



FINANCIAL ACCOUNTING FOR MANAGEMENT

AN ANALYTICAL PERSPECTIVE

AMBRISH GUPTA



ALWAYS LEARNING

PEARSON



**FINANCIAL
ACCOUNTING
FOR MANAGEMENT**

An Analytical Perspective

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FINANCIAL ACCOUNTING FOR MANAGEMENT

An Analytical Perspective

FIFTH EDITION

AMBRISH GUPTA

Senior Professor

Finance and Accounts

FORE School of Management

New Delhi

PEARSON

Delhi • Chennai

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ISBN: 978-93-325-5949-3

eISBN: 978-93-325-7360-4

Head Office: A-8 (A), 7th Floor, Knowledge Boulevard, Sector 62, Noida 201 309, Uttar Pradesh, India.

Registered Office: Module G4, Ground Floor, Elnet Software City, TS-140, Block 2 & 9 Rajiv Gandhi Salai, Taramani, Chennai 600 113, Tamil Nadu, India.

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पूजनीयमातृपितृचरणयोः
सादरं समर्पितोइयं ग्रन्थः

*To
My Father
and
My Late Mother*

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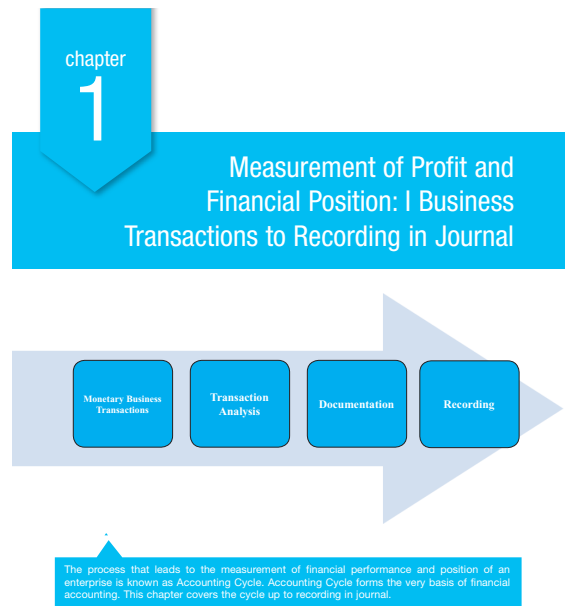
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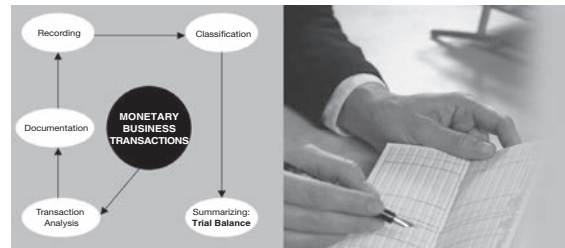
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chapter
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Measurement of Profit and Financial Position: II Journal to Trial Balance

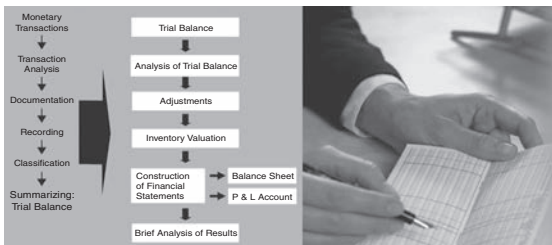


The process that leads to the measurement of financial performance and position of an enterprise is known as Accounting Cycle. Accounting Cycle forms the very basis of financial accounting. This chapter covers the cycle up to trial balance.

Chapter 3 Measurement of Profit and Financial Position: III Trial Balance to Balance Sheet and Profit and Loss Account: Non-corporate Entities

3

Measurement of Profit and Financial Position: III Trial balance to Balance Sheet and Profit and Loss Account: Non-corporate Entities



This chapter finally completes the accounting process of measuring the business performance and financial position by illustrating the construction of balance sheet and profit and loss account of Non-corporate entities.

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Measurement of Profit and Financial Position: IV Corporate Entities

Indian Oil Corporation Limited
 Regd. Office : IndianOil Bhavan, G-9, All Yashraj Marg, Bandra (East), Mumbai-400 051
 www.iocl.com

AUDITED FINANCIAL RESULTS FOR THE YEAR ENDED 31st MARCH 20

	2019-20	2018-19	2017-18	2016-17	2015-16
1. SEGMENT REVENUE					
(a) Sale of Petroleum Products	8810.51	7258.52	39053.59	24326.35	30481.04
(b) Sale of Petrochemicals	2316.37	864.78	3747.04	3286.84	3747.04
(c) Other Business Activities	3135.20	5461.18	29163.81	24252.82	8872.55
Sub-total	14262.08	13684.48	71964.44	51865.99	43099.63
Less: Inter-segment Revenue	1372.23	415.98	3005.24	1737.48	5005.24
TOTAL REVENUE	12889.85	13268.50	68959.20	50128.51	38094.39
2. SEGMENT RESULTS:					
(a) Profit Before Tax, Interest Income, Interest Expense and Dividend from each segment	4831.88	7486.23	11524.82	13836.90	13007.89
(i) Sale of Petroleum Products	1857.33	70.72	17506.22	456.26	11706.23
(ii) Sale of Petrochemicals	1168.55	1193.50	1642.58	1193.50	1193.50
(iii) Other Business Activities	2005.99	612.01	2727.62	787.14	708.16

From non-corporate, this chapter moves over to measurement of profit and financial position of corporate entities. Company form of business organisation has certain peculiar features and its financial statements are drawn in the format prescribed by the companies act, 2015.

5

Vertical Financial Statements of Corporate Entities

SHASHAANK INDUSTRIES LTD.

BALANCE SHEET AS AT 31-03-20CV

	Note No.	Amount (₹)
EQUITY AND LIABILITIES		
Shareholders' Funds		
Share Capital	1	14,85,000
Reserves and surplus	2	1,22,570
Sub-total.....		16,07,570
Non-current Liabilities	3	5,85,000
Long-term borrowings		5,85,000
Other Long term liabilities		—
Long-term provisions		—
Sub-total.....		5,85,000
Current Liabilities	4	9,85,250
Short-term borrowings		9,85,250
Trade payables		6,45,540
Other current liabilities		1,15,761
Short-term provisions		2,46,143
Sub-total.....		19,92,694
TOTAL.....		41,85,264

The corporate financial statements are now required to be presented in vertical form. Hence it is necessary to develop knowledge of how they are constructed.

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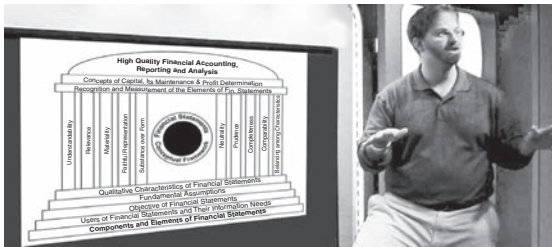
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Conceptual Framework of Financial Statements



In the dynamic and complex business environment of the day, it has become imperative to have a strong conceptual framework for accounting and financial statements that sets out the principles and concepts underlying their preparation and presentation.

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Specific Day Books

An example of the SALES Day Book (page 26)

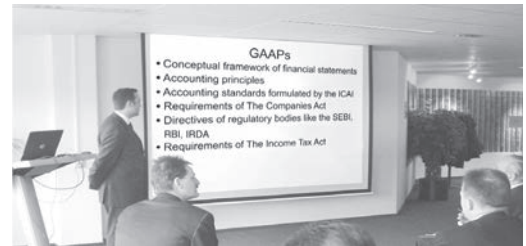
Sales Day Book					
Date	Details	Folio	Goods	GST	Total
2013			£	£	£
May 3	Champion Sports	SL12	400.00	80.00	480.00
May 13	BD Sports Ltd	SL39	84.00	16.80	100.80
May 22	Delta Products	SL125	120.00	24.00	144.00
May 29	Zhang Sports	SL249	178.00	35.60	213.60
			782.00	156.40	938.40
			GL44	GL50	*

Increase in the volume of business often necessitates the maintaining of specific day books for specific voluminous transactions of the same type, more particularly in the case of corporate entities. It is necessary to understand their respective roles.

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Generally Accepted Accounting Principles



The corporate accounts and financial statements are prepared and presented on the basis of Generally Accepted Accounting Principles (GAAPs) as being presented above. Effective formulation of GAAPs assumes great importance in view of their far-reaching impact on the quality of reported earnings.

PART 3: ASSET VALUATION

9

Valuation of Tangible Fixed Assets



Tangible fixed assets, such as plant and machinery, enable companies to produce goods/services and provide marketing and administrative support to their businesses. They lead to the generation of operational revenue, which speaks of their crucial importance. Hence, the need for their proper valuation.

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Depreciation on Fixed Assets



Value of fixed assets keeps on reducing over their useful lives due to their use. This reduction, known as depreciation, is charged to profit and loss account. Depreciation has a significant bearing on the measurement of financial performance and position.

11

Valuation of Assets under Finance Lease and Intangible Assets, Amortization and Asset Impairment



The contemporary issues relating to fixed assets—finance lease, intangibles, their amortisation and asset impairment—are providing a face-lift to the financial statements. The emphasis is on substance over form, prudence, ensuring the sanctity of the financial statements and quality of earnings.

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Valuation of Inventories



Inventories such as raw materials and finished goods in general, and in manufacturing companies in particular, constitute the second largest item after fixed assets. Therefore, they require a fair valuation so that the financial statements fairly portray the performance and financial position of the business.

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Valuation of Investments



Investments in general, and in manufacturing companies in particular, represent deployment of surplus funds to earn dividends, interest, rentals and capital appreciation for strategic reasons. Investments represent major assets and business activities for investment companies. Their performance depends on the results of this activity.

PART 4: UNDERSTANDING THE ANNUAL REPORT

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Corporate Financial Statements Along With Notes to Accounts and Significant Accounting Policies

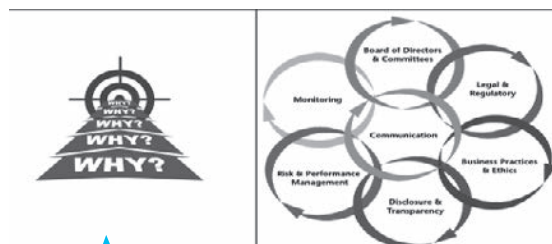
NESTLE INDIA LIMITED				
Balance Sheet as on December 31, 2014				
Notes	2014 (₹ in Millions)	2013 (₹ in Millions)		
EQUITY AND LIABILITIES				
SHAREHOLDERS' FUNDS				
Share capital	1	964.2	964.2	
Reserves and surplus	2	27,407.9	28,379.1	23,687.5
NON-CURRENT LIABILITIES				
Long-term borrowings	3	164.6	11,894.6	
Deferred tax liabilities (net)	4	2,227.2	2,154.7	
Long-term provisions	5	13,866.6	16,260.4	25,983.4
CURRENT LIABILITIES				
Short-term borrowings	6	41.1	0.1	
Trade payables	7	7,267.1	6,330.4	
Other current liabilities	7	4,065.7	5,002.5	
Short-term provisions	8	2,130.6	13,554.5	13,471.8
Total		58,196.0	58,196.0	63,142.7
ASSETS				
NON-CURRENT ASSETS				
Fixed assets	9			
-Tangible assets		31,766.4	33,693.1	
-Intangible assets		2,447.9	2,947.3	
-Capital work-in-progress		56,219.0	36,640.2	

Understanding the annual report is a precursor to analysing it. This chapter attempts developing its understanding with reference to the case of Nestle India Ltd.

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Other Mandatory Financial Reports



Corporate annual reports contain, in addition to financial statements, some other financial reports as well. Auditors' report is an instrument of discharging attest function and expressing opinion about the truth and fairness of financial performance and position. Corporate governance report seeks to report the effectiveness with which the management is discharging its responsibility of running the corporate affairs. Management discussion and analysis report seeks to present the management's analysis of the physical and financial performance of the company with a brief on future outlook. Report on CSR activities seeks to report the details of such activities together with the mandatory social spend.

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Chapter 16 Quality of Earnings: Window Dressing, Creative Financial Practices and Issues Related to Quality of Disclosures in Reported Earnings 414

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Quality of Earnings: Window Dressing, Creative Financial Practices and Issues Related to Quality of Disclosures in Reported Earnings



Window dressing of financial statements is resorted to by the managements to portray a rosier performance and financial position of the company than actuals to suit their motives. An analyst needs to beat window dressing for a meaningful assessment of the quality of earnings.

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CORPORATE FINANCIAL PRACTICES
Liberty Shoes Ltd.
Extracts from Annual Report 2001-2002

Particulars	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-2001	2001-2002
RESULTS FOR THE YEAR								
Sales & Other Income	3041.07	4470.50	5398.63	6690.78	7647.58	1812.89	8500.00	7352.16
Index	1.00	1.47	1.78	2.20	2.52	2.50	2.80	2.42
Profit before Depreciation & Tax	890.25	1019.22	1038.72	1126.84	1271.69	974.93	1482.77	1083.07
Index	1.00	1.14	1.17	1.27	1.43	1.14	1.42	1.22
Profit before Tax	892.49	862.13	892.30	971.48	1040.47	896.73	955.33	786.27
Index	1.00	1.07	1.07	1.18	1.26	1.24	1.20	0.98
Profit after Tax	627.56	744.02	731.20	756.46	897.97	740.73	698.19	620.36
Index	1.00	1.19	1.17	1.21	1.34	1.18	0.94	0.99
Equity Dividend (total outlay)	-	157.68	258.01	254.01	278.85	380.25	228.15	253.50

Financial statement analysis seeks to evaluate the performance, financial strength, ability to generate enough cash and the growth outlook of a company. A number of tools are available in the tool kit of the analyst for this purpose. Five of them are covered here.

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Financial Statement Analysis and the Tool Kit of the Analyst: II Earnings per Share (EPS) Analysis



Earnings Per Share (EPS) is the single most important ratio for the investors, capital market and company valuation. EPS gets dilutive under certain circumstances. Dilutive EPS is the real sustainable EPS.

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Financial Statement Analysis and the Tool Kit of the Analyst: III Ratio Analysis

GRASIM INDUSTRIES LTD.
ROI RATIOS

Ratio	Formula	2011-12		2010-11		Comparison 2011-12/2010-11	
		₹ crores	Result- %	₹ crores	Result- %	Change	Direction of change
1. RONW	N PBT X100	1177.00 x 100	13.86%	1181.71 x 100	15.47%		
D	Net Worth:-						
	Equity	91.72		91.71			
	Plus: Reserves and surplus	8,524.85		7,547.85			
2. EPS	N PAT	1,177.00	128.39	1,181.71	128.87	-0.40%	Down
D	Wtd. Av. No. of Eq. Shares O/S-Crores	9.17		9.17			
3. CEPS	N PAT	1,177.00	144.08	1108.71	148.09	-2.30%	Down
	Plus: Non cash changes	144.20		176.29			
D	Wtd. Av. No. of Eq. Shares O/S-Crores	9.17		9.17			

Analysis continues with Ratio Analysis. It is a more focussed and comprehensive tool of analysis in that it establishes cause and effect relationships between either two items of balance sheet or of profit and loss account or both the balance sheet as well as profit and loss account.

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Model for Strategic and Integrated Managerial Financial Analysis of Annual Report 606



It is time now to begin a strategic and integrated managerial analysis of corporate financial statements and financial reports forming part of an annual report. Keeping this in view a comprehensive model has been developed based on the annual report of Nestlé India Ltd.

20

Construction and Analysis of Corporate Cash Flow Statement

NESTLE INDIA LTD. CASH FLOW STATEMENT			
For the Year Ended 31st December, 2014			
	2014 (` in millions)	2013 (` in millions)	
A. CASH FLOW FROM OPERATING ACTIVITIES			
Net profit before tax	17,743.5	16,780.2	
Adjustments for:			
Exceptional items	(79.0)	(136.1)	
Other income considered separately	(823.2)	(882.2)	
Unrealised exchange differences	39.7	(6.3)	
Deficit (Surplus) on fixed assets sold/scrapped/written off (net)	74.5	(12.1)	
Depreciation	3,275.4	3,299.3	
Finance costs	142.3	305.1	
Impairment loss on fixed assets	81.1	99.4	
Operating profit before working capital changes	20,974.3	19,556.8	
Adjustments for:			
Decrease/(increase) in trade receivables	(142.8)	32.9	
Decrease/(increase) in loans & advances and other assets	336.7	(653.9)	
Net cash from operating activities	16,442.2	17,884.0	

Cash flow statement depicts the cash generated and utilised by a company. It is imperative to have a sound knowledge and understanding of the corporate cash flow statements as reported in annual reports, as illustrated here through the case of Nestlé India Ltd.

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PART 6: MORE ON FINANCIAL REPORTING AND ANALYSIS

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Analysis of Information from Sources Other than Annual Reports and Inter-company Comparison



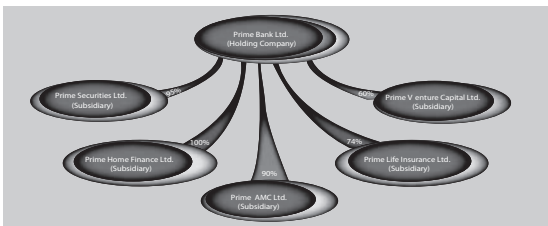
Virtually endless sources of financial information are available outside the published annual report. The continuous availability of financial and business information after its publication is most crucial for an analyst to keep himself updated. These sources fill this gap, that too with accompanied analysis.

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Analysis of Group Performance: Consolidated Financial Reporting



Capital provided by the shareholders of the parent company flows into other group companies. Various stakeholders of the parent company, particularly the investors, are concerned to know how the investments made in the group companies, out of money they provided to the parent company, are faring. Consolidated financial statements bring out the real profitability and financial position of the group to the fore.

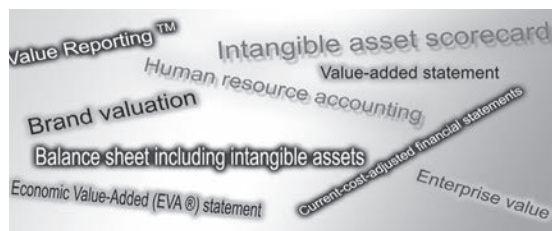
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Emerging Dimensions in Voluntary Financial Reporting: Contemporary Analytical Techniques



Accounting has been witnessing the emergence of new dimensions, as mentioned above, in voluntary financial reporting. These techniques have yet to find widespread popularity. Yet they strengthen the decision-making of the stakeholders. Leading companies, such as Infosys, have been providing such information in their annual reports.

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Appendix 1 Present Value of An Annuity of Rupee 1 Paid at The Year End

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Appendix 2 Present Value Factor of A Lump Sum (PVF) of Re 1

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APPENDICES

APPENDIX 1: PRESENT VALUE OF AN ANNUITY OF RUPEE 1 PAID AT THE YEAR END

APPENDIX 2: PRESENT VALUE FACTOR OF A LUMP SUM (PVF) OF RE 1

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OUTSTANDING PEDAGOGICAL FEATURES

The outstanding pedagogical features in the book have been designed to chart a clear and well-targeted route map for students' understanding and knowledge enhancement. These features are:

1. Chapter Openers

Every chapter opens with a pictorial/diagrammatic presentation and a nugget description of what lies ahead in the chapter. Openers will initiate and stimulate the students' interest.

2. Chapter Objectives

An exhaustive list of chapter objectives provides details of the issues whose knowledge and understanding the students are expected to develop by the time they finish a particular chapter.



CHAPTER OBJECTIVES

This chapter seeks to enable you to develop knowledge and understanding of:

- 1 The fact that modern accounting owes its origin to India.
- 2 The anatomy of business and its relationship with financial accounting.
- 3 The steps involved in the process of accounting, up to recording, that leads to the measurement of profit and financial position.
- 4 How to do documentation of business transactions by way of vouchers.
- 5 How to do recording of vouchers in journal.
- 6 Application of certain fundamental accounting concepts in the process.
- 7 Basic features of partnership firm and their implications for financial accounting.

Thus enabling you to be able to complete the accounting cycle in the chapters that follow.

3. Bird's Eye View Box

Regular bird's eye view boxes, which provide a snapshot of the subject matter covered, enable students to know the coverage of a particular section and help them in quick revision.

16

Quality of Earnings: Window Dressing, Creative Financial Practices and Issues Related to Quality of Disclosures in Reported Earnings



Window dressing of financial statements is resorted to by the managements to portray a rosier performance and financial position of the company than actuals to suit their motives. An analyst needs to beat window dressing for a meaningful assessment of the quality of earnings.



BIRD'S EYE VIEW

The Anatomy of Business

- Assets
 - Fixed assets
 - Current assets
 - Investments
- Liabilities
 - Long term (non-current) liabilities
 - Current liabilities
- Financial Position
- Income
- Expenses
- Financial Performance

4. Web site Resource Box

During the course of discussion, regular references have been provided, side-by-side, to the Web site resources on the subject matter covered to enable the students to know more on the subject.



Visit www.mca.gov.in if you wish to update yourself on company law matters.



For more details refer to the 'Guide to the Companies Act' by A Ramalya or any other book on company law.

5. Publication Resource Box

Likewise, regular references have been provided, side-by-side, to the related books on the subject matter covered to enable the students to further enhance their knowledge.



BEFORE YOU MOVE FURTHER...

Stop. Think over, Discuss and Debate in Small Groups.

Do you agree with the following statements?

1. Since assets are debited, increase in assets has to be debited and decrease credited.
2. Since liabilities are credited, increase in liabilities has to be credited and decrease debited.
3. Since income is credited, increase in income has to be credited and decrease debited.
4. Since expenses are debited, increase in expenses has to be debited and decrease credited.

6. Before You Move Further, Stop... Box

These boxes, containing discussion questions, have been provided at regular intervals in the chapters. The objective is to enable the students test and firm up the knowledge acquired by them in a particular section before moving over to the next. It will encourage sharing of knowledge and help them widen their horizons.

7. Chapter Illustrations

A large number of illustrations are provided in the text of each chapter. These illustrations aim at supporting the conceptual input provided during the text of the chapters with the practicals and prepare the students to effectively handle the chapter-end exercises.

A. Case Studies A large number of case studies have been illustrated and analysed during the text throughout the book. A vast number of illustrations are case-centric. What is more, barring one case, all others represent real life case studies of a large number of leading Indian corporates and MNCs. The cases seek to illustrate to the students analysis of complex financial accounting issues through real life business situations and appropriate decision-making.

B. Corporate Financial Practices These are again leading corporates' case studies, in large numbers, illustrated to drive home some complex issue but whose analysis has been left to the students.

CASE 2



Horizontal Financial Statements of Bajaj Auto Ltd.



BAJAJ AUTO LIMITED
Distinctly Ahead.....Since 1945

BALANCE SHEET AS AT 31ST MARCH			
(₹ in Crore)			
Particulars	Note No.	2012	2011
EQUITY AND LIABILITIES			
Shareholders' funds			
Share capital	2	289.37	289.37
Reserves and surplus	3	5,751.70	4,620.85
		6,041.07	4,910.22
Non-current liabilities			
Long-term borrowings	4	97.48	133.88
Deferred tax liabilities (net)	5	48.44	29.71
Other long-term liabilities	6	157.07	193.71
Long-term provisions	7	111.85	124.54
		414.84	481.84
Current liabilities			
Short-term borrowings	8	-	157.84
Trade payables	9	2,003.08	1,789.26
Other current liabilities	9	559.04	477.11
Short-term provisions	7	2,053.04	1,431.26
		4,625.16	3,855.47



CORPORATE FINANCIAL PRACTICES
INDIAN OIL CORPORATION LTD.
Annual Report 2001-02
Extracts from Schedule E—Fixed Assets

JOINTLY OWNED FIXED ASSETS				
(₹ in Lakhs)				
	Gross Block as at 31.03.02	Total Depreciation and Amortisation up to 31.03.02	W.D.V. as at 31.03.02	
Total Fixed Assets of the Company	29,74,061.06	10,96,081.90	18,77,979.16	
Details of Company's Share of Jointly Owned Assets Included Above				
(₹ in Lakhs)				
Assets Particulars	Name of Joint Owners	Original Cost	Accumulated Depreciated & Amortization	W.D.V. as at 31.03.02
Land—Freehold	HPC/IBP	119.02	0.00	119.02
Land—Leasehold	BPC/IBP	95.31	10.50	84.81
Buildings	HPC	42.54	7.38	35.16

C. Corporate Window Dressing/Creative Financial Practices These illustrations are again drawn from real life practices of leading corporates to show how the financial statements are *window dressed* to present a position rosier than reality to suit the motives of the management. These are titled as ‘*Creative Financial Practices*’ and presented in Chapter 16.



CREATIVE FINANCIAL PRACTICES
LIBERTY SHOES LTD.
 Extracts from the Schedules of Significant Accounting Policies and Notes on Accounts from Annual Reports

INVESTMENT IN JOINT VENTURE: LIBERTY & NINO, RUSSIA
NON-PROVISION OF DIMINUTION IN THE VALUE OF LONG-TERM INVESTMENTS

Annual Report 1994-95: Note 10
 The company has made an investment of ₹ 1,67,73,640/- under a joint venture with **Liberty & Nino, Russia**. No trading/manufacturing activities are being carried out by the joint venture. The Company has taken steps for realization of the investment and the realisable value is not ascertainable.

Annual Report 1995-96: Note 6

EXHIBIT 1 **NESTLÉ INDIA LTD.**
CASH FLOW STATEMENT



D. Exhibits Chapters 14 and 20 contain exhibits representing balance sheet, profit and loss account, cash flow statement and all schedules to accounts from the annual report of *Nestle*. These have been discussed and analysed for a systematic and integrated *reading and understanding of the entire annual report*.

For the Year Ended 31st December, 2014

		2014 (₹ in millions)	2013 (₹ in millions)
A. CASH FLOW FROM OPERATING ACTIVITIES			
Net profit before tax		17,743.5	16,780.2
Adjustments for:			
Exceptional items		(70.0)	(138.1)

E. Computational/Numerical Illustrations The main focus of these illustrations, accompanied by computer icon, is on demonstrating to and guiding the students in the core accounting treatment of various issues, say, preparation of balance sheet, income statement and cash flow statement, valuation of assets and computation of ratios, etc. They contain some *analytical elements* as well.



SHAABAASH LTD.
ANTI-DILUTIVE CONVERTIBLE DEBENTURES



Shaabaash Ltd. supplies you with the following details for the year 2006-07. Determine its BEPS and DEPS.

	₹ and Nos. of Shares (In crores)
Net profit	1.30
No. of equity shares outstanding (FV ₹ 10)	1.00
No. of 15% convertible debentures of ₹ 100 each issued on 1st April 2006. Each compulsorily convertible into 4 equity shares of ₹ 10 each at a premium of ₹ 15 each.	20.00 lakh
Interest expense on convertible debentures	3.00
Income tax relating to interest expense (35%)	1.05

SOLUTION

F. Analytical Illustrations The main focus of these illustrations, accompanied by analysis icon, is on demonstrating to and guiding the students to carry out financial analysis of the information generated/given in the illustration, put the analysis crisply and make appropriate decisions. They contain some *numerical elements* as well.



LEPICIER CYRILLE COSMETICS LTD.
COMPARATIVE STUDY OF STATUTORY DEPRECIATION PROVISIONS
BOOK PROFIT AND TAXABLE PROFIT



Lepicier Cyrille Cosmetics Ltd. purchases a machine costing ₹ 150 lacs and factory building for ₹ 5 lacs on 1st April 2006. Assume that the company does not own any other depreciable asset. Work out the **first year depreciation** as per SLM and WDV methods for all the three shifts under the Companies act and as per the Income Tax act. Also work out the book profit and taxable profit for the year 2006-07 assuming that the profit before depreciation but after providing for all other expenses for the year was ₹ 80 lacs. Analyse the results.

SOLUTION

First Year Depreciation	Income Tax Act (WDV)	Companies Act						
		SLM			WDV			
		SHIFTS			SHIFTS			
		Single	Double	Triple	Single	Double	Triple	
Rates of depreciation:								
■ Factory building	10%		3.34%			10%		
■ Machine	15%	4.75%	7.42%	10.34%	13.91%	20.87%	27.82%	
Amount of depreciation (₹):								
■ Factory building	50,000	16,700	16,700	16,700	50,000	50,000	50,000	
■ Machine	22,50,000	7,12,500	11,13,000	15,51,000	20,86,500	31,30,500	41,73,000	



RESEARCH IN FINANCIAL REPORTING
Select Indian Corporates Across Industry Sectors



CLOSING INVENTORY AND OTHER DETAILS AS ON 31st MARCH 2006

₹ in Crores

Sl. No.	Company	Industry	Total Assets	Closing Inventory	Closing Inventory to Total Assets	Sales	Inventory Holding Period (Days)	PBT for The Year
1	Asian Hotels Ltd.	Hotels--Tourism	633	8	1%	328	9	87
2	Bharti Airtel Ltd.	Telecom	19,030	18	0.09%	11,229	0.59	2,286
3	Indraprastha Medical Corporation Ltd.	Hospital--Healthcare	259	6	2%	205	11	22
4	Indraprastha Gas Ltd.	Natural Gas	517	18	3%	521	13	160
5	ITC Ltd.	FMCG	13,084	2,636	20%	9,791	98	3,269
6	JK Cement Ltd.	Cement--Hosing related	1,466	84	6%	874	35	52
7	Ranbaxy Laboratories Ltd.	Healthcare	4,661	891	19%	3,570	91	190

affairs a set of 35 IFRS converged Indian Accounting Standards (Ind ASs). Their implementation was initially planned to be w.e.f. 1.04.2011 in a phased manner. However, the ministry has deferred their implementation until various issues including tax-related issues are resolved with the concerned departments and, therefore, the date of implementation of the Ind ASs will be notified at a later date. *In the meantime, to keep the students in readiness for full-fledged understanding of IFRS converged Ind ASs when implemented, key distinctive features thereof versus existing accounting standards have been explained in the text at relevant places in various chapters.* A template has been developed for this purpose, an example of which appears, as shown here. *The icon on the top-left is symbolic of Convergence.*

I. New Format of Financial Statements The Companies act 1956 has been replaced by the new Companies act 2013. Schedule III to the act has prescribed new vertical format of financial statements for corporate entities. Chapter 5 'Vertical Financial Statements of Corporate Entities' has been introduced for a thorough study and illustration of the new format. Chapter 14 'Corporate Financial Statements of Nestle India Ltd. along With Notes to Accounts and Significant Accounting Policies' has been introduced for a thorough examination of annual report of Nestle India Ltd. for the year ending 31st December, 2014 in the new format. Further in all the chapters on financial analysis, all the illustrations and exercises of real life companies have been replaced by their recent new format financial statements.

G. Research in Financial Reporting This feature has been introduced to emphasize and bring home the significance of the financial issues under discussion for a true and fair reporting of corporate performance and financial position and other aspects. In most cases, it culls out relevant data from select Indian corporates across industry sectors and analyses the same to arrive at meaningful conclusions. It is accompanied with the icon of a microscope. The top left-hand icon signifies that the data has been extracted from individual company's annual reports.

H. IFRS Convergence India is moving towards convergence with International Financial Reporting Standards (IFRS). Institute of Chartered Accountants of India (ICAI) has developed and submitted to the ministry of corporate

IFRS CONVERGED IND AS 1 VS EXISTING AS 1

DISCLOSURE OF ACCOUNTING POLICIES AND PRESENTATION OF FINANCIAL STATEMENTS

The IFRS Converged Ind AS 1 corresponding to existing AS 1 on Disclosure of Accounting Policies is titled as 'Presentation of Financial Statements'. Key distinctive features of Converged Ind AS 1, as related to the matter covered above, are as under:

- 1 The Converged Ind AS 1 generally deals with presentation of financial statements, along with the disclosure of accounting policies, whereas existing Ind AS 1 deals only with the disclosure of accounting policies. The scope covered by the Converged Ind AS 1 is thus much wider
- 2 The Converged Ind AS 1 requires disclosure of judgments made by management while framing of accounting policies. **For example**, why life of patent assumed to be 15 years.
- 3 The converged Ind AS 1 requires presentation of:
 - Single statement of profit and loss including components of other comprehensive income (a new item).
 - Balance sheet including a statement of changes in equity (a new item) as a part of the balance sheet.
 - Balance sheet as at the beginning of the earliest period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in the financial statements, or when it reclassifies items in its financial statements.

NESTLE INDIA LIMITED				
Balance Sheet as on December 31, 2014				
	Notes	2014 (₹ In Millions)	2013 (₹ In Millions)	
EQUITY AND LIABILITIES				
SHAREHOLDERS' FUNDS				
Share capital	1	964.2	964.2	
Reserves and surplus	2	27,407.9	22,723.3	23,687.5
NON-CURRENT LIABILITIES				
Long-term borrowings	3	154.6	11,894.8	
Deferred tax liabilities (net)	4	2,227.2	2,154.7	
Long-term provisions	5	13,886.6	11,933.9	25,983.4
CURRENT LIABILITIES				
Short-term borrowings	6	41.1	0.1	
Trade payables		7,287.1	6,330.4	
Other current liabilities	7	4,096.7	5,002.5	
Short-term provisions	8	2,130.6	2,138.8	13,471.8
Total.....		58,195.0	46,454.7	63,142.7
ASSETS				
NON-CURRENT ASSETS				
Fixed assets	9			
– Tangible assets		31,766.4	33,693.1	
– Capital work-in-progress		2,447.8	2,947.1	
		34,214.2	36,640.2	

J. Integrated Project This is a *research-based integrated project*. Chapter 21 is devoted to developing a model for strategic and integrated managerial financial analysis of annual report of Nestlé. The students will be enormously benefited by this project in developing and analysing an integrated project of some other corporate of their choice as per the exercises given in chapters 14 and 21.



K. Examples of Leading Companies in the Running Text The discussion on the conceptual issues in the running text has been further enriched by giving large number of examples of leading corporates with their names **emboldened**. It will help the readers establish connectivity between the concepts and the corporate practices.

L. Example / For Example Emboldened in the Text A large number of examples have been given in the running text. The words 'Example'/'For example', 'Examples' have been emboldened to catch the attention of the students.

Further suppose, in a public issue, valuation report was submitted to the client on 28th February and prospectus filed on 15th April. Cost of services rendered during March in the preparation of prospectus represents work-in-progress for **SBI Capital Markets Ltd.** which it should ideally recognize in its financial statements drawn for the year ended 31st March since the part of the service has already been rendered for which fee will be received thereafter. AS-2 does not apply to such inventory of work-in-progress of service providers. A perusal of the 2005–06 annual reports of **SBI Capital Markets Ltd., Satyam Computer Services Ltd., Infosys Technologies Ltd.** and **TATA Consultancy Services Ltd.** reveals that none of these companies has recognised work-in-progress on this count. The sample suggests that Indian service providing industry does not recognize revenue for services rendered but remaining unpaid as on the balance sheet date.

Consistency principle not violated Consistency principle is not supposed to have been violated when different methods of depreciation are used for:

- *Different kind of assets*, **for example**, SLM for buildings and WDV for machinery or SLM for one kind of machinery and WDV for another kind. We have noted earlier that *type of asset* is one of the determinants of the method of depreciation to be adopted.
- *Similar assets* acquired up to a particular date and thereafter, **for example**, SLM on machinery acquired up to 31-03-2005 and WDV for that acquired on or after 1-04-2005.
- *Similar assets* located in different geographical regions, **for example**, WDV for machines in Delhi plant and SLM for same machines at Mumbai plant. This case is however questionable.

8. Keywords Keywords, provided at the end of each chapter, will help the students recap the subject faster and enhance their accounting and financial vocabulary.



KEYWORDS

- | | | |
|-----------------------------|---|--------------------------|
| ■ Accounting Process/Cycle | ■ Dual Aspect Concept | ■ Naame (नामे) |
| ■ Accrual Concept | ■ <i>Hindustani Bahikhaataa Paddhati</i>
(हिन्दुस्तानी बहीखाता पद्धति) | ■ Owner's Capital/Equity |
| ■ Assets | ■ J.F. | ■ Sutras (सूत्र) |
| ■ Balance sheet identity | ■ Jamma (जमा) | ■ Trial Balance |
| ■ Basic Accounting Equation | ■ Journal | ■ Upanisads (उपनिषद्) |
| ■ Business Entity Concept | | ■ Vedas (वेद) |
| ■ Cost Concept | | ■ Voucher |

9. References Next to keywords is given the consolidated list of all the resources, referred to in a chapter, sorted out according to the sources of referenced material. This feature has a lot of recall and recap value. It includes:

- Web sites
- Books and Magazines
- Annual Reports
- Newspapers
- IPO
- Capitaline Plus

10. Chapter-end Exercises A large number of exercises are given at the end of each chapter. Suitable icons representing their characteristics accompany almost all of them. These aim to develop wide and varied skill sets in the students.

References



- Bombay Stock Exchange, www.bseindia.com
- Ministry of Company Affairs, Government of India, www.mca.gov.in
- Rallis India Ltd., www.rallis.co.in
- Sona Koyo Steering Systems Limited, www.sonagroup.com.
- Hindalco Industries Ltd., www.hindalco.com



- Taxmann's Companies Act*, Taxmann Allied Services (P) Ltd., New Delhi, 2015.
- Guide to the Companies Act*, A. Ramaiya, Wadhwa and Company, Nagpur, 2014.



- Hindalco Industries Ltd., Annual Report, 2005–06.
- Sona Koyo Steering Systems Limited, Annual Report, 2005–06.



- The *Economic Times*, business daily:
- Hindustan Lever Ltd.
 - IITC Ltd.



- Reliance Petroleum Limited, Red Herring Prospectus, April 2006.



- Capitaline Plus



EXERCISES

CASE 1



A. Case Studies A large number of blue chip corporates' case studies, on the lines of cases illustrated and expanded further, are the major highlights of chapter-end exercises. Like illustrations, exercises are also *case-centric*. The cases are *well structured, elaborate, objective-oriented* and *to the point*. All these cases seek to develop an *integrated competency set* of core numerical skills, financial analysis, evaluation of financial policies and practices, appropriate decision-making and crisp report writing in the students.



B. Integrated Group Projects Group project exercises start from Chapter 14 and continue all through the text there onwards. These are *basically research based* and well structured. The purpose behind the group projects is to facilitate the students apply the knowledge, gained by them through the case of Nestle, to some other prominent corporates of their choice and thus build up a strong understanding of the financial and other reports and develop competencies in analysing and interpreting them strategically and integratively for necessary decision-making.



C. Computational/Numerical Exercises The main focus of these exercises is on developing *core computational skills* in the students for accounting treatment of various matters on the lines of computational/numerical illustrations. They contain some *analytical elements* as well. Numerical illustrations will help the students handle these exercises well.



D. Analytical Exercises The main focus of these exercises, on the lines of analytical illustrations, is on developing the student's skill to carry out *financial analysis, appropriate decision-making* and *crisp report writing* to enhance written analysis and communication skills. They contain some *numerical elements* as well. Analytical illustrations will help the students handle these exercises well.



E. WAC (Written Analysis and Communication) Exercises/Group Assignments A general 'Written Analysis and Communication (WAC)' paper is taught as a core paper in MBA programmes in a large number of institutes and universities. These exercises seek to enhance the *WAC skills* of the students *with respect to accounting and financial information*, an essential aspect of the corporate finance professionals' day-to-day activity. Hence, exercises on WAC in a large number of chapters.



F. MOC (Managerial Oral Communication) Group Assignments Further to WAC, a general 'Managerial Oral Communication (MOC)' paper is also taught as a core paper in MBA programmes. These exercises seek to *enhance the MOC and PowerPoint Presentation skills* of the students *with respect to accounting and financial information*. These exercises have been set in a collaborative environment. Inter-group competition is an integral part of these exercises. In most chapters, MOC presentation requirements by the student groups on group project exercises also follow the latter. This will help all groups to learn from each other about the financial practices of a large number of corporates across industries.



G. Capitaline Plus/CMIE Prowess Data-based Exercises These exercises, in chapters 22, seek to encourage the students search the above mentioned major financial databases of our country built on and around corporate annual reports and other related voluminous information, for example, the industry information, newspaper clippings and share prices. They seek to develop a research orientation among the students.



OPEN EXERCISES

H. Open Exercises These exercises, in chapters 18, 22, 23 and 24, seek to encourage the students to explore a wide open field comprising Web sites, CFDS Portal system, newspapers, magazines, etc. to find out financial and business information, analyse the same and thus widen their horizons.

I. Integration of Exercises Through Various Chapters

To provide a holistic view of and to take a particular exercise to its logical conclusion, wherever required, such exercises have been integrated through various chapters. For example, the case of Maruti Suzuki Ltd. is spread over chapters 17, 19 and 20.

LIST OF COMPANIES WHOSE CASES and FINANCIAL PRACTICES/INFORMATION HAVE BEEN INCORPORATED IN THIS BOOK

SI No.	Company	Industry	Reference Chapter No.
1	Asian Hotels Ltd.	Hotels	9, 10, 11, 12
2	Bajaj Auto Ltd.	Two wheelers	17
3	Bharti Airtel Ltd. (Earlier, Bharti Tele-Ventures Ltd.)	Telecom	9, 10, 11, 12, 13
4	Boeing Company USA	Aerospace	20
5	Britannia Industries Ltd.	Food Processing: MNC	22
6	Cadila Healthcare Ltd.	Pharmaceuticals	16
7	Century Textiles Ltd.	Diversified: Mega	22
8	Cholamandalam DBS Finance Ltd.	Finance and Investment	13
9	Colgate Palmolive (India) Ltd.	Personal Care: MNC	11, 13, 23
10	Crosswords book stores Ltd.	Retail book stores	16
11	Dabur India Ltd.	Diversified: Large	14, 22
12	DCM Shriram Consolidated Ltd.	Diversified: Large	22
13	Dr. Reddy's Laboratories Ltd.	Pharmaceuticals	8
14	Duncans Industries Ltd.	Diversified: Mega	22
15	GlaxoSmithkline Consumer Healthcare Ltd.	Food Processing: MNC	22
16	Grasim Industries Ltd.	Diversified: Mega	19, 22
17	HDFC Ltd.	Housing Finance	13
18	Hero MotoCorp Ltd.	Automobiles: Motorcycles	20
19	Hindalco Industries Ltd.	Aluminium	4, 13
20	Hindustan Lever Ltd.	Diversified: Mega	16, 22
21	Hindustan Motors Ltd.	Automobiles: Passenger Cars	15, 16
22	ICICI Bank Ltd.	Private Sector Bank	8, 13, 23
23	i-flex Solutions Ltd.	Computers: Software—Large	8
24	Indian Oil Corporation Ltd.	Refineries	4, 9
25	Indo Rama Synthetics (India) Ltd.	Textiles: Spinning	15
26	Indraprastha Gas Ltd.	Natural Gas	9, 10, 11, 12, 13
27	Indraprastha Medical Corporation Ltd.	Hospital—Healthcare	9, 10, 11, 12

28	Infosys Technologies Ltd.	Computers: Software—Large	9, 10, 11, 13, 24
29	INTEL Corporation (US)	Microprocessors	20
30	ITC Ltd.	Diversified	9, 10, 11, 12, 13, 22
31	Kesoram Industries Ltd.	Diversified: Large	22
32	JAIPRAKASH Associates Ltd.	Construction	16
33	JK Cement Ltd.	Cement	9, 10, 11, 12, 16
34	Larsen & Toubro Ltd.	Diversified: Mega	11, 22
35	Liberty Shoes Ltd.	Leather/Leather Products	16, 17, 18, 24
36	Maruti Suzuki Ltd.	Automobiles: Passenger Cars	19, 17, 20
37	Nestle India Ltd.	Food Processing: MNC	11, 14, 15, 20, 21, 22
38	NTPC Ltd.	Energy	23
39	Oil and Natural Gas Corporation Ltd.	Oil Drilling	8, 9, 10
40	Ranbaxy Laboratories Ltd.	Pharmaceuticals	9, 10, 11, 12, 13
41	Rallis India Ltd.	Pest/Agro	4
42	Reliance Energy Ltd.	Power Generation	9, 10, 11, 12, 13, 16
43	Reliance Industries Ltd.	Diversified: Mega	7, 8, 9, 10, 11, 12, 13, 17, 19, 22, 23
44	Reliance Petroleum Ltd.	Refineries	4
45	SBI Capital Markets Ltd.	Finance: Merchant Banking	13
46	Shoppers' Stop Ltd.	Retail	9, 10, 11, 12, 17
47	Skyline India Ltd. (Imaginary Company)		20
48	Tata Motors Ltd.	Auto-LCVs/HCVs	7
49	Titan Industries Ltd.	Watches and Jewellery	11, 12, 17, 20
50	Torrent Cables Ltd.	Cables: Power	22
51	TVS Motor Company Ltd.	Two wheelers	17
52	Voltas Ltd.	Diversified: Mega	22
53	Whirlpool of India Ltd.	Domestic Appliances	9, 10

PREFACE TO THE FIFTH EDITION

Financial Accounting for Management: An Analytical Perspective is now into its fifth edition. In between the first and the fourth editions, while maintaining the original focus and character of the book, many major additions and improvements have been made, such as changes in the anatomy of the book, addition of new chapters, addition of an appendix on ESOP in the erstwhile chapter 11, increase in number of corporate cases from 38 to 53, substantial expansion of numerous chapters, introduction of new pedagogical features, addition of a large number of new illustrations and exercises, further simplification of the subject matter, convergence with international financial reporting standards (IFRS convergence), and new vertical format of financial statements as per the revised schedule VI of the Companies Act, 1956.

Now, I am happy to present before the readers the fifth edition of *Financial Accounting for Management: An Analytical Perspective* in a more contemporary layout and in two colours. This edition comes with substantial changes and revision of its subject matter and updation in the light of statutory requirements, notably Schedule III of the new Companies Act 2013 prescribing a new format of vertical financial statements.

The changes and revision have been brought about by introduction of new chapters, substantial rewriting of certain initial chapters, introduction of simpler and smaller illustrations, and including new exercises for all chapters. Content that is no longer relevant to the current scenario have been deleted. Consequently the book is now organized into 6 parts, 24 chapters and 2 appendices as against 8 parts, 28 chapters and 6 appendices in the 4th edition. The new chapter arrangement—vis-à-vis the 4th edition—is as follows:

Parts and Chapters in the 5th Edition			Corresponding
Chapter No.	Chapter Description	Nature of Change	Old Chapter No. in 4th Edition
PART 1: THE FOUNDATION			
1	Measurement of Profit and Financial Position: I, Business Transactions to Recording in Journal	Substantially Rewritten	1
2	Measurement of Profit and Financial Position: II, Journal to Trial Balance	Substantially Rewritten	1
3	Measurement of Profit and Financial Position: III, Trial balance to Balance Sheet and Profit and Loss Account: Non-corporate Entities	Substantially Rewritten	2
4	Measurement of Profit and Financial Position: IV, Corporate Entities	Updated	3
5	Vertical Financial Statements of Corporate Entities	Totally new chapter	...
6	Specific Day Books	Totally new chapter	...

(Continued)

Parts and Chapters in the 5th Edition			Corresponding
Chapter No.	Chapter Description	Nature of Change	Old Chapter No. in 4th Edition
PART 2: CONCEPTS AND PRINCIPLES			
7	Conceptual Framework of Financial Statements	Updation and pruning	4
8	Generally Accepted Accounting Principles	Updation and pruning	5
PART 3: ASSET VALUATION			
9	Valuation of Tangible Fixed Assets	No change	6
10	Depreciation on Fixed Assets	No change	7
11	Valuation of Assets Under Finance Lease and Intangible Assets, Amortization and Asset Impairment	No change	8
12	Valuation of Inventories	No change	9
13	Valuation of Investments	No change	10
PART 4: UNDERSTANDING THE ANNUAL REPORT			
14	Corporate Financial Statements of Nestle India Ltd. along With Notes to Accounts and Significant Accounting Policies	Totally new chapter and consolidation	11, 12, 13
15	Other Mandatory Financial Reports	Consolidation and updation	15, 16
PART 5: FINANCIAL STATEMENT ANALYSIS			
16	Quality of Earnings: Window Dressing, Creative Financial Practices and Issues Related to Quality of Disclosures in Reported Earnings	Minor changes	17
17	Financial Statement Analysis and the Tool Kit of the Analyst: I, Multi-step, Horizontal, Vertical and Trend Analyses and Analytical Balance Sheet	Updated	18
18	Financial Statement Analysis and the Tool Kit of the Analyst: II, Earnings Per Share (EPS) Analysis	No Change	19
19	Financial Statement Analysis and the Tool Kit of the Analyst: III, Ratio Analysis	Updated	20
20	Construction and Analysis of Corporate Cash Flow Statement	Updation and consolidation	14, 21
21	Model for Strategic and Integrated Managerial Financial Analysis of Annual Report	Revision	22
PART 6: MORE ON FINANCIAL REPORTING AND ANALYSIS			
22	Analysis of Information From Sources Other Than Annual Reports and Inter-company Comparison	No Change	25
23	Analysis of Group Performance: Consolidated Financial Reporting	No Change	26
24	Emerging Dimensions in Voluntary Financial Reporting: Contemporary Analytical Techniques	No Change	28

The Companies Act 1956 has been replaced by the new Companies Act 2013. Schedule III of the Act has prescribed new vertical format of financial statements for corporate entities. Chapter 5 on *Vertical Financial Statements of Corporate Entities* has been introduced for a thorough study and illustration of the new format. *Corporate Financial Statements of Nestle India Ltd. along With Notes to Accounts and Significant Accounting Policies* (Chapter 14) has been introduced for a thorough examination of the annual report of Nestle India Ltd. (for the year ending 31st December, 2014) in the new format. Furthermore, in all the chapters on financial analysis and all the illustrations and exercises of real-life companies have been replaced by their recent format of financial statements. Chapter 15 has been updated in view of the latest changes, such as Corporate Social Reporting. Chapter 20 represents consolidation and revision of Chapter 14 and 21 in the earlier edition. Chapter 6 on *Specific Day Books* has been introduced on the basis of feedback received from instructors.

Chapter No. 23, 24 and 27 of the 4th edition have not been retained in this edition as it was felt that they were not needed. Likewise appendices 1 to 3 and 6 of the 4th edition have become redundant and hence not retained.

For accessing the annual report 2014 of Nestle India Ltd., a separate online link is being provided on the back cover of the book.

This edition comes out with expansion, enrichment, simplification and aesthetic improvement of subject matter in more ways than one. The new features in this edition are:

1. More exhaustive explanations, examples and exercises throughout the book
2. Addition of a large number of simple and smaller illustrations and exercises
3. Publication in two colours
4. New and interesting icons for each pedagogical feature
5. References updated to recent editions of the books
6. Certain chapters deleted due to the redundancy of content.

All the changes, revisions, consolidations, and improvements brought about have ultimately resulted in significantly reducing the number of pages in this edition. Finally, I wholeheartedly acknowledge the support provided to this book by innumerable teachers from India and abroad through its adoption and providing constructive feedback. I have drawn upon many of them in shaping this edition and humbly look forward to their continued support. I may be reached at ambrish@fsm.ac.in.

AMBRISH GUPTA

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PREFACE

I am happy to place *Financial Accounting for Management: An Analytical Perspective*, before the students, teachers and other readers. The inspiration to write this book came from my MBA teaching experience coupled with a realization, strengthened further by some of my colleagues who shared their views with me as well as students' demand, that they needed, on the subject, an analysis and decision-making-oriented book with real life applications catering to the needs of the MBA students. I also saw an opportunity, in this realization, to bring a practitioner's perspective to the book by drawing upon my industrial experience in the area of finance. It took more than two years to transform this inspiration into outcome.

The Context and Purpose

Financial Accounting is known as the language of business. and rightly so since it measures, translates and sums up the impact of all business activities into financial terms in the form of *financial statements*, namely the balance sheet, income statement and cash flow statement, and facilitates an enterprise to analyse and assess periodically whether it is running profitably and enjoys a sound financial health or not. Based on this financial information a business formulates its strategies for revenue enhancement, cost economies, efficiency improvements, restructuring of its operations and further expansion/diversification for creating and enhancing the wealth of its shareholders.

Financial statements, nowadays, are no longer meant for just the promoters or owners of an enterprise. The growing complexities of modern-day business have put heavy demands on the enterprises in the preparation and presentation of their financial statements and other financial reports for the various stakeholders. These complexities are manifest, for example, in

- the separation of ownership and management
- public participation in the capital
- dependence upon the lending institutions
- multiplicity of legal interventions
- divergence between the requirements of accounting standards and fiscal laws
- global fund-raising and, therefore, compliance with the US and international financial reporting standards
- increasing pressure for harmonization of financial reporting internationally
- introduction of complex financial instruments
- emergence of proactive institutional investors
- general public awareness and
- ever-increasing and, now, predominant role and influence of the regulatory authorities on the operations of the enterprises.

Obviously, the students of MBA/PGDM/PGDBM and other allied courses, such as MFC and MBE, need to develop a sound understanding of financial accounting and skills in analysing its outcome, that is, financial state-

ments and other financial reports such as directors' report, corporate governance report, and management discussion and analysis report, to be able to make effective decisions when they proceed to join the corporate world.

This book has been brought out in this context and seeks to serve the purposes as stated above.

Focus

The needs of the MBA/MFC/MBE students in learning financial accounting are different from those of students of professional accounting courses like chartered accountancy. For the former, after initiation into the basic accounting activity that leads to the preparation of financial statements, emphasis needs to be placed on their analysis leading to strategic decision-making. In other words, they need to get more analytical input than the knowledge of accounting process, which is just a *means* to achieve the major *objective* of developing analytical and interpretation skills.

The literature that is available on the subject generally concentrates more on the *means* and pays far less attention than required to the *objective*. The book seeks to correct this imbalance and provide to the students with an analytical perspective all through the text. The book, thus, focuses more on the analysis, interpretation and strategic decision-making.

Target Audience

1. Primarily meant for students of MBA/PGDM/PGDBM and MFC/MBE.
2. Students of CA, CWA, CS, CFA, CPA, CAIIB will also find the book very useful *due to its emphasis on analysis*.
3. Quite useful for management development/in-company training programmes on finance, accounting and analysis for *finance as well as non-finance executives*.
4. Finance professionals in accounting firms and industry will also benefit from the book by updating themselves with the *latest in financial reporting and analysis*.

From collegiate to corporate management bigwigs, it is expected that the book will meet the requirements of all users.

Organization

A. Parts

1. The Foundation
2. Concepts and Principles
3. Asset Valuation
4. Understanding Corporate Financial Statements and Other Financial Reports Included in Annual Reports
5. Financial Statement Analysis
6. Strategic and Integrated Managerial Analysis of Corporate Financial Statements and Other Financial Reports of Nestlé India Ltd. forming Part of Its Annual Report
7. More on Financial Analysis
8. Contemporary Issues in Financial Reporting and Analysis

These parts contain, in all, *twenty-eight chapters*.

B. Appendices at the End of Part 8

1. Brief Profile of Nestlé India Ltd.
2. Annual report of Nestlé for the year ended 31.12.2001.
3. Certain extracts from annual report of Nestlé for the year ended 31.12.2000.
4. Present Value of an annuity of Rupee 1 paid at the year-end.

5. Present Value Factor of a lump sum (PVF) of Re 1
6. Cash flow statement of Nestlé India Ltd. for the year ended 31 December 2001 as prepared from its entire annual report.

C. Subject Index

Unique Features

1. Student-friendly. Written in a *lecture mode and conversational style*. Classroom simulative.
2. *Case study–centric and analysis-oriented*. A practical business oriented analysis keeping in mind the real-world financial practices of blue-chips corporates. *Cases and financial practices of 62 leading companies, Indian as well as multinational, have been covered.*
3. Enriched by my own industry experience, independent thinking and research on the subject, resulting into providing a *practitioner’s perspective* and making the text thoroughly enjoyable.
4. Thorough discussion on *Conceptual Framework of Financial Statements* and contemporary issues such as *Generally Accepted Accounting Principles (GAAPs), Valuation of Assets Under Finance Lease, Intangible Assets, Amortization and Asset Impairment, Earnings Per Share (EPS) Analysis, Analysis of Group Performance: Consolidated Financial Reporting and Employee Stock Option Plans.*
5. *Accounting Standards interwoven with the text* throughout the book, in a non-technical language, to the extent possible—instead of bundling them in a separate chapter—with the objective of making their understanding more and more contextual and enjoyable.
6. Thorough coverage of *Significant Accounting Policies and Notes to Accounts, Auditors’ Report, Directors’ Report, Corporate Governance Report, Management Discussion and Analysis Report, Quality of Earnings, Window Dressing, and Information from Sources Other than Corporate Annual Reports.*
7. A systematic, organized and integrated *reading and understanding of financial statements and reports* through the case of *Nestle India Ltd.*, based on its external annual financial reporting, in Part 4 of the book.
8. A *model developed for a strategic analysis and interpretation* of the annual report comprising an integration of financial, qualitative and quantitative information, with the objective of giving recommendations to the management on strategic issues emanating out of analysis and suggesting more transparency in financial reporting.
9. Nestle’s full *annual report* analysed as per the said model in Chapter 23 in Part 6. Special emphasis laid on contemporary financial issues such as *Corporate Governance, Segment Reporting, Related Party Disclosures, Earnings Per Share, Impairment Loss, Accounting for Taxes on Income and Contingency Provision*, and analysed threadbare.
10. Innovative analytical techniques like *Per Employee Analysis* and *Per Equity Share Analysis* introduced.
11. Detailed discussion on *Global Financial Reporting*.
12. Coverage of *emerging dimensions in financial reporting*, that is, Value reporting^(TM) comprising *Intangible asset scorecard, Human resource accounting, Value-added statement, Brand valuation, Balance sheet including intangible assets, Economic Value-added (EVA[®]) statement, Enterprise value and Current-cost-adjusted financial statements.*

External Resource Support to Teachers

Three external resources are hosted on www.pearsoned.co.in/ambrishgupta to support those teachers who adopt this book. The publishers will provide them password to access these resources.

1. Instructors' Manual

This manual seeks to explain to the instructors the purposes and objectives of different types of exercises, case studies and group projects, their focus areas, learning purported to be gained by the students and how to approach and address them.

2. Solutions Manual

This manual provides solutions to the chapter-end exercises. It acts as a ready reckoner for instructors and aims to save their time. At places, particularly in the analysis part of the exercises/case studies/projects, instructors may have views different from those expressed in the solutions manual. In such cases, they should discuss their own perspectives with the students as well.

3. PowerPoint Presentation Slides

This package of comprehensive chapter-wise PowerPoint presentation slides of the whole text, including illustrations, will, I hope enable the instructors derive fully the advantages intended from the package. It will save their quality time and should lead to more interactive class discussions and visual reinforcement of financial accounting, reporting and analysis techniques.

Acknowledgements

My thanks and gratitude to all those who have helped, encouraged and supported me all through this project: my institution FORE and its management; my publisher Pearson Education, their editorial team and panel reviewers, for their positive opinions on the book; my students, my friends, my secretary Sonika and my immediate family—Usha, Kamal and Bharat. Kamal and Bharat always kept me on my toes with queries like ‘When are you going to finish the book,’ ‘Why don’t you finish it early,’ and seeking regular progress reports from me. Really *it is these teenager sons of mine and their mother Usha*, who suffered a lot as a result of their neglect by me during the period this project was underway but never complained, and who played an instrumental role in the completion of this project by their constant and *persistent* encouragement.

Feedback

I seek critical reviews, comments and observations from my readers in an effort to improve the further edition of this book. I may be reached at ambrish@fsm.ac.in.

AMBRISH GUPTA

ABOUT THE AUTHOR



Dr Ambrish Gupta, M.Com., Ph.D., FCA, Chartered Accountant, is a senior professor in finance and accounting area at FORE School of Management, New Delhi. He is a recipient of the ‘Distinguished Management Teacher’ and ‘Rashtriya Gaurav’ awards.

Dr Gupta possesses over 32 years of experience in management teaching, research, academic administration, investment banking and primary capital market. He has three books to his name—two authored and one edited. He has also published 28 papers in leading journals and other publications, 2 case studies with The Case Centre, UK/USA, 10 working papers under the aegis of FORE and 4 papers in the proceedings of international conferences in Germany, Macau (China), Thailand and India and 5 chapters in edited books.

His areas of teaching and research interests are:

- Investment banking and primary capital market
- Contemporary corporate reporting practices
- Project appraisal and financing
- Financial accounting, reporting and analysis
- IFRS convergence of Indian accounting standards and their impact on the quality of financial reporting and corporate financial health
- Corporate governance and social responsibility

He has provided research guidance to 60 major research projects of PGDM/MBA students and one Ph.D. scholar (Theses awarded). He has delivered numerous talks on topics related to his interest areas in MDPs and seminars including for IAAS officers.

He is at present:

- Co-editor—International Journal ‘*GSTF Business Review*’, Singapore.
- Member—Editorial board-Universal Journal of Accounting and Finance, USA.
- Member—Editorial board-International Research Journal ‘*Public and Municipal Finance*’, Ukraine.
- Member—Program Committee-Series of Annual International Conferences on Accounting and Finance, Global Science and Technology Forum, Singapore.
- Fellow Member—The Institute of Chartered Accountants of India.
- Member—Doctoral committee-Department of Management-Jamia Hamdard University, Delhi.
- Member—Editorial advisory board-International Journal of Management Science Review, Jamia Hamdard University, Delhi.
- Member-National editorial advisory board—Journal of Management Research and Analysis, Delhi.
- Member—Editorial board-Indian Journal of Finance, Delhi.
- Member—Editorial board-Indian Journal of Research in Capital Markets, Delhi.

- Member—Editorial board-ELK Asia Pacific Journal of Project Management and Control, Delhi.
- Member—Capital market committee-PHD Chamber of Commerce and Industry, Delhi.
- Member—CFO Guild, the Institute of Chartered Accountants of India.

At FORE he has been:

- Area chairperson (Finance and Accounts) for 6 years.
- Programme Director (PGDM-Working Managers' Group) for two years.
- Member/chairman of various committees.

Prior to 1997, he spent 14 years in industry. He held leadership positions such as Director, Senior Vice President, and Country Head in the investment banking industry for 12 years. As an investment banker, he advised a large number of corporate clients and managed and marketed 85 IPOs/Rights equity issues and private debt placements. He also visited plants of a number of leading companies in India and addressed more than 50 conferences relating to IPOs attended by corporate finance managers, capital market intermediaries, national & regional press and investors.

PART

1

THE FOUNDATION

- Chapter 1:** MEASUREMENT OF PROFIT AND FINANCIAL POSITION: I
BUSINESS TRANSACTIONS TO RECORDING IN JOURNAL
- Chapter 2:** MEASUREMENT OF PROFIT AND FINANCIAL POSITION: II
JOURNAL TO TRIAL BALANCE
- Chapter 3:** MEASUREMENT OF PROFIT AND FINANCIAL POSITION: III
TRIAL BALANCE TO BALANCE SHEET AND PROFIT AND LOSS ACCOUNT:
NON-CORPORATE ENTITIES
- Chapter 4:** MEASUREMENT OF PROFIT AND FINANCIAL POSITION: IV
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chapter

1

Measurement of Profit and Financial Position: I Business Transactions to Recording in Journal

Monetary Business Transactions

Transaction Analysis

Documentation

Recording

The process that leads to the measurement of financial performance and position of an enterprise is known as Accounting Cycle. Accounting Cycle forms the very basis of financial accounting. This chapter covers the cycle up to recording in journal.



CHAPTER OBJECTIVES

This chapter seeks to enable you to develop knowledge and understanding of:

- 1 The fact that modern accounting owes its origin to India.
- 2 The anatomy of business and its relationship with financial accounting.
- 3 The steps involved in the process of accounting, up to recording, that leads to the measurement of profit and financial position.
- 4 How to do documentation of business transactions by way of vouchers.
- 5 How to do recording of vouchers in journal.
- 6 Application of certain fundamental accounting concepts in the process.
- 7 Basic features of partnership firm and their implications for financial accounting.

Thus enabling you to be able to complete the accounting cycle in the chapters that follow.

INTRODUCTION

Suppose your friend **Sachin** possesses a surplus of ₹ 10 crore. What should **Sachin** do with this money? One option is to invest it in a safe avenue with fixed stream of regular income, say; in a bank fixed deposit which earns him interest income of 9% per annum (p.a.). However **Sachin**, being quite enterprising, decides to embark upon a business. Do you wonder “Why”? Simple! **Sachin** wants a return of more than 9% p.a., or in other words, his motive is to earn profit. Any business for that matter is started with the objective of making money on money invested therein. **For example, Reliance Industries Ltd.**, the largest private sector company in India, is running a huge oil & gas, petrochemicals and textile business with thousands of crores of rupees invested therein by its promoters and millions of other shareholders. As yet another **example, Arcelor Mittal Steel Company**, Luxembourg, is operating the largest steel empire in the world with billions of U S Dollars. Simply these businesses, and for that matter all businesses, need to earn a decent profit to keep their shareholders happy. The questions that arise are how to ascertain whether the business is earning profit or not, are the profits earned decent or not, is the business in red, etc.? Financial Accounting comes to the rescue of the enterprise here. It enables preparation of financial statements, namely the Profit and Loss Account and the Balance Sheet, which measure the *financial performance*, i.e., the profit earned or the loss suffered and the *financial position*, i.e., what is the status of the money invested or what the enterprise *owns* and what it *owes*, respectively. How these financial statements are prepared? What is the process that leads to their preparation? Or in other words how do we ascertain the financial performance of a business for a given period and its financial position as on a given date? These and many other related questions will be answered in this and the next chapters.

However, before we move further it will be interesting at this stage to peep into the history of financial accounting and see that the roots of modern accounting lie in ancient India.

INDIA—THE PLACE OF ORIGIN OF MODERN ACCOUNTING

History of the Accountancy Profession in India, Volume I, researched and written by **Shri G.P. Kapadia** and published by the **Institute of Chartered Accountants of India** in the year 1972, and reprinted in 1988, is a classic treatise on the subject. Here are some extracts from the first chapter of the book.



Want to know more about the history of accounting? Refer to Chapter 1 of this treatise.

The birth of double entry book-keeping is suggested to have been at the hands of a Franciscan Monk, **Luca Pacioli**, who published a book in 1494, a philosophical and mathematical work, which included a treatise on book-keeping.

(However), sufficient evidence exists to lead one to conclude that the art and practice of accounting, as a highly developed system, was in vogue in

India even during the times of the *Vedas* (वेद), *Sutras* (सूत्र) and the *Upanishads* (उपनिषद्).

Indication about the existence of the profession or vocation of an accountant can be had from the rich material available in respect of the evolution of industry and commerce in olden times. The business that was carried on included a very extensive and developed entrepot trade and commercial activities extended to various parts of the world. It is, therefore, not surprising if one finds the system of trade organizations developed to a very high level in ancient India. It is certain that at least about the 5th century, B.C., if not much earlier, “Crafts and commerce were flourishing, highly organized corporately, under conditions of individual and corporate competition, the leading men therefore the friends and counsellors of kings...” and Indians in those times had a thorough familiarity with money and credit, ages before 7th century A.D. (Camb. *History of India*, p. 219.)

The profuse references given with regard to the pre-Vedic and Vedic times should confirm the position that accountancy existed in a highly developed form even in those days in India. We are in a position to surmise that the art and practice of accounting had existed on our soil even before the days of Babylonian empire and that a highly developed system was in vogue in India even during the time of the *Vedas*. Clear references, as were indicated, are found in the various treatises dating back to the period of the *Vedas* and the *Upanishads* to various professions and vocations in existence at that time and the profession of accountant is clearly one of them, and taking these aspects and considerations, one could come to a natural conclusion that accountancy had its origin in India.

In conclusion, a reference needs to be made to a pertinent observation made by **Alexander Hamilton** F.R.S., the noted orientalist. In the Book Review in “Monthly Review” 26 (1798) page 129, he stated as under:

‘We would remark that the Banias* of India have been from time immemorial, in possession of the method of book-keeping by double entry, and that Venice was the emporium of Indian commerce at the time at which Friar Lucas’s (Pacioli’s) treatise appeared’.

From the above extracts we may conclude with surety that the हिन्दुस्तानी बहीखाता पद्धति (*Hindustani Bahikhaataa Paddhati*/Indian System of Accounting) is a fully developed scientific system of double entry accounting, based on नामे (*Naame/Debit*) and जमा (*Jamaa/Credit*), which was invented and practiced thousands of years ago and refined over these years. Luca Pacioli’s references are just a few centuries old.

Modern day double entry accounting is also based on the two pillars of debit and credit. These—**debit, credit and double entry accounting**—will be discussed a little later.

As financial accounting seeks to measure the financial performance and position of business, we need to first understand the anatomy of business, and then we will move over to the accounting process.

*Banias mean Businessmen.

THE ANATOMY OF BUSINESS

Let us take an **example**. Suppose **Radhika Enterprises**, promoted by Radhika Agarwal as her proprietary firm, enters business of textile manufacturing. How does it do that? It invests in land, factory building, administrative building, plant and machinery, vehicles, furniture and office equipments etc. to produce and sell textiles and earn profit. Radhika contributes partly her own money and partly borrows a term loan repayable over five years, say, **for example** from **Delhi Financial Corporation**, to finance her investment. Once the plant is constructed and commissioned, the firm needs further funds for its normal operating cycle, that is, to purchase raw materials, produce textiles, sell them to customers, realise cash and pay back to the suppliers from whom credit availed. In this process the firm may not be able to sell its entire production, and otherwise also it needs to stock reasonable quantities of its finished goods to be able to execute orders quickly, and thus it will have to carry inventory of finished goods. Likewise the production process may take a few days to convert raw materials into finished goods thus leading to work-in-progress inventory. The firm would also like to maintain inventory of raw materials so that the production process is not held up for want of materials. Likewise it may have to sell its textiles to customers on credit. Again it may have to pay to the suppliers immediately on purchase of materials or even in advance. It also needs cash to meet day to day expenses on its establishment. Naturally Radhika Enterprises needs further funds to finance these activities. Partly they come from Radhika and partly from, say, **State Bank of India** in the form of bank overdraft or cash credit limits. In the business credit may also be available from suppliers against raw materials purchased as well as advances from customers against sale and to that extent these sources also become a source of finance for these activities.

Establishment of business and subsequent business operations lead to creation of assets and liabilities and generation of income and incurring of expenses towards that generation. Let us develop a *basic understanding* of what these terms ‘*Assets*’, ‘*Liabilities*’, ‘*Income*’ and ‘*Expenses*’ mean and convey and how they constitute ‘*Financial Position*’ and ‘*Financial Performance*’ before we proceed further.

Assets

We have referred above to resources like *land, buildings, plant and machinery, vehicles, furniture, office equipments, inventories of raw materials, work-in-progress and finished goods, amount receivable from customers to whom finished goods sold on credit*, commonly referred to as *debtors, advances to suppliers of raw materials and cash*. These resources are known as *assets*. Assets thus collectively refer to the resources controlled by a business enterprise which enable it carry out its business operations for generating revenue. Assets are usually of two types-*fixed* and *current*. At times there can be one more asset known as *investments*.

Fixed assets In the **example** of Radhika Enterprises given above *land, buildings, plant and machinery, vehicles, furniture and office equipments* represent physical infrastructure of the firm or its *fixed assets* as they enable the firm produce textiles and provide marketing and administrative support to business on an ongoing basis over their life span. These assets provide a long term economic benefit,



BIRD'S EYE VIEW

The Anatomy of Business

- Assets
 - Fixed assets
 - Current assets
 - Investments
- Liabilities
 - Long term (non-current) liabilities
 - Current liabilities
- Financial Position
- Income
- Expenses
- Financial Performance

usually spanning beyond one year, to the firm but they themselves are not held for sale. *Hence the term fixed assets.*

Current assets In the above **example**, *inventories of raw materials, work-in-progress and finished goods, debtors, advances to suppliers of raw materials and cash*, needed for the operating cycle as discussed, represent *current assets*. These assets are held for *consumption* (raw materials and work-in-progress) or for *sale* (finished goods) and are expected to be realised in *cash* (debtors) or in *kind*, for example, through the *supplies of raw materials* (advances to suppliers) during the operating cycle. *Cash* itself is a current asset held for financing other current assets, fixed assets and meeting day to day expenses.

Investments Business is supposed to generate profit. When generated this profit may be further deployed in the fixed and current assets to expand the business activities. In case however if there is no further scope for expansion or the owner does not want to expand, this profit piles up in the form of cash or *surplus funds*. These funds however cannot be kept idle and are therefore invested into, say, shares and debentures of companies like, **for example, Reliance, Tata Motors, Grasim and ONGC** etc. to name a few. *Investments* thus represent assets held by an enterprise for earning income by way of *dividends, interest* or gain on their disposal known as *capital gain*. There is however a risk of losing money also on their disposal known as *capital loss*.

Liabilities

We have referred above to sources of financing the assets, like **Radhika's contribution**, commonly referred to as *owners' capital, term loan, bank borrowings for financing current assets, amount payable to suppliers from whom raw materials purchased on credit*, commonly referred to as *creditors and advances from customers*. These sources represent *liabilities* since they have to be *paid back* (Radhika's capital, term loan, bank borrowings and creditors) and *settled through delivery of textiles* (advances from customers). Liabilities are thus the obligations of the business enterprise that arise in the course of its business operations and are to be *discharged/settled* in future. *It should be interesting for you to note that even though Radhika Agarwal is the proprietor of Radhika Enterprises; her capital represents a liability for the latter as it, as a business entity, is independent of its proprietor and has to return this capital to Radhika in the event of the closure of the business. Otherwise also Radhika can with draw the surplus capital from Radhika Enterprises any time.* You need to be clear that we are discussing here about the liabilities of Radhika Enterprises, *the business enterprise*, and not of Radhika, *the individual* who may have other interests as well. Liabilities thus represent *those payable to outsiders and that to the owner*. Liabilities are usually of two types-long term and short term or current.

Long term (non-current) liabilities In the above **example** *term loan for financing the fixed assets is repayable over five years*. Any liability repayable over a period exceeding one year is termed as a *long term liability*. Likewise *Radhika's capital* is also a long term liability as it represents a long term perpetual commitment of the proprietor towards the firm.

Current liabilities In the above **example** *bank borrowings for financing current assets, creditors and advances from customers* represent current liabilities. Current liabilities have to be essentially discharged during the *operating cycle* (creditors and advances from customers) and in any case *within one year* (bank borrowings for financing current assets as the banks sanction these for a year). *Hence the term current liabilities.*

Financial Position

Assets and liabilities put together constitute the *financial position* of the enterprise. They are tabulated in a statement known as *Balance Sheet*. As discussed above assets represent the resources at the command of the enterprise, outside liabilities the money owed by it to the outsiders and the excess of the former over the latter to the owner. More the excess of assets over the outside liabilities more strong is the financial position and vice versa. From this follows, what is known as, the *basic accounting equation* expressed as under:

- Assets = Liabilities, or
- Assets = Outside Liabilities *plus* Owner's Capital, or
- Assets *less* Outside Liabilities = Owner's Capital

The *basic accounting equation* is also known as the *balance sheet identity*.

Let us now turn our attention to **Income, Expenses and Financial Performance**.

Income

Business activities of an enterprise generate revenue or income for it. *Sale of goods* is the most common business income. **For example**, Radhika Enterprises earns its *income by selling textiles* to its customers. In a business there may be other incidental incomes also, **for example**, export incentives and cash discount. Business also earns through interest and dividends from investments. Income also includes *gains* such as capital gains on disposal of investments as discussed above. A business engaged in services earns its main income not through sale but through *fees for rendering services*. **For example, JM Financial Ltd.**, the well known investment banking company earns its revenue from fees for managing initial public offers and mergers and acquisitions etc. for its client companies. Income, once earned, is earned for good and is not payable back. *It becomes the resource of the enterprise.*

Expenses

Expenses are incurred in the course of the business operations of the enterprise towards generating income. **For example**, Radhika Enterprises incurs lots of expenses like *raw materials consumed for producing textiles, production expenses like wages, power, fuel etc., administrative expenses like salaries, office rent, travelling and conveyance etc. and marketing expenses like publicity and advertisements* etc. to be able to effect sale of textiles. Expenses are known as *revenue expenses* also as they represent the *cost* of generating the revenue and, once incurred, they are incurred for good and no further materials are delivered or service is rendered by the payee or in other words no further economic benefit is derived from them. Expenses also include *losses*, **for example**, capital loss on sale of investments as discussed earlier or loss due to fire or loss on sale of old fixed assets etc.

Financial Performance

Expenses and losses are charged against income and gains. Income and expenses are tabulated in a statement known as *Profit & Loss Account*. Excess of income and gains over expenses and losses represents *net profit* earned by the business and *net loss* in a vice versa case. Obviously net profit increases the capital of the owner and net loss reduces it. Net profit thus strengthens the financial

position of the enterprise and net loss eats into it. Profit is the motive behind business, and therefore all efforts of the owner are directed towards earning and further enhancing it, though losses also occur in a large number of cases. Basic accounting equation, illustrated earlier, can now be further expanded as under:

- Assets = Liabilities, or
- Assets = Outside Liabilities *plus* Owner's Capital, or
- Assets *less* Outside Liabilities = Owner's Capital, or
- Assets *less* Outside Liabilities = Owner's Brought in Capital *less* Owner's Drawings *plus* Net Profit (–Net Loss), or
- Assets *less* Outside Liabilities = Owner's Brought in Capital *less* Owner's Drawings *plus* Income *less* Expenses



BEFORE YOU MOVE FURTHER...

Stop. Think over, Discuss and Debate in Small Groups.

1. Are you convinced about India being the birth place of modern accounting?
2. Are you clear how business is structured and how financial accounting is related to it? Narrate.
3. Why should assets be equal to liabilities? What does the basic accounting equation convey?

To enrich your discussion, add your own ideas, thoughts and practical inputs.

And now we discuss the accounting process.

THE ACCOUNTING PROCESS

The process that leads to the measurement of financial performance and position of an enterprise passes through the following stages:

1. **Analysis of business transactions** that are capable of being expressed *in terms of money*, as per the rules of debit and credit as discussed a little later. A business enterprise carries out a number of activities and executes a number of transactions that could relate to purchase, sale, receipts and payments, etc. as seen above.
2. **Documentation** of business transactions by way of what is known as *voucher*.
3. **Recording** of vouchers in a daybook called *journal/journal* and *specific day books*. Daybook is the book which records transactions chronologically on a daily basis, and, hence the term.
4. **Classifying** the transactions so recorded by their nature. **For example**, putting all purchase transactions at one place chronologically so as to enable an understanding of the total build-up and effect of that particular activity. This is done through a book called *ledger*.



BIRD'S EYE VIEW

The Accounting Process

- Analysis of Transactions
- Documentation: Voucher
- Recording
- Classifying: Ledger
- Summarising: Trial Balance
- Bifurcating the Trial Balance: Profit and Loss Account and Balance Sheet

5. **Summarizing** the transactions so classified to understand and appreciate the total build-up and effect of various activities. This is done through a statement called *trial balance*. This document provides the net effect of all the transactions, by their nature, carried out by the enterprise during a particular period.
6. **Bifurcating** the trial balance into *statement of profit and loss* and *balance sheet* to measure the financial performance and position, respectively, of the enterprise.

The process mentioned above is also known as *accounting cycle* or *accounting process*. It is the very basis of financial accounting, reporting and analysis. This process has been organised in this book as under:

- Analysis of business transactions to recording: this chapter.
- Classifying and summarising: next chapter.
- Statement of profit and loss and balance sheet: next to next chapter.

Let us illustrate the accounting process, beginning with documentation and recording.

ANALYSIS, DOCUMENTATION AND RECORDING OF BUSINESS TRANSACTIONS

Analysis

Documentation and recording is based on what is known as the *dual aspect concept*. What it means is that every transaction has two sides. **For example**, in the case of cash sale the business receives cash from the customer in lieu of giving away the product to him. Therefore, the accounting process should show how much cash has been received, represented by how much sale. In case the goods have been sold on credit, that is, the amount due will be received in future on an agreed date, the accounting process should show how much is due from the customer against how much sale. Every transaction is therefore recorded on two sides, represented by *debit* and *credit*. Each transaction is debited and credited to what is known as *account*, represented by the nature and effect of the dual aspects of the transaction.

Debit and credit and the dual aspect concept or the double entry system is the foundation of the entire accounting system. Accounting cannot take shape without the double entry system. It is, therefore, essential to visit the wonder-land of debit and credit and develop a clear understanding thereof.



BIRD'S EYE VIEW

Analysis, Documentation and Recording of Business Transactions

- Analysis
- Wonderland of Debit and Credit
 - Reversal of income and expenses
 - Personal accounts
- Dual Aspect Concept
 - Cash: An asset
 - Double entries
 - Credit transactions
- Accrual Concept/Mercantile System of Accounting
 - The receiver and the giver
- Documentation: Voucher
- Recording: Journal