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Commerce

ROLE OF FINANCIAL STATEMENTS FOR NBFCs

Dr. Amardeep Assistant Professor (SFC) Commerce, J.K.P. P.G. College, Muzaffarnagar,

ABSTRACT A mere application of proper accounting methods and procedures in the preparation of financial statements do not automatically ensure fairness of financial statements unless the financial information relevant to various users is properly disclosed therein.

KEYWORDS : :

MEANING OF FINANCIAL STATEMENTS

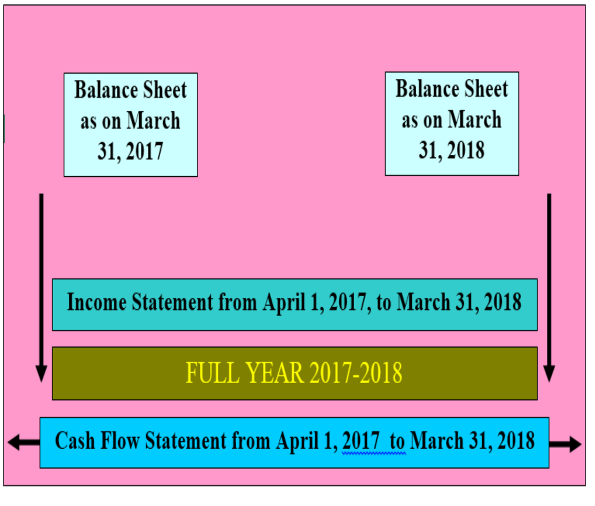
Financial Statements of NBFCs– Present Status and Issues

A complete set of 'Financial Statements' normally includes a balance sheet, a statement of profit and loss, cash flow statement and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements.

Financial reporting in the form of financial statements to users of financial information is universally accepted as an important end-product of the accounting process. External financial reporting is becoming increasingly a critical factor in business with the increase in separation between the promoters and management of a public limited company on one side and large number of scattered shareholders on the other.

Similarly, present and prospective investors/creditors of a company place high reliance on the external financial reporting for their decision-making process. A mere application of proper accounting methods and procedures in the preparation of financial statements do not automatically ensure fairness of financial statements unless the financial information relevant to various users is properly disclosed therein. Users of the financial statements, particularly those who are relatively less sophisticated in technical matters of accounting, depend heavily upon the disclosures made in the financial statements when it comes to understanding and interpreting the financial information.

DIAGRAM : 1.1
RELATIONSHIP BETWEEN BALANCE SHEET, INCOME STATEMENT AND CASH FLOW STATEMENT



Therefore, the critical question that has been debated all along in the evolution of the accounting process is: What should be the level that may be considered as fair disclosure keeping in mind, among other things, the nature and volume of financial information, the target user groups, objectives sought to be achieved, and the cost of providing, as against the benefits, of such disclosures.

ANALYSIS OF FINANCIAL STATEMENTS

“Financial statement analysis is designed to indicate the strength and weaknesses of business undertaking through the establishment of certain crucial relationship by regrouping and analysis of figures contained in financial statements.

“Financial Statement analysis is a judgmental process which aims to estimate current and past financial positions and the results of the operation of an enterprise, with the primary objective of determining the best possible estimates and predictions about future conditions.”

PURPOSE OF FINANCIAL STATEMENTS

"The objective of financial statements is to provide information about the financial strength, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions."

Financial statements should be understandable, relevant, reliable and comparable. Reported assets, liabilities and equity are directly related to an organisation's financial position. Reported income and expenses are directly related to an organisation's financial performance. Financial statements are intended to be understandable by readers who have "a reasonable knowledge of business and economic activities and accounting and who are willing to study the information diligently."

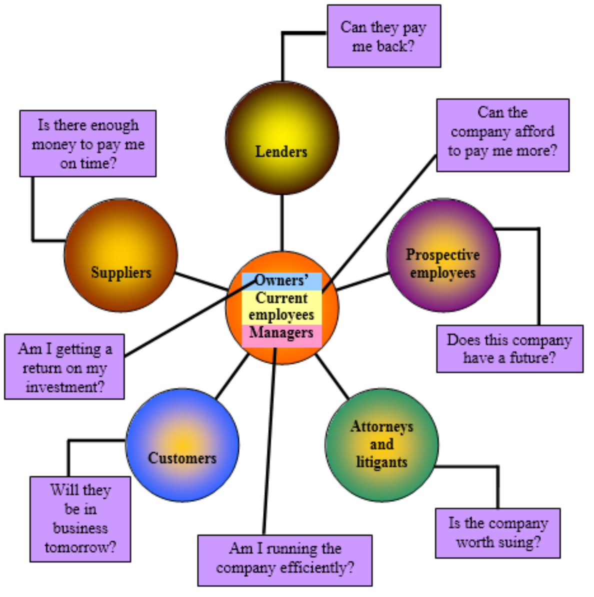
USERS OF FINANCIAL STATEMENTS

(1). Financial statement users are broadly classified into two groups. Internal users, primarily the managers of a company, are involved in making operating and strategic decisions for the business. As employees, they typically have complete access to a company's information system. Internally generated financial reports are, therefore, specifically tailored to the unique information needs of an internal decision maker, such as a CEO, CFO, or internal auditor. External users are individuals not directly involved in the company's operations. These users must rely on information provided by management as part of the financial reporting process. This book stresses the analysis needs of external users of general-purpose financial statements. Nevertheless, many analysis techniques described here are usefully applied by internal users.

(2). There are many classes of external users of financial statements. Creditors are bankers, bondholders, and other individuals who lend money to business enterprises. Creditors look to financial statements for evidence concerning the ability of the borrower to pay periodic interest payments and repay the principal amount when the loan matures.

(3). Equity investors include existing and potential shareholders of a company. Existing shareholders need financial information in deciding whether to continue holding the stock or sell it. Potential shareholders need financial information to help in choosing among competing alternative investments. Equity investors are generally interested in assessing the future profitability and/or riskiness of a company. Merger and acquisition analysts are interested in determining the economic value and assessing the financial and operating compatibility of potential merger candidates.

DIAGRAM : 1.2 USERS OF FINANCIAL STATEMENTS



Source : James Bandler, "How To Use Financial Statements A Guide To Understanding The Numbers", McGraw-Hill, New York.

(1). Auditors use financial analysis techniques in determining areas warranting special attention during their examination of a client's financial statements. A company's board of directors, in their role as appointees of shareholders, monitors management's actions. Regulatory agencies utilize financial statements in the exercise of their supervisory functions, including the Securities and Exchange Commission, which vigilantly oversees published financial statements for compliance with federal securities laws certain price-regulated industries, such as public utilities, submit financial reports to regulators for rate-determination purposes. Other users include employees (in evaluating the fairness of their wages and working conditions), intermediaries (in offering investment advice), suppliers (in determining the creditworthiness of customers), and customers (in evaluating the staying power of their suppliers). All of these users rely on the analysis of financial statements.