## FINANCIAL STATEMENTS

Financial Statements are the end products of accounting process and are prepared at end of the accounting period, to reveal the financial position of the enterprise at a date and the result of its business operations for an accounting period. Financial Statements are prepared as per the prescribed format as mentioned in ***Schedule III of Companies Act 2013.***

***The Schedule III of Companies Act 2013, prescribes only the "vertical format" for presentation of financial statements.*** Thus, a company will now not have an option to use horizontal format for the presentation of financial statements.
As per Section 2(40) of the Companies Act, 2013 Financial Statements includes:

1. **Balance Sheet( Financial Position Statement):** It Shows the Financial Position of a business. It is aa statement of Assets, Liabilities and Equity of the Company on a given date. It is prepared as per the format mentioned in Part I of Schedule III of Companies Act.
2. **Profit & Loss A/c (Income Statement):** It shows the financial Performance of the Entity during the given period.
3. **Notes to Accounts:** Details of the items mentioned in BS and P/L is provided in the notes to Accounts.
4. **Cash Flow Statement:** Its Shows the inflows and outflows of cash and Cash Equivalents. It is prepared in accordance with Accounting Standard-3.

**Contents of Annual Report:**

1. **A report of the Board of Directors**- It Contains Report as specified in section 134 of Companies Act, Directors' Responsibility Report, Report of Corporate Governance etc.
2. **Auditors Report.**
3. **Financial Statements**: Balance Sheet/ P& L A/c, Cash flow and Notes to Accounts.

## PART I – BALANCE SHEET

**Contents of Balance Sheet:**

- ✓ **An Asset** is a resource controlled by the enterprise because of past events from which future economic benefits are expected to flow to the enterprise.
- ✓ **Liability** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
- ✓ **Equity** is the residual interest in the assets of the enterprise after deducting all its liabilities.

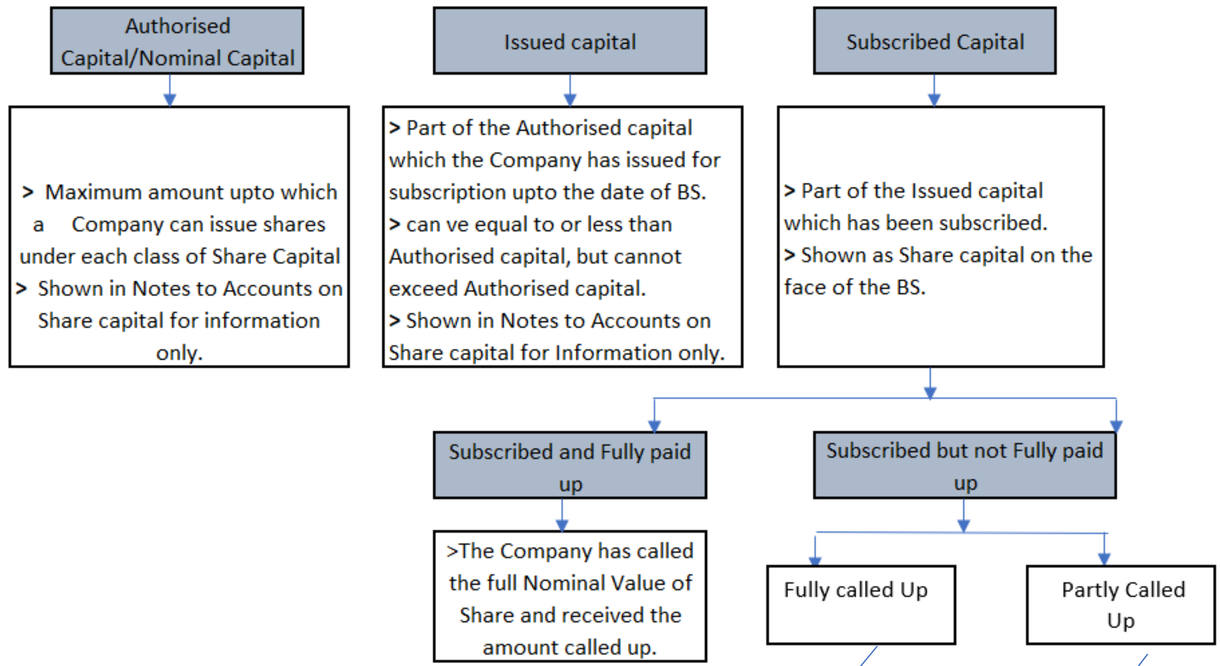
**Format of Balance Sheet as prescribed in part I of Schedule III.**

| Particulars | Note No | Figures as at end of current reporting period | Figures as at the end of the previous reporting period |
|---|---|---|---|
| **1** | **2** | **3** | **4** |
| **I. EQUITY AND LIABILITIES**<br><br>**(1) Shareholders' funds**<br><br>(a) Share capital<br>(b) Reserves and surplus<br>(c) Money received against share warrants<br>**(2) Share application money pending allotment**<br><br>**(3) Non-current liabilities**<br><br>(a) Long-term borrowings<br>(b) Deferred tax liabilities (Net)<br>(c) Other Long-term liabilities<br>(d) Long-term provisions<br>**(4) Current liabilities**<br><br>(a) Short-term borrowings<br>(b) Trade payables<br>(c) Other Current liabilities<br>(d) Short-term provisions | | | |
| **Total** | | | |
| **II. ASSETS**<br><br>**(1) Non-current assets**<br><br>**(a)Fixed assets**<br>(i) Tangible assets<br>(ii) Intangible assets<br>(iii) Capital work-in-progress<br>(iv) Intangible assets under development<br><br>**(b)Non-current investments**<br>**(c)Deferred tax assets (net)**<br>**(d)Long-term loans and advances**<br>**(e)Other non-current assets**<br>**(2) Current Assets**<br>(a)Current investments<br>(b) Inventories<br>(c) Trade receivables<br>(d) Cash and cash equivalents<br>(e)Short term loans and advances<br>(f)Other current assets | | | |
| **Total** | | | |

## I. EQUITY AND LIABILITIES

## 1) Shareholders' funds

### (a) Share capital




**Notes to Accounts** — **Current Year**

| **Particulars** | **Amount** | **Amount** |
|---|---|---|
| **Share Capital** | | |
| Authorized capital | | |
| 1,00,000 Equity Shares of Rs. 10 each | | 10,00,000 |
| 1,00,000 Preference Shares of Rs. 10 each | | 10,00,000 |
| **Issued Capital** | | |
| 50,000 Equity Shares of Rs. 10 each | | 500,000 |
| 50,000 Preference Shares of Rs. 10 each | | 500,000 |
| **Subscribed Capital** | | |
| **Subscribed and Fully paid up** | | |
| 40,000 Equity Shares of Rs. 10 each ( *<u>Out of above, 10,000 Equity Shares has been issued for Consideration other than cash)</u>* | | 400,000 |
| 40,000 Preference Shares of Rs. 10 each | | 400,000 |
| **Subscribed But not Fully paid up** | | |
| 10,000 Equity Shares of Rs. 10 each | 100,000 | |
| Less: calls in Arrears (10,000*2) | (20,000) | 80,000 |
| 10000 Preference Shares of Rs 10 each, Rs. 8 called up | 80,000 | |
| Less: Calls in arrears (10000*2) | (20,000) | 60,000 |
| **Total (Shown in Share capital on the face of BS)** | | **940,000** |

**Called up Capital**: It is that part of the **subscribed capital** which has been called up on the shares. The company may decide to call the entire amount or part of the face value of the shares. For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called-up capital is Rs. 7 per share. The remaining Rs. 3 may be collected later.

**Paid up Capital**: It is that portion of the **called-up capital** which has been received from the shareholders.

**b. Reserves and Surplus**

- **Reserves-** Amount set aside out of profits and surpluses to meet future uncertain, prospective losses or to strengthen financial position of the Company.
- **Surpluses-** Accumulated profits not appropriated or distributed as dividend ( PAT- reserves-dividends)

***<u>Reserves and Surplus is shown as a single amount on the face of Balance Sheet against Shareholders Fund. Details of Reserves and surplus is shown in Notes to Accounts as</u>***

**Opening balance (+) Additions/deductions (=) closing balance.**

Reserves and Surplus shall be classified as :

- Capital Reserves;
- Capital Redemption Reserve;
- Securities Premium Reserve;
- Debenture Redemption Reserve;
- Revaluation Reserve
- Share Options Outstanding Account;
- Other Reserves – (Specify the nature and purpose of each reserve and the amount in respect thereof such as Tax Reserve);
- Surplus i.e. Balance in statement of Profit & Loss.

**Note:**
*<u>Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'surplus'. Similarly, the balance of 'Reserves and Surplus', After adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus'</u>* ***<u>even if the resulting figure is in the negative.</u>***

*<u>Example:</u>*

**Notes to Accounts** **Current Year**

| **Particulars** | **Amount** | **Amount** |
|---|---|---|
| Reserves and Surplus | | |

| | | |
|---|---|---|
| a) Securities Premium Reserve | | 200,000 |
| b) Profit & Loss A/c (Opening balance) | 100,000 | |
| Add: Profit (Loss) for the year | (400,000 ) | (300,000) |
| Reserves and Surplus Net balance (**to be shown in BS)** | | **(100,000 )** |

**(c) Money received against share warrants:**

These are the financial instruments which will be converted into Equity shares later at a predetermined price.

**(2) Share application money pending allotment:**

Amount Received by the Company towards share capital and against which it will ***certainly allot shares*** in the future is shown as Share application money pending Allotment. ***This situation arises when the allotment is made after the BS date.***

**Share application money against which shares will not be allotted will be shown as " Other Current Liabilities " under the head "Current Liabilities"**

**(3) Non- Current Liabilities:**

**A liability shall be classified as non-current if it is not a current liability**. The following items shall be disclosed under non-current liabilities:

- **Long-term borrowings** -( *repayable after 12 months from the date of BS* ***or after the normal Operating cycle****. E.g.-Debentures, bonds, Long term loans, public deposits etc.)*
- **Deferred tax liabilities** (Net)- **(Not in Syllabus)
- **Other Long-term liabilities** -( Examples- Trade payables if agreed to be settled *after* 12 months, Premium payable on redemption of debentures if debentures are shown as Long-term liabilities, Premium payable on redemption of preference shares if preference shares are redeemable after 12 months )
- **Long-term provisions-(**Examples Provision for employee benefits. Example: Provision for Provident Fund Provision for Warranties etc. )

**(4) Current Liabilities**

➢ Liability shall be classified as current when it satisfies ***any*** of the following criteria:

- It is expected to be settled in the company's normal ***operating cycle***; or
- It is held primarily ***for being traded***; or
- It is due to be settled ***within twelve months*** after the reporting date; or
- The company ***does not have an unconditional right to defer settlement of the liability*** for at least twelve months after the reporting date.

** **An operating cycle** is the time between the acquisition of an assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

***material ➡ processing to make finished goods ➡ Selling it ➡ Realizing cash & cash Equivalents.***

Operating Cycle of a Company ***may be 12 months or more***. In case the Operating Cycle is more than 12 months, all the liabilities are shown as Current Liabilities if they are expected to be settled within the period of operating cycle. ***Any Liabilities to be settled after operating cycle will be classified as Long-term Liabilities.*** If a Company has more than one business, operating cycle will be determined for all the business separately.

| **Particulars** | **Operating Cycle** | **Expected period of Payment (Months)** | **Current Liabilities/ Non-Current Liabilities** | **Comments** |
|---|---|---|---|---|
| Trade Payables | 10 | 8 | Current Liabilities | payment Terms and Operating Cycle is less than 12 months |
| Trade Payables | 10 | 12 | Current Liabilities | payment Terms and Operating Cycle is less than 12 months |
| Trade Payables | 10 | 15 | Non-Current Liabilities | payment Terms is more than 12 months |
| Trade Payables | 18 | 15 | Current Liabilities | Expected period of Payment is less than Operating cycle |
| Trade Payables | 18 | 24 | Non-Current Liabilities | Expected period of Payment is More than Operating cycle and after 12 months from the BS date |

The following items shall be disclosed under non-current liabilities:

a) **Short-term borrowings**
b) **Trade payables**
c) **Other Current liabilities**
d) **Short-term provisions**

**4.a. Short-term borrowings:**

Short-term borrowings are the borrowings which are payable within 12 months from the date of Balance Sheet or within the period of operating cycle. The following items are included in short term borrowings:

- Loans repayable on demand;
- Bank overdraft and cash credit limit form banks;
- Loans from other parties repayable within 12 months;
- Deposits; and
- Other loans and advances (Specify nature).

**4.c. Other current liabilities**

The amounts shall be classified as :

- Current maturities of long-term debt;
- Current maturities of finance lease obligations;

- **Interest accrued but not due on borrowings** (i.e. Interest provided in the books of Accounts, but it has not become due for Payments).
- **Interest accrued and due on borrowings (i**.e. Interest provided in the books of Accounts, but it has become due for Payments).
- Income received in advance;
- Unpaid dividends ( i.e. Dividends declared but remain unclaimed by Share Holders)
- Application money received for allotment of securities and due for refund and interest accrued thereon;
- Unpaid matured deposits and interest accrued thereon;
- Unpaid matured debentures and interest accrued thereon;
- Calls-in-Advance
- Other payables (specify nature).

**(C) Interest accrued but not due on borrowings:**

If A company pays half yearly interest in the months of June and Dec. and closes its books of Accounts on 31$^{st}$ March, it will accrue interest for Jan to March in the current year, but the interest becomes due for payment in the Next Year Only. The interest for the quarter Jan to March is classified as " Interest accrued but not due for payments.

**(D) Interest accrued and due on borrowings:**

If the half yearly interest for Dec ( in the above example) is accrued in the books of payments but has not been paid 31$^{st}$ March, it is classified as Interest accrued and due for payments.

**4.d. Short-term Provisions**

Provisions which are expected to be paid within 12 months or within the period of the Operating Cycle, which ever is longer are classified as short-term provisions.

The amounts shall be classified as :

(a) Provision for employee benefits;
(b) Provision for Expenses;
(c) Provision for tax;
(d) Others (specify nature).

- These amounts should be disclosed separately specifying nature thereof.

**II. ASSETS**

1) **Non-current assets**

**Non- Current Assets are those assets which are not Current Assets**. Non-Current Assets are classified into five major heads:

**(a)Fixed assets** (These assets are held by the Company not for sale but for increasing the earnings of the Company. Fixed Assets are classified as follows:

- **Tangible assets**- Assets which have physical existence. E.g. Land & Building, Furniture, Machinery etc.
- **Intangible assets**- Assets which do not have physical existence. E.g. Goodwill, Trademarks, copy rights , Intellectual Property Rights, etc.
- **Capital work-in-progress**- Tangible assets under Construction.
- **Intangible assets under development**

Intangible Assets under development should be disclosed under this head provided they can be recognized based on the criteria laid down in AS-26. Examples are patents, computer software under development.

**(b)Non-current investments:** Such investments are not used in operating activities to generate revenues. In other words, LT investments are assets that are held for more than one year or accounting period and are used to create other income outside of the normal operations of the company.
**Investments are further classified as "Trade Investments" and "Other Investments".**

**Trade Investments-** Investment made by a company in shares or debentures of another company, to promote the trade or business of the first company.
**Non- Trade Investments-** Investments other than Trade Investments.

Non-Current Investments is further classified as :

- Investment in property;
- Investment in Equity Instruments;
- Investment in preference shares;
- Investment in Government or trust securities;
- Investment in debentures or bonds.
- Investment in Mutual Funds;
- Investment in partnership firms;
- Other non-current Investments (specify nature)

**(c)Deferred tax assets (net)-Not in Syllabus.**

**(d)Long-term loans and advances (**Loans and advances that are not expected to be received back in cash or in the form of an asset within 12 months are known as Long-Term loans and advances.)

Long-term loans and advances shall be classified as :

- Capital Advances (Capital advances are advances given for procurement of fixed assets which are non-current assets.
- Security Deposits;
- Loans and advances to related parties (giving details thereof);-**Not in Syllabus**
- Other loans and advances (specify nature)- E.g. Long-Term Loan to Employees; Long term advances to Suppliers.

**(e) Other non-current assets**

**(2) Current Assets**

An asset shall be classified as current when it satisfies *any* of the following criteria :

- It is expected to be realized in, or is intended for sale or consumption in the company's normal operating cycle; or
- It is held primarily for being traded; or
- It is expected to be realized within twelve months after the reporting date; or
- It is cash or cash equivalents ***unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date***.

  All other assets shall be classified as non-current.

> ****Example of Restricted cash & Cash Equivalents**- Company having bank Outside Country and has been restricted to transfer funds outside the Country. Restricted cash & Cash Equivalents are classified as "Non- Current Asset".

> ****An operating cycle** is the time between the acquisition of an asset for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

| Particulars | Operating Cycle | Expected period of Realization (Months) | Current Assets/ Non-Current Assets | Comments |
|---|---|---|---|---|
| Trade Receivables | 10 | 8 | Current Assets | Expected realization is less than Operating cycle |
| Trade Receivables | 10 | 12 | Current Assets | Expected realization is less than 12 months |
| Trade Receivables | 10 | 15 | Non-Current Assets | Expected period of realization is more than 12 months and operating cycle |
| Trade Receivables | 18 | 15 | Current Assets | Expected period of realization though more than 12 months but less than Operating cycle |
| Trade Receivables | 18 | 24 | Non-Current Assets | Expected period of realization is more than 12 months and greater than Operating cycle |

Current Assets are classified under the following six Sub heads:

(a)Current investments

(b) Inventories

(c) Trade receivables

(d) Cash & Cash Equivalents

(e) Short Term Loans and Advances

(f) Other Current Assets

**II.2.a. Current Investments** (Current Investments are the investments which are held to be converted into cash within, short period, i.e., within 12 months)

Current investments shall be classified as :

- Investment in Equity Instruments;
- Investment in preference shares;
- Investment in Government or trust securities;
- Investment in debentures or bonds.
- Investment in Mutual Funds;
- Investment in partnership firms;
- Other Investments (specify nature)

**II.2.b. Inventories (Stock)**

Inventories shall be classified as :

- Raw materials;
- Work-in-progress;
- Finished goods;
- Stock-in-trade (in respect of goods acquired for trading);
- Stores and spares;
- Loose tools;
- Other (specify nature)

**II.2.c. Trade Receivables**- (A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due because of goods sold or services rendered in the normal course of business. A trade receivable will be treated as current if it is likely to be realized within 12 months from the date of Balance Sheet or Operating cycle of the business).

**II.2.d. Cash and Cash Equivalents**

As defined in AS-3, Cash flow Statement, cash and cash equivalents are short term highly liquid investments that are readily convertible into known amount cash and which are subject to an insignificant risk of change in value.

Cash and cash equivalents shall be classified as :

- Balances with banks;
- Cheques, drafts on hand,
- Cash in hand;
- Other (specify nature)

**II.2.e. Short-term Loans and Advances**

Short-term Loans and Advances shall be classified as :

- Loan and advances to related parties (giving details thereof): **Not in Syllabus**
- Other (specify nature)

**II.2.e.f. Other Current Assets (specify nature)**

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset, categories e.g. Unbilled Revenue, Unamortized expenses to be written of within 12 months, Premium on Forward Contracts, prepaid expenses, dividend receivable, advance taxes etc.

**Contingent Liabilities and Commitments:**

**Contingent Liabilities**: Contingent Liabilities are those Liabilities which may or may not arise. They are dependent on a happening in future. Hence Contingent Liabilities are not shown in Balance Sheet, but a Company needs to disclose the Contingent Liabilities as a footnote of Balance sheet or in Notes to Accounts.

**Examples:** Proposed dividend, Potential lawsuits, product warranties, and pending investigation, etc.

**Commitments:** A commitment is an obligation of a company to external entities that often arises in connection with the legal contracts executed by the company.

**Examples:**

- Short-term and long-term contractual obligations with the suppliers for future purchases
- Capital expenditure commitment contracted but not yet incurred.

## PART II- STATEMENT OF PROFIT AND LOSS

It is a statement prepared to show the result of business operations during an accounting period. It shows the operating performance of a company during the accounting period. A Statement of Profit & Loss of a Company is prepared as per the format prescribed **in Part II of Schedule III** of the Companies Act, 2013.

Statement of Profit & Loss For the year ended_____________

| **Particulars** | **Note No** | **Figures as at end of current reporting period** | **Figures as at end of the previous reporting period** |
|---|---|---|---|

| | | | |
|---|---|---|---|
| I. Revenue from operations | | ……….. | ……….. |
| II. Other Income | | ……….. | ……….. |
| **III. Total Revenue (I+II)** | | | |
| **IV. Expenses :** | | | |
| · Cost of Material consumed | | ……….. | ……….. |
| · Purchases of Stock-in-Trade | | ……….. | ……….. |
| · Changes in Inventories of Finished Goods, Work-in- progress and Stock-in-trade | | ……….. | ……….. |
| · Employees Benefit Expenses | | ……….. | ……….. |
| · Finance Cost | | ……….. | ……….. |
| · Depreciation & Amortization Expenses | | ……….. | ……….. |
| · Other Expenses | | ……….. | ……….. |
| **Total Expenses** | | | |
| **V. Profit before Tax (III-IV)** | | ……….. | ……….. |
| VI. Less : Tax | | (………..) | (………..) |
| **VII. Profit after Tax (V – VI)** | | ……….. | ……….. |

I. **Revenue from Operations** : It refers to the revenue earned by the company from its business operations.
Fox example : Revenue from sale of products or services
*** Sale of scrap inventory forms part of revenue from operations.

**II. Other Income :** It refers to the revenue earned by the company from activities ***other than*** its business operations.
Fox example :

- Profit from sale of Fixed Assets
- Bad Debts recovered
- Provision written back
- Interest earned on investments/ Fixed deposits etc.
- Refund of Income Tax

**IV EXPENSES**

- **Cost of Material Consumed:** Means cost of Raw materials and other materials consumed in manufacturing the goods.
  Cost of material consumed is calculated as : = Opening inventory of Raw Materials **(+)** Net Purchases of Raw Materials **(–)** Closing Inventory of Raw Materials.
  ****Note:** Inventory of Work-in-progress, finished goods and Stock-in-trade are not considered for calculating cost of material consumed. These are considered to calculate changes in inventories of Finished Goods, Work in Progress and Stock in Trade.

- **Purchase of stock in Trade:** It includes goods purchased for resale purpose in same form i.e., without any further processing. If a company carries out further processing on the goods purchased, they do not remain stock in Trade, but form part of Cost of material Consumed.

- **Changes in Inventories of work-in-progress finished goods and stock-in-trade:** = Opening Inventories – Closing Inventories.
  In the Notes to Accounts on Changes in Inventories of work-in-progress finished goods and stock-in-trade, each item of Inventory is shown separately and the total balance under each inventory is added together to show one amount in Profit & Loss Account.

- **Employees Benefit Expenses** : It includes all expenses incurred by the company on its employees such as :
  (i) Wages, salaries, bonus etc.
  (ii) Leave encashment, staff welfare expenses, etc.
  (iii) Employer Contribution to employee's provident fund and other funds.

- **Finance Cost:** It means cost incurred by a company on its borrowings i.e., debentures issued, or loan taken by it.
  It includes:
  (I)Interest on loan & debentures
  Loan Processing Fess
  *Discount on issue of Debentures*
  *Premium payable on redemption of Debentures*
  ****Note**- bank Charges are not shown under Finance Cost but are shown under " Other Expenses"
- **Depreciation and Amortization expenses** : Depreciation is the cost of tangible fixed assets written of over their useful life such as on building, plant & machinery etc.
  Amortization is the cost of intangible fixed assets written off over their useful life such as on patents, trademarks, computer software etc.
- Other Expenses: Expenses that are not shown in any of the above-mentioned heads are shown here.

For example:

- Carriage Inwards/Outwards
- Audit Fees
- Insurance charges
- Rates & taxes
- **Bank charges**
- Advertisement expenses
- Administrative expenses
- Selling and distribution expenses
- Power and electricity expenses
- Repairs of Fixed Assets etc.
- Rent
- Telephone expenses
- Sundry Expenses

| Summary of Expenses | |
|---|---|
| (a) Cost of Materials | It applies to manufacturing companies. Formula-Opening inventory of Raw Materials (+) Net Purchases of Raw Materials (–) Closing Inventory of Raw Materials. |
| (b) Purchase of Stock-in-trade | It means purchases of goods for the purpose of trading. |
| © Changes in Inventories of work-in-progress finished goods and stock-in-trade | It is the **difference** between **opening** inventory (stock) finished goods, WIP and of finished goods, WIP and stock-in-trade and **closing** stock-in-trade inventory. |
| (d) Employees benefit expenses | Expenses incurred on employees towards salary, wages, leave encashment, staff welfare, etc., are shown under this head. Employees benefit expenses may be further categorized into direct and indirect expenses. |
| (e) Finance cost | It is the expenses towards interest charges during the year on the borrowings. Only the interest cost is to be shown under this head. Other financial expenses such as bank charges are shown under “Other Expenses”. |
| f) Depreciation | Depreciation is the diminution in the value of fixed assets whereas amortization is writing off the amount relating to intangible assets |
| (g) Other expenses | All other expenses which do not fall in the above categories are shown under other expenses. Other expenses may further be categorized into direct expenses, indirect expenses and non-operating |

**USERS OF FINANCIAL STATEMENTS:**

The users of financial statements include management, investors, shareholders, creditors, government, bankers, employees and public at large. Financial statements provide the necessary information about the performance of the management to these parties interested in the organization and help in taking appropriate economic decisions. The various uses and importance of financial statements are as follows:
**1. Shareholders:** Financial statements report the performance of the management to the shareholders. The gaps between the management performance and ownership expectations can be understood with the help of financial statements.

**2. Management:** The Management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost control and reduction, investments into new ventures etc.

**3. Government Authorities:** The fiscal policies, particularly taxation policies of the government, are related with the financial performance of corporate undertakings. The financial statements provide basic input for industrial, taxation and other economic policies of the government.

**4. Banks & Financial Institutions:** Corporate undertakings must borrow funds from banks and other financial institutions for different purposes. Credit granting institutions take decisions based on the financial performance of the undertakings. Thus, financial statements form the basis for granting of credit.

**5. Basis for prospective investors**: The investors include both short-term and long-term investors. Their prime considerations in their investment decisions are security and liquidity of their investment with reasonable profitability. Financial statements help the investors to assess long-term and short-term solvency as well as the profitability of the concern.

**6. Investors:** Shareholders of companies are interested in knowing the status, safety and return on their investment. They may also need information to take decision about continuation or discontinuation of their investment in the business. Financial statements provide information to the shareholders in taking such important decisions.

**7. Aids trade associations in helping their members**: Trade associations may analyses the financial statements for the purpose of providing service and protection to their members. They may develop standard ratios and design uniform system of accounts.

**8. Helps stock exchanges:** Financial statements help the stock exchanges to understand the extent of transparency in reporting on financial performance and enables them to call for required information to protect the interest of investors. The financial statements enable the Stock brokers to judge the financial position of different concerns decisions about the prices to be quoted.

**LIMITATIONS OF FINANCIAL STATEMENTS**

Though utmost care is taken in the preparation of the financial statements and provide detailed information to the users, they suffer from the following limitations:

**1. Do not reflect current situation**: Financial statements are prepared based on historical cost. Since the purchasing power of money is changing, the values of assets and liabilities shown in financial statement do not reflect current market situation.

**2. Assets may not realize:** Accounting is done based on certain conventions. Some of the assets may not realize the stated values, if the liquidation is forced on the company. Assets shown in the balance sheet reflect merely unexpired or unamortized cost.

**3. Bias:** Financial statements are the outcome of recorded facts, accounting concepts and conventions used, and personal judgements made in different situations by the accountants. Hence, bias may be observed in the results, and the financial position depicted in financial statements may not be realistic.

**4. Aggregate information:** Financial statements show aggregate information but not detailed information. Hence, they may not help the users in decision-making much.

**5. Vital information missing:** Balance sheet does not disclose information relating to loss of markets, and cessation of agreements, which have vital bearing on the enterprise.

**6. No qualitative information:** Financial statements contain only monetary information but not qualitative information like industrial relations, industrial climate, labor relations, quality of work, etc.