ANALYSIS OF FINANCIAL STATEMENTS

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LEGAL POSITION REGARDING FINANCIAL STATEMENTS

Format: for banking Cos. the format for Balance Sheet and P/L account are prescribed by BR Act.

In case of other Cos., the format for B/S is prescribed by the Companies Act but for the P/L account the format is not prescribed. But the companies act requires P/L account to show the specific information as per Schedule IV.

The balance sheet can be drawn in Horizontal or Vertical format as under:

Horizontal form

Liabilties	Amount (Rs)	Assets	Amount (Rs)
Share capital 500000		Fixed assets	
(-) Net loss 22625		Machinery	74375
(-) Drawings 11000	466375	Investments	
Long-term liabilities		Bank fixed deposit	15000
loan from bank	200000	Current assets, loans and advances	
		Cash	400000
		Bank	177000
	666375		**666375**

Vertical form

Particulars	Schedule	Amount (Rs)
Sources of Funds		
Shareholder's funds		
Share capital	1	489000
Reserves and surplus	2	(22625)
Loan funds		
Secured loans	3	200000
Total		**666375**
Application of Funds		
Fixed assets		
Gross block	4	75000
(-) depreciation		625
Net block		74375
Investments	5	15000
Current assets, loans & advances		
Cash & bank balance	6	577000
(-) current liabilities and provisions		-
Net current assets		577000
Total		**666375**

Accounting Period: as per the IT rules, April-March is considered as a financial year for the tax purpose.

But as of companies act it can be different but restriction of the maximum duration of the financial year can be 15 months and can be extended up to 18 months with the permission of the ROC.

Every company has to prepare the financial statements even if there is no activity during the accounting period or the project is not completed.

BALANCE SHEET

- It is statement of the assets and liabilities.
- It measures the financial position of the entity as on a certain date.
- It tells about what an entity **owns** and what it **owes.**

LIABILITIES	Rs.	ASSETS	Rs.
• Share Capital Partners' capital Paid-up Capital / Owners funds • Reserves (General Reserve, Capital Reserve, Revaluation Reserve and Other Reserves) These funds are brought in by the promoters as their investment in business or generated by and retained in business) **LONG TERM LIABILITIES** • Term Loan (Banks or		FIXED ASSETS (Such as Land and Building, Plant Machinery etc.) • Original value • Less depreciation • Net value or book value or written down value (These are purchased for long term use and are depreciated every year) **NON-CURRENT ASSETS** • Investment in non-quoted	

Institutions) Debentures / Bonds • Unsecured Loans • Fixed Deposits • Other Long-Term Liabilities (Only those liabilities to be taken which are not due for payment within 12 months from date of the balance sheet) **CURRENT LIABILITIES** • Bank Working Capital limits such as Cash Credit, Overdraft, bills, export credit. • Sundry Creditors, Bills payable • Short duration loans or deposits Expenses payable • Provisions against various items (Only those liabilities to be taken which are due for payment within 12 months		shares/ securities • Investments in Long term nature In associate or firms or companies, • Old stocks are old disputed book debts Long term security deposits. • Other misc. assets which are not current or fixed assets **CURRENT ASSETS** • Cash/Bank balance including fixed deposits with banks • Marketable/ other securities/ quoted govt. or • Book debts / Sundry debtors / debtors/ bills receivables • Stocks / Inventory such as raw material, stock in process, finished goods • Stores & spares meant for regular consumption • Advance payment of taxes, pre-paid expenses	

from date of the balance sheet)		• Loan & Advances recoverable within 12 months. **INTANGIBLE ASSETS:** Patents, Goodwill, Debit balance of P&L account, Preliminary or preoperative expenses	
Total		TOTAL	

LIABILITIES

Shared capital

- Divided into **equity capital and preference shares.**
- Equity capital represents the contribution of equity shareholders who are owners of the firm and no dividend is to be paid at the fixed rate.
- But for the preference capital, dividend rate may be fixed and cumulative.

Reserves and surplus

- **2 type of reserves: revenue reserves and capital reserves**
- **Revenue reserves** represent the accumulated and retained earnings from the profits of normal business operations. E.g.

general reserves, investment allowance reserves, dividend equalization reserves etc.

- **Capital reserves** arise out if gains which are ***not related to the normal business operations.*** E.g. revaluation reserves etc.
- Surplus is the balance in the P/L account which has not been appropriated to any particular reserve.

Secured loans – borrowings of the firm against which specific securities have been provided. E.g. debentures, loans against mortgage etc.

Unsecured loans – no specific security is provided for the firm's borrowings. E.g. loans from promoters, inter firm loans/ unsecured loans from the banks/ FIs etc.

Current liabilities and provisions - The current liabilities are the liabilities the **repayment of which is to be made within 12 months of date of balance sheet**. E.g. goods/ services bought on credit, accrued expenses, unclaimed dividends, provisions of taxes, advance payments received for goods and services, sundry creditors, bills payables, statutory liabilities etc.

ASSETS

Assets are the properties owned by a business and are acquired to use them for generation of income through operations.

Fixed Assets

- These are the assets which are of relatively permanent nature and they are not meant for sale.
- Land, building, plant and machinery, office furniture, computer system etc.

Investments

- These are financial securities owned by the firm.
- It may also be investment of the firm in the subsidiaries, associates etc.
- All non-quoted investments ate Non-current assets and quoted ones are current assets.

Current Assets

- Asset which evolve themselves in maximum 12 months of the time and are held for day to day operations of the entity.
- They are held temporarily for subsequent conversion into cash maximum within a period of 12 months.
- The financing of current assets is partly be from the long-term funds and partly, the current liabilities.
- E.g. cash/ bank balances, account receivables, sundry debtors, stock/ inventory, quoted investments, tradable Govt securities, prepaid expenses, advances for purchase of raw materials etc.

Intangible Assets

- Assets which do not have the physical presence.
- E.g. goodwill, patents, copyright, preliminary expenses, loss incurred by the entity etc.

PROFIT AND LOSS ACCOUNT

It is a statement of income and expenditure of an entity for the accounting period.

1. Gross and Net Sales

- **Gross Sales**: The total revenue a company earns from selling goods or services before any deductions.
- **Net Sales**: Gross sales minus excise duty or any other deductions.

Example:

- A company sells 1,000 mobile phones for ₹10,000 each.
- Total revenue = 1,000 × ₹10,000 = ₹1,00,00,000 (₹1 crore) → **Gross Sales**
- Excise duty = ₹5,00,000
- **Net Sales = ₹1,00,00,000 - ₹5,00,000 = ₹95,00,000**

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2. Cost of Goods Sold (COGS)

- The total cost incurred in manufacturing or purchasing goods that are sold during the year.
- Includes **raw material cost, labor cost, and factory expenses**.
- **Different from Cost of Production**, which includes the cost of goods that are produced (not necessarily sold).

Example: A furniture company:

- Raw materials (wood, paint) = ₹2,00,000
- Labour cost = ₹1,00,000
- Factory expenses = ₹50,000
- **Total COGS = ₹3,50,000**

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3. Gross Profit

- The profit a business makes **before deducting operating expenses**.
- **Formula**:

  Gross Profit = Net Sales – Cost of Goods Sold

Example:

- **Net Sales = ₹10,00,000**
- **COGS = ₹6,00,000**
- **Gross Profit = ₹10,00,000 - ₹6,00,000 = ₹4,00,000**

4. Operating Expenses

- Expenses that a business incurs to run daily operations.
- Includes:

- Administrative expenses (Office rent, salaries)
- Selling & distribution expenses (Advertising, delivery charges)
- Depreciation (Wear and tear of machinery)

Example: If a company has:

- Rent = ₹50,000
- Advertising = ₹30,000
- Depreciation on machinery = ₹20,000

  Total Operating Expenses = ₹1,00,000

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5. Operating Profit

- The profit earned **after deducting operating expenses** from gross profit.
- **Formula**:

  Operating Profit = Gross Profit - Operating Expenses

Example:

- **Gross Profit = ₹4,00,000**
- **Operating Expenses = ₹1,00,000**
- **Operating Profit = ₹4,00,000 - ₹1,00,000 = ₹3,00,000**

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6. Non-Operating Surplus

- Profits from **other than core business activities**.
- Example: Interest on investments, selling old machinery.

Example:

- A company **sells an old machine** and gains ₹50,000.
- Interest earned on investments = ₹20,000
- **Total Non-Operating Surplus = ₹70,000**
- **Non-Operating Deficit**: Losses from activities outside the core business, like loss on asset sale.

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7. Profit Before Interest and Taxes (EBIT)

- The sum of **Operating Profit + Non-Operating Surplus/Deficit**.
- Also called **Earnings Before Interest and Taxes (EBIT).**

Example:

- **Operating Profit = ₹3,00,000**
- **Non-Operating Surplus = ₹70,000**
- **EBIT = ₹3,00,000 + ₹70,000 = ₹3,70,000**

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8. Interest

- Interest paid on borrowed funds such as loans, debentures, or working capital.

Example: If a company has a **loan of ₹10,00,000** at **10% annual interest**,

- Interest to be paid = ₹1,00,000

9. Profit Before Tax (PBT)

- EBIT minus interest.
- **Formula**:

  PBT = EBIT - Interest

Example:

- **EBIT = ₹3,70,000**
- **Interest = ₹1,00,000**
- **PBT = ₹3,70,000 - ₹1,00,000 = ₹2,70,000**

10. Tax

- The income tax that the company pays on its profit.

Example:

- If **Tax Rate = 30%**,
- **Tax = 30% of ₹2,70,000 = ₹81,000**

11. Profit After Tax (PAT)

- The final profit after paying taxes.
- **Formula**:

  PAT = PBT - Tax

Example:

- **PBT = ₹2,70,000**
- **Tax = ₹81,000**
- **PAT = ₹2,70,000 - ₹81,000 = ₹1,89,000**

Conclusion

- **Gross Sales** = Total Revenue
- **Net Sales** = Gross Sales - Excise Duty
- **Gross Profit** = Net Sales - COGS
- **Operating Profit** = Gross Profit - Operating Expenses
- **EBIT (PBIT)** = Operating Profit + Non-Operating Surplus
- **Profit Before Tax** = EBIT - Interest
- **Profit After Tax** = PBT - Tax