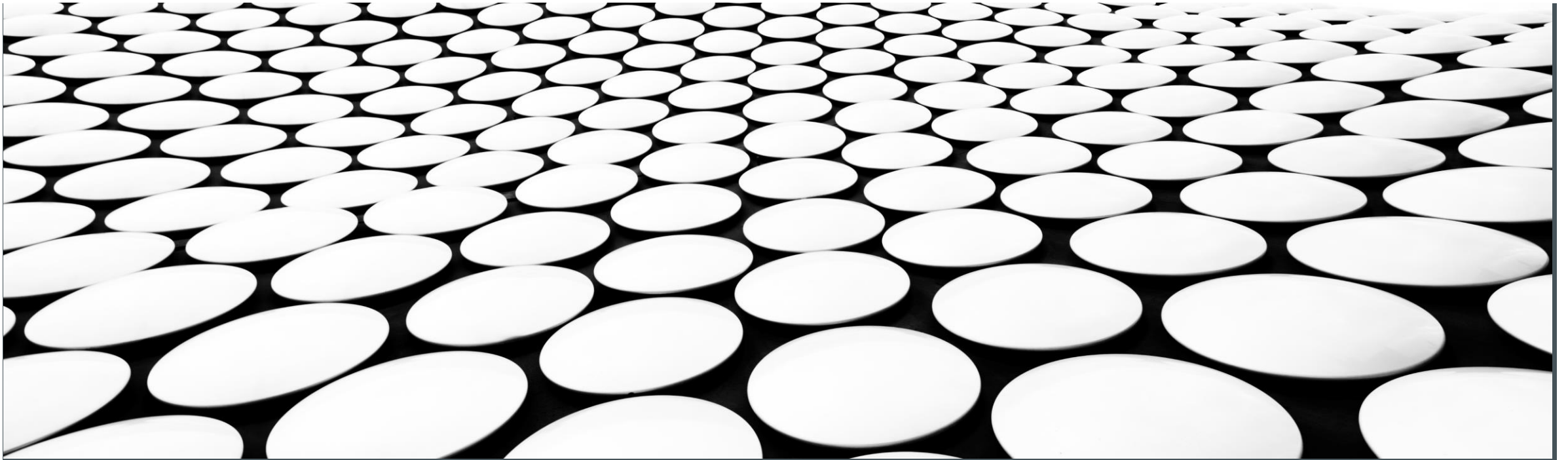


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# **FUNDAMENTALS OF ACCOUNTING – MODULE III**

## **FINANCIAL STATEMENTS**

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# **Financial Statements**

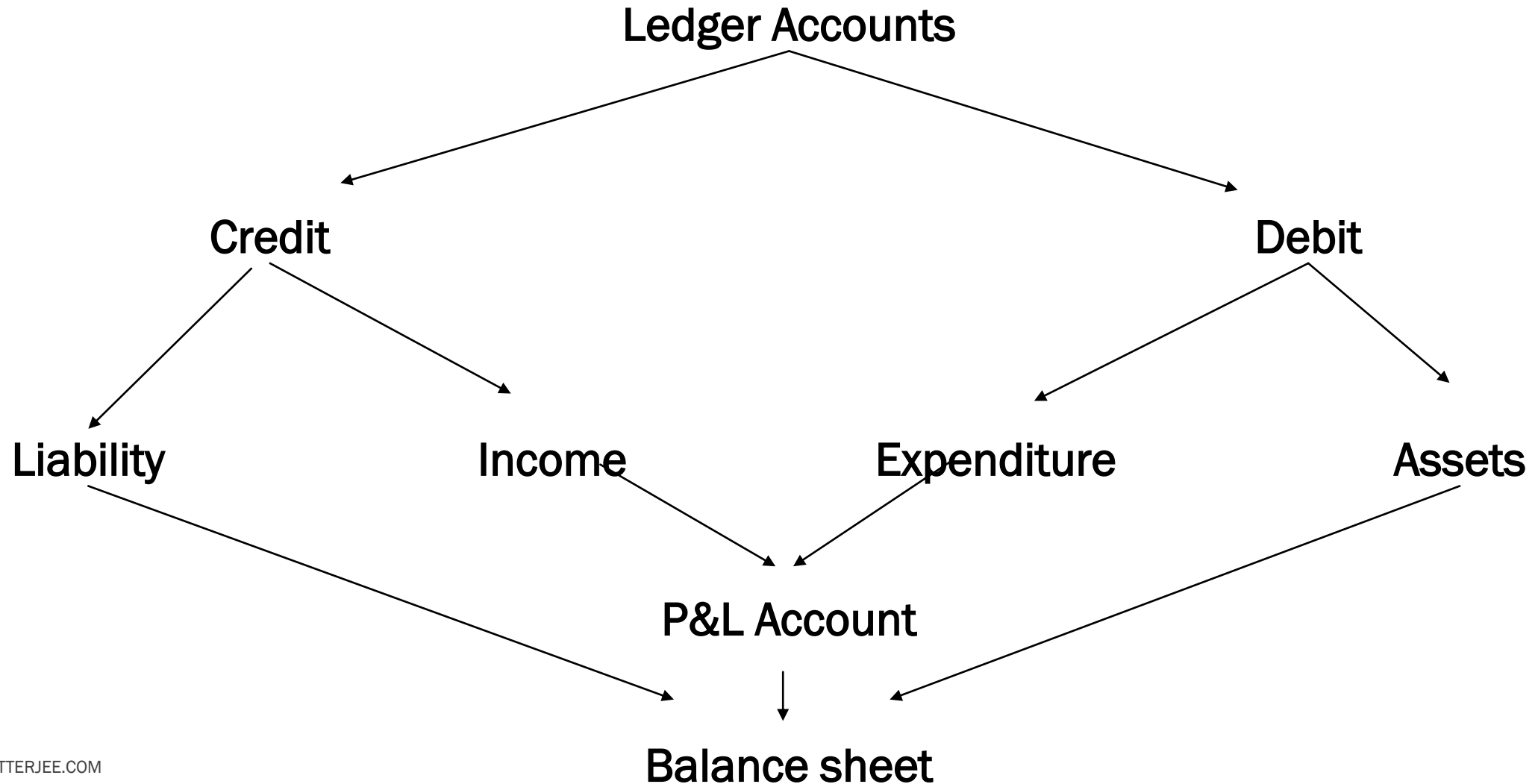
# FINANCIAL STATEMENTS

- Financial Statements are Summary-level reports about an organization's financial results, financial position and cash flows. Useful for:
  - Determining the ability of a business to generate cash, and the sources and uses of that cash.
  - Determining whether a business has the capability to pay back its debts.
  - Tracking financial results on a trend line to spot any profitability issues.
  - Investigating the details of certain business transactions.

# CONTENTS OF FINANCIAL STATEMENTS

- **Balance Sheet** : Shows the entity's assets, liabilities, and shareholders' equity as of the report date.
- **Income Statement** : Shows the results of the entity's operations and financial activities for the reporting period. It includes revenues, expenses, gains, and losses.
- **Statement of Cash Flows** : Shows changes in the entity's cash flows during the reporting period.
- **Supplementary Notes** : Includes explanations of various activities, additional detail on some accounts, and other items as mandated by the applicable accounting framework worldwide

# Structure of Accounting



# PROFIT & LOSS ACCOUNT

- Financial statement that summarizes the revenues, costs, and expenses incurred during a specified period, usually a year or even Quarterly (for Stock Exchange Listed Companies).
- This Statement provide information about a company's ability or inability to generate profit by increasing revenue, reducing costs, or both.
- P&L Management refers to how a company handles its Profit or Loss through revenue and cost management, by taking suitable decisions.

# Types of Profit & Loss Statements

## Cash method

This method is used when cash goes in and out of the business. This is a very simple method that only accounts for cash received or paid. A business records transactions as revenue whenever cash is received and as liabilities whenever cash is used to pay any bills or liabilities. This method is commonly used by smaller companies as well as people who want to manage their personal finances.

## Accrual method

The accrual accounting method records revenue as it is earned. This means that a company using the accrual method accounts for money that it expected to be received in the future. For instance, a company that delivers a product or service to its customer records the revenue on its P&L statement, even though it hasn't yet received payment. Similarly, liabilities are accounted for even when the company hasn't yet paid for any expenses .



## FORMAT OF P&L A/C

| Profit and Loss account for the year ended |                    |                             |        |
|--|--------------------|-----------------------------|--------|
| Dr   | For the year ended |                             | Cr     |
| Particulars                                | Amount             | Particulars                 | Amount |
| To Gross loss b/d                          | xxx                | To Gross Profit             | xxx    |
| To salaries                                | xxx                | To Discount received        | xxx    |
| To office rent, rates & taxes              | xxx                | By commission received      | xxx    |
| To Printing & stationery                   | xxx                | By commission received      | xxx    |
| To advertisements                          | xxx                | By bank interest            | xxx    |
| To Postage and Telegram                    | xxx                | By Rent received            | xxx    |
| To Telephone and Internet                  | xxx                | By dividend on shares       | xxx    |
| To Electriciy and Charges                  | xxx                | By Profit on sale of assets | xxx    |
| To carriage outward                        | xxx                | By net loss                 | xxx    |
| To bad debt                                | xxx                |                             |        |
| To Depreciation                            | xxx                |                             |        |
| To Insurance                               | xxx                |                             |        |
| To Net loss                                | xxx                |                             |        |
|  | xxx                |                             | xxx    |

## FORMAT OF P&L A/C

| <b>Profit and Loss Statement for the year ended</b> |               |
|---|---------------|
| <b>Particulars</b>                                  | <b>Amount</b> |
| <b>I) Revenue From Operation</b>                    | XX            |
| <b>II) Other Income</b>                             | XX            |
| <b>III) Total Revenue (I+II)</b>                    | <b>XXX</b>    |
| <b>IV) Expenses</b>                                 |               |
| <i>Cost of Material</i>                             | XX            |
| <i>Changes in Inventory</i>                         | XX            |
| <i>Employee Benefit Expenses</i>                    | XX            |
| <i>Operating Expenses</i>                           | XX            |
| <i>Finance Cost</i>                                 | XX            |
| <i>Depreciation and Ammortization</i>               | XX            |
| <i>Other Expenses</i>                               | XX            |
| <b>Total Expenses</b>                               | <b>XXX</b>    |
| <b>V) Profit Before Tax (PBT) (III-IV)</b>          | <b>XXX</b>    |
| <b>VI) Tax</b>                                      | (XX)          |
| <b>VII) Profit After Tax</b>                        | <b>XXX</b>    |

# BALANCE SHEET

- A balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity at a specific point in time and provides a basis for computing rates of return and evaluating its capital structure.
- It is a financial statement that provides a snapshot of what a company owns and owes, as well as the amount invested by shareholders.

## FORMAT OF BALANCE SHEET

| Balance sheet as at        |        |                       |        |
|----------------------------|--------|-----------------------|--------|
| Liabilities                | Amount | Assets                | Amount |
| <b>Capital</b>             | xxx    | <b>Fixed Assets</b>   | xxx    |
| Opening Balance            | xxx    | Land                  | xxx    |
| Add: Net Profit            | xxx    | Plant & Machinery     | xxx    |
| (Less): Net Loss           | xxx    | Investments           | xxx    |
| (Less): Net Drawings       | xxx    |                       |        |
| Long term borrowings       | xxx    | <b>Current Assets</b> | xxx    |
| Loan                       | xxx    | Accrued Income        | xxx    |
|                            |        | Prepaid expenses      | xxx    |
| <b>Current Liabilities</b> | xxx    | Sundry Debtors        | xxx    |
| Income received in advance | xxx    | Bills Receivables     | xxx    |
| Subndry Creditors          | xxx    | Closing Stock         | xxx    |
| Outstanding expenses       | xxx    | Cash at bank          | xxx    |
| Bills Payables             | xxx    | Cash in Hand          | xxx    |
| Bank OD                    | xxx    |                       |        |
|                            | xxx    |                       | xxx    |

# FORMAT OF BALANCE SHEET

| Balance Sheet as at.....        |        |        |
|---------------------------------|--------|--------|
| Particulars                     | Amount | Amount |
| <b>Equity &amp; Liabilities</b> |        |        |
| <b>Shareholders Funds</b>       |        |        |
| Share Capital                   | xx     |        |
| Reserve and Surplus             | xx     | XX     |
| <b>Non-Current Liabilites</b>   |        |        |
| Long Term Borrowings            | xx     |        |
| Deffered Tax Liabilities        | xx     |        |
| Long Term Provisions            | xx     | XX     |
| <b>Current Liabilities</b>      |        |        |
| Short Term Borrowings           | xx     |        |
| Trade Payables                  | xx     |        |
| Other Current Liabilities       | xx     |        |
| Short Term Provisions           | xx     | XX     |
| <b>Total</b>                    |        | XXX    |
| <b>Assets</b>                   |        |        |
| <b>Non-Current Assets</b>       |        |        |
| Fixed Assets                    | xx     |        |
| <i>i)Tangible Assets</i>        | x      |        |
| <i>ii)Intangible Assets</i>     | x      |        |
| Non-Current Investments         | xx     |        |
| Long-term Loans and advances    | xx     | XX     |
| <b>Current Assets</b>           |        |        |
| Current Investments             | xx     |        |
| Short Term loans and advances   | xx     |        |
| Inventories                     | xx     |        |
| Trade Receivables               | xx     |        |
| Cash in Hand                    | xx     |        |
| Cash at Bank                    | xx     | XX     |
| <b>Total</b>                    |        | XXX    |

# CASH FLOW STATEMENT

- Cash Flow Statement summarizes the amount of cash and cash equivalents entering and leaving a company during a particular period
- The cash flow statement (CFS) measures how well a company generates cash to pay its debt obligations and fund its operating expenses.

## FORMAT OF CASH FLOW INDIRECT METHOD

| Cash Flow Statement                            |        |            |   |  |  |
|--|--------|------------|---|--|--|
| Particulars                                    | Amount | Amount     |   |  |  |
| <b>Operating Expenses</b>                      |        |            | <b>Cash Flow from investing activities</b>                  |  |  |
| Net income                                     |        | xxx        | <i>Add:</i>   |  |  |
| <i>Add:</i>                                    |        |            | Sale of fixed Assets or investments                         |  |  |
| <b>Non-Cash and Non-operating Expenses</b>     |        |            | Interest/Dividend/Rent Received                             |  |  |
| Depreciation                                   | xx     |            | Less: Purchase of Fixed Assets                              |  |  |
| Goodwill                                       | xx     |            | Purchase of Long Term Investments                           |  |  |
| Interest Paid                                  | xx     |            | <b>Net Cash Flow From investing Activities</b>              |  |  |
| Loss on Sale of Fixed assets                   | xx     |            |   |  |  |
| Less:  |        |            |   |  |  |
| <b>Non-operating incomes</b>                   |        |            | <b>Cash Flow form financing Activities</b>                  |  |  |
| Dividend Received                              | (xx)   |            | <i>Add:</i>   |  |  |
| Profit on Sale of fixed assets                 | (xx)   |            | Issue of shares   |  |  |
| Interest Received                              | (xx)   |            | Issues of debentures and long term borrowings               |  |  |
| <b>Operating Profit</b>                        |        |            | <i>Less:</i>  |  |  |
| Add: Decrease in Current Assets                | xx     |            | Repayment of long term debentures                           |  |  |
| Increase in current liabilities                | xx     |            | Redemption of preference share                              |  |  |
| Less: Increase in current assets               | (xx)   |            | Interest Paid   |  |  |
| Decrease in current liabilities                | (xx)   |            | Dividend  |  |  |
| Cash Generated from operating activities       | xx     |            | Net cash flow from financing activities                     |  |  |
| Less: Income Tax paid                          | (xx)   |            | <b>Net increase or decrease in Cash and Cash equivalent</b> |  |  |
| <b>Net Cash Flow From Operating activities</b> |        | <b>xxx</b> | Add: cash at the begining                                   |  |  |
|  |        |            | <b>Cash at the end</b>                                      |  |  |

# COMPUTERIZATION OF ACCOUNTS

- Like all functions which are being automated now, Accounting is also automated through Computerization & Specific Accounting Software.
- Computerized Accounting System is Accounting Information System which processes financial transactions and events as per Generally Accepted Accounting Principles (which we saw earlier) to produce Reports as per User Requirement.
- Based on the size of organization, there may be „Single User“ software or there may be a „Server having Software“ with number of users.
- “Tally” and “Focus” are most widely used Software's in India.



# ADVANTAGES OF COMPUTERISED ACCOUNTING SYSTEM

- 1. **Speed:** Accounting data is processed faster by using a computerised accounting system than it is achieved through manual efforts. This is because computers require far less time than human beings in performing a task.
- 2. **Accuracy:** The possibility of error is eliminated in a computerised accounting system because the primary accounting data is entered once for all the subsequent usage and processes in preparing the accounting reports. Normally, accounting errors in a manual accounting system occur because of repeated posting of same set of original data by several times while preparing different types of accounting reports.
- 3. **Reliability:** The computer system is well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. As a result, computers are highly reliable compared to human beings. Since computerised accounting system relies heavily on computers, they are relatively more reliable than manual accounting systems.
- 4. **Up-to-Date Information:** The accounting records, in a computerised accounting system are updated automatically as and when accounting data is entered and stored. Therefore, latest information pertaining to accounts get reflected when accounting reports are produced and printed. **Real Time User Interface:** Most of the automated accounting systems are inter-linked through a network of computers. This facilitates the availability of information to various users at the same time on a real time basis (that is spontaneously).

# ADVANTAGES OF COMPUTERISED ACCOUNTING SYSTEM

- **5. Automated Document Production:** Most of the computerised accounting systems have standardised, user defined format of accounting reports that are generated automatically. The accounting reports such as Cash book, Trial balance, Statement of accounts are obtained just by click of a mouse in a computerised accounting environment.
- **6. Scalability:** In a computerised accounting system, the requirement of additional manpower is confined to data entry operators for storing additional vouchers. The additional cost of processing additional transactions is almost negligible. As a result the computerised accounting systems are highly scalable.
- **7. Legibility:** The data displayed on computer monitor is legible. This is because the characters (alphabets, numerals, etc.) are type written using standard fonts. This helps in avoiding errors caused by untidy written figures in a manual accounting system.
- **8. Efficiency:** The computer based accounting systems ensure better use of resources and time. This brings about efficiency in generating decisions, useful information and reports.  **Quality Reports:** The inbuilt checks and untouchable features of data handling facilitate hygienic and true accounting reports that are highly objective and can be relied upon.
- **9. MIS Reports:** The computerised accounting system facilitates the real time production of management information reports, which will help management to monitor and control the business effectively. Debtors' analysis would indicate the possibilities of defaults (or bad debts) and also concentration of debt and its impact on the balance sheet.

# LIMITATIONS OF COMPUTERISED ACCOUNTING SYSTEM

- 1. Cost of Training:** The sophisticated computerised accounting packages generally require specialised staff personnel. As a result, a huge training costs are incurred to understand the use of hardware and software on a continuous basis because newer types of hardware and software are acquired to ensure efficient and effective use of computerised accounting systems.
- 2. Staff Opposition:** Whenever the accounting system is computerised, there is a significant degree of resistance from the existing accounting staff, partly because of the fear that they shall be made redundant and largely because of the perception that they shall be less important to the organisation.
- 3. Disruption:** The accounting processes suffer a significant loss of work time when an organisation switches over to the computerised accounting system. This is due to changes in the working environment that requires accounting staff to adapt to new systems and procedures.
- 4. System Failure:** The danger of the system crashing due to hardware failures and the subsequent loss of work is a serious limitation of computerised accounting system. However, providing for back-up arrangements can obviate this limitation. Software damage and failure may occur due to attacks by viruses.

# LIMITATIONS OF COMPUTERISED ACCOUNTING SYSTEM

- 5. Inability to Check Unanticipated Errors:** Since the computers lack capability to judge, they cannot detect unanticipated errors as human beings commit. This is because the software to detect and check errors is a set of programmes for known and anticipated errors.
- 6. Breaches of Security:** Computer related crimes are difficult to detect as any alteration of data may go unnoticed. The alteration of records in a manual accounting system is easily detected by first sight. Fraud and embezzlement are usually committed on a computerised accounting system by alteration of data or programmes. Hacking of passwords or user rights may change the accounting records.
- 7. Ill-effects on Health:** The extensive use of computers systems may lead to development of various health problems: bad backs, eyestrain, muscular pains, etc. This affects adversely the working efficiency of accounting staff on one hand and increased medical expenditure on such staff on the other.



**THANK YOU!**