Financial Accounting
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Lecture - 02
Financial Statements

Namaste to all of you, this is our second session on Financial Accounting, I am sure you would have enjoyed the first session. In the first session it was just an introductory session so, we had just started with understanding what is accounting, then what is the distinction between various streams of accounting like financial cost, management accounting after that we have moved to Financial Statements. So, we have seen how are financial statements emerging? So, basically they emerge from money cycle.

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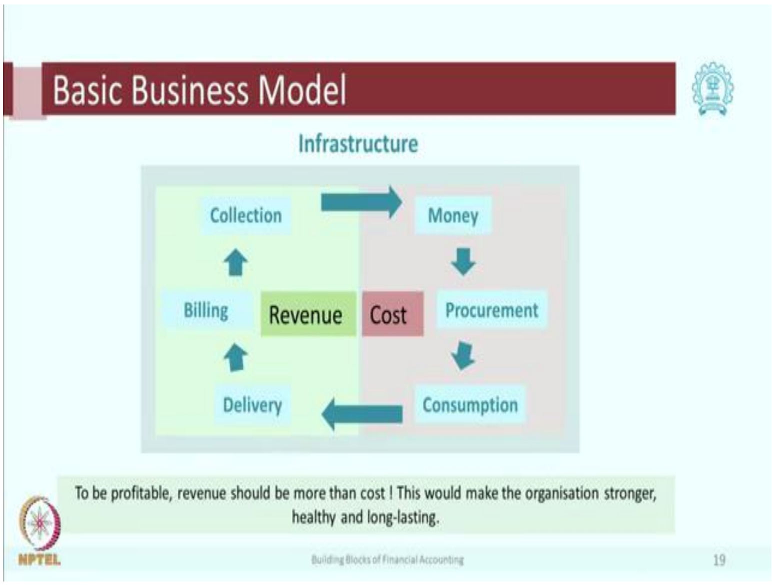

So, you can have a view at the slide where we have just seen what is a money cycle; I am trying to go from a very much of a layman who does not know accounting some of you might be well versed with accounting terms. So, please bear with me, we will go in details in the coming sessions.

But to begin with this is what is a money cycle, it starts with money procurement and so on goes back to money. So, at the stage of procurement and consumption the costs are incurred then delivery collection is a time you get the revenue.

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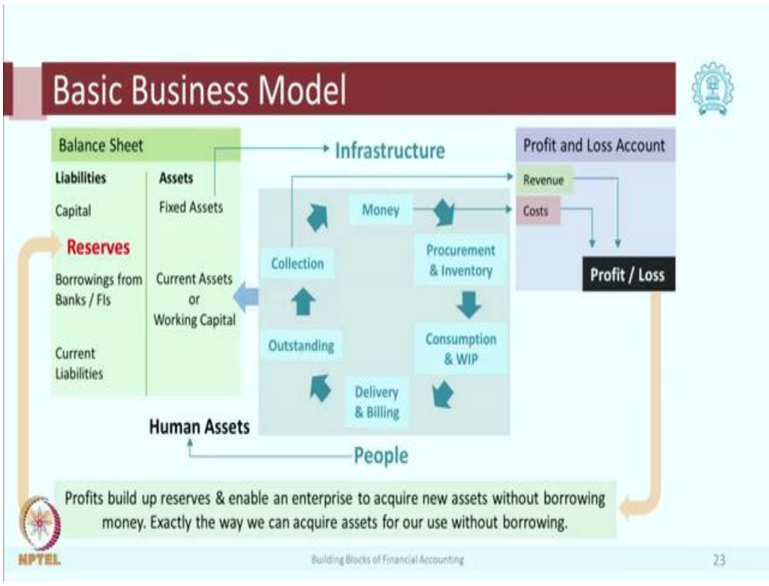

Now, from this money cycle the basic financial statements emerged so on one hand we have got a P and L account, it records your revenues it records your costs and it compares the revenues and the cost the net result is given to you in the form of profit or loss. On the other side we have got balance sheet, now what does the balance sheet do? It lists out the resources for the business those resources for the business are known as the assets, it also list out the providers for resources which are known as the liabilities, in the last session we had also seen what are the important assets.

So, you can again look at those slides I think you know it all now the first one is fixed assets which is nothing, but infrastructure needed for the business can you think of any example. So, it can be land, building, it can be vehicle, it can be software, it can be patents these are all your fixed assets. What are the current assets? All those assets which are getting converted or which are moving in money cycle; so, it includes your stocks, it includes your receivables, it includes your cash balances, it includes any moneys which you have to receive from let us say from electricity authority as a deposit all these are included in current assets, human assets are important, but not part of balance sheet.

Then on liability side we have got three important items, we have got capital this is the money which owners have put in, then we have got borrowings this is the money which lenders have put in as various types of loans and then we have got current liabilities. Current liabilities again are coming from money cycle for example, the payables to suppliers. So, if we purchase some goods do not pay that money immediately, then that much balance will be your payable or if you use let us say electricity, but have not paid the electricity bill then the outstanding electricity bill will become your current liability ok

So, this was a brief of what we did last time. If you look at the bottom part of the slide it is sort of trying to tell the purpose of these two statements. So, balance sheet is one which shows you the financial position of the organisation and P and L account it tells you about the profitability of the organisation. Now moving ahead again it tells you what does the balance sheet gives?

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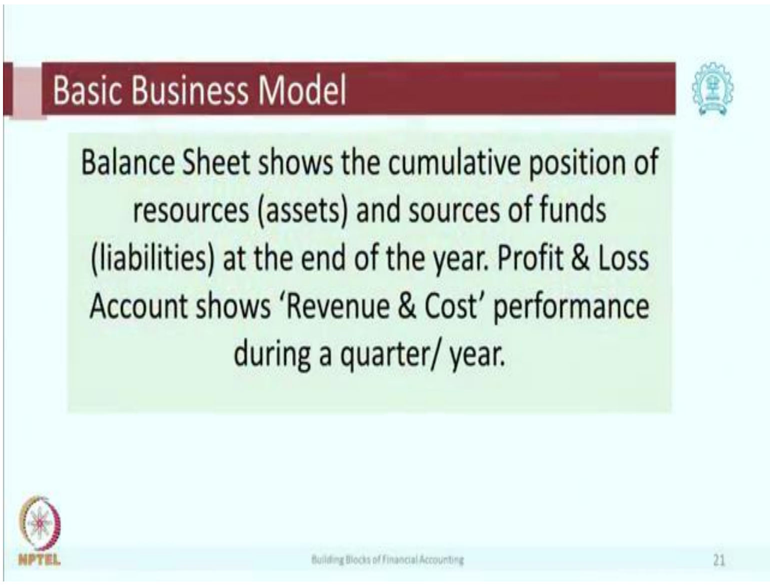

So, it shows the cumulative position of resources that is your assets and the sources of the funds that is your liabilities at the end of the year of course, it can be at the end of the month or a quarter also, but keep in mind it is a cumulative position.

So, if you purchase your some land 10 years before it will come continue to appear in balance sheet today unless you have sold it. So, all your assets continue your liabilities will also continue. So, if you have obtained a loan 4 years back it will appear in the balance sheet at that time it will even appear in the balance sheet today as long as you have not yet repaid it. So, you cannot say that this loan was taken four years ago, let us forget it now that is not possible loan was there then, loan is there now, the outstanding balance will be shown in the balance sheet of today also, that is why it has been called as a cumulative position as on a particular date.

The profit and loss statement essentially gives you revenues and cost performance, but for a particular quarter or a year. So, if you have made any sales in this month and if you make profit and loss for this month it will come as a profit and loss of this month, but it cannot be shown in the next year it can only be shown in the current year ok. So, it is not accumulative performance it is a performance for that period that is shown in the P and L account.

Now very important statement is as we have seen in the beginning your resources and sources match. So, your balance sheet exactly matches, but after doing business for sometime your business cycle is continuously going on will the balance sheet still match is it possible? Suppose you are doing well in the business your assets will slowly go on increasing your liabilities will not increase infact liabilities can go on decreasing then will the balance sheet still tally or match.

Now I am just going back to the slide so, that you can have a view of the balance sheet. So, you can just look at the asset side normally what will happen is if your business is doing well your stocks will go up, then your receivables will go up, your cash will go up while on liability side you might be repaying your loan so, loan balances will go down. If you pay your suppliers or employees on time your current liabilities will also go down. So, your liabilities are falling assets are rising, then will the balance sheet still tally is it possible that the total of assets and liabilities will match, what do you think? Just have a thought on this.

Is any item missed out in the given assets or liabilities which should be there. Actually very important item is known as reserves which was not shown earlier, but I am just showing it now to highlight it or bring your attention to it. So, what will happen is after say 1 year you have made some profit in profit and loss account that profit either is taken away by the owners it is their profit they can take it away, but mostly owners do not take away the whole of profit they may take some money remaining money is accumulated in the business in the form of reserves.

So, that reserve goes on increasing, see we have already seen that assets are raising your external liabilities are not rising in fact, they are falling. So, there is a difference that difference will be given in the form of reserves. So, what happens is for a healthy business profit goes on building up and that accumulates in the balance sheet in the form of reserve. Now suppose you have no time to study the balance sheet the old balance sheet of a company just have a look at balance sheet and look at the reserves position, if the reserves money is high it immediately tells you that companies able to generate profit on a consistent basis because 1 year's profit you can get through P and L.

But it is only for that year, but that whole profit is getting added up in reserves, if the total profit for so many years minus what profit they have taken away is what is shown in the reserves and if that amount is very high it will mean that company is having a good financial position for a pretty long time. You would have heard of Blue Chip Companies most of the top rated companies have a high level of reserves.

Now, what happens is if you have good amount of reserves then company can easily expand, they do not have to go to bank to borrow new money, they can spend that money on anything which they want and the company will grow in a very healthy manner. Now once again I have summarized the financial positions.

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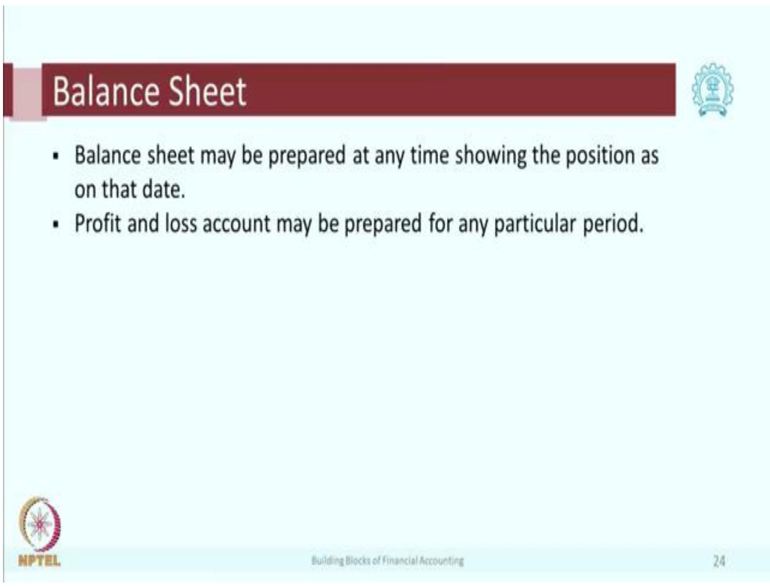

So, balance sheet it may be prepared at any time not necessarily at the end of the year, but it gives you position as on that day and profit and loss account is normally prepared and presented at the end of a particular period.

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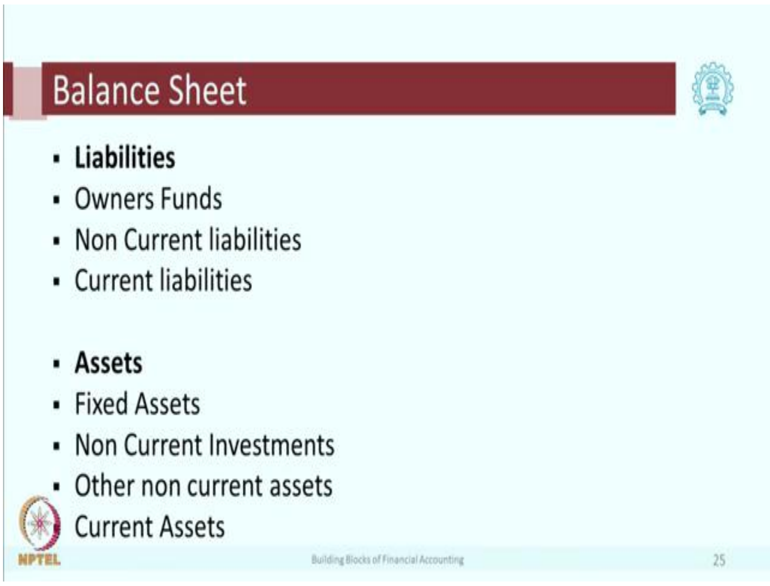

This is once again summarizing the items in the balance sheet for you, so, we have got liabilities, now the first item I have put it as owners fund. Now what do you understand by owners fund? If we just go back we had earlier put capital and we had the second item was reserve. So, these two items taken together capital plus reserves are known as owners fund. Now how do you define capital? If we remember we have seen that money which owners put in is a capital here business is generating profits and giving it to owners in the form of reserves.

So, capital plus reserves together is the first item in the liability side of the balance sheet that is known as owners fund. The second item is noncurrent liabilities in the earlier balance sheet we have called it borrowings as an example, but any liability which is of long term in nature is called as a noncurrent liability mainly it will include borrowings or loans it can also include any other item which you have not paid in 1 years time. The third item is current liability so, current liability we had seen that from the money cycle certain liabilities arise as far as the definition is concerned if that liability is intended to be paid in 1 years time then it is called as a current liability.

So, we have seen two three examples can you think of any other example. For example, if you have employees with you should pay salary at the end of the month, but if you do not pay that salary then the amount of salary which is still unpaid it will be called as a current liability. If suppose there are some other expenses let us say office expenses, you have not yet paid them then that is also current liability.

So, all those liabilities which are due or which are payable within 1 years time they are in current liabilities all those liabilities which are not intended to be paid in 1 year are noncurrent liabilities. So, both these noncurrent plus current these are external liabilities and the top item or the first item was owners funds this is also called as an internal liability.

Now, go to asset side we have already discussed what is a fixed asset. So, this is a infrastructure or these are the assets which are long term with the business to be used for the business, then we have added one more item here that is known as noncurrent investments and the last item the bottom most item is a current asset which I think we have already discussed.

So, what we mean by current assets is these are those items which are to be liquidated or which are to be received within 1 years time or and they are not normally coming from the money cycle. So, all those items which are likely to last for more than 1 year are called as noncurrent ok. So, assets broadly are noncurrent current; current is the last item within noncurrent we have got fixed assets then next is noncurrent investments.

Now what is this non current investment? First of all what is meant by investment? If you see I will just take you back in the earlier balance sheet we had not mentioned of any investment we had just seen fixed assets and current asset because that was a balance sheet which emerges from money cycle, but in case you have invested some money outside your business then that money is called as an investment.

So, here any money which we have put outside your business and which is to last for more than 1 year then it is called as a non current investment. So, can you think of any examples of noncurrent investment may be something like fixed deposit kept in bank for more than 1 year not in your bank account because, bank account is a current asset, but if you keep the money in fixed deposit with a bank for 2 years, then that will be an example of non current investment. Similarly, if you invest in shares of some other company then that is non-current investment are you getting me.

So, you can have some examples of those money put outside your business that is the non current investment apart from these if you have any noncurrent assets then they are categorized as other noncurrent assets. So, are you getting these are the important items in balance sheet under liabilities and assets. Now we will come to the next item we are going to discuss balance sheet and P and L in the next sessions, but right now it is very important for you to know where from you get all these information.

The best source of information for you is a annual report because every company comes out with the annual report and that annual report has financial statements.

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Whatever financial statement that we have discussed like balance sheet, P and L, cash flow, they will all be available in the annual reports along with notes to accounts and some more disclosures. Then there are some other things in annual report also, there will be chairman's statements, there will be board of directors analysis, there will be auditor's report, there will be report on corporate governance, there will be consolidated financial statements, then there is a management discussion and analysis.

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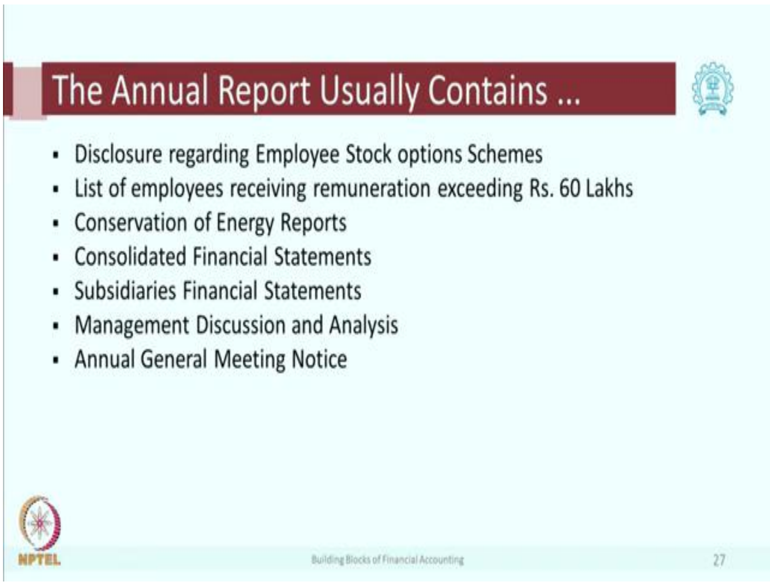

There is also a list of employees receiving remuneration more than 60 lakhs maybe some of you are aspiring for that may be someday even my name should appear among the employees who are earning more than 60 lakhs per year. So, there is a list given out there that who are these people what is their qualifications and experience and so on. So, this annual report is a authenticated document and a very useful document for any learner, you will get financial statements here I am telling you this right away because I am expecting each one of you to download the annual report of the company this is freely available.

So, please choose your company download your annual report read it go through it because in our course in coming lectures we are going to discuss about balance sheet, P and L, cash flow some more requirements of preparation of financial statements all these should not be theoretical. Go through your annual report look at the balance sheet and L and L of your own company, your own means you do not may not be owning it, but consider it as your company and start studying it from now, that is why in this situation I have told you what is annual report in detail we are going to look at various financial statements in the coming sessions.

I hope you have like the second session also this was bit shorter one, but the third session onward now we will go into technical details about each of the financial statements.

Thank you so much and Namaste.