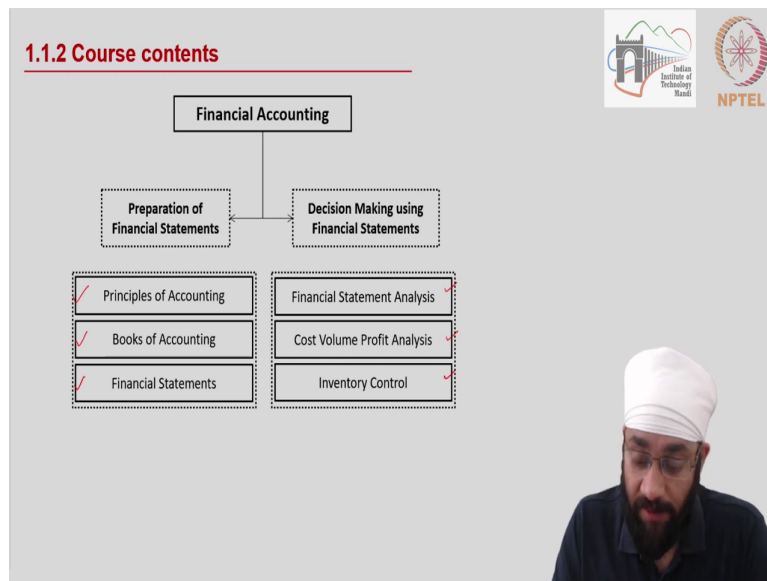


Financial Accounting
Dr. Puran Singh
School of Humanities and Social Sciences
Indian Institute of Technology, Mandi

Lecture – 69
6.0 Recap and way forward

(Refer Slide Time: 00:24)





Hi there! Congratulations on having completed a significant portion of the course. You have now learnt the preparation of the financial statements. You know about the principles of accounting; you know about various books in which the transactions are recorded and you also know about the balance sheet and the income statement which are called the financial statements or the final accounts of a company.

From now on, we are going to discuss the decision making, using the data from the financial statements. We will learn about financial statement analysis and some more techniques to take decisions in the business with respect to the operational level of the business, controlling the inventory, the stock in the business.

(Refer Slide Time: 01:09)

What you should know by now?



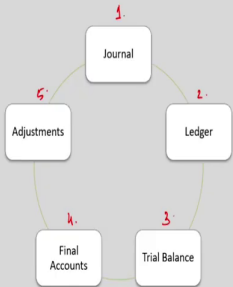
- Recording the transactions in Journal ✓
- Classifying the transactions in Ledger ✓
- Summarizing the transactions in Trial Balance ✓
- Preparing Final Accounts ✓



To quickly recap: you have learnt the accounting cycle where you learnt the process of journalizing, ledger posting, bringing the balances to trial balance, and then, finally, preparing the balance sheet and the income statement.

(Refer Slide Time: 01:22)

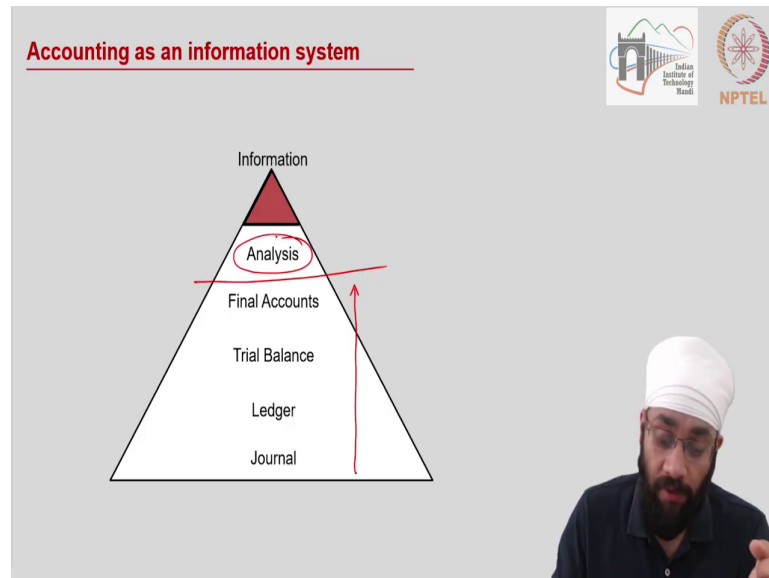
1.1.3 Preparation of Financial Statements: Accounting cycle



The complete accounting cycle is what we have done till now in the course and you should be a very comfortable with this process and very comfortable with the contents of the financial

statements. Going forward, we are going to use the financial statements to make some decisions, do some analysis.

(Refer Slide Time: 01:46)



You may also remember this slide. Now, according to this slide, we are right here. We have learnt to prepare the final accounts. So, the whole backend is now ready and it is time for you to start analyzing the data and that is what we are going to do in the next video onwards. We will learn the techniques to analyse the contents of the final accounts.

(Refer Slide Time: 02:13)

The slide is titled "What is next?" and contains the following text and annotations:

- Header: **What is next?**
- Text: Analyzing the data in the financial statements to know
- List of goals:
 - ✓ Short Term and Long Term Financial health of the company
 - ✓ Operating efficiently of the company
 - ✓ Profitability of the company
- Handwritten notes:
 - Under "Short Term and Long Term Financial health": "S.T" and "L.T" with arrows pointing down to "Pay the dues".
 - Below the list: "input → Output"
 - Bottom left: "Return on Investment"
- Logos: Indian Institute of Technology Mandi and NPTEL.
- Video inset: A man wearing a white turban and glasses speaking.

While we do this analysis, what is going to be our goal? What is it that we are looking for? Why are we analysing the data? What kind of decisions do you need to take? I am going to spend a few minutes discussing, answering these questions and then take it forward. The purpose of analysing the data in the final accounts, in the financial statements is as follows. We are interested in understanding the short term and long-term financial health of the company. What do you mean by financial health? Well, financial health of a company in the short-term and in long-term refers to the company's ability to pay off its liabilities. So, the financial health is the ability to pay the dues in the short run and also in the long run.

We also want to know whether the company will be in a position to meet these liabilities because if that does not happen, there are various repercussions on the reputation of the company and on the existence of the company as well. So, you want to be sure that you are going in the right direction just like a doctor would check the vitals of a patient even if the patient is looking fine on the surface. There may be some underlying diseases, there may be some underlying indicators, some symptoms which tell the doctor that there is some serious illness that may surface 3 months from now or 6 months from now and will affect the patient.

Likewise, we want to be able to detect such problems in a company's financial health in advance. We want to know what we need to do in order to correct those indicators, to bring the company to good financial health. This is the first goal. Another thing that you may be

interested in is the operational efficiency. What do we mean by operational efficiency? Operational efficiency means you know efficiency typically is a relationship between input and output. In the context of a company, you input various resources into the company, shareholders bring in money, creditors lend money, vendors supply goods on credit. So, there are various resources that are supplied to the business using which the business is supposed to operate, generating some outcome. The outcome of interest, the output, is the sales, the revenue. The operations that business does, how efficiently are you able to use those resources, are you able to generate the maximum possible output using the minimum possible inputs or are you being lax and inefficient. You can do a year-on-year comparison. You could compare to the competitors as well to then benchmark the performance of the company. So, hence the operational efficiency becomes of great interest to the management, to the investors, to other stakeholders in the business. And finally, the third thing is the profitability of the company. Now, the stakeholders, the investors, they are interested in knowing what is my return on investment; whatever is being put into the company, the resources, what is the return that I am getting on the top of that. And, you have your shareholders who are interested in knowing this, also the debt holders may be interested in knowing the profitability of the company.

You also want to know are we spending too much on some items? Are we spending too little on some items? What are our gross margins? Net margins? There are certain market driven indicators as well, what is the demand for the share of a particular company? So, there are various ratios, there are various indicators which would help you understand the profitability, status of profitability of the company.

To sum up, we are interested in these three things. Short-term and long-term financial health of the company, the survival of the company, then the efficiency of the company, are we doing things you know with minimum resources and the profitability, are we able to generate enough returns for the business?

To answer these questions, we do this analysis of the financial statement and while doing this analysis, we come up with various indicators, various numbers, you know which will indicate to us whether the financial health is good or not good or moderate. And hence, it will help us

in taking various corrective actions for the business or improving the financial health of the company.

So, I will see you in the next video.