INTRODUCTION ON FINANCIAL REPORTS-ITS NEED AND IMPORTANCE

Accounting system – a source of financial information

A guide post to management

It gives the financial implications of its operations

Accounting may be defined –is a process of identifying, measuring and communicating economic information to its users.

The accounting information is needed for the following purposes:

1. To Make decisions -Management
2. To control manpower and material resources-Employment/Raw material
3. To report on the custodianship of resources-Managers
4. To facilitate social functions and controls-Customers, employees, Government, investors

To provide information accounting has to perform three functions

a. Accumulation of information -Recording of information measurement of information
b. Analysis of economic events-estimating in some cases
c. Communication of information -Periodically communicating the users

Users of Accounting information:

1. Owners
2. Managers
3. Creditors
4. Potential investors
5. Employees/trade unions
6. Customers
7. Government

FINANCIAL STATEMENTS

1. Two Major financial statements are
2. Balance Sheet
3. Profit&Loss a/c/ Income&Expenditure a/c/Receipts &Payments a/c
4. The annual report includes theChairmans speech/Report, Auditors report /Accounting policies etc.,

The OBJECTIVES of Financial reports are-

To provide reliable financial information

To provide information about changes in net resources

To estimate the earning potential of the enterprise

To inform changes in economic resources and obligations

Other information's needed to users

REPORTS ON BALANCE SHEET &PROFIT AND LOSS ACCOUNT

BALANCE SHEET

This reveals the –Assets and Liabilities of the organization on any particular date.

ASSETS

Assets are classified as

Fixed Assets,-Long term assets- Tangible /Intangible (Goodwill, Copyright)

Investments-Long term investments in shares, debentures, bonds etc.,

Loans and Advances,-Longterm/shortterm loans & advances for capital goods

Current assets & : Called as liquid assets-Inventory such as raw material, work-in progress, finished goods, cash, bank balance, debtors, deposits .

: Prepaid expense, bills receivables, marketable securities etc.

Non current assets. : Preliminary expenses, deferred charges etc., are grouped under non current assets

LIABILITIES

Liabilities are debts payable in future to its creditors.

Examples are

1. Creditors for purchases/expenses/others,
2. Bills payable
3. Wages & salaries payable
4. Interest, Taxes, debentures, deposits, loans etc.

Capital =owners/Share holders fund

Owners funds are not as of creditors whom the payment is with in the agreed period. Capital repayment comes into effect only when the firm is liquidated.

Paid up share capital –Equity, Preference shares

Reserves & surplus-Retained earnings-earmarking for debenture redemption.

Long term Loans-Such as project loans from banks &other agencies-called fixed liabilities

Debentures,Bonds,Secured loans against mortgage of assets

Current Liabilities-

Creditors for –Purchase of materials

Creditors for-Expenses such as salary, Electricity etc.,

Creditors for others-TDS, PF etc.

Provisions

Provision for Bad debts

Provision for Depreciation

Provision for gratuity

Relationship between Assets and Liabilities& owners Equity

TL=TL+OE

Total Assets=Total Liabilities-Owners equity

Alternatively- Total assets-Total liabilities=owners equity

TA-TL=OE

NET WORTH =OE+FR&S OR TA-ITA-CL-LTL

NET WORKING CAPITAL=CA-CL

NET WORKING CAPITAL GAP= CA-CL (excluding Bank overdraft)

This current ratio position is needed for assessing the working capital requirement in an organization.

CAPITAL EMPLOYED

This represents the owners equity+ free reserves long term loansor

net fixed assets - net current assets or

net fixed assets + net working capital gap

FUNCTIONS OF BALANCE SHEET

1. It gives concise summary of the firms resources
2. It is a measure of the firms liquidity
3. It is a measure of the firms solvency
4. It is useful for investors lenders like banks

PROFIT &LOSS ACCOUT/INCOME &EXPENDITURE ACCOUNT/RECEIPTS &PAYMENTS ACCOUNT

The earning capacity and potential of a firm are reflected by its profit or loss account. It is the scoreboard of the Firms performance during a given period of time . This reveals the results of operation.

This statement reveals the summary of revenues, expenses and net income.

Nature of REVENUES:

1.By sale of products

2.By rendering services

3.By return on investments of firms funds

4.Sale of assets

REVENUE CAN BE CLASSIFIED AS **'OPERATING'** AND '**NON-OPERATING'**

Operating revenues are

1.Sale of products

2.Charges collected for service rendered

Non-Operating revenues are

1.Sale profit on assets

2.Interest on investments

3.Course fee

4.Std charges

METHOD OF ACCOUNTING-CASH OR ACCRUEL BASIS

Accrual /realization principle requires revenue to be recognized during the period when the sale is made or when the service is performed. This method of recognition is called the accrual concept.

Revenue can be recognized only when cash is received for the sale or service irrespective of when the sale is made or service is rendered.

NATURE OF EXPENSES

The Cost of earning revenue is called an expense.

Expired cost

Expired cost is nothing but the revenue expenses chargable to the p&L a/c.

Unexpired cost

This is the cost incurred in acquiring capital costs such as Instruments, Equipments, Building.,

Expense recognition principles are-

Cause & effect association-Raw materials of a specific product/service

Cost allocation –Depreciation-Irrespective of revenue on this

Recognition -Loss on fire, sale of securities etc.-To recognize immediately and close

Operating Expenses

Expense on main operation of the firm os operating expense

NON-operating Expense

Expense not directly connected with the main operation say production, service are non operating expenses.

1. Reportable points from the P&L a/c are
2. Gross profit
3. Operating profit
4. Non operating profit
5. Net profit

To arrive at the gross profit the cost goods sold/service rendered are to be arrived at.

The cost of goods sold is-

Op.Stock+purchases-clo.stock

+

Manufacturing expenses (salary, processing charges, electricity etc.)

Operating profit is-

Gross profit – (Operating expenses depreciation)

Net profit is-

Operating profit+nonoperating income –nonoperating expenses.

SUMMARY

Financial reporting is necessary for financial planning, analysis and decision making.

The Profit and loss statement and the Balance sheet are the basic instruments to communicate financial information to the users.

ARUM&Co.MADURAI

TRADING ACCOUNT

For the year ending 31.3.2005

EXPENDITURE			INCOME		
To Opening stock	1	10000	Sales –Direct	1800000	
To purchases	2	4000000	**-Credit**	**5000000**	4
To Packing forwarding	2a	300000		-----------	
To commission on sales	2b	80000		6800000	
			Less-Returns	20000	67**80000**5
			Closing stock	200000	6
To Gross Profit c/d	3	**2500000**			
		----------------		------------------	
		6980000		6980000	
		-----------------		-------------------	

PROFIT OR LOSS ACCOUNT

For the year ending 31.03.2002

EXPENDITURE			INCOME	
			By Gross profit B/d	2500000
To Periodicals		5000	By Miscellaneous income	5000
To R& M		60000		
To vehicles Maintenance		50000		
To Salary & wages		1500000		
To Electricity charges		200000		
To Postage&Telegram		5000		
To Telephones		15000		
To printing & stationery		7000		
To Rent		36000		
To Welfare expenses		3000		
To Entertainment expenses		1000		
To Miscellaneous expenses		15000		
Depreciation		50000		
NET PROFIT	7	**558000**		
		-----------		**-------------**
		2505000		2505000
		-----------		-------------

BALANCE SHEET AS AT 31.03.2002

LIABILITIES		ASSETS		
7a.Share capital	500000	18.**Fixed Assets**	1200000	
8. Reserves surplus	200000	19.less-depreciation 200000		1000000
9. Profit&loss a/c	558000	**Current Assets**		
10.SBI-LT Loan a/c	500000	20.Investments		600000
Sundry creditors		21.Stock in trade	200000	
11.Bank overdraft	200000	22.Deposits/ Advances	158000	
12. Deposits &advances	50000	23.Debtors/Receivables	200000	
13. Creditors for purchases	100000	24.Cash & Bank Balances	50000	
14. Creditors for expenses	50000	**Non current assets**		
Provisions		25.Goodwill	100000	
15. Prov. for gratuity	50000	26.Defrd.Rev.Expend.	50000	
16. Prov. For Bonus	100000			
17. Prov. For contingency	50000			
	---------------		-----------------	
	2358000	27	2358000	

POSTGRADUATE DIPLOMO IN HOSPITAL MANAGEMENT LAICO

DEPRECIATION, MEANING, METHODS &TREATMENT

Depreciation means a fall in the value of an Asset. (Except Land &Goodwill) ie.FIXED ASSETS

The main causes are:

1.Wear and tear -on use

2.Efflux of Time -Deterioration due to pass of time

3.Obsoloscence -Coming of new &improved models

4.Fall in market price-Not to keep a higher cost in the books

Depreciation is a non-cash charge in the income and expenditure account. Hence it is only an estimated charge which will become true at the end of its life period.

The need for Depreciation accounting are:

It is necessary to book depreciation as expenditure in the books to show the true and fair profit or loss of the concern.

To retain sufficient funds to replace the asset when it becomes useless or its life period is over.

In the case of current Assets –the portion of depreciation is the fall in value of current assets –on valuation of stock and the provision for bad debts in the case of Debtors.

FUNCTIONS OF DEPRECIATION

The objectives are

1.Stating the Assets in the Balance sheet at its proper valueie.Costless depreciation

2.Reporting correct profit or losses

3.To retain enough funds for the replacement of the Asset at the end of its commercial life.

To Calculate Depreciation the basic factors required are:

1.Cost of the Asset

2.The estimated scrap value of the asset at the end of its life period

3.The estimated years of its commercial life.-Example

METHODS OF DEPRECIATION

1.Straight line method/Fixed percentage method/fixed installment method

2.Written down value method/Reducing installment method

3.Sum of the years method

4.Annuity method

5.Depreciation fund method

6.Insurance policy method

7.Revaluation method

8.Depletion method

9.Machine hour rate method

1.Under straight line method the depreciation is calculated based on the following formulae.

Cost - Estimated scrap value/

Estimated life in years illustration

2.Written down value method-The formulae

Op.Asset value after depreciation x rate of depreciation illustration

3.Sums of the digits method:

Under this method the depreciation is worked out based on the following formulae.

No. of years of remaining life of the asset (including current year)

The total of all the digits representing the life of the asset illustration

4.Annuity method:

This method incorporates the interest portion of the investment on the Asset. The interest is calculated at the proper rate say 5% and debited to the Asset account. An annuity table giving rates of depreciation for the years and the rate of interest. This table is worked out taking the present 1 rupee earns at the rate of interest at the end of the year and according to the annuity table the annual depreciation is worked out and charged.

5.Depreciation fund method :

Under this method the appropriation or provision of annual depreciation as arrived at in the annuity method is kept invested in easily realizable and saleable securities so as to draw and acquire the new asset at the end of the life of the depreciated asset. To arrive at the current investment to get the required fund at the end of the life of the asset, Sinking fund table is prepared and the investable amount every year is arrived at.

6.Insurance policy method:

The annual depreciation amount is credited to the depreciation fund account. An equal amount is paid as insurance premium and debited to depreciation fund insurance a/c. At the close of the period the sum of policy amount received is credited to the insurance account and the balance is transferred to the depreciation fund account .The cost of the asset is debited to this account and any balance is taken to the Income & expenditure account.

7.Depletion method:

This method is normally used in accounts of Mines. Every year the mine is depleted due to extraction Of the ore. During the lifeof the mines ie. By which the mine is fully depleted there will be no mine as asset. To charge the los of mine deposits (depletion in asset value) the annual average rate of the cost of the mine is charged in the accounts as Depreciation. The reserve so made will be utilized to purchase another mine (asset) after its depletion.

8.Machine hour rate method:

In case of concerns where machine usage is primary, such as lath works the life of the machine is fixed on hours. The value of the machine will be divided per machine hour and this rate will be adopted to arrive at the depreciation by multiplying the hour rate to the hours run.

Consistency:

The consistency in the method of depreciation is to be adopted to show a true and fair view of the income or expenditure of the concern. Otherwise in the year where there is a change in the method of valuation adopted it should be revealed by a note in the annual accounts.

PROVISION ACCOUNTING-NEED & TREATMENT

PROVISION & RESERVE

Provision is a charge to the income &expenditure account against a future liability exact amount of which is not known.

Reserve is setting aside a definite sum in the Income & expenditure account which is a known liability and payable on a future date.

Method of Accounting: The question of making provision in accounts comes when the books are maintained **on 'accrual basis of accounting'** and not on cash basis.

PROVISION

Provisions are normally made for the following nature of transactions.

Provision for Bad debts.

Book debts and advances which are not recovered within a period of 3 years are time barred debts. In such cases legal action cannot be instituted against such defaulted debtors. Such items some times are recovered in the course of the business by mutual correspondence and continued business activity. In some cases debts which are considered to be doubtful of recovery have to be written off n the books as loss. Every year the long standing dues will be reviewed and the considered bad debts will be provided for in the Income & expenditure account as a PROVISION FOR BAD DEBTS. The amounts are since are not exactly known a percentage on the total debts is charged to the income and expenditure a/c as provision.

The recovery of such bad debts when accounted, the provision made to that extend will be reversed crediting the income &expenditure account in the year of recovery.

Provision for Depreciation:

The value of an asset is divided by its commercial life in terms of years and the per year value is debited to the Depreciation account which is a charge to the income &expenditure account. This is a provision to set aside funds to equate the depreciated portion of an asset so as to replace at the end of its life period from out of the provided funds.

Provision for Gratuity:

Gratuity is a statutory obligation to pay to the employee after certain period of service at the time of retirement. The amount of gratuity is calculated at the average salary of the individual just prior to the date of retirement. As this will be a future lump sum payment an annual provision to meet this expenditure at the time of ones retirement is necessary. The annual gratuity amount is worked out on actuarial valuation and the same is debited to the income & expenditure account every year so as meet the liability at the time of retirement.

Provision for Taxes:

Income Tax is assessable at the end of every year by the Income tax department as per the provisions of the Income Tax Act,1961. Concerns having taxable income have to pay Tax after the close of accounts of the year. An estimated Tax amount may be provided for in the accounts to meet this liability.

Similarly Municipal taxes such as property tax, water tax etc. which would become payable after the end of the year have to be provided for.

Provision for Expenses:

Certain expenses incurred and due may not be paid during the year. Example Audit Fee, Rent, Interest etc. A provision is made for these items in the income & expenditure account. At the time of actual payment such amounts will be debited to the provision account.

<u>RESERVES</u>

Reserve means of accumulated profits.

The purpose of reserves may be for

1. Expansion Buildings, Assets, new venture
2. Redemption of liabilities Debentures
3. Declaring and paying dividends to share holders
4. Legal requirements Investment reserve
5. Unforeseen contingencies

Specific reserves are to meet the particular purposes & the balance is called **General Reserve** which is available for any purpose.

Reserve Fund: A reserve which is made for a specific purpose and identified by investment in securities are called as Reserve Fund. Such funds are invested out side the business.

Capital reserve:

Any profit out of sale of capital assets are credited to this account. The funds under this account are utilized to acquire new assets.

Secret reserves:

Sacred reserves are not disclosed in the accounts as Reserve. This is made by the following ways.

By under valuing stocks

10. Providing excess depreciation
11. Treating capital expenditure as revenue
12. Not accounting income earned but not received
13. Treating income as a liability.