

Financial Statement Analysis and Reporting
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Lecture – 28
Corporate Financial Statements Part-IV

Welcome students. So, in the previous lecture we were talking about the different types of the shares, especially the preference shares. So, we discussed that there are broadly two categories of the shares; preference shares and equity shares. So, preference shares are of the four categories, and we have discussed two categories in the previous lecture; that is the say cumulative and non cumulative, and then convertible and nonconvertible. So, as I told you that cumulative preference shares are those, where if dividend is not paid in 1 year, means payment of the dividend is certain, if it because of any reasons that the country does not have the sufficient profits, and the dividend could not paid in one year in that case, second year or in the next year the dividend will be paid at the double rate, means if the 10 percent preference shares are issued, then if the dividend is not paid in the first year, than in the second year 20 percent dividend has to be paid.

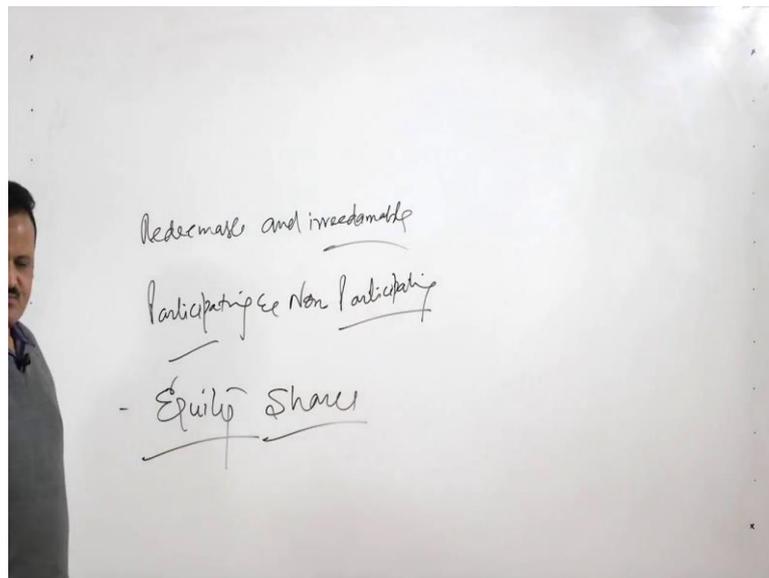
But if the non cumulative shares are there, then there is no obligation on the part of the company that they have to pay dividend every year, when there is a sufficient profit and no funds crunch, then the dividend can be paid at the rate of 10 percent or the pre-specified rate, and if there is a means no availability of the funds or sufficient profits then dividend cannot be paid, or may not be paid.

Similarly, in case of the convertible shares. Convertible shares are those which can be converted on the willingness of both the sides, the buyer as well as the, the buyer of the shares as well as the issue of the shares means a company. If both normally the shared preference shares are issued in India for 5 years. After 5 years either they have to be redeemed means got back by the company, or if they are convertible they may be converted into the equity shares.

So, both the sides are comfortable, buyer is also comfortable and the seller, means the companies also comfortable that they also do not want to get it the money back, and company also does not want to pay the money back to the buyer, in that case though shares can be converted into equity shares. So, those are the convertible preference

shares, and similarly the non convertible, means those shares preference shares which are not convertible into the equity shares, means after the period for which they have been issued may be for the 5 years or the 10 years they have to be redeemed, they have to be bought back by the company, and the funds have to be returned back to the shareholders. So, they are the convertible shares. Now, we will talk about the next two categories; that is redeemable preference shares, and irredeemable preference shares.

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Redeemable preference shares are those preference shares, as I told you that the preference shares are issued only for a limited period of time, say 5 years or 10 years, and after the on the expiry of that period if these preference shares are redeemable preference shares, then we have to be redeemed in every respect, means the shares have to be bought back by the company, and the funds have to be returned to the buyer or the buyers has to return it back to the company.

He has to get the money back the investment back, and the company has to accept the shares back, they have to buy it back, they are redeemable. and if they are irredeemable in that case means, it is the choice of both the parties that if they cannot be ready redeemed, it means they can continue for an unlimited period of time, and there is no need for the redemption of the preference shares, but in India irredeemable preference shares cannot be issued, irredeemable preference shares cannot be issued, it is possible in the other countries. But in India or in the Indian scenario only redeemable preference

shares are issued, it means the preference shares are issued for a certain period of time 5 years or 10 years, and after the expiry of that period, these shares have to be brought back by the company, and the funds have to return back to the shareholders.

Last category of the shares are participating and non participating as I told you yesterday. Participating and non participating. Participating and non participating preference shares - Participating and non participating preference shares which was participating preference shares, first you understand this said and then will you understand the reverse of the participating preference shares. Participating preference shares are those preference shares. Look that if, when the company has sufficient profits for sometime very good profits, company declares the dividend that a certain percentage or certain part of the profit will be paid as dividend.

Now as I told you that preference shares have the preference over receiving the dividend as compared to the equity shareholders. In that situation, first the dividend will be paid by the company to the preference shareholders, but as I told you earlier, that the dividend to be paid to the preference shareholders is fixed. Say 10 percent preference shares or 20 percent preference shares or 15 percent preference shares. So, they have to be paid the dividend at the pre-specified rate, and not more than that not less than that, but see if the amount of a profit is very high, and the management of the company, board of directors have allocated a very big sum of profit, which they maybe probably they not need this funds to be reinvested back in the business. So, they thought that it should be distributed to the shareholders to serve their best interest. So, they have declared a big amount of the profit as; that means, to be paid as dividend.

In that situation first the dividend will be paid to the preference shareholders at the pre-specified rate, and then the remaining amount of the debit, profit which is declared certain side to be used as a for the payment of the dividend. In that case the equity shareholders will be given the dividend. Now, the equity shareholders can be given the dividend at the maximum possible rate.

For example, now the equity shareholders are paid the dividend by the company at the rate of 40 percent or 45 or 50 percent, but even after paying, but they cannot be paid more than that, because the management of the board of directors do not want to spoil the habit of the equity shareholders also. They do not want to increase the expectations

of the equity shareholders also, that yes any amount of the dividend can be expected by them. It may be paid ones, but next year the profitability may go down. So, the dividend may not be paid or dividend paid will be very less. So, there will be a, you can call it as disturbance of the symbiosis.

So, management does not want like that, they will pay the handsome amount of dividend to the equity shareholders; say 40 percent or 45 percent. And even after paying this much dividend to the equity shareholders, still there are the funds left in the dividend account. Now, the pay dividend first to the preference shareholders, then they paid the dividend means preference shareholder are given the dividend may be 10 or 15 percent, pre-specified rate, it cannot be increased. And then equity shareholders are paid a very high rate of interest.

See equity shareholders there is no more dividend is fixed for the equity shareholders if the profit is very high, that the rate of dividend will also go very high. If the profit is low rate of dividend will also be very low, and some time no dividend can be paid. So, equity shareholders cannot ask for any kind of return, any kind of the dividend to be paid to them certainly, as is a case with the preference shareholders, if they are cumulative preference shares.

Now, after paying a huge amount or dividend to the equity shareholder, still the funds are left in the dividend account. Then if the preference shares are participating preference shares, then those shareholders can be paid the dividend again in the second round. Means those shareholders can participate in the dividend in the second round, means they can participate in the leftover funds, and they can be paid the dividend in the second round. First they were pay 10 percent, because the preference share is 10 percent, then equity shareholders 40 percent, and then still some funds are left. So, means again in the second round, means in that case preference shareholders will get the dividend two times or again at the rate of 10 percent they are getting the dividend in the second round.

So, it means those preference shares who can participate in the leftover funds in the dividend account, and in get the dividend in the second round, those shares are called as preference shares, means participating preference shares. So, in this case if they participate in the second round and if your 10 percent preference shares, in that case they are getting the dividend at the rate of 20 percent, and equity shareholders are getting the

dividend at the rate of 40 percent. So, at least to some extent the company is going to bridge the gap between the preference and equity shareholders, as far as the payment of dividend is concerned. So, that can be done sometimes. So, but it is only possible if the preference shares are participating preference shares.

The non participating preference shares, then they cannot be allowed to participate in the second round of dividend payment. Only first round of the dividend payment they will be pay dividend and even some money is left, but these shareholders, preference shareholders cannot participate in the second round and the leftover money, after paying the dividend equity shareholders that will be reinvested back in the company's funds, and the capital of the company will go up.

So, these are the four broad categories of the preference shares; they are cumulative and non cumulative, then they are convertible and nonconvertible, redeemable and irredeemable, and then they are participating and non participating. Out of these four or eight categories only irredeemable preference shares cannot be issued in India, they are not allowed as per the Indian Companies Act 1956.

After that we talked about the second category of the shares is the equity shares. So, as I told you, that what are the equity shares means. Those shares which are not preference shares, they are equity shares. Those shares which are not preference shares they are equity shares. equity shares means they will not get any kind of the preference, maybe not in terms of payment of dividend or at the time of the dissolution of the company, they will be paid return their capital in the last.

First financial institutions, then the bond holders, debenture holders, then the preference shareholder and lastly some funds are left in that equity, then the funds will be paid or the capital of the equity shareholders will be retired. So, in a case they are getting a huge amount of the dividend, if the company is highly profitable concerned, but they are getting no dividend if the companies incurring losses or the profit or the extent of the profit is not sufficient; that is a one case. And the second case is when the company situation means condition detonates, and in any case if the company has to be closed on or dissolved even then the equity shareholders are at the receiving end.

But in the real sense the positive effect of the equity shareholders is, that they have, they are the real shareholders, because they have the voting right. As I told you in my previous lecture also, that the equity shareholders of the voting right. They have the right to decide the shares of the company, and whenever on any issue a decision has to be taken, then the equity shareholders are consulted by the management as well as the initial promoters, and preference shareholders have no say. Similarly as I told you that at least once a year annual general meeting is must to be held, once a year the management must call all the shareholders, they must explain them the total affairs of the company; that is called as the AGM annual general meeting of the company, and in that AGM if there is some contains an issue, on which the shareholders are divided, or they are not able to decide whether to take up that particular project or not, or means go for that particular decision of not, in that case the voting has to be done, and in that case the voting right is with the equity shareholders.

So, in that sense the real owners are equity shareholders. preference shareholders are kind the bondholders, means they only, as the bondholders they get the dividend, means that as a bond holders they get the interest at the fixed rate, and they also get their capital back and priority in getting the their funds back, if the company has to be dissolved same is a case with the preference shareholders, but preference shareholders get the dividend and the bondholders get that interest. So, means in a way, in the say, companies means accounting language the preference shareholders are also treated like the bond holders, and even the preference shares are also called as the fixed income shares, or the fixed income securities.

Now, I will take you to little process that how this closing up of the companies is done. For example, that if some companies not doing well. If some company is not doing well, and the company is not able to pay his debts, or pay the interest on the loans, or pay the installment of the debts, and or there is some other, maybe not able to pay the salaries of the employees, or there is a severe financial crunch.

So, it means the financial institution the bond holders, even the employees they will wait for some time, and even if the situation does not improve, then finally, what will happen, there will be a hue and cry. And especially the bigger financial institutions, who have lent the big amount of the money they will take the company to the court of law. They will file a case against the company that they borrowed this much money from us, and

they are not returning it, either they are paying interest on it, monthly interest. Now they are paying that six months quarterly statement on the principle amount, and we doubt that financial position of the company is not good.

So, the matter should be resolved. So, matter will be discussed in the court, and the court will say investigate or will ask a concerned authorities, to investigate the total affairs of the company, and if it is observed by the court that this company's financial position has badly deteriorated, it cannot improve now, it cannot be restructured, it cannot be may be brought back on the wheels. So, in that case court may order that this company may be dissolved or closed down. Now, how the company will be dissolved or closed down? Then the management of the company will be asked now to stay away from the affairs of the company. Court will appoint one person, who is called as official liquidator of the company. He may be a chartered accountant (Refer Time: 15:51) chartered accountant or he may be a lawyer, who has some knowledge of the economic affairs or the financial affairs you will may be a (Refer Time: 15:57) lawyer in the court.

He will be appointed as the official liquidator of the company. He will initiate the process of selling the assets of the company in the market, and he will auction the assets, whatever the way he adopts, may be gives an advertisement or he informs the potential buyers or somebody something like that, then that advertisement will be given, and all the assets land, plant, building, machinery, furniture everything current asset, stock, inventory everything will be sold by him in the market, and whatever the sale proceeds are received by him. He will use that money first to pay the claims of the financial institutions, who are the large or the bigger substantial lenders to the form one. After that he will settle the claims of the individual lenders, will be the bond holders or the debenture holders, then third he will pay he settle the claim of the preference shareholders, and lastly he will if some funds are left in the say that companies kitty or in that dissolution, means after dissolution whatever the funds are received in that kitty, if something is left in that case the claims of the equity shareholders will also be settled.

So, this is the way that how the companies are closed down, and the official liquidator is appointed by the court, and he does everything and sells the assets of the company the market, he settle the claims of all the lenders as well as the shareholders, and that with the companies are closed on, or there could be other way round, that to save the companies. For example, if the company is good doing well, but because of certain

reasons it has gone out of track, but there is a good, very good potential that the company can be improved, can be structure, or can be taken over by some other good company.

So, in that case, there is no need to dissolve the company, matter will be investigated, maybe on the complete of the employees around the complaint of financial institutions, are on the complaints of some other stakeholders, matter will be, may be taken to the court or may be reported to the government agencies like registrar of companies or SEBI, and on the instructions of these regulatory authorities, SEBI or registrar of companies, government may inquiry into the affairs of the company, and if it is found that, because of the miss management by the present management, the company has gone out of track, but it has the po10tial to say come back on the wheels. Then in that case the companies, the company can be offered either by the government or by the existing management shareholders to be sold to the other company, and the sick company can be acquired by the other companies also. No need to dissolve it, no need to sell the assets nothing, only the name will change, and the total, means whatever is left with the company will be taken over by the new company, it has happened in case of the Satyam computers.

That Satyam computer was a good company, doing very well, having very good clientele, having good very good product it was selling in the market, but because of the bad intentions of the chairman of the company and the two auditors of the prices water house cooper, company went out of the track, but when this affair came on the surface, because there was a severe financial crunch. So, when the matter was complain to the government and government authorities when they are inquired into the total process and total affairs of the company, they found that it is, because of the one person mister Ramalinga Raju, the company has gone out of track, now that everything was.

So, case was registered against him, he was put behind the bars, then the government investigated into the affairs of the company and finally, it was observed and decided by the government that the company has a very good potential, it has a very good product, very good potential, very good clientele, within India and outside India.

So, there was no need to close down the company, and then the government offered the sale of the company or the company to be acquired by some other company, and Tech Mahindra has taken over Satyam Computers. So, it means in that case, the interest of everybody safe, employees are safe, they are working now, the employees of Satyam

Computer under the overall management of Tech Mahindra, even the suppliers are safe, even the buyers are safe, even the financial institutions are safe, because in that case total liabilities and assets of the company are taken over of the acquiring, means acquired a company are taken over by acquiring company.

In that case all the liabilities, means the loans of financial institutions, then say the bondholders claims, preference shareholders, equity shareholders all every, everybody claims are taken over by the acquiring company, and then they become the shareholders, lenders, bondholders for the acquiring company, and their process continues, as it was continuing in the past.

But if there is nobody to take over the company in the market, and everybody feels that this company is now a crap, cannot be brought back on the wheels, in that case it has to be closed down. when it has to be closed down I explained you the process that, by appointing official liquidator the company can be closed down, and the assets can be sold, and the claims of different stakeholders, including financial institutions, bondholders preference shareholder including equity shareholders can be settled in that order.

So, till now we talked about what are the different types of the share capital, how the shares are sold in the market, different installments, then we talked about the different type of the shares, preference and equity shares, and what are the rights and responsibilities of both preference and equity shares, and how the claims of the different stakeholders are settled if the company is not doing well.

Now, we will be talking about the financial statements of the different these companies, and how to prepare the financial statement of this company. So, we have got a problem, which is especially related to the financial statements of the public limited companies, and here we have the information, what we dealt with earlier, in case of the see the other organizations like partnership firms, private limited companies of the sole proprietors. those kind of the items are there, similar trial balance we have, debit balance is credit balance everything is there, but in this case we have something extra also, which is their in the companies only not in the other forms of organizations.

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The following is the Trial Balance of Mamta Fashions Ltd. as on 31st March, 2016

Sr. No.	Head of Account	Amount (Dr.)	Amount (Cr.)
1.	Premises	3,60,800	
2.	Plant & Machinery	4,95,000	
3.	Opening Inventory	1,12,500	
4.	Debtors	1,06,050	
5.	Land	87,500	
6.	Cash in Hand	4,725	
7.	Current Account	45,500	
8.	Bills Receivables	58,875	
9.	Purchases	27,00,000	
10.	Preliminary expenses	7,500	
11.	Wages	86,970	
12.	General expenses	10,252	
13.	Salaries	90,338	
14.	Bad Debts	3,165	
15.	Interest on term loan	27,000	
16.	Equity share capital		3,00,000
17.	10% Preference Share Capital		1,00,000
18.	Secured Loan @ 12% p.a.		4,50,000
19.	P&L A/C Balance as on 1.4.2015		39,375
20.	Bills Payables		55,500
21.	Creditors		83,000
22.	Sales		31,20,000
23.	General Reserves as on 1.4.2015		37,500
24.	Central Sales tax Payable		10,800
	Total	4,196,175	4,19,6175

So, this problem is a trial balance of Mamta Fashions Limited as on 31st March 2016. This is a trial balance, you see that we have again the same heads of accounts like premises, means the buildings, plant and machinery, opening inventory debtors land, cash in hand, cash at bank, bills receivables, purchases, preliminary expenses, wages, general expenses, salaries, bad debts, interest on term loans than equity share capital that was not there, then is a preference share, capital 10 percent.

Now you see it is writ10 here that 10 percent preference share capital, it means that the dividend on these shares will be paid at the rate of 10 percent. Then it is the secured loans; that is 12 percent, 12 percent means at the rate of 12 percent interest per annum, that profit and loss account; that is the balance of the profit and loss account. These are some new items, we have not discussed earlier. Then bills payable, creditor, sales, journal, reserve balance is also there. Then the central sales and tax payable is there, tax was not, we have not dealt with tax related information earlier, and apart from this information. So, here you see that there are certain new things. For example, preliminary expensive we have not dealt with so far. Then we have say equity share capital we have not dealt with so far.

Then we have the preference share capital, we have not taken this care of so far. So, there is some new items in this trial balance which were not there, it means company forms of organizations or the ultimate forms of the organizations, and if we know that

how to prepare the financial statements of the companies, and at the same time how to analyze it. Then doing for the other organization; likes private limited companies, partnership firms and sole proprietors will not be very difficult for us. So, we will have to now discuss this advanced level. Apart from this we have some other information also, and when we talk about the other information, we have some adjustments, as we had some adjustments in the past. So, though the adjustments are also here, and we will be doing with these adjustments.

So, we will discuss about that additional information also that what adjustments are there and what information is there in the adjustments. In the adjustments you will find many things; that is a say, we have to deal with the say, your text part will have to deal with the dividend to be paid to the shareholders, we have to learn that how to calculate the dividend. I do not know what percentage the dividend has to be paid or dividend has to be decided. So, everything will have to talk about, and take care of that, and discuss about. So, let us start preparing the trading account of this company, and when we talk about preparing the trading account of this company. we are again doing the same thing, and in this case also, will be starting with, as we were doing there in the other organizations case, we will be starting with the opening stock of inventory, then we will have to take the opening stock of the raw material. See it is given already has the openings inventory.

Opening inventory means, we are not given any date, but it is written clearly that it is opening inventory. So, we have to take the material, and then similarly at the same time we are given the wages. So, we have to find out the three direct expenses material, then is your wages, and then the other direct expenses.

Material is opening inventory, and will be somewhere as the purchases. So, if we are given the purchases, we will take the purchases into account, purchase here and very big amount of 27 lakhs is given, opening inventory is just 112500, and similarly will be given some other direct expenses. So, for example, premises building not to be taken, plant and machinery, opening inventory, bill take, debtors, land, cash in hand, cash at bank, purchases we are going to take preliminary expenses are not to be taken here, they will be taken in the profit and loss account, and then these are the wages, yes will be taking the wages in the trading account. Then general expenses no, salaries, bad debt, interest on loan, secured loans, bills payable, creditors, sales, sales we are going to take

here, and then we are going to take here the general reserves, not here in the trading account, but will be discussing it in the later part of the discussion.

So, I think we do not have much here to talk about, and will be only taking the opening inventory, then the purchases. No purchase returns or anything, and then will be taking the wages, and on the credit side will be taking the closing stock, and then will be taking the sales and the closing stock. So, these different items will be taking and preparing the trading account, and then will be preparing the profit and loss account and balance sheet for this firm. So, and one more important thing here is, that in this situation, what are the information is given to us, will be preparing the profit and loss appropriation account also today.

We seen this part, means in this say particular problems, will be preparing the profit and loss appropriation account also. So, we will learn that how to calculate the gross profit, how to calculate the net profit. This we have done in the past also, but some additional items are here. Then we will be preparing the profit and loss appropriation account that how that earned profit is distributed and adjusted to the different heads, and then we will be preparing the balance sheet. And in the balance sheet also will be dealing with the problems like as I discussed you in the last part of discussion that will be taking the share capital.

So, share capital will be starting with authorized capital, and then we will be summing up all the other four categories; that is the issued capital, subscribed capital, called up and the paid up capital will be taking that. So, that share capital will be shown, and then the other claims of the financial institutions then the other long term and the current liabilities, and then the assets; that is a long term fixed assets and current assets and will be balancing the balance sheet. So, we will prepare the financial statements for Mamta Fashions Limited. This is a public limited company, and will start with the trading account, and that I will be doing or I will be starting in the next part of discussion.

Thank you very much.