Financial Reporting Statement And Analysis
Financial Statement Reporting (Module-2)

INTRODUCTION:-

Having understood how a company raises its capital, we have to learn the nature, objectives and types of financial statements it has to prepare including their contents, format, uses and limitations. The financial statements are the end products of accounting process. They are prepared following accounting policies consistently accounting standards prescribed in the Companies Act and accounting concepts, principles, procedures and also the legal environment in which the business organisations operate. These statements are the outcome of the summarising process of accounting and are, therefore, the sources of information on the basis of which conclusions are drawn about the profitability and the financial position of a company. Hence, they need to be arranged in a proper form with suitable contents so that the shareholders and other users of financial statements can easily understand and use them in their economic decisions in a meaningful way.

Meaning of Financial Statements

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include investors, tax authorities, government, employees, etc. These refer to:

1.the balance sheet (position statement) as at the end of accounting period

2.the statement of profit and loss of a company and the cash flow statement

Nature of Financial Statements

The chronologically recorded facts about events expressed in monetary terms for a defined period of time are the basis for the preparation of periodical financial statements which reveal the financial position as on a date and the financial results obtained during a period. The American Institute of Certified Public Accountants states the nature of financial statements as, "the statements prepared for the purpose of presenting a periodical review of report on progress by the management and deal with the status of investment in the business and the results achieved during the period under review. They reflect a combination of recorded facts, accounting principles and personal judgements".

The following points explain the nature of financial statements:

1. Recorded Facts: Financial statements are prepared on the basis of facts in the form of cost data recorded in accounting books. The original cost or historical cost is the basis of recording transactions. The figures of various accounts such as cash in hand, cash at bank, trade receivables, fixed assets, etc., are taken as per the figures recorded in the accounting books. The assets purchased at different times and at different prices are put together and shown at costs. As these are not based on market prices, the financial statements do not show current financial condition of the concern.

2. Accounting Conventions: Certain accounting conventions are followed while preparing financial statements. The convention of valuing inventory at cost or market price, whichever is lower, is followed. The valuing of assets at cost less depreciation principle for balance sheet purposes is followed. The convention of materiality is followed in dealing with small items like pencils, pens, postage stamps, etc. These items are treated as expenditure in the year in which they are purchased even though they are assets in nature. The stationery is valued at cost and not on the principle of cost or market price, whichever is less. The use of accounting conventions makes financial statements comparable, simple and realistic

3. Postulates: Financial statements are prepared on certain basic assumptions (pre-requisites) known as postulates such as going concern postulate, money measurement postulate, realisation postulate, etc. Going concern postulate assumes that the enterprise is treated as a going concern and exists for a longer period of time. So the assets are shown on historical cost basis. Money measurement postulate assumes that the value of money will remain the same in different periods. Though there is drastic change in purchasing power of money, the assets purchased at different times will be shown at the amount paid for them. While, preparing statement of profit and loss the revenue is included in the sales of the year in which the sale was undertaken even though the sale price may be received over a number of years. The assumption is known as realisation postulate.

4. Personal Judgements: Under more than one circumstance, facts and figures presented through financial statements are based on personal opinion, estimates and judgements. The depreciation is provided taking into consideration the useful economic life of fixed assets. Provisions for doubtful debts are made on estimates and personal judgements. In valuing inventory, cost or market value, whichever is less is being followed. While deciding either cost of inventory or market value of inventory, many personal judgements are to be made based on certain considerations. Personal opinion, judgements and estimates are made while preparing the financial statements to avoid any possibility of over statement of assets and liabilities, income and expenditure, keeping in mind the convention of conservatism.

Thus, financial statements are the summarised reports of recorded facts and are prepared the following accounting concepts, conventions, accounting policies, accounting standards and requirements of Law.

Objectives of Financial Statements:-

Financial statements are the basic sources of information to the shareholders and other external parties for understanding the profitability and financial position of any business concern. They provide information about the results of the business concern during a specified period of time in terms of assets and liabilities, which provide the basis for taking decisions. Thus, the primary objective of financial statements is to assist the users in their decision-making. The specific objectives include the following:

1. To provide information about economic resources and obligations of a business: They are prepared to provide adequate, reliable and periodical information about economic resources and obligations of a business firm to investors and other external parties who have limited authority, ability or resources to obtain information.

2. To provide information about the earning capacity of the business: They are to provide useful financial information which can gainfully be utilised to predict, compare and evaluate the business firm's earning capacity.

3. To provide information about cash flows: They are to provide information useful to investors and creditors for predicting, comparing and evaluating, potential cash flows in terms of amount, timing and related uncertainties.

4. To judge effectiveness of management: They supply information useful for judging management's ability to utilise the resources of a business effectively.

5. Information about activities of business affecting the society: They have to report the activities of the business organisation affecting the society, which can be determined and described or measured and which are important in its social environment.

6. Disclosing accounting policies: These reports have to provide the significant policies, concepts followed in the process of accounting and changes taken up in them during the year to understand these statements in a better way

Types of Financial Statements

The financial statements generally include two statements: balance sheet and statement of profit and loss which are required for external reporting and also for internal needs of the management like planning, decision-making and control. Apart from these, there is also a need to know about movements of funds and changes in the financial position of the company. For this purpose, a cash flow statement is prepard. Every company registered under The Companies Act 2013 shall prepare its balance sheet, statement of profit and loss and notes to account thereto in accordance with the manner prescribed in the revised Schedule III to the Companies Act, 2013 to harmonise the disclosure requirement with the accounting standards and to converge with new reforms.

4 types of financial statements that every business needs

1. balance sheet
2. Cash flow statement
3. Income statement
4. Equity statement

1. Balance sheet

Also known as a statement of financial position, or a statement of net worth, the balance sheet is one of the four important financial statements every business needs.

Based on the basic accounting equation, or balance sheet equation [Assets = Liabilities + Equity], the balance sheet provides a snapshot of a business's assets, liabilities, and equity.

It also provides users with a look at the business's financial position at a specific point in time, and financial statement analysts use the information it contains to calculate several important financial ratios.

2. Income statement

The income statement is another important financial statement for your small business. It provides users with a picture of the business's financial performance over a specific period of time.

Also known as a statement of revenue and expense, or a profit and loss statement (P&L), the income statement is a statement of earnings that shows a business's operating and nonoperating revenue and expenses.

Like the balance sheet, the information contained in an income statement is used in financial statement analysis to calculate financial ratios that provide users with further insight into a business's financial performance.

3. Cash flow statement

The cash flow statement, also known as a statement of cash flows, or a statement of changes in financial position, is an important financial statement that gives users an understanding of how well a business is managing its cash flow.

Using the information in a cash flow statement, users are able to see whether a business is **generating sufficient cash** to meet both its debt obligations and its operating expenses.

The typical **cash flow statement** format provides information about a business's **cash from operating activities**, cash from investing activities, and cash from financing activities.

4. Statement of owner's equity

The fourth financial statement that a business needs is a statement of owner's equity, also known as a statement of changes in equity, or a statement of shareholders' equity.

It shows the business's retained earnings—the profit kept, or retained, within a business rather than distributed to owners or shareholders—both at the beginning and at the end of a specific reporting period.

Retained earnings are often used to either reinvest in the company, or to pay off the business's debt obligations. It provides users with information regarding the financial health of a business, as it shows whether the business is capable of meeting ongoing financial and operating obligations without requiring its owners to contribute more capital

Vertical Format of Corporate Financial Statements:

Vertical Balance Sheet Some Critical Elements of the Balance Sheet are explained as follows:

Capital work-in-progress: Itrepresents costs incurred to date on a fixed asset that is still under construction at the balance sheet date.

Debentures: It is long-term security,i.e.,the type of bond or other debt instrument yielding a fixed rate of interest, issued by a company and generally unsecured by collateral. Deferred tax

assets: A deferred tax asset results from an overpayment or advance payment of taxes. It is the opposite of a deferred tax liability, which represents income taxes owed.

Financial assets:A financial asset is a non-physical asset whose value is derived from a contractual claim, such as bank deposits, bonds, and participation in companies' share capital. Financial assets are usually more liquid than other tangible assets, such as commodities or real estate.

Provisions: A provision is an amount set aside from a company's profits to cover an expected liability or a decrease in the value of an asset, even though the specific amount might be unknown.

Goodwill: Goodwill is an intangible asset associated with the purchase of one company by another. Specifically, goodwill is recorded in a situation in which the purchase price is higher than the sum of the fair value of all visible solid assets and intangible assets purchased in the acquisition and the liabilities assumed in the process. The value of a company's brand name, solid customer base, good customer relations, good employee relations, and any patents or proprietary technology represent some examples of goodwill.

Every company registered under The Companies Act 2013 shall prepare its balance sheet, statement of profit and loss and notes to account thereto in accordance with the manner prescribed in the revised Schedule III to the Companies Act, 2013 to harmonise the disclosure requirement with the accounting standards and to converge with new reforms.

Balance Sheet as at 31st March, 20.....

Particulars	Note No	Figure as at the end of Current reporting period	Figure as at the end of previous reporting period
I. EQUITY AND LIABILITIES 1) Shareholder's Funds (a) Share Capital (b) Reserves and Surplus (c) Money received against share warrants 2) Share Application money pending allotment 3) Non-current Liabilities (a) Long term borrowings (b) Deferred tax liabilities (net) (c) Other long term liabilities (d) Long term provisions			

<u>4) Current Liabilities</u> (a) Short-term borrowings (b) Trade payables (c) Other current liabilities (d) Short-term provisions			
Total			
II. ASSETS <u>1) Non-Current Assets</u> (a) Fixed assets (i) Tangible assets (ii) Intangible assets (iii) Capital work-in-progress (iv) Intangible assets under development (b) Non-current investments (c) Deferred tax assets (net) (d) Long-term loans and advances (e) Other non-current assets <u>2) Current Assets</u> (a) Current investments (b) Inventories (c) Trade receivables (d) Cash and cash equivalents (e) Short term loans and advances (f) Other current assets			
Total			

Important Features of Presentation

1. It applies to all Indian companies preparing financial statement as per Schedule III to the Comapnies Act, 2013.
2. It does not apply to
(i) Insurance or Banking Company,
(ii) Company for which a form of balance sheet or income statement is specified under any other Act.
3. Accounting standards shall prevail over Schedule III of the Companies Act, 2013.
4. Disclosure on the face of the financial statements or in the notes are essential and mandatory

5. Terms in the revised Schedule III will carry the meaning as defined by the applicable accounting standards.
6. Balance to be maintained between excessive details that may not assist users of financial statements and not providing important information.

7. Current and non-current bifurcation of assets and liabilities is applicable.

8. Rounding off requirements is mandatory .

9. Vertical format for presentation of financial statement is prescribed .

10. Debit balance in the statement of profit and loss to be disclosed as negative figure under the head "Surplus".

11. Mandatory disclosure for share application money pending allotment.

12. 'Sundry Debtors' and 'Sundry Creditors' replaced by terms 'Trade Receivables' and 'Trade Payables'.

Shareholders Fund

The shareholders' funds are sub-classified on the face of the balance sheet.
a) Share Capital
b) Reserves and Surplus
c) Money received against Share Warrants

Share Capital

Disclosures relating to share capital are to be given in notes to accounts. The following additions/modifications are significant:
a) For each class of shares, recognition of the number of shares outstanding at the beginning and at the end of the reporting period is required.
b) The rights, preferences and restrictions attached to each class of shares including restrictions on the distribution of dividends and repayment of capital.
c) In order to bring clarity regarding the identity of ultimate owners of the company
i) Disclosure of shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of holding company or the ultimate holding company in aggregate.
ii) Disclosure of shares in the company held by each shareholder holding more than 5% shares specifying the number of shares held.
iii) Disclosure of the following for the period of 5 years immediately preceding the date of the balance sheet: Aggregate number and class of shares allotted as fully paid up
ϒ pursuant to contracts without payment being received in cash. Aggregate number and class of shares allotted as fully paid up
ϒ by way of bonus shares. Aggregate number and class of shares bought back

This may be noted that the information of shareholders funds are presented on the face of financial statements limited only to broad and significant items. Details are given in Notes to Accounts.

d) For each class of share capital:
i) The number and amount of share authorised.
ii) The number of shares issued, subscibed, fully paid and subscribed but not fully paid.
iii) Par value per share.
iv) Reconciliation of the number of shares outstanding at the beginning and end of the accounting period.

v) Rights, preferences and restrictions attaching each class of shares including restrictions on the distribution of dividends and repayment of capital.
vi) Aggregate number of shares with respect to each class in the company held by its holding company, its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company.
vii) Shares reserved for issue under options and contracts/ commitments for the sale of shares/disinvestment, including terms and amount.
viii) For a period of 5 years immediately proceeding the date at which balance sheet in prepared for:
(a) Shares reserved under contracts/commitments.
(b) Number and class of shares bought back.
(c) Number and class of shares allotted for consideration other than cash and bonus shares.
ix) Terms of any securities convertible into equity/preference shares issued along with earliest date of conversion in descending order, starting from the farthest such date.
x) Calls unpaid (aggregate).
xi) Forfeited shares (amout originally paid up)

Reserve and Surplus:-
Reserves and Surplus are required to be classified as:
i) Capital Reserve
ii) Capital Redemption Reserve
iii) Securities Premium Reserve
iv) Debenture Redemption Reserve
v) Revaluation Reserve
vi) Share Options Outstanding Account
vii) Other Reserves (Specifying nature and purpose)
viii) Surplus: Balance in statement of profit and loss; disclosing allocations and Appropriation such as dividend, bonus shares, transfer to/from reserve, etc.

Significant additions/modifications regarding disclosure of reserve and surplus are as follows:
a) A reserve specifically represented by earmarked investments shall be termed as "Fund".
b) 'Debit' balance of statement of profit and loss shall be shown as a negative figure under 'Surplus' head.
c) The balance of "Reserve and Surplus" after adjusting negative balance of Surplus, if any, shall be shown under "Reserve and Surplus" read even if the resulting figure is 'negative'.
d) Share options outstanding account has been recognised as a separate item under 'Reserve and Surplus'. ICAI's Guidance Note on Accounting for Employee share based payments requires a credit balance in the 'Stock option outstanding Account' to be disclosed in balance sheet under separate heading' between share capital and reserves and surplus as a part of shareholders fund.

Money Received against share warrants:-
It is the amount received by the company which are converted into shares at a specified date on a specified rate. The instrument issued against the amount so received as share warrants. Money received against share warrants' to be disclosed as a separate line item under 'shareholder's fund'.

Current and Non-current Classification
The classified balance sheet in terms of current and non-current assets and current and non-current liabilities have been introduced. The criteria for defining current assets and liabilities has been clearly spelled out with non-current assets and liabilities being the residual items.

Current/Non-current distinction
An item is classified as current:

- if it is involved in entity's operating cycle or, is expected to be realised/settled within twelve months or,
- if it is held primarily for trading or,
- is cash and cash equivalent or,
- if entity does not have on unconditional rights to defer settlement of
- liability for atleast 12 months after the reporting period, Other assets and liabilities are non-current.

Share application money pending allotment
Share application money not exceeding the issued capital and to the extent non-refundable shall be classified as non-current. It will be shown on this face of balance sheet as share application money pending allotment.

Borrowings
Total borrowings are categorised into long-term borrowings, short-term borrowings and current maturities to long-term debt.
(i) Loans which are repayable in more than twelve months/operating cycle are classified as long-term borrowings on the face of balance sheet.
(ii) Loans repayable on demand or whose original tenure is not more than twelve months/operating cycle are classified as short-term borrowings on the face of balance sheet.
(iii) Current maturities to long-term loan include amount repayable within twelve months/operating cycle under other current liabilities with Note to Account.

Deferred tax assets/liabilities
are always non-current. This is in accordance with Schedule III of the Companies Act.

Trade payables
Sundry creditors have been replaced with the term Trade payables and are classified as current and non-current. Trade payables to be settled beyond 12 months from the date of balance sheet or beyond the operating cycle are classified under "other long-term liabilities" with Note to Account. For example, purchase of goods and services in normal course of business. The balance of trade payables are classified as current liabilities on the face of balance sheet.

Proposed Dividend
Proposed dividend is proposed by the Board of Directors and declared (approved) by the shareholders in their Annual General Meeting. Board of Directors propose the dividend after the annual accounts for the year have been prepared. Annual General Meeting of the shareholders is held thereafter meaning it is held in the next financial year. Shareholders may reduce the amount of proposed dividend but cannot increase it. Since declaration of proposed (final) dividend is contingent upon shareholders approval, Proposed dividend is shown as contingent liability. AS-4, Contingencies and Events Occurring after the Balance Sheet Date prescribes that proposed dividend will be shown in the Notes to Accounts. After the Proposed dividend is declared by the shareholders, it becomes a liability for the company and is accounted in the books. As a consequence, proposed dividend of previous year will be declared (approved) by the shareholders in the current year and this declared (approved) proposed dividend will be accounted during the year. Proposed dividend for the current year will be relevant for the next financial year. Briefly, proposed dividend of previous year will be accounted in the current year after it is declared (approved) by the shareholders in their annual general meeting.

Provisions
The amount of provision settled within 12 months from balance sheet date or within operating cycle period from date of its recognition is classified as short term provisions and shown under current liabilities on the face of balance sheet. Others are depicted as long-term provisions under non-current liabilities on the face of balance sheet.

Fixed assets
There is no change in the treatment of fixed assets. Both tangible and intangible assets are non-current. This may also be noted if the useful life of the asset is less than 12 months, it will still fall under non-current.

Investments
Investments are also classified into current and non-current categories. Investments expected to realise within twelve months are considered as current investments under current assets. Others are classified as non-current investments under non-current assets. Both are however shown on the face of the balance sheet.

Inventories
All inventories are always treated as current.

Trade receivables
Trade receivables realised beyond twelve months from reporting date/ operating cycle starting from the date of their recognition are classified as “Other non-current assets” under the head non-current assets with Note to Accounts. For example, sale of goods or services rendered in normal course of business. Others are classified as current assets and shown on the face of the balance sheet.

Cash and cash equivalent
It is always current however, amounts which qualify as cash and cash equivalents as per AS-3 is shown here. The supremacy is accorded to AS over Schedule III, cash and cash equivalents are to the disclosed in accordance to the prescribed standard.

Form and content of Statement of Profit and Loss
Statement of Profit and Loss for the year ended

Sr no.	particular	Notes no.	Figure as at the end of Current reporting period	Figure as at the end of previous reporting period
I II III IV	Revenue from operations Other income Total Revenue (I+II) Expenses: Cost of materials consumed Purchases of stock-in-trade Changes in inventories of finished goods Work-in-progress and stock-in-trade Employee benefits expense Finance costs Depreciation and amortisation expense			

V VI	Other expenses Total expenses Profit before extraordinary items and tax(III-V) Less: Exceptional items			
VIII	Profit before extraordinary items and tax			
	Profit before tax Less: Extraordinary items			
IX	Profit before tax			
	Less: Tax expense: (1) Current tax (2) Deferred tax Profit/(Loss) for the period from continuing operations Profit/(Loss) for the period Less: Earnings per equity share: (1) Basic (2) Diluted			
	Balance transferred to B/S			

The items of statement of profit and loss are discussed as follows:

1. Revenue from operations This includes:

(i) Sale of products (ii) Sale of services (iii) Other operating revenues In respect to a finance company, revenue from operations shall include revenue from interest, dividend and income from other financial services. It may be noted that under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

2. Other income

(i) Interest income (in case of a company other than a finance company),
(ii) Dividend income,
(iii) Net gain/loss on sale of investments,
(iv) Other non-operating income (net of expenses directly attributable to such income).

3. Expense

(a) Cost of Materials	It applies to manufacturing companies. It consists of raw materials and other materials consumed in manufacturing of goods.
(b)Purchase of Stock-in-trade	It means purchases of goods for the purpose of trading.
(c) Changes in inventories of finished goods Work-in-progress and stock-in-trade	It is the difference between opening inventory (stock) of finished goods, WIP and stock-in-trade and closing inventory.
(d)Employees benefit expenses	Expenses incurred on employees towards salary, wages, leave encashment, staff welfare, etc., are shown under this head. Employees benefit expenses may be further categorised into direct and indirect expenses
(e) Finance cost	It is the expenses towards interest charges during the year on the borrowings. Only the interest cost is to be shown under this head. Other financial expenses such as bank charges are shown under "Other Expenses"
(f) Depreciation	Depreciation is the diminution in the value of fixed assets whereas amortisation is writing off the amount relating to intangible assets.
(g) Other expenses	All other expenses which do not fall in the above categories are shown under other expenses. Other expenses may further be categorised into direct expenses, indirect expenses and non-operating expenses.

Illustration

From the following particulars, prepare Statement of profit and loss for the year ending March 2017, showing profit before tax as per schedule III of the companies Act – 2013.

Balances	(Rs.)	(Rs.)
Plant and machinery	160000	
Land	674000	
Depreciation on plant and	16000	
machinery	400000	
Purchase(adjusted)	15000	
Closing stock	120000	
Wages		100000
Sales(net)	80000	
Salaries		
Bank o/d		200000
10% debenture (issued on 1st April		
2016)		100000
Equity share capital- shares of Rs		200000
100 each(fully paid)		

Preference share capital-1000,6% shares of Rs.100 each (fully paid)		100000
	1600000	**1600000**

Solution:

Statement of Profit and Loss
for the year ending 31st March, 2017

Particular	**Note no**	**amt**
I. Income Revenue from operations (Sales)		 **10,00,000**
II. Total		**10,00,000**
II. Expenses Cost of materials consumed (Adjusted purchase) Employees benefit expenses Finance cost Depreciation and amortization	 **1**	 **400000** **200000** **10000** **16000**
III. Total		**6,26,000**
Profit before tax (II-III)		**3,74,000**

Notes to Accounts

Particulars	Amount	Amount
1. Employee Benefit Expenses (i) Wages (ii) Salary	 1,20,000 80,000	 2,00,000