

Financial Accounting
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Lecture – 03
Balance Sheet 1

Namaste to all of you. Welcome to the third session of Financial Accounting. In our first session, we had discussed the distinction between financial cost and management accounting, and we had also seen the importance of accounting. In the second session, we started with our discussion on financial statements. If you remember we have discussed the basic format of Balance Sheet and then we went on to understand what is annual report. If you remember, balance sheet is a statement which gives the financial position as on a particular date, it is a cumulative statement.

Today, we are going to discuss further in detail about what is balance sheet and how it is prepared. We also discussed about annual report. Now, this is a authenticated document which is published by the company and it is a treasure of lot of data about companies. It is freely available. So, I had told you to download annual report of one particular company and go through it in detail. It will give you financial statements, it will give you consolidated balance sheet, it will also give you various other statements which are very much relevant to understand the company, the nature of company and so on. I had told you that there will be a list of employees who are earning more than 60 lakhs per year. So, if you aspire to go there first of all you should know the list. So, lot of information will be available.

I hope by now you have decided your company and also downloaded your annual report. We will be giving you some assignments at the end of the week which you have to do on your company. But, right now let us move to our session 3, which we will discuss further about the balance sheet.

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Financial Statements



Financial statements are records that provide an information of an individual's, organization's, or business' financial status.

They are normally prepared general or specific purposes.

General purpose Financial Statement

Examples:

- Balance Sheet
- Profit and Loss A/c
- Cash Flow Statement



Financial Statements Balance Sheet

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So, introduction to the balance sheet and the elements of balance sheet. Now, you already know that financial statements records are the provides information for about financial status; it can be for individual, it can be for organisation, it can be for a particular business and so on.


There are three important financial statements: balance sheet, profit and loss and cash flow statement. So, in our course we are going to discuss about how these are prepared and how they can be read and interpreted.

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Balance Sheet

Balance Sheet portrays value of economic resources controlled by an enterprises and the way they are financed.

A balance sheet or statement of financial position is a summary of the financial balances of an entity on a particular point of time. i.e. summary of organization's assets, liabilities and equity as of a specific date.



Financial Statements Balance Sheet

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Now, coming to specifically what the balance sheet is, it portrays the value of economic resources which are controlled by the enterprises. So, what they are known as economic resources controlled by enterprise? The accounting terminology for it is assets and also how they are financed. They are financed through variety of liabilities. So, either it is money put in by outsiders which is known as liability or it is money put in by the owners themselves which is known as owners fund or it is also called as equity. So, balance sheet is a statement which summarises asset on one side and external and internal liabilities on the other side.

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Balance Sheet (Short Format)			
Liabilities	Rs.	Assets	Rs.
Owners Fund	XX	Fixed Assets	XX
Non Current Liabilities	XX	Non current Investments	XX
Current Liabilities	XX	Current Assets	XX

Every balance sheet shall give a true and fair view of state of affairs of the company as at the end of financial year.

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Now, just to get a feel of the balance sheet this is the format in short. So, you can start from the asset side, in the last session we are already discussed what are those terms. So, the first one is fixed assets; this is various infrastructure of the company. The second one is non-current investments. These are long term investments which are going to last for more than 1 year outside our business. The third one are current assets. These are assets which are intended to be held for less than 1 year. So, these three are the major assets or the resources of the undertaking.

On the other side, we have got liabilities. Liabilities are the providers of funds. The first item there is owners' fund. In our last session we have discussed what does it consist of. Do you remember what is included in an owner fund? There are two items. The first one is capital and the second one is reserves or accumulated profits. The second item is

noncurrent liabilities. As the name suggest noncurrent refers to one which is likely to last for more than 1 year. So, long term liabilities the third one is current liabilities or short term liabilities or those liabilities which are likely to last for less than 1 year. So, to just to have a glance, this one is not official format. We are going to it in the next slide. But, just to understand in short what the balance sheet is I think this format is very much useful.

So, any balance sheet can be very much longer because of long large number of items. It can be summarised in this particular short form just to give at a at a first eye view of the balance sheet. Now, every balance sheet shall give a true and fair view of state of affairs. This is the terminology which accountants use. They do not show correct they do not say correct view because there are a lot of assumptions which go into valuation of certain items in the balance sheet. We will be discussing it later, but any balance sheet is supposed to give a true and fair view as at the end of financial year or it can also be prepared in between; it will give you a balance sheet as at the end of that particular day.

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Balance Sheet (Detailed Format)			
	Particulars (format as per revised schedule VI)	As at	As at
		31st Mar 2011	31st Mar 2010
I.	EQUITY AND LIABILITIES		
1	Shareholder's Funds		
	(a) Share Capital	-	-
	(b) Reserves and Surplus	-	-
	(c) Money received against Share Warrants	-	-

Now, let us go for a detailed balance sheet. Now, this is the official format as per the schedule VI of Companies Act. This particular format was introduced in year 2011, that is why I have kept there 10 and 11, for a corporate balance sheet two year data is to be given. So, you can see the columns there one for 2010, the other one is for 2011. Now, the first item there it is going to start with the equity and liabilities that is I; in that one is

shareholders funds. If you remember in our earlier balance sheet; I will just go back. See, here I have shown the first item as owners fund. Now, in this format it uses the term shareholders fund.

Now, why is this difference why there it was owners fund and why here it is shareholders fund? Can you think of what is the difference? There is no difference as such. Shareholders are nothing, but the owners of the company. But, since this is the format meant for the company they have specifically used the term shareholders. While for using the short form I had used the term owners fund because every balance sheet is not a balance sheet of a company. It can be a company if it is a partnership firm what whose capital it will be? It will be called as a partners capital. If it is a proprietary concern with a single owner it will be called as a proprietors capital. In case of NGO or a non profit organization what it will be called? It is called as a capital fund ok. So, overall whoever are the owners, it is their capital.

Now, let us go back to company balance sheet. In company balance sheet it is called as shareholders funds. Inside the shareholders fund item a is share capital. Now, how do you define share capital? What is the share capital? Yesterday we have discussed in the last session we had discussed about capital. Do you remember what is the capital? Capital refers to the money which is put in by the owners. In case of company the shareholders are the owners. So, money which is put in by the shareholders is known as share capital. There are three-four specific items under share capital, but we will not go right now into it. But, whatever the money which they have paid it is known as paid up capital that will come here in the balance sheet. So, item a is share capital.

Second item is reserves and surplus. Now, what do you understand by reserve and surplus? Reserves I think in the last session we had discussed. If you remember from the profit and loss account the profit is generated by the entity or by the company. There are two choices with the company: either it can distribute profit in to the owners, then it will not come in the balance. But, most of the good companies do not distribute whole of the profit. They may give part of the profit to the owner and remaining profit is ploughed back into the balance sheet; ploughed back means instead of distributing it is kept with the company and in the balance sheet it appear as a reserve. So, but the full name for it is reserves and surplus.

Now, in the last session we are seen that this profit which is ploughed back is a reserve. Actually for a company there are some other type of reserves also. There can be statutory reserve, there can be capital reserve or there can be dividend equalisation reserve. These are of few examples of reserve. The total of reserves and surplus is given as item b in the balance sheet.

Now, take a look at item c. The item c is money received against share warrants. Now, the question which will arise in your mind is what is share warrant? I think everybody knows the share. What is the share? So, in the partnership firm, let us say there are three partners. Instead of writing total capital we will say as a's capital, b's capital, c's capital. But, in company what happens there are 1000, 10000, 1 lakh, 10 lakh there are large number of owners. So, we do not write everybody's name in the balance sheet. We write the amount which is contributed by that persons together it form share capital.

So, share refers to the share in the ownership of a particular company. So, for so many shareholders suppose there are 10000 shareholders in the company everybody would have put in some capital, that total is item number a share capital. In item number c, it talks about share warrant. So, you will be wondering what is a warrant? Does anybody know what is a share warrant? Now, sometime what happens is a few people are entitled to receive share in future.

So, as of today they have not yet received share, so, we cannot show it in the share capital. Whoever has received share from a company and has paid the money will be share capital, item a. But, if that person has paid the money, but still has not been received has not been issued a share, but has been issued a right to receive share in future it is called as share warrant. That means, suppose I am a company, there are hundred people who have paid me some money and I have issued them the warrant which gives them are right to get share in future. The money which is received by me; I am a company, so, money which is received by me against those share warrants is that item number c. The money received against share warrant.

Now, you may be wondering why should company go into this business of issuing warrants. There are variety of reasons. As I told you one simple way is take money give them share, then it will go in item a that is known as share capital. But, in certain instances as a company I do not want to give them share now, but I want to receive

money and give them share in future, then in such scenario I issue them share warrant. Can you think of any such scenario where a share warrant is received?

I think some of you guessed it correct. In many cases there are some shares known as ESOPs. ESOP that is Employee Stock Option Plan sometimes is also sweat equity. So, there are managers or executives who are working for the company we want to incentivise them. We want to give them some benefits because they are working very well, but we also want them to stay in the company, we do not want them to go out. So, what we do is we will issue them warrant and attach a condition that if they continue in the company for next 3 years then that warrant can be converted into share. So, this is one example of when the share warrant is received.

Can you think of any other example? Sometimes what happens is company wants to raise loan. Let us say I go to bank and request the bank to give me loan, but what bank says is that bank wants the share in our profit. Now, we cannot directly give them share. So, what we do is when we take loan we give them some share warrants and these share warrants can later on be converted into shares by the bank. They pay some token money to receive the share warrant and that money is shown in item number c.

Now, you may be wondering that the share warrants is a small amount, why so much discussion on it? Why so much discussion because later on it is going to be added to and keep in mind that share capital is a very important item. These are the owners of the company. So, today's investor should know that there are some owners which are in future going to be included in the list of shares. Now, they can be employees, they can be bankers, in some cases company get some technology from some technical experts or some professionals, maybe to compensate them we give them warrants. So, all these are shown under item number c that is money received against share warrants.

Obviously, this item c is not there for a proprietary concern or for a partnership concern. So, in that earlier short balance sheet it was not there, but in a company balance sheet in a detailed format this item is bound to be disclosed. I hope you are getting what is item number c. Now, we will go to the next slide.

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Balance Sheet (Detailed Format)		
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	- -

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Now, item number 2; this is share application money pending allotment. Now, what is meant by application money? Many of you would be aware that whenever the shares are issued first of all the shareholder or a prospective share holder has to pay to the company. So, suppose I am company, I want to issue shares; of course, I am not giving them for free they are going to pay me. So, I declare that I am willing to issue share to prospective investors; people who want the shares in my company, they would come forward and pay me some money. Now, I receive money if I give them shares then no problem it will go in one a, that is share capital.

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Balance Sheet (Detailed Format)		
2	Current Assets	
	(a) Current Investments	- -
	(b) Inventories	- -
	(c) Trade Receivables	- -
	(d) Cash and Cash Equivalents	- -
	(e) Short-Term Loans and Advances	- -
	(f) Other Current Assets	- -
	TOTAL	- -

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However, what happens is if a company wants to issue shares it declares that is willing to issue share whoever wants to invest, that is the prospective investors, they would pay money and they want to issue shares receive shares. Now, if they are issued shares then it will go in one a no problem.

But, in some cases what happens is the allotment of shares is delayed means I receive the money now, but till the end of the year the shares are not allotted that is and then where will you keep that money that that particular amount is kept under this item number 2. So, I hope you have got it now.

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Balance Sheet (Detailed Format)		
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	- -

So, share application money pending allotment; that means, suppose I have received 10 lakhs from the shareholders as till not given them shares. So, it is an application money, but the allotment of shares has not happened; allotment means giving process of giving the shares that has not yet happened. That is why it is shown as share application money pending allotment. It is shown as a separate item because later on it is going to be added to one a that is share capital or the other possibility is I can reject their applications and I will refund the money.

So, it is not yet clear whether it is a share holders funds or whether it is liability. If I give them shares it become shareholder fund if I give them back to the prospective investors it becomes a external liability. That is why there is a second item is a specific item known as share application money pending allotment ok.

Now, the third item. The third item is noncurrent liabilities. Now, we have discussed it earlier in the last session also and also in the beginning of the session. So, what do you understand by noncurrent? I think by now everybody knows that whatever is intended to be settled within one year is we call current. If it is likely to last for more than 1 year we call it noncurrent. So, all these items under are the examples of long term liabilities, they are going to be for more than 1 year. So, they come under item number 3 noncurrent liabilities.

In that if you see a, it is long term borrowings. Now, as the name suggests it is for a long term more than 1 year borrowing. What do you mean borrowing? Borrowing refers to the loans which are taken by the company. So, company most probably will take loans from banks, it can also take loan from financial institutions it can take loans from non banking financial companies or NBFCs are as they are known as. From anybody if they have taken loan then it will be shown under the head 3 a as long term borrowings.

Now, 3 b, deferred tax liability. Now, what do you mean by deferred? Deferred means instead of paying now I am going to pay it in future after one year and tax liability. See normally the tax liabilities are to be paid in the same year then it is known as current tax liability, but a part of the tax liability instead of paying now is paid after 2 years, 3 years, 4 years then it is called as a deferred tax liability. Of course, this is not as per the wish of taxpayer otherwise he/she will say I do not want to pay now and I will defer it.

Government decides as to what tax liability you have to pay now and a part of the tax liability as a incentive they say you do not pay it now you pay after 2-3 years. We will discuss it later on as to which items are deferred, but in general whichever items which are not to be paid in next year, but can be paid beyond that then it is called as a deferred tax liability. Then the item c, 3 c is other noncurrent other long term liabilities non noncurrent and long term is almost same.

So, we have already seen that a refers to long term loans, b refer to deferred tax liability, other than these are shown under c as other noncurrent liability. Now, the question in your mind will be which are such items. Can you think of any such item? I will just give you one example. Suppose, we have received deposit from somebody it is not the loan, but the deposit is likely to be paid after 2 years, 3 years, 4 years etcetera then it will fall in 3 c because it is neither borrowing nor it is a tax liability, but it is a long term in

nature. It is not a short term deposit. It is to be paid after 2-3 years, then it will be shown as a other noncurrent liability.

Then the fourth item 3 d, that is long term provisions. Long term means more than 1 year that you are aware, but what do you understand by provision. Is anybody aware what is a provision? See, this is the amount which is payable, but how much is payable is not known to me to the full accuracy with the exact details a few of the details are not yet known, information is not available. So, what I do is I make the best estimate of a particular liability and show it as a provision. So, such long term items are shown as long term provisions.

Can you think of any example of any provision which is long term in nature? Suppose, a customer has filed a complaint against me and wants to take some compensation because, of deficiency in service. We are having argument with the customers some case is on or some discussion is on. We are not going to paid it immediately. After some court decision or after some authority's decisions we will pay it. It will take to 2, 3, 4 years in such case whatever is likely to be payable as a compensation will be shown as a long term provision.

Or another example I give. We have got lot of employees working in our company. When they retire they have to be paid with gratuity. At the time of retirement employees get gratuity amount however we do not know the gratuity amount because it depends on the salary of that person at the time of retirement. Age of retirement we do not know or in case of unfortunate death of the person we have to pay it at the time of death. So, nobody knows the date of death.

So, naturally we do not know the exact amount of gratuity, but we make our best estimate and that estimated liability of gratuity will be shown as a long term provision. Later on we are going to discuss a bit more on provision, but right now I think you would have generally understood that this is the one of the long term liabilities that is why it shown under item 3, that is noncurrent liabilities.

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Balance Sheet (Detailed Format)		
4	Current Liabilities	
	(a) Short-Term Borrowings	-
	(b) Trade Payables	-
	(c) Other Current Liabilities	-
	(d) Short-Term Provisions	-
	TOTAL	-

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Now, the next one is current liabilities. Now, in the last session we have already discussed what is a current liability; it is less than 1 year period and it comes from the business cycle. So, mostly it relates to day today transactions of the business. So, 3 a refers to short term borrowings.

Now, we already know long term borrowings means more than 1 year, the short term borrowings are loans which are taken for less than 1 year. So, for example, we have approach bank for a bridge loan; bridge loan is typically sanction for just 2 months, 3 months, 4 months period. That means, we are going to start a new project, but it will start after 3 months. So, for that 3 months we have obtained some loan that bridge loan which is 3 month loan so, it is shown as a short term provision. For that matter any loan which is less than one year accepted from bank or NBFCs will be a short term borrowing.

Next one is trade payables. I think most of you are aware about it that whenever we buy any item in a B2B transaction it is not across the counter. If you are in business transaction what happens company places a order, the goods are delivered and payment is done after 15 days, 1 month, 2 month etcetera. So, from the date of purchase till the date of payment the amount is a payable it is related to our regular trading activity, that is why it is shown as a trade payable. Usually trade payables will be for 15 days, 1 month, 2 months and so on. So, that is why they are clubbed under current liabilities.

The third one are other current liabilities. So, as you know what is not covered in borrowing or trade payables there can be any other items. Can you think of any examples? Most of you would have got this in your mind that suppose salaries are there, so, we are supposed to pay salary on thirty first of the month or thirtieth of the month. But, if you do not pay then till the time you pay it becomes a outstanding salary. So, it is an example of other current liabilities. Same way electricity bill, rent, and any other office expenses which is not paid, but is payable in the short term that will be other current liability.

And, the last item in this head that is 4 d is short term provision. We have already discussed the provision. So, a particular liability where amount is not known with substantial accuracy is a provision, but it is payable in the short term period then it is called as a short term provision.

So, with this that is right now we have gone through 1, 2, 3 and 4. So, we have finished the asset side of a detailed format. In the next session, we will discuss about we have completed the liability side of the format. Now, we will next session we will discuss about the asset side Namaste.