

Financial Statements Analysis and Reporting
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Lecture - 17
Financial Statements with Adjustments Part-VI

Welcome students. We are discussing the financial statements preparation. And in my previous lecture, I discussed with you that how to prepare the financial statements with adjustments. So, with adjustments, we all know now that what are the adjustments and its additional information given outside the trial balance; and while preparing the financial statements we will have to adjust that information also, so that the correct profit or loss or balance sheet profit or loss and balance sheet can be prepared.

So, in my previous lecture, I discussed with you how to prepare the trading and profit and loss account. And when we prepared the trading and profit and loss account, they arrived at the net profit. Normally, we have to calculate it in two steps, net profit before tax and net profit after tax. But since in this particular problem, there is no information about the tax. So, whatever the profit we have calculated from the profit and loss statement that is means final profit or the profit after tax. So, there is no need to think about the tax part here, but when the tax issue will be there, we will be discussing the tax also tax part also and will be adjusting.

So, then in that case the profit will be calculated in two steps one-step will be profit before tax, and the second step will be profit after tax.

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From the following Trial Balance extracted from the books of Waterfalls Pvt. Ltd., prepare a Trading and Profit and Loss Account for the year ended on 30th September, 2011 and a Balance Sheet as on that date:

Debit Balances	Rs.	Debit Balances	Rs.
Drawings	6,480	Sundry Debtors	37,800
Land and Buildings	25,000	Stock(1 st October, 2010)	26,420
Plant and Machinery	14,270	Fire Insurance	490
Furniture and Fixtures	1,250	Cash at bank	13,000
Carriage Inwards	4,370	Cash in Hand	850
Wages	21,470	Credit Balances	Rs.
Salaries	4,670	Capital Account	90,000
Sales Returns	1,760	Bad Debts Provisions(as on 1-10-2010)	2,470
Bank Charges	140	Sales	91,230
Coal, Gas and Water	720	Discount Account	120
Rate and Taxes	840	Purchases Returns	8,460
Purchases	42,160	Sundry Creditors	12,170
Bills Receivable	1,270	Apprentice Premium	500
Trade Expenses	1,990		

Charge depreciation on Land and Building account at 2.5%, on Plant and Machinery Account at 10%, and on Furniture and Fixtures Account at 10%. Make a Provision of 5% on Sundry debtors for Doubtful Debts. Carry forward the unexpired amounts for Fire Insurance Rs. 125, Rates and Taxes Rs. 240 and Apprentice Premium Rs. 400. Charges 5% interest on Capital and interest on Drawings is Rs. 300. The value of stock as on 30th September, 2011, was Rs. 29,390. (204950).

So, we had adjusted part of this information and one effect of that we have already given in the profit and loss account. And if sometimes some adjustments are there whose effect is also coming in the trading account also, we will give that effect to trading account also. So, one effect will be in the trading or in the profit and loss account and the second effect will be in the balance sheet. So, today, in this continuing with the same problem, we will learn to how to prepare the balance sheet, and we will prepare the balance sheet, today.

And then we will again will have a snap shot of the things that how to adjust these different type of information, and how to prepare the final accounts financial statements profit and loss account and balance sheet when the total information is given to us that is in the trial balance and outside the trial balance. Total information has to be adjusted and financial statements have to be prepared. So, today let us learn how to prepare the balance sheet by adjusting the information given in the adjustments.

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Balance Sheet of Waterfalls Pvt Ltd as on 30.9.2011

Capital & Liabilities	Am't	Assets	Am't
Capital 90000			
Add N/P 18838			
<u>108838</u>			
Add Interim Capital 4500			
<u>113338</u>			
Less Drawings (6480)			
Less Interim Drawings (350)			
	106558		
Sundry Creditors	12170		
Ad. Ap. Premium	400		

So, again the same format dividing it into two equal halves, this is called as T format and we have four columns here. If you recall the balance sheet, we prepared the simple balance sheet we prepared earlier, you would be able to understand that same balance sheet we are preparing now, here we are taking the capital and liabilities, capital and liabilities, and here it is amount, here it is assets, and here it is amount. So, we are preparing this balance sheet now. So, the name of the firm was balance sheet of means books of Waterfalls private limited. It is a private limited company not a public limited company. We will learn later on how to prepare the accounts of the public limited companies.

We know the difference between the private limited company and the public limited company. Let us know about it. You see that this word limited is there. Limited means what does it mean companies can be private limited or companies can be public limited. Now, it is private limited company, it means the share capital of this company is privately held by a few people, and the membership of these companies can be minimum 2, maximum 50. So, minimum 2 people can form a private limited company or maximum 50 people can form a private limited company. In case of the public limited companies, the membership limit is minimum 7 people have to be there, and maximum there is no limit.

As we have seen that there can be thousands and lakhs of shareholders to whom the stocks of the companies can be sold. And they can purchase the shares may be from the company itself through IPOs or FPOs that is initial public offer and the follow on public offers; and after that in the resale from the market or may be from the stock exchanges, so that be unlimited number of the people can become the shareholder of public limited companies.

Now, what does it mean, the word limited means limited means this is concerned about the liability of the members of the companies, owners of the companies. Whether it is a private limited company or a public limited company, both the cases this clause of the limited is same. Limited means the liability of the owners of the company or the members of the company is limited to the extent of shares they have purchased, is limited to the extent of shares they have purchased.

Means if somebody has purchased the shares of a company worth rupees 1000, so if he was already paid 1000 to the company, and if company becomes bankrupt insolvent, in that case he will not be asked to pay anything more. Because he had promised to pay to the company 1000 rupees he has already paid purchased the share of 1000 rupees and paid that 1000 rupees to the company. So, he cannot be asked to pay anything more may be the company is able to pay off its all liabilities at the time of dissolution of the company, when the company is dissolved at the time of dissolution of the company whether the company is able to pay off its all liabilities from the assets or not. But the members of the owners will be asked only to pay that part from which they have purchased the shares of the company, and their liability is limited to that extent.

So, in both the cases private limited companies and public limited companies, the liability of the shareholders, the liabilities of the members is limited only to the extent of the shares they have purchased not more than that clear. So, this means this is the concept of the private limited companies and the public limited companies, and what this concept of limited says.

Now, we are preparing. So, you have to be very careful about the title of the balance sheet. So, it means we are to write here balance sheet of Waterfalls private limited as on 30th September means 30th 9, 2011. It is the very important thing that we have to be careful about that it is as on. In case of the profit and loss account it was for the year

ending, trading and profit and loss account of Waterfalls private limited for the year ending on 30th September, 2011 or may be whatever the year is given to us. But in case of the balance sheet, we are writing that the balance sheet of Waterfalls private limited as on 30th September, 2011.

So, it means the profit and loss account depicts the picture of the company's profit or loss for a period of one year, one accounting period one year, but the balance sheet depicts the picture of the financial position of the company only for one day. So, I will again come up on this concept, but let us first learn how to prepare the balance sheet here. So, we have put the title balance sheet of Waterfalls private limited as on 30th September, 2011.

We have this T format dividing it in to two equal halves that is capital and liabilities assets, this is amount, that is also amount column and no debit, no credit. Here no debit, no credit only, liabilities and capital on the left hand side, and the assets on the right hand side and simple amount. Another thing is when we are preparing the trading and profit and loss account, we are using the word here to, and this side we are using the word by. But in case of the balance sheet, no such words will be used and directly the name of the item will be written here. So, we will have to put here all the liabilities, and we have to put here all the assets. Liabilities means: the total sources from where the funds have been generated by the companies. And assets means where this funds have been used.

So, these are the, so this side is also called as sources of fund and this is called as the application of funds. So, it means how much funds have raised by the company, equal amount of the asset company should have on a particular date, and we check it every year. On the last day of the year, we check it that the company's liabilities are equal to the assets and the assets are equal to the liabilities, and the financial position of the company is balanced. So, let us start preparing the balance sheet.

And the first item, which comes in the balance sheet is capital. First item comes is the capital. And here if you look at the things given here, we are also given the capital you will always find in the credit balances, it is not a debit balance, always capital has the credit balance. So, capital account is given here as 90,000 rupees. So, it is 90,000 rupees here you have to add in this the net profit add net profit. The profit, which we earned there in the profit and loss account, in my previous lecture I told you that profit is a

portion distributed among us at different stakeholders. One part of the profit is given to the shareholders, if it is a public limited company as dividend. Another part goes to creation of the specific reserves than one part goes to creation of the general reserves, and then whatever is left out that is added in the capitals or capital keep on appreciating when the company earns the profits. So, here that part is the here we are adding. So, in this case since we have not it is a private limited company, so there is no issue; there is no question of paying any dividend.

Second thing is this company has not to create any kind of the other reserves, so it means whatever the profit the company has earned that is straight way going to the capital going to added in the capital, and the capital is going to appreciate by that amount. So, in this case, yesterday means in the previous lecture, we have seen that the company had earned some profit and that profit was 18838, which I have shown to you while preparing the profit and loss account. So, it means this is the total capital previous year, year the capital was 90,000 rupees now we have earned the profit of 18838 rupees. So, now, the capital has become plus that, so it is 108838 capital is here. So, this is a total amount of the capital we have to putting.

Now, in this case sorry means we can do one thing that we have to calculate the total balance of the capital. So, it is you can say that we can adjust it before putting it in the outer column let us total it up here 1,08,838, then we have to add one more thing here, add we have calculated one thing that is interest on capital, that is interest on capital and that we have also provided. We have segregated some amount from the profit and loss account, and we are going to add, but as I told you the adjustment of the interest on capital is that we never pay that interest to anybody.

We only take it out from the profit and loss account, if it is asked to be done like that and then it is only a book entry and then we add that interest in it balance sheet that interest is not paid to any shareholder any member of the company. Only by making a book entry making a provision in the profit and loss account, we add that in the capital, so that is also going to increase the capitals. So, it is 4500 interest on capital was there. And similarly, if you now calculate this, this balance becomes 8333 and 1 1, so it is 1,13,338 but this is not the final capital available. We have now to subtract something from this capital.

And I told you that the subtraction is for subtraction is in terms of drawings. Drawings mean that part of funds or goods which are withdrawn by the owner of the business from the business. So, they are called as drawings. So, if anything is drawn, then we have to subtract that if that anything withdrawn that reduces the amount of capital. So, interest increases amount of capital and if anything is drawn by the owner, then it reduces the balance of the capital. So, it means it was given to us somewhere that the drawings were means drawings are given to us; and if you look at the drawings figure we have to find out the drawings figure here. And drawings figures was something like first figure is 6480, and it is not only this one, it is given here one adjustment also that interest on drawing has to be provided at the rate of 300 rupees.

So, it means total drawings are not 6480 plus interest on that it is 6480 plus 300 - 6780. So, we have to subtract it. So, less drawings, this amount is 6480, you have to put like this independently and then less interest on drawings interest on drawings and this amount is 300. So, these two things have to be subtracted. So, we have to subtract the total amount of 6780. And if you subtract this amount of the 6780 in that case the balance left with us is 8 then finally, means if you calculate it, it works out as 106 and 558, 106558, and this is the one part.

Now, we talk about the next part that is next thing we have to take here is look at the credit balance. So, one thing is another liability is after capital now the next liability is the sundry creditors. Sundry creditors; creditors means who provide either funds to the business or raw material or any other goods, any other input to the business on credit. They have already supplied that material, they have already given whatever the company wanted to have from them, but the company has not paid them. So, it means till the time company pays them it remains as a till the time company pays to these suppliers, they stand in the records of the companies as a sundry creditors. So, they are the sundry creditors. So, it means sundry creditors balance is given to us and that balance is 12170, this balance of the sundry creditors.

Then there is another liability. You see that you were given one item like apprentice premium. And it is shown here that apprentice premium already received by the apprentice premium is what apprentice premium is basically a kind of income to the company which was on account of some consultancy given by the company to outside organizations or some training of to the employees of other companies given by one

company. This company for example, and when they train the employees for other companies they receive that income because that other companies whose employees are trained that company pays to the company whose training their employees. So, it may be it is assumed here or if it is given you can make out that this company is training the employees of other companies and that other company is paying the premium or may be the charges of training to this companies (Refer Time: 18:39) it is the apprentice premium.

So, apprentice premium to the extent of 500 rupees is given to us, which is received by the company, but here we have to find out this one adjustment and that adjustment is here premium carry forward the unexpired amount of the fire insurance, rate and taxes and apprentice premium. It means I gave you one adjustment that incomes received in advance means incomes, which are not earned by the company, but they have already been received.

So, what was the double effect there if you recall the double effect I told you? One effect of that will be that this income received in advance will be first effect will come in the profit and loss account. And in the credit side of the profit and loss account, where we are showing this as income of 500 rupees as apprentice premium there we will subtract this 400 rupees which is received in advance which is not yet earned which is not yet due. So, we have done there we have subtracted there 400 rupees from there in the profit and loss account credit side. And now the second effect will be income received in advance which are not due until and unless, they become due they stand as a liability in the balance sheet. So, it means this is the liability in the this will stand as a liability in the balance sheet and 400 rupees we are showing because it is not due to us.

So, it means anything which is not due for example, if you say that if you received anything any money from somebody which is not due to you, he pays he gives it to you that you use this money now and I will take it from you later on. Or you give me supply me some material you please receive it in advance, but you supply me material at the later date or you train my employees later on, but I am paying you the total amount today. So, it means that is received in advance this is the liability. Until and unless you return something back to the payer of that money tell that it is a liability. So, same as the case company's employees are trained for 100 rupees, they have already paid 500 rupees mean to the extent of to the tune of 400 rupees it is paid in advance. So, it is advance

apprentice premium and that amount is to the extent of 400 rupees. So, this is the double effect.

One effect we have already showed that we have subtracted it from the profit and loss account credit side showing 500 rupees income less income received apprentice premium received in advance 400 rupees. So, we have actually taken their 100 rupees and that second effect of this 400 rupees is coming here that is 400 rupees is the liability because it is received in advance. Other than this if you look is there any other item which is left we have not taken it as a liability. Let us again count it and consider it.

And if you count and consider it in that case again just have a snapshot of it drawings, we have already taken care of. Land and building is a asset, it will not come in the liability side; it will come the asset side. Plant and machinery is not liability, it is a asset will come in the asset side of the balance sheet. Now, you can keep on checking it ticking it also. Then furniture and fixture is again a asset will not coming in the liability side of the balance sheet. Carriage inwards is we have already taken that is carriage on purchases and that is we have already taken in the trading account.

Wages we have already taken in the trading account it is a direct expense. Salaries we have taken in the profit and loss account it is a indirect expense. Sales returns we have already adjusted in the credit side of trading account, sales minus sales returns. Bank charges we have already taken in the profit and loss account. Coal gas and water we have already taken in the trading account. Rate and taxes we have already taken say in expense we have already taken in the income profit and loss account is an expense. Purchases as a material purchase, we have taken in the trading account debit side. Bills receivables are assets they will come in the asset side of balance sheet. Trade expenses we have already taken as an expense in the expense side of (Refer Time: 22:56) account.

Sundry debtor is an asset will come in the asset side of balance sheet. Stock is opening stock we have already taken in the trading account debit side as a material opening stock. Fire insurance we have already treated shown as an expense in the profit and loss account and there is adjustment also. So, we will again talk about that may be we will talk about it. Cash at bank and cash in hand or all are assets, both are assets and will go in the asset side of balance sheet.

Similarly, when you come down to lower part capital we have already taken in the liability side, capital and liabilities. Bad debts provisions we have already done opening provisions they are previous years provisions. So, means no bad debt was there in the current year, it means we have to return it back to the company and we have shown it in the credit side of profit and loss account. Sales, we have already shown in the credit side of trading account. Discount we have already shown as the income in the credit side of profit and loss account say income gain. Purchase returns we have already adjusted purchases minus purchase returns in the trading account. Sundry creditors we have already taken here as a liability in the liability side of the balance sheet. Apprentice premium we have already adjusted.

So, it means all the items here and here we have taken and we have already adjusted here, there is no need no point now means we have not left any item here. It means our one side of the balance sheet is complete and that is the liability side, capital plus liability side of the balance sheet is complete. And we will put here the assets also on the asset side of the balance sheet. And then we will see that whether both the sides are equal or not. And if both the sides are equal in that case we can say that how much liabilities a company has raised on itself equal amount of the properties the company has with them.

What does it mean, if you borrow 100 rupee from somebody this should be able to show it that what we have done with that 100 rupees. If you for example, spend that hundred rupee and you do not have now anything with you, you would not be able to return that 100 rupees back to the person who has for why did you who has given you that 100 rupees. So, it means next time he will not give you any money, he will not trust you he will not give you any money next time, it means you have to you are considered as insolvent bankrupt, because you have borrowed money, but you are not able to justify it and you are not able to return it.

Same is the case with the companies. Whatever the billions and crores of rupees they borrow from the market from the shareholders from the members or anybody they are all listed on the liability or the capital side liabilities and capital side of the balance sheet. And we have to check that whatever the resources are shown here or sources are shown here equal amount of the properties or assets company has with them or not. If that equal amount the assets company does not have in that case the company is bankrupt; and that company cannot be allowed to continue. Because if that company is allowed to continue

the do with the business what will happen they will borrow more money, they will drain it out and they would not have the assets here to justify and then people money is at risk

So, it is a government responsibility, government is a custodian of public faith. So, it is a government's responsibility that whatever the funds companies are generating from different sources, they should be held accountable for that. And they should be able to show it up that where those funds have gone to. If they do not have the proper record of the funds then they cannot be allowed to run the business. You might have heard about the Satyam case; Satyam computers was something like that whatever this funds they generated and they were showing the liabilities in the liabilities side of the balance sheet they did not have that much of the assets with them.

And one day when it was means found difficult by the company to pay the salaries of employees to their employees may be that you see that if on the on the on this side company is earning profit we are showing the entry of profit and we are adding in the capital. But the second effect of that that this profit must have equal amount of the cashier and when there is no cash, so where the cash was going.

When there is no cash and the company means was finding it difficult to pay off its expenses; and one day came when they were not able to pay of the salaries of its employees it means then it was found that there is something wrong with the company, when there was a hue and cry there was something wrong in the company then the company government enquired about the total affairs of the company they found that there is some big scam going on and company's profits are being pocketed by the chairman of the company with the help of the auditors from the price quarter house cooper. So, then the company was found that internally it has become bankrupt, it has become insolvent and this company cannot be allowed to carry on the business. So, it means this kind of the situation if comes up in that case the companies cannot.

So, we have to check once in a year that the company is balance sheet is having a balanced position or not. If the balanced position is not there then the company is bankrupt and company cannot be allowed to do the business. But it can be other way round also. If the company is doing very well then what happens this, this side may be more than this side it means companies assets are more than the liabilities. In that case what will be there finally, that amount that situation is not shown in the balance sheet,

we will keep the balance sheet balanced, but internally the company is very strong. It means here actually the assets are more than the liabilities, but we are showing here that the assets are equal to the liabilities and the balance sheet is balanced.

But that situation may also be there, but if that happens how to deal with that situation i will discuss with you later on. But currently you see you have to means keep yourself your knowledge limited that, yes how the companies check their financial position and whether the balance sheet of companies balanced or not that has to be checked by preparing the balance sheet. So, then now we will proceed further to prepare the means put the things on the asset side of the balance sheet, and then we will see total both the sides up then what is the total of this side.

So, here we have three items only. One item is the capital that after we have taken the initial balance of 90000 thousand adding into that profit we earned 18838, it became this amount. Then interest on capital we added then drawings plus interest on drawings, we subtracted and finally, the balance of the capital left is 106558, this is the one item. Second item is a sundry creditor, 12170.

And then the third item is the apprentice premium that was received in advance now justified by the company. So, it means these are the three things we have put in the liability side of the balance sheet nothing else is left. So, now we will come to the asset side, and we will see that these total funds which the company has generated whether equal amount of the assets are there in the company or not and that I will discuss with you in my next lecture.

Thank you very much.