

Profit of Bank: ICICI Bank

Profit of an enterprise as reported in its financial statements is an opinion. This statement is truer for financial institutions like banks and insurance companies. These institutions have assets and liabilities which are to be paid over period of years. Determining the nature of assets and liabilities is the key to figuring the financial health of banks and insurance companies. A slight change in nature of assessment made about assets or liabilities can change the profit figure significantly. We will discuss a simple balance sheet for a bank to see how profit alterations can be made. We will then discuss the case of ICICI Bank to find the first estimate for its true profit. As we proceed with this series we would get a better picture of ICICI Bank's profits.

Consider a simplified balance sheet and Profit & Loss statement of a hypothetical bank

Balance Sheet

Assets	Liabilities
Loans Rs 12.5 crores	Equity (Including Reserves) Rs 1.5 crores
Investments Rs 7.5 crores	Deposits (Including Bonds) Rs 18.5 crores
Total Rs 20 crores	Total Rs 20 Crores

Profit & Loss Statement

Net Interest Received	1 crore
Provisions for bad loan\investments	0.2 crore
Profit before Tax	0.8 crore
Tax	0.2 crore
Profit after Tax	0.6 crore

The bank has equity of Rs 1.5 crores. It collects deposits of Rs 18.5 crores. It uses this fund to make loans of Rs 12.7 crores and invests in financial securities worth Rs 7.5 crores. The bank receives interest on loans and advances and pays interest on deposits. On net basis it receives interest of Rs 1 crore. About Rs 0.2 crore worth of loans go bad. So the bank makes a provision of the same amount. After paying the tax we arrive at figure of profit after tax. Now suppose instead of bad loan figure was Rs 0.5 crore instead of Rs 0.2 crore. The bank made a decision that it would not provision for the balance Rs 0.3 crore. In that case, the profit before tax has been overstated by Rs 0.3 crore. The actual profit before tax would be Rs 0.5 crore. The profit figure has been grossly overstated. For banks since the loan amount is so much greater than profits this is a real problem.

Now consider the case of ICICI bank. The net consolidated profits have gone up to Rs 3400 crores in 2007-08 from Rs 2760 crores in 2007-06. That seems like an improvement. However, the bad loans have gone from Rs 2000 crore to Rs 3500 crores. If the bank had provisioned for keeping the bad loans constant the profit figures seem much worse. The actual profits would come close to Rs 2500 crores. Profit of ICICI Bank has decreased not increased in the current financial year, just based on the public loss disclosures. If the actual bad loans are higher than situation would be much worse. There are reasons to believe that actual bad loans are higher. We will shed light on this aspect later in this series. Also later how investments and liabilities can be manipulated to show a higher profit.

(To keep things simple some approximations have been made with the representation of balance sheet and P&L. The idea is to convey the issue rather than to be precise with representation.)