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A Study Of Financial Statement

* Pratik P. Valand

*Lecturer,K.k.shastry Commerce College(East), Maninager,Ahmedabad

ABSTRACT

Financial Statements of an organization are the basic data required for financial decision making. The financial statement and their accompanying notes explain a company's financial performance and recent financial history. Financial analysis use these statements in several ways such as to evaluate a company's overall performance, identify strengths and weakness, anticipate future successes or problems and ultimately help them decide if the company is a good investment opportunity.

As such, correct understanding of the structure of financial statements and also of the tools available for the interpretation of financial statements is a must before one talk of any of the further discussion on financial management. These financial statements are the eyes of an enterprise.

Keywords :Type of financial statement, Objectives of financial statements, Nature of financial statement, Characteristics of financial statement

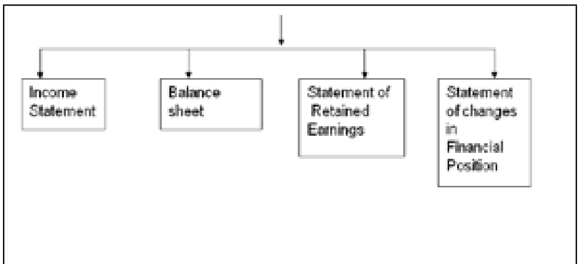
INTRODUCTION

A financial statement is an organized collection of data according to logical and consistent accounting procedures. Its purpose is to convey an understanding of some financial aspects of a business firm. It may show a position at a moment in time as in the case of a balance sheet, or may revel a series of activities over a given period of time. Thus, "financial statements refer to the statements that show the financial position and results of business activities at the end of the accounting period".

Thus, the term financial statements generally refer to two basic statements.

1. Income Statement
2. Balance Sheet
   Of course, a business may also prepare,
3. A Statement of Retained Earning
4. A Statement of changes in financial position in addition to the above two statements.

TYPE OF FINANCIAL STATEMENT



Types of Financial Statement

❖ INCOME STATEMENT

The income statement (profit & loss account) is generally considered to be the most useful of all financial statements. It explains what has happened to a business as a result of operation between two balance sheet dates for this purpose it matches the revenues and costs revenues and shows the net profit earned or loss suffered during a particular period.

❖ BALANCE SHEET

It is a statement of financial position of a business at a specified moment of time. It represents all assets owned by the business at a particular moment of time and the claims (or equities) of the owners and outsiders against those assets at that time. It is in a way snapshot of the financial condition of the business at that time.

❖ STATEMENT OF RETAINED EARNINGS

The term retained earnings means the accumulated excess of earnings over losses and dividends. The balance shown by the Income Statement is transferred to the Balance sheet through this statement, after making necessary appropriation. It is thus, a connecting link between the balance sheet and the Income statement. It is fundamentally a display of things that have caused the beginning of the period balance sheet. The statement is also termed as Profit & Loss Appropriation Account in case of companies.

❖ STATEMENT OF CHANGES IN FINANCIAL POSITION

The Balance sheet shows the financial condition of the business at a particular moment of time while the Income Statement discloses the results of operations of business over a period of time. However, for a better understanding of the affairs of the business, it is essential to identify the movement of working capital or cash in and out of the business. This information is available in the statement of changes in financial position of the business. The statement may emphasize any of the following aspects relating to change in financial position of the business.

- Changes in the firm's working capital
- Changes in the firm's cash position
- Changes in the firm's total financial position.

OBJETIVES OF FINANCIAL STATEMENBTS

Financial statement serves as horoscope of a business as they enable readers to measure financial position of a concern. Such statements contain sufficient valuable information about various aspects of business that can be useful for business decision. As stated by the Accounting Standards Board of India that, " the objective of financial statement is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decision." The various objectives of such statements are summarized bellow:

- To provide financial data on economic resources and obligations of a concern.
- To revel implication of operating profit on the financial position of a concern.

- To provide sufficient and relevant information to various parties interested in financial statement.
- To present true and fair view of the business.
- To serve as the basis of future operation.

NATURE OF FINANCIAL STATEMENT

According to the American Institute of certified Public Accountants, financial statement reflects a combination of recorded facts accounting conventions implies that data exhibited in the financial statement are affected by recorded facts, accounting conventions and personal judgments.

1. RECORDED FACTS

The term recorded facts means which have been recorded in the accounting books facts which have not been recorded in the financial books are not depicted in the financial statement however material they might be for example, fixed assets are shown at cost irrespective of their market or replacement price since such price is not recorded in the books.

2. ACCOUNTING CONVENTIONS

Accounting conventions imply certain fundamental accounting principles which have been sanctified by long usages. For example, an account of the convention of "conservation" provision is made for expected losses but expected profits are ignored. This means that the real financial position of the business may be much better than what has been shown by the financial statement.

3. PERSONAL JUDGMENTS

Personal judgments have also an important bearing on the financial statements. For examples, the choice of selecting methods of depreciation lies on the accountant similarly, the mode of amortization of fictitious assets also depends on the personal judgment of the accountant.

CHARACTERISTICS OF FINANCIAL STATEMENT

Financial statement is regarded as indices of an enterprise's performance and position. As such, extreme care and caution should be exercised while preparing these statements generally reflects the following observable characteristics:

❖ **Intended Audience**

Financial statement are intended for those who have an interest in a given business enterprise. They have to be prepared on the assumption of the terms used in that business.

❖ **Articulation**

The basic financial statements are interrelated and therefore are said to be "articulated ". For example, Profit and Loss Account shows the financial results of operation and represents an increase or decrease in the various balances in the Balance Sheet.

❖ **Historical Nature**

Financial statement generally report what has happened in the past. Though they are used increasingly as the future by prospective investor and creditors, they are not intended to provide estimates of future economic activities and their effects on income and equity.

❖ **Legal and Economic Consequences**

Financial statement reflects elements of both economics and law. They are conceptually oriented towards economics, but many of the concepts and conventions have their origin in law.

❖ **Technical Terminology**

Since financial statement is products of a technical process called "accounting", they involve the use of technical terms. It is, therefore, important that users of these statements should be familiar with the different terms used therein and conversant with their interpretation and meanings.

❖ **Summarization and Classification**

The volume of business transaction affecting the business operations are so that summarization and classification of business events and items alone will enable the reader to draw-out useful conclusions.

ESSENTIAL QUALITIES OF FINANCIAL STATEMENT

As started earlier, the basic of financial statement is to provide information useful to the users of these statements. Different users like shareholders, investors, financial institution, workers etc. are interested in financial statements with varying objectives. Generally, it is not possible for a firm to prepare these statements in such a form that may suit every interested user. However, such statements should possess at least the following essential qualities:

❖ **Relevance**

Only that information should be disclosed in financial statement which is relevant to the objectives of the firm. The information is said to be relevant only when it influences decision of the users while evaluating any event or correcting past evaluation. The conclusions drawn on the basic of irrelevant information would be misleading and of no use. Therefore, the information irrelevant to the statements be avoided, otherwise it would be difficult to make a distinction between relevant and irrelevant information.

❖ **Understandability**

The main objective of financial statement is to provide necessary information about the firm's resources and performance. To fulfill this objective, the information contained in these statements should be clear, simple and lucid so that a person who is not well versed with the accounting terminology shall be able to understand without much difficulty.

❖ **Reliability and Accuracy**

The information incorporated in financial statements should be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users.

❖ **Comparability**

Comparison is the essence of financial statement analysis. Comparable information will reveal strong and weak points. Financial statements should be prepared in such a way that current year's progress can be compared with that of previous year and inter firm comparison is possible. To facilitate comparison, it should be more useful to provide with the financial statements of 5 to 10 years summary of important terms such as production in quantity, net sales, net profits, dividend paid, working capital etc.

❖ **Completeness**

The information contained in the financial statements should be complete in all respects. It must be ensured that there is no possibility of any information being incomplete or doubtful. Therefore, full disclosure should be made of all significant information in a manner that is understandable and does not mislead creditors, investor and other users.

❖ **Timeliness**

Financial statement is prepared for a definite period of time. At the end of this period, they should be ready and submitted to the parties concerned. If the statements are not presented in time, they can not be property used and the firm cans not formula plans for future developments.

LIMITATIONS OF FINANCIAL STATEMENTS

❖ In Profit and loss Account net profit is ascertained on the basis of historical costs.

❖ Profit arrived at by the Profit and Loss account is of interim nature. Actual profit can be ascertained only after the firm achieves its maximum capacity.

❖ The net income disclosed by the Profit and Loss Account is not absolute but only relative.

❖ The profit and Loss Account does not disclose factors like quality of product, efficiency of the management etc.

❖ The net income is the result of personal judgement and bias of accountants cannot be removed in the matters of depreciation, stock valuation etc.

❖ The book value of assets is shown as original cost less depreciation. But in practice, the value of the assets may differ depending upon the technological and economic changes.

❖ The assets are valued in a Balance Sheet on a going concern basis. Some of the assets may not realize their value on winding up.

CONCLUSION

Financial statement analysis is a scientific evaluation of profitability, efficiency and of any business concern. The analysis of financial statement is an attempt made to help the preparations of the most profitable design of promising alternatives and aid in selecting the most feasible option. The financial statement analysis looks at the projected as well as past performance.