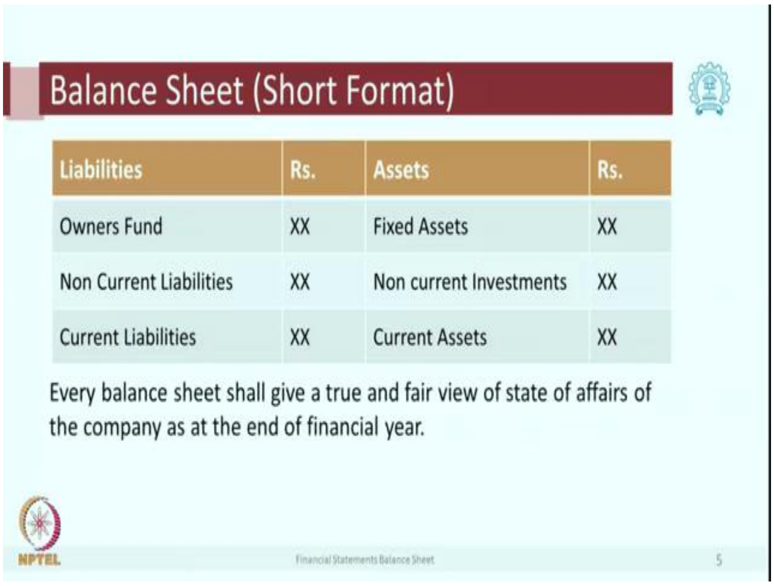
Financial Accounting
Prof. Varadraj Bapat
School of Management
Indian Institute of Technology, Bombay
Lecture - 06
Balance Sheet 4

Namaste In financial accounting, if you remember in our first session, we had tried to understand what is accounting and then started discussion on financial statements. In the second session, we discussed what a business cycle is and from that how the main financial statements that are balance sheet and P and L account emerges. Then in session 3 and 4 we went into what is balance sheet and what are the items in balance sheet.

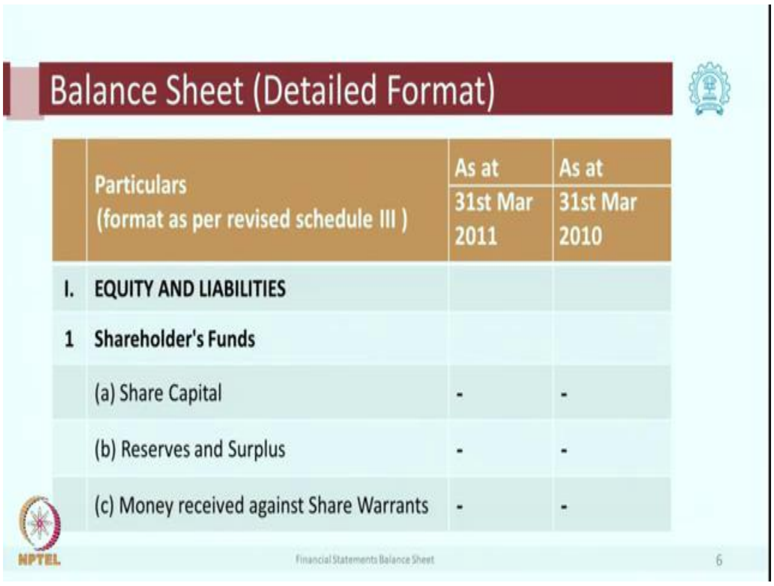
Today we will continue with our discussion on Balance Sheet, and then we will proceed to understand the profit and loss account. We will take a quick review of balance sheet.

(Refer Slide Time: 01:12)



So, you already know short form format of balance sheet. There are 6 items. Then I will go ahead, we are going to discuss each of them in detail. We had also seen a detailed format of balance sheet under schedule III of Companies Act.

(Refer Slide Time: 01:17)

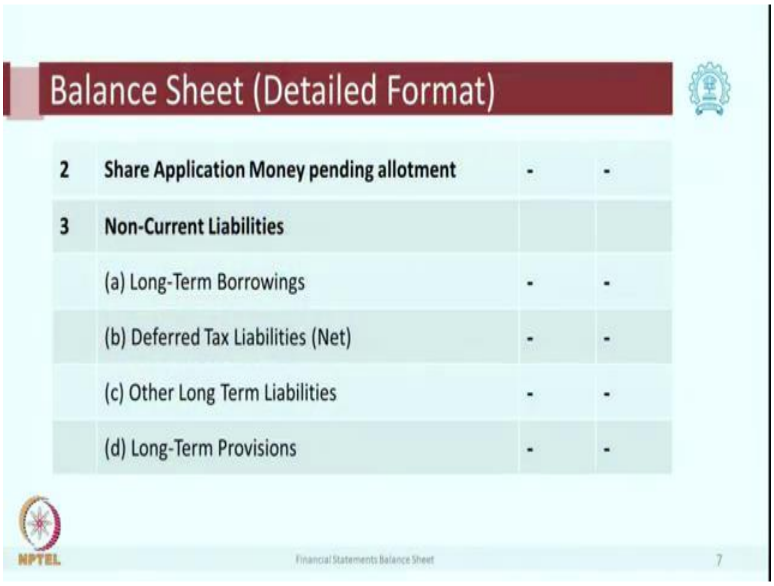


Balance Sheet (Detailed Format)

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

So, we have equities and liabilities, then shareholder's funds, share capital, reserves and surplus. I hope you know their meanings. If you really do not know please do not keep quiet ask them on the discussion forum. Then you have got money received against share warrant.

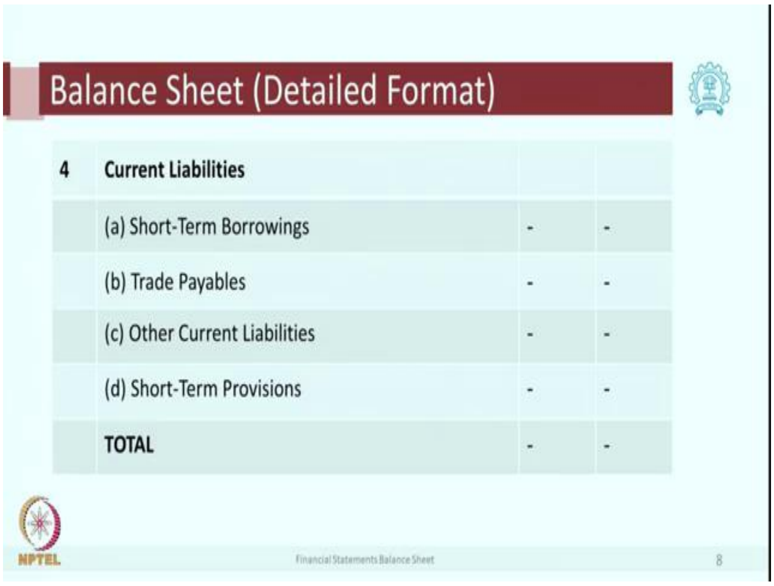
(Refer Slide Time: 01:52)



Balance Sheet (Detailed Format)

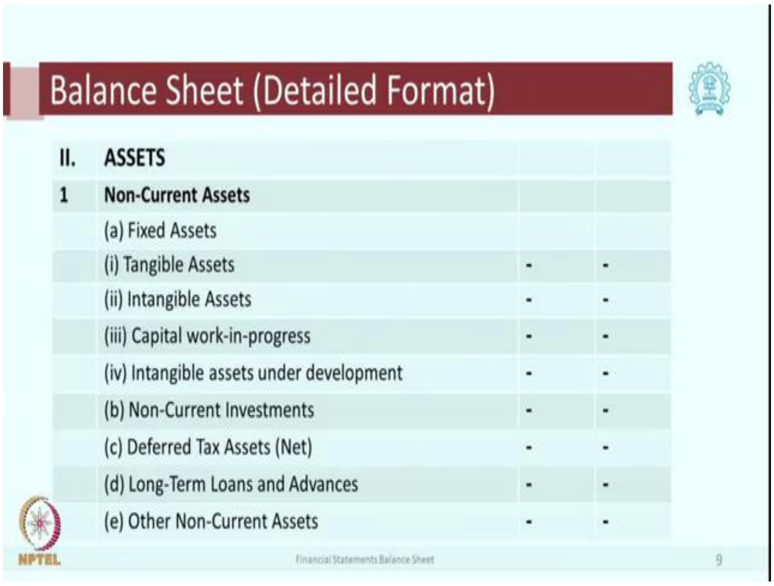
2	**Share Application Money pending allotment**	-	-
3	**Non-Current Liabilities**		
	(a) Long-Term Borrowings	-	-
	(b) Deferred Tax Liabilities (Net)	-	-
	(c) Other Long Term Liabilities	-	-
	(d) Long-Term Provisions	-	-

(Refer Slide Time: 01:54)



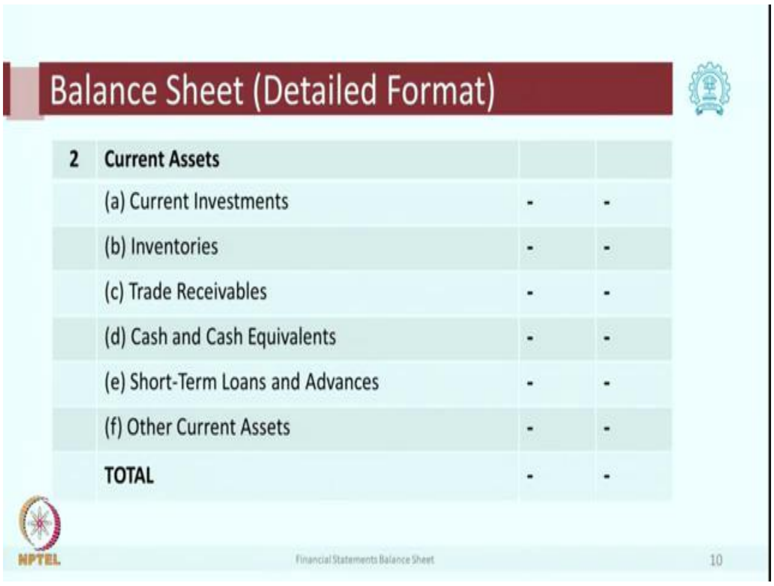
Then we went on to discuss share application money pending allotment and non-current liabilities, then current liabilities.

(Refer Slide Time: 01:56)



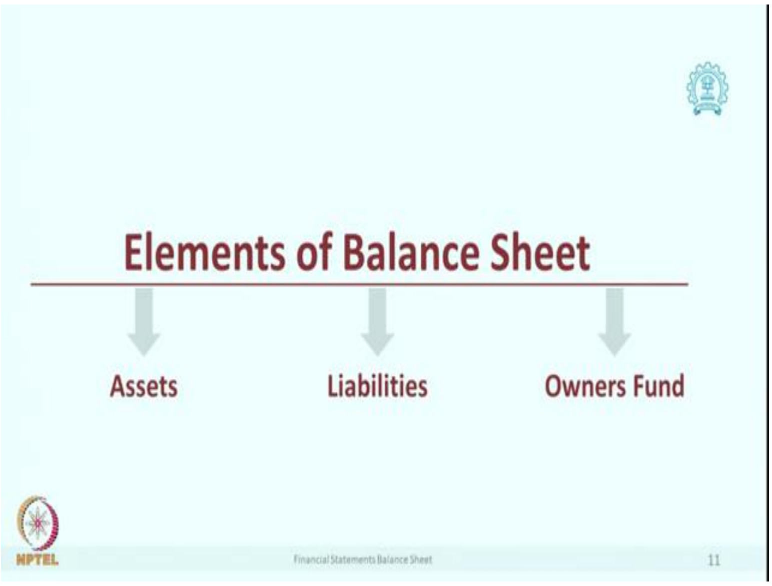
Then we discussed on assets, again divided as non-current assets followed by current asset.

(Refer Slide Time: 02:02)



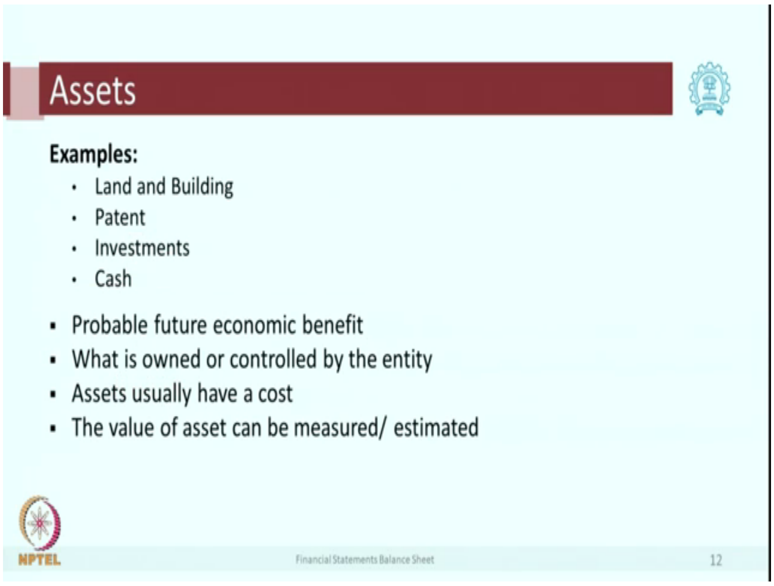
If you look at the format it is as per the permanence. So, what is permanent comes first. For example, in balance sheet share capital has the longest renewal that comes first, then non-current liabilities, then current liabilities. In assets first we have got non-current liabilities because they are going to be with us for more than 1 year, within that also fixed assets are likely to be more with the company for a longer tenure, so first we have got fixed asset then we have got other non-current assets then we have got current assets.

(Refer Slide Time: 02:37)



So, in the format of balance sheet if you look at the elements which we are going to discuss in detail now, there are 3 elements one is assets, next liabilities; here I mean external liabilities followed by owner's funds.

(Refer Slide Time: 02:53)

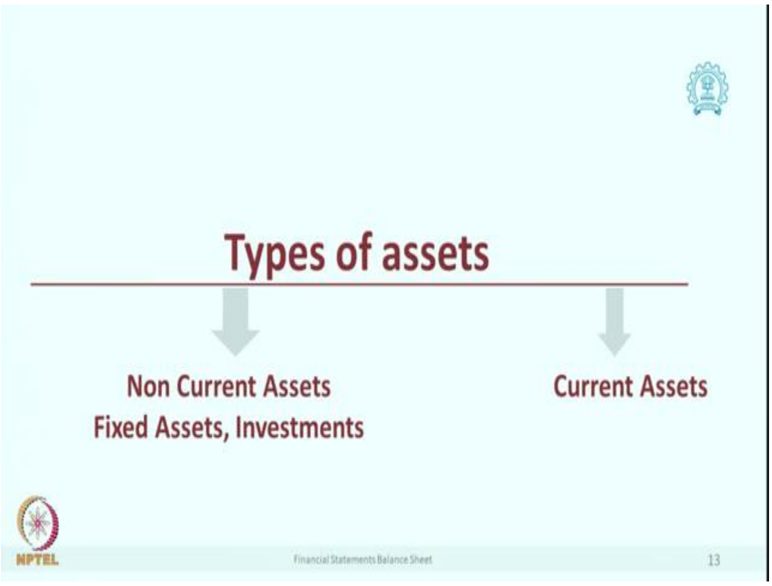


In the last session we are just started our discussion on assets. So, we will just start again from that. In the assets we are already seen the major examples of assets. So, we have got land building, patents, investments, cash and so on. As a definition something which is a property of the company which has a probable economic value that is called as a asset.

And the second condition is it must be owned or controlled by the entity. We also saw in our earlier sessions we had seen that business cycle you need human power, you need people to manage the business, they are invaluable assets of the enterprise, their skills are important, how they behave is important. However, they cannot be shown in the balance sheet because human beings are not owned by the company.

In assets essentially there are the items which are owned by the company and which are going to have economic value in future. Usually, assets will not be made available to company for free, so there will be some cost for the asset and we are assuming that there is a economic value which can be measured and if exact value is not known at least it can be estimated.

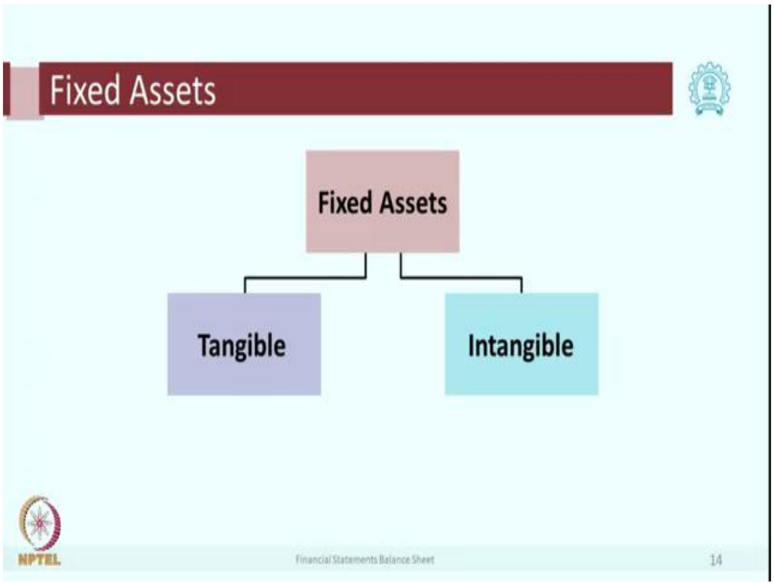
(Refer Slide Time: 04:25)



Now, coming to the types of assets; as we know there are major two types of assets one are non-current then other ones are current. Non-current means those which are likely to last for more than 1 year, which again the major examples of fixed assets and current assets.

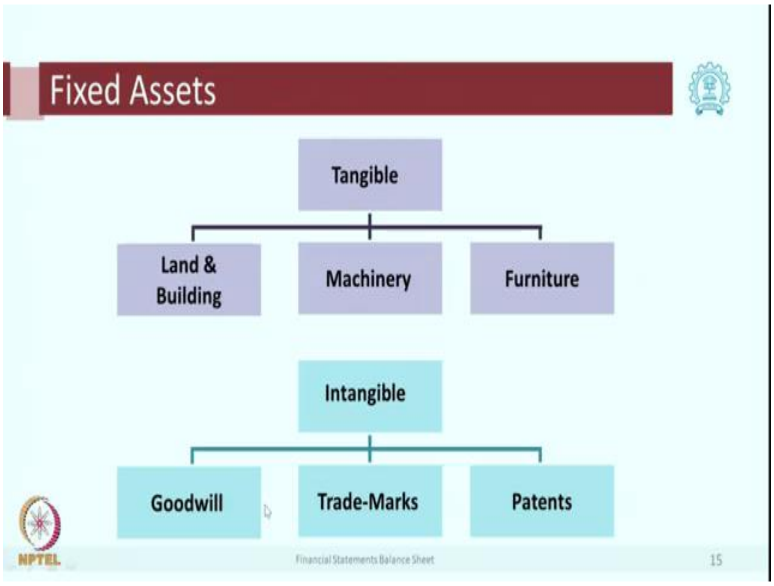
Do you remember what is meant by fixed assets? Because when we discussed money cycle, we had started with the first asset which is fixed asset. Do you remember what it is? Yes, many of you are correct I think. It is a kind of infrastructure using which company does its business. Whatever operations are happening fixed assets themselves do not get converted, but they act as catalysts, they support the whole process.

(Refer Slide Time: 05:23)



Now, what are the types of fixed assets? There are two types, one is tangible the other is intangible. Tangible means something which you can touch, which you can feel, which has physical existence. They are called as tangible assets. I think the examples are very very easy everybody knows what are the examples of tangible assets. We have got land, machinery, furniture, vehicles, large number of say computers, cameras, mobile, phones, large number of assets which you can touch, feel are all called as tangible fixed assets.

(Refer Slide Time: 05:44)



The other type is intangible. Now, this is something which you cannot touch or feel, but still they have a value. They are going to be with the company for a long time. So, what are the examples of intangible assets? Can you think of any examples?

Earlier I had taken one example if you remember. We had seen that we have a computer is it a fixed asset the answer is yes, there are two things in computer there is a hardware, there will be a mouse, there will be a keyboard, there will be all other parts, now whatever you can touch whatever you can see these are all tangible parts, but there is also intangible part which is software, which is loaded in the computer.

And many of you use mobile phone, so in mobile phone more frequently whole day I think most of you would be on mobile phone. So, you can see your instrument, but in that instrument, there are apps there are various other things which are loaded on instrument which do not have physical existence which are but which are of very much used to you. Those things are an example of intangible assets.

Ok, any other examples of intangible asset do you think of? Let us see you are doing some scientific research and you get a new formula or you develop a new product then you will apply for a patent. If you get a patent it has a very important economic value and patent will be an example of intangible asset. Those of who are good in art or those who have got creative attitude, you might have a new drawing or you may might come out with the new size or a design that also can be registered. It is registered as a copyright then a copyright or a trade mark is also an example of intangible asset, ok. Are you seeing the example?

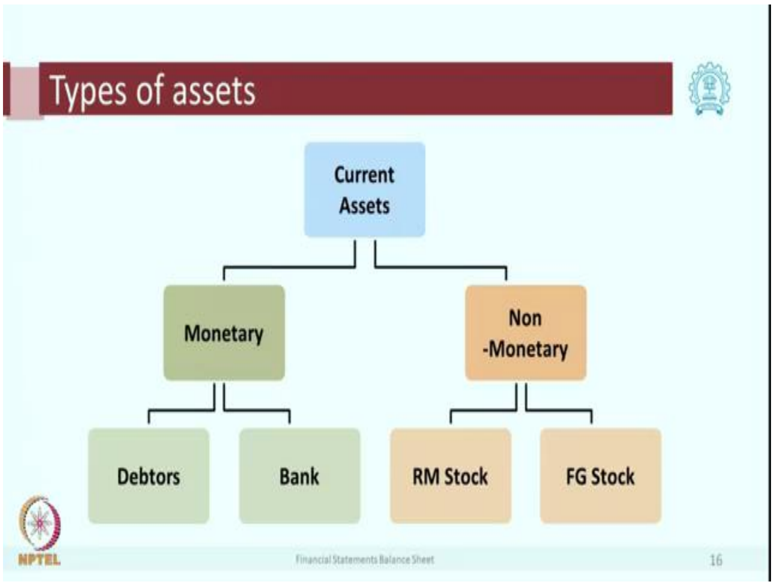
So, you have got patents, we have got trademarks, we have got goodwill. Now, what is goodwill? As the name suggests it is a good name of the concern. If you are say running a shop for many years 2 years, 3 years, 5 years, 10 years several people in the locality or even from faraway places we will know your shop they would prefer your shop over other shops, because of the trust factor, because of reliability and so on, that will be what is known as goodwill.

There are several brands of international and national importance, they can be considered to be valuable, that brand name itself is valuable. Can you name of or think of a few brands? I think everybody would have heard of Tata which is highly reputed brand all over India, there are several companies under Tatas like TCS or Tata motors or Tata steel, but the brand name is Tata. So, that Tata name is attached with lot of goodwill.

Similarly, nowadays most of you know Jio. So, Jio is a brand name which is owned by reliance industries that is also brand name. I do not want to advertise too many companies but I am just giving you examples. For example, relatively new, but which has taken a big name is Patanjali. So, Patanjali is a big brand name today not only in yoga, but also in ayurved. Like that there are also several international brands. So, all of these are backed by some goodwill of that company. It is sometimes copyrighted, then the copyright is a intangible assets, sometimes it is not copyrighted then it can be called as a goodwill.

Now, valuation of intangible assets is bit difficult. Relatively valuation of tangible assets is easy, anyway we will go into it later on, but right now on your screen you have got variety of both tangible and intangible fixed assets.

(Refer Slide Time: 10:29)



Now, the next one is current assets. Now, what is the definition of current asset? I think we have seen it earlier, we have got a money cycle or a cycle of operations and in the operation cycle or in the money cycle or in the value addition cycle many assets are getting continuously exchanged, those assets are typically what are known as current assets. Normally, the life of these assets is not very long, they are likely to be with you for a relatively shorter time maybe 15 days, 1 month, 2 months, 3 months and so on; these assets are known as current assets.

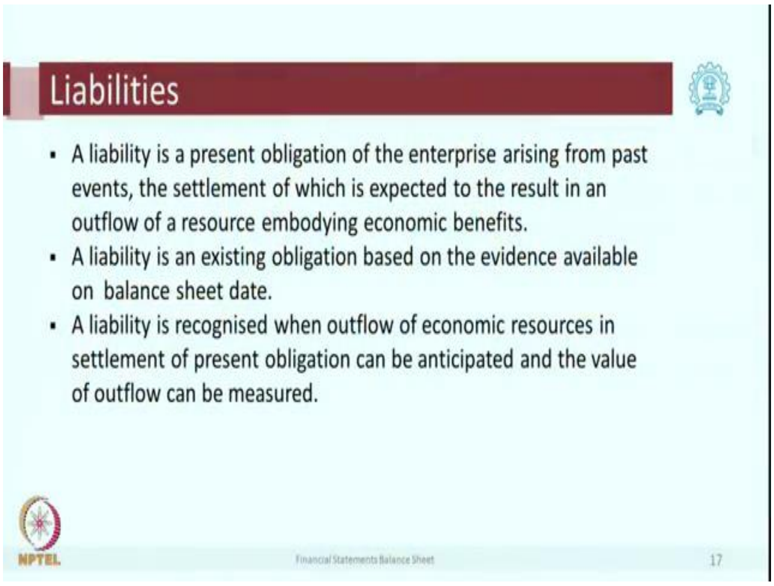
Now, current assets can be classified into two types, one is a monetary one, the other one is non-monetary. Now, can you give examples of monetary current assets or non-monetary current asset? Is anyone of you able to think? Something which can be expressed in money terms is monetary, I think most of you would be thinking of it, but in fact every value in the financial statement can be expressed in monetary terms. Then can you call everything as a monetary, then what will come as non-monetary, ok. I will try to respond to your question.

So, see monetary assets are debtors and bank. So, they represent something which you are going to receive from bank or something which you are going to receive from your customers or debtors. Their value does not change. So, they are called as monetary fixed assets, monetary current assets. Then, what are non-monetary current assets? Can you think of any examples? Non-monetary current assets are variety of stocks or inventory with you.

So, if you have purchased raw material, it is a fixed, it is a inventory of raw material you will converted into finished goods it becomes inventory of finished goods. Some of the companies only deal trading business, they purchase finished goods, they sell finished goods, in that case the stock of finished goods in their hand is a non-monetary current asset.

As I was just saying even non-monetary assets have a monetary value, then why do you call them non-monetary? The reason is because their value goes on changing with the changes in the market value in the market. So, for example, the value of inventory of finished goods may go up and down, value of investment sometimes go up and down. So, such assets are known as non-monetary current assets, ok. Now, I think you would have understood what are the important assets. Now, let us go to the next part that is liability.

(Refer Slide Time: 13:46)



Now, what is meant by a liability? I think you are able to see it on the screen, that it is a present obligation of the enterprise that arise from the past events. So, in the past suppose we have got purchase we have purchased raw material from somebody, if you pay in cash you get raw material you pay cash then there is no liability. But, if you purchase raw material but you are yet to pay, let us say you are going to pay at the end of one month, but as of today you are not paid then it will be shown as a liability in your books. It will be what type of liability in the example which I am saying.

I have purchased raw material I have not yet paid I am going to pay within a month, what type of raw liability it is? I think most of you are guessing it correctly it will be a current liability, because it is going to be settled in just 1 month. Anyways, types we will see later on. Now, it is an existing obligation there should be some evidence available on the balance sheet date and it is expected that there will be some outflow which can be anticipated and value also can be measured. So, suppose we have purchased raw material of 1 lakh, we will pay after 1 month rupees 1 lakh.

So, you know that expected outflow is 1 lakh that is why it is called as a liability. Sometimes you do not know exact value, but you can estimate the value, still it will be called as a liability. Can you think of any examples of liability other than what example I gave you? I think most of you are guessing it rightly. Suppose I take a loan from bank I will have to repay it, so bank loan also is an example of a liability. Now, what are the types of liabilities? Nowadays, your life is very simple. If you remember current, one type is current the other type is non-current.

So, non-current is something which will be settled after 1 year, which has a life of more than 1 year. So, can you think of any examples of non-current liability. I think bank loan which we discussed was one, because it is mostly for more than 1 year. But other than bank loan, are there any other liabilities any other non-current liabilities, ok.

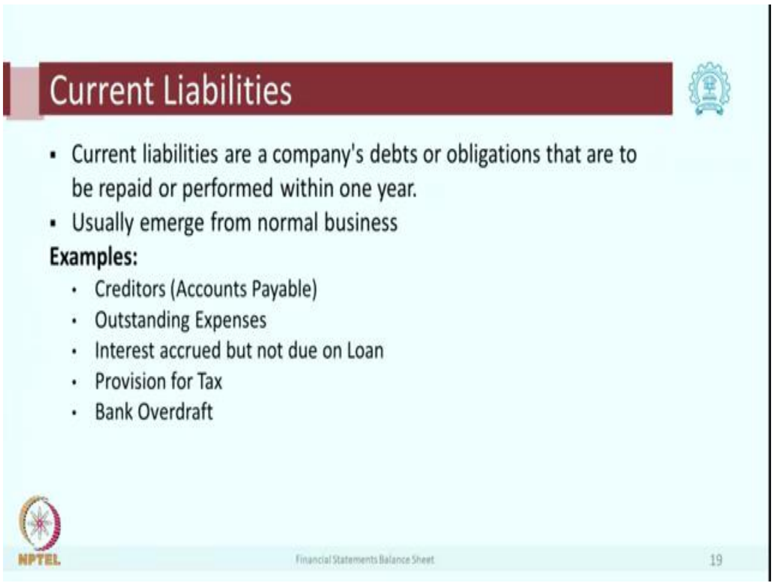
(Refer Slide Time: 16:15)

These are long term or non-current liabilities. They are likely to be repaid or perform beyond 1 year. Usually, they represent sources of funds because that is how the enterprise or company is raising it funds. Now, example one is bank loan you already know if it is more than 1 year it can be loan from NBFCs. Do you know what is NBFC? Full form is Non-Banking Financial Companies. So, other than banks there are companies which give you variety of loans that is also a non-current liability for us.

One more possible liability is debenture. Now, what do you understand by debentures? Debenture also is a type of loan. So, many companies come out with a debenture issue, they inform the investors that we will issue a debentures, investors pay them money and they issue a certificate for debenture. So, it is a loan, but which can be traded in the debt market. In any case as for as the balance sheet is concerned it is an example: of a long-term loan.

One more possible liability is deferred tax liability. Earlier we had discussed a bit on it when we discuss the format. So, normally the tax liability should be paid within 1 year, but under special circumstances or because of some specific provision in the law if it can be paid after more than 1 year it will be called as a before tax liability. Now, the other exam the other type is current liability I think you all know the examples, but just have a look.

(Refer Slide Time: 17:59)



So, these are the obligations which are likely to be repaid or performed within 1 year and normally they come from day to day business transactions or from the money cycle or from the business cycle as we were see. I think you know most of the examples, one is creditors also known as accounts payable, then outstanding expenses. Now, what do you mean by outstanding expenses?

So, for example, if you have got 100 employees normally the salary should be paid on the last day of the month, say on 30th or 31st. If we do not pay salary on that day and we pay salary on let us say salary of April should be paid by 30th of April, but if you do not pay, if we pay it in May, on 10th of May then on 30th of April up to 9th of May if you make a daily balance sheet in each balance sheet it will be shown as a outstanding expense or it can be also called as an outstanding liability. Like that any expense which is unpaid will be considered as an outstanding expense.

Then one more example is interest accrued, but not a due. Now, what is the meaning? So, suppose you have taken loan from bank let us say you have taken loan of 1 lakh at 10 percent per annum that means, every year you have to pay 10 percent. So, on 1 lakh you have to pay 10,000, but at the end of the year; now at the end of the year if you do not pay 10,000 it will be an example of an outstanding expense which we have already discussed.

But even during the year let us say 3 months are over and you are preparing a balance sheet, so you have to pay 10,000 at the end of the year, that means at the end of 3 months you have to pay one-fourth of 10,000 or say 2500, but you do not have to pay it now you will pay it at the end of the year. But at the end of 3 months you have already created an obligation it is called as an accrued interest; it is accrued but not due. When will it become due? After 1 year, but after 3 months since you have used the funds you will need to show 2500 as an accrued interest. It is one more example of current liability.

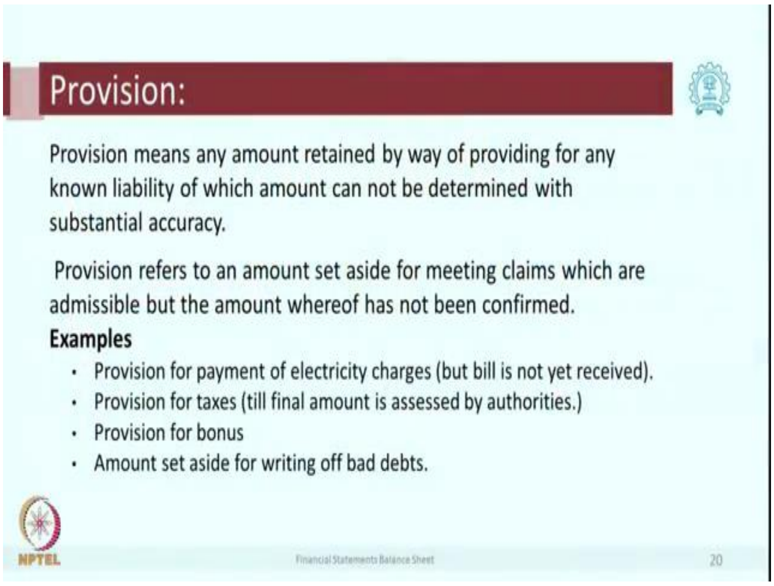
The next example is provision for tax. Now, what is the meaning? As we were discussing whatever profit we earn we have to pay income tax on it. The calculation is done by us. Finally, it is to be approved by income tax department until it is approved by department we will show as per hour calculation we will calculate the profit, as per our calculation we will also calculate the taxes payable. Till the time we pay it, it will be shown as provision for tax under the head current liabilities.

The next is bank overdraft. Now, what is the meaning of bank overdraft? Now, bank gives a facility to the account holder that account holder can withdraw some money that is called as a bank overdraft. So, suppose we have deposited 10,000 in bank normally we can withdraw only 10,000 balance will be 0, but in case of current accounts you can deposit 10,000 but you can withdraw 15,000, that 5000 which we have taken more the balance in the bank account will be appearing as minus 5000, that minus 5000 is called as a bank overdraft.

Of course, there will be a limit that a particular company can draw how much from the bank, but it is payable in the short term. So, it is considered as a current liability. Are you getting? Just think of some more examples of current liabilities. Now, we have understood both non-current assets, current assets, then current non-current liabilities, current liabilities. Think of the examples and they will be discussed on the discussion forum, ok.

Now, let us go to one special type of liability that is called as a provision. If you have marked when we discuss the current liability, we had shown one item known as provision for tax. Now, did you think why it is called as a provision? Why I did not call it as outstanding tax? If I pay tax on time, no problem, no liability is created. If I do not pay tax on time it should have been shown as a outstanding tax, but instead of calling it out standing we are calling it provision for tax. Now, what is the reason? Ok.

(Refer Slide Time: 23:16)



Now, have a look at it. So, provision are those amounts which are retained by way of providing for a known liability for which amount cannot be determined with substantial accuracy. That means, I know there is a obligation, I know there is a liability, but I do not know exactly how much should be payable, in such scenarios you create a special item it is also a type of liability, but it has a special name as provision. So, provision refers to amount which is set aside for meeting claims which are admissible, but amount is not yet confirmed.

Examples are also in front of you. One example is provision for electricity charges. Now, let us say we prepare accounts or balance sheet at the end of 31st of March and every month we get the bill for electricity on the 10th of next month; that means, February bill will occur on 10th of March, March bill will occur on 10th of April. That means, on 31st

March I do not know the amount of bill, but I know that I have consumed electricity, that means some amount is payable on account of electricity charges. I did not pay the bill till date if fact I did not received the bill which will me on 10th of April. So, as on 31st March when I am making a balance sheet I am unaware of the amount which I have to pay, but I am very much aware that electricity has been consumed, that means some amount needs to be provided for. So, we will create a provision.

Now, the question which will come in your mind is, so far we have not received any bill, so how will we know the charges for electricity bill for the month of March. Now, there are various ways of estimating. For example, I can do one thing I know the charges for last 11 months, right from April to February I have all the bills, only March bill is pending. So, I can take average of 11 months or I can even take a last March electricity bill and add a 5 or 10 percent and treat it as a provision for this March. So, there are various ways of estimating but there will be some estimation done and a provision is created. I hope you are getting what is a provision.

Another example which we are already discussed was provision for taxes. Now, as far as the provision is concerned, we do not know how much taxes will be finally payable, because those decisions are taken by tax authorities. But what I do is based on my understanding I calculate profit; I also calculate the taxes payable and make a provision in the balance sheet. For estimated amount of taxes likely to be paid that is called as a provision for tax.

Same way to the employees, normally bonus is paid at the end of the year based on their performance, exact amount is not known because that will be known after performance evaluation. So, as on 31st March some estimated provision is made for bonus that is called as provision for bonus. There is a possibility that there will be some bad debts. We are having debtors or accounts receivable in the balance sheet, there could be some bad debts may be half percent, may be 1 percent, may be 2 percent, may be 5 percent, according to the type of business I will make an estimate and create a provision that is known as provision for bad debts.

So, today we have discussed both current, non-current assets, then current, non-current liabilities and we have come up to some specific liability which is called as provision. In our next session we will go ahead and going to further some more types of liabilities and then into profit and loss account Namaste.

Thank you so much.