Subject: FAA

Subject Code: MBPC1003

Branch: MBA Semester: 1ST SEM

Lecture notes prepared by: Prof. Sumana Mondal

Disclaimer:

SYLLABUS

MBPC1003 FINANCIAL ACCOUNTING AND ANALYSIS (3-0-0)

Course Objectives:

1. To familiarize the students with accounting principles and acquaint them with accounting mechanisms, process and systems so as to develop their skills of preparing financial statements.
2. To develop their ability to read annual reports and develop their skills to interpret financial statements.
3. To familiarize the students with different financial accounting concepts affecting stakeholders.

Module-I:

Introduction to Accounting: Accounting as a language and need for Accounting, Basic Terminologies of Accounting. External and Internal users of Accounting Information, Accounting concepts and conventions, Accounting cycle, Accounting Equations, Nature of GAAP, Need for Accounting Standards, Limitations of Accounting, Ethical Issues in Accounting, Mechanics of Accounting: Introduction, Classification, Double Entry System, Preparing Journal, Subsidiary books, Ledger, preparation of Trial Balance.

Module- II:

Preparation of Financial Statements: Income statement and Balance Sheet, Corporate Accounts: Share and Share Capital, Issue of Shares, Payment in installment, Buyback of shares, Debentures and Bonds, understanding Corporate Income statement and Balance Sheet as presented in the Annual Reports of companies.

Module-III:

Financial Statement Analysis: Analysis and interpretation of Financing Statements, Common size statement, Comparative statement analysis, Trend analysis, Ratio Analysis, Cash Flow Analysis as per IND AS 7.

Course Outcomes:

CO-1: Explain the role of accounting as a language for financial communication of businesses, and meet the needs of both external and internal users using accounting principles.

CO-2: Illustrate the complete accounting process, including journalizing transactions, posting them to ledger, maintaining subsidiary books, preparing trial balance and drawing the financial statements for sole traders.

CO-3: Demonstrate a comprehensive understanding of corporate accounts, including the concepts of shares, share capital, the issuance of shares, instalment payments, share buybacks, and the use of debentures and bonds in corporate financing.

CO-4: Analyse corporate financial statements using techniques like Common Size Statement, Trend Analysis, Ratio Analysis, and Cash Flow Analysis as per IND AS 7.

Text Books:

1. Financial Accounting for Management; Paresh Shah,Oxford
2. Financial Accounting A managerial Perspective-Bapat & Raitha, McGrawHill
3. Financial Accounting for Managers-Sanjay Dhamija,Pearson
4. Accounting for Business Managers- Sakshi Vasudeva,HPH
5. Financial Accounting for Management,A.K.Bhattacharya
6. Financial Accounting for Management,Narayanswamy
7. Financial Accounting by S.N Maheswari VikasPublications
8. Financial Accounting by Satapathy, Mohapatra, Patra,Vrinda

UNIT - I

Meaning of Accounting

Accounting is the process of identifying, measuring, recording business transactions, and communicating the required information to interested users. It ensures that all financial activities of a business are systematically captured and presented in a way that is useful for decision-making and understanding the economic performance of the organization.

Accounting as a Source of Information

Accounting serves as an information system that identifies, measures, records, and communicates the economic events of an organization to its stakeholders. By systematically processing financial data, accounting provides relevant and timely information that assists managers, investors, creditors, and other users in making informed decisions regarding the business.

Users of Accounting Information

The users of accounting information include those with a direct financial interest, such as management, present and potential investors, and creditors, who rely on accurate data to assess performance and make financial decisions. Additionally, indirect users such as regulatory agencies, tax authorities, customers, labour unions, trade associations, and stock exchanges depend on accounting information to monitor compliance, ensure transparency, and understand the financial health of the business.

Qualitative Characteristics of Accounting

To be useful for decision-making, accounting information must possess certain qualitative characteristics. Reliability ensures that the information is accurate and trustworthy. Understandability guarantees that users can comprehend the data presented. Relevance ensures that the information provided assists users in making decisions. Comparability allows users to evaluate financial information consistently over time, enabling meaningful analysis and assessment.

Objectives of Accounting

The primary objectives of accounting are to maintain accurate records of business transactions, calculate profit or loss for an accounting period, depict the financial position of the business, and make relevant information available to various users. These objectives help organizations maintain transparency, ensure accountability, and support strategic planning and operational decisions.

Role of Accounting

Accounting is not an end in itself but a means to achieve broader business objectives. It acts as the language of business by providing a systematic way to communicate financial information. It serves as a historical record of economic activities, reflects the current economic reality of the organization, functions as an information system for various stakeholders, and provides valuable services to users in understanding and evaluating business performance.

Branches of Accounting

Financial Accounting	Cost Accounting	Management Accounting
Records all financial transactions systematically	Analyses and controls costs of products/services	Assists management in planning, decision-making, and performance evaluation
Determines profit or loss for an accounting period	Calculates cost of products/services	Analyses financial and non-financial data for decisions
Ascertains financial position at period-end	Helps in cost control and reduction	Supports policy, strategic, and operational decisions
Provides financial information to management and stakeholders	Provides costing information for pricing and management decisions	Evaluates impact of decisions and actions for management efficiency
Useful for investors, creditors, regulators, and management	Useful mainly for production and management departments	Useful for top and middle management

Basic Terminologies

1. ***Entity:*** An entity is a reality that has a definite and separate existence. A business entity refers to a specifically identifiable business enterprise such as Super Bazaar or ITC Limited. Accounting records and reports are always maintained for a particular entity.

2. ***Transaction:*** A transaction is an event involving some value between two or more entities. Examples include purchase of goods, payment to creditors, or receipt of money. Transactions can occur in cash or on credit.

3. ***Assets:*** Assets are economic resources of a business that can be measured in monetary terms and provide future benefits. They are items of value used in business operations. Assets are broadly classified as current or non-current.

4. ***Liabilities***: Liabilities are obligations or debts that a business must settle in the future. They represent creditors' claims on the business's assets. Liabilities can be short-term (current) or long-term (non-current).

5. ***Capital:*** Capital is the amount invested by the owner in the business, either in cash or assets. It represents the owner's claim on the business resources. Capital is shown on the liabilities side of the balance sheet.

6. ***Sales:*** Sales are the total revenues earned by selling goods or providing services to customers. Sales can be made in cash or on credit. It represents the primary source of revenue for a business.

7. ***Revenues:*** Revenues are amounts earned from business operations, such as sales of goods, services, commission, interest, rent, royalties, or dividends. Revenue is also referred to as income. It increases the resources of the business.

8. ***Expenses:*** Expenses are the costs incurred in earning revenue during an accounting period. Examples include wages, salaries, rent, utilities, and depreciation. They reduce the profit of the business.

9. ***Expenditure:*** Expenditure is the spending of money or incurring a liability to acquire benefits, services, or property. Revenue expenditure provides benefits within a year, while capital expenditure provides benefits over multiple years. Examples include purchases of goods, machinery, and furniture.

10. ***Profit:*** Profit is the excess of revenues over expenses during a specific accounting period. It represents the financial gain of the business. Profit increases the owner's investment in the business.

11. ***Gain:*** Gain is a profit arising from events or transactions incidental to business operations, such as selling fixed assets at a higher price or winning a court case. Gains are not part of normal business income.

12. ***Loss:*** Loss occurs when costs are incurred without receiving benefits, such as theft, fire, or loss on sale of fixed assets. Losses reduce the wealth of the business.

13***. Discount:*** Discount is a reduction in the selling price of goods. Trade discount is offered at the time of sale, while cash discount is given for prompt payment. Discounts encourage sales and timely payments.

14. ***Voucher:*** A voucher is the documentary evidence supporting a transaction. Examples include cash memos for cash purchases, invoices for credit purchases, and receipts for payments. Vouchers validate and authorize financial transactions.

15***. Goods:*** Goods refer to products that a business buys and sells for profit. Items used internally by the business, such as furniture for a furniture dealer, are treated as assets or expenses. The classification depends on the purpose of use.

16. ***Drawings:*** Drawings are withdrawals of cash or goods by the owner for personal use. They reduce the owner's capital or investment in the business. Drawings are not treated as business expenses.

17. ***Purchases:*** Purchases are the total goods procured for use or resale. In trading businesses, purchases are made for resale; in manufacturing businesses, raw materials are purchased and processed into finished goods. Purchases can be cash or credit.

18. ***Stock:*** Stock (inventory) is the measure of goods, raw materials, or other items on hand. Closing stock is the inventory at the end of an accounting period, while opening stock is the inventory at the beginning. Stock is an asset of the business.

19. ***Debtors:*** Debtors are individuals or entities that owe money to the business for goods or services sold on credit. The total outstanding amount is shown as sundry debtors on the asset side of the balance sheet. Debtors represent a source of future cash inflow.

20. ***Creditors:*** Creditors are individuals or entities to whom the business owes money for goods or services received on credit. The total outstanding amount is shown as sundry creditors on the liabilities side of the balance sheet. Creditors represent a future cash outflow.

Accounting Concepts

1. Separate Business Entity Concept

In accounting, a clear distinction is made between the business and its owner. All transactions are recorded from the viewpoint of the business and not of the proprietor. For example, capital invested by the owner is treated as a liability of the business, since it represents the owner's claim on the firm. Similarly, if the owner withdraws money for personal use, it is shown as a reduction of business cash. This concept is essential for evaluating the performance of the business separately from the personal affairs of its owner, whether it is a sole proprietorship, partnership, or company.

2. Money Measurement Concept

Only those transactions which can be expressed in monetary terms are recorded in accounting books. Money acts as a common unit of measurement, enabling comparison of assets, liabilities, and transactions. However, factors such as employee efficiency, working conditions, or the reputation of the firm, though important, are excluded because they cannot be expressed in money terms. Another limitation is that accounting assumes money has a constant value, ignoring the effects of inflation or deflation on asset values.

3***. Dual Aspect Concept***

According to this concept, every transaction has two aspects – a giving aspect and a receiving aspect – which must be recorded simultaneously. This forms the foundation of the double-entry system, where the total of debits always equals the total of credits. It leads to the accounting equation: Assets = Liabilities + Owner's Equity. This ensures that resources owned by the business are always equal to the claims of owners and outsiders.

4***. Going Concern Concept***

Accounting assumes that the business will continue its operations for the foreseeable future unless there is strong evidence to the contrary. On this basis, assets are valued at their historical cost rather than liquidation value, and expenses like depreciation are spread over their useful life. This assumption provides stability and helps investors, creditors, and management assess long-term performance. However, if liquidation is expected, assets and liabilities are valued at their current market values and such disclosure must be made in the financial statements.

5. ***Accounting Period Concept***

The life of a business is divided into fixed intervals, usually one year, called the accounting period. At the end of each period, financial results are determined to provide timely information to owners, creditors, and other stakeholders. Although actual results can only be known when the business closes down, periodic reporting is necessary to evaluate performance. This requires proper matching of revenues and expenses to the period concerned, even if cash has not been received or paid.

6. Cost Concept

Assets are recorded in the books at their original purchase price, known as historical cost, and not at current market value. For example, if machinery is bought for ₹5,00,000, it will be entered at that cost even if its present value is higher or lower. Depreciation may be charged over the useful life of the asset, but the base remains the original cost. This concept ensures objectivity and reliability, though it may not always reflect the real market worth of assets.

7. Matching Concept

The matching concept requires that expenses of an accounting period should be matched with the revenues of the same period to calculate profit or loss. Income is measured by comparing the revenues earned with the expenses incurred in earning them. For instance, prepaid and outstanding expenses, or accrued incomes, are adjusted so that only those items which relate to the current period are included. This ensures that financial results show a true picture of performance.

8. Accrual Concept

Under this concept, revenues are recorded when they are earned, and expenses are recorded when they are incurred, irrespective of actual cash flow. It distinguishes between cash receipts and the right to receive cash, and between cash payments and the obligation to pay. This concept ensures that income measurement reflects all rights and obligations of the business during a period, providing a fair view of financial performance.

9***. Realisation Concept***

Revenue is recognised when a sale is made, i.e., when ownership of goods or services passes to the buyer and payment becomes legally due. For example, revenue is considered realised when goods are delivered or services rendered. In special cases like long-term construction contracts or instalment sales, revenue may be recognised progressively, based on completion or collection. This ensures that income is not overstated or recorded before it is actually earned.

Accounting Conventions

1. Convention of Materiality

The materiality concept states that insignificant items need not be recorded with strict accuracy, as the cost of detailed reporting may outweigh the benefits. For example, a low-cost calculator can be treated as an expense in the year of purchase instead of spreading its cost over several years. What is material varies from case to case, but all significant information must be disclosed to ensure financial statements remain clear and useful, as required by IAS-1.

2. Convention of Conservatism

The conservatism principle requires accountants to "anticipate no profit but provide for all possible losses," meaning assets and revenues are recorded at the lowest possible value, while liabilities and expenses are recorded at the highest. Examples include valuing stock at cost or market price (whichever is lower) and creating provisions for doubtful debts. However, overuse may result in hidden reserves and misrepresentation, so it must be applied with caution.

3. Convention of Consistency

The consistency convention requires firms to use the same accounting methods and policies year after year for comparability of financial statements. For example, if depreciation is charged using the straight-line method, the same method should continue unless a valid reason justifies change. When changes occur, their impact must be disclosed. This principle ensures reliable comparisons across different accounting periods.

USERS OF ACCOUNTING

Internal Users	**Purpose/Interest**	**Examples of Information Used**	**External Users**	**Purpose/Interest**	**Examples of Information Used**
Owners	Assess financial performance and position of business to safeguard investment.	Balance Sheet, Profit & Loss Account, Equity Statement	**Investors**	Judge profitability, risk, and future potential before investing.	Annual Reports, EPS (Earnings per Share), Cash Flow Statements

Internal Users	Purpose/Interest	Examples of Information Used	External Users	Purpose/Interest	Examples of Information Used
Management	Set goals, evaluate progress, motivate staff, and take corrective actions.	Budgets, Cost Reports, Variance Analysis	**Creditors**	Check creditworthiness and repayment capacity.	Balance Sheet, Liquidity Ratios, Cash Flow Statements
Employees	Concerned with financial health as it affects salaries, bonuses, and benefits.	Profitability Reports, HR Cost Reports	**Government Agencies**	Levy taxes and regulate businesses accurately.	Tax Returns, Financial Statements, Audit Reports
Individuals	Manage personal finances, investments, and purchase decisions.	Bank Statements, Loan Reports, Personal Balance Sheet	**Customers**	Ensure continuous supply of goods/services.	Sales Reports, Inventory Data, Financial Statements of supplier
			Public	Evaluate financial health of businesses and their effect on the economy.	Annual Reports, Corporate Social Responsibility (CSR) Reports
			Non-Profit Organizations	Manage funds transparently and satisfy stakeholders.	Income & Expenditure Account, Receipts & Payments Account

Accounting Cycle

The accounting cycle is a step-by-step process that businesses use to record, process, and report financial transactions during an accounting period. It ensures that all financial data is accurately captured, summarized, and presented in financial statements. The cycle begins with identifying transactions and ends with closing the books, after which it restarts for the next accounting period. Its main purpose is to maintain accurate and reliable financial records that help in decision-making.

1. Identify & Analyse Transactions

↓

Examine all financial events during the accounting period, such as sales, purchases, cash receipts, and payments, to determine their impact on the business.

2. Record Transactions in Journal

↓

Enter each transaction in the journal chronologically as debit and credit entries, using double-entry accounting to maintain balance.

3. Post to General Ledger

↓

Transfer the journal entries into respective general ledger accounts to summarize all transactions by account.

4. Prepare Unadjusted Trial Balance

↓

List all ledger account balances to ensure that total debits equal total credits before making any adjustments.

5. Analyze Worksheet

↓

Review the trial balance and accounts to detect errors, discrepancies, or missing entries that need correction.

6. Adjust Journal Entries

↓

Make necessary corrections, record accruals, prepaid items, depreciation, or provisions to ensure accurate financial reporting.

7. Prepare Financial Statements

↓

Compile the Income Statement, Balance Sheet, and Cash Flow Statement to summarize the company's financial performance and position.

8. Close the Books

↓

Reset temporary accounts like revenues and expenses to zero, and transfer net profit or loss to retained earnings for the next accounting period.

What is the accounting equation?

The accounting equation represents the relationship between the assets, liabilities and capital of a business and it is fundamental to the application of double entry bookkeeping where every transaction has a dual effect on the financial statements. The purpose of this article is to consider the fundamentals of the accounting equation and to demonstrate how it works when applied to various transactions.

In its simplest form, the accounting equation can be shown as follows:

Capital = Assets – Liabilities

Capital can be defined as being the residual interest in the assets of a business after deducting all of its liabilities (ie what would be left if the business sold all of its assets and settled all of its liabilities). In the case of a limited liability company, capital would be referred to as 'Equity'.

Capital essentially represents how much the owners have invested into the business along with any accumulated retained profits or losses. For example, if you were to start a sole trade business with a $1,000 investment then on the first day of trading the accounts of the business would show that it has $1,000 of cash available and that this came from an investment made by you. The capital would ultimately belong to you as the business owner.

Rohan started a business on 1st April 2025 with a capital of ₹1,00,000 in cash. During the year, the following transactions took place:

1. Purchased furniture for ₹20,000 in cash.
2. Bought goods worth ₹30,000 on credit from M/s Sharma Traders.
3. Sold goods costing ₹15,000 for ₹25,000 in cash.
4. Paid rent of ₹5,000 and electricity bill of ₹2,000.
5. Purchased a vehicle for ₹40,000 by paying ₹10,000 in cash and the balance on credit.
6. Borrowed ₹50,000 from a bank as a loan.
7. Paid salaries of ₹8,000 to employees.
8. Depreciation of furniture at 10% per annum and vehicle at 20% per annum was recorded.
9. Accrued interest on bank loan ₹2,500.
10. Owner withdrew ₹5,000 in cash for personal use.
11. At the end of the year, ₹3,000 worth of goods remained unsold in inventory.
12. Outstanding rent of ₹1,000 was to be paid next month.
13. Prepaid insurance of ₹2,000 was recorded during the year.
14. Received commission income of ₹4,000 in cash.

PARTICULARS	ASSETS						CAPITAL		LIABILITIES		
	CASH	FURNITURE	STOCK	VECHICLE	BANK	PREPAID INSURANCE			CEDITOR	LOAN	OUTSTANDING RENT
Started business with cash	100000						100000				
	100000						100000				
Purchased furniture on cash	-20000	20000									
	80000	20000					100000				
Brought goods on credit			30000						30000		
	80000	20000	30000				100000		30000		
Sold goods costing 15000 for 25000, profit- 10000	25000		-15000				10000				
	105000	20000	15000				110000		30000		
Paid rent of ₹5,000 and electricity bill of ₹2,000.	-7000						-7000				
	98000	20000	15000				103000		30000		
Purchased a vehicle for ₹40,000 by paying ₹10,000 in cash and the balance on credit	-10000			40000					30000		
	88000	20000	15000	40000			103000		60000		
Borrowed ₹50,000 from a bank as a loan					50000					50000	
	88000	20000	15000	40000	50000		103000		60000	50000	
Paid salaries of ₹8,000 to employees	-8000						-8000				
	80000	20000	15000	40000	50000		95000		60000	50000	
Depreciation of furniture at 10% per annum and vehicle at 20% per annum		-2000		-8000			-10000				
	80000	18000	15000	32000	50000		85000		60000	50000	
Accrued interest on bank loan ₹2,500	-2500						-2500				
	77500	18000	15000	32000	50000		82500		60000	50000	
Owner withdrew ₹5,000 in cash for personal use.	-5000						-5000				
	72500	18000	15000	32000	50000		77500		60000	50000	
Outstanding rent of ₹1,000 was to be paid next month.							-1000				1000
	72500	18000	15000	32000	50000		76500		60000	50000	1000
Prepaid insurance of ₹2,000	-2000					2000	4000				
	70500	18000	15000	32000	50000	2000	80500		60000	50000	1000
Received commission income of ₹4,000 in cash	4000										
	74500	18000	15000	32000	50000	2000	80500		60000	50000	1000
TOTAL	191500						191500				

GAAP (Generally Accepted Accounting Principles)

1**. Nature of GAAP**

- GAAP is a standardized set of rules, principles, and procedures used in the U.S. for financial reporting.
- Ensures financial statements are accurate, transparent, comparable, and reliable.
- Developed by FASB (Financial Accounting Standards Board) for private sector and GASB (Governmental Accounting Standards Board) for government entities.
- Provides a common framework for financial reporting across companies and periods.

Key Aspects of GAAP

1. Standardization: Uniform guidelines for recording and reporting financial information.
2. Accuracy & Transparency: Financial statements must be truthful and free from misleading information.
3. Comparability: Enables investors to compare financial performance across companies.
4. Reliability: Enhances trust as statements follow agreed principles and can be verified.
5. Regulatory Compliance: Mandatory for public companies, government agencies, and non-profits.
6. Developed by Boards: FASB for private entities, GASB for government entities.

Fundamental Principles within GAAP

- Accrual Accounting: Record revenue when earned, expenses when incurred, not just when cash moves.
- Historical Cost: Assets recorded at original purchase price, not market value.

- Materiality: Disclose information significant enough to influence users' decisions.
- Prudence: Conservative approach, ensuring factual and non-speculative reporting.
- Periodicity: Financial data reported over specific periods (quarter, year).
- Consistency: Apply accounting methods consistently across periods.

Indian Accounting Standards (Ind AS)

Volume I: Ind AS 101–116

1. Ind AS 101 – *First-time Adoption of Indian Accounting Standards*: Provides guidance for entities adopting Ind AS for the first time.
2. Ind AS 102 – *Share-based Payment*: Deals with the accounting for share-based payment transactions.
3. Ind AS 103 – *Business Combinations*: Prescribes the accounting treatment for business combinations.
4. Ind AS 104 – *Insurance Contracts*: Addresses the accounting for insurance contracts.
5. Ind AS 105 – *Non-current Assets Held for Sale and Discontinued Operations*: Specifies the accounting for non-current assets held for sale and discontinued operations.
6. Ind AS 106 – *Exploration for and Evaluation of Mineral Resources*: Provides guidance on accounting for exploration and evaluation of mineral resources.
7. Ind AS 107 – *Financial Instruments: Disclosures*: Requires disclosures about the significance of financial instruments.
8. Ind AS 108 – *Operating Segments*: Requires disclosure of information about operating segments.
9. Ind AS 109 – *Financial Instruments*: Prescribes the accounting for financial instruments.
10. Ind AS 110 – *Consolidated Financial Statements*: Requires the preparation of consolidated financial statements.
11. Ind AS 111 – *Joint Arrangements*: Addresses the accounting for joint arrangements.
12. Ind AS 112 – *Disclosure of Interests in Other Entities*: Requires disclosures about interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities.
13. Ind AS 113 – *Fair Value Measurement*: Defines fair value and sets out a framework for measuring fair value.
14. Ind AS 114 – *Regulatory Deferral Accounts*: Addresses the accounting for regulatory deferral account balances.
15. Ind AS 115 – *Revenue from Contracts with Customers*: Establishes principles for reporting the nature, amount, timing, and uncertainty of revenue and cash flows.
16. Ind AS 116 – *Leases*: Requires lessees to recognize assets and liabilities for all leases.

Volume II: Ind AS 1–41

17. Ind AS 1 – *Presentation of Financial Statements*: Prescribes the basis for presentation of general-purpose financial statements.

18. Ind AS 2 – *Inventories*: Provides guidance on the determination of cost and its subsequent recognition as an expense.
19. Ind AS 7 – *Statement of Cash Flows*: Requires the presentation of information about the historical changes in cash and cash equivalents.
20. Ind AS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*: Prescribes the criteria for selecting and changing accounting policies.
21. Ind AS 10 – *Events after the Reporting Period*: Deals with the accounting treatment of events occurring after the reporting period.
22. Ind AS 12 – *Income Taxes*: Prescribes the accounting treatment for income taxes.
23. Ind AS 16 – *Property, Plant and Equipment*: Prescribes the accounting treatment for property, plant, and equipment.
24. Ind AS 19 – *Employee Benefits*: Prescribes the accounting for employee benefits.
25. Ind AS 20 – *Accounting for Government Grants and Disclosure of Government Assistance*: Deals with the accounting for government grants and disclosure of government assistance.
26. Ind AS 21 – *The Effects of Changes in Foreign Exchange Rates*: Prescribes the accounting treatment for transactions in foreign currencies.
27. Ind AS 23 – *Borrowing Costs*: Deals with the accounting treatment of borrowing costs.
28. Ind AS 24 – *Related Party Disclosures*: Requires disclosure of related party relationships and transactions.
29. Ind AS 27 – *Separate Financial Statements*: Prescribes the accounting and disclosure requirements for separate financial statements.
30. Ind AS 28 – *Investments in Associates and Joint Ventures*: Prescribes the accounting for investments in associates and joint ventures.
31. Ind AS 29 – *Financial Reporting in Hyperinflationary Economies*: Provides guidance on financial reporting in hyperinflationary economies.
32. Ind AS 32 – *Financial Instruments: Presentation*: Deals with the presentation of financial instruments.
33. Ind AS 33 – *Earnings per Share*: Prescribes the calculation and presentation of earnings per share.
34. Ind AS 34 – *Interim Financial Reporting*: Prescribes the minimum content for interim financial reports.
35. Ind AS 36 – *Impairment of Assets*: Prescribes the procedures for ensuring that assets are carried at no more than their recoverable amount.
36. Ind AS 37 – *Provisions, Contingent Liabilities and Contingent Assets*: Deals with the accounting for provisions, contingent liabilities, and contingent assets.
37. Ind AS 38 – *Intangible Assets*: Prescribes the accounting treatment for intangible assets.
38. Ind AS 39 – *Financial Instruments: Recognition and Measurement*: Prescribes the recognition and measurement of financial instruments.

39. Ind AS 40 – *Investment Property*: Prescribes the accounting treatment for investment property.

40. Ind AS 41 – *Agriculture*: Prescribes the accounting treatment for agricultural activity.

JOURNAL ENTRY

DATE	PARTICULARS	LF	AMOUNT (Dr.)	AMOUNT (Cr.)
YY Mm/dd	Name of the account (debit) Dr. To name of account (credit) (Narration)		XXX	 XXX

Elements of the journal entries-

1***. Date:*** In this column, the date on which the transaction was recorded is mentioned. The year is written at the top, following the month and then the day.

2. ***Particulars:*** Every transaction affects at least two accounts. One is debited and the other one is credited. The item that is debited is mentioned first and the word 'Dr.' is also written after that. In the next line, the item which is credited is written, a few spaces away from the margin, starting with 'To'.

Narration- After every journal entry, a brief explanation of the transaction with necessary details is given.

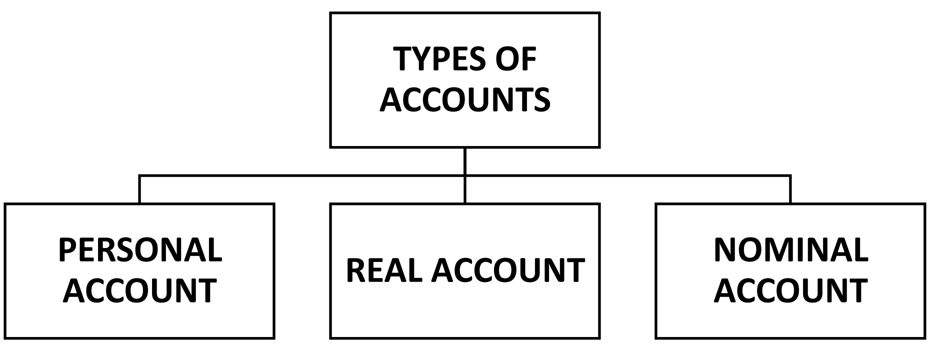
3. ***Ledger Folio or LF:*** Ledger Folio shows the number of the page on which the ledger account of that particular item is made.

4. ***Amount (Dr.):*** The amount that is debited is mentioned here.

5. ***Amount (Cr.):*** The amount that is credited is mentioned here.

Golden Rules Of Accounting

TYPES OF ACCOUNTS



Natural Personal Account:	**Accounts of natural persons; i.e., accounts of particular human beings are considered in this. Example, Ram A/c, Mohan A/c, Creditors A/c, Debtors A/c, Drawings A/c etc.**
Artificial Personal Account:	**These accounts do not have the physical existence of a human being but a group of human beings working together is considered to be an Artificial Personal Account. For example, Company A/c, Partnership Firm A/c, Bank A/c, Club A/c etc.**
Representative Personal Account:	**When an account represents a particular person or group of persons, then it is called a Representative Personal Account.**
RULE:	***Debit the Receiver, Credit the Giver***

Tangible Real Accounts:	The real accounts **which can be touched, felt, measured, purchased, and sold. For example,** Cash A/c, Stock A/c, Furniture A/c, Machinery A/c, etc.
Intangible Real Accounts:	The real accounts **which can not be touched but their value can be measured** in terms of money. **For example,** Goodwill A/c, Patent A/c, Copyright A/c, Trademark A/c Etc.
RULE:	***Debit What Comes in, Credit What Goes out***

Expenses:	Expenses include Salaries Paid, Rent Paid, Discount Allowed, etc. It implies that all the **expenses and losses incurred in business are debited**
Incomes:	Incomes include Commission Received, Interest Received, Discount Received, etc. **all the income and gains should be credited**.
RULE:	***Debit all the Expenses and Losses, Credit all the Incomes and Gains***

Recording of Transactions in the Journal

All business transactions are recorded in the journal by applying the *rules of debit and credit* as per the double-entry system of bookkeeping. According to this system, every transaction affects two accounts — one is debited and the other is credited with an equal amount.

Financial transactions are generally classified into three main categories:

1. Transactions relating to persons: These include dealings with individuals, firms, or other organizations.
2. Transactions relating to assets and properties: These cover the acquisition or disposal of business assets such as cash, machinery, buildings, etc.
3. Transactions relating to expenses and incomes: These include all expenditures and revenues that occur in the course of business operations.

On the basis of this classification, accounts are grouped and recorded systematically to ensure accuracy and transparency in financial reporting.

EXAMPLE:

The following is a list of various accounts. State the nature of each account (personal, real, or nominal) and also which account will be debited and which account will be credited:

1. Salary paid
2. Rent received
3. Machinery sold
4. Wages outstanding
5. Rent paid
6. Capital introduced
7. Goods purchased
8. Goods sold
9. Cartage paid
10. Prepaid salary
11. Stationery expense
12. Advertisement
13. Bank deposit
14. Rent outstanding
15. Bank overdraft
16. Discount allowed
17. Interest paid
18. Goods returned by buyer
19. Drawings by proprietor
20. Cash received

21. Commission received

22. Furniture purchased

Account	Nature of Account	Debited or Credited
Salary paid	Nominal	Salary Debited
Rent received	Nominal	Rent Credited
Machinery sold	Real	Machinery Credited
Wages paid	Nominal	Wages Debited
Rent paid	Nominal	Rent Debited
Capital introduced	Personal	Capital Credited
Goods purchased	Real	Purchases Debited
Goods sold	Real	Sales Credited
Cartage paid	Nominal	Cartage Debited
Prepaid salary	Personal	Prepaid Salary Debited
Stationery expense	Nominal	Stationery Debited
Advertisement	Nominal	Advertisement Debited
Bank deposit	Personal	Bank Debited
Rent outstanding	Personal	Rent Outstanding Credited
Bank withdrawal	Personal	Bank Credited
Discount allowed	Nominal	Discount Debited
Interest paid	Nominal	Interest Debited
Goods sold returned by buyer	Real	Sales Returns Debited
Drawings by proprietor	Personal	Drawings Debited
Cash received	Real	Cash Debited
Commission received	Nominal	Commission Credited
Furniture purchased	Real	Furniture Debited

Trial Balance

Meaning:

A Trial Balance is a statement prepared to check the arithmetical accuracy of ledger accounts. It lists all the debit and credit balances of various ledger accounts as on a specific date. The equality of the totals on both sides (debit = credit) ensures that the books are correctly balanced according to the Double Entry System of accounting, where every transaction has equal debit and credit effects.

According to Carter:
"Trial Balance is the list of debit and credit balances, taken out from ledger. It also includes the balances of cash and bank taken from cash book."

Objectives of Trial Balance:

1. Summarizes Ledger Accounts – Presents all ledger balances in one place for a quick overview of assets, liabilities, incomes, and expenses.
2. Checks Arithmetical Accuracy – Ensures debit and credit entries are equal and correctly posted.
3. Assists in Preparing Final Accounts – Becomes the base for preparing the Trading, Profit & Loss Account, and Balance Sheet.
4. Helps in Detection and Rectification of Errors – If both sides do not tally, it indicates possible posting or totaling errors that can be identified and corrected.
5. Ensures Reliability of Accounts – Builds confidence that accounting records are maintained systematically.

Rules and Regulations of Preparing a Trial Balance:

1. Debit Balances:
   All accounts showing debit balances are recorded on the debit side of the trial balance. These usually include:
   - All assets (Cash, Furniture, Debtors, etc.)
   - All expenses and losses (Rent, Salaries, Purchases, etc.)
2. Credit Balances:
   All accounts showing credit balances are recorded on the credit side. These usually include:
   - All liabilities (Creditors, Loans, Outstanding Expenses, etc.)
   - All incomes and gains (Commission Received, Interest Received, Sales, etc.)
   - Capital Account of the owner
3. Accounts with Nil Balance:
   Accounts with equal debit and credit totals (showing no balance) are not included in the trial balance.
4. Balancing of Sides:
   The total of the Debit column must equal the total of the Credit column. If not, errors must be investigated.

5. Timing:
   Trial Balance can be prepared monthly, quarterly, half-yearly, or at the end of the financial year.
6. Base for Final Accounts:
   Only after the trial balance agrees, final accounts are prepared.
7. Rectification Before Final Accounts:
   If the trial balance does not tally, adjustments or rectifications must be made before preparing financial statements.

Practical Question – Trial Balance

The following balances have been extracted from the books of M/s Rohan Traders as on 31st March 2025. You are required to prepare a Trial Balance as on that date:

Particulars	**₹**
Capital	80,000
Drawings	6,000
Cash in Hand	4,500
Cash at Bank	25,000
Bills Payable	10,000
Bills Receivable	5,000
Debtors	20,000
Creditors	15,000
Purchases	40,000
Sales	75,000
Returns Inward (Sales Returns)	2,000
Returns Outward (Purchase Returns)	1,500
Carriage Inwards	1,200
Carriage Outwards	800
Wages	5,500
Salaries	8,000
Rent and Taxes	2,500

Particulars	**₹**
Insurance Premium	1,200
Furniture	10,000
Machinery	25,000
Interest Received	1,500

SOLUTION-

Particulars	**L.F.**	**Debit (₹)**	**Credit (₹)**
Cash in Hand		4,500	
Cash at Bank		25,000	
Bills Receivable		5,000	
Debtors		20,000	
Purchases		40,000	
Returns Inward		2,000	
Carriage Inwards		1,200	
Carriage Outwards		800	
Wages		5,500	
Salaries		8,000	
Rent and Taxes		2,500	
Insurance Premium		1,200	
Furniture		10,000	
Machinery		25,000	
Drawings		6,000	
Sales			75,000
Returns Outward			1,500
Creditors			15,000
Bills Payable			10,000

Particulars	L.F.	Debit (₹)	Credit (₹)
Capital			80,000
Interest Received			1,500
Total		**1,56,700**	**1,56,700**

Define Subsidiary Books

Subsidiary Books are the books that record the transactions which are similar in nature in an orderly manner. They are also known as special journals or Daybooks. In big business institutions, it is not easy to record all the transactions in one journal and post them into various accounts. So, for the easy and accurate recording of all the transactions, the journal is subdivided into many subsidiary books. For every type of transaction, there is a separate book.

Types of Subsidiary Books

There are 8 main subsidiary books, each meant for a particular type of transaction:

1. Cash Book
2. Purchase Book
3. Sales Book
4. Purchase Return Book
5. Sales Return Book
6. Bills Receivable Book
7. Bills Payable Book
8. Journal Proper

(i) Cash Book

The Cash Book records all transactions relating to cash and bank receipts and payments. It serves the purpose of both a journal and a ledger for cash and bank accounts.

Types of Cash Books:

1. Single Column Cash Book:
    - Records only cash transactions.
    - Has a debit side (receipts) and a credit side (payments).
2. Double Column Cash Book:
    - Has two columns on each side: one for cash and one for discount.
    - Records discount allowed (debit side) and discount received (credit side).
3. Triple Column Cash Book:
    - Contains Cash, Bank, and Discount columns on both sides.

- Records all cash and bank transactions along with discounts.

(ii) Purchase Book

The Purchase Book records all credit purchases of goods that are meant for resale.
Cash purchases and purchases of assets are not recorded here.

Format of Purchase Book

Date	Name of Supplier	Invoice No.	L.F.	Details	Amount (₹)
Jan 5	M/s Gupta Traders	101	11	20 boxes @ ₹500 each	10,000
				Total	**10,000**

(iii) Sales Book

The Sales Book records all credit sales of goods.
It does not include cash sales or sale of fixed assets.

Format of Sales Book

Date	Name of Customer	Invoice No.	L.F.	Details	Amount (₹)
Jan 6	M/s Verma Traders	205	14	10 chairs @ ₹700 each	7,000

(iv) Purchase Return Book (Returns Outward Book)

This book records all goods returned to suppliers which were earlier purchased on credit.
A Debit Note is issued for every return.

Format of Purchase Return Book

Date	Name of Supplier	Debit Note No.	L.F.	Details	Amount (₹)
Jan 10	M/s Gupta Traders	DN-05	21	2 boxes damaged @ ₹500	1,000

(v) Sales Return Book (Returns Inward Book)

Records all goods returned by customers which were sold on credit.
A Credit Note is issued for each return.

Format of Sales Return Book

Date	Name of Customer	Credit Note No.	L.F.	Details	Amount (₹)
Jan 12	M/s Verma Traders	CN-04	24	1 chair defective @ ₹700	700

(vi) Bills Receivable Book

Used to record all Bills of Exchange or Promissory Notes received from customers.

Format of Bills Receivable Book

Date	From Whom Received	Term	Date of Bill	Due Date	Amount (₹)
Jan 15	M/s Verma Traders	3 Months	Jan 15	Apr 18	7,000

(vii) Bills Payable Book

Records all bills that the business has accepted and is liable to pay in the future.

Format of Bills Payable Book

Date	To Whom Given	Term	Date of Bill	Due Date	Amount (₹)
Jan 16	M/s Gupta Traders	2 Months	Jan 16	Mar 19	10,000

(viii) Journal Proper

Used for transactions that cannot be recorded in any other subsidiary book.
Examples include:

- Opening and closing entries
- Adjusting entries
- Depreciation and bad debts
- Credit purchase/sale of assets
- Rectification entries

Format of Journal Proper

Date	Particulars	L.F.	Dr (₹)	Cr (₹)
Jan 31	Depreciation A/c Dr.	45	2,000	
	To Machinery A/c			2,000
	(Being depreciation charged on machinery)			

Unit-II

Every business prepares its Final Accounts at the end of an accounting year to determine:

1. The profit or loss made during the year.
2. The financial position of the business on the last day of the accounting period.

Final Accounts include the Trading Account, Profit & Loss Account, and Balance Sheet, which are prepared after the Trial Balance and necessary adjustments to ensure a true and fair view of the financial statements.

Businesses prepare Financial Statements because they want to know:

- How well the business has performed during a particular period.

- What the current financial position of the business is.

These statements help to:

- Determine profit or loss made during the year.
- Identify the assets and liabilities of the business.
- Provide information to owners, investors, creditors, and management for decision-making.
- Ensure accuracy, transparency, and accountability in financial reporting.

Thus, Financial Statements act as a summary of all accounting records, showing the results of operations and the financial health of the business. They reflect what the business owns (assets) and what it owes (liabilities) on a specific date.

Definition:

"Financial Statements are those statements which show the profitability and financial position of a business enterprise at the end of the accounting period."

3. Objectives of Financial Statements

1. To ascertain profit or loss of the business.
2. To determine the financial position (assets, liabilities, and capital).
3. To provide useful information to owners, investors, and creditors.
4. To help in decision-making and planning for the future.
5. To ensure legal compliance and accountability.

Components of Financial Statements

The three main components are:

1. Trading Account
2. Profit and Loss Account
3. Balance Sheet

Trading Account

Meaning

The Trading Account is prepared to determine the gross profit or gross loss of a business during an accounting period.
It focuses on the relationship between sales revenue and direct costs associated with goods sold, such as purchases, direct expenses, and opening/closing stock.

Gross Profit = Sales – Cost of Goods Sold

If Cost of Goods Sold (COGS) exceeds sales, it results in a Gross Loss.

The trading account considers only the direct expenses and direct revenues while calculating gross profit. This account is mainly prepared to understand the profit earned by the business on the purchase of goods.

Items that are seen in the debit side include purchases, opening stock and direct expenses while credit side includes closing stock and sales.

Closing entries for Gross Loss or Gross Profit

Format of Trading Account

Trading Account

Dr. (For the period ended . . . .) Cr.

Particulars	Amount	Particulars	Amount
To Opening stock		By Sales	
To Purchases		Less: Sales returns	
Less: Purchases returns		By Closing stock	
To Wages			
To Customs and import duty			
To Carriage expenses			
To Royalty			
To Manufacturing expenses			
To Packing expenses			
Total		Total	
To gross profit transferred to profit and loss account		By gross loss transferred to profit and loss account	

PROFIT AND LOSS ACCOUNT

The Profit and Loss Account is an important part of the Final Accounts of a business. It is prepared after the Trading Account and shows the net profit or net loss of the business during an accounting period. The main objective of preparing a Profit and Loss Account is to determine how much profit the business has earned or how much loss it has incurred after taking into account all indirect expenses and incomes.

Structure of Profit and Loss Account

The Profit and Loss Account consists of two sides:

- Debit Side: It includes all indirect expenses related to the operation and administration of the business, such as salaries, rent, insurance, depreciation, bad debts, discount allowed, interest paid, etc.
- Credit Side: It includes all indirect incomes such as commission received, rent received, discount received, interest received, dividend, and any other income not related to direct trading.

The balance of the Trading Account (Gross Profit or Gross Loss) is transferred to the Profit and Loss Account:

- If there is Gross Profit, it is shown on the credit side.
- If there is Gross Loss, it is shown on the debit side.

Profit & Loss Account

(For the year ended...)

Dr. Particulars	Amount	Particulars	Cr. Amount
To Gross loss b/d	Xxx	By Gross Profit b/d	Xxx
To Salaries	Xxx	By Discount Received	Xxx
To Office rent, rates and taxes	Xxx	By Commission Received	Xxx
To Printing & stationery	Xxx	By Bank Interest	Xxx
To Telephone expenses	Xxx	By Rent received	Xxx
To Postage & telegram	Xxx	By Dividend on shares	Xxx
To Discount Allowed	Xxx	By Interest earned on debentures	Xxx
To Insurance	Xxx	By Profit on sale of asset	Xxx
To Audit Fees	Xxx	By Net loss	Xxx
To Electricity charges	Xxx		
To Repairs & renewals	Xxx		
To Depreciation	Xxx		
To Advertisement	Xxx		
To Carriage Outwards	Xxx		
To Bad Debts	Xxx		
To Provision for Bad debts	Xxx		
To Selling commission	Xxx		
To Bank Charges	Xxx		
To Interest on loans	Xxx		
To Loss on sale of asset	Xxx		
To Net Profit	Xxx		
	xxx		xxx

If the debit side exceeds the credit side, the difference is called Net Loss, and if the credit side exceeds the debit side, the difference is called Net Profit.

Purpose and Importance

1. Determines Net Profit or Loss: It helps in knowing the actual profitability of the business.
2. Helps in Decision Making: Management uses the information to plan future business strategies.
3. Tax Assessment: Net profit shown in this account is used to calculate tax liability.
4. Performance Evaluation: It shows the efficiency of operations and management.
5. Aid to Financial Position: The balance (Net Profit or Loss) is transferred to the Capital Account in the Balance Sheet to reflect the updated financial position.

INTRODUCTION TO COMPANY

Meaning, Characteristics and Kinds of Company: • Meaning of a Company: i. As per section 2(20) of the Companies Act, 2013, "Company means a company incorporated under this Act or any previous Company Law." ii. iii. iv. v. A company (or a joint stock company) is an entity incorporated by a group of persons through the process of law in order to undertake a business.

A company is divided into units called shares, the owners of which are known as members or shareholders. A company is an artificial person which is separate from its members (shareholders). Therefore, insolvency or death of a member does not affect the company, i.e., the company continues even if a member becomes insolvent or dies. A company is an artificial person, created by law having separate legal entity with perpetual succession and a common seal.

CHARACTERISTICS OF COMPANY

Feature	Description
1. Incorporation	A company comes into existence only after registration under the *Companies Act, 2013*.
2. Separate Legal Entity	It is treated as a person in the eyes of law – separate from its owners.
3. Artificial Person	Though not a natural being, it can own property, enter contracts, sue and be sued.
4. Perpetual Succession	The company continues despite death or insolvency of its members.
5. Limited Liability	Members are liable only to the extent of their share value or guarantee.
6. Transferability of Shares	Shares can be freely transferred (except in private companies).
7. Separation of Ownership & Management	Shareholders own the company, but directors manage it.
8. Common Seal	Used as the company's signature on official documents.

PARTNERSHIP VS COMPANY **Basis**	**Partnership**	**Company**
Formation	By agreement among partners	By registration under the Companies Act
Governing Law	Indian Partnership Act, 1932	Companies Act, 2013
Members	2 to 50 partners	Pvt. Co.: 2–200; Public Co.: Min. 7, no max limit
Liability	Unlimited	Limited (except in unlimited companies)
Profit Sharing	As per Partnership Deed	As per Articles of Association (dividend)
Existence	Affected by partner's death or insolvency	Unaffected — perpetual succession
Audit	Not mandatory	Mandatory
Management	Managed by partners	Managed by directors

PARTNERSHIP VS COMPANY Basis	Partnership	Company
Transfer of Interest	Needs consent of all partners	Freely transferable (except in private co.)
Business Scope	As partners agree	Restricted to Object Clause in MOA
Winding Up	By agreement or court	As per Companies Act procedure

Kinds of Companies: There are 3 kinds of companies as follows:

i.One Person Company (OPC): As per Section 2(62) of the Companies Act, 2013, 'One Person Company means a company which has only one person as member'. It is governed by Rule 3 of the Companies (Incorporation) Rules, 2014. Such company should have at least 1 director but not more than 15 directors.

ii. Private Company: As per Section 2(68) of the Companies Act, 2013, it is a company which has a minimum paid-up share capital as may be prescribed and which by its Articles of Association:

a. restricts the right to transfer its shares, if any.

b. except in the case of one person company, limits the number of its members excluding its present or past employee members to 200. Where shares are held by two or more persons jointly they shall be treated as a single member.

c. Prohibits any invitation to public to subscribe for any securities of the company. It is a company which should have at least 2 directors but not more than 15 directors and also the name of such company ends with the words, 'Private Limited'.

iii. Public Company: As per Section 2(71) of the Companies Act, 2013, a Public Company is a company which:

a. is not a private company;

b. has a minimum paid-up capital as may be prescribed; and

c. is a Private Company, being a subsidiary of a company which is not a Private Company.

Such company must have at least 7 members and there is no restriction on the maximum number of members. Also, it should have at least 3 directors but not more than 15 directors. The name of such company ends with the word 'Limited'. Understanding Limited Liability Company, Unlimited Liability Company, and Company Limited by Guarantee.

a. ***Limited Liability Company (or Company Limited by Shares):*** As per Section 2(22) of the Companies Act, 2013, it is a company having the liability of its members limited by the memorandum to the amount if any, unpaid on shares respectively held by them.

b. ***Unlimited Liability Company:*** As per Section 2(92) of the Companies Act, 2013, it is a company where the liability of its members is unlimited. Therefore, in the event of winding up of such company, debts of the company shall be met from private property of the members.

c***. Company Limited by Guarantee:*** As per Section 2(21) of the Companies Act, 2013, it is a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of it being wound up.

Classes Or Kinds of Shares:

i. Section 43(b) of the Companies Act, 2013 on Preference Shares: These are the shares that carry the following two preferential rights:

o Right to receive dividend before it is paid to Equity Shareholders. Such dividend is paid as a fixed amount or an amount calculated at a fixed rate which may either be free of or subject to income tax.

o Right to receive capital before equity shares in the event of winding up. Preference Shares can be classified with reference to:

o ***Dividend:*** With reference to dividend, Preference shares are classified as Cumulative and Non-Cumulative Preference Shares.

Cumulative: This class carries the right to receive arrears dividend before dividend is paid to the Equity Shareholders.

Non-Cumulative: This class do not carry the right to receive arrears of dividend. Participation in Surplus Profit: With reference to participation, Preference shares are classified as Participating and Non-Participating Preference Shares.

Participating: This class has the right to participate in the profits remaining after the dividend has been paid to the Equity Shareholders.

Non-Participating: This class has no right to participate in the profits remaining after the dividend has been paid to the Equity Shareholders.

Convertibility: With reference to convertibility, Preference shares are classified as Convertible and Non-convertible Preference Shares.

Convertible: This class are those which carry a right to be converted into Equity Shares.

Non-Convertible: This class are those which do not carry a right to be converted into Equity Shares.

Redemption: With reference to redemption, Preference shares are classified as

Redeemable and Irredeemable:

Redeemable: This class of preference shares can be redeemed by the company at the time specified for their repayment or earlier.

Irredeemable: This class of preference shares are those the amount of which can be returned by the company to the holders of such shares when the company is wound up.

Difference between Preference Shares and Equity Shares:

Sr. No.	Basis	Preference Shares	Equity Shares
1	**Right to Dividend**	Dividend on such shares is paid **before** the dividend on equity shares.	Dividend on such shares is paid **after** the dividend is paid on the preference shares.
2	**Rate of Dividend**	It has a **fixed rate** of dividend.	It pays dividend at the rate that is **proposed by the Board of Directors** every year.
3	**Arrears of Dividend**	In case of **cumulative preference shares**, arrears of dividend are paid before dividend is paid on equity shares.	In case dividend is not declared during the year, it is **not accumulated** to be paid in the coming years.
4	**Convertibility**	They **can be converted** into equity shares if the terms of issue so provide.	These shares are **not convertible**.
5	**Redemption**	They are **redeemable on due date** as per the terms of issue.	A company may **buy back** its equity shares.
6	**Voting Rights**	These shareholders have voting rights **only in special circumstances**.	These shareholders have voting rights **in all circumstances**.
7	**Refund of Capital**	In the event of winding up, these shareholders are **repaid before** the equity shareholders.	In the event of winding up, these shareholders are **repaid after** the preference shareholders.
8	**Right to Participate in Management**	These shareholders **do not have** the right to participate in the management of the company.	These shareholders **have the right** to participate in the management of the company.

Classification of Share Capital for Accounting purpose:

For accounting purpose, provisions specified in the Companies Act, 2013 are to be followed. As per the form prescribed for preparation of Balance Sheet in Part I of Schedule III of the Companies

Act, 2013, Share Capital of the company is to be classified and shown as follows:

i. Authorised Capital;

ii. Issued Capital;

iii. Subscribed Capital for each class of Share Capital

Understanding each of the heads:

i. Authorised Capital: It is the amount stated in the Memorandum of Association and such amount is the maximum amount that a company can raise as share capital. It is stated separately for each class or kind of shares. As per Section 2 (8) of the Companies Act, 2013, such capital as authorized by the memorandum of a company to be maximum amount of share capital of the company is called as Authorised Capital or Nominal Capital.

ii. Issued Capital: It is a part of the nominal value or Authorised Share Capital which is issued from time to time for subscription. Therefore, amount of Issued Capital cannot exceed the company's Authorised Share Capital. As per Section 2 (50) of the Companies Act, 2013, such capital of the company that it issues from time to time for subscription.

iii. Subscribed Capital: It is a part of the capital which is for the time being subscribed by the members of a company. As defined by Section 2 (86) of the Companies Act 2013, such part of the capital which is for time being subscribed by the members of a company. This can further be divided into:

Subscribed and fully paid-up: It is a situation where the company has called-up the total nominal value of the share and has received the same.

Subscribed and not fully paid-up: It is a situation where the company has called-up the total nominal value of the share, but has not receive it or has not called-up the total nominal value of the share.

Understanding the two terms, i.e., Called-up and Paid-up:

a. Called-up Capital: According to section 2(15) of the Companies Act, 2013, Called-up Capital means such part of the capital which has been called for payment.

b. Paid-up Capital: According to section 2(64) of the Companies Act, 2013, Paid-up Share Capital or Share Capital Paid-up means the amount that the shareholder has paid and the company has received against the amount Called-up in respect of the shares towards share capital or has been credited to it as paid-up.

Understanding Reserve Capital and Capital Reserve:

Reserve Capital: It is a part of Subscribed Capital remaining uncalled that a company resolves, by a Special Resolution, not to call except in the event of winding up of the company. Such number of shares are shown as "Subscribed but not fully paid-up".

Capital Reserve: It is a type of reserve which is created out of capital profits and is not free for distribution as dividend.Disclosure of Share Capital in a Company's Balance Sheet: Share Capital is shown in the

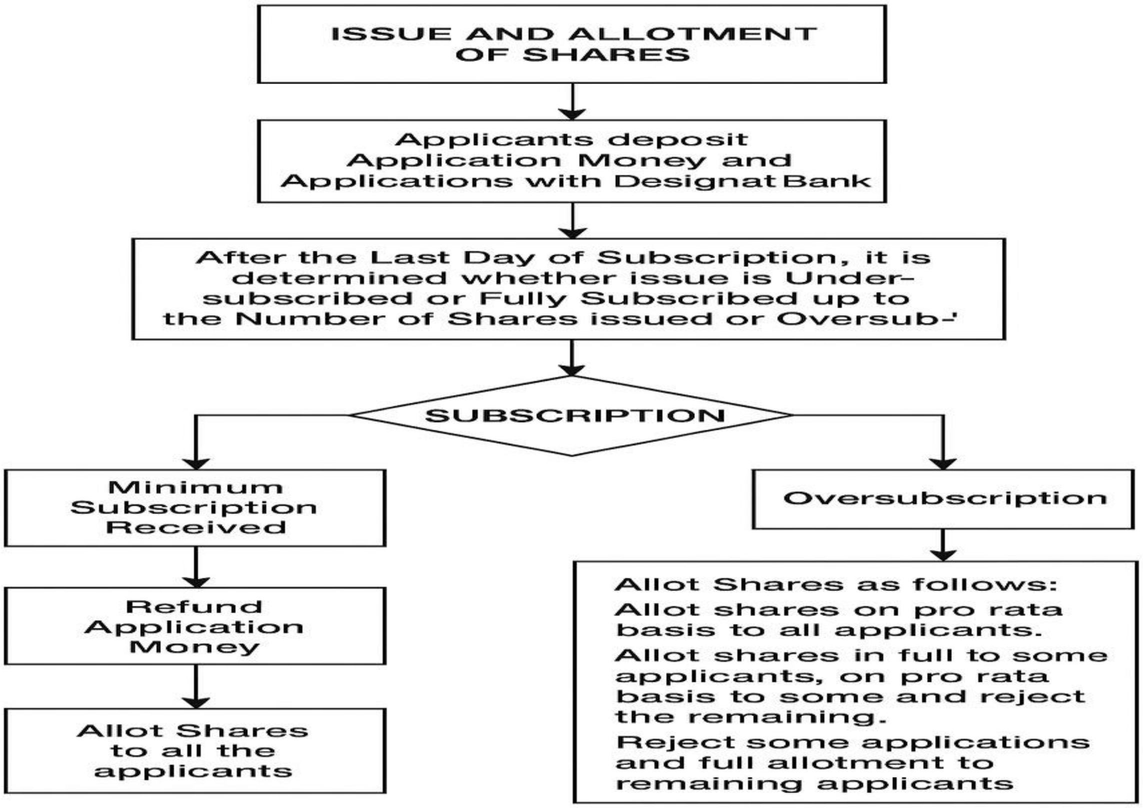
Company's Balance Sheet as follows:

Balance Sheet of … (Extract) as at …

Particulars	**Note No.**	**Amount (₹)**
I. EQUITY AND LIABILITIES		
Shareholders' Funds		
Share Capital	1	…
Notes to Accounts		
1. Share Capital		

Particulars	Note No.	Amount (₹)
Authorised Capital		
… Equity Shares of ₹ … each		…
… Preference Shares of ₹ … each		…
Issued Capital		
… Equity Shares of ₹ … each		…
… Preference Shares of ₹ … each		…
Subscribed Capital		
Subscribed and fully paid-up		
… Equity Shares of ₹ … each		…
… Preference Shares of ₹ … each		…
Subscribed but not fully paid-up		
… Equity Shares of ₹ … each, ₹ … called-up		…
Less: Calls-in-Arrears		(…)
… Preference Shares of ₹ … each, ₹ … called-up		…
Less: Calls-in-Arrears		(…)
Add: Forfeited Shares		…
Amount to be shown in the Balance Sheet against Share Capital		**₹ …**

PROCESS OF ISSUE AND ALLOTMENT OF SHARES



Issue of Shares for Cash

This is the issue of shares which means the shares are issued by a company against payment received by cheque or a banking instrument. Such issue can be made at par or premium but not at discount and the amount received on such issue can be received either in lump sum or in instalments.

Accounting Treatment

i. If issue price received in Lump Sum

In this type of issue, total issue price of shares is payable in one instalment.
a. To receive Shares Application Money:
Bank A/c …Dr. [amount received]
To Shares Application A/c
(Being application money received)

b. To Allot Shares:
Shares Application A/c …Dr. [nominal value]
To Share Capital A/c
To Securities Premium Reserve A/c [premium amount, when issued at premium]
(Being shares allotted and application money transferred to Share Capital Account and Securities Premium Reserve Account)

ii. If issue price received in Instalments

I. For receipt of Application money:
Bank A/c …Dr. [amount received with application]
To Shares Application A/c

II. For Allotment of Shares:
Shares Application A/c …Dr. [application money on shares allotted]
To Share Capital A/c

III. For Amount due on Allotment:
Shares Allotment A/c …Dr. [Money due on shares allotted]
To Share Capital A/c

IV. For receipt of Allotment money:
Bank A/c …Dr. [amount received on shares allotted]
To Shares Allotment A/c

V. For first call being due:
Shares First Call A/c …Dr. [amount payable on first call]
To Share Capital A/c

VI. For receipt of first call:
Bank A/c …Dr. [amount received on first call]
To Shares First Call A/c

Points to Remember when shares are issued to public for subscription

I. Calls are made as provided in the Articles of Association of the company.
II. If the company does not have its own Articles of Association or Articles of Association does not have a clause to this effect, Table F of the Companies Act, 2013 will apply.
Table F has the following provisions:
i. Period of one month must elapse between two calls.
ii. The amount of one call should not be less than 25% of the face value of the share.
iii. Notice of 14 days period should be given to the shareholders to pay the amount.
iv. Calls should be made on uniform basis on all shares within the same class.

Terms of Issue of Shares

I. Shares are issued at Par: It means that the issue price is same as the nominal value (face value) of the shares.
II. Shares are issued at Premium: It means that the issue price is more than the nominal value (face value) of the shares. Amount in excess of the nominal value of the share is termed as premium and such amount of premium is credited to Securities Premium Account or Securities Premium Reserve Account.

Oversubscription and Undersubscription of Shares

Oversubscription means, the number of applications received are more than the number of shares offered. In such case, allotment can be done by any of the three alternatives:

i. Some applications are accepted and excess applications are rejected.
ii. All applicants are allotted shares in proportion which is known as Partial or Pro-rata Allotment.
iii. A combination of the above two alternatives may be adopted.

Journal Entries for Oversubscription of Shares

a. For application money received:
Bank A/c …Dr.
To Shares Application A/c

b. For application money for allotted shares:
Shares Application A/c …Dr.
To Share Capital A/c

c. For excess application money refunded:
Shares Application A/c …Dr.
To Bank A/c

d. For excess application money adjusted with allotment and calls:
Share Application A/c …Dr.
To Shares Allotment A/c
To Calls in Advance A/c

e. Combined entry for refund and adjustment:
Shares Application A/c …Dr.
To Share Capital A/c
To Bank A/c
To Shares Allotment A/c
To Calls-in-Advance A/c

Meaning and Accounting Treatment of Calls-in-Arrears and Calls-in-Advance

Meaning and Accounting Treatment of Calls-in-Arrears:

• Meaning of Calls-in-Arrears and Interest on Calls-in-Arrears:

i***. Calls-in-Arrears:*** If the shareholder does not pay the call amount due on allotment or on any subsequent calls according to the terms, the amount not received is called Calls-in-Arrears.

ii. Interest on Calls-in-Arrears: If the company is authorized by the Articles of Association, it may charge interest at a specified rate on Calls-in-Arrears from the due date to the date of payment. If the Articles are silent, Table F of the Companies Act, 2013 applies, providing interest at 10% p.a., though directors may waive this interest.

• ***Accounting Treatment of Calls-in-Arrears:***

i. *Without opening Calls-in-Arrears Account:*

- Call Money Due:
  Share First Call A/c …Dr.
  To Share Capital A/c

- Call Money Received:
  Bank A/c …Dr.
  To Share First Call A/c

ii. *By opening Calls-in-Arrears Account:*

- Call Money Due:
  Share First Call A/c …Dr.
  To Share Capital A/c

- Call Money Received:
  Bank A/c …Dr.
  Calls-in-Arrears A/c …Dr.
  To Share First Call A/c

• Disclosure: Calls-in-Arrears is shown in Notes to Accounts on 'Share Capital', deducted from Subscribed but not fully paid-up capital.

Meaning and Accounting Treatment of Calls-in-Advance:

• Meaning of Calls-in-Advance and Interest on Calls-in-Advance:

i. Calls-in-Advance: Amount accepted by the company against calls not yet made, allowed only if permitted by the Articles of Association.

ii. Interest on Calls-in-Advance: If Articles provide, interest is paid; otherwise, as per Table F of the Companies Act, 2013, interest is 12% p.a.

• Accounting Treatment of Calls-in-Advance:

i. To record calls-in-advance:
Bank A/c …Dr.
To Calls-in-Advance A/c

ii. When the respective call becomes due:
Calls-in-Advance A/c …Dr.
To Respective Call A/c

Difference between Calls-in-Arrears and Calls-in-Advance:

Basis	Calls-in-Arrears	Calls-in-Advance
Meaning	Amount called-up but not paid by shareholders.	Amount not called-up but paid by shareholders.

Interest	Interest is charged on Calls-in-Arrears.	Interest is allowed on Calls-in-Advance.
Rate of Interest	10% p.a. (Table F, Companies Act, 2013).	12% p.a. (Table F, Companies Act, 2013).
Authority	No such clause required as non-payment is beyond control.	Accepted only if authorized by Articles of Association.
Disclosure	Shown as deduction from Subscribed but not fully paid-up capital.	Shown as a separate item under 'Other Current Liabilities'.

Shares Issued for Consideration Other Than Cash:

• Shares may be issued to vendors against purchase of assets or business.

a. If shares are issued for purchase of assets:
Sundry Assets A/c ...Dr.
To Vendor's A/c

b. If shares are issued for purchase of business, depending on the consideration amount, Goodwill or Capital Reserve may arise.

• Issue of shares to Vendors:

i. At par: Vendor's A/c ...Dr.
To Share Capital A/c

ii. At premium: Vendor's A/c ...Dr.
To Share Capital A/c
To Securities Premium Reserve A/c

Forfeiture and Reissue of Shares:

• Forfeiture means cancellation of shares for non-payment of due calls. It can be done only if allowed by the Articles of Association.

• Entry for forfeiture (issued at par):
Share Capital A/c ...Dr.
To Forfeited Shares A/c
To Share Allotment A/c
To Shares Call A/c

• Entry for forfeiture (issued at premium):
Share Capital A/c ...Dr.
Securities Premium Reserve A/c ...Dr.
To Share Allotment A/c
To Shares Call A/c
To Forfeited Shares A/c

• Reissue of forfeited shares can be done at par, premium, or discount (within permissible limits).

Company Balance Sheet (Statement of Financial Position)

The Balance Sheet provides a snapshot of a company's financial position at a specific point in time. It summarizes what the company owns (assets), what it owes (liabilities), and the residual interest belonging to shareholders (equity).

Name of the Company: ...
Balance Sheet
as on 31st March 20XX (₹ in ....)

Particulars	Note No.	Figures at the end of Current reporting period	Figures at the end of the previous reporting period
I. Equity and Liabilities: **1. Shareholder's Funds:**			
a) Share Capital		XXXX	XXXX
b) Reserves and Surplus		XXXX	XXXX
c) Money received against share warrants		XXXX	XXXX
2. Share application money pending allotment		XXXX	XXXX
3. Non-current Liabilities:			
a) Long-term Borrowings		XXXX	XXXX
b) Deferred tax liabilities (net)		XXXX	XXXX
c) Other Long-term liabilities		XXXX	XXXX
d) Long-term provisions		XXXX	XXXX
4. Current Liabilities:			
a) Short-term Borrowings		XXXX	XXXX
b) Trade Payables		XXXX	XXXX
c) Other Current Liabilities		XXXX	XXXX
d) Short-term Provisions		XXXX	XXXX
Total		**XXXX**	**XXXX**
II. Assets: **1. Non-Current Assets:**			
a) Property, Plant and Equipment and Intangible Asset*:			
i) Property, Plant, and Equipment		XXXX	XXXX
ii) Intangible Assets		XXXX	XXXX
iii) Capital Work-in-progress		XXXX	XXXX
iv) Intangible Assets under Development		XXXX	XXXX
b) Non-current Investments		XXXX	XXXX
c) Deferred Tax Assets (Net)		XXXX	XXXX
d) Long-term Loans and Advances		XXXX	XXXX
e) Other Non-current Assets		XXXX	XXXX
2. Current Assets:			
a) Current Investments		XXXX	XXXX
b) Inventories		XXXX	XXXX
c) Trade Rececivables		XXXX	XXXX
d) Cash and Cash Equivalents		XXXX	XXXX
e) Short-term Loans and Advances		XXXX	XXXX
f) Other Current Assets		XXXX	XXXX
Total		**XXXX**	**XXXX**

Structure of the Balance Sheet

The Balance Sheet is divided into three main sections:

- **Assets**
- **Liabilities**

• **Shareholders' Equity**

Assets

Assets represent resources owned by the company expected to bring future economic benefits. They are categorized as current or non-current assets depending on the expected time of realization.

• ***Current Assets*** – Expected to be converted into cash or used within one year. Examples include cash, accounts receivable, inventory, and prepaid expenses.

• ***Non-Current Assets*** – Held for more than a year and used to generate long-term income. Examples include property, plant & equipment (PPE), intangible assets, and long-term investments.

Intangible Assets are non-physical assets such as trademarks, patents, goodwill, and copyrights. Goodwill arises when a company is purchased for more than the fair value of its net assets.

Liabilities

Liabilities represent the company's obligations to external parties. They indicate the sources of funds borrowed to finance assets.

• ***Current Liabilities*** – Obligations due within a year, such as trade accounts payable, accrued expenses, or short-term loans.

• ***Non-Current Liabilities*** – Long-term obligations such as bank loans or bonds payable with repayment terms exceeding one year.

Commitments are future obligations agreed upon by the company, while contingencies are possible liabilities that depend on uncertain future events (e.g., lawsuits). Only probable and measurable contingencies are recorded in financial statements.

Shareholders' Equity

Equity represents the owners' residual claim after deducting all liabilities from total assets. It reflects the company's net worth.

Components of Shareholders' Equity include:

• ***Common Shares –*** Represent ownership and voting rights.

• ***Preferred Shares*** – Carry fixed dividends and priority over common shareholders but limited voting rights.

• ***Retained Earnings*** – Profits retained for reinvestment instead of dividends.

• ***Contributed Surplus*** – Amount received from shareholders over the par value of shares.

• ***Other Comprehensive Income (OCI)*** – Unrealized gains or losses on investments or revaluation items not reflected in net income.

Key Balance Sheet Concepts

• Assets and liabilities are arranged in order of liquidity.

• Total Assets must always equal Total Liabilities + Shareholders' Equity (Accounting Equation).

• It shows the company's solvency, liquidity, and capital structure at a point in time.

• Used by management, investors, and creditors to assess financial stability and risk.

Income Statement (Statement of Operations or Profit & Loss Account)

The Income Statement summarizes the company's financial performance over a specific accounting period. It measures profitability by comparing revenue earned with expenses incurred to generate that revenue.

Statement of Profit and Loss

Name of the Company-----------------

Profit and Loss Statement for the year ended ----------

(Rupees in----------)

	Particulars	Figures at the end of current reporting period	Figures at the end of the previous reporting period
I	Revenue from operations	xxx	xxx
II	Other Income	xxx	xxx
III	Total Revenue(I+II)	xxx	xxx
IV	Expenses:	xxx	xxx
	Cost of Materials	xxx	xxx
	consumed Purchases	xxx	xxx
	of Stock-in-trade		
	Change in inventory of finished goods,	xxx	xxx
	work- in-progress and Stock-in-trade	xxx	xxx
	Employee benefit	xxx	xxx
	expense Finance Cost	xxx	xxx
	Depreciation and amortisation	xxx	xxx
	expense Other expense	xxx	xxx
V	Total expenses		
	Profit before exceptional and extraordinary items and tax(III-Iv)	xxx	xxx
VI	Exceptional Items	xxx	xxx
VII	Profit before extraordinary items and tax(V-VI)	xxx	xxx
VIII	Extraordinary Expenses	xxx	xxx
IX	Profit before tax(VII-VIII)	xxx	xxx
X	Tax expense	xxx	xxx
	1. Current tax	xxx	xxx
	2. Deferred tax	xxx	xxx
XI	Profit (Loss) for the period from continuing operations (IX-X)	xxx	xxx
XII	Profit/(loss) from discontinuing operations	xxx	xxx
XIII	Tax expense of discontinuing operations	xxx	xxx
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)	xxx	xxx
XV	Profit (Loss) for the period (XI +	xxx	xxx
XVI	XIV) Earnings per equity share:		
	(1) Basic	xxx	xxx
	(2) Diluted	xxx	xxx

Structure of the Income Statement

The Income Statement is generally divided into the following sections:

• **Revenues**

• **Expenses**

• **Profit or Loss**

Revenues

Revenues represent the income earned from the primary operations of the company, such as sales of goods or services.

Cost of Goods Sold (COGS)

COGS represents direct costs involved in producing goods or delivering services. It includes direct materials, direct labor, and factory overheads. Gross Profit is calculated as:

Gross Profit = Revenue – COGS

Operating Expenses (SG&A)

Selling, General, and Administrative (SG&A) expenses represent indirect operating costs not tied directly to production. Examples include advertising, rent, utilities, office supplies, legal fees, and insurance.

Operating Profit (EBIT)

Operating Profit, or Earnings Before Interest and Taxes (EBIT), reflects the profitability from core business operations before considering financing and tax expenses.

Other Income and Expenses

These include gains or losses not part of regular operations, such as income from investments, foreign exchange differences, or sale of assets.

Net Profit and Comprehensive Income

Profit Before Tax (PBT) = Operating Profit + Other Income – Interest Expense

Net Profit = PBT – Income Tax Expense

Other Comprehensive Income (OCI) includes unrealized gains/losses on investments and currency translation adjustments, combined with Net Profit to give Total Comprehensive Income.

<u>Types of Income Statements</u>

• ***Single-Step:*** Groups all revenues together and all expenses together to calculate net profit.

• ***Multi-Step:*** Separates gross profit, operating profit, and net income for detailed performance analysis.

Key Ratios Derived from Income Statement

• ***Net Profit Margin = (Net Profit / Revenue) × 100***

• ***Earnings Per Share (EPS) = Net Income / No. of Shares***

• ***Return on Assets (ROA) = Net Income / Total Assets***

• ***Return on Equity (ROE) = Net Income / Shareholders' Equity***

UNIT -III

Common Size Analysis

Common size analysis, also known as vertical analysis, is a financial analysis technique used to evaluate financial statements by expressing each line item as a percentage of a base amount for that period. It helps financial managers and analysts understand the relative significance of each component within the financial statements, making it easier to compare across different periods or companies of varying sizes.

Purpose and Application

Common size analysis can be applied to all three major financial statements — the balance sheet, income statement, and cash flow statement. In a balance sheet, total assets serve as the base item, while in an income statement, total revenues or sales act as the base. By converting figures into percentages, this analysis allows easier comparison of financial performance and structure both over time and across different companies.

Formula for Common Size Analysis

The general formula used in common size analysis is:

Common Size % = (Line Item Amount / Base Item Amount) × 100

For instance, in an income statement, the cost of goods sold (COGS) as a percentage of total revenue is calculated as:

COGS % = (COGS / Total Revenue) × 100

Types of Common Size Analysis

Common size analysis can be categorized into two main types: Vertical and Horizontal Analysis.

• Vertical Analysis – Compares line items to a base item within the same financial period. For example, each expense item in an income statement is expressed as a percentage of total revenue.
• Horizontal Analysis – Compares line items over different periods to identify trends and changes. For instance, comparing revenue or expense percentages from one year to the next.

Balance Sheet Common Size Analysis

In the balance sheet, total assets are typically used as the base figure. Each item such as cash, inventory, or accounts payable is expressed as a percentage of total assets. This allows analysts to assess the structure of a company's resources and obligations relative to its asset base.

For example, an analyst may observe that current assets represent a significant portion of total assets, indicating strong liquidity, while a high percentage of long-term debt might signal potential solvency risks.

Income Statement Common Size Analysis

For the income statement, total revenue (or total sales) serves as the base. Each expense and profit figure is expressed as a percentage of total revenue. This approach helps in determining profitability and operational efficiency.

Common-size Income Statement for the year ended ...

Particulars	Note No.	Absolute Amounts		Percentage of Revenue from Operations (Net Sales)	
		Figures for the Previous Year (₹)	Figures for the Current Year (₹)	Previous Year (%)	Current Year (%)
I. Revenue from Operations (Net Sales)		XXXX	XXXX	100	100
II. Other Income		XXXX	XXXX	XX	XX
III. **Total Revenue (I + II)**		**XXXX**	**XXXX**	**XX**	**XX**
IV. **Expenses**					
a) Cost of Materials Consumed		XXXX	XXXX	XX	XX
b) Purchase of Stock-in-Trade		XXXX	XXXX	XX	XX
c) Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade		XXXX	XXXX	XX	XX
d) Employees Benefit Expenses		XXXX	XXXX	XX	XX
e) Finance Costs		XXXX	XXXX	XX	XX
f) Depreciation and Amortisation Expenses		XXXX	XXXX	XX	XX
g) Other Expenses		XXXX	XXXX	XX	XX
Total Expenses		**XXXX**	**XXXX**	**XX**	**XX**
V. **Profit before Tax (III-IV)**		XXXX	XXXX	XX	XX
VI. Less: Income Tax		XXXX	XXXX	XX	XX
VII. **Profit after Tax (V - VI)**		**XXXX**	**XXXX**	**XX**	**XX**

It can reveal how much of each revenue dollar is consumed by costs such as production, marketing, or administration, and how much remains as profit. This aids in evaluating gross margin, operating margin, and net profit margin.

Benefits of Common Size Analysis

Common size analysis provides several advantages for both internal management and external stakeholders:

• Enables easy comparison of companies regardless of their size or currency denomination.
• Highlights significant year-over-year changes within the financial statements.
• Helps identify areas of cost control, margin improvement, or inefficiency.
• Useful for benchmarking against competitors or industry standards.
• Simplifies the evaluation of long-term financial structure and profitability trends.

Illustrative Application

Consider a hypothetical company performing common size analysis on its balance sheet and income statement:

• Cash represents 15% of total assets, indicating adequate liquidity.
• Inventory forms 10% of total assets, suggesting efficient inventory control.

• Accounts payable equal 12% of total assets, showing manageable short-term liabilities.

In the income statement, operating expenses might represent 20% of total revenues, and net income could account for 10% of total revenues. These insights help in assessing cost efficiency and overall profitability.

Key Insights and Considerations

• Always use consistent base figures when comparing companies or years.
• Significant fluctuations in common size percentages over time can indicate operational or financial shifts.
• Although it simplifies analysis, common size analysis should be used along with ratio and trend analysis for deeper insights.

Summary

Common size analysis is a vital financial tool that helps in understanding the relative importance of each line item in financial statements. By expressing data as percentages, it standardizes financial information, facilitates easy comparison across firms and periods, and highlights structural or performance changes that may affect business decisions.

Comparative Income Statement

A Comparative Income Statement is a financial report that presents the results of multiple accounting periods side by side. It allows management and analysts to evaluate the company's performance over time and assess growth or decline trends. By comparing revenues, expenses, and profits from two or more years, organizations can make informed decisions regarding their financial stability and future strategies.

What is a Comparative Income Statement?

A Comparative Income Statement, also known as a Comparative Statement of Profit & Loss, is a horizontal analysis of the Income Statement that shows the operating results for two or more accounting years. It highlights both absolute and percentage changes in revenue and expenses between periods, thereby enabling a detailed study of the company's financial performance trends.

Objectives of Comparative Income Statement

The primary objectives of preparing a Comparative Income Statement are as follows:

• To analyze each item of revenue and expense for two or more years.
• To determine the increase or decrease in each item of revenue and expense in both absolute and percentage terms.
• To identify trends in profits, such as growth or decline, over multiple years.
• To analyze and understand the reasons behind changes in financial performance.
• To provide a clearer view of operational efficiency and cost management across periods.

Advantages of Comparative Income Statement

The Comparative Income Statement provides several key benefits to analysts, investors, and management:

• Helps identify the increase or decrease in sales revenue.
• Highlights changes in the cost of goods sold (COGS).
• Shows variations in gross profit and operating profit.
• Assists in evaluating operating expenses and efficiency levels.

• Indicates fluctuations in non-operating incomes and expenses.
• Displays trends in net profit or loss over multiple years.
• Supports decision-making and forecasting for future business strategies.

Preparation of Comparative Income Statement

A Comparative Income Statement is generally prepared in six columns, which provide a detailed comparison between two accounting periods. The columns include both numerical and percentage changes to highlight financial trends.

1. **First Column:** Lists every item of revenue and expense from the Statement of Profit & Loss.
2. **Second Column:** Includes note numbers corresponding to each item (if applicable).
3. **Third Column:** Contains the amounts from the previous accounting year.
4. **Fourth Column:** Contains the amounts from the current accounting year.
5. **Fifth Column:** Shows the absolute change (increase or decrease) between the current and previous years.
6. **Sixth Column:** Displays the percentage change, calculated as:

Percentage Change = (Absolute Change / Amount of Previous Year) × 100

Format of Comparative Income Statement

The format of a Comparative Income Statement or Statement of Profit & Loss typically includes the following structure:

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Absolute Change (₹)	Percentage Change (%)
Revenue from Operations	1	4,00,000	5,00,000	+1,00,000	+25%
Other Income	2	50,000	60,000	+10,000	+20%
Total Revenue		4,50,000	5,60,000	+1,10,000	+24.4%
Cost of Goods Sold	3	2,00,000	2,60,000	+60,000	+30%
Operating Expenses	4	50,000	55,000	+5,000	+10%
Operating Profit		2,00,000	2,45,000	+45,000	+22.5%
Interest	5	10,000	12,000	+2,000	+20%
Profit Before Tax		1,90,000	2,33,000	+43,000	+22.6%

Tax	6	50,000	60,000	+10,000	+20%
Net Profit		1,40,000	1,73,000	+33,000	+23.6%

Note: If the current year's value has decreased, the absolute and percentage changes should be shown in brackets to indicate a negative movement.

Working Note

In cases where the company reports a loss, income tax is not levied. The working notes provide detailed calculations of percentage change and any adjustments made to arrive at the comparative figures.

Summary

A Comparative Income Statement is a powerful tool in financial analysis. It assists in identifying performance trends, spotting inefficiencies, and forming the basis for strategic business decisions. By highlighting both absolute and percentage changes, it gives a clearer view of operational results and supports year-over-year comparisons.

Trend Analysis & Trading Strategies – Predicting Market Movements

Definition

Trend analysis is a technical analysis technique used to predict future stock price movements by studying historical price data and market behavior.
It helps investors and traders identify the general direction of the market (upward, downward, or sideways) and make informed buy/sell decisions.

What is Trend Analysis?

Trend analysis attempts to forecast future price movements based on recently observed data and ongoing market trends.
It provides insights into market sentiment, helping traders identify momentum and potential reversals.

Key Points

- Based on the principle that past patterns tend to repeat in markets.
- Utilizes historical price, volume, and technical indicators.
- Focuses on three time horizons:
    - Short-term: Days to weeks
    - Intermediate-term: Weeks to months
    - Long-term: Months to years

Objectives of Trend Analysis

1. Identify market direction (bullish, bearish, or sideways).
2. Forecast future prices based on historical data.
3. Spot entry and exit points for trades.
4. Understand market psychology and investor sentiment.

5. Enhance portfolio management and minimize risks.

<u>Types of Market Trends</u>

1. Upward Trend (Bull Market)

- Prices consistently rise over time.
- Indicates economic strength, high demand, and positive investor sentiment.
- Characterized by higher highs and higher lows.

2. Downward Trend (Bear Market)

- Prices consistently fall over time.
- Reflects economic weakness, low demand, and pessimism.
- Characterized by lower highs and lower lows.

3. Sideways Trend (Range-bound Market)

- Prices fluctuate within a narrow range.
- Indicates market indecision or balance between buyers and sellers.
- Traders often use range-bound strategies like buy low and sell high.

<u>Process of Conducting Trend Analysis</u>

1. Select the market or security to analyze (e.g., a stock, index, sector, or commodity).
2. Collect relevant data – price, volume, and market indicators.
3. Organize and visualize data using charts or spreadsheets.
4. Identify patterns and calculate statistical measures.
5. Interpret results to forecast future movements.
6. Use findings to make trading or investment decisions.

<u>Statistical Tools Used in Trend Analysis</u>

1. ***Moving Averages (MA)***
    - Smooth out price fluctuations to identify overall direction.
    - Example: 50-day and 200-day moving averages.
    - Signals:
        - Short-term MA crossing above long-term MA → *Buy signal*
        - Short-term MA crossing below long-term MA → *Sell signal*
2. ***Linear Regression***
    - Fits a line to historical data to show the direction and strength of a trend.
    - Slope indicates trend strength (positive = uptrend, negative = downtrend).
3. ***Correlation Analysis***

- Measures the relationship between two variables (e.g., stock price and market index).
- Positive correlation → move together; Negative correlation → move oppositely.

Trend Trading Strategies

Trend traders aim to profit from sustained market directions rather than short-term fluctuations.

1. **Moving Average Strategy**

- Enter long (buy) when short-term MA crosses above long-term MA.
- Enter short (sell) when short-term MA crosses below long-term MA.

2. **Momentum Indicator Strategy**

- Uses tools like the Relative Strength Index (RSI) or MACD to gauge momentum.
- Buy when momentum strengthens; Sell when momentum weakens.

3. **Trendline & Chart Pattern Strategy**

- Uses trendlines to connect price highs/lows and identify breakout points.
- Traders enter trades in the direction of the breakout, placing stop-losses near support/resistance.

Preparing a Trend Analysis (Step-by-Step)

1. Identify the security or market for study.
2. Gather data (historical prices, economic indicators, etc.).
3. Organize data into charts or graphs.
4. Analyze trends using technical tools and indicators.
5. Interpret trends to determine market direction and opportunities.
6. Act on findings—buy, sell, or hold based on signals.

Example of Trend Analysis

An investor analyzes a company's 5-year performance:

- Revenues and profits show a steady increase.
- The stock price also trends upward.
- Linear regression confirms a positive correlation between profits and stock price.

The investor predicts continued growth and decides to buy the stock.

Pros and Cons of Trend Analysis

Advantages

- Identifies buying/selling opportunities.
- Reduces investment risks.
- Provides insights into market momentum and psychology.
- Enhances decision-making and portfolio performance.

Disadvantages

- Dependent on data quality – inaccurate data → misleading results.
- Historical bias – past trends may not predict future behavior.
- May ignore external factors (policy changes, new management, etc.).
- Different statistical models can yield different interpretations.
- Critics argue that in an efficient market, all available info is already priced in.

Criticisms of Trend Analysis

- Supporters of the Efficient Market Hypothesis (EMH) claim that all information is already reflected in stock prices.
- Therefore, past price patterns do not guarantee future outcomes.
- Fundamental analysts argue that price movements are random and should instead be studied through financial statements and intrinsic value.

The Bottom Line

- Trend analysis helps investors analyze market direction and make strategic decisions.
- It uses technical and statistical tools like moving averages, regression, and correlation.
- Trend trading can be profitable but must be approached with caution.
- Always remember: Past performance does not guarantee future results.

Ratio Analysis

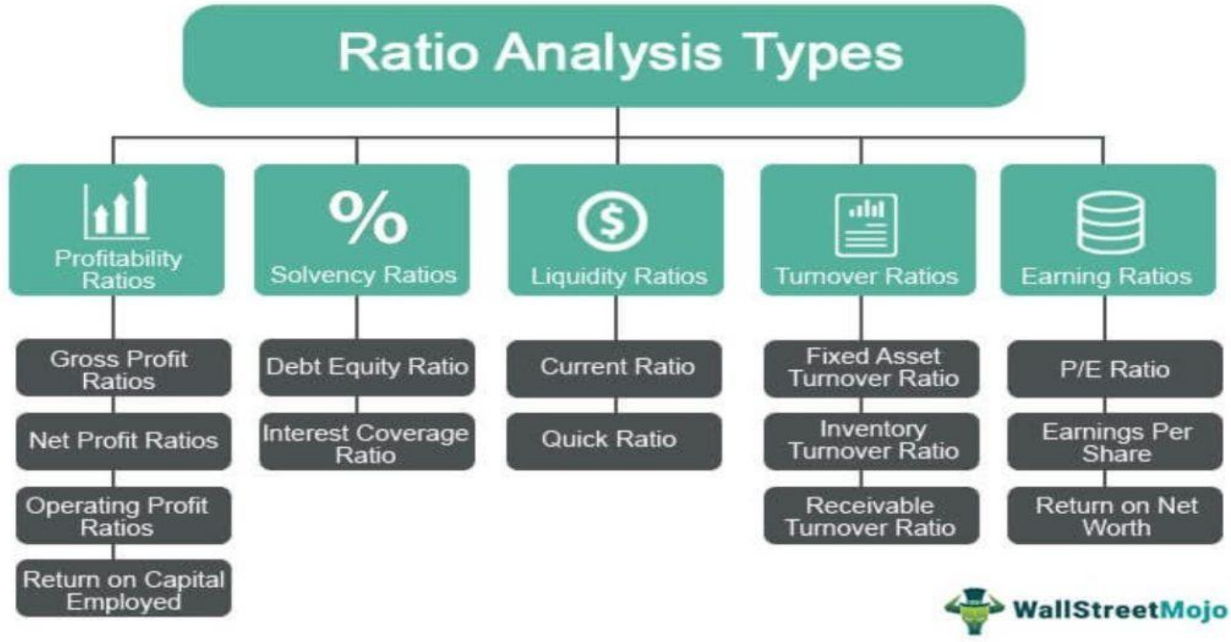
Introduction

Ratio Analysis is a vital tool for interpreting a company's financial statements.
It establishes relationships between different accounting figures to assess a firm's liquidity, solvency, efficiency, and profitability.

It helps:

- Investors evaluate performance and growth potential.
- Creditors assess repayment capacity.
- Management make informed financial decisions.

Types of Ratios



Ratio Analysis with Examples and Interpretations

Category	Name of Ratio	Formula	Notes / Example / Interpretation
1. LIQUIDITY RATIOS	Measure short-term solvency — ability to meet short-term obligations.		
a. Current Ratio (Working Capital Ratio)	Current Ratio = Current Assets / Current Liabilities	Ideal Ratio: 2:1 Interpretation: ₹2 in current assets for every ₹1 in current liabilities. Example: CA = ₹5,00,000; CL = ₹2,50,000 → 5,00,000 ÷ 2,50,000 = 2:1.	
b. Quick Ratio (Acid-Test or Liquid Ratio)	Quick Ratio = Liquid Assets / Current Liabilities Liquid Assets = Current Assets – Inventory	Ideal Ratio: 1:1 Interpretation: Indicates immediate liquidity excluding inventory. Example: CA = ₹5,00,000; Inventory = ₹1,00,000; CL = ₹2,50,000 → (5,00,000–1,00,000)/2,50,000 = 1.6:1.	

c. Super Quick Ratio (Absolute Cash Ratio)	(Cash + Bank + Marketable Securities) / Current Liabilities	Measures the most liquid assets against current liabilities.	
2. SOLVENCY RATIOS	Indicate long-term financial stability — ability to meet long-term obligations.		
a. Debt to Equity Ratio	Debt to Equity Ratio = Debt / Equity	Ideal Ratio: 2:1 Example: Debt = ₹6,00,000; Equity = ₹4,00,000 → 6,00,000 ÷ 4,00,000 = 3:2.	
b. Total Assets to Debt Ratio	Total Assets to Debt Ratio = Total Assets / Debt	Interpretation: Higher ratio → stronger solvency. Example: Assets = ₹3,00,000; Debt = ₹75,000 → 3,00,000 ÷ 75,000 = 4:1.	
c. Proprietary Ratio	Proprietary Ratio = Shareholders' Funds / Total Assets	Interpretation: Higher ratio → greater owner's investment. Example: Equity = ₹6,00,000; Reserves = ₹2,00,000; Assets = ₹16,00,000 → (6,00,000+2,00,000)/16,00,000 = 1:2.	
d. Interest Coverage Ratio	Interest Coverage Ratio = Net Profit before Interest and Tax / Fixed Interest Charges	Interpretation: Indicates ability to pay interest. Example: NPBIT = ₹4,80,000; Interest = ₹1,20,000 → 4,80,000 ÷ 1,20,000 = 4:1.	
3. ACTIVITY (TURNOVER) RATIOS	Measure efficiency of using assets to generate sales.		
a. Inventory Turnover Ratio	Inventory Turnover Ratio = Cost of Goods Sold / Average Inventory	Interpretation: Shows how many times inventory is sold. Example: COGS = ₹5,00,000; Opening = ₹1,00,000; Closing = ₹1,50,000; Avg = ₹1,25,000 → 5,00,000 ÷ 1,25,000 = 4 times.	
b. Debtors (Receivables) Turnover Ratio	Receivables Turnover Ratio = Net Credit Sales / Average Receivables	Interpretation: Efficiency in collecting receivables. Example: Sales = ₹8,00,000; Op. Debtors = ₹1,00,000; Cl. Debtors = ₹1,40,000; Avg =	

		₹1,20,000 → 8,00,000 ÷ 1,20,000 = 6.67 times (≈20:3).	
c. Creditors (Payables) Turnover Ratio	Payables Turnover Ratio = Net Credit Purchases / Average Payables	Interpretation: Measures how quickly suppliers are paid. Example: Purchases = ₹6,00,000; Op. Creditors = ₹90,000; Cl. Creditors = ₹1,10,000; Avg = ₹1,00,000 → 6,00,000 ÷ 1,00,000 = 6 times.	
d. Working Capital Turnover Ratio	Working Capital Turnover Ratio = Net Sales / Net Working Capital	Interpretation: Measures how effectively working capital is used. Example: Sales = ₹12,00,000; CA = ₹6,00,000; CL = ₹4,00,000; WC = ₹2,00,000 → 12,00,000 ÷ 2,00,000 = 6 times.	
4. PROFITABILITY RATIOS	Measure earning capacity and efficiency of a business.		
a. Gross Profit Ratio	Gross Profit Ratio = Gross Profit / Net Revenue × 100	Interpretation: Higher ratio → better efficiency. Example: GP = ₹4,00,000; Revenue = ₹10,00,000 → (4,00,000 ÷ 10,00,000) × 100 = 40%.	
b. Operating Ratio	Operating Ratio = (COGS + Operating Expenses) / Net Revenue × 100	Interpretation: Lower ratio → higher efficiency. Example: COGS = ₹6,00,000; Op. Exp = ₹2,00,000; Revenue = ₹10,00,000 → (8,00,000 ÷ 10,00,000) × 100 = 80%.	
c. Operating Profit Ratio	Operating Profit Ratio = Operating Profit / Net Revenue × 100	Interpretation: Measures operating profitability. Example: Revenue = ₹12,00,000; COGS = ₹7,00,000; Op. Exp = ₹2,00,000; Op. Profit = ₹3,00,000 → (3,00,000 ÷ 12,00,000) × 100 = 25%.	
d. Net Profit Ratio	Net Profit Ratio (Before Tax) = Net Profit before Tax /	Interpretation: Overall profitability measure. Example: COGS = ₹6,00,000;	

	Net Revenue × 100 Net Profit Ratio (After Tax) = Net Profit after Tax / Net Revenue × 100	Op. Exp = ₹3,00,000; Non-Op. Exp = ₹10,000; Revenue = ₹10,00,000 → NP (Before Tax) = ₹90,000 → (90,000 ÷ 10,00,000) × 100 = 9%.	
e. Return on Investment (ROI) / Return on Capital Employed	ROI = Net Profit before Interest and Tax / Capital Employed × 100	Interpretation: Measures efficiency of capital use. Example: NPBIT = ₹3,00,000; Capital Employed = ₹12,00,000 → (3,00,000 ÷ 12,00,000) × 100 = 25%.	

Summary of Key Ratios

Category	Ratio	Formula	Ideal / Key Insight
Liquidity	Current Ratio	CA / CL	2:1
	Quick Ratio	(CA – Inventory) / CL	1:1
Solvency	Debt to Equity	Debt / Equity	2:1
	Proprietary Ratio	Shareholder's Fund / Total Assets	Higher = Better
	Interest Coverage	NPBIT / Interest	>3 Times
Activity	Inventory Turnover	COGS / Avg. Inventory	Higher = Efficient
	Receivable Turnover	Net Credit Sales / Avg. Receivables	Higher = Faster Collection
	Payables Turnover	Net Credit Purchases / Avg. Payables	Moderate = Efficient
	Working Capital Turnover	Net Sales / Working Capital	Higher = Better Utilization
Profitability	Gross Profit Ratio	GP / Sales × 100	Higher = Efficient
	Operating Ratio	(COGS + Opex) / Sales × 100	Lower = Better
	Net Profit Ratio	NP / Sales × 100	Higher = More Profitable
	ROI	NPBIT / Capital Employed × 100	Higher = Efficient Use of Capital

Conclusion

- Ratio Analysis transforms raw financial data into meaningful insights.
- It helps in decision-making, trend analysis, and financial comparison.

- However, ratios should be interpreted in context—considering industry norms, company size, and economic conditions.

CASH FLOW STATEMENT

Introduction

A Cash Flow Statement is a financial statement that shows the inflows and outflows of cash and cash equivalents during a specific period.
It helps determine how a business generates and uses cash through its operating, investing, and financing activities.

Meaning

(a) Cash Flow

- Refers to inflow (receipts) and outflow (payments) of cash and cash equivalents.
- Cash and Cash Equivalents include:
    - Cash in hand
    - Bank balance
    - Marketable securities / short-term investments

(b) Cash Flow Statement

A statement showing the sources (inflows) and uses (outflows) of cash and cash equivalents during a period, classified under:

1. Operating Activities
2. Investing Activities
3. Financing Activities

Classification of Cash Flows (AS-3)

A. Cash Flow from Operating Activities

These are the core business activities — the principal revenue-generating operations.

Examples

- Inflows:
    - Cash sales
    - Cash received from debtors
    - Commission, royalties, and fees received
- Outflows:
    - Cash purchases
    - Payment to creditors
    - Wages and salaries paid

For Financial Companies:
Includes purchase/sale of securities, interest, dividends, salaries, and taxes.

For Non-Financial Companies:
Includes purchase/sale of goods and services, payments to suppliers, employee benefits, and taxes.

B. Cash Flow from Investing Activities

Relates to acquisition and disposal of long-term assets and investments.

Examples

- Inflows:
  - Sale of fixed assets or long-term investments
  - Interest and dividend received
- Outflows:
  - Purchase of fixed assets (Land, Building, Machinery)
  - Purchase of investments

C. Cash Flow from Financing Activities

Deals with raising and repayment of capital and long-term funds.

Examples

- Inflows:
  - Issue of shares or debentures
  - Long-term borrowings
- Outflows:
  - Repayment of loans
  - Redemption of shares/debentures
  - Payment of dividends and interest
  - Buy-back of shares

Objectives of Cash Flow Statement

A Cash Flow Statement is prepared to:

1. Determine Sources of Cash – From operating, investing, and financing activities.
2. Determine Applications of Cash – How cash is utilized in various activities.
3. Measure Net Change in Cash – Net increase or decrease in cash between two balance sheet dates.

Importance / Uses of Cash Flow Statement

1. Facilitates Short-Term Planning
   - Helps plan investments and manage financial needs.

2. Assesses Liquidity and Solvency
    - Measures the ability to meet short-term and long-term obligations.
3. Aids in Efficient Cash Management
    - Identifies cash surpluses or deficits for better fund utilization.
4. Facilitates Comparative Analysis
    - Compares actual vs. projected cash flows to analyze deviations.
5. Justifies Cash Position
    - Explains reasons behind surplus or shortage of cash.
6. Evaluates Management Decisions
    - Assesses the impact of management decisions on operations, investments, and financing.
7. Helps in Dividend Decisions
    - Determines whether sufficient funds exist to pay dividends.

Limitations of Cash Flow Statement

1. Ignores Non-Cash Transactions
    - Items like depreciation or credit purchases are excluded.
2. Not a Substitute for Income Statement
    - Income statement is on accrual basis; cash flow is on cash basis.
3. Not a Substitute for Balance Sheet
    - Does not show the full financial position of the firm.
4. Historical in Nature
    - Based on past transactions; does not predict future cash flows directly.
5. Incomplete Measure of Liquidity
    - Focuses only on cash, not total current assets.
6. Dependent on Financial Statement Accuracy
    - Errors in accounting statements affect cash flow accuracy.

Key Terms Used in Cash Flow Statement

(a) Cash and Cash Equivalents

- Cash: Cash in hand and demand deposits with banks.
- Cash Equivalents: Short-term, highly liquid investments with insignificant risk and maturity ≤ 3 months (e.g., treasury bills, commercial paper).

▧ Disclosure Example:

Transactions Not Regarded as Cash Flow

- Movements within cash equivalents, such as:
    - Cash deposited in bank
    - Withdrawal from bank
    - Purchase/sale of short-term investments

Non-Cash Transactions

Transactions not involving actual cash movement:

- Depreciation
- Amortisation
- Issue of bonus shares
- Conversion of debentures into shares

These are excluded from the cash flow statement.

Types of Business and Effect on Cash Flows

Type	**Core Activity**	**Example of Operating Activity**
Financial Enterprise	Lending & Borrowing	Interest received/paid, purchase/sale of securities
Non-Financial Enterprise	Goods & Services	Sale of goods, payment to suppliers

The classification of a transaction as operating, investing, or financing depends on the nature of business.

Importance of Separate Disclosure

Activity	**Purpose**
Operating	Measures efficiency and ability to generate cash from operations.
Investing	Shows resource allocation for future income generation.
Financing	Reveals how funds are raised and repaid.

Extraordinary Items

- Refers to unusual, non-recurring transactions outside normal business activities.
- Examples:
    - Buy-back of shares
    - Insurance claim received
    - Compensation for damages

These are disclosed separately under the relevant activity.

Cash Flow from Operating Activities (Indirect Method)

Steps:

1. Start with: Net Profit before Tax and Extraordinary Items.
2. Add Non-Cash & Non-Operating Expenses: Depreciation, amortization, loss on sale of assets.
3. Subtract Non-Operating Incomes: Interest/dividend received, profit on asset sale.
4. Adjust for Working Capital Changes:
    - Increase in Current Assets → (−)
    - Decrease in Current Assets → (+)
    - Increase in Current Liabilities → (+)
    - Decrease in Current Liabilities → (−)
5. Subtract Taxes Paid to arrive at Net Cash from Operating Activities.

Cash Flow from Investing Activities

Includes:

- Purchase/Sale of fixed assets
- Investments (other than cash equivalents)
- Loans/advances to others and their repayments

Indicates: How much cash is invested in long-term resources.

Cash Flow from Financing Activities

Includes:

- Issue or redemption of shares/debentures
- Raising or repayment of long-term loans
- Dividend and interest payments

Indicates: How the enterprise raises capital and meets obligations to financiers.

Treatment of Special Adjustments

Item	**Treatment**
Bank Overdraft	Short-term borrowing → Financing Activity
Interim Dividend	Outflow under Financing Activities
Income Tax Refund	Deduct from tax paid (Operating)
Discount Written-off	Add back to Net Profit (Operating)
Discount Allowed on Issue	Reduce from Cash from Financing
Provision for Tax	Adjust under Operating Activities

Item	Treatment
Depreciation / Amortisation	Non-cash expense → Add back to profit

Activity	Example Inflows	Example Outflows
Operating	Cash sales, Debtor receipts, Royalties	Wages, Payments to creditors
Investing	Sale of assets/investments	Purchase of assets/investments
Financing	Issue of shares, Borrowings	Dividend, Interest, Loan repayments

Conclusion

The Cash Flow Statement:

- Acts as a bridge between Income Statement and Balance Sheet.
- Reveals the true liquidity position of a firm.
- Assists management in financial planning, control, and decision-making.

However, it must be used along with other financial statements for a complete understanding.

CASH FLOW STATEMENT ________ LTD FOR THE YEAR ENDED __________		
Particulars	**Details**	**Amount**
A. Cash flow from operating activities:		
Net Profit before tax		
Adjustments for non-cash and non-operating items:		
Add: Depreciation		
Preliminary expenses/ discount on issue of debentures w/off		
Goodwill, patents, and trademarks amortized		
Interest paid on short term and long-term borrowings		
Interest paid on bank overdraft		
Loss on sale of fixed assets		
Increase in provision of doubtful debts		
Less: Interest income		
Dividend income		
Rental income		
Gain (profit) on sale of fixed assets		
Decrease in provision for doubtful debts		
Operating profit before working capital changes		
Add: decrease in current assets		
Increase in current liabilities		
Less: Increase in current assets		
Decrease in current liabilities		
Cash generated from operation		
Less: Income tax paid (net of tax refund received)		
Net cash from operating activities		
B. Cash flow from investing activities:		
Proceeds from sale of tangible fixed assets		
Proceeds from sale of intangible fixed assets like goodwill		
Proceeds from sale of non-current investment		
Interest and dividend received		
Rent received		
Less: Purchase of tangible fixed assets		
Purchase of intangible fixed assets like goodwill		
Purchase of non-current investments		
Net cash from investing activities		
C. Cash flow from financing activities:		
Proceeds from issue of shares and debentures		
Proceeds from other long-term borrowings		
Proceeds from short-term borrowings		
Less: decrease in bank overdraft balance		
Payment of interim dividend		
Payment of proposed dividend of previous year		
Interest paid on short-term and long-term borrowings		