved. In order to control the whole procedure, performance reports which consists of a comparison of actual outcomes and planned outcomes is used (Drury 2004, 11).

2 METHODS

Financial statements are like fine perfume; to be sniffed but not swallowed.

Abraham Brilloff

Financial statements analysis is a process which provides a variety of results for many different purpose users over certain period of time and in comparison with the industry. Therefore there are a number of ways to analyze and convert the data into comprehensive form. These methods will be illustrated in the following subchapters.

2.1 Absolute indicators

2.1.1 Vertical analysis

Vertical analysis is also known as common size analysis tool in which every entry is shown as a percentage of a common base entry in a financial statement. In balance sheet, each account is expressed as a percentage of total assets; in contrast each account on income statement is shown as a percentage of net sales. As mentioned in 'Understanding financial statements', common size statement facilitate internal or structural analysis of a firm (Fraser and Ormiston 2001, 158). Therefore comparing the magnitudes between several years makes easy to evaluate a company's financial position and performance relatively with sales and total assets.

Each financial statement has its own way of calculating. In balance sheet, total asset is taken as base. Other entries show their relative size of each category in the balance sheet. The formula is give below.

$$\text{Percentage} = \frac{\text{Each item on Balance Sheet}}{\text{Total assets}}$$

In income statement, net sales is used as base to calculate the percentage. Net sales is expressed as 100% and other items show their percentage in net sales.

$$\text{Percentage} = \frac{\text{Each item on Income Statement}}{\text{Net Sales}}$$

2.1.2 Horizontal analysis

Financial statement analysis is generally about comparing information with one another. The horizontal analysis compares individual items over a certain period of time. The procedure aims to reveal the change or trend which has taken place meanwhile. The change can be expressed as either an amount or percentage. In most cases it would be easier to comprehend the percentage form, comparing to the amount form. In this analysis the formula of changes since base period will be used.

$$\text{Change since base period} = \frac{\text{Current year amount-Base year amount}}{\text{Base year amount}}$$

2.2 Ratio Analysis

Expressing relationships between different financial statements, financial ratio analysis uses entries from different statements. Current year numbers are used to calculate the ratios and then those are compared to the previous years, and the industry average in order to determine company's financial position. Even though it is considered that there is no 'right' set of financial ratios to which all companies should aspire. For instance, an optimal level of debt for company A would not be appropriate for company B (Brealey and Myers 2003, 824).

There are four main categories of ratios to be covered, e.g. solvency ratios, liquidity ratios, profitability ratios and asset utilization ratios.

Before coming down to the point, it is important to be aware that even ratios have certain limitations. However it shows the strength and weakness of certain areas, and reveals the cause of concern, ratios does not provide 'how to' answer for the case. As a result it is highly recommended to be used with other financial analyzing tools.

2.2.1 Solvency ratios

This group of ratios measures the financial risk of a company in its debt obligation sense, reflecting in the balance sheet. In other words the ratios are intended to address the firm's long-run ability to meet its obligations or, more generally, its financial leverage (Ross, Westerfield and Jaffe 2008, 49). Investors and stockholders mostly pay attention to it because the ratios point out company's ability to pay its financial obligations and the amount of investment a company has. There are three commonly used ratios, i.e. debt to total assets ratio, debt to equity ratio, and times interest earned ratio.

Debt to total assets ratio measures the effect of financial leverage. As it is logical to assume from the formula, when the percentage of debt total assets increases, the company become more risky being unable to pay its maturing obligations. Therefore it is preferable for creditors to have a low ratio of debt to total assets.

$$\text{Debt to total assets} = \frac{\text{Total debt}}{\text{Total assets}}$$

Debt to equity ratio shows the proportion of debt and equity in company’s financing. Thus it contributes to measure the riskiness of a company’s capital structure. The same rule as debt to total assets ratio works, i.e. the higher the proportion, the more risky.

$$\text{Debt to equity ratio} = \frac{\text{Total liabilities}}{\text{Stockholders' equity}}$$

Times interest earned ratio is used to indicate a company’s ability to meet interest payment as they come due. Interest payment is one of the significant financial commitments, indicating the solvency. The more times a company can cover its annual interest expense from operating earnings, the better off will be the firm’s investors (Fraser and Ormiston 2001, 168).

2.2.2 Liquidity ratios

Apart from solvency ratios, information about company’s ability to meet its short-term financial obligations is provided by the liquidity ratios. Short-term creditors such as bankers and suppliers particularly use the ratio to determine whether the company will be able to continue as a going concern (Liquidity Ratio n.d.). Payments to suppliers in accounts payable and notes are the classic examples of short-term obligations. Therefore it is assumed balance sheet is principally used to calculate the liquidity ratios. These are current ratio, acid-test ratio, and current cash debt coverage ratio.

Current ratio determines the company's ability to meet its short-term debt-paying ability. According to Ormiston, current liabilities are used as denominator of the ratio because they are considered to represent the most urgent debts, requiring retirement within one year or one operating cycle. The available cash resources to satisfy these obligations must come primarily from cash or the conversion to cash of other current assets (Fraser and Ormiston 2001, 161).

From the short-term creditors point of view, the higher the current ratio and the lesser the risk.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Acid-test ratio is financial metric which measures a company's immediate short-term liquidity. Often referred as quick ratio, it does not include inventory, reducing the drawback of the test. Because inventory can have certain difficulties such as uncertain liquidation values.

$$\text{Acid-test ratio} = \frac{\text{Current assets - Inventory}}{\text{Current liabilities}}$$

Current cash debt coverage ratio measures the short-term debt paying ability as well. Unlike other acid-test ratio, it uses net cash provided by operating activities rather than year-end balance which provides the better possibility to have a closer look into the company's current position.

$$\text{Current cash debt ratio} = \frac{\text{Net cash provided by operating activities}}{\text{Average current liabilities}}$$

2.2.3 Profitability ratios

Profitability ratios are possible to be measured by several ratios. Profit margin, cash return on sales, total asset turnover, return on assets (ROA), return on common stockholder's equity (ROE), and payout ratio are used to determine how successful a firm generates income from the resource for a given period of time, reflected in company's income statement.

Profit margin indicates what proportion of sales contributes to the income of a company (Profit Margin n.d.). If the ratio is low; it will indicate lower earnings are generated from the revenue. Therefore it is better for the company to control its cost structure.

$$\text{Profit margin} = \frac{\text{Net income}}{\text{Net sales}}$$

Return on assets (ROA) indicates the amount of profit earned relative to the level of investment in total assets (Fraser and Ormiston 2001, 170). The ROA of one firm is often compared to other competitors to evaluate the effectiveness of top management. That means the management performance is reflected on the ratio.

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Total assets}}$$

Return on equity (ROE) is commonly mentioned in financial analysis as well as ROA due to their importance as being the overall measure of efficiency of the firm in managing its total investment in assets and in generating return to shareholders (Fraser and Ormiston 2001, 170). Apart from ROA, ROE indicates how shareholders' investment is being treated. In other words, this is the percentage of net income earned for each dollar invested by the shareholders. The formula is given below.

$$\text{Return on equity} = \frac{\text{Net income}}{\text{Total equity}}$$

Payout ratio indicates how well earnings support the dividend payments: the lower the ratio, the more secure the dividend because smaller dividends are easier to pay out than larger dividends (Payout Ratio n.d.).

$$\text{Payout ratio} = \frac{\text{Cash dividens}}{\text{Net income}}$$

2.2.4 Asset management ratios

These ratios are intended to describe how efficiently, or intensively, a firm uses its assets to generate sales (Ross, Westerfield and Jaffe 2008, 50). Two important current assets, inventory and receivables, are used.

Inventory turnover determines the number of times that inventory is sold and replaced during the year provides some measure of its liquidity and the ability of the company to convert inventories to cash quickly if that were to become necessary (Luecke 2003, 23). However a high ratio of turnover demonstrates efficient inventory management and the profit in general sense, it is necessarily industry-specific. The ratio varies from industry to industry, e.g. the retail grocery business have extremely high inventory ratio while real estate business gives significantly lower ratio.

$$\text{Inventory turnover} = \frac{\text{Sales}}{\text{Inventory}}$$

Receivables turnover estimates the liquidity of the receivables. The ratio shows the number of times, on average, receivables are collected during the period. The general rule applies for the reliance of the current and acid-test ratios for assessing liquidity. It is better to have faster turnover in order to increase the confidence.

$$\text{Receivables turnover} = \frac{\text{Sales}}{\text{Accounts receivables}}$$

Total asset turnover ratio is useful to determine the amount of sales that are generated from each dollar of assets. Using the ratio it is possible to check whether the company is raising its revenue in proportion to sales. The ratio shows different results depending on the industries. In general, companies with lower profit margin have higher asset turnover ratio, in contrast the companies with higher profit margin show lower asset turnover ratio. In case either total asset turnover is lower than previous years or industry average, checking the investment amount or slower sales might give the clue.

$$\text{Total assets turnover ratio} = \frac{\text{Net sales}}{\text{Total assets}}$$

2.3 Fraud detection in financial statements

Management should stay aware of a number of risky operations that could happen in a company. One of them is having fraud. The 'term' fraud is commonly used to describe the use of deception to deprive, disadvantage or cause to loss to another person or party. This can include theft, the misuse of funds or other resources, or more complicated crimes such as false accounting and the supply of false information (Fichnova 2010). Even though fraud analysis might be used most often by auditors, it can be crucial to prevent from fraud in any level of the organization. Misstatements arising from fraudulent financial reporting are intentional misstatements or omissions of amounts or disclosures in financial statements intended to deceive financial statement users (Fichnova 2010). Embezzling cash received, stealing assets, causing the company to pay for goods or services not received are the typical examples of fraud. According to Fichnova, all types of businesses are vulnerable to fraud. Therefore it is clear that every level of organization is vulnerable to fraud. Perpetrators of the fraud are defined below.

Profile of internal fraudsters:

- Junior staff – 70%
- Middle and senior management – 30%

Profile of external fraudsters:

- Agents, intermediates – 56%
- Customers – 33%
- Vendors – 11%
- Others (Fichnova 2010)

In order to detect the fraud, there are certain formulas that can be used by either management or any other interested parties. In this paper, following fraud detection formulas will be used; sales growth index, gross margin index and days' sales in receivables index.

Sales growth index (SGI)

Companies with high growth rates find themselves highly motivated to commit fraud when the trend reverses. Shareholders from inside and outside the company expects that growth to continue and those expectations pressure managers to produce (Fichnova 2010). Companies that manipulated earnings have SGI 1.607 – 1.411.

$$\text{Sales growth index} = \frac{\text{Sales}_{\text{t}}}{\text{Sales}_{\text{t}-1}}$$

Gross margin index (GMI)

Comparing the gross margins from one period to the previous period produces the gross margin index. When the GMI is greater than 1 the company's gross margins have deteriorated and management is motivated to show better numbers (Fichnova 2010). GMI 1.193 – 1.036 is the sign of manipulation.

$$\text{Gross margin index} = \frac{\text{Sales}_{\text{t}-1} - \text{Cost of sales}_{\text{t}-1}}{\text{Sales}_{\text{t}-1}} \div \frac{\text{Sales}_{\text{t}} - \text{Cost of sales}_{\text{t}}}{\text{Sales}_{\text{t}}}$$

Days' Sales in Receivables Index (DSRI)

Sales and receivables typically stay in fairly consistent trend. If the ratio detects a rise in receivables the change might result from revenue inflation. The DSRI is an example of how the ratio might give a false signal (Fichnova 2010). DSRI 1.465 – 1.281 is the sign of overstated revenue.

$$\text{Day}'\text{sales in receivables index} = \frac{\text{Accounts receivable}_{\text{t}}}{\text{Sales}_{\text{t}}} \div \frac{\text{Accounts receivable}_{\text{t}-1}}{\text{Sales}_{\text{t}-1}}$$

If the company is considered having fraud, management should take certain activities into consideration.

- Considering seeking specialist professional advice.
- Reassessing the way organization conducts and manages its business to ensure it is adequately protected against this type of fraud occurring in future.

3 LIMITATIONS OF FINANCIAL STATEMENTS

As mentioned earlier, financial statements are capable of informing firm's financial position to a number of financial bodies. Thus these statements are used to make further financial decisions in a company. On the other hand, users of financial statements usually bear in mind that there are certain disadvantages of financial statements. Quantitative information is not the only one factor that influences management to make decisions. In most cases, qualitative information is missed in financial statements.

3.1 Historical information

Information on financial statements is the reflection of past performance of a company. Those data shows only what has happened with company's financial situation in the past. However analyzing historical facts is important for any users of financial statements to predict the future performance; there is no guarantee that company will perform in same way as it was in the past years. It is considered that historical data helps to make probable estimation of earning. As a matter of fact future earnings depend on many factors such as local and global market condition, price change, inflation etc.

3.2 Ignorance of qualitative aspects

As important as quantitative data, the qualitative data can have priceless impact on decision making process. Certain qualitative elements are not considered in the financial statements terms like the quality and reputation of the management team and employees because they are incapable of being measured in monetary terms (Limitations of The Financial Statements 2006).

3.3 Omission of structural change

It is widely known that change in structural elements influences company's financial position, i.e. building new plant, new product launch, acquisition etc. Financial statements do not show directly this information of changes, especially if it is planned for future. Therefore a user of financial statement should stay aware of this omitted information.

II. ANALYSIS

4 CORPORATE INFORMATION OF GOBI CORPORATION

Gobi Corporation is a public limited company incorporating in Mongolia since 1981. The company deals with the production of high quality cashmere and camel wool products and wholesale and retail sales on domestic market and export sales to various international markets. By the decree of the Government of Mongolia in 1993, 25% of the Gobi Company was privatized, and in December 1994, it became a newly organized share holding company with 75% government ownership (Mcashmere.com n.d.). Nowadays Gobi Corporation has 1336 employees and exporting over 30 countries.

Gobi Corporation is considered as the most competitive player among 30 other cashmere producers on Mongolian cashmere production markets, continuing their operations at the normal scale in a number of economic difficulties. In the beginning of 2000s, cashmere price has dropped enormously and the situation has caused a few of other cashmere processing factories to close down. However the Gobi Corporation run into huge losses and difficulties to meet repayment of bank loans and interest, the company survived the challenge successfully. Currently company sells their products locally through:

- Factory store
- Gobi shops
- Distributors

From year to year, Gobi Corporation is expanding its production and services ether in Mongolia or on foreign markets. For instance, company has launched the Gobi Boutique in Kempinski Hotel in Ulaanbaatar, Mongolia in December, 2008. In the boutique all the products are offered in white color only which is illustrating cahmere’s softness and luxury. In general company has a long-term partners throughout Asia, Europe, North America and Australia and exporting 100% pure cashmere & camel wool products to over 130 partners around the world. Customers in New-York, Tokyo, London, Berlin, Paris, Hamburg, Brussell, Moscow and Seoul are happy with Gobi’s products bearing the "Gobi " Made in Mongolia" label (Gobi Corporation n.d.).

5 METHODS

In order to find out the Gobi Corporation's financial situation and possibilities, financial spending and their results, and disadvantages and advantages in the scope of the financial assets; following methods were used. i.e. absolute indicators and ratio analysis. These methods help management to reach better understanding and make appropriate decision with the help of underlying facts that happened during the financial period.

5.1 Absolute indicators

5.1.1 Vertical and Horizontal analysis of balance sheet

Horizontal: During the four years period of time, there have been a number of significant changes occurred in Gobi Corporation. In the assets section, cash increased to MNT 6 billion, or 734%. Another significant increase is that inventory has grown 70% in 2008 due to the raw cashmere price change. The company purchases these raw cashmere and dehairs them before selling it in the international market. It is incurred approximately MNT 4 400 in order to dehair 1 kg of raw cashmere. In the process, 50% of these raw cashmere is wasted. Therefore the cost of 1 kg of processed cashmere is approximately MNT 58 400 or equivalent. Also in the beginning of the period, Gobi's investment has grown 140% in 2006 comparing to the previous year. This is caused by the company's investment of placing computerized knitting machines from Germany.

In liabilities section, net payables increased 181% in 2006. But this trend went down for the following years until MNT 6 million, or -12%. Because in 2006 Gobi increased its provision payables up to MNT 7 million and then following years the amount was cut. Another growing trend is the gain of reevaluation of fixed assets to 45% in 2008. Gobi had reevaluated its property, plant and equipment in 2004, 2007 and 2008. The reevaluation was based on open market valuations on existing use bases carried out by independent valuer. Overall company has gradual increase in its capital structure.

Vertical: As we can see that Gobi's inventories contributed to increase the total current assets from 40.4% to 52.5% by the end of the period. This change happened due to the gradual increase of raw materials, i.e. raw cashmere, and wool, during the last 2 years on Mongolian market. For liabilities and equity side, shareholders' equity fill approximately 97%. Especially the company has high amount of retained earnings in its shareholders' equity.

5.1.2 Vertical and Horizontal analysis of income statement

Horizontal: When looking at the overall change, Gobi's net sales increased 56% in contrast with the base year, 2005. Most of this change happened in 2007 due to the fully privatization of the company. Therefore new management team implemented several efficient plans on internal sales scheme, which is on Mongolian market. But negative news is about the decline of gross profit amount during the period. Continually, cost of sales has being increased for four years. First of all, because of company's new knitting machine placement, the producing capacity has increased in visible amount. On the other hand this cost can be the result of raw cashmere and wool price growing.

Even though Gobi's operating income went down by 23% in general, certain expenses i.e. transfer and insurance expense and interest expense have grown. As mentioned earlier, Gobi had short-term borrowing which was due in April, 2009. Regarding to the interest income increase up to 404% in 2007, most of Mongolian commercial banks provide savings interest for their customers. Another point to be mentioned is that the trend of decreasing net income by the end of the period. This is caused by the cost of goods as well.

Vertical: According to the income statement, we can observe that Gobi's revenue is made by its sales of own products from internal and external market, mostly external sales. This is very typical feature in most of the textile producing companies. We can see the continuous operating income decrease from 38.5% to 19% by 2008 during the analyzing four years. Because the interest expense was going up gradually at the same time.

The good news is that the amount of taxation was getting low from 18.4% to 7.5% by 2008. The lesser the tax, the more the income after tax amount. In contrast, the dividend became less and less over the time. It might come to the unsatisfactory result for the shareholders.

5.2 Ratio analysis

5.2.1 Solvency ratio

Table 1. Solvency ratios – Gobi Corporation

	2005	2006	2007	2008
Debt to total assets	1.47%	3.84%	2.37%	1.86%
Debt to equity	1.49%	3.99%	2.43%	1.89%
Times interest earned (times)	51.34	20.54	-	10.82

Over the period of time debt to total assets ratio stayed in one digit percent, indicating that the company's was highly able to meet its long-term obligations. During the analyzing period company's use of any borrowed funds was very low in comparison to the assets. Once the company liability was lower, the debt to equity ratio stayed as low as debt to total assets. This indicates that most part of the company capital structure was based on the shareholders' equity, especially on retained earnings. Due to low borrowing fund, times interest ratios were comparatively high in the beginning of the period. In 2007 company did not have any interest expense to pay, thus the ratio was not calculated. From 2006 to 2008, Gobi's interest expense is covered less than the beginning of the period. Because company's net income has decreased in relation with increasing interest expense. The reason behind is that Gobi had short term borrowing which has passed its due date on 18 April 2009. Therefore in 2008, times interest earned ratio came to 10.82 times.

5.2.2 Liquidity ratios

Table 2. Liquidity ratios – Gobi Corporation

	2005	2006	2007	2008
Current ratio	27.53	13.33	24.86	28.24
Acid-test ratio	11.10	4.00	14.26	7.73
Current cash debt coverage	-	6.96	6.11	6.30

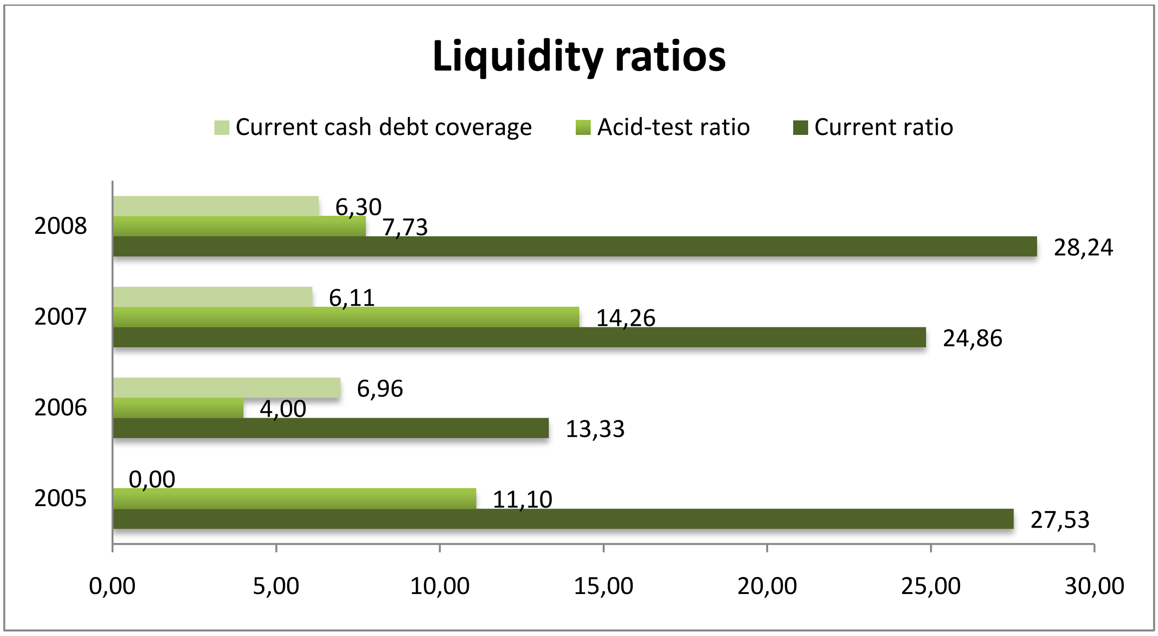

Figure 2. Liquidity ratios- Gobi Corportation

There is a significant decrease in current ratio with 13.33 times in 2006. Because in 2006 Gobi experienced greater amount of net payables in 2006 of MNT 1 billion which is the result of increase in provision payables. As well as current ratio, Gobi's acid-test ratio has experienced the decrease in 2006.

On the contrary, Gobi's cash flow coverage of average current liabilities still remained stable from 2006 to 2008. Overall the higher liquidity ratios can be taken as positive fact. That means the company's probability of paying to customers is secure. But in other words, having too much cash in hand is not really productive once this amount, alternatively, can be invested into profitable projects.

5.2.3 Profitability ratios

Table 3. Profitability ratios – Gobi Corporation

	2005	**2006**	**2007**	**2008**
Profit margin	28.2%	18.3%	17.9%	11.6%
Return on assets	14.9%	10.5%	14.0%	7.6%
Return on equity	15.2%	10.9%	14.3%	7.7%
Payout ratio	30.0%	38.6%	30.8%	30.5%

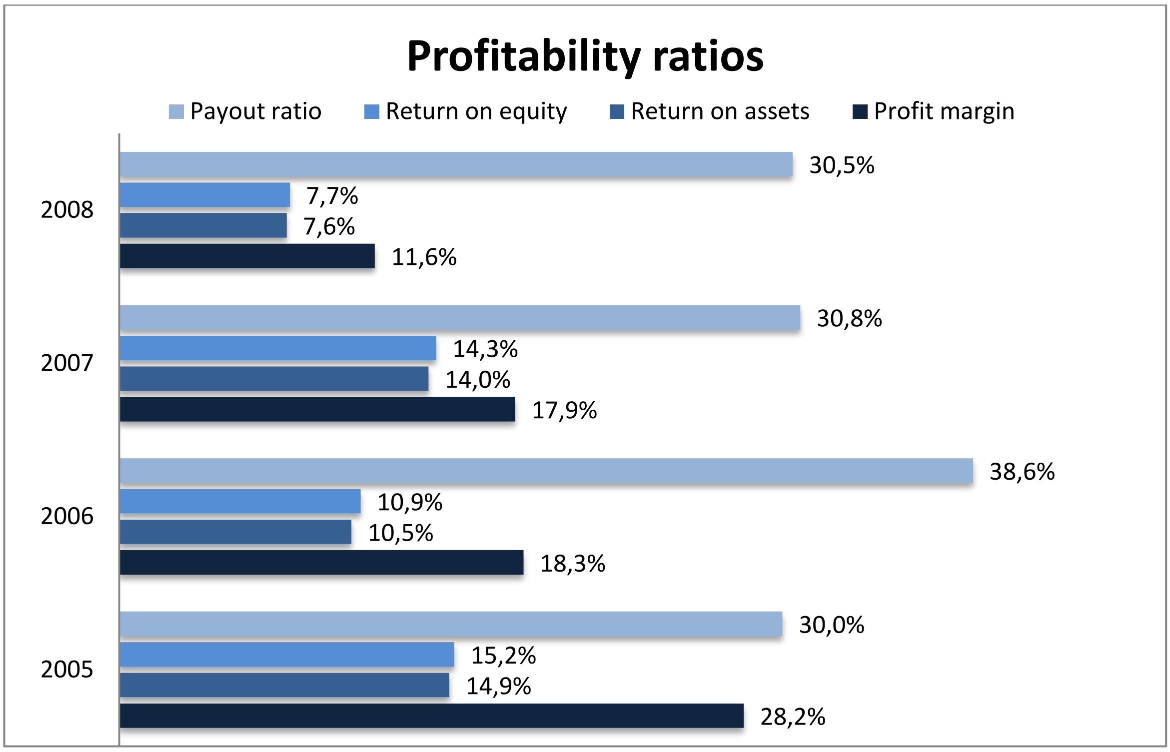

Figure 3 Profitability ratios –Gobi Corporation

Gobi experienced a decrease in its profit margin from 2005 to 2008, even though the ratio is comparatively high than usual. During the financing period company's net sales has gradually increased and reached approximately MNT 22 billion in 2008. External sales have created the most part of the net sales in Gobi since company increased the amount of export to the USA from 2006.

The slight fluctuating ratios were observed on return on assets. There are two underlying reasons. First of all during the last 2 years average price of raw Mongolian cashmere were slightly increasing. Therefore the company's spending on raw materials and other inventories have grown due to the price change. This increase influences total assets. Secondly, Gobi's net income has declined in 2008 because of higher non-operating expenses.

Regarding to return on equity ratio, the most highlight occurred in 2008 with the decrease to 7.7%. It is also connected to the gradual increase of shareholders' equity in Gobi during the period.

5.2.4 Asset management ratios

Table 4. Asset management ratios – Gobi Corporation

	2005	2006	2007	2008
Inventory turnover	2,19	1,60	3,11	1,72
Receivables turnover	5,99	4,52	6,20	6,72
Total assets turnover	0,53	0,57	0,78	0,66
Day's sales in inventory	166,45	227,52	117,50	212,27
Day's sales in receivables	60,93	80,69	58,83	54,35

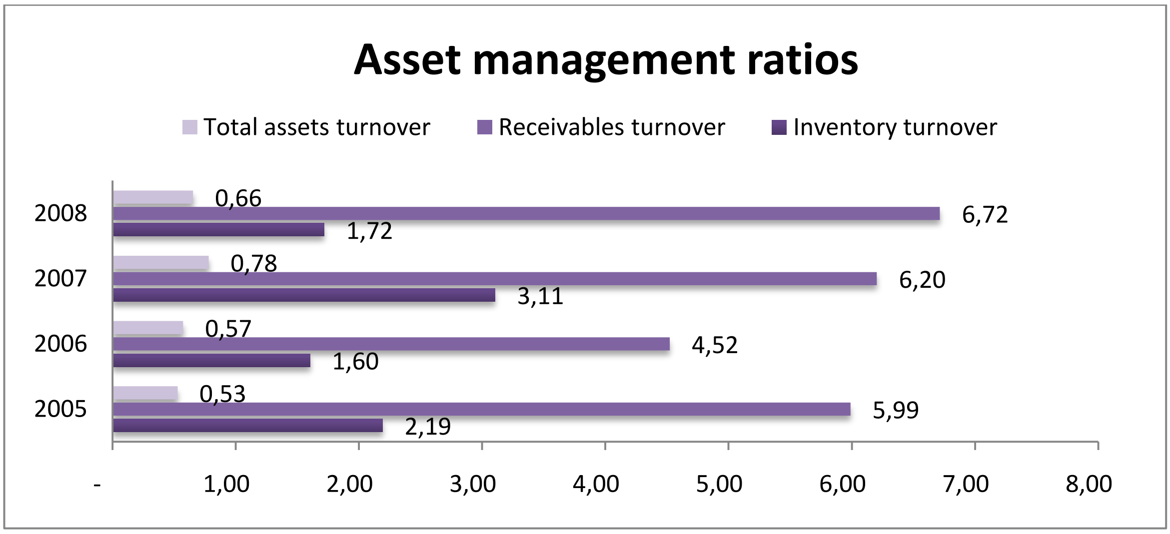

Figure 4. Asset management ratios 2005-2008 – Gobi Corporation

The inventory turnover ratio has fluctuated for 4 years. Assuming that the inventory for Gobi at the beginning of 2005 was MNT 6 billion, inventory turnover ratio was 2.19 times. But in the end of the period, inventory increased to MNT 12 billion, twice as previous amount, with 1.72 times in 2008. Generally, the faster the inventory turnover, the less cash that is tied up in inventory and the less the chance of inventory obsolescence. Therefore Gobi might be holding excess inventory which can be unproductive. Even average selling time seems prolonged trend up to 212 days in the table. But on the other hand it can be explained that company’s overseas sales are increasing, thus the selling time becomes longer than previous years.

Receivables and total assets turnover ratios remained comparatively stable. The positive news in the table is that receivables’ collection period became shorter up to 54 days from 60 days. It is clear that company has pursued the effectiveness of a company’s credit and collection policies.

5.3 Fraud analysis

Table 5. Fraud analysis – Gobi Corporation

	2006	2007	2008	Manipulated number
Sales growth index	1.170	1.416	0.943	1.607 - 1.411
Gross margin index	1.068	1.473	1.147	1.193 - 1.036
Days' sales in receivables index	1.324	0.729	0.924	1.465 - 1.281

As we can see from the table, sales growth index was usually under the warning ratio. Only in 2007, since company had great amount of increase in its net sales, SDI was slightly over the fraud risky amount. Regarding to the gross margin index, the indexes stayed in the fraud risky range. Therefore GMI can be the potential sounds of caution for Gobi. Management might be recommended to look deeper into reporting of sales and costs of goods sold. However the days' sales in receivables index remained low in the end of period, there was a sign of caution in 2006 with 1.324. An explanation of a rising DSRI might be the perfectly legal activity of a company extending more credit to customers (Fichnova 2010).

CONCLUSION

Financial statements have a lot of information that can be used by various users. Company's management is one of the important users in this sense. As a rule, management needs to make further decision in order to keep running the business successfully. A number of quantitative data can be obtained from financial statements with the use of certain financial methods.

As shown in practical part, Gobi Corporation's financial statements were used to determine the informative aspect of financial statements. Several financial methods such as horizontal and vertical analysis, ratio analysis, fraud analysis were used to represent the company's current financial position and performance with relation to the previous yeas since 2005. Looking back to analyzing methods, generally it was clear that over the period of time company was increasing its sales from MNT 14 billion to MNT 22 billion which can be considered as good news. Although the gradual increase of sales has a promising sound, the amount of inventory was growing at the same time. This is caused due to the price change of raw cashmere. Therefore Gobi's profit margin ratios became lower and lower during the period. Even though company's sales were increasing at the same time, it could not reach up to the inventory. Thus Gobi needs to be cautious towards the raw material price increasing, once it is highly influential matter for this kind of manufacturing business. In addition during the analyzing period, Gobi's current assets amount in its total assets has reached from 40.4% to 52.5%. Even though it is relatively less than percentage of accumulated depreciation. Until 2007 Gobi's accumulated depreciation was continuously more than 50% of total assets, but in 2008 the percentage went down until 24.3%. In income statement, the negative news is observed. It is the decreasing trend of gross profit with the relation to net sales. In 2005, gross profit filled 53.5% of net sales, but by 2008 it came to the percentage of 29.7. The reason behind it was the gradual increase of cost of sales. Therefore Gobi should work on its cost of sales. But there might certain that can not be controlled by Gobi such as material price on the market, inflation etc.

Referring to the fraud analysis, the ratios generally look reasonable and relatively clear, without influential manipulation. But in 2008 there were a bit of sign in gross margin analysis which reached over the manipulation number. Therefore management should be aware of this change in case if there is any intentional manipulation in order to get on with well with shareholders.

With the help of financial methods, one of the management's objectives can be to reduce the cost of sales and increase the sales once it is general goal of any management. In order to reduce the cost of sales, management should look for new sources of suppliers for raw materials. Increasing net sales can be reached through developing new products in existing markets. This seems more probable way of the solution in Gobi Corporation. Once most of the sales part comes from external sales, Gobi should concentrate more on this market to acquire as much as possible.

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LIST OF ABBREVIATIONS

EBIT Earnings before interest and taxes

ROA Return on assets

ROE Return on equity

ROI Return on income

SGI Sales growth index

GMI Gross margin index

DSRI Days' sales in receivables index

MNT Mongolian tugrug

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APPENDIX PI: GOBI CORPORATION'S FINANCIAL STATEMENTS 2005-2008

(in MNT thousand)	2005	2006	2007	2008
TOTAL ASSETS	26,790,315	28,850,652	30,053,300	33,799,798
Cash	2,002,026	765,506	6,388,116	1,557,737
Account receivable	2,364,955	3,664,873	3,784,259	3,297,491
Inventories	6,460,594	10,333,379	7,558,161	12,878,018
Total current assets	10,827,575	14,763,759	17,730,536	17,733,246
Property	6,353,216	6,766,704	7,576,549	8,427,790
Plant and equipment	22,608,695	21,832,785	20,257,672	13,112,302
Others	251,536	539,419	836,761	1,396,806
Property, plant and equipment	29,213,447	29,138,908	28,670,982	22,936,898
Accumulated depreciation	15,400,157	17,400,548	17,666,721	8,210,758
Investment	654,329	1,569,981	909,492	896,908
Prepaid salary	40,994	10,126	5,903	6,313
Prepaid tax	1,053,160	365,085	0	387,504
Deprivation	400,968	403,342	403,108	13,394
Intangible assets	0	0	0	36,295
Total fixed assets	1,495,122	778,552	409,011	443,505
TOTAL LIABILITIES AND EQUITIES	26,790,315	28,850,652	30,053,300	33,799,798
Net payables	390,309	1,097,021	742,087	619,320
Deferred taxes	2,952	10,339	-28,789	8,526
Total liabilities	393,261	1,107,360	713,297	627,846
Capital stock	780,113	780,113	780,113	780,113
Gain of reevaluation of fixed assets	6,885,220	6,885,220	6,306,948	9,169,679
Retained earnings	18,731,722	20,077,960	22,252,943	23,222,161
Total stockholders' equity	26,397,054	27,743,293	29,340,003	33,171,952

(in MNT thousand)	2005	2006	2007	2008
Net sales	14,166,736	16,577,606	23,478,738	22,144,219
Cost of sales	6,583,203	8,263,654	15,490,470	15,572,849
Gross profit	7,583,533	8,313,953	7,988,268	6,571,370
Administrative and operational expenses	658,844	1,087,652	1,074,805	1,052,003
Administrative expenses	572,244	567,262	635,494	528,129
Transfer and insurance expenses	86,600	210,397	327,589	301,935
Other expenses	0	309,993	111,722	221,939
Depreciation	1,463,717	2,000,391	1,352,905	1,292,877
Operating income	5,460,972	5,225,910	5,560,559	4,226,490
Interest expenses	131,228	256,473	0	430,528
Interest income	20,555	20,989	105,813	78,622
Non-operating income	1,873,477	537,782	1,786,998	1,398,714
Non-operating expenses	617,534	517,896	486,291	1,045,586
Income before tax	6,606,242	5,010,311	6,967,079	4,227,712
Taxation	2,606,167	1,979,124	2,761,832	1,666,085
Income after tax	4,000,075	3,031,186	4,205,247	2,561,627
Net income	4,000,075	3,031,186	4,205,247	2,561,627
Dividends	1,199,813	1,170,169	1,294,987	780,113
Addition to reained earnings	2,800,262	1,861,018	2,910,261	1,781,514

APPENDIX PII: HORIZONTAL ANALYSIS OF THE BALANCE SHEET – GOBI CORPORATION

(in MNT thousand)	2005	2006	2007	2008	06/05	07/06	08/07	08/05
TOTAL ASSETS	26,790,315	28,850,652	30,053,300	33,799,798	8%	4%	12%	26%
Cash	2,002,026	765,506	6,388,116	1,557,737	-62%	734%	-76%	-22%
Account receivable	2,364,955	3,664,873	3,784,259	3,297,491	55%	3%	-13%	39%
Inventories	6,460,594	10,333,379	7,558,161	12,878,018	60%	-27%	70%	99%
Total current assets	10,827,575	14,763,759	17,730,536	17,733,246	36%	20%	0%	64%
Property, plant and equipment	29,213,447	29,138,908	28,670,982	22,936,898	0%	-2%	-20%	-21%
Accumulated depreciation	15,400,157	17,400,548	17,666,721	8,210,758	13%	2%	-54%	-47%
Investment	654,329	1,569,981	909,492	896,908	140%	-42%	-1%	37%
Prepaid salary	40,994	10,126	5,903	6,313	-75%	-42%	7%	-85%
Prepaid tax	1,053,160	365,085	0	387,504	-65%	-100%	-	-63%
Deprivation	400,968	403,342	403,108	13,394	1%	0%	-97%	-97%
Intangible assets	0	0	0	36,295	-	-	-	-
Total fixed assets	1,495,122	778,552	409,011	443,505	-48%	-47%	8%	-70%
TOTAL LIABILITIES AND EQUITIES	26,790,315	28,850,652	30,053,300	33,799,798	8%	4%	12%	26%
Net payables	390,309	1,097,021	742,087	619,320	181%	-32%	-17%	59%
Deferred taxes	2,952	10,339	-28,789	8,526	250%	-378%	-130%	189%
Total liabilities	393,261	1,107,360	713,297	627,846	182%	-36%	-12%	60%
Capital stock	780,113	780,113	780,113	780,113	0%	0%	0%	0%
Gain of reevaluation of fixed assets	6,885,220	6,885,220	6,306,948	9,169,679	0%	-8%	45%	33%
Retained earnings	18,731,722	20,077,960	22,252,943	23,222,161	7%	11%	4%	24%
Total stockholders' equity	26,397,054	27,743,293	29,340,003	33,171,952	5%	6%	13%	26%

APPENDIX PIII: VERTICAL ANALYSIS OF THE BALANCE SHEET – GOBI CORPORATION

(in MNT thousand)	2005		2006		2007		2008	
TOTAL ASSETS	26,790,315	100.0%	28,850,652	100.0%	30,053,300	100.0%	33,799,798	100.0%
Cash	2,002,026	7.5%	765,506	2.7%	6,388,116	21.3%	1,557,737	4.6%
Total receivabeles	2,364,955	8.8%	3,664,873	12.7%	3,784,259	12.6%	3,297,491	9.8%
Inventories	6,460,594	24.1%	10,333,379	35.8%	7,558,161	25.1%	12,878,018	38.1%
Total current assets	10,827,575	40.4%	14,763,759	51.2%	17,730,536	59.0%	17,733,246	52.5%
Property, plant and equipment	29,213,447	109.0%	29,138,908	101.0%	28,670,982	95.4%	22,936,898	67.9%
Accumulated depreciation	15,400,157	57.5%	17,400,548	60.3%	17,666,721	58.8%	8,210,758	24.3%
Investment	654,329	2.4%	1,569,981	5.4%	909,492	3.0%	896,908	2.7%
Prepaid salary	40,994	0.2%	10,126	0.0%	5,903	0.0%	6,313	0.0%
Prepaid tax	1,053,160	3.9%	365,085	1.3%	0	-	387,504	1.1%
Deprivation	400,968	1.5%	403,342	1.4%	403,108	1.3%	13,394	0.0%
Intangible assets	0	-	0	-	0	-	36,295	0.1%
Total fixed assets	1,495,122	5.6%	778,552	2.7%	409,011	1.4%	443,505	1.3%
TOTAL LIABILITIES AND EQUITIES	26,790,315	100.0%	28,850,652	100.0%	30,053,300	99.9%	33,799,798	100.0%
Net payables	390,309	1.5%	1,097,021	3.8%	742,087	2.5%	619,320	1.8%
Deferred taxes	2,952	0.0%	10,339	0.0%	-28,789	-0.1%	8,526	0.0%
Total liabilities	393,261	1.5%	1,107,360	3.8%	713,297	2.4%	627,846	1.9%
Capital stock	780,113	2.9%	780,113	2.7%	780,113	2.6%	780,113	2.3%
Gain of reevaluation of fixed assets	6,885,220	25.7%	6,885,220	23.9%	6,306,948	21.0%	9,169,679	27.1%
Retained earnings	18,731,722	69.9%	20,077,960	69.6%	22,252,943	73.9%	23,222,161	68.7%
Total stockholders' equity	26,397,054	98.5%	27,743,293	96.2%	29,340,003	97.5%	33,171,952	98.1%

APPENDIX PIV: HORIZONTAL ANALYSIS OF THE INCOME STATEMENT – GOBI CORPORATION

(in MNT thousand)	**2005**	**2006**	**2007**	**2008**	**06/05**	**07/06**	**08/07**	**08/05**
Net sales	14,166,736	16,577,606	23,478,738	22,144,219	17%	42%	-6%	56%
Cost of sales	6,583,203	8,263,654	15,490,470	15,572,849	26%	87%	1%	137%
Gross profit	7,583,533	8,313,953	7,988,268	6,571,370	10%	-4%	-18%	-13%
Administrative and operational expenses	658,844	1,087,652	1,074,805	1,052,003	65%	-1%	-2%	60%
Administrative expenses	572,244	567,262	635,494	528,129	-1%	12%	-17%	-8%
Transfer and insurance expenses	86,600	210,397	327,589	301,935	143%	56%	-8%	249%
Other expenses	0	309,993	111,722	221,939	-	-64%	99%	-
Depreciation	1,463,717	2,000,391	1,352,905	1,292,877	37%	-32%	-4%	-12%
Operating income	5,460,972	5,225,910	5,560,559	4,226,490	-4%	6%	-24%	-23%
Interest expenses	131,228	256,473	0	430,528	95%	-100%	-	228%
Interest income	20,555	20,989	105,813	78,622	2%	404%	-26%	283%
Non-operating income	1,873,477	537,782	1,786,998	1,398,714	-71%	232%	-22%	-25%
Non-operating expenses	617,534	517,896	486,291	1,045,586	-16%	-6%	115%	69%
Income before tax	6,606,242	5,010,311	6,967,079	4,227,712	-24%	39%	-39%	-36%
Taxation	2,606,167	1,979,124	2,761,832	1,666,085	-24%	40%	-40%	-36%
Net income	4,000,075	3,031,186	4,205,247	2,561,627	-24%	39%	-39%	-36%
Dividends	1,199,813	1,170,169	1,294,987	780,113	-2%	11%	-40%	-35%
Addition to reained earnings	2,800,262	1,861,018	2,910,261	1,781,514	-34%	56%	-39%	-36%

APPENDIX PV: VERTICAL ANALYSIS OF THE INCOME STATEMENT – GOBI CORPORATION

(in MNT thousand)	2005		2006		2007		2008	
Net sales	14,166,736	100.0%	16,577,606	100.0%	23,478,738	100.0%	22,144,219	100.0%
Cost of sales	6,583,203	46.4%	8,263,654	49.8%	15,490,470	66.0%	15,572,849	70.3%
Gross profit	7,583,533	53.5%	8,313,953	50.2%	7,988,268	34.0%	6,571,370	29.7%
Administrative and operational expenses	658,844	4.7%	1,087,652	6.6%	1,074,805	4.6%	1,052,003	4.8%
Administrative expenses	572,244	4.0%	567,262	3.4%	635,494	2.7%	528,129	2.4%
Transfer and insurance expenses	86,600	0.6%	210,397	1.3%	327,589	1.4%	301,935	1.4%
Other expenses	0	-	309,993	1.9%	111,722	0.5%	221,939	1.0%
Depreciation	1,463,717	10.3%	2,000,391	12.1%	1,352,905	5.8%	1,292,877	5.8%
Operating income	5,460,972	38.5%	5,225,910	31.5%	5,560,559	23.7%	4,226,490	19.1%
Interest expenses	131,228	0.9%	256,473	1.5%	0	-	430,528	1.9%
Interest income	20,555	0.1%	20,989	0.1%	105,813	0.5%	78,622	0.4%
Non-operating income	1,873,477	13.2%	537,782	3.2%	1,786,998	7.6%	1,398,714	6.3%
Non-operating expenses	617,534	4.4%	517,896	3.1%	486,291	2.1%	1,045,586	4.7%
Income before tax	6,606,242	46.6%	5,010,311	30.2%	6,967,079	29.7%	4,227,712	19.1%
Taxation	2,606,167	18.4%	1,979,124	11.9%	2,761,832	11.8%	1,666,085	7.5%
Net income	4,000,075	28.2%	3,031,186	18.3%	4,205,247	17.9%	2,561,627	11.6%
Dividends	1,199,813	8.5%	1,170,169	7.1%	1,294,987	5.5%	780,113	3.5%
Addition to reained earnings	2,800,262	19.8%	1,861,018	11.2%	2,910,261	12.4%	1,781,514	8.0%