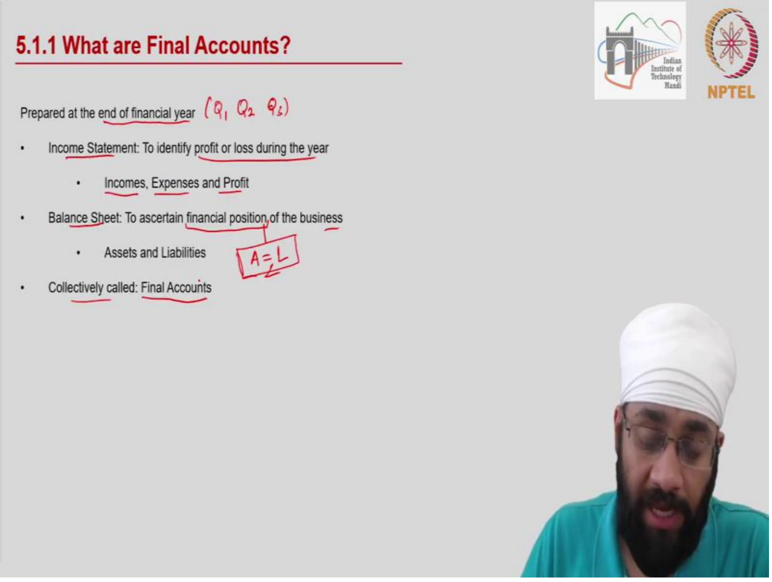
**Financial Accounting**
**Dr. Puran Singh**
**School of Humanities and Social Sciences**
**Indian Institute of Technology, Mandi**

**Lecture – 51**
**5.1 Introduction to Final Accounts**

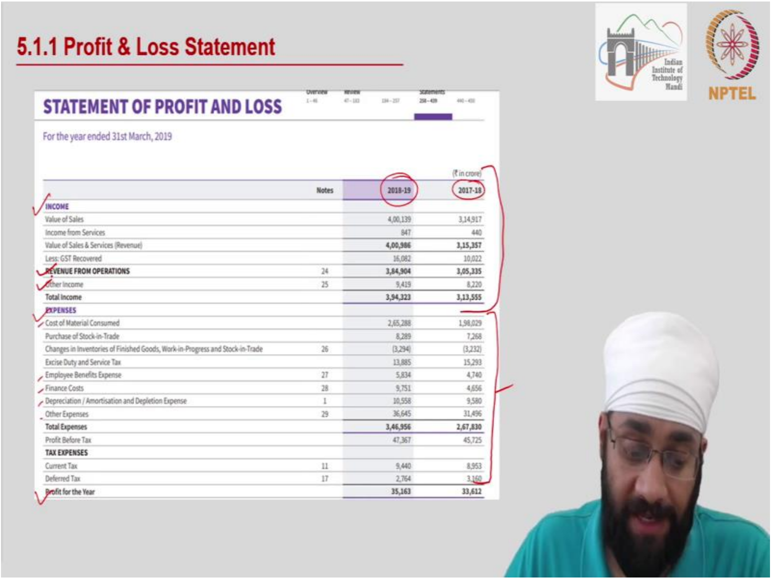
In this video I am going to introduce you to the format of the Final Accounts: balance sheet and income statement. Although I have shown you the income statement and balance sheet of a company, I would like to introduce you to the format that we are going to be using so that it becomes easier for you.

(Refer Slide Time: 00:37)




The final accounts are typically prepared at the end of a financial year. We have also discussed that public companies have to disclose quarterly statements as well. The income statement helps us identify the profit or loss during the year by matching the incomes to the expenses. So, if you want to look at the incomes, expenses, and profit, you refer to this statement. The other statement is the balance sheet that helps us ascertain the financial position of the business. When we say financial position, we are referring to the accounting equation: assets = liabilities. This equation should hold for business to sustain. As and when this equation is not balanced, the business can be in trouble. For example, the liabilities are higher than the assets. That is what we mean by these two words: *financial position*. We will talk more about this as we go forward. Collectively we call these two statements final accounts. There is a third statement called cash flow statement, but for now we are keeping that as an additional statement. It was introduced later in the final accounts. So, we will talk about the cash flow statement later.

(Refer Slide Time: 02:02)




STATEMENT OF PROFIT AND LOSS

For the year ended 31st March, 2019

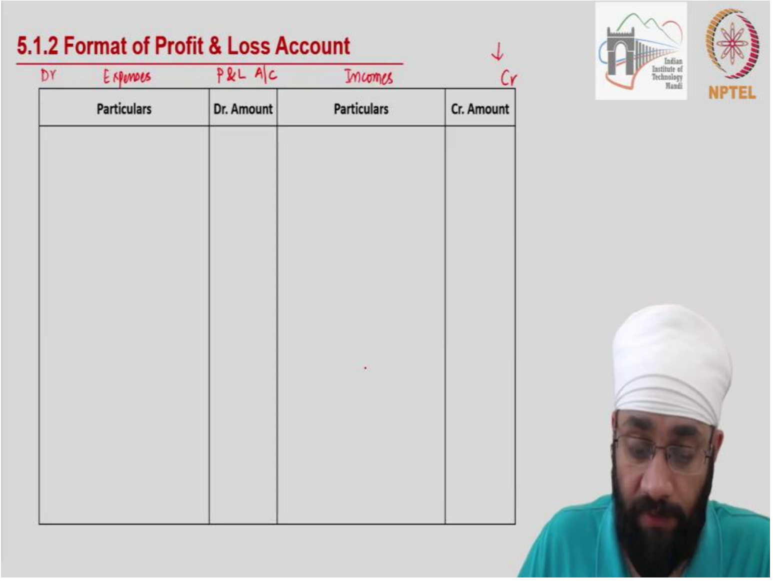
(₹ in crore)

| | Notes | 2018-19 | 2017-18 |
|---|---|---|---|
| INCOME | | | |
| Value of Sales | | 4,00,139 | 3,14,917 |
| Income from Services | | 847 | 440 |
| Value of Sales & Services (Revenue) | | **4,00,986** | **3,15,357** |
| Less: GST Recovered | | 16,082 | 10,022 |
| **REVENUE FROM OPERATIONS** | 24 | **3,84,904** | **3,05,335** |
| Other Income | 25 | 9,419 | 8,220 |
| **Total Income** | | **3,94,323** | **3,13,555** |
| EXPENSES | | | |
| Cost of Material Consumed | | 2,65,288 | 1,98,029 |
| Purchase of Stock-in-Trade | | 8,289 | 7,268 |
| Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade | 26 | (3,294) | (3,232) |
| Excise Duty and Service Tax | | 13,885 | 15,293 |
| Employee Benefits Expense | 27 | 5,834 | 4,740 |
| Finance Costs | 28 | 9,751 | 4,656 |
| Depreciation / Amortisation and Depletion Expense | 1 | 10,558 | 9,580 |
| Other Expenses | 29 | 36,645 | 31,496 |
| **Total Expenses** | | **3,46,956** | **2,67,830** |
| Profit Before Tax | | 47,367 | 45,725 |
| **TAX EXPENSES** | | | |
| Current Tax | 11 | 9,440 | 8,953 |
| Deferred Tax | 17 | 2,764 | 3,160 |
| **Profit for the Year** | | **35,163** | **33,612** |

Here is the statement of profit and loss. This is Reliance Industry Limited's income statement. We have seen this earlier. There is income and there are expenses and you have profit for the year and two years data has been shown here. The Companies Act prescribes the format of these statements. Also, in some cases, sequence- that you should first show income, then expenses and the categories-are prescribed by the Act. For example, you see cost of material, you see employee benefit costs, depreciation, finance costs. These categories, these buckets are also defined. Most of the companies are going to follow this format. All the public companies, for sure, and there can be small changes here and there, in the nitty gritties, in the details which are allowed, but largely this is how the profit & loss statement is shown.

Now, the reason we are looking at this again is that the way we are going to prepare the statement is going to be slightly different to start with, because right now we will learn to prepare this statement in such a way that it also helps us in converting the data into information. The next step is data analysis of the final accounts.

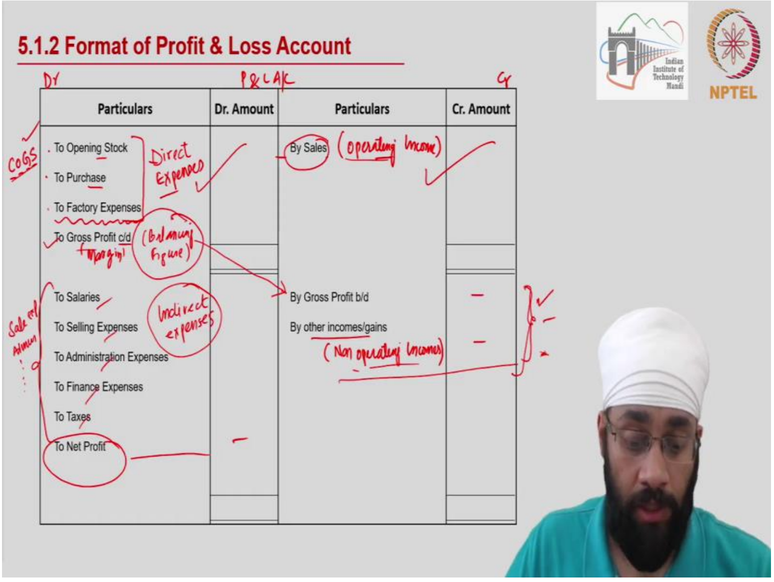
(Refer Slide Time: 03:29)




So, here is the format that we are going to be using. This is a familiar format; this is called account format. You have a debit side to this account and a credit side to this account. All we are going to do is to pick up this part, income part, and we are going to bring it here. All the incomes are going to be shown on the credit side as have credit balances. So, all credit balances are going to be shown on the credit side. On the other hand, all these expenses, the expenses we are going to pick this side and bring it to the debit side, because all expenses have debit balances. All we are doing is using an account format and we are calling this profit and loss account, rather than a profit and loss statement or statement of profit and loss.

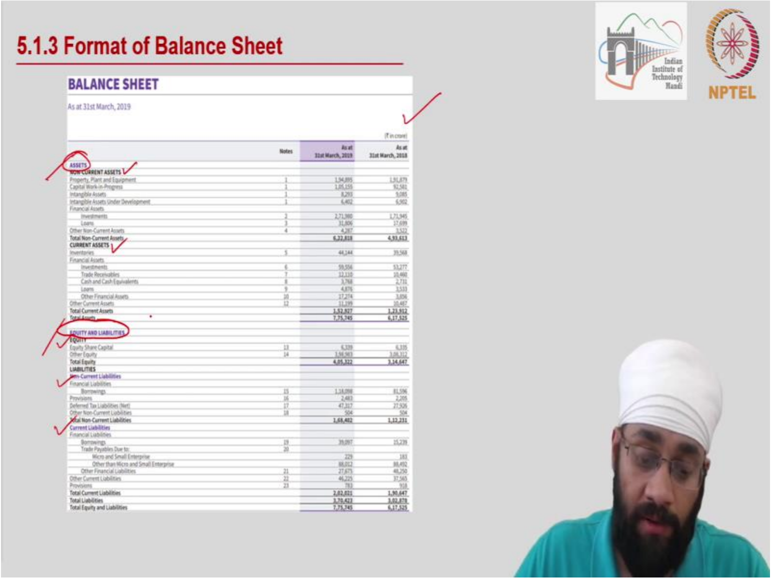
You are familiar with the account form of business. This is simply the ledger account that you learnt how to prepare. We are going to use the same similar principles. You just bring the incomes on the credit side, expenses on the debit side and you figure out the balancing figure which can be profit or loss. And when you have to present it to the public, you just transpose this into a different format, landscape format. You show incomes at the top and expenses at the bottom. Simple as that. But it is only for our convenience and in order to create some additional information for analysis purposes, that we are using the account format.

(Refer Slide Time: 05:18)



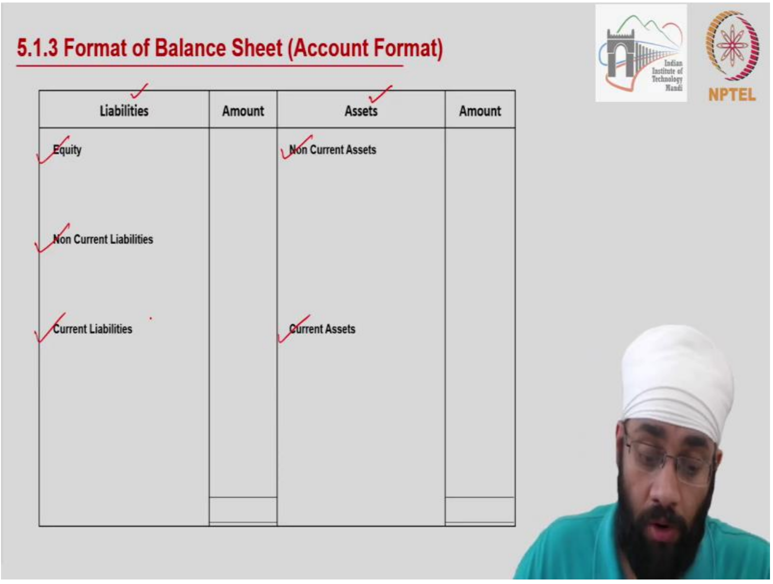

This is the statement. This is how we are going to do the profit and loss. And typically, this is how it is going to look and feel, as we move forward. This is the same account. You have a P & L account. On the credit side you have incomes, on the debit side you have expenses. You bring your operating income here. This is sales. Sales is an operating income. Sales is the only operating income that the business has. Sale of primarily the goods and services which the business manufactures or trades is the revenue coming in and that is what is operating income. All the other incomes are here, non operating incomes. These two have been segregated here for a specific purpose and I will tell you the purpose. But the idea is that operating incomes are going to be shown first and then non-operating incomes. If you look at this statement here you have operating income and non-operating income. So, we just use the account format. The presentation is different, but it is the same as shown in the statement format. On the debit side you have the value of opening stock, you have purchases, factory expenses and then you have something called a gross profit. What does this mean? All the items here are called direct expenses. What do we mean by direct expenses? We have discussed operating and non operating expenses, but direct expenses is something that we have not discussed before. Direct expenses are related to the manufacturing of the goods. All the expenses which have to be spent in order to produce the goods or make the goods ready to be sold are called direct expenses. So, those are called direct expenses and I have written factory expenses. So, whatever production level expenses are there will be shown here and then there is an item called gross profit. What is gross profit? In common parlance the word margin is used. So, you deduct from the sales, the cost of the sales. So, this is cost of goods sold or COGS. So, you have the stock unsold from the last year which is going to be sold in this year, you have purchases that you do in this year and then you have various factory related expenses that have to be incurred to make the goods ready to be sold. All these together are called the cost of the goods which are sold during the year. The difference between sales and cost of goods sold is the gross profit, this is the balancing figure. And I am sure you would know what is a balancing figure and what is meant by c/d, carried down. The margin here is called gross profit. This is an accounting term. This gross profit is then brought down, not into the next year, but into the next section here and you write the gross profit here. Then you add to the gross profit whatever additional income you have. So, this gives you the total available income that you have, out of this you are going to be spending now on selling. Sales expenses, advertisement, administrative expenses, anything which is after the production of the goods, after the goods have been converted into a form which is ready to be sold, are going to be shown here. The difference between this section (the total income which includes gross profit plus the other income), and all the expenses (indirect expenses) is called net profit. All the expenses which are not related to the manufacturing of the goods or getting the goods ready for sales like sales staff salaries, selling expenses, administrative, finance cost, taxes and everything else are called indirect expenses. Finally, you have a net profit which you show here. To summarize we are converting this statement into an account form, we take operating income and we take direct expenses. We figure out the gross profit, then gross profit is added to all the rest of incomes to find out the income available, to take care of the indirect expenses and then you figure out your net profit here. This is the format we are going to be using. This will become more clear as we solve more problems and do more tutorials.

(Refer Slide Time: 10:33)




The other statement is the balance sheet. Again, you have seen this statement, there are two sides to it: assets and liabilities (equities and liability side). So, these two sides; we are going to convert this as well into an account format.

(Refer Slide Time: 10:53)




You have assets on the one side, liabilities on the other side and traditionally we show liabilities on the left-hand side. It does not matter. You could swap the two as well, because earlier this was the convention, but now the law requires that the statement should be shown in this format. It does not matter what you show on the left side and right side, but what is shown on the top and bottom. So, this is the format that most companies will use, they will show assets first, liabilities after that. Then within the assets you have current assets and noncurrent assets. In the equities and liabilities side, you have three sub heads: noncurrent liabilities, current liabilities and equity. Similarly, we are going to follow this format here. Liability side you will have share capital here and you will have noncurrent liabilities and current liabilities; on asset side noncurrent assets and current assets. The headings are the same, the flow is the same, the only thing is rather than placing these you know one at the top of the other, we are using a vertical format, we have liabilities on one side, assets on the other side, just for creating more information in the process.

I hope now you have some sense of the format that we are going to use for the income statement and the balance sheet. In the next video I will talk more about how to prepare these two statements from the data generated through the accounting cycle process.