Chapter- 3

Financial Statements of a Company

❖ Meaning of Financial Statements

The Financial Statements are those statements that express the performance and position of an organisation in financial terms to various users of accounting information such as, creditors, management, employees, etc.

❖ Nature of Financial Statements

The nature of the financial statements depends upon the following aspects like recorded facts, conventions, concepts, and personal judgment

- ***Recorded facts***- As the items are recorded in the financial statements at their original cost (i.e. the cost at which they were acquired), therefore, the financial statements fail to reveal the current market price and fail to capture the inflation effects.
- ***Conventions***- The adherence of accounting conventions for preparation of financial statements such as, Prudence Convention, Materiality Convention, Matching Concept, makes the financial statements easy to understand, comparable and reflect the true and fair financial position of a company.
- ***Accounting Assumptions***- The adherence of postulates (accounting assumptions) such as, Going Concern Concept, Money Measurement Concept, Realisation Concept, etc reflects the nature of such postulates in the nature of the financial statements.
- ***Personal Judgments***- Different value judgments are attached to different practices of recording transactions in the financial statements. For example, provision on various assets, method of charging depreciation, period related to writing-off intangible assets depends on personal judgment.

❖ Objectives of Financial Statements

- To know the performance and position of enterprise in financial terms.
- To judge the efficiency of management.
- To provide information about expenses incurred and revenues from various activities.

- To use the information for drafting policies and plans by conducting inter-firm and intra-firm comparisons.
- To disclose important changes in the accounting methods, practices and accounting process of the company, so that the financial statements are simple, true and enables different accounting users to understand without any ambiguity

❖ **Annual Reports**

- *Meaning and Components of Annual Reports*
  - The Annual Reports of a company provide information about various affairs and financial statements of the company.
  - Annual Reports comprise of Directors' Report, Auditors' Reports, Cash Flow Statements, Segment Reports, Financial Statements- Income Statements and Balance Sheets. Besides these, the Annual Reports also consist of notes regarding adaption of accounting policies, explanatory notes and other notes disclosing information that are required as per the Schedule III of the Companies Act.

- *Which companies need to prepare Annual Reports?*
  - All the companies that are listed on the recognised Stock Exchanges,
  - Enterprises having a turnover of more than Rs 50 crores, and
  - Companies having accepted Rs 10 crores of Public Deposits

❖ **Financial Statements of a Company**

As per the ***Schedule III of the Companies Act, 2013***, the financial statements of a company consist of:

- Statement of Profit and Loss
- Balance Sheet
- Cash Flow Statement
- Statement of Changes in Equity (if applicable)
- Any explanatory notes or Notes to Accounts annexed to or forming part of any of the documents listed above

❖ **Statement of Profit and Loss- Purpose**

- These are prepared to ascertain profit earned (or loss incurred) by a company during an accounting period
- The Statement of Profit and Loss also present a concise version (summary) of revenues earned and expenses incurred to earn revenues.

❖ **Presentation of Statement of Profit and Loss**

As per the Schedule III of the Companies Act, 2013, the format for preparing the Statement of Profit and Loss is given below as:

Statement of Profit and Loss
for year ended...

S. No.	Particulars	Note No.	Figures for the Current Year	Figures for the Previous Year
I	Revenue from Operation			
II	Other Income			
III	Total Revenue (I + II)			
IV	Expenses:			
	Cost of Material Consumed			
	Purchase of Stock-in-Trade			
	Changes in inventories of finished goods			
	Work-in-progress and Stock-in-Trade			
	Employee Benefit Expenses			
	Finance Cost			
	Depreciation and amortisation expenses			
	Other Expenses			
	Total Expenses			
V	Profit before exceptional and extraordinary items and tax (III – IV)			
VI	Exceptional items			
VII	Profit before extraordinary item and tax (V–VI)			
VIII	Extraordinary Items			
IX	Profit Before Tax (VII – VIII)			
X	Tax Expenses			
	(1) Current Tax			
	(2) Deferred Tax			

XI XII XIII	Profit/(Loss) for period from continuing operations (IX – X) Profit/ (Loss) from discontinuing operations Tax expenses of discontinuing operations			
XIV XV XVI	Profit/(Loss) from discontinuing operations (after Tax (XII – XIII) Profit (Loss) for the period (XI + XIV) Earning Per Equity Shares (1) Basic (2) Diluted			

❖ **Balance Sheet- Meaning**

It refers to a statement that shows the financial position of an organisation in the form of assets and liabilities on a particular date.

❖ **Presentation of Balance Sheet**

Company Balance Sheet is prepared by following the general principles of accounting. As per the Schedule III of the Companies Act 2013, the Company's Balance Sheet is prepared in the following manner.

Balance Sheet

as at...

Particulars	**Note No.**	**Figures at the end of the Current Year**	**Figures at the end of the Previous Year**
I. Equity and Liabilities			
1. Share holder's Funds			
a. Share Capital			
b. Reserves and Surplus			
c. Money received against Share Warrants			
2. Share Application Money Pending Allotment			
3. Non-Current Liabilities			
a. Long-Term Borrowings			
b. Deferred Tax Liabilities			

c. Other Long-Term Liabilities d. Long-Term Provisions **4. Current Liabilities** a. Short-Term Borrowings b. Trade Payables c. Other Current Liabilities d. Short-Term Provisions			
Total			
II. Assets **1. Non-Current Assets** a. Fixed Assets i. Tangible Assets ii. Intangible Assets iii. Capital Work-in-Progress iv. Intangible Assets under Development b. Non-Current Investments c. Deferred Tax Assets d. Long-Term Loans and Advances e. Other Non-Current Assets **2. Current Assets** a. Current Investments b. Inventories c. Trade Receivables d. Cash and Cash Equivalents e. Short-Term Loans and Advances f. Other Current Assets			
Total			

- **Cash Flow Statement**

  It refers to a statement that records inflows and outflows of cash and cash equivalents during a particular period.

- **Statement of Changes in Equity**

  It provides the details of the change in owners' equity over an accounting period. Statement of changes in Equity includes few of the following items such as Net profit or loss, change in share capital reserves, dividend payments to shareholders, change in accounting policies, etc.

- **Notes to Accounts**

  It provides the details regarding the items mentioned in the Balance Sheet and Statement of Profit and Loss. Additional disclosures specified in the Accounting Standards are made by the way of notes to accounts or by the way of additional statement unless required to be disclosed on the face of the Financial Statements.

- **Importance/Advantages of Financial Statements**
  - ***Provides Information***- Financial statements provide information to various accounting users both internal as well as external users.
  - ***Cash Flow***- Financial statements provide information about the cash flows of the company. The financial statements help the creditors and other investors in determining solvency of company.
  - ***Effectiveness of Management***- The comparability feature of the financial statements enables management to undertake comparisons- inter-firm and intra-firm comparisons. This not only helps in assessing the viability and performance of the business but also helps in designing policies and drafting policies, thereby enhances the effectiveness and efficacy of the management.
  - ***Disclosure of Accounting Policies***- Financial Statements disclose vital information regarding various policies, important changes in the methods, practices and process of accounting by the company, which makes it simpler, true and comprehend without any ambiguity.
  - ***Policy Formation by Government***- Financial Statements provide various information to the government to determine national income, GDP, industrial growth, etc and also to formulate various policy measures to address economic problems such as, employment, poverty, etc.

- ***Attracts Investors and Potential Investors***- The financial statements attract investors by enabling them to assess the viability and prospectus of their investment in the company.

❖ **Limitations/Disadvantages of Financial Statements**

- ***Historical Data***- As the items recorded in the Financial Statements reflect their original cost and the current market price, so the financial statements fail to capture the inflation effects.
- ***Ignorance of Qualitative Aspect***- Financial Statements does not reveal the qualitative aspects such as, colour, size, employees' capabilities and market position.
- ***Biased***- Financial statements are based on the personal judgments the concerned accountants and clerks regarding the use of methods of recording.
- ***Inter- firm Comparisons***- Usually, it is difficult to compare the financial statements of two companies because of the difference in the methods and practices followed by their respective accountants.
- ***Window dressing***- The possibility of window dressing is probable. This might be because of the motive of the company to overstate or understate the assets and liabilities to attract more investors. A recent example of this practice can be traced to the case of Satyam Industries.
- ***Difficulty in Forecasting***- Since the Financial Statements fail to reflect the effect of inflation, so forecasting and policy designing is difficult on the basis of the historical cost.