Financial Statements Analysis and Reporting
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Lecture - 59
Financial Reporting Part – I

Welcome students. So, till my last lecture we completed the process of analysis of the financial statements, we discussed the process of analysis of the financial statements and we learnt about the 2 techniques that is say ratio analysis and the cash flow statement and there are some techniques also. So, these are the prominent techniques generally we used and there are certain other techniques also. So, I will talk to you just for a minute or 2 in the passing reference about those techniques and then I will move to the third part that is about the say regulatory frame work of the financial reporting in India that is for your reference I would like to discuss.

So, the other techniques of the financial analysis, if you want to learn about there is a very easy technique means any book or anywhere you can easily find if you have any book on the financial and the corporate reporting or the corporate accounting or financial accounting you will easily find those Techniques.

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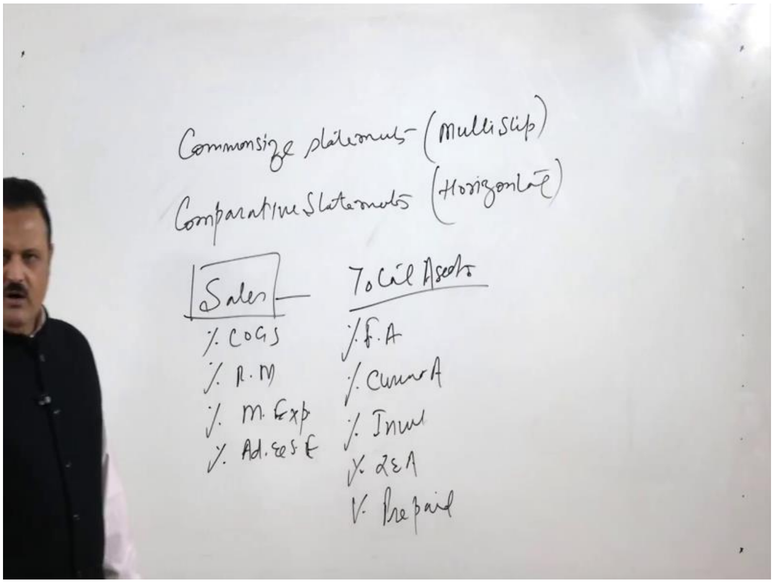

Those techniques are see you can call it as common sized statements common sized statements and second are the comparative statements. So, these are the other by preparing other statements also you can do the financial analysis for the more also if you want to understand about the progress of the company or the say performance of the company.

Common sized statement is otherwise you can call them as common size or maybe the multi stepping statement multi stepping income statement and here you call it as horizontal statements. So, in this case, what is; what we do in the common sized statement that we take that one important figure as common. So, for example, you talk about the sales is the common figure and against that figure we compare what is the percentage of the cost of goods sold, similarly what is the percentage of the raw material, similarly what is the percentage of the say manufacturing expenses, similarly what is the percentage of other say administrative and selling and distribution expenses so as a percentage of the sales.

So, taking one item as common and then comparing the other figures against that item we do by preparing the common sized statement almost the same thing we did in the multi stepping income statement also. So, the difference in the multi stepping income statement was that we calculated the profits at the multi steps we did not jump to the simple net profit after tax, but we calculated first of all the total sales gross sales minus excise duty then net sales and then we say subtracted from this was the cost of raw material then manufacturing expenses then we got the got the cost of goods sold and then we subtracted other expenses.

So, we got the profit before tax and depreciation interest and tax and then we got the subtracted appreciation then profit before interest and tax then we subtracted interest then the profit before interest and tax. So, that was calculation of the multi user calculating the profit or income in a multi step way, but in the common sized statements we do the same thing almost, but we do not compare any profit or income we simply compare the different items which are making the income statement profit and loss account you can easily compare the items of that income statement profit and loss account with one common figure and if you take that against the sales what is the cost of goods sold what is the raw material what is manufacturing expenses what is administrative and selling and distribution expenses that we can prepare the common size statement by following the multi steps.

So, this is the one way of doing the analysis and this analysis is largely done with the income statement with the profit or loss account, we do not do it in the balance sheet, for the balance sheet, you can use the second it is the comparative statements. So, for analysis of you profit and loss account or the you can do it in the balance sheet also because in the balance sheet you can take the total assets as a common figure and against the total assets here you take it as a total assets as a common figure and against the total assets you subtract the what are the fixed assets, what is the percentage of the fixed assets? What is the percentage of the current assets and what are the; what is the percentage of investments? What is the percentage of loans and advances? What is the percentage of prepaid expenses?

It can be done also. So, means you can take one item as a common in the balance sheet in the financial position statement and then you can compare the other sales subsequent say parts belonging to that category with against that major category and then you can say that you can easily make out that out of the total assets what percentage of the total assets is fixed assets what percentage of the total assets is the current assets because we want to know that current assets level should be as low as possible and fixed assets should be high.

So, similarly prepaid expenses should also be low there is a loans and advances and investments can be more. So, we can easily make out that what constitutes the fixed assets what constitutes the say liabilities also you can take the total liabilities and out of the total liabilities what is the percentage of internal funds what is the percentage of external funds loans and advances means loans and debentures and then the current liabilities.

So, that way the common size statements can be prepared and this is called as a vertical statement this is a vertical statement this is one statement that can be prepared and the one analysis can be done then the second way of analyzing another technique of analyzing the financial statements is the say horizontal analysis by preparing the comparative statements by preparing the comparative statements. So, normally we do prepare the comparative statement we can use you can do it for the income statement also for the income statement also and for the balance sheet also.

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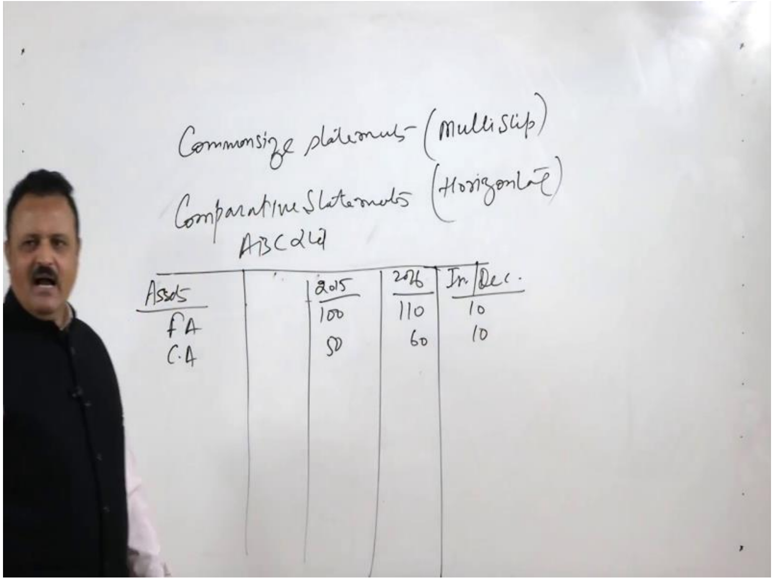

So, for example, largely we use it for analyzing the balance sheet and if you say prepare the horizontal statement you can take one company and then you can say; ABC limited and see we can have the figures here.

So, for example, you are talking about this is the asset side. So, you can say the assets of the company if you take the assets of the company in the assets total assets of the company you can say that will be will be taking not only for one year we can take the figure of 2014 and we can take the figures of 2015 and then we take the figures of 2016 or we can take the figures for other years also. So, normally we take the 2 year’s figures. So, you can take the figures of say 2 14, 15 and 16 and then we make the one column here that is the column for increase or decrease. So, in see you see that what was the level of your assets say fixed assets you talk about.

So, if you take the fixed assets, then here it was 100 and it has become 110. So, there is a increase by 10, it can be in percentage terms also it can be in the absolute terms also similarly you talk about the current assets current assets were here say 50 and now they have become 60. So, there is increase by 10. So, you can easily make out that what is the how the how the things are moving out maybe when you are moving from one year to the another year comparative position of the companies what comparative picture of the companies what whether the company is improving its asset base and the fixed term long term assets are increasing as compared to the current assets or current assets are increasing as compared to the fixed assets or both are static. So, a trend can be worked out this is called as the trend analysis also a trend can be worked out. So, this statement is called as comparative statement this is horizontal analysis because you do it this way and the common size you prepare this way that is called the vertical analysis.

So, these are some and here you call it them as a trend analysis also this is going to give you the trend if you put the la say in the horizontal analysis if you add some more years. So, 2, 3, 4, 5 years, if you make and you draw a line it will give a trend that over the period 2010 to 16, how the assets have moved. So, you can draw the lines and you can understand the trend of the firm and you can understand the whole process.

So, these are some further ways of analyzing the income statements or the financial statements that apart from ratio analysis and the cash flow statement which we discussed in detail you can use the common size statement, you can use the comparative statement and you can know the company in which you are interested or you are somebody else is interested and you are acting as a financial analyst to him or her. Then you can use these techniques and by doing a detailed analysis by using the third these third some other techniques means in the third category common size comparative common size statements comparative statements then yes it can be done and it will give you a better picture about the overall financial performance and position of the company in which you are interested or somebody else is interested and you are acting for him and her as the financial analyst.

So, with this, I complete the process of the analysis of the financial statements and now in the remaining this class and in one more next class; last class I will be talking for the reference purpose not in detail, I will be talking to you about the financial reporting process in India. So, now, let us move to this part that is the regulatory framework of the financial reporting in India and we will be discussing this to some extent because this largely is a structure and system which is available everywhere different sources are there and this information is easily available, but as a student of financial statement analysis and reporting you should be knowing something here and we should be discussing something here. So, I thought of say enlightening you about the financial reporting process that is a regulatory financial reporting process in the existing in India that is in the country and let us discuss something about that.

So, this is we are going to talk in the remaining part of this lecture and then in the next one more lecture look when we talk about the regulatory framework; framework of the financial reporting in India or in any country you see there the different say bodies because in an economy if there is a business then there are some rules and regulations of running the business and adherence to those rules and regulations either the companies have to say ensure themselves and companies are doing that also there are certain abrasions like Satyam case or maybe sometime Harshad Mehta was a case earlier which created a problem in the securities market then this Satyam case is there then some you can call it as Vijaya Mallya's case is there. So, these are some cases when the things are not moving in the right direction or in the desired direction, but generally the things are means correct and the business is also say acting as a very responsible stake holder in the market, but sometime it creates the problem.

So, see that when we are talking about the financial statements preparation of the financial statements means what is the purpose of the financial statements means if the business is going on and we are manufacturing certain products or creating rendering certain services in the market we are doing it on the continuous basis and we are getting raw material converting that into finished product finished product is going to market firm is getting back its funds through sales and its getting the profit share holders are getting dividend employees are getting salaries government is getting the taxes and people are getting the good quality product.

So, what is the purpose of preparing the financial statements why the government has fixed the say the requirement of preparing the financial statements and why it is in mandatory has been made mandatory to say have the financial statements once in a period of 12 months, that is a accounting period. We call it as the accounting period why it is necessary why it is required that is a billion dollar question here and then means arises the need of financial reporting means when we prepare the these financial statements.

Earlier these were the 2 statements that is the income statement and balance sheet it means by using these statements preparing these statements every twelve months it company ensures and company reports to the different stake holders that how the business is going on different stake holders means when we talk about the different stake holders first are the share holders then means first are the lenders debenture holders share holders employees of the company. Even the customers of the company consumers of the company then the tax authorities then the public means the then the government and then the public at large everybody sometimes remain say concerned about the overall financial performance of certain companies.

So, for example, now there are now popular companies like reliance industries or Infosys or your Tata group companies or some other important companies. So, people generally general public also remains the concerned about it. So, when you open the new paper in the morning and on the business page of times of India when we find that this these are the developments with regards to Tata's growth or Tata has acquired this company or Tata's profit is going to go up this quarter or this say year or reliance industries financial performance is that it means that is a mean I am the share holder of Tata's companies or I am the share holder of reliance companies, but then I open the page of the news paper I am really interested to look at that news how one important industrial house or the business house in my country is doing.

So, in that case even the general public is also is an every important stake holder. So, by preparing these financial statements that is the say trading and profit and loss account you can call this statement as the income statement also. And then the balance sheet we report to the different stake holders that how we have been doing in the past twelve months whether we have ended up with the profit or with the loss or if there is a profit then how much profit is there and if there is a loss how much loss is there and whether our profit is going up in the current year as compared to previous year or our loss has come down in the current year as compared to the previous year.

So, all these things are the means are some objectives which are met with the help of preparing the income statement similarly we prepare the balance sheet and by preparing the balance sheet we confirm that our assets are equal to liabilities and vice versa. And we convey to the interested stake holders that yes we are doing the good business balance sheet of the financial position is balanced is within control and nothing is wrong in the firm and means all the stake holders should rest it assure that we are doing a good quality business the company communicates.

And now the third statement is also very important mandatory statement that is the cash flow statement that under the cash flow statement the companies tell to the outside world to different stake holders that say larger chunk of the profit is from the operations if it is a manufacturing organization and is from financing activities if it is a financing company and from the investing activity it is a investment company. So, that is the way and that is the objective of the financial statements or preparing the specially the cash flow statement.

So, in this process of say preparing these three mandatory statutory statements the purpose of preparing these statements is means in a way reporting of the financial affairs of the company's business organizations and by preparing these statements apart from these statement we prepare some other statements also. But they are not mandatory they are only for the internal control many companies analyze the financial statement they prepare analytical report also by doing detailed ratio analysis or sometime by preparing comparative statement common sixed statement, but they are not for the external reporting for the external reporting these three statements are mandatory and they are prepared this is the one part that preparation of the financial statements in itself is a one act of reporting of the financial performance of the companies.

Now, the second question arises here what is the basis of reporting what facilitates the better reporting of the financial affairs of the business affairs to the outside border or to the rest of the world then we started discussion on the subject, I started with one thing that the basis of preparation of the financial statements is or financial reporting now I would call it as that the basis of that preparation of the financial statements and the financial reporting.

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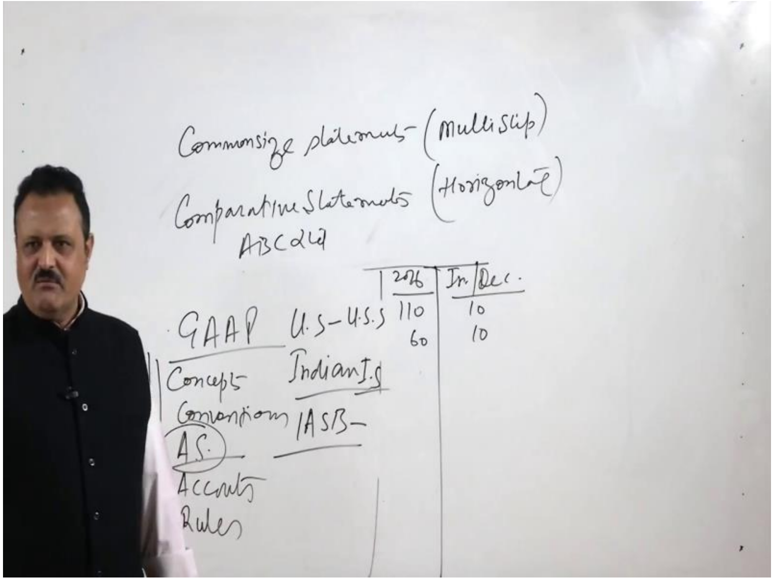

I have already talked to you is that is the GAAP, generally accepted accounting principles; generally accepted accounting principles and when we talk about the generally accepted accounting principles we talk about so many things we talk about the accounting concepts then we talk about the accounting conventions then we talk about the accounting standards and then we talk about the different types of accounts and then we talk about the different rules of passing or recording the business transactions in the books of accounts this all. So, the large component major components are these three that is the conceptions conventions and accounting standards, but these are also the ancillary parts of the GAAP that is different types of accounts and their rules ore recording rules of recording the transactions in the books of accounts.

So, accounting standard is are the most important part because when we talk about the accounting standards means in the GAAP we talk about something that it is a standardized way to report the corporate information or the financial information of the corporate or companies to the rest of the world. So, that everybody not in India everywhere if they look at the balance sheet they understand that it in the same sense or in the same meaning and when you talk about the GAAP every country has its own GAAP, we have we have US GAAP, we have Indian GAAP, we have other countries means every country has a GAAP. They have their own their generally accepted accounting principles and a common body which is say connecting each country to the other country and coordinating among countries is the another body which is called as the IASB international accounting standards board.

So, it means when you talk about us GAAP they have us standards when you talk about the say Indian GAAP, India has its own Indian standards and when you talk about the IASB, IASB has also developed its own standards which now are called as IFRS international financial reporting standards. So, first every country is developing its own standards and then they are trying to harmonize their own standards with the world standards they are international not world standards with the international standards and they are the IFRS currently we have 2 systems of accounting one is the national system of accounting which is there in every country being observed by say following the every countries accounting standards and then we are because now we are becoming a global village and there are means boundaries for the business are shrinking it means you see that today if you want to buy any product being manufactured in any part of the world earlier was being manufactured in any part of the world that is available today in India.

The companies which were means earlier the you can call it as external operators they were not allowed to operate in India because India was a closed economy today you find these companies are working here and not working here sometimes they are manufacturing more here and supplying it to their home countries also to the other countries in the world. So, when you are dealing across the boundaries across the countries in that case it means if India has a one different accounting standards other country has a different accounting standards if production is in India and sales are to be done product is to be transferred from India to UK or to US or to Japan in that case there comes the problem means at what price the problem should be sent is in at what price should be priced in India what price it should be transported or sent to Japan or US or UK. So, transfer pricing is one important issue. So, what is going on?

Now, slowing and steadily we are moving to a process we have national accounting and we have international accounting and slowly and steadily we are moving from the national and international account to the world accounting. So, word accounting would be the day when there would no national and international standards all the standards will be the same around the world all the countries are valuing their fixed assets their current assets their liabilities their income and expenses in the same way as one company is doing in India same way the other company is doing in the US.

That means, we are moving slowly and steadily complete harmonization of the accounting standards, but we have not done been not able to do that so far, but the recently the development has been that say we had say common national standards, but now most of the say international community members from different countries in the world they have agreed that they would like to converge their national standards with the international accounting standards means you can call them as the international financial reporting standards given by the international standard board. So, means that the process which you will have is a time will come when you have a common gap, but we do not have a common gap today every company has its own gap and on the basis of that the financial statements are prepared and financial reporting is done.

So, I will take you through this journey to see this presentation and later on you can go through this presentation yourself and some broad provisions, I have given here and then you can get to know about the provisions of this discussion.

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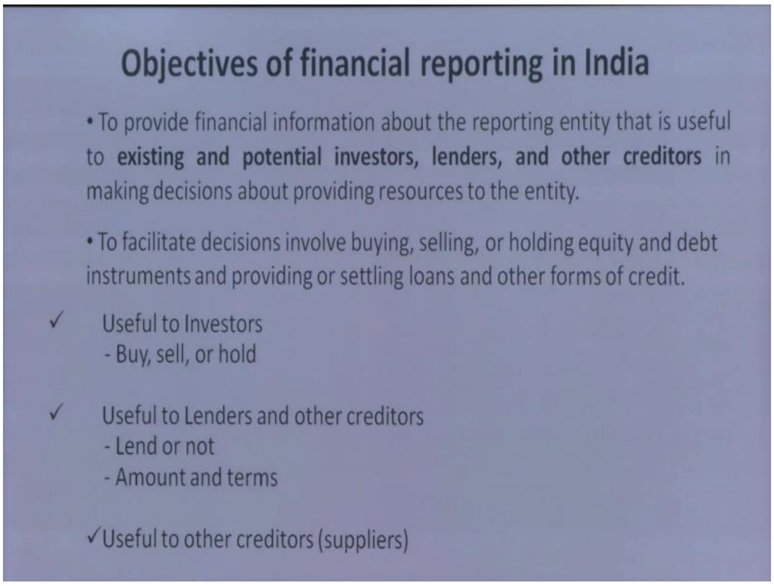

So, first of all let us talk about the say objectives of financial reporting in India or maybe not in India anywhere in the world you can say. So, there are the different objectives first important objective is to provide financial information about the reporting entity that is useful to the existing and potential investors lenders and other creditors in making decisions about providing resources to the entity or that business organization or that company this is the first objective means should you become a investor in this company by buying the share of the company should you lend money as a financial institution to that company or should you supply your material to that company on credit basis you will do that if your funds are secure.

So, that is only possible if the financial reporting is you are rating through with the help of financial reporting then you are analyzing these financial statements of the companies you are able to make out that it is, this is a good company this is a strengthful company as we have seen in case of the companies like skyline we have analyzed the skyline or earlier we have analyzed here Grasim industries. So, if you look at their; what are their reporting through their financial statements you can find out this they are the good companies and nobody will even think twice to deal with those kind of the companies. So, that is the purpose.

Second objective is to facilitate decisions involving buying selling or holding equity and debt instruments and providing or settling loans and other forms of the credit very useful information you can get from the financial statements only because it is information about the internal affairs about the company. So, finally, you can say it is useful to investors whether to buy the shares of that company or sell the shares of the company whose shares they are already having or hold it for some period of time maybe the situation is not good maybe in case of the Grasim industries we have seen that their say price went up 2700 rupees 2778 rupees in January, but later it fell down. So, maybe people deciding that when it fell down in march and people were holding the shares they could have decided hold it further for some period of time again it will go up to 2,700 or 2,800 and if it reaches 2,700 or 800 or touches 300 rupees I will sell and I will get the maximum returns. So, that way the decisions are taken.

Useful to lenders and other creditors financial institutions lend big money to the business undertakings and they have to have some basis of substantiating the decisions that whether they should lend or not and then it is useful to the creditors also you see that most of the business is on the credit. So, suppliers supply the lot of inputs to the companies on credit and they have to be sure that how this company is doing. So, whatever the company is reporting in the financial statements you can easily analyze as a supplier and you can take a decision about that. So, these are the three important objectives of the financial reporting anywhere in the world including India.

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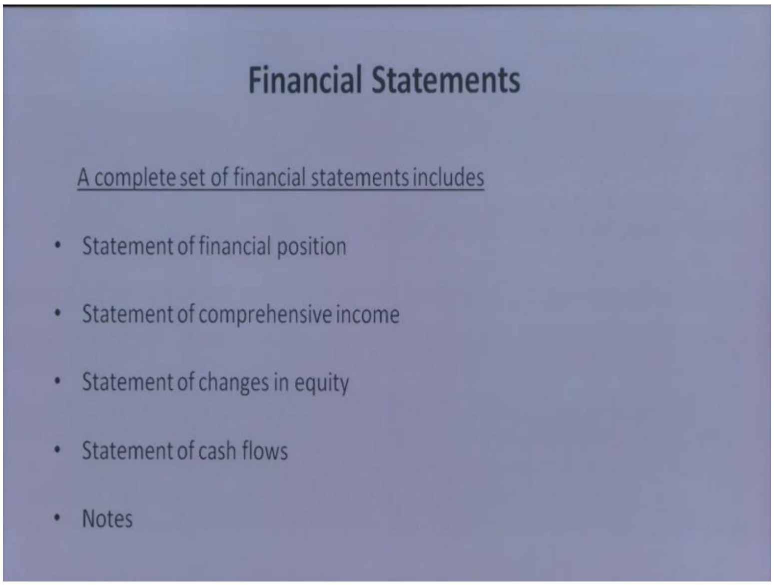

Then we talk about financial statements which are important financial statements required to be prepared we have already discussed many times what here for the reporting purpose I am recalling it for the say just the reference purpose we all know that you have to have a the complete set of the financial statements includes that is statement of financial position. Means balance sheet that depicts the financial position of the firm only for one day then is the statement of comprehensive income means it is a income statement profit and loss account which gives you the details about trading account profit and loss account and overall income and expense position of the firms.

So, it is a comprehensive income statement then statement of changes in equity sometimes some companies not in India, it is not very common, but in us some companies prepare the statement of changes in the equity also they prepare that how the share capital is changing what was in the beginning have they issued more some more shares in the current year or bonus years in the current year or some change. So, there are some companies when there is a big change in the. So, sometimes when a company comes with an IPO or FPO then this statement is required, but in general way balance sheet serves the purpose. So, this is not required, but sometimes some companies can separately give the statement that apart from the balance sheet some additional information is available in the statement of changes in the equity, but may not be done.

Then the third important component is of the financial statement of the set of the financial statements is the cash flow statement it is very important nowadays after 1997, it means 1994 1st January IASC and means you call them IASC is now IASB, I will give you the reference of the history of the IASC. So, IASC came out with the new standard that is the making the cash flow statement mandatory or statutory statement. So, in India also from 1997 onwards this has become a statutory statement this is the third statement and then notes; notes means detailed schedules because balance sheet is only 2 page document its talking about the assets.

So, what how the assets that figure has been arrived at the details are in the schedule and schedules run thick maybe some 20, 30, 40, 50 pages one schedule some goes up and details of that should be appended to the balance sheet. So, that if you are satisfied with the first 2 pages with the asset liability position it is fine. But if you want to know in detail how this asset figure has been worked out like liabilities figure has been worked out or the investments have been worked out you will have to refer to the back detailed schedules which are again required to be prepared by the companies while completing their reporting process.

So, these are some of the important financial statements. So, these are the objectives and some important financial statements which are required to be prepared some other reporting related aspects I will be talking to you in my next part of discussion and that will be that will be our last class also.

Thank you very much.