**Financial Statements Analysis and Reporting**

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**Lecture - 60**
**Financial Reporting Part – II**

Welcome students. So, this is our final lecture and we are discussing the process of financial reporting, after this we will be closing the discussion on this particular subject. So, after this long journey of you can call it as, say 59 lectures.

Now, this is the last step 60th. So, we will be having discussion on it, and then for the detailed reference you can refer to the different sources. And lastly when we talk about the financial reporting, you can use the important, say provisions you can refer to the important provisions of Indian companies act 1956 and amends done in different at different times, say in 2013 and then you can refer to the income tax act also, and some important provisions are there given to and then the other things I will be talking to you, that you have to refer to for the detailed reference of the financial reporting. So, we will talk about the objectives and financial statements, in the last lecture or in the last part of the discussion, and then some other things important related to the financial reporting are, say characteristics of a coherent financial reporting framework.

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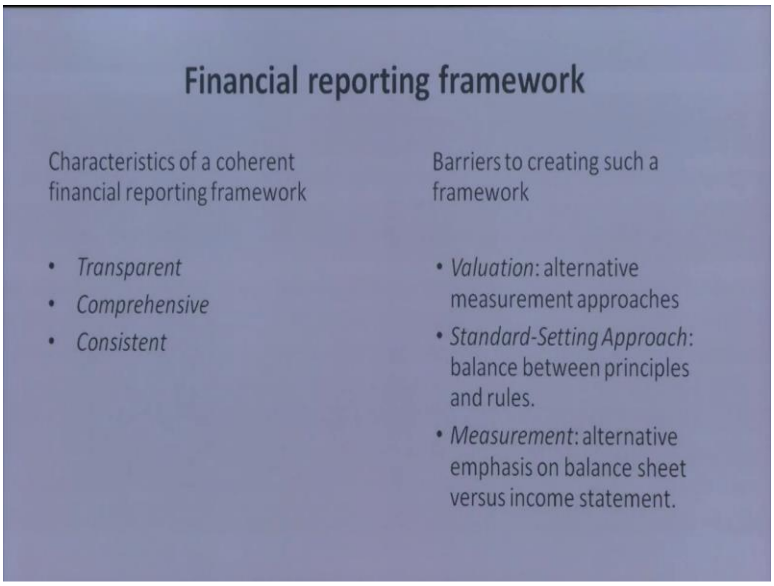

So, to make important reporting interesting and important. The reporting means all the financial statement we are preparing, and using for the reporting they should be transparent; means that is a one important requirement that they should be transparent enough. There should not be any hidden information, anything which is concealed from the share holders or from the lenders, or from the say; the suppliers or anybody else that should be avoided comprehensive, it should include as much as information, so that by reading even the first two pages; that is of the balance sheet and income statement.

You can be clear about the maximum things, and you do not need to look at anything more beyond that and consistent. Consistency is the most important component of the financial reporting, because consistency, if consistency is not maintained it is not allowed also not to being consistent, and sometimes consistency is not maintained, then it is very difficult to understand the information given. So, for example, we normally talk about the consistency with regard to the depreciation charging methods.

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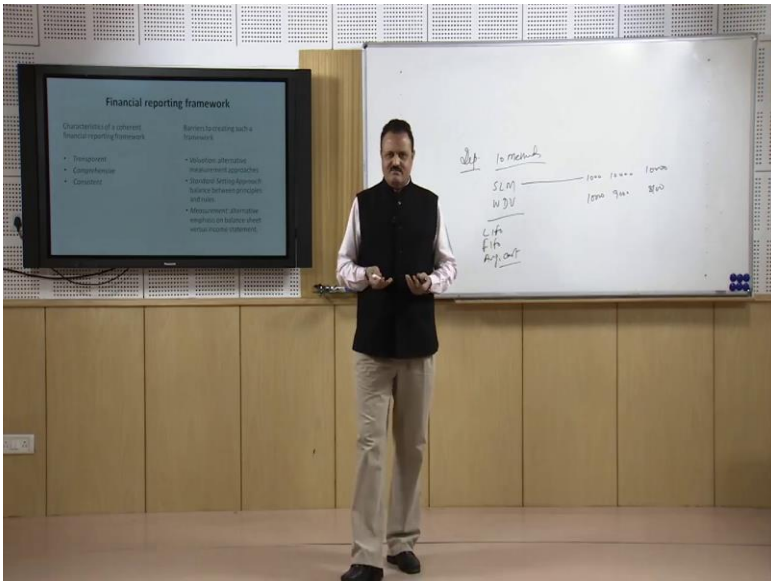


So, when you charge the depreciation. If you talk about the concept of depreciation we could not get the time here, otherwise I could have discussed with you the concept of depreciation also. So, if you want to calculate the depreciation to be charged on the fixed assets, you have almost 10 methods, to charge the depreciation. Though every method is giving you the same amount of depreciation for that given period of time, for example, one machine is depreciating in ten years, then at the end of the 10th year the residual value will also come as same, the depreciation amount will come as a same, and depreciation the method the asset will be depreciated, finally, to the extent we want to depreciate it or is equal to the end of its technical value, but the annual values maybe different. The annual amount of the depreciation maybe different.

So, we are using the different methods; commonly we use methods are like straight line method, that is SLM, and written down value method is the WDV methods. So, when you use the straight line method, your depreciation amount remains the same all through the years for example, it is 10,000 and it is 10,000, but in case of the written down value method it changes ;1st year it will be 10,000 next year it may be 9,000 next year it may be 8,100 like that. So, value of the depreciation changes.

So, it means in the 1st year, if you are using the straight line method, and 4th year onwards you started suddenly, changed the method from the say; straight line method to the written down value method it means the consistency is broken, that consistency should not be broken and this should remain consistent. For some reason if some change is required, then on the same page of where that depreciation figure is given, or being given in the profit and loss account there on the same page, by putting a line drawing a line on the as a foot note, you should give a note there that there is a change in the depreciation method, and detailed discussion about that has been detailed explanation, and calculations have been given in the scheduled number this, appended to the profit and loss account so that disclosure important.

Normally, methods should not be changed, but if it is required to be changed, then say the disclosure is important. So, consistency is a very important characteristic of the better financial reporting. Then we talk about. These are some barriers also, but because we have the different valuation methods. In that case valuation techniques are different. So, some company uses some techniques. So, company uses other techniques, and even the country wise also the valuation is different, for example, the valuation of inventory. Now you talk about the valuation of inventory there are different methods like LIFO, then we have FIFO, and then we have average cost method. So, different methods are there, different companies, different use, different methods of valuations.

So, means similar information cannot be worked out. So, these are the barriers. Then standard setting approach, means when you talk about the standard setting approach in the different country, because we are not a world, like we are not in the world accounting system. So, when the standard stating approach you talk about; India has a different standard, Pakistan has a different standards, US has different standards, UK has different standards, and though we are referring and trying to converge with the IFRS, international financial reporting standard, but that will take time.

So, in that case the figures are different, the total reporting process is different. And similarly, you talk about the measurement; that is, means how you to measure the different items, and it means the focus should be on the balance sheet or the income statement. Means both the statements are equally important; one is reporting the profit or loss situation and another is reporting the financial position. So, they should be looked at with equal importance, but sometimes we are only looking at the balance sheet line, more emphasis on the balance sheet less on the profit and loss account. So, some kind of the barriers are there in the financial reporting, which should be recorded and which should be avoided I would like to say. So, then we talk about the other important things, when you talk about the other things, then the disclosure of the relevant accounting policies; that is also very important.

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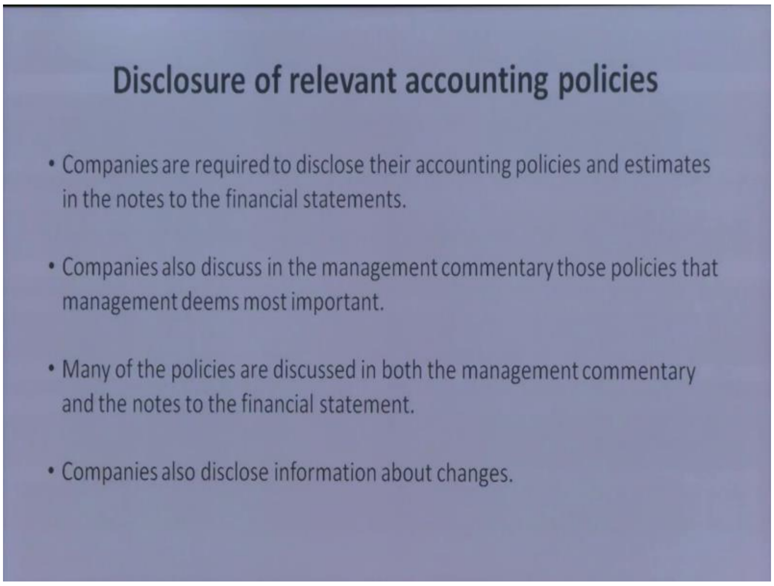


While we talk about the financial reporting process, say important points that companies are required their accounting policies and estimates in the notes to the financial statements. Means I told you that they are the three components; one is the profit and loss account balance sheet, and then the schedules are notes.

So, the notes what are the policies being provided, how what are the standards being followed, how the calculations have been done. Details should be given in the schedules then companies also discuss. In the management commentary those policies that management deems most important what is the say some. In a brief manner what is the say strategy of the firm, or what is the what are the important policies say for example, the policies with regard to employees, policies with regards to payment of dividend, policies with regard to transferring of the, say part of the profit to reserves, some brief analysis and discussion also remains. Many of the policies are discussed in both the management commentary and in the notes of the financial statements, and finally, company also disclose information's about changes.

Naturally, as I told you that if you are changing the method of depreciation, or the changing the method of inventory valuation. in that case you have to disclose it, where you are changing that figure or you are giving the changed figure, that has to be given by putting a line after; that means, at the last part of the page, where that figure is given that by drawing a line as a foot note, you have to put the detailed description, why there is a change in the current year's figure as compared to previous year's figure, because we have changed the method of depreciation. We have changed the method of inventory valuation, and that is the reason why this difference is occurring.

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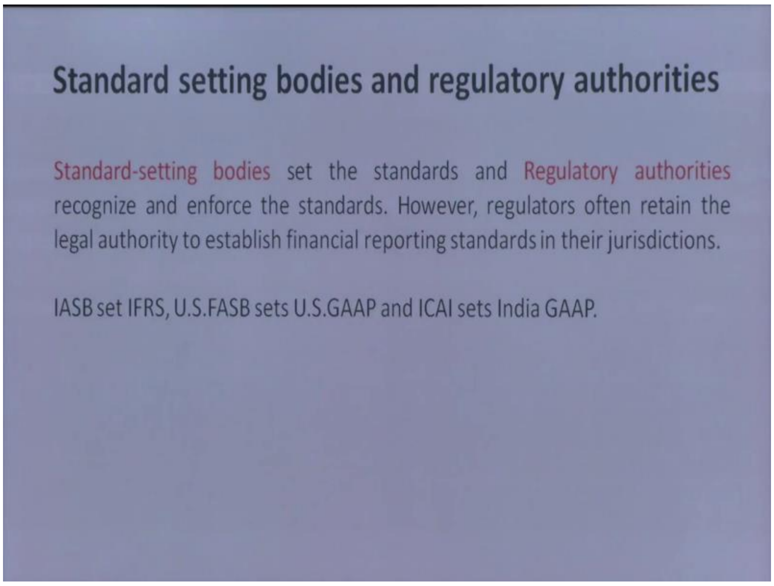


Now, we talk about that important role in the better financial reporting is of the two important bodies; one is of the standard setting bodies, and second is of the regulatory bodies right. Standard setting bodies and the regulatory bodies, first role in this process comes up of the standard setting bodies, and if you talk about the standard setting bodies, every country has a standard setting body.

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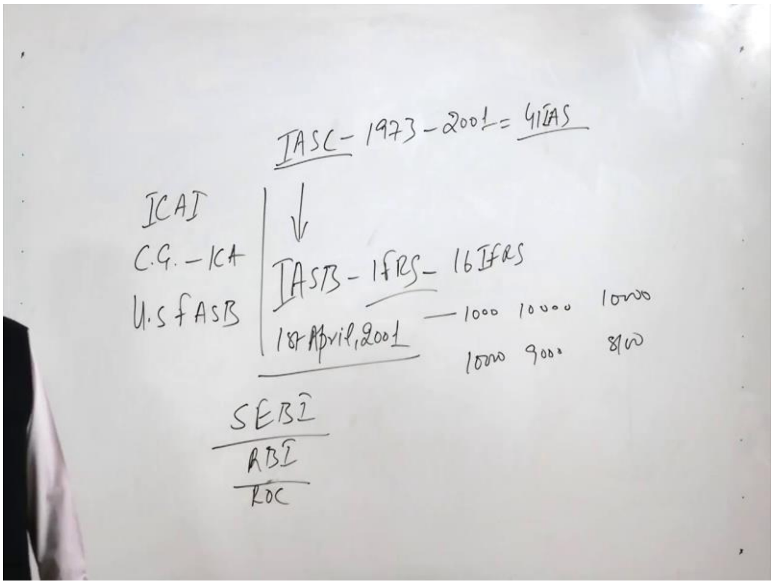


And in this case, say for example, you talk about the India, in India the standard setting body is one ICAI; institute of chartered accountants of India can set the standards for financial reporting in India, that how the financial reporting has to be done. Apart from that the government, the central government also has some their own standards. They have also developed some standards under the Indian companies act. Under the Indian companies act also some standards are developed by the government also ministry of corporate affairs, but generally the main responsibility of developing the standards for the financial reporting in India are with the ICAI. for example, you talk about the us now in US there is a body like USFASB; that is united states financial accounting standards board, they make the standards for us, and likewise the different countries have their own say standard setting bodies, and to harmonize and to coordinate among these bodies, there is a one standard body which is called as IASB, and IASB is setting the standards which are called as IFRS, and they are the International Financial Reporting Standards.

Now, little back ground and discussions about the IASB International Accounting Standard Board actually, we have called International Accounting Standard Board, but before that it was IASC International Accounting Standard Committee, it was International Accounting Standard Committee. This committee came into being in 1973, before 1973 the financial reporting at the international level was quite fragmented. Every country was moving its own direction, but when the leading institutes of US and UK they came forward in 1973, and they decided that to guide the reporting at the international level, especially for the multinational companies, also the exporters and others, we should have some kind of the standards, and for that we should have some standard setting body.

So, these leading national level bodies, they set up this body which was say to develop the international standards, facilitating the international trade by the multinational companies, and they set this body in 1973. So, this body was called as international accounting standard committee. And since 1973 till 2001, this company was in existence, and during this period of 1973 to 2001, they gave 41 IAS, they gave 41 IAS International Accounting Standards. And from 1st April 2000, then this was converted into from 2001 onwards, after 2001, this body was reconstituted re- organized and was renamed as IASB International Accounting Standard board, and this started functioning, means started, this came into existence and started functioning from 1st April 2001.

So, after 1st April 2001 IASC is called as IASB, and the name of the standards is also changed, and earlier it was called as International Accounting Standards and this IASC has given 41 standards so far they are still in practice, they are used and then it was converted from IASC to IASB, then they also started giving the further standards and. Whatever the standards are now given by the IASB they are called under a different name and they are called as International Financial Reporting Standards, and so far IASB has given us the 16 IFRS. So, total standards are 41 plus 16 that is 57. And IASB keeps on developing new standards also, as and when the problems come up to go for, to deal with different aspect of financial reporting especially at the international level.

So, this is the one part that we have the standard setting bodies at the country level. And second important role in the financial reporting is of the regulatory authorities and regulatory authorities for example, in regulatory authorities in the different countries regulatory authorities are there. So, if you talk about the regulatory authorities who has an eye and watch upon the reporting process of the corporate in India. So, first name comes is the SEBI; Security and Exchange Board of India. This is the first regulator which is important regulator, specially for the joint stock companies, who are using the share capital, and who are issuing the shares to the general public and using the share capital. So, they are the first regulator SEBI.

Apart from that some other regulators are also there, but their role is secondary, say RBI is also to some extent acts as a regulator, then registrar of companies is the another place, that also acts as a, means registrar of companies where the company is registered ROC they also act as a regulator. So, different regulators are there, but the main regulator if you talk about, that role is played by, in case of the company form of organization joint stock companies SEBI is the most important regulator. Every country has their own regulatory authorities, and they play the regulatory role.

So, the if you talk about the connecting role between the regulator and the standard setting bodies, that the standard setting bodies gives the standards and guidelines, and implementation of those guidelines the regulators power is, that he can ensure that whatever the standards are developed by the standard setting body, they are being followed, they are being observed, and financial reporting is being done on the basis of the prevalent or extent financial reporting, financial accounting or the financial reporting standards. So, we will say, some important developments about the financial reporting standards are.

Although many countries are adopted IFRS, not all the countries have done so far. Means many countries are moving from the national accounting to international accounting, but still it is taking time. So, for example, in India we have say two kinds of the standards. Earlier we used to call our standards as A S that is the accounting standards. We had about 32 standards, and now we have changed the name. So, those A S which are similar to IFRS, we have converged with IFRS and we are using the same standards in India also as they are the IFRS, but those standards which are little different, for them now we are calling under different name, and they are called as IND A S, IND accounting standards.

So, it means there are process is going on a time will come, that both the say standards will same, in that case everybody will use the IFRS, but the time has not come. Financial reporting standards both IFRS and home country GAAP, continue to evolve for various reasons including, changes in economic activity, improvement of distinct standards and convergence between the international and the home country standards. So, currently both are in existence, but when we are becoming more advanced, we are means more nearer to each other in the rest of the world, and when the business world boundaries are sinking or eliminating, then maybe possible that is we have only one type of standards, and everybody has converged with the IFRS, but the time has not come so far.

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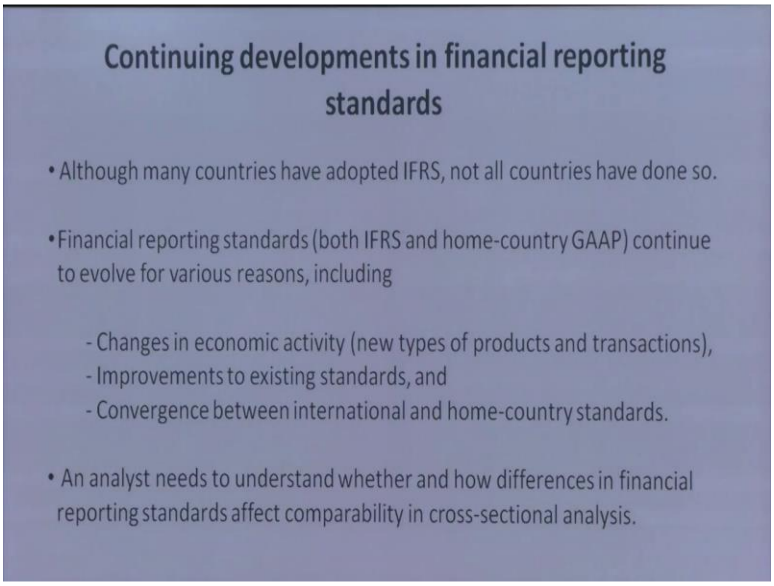

An analyst needs to understand, whether and how differences in the financial reporting standards affect comparability in the cross sectional analysis, that is the intelligence of the analyst. He has to look if that from the country's standard point of view also, and by using the international standards also, and then he has to give his own opinion that how this company is doing, and how its position or the performance is. Then if you talk about the global conversion of the accounting standards still there is a difference. Means as I told you that even you talk about that most of the economies are converging with the, or most of the national economies are converging with the IFRS, but still those differences are existing. So, for example, you talk about US now, if you compare the convergence of the US GAAP and that with the IFRS. Still that difference is there though the US has converged to a larger extent with IFRS, but still the GAAP is remaining, and complete convergence is not possible, means some country level differences will also be there.

So, if you talk about the country level difference, say in US you talk about there is a method of valuing elementary which is called as LIFO. So, as per IFRS means under IFRS use of the LIFO is not allowed last in first out, it is not permissible, but in us LIFO is the most important method, and they value their inventory on the basis of LIFO, because the problem in US is structural, because the companies when they have to value the inventory. So, and if you want to take the income tax advantage, they want to reduce their income tax liability in that case they have to use LIFO, and means that income tax liability can be reduced, advantage of income tax can be taken by the us companies provided their own, say reporting process is based upon the LIFO and in their own internal and or maybe the external reporting process on the basis of the company's act. They have used the LIFO, then they can claim the income tax advantage.

So, it means if the US government has to derecognize LIFO, then they have to make the change in the income tax act. So, that they have to make it that they use any method of inventory valuation, and you prepare your company's statement by using LIFO or any other method, you will be given an income tax advantage, but that difference always remains, and that change the government is not trying to make in US. See even you converge, but some problems will be there and some differences will be there. Here are some examples of the regulatory authorities; you were talking about in India, we have the SEBI that is the securities and exchange board of India.

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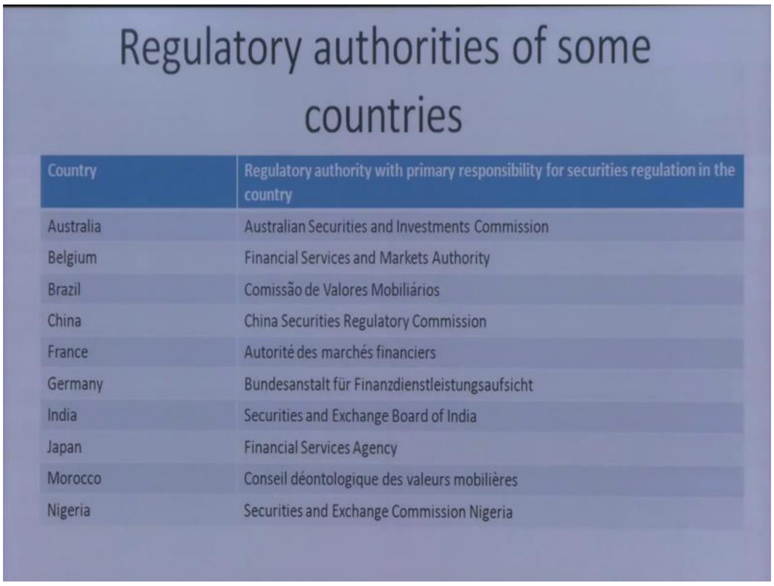


So, Australia has it is the Australian securities and investments commission financial services and market authority in Belgium, and Japan is financial services agency. Similarly, Nigeria security and exchange commission of Nigeria. So, it means different regulators are there, after that RBI is also a regulator then the registrar of companies is also regulator to some extent.

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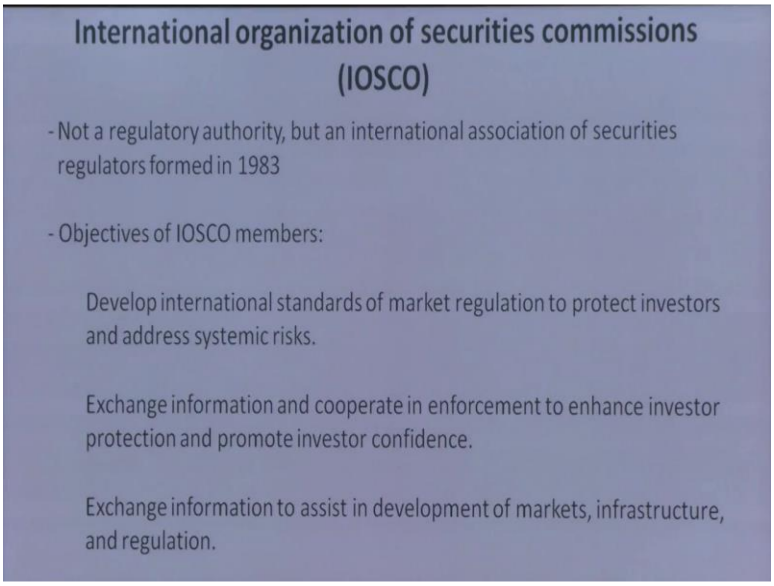


Then these, say regulators have formed an international organization, which is called as I OSCO International Organization of Securities Commissions, and they have created this organization just to remain closer to each other. So, that to share the regulatory process with the other countries, means India to share with the other countries, draw good benefits from their system, and they can draw good benefits from our system. So, that the investor protection can be maximized, and overall stability can be insured in the economic system or in the financial system of that country.

So, for that they are regularly meeting at the international level, and they have formed the association also. So, that financial system improves, and the financial system improves reporting will improve, and reporting improves then investor is safe, lender is safe, supplier is safe. So, that is the job of the regulator now, we will talk about quickly about the components of the financial reporting in India when you talk about the components of the financial reporting in India that, they are divided into five parts; first is the legal requirements of financial reporting. They are described under the Indian companies act, and under the Indian income tax. Indian Companies Act 1956 and amendments done in 2000 and then in 2013, and in income tax act, Indian income tax act that is 1961, under these two acts the financial reporting process is carried on. And the second is the financial reporting, the requirement is, adhering to the accounting standards, and guidance notes of the ICAI that is again important requirement, if you talk about the reporting process.

And third is, say ensuring adhering to the IAS and IFRS. If you are dealing internationally, if you are a national company only, then there is no problem you can means by doing your job by following only the local standards Indian standards, but if you are dealing in anyway, with the if you are transferring your product from India to other country or some multinational companies subsidiary is working here, they are manufacturing the product here and they are selling it to the say, even their holding company back in their home country. So, it means we are indulging into international trade, and for them the observance of the IAS and IFRS is important. Requirement of the stock exchange is another component, which is again the part of the regulatory network, and then some other trends which are really important for us, say for example, having the say information in the financial statement about corporate governance.

Similarly, about the corporate social responsibility, similarly about the environmental protection for the companies are doing. So, having this additional information in the financial statements again is the important requirement. So, these are the five broad components, under which the financial processing in India can be studied, can be understood and can be divided.

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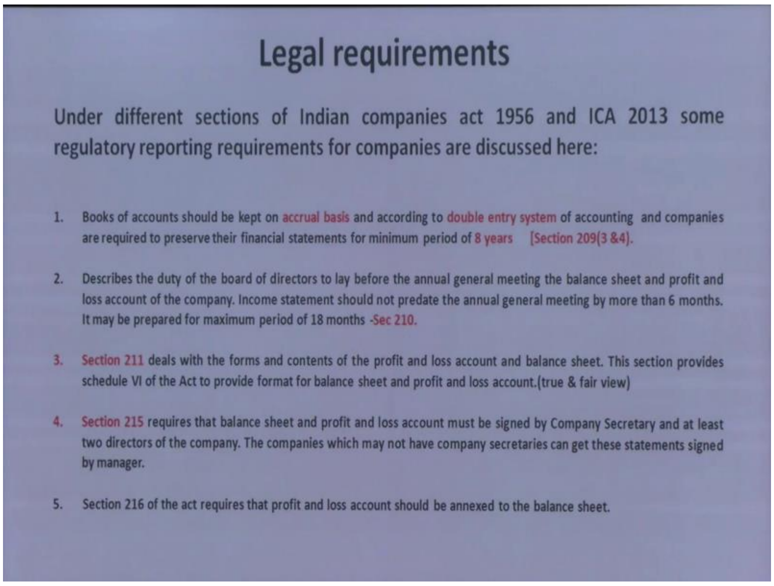


Now, we are running short of time, but still I would like to go through, means I would like to share with you the some important provisions of the Indian companies act; that is 21956 amendments done in 2013. And some important provisions or some relevant sections which are useful for Indian reporting process is, we will be talking about to the extent we could talk here, and that is say books of accounts is should be kept on first requirement is, under the section 209 sub section three and four books of accounts should be kept on accrual basis. We all know that and according to double entry system of accounting what we learnt in detail about that, and companies are required to preserve their financial statement for 1 year for minimum next 8 years.

This is the requirement of this section. Second are the requirements of section 210 describes. This section describes the duty of boards of directors to lay before the annual general meeting. The balance sheet and the profit and loss account of the company, income statement should not predate 6 months, it should not be 6 months old, when you are preparing the income statement, it should be latest, it should be prepared after the last operating day after taking into consideration the total information with regards to expense and income, it should not be old information, it should be latest information and the provision here it kept is that is, it should not be at least 6 months old. And it may be,, means one way at one point of time you can prepare it, not only for one accounting period it can be for the 1 and a half year 18 months, it can be prepared, but for us the useful information will be only for say 12 months, but we can get to know that what is happening in the past 6 months, or what is going to happen in the. What has happened in the past 6 months means current 12 months and past 6 months. So, total is the 18 months information can be gear there.

Section 211 deals with the forms and contents of the profit and loss account and balance sheet. It means ultimately and this section provides schedules 6 of the act to, provide format for the balance sheet and profit and loss account. It means ultimately the objective of financial reporting is what, that the company should be reporting true and fair view of their performance. This is the objective of preparing these statements, every 12 months. This is the objective of getting these statements audited from the independent chartered accountants, certified chartered accountants, means everything profit and loss account and balance sheet it should be like Satyam's computers balance sheet that Rama Linga Raju was getting it window dressed, with the help of the auditors, who had brought the auditors from the prize what was Coopers of these two guys, and they were say misappropriating in that case the purpose of the financial reporting is defeated.

Then section 215 requires that balance sheet and profit and loss account must be signed by the company's secretary, and signed by at least two directors, and if there is no company secretary then apart from two directors. It must be signed by any designated secretary who may be a manager even, and last is the section 2016 of the act requires that profit and loss account should be annexed to the balance sheet. Both the things should be put together. Apart from that the third is now also mandatory; that is the cash flow statement.

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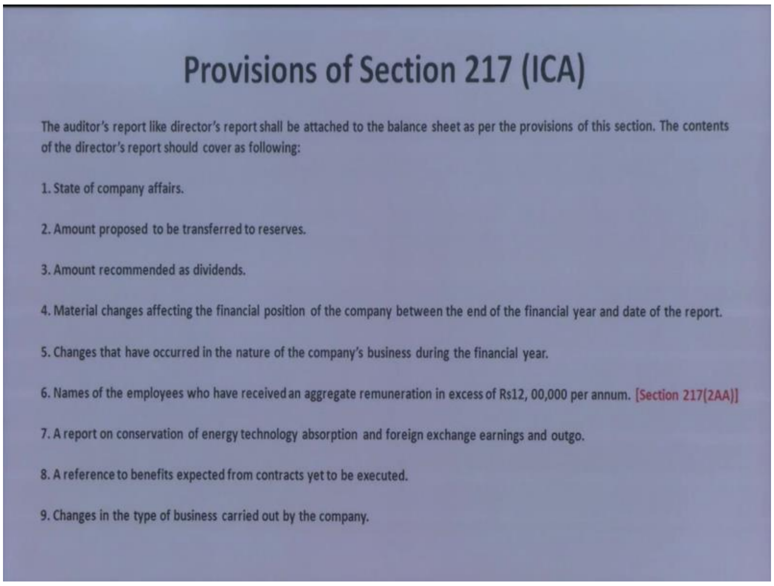


Now, there are some additional provisions, with regard to section 17 217, the Indian companies act, and these are the important points totally I will read out for you, that is the state of company affairs it must explain in detail amount proposed to be transferred to the reserves how much that should be clearly given. Amount recommended as dividend that should be clearly given. material changes affecting the financial position of the company between the end of the financial year, and at the date of the report, and changes that have occurred in the nature of company’s business during the financial year, that detail should be there names of the employees, who have received an aggregate enumeration in excess of rupees 12 lakhs per annum under section 17 217 sub section two a, which was introduced in the companies amendment act 2000, this section was added. So, that it can be made out, to whom the salary is more than 1 lakh per month has been paid, who are those people and why the amount has been made, their names and details should be there.

A report on conservation of energy technology has a option, and foreign exchange earnings and the use, that should be there. A reference to benefits expected from the contacts have to be executed, and lastly changes in the types of business carried out by the company. So, these some further information should also be there in the say in the income statement as well as in the balance sheet, apart from the profit and loss position financial position, and cash flow position, some additional information is also required under the financial reporting.

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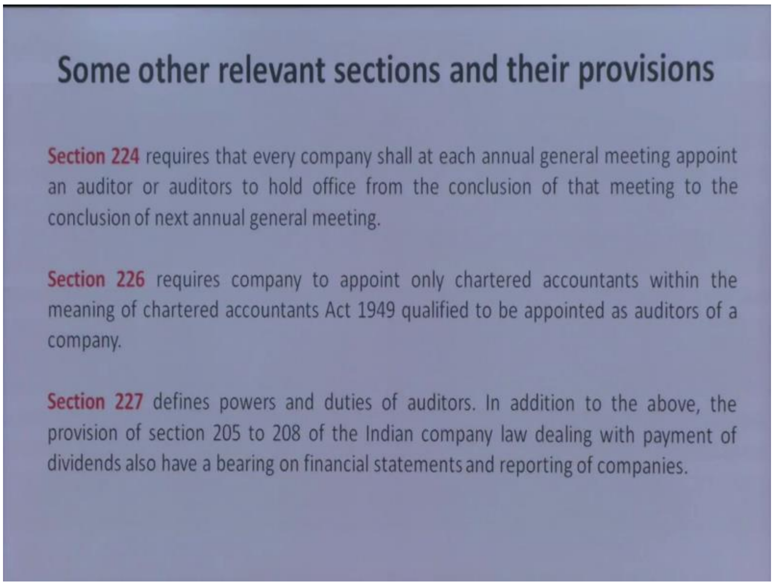


And some other relevant sections are section 224, it requires that every company shall at each annual general meeting appoint an auditor, most important thing an auditor or auditors, to the to hold office from the say conclusion of that meeting to the conclusion of the next meeting. So, for one full year beginning of the year and till the end of the next year, that accounting period you have to appoint the auditors, and section 226 says that those auditors have to be the chartered accountants. Who are chartered accountants under the chartered accountants act 1949, and who are qualified to be appointed as auditors of the company, they are only the qualified chartered accountants, they are qualified auditors. and section 227 says, powers and duties of auditors should be properly, means they are defined under 227, if somebody is appointed as a auditor of the company, it means he knows what are his powers and duties.

In addition in addition to the above the provision of section 205 to 208 of the Indian companies law 1956, and further amendments, dealing with payment of dividends also have a bearing on the financial statements and reporting of the companies. So, some important provisions, I am quickly taking up with you. Then provisions of the Indian income tax act; that is two important sections are there, section 44 AB requires all the companies in India, to have tax audit as mandatory.

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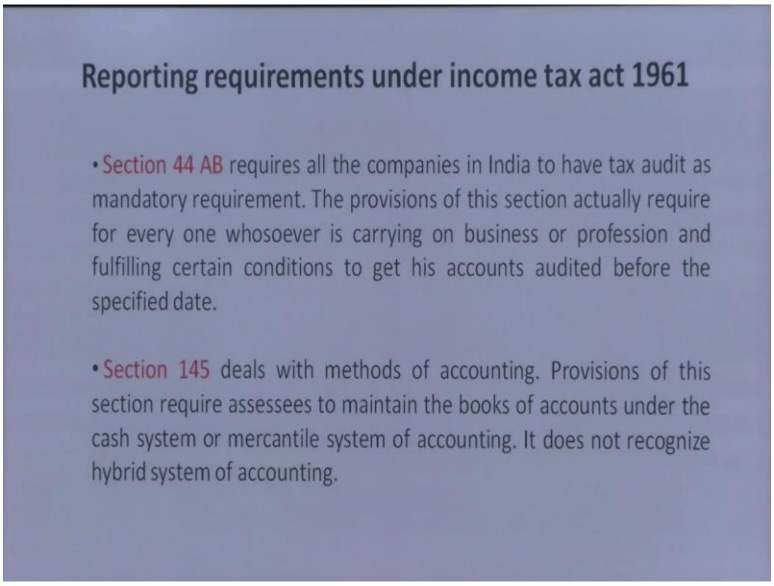


Means you have any form of organization. It is important and mandatory for the company form of organization if it is a joint stock company, but if it is a sole proprietor or if it is a partnership firm, even then for them the mandate. It means the tax audit as mandatory, the provisions of this section actually require for everyone, whosoever is carrying on the business or profession, and fulfilling certain condition to get his accounts audited before the specified date.

And then last is section one 45 deals with methods of accounting, provisions of this section require assesses to maintain the books of accounts, under the cash system of accounting or the mercantile system of accounting, but only one system of accounting, not hybrid of the two. So, for example, in India for the business is rather than banking, they are allowed to follow the mercantile system of accounting or the accrual system of accounting, but the banking sector, banking organization in India, they have to compulsorily follow the cash systems of accounting. So, in whichever category you fall whether you follow the cash system of accounting, or you follow the mercantile system of accounting, but you have to have only one system. You cannot have that part of the statements are on cash and part of the statements are on mercantile accrual, and you are creating a hybrid kind of a system, that is not allowed.

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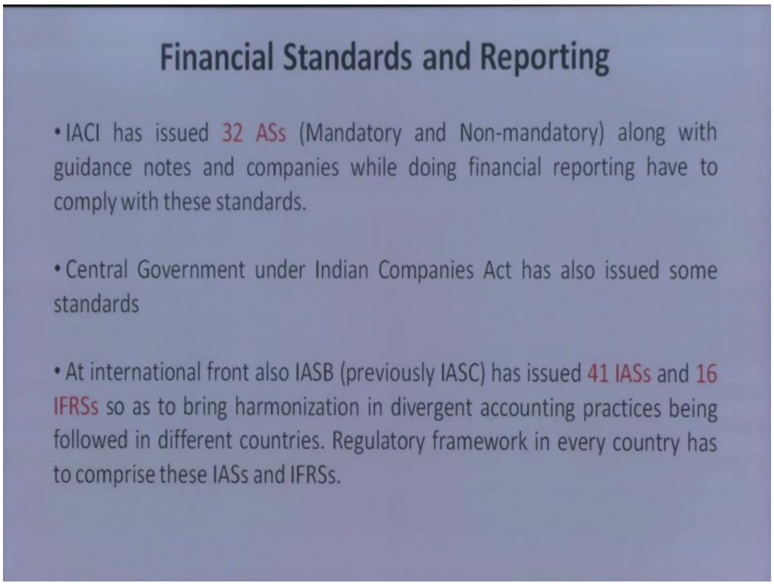


Then financial standards and reporting ICAI has delved 32 accounting standard so far. So, they are relevant for, which are means 29 are mandatory and three are non mandatory. apart from that central government under Indian companies act have delved their own standards, and after beyond that we use the 41 IAS and 16 IFRS also, for harmonization of the divergent accounting practices, they are also in use and companies who are dealing with in the international business or who are dealing at the international level that have to observe the IAS and the IFRS also.

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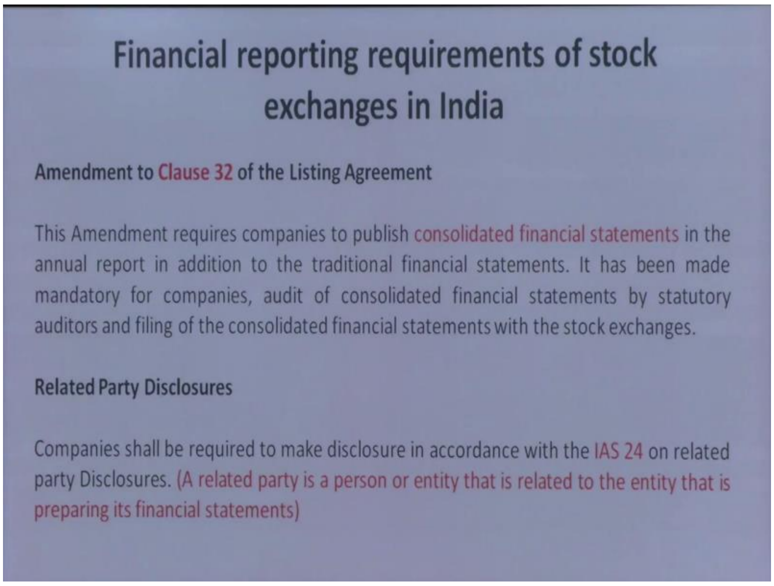

And then we have the some important points with regard to the, say financial reporting requirements of the stock exchanges in India. So, I have discussed these some provisions here, and you can refer to the different stock exchanges also the information is given at the stock exchanges level also. So, you can easily go through these provisions and you can understand what are the requirements of the stock exchanges provisions, and then we have some other requirements.

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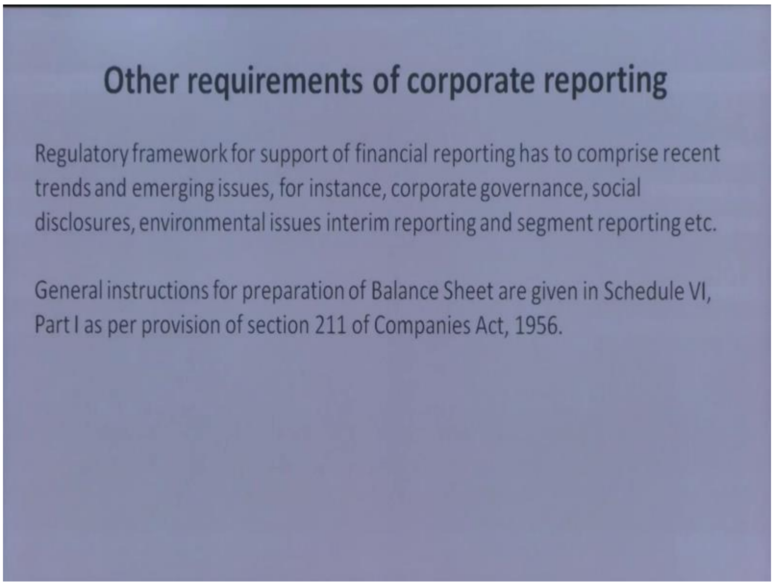


Last is the other requirement that regulatory framework for support of financial reporting has to comprise. Means regulatory framework for support of financial reporting has to comprise recent trends and emerging issues; for instance; corporate governance, social disclosures, environmental issues, interim reporting and segment reporting. These are also some additional requirements the recent trends going on. And general instructions for the preparations of the balance sheet are given in the schedule 6 part 1 as per the provisions of section 211 of the companies act 1956.

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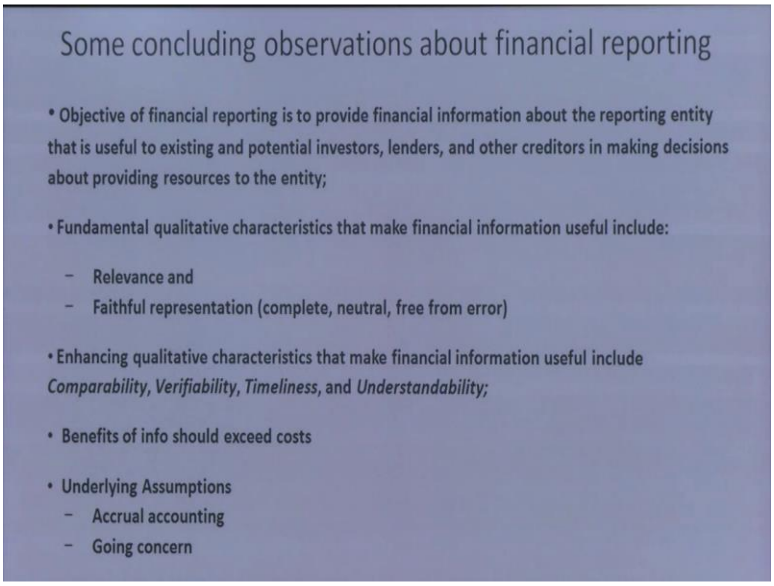


So, last the concluding part is for this whole discussion that, if you look at these some observations concluding observations you will see, and agree with me that objective of financial reporting is to provide, financial information about the reporting entity; that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Fundamental qualitative characteristics that make financial information useful include, relevance. Whatever the information is given that should be relevant, faithful representation that whatever the information is there that should be complete, prepared in the neutral, with the neutral mind, and it should be free from error.

Enhancing qualitative characteristics that make financial information useful, include comparability, verifiability, timeliness and understandability, and benefits of preparing the financial statements should certainly outweigh the cost. And lastly underline assumptions of the financial reporting are; accrual accounting, means for the businesses other than banking, they have to follow the accrual accounting system, and businesses concerned as always a going concern. Without seeing that the business is going to, say going to end up its life in the near future, its considered as a entity with the perpetual section with unending life, and with that perception in mind, we prepare our trading and profit and loss account and balance sheet and cash flow statement, and other related statements, and complete the process of and complete the process of financial reporting.

So, this quickly I could discuss with you, about the financial reporting and for the detailed reference, you can refer to these different means you go to the SEBI website, you can go to RBI website, you can go to the say concerned ROCs registrar of companies websites, and you can have some important references with the Indian companies act, which are easily available on the websites of respective ministries. Then income tax act, and say you can it is very important source for the information for you will be the website of institute of chartered accountants of India.

So, you these are the different resources you can use, and you can refer and you can learn about the entire subject of this, that part we discussed in the last 60 lectures that is the financial statements analysis and reporting where we learnt how to prepare the important financial statements; that is the profit and loss account, balance sheet and cash flow statement. How to analyze the important financial statements and what are the important provisions with regards to the financial reporting.

So, with this I complete my discussion on the subject. I hope that you have learnt something after going through all the 60 lectures, and you have felt benefited, and I am really confident that you will perform very well in examination. Tomorrow wherever in any, say area of your life, in any sector of your life you go and you join you will really prove to be an excellent financial analyst, and you will be able to justify your position and the knowledge, which you have gained by studying this very interesting and important subject. Wish you all the best.

Thank you very much.