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How to Read Annual Report and Balance Sheet

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Abstract – In any company, there are many departments, which perform many operational activities to reach organizational objective. The performance of these departments may or may not be mutually dependent, but at the ending they are related together by one common thread – Accounting & Finance department. The aspects of every department are recorded and reported to various stakeholders. The Reporting involve the disclosure of financial information about financial position of the business. Companies are evaluated and decisions are made on the basis of opinion arrive at on scrutinising the annual report and financial statement. Deals are clinched and opinion are win on quote information read and data procured from the annual report and yet ,there is a lack of knowledge of financial statement-an ignorance of the innovativeness of creative accounting and manipulation of accounting principles. The purpose of this paper to guide the person who reads throughout the annual report, to make clear the financial statement prepared and to make him aware of the innovativeness of creative accounting that can arise by the manipulation of accounting principles.

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INTRODUCTION

Companies fight with each other to present inspiring annual reports to their stakeholder. Prizes are awarded by noble bodies such as the institution of chartered accountants for the report that is, in their view, the best presented. A lot of work goes into the research of annual report. Multi coloured pie and bar charts are included to show and explain to the shareholders facts such as the growth of the company and the manner in which the income earned has been utilised. The average shareholder does not look much future. If annual report appears worthy of the company whose name it bears, if the photographs are impressive and the company has paid a reasonable divided, the shareholder reads no more. He sits back content in the belief that the future of the company are in good hand. This must not be the criteria by which a company is judged. Rather than be converted on the state of affairs of a company by gazing at charts and impressive array of figure and statistics ,the reader of the report would be wise to investigate deeper-to read between and beyond the lines and to peep behind the figure. The component of an annual report includes director report, auditor report and the financial statement.

DIRECTOR REPORT:

The first report that a stakeholder of the annual report statement of a business is confronted with is the directors' report. The directors' report is a summation of the activities of the company in the period reported on –its result, its sales, its divisions and other relevant factors including of course the dividends that are recommended to be paid to the shareholders. All directors' report is well written. Every sentence, every word has been subjected to the most dull analysis. Every event of favourable significance is catalogued and mentioned in a manner that would make appear to stakeholder that the company is in good hand. And to the extent this is really what the directors report attempts to do- it attempt more often than not to give to the shareholders a feeling that the directors are worthy of the trust reposed and the responsibility vested in them by the shareholders. In many cases they are but there is a tendency to polish over unhappy situation at times or not to mention them at all. In order to become aware of all the facts it is necessary to read beyond the lines. The "blowing of one's trumpet" by the directors must not be taken at its face value. A director's report gives the reader a valuable insight to the activities of the business, new project and diversification plans of a company. Stakeholder knowing industry condition, can determine whether this new project, diversification could be wise because all diversification may not suit a company, the reader must evaluate for himself. a directors report is therefore a valuable document and if read intelligently can give reader a good grasp of the working s of the company, the problems faced, the direction it intends taking and its prospects.

AUDIT REPORT:

Auditing begins, where accountancy ends. After the accountant has completed his work an auditor is invited to verify the work done by accountant. It is not the duty of auditor to prepare the accounts .he is concerned with critical examination and verification of accounts prepared by other.After completing his work, auditor has to submit a report of the fact whether or not profit and loss account and balance sheet exhibit true and fair position of business. The auditing has its origin in the necessity in the development of some system to put a check on the persons whose duties were to record receipts and disbursement of money on the behalf of owners. In the ancient day auditing was confined to the public accounts only.an auditor report is the format result of all effort that goes into an audit. Communicating the auditor findings to interested user is part of all audits. Thus the final phase of an audit involves preparing that communication, which is known as the auditors and for all those who rely on his wo0rk.the languages and words used in audit report are of great importance. The extent of liability of the auditor for negligence and fraud depends upon the wording of the report.

The auditor represents the stakeholder and his job to report to the stakeholders whether the financial statement presented true and fare view of the state of the company. It is the only impartial report that a stakeholder actually gets on the company. An audit report is the end result of an audit and can be used by the stakeholders as a tool for financial decision .An effective report is essential to making sure the result of audit are presented in a way that is useful to the party receiving the audit. It is the audit report that draws the attention of the reader to the subtleties of creativity and informs him of what the facts actually are. The reader would be risky to ignore the audit report because it informs him of the truth.

FINANCIAL STATEMENT:

The financial statement of the company in an annual report comprises of the balance sheet as at the end of the accounting year and profit and loss accounts which summarises the activities of the company for the period of annual report.

a. The Balance Sheet: a company is a body separate from the shareholder who owns it. It is a separate legal entity. It can sue in its name, own property and do all other acts that a person can do. The balance sheet shows the financial position of a company on a particular date. The balance sheet also shows the company assets and liabilities appropriately grouped under various categories on a particular date. It must be remembered that as a balance sheet comprises of the balances on a particular day these balances can and are capable of being materially different the next day as a consequence of which the perusal of the balance sheet may result in the reader arriving at totally different conclusions than which he would have arrived at the previous day.

The notes to the accounts are maybe the most important feature in the financial statement as it is here that the company actually states its company policies and the changes that it has done and the liabilities that it has not provided. The most important liability the notes discuss is contingent liabilities .contingent liabilities are those liabilities that may become liabilities on the happening of an event which may or may not occur. The most common contingent liabilities that are seen on financial statement are bill discounted. This is measured a contingent liabilities since should the buyer refuse to pay. The liabilities would transfer on the company. The notes are varied and include details of the makeup of items, change in company policy.

A company is also mandatory to detail the various stocks it holds of various products and the sales made during the year. It gives reader the opportunity to find out whether some items are slow moving and if other is being sold as fast as they are produced.

In short the notes and schedules to the accounts provide a wealth of information to a reader and it is not possible for a reader to evaluate a company without actually reading and assimilating the notes and schedules to the accounts.

b. **Ratio Analysis**: financial statements can be approachable. Many people find them overpowering even alarming purely because they do not understand them. As a result, they give the impression of being at the revenue and if increases seem to be on future in believe that all is well. This may not be true dividends may be being paid out of accumulated profits. The profitability may have decreased and liquidity position of company may have declined. Ratio put number into perception. It is difficult to see how a company is doing at a large numbers of items. Ratios summarise the figures in a form that is easily understand, interpreted and used. It is an important tool and enables one to assess strength and weakness of a company. With the help of ratio one to determine trends and predict future performance.

A reader must check liquidity position of a company. It can discharge it's currently Maturing financial obligations as well as have enough cash to meet its operational requirements. If a company cannot do so, it may be forced to sell its more important assets at a loss and, in extreme cases be forced into liquidation.

c. **Cash flow and liquidity**: this is the age of creative accenting and innovative ideas. Accounting principles are changed, provision are manipulated and accounting theory itself is engineered by companies to create profit sometimes out of thin air, shareholders and investors are generally a trusting lot and look no further than he published figures. It comes to them as a shock therefore when a company that had been declaring profit and paying dividends suddenly. They ask them self ,how could this be, the reason usually lies in the fact that company cash flow and yet it is not often considered the company cash flow and yet it is for a company its very life blood..This fact has always been recognised by the premier trading community of India the manager and they deal entirely on the inflow and out flows. This is the strength and weakness of a company. If an excellent, well reputed company ran to difficulties on account of its inability to raise working capital and pay its creditors. It means that balance sheet can be window dressed and profit can, with ingenuity, be whether one wants it to be. It is not however possible to manipulate the cash flow of a company-its source and uses of funds-and it is important that at the time of evaluation, the reader examines a company's sources and uses of funds. It is importance has already been recognised in the united states where it is mandatory for a company to publish with its annual report a statement of change in financial statement which in effect a cash flow statement. In short the importance of the sources and uses of fund cannot be over emphasised at it reveals exactly from where the monies come for a company and it has been utilised. To check the liquidity reader must examine whether a company has adequate cash or cash equivalents to meet its current obligations without having to resort to liquiditation non cash, assets such as having to resort to liquidation non cash, assets such as stocks. The ratio aim to emphasise that the immediate sale of stock would be less than at cost. Hence reader must check whether the company has adequate. cash or easily realisable assets. The reader will be wise to examine the company cash flow and its liquidity as it would indicate the financial viability of the company and these statements do, in reveal the stark and naked truth and this is what one need to now

d. **Debts service capacity**: it is important therefore that prior to purchasing debentures in a company or placing fixed deposit init or even purchasing share in the company that one checks whether the company can service its debts. A company that cannot generate adequate profit to meet its debts commitments is a company on the verge of collapse. A company ability to service debts can be assessed by examining its debts service capacity ratios. The basic assumption in these ratios is that a company is a going concern and the debts would be repaid out of internally generated funds and not from the sale of assets or from additional borrowings. The debts service ratios therefore indicate the relationship between cash flow and the company liabilities. The reader also check fixed charge coverage ratio, interest coverage, liabilities coverage ratio when analysis the annual report of a company.

e. **Profitability:** a company is known by profits its make; its profits reflect the quality of its products, the competence of its management and the efficiency of its organisation. Profits are indeed its very lifeblood. It is profit that makes the company grow. It is profits that attract investor to it and it is profit that attracts the finances required for expansion. Profits are relative. A large company may have profits much larger than a smaller one but the smaller one may be better organised and more profitable. The submission made is that one should not look at mere numbers because the numbers can be misleading .what one must examine is the profit ability the return earned on capital invested and the margin as this really differentiates the efficient from the inefficiency –the good from the bad. The reader should look the margin ratio and return ratio to evaluate the profitability of a company.

f. **Asset management and efficiency**: it is important to study whether company is utilising its assets efficiently as the entire future to the company-its growth, its expansion and even its very existence may depend on it. It should be therefore examined whether the total amount of each type of assets of a company has its reasonable, too high or too low in the light of current and forecasted operating needs. If there are more assets than necessary or if the assets are not being utilised efficiently the interest paid by the company would be higher than other wise. In time of recession or depression this can even lead to the death of an otherwise sound company as the company may not be able to, when profit are low, service the high borrowing the company has made. Conversely, should there be fewer assets than is necessary, the company operation would not be as efficient. Assets management and efficiency ratio enable one to consider how effectively a company manage its assets. The reader must necessarily examine the method of valuation of stock and read the note to be accounts extremely carefully. The reader of annual report would be wise to examine fixed assets and method of depreciation.

g. **Intangible assets and research and development**: there are assets which provide benefits to a company but do not have any physical from. Such assets are known as intangible assets. These assets are yet to be written off. They are often not written off in the year the expense is incurred on the argument that the benefit that accrues as a consequences extends over many years. They usual intangible Assets that one comes across on the balance sheet of companies are-research cost, advertising costs, patents, trade secrets, preliminary expenses, share issue expenses.

The company did not write many of these expenses off as it wishes to .at this time, show large and impressive profit. Although the management of companies argue that the reason why intangible assets such as advertising costs, research and developments cost etc. Are not written off immediately is because the benefits that accrue to the company would be wise to remember that the intangible assets has no real value especially if it is a deferred expense. He should therefore not take into consideration when evaluating the company.

h. **Management**: in India management can be broadly divided into two parts family management and professional management in India apart from large multinationals like levers Siemens and PEICO, the large companies are family owned. However ,their saving grace or rather their attraction to the common man is the fact that although they are dominated by members of the family (Tata,Birla) the companies are managed on a day to day basis by professional by managers. The controlling families too have been exposed to modern management techniques and some like rahul bajaj has attended prestigious educational institution like the Harvard business school. A family that is managing three companies well is more than likely to be managing the fourth also well. The reader would be wise to know that management is family management or professional management.

CONCLUSION

Companies are evaluated, investment decision are made and fund are committed on the basis of opinion arrived at on scrutinising the annual report and the financial statement of a company. A directors report is therefore a valuable document and if read intelligently can give reader a good grasp of the working s of the company, the problems faced, the direction it intends taking and its prospects .The reader will be wise to examine the company cash flow and its liquidity as it would indicate the financial viability of the company and these statements do, in reveal the stark and naked truth and this is what one need to now. The reader would be risky to ignore the audit report because it informs him of the truth. Hence reader must check whether the company has adequate cash or easily realisable assets. It is vital therefore while analysing a company that one examines and studies its exposure and dependence to companies in other countries.

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