Financial Statements Analysis and Reporting
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Lecture – 25
Corporate Financial Statements Part-1

Welcome students. So, as I told you in my previous lecture that we will be now discussing the financial statements of the joint stock companies or the company firms of organizations. So, that we will be now starting; we will be talking about and starting. So, in the company firm of organizations I gave you certain important clues that how they are different from the other firms of organizations, how their financial statements are different from the other firms of organizations and why, the company firms of organizations of financial statements are very very important as far as the reporting of the financial statements is concerned.

So, first those financial statements are got prepared by the management of the company and in the management of the company, as I told you earlier that normally the management remains hired professionals and the major shareholders also can be the into the management, but they are not in to day to day management they are only directing there in to the top role. Say for example, we see that Mukesh Ambani is the chairman of reliance industries. So, he is the major shareholder also, reliance industry's major shareholder and he is a chairman of the company also and that way he is say controlling the affairs of the company.

But he is not into day to day management he the day to day management is being taken care of by the professional managers. So, that is the one part when we talk about preparing the financial statements they are got prepared by the finance department of the companies that is CFO; chief financial officer of the company he is normally a man of finance financial expert and then these financial statements that is the trading and profit and loss account profit and loss appropriation account and balance sheet must there ready they are prepared they have no value until and unless they are certified by the chartered accountants.

Means they are said means to be audited by the certified auditors or the certified auditors in India are the charted accountants. So, is not in India everywhere all around the world every country has a body; specialized body who creates who is responsible for the accounting standards, accounting norms a gap that is generally accepted accounting creation of the gap generally accepted accounting principles and everything. So, that way once the financial statements are ready, they are prepared got prepared by the CFO of the company people in the finance department and then they have to be presented before the auditors or team of auditors they all the different firms of the chartered accountants they come and they audit the total say financial statements which have been prepared and presented before them they look at each and every item that how the profit and loss account has been prepared, how the balance sheet has been prepared, how the profit has been a portioned and from where the different items have come. So, that there is no misappropriation.

And once it is certified by the chartered accountants means they first audit and they try to satisfy themselves from every angle must they are say satisfied that yes the financial statements prepared by the company are are really say depicting the fair view of the overall financial position as well as the profitability of the business then they put the seal and signatures they sign on it and then they finally, approve the balance sheet once the balance sheet is certified by the chartered accountant as the auditor of the company then it becomes the you can call it as acceptable statutory document that is the acceptable statutory document until unless it is audited by anybody it is not the say authenticated document nobody will accept it. So, this is one part so that that is important.

In case of the sole proprietor and in case of the partnership firms and in case the private limited companies, normally the say certification of the balance sheets is not required. Normally they also get it done from the chartered accountants auditing, they also get it done because they also have to go to the financial institutions for borrowing the money and then for additional resources and something like that they have to also to go to the financial institutions.

So, they also get it done from the chartered accountants get it audited, but it is more important in case of the public limited companies their auditing; auditing certification of the balance sheets is very very important. You must have heard about the Satyam case, so Satyam case was that Ramalingam Raju was the chairman of the company Satyam computers and he was say over viewing the affairs of the company. So, there are the there where the different managers also. So, he say thought of commuting that fraud and he was interested that whatever the total revenue or the wealth is coming to the Satyam computers, he wanted to siphon that off and finally, declared their company as bankrupt and then to say transfer the total funds and wealth of Satyam computers to his own personal accounts and later on to create his own personal organization.

He wanted to do something like that because Satyam computers were a public limited company. So, he thought that if it is declared insolvent, bankrupt then finally, he will grab, he will be able to grab the entire wealth, it will be his wealth and he will create his own personal organizations later on so, but you see that as I told you that whatever the things were being done. Or whatever the financial reporting was being done by the Satyam computers that would not have been allowed to be done until unless the auditors are not involved because what he was doing though the Satyam computer was a profit making company they were having a huge sales they were having a good reputation in the market good name in the market they have huge international client tail also lot of people who were the getting the software made from them like Infosys.

And they would getting huge revenue, but the company's cash account was empty there is no cash in the company's cash account it means if it is a profit making company huge cash is flowing in the company. So, where the means cash is going where the revenue is going. So, what was happening that cash which was being received by the company was not being deposited by the company's management in the company's accounts rather that was being deposited in the personal accounts of Mister Ramalingam Raju, so that process continued for say number of years.

Initially he started diverting the funds to not to a very large extent, to a limited extent then he expanded the span then he expended the span. So, means the company the situation reached one day that if it is a profit making company, but the company does not have the funds even to pay the salaries of its employees when it became so difficult even to pay the salaries of the employees then this that their fraud came on the surface. But you see that how the diversion of the funds was allowed from the companies account to the personal accounts of Ramalingam Raju that was only possible with a (Refer Time: 07:45) with the auditors of the company.

They were the 2 auditors who were auditing the accounts of Satyam computers; they were from Price Waterhouse Cooper, a very well known auditing firm; international firm; multinational firm I would say. So, they these 2 people were deputed by the Price Waterhouse Cooper to order the accounts of Satyam computers and (Refer Time: 08:09) with the Ramalingam Raju, whatever was being presented before them though that was not a factual position because company is showing the profit, but there is no cash. So, most of the sales were being shown on credit and when the most of the sales or the software is on the credit there were showing that though we have the profit, but the cash profits are not there.

When the cash profits are not there so, our profit making company is a cash poor company. So, when there is no sufficient cash available. So, it means the companies facing the problem, but this was not possible because software kind of a business we are not manufacturing a product and we are passing it on and we do not have the market when you have a very good reputation in the market why are you selling a software on credit you have to sell it on cash or you have to not to give the very longer credit period. So, in that case, when that situation became, so you can call it is as grebe that company did not have even the funds to pay the salaries of their employees then that entire fraud came on the surface and when the registrar of the company is referred to the independent auditors and when they audited the total affairs of the company they found it.

That the funds being received by the Satyam computers they were not being deposited in the company’s account rather they were being deposited in the personal accounts of Ramalingam Raju that is how a good profit making company became a cash poor company and one day situation came that it was not able to pay the salary because there is no cash in the account they will not be able to pay in the salaries or to pay for the other expenses. So, that finally, government had to take the action Ramalingam Raju was arrested and then he was at behind the bars and then that a entire affair was investigated and finally, to stoke to protect the interest of shareholders and other importance stakeholders like employees of the company like financial institutions everything, the company was say sold out and Tech Mahindra has purchased the company now and Satyam computers has become the part of Tech Mahindra. So, that with entire thing was there.

So, yes, if some (Refer Time: 10:14) is done by the top management of the company with the public auditors then there is everything is possible, but if the auditors are not ready to say submit with them in that situation it becomes very difficult. So, because public money is involved in the public limited company. So, because of that reason governments responsibility increases and government being the student of public faith becomes a very very important stakeholders who has to get that say financial performance of the company reported to its agencies and agencies job is to make sure that everything is going on well in every company and the interest of every stakeholder whether it is a shareholder it is a supplier, it is a tax authorities or any other important stakeholder or maybe the customer everybody is stake is safe everybody's interest is safe and the business is running on the right track.

So, this is the additional things we have to do in case of the company firm of organizations and preparing their financial statements and reporting these financial statements.

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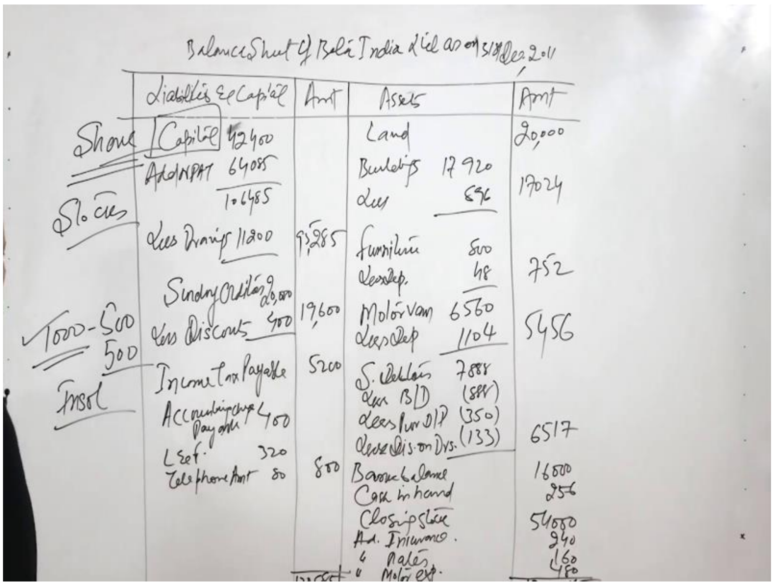

So, one thing that I told you that say here in case of the public limited companies the difference is here we have only capital when we are talking about this balance sheet. We are using the word capital because that is provided by the owner of the business only, maybe a sole proprietor or a partnership firm or may be the members of a private limited company. But in case of the public limited companies use the word here as the share capital we have to strictly use a word as a share capital because the funds of the public limited companies come from the share capital and share capital is provided by thousands and the lakhs of the people because as I told you that number of members in these companies can be minimum 7 who create the company first initial promoters they call them initial promoters and then they come out with IPOs; initial public offers and followed public offers and then they offer the shares to the general public.

So, if anybody among the say general public is interested to buy the shares of that company in that case they can come forward they can buy the shares of that company. So, that is why it is called as the share capital or it is also other name of the share capital is the stocks. So, the stocks of the company or the shares of the company has sold in the open market general market and anybody can buy the shares and they can become the shareholder to that extent about the public and private limited. I have already told you that why we use the word public and limited and private limited what is the meaning of word limited it means that liabilities of the shareholders of the companies whether public or private is limited to the extent of the shares they have purchased in that company not more than that.

Even if somebody has purchased the shares in that company to the extent of worth rupees 1,000 and if the company becomes insolvent in that case, he cannot be asked to pay more money to settle the claims of the outsiders of the financial institutions. If you has already paid 1,000 rupees, if he has already paid the 1,000 rupees and company becomes bankrupt; company becomes insolvent; he cannot be asked to pay any more money may be the companies not able to settle the total claims against it that may be there, but nobody can ask the company to or though nobody can ask these shareholders to pay anything more.

So, that is why the liability means liability of every shareholder maybe a private limited company or a public limited company is limited to the extent of the shares they have purchased in the company if he has already paid that much amount to the company then its fine or if he has not paid then yes say for example, somebody has purchased the shares of 1000 rupees, but he has only paid. So, far 500 rupees to the company and company becomes bankrupt. So, he can be asked to pay 500 more rupees because he has he is a shareholder in the company to the tune of 1,000 rupees.

So, maximum it becomes 1000, once he has paid given 1000 to the company after that nothing can be ask from him. So, that is the meaning of the word limited or the clause of the limited liability may be public or the private now we will discuss in detail the concept of share capital its really very interesting concept and literal you can call it as a broader also in the sense that yes is a bigger concept. It is a broader concept, share capital; it is not simple as we simply know that the share capital is something like it is not that simple as we understand it or as we know it is again complex concept share capital.

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Then we talk about the share capital, share capital is basically of the 5 types; share capital basically is of the 5 types. These 5 types are authorized share capital; authorized share capital, then it is issued share capital, then it is subscribed share capital, then it is called up share capital; called up share capital and finally, it is the paid up share capital; paid up share capital. These are the 5 categories of the share capital.

It is not that simple as we see that we write that the share capital is there its, it has the 5 kinds of the share capital lastly when we see the balance sheet that amount which exist in the balance sheet is this is the this capital that is the paid up share capital; paid up share capital that is taken into account in the balance sheet. So, these others also shown in the balance sheet, but finally, we count for the last one that is a paid up share capital. So, what are these 5 different categories of the share capital authorized issued subscribed called up and paid up share capital authorized means that capital which the company is authorized to raise it from the market by selling is to shares to the general public throughout its lifetime or at least very long during a very longer duration authorized share capital.

Or may be at time when the company comes into existence as a public limited company or when a private limited company is converted into a public limited company, they are authorized that during your lifetime or next 15-20 years, you will be authorized to raise this much of the capital from the market very long duration the company is authorized that because why they are becoming public from private. Because now they want to expand at a larger scale this company as a private limited company has proven its metal they have been very successful in the market they are doing very well in the market and they thought that the initial members of the company thought that we should know expand its wings its horizons and we should now diversify or go international or increase the span of this company.

So, if have to do this you need more capital and if you have to have more capital it means you have to say become a public limited company that is why the general public can come forward that make invest they can invest their funds in the company and then they can provide huge resources larger resources to the company. So, that the financial needs of the company can be fulfilled that is why the company is converted from the private limited to the public limited now for example, you take about the Infosys initially was created by the 6 people and later on it was converted to a public limited company because when they thought that now we are very successful venture and we need more resources. So, left the general public also invests in our company. So, then they became the public limited company and then they started performing in the market and when the public saw the performance. So, they also I means agreed to become the shareholder of that company.

So, that way when we need more resources you want to in expand its horizon we convert the private limited company to the public limited companies very few companies will be there which come into existence in the beginning first day as the public limited companies largely the business is start as a sole proprietorship then they become partnership firms then they become per private limited companies and then they are converted into the public limited companies.

When the company becomes public limited company, it is authorized by the government to raise certain amount of the capital throughout its lifetime or though a foreseeable periods so that is called as the authorized capital. Now who authorizes it and what is the process? When the company has to become a public limited company that company is required to get registered itself as a public limited company and there is a office under the ministry of company affairs corporate affairs that office is called as a office of registrar of companies. Registrar of companies office is there in every state has a office of registrar every state has the office of registrar of companies. So, the state where the registered office of the company has to be located there the shareholders of the initial promoters will given application to the registrar that we want to create this company as a public limited company or we are already into existence as a private limited company and we want to convert this company into a public limited company.

So, we want to get it registered with your office. So, we should you permitted for that now for the registration that application goes with certain documents and the important initial documents are 2 - one is the memorandum of association which we call as m a and second is the article of association these 2 documents are to be prepared by those people initial promoters who want to get that public limited company registered with the registrar of companies memorandum. The basic difference would be in these 2 documents is memorandum of the association talks about the exterior structure of the company before the company comes into existence memorandum explains what will be the name of the company where the registered office of the company will be located who will be the initial 7 shareholders of the company promoters of the company - what will be their qualifications, how much capital the company want to raise throughout its lifetime that is the authorized share capital and important post and other clauses the business clause that what kind of the business this company want to do.

So, before that company comes into existence that entire blueprint of the company is given in the document which is called as memorandum of association name clause, registered office clause, promoters clause, business clause and other different kind of things which are going to make a company which are going to make their company as a organization. And article of association talks about that once their company comes into existence. Once their company comes into existence, how that company will be run, who what will be the different management positions on the company may be the whole chairman and his qualification managing director and his qualification board of directors and their qualifications who can be board of directors, their qualification, rights and responsibilities, who will be the company secretary or his qualification, the other structures that how many different departments will be there, marketing, finance, HR, IT, all these departments will be there, who will be the heads of this departments, entire organizational structure, responsibilities, authorities, duties of everybody, each and other everything is just given in this article of association.

All the details are remain contained in the article of association. So, this document talks about before the company comes into existence, but this will be all about and once this comes in to existence this documents job starts work starts that how this company will be managed by the different people and how that total organizational hierarchies will work, how many hierarchies will be there, how many how these hierarchies will work and how this entire process of the company will take place.

So, that is called as a article of association these are the 2 important documents and third important document is that is again important for the companies that is called as prospectus. But that is not required at the time of registration, as we registration as public limited company the document may be delayed also maybe that document is more important when this company is registered allowed to be registered by the register registration certificate is issued, company comes into existent they start their affairs they start their work initially they have the level of the business same as it was the level of private limited company they have their own resources then after sometime maybe 2, 3, 4, 5, 6 or may be months or year. So, when the company feels now after becoming a public limited company after one year or so that now we need additional resources additional capital.

So, then if they need additional resources additional capital then the if the fees that now they need to go to the public general public then this document is required which is called as the prospectus. So, the first document they have to prepare is the public limited company has to prepare is the prospectus. Their prospectus will be prepared and that prospectus will have the total details that prospectus will have the details about the 5 types of the capitals authorized issued subscribed called up and the paid up share capital. So, at least 3 capital should be there authorized capital how much there going to issue capital the how much they are going. So, 2 kind of the details must be there 2 kinds of the capitals details should be there how much is authorized capital of the company and how much they are intending to issue the out of the authorized capital how much they are going to issue in the first lot.

That is in the IPO, initial public offer, how much capital, how much shares they are going to issue to the general public, how much capital they are going to raise from the general public. So, these 2 details will be given in the prospectus. To raise that particular amount say for example, they say that we are going to raise 10 [FL] rupees. So, that will be now the company's authorized share capital I will come up to these concepts again also, but let us assume that total capital of the authorized share capital of the companies is 100 [FL] out of those 100 [FL] in the first offer IPO they are going to issue the 10 [FL].

So, that will they will say that we are going to raise 10 [FL] rupees and the total shares to raise this 10 [FL] rupees will be say 1 lakh and we are going to sell these 1 lakh shares in the market you want to sell these 1 lakh shares in the market. So, those 1 lakh shares they have to explain what kind of the shares preference shares, equity shares they have to explain all those and then total details that what will be the minimum price of the share if any premium is going to be charged how much premium can be charge if any discount is going to be given some prevision for that can also be there, price per share total number of shares total capital going to be raised when the issue will start when the issue will close all the details they have to been included in this document which is called as the prospectus.

This prospectus has to be given to the registrar of companies once the registrar of company approves that prospectus then that prospectus has to be given to the regulatory body of Indian companies that is the stock market and that body is the name of that body is SEBI; securities and exchange board of India that document has to go after the approval by the registrar that document should be approved by the securities and exchange board of India and one copy of that has to be submitted to SEBI.

Once SEBI approves it that yes this document sorry prospectus is in right spirit it explains everything about the shares they are going to sell in the market, the capital there going to raise from the market, then the SEBI will approve, they will put that prospectus on its site and anybody and then this company will SEBI will allowed to issue the shares in the market to sell the shares to the people in the market and the process of selling once that prospectus is proved by both the offices registrar of companies and SEBI. And SEBI puts is shown website this company will they allow to say start the process of issuing the shares to the general public in the market and say generating the capital through share capital. So, that will be allowed that will be means that that will begin and then IPO of the company can come and the process of raising the capital for the market from the market can start.

So, what is the process of raising from the capital from the market and how this process from where it begins, how where it ends, how the capital is generated and what are the these different 5 types of the capitals this process. Now we are continuing, we will discuss, we will continue and remaining part of this discussion I will take up in the next lecture.

Thank you very much.