International Journal of Education, Modern Management, Applied Science & Social Science (IJEMMASSS)
ISSN : 2581-9925, Impact Factor: 6.882, Volume 04, No. 04(II), October - December, 2022, pp. 01-07

FINANCIAL STATEMENTS: A BRIEF STUDY IN CASE OF MANUFACTURING COMPANY

Dr. Mukesh Kumar*
Dr. Naina Vohra**

ABSTRACT

Financial statements are prepared for the purpose of presenting a periodical review or report on the progress by the management and deal with the (a) status of the investments in the business, (b) results achieve during the period under review. The term financial statements as used in accounting refer to at least two statements which the accountant prepares at the given period of time for the business enterprises. These statements are (a) Profit and Loss Account and (b) Balance Sheet. Balance Sheet is prepared with a view to show the financial position as on a particular date on that date when book of account are closed. The purpose of preparation of profit and loss account is to ascertain the net profit of the trading activities. In case of public limited company financial statements are also includes "profit and loss appropriation account", sometimes this is also called in the name of statement of sources and application of funds.

Keywords: *Financial Statement, Profit & Loss and Balance Sheet.*

Introduction

The purpose of preparation of financial statements is basically to find out the liquidity, profitability and solvency of the organisation for the short term as well as long term purpose. Financial statements essentially are interim reports, presented annual and reflect a division of the life of a enterprises into more or less arbitrary accounting, period-more or less frequently a year. In other words, financial statements provide a summary of the accounts of business enterprises, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the results of operations during a certain period.

Financial Management is concerned with the planning and controlling of financial resources of the enterprise. Under financial management, object is not only to collect the fund for organisation but also the efficient utilization of fund. It includes investment decisions, financing decision, dividend decision, liquidity decision budgetary decision and capital budgeting.

Financial Management is that area of business management devoted to a judicious use of capital and careful selection of sources of capital in order to enable a spending unit to move in the direction of reaching its goals.

Objectives of Financial Statement

The main objective of any business is to earn a satisfactory return on the funds invested in it, along with good financial position. A detail study with cause and effect of the profitability and financial position is to be reflecting with the help of financial statement. The main objectives of financial statement are as follows:

- To provide necessary information for optimum utilisation of resources of organisation, since resources are in scare, it show how these scare resources use in the best way so that production increase with minimising of cost.
- Financial Statement provides information to internal and external interested parties in the organisation such as creditors, investors, Governments and to management itself.

---

* Associate Professor in Commerce, Government College, Sector-9 Gurugram, Haryana, India.
** Extension Lecturer in Commerce, Government College for Girls, Sector-9, Gurugram, Haryana, India.

- With the help of financial statements profitability and solvency of organisation can be easily known so that if there is any week spot in the organisation, it can be remove by taking positive action.
- It helps in identify, analysis, assessment and valuation of various assets and liability in the organisation.
- With the help of financial statements, not only the growth of a company is identified but also the growth of all organisation is easily identify, which develop the growth of our country.

Nature of Financial Statement

Financial Statements are prepared for the purpose of presenting a periodical review or report on progress by the management and deal with the status of the investment in the business and result achieved during the period review. These statements are prepared on the basis of recorded facts which can be expressed in monetary terms. These data are recorded facts, personal decisions, accounting conventions and self-proclaimed assumptions.

Four elements are considered to study the nature of financial statement:

- Recorded Facts,
- Accounting Conventions,
- Postulates,
- Personal Judgments.
- **Recorded Facts**: On the basis of recorded facts, financial statement are prepared. It means any events or facts are happen in the business, it is recorded that price. For example, cash in hand, purchase or sale, debtors or creditors, fixed assets etc. are all recorded facts. In this case current value or replacement cost of assets is not recorded in the book. For example any assets purchased by the business or any amount paid to creditors are shown at their actual cost in balance sheet.
- **Personal Judgment:** In case of financial statement, some valuation of assets or segregation of expenditure depends on the personal judgment of accountant. For example, valuation of closing stock, depreciation methods and capital & revenue expenditure, all these differ from business to business.
- **Postulates:** When business is a going concern i.e. it is assumed that there is neither any intention to close down the business in future nor there is a need for such. Some income or expenditures must relate with a particular time period whether such income is received or not or whether such expenses are paid or not, but they are concerned with the same accounting year. Some accountant, believe that the value of money remain stable throughout the year, hence it make no difference on the business transactions carried out a different dates.
- **Accounting Conventions:** Accounting conventions means certain assumptions or procedure are to be followed while prepare the financial statement. Regarding classification of expenditure or depreciation on fixed assets, for example purchase of pen, pencil, rubbers are treated as revenue expenses which purchase of furniture or fixed assets are treated as capital expenditure.

Advantages and Uses of Financial Statement

Financial Statement is also called as a mirror for any business organisation which reflects the profitability or financial position of the business. With the help of financial statement we can easily known the various information, such as quantum of assets and liability Besides this, the progress of business can be easily known because they reflect the profitability, liquidity, solvency and financial position of the organisaton. The various importance or functions of financial statement can be explained as under:

- Importance for Management.
- Importance for Investors
- Importance for Creditors
- Importance for Employees
- Importance for Tax Authority
- Importance for Banking and Financial Institutions
- Importance for Government
- Importance for Stock Exchange.

- **Importance for Management:** While preparation of planning and controlling the business activities, various information are required and these information can be easily obtain with the help of financial statements. Financial Statements not only reflects with profitability or liquidity but also spot the weakness of the organisation so that these weakness can be remove and objective is to be achieved with the help of financial statement in the organisation. According to Gerstenberg:- "Management can measure the effectiveness of its own policies and decisions, determine the advisability of adopting new policies, procedures and documents to owners the result of their managerial efforts.
- **Importance for Investors:** Investors are concerned with the safety of their money which is to be invested in the organisation. Safety may be in the form of earning capacity of the organisation or profitability or solvency so that their money can be refunded along with the dividend and from the debenture holders point of view , they know that whether the business is in a position to pay interest on their money invested in the business or not. With the help of financial statement sales, profits and assets for last several years are to be compared with each other to find out whether the ratio is good or bad.
- **Importance for Creditors:** Creditors are interested in the short term financial position by considered the current ratio and liquid ratio of the business. With the help of financial statements they can known whether the business is able or not to repay the liability of trade creditors as and when it become due.
- **Importance for Employees:** With the help of financial statement, employees can easily know whether the amount of salary or wages which is paid by the organisation is in the proportionate of profit of business or not. Thus, financial statements are particularly useful for the employees.
- **Importance for Tax Authority:** With the help of financial statement, tax authority can know whether the tax provision for business houses is properly followed or not. Financial statements provide the information regarding the profitability of the oranisation so that the decision regarding tax amount is to be compared with the amount of profit.
- **Importance for Bankers and Financial Institutions:** Banks and other Financial Institutions can take decision whether their money which are provided in the form of loan are safe or not and whether the organisation is able to repay the loan amount, not only this whether any assets are required to keep as a securities or not while distribution loan to the business. Financial Statement also reflects the value of goodwill of any business.
- **Importance for Government:** Government can also access that whether the policies and rules which are framed according to law for the running of business are to be implementing or not because the progress of country mainly depends on the progress of the all organisation.
- **Importance for Stock Exchange:** Stock Exchange is also play an important role to judge the valuation of assets and liabilities of organisation so that in the time purchase or sale of business securities, their real value can be easily ascertain.

Limitations of Financial Statements

- Lack of Accuracy
- Based on Historical Data
- Influenced by Personal Judgment
- Do not include non monetary items
- Windows Dressing
- Only Interim Report
- Difficulty in Comparison
- Based on accounting concepts and conventions
- Do not reflect price level change
- Static Statements
- Not proper decision making.

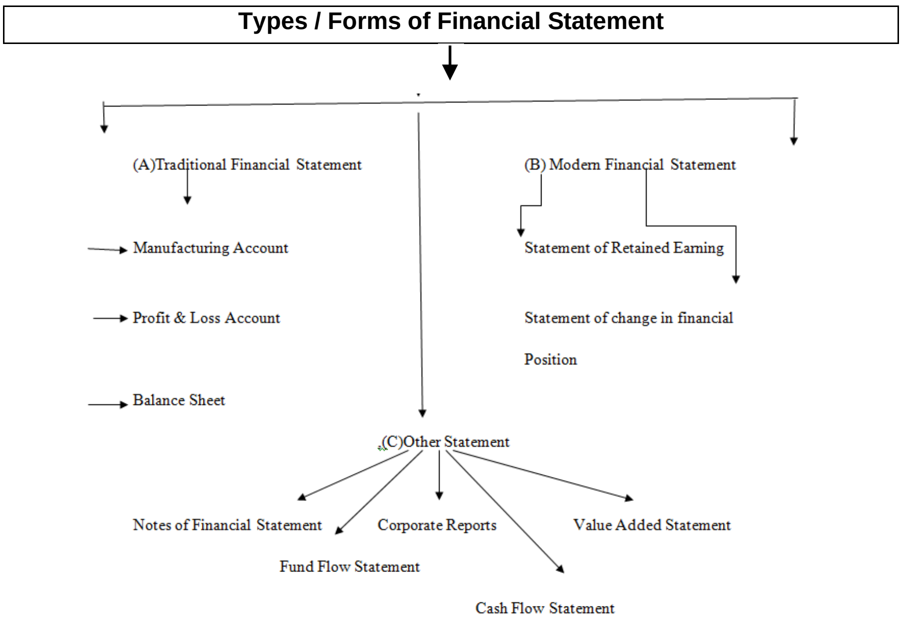
- **Lack of Accuracy:** The information which is obtained with the help of financial statements is based on accounting conventions and concepts. Since there is no method available which reflect the accurate information to judge the profitability or liquidity of the business.
- **Based on Historical Data:** Financial Statement are prepared with the help of historical records, due to change in the market price of assets are not shown in the book of account of business. Thus, the balance sheet is unable to exhibit the true and correct financial position of the business. Financial Statement provides only historical information to the business.
- **Influenced by Personal Judgment:** Sometime, balance sheet and profit & loss account does not reflect the true and fair view of affairs of organisation due to personal judgment in various information by accountant,. For example, there are many methods are available for valuation of inventories such as FIFO, LIFO, HIFO, AVERAGE AND WEIGHTED AVERAGE and in case of depreciation of fixed assets such a fixed installment method, diminishing balancing method or annuity method, which method is best is the problem.
- **Do not include non monetary items:** Only those transactions which can be measured in term of money are considered, but some transactions which are not a part of money and reflect the value of goodwill and efficiency of management are not to be considered, although they play a very important role in the organisation.
- **Windows Dressing:** Sometime, the account which are prepared show the different meaning which is also called as a window dressing which effect the value of profit or loss and the financial position of business such as valuation of inventory and depreciation on fixed assets.
- **Only Interim Report:** While during running the business, actual position of business cannot be ascertain in accurately, this can be possible when business is shut down.
- **Difficulty in Comparison**: Financial Statements of a business cannot compare with the data of other business in the same industry. They are reflecting the current position of the business but not given any importance to the previous year data which is also an important for the business for taking decisions.
- **Based on accounting concepts and conventions:** Due to based on conservatism and historical concepts and conventions, these account are not show the actual position of the business.
- **Do not reflect price level change:** Due to change price from year to year, data which are compared to previous year not presented accurate position of profitability and liquidity of business.
- **Static Statements:** While implementation financial statement, their principles and procedure are static or rigid and they are not change according to change in the business environment.
- **Not proper decision making:** Only the preparation of financial statement, all the business decision are not to be taken because while taking the business decisions several other factors are also to be considered.

Characteristics of Ideal Financial Statements

Several interested parties either inside or outsiders of those interest are affected by the financial statement of business have deeply interested to know the profitability, liquidity and solvency position of the business.While preparing the financial statements of business following ideal characteristics should be considered.

- Financial Statement should be reliable.
- Easy to prepare.
- Financial statement should be prepared on proper time.
- Completeness
- Relevance
- Financial Statement must be comparable
- They should be attractive
- They must be analytical form
- Financial statement must be brief.

- **Financial Statement should be reliable:** Important information must be included in the financial statement and they should be based on actual ground so that they reflects the true and fair view of affairs of the business. Most of the decisions are based on the information which is mention in the financial statements so appropriate action is to be taken which preparation of financial statement
- **Easy to prepare:** While preparation of financial statement difficult calculations or procedure should not be follow. Besides this, size of statement must be small so that it can be easily understandable not only for management but outsiders also.
- **Financial statement should be prepared on proper time:** When the information is published or circulated after the expiry of time, it has no meaning or their utility might be lost to a great extent. So far as possible financial statement must be prepared well in time. Accountant should given more conscious that most of the business decisions are affected by the financial statement.
- **Completeness:** The financial statement which has incomplete information does not fulfill the requirement of the business. They should be complete in all the possible ways by using tables, graphs, footnotes or any other way so that judgment regarding the solvency of business is to be taken.
- **Relevance:** The information which is circulated in the form of financial statement must be relevant with the objective of the business, information which is in the absence of object has no relevance.
- **Financial Statement must be comparable:** Financial Statement must be in a comparable form not only profit is to be considered but also sales, fixed assets, current assets, liabilities, expenses or incomes from year to year and business to business in the same industry to check out the progress or growth of organisation which facilitate themselves to maintain in the competitive market.
- **They should be attractive:** The presentation of financial statement should be in the form that the users of this statement can easily understand the main information which is mention in underlines or bold letter. The main information should be highlight by using the different techniques or tools so that they reflect the business position in the better way.
- **They must be analytical form:** When information are circulated in the form of financial statement, an analysis also may be made so that if there is any variances in the data, it can be rectify well in time and accuracy may be maintain in the business.
- **Financial statement must be brief:** Only that information which is relevant with the business is to be incorporated in this statement so that unnecessary information can be avoiding, not only this, information must in the summarized form.



Traditional Financial Statement

Traditional Financial Statement means historical account which is required for every organisation to prepare in form of manufacturing account, trading and profit & loss account, profit and loss appropriation account, balance sheet. We can say those account which are compulsory according to factory act 1948 or company act 1956 which reflect the true and fair picture of the organisation as far as financial figures is considered. The following are the account which pertains under the traditional system:-

- **Manufacturing Account:** This account is prepared by that organisation who is engaged in the production of goods and service. The purpose of preparing this account is to find out the cost of production in total or cost per unit. This account is not necessary for that organisation who is engaged in the activities of buying and selling of goods and services. The balance of this account is to be transferred in profit and loss account.
- **Profit and Loss Account:** The purpose of this account is to calculate the amount of profit and loss of the organisation. In this account all amount of purchase, sales, all direct expense and amount of opening as well as closing stock appearing in trading account, thereafter, such balance transferred to profit and loss account. In profit and loss account all indirect expenses as well as all indirect incomes are posting for the purpose of calculate the amount of net profit or net loss. The purpose of this account is to find out the amount of profitability and liquidity of the organisation.
- **Balance Sheet:** The purpose of this is basically to find out the amount of total assets and total amount of liabilities. Solvency or financial position of the business or paying capacity of the business is basically found with the preparation of balance sheet. It is prepared on a particular date which shows the true and fair view of affairs of the business.

Modern Financial Statement

Under this statements, the information which is obtain with the help of balance sheet are presented to management in the different forms, graphs, tables and other way so that they can be analyzing in the different angles which help the management to take appropriate decisions in the right time. Statement of retained earnings and statement of change in financial position are including in modern financial statement.

- **Statement of Retained Earning or Profit Loss Appropriation Account:** The balance of profit and loss is transferred to profit and loss appropriation account. There are certain incomes or expenses which are the internal part of the organsiation or we can say those transactions which does not affect the production of the business and which are done by the organisation after the goods sold or after the net amount of profit is calculated. Their balance at the last transferred to balance sheet.
- **Statement of change in financial position:** Sometimes, the information which is obtain form the balance sheet does not reflect the amount of fund and cash in details. It may be possible that there is good amount of profits but business suffering shortage of fund and cash due to some circumstances or reasons. These reasons are to be identified when business prepares fund flow statement and cash flow statement. Both these statement shows the sources of fund as well as application or utilization of fund, not only this it indicates the cash inflow and cash outflow.

Other Statements

Whenever the desired information is not obtain by the management, other statement in different ways are also prepared for taking the various decisions. These statements may be made in the following ways:

- **Value added Statement:** Value added statement means to find out the reasons for increasing the cost of production or service or whether of demand for our product or service are good in the market or not. In these statements, although the total cost or amount of profit if not identified but reasons for cost or profit or demand or supply or any others reasons which help the business for increasing the production is to be finding out.
- **Notes to Account:** Notes of account means the details of information which is obtain with the help of balance sheet are known deeply. It is just an annexure which clear any doubt about any information which represent either assets side or liabilities side. A details summary of any information is known as notes to account.

- **Corporate Reports:** With the help of corporate report various information about the policy, procedures, rules, regulations and past achievement of organization easily known. The objectives of the business are also explained in the reports and how to achieve that objective with scare resources of the business is also mentioned.

References

1. Hardeepkaur (2015) "Performance and structure if cooperative banks in Agriculture Credit in Haryana", International Journal of research in commerce and management, vol.6(2015),issue no. 03.
2. Anjani Kumar, K. M. Singh, Shradhajali Sinha, 2015, Agriculture Economics Research Review Vol. 23 July December 2015.
3. R. Solanki (2016)," A Study of Agricultural Finance by Commercial Banks in India: A Case study of Central bank of India", Vol.5 Issue 4.
4. Sena P.C. (2015) "Management of Agricultural Credit and the impact of Indian Banking and Sector Reforms on Agriculture".
5. International Review of Research in Emerging Markets and the Global Economy,Vol.1, Issue3.
6. Kannan, E (2011),"Relationship between Agricultural Credit Policy, Credit Disbursements and Crop Productivity.
7. Sector Reforms on Agriculture:-International Review of Research in Emerging Markets and the Global Economy, Vol.1,Issue3.
8. Sidharth Mishra(2014)."Trends of agricultural finance by commercial banks: A case study of Union Bank of Baroda and State Bank of India." International journal of research in commerce, economics and management, Vol.No.4, Issue11.