



### **What are Financial Statements?**

Financial Statements are the annual reports responsible for revealing the financial position of a company for better decision-making process and management. They are the end part of the accounting process and show the results of a particularly specified time.

### **Nature of Financial Statements**

- Financial Statements consist of recorded data based on facts and figures alone.
- Various Accounting Conventions are followed in making of the financial statements.
- They are based on assumptions known as postulates
- There are various occasions of intervention of personal judgement in making of financial statements.

### **Objectives of Financial Statements**

- To provide information about economic resources and obligations of a business.
- To provide information about the earning capacity of the business
- To provide information about cash flows
- To judge effectiveness of management
- Information about activities of business affecting the society
- Disclosing accounting policies

### **Types of Financial Statements**

There are generally two types of financial statements

- Balance Sheet
- Statement of Profit and Loss

### **Shareholder's Fund**

They are classified into three sub-sections:

- **Share Capital-** Disclosures relating to share capital are to be given in notes to accounts.
- **Reserve and Surplus- They are classified as:**
  - (i) Capital Reserve
  - (ii) Capital Redemption Reserve
  - (iii) Securities Premium Reserve
  - (iv) Debenture Redemption Reserve
  - (v) Revaluation Reserve
  - (vi) Share Options Outstanding Account
  - (vii) Other Reserves (Specifying nature and purpose)
  - (viii) Surplus: Balance in statement of profit and loss; disclosing allocations and Appropriation such as dividend, bonus shares, transfer to/from reserve, etc.
- **Money Received against Share Warrants-** It is the amount received by the company which are converted into shares at a specified date on a specified rate. The instrument issued against the amount so received as share warrants. It is disclosed as a separate line item under 'shareholder's fund'.

**Current/Non-current Classification-** They are classified into following items:

- Current Assets
- Current Liabilities
- Non-current Assets
- Non-current Liabilities

The classification is done on the basis that non-current assets and liabilities are residual items

### **Current/Non-current Distinction**

An item will fall under current assets or liabilities if:

- if it is involved in entity's operating cycle

- is expected to be realised/settled within twelve months or
- if it is held primarily for trading or
- is cash and cash equivalent or
- if entity does not have on unconditional rights to defer settlement of liability for atleast 12 months after the reporting period

All the other assets and liabilities that do not fall under these guidelines are non-current assets and liabilities

**Share Application Money Pending Allotment-** If it exceeds the said limit or is non-refundable to a larger extent, it will be classified as non-current.

- **Borrowings-** They are categorised into long-term borrowings (Loans which are repayable in more than twelve months) , short-term borrowings (Loans repayable on demand or whose original tenure is not more than twelve months) , and current maturities (amount repayable within twelve months/operating cycle under other current liabilities with Note to Account) .
- **Deferred Tax assets/liabilities-** They are always non-current
- **Trade Payables-** Sundry creditors have been replaced with the term Trade payables and are classified as current and non-current.
- **Proposed Dividend-** Proposed dividend is proposed by the Board of Directors and declared (approved) by the shareholders in their Annual General Meeting. Proposed dividend is shown as contingent liability.
- **Provisions-** The amount of provision settled within 12 months from balance sheet date is classified as short term provisions and shown under current liabilities.
- **Fixed Assets-** There is no change in the treatment of fixed assets. Both tangible and intangible assets are non-current.
- **Investments-** Investments expected to realise within twelve months are considered as current. Others are classified as non-current investments.
- **Inventories-** All inventories are always treated as current.
- **Trade Receivables-** Trade receivables realised beyond twelve months from reporting date are classified as "Other non-current assets.
- **Cash and cash equivalent-** It is always current however, amounts which qualify as cash and cash equivalents.

#### Items of Statement of Profit and Loss

- **Revenue from operations-** Sale of products, Sale of services, Other operating revenues
- **Other income-** Interest income (in case of a company other than a finance company), Dividend income, Net gain/loss on sale of investments, Other non-operating income (net of expenses directly attributable to such income).
- **Expense**

#### Uses and Importance of Financial Statements

- Financial statements report the performance of the management to the shareholders.
- The financial statements provide basic input for industrial, taxation and other economic policies of the government.
- Financial statements form the basis for granting of credit.
- They help the investors to assess long-term and short-term solvency as well as the profitability of the concern.
- They provide information to the shareholders in taking such important decisions.
- Trade associations may analyse the financial statements for the purpose of providing service and protection to their members.
- Financial statements help the stock exchanges to understand the extent of transparency in reporting on financial performance and enables them to call for required information to protect the interest of investors.

#### Limitations of Financial Statements

- Do not reflect current situation
- Assets may not realise

- Bias may be observed in the results, and the financial position depicted in financial statements may not be realistic
- Financial statements show aggregate information but not detailed information.
- Vital information missing
- No qualitative information
- They are only interim reports

