

Financial Statements

Financial statements are the final outcome of the process of accounting.

It is a way in which the business communicates with its stakeholders, such as shareholders, management, employees, customers, suppliers, loaners, etc.

Apart from being a business responsibility, preparing financial statements is a legal responsibility as well, as the legal authorities are also equally interested in knowing the final results of an entity.

A

Debit or Credit

Golden Rule of Accounting

# Real

Transaction Happens

Which ledger to choose

* Debit What Comes In
* Credit What Goes Out

**Personal**

Nature of Accounts

Real

Nominal

* Debit the Receiver
* Credit the Giver

**Nominal**

A

B

* Debit all Expenses & Losses
* Credit all Income & Gains

Personal

Balance Sheet

Cash Flow Statement



B

Consolidation of Accounts

Profit and Loss Account

Trial Balance

Financial performance for a period

Financial position as on a date

Cash movement for a period

Balance Sheet

Profit & Loss

Cash Flow Statement

Financial Statements

**Ratio Analysis**

* These are used to describe relationships between different variables used in financial accounts.
* These are extensively used to make a comparison between different companies and between different time periods.
* Microeconomic relationships within a company that helps project earnings and free cash flow
* A company's financial flexibility
* Management’s ability

**Ratios can aid a user in judging:**

* The heterogeneity of a company’s operating activities
* Results of ratio analysis may not be consistent
* Judgment required for interpretation
* Different accounting methods used

**Limitations of Ratios:**

**Five Categories of Ratios**

Indicator of how well a company utilizes various assets e.g., inventory turnover, receivable turnover, asset turnover, etc.

**1**

**Activity Ratio**

Indicator of the ability to pay cash expenses in the short term as they come due. e.g., Current ratio, Quick ratio, Cash ratio.

**2**

**Liquidity Ratio**

Indicator of the firm's financial leverage and ability to meet its longer-term obligations. e.g., debt-to-equity, debt-to-capital, debt-to-assets, financial leverage, interest coverage, and fixed charge coverage ratios.

**Solvency (Leverage) Ratio**

**3**

Indicator of how well the company generates operating profits and net profits from its sales. e.g., net, gross, and operating profit margins, pretax margin, return on assets, operating return on assets, return on total capital, return on total equity, and return on common equity.

**4**

**Profitability Ratio**

Sales per share, earnings per share, and price to cash flow per share are examples of ratios used in comparing the relative valuation of companies.

**5**

**Valuation (Market) Ratio**

**A. Introduction**

* An accounting expert appointed by shareholders to independently review the FS prepared by the management.
* Every country’s regulatory body prescribes the minimum qualification that is required for an auditor.
* Attestation function – signing and certification that the FS are free from material errors.

**Auditor:**

* To **get an independent opinion** on the fairness and reliability of financial statements.
* To check whether generally accepted accounting policies (GAAP) were followed.
* To examine the efficiency of **accounting & internal control system**.
* To determine whether financial statements contain **no material errors**.

**Objective of Audit:**

* Audit report is addressed to the shareholders and NOT to the management.
* Auditor is not a BLOODHOUND. He is just a WATCH DOG.
* He has the responsibility to **reasonably** assure the stakeholders about the **fairness** of FS.
* Different accounting fraud has led to a debate on the role and responsibility of the auditor.

**Audit reports to the shareholders and NOT to the management.**

**B. Audit Reports: Types of Scenarios**

On the basis of his analysis, an auditor can issue one of the following 4 reports:

# 1. Unqualified opinion:

* FS are free from material omissions and errors.
* FS reflect the true and fair picture of the business.
* Except for a few material issues, FS reflect the true and fair picture of the business.
* Above material issues do not change the overall message communicated by the FS.
* Auditors must explain these exceptions in the audit report.

**2. Qualified Opinion:**

* Statements DO NOT represent the true and fair picture.
* There are material omissions / errors.

**3. Adverse Opinion:**

* Due to some circumstances, an audit is unable to express any opinion on the FS, he issues a disclaimer.
* Disclaimer DOES NOT mean that FS are incorrectly prepared by the management.
* Disclaimer is Inability of expression.

**4. Disclaimer of Opinion:**

**C. 4 Elements of a Standard Report**

**1** FS preparation is the responsibility of management.

Accounting standards have been followed and there is reasonable assurance that FS are free from material errors.

**2**

Accounting estimates and principles used in FS preparation are reasonable.

**3**

Auditor’s Comment on the internal controls in the organization.

**4**

**D. Auditor’s Report: Explanatory Paragraph**

* Auditor’s report contains an explanatory paragraph when material loss is probable, but the amount can’t be reasonably ascertained.
* Uncertainties are caused due to issues related to:
  1. Going concern assumptions
  2. Any **litigation**
  3. Realization of assets values
* For example, in the case of British Petroleum oil spill, the auditor would include an explanatory paragraph on the material loss.

Download detailed trial balance from Tally

Link all sub schedules to line item of trial balance

Calculate DTA and Provision for Tax

Profit & Loss Account should be linked to sub schedules

Put notes in the accounting policies of the Company

Put notes in the background of Company

Balance Sheet should be linked to sub schedules

Prepare the cash Flow



Thank You!

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