T.Y.B.COM.

SEMESTER - V (CBCS)

GROUP B: BUSINESS MANAGEMENT

BUSINESS MANAGEMENT PAPER-V

FINANCIAL MANAGEMENT

SUBJECT CODE : 23108

Programme Co-ordinator : **Prof. Rajashri Pandit**
Asst. Prof. in Economic,
Incharge Head Faculty of Commerce,
IDOL, University of Mumbai, Mumbai

Course Co-ordinator : **Mr. Vinayak Joshi**
Assistant Professor, IDOL,
University of Mumbai, Mumbai

Course Writer : **Mr. Vinayak Joshi**
Assistant Professor, IDOL,
University of Mumbai, Mumbai

: **Dr. Prakash Rodiya**
Rajarshi Shahu Mahavidyalaya, Autonomous,
Chandra Nagar, Latur, Maharashtra

: **Ms. Priya Shetty**
Ramniranjan Jhunjhunwala College,
Ghatkopar (West) Mumbai

: **Ms. Samina Shaikh**
Assistant Professor, IDOL,
University of Mumbai, Mumbai

: **Ms. Shilpi Jain**
SVKM's Narsee Monjee College of Commerce
and Economics, Vile Parle (West), Mumbai

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Group B: Business Management

2. Business Management Paper-V: Financial Management

Modules at a Glance

Sr. No.	Modules	No. of Lectures
1	Introduction to Financial Management	11
2	Study of Financial Statements	11
3	Ratio Analysis	12
4	Sources of Finance and Cash Flow Analysis	11
	Total	**45**

Sr. No.	Modules / Units
1	**Introduction to Financial Management**
	• Definition, nature and functions of financial management • Objectives of financial management • Importance of financial management and limitations. • Preparation of financial Statements adhering to current statutory requirements.
2	**Study of Financial Statements**
	• Objectives of financial statement analysis and interpretation • Steps involved in the analysis of financial statements • Comparative Statements • Common Size Statements • Trend Analysis
3	**Ratio Analysis**
	• Ratio Analysis – Meaning and objectives and Classification of Ratios-Traditional classification, functional classification and classification from the point of view of users • Balance Sheet Ratios- Current Ratio, Liquid Ratio, Proprietary Ratio, Stock-Working Capital Ratio, Capital Gearing Ratio, Debt Equity Ratio • Revenue Statement Ratios - Gross Profit Ratio, Operating Ratio, Expense Ratios, Net Profit Ratio, Stock Turnover Ratio. • Combined Ratios - Return on Capital Employed, Return on Proprietors' Funds, Return on Equity Share Capital, Debtors' Turnover Ratio (Debtors' Velocity), Earning Per Share, Dividend Payout Ratio, Price Earning Ratio • Importance and limitations of Accounting Ratios
4	**Sources of Finance and Cash Flow Analysis**
	• Classification of sources of finance with reference to period , ownership and source of generation • Internal and external financing including choice of financial instruments • Cash Flow Statement – Meaning and Classification • Uses of Cash Flow statement • Preparation of Cash Flow Statement – Direct and Indirect

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INTRODUCTION TO FINANCIAL MANAGEMENT

WHAT IS FINANCE?

Finance is the soul of any business concern, and we cannot imagine a world without Finance. When we say finance, it generally means money for a layman but it is not only the money, it is a wider concept that is related to money and its flow. The word finance is a French word and it means 'Management of Money'.

Finance is such a powerful source that it performs an important role to operate and co-ordinate the various economic activities of the business. Like other resources finance is also limited and a business entity needs to manage its finances efficiently and effectively.

The figure below shows the different perspectives of finance:

General

Finance is the administration of funds and other valuables that can be converted into cash.

Experts

Finance is a simple task of providing the necessary funds (money) required by the business entities like companies, firms, individuals

Entrepreneurs

Finance is all about money. This is because every financial transaction involves cash, either directly or indirectly.

Academicians

Finance is the acquisition (to get, obtain) and effective (well-planned) use of funds. It also relates with profits that adequately compensate for the

Finance is the lifeline of any Business whether large scale, medium scale or small scale because all the activities depend on finance. For any business to be successful, business needs to have a sufficient amount of finance. As a result, it is essential to fully understand the concept of financial management.

WHAT IS FINANCIAL MANAGEMENT?

To understand financial management let's see some definitions of Financial Management, "Financial management is the activity concerned with planning, raising, controlling and administering of funds used in the business." – **Guthman and Dougal**

"Financial management is that area of business management devoted to a judicious use of capital and a careful selection of the source of capital in order to enable a spending unit to move in the direction of reaching the goals." – **J.F. Brandley**

"Financial management is an application of general managerial principles to the area of financial decision-making". - **Howard and Uptron**

"Financial management is an area of financial decision making, harmonizing individual motives and enterprise goal". - **Weston and Brighem**

"Financial management is concerned with the efficient use of an important economic resource, namely capital funds" - **Solomon Ezra & J. John Pringle.**

"Financial Management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations" **- Joseph & Massie**

"Financial Management is concerned with managerial decisions that result in the acquisition and financing of long-term and short-term credits of the firm. As such, it deals with the situations that require selection of specific assets (or combination of assets), the selection of specific liability (or combination of liabilities) as well as the problem of size and growth of an enterprise. The analysis of these decisions is based on the expected inflows and outflows of funds and their effects upon managerial objectives". - **Phillippatus.**

Financial Management is a managerial process that is concerned with the planning, organizing, directing, and controlling of financial resources.

Initially, financial management was concerned only with the collection of funds. Later on, proper utilization of funds also became an important aspect of Financial Management. In today's world, Financial Management examines all financial issues of a company.

Financial Management involves functions like

- Fund procurement
- Working capital management
- Capital budgeting and capital structure designing of an organization
- Controlling and managing an organization's financial assets
- Making strategies related to expansion, diversification, joint venture, and mergers & acquisitions.

Financial Management influences both profit-oriented firms and non-profit firms. Since Financial Management has acquired a vital role in every type of organization, the financial manager has become an important constituent of any organization.

The financial manager provides a significant contribution to all business activities by estimating the requirement of funds, planning the different sources of funds, and performing the functions of collection of funds and their effective utilization.

He must be clear about the financial objectives of the firm and also his duties and responsibilities about the business activities like production, purchase, marketing, sales, etc. which include the creation and utilization of funds.

EVOLUTION OF FINANCIAL MANAGEMENT

The evolution of Financial Management can be divided into two phases

1. Traditional approach
2. Modern approach

Traditional Method

The traditional approach of financial management refers to its subject matter as a separate branch of academic study in the early stages of its evolution in academic literature. The term 'corporation finance' was used to define what is now called as 'financial management' in academia. Corporation finance, as the name implies, was concerned with the funding of corporate enterprises. In other words, the traditional approach limited the finance function to the procurement of funds by companies to meet their funding requirements. The term "procurement" was used broadly to encompass the entire process of raising funds from outside sources.

Limitations of the traditional approach

- The traditional approach focuses on the procurement system and the issues that may arise. It does not provide a system for maximizing the use of funds obtained.
- The traditional approach considers budgetary allocation as a contingency for unpredictable incidents, neglecting everyday financial difficulties that a business enterprise may face. Working capital financing choices are also kept outside of the purview of a conventional approach.
- The traditional approach's primary focus is on corporate entities. Non-corporate entities, such as partnership firms, are not covered.

Modern approach –

The modern approach takes a broad view of the term financial management and provides an analytical and conceptual framework for financial decision making. As such, the finance function includes both the acquisition and allocation of funds. Apart from the issues involved in acquiring external funds, the primary goal of financial management is the efficient and prudent allocation of funds to various uses. In a broader context, it is regarded as an essential component of overall management.

The new method is an analytical way of looking at a company's financial problems. What is the total amount of funds that an enterprise should commit? What specific assets should a company purchase? How should the necessary funds be raised? These are the main aspects of this method.

Alternatively, the following are the main components of the modern approach to financial management:

1. How large should an enterprise be, and how quickly should it grow?
2. In what form should assets be held?
3. How should its liabilities be structured?

The three questions raised above cover the major financial issues confronting a company. In other words, according to the new approach, financial management is concerned with the resolution of three major problems relating to a firm's financial operations, pertaining to the three questions of investment, financing, and dividend decisions. Thus, financial management in the modern sense can be divided into three major decisions such as:

1. the investment decision;
2. the financing decision;
3. the dividend policy decision.

The modern method will make provision for a variety of irregular events. The main components of this method are as follows:

- Planning your finances
- Continuous operation and appropriate capital budgeting evaluation
- Provision for optimal working capital management
- A broad range of capabilities for measuring a company's performance

As a result, the modern approach contributes to the establishment of a financial standard for the company's success.

OBJECTIVE OF FINANCIAL MANAGEMENT

Financial management generally deals with procurement, allocation and control of financial resources and the two most widely used objectives are

a) Profit Maximization

b) Wealth maximization

Profit maximization: Profit maximization is considered as the basic objective of financial management. It should focus on increasing profit rather than decreasing profit.

The term 'profit' is used in two senses

1. Owner oriented concept: It means the amount of net profit, which goes in the form of dividends to the shareholders.
2. Operational concept- It refers to profitability, which is an indicator of the economic efficiency of the firms.

Earning profit is the main aim of any business concern and so profit is the main parameter that is considered to measure the efficiency of the business concern. Profit maximization objectives help to reduce the risk of the business. To attain the objective of Profit maximization, the enterprise should consider the assets, projects and decisions that are profitable and the non-profitable ones shouldn't be considered. Let us now discuss some merits and drawbacks of Profit Maximization.

Benefits of Profit Maximization

1. It is the best criteria for decision making since it helps in judging the economic performance of the firm.
2. It helps in the efficient allocation of resources so that the firm can make maximum profit.
3. It helps the firm to allocate and utilize its available resources in the best possible manner.
4. It helps in payment of maximum returns on investments in the form of dividends to the shareholders, regular payment to lenders, higher wages, increase in jobs, better quality products, and reduce the price of products which in turn benefits the society at large.

Drawbacks of Profit Maximization

1. The term profit is not clearly stated which can lead to unnecessary assumptions regarding earning habits of the organization. It can be

a. long term or short term

b. total profit or rate of profit

c. net profit before tax or net profit after tax

d. return on total capital employed or total assets or shareholders equity

2. It does not consider the time value of money or the net present value of the cash inflow.
3. It affects the overall operation of the organization since it ignores internal or external risk factors.

Wealth Maximization:

Wealth maximization is also called value maximization or net present worth maximization. It involves the latest innovations and improvements in the field of business concern. The term wealth means shareholder wealth or the wealth of the persons who are involved in the business concern.

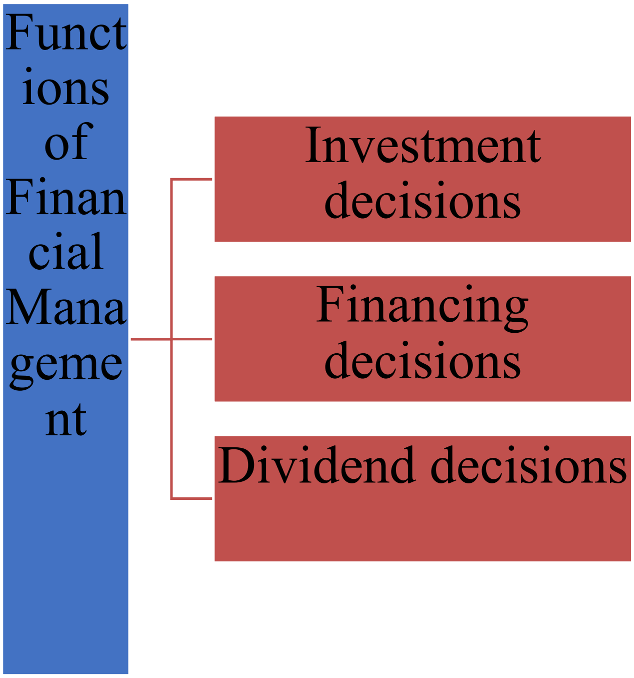
It helps in the better valuation of the organization. It takes into account both the factors i.e. time and risk. It provides efficient allocation of resources and considers the generation of cash flows and not accounting for profit. The computation of inflows and outflows of cash is accurate. It considers the time value of money concept. A right financial decision increases market value whereas poor financial decisions reduce the market value of the owners' equity.

The concept of wealth maximization is universally accepted, because it takes care of the economic welfare of people who are directly or indirectly involved in the overall development of the company such as shareholders, lenders, workers, society, etc.

It eliminates the technical drawbacks of profit maximization therefore it is considered as the modern objective of Financial Management.

FUNCTIONS OF FINANCIAL MANAGEMENT:

It is concerned with providing solutions to problems like investment, financing and dividend decisions of the financial activities of an organization.



1. Investment Decision

It is concerned with the selection of both long-term and short-term assets in which a firm's funds will be invested. Long-term assets, or fixed assets, will generate a return over time, whereas short-term assets, or current assets, are those that can be converted into cash within a financial period, such as a year.

Capital budgeting refers to long-term investment decisions, while working capital management refers to short-term investment decisions. Capital budgeting can also refer to long-term planning for allocating funds among various investment options. Risk and uncertainty analysis is a critical component of capital budgeting decisions. Because the return on investment proposals can be derived for a longer period of time in the future, the capital budgeting decision should be weighed against the risk associated with it. This method aids in determining the assets' 'Net Present Value.'

The financial manager, on the other hand, is also in-charge of the efficient management of current assets, also known as working capital management. Working capital is an essential component of financial management. These decisions include whether to invest funds in inventory, cash, bank deposits, or other short-term investments. They have a direct impact on the liquidity and performance of the business.

2. Financing Decision

The second critical function is financial decision-making. It is concerned with a company's capital – mix, financing – mix, or capital structure. The proportion of debt capital and equity capital is referred to as capital structure. A firm's financing decision is related to the financing – mix. Finance acquisition decisions must be made by the finance manager.

It must be decided whether the entire required capital should be raised in the form of equity capital or whether the amount should be from the loan fund. Even the timing of capital acquisition should be well defined. In a firm's financing decisions, there is a conflict between return and risk. As a result, the financial manager must strike a balance between risk and return by maintaining the proper balance of debt and equity capital. On the other hand, it is also the financial manager's job to identify an appropriate capital structure. The ideal capital structure would always maximize wealth.

3. Dividend Decision

The dividend policy decision is the third major function. Decisions on dividend policy are concerned with the distribution of a company's profits to its shareholders. How much of the profits should be distributed as dividends, specifically, the dividend pay-out ratio.

The decision will be based on the shareholder's preferences, investment opportunities within the firm, and opportunities for future growth of the firm. The dividend payout ratio must be determined in light of the goal of increasing the share's market value. As a result, the dividend decision has become a critical component of the financing decision. Dividend decision-making must be evaluated with respect to the firm's financing decisions to decide the part of retained earnings to be used as direct financing for the company's future expansions.

IMPORTANCE OF FINANCIAL MANAGEMENT

Finance is the lifeblood of a business organization. It needs to meet the requirements of the business concern. Each and every business concern must maintain an adequate amount of finance for the smooth running and achieve the goal of the business concern. The business goal can be achieved only with the help of effective management of finance. We can't neglect the importance of finance at any time and at any situation. Some of the importance of financial management is as follows:

Employees

Efficient financial management helps in profit maximization and also welfare of the employees by payment of incentives, bonus and increment in salary.

Shareholders

Financial management plays an important role towards dividend payment to the shareholders by taking correct and timely financial decisions.

Government

Financial management helps the firm to fulfill the duties and responsibilities towards the government by payment of tax, licence fees, etc.

Customers

Proper planning of financial matters leads to customers satisfaction by providing good and quality products and services at reasonable prices.

Management

Efficient Financial management helps the management in overall image building, increase in the market share, optimizing shareholders wealth and profit.

Other departments

Financial management through efficient management of funds has to ensure that adequate funds are made available to all departments like productions, marketing, etc for their smooth functioning.

lenders

lenders rely on effective financial management for safety of their funds, timely repayment of the principal amount as well as interest on the same.

Helps to study Risk-Return Relationship

The prospective investors expect higher returns on investment from the firm, therefore there is a need for Financial Management.

Promoting Savings

Savings are possible only when the business concern earns higher profitability and maximizes wealth. Effective financial management helps to promote and mobilize individual and corporate savings.

Nowadays financial management is also popularly known as business finance or corporate finances. The business concern or corporate sectors cannot function without the importance of financial management.

NATURE OF FINANCIAL MANAGEMENT

The nature of financial management includes the following −

Estimates the amount of funds needed

Financial management aids in the planning of funds by estimating the amount of working and fixed capital required to carry out business operations. Financial management aids in the estimation of money for the firm's short, medium, and long term operations.

Determine the capital structure

A proper balance of debt and equity should be achieved in order to reduce the cost of capital. Financial management determines the appropriate allocation of various securities like equity and debt.

Select source of fund

Source of funds is one of the crucial decisions in every organization. Every organization should properly analyze various sources of funds (shares, bonds, debentures etc.) and must select appropriate funds which involve minimal risk.

Fund Management

All cash movements (inflow and outflow) are monitored by the finance manager to ensure that there are no cash shortages or surpluses.

Suitable to all concern

The financial management concept is relevant to all types of businesses, whether they are small, medium, or large, profit or non-profit, educational or corporate, and so on.

Goal

Financial management establishes the firm's objectives and goals, as well as the path for achieving current and future objectives.

Decision Making

Financial management assists the firm's top management in making accurate and timely decisions.

Optimum use of resources

Financial management aids in the efficient and appropriate utilization of available financial resources, resulting in the firm's success and profit.

SCOPE OF FINANCIAL MANAGEMENT

Financial management is concerned with acquiring finance as well as utilizing it to the best of one's ability for the firm's growth and development.

Cash management

The financial manager must manage cash because sufficient cash availability is required to meet the cash requirements of the firm's various departments.

Profit maximization

Financial manager has to plan the activities to achieve profit maximization and future prospects of the firm by adopting profit maximization approach.

Capital budgeting

Financial managers has to study the area of future long term projects and its profitability through the systematic investment programme, that is capital budgeting. As per firm’s cash flows and availability of funds capital budgeting should be essentially done.

Capital structure - Finance manager need to ensure proper and regular financing for the firm by assuring appropriate capital structure of the firm.

Working capital management

Financial manager has to study the regular working capital changes and accordingly assigns the finance required as per the changes so as to ensure adequate liquidity in the firm.

Financial performance evaluation

Management information and control systems (MICS) constantly review the financial performance of the entire organization and assist in evaluating how funds have been used in various divisions and what can be done to improve it.

LIMITATIONS OF FINANCIAL MANAGEMENT

It is critical that financial management objectives are properly understood. Organizational leaders must make the necessary efforts to understand regulatory requirements and develop procedures that meet the standards without incurring excessive costs. To better understand the limitations of financial management, let us first take a look at them.

Uncertainty regarding the future

The assumption about the project's future circumstances is a major drawback of financial management. The nature of the future is unexpected, and things do not always turn out the way we expect them to. The dependability of financial data is greatly influenced by future uncertainty.

Rigidity

Financial management contributes to organizational rigidity by establishing specific criteria for evaluating performance. All of the standards are set in accordance with a set of criteria. As a result of the rigidity of standards, it is impossible to meaningfully compare real and standard performance.

Inaccuracy in the Data Used to Make Decisions

Financial management is the process method of predicting the future based on past or researched data gathered from various sources. If financial management data has limitations, the data's foundation is faulty, as the results purpose of financial planning could be impacted incorrectly. Because all predictions may be incorrect, the credibility and quality of the data on which the computations are based are critical.

Criteria standardization and determination

Financial management necessitates the development of performance criteria for assessing actual performance, which would be a time-consuming and complex process. There are no appropriate setup prerequisites for establishing standards, and the standards may be formed inaccurately.

Rapid changes in the environment and public policy

Government laws and regulations guiding the economic environment may change significantly, which can have a significant effect on financial management. If the strategy does not have the agility to adapt to changing conditions, it may go from being a perfect financial plan to a financial failure.

Inadequate availability of essential information

Financial records can be altered for a variety of reasons. This is the most major drawback of financial management. It could, for example, be presented in accordance with management's wishes or formed from the viewpoint of shareholders. Profits and financial circumstances, as well as the rate of profitability, are the only things that are made publicly available when it comes to financial management.

Warning

Business executives must have systems in place to keep ahead of the rapidly changing regulatory environment. The employer is responsible for making changes to company policies to accommodate this change. Penalties are imposed regardless of whether or not business owners are aware of the change. To overcome the disadvantages of financial management, one should always have up-to-date business information.

Costly

For commercial enterprises, financial management is a time-consuming and costly activity. Financial management comprises the use of various financial control instruments to manage and measure costs. These tools are both costly and time-consuming to operate.

A challenge in setting a reasonable price

Financial management is assigned with the primary responsibility of generating income streams for the firm. Each time new manufacturing processes, business models, or customer preferences are introduced, new needs are created. Financial management's dependability and limitations are debatable, and its effectiveness is strongly questioned.

External Sources Factors

External factors which are not directly involved in your business strategy but have the potential to have a negative impact on your planning, such as war, natural disasters, pandemics, and other such events, are extremely difficult or impossible to predict. To avoid these types of financial management constraints, you must take appropriate steps, such as insurance, to minimize the financial loss that can result from such difficulties.

PREPARATION OF FINANCIAL STATEMENT ADHERING TO CURRENT SATAUTORY REQUIREMENT

[The below content has been adapted from Institute of Chartered Accountant of India (ICAI)]

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS OF A COMPANY

GENERAL INSTRUCTIONS

1. Where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head or subhead or any changes, inter se, in the financial

statements or statements forming part thereof, the same shall be made and the requirements of this Schedule shall stand modified accordingly.

2. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards under the Companies Act, 2013. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts or by way of additional statement unless required to prescribed be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act shall be made in the notes to accounts in addition to the requirements set out in this Schedule.

3. (i) Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required

(a) narrative descriptions or dis-aggregations of items recognized in those statements; and

(b) information about items that do not qualify for recognition in those statements.

(ii) Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and not providing important information as a result of too much aggregation.

4. (i) Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as given below:—

Sr. No.	**Turnover**	**Rounding off**
1	Less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
2	One hundred crore rupees or more	To the nearest lakhs, millions or crores, or decimals thereof.

(ii) Once a unit of measurement is used, it shall be used uniformly in the Financial Statements.

5. Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all

items shown in the Financial Statements including notes shall also be given.

6. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

Note: This part of Schedule sets out the minimum requirements for disclosure on the face of the Balance Sheet, and the Statement of Profit and Loss (hereinafter referred to as "Financial Statements" for the purpose of this Schedule) and Notes. Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Accounting Standards.

PART I — BALANCE SHEET

Name of the Company…………………….

Balance Sheet as at ………………………

Particulars	**Note No.**	**Figures as at the end of current reporting period**	**Figures as at the end of previous reporting period**
1	**2**	**3**	**4**
I. EQUITY AND LIABILITIES			
(1) Shareholders' funds			
(a) Share capital			
(b) Reserves and surplus			
(c) Money received against share warrants			
(2) Share application money pending allotment			
(3) Non-current liabilities			
(a) Long-term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long-term provisions			

(4) Current liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
TOTAL (1+2+3+4)			
II. ASSETS			
Non-current assets			
(1) (a) Fixed assets			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under Development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long-term loans and advances			
(e) Other non-current assets			
(2) Current assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents			
(e) Short-term loans and advances			
(f) Other current assets			
TOTAL (1+2)			

See accompanying notes to the Financial Statements.

General Instructions for Preparation of Balance Sheet

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

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

a) it is expected to be realised in, or is intended for sale or consumption in, the company's normal operating cycle;

b) it is held primarily for the purpose of being traded;

c) it is expected to be realised within twelve months after the reporting date; or

d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

3. A liability shall be classified as current when it satisfies any of the following criteria:—

(a) it is expected to be settled in the company's normal operating cycle;

(b) it is held primarily for the purpose of being traded;

(c) it is due to be settled within twelve months after the reporting date; or

(d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

4. A receivable shall be classified as a "**trade receivable**" if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.

5. A payable shall be classified as a "**trade payable**" if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.

6. A company shall disclose the following in the notes to accounts.

A. Share Capital

For each class of share capital (different classes of preference shares to be treated separately):

(a) the number and amount of shares authorised;

(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;

(c) par value per share;

(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;

(e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

(f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;

(g) shares in the company held by each shareholder holding more than 5 per cent. shares specifying the number of shares held;

(h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;

(i) for the period of five years immediately preceding the date as at which the Balance Sheet is prepared:

(A) Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.

(B) Aggregate number and class of shares allotted as fully paid-up by way of bonus shares.

(C) Aggregate number and class of shares bought back.

(j) terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date;

(k) calls unpaid (showing aggregate value of calls unpaid by directors and officers);

(l) forfeited shares (amount originally paid-up).

B. Reserves and Surplus

(i) Reserves and Surplus shall be classified as:

(a) Capital Reserves;

(b) Capital Redemption Reserve;

(c) Securities Premium Reserve;

(d) Debenture Redemption Reserve;

(e) Revaluation Reserve;

(f) Share Options Outstanding Account;

(g) Other Reserves–(specify the nature and purpose of each reserve and the amount in respect thereof);

(h) Surplus i.e., balance in Statement of Profit and Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/ from reserves, etc.;

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

(ii) A reserve specifically represented by earmarked investments shall be termed as a "fund".

(iii) Debit balance of statement of profit and loss shall be shown as a negative figure under the head "Surplus". Similarly, the balance of "Reserves and Surplus", after adjusting negative balance of surplus, if any, shall be shown under the head "Reserves and Surplus" even if the resulting figure is in the negative.

C. Long-Term Borrowings

(i) Long-term borrowings shall be classified as:

(a) Bonds/debentures;

(b) Term loans:

(A) from banks.

(B) from other parties.

(c) Deferred payment liabilities;

(d) Deposits;

(e) Loans and advances from related parties;

(f) Long term maturities of finance lease obligations;

(g) Other loans and advances (specify nature).

(ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

(iv) Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.

(v) Particulars of any redeemed bonds/debentures which the company has power to reissue shall be disclosed.

(vi) Terms of repayment of term loans and other loans shall be stated.

(vii) Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

D. Other Long-term Liabilities

Other Long-term Liabilities shall be classified as:

(a) Trade payables;

(b) Others.

E. Long-term provisions

The amounts shall be classified as:

(a) Provision for employee benefits;

(b) Others (specify nature).

F. Short-term borrowings

(i) Short-term borrowings shall be classified as:

(a) Loans repayable on demand;

(A) from banks.

(B) from other parties.

(b) Loans and advances from related parties;

(c) Deposits;

(d) Other loans and advances (specify nature).

(ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

(iv) Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

(v) current investment of long term borrowings shall be disclosed separately.

G. Other current liabilities

The amounts shall be classified as:

(a) Current maturities of finance lease obligations;

(b) Interest accrued but not due on borrowings;

(c) Interest accrued and due on borrowings;

(d) Income received in advance;

(e) Unpaid dividends;

(f) Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorised capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable, i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under "Óther current liabilities";

(g) Unpaid matured deposits and interest accrued thereon;

(h) Unpaid matured debentures and interest accrued thereon;

(i) Other payables (specify nature).

H. Short-term provisions

The amounts shall be classified as:

(a) Provision for employee benefits.

(b) Others (specify nature).

I. Tangible assets

(i) Classification shall be given as:

(a) Land;

(b) Buildings;

(c) Plant and Equipment;

(d) Furniture and Fixtures;

(e) Vehicles;

(f) Office equipment;

(g) Others (specify nature).

(ii) Assets under lease shall be separately specified under each class of asset.

(iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if changes 10% or more in the aggregate in the net carrying value of each class of tangible assets) and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.

(iv) Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

J. Intangible assets

(i) Classification shall be given as:

(a) Goodwill;

(b) Brands /trademarks;

(c) Computer software;

(d) Mastheads and publishing titles;

(e) Mining rights;

(f) Copyrights, and patents and other intellectual property rights, services and operating rights;

(g) Recipes, formulae, models, designs and prototypes;

(h) Licences and franchise;

(i) Others (specify nature).

(ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if changes 10% or more in the aggregate in the net carrying value of each class of intangible assets) and other adjustments and the related amortization and impairment losses/reversals shall be disclosed separately.

(iii) Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

K. Non-current investments

(i) Non-current investments shall be classified as trade investments and other investments and further classified as:

(a) Investment property;

(b) Investments in Equity Instruments;

(c) Investments in preference shares;

(d) Investments in Government or trust securities;

(e) Investments in debentures or bonds;

(f) Investments in Mutual Funds;

(g) Investments in partnership firms;

(h) Other non-current investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof;

(iii) The following shall also be disclosed:

(a) Aggregate amount of quoted investments and market value thereof;

(b) Aggregate amount of unquoted investments;

(c) Aggregate provision for diminution in value of investments.

L. Long-term loans and advances

(i) Long-term loans and advances shall be classified as:

(a) Capital Advances;

(b) Loans and advances to related parties (giving details thereof);

(c) Other loans and advances (specify nature).

(ii) The above shall also be separately sub-classified as:

(a) Secured, considered good;

(b) Unsecured, considered good;

(c) Doubtful.

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

M. Other non-current assets

Other non-current assets shall be classified as:

(i) Long-term Trade Receivables (including trade receivables on deferred credit terms);

(a) Security Deposits;

(ii) Others (specify nature);

(iii) Long term Trade Receivables, shall be sub-classified as:

(a) (A) Secured, considered good;

(B) Unsecured, considered good;

(C) Doubtful.

(b) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(c) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

(iv) For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule

(Amount in Rs.)

Particulars	Outstanding for following periods from due date of payment #					Total
	Less than 6 months	6 months- 1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables - considered good						
(ii) Undisputed Trade receivables - considered doubtful						
(iii) Disputed Trade receivables - considered good						
(iv) Disputed Trade receivables - considered doubtful						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately

N. Current Investments

(i) Current investments shall be classified as:

(a) Investments in Equity Instruments;

(b) Investment in Preference Shares;

(c) Investments in Government or trust securities;

(d) Investments in debentures or bonds;

(e) Investments in Mutual Funds;

(f) Investments in partnership firms;

(g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate [indicating separately whether such bodies are: (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities] in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) The following shall also be disclosed:

(a) The basis of valuation of individual investments;

(b) Aggregate amount of quoted investments and market value thereof;

(c) Aggregate amount of unquoted investments;

(d) Aggregate provision made for diminution in value of investments.

O. Inventories

(i) Inventories shall be classified as:

(a) Raw materials;

(b) Work-in-progress;

(c) Finished goods;

(d) Stock-in-trade (in respect of goods acquired for trading);

(e) Stores and spares;

(f) Loose tools;

(g) Others (specify nature).

(ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

(iii) Mode of valuation shall be stated.

P. Trade Receivables

(i) For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables ageing schedule

(Amount in Rs.)

Particulars	**Outstanding for following periods from due date of payment #**					**Total**
	Less than 6 months	**6 months-1 year**	**1-2 years**	**2-3 years**	**More than 3 years**	
(i) Undisputed Trade receivables - considered good						
(ii) Undisputed Trade receivables - considered doubtful						
(iii) Disputed Trade receivables - considered good						
(iv) Disputed Trade receivables - considered doubtful						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately\

(ii) Trade receivables shall be sub-classified as:

(a) Secured, considered good;

(b) Unsecured, considered good;

(c) Doubtful.

(iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q. Cash and cash equivalents

(i) Cash and cash equivalents shall be classified as:

(a) Balances with banks;

(b) Cheques, drafts on hand;

(c) Cash on hand;

(d) Others (specify nature).

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than twelve months maturity shall be disclosed separately.

R. Short-term loans and advances

(i) Short-term loans and advances shall be classified as:

(a) Loans and advances to related parties (giving details thereof);

(b) Others (specify nature).

(ii) The above shall also be sub-classified as:

(a) Secured, considered good;

(b) Unsecured, considered good;

(c) Doubtful.

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

S. Other current assets (specify nature)

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

T. Contingent liabilities and commitments (to the extent not provided for)

(i) Contingent liabilities shall be classified as:

(a) Claims against the company not acknowledged as debt;

(b) Guarantees;

(c) Other money for which the company is contingently liable.

(ii) Commitments shall be classified as:

(a) Estimated amount of contracts remaining to be executed on capital account and not provided for;

(b) Uncalled liability on shares and other investments partly paid;

(c) Other commitments (specify nature).

U. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately.

V. Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.

Where the company has not used the borrowings from banks and financial institutions for the specific purpose for which it was taken at the balance sheet date, the company shall disclose the details of where they have been used.

W. If, in the opinion of the Board, any of the assets other than fixed assets and non-current investments do not have a value on realisation in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated.

PART II – STATEMENT OF PROFIT AND LOSS

Name of the Company…………………….

Profit and loss statement for the year ended ………………………

	Particulars	**Note No.**	**Figures as at the end of current reporting period**	**Figures as at the end of the previous reporting period**
	1	**2**	**3**	**4**
I	Revenue from operations			
II	Other income			
III	**Total Revenue (I + II)**			
IV	**Expenses:**			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, work-in-progress and Stock-in-Trade			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total expenses			
V	**Profit before exceptional and extraordinary items and tax (III - IV)**			
VI	Exceptional items			

VII	**Profit before extraordinary items and tax (V - VI)**			
VIII	Extraordinary items			
IX	**Profit before tax (VII-VIII)**			
X	Tax expense:			
	(1) Current tax			
	(2) Deferred tax			
XI	Profit (Loss) for the period from continuing operations (VII-VIII)			
XII	Profit/(loss) from discontinuing operations			
XIII	Tax expense of discontinuing operations			
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)			
XV	**Profit (Loss) for the period (XI + XIV)**			
XVI	**Earnings per equity share:**			
	(1) Basic			
	(2) Diluted			

See accompanying notes to the financial statements.

General instructions for preparation of Statement of Profit and Loss

1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of clause (40) of section 2 in like manner as they apply to a statement of profit and loss.

2. (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from—

(a) Sale of products;

(b) Sale of services;

"(ba) Grants or Donations received (relevant in case of section 8 Companies only)".

(c) Other operating revenues;

Less:

(d) Excise duty.

(B) In respect of a finance company, revenue from operations shall include revenue

from—

(a) Interest; and

(b) Other financial services.

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

3. Finance Costs

Finance costs shall be classified as:

(a) Interest expense;

(b) Other borrowing costs;

(c) Applicable net gain/loss on foreign currency transactions and translation.

4. Other income

Other income shall be classified as:

(a) Interest Income (in case of a company other than a finance company);

(b) Dividend Income;

(c) Net gain/loss on sale of investments;

(d) Other non-operating income (net of expenses directly attributable to such income).

5. **Additional Information:**

i). A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:—

(a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].

(b) Depreciation and amortisation expense;

(c) Any item of income or expenditure which exceeds one per cent of the revenue from operations or Rs.1,00,000, whichever is higher;

(d) Interest Income;

(e) Interest expense;

(f) Dividend income;

(g) Net gain/loss on sale of investments;

(h) Adjustments to the carrying amount of investments;

(i) Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);

(j) Payments to the auditor as

(a) auditor;

(b) for taxation matters;

(c) for company law matters;

(d) for management services;

(e) for other services; and

(f) for reimbursement of expenses;

(k) In case of Companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities;

(l) Details of items of exceptional and extraordinary nature;

(m) Prior period items;

(ii) (a) In the case of manufacturing companies,—

(1) Raw materials under broad heads.

(2) goods purchased under broad heads.

(b) In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.

(c) In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.

(d) In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchases, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.

(e) In the case of other companies, gross income derived under broad heads.

(iii) In the case of all concerns having works in progress, works-in-progress under broad heads.

(iv) (a) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance sheet is made up.

(b) The aggregate, if material, of any amounts withdrawn from such reserves.

(v) (a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.

(b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.

(vi) Expenditure incurred on each of the following items, separately for each item:—

(a) Consumption of stores and spare parts;

(b) Power and fuel;

(c) Rent;

(d) Repairs to buildings;

(e) Repairs to machinery;

(f) Insurance;

(g) Rates and taxes, excluding, taxes on income;

(h) Miscellaneous expenses,

(vii) (a) Dividends from subsidiary companies.

(b) Provisions for losses of subsidiary companies

(viii) The profit and loss account shall also contain by way of a note the following information, namely:—

(a) Value of imports calculated on C.I.F basis by the company during the financial year in respect of—

I. Raw materials;

II. Components and spare parts;

III. Capital goods;

(b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;

(c) Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;

(d) The amount remitted during the year in foreign currencies on account of dividends with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;

(e) Earnings in foreign exchange classified under the following heads, namely:—

I. Export of goods calculated on F.O.B. basis;

II. Royalty, know-how, professional and consultation fees;

III. Interest and dividend;

IV. Other income, indicating the nature thereof.

(ix) Undisclosed income: The Company shall give details of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (such as, search or survey or any other relevant provisions of the Income Tax Act, 1961), unless there is immunity for disclosure under any scheme and also shall state whether the previously unrecorded income and related assets have been properly recorded in the books of account during the year.

(x) Corporate Social Responsibility (CSR)

Where the company covered under section 135 of the companies act the following shall be disclosed with regard to CSR activities:

(a)amount required to be spent by the company during the year,

(b) amount of expenditure incurred,

(c) shortfall at the end of the year,

(d) total of previous years shortfall,

(e) reason for shortfall,

(f) nature of CSR activities,

(g) details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,

(h) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

(xi) Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:

(a) profit or loss on transactions involving Crypto currency or Virtual Currency

(b) amount of currency held as at the reporting date, deposits or advances from any

Note:— Broad heads shall be decided taking into account the concept of materiality and presentation of true and fair view of financial statements.

Structure for preparing Notes to Account

[The below content has been adapted from Institute of Chartered Accountant of India (ICAI)]

NOTES TO ACCOUNTS	₹
1. Share Capital ● Authorised Shares (Par Value per Share:Rs……….) ● Issued, subscribed, called up & fully paid Shares ● Subscribed but not fully paid Shares ● Less: Calls unpaid – By Directors by – By Officers – By Others ● Forfeited Shares ● Forfeited Shares reissued ● Reconciliation of Shares Outstanding	
2. Reserves and Surplus ● Capital Reserves ● Capital Redemption Reserve ● Securities Premium ● Debenture Redemption Reserve ● Revaluation Reserve	

● Share Options Outstanding Account ● Other Reserves ● General Reserves ● Surplus – Balance b/d – Add: Profit for Year – Less: Appropriations	
3. Long Term Borrowings ● Bonds / Debentures ● Term Loans – Term Loans from Banks. – Term Loans from Other Parties ● Deferred Payment Liabilities ● Deposits – Public Deposits – Inter-Corporate Deposits ● Loans and Advances from Related Parties. ● Long Term Maturities of Finance Lease Obligations ● Other Loans and Advances	
4. Other Long Term Liabilities ● Trade Payables ● Other Payables – Trade Deposits – Security Deposits	
5. Long Term Provisions ● Provision for Employee Benefits ● Others – Provision for Warranties	
6. Short Term Borrowings ● Loans Repayable on Demand – From Banks – From Other Parties ● Loans and Advances from Related Parties ● Deposits ● Other Loans and Advances	

7. Other Current Liabilities ● Current Maturities of Long Term Debt ● Current Maturities of Finance Lease Obligations ● Interest Accrued but not Due on Borrowings. ● Interest Accrued and Due on Borrowings ● Income Received in Advance ● Unpaid Dividends ● Application Money Refund and Interest Due ● Unpaid Matured Deposits and Interest Accrued thereon ● Unpaid Matured Debentures and Interest Accrued thereon ● Other Payables – Calls-in-Advance – Non-Trade Payables – Taxes Payable	
8. Short Term Provisions ● Provision for Employee Benefits ● Others – Provision for Tax (Net of tax payments)	
9. Tangible Assets ● Land ● Buildings ● Plant and Equipment ● Furniture and Fixtures ● Vehicles ● Office Equipment ● Others (specify nature)	
10. Intangible Assets ● Goodwill ● Brands /Trademarks ● Computer Software ● Mastheads and Publishing Titles ● Mining Rights ● Copyrights, Patents, etc.	

● Recipes, Formulae. Models, Designs and Prototypes ● Licenses and Franchise ● Others (specify nature)	
11. Non-Current Investments ● Investments in Property ● Investment in Equity Instruments ● Investments in Preference Shares ● Investments in Government or Trust Securities ● Investments in Debentures or Bonds ● Investments in Mutual Funds ● Investments in Partnership Firms ● Other Non Current Investments and Advances	
12. Long Term Loans and advances ● Capital Advances ● Security Deposits ● Loans and Advances to Related Parties ● Other Loans and Advances – Advance Tax (Net of provision) – CENVAT Credit Receivable – VAT Credit Receivable – Service Tax Credit Receivable	
13. Other Non Current Assets ● Long Term Trade Receivables ● Others	
14. Current Investments ● Investments in Equity Instruments ● Investments in Preference Shares ● Investments in Government or Trust Securities ● Investments in Debentures or Bonds ● Investments in Mutual Funds ● Investments in Partnership Firms ● Other Investments	

15. Inventories	
● Raw Materials	
● Work-in-Progress	
● Stock-in-Trade	
● Stores and Spares	
● Loose Tools	
● Others	
16. Trade Receivables	
● Secured, Considered Good	
● Unsecured Considered Good	
– More than 6 months	
– Other	
● Doubtful	
– Less: Provision for Bad and Doubtful Debts	
17. Cash and Cash Equivalents	
● Balances with Banks	
● Cheques, Drafts on Hand	
● Cash on Hand	
● Others (specify nature)	
– Other Bank Balances	
– Earmarked (Unpaid Dividend A/c)	
– Margin Money Deposit	
– Deposits Maturing After 12 Months	
18. Short Term Loans and Advances	
● Loans and Advances to related parties	
● Others	
● Prepaid Expenses	
● Tax Refund Receivable vide A.O.	
19. Other Current Assets	
● Non-Trade Receivables	
● Unamortized Expenditure	
● Unbilled Revenue	

20. Revenue from Operations ● Sale of Products ● Sale of Services ● Other Operating Revenues – Sale of Manufacturing Scrap ● Less: Excise Duty Collected	
21. Other Income ● Interest Income ● Dividend Income ● Net Gain/Loss on Sale of Investments ● Other Non-Operating Income (Net) – Profit on Sale of Fixed Assets	
22.Cost of Materials Consumed ● Raw Materials ● Purchased Components	
23. Change in Inventories ● Finished Goods Opening Stock Less: Closing Stock ● Work-in-progress Opening Stock Less: Closing Stock ● Stock-in-Trade Opening Stock Less: Closing Stock	
24. Employee Benefits Expense ● Salaries and Wages ● Contribution to Provident and Other Funds ● Expense on ESOP and ESPP ● Staff Welfare Expenses	
25. Finance Costs ● Interest on Borrowings from Bank ● Interest on Borrowings from Others ● Interest on Debentures	

● Finance Charge on Lease Financing ● Interest by Tax Department ● Other Borrowing Costs – Commitment Charges – Amortization of Discount/Premium/Issue Expenses on Debentures – Ancillary Charges (Processing/Guarantee / Facilitation)	
26. Other Expenses ● Consumption of Stores and Spare Parts ● Power and Fuel ● Rent ● Repairs to Buildings ● Repairs to Machinery ● Insurance ● Rates and Taxes excluding, Taxes on Income ● Payment to Auditor – Payment for Audit Services – Payment for Taxation Matters – Payment for Company Law Matters – Payment for Management Services – Payment for Other Services ● Payment for Reimbursement of Expenses ● Adjustment to Carrying Amount of Investments ● Loss on Foreign Currency Transaction/Translation ● Expenses on CSR Activities ● Exceptional (Major) Items – Costs of Restructuring – Disposal of Fixed Assets – Disposal of Long Term Investments – Effect of Retrospective Legislation – Legal Settlements – Reversal of Provisions – Write Down of Inventory to NRV	

● Extra-ordinary (Major) Items	
– Loss from Attachment of Property	
– Loss from Earthquake	
– Profit from Insurance Claim	
– Write-Back of Self-Insurance Reserve	
● Prior Period Expenses	
● Miscellaneous Expenses	
(Higher of 1% of Operating Revenue or □ 1,00.000)	
Contingent Liabilities and Commitments (to the Extent Not Provided For)	
a) Contingent Liabilities	
– Claims against the company not acknowledged as debt:	
– Guarantees;	
– Other money for which the company is contingently liable	
b) Commitments	
– Estimated amount of contracts remaining to be executed on capital account	
– Uncalled liability on shares and other investments partly paid	
– Other Commitments (non-cancellable)	

Note:

Illustration no. 01

The following balances have been extracted from the accounting records of B. R. Cold storage ltd. as of 31st March,2021.

Particulars	Rs. (Amt.)
Opening Stock of finished goods	3,00,000
Purchase	2,35,000
Net Sales	10,00,000
Closing Stock of finished goods	1,00,000
Interest on Investment	40000
Dividend received	10000
Depreciation on Furniture	20000
General expenses	10000
Salaries	45000
Interest on Bank loan	30000
Income tax	2,00,000

Solution :

B . R . Cold Storage

Profit and loss statement for the year ended 31st March, 2021

Sr. No.	Particulars	Note No.	Amt.
1	**2**	**3**	**4**
I	Revenue from operations (Net Sales)		10,00,000
II	Other income	1	50,000
III	**Total Revenue (I + II)**		**10,50,000**
IV	Expenses:		
	Cost of materials consumed (Purchase of Finished goods)		2,35,000
	Changes in inventories of finished goods (Opening - Closing) (3,00,000 - 1,00,000)		2,00,000
	Employee benefits expense (Salaries)		45,000
	Depreciation (On Furniture)		20,000
	Finance costs (Interest on Bank loan)		30,000
	Other expenses (General expenses)		10,000
	Total expenses		**5,40,000**
V	Profit before tax (III - IV)		5,10,000
VI	(-) Income Tax		2,00,000
VII	Profit / (Loss) for the period (V- VI)		**3,10,000**

Notes to Accounts

Note No.	Particulars	Amt.
1	<u>**Other Income**</u>	
a.	Interest on Investment	40,000
b.	Dividend received	10,000
	Total	**50,000**

Illustration no. 02

From the following ledger balances of Addu and Anshu ltd. as on 31st March, 2021, you are required to Prepare a balance sheet as on that date as per the Companies Act, 2013

Debit Balance	Amt.	Credit Balance	Amt.
Advances to employees	3,00,000	Share Capital	7,50,000
Cash in hand	1,00,000	General reserves	2,50,000
Cash at Bank	50,000	Loan from Bank of India	1,25,000
Plant and Machinery	2,00,000	Provision for Employee's welfare fund	1,45,000
Building	1,50,000	Provision for Expense	1,10,000
Copyrights	3,00,000	Short term loan from Bank	75,000
Expenses on Issue of Debentures (not written off)	1,55,000	Unclaimed Dividend	25,000
Debtors	2,00,000	Profit and loss A/c	1,00,000
Advance income tax	75,000	Bill payable	50,000
9 % Goverment Securities	1,00,000	Creditors	50,000
Inventories	50,000		
	16,80,000		**16,80,000**

Solution:

Addu and Anshu ltd.

Balance sheet as on 31st March, 2021

0	Particulars	Note No.	Amt.
1	2	3	4
I	**EQUITY AND LIABILITIES**		
1	**Shareholder's Funds**		
a	Share Capital		7,50,000
b	Reserves and Surplus		3,50,000
c	Money received against share warrants		
2	**Share application money pending allotment**		-
3	**Non-Current Liabilities**		
a	Long-term borrowings (loan from bank of India)		1,25,000
b	Deferred tax liabilities (Net)		
c	Other Long term liabilities		
d	Long term provisions (Employee's welfare)		1,45,000
4	**Current Liabilities**		
a	Short-term borrowings (Short term loan from Bank)		75,000
b	Trade payables		1,00,000
c	Other current liabilities (Unclaimed Dividend)		25,000
d	Short-term provisions (Provision for Expense)		1,10,000
	Total (1+2+3+4)		**16,80,000**
II	**Assets**		
1	**Non-current assets**		
a	Fixed assets		
i	Tangible assets		3,50,000
ii	Intangible assets (Copyrights)		3,00,000
b	Non Current Investments (Government securities)		1,00,000
c	Other non-current assets (Expenses on Issue of Debentures (not written off))		1,55,000

2	**Current assets**		
a	Inventories		50,000
b	Trade receivables (Debtors)		2,00,000
c	Cash and Cash equivalents		1,50,000
d	Short-term loans and advances (Advances to employees)		3,00,000
e	Other current assets (Advance Income tax)		75,000
	Total (1+2)		**16,80,000**

Notes to Accounts

Note No.	Particulars	Amt.
1	**Reserves and Surplus**	
a.	General reserves	2,50,000
b.	Profit and loss A/c	1,00,000
	Total	**3,50,000**
2	**Trade payable**	
a.	Creditors	50,000
b.	Bill payable	50,000
	Total	**1,00,000**
3	**Tangible Assets**	
a.	Plant and Machinery	2,00,000
b.	Building	1,50,000
	Total	**3,50,000**
4	**Cash and Cash Equivalent**	
a.	Cash in hand	1,00,000
b.	Cash at Bank	50,000
	Total	**1,50,000**

Illustration no. 03

The following are the balances of M/s Ganesh ltd. as on 31st March, 2020

Debit Balance	**Amt.**	**Credit Balance**	**Amt.**
land and Building	32,00,000	Equity Share Capital (Rs. 10)	45,00,000
Plant and Machinery	25,00,000	10% Debentures	15,00,000
Stock	1,50,000	General reserves	2,50,000
Patent	13,50,000	Sales	50,00,000
Sundry Debtors	2,50,000	Creditors	2,00,000
Bank balance	1,50,000	Bills payable	3,50,000
Calls in arrears	50,000	Capital reserves	1,50,000
Purchase	23,50,000		
Share issue expenses	1,00,000		
Wages	8,00,000		
General expenses	75,000		
Salaries	3,00,000		
Bad Debts	5,00,000		
Interest on Debenture	1,75,000		
	1,19,50,000		1,19,50,000

Adjustments:

1. Stock on 31-03-2020 was Rs. 1,00,000
2. Depreciation Plant and Machinery by 10 %
3. Write off Rs. 9,000 from Share issue expenses
4. Create 5 % provision for doubtful debts
5. Provide for Income tax @ 40 %

Prepare Final accounts of the company as per Companies Act , 2013

Solution:

In the Books of M/s Ganesh

Balance sheet as on 31st March, 2020

	Particulars	Note No.	Amt.
1	2	3	4
I	**EQUITY AND LIABILITIES**		
1	**Shareholder's Funds**		
a	Share Capital	1	44,50,000
b	Reserves and Surplus	2	6,87,100
c	Money received against share warrants		-
2	**Share application money pending allotment**		-
3	**Non-Current Liabilities**		
a	Long-term borrowings (10 % Debenture)		15,00,000
b	Deferred tax liabilities (Net)		-
c	Other Long term liabilities		-
d	Long term provisions		-
4	**Current Liabilities**		
a	Short-term borrowings		-
b	Trade payables	3	5,50,000
c	Other current liabilities (Interest on Debenture)		-
d	Short-term provisions (Income tax)		1,91,400
	Total (1+2)		**73,78,500**
II	**Assets**		
1	**Non-current assets**		
a	Fixed assets		
i	Tangible assets	4	54,50,000
ii	Intangible assets (Patent)		13,50,000
b	Non Current Investments		-

c	Other non-current assets	**5**	91,000
2	<u>**Current assets**</u>		
a	Inventories		1,00,000
b	Trade receivables (Debtors)	**6**	2,37,500
c	Cash and Cash equivalents (Bank Balance)		1,50,000
d	Short-term loans and advances		
e	Other current assets		
	Total (1+2)		**73,78,500**

Profit and loss account for the year ended 31st March, 2020

	Particulars	**Note No.**	**Amt.**
1	**2**	**3**	**4**
I	Revenue from operations (Sales)		50,00,000
II	Other income		-
III	Total Revenue (I + II)		**50,00,000**
IV	Expenses:		
	Cost of materials consumed (Purchase)		23,50,000
	Changes in inventories (Opening stock - Closing stock) (1,50,000 - 1,00,000)		50,000
	Employee benefits expense	**7**	11,00,000
	Depreciation (On Plant and Machinery)		2,50,000
	Finance costs (Interest on Debenture)		1,75,000
	Other expenses	**8**	5,96,500
	Total expenses		**45,21,500**
V	Profit before tax (III- IV)		4,78,500
VI	(-) Income Tax @ 40 %		1,91,400
VII	Profit / (Loss) for the period (V- VI)		**2,87,100**

Notes to Accounts:

Note No.	Particulars	Amt.
1	**Share Capital**	
	Issued, Subscribed and Paid-up Capital	
	4,50,000 Equity Shares of Rs. 10 each fully paid up	45,00,000
	(-) Calls in arrears	50,000
	Total	**44,50,000**
2	**Reserves and Surplus**	
	General reserves	2,50,000
	Capital reserves	1,50,000
	Profit for the year	2,87,100
	Total	**6,87,100**
3	**Trade payable**	
	Creditors	2,00,000
	Bills payable	3,50,000
	Total	**5,50,000**
4	**Fixed assets -**	
	Tangible	
	land and Building	32,00,000
	Plant and Machinery 25,00,000	
	(-) 10% Depreciation 2,50,000	22,50,000
	Total	**54,50,000**
5	**Other Non Current assets**	
	Share Issue expenses	1,00,000
	(-) Written off	9,000
	Total	**91,000**
6	**Trade Receivable**	
	Sundry Debtors	2,50,000
	(-) Provision for Doubtful Debts @ 5 %	12,500
	Total	**2,37,500**

7	**Employee Benefits Expenses**	
	Wages	8,00,000
	Salaries	3,00,000
	Total	**11,00,000**
8	**Other Expenses**	
	Bad Debts 5,00,000	
	(+) Provision for Doubtful Debts @ 5 % 12,500	5,12,500
	Share issue expenses	9,000
	General Expenses	75,000
	Total	**5,96,500**

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2

ANALYSIS OF FINANCIAL STATEMENTS

Unit Structure

2.0 LEARNING OBJECTIVES

After studying the unit, the students will be able to:

- Understand the objectives and nature of Financial Statements.
- Know the characteristics of Financial Statements.
- Discuss about the qualities of Ideal Financial Statements.
- Interpret the financial statements.

2.1 THE FINANCIAL STATEMENTS

(i) "Financial Statements" is a set of documents consisting of:

(a) **Balance Sheet** as on date - shows position of assets and liabilities as on date.

(b) **Profit and loss** account- shows profit or loss for the period.

(c) **Cash Flow Statement-** wherever applicable

(d) **Statements and Explanatory Notes** – part of balance sheet

(e) **Supplementary Schedule and Information**

(ii) The financial statements help one to realize,

- the progress made by a business,

- the resources utilized by the business or

- the failure suffered by a business.

(iii) Financial statement does not include

- Report by directors

- Statement by the chairman

- Management discussion & analysis report (MDAR)

2.2 NEED AND IMPORTANCE OF FINANCIAL STATEMENT

The users of these financial statements need to have an honest assurance that the statements have been properly

- **C**ompiled,
- **P**repared, and
- **P**resented.

They want a reasonable degree of assurance as regards the reliability and accuracy of the financial statement.

Limitations of Financial statements

The company releases financial statements, and hence the obvious limitation is that the information an analyst gets is limited to what the company wants to show and how it plans to manipulate the information.

Limitations of Financial Statements

Interim

1. Only Interim Reports

The data in financial statements is based on approximation and do not give a clear picture. The actual results can only be known in condition of sale or liquidation of business. Generally statements are prepared for different accounting period say yearly, during the lifetime of concern. Cost and income be apportioned to different periods with a view to determine profits etc.

Accountant, on his personal judgement do allocation of income and expenses. The existence of contingent assets and liabilities also make statements imprecise. So financial statements do not actual picture and at the most they are interim reports

2. Exact position not known

The financial statements are expressed in monetary terms, so they tend to give final and accurate position. The fixed asset value in the balance sheet neither represents the value for which fixed assets can be sold nor the amount which will be required to replace these assets. The balance sheet is prepared on the presumption of a going concern.

So, fixed assets are shown at cost less accumulated depreciation. There are certain assets in the balance sheet such as preliminary expenses, goodwill, discount on issue of shares which will realize nothing at the time of liquidation though they are shown in the balance sheet.

3. Historical cost

The financial statements are prepared on the basis of historical costs or original costs. The diminishing value in asset is not accounted for. The statements are not prepared keeping in view the present economic conditions.

The balance sheet loses the significance of being an index of current economic realities. Similarly, the profitability shown by the income statement may not represent the earning capacity of the concern. The increase in profits may be due to an increase in prices or due to some abnormal causes and not due to increase in efficiency. The conclusions drawn from financial statements may not give a fair picture of the concern

4. Non-monetary factors impact left unseen

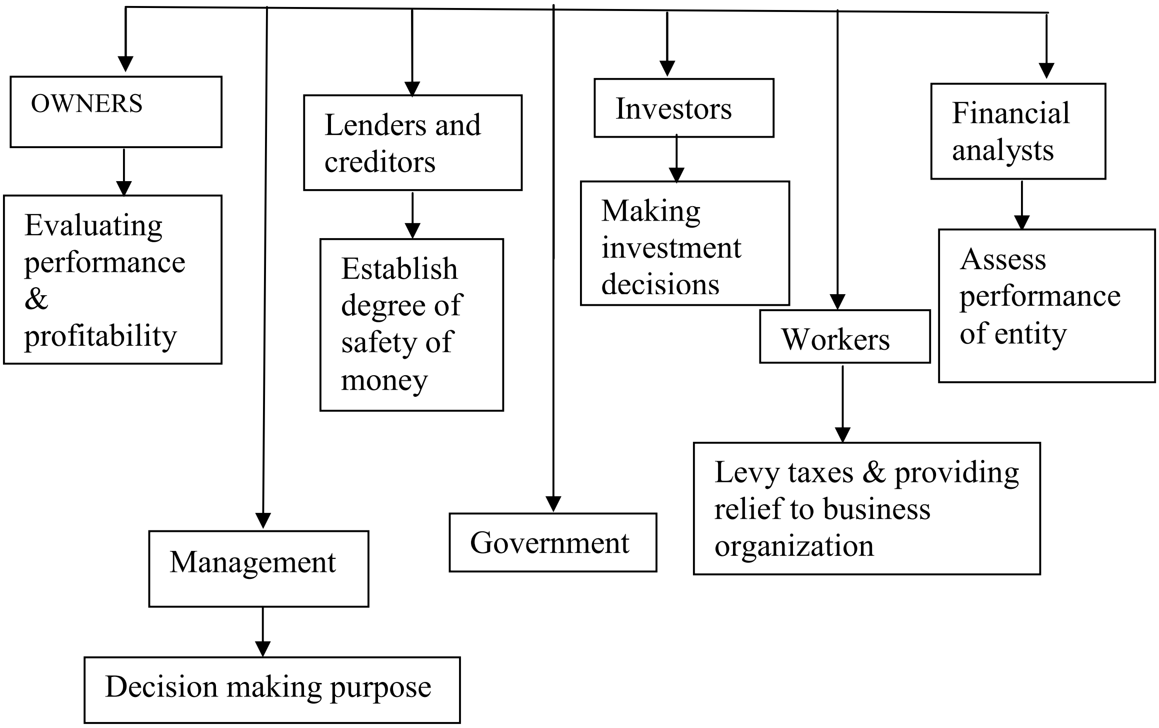
There are certain factors which have a relevance on the financial position and operating results of the business but they do not become a part of these statements because they cannot be measured in monetary terms.

Such factors may include the management reputation credit worthiness of the concern, sources and commitments for purchases and sales, co-operation of the employees, etc. The financial statements only show the position of the financial accounting for business and not the financial position.

5. No precision in Financial Statements

There is no possibility in precision of financial statements because the statements deal with matters which cannot be precisely stated. The data are recorded by conventional procedures followed over the years. Various conventions, postulates, personal judgments etc. are used for developing the data.

USERS AND THEIR PURPOSE



2.3 ANALYSIS AND INTERPRETATION

(1) Need for Analysis and Interpretation : A typical Financial Statement of a company may run into many pages. It normally contains a huge mass of data and figures. A common user would be at a loss to understand which figures are important and what is the exact significance of all the figures shown in the Financial Statements. The Financial Statements are basically prepared for the owners or managers and outsiders such as Creditors, Lenders or researchers have re-organise the figures appearing in the Financial Statements for the purpose of their study.

(2) Meaning of Analysis: 'Analysis' means - to resolve something into its elements or components, For an outside user, the details in the Financial Statements signify only raw data or 'raw material'! This raw material' needs to be re-organised, processed and converted into an easy to understand form. The process of breaking up a large mass of raw data into manageable form is called "analysis' of the Financial Statements.

(3) Financial Statement Analysis : Financial statement analysis is a process of evaluating the relationship between the component parts of a financial statement to obtain a better understanding of a firm's financial position and performance (Metcalf and Tigard). Analysis of Profit and Loss Account, therefore, means breaking down the Profit and Loss Account into its various components or segments i.e. Gross Sales, Net Sales, Cost of Goods Sold, Operating Profit and so on. This is done by converting the T Form Profit and Loss Account into a Vertical Income Statement. Analysis of Balance Sheet means breaking down or "analysing' the Funds into Total Funds Available and Total Funds Employed. The Total Funds Available are further broken down into Owners' Funds and Loan Funds. The Total Funds employed are broken down into Fixed Assets and Working Capital. This is done by converting the T Form Balance Sheet into a Vertical Balance Sheet.

2.4 BALANCE SHEET

ASSETS

Definitions

(1) Expenditure means a payment made by a business to obtain some benefit i.e., assets, goods or services (Guidance Note - ICAI). While an expenditure on obtaining goods or services by a concern in the course of its business activity is known as revenue expenditure, an expenditure in the course of its investing activity (obtaining an asset) is known as capital expenditure.

(2) Capital expenditure means an expenditure carrying probable future benefits (Guidance Note. ICAl. Capital expenditure gives rise to 'assets'.

Types and Valuation

Following are the different types of assets as defined by the ICAI in its Guidance Note, and the mode of valuation:

(1) 'Assets" are tangible objects or intangible rights, owned by a concern, carrying probable future benefits. Thus, assets include tangible items (capital assets, current assets) and intangible rights (intangible assets).

(2) 'Capital assets' means assets including investments not held for sale, con version or consumption in the ordinary course of business. Capital assets thus include fixed assets and investments.

(3) 'Capital work-in-progress means expenditure on capital assets which are under construction or completion. It is valued at cost incurred till date.
(4) Current assets are cash and other assets that are (i) expected to be converted into cash or

(in) consumed in the production of goods or rendering of services in the normal course of business. Thus, current assets, as opposed to capital assets, are short-term assets (debtors, stock etc.. Debtors and stocks are shown at their Net Realisable Value, if and only if, it is lower than cost.

(5) Fixed asset is an asset held for the purpose of providing or producing goods or services, and which is not held for resale in the normal course of business. Fixed assets may be either depreciable assets (machinery etc.) or wasting assets (mines etc.). Fixed assets are valued at cost incurred upto installation, i.e. Invoice price + Tax + Delivery charges + Installation cost + Cost of trial runs + Initial spares.

(6) Depreciable asset' is a fixed asset which has a limited useful life. These are valued at the WDV (Cost less Depreciation).

(7) Wasting assets' are natural resources like mine, oil-well etc. which are exhausted or depleted due to extraction or use. These are valued at WDV (Cost less amount amortised).

(8) Investment' is expenditure on assets held, not for business operations, but to earn interest, income, profit or other benefits e.g. shares, debentures, immovable properties etc. Investments are normally valued at cost.

(9) Intangible asset' is an asset which does not have a physical identity e.g. goodwill, patent, copyright etc. Intangible assets are valued at WDV (cost less amount amortised).

(10) 'Fictitious asset' is an item shown under assets in the balance sheet which has no real value (e.g. debit balance of profit and loss account which indicates accumulated losses)

(In) Hidden assets do not appear on the balance sheet. Examples are : self created good will, assets Written off in books but still in use, options on lease, exclusive trading agreements, secret process or designs and so on. Hidden assets are like 'secret reserves'

Deferred Revenue Expenditure

(1) Meaning: Deferred Revenue Expenditure' is that expenditure which is carried forward on the presumption that it will be of benefit over subsequent period(s) (Guidance Note-ICAl. It is also known as "deferred expenditure'. To defer' means to postpone. Deferred revenue expenditure has a mixed nature and has some features of both revenue and capital expenditure. It may be either a basically revenue expenditure whose benefits can be enjoyed for a number of years; or a capital expenditure not represented by any real asset.

(2) Accounting : The items of expenditure having medium term benefits (say 3 years) are treated as deferred revenue expenditure. The proportionate cost (1/3 cost) related to current year is charged as expenses. The balance (unexpired) cost (2/3) is carried forward as "fictitious asset' in the balance sheet and written off in next years. Such gradual and systematic writing off is known as 'amortisation' (Guidance Note -ICAL).

(3) Applicable Only to Companies : Earlier, research expenses, heavy advertisement expenditure, preliminary expenses, expenses on shifting the business etc. used to be treated as deferred revenue expenditure and written off over 3 to 5 years. However, Accounting Standard 26 (Intangible Assets) requires that such items should be treated as revenue expenses. However, according to the ICAI Guidance Note on Revised Schedule VI to the Companies Act, a Limited Company may treat the following as deferred revenue expenditure - (1) Share issue expenses (2) Discount on issue of Shares (3) Debenture issue expenses (4) Discount on issue of debentures, and (5) Premium payable on redemption of debentures. Many companies amortize share issue expenses, discount on shares etc. over the period of benefit, i.e., normally 3 to 5 years. Expenses on issue, discount or premium relating to debentures can be amortized over the period of debentures. Proportionate amount related to current year is charged as expenses in the profit and loss statement of the company. Balance amount not yet written off is shown as Unamortized Expenditure' on the Assets side of the company balance sheet.

LIABILITIES

Definitions

Capital means the amounts in vested in the concern by its owners e.g. paid-up capital in a corporate enterprise. It is also used to refer to the interests of the owners in the assets of the enterprise (ICAI). Capital is refunded to the owners only when the concern finally stops its business and is closed .

Liability means the financial obligation of an enterprise other than owner's funds (ICAN).

Long term (Non-current) Liability is a liability which does not fall due for payment in a short period i.e. twelve months (ICAI) Current Liability is a liability including loans, deposits and bank overdraft which falls due for payment in a relatively short period, normally not more than 12 months (ICAL).

Disclosure in Final Accounts

Capital and Liabilities are shown in Balance Sheet. Capital receipt from sale of asset or

Investment is deducted from the concerned fixed asset or investment shown on the Assets side in the balance

CONVENTIONAL OR T'FORM

The conventional form of Balance Sheet (also called the T form or the Account form), shows the Assets on the right hand side and the Liabilities on the left hand side.

In this form the Assets are normally shown in order of Permanence. The least Liquid asses, i.e.-the fixed Assets are shown First, followedloy the most Liquid assets, ie. the current asses: [Even under cash head, items of assets are arranged in the order of Permanance e.g. under Current A sos stace spears first and Cash & Bank balance which is the most liquid, appears last]. The Liabilities are shown in order of priority of e-amont. Permanent Liabilities (e.g. Capital) are shown first followed by long term Loans and short term Loans. Current Liabilities appear last. This form is used by non. corporates e.g. sole trader or firm. Thus, the Balance Sheet in conventional form appears like this:

EXHIBIT 1 : BALANCE SHEET IN 'T' FORM

Liabilities	₹	Assets	₹
Capital	XX	Fixed Assets	XX
Reserves & Surplus	XX	Investments	XX
Long term Loans	XX	Current Assets	XX
Short term Loans	XX	Loans and Advances	XX
Current Liabilities	XX		
Provisions	XX		
	XX		XX

Note: If the items are shown in order of liquidity, the above sequence is reversed. On the assets side, current assets are shown first, followed by fixed assets. On the liabilities side, current liabilities are shown first, followed by short term loans, long term loans and capital.

NEED FOR VERTICAL FORMAT

The horizontal format of Balance Sheet is designed from the point of view of the owner of a concern It enables the owner to know at a glance the amount of Total Funds Owned (Total Assets) and the amount of Total Funds Owed (Total Liabilities). It also enables the owner to know which assets will take time to sell (Fixed Assets) and which assets can be realised quickly (Current Assets). The order of payment of liabilities in the event of Liquidation can also be ascertained from such a Balance Sheet in conventional form.

However, the Conventional Form of Balance Sheet is not suitable for financial analysis, precisely because.

(1) It is designed for the owner. It does not serve the purpose of the other users such as a potential investor or lender.

(2) Its presentation and sequence or order of items is relevant only in the event of Liquidation; it is unsuitable for financial analysis of a 'going concern'.

Hence, a user or Financial Analyst, generally converts the horizontal Balance Sheet, into a Vertical Format, which is more suitable for financial analysis especially in Ratio Analysis. Even the vertical financial statements for a limited company prepared under Schedule VI of the Companies Act need to be converted into the following format for financial analysis. The Balance Sheet in Vertical Format for financial analysis will appear as follows :-

VERTICAL FORMAT

WORKSHEET 2 : VERTICAL BALANCE SHEET (DETAILED ITEMS)

	Particulars	₹	₹	₹
I	**SOURCES OF FUNDS**			
1	**Owner's Funds**			
A	**Capital**			
i	Equity Share Capital / Capital of Proprietor or Partner	XX		
ii	Preference Share Capital Amount Subscribed / Called-up	XX		
iii	Less : Unpaid Calls / Drawings of Proprietor or Partner	XX		
iv	Add : Forfeited Shares / Fresh Capital by Prop. / Partner	XX		
v	Add : Received Against Share Warrants	XX	XX	
B.	**Reserves and Surplus**			
i	Capital Reserve	XX		
ii	Capital Redemption Reserve	XX		
iii	Share Premium	XX		
iv	General Reserve	XX		
v	Other Reserve	XX		
vi	Profit & Loss A/c - Cr. balance	XX		
vii	Sinking Funds / Other Funds	XX	XX	
C.	**Less : Losses & Fictitious Assets**			
i	Profit & Loss A/c - Dr. balance	XX		
ii	(in) Misc. Expenditure not written off	XX		
iii	Share Issue Expenses	XX		
iv	Discount on Issue of Shares	XX		
v	Debenture Issue Expenses	XX		

vi	Discount on Issue of Debentures	XX		
vii	Premium Payable on Redemption of Debentures	XX	XX	
	Own Funds or Net Worth (1) (A+B-C)			XX
	(Capital + Reserves & Surplus - Losses & Fictitious Assets)			
2	**Loan Funds/Borrowed Funds**			
D.	**<u>Secured Loans / Long Term Borrowings</u>**			
	Debentures or bonds	XX		
	Loans from Banks	XX		
	Loans from Financial Institutions	XX	XX	
E.	**<u>Unsecured Loans</u>**			
	Public Deposits	XX		
	Loan from Directors	XX	XX	
	Owed Funds (D + E) (Secured Loans + Unsecured Loans)			XX
	Total Funds Available / Capital Employed			XX
	(Own Funds + Owed Funds) (1 + 2)			
II	**APPLICATION OF FUNDS**			
3	**<u>Net Fixed / Non-Current Assets</u>**			
F.	**Tangible**	XX		
	Land and building	XX		
	Leaseholds	XX		
	Plant and Machinery	XX		
	Furniture and Fittings	XX		
	Vehicles	XX	XX	
G.	**Intangible**			
	Goodwill	XX		
	Patents, copyrights, trademarks and designs	XX	XX	
	Total Fixed Assets **(F + G)**			XX
	(Net Tangible Assets + Intangible Assets)			

4	**Long Term / Non-current Investments**			
	Investments in Government Securities		XX	
	Shares, Debentures etc.		XX	
	Less: Sinking Funds / Other Funds / Investments		XX	
	Investments in immovable properties		XX	
	Investments in Capital of Partnership Firms		XX	
	Long Term Loans given		XX	XX
5	**Working Capital**			
H.	**Quick Assets**			
a	Cash and Bank	XX		
b	Debtors (Net) / Trade Receivables	XX		
c	Bills Receivable	XX		
d	Short Term Loans & Advances Given	XX		
e	Accrued Income	XX		
f	Short-term or Marketable Investments	XX		
	Total Quick or Liquid Assets (a to f)	XX		
I	Non-Current Assets	XX		
g	Inventory	XX		
h	Pre-payments (pre-paid expenses, advance for goods, advance tax)	XX	XX	
	Current Assets (a to h)			
Less:				
J.	Quick Liabilities			
a	Creditors / Trade Payables	XX		
b	Bills Payable	XX		
c	Advances Received	XX		
d	Outstanding Expenses	XX		
e	Accrued Interest	XX		
f	Provision for Tax	XX		
g	Unclaimed Dividend	XX		
h	Short Term Loans	XX		
	Total Quick Liabilities (a to h)	XX		
K.	Non-Quick Liabilities			

i	Bank Overdraft	XX		
j	Cash Credit	XX		
k	Incomes received in advance	XX		
	Current Liabilities (a to k)		(XX)	
	Net Current Assets or Working Capital (A - B)			X X
	Total Assets or Total Funds Employed			X X
	(Fixed Assets + Investments + Working Capital) (3 + 4 + 5)			

Notes

(1) Thus, a Vertical Analytical Balance Sheet differs from a Horizontal Balance Sheet in following respects

(a) Current Liabilities are deducted from the Current Assets;

(b) Fictitious Assets are deducted from the Owners' Funds. This should be kept in mind while converting a Horizontal Balance Sheet into a Vertical Balance Sheet.

(2) At times, Application of Funds (FA and WC) is shown first, followed by Sources of Funds (OF and LF).

EXPLANATION (MAIN HEADINGS)

The vertical form has two parts - I. Source of Funds and II. Application of Funds.

I. SOURCES OF FUNDS

A concern has two main sources of funds - 1. Own Funds and 2. Loan Funds.

1. Proprietors' or Own Funds OF

Proprietors' or Own Funds (or internal sources) mean (a) capital of the owners (proprietor, partners, or shareholders) and (b) Retained Earnings (or Reserves & Surplus). To arrive at the Net Worth or Owners' Funds, Capital and Reserves are added and the accumulated losses and fictitious assets are deducted. The accumulated losses (Profit and Loss A/c - Dr.

balance) and fictitious assets (Misc. Expenditure Not Written off) reduce the amount of funds available or attributable to the owners and hence have to be deducted to ascertain the owners' net worth.

2. Borrowed or Loan Funds [LF]

Borrowed or Loan Funds (Long Term Borrowings) constitute another major source of funds. Loan funds may be (a) Secured Loans like Debentures, bonds, Loans from banks, loans from financial institutions, or (b) Unsecured Loans e.g. public deposits. The total of Secured Loans and Unsecured Loans give the total amount of Loan Funds or 'Owed' funds.

Total Funds Available: The total of Own Funds and Owed Funds is the total amount of Funds Available to the concern as on date of the Balance Sheet. How these funds were actually employed or used is shown in the second part of vertical Balance Sheet, viz. Application of Funds.

II. APPLICATION OF FUNDS

The Total Funds Available are used to finance 1. Fixed Assets and 2. Net Current Assets (called Working capital).

1. Fixed Assets [FA]

The Fixed Assets (also known as Non-Current Assets) may be classified into Tangible, Intangible and Investments.

A. Tangible Assets have definite physical existence. ('Tangible' means that which can be 'touched'). Thus Land, Building, Machinery, Vehicle are tangible fixed assets. These are shown at net cost, i.e. cost less depreciation.

B. Intangible Assets cannot be seen (or 'touched'), but do earn income for the concern-such as Goodwill, Trade-mark etc.

Net Fixed Assets mean Fixed Assets less accumulated depreciation thereon till date (ICAN).

2. Long Term or Trade Investments

Long term or trade investments are those investments which are intended to be held for a long term (such as investments in immovable properties) or those which are held in the normal course of business (e.g. investment in the capital of a partnership firm). Investments in Government Securities shares, bonds, etc. may be Long Term or Short Term depending upon the circumstances.

3. Working Capital [WC]

Working Capital is represented by. the excess of current assets over current liabilities including short-term loans (ICAD). It means the funds available for conducting the day-to-day operations of the enterprise.

A. Current Assets [CA] : Investments in Fixed Assets is a permanent or long-term investment. A concern also has circulating funds, i.e. short-term assets like stock, debtors, etc. called current assets. These assets keep getting converted into cash. Those current assets which can be quickly converted into cash are called Liquid or Quick Assets.

B. Current Liabilities [CL]: Current Liabilities, on the other hand, are short-term liabilities payable within a year. These arise out of purchase of goods on credit, outstanding expenses etc. The excess of current assets over current liabilities is called Net Current Assets or Working Capital.

Total Fund or Capital Employed [CE]

Capital Employed means the finances deployed by an enterprise in its Net Fixed Assets, Investments and Working Capital (ICAI).

The amount of Total Funds used or employed is equal to Net Fixed Assets + Working Capital.

Vertical Balance Sheet structure can be analysed through the following equations:

(1) Own Funds + Loan Funds = Fixed Assets + Investments + Working Capital or OF + LF= FA + Inv. + WC

(2) TA (Total Assets) = FA + Inv. + CA = TL (Total Liabilities) = OF + LF+ CL

(3) CE (Capital Employed) = FA + WC = FA+ (CA - CL) = OF+ LE

(4) OF (Owners' Funds) = TA - CL - LF

The items to be included under each of the above main headings are described in detail below.

EXPLANATION (DETAILED ITEMS)
I. SOURCES OF FUNDS
1. Proprietors' Funds
A. Capital

Capital refers to the amount invested in an enterprise by its owner. It also refers to the interest of the owners in the assets of an enterprise (Guidance Note on Terms used in Financial Statements -ICAl henceforth mentioned as "GN by ICAI".)

In case of a Proprietor, Capital would be equal to
Opening Balance
Add Profit during year
Additional Capital brought in during year

Less Loss during year
Drawing during year
Closing Balance.

In case of a firm, capital would be the total of the closing balances of the Capital Accounts, determined as above, for all partners.

In case of a Limited Company; Capital would include (i) Equity Share Capital and (ii) Preference Share Capital. Under each type of share capital, the amount paid-up is shown. The paid-up amount is equal to Called up Amount Less Unpaid Calls Plus Forfeited Shares. Money received against share warrants (to be converted into shares) is also part of shareholders' funds.

B. Reserves & Surplus:

Reserves means the profit retained or ploughed back in business and not distributed as dividends. Reserves are defined as the portion of the earnings receipts or other surplus of an enterprise (whether capital or revenue appropriated by the management for a general or specific purpose (GN by ICAI).

(i) Capital Reserves: Capital Reserves are those reserves of a company which are not available for distribution as dividend (GN by ICAN. These are not created out of normal business profits of the company. They are created out of premium received on issue of shares, profit on sale of fixed assets. Capital redemption reserve (reserve created on redemption of preference shares), profit on forfeiture of shares etc. These are not available for payment of dividends.

(ii) General Reserve: General Reserve is a Revenue Reserve not earmarked for any specific purpose (GN by ICAD. This represents undistributed normal profits of the company. Profits may be distributed by way of dividends or retained by way of reserves.

(iii) Funds: Fund is a Reserve or a Provision represented by specifically earmarked asset (GN by ICAD. A Fund as Sinking Fund, Provident Fund, or Staff Benefit Fund denotes that the amount shown under that Fund has been invested in specific (earmarked) securities. In a vertical balance sheet, the amount of such earmarked investments is adjusted against the amount of Fund and only the net amount (Fund less Investment), is shown under 'reserves

C. Losses and Fictitious Assets The accumulated losses (Profit & Loss Account - Dr. balance) and Fictitious Assets, i.e. Misc Expenditure Not Written off are shown on the Assets side of the conventional balance sheet. However, in the Vertical balance sheet, these are deducted from the total of (a) Capital and (b) Reserves & Surplus to determine the net Equity or net Worth. These include- (i) Profit & Loss A/c - Dr. balance (ii) Miscellaneous expenses not written off (also known as Unamortized Expenses) –

(1) Share issue expenses
(2) Discount on issue of Shares
(3) Debenture issue expenses

(4) Discount on issue of debentures, and
(5) Premium payable on redemption of debentures.

Net Worth, also known as Shareholders Funds, means the excess of the book value of the assets (other than fictitious assets) of an enterprise over its liabilities (ICAI). Net worth is the same as Owners Funds or Proprietors Funds.

Owners' Funds = Capital + Reserves & Surplus - Losses & Fictitious Assets

2. Loan Funds

Loan or Liability means the financial obligation of an enterprise other than owner's funds (GN by ICAl). This are the long-term Borrowings.

This is the Second Source of finance for a concern. The distinction between the Proprietors Funds (own Funds) and the Loan Funds (owed Funds) is as follows:

EXHIBIT 2: OWN FUNDS VS. OWED FUNDS

No.	Own Funds	Owed Funds
1	Internal source of finance	External source of finance.
2	Represents claim of outsiders on the assets of the concern.	Represents claims of owners on the assets of the concern.
3	Own Funds i.e. Capital earns dividends.	Owed Funds, i.e. Loans earn interest
4	Dividends are paid out of profits ("appropriations out of profits') and the rate may vary.	Interest is charged against profits (i.e. paid irrespective of profit or loss), at a fixed rate
5	In liquidation, own funds are returned last. Hence Own Funds are called "Permanent Funds.'	In Liquidation, Owed Funds are repaid before capital. Even otherwise, loans have to be repaid according to the terms of the agreement. Hence, Owed Funds are called "Semipermanent Funds."
6	Own Funds are not 'secured' by charge on assets.	Loans may be secured by charge on Fixed or Current Assets.

A. Secured Loans:

Loans may be for Secured or Unsecured.

Secured loans (also called Fixed Liabilities) consist of:

(i) Debentures or Bonds repayable after a fixed period.

(ii) Bank Loans

(iii) Loans from Financial Institutions

B. Unsecured Loans:

Public Deposits are deposits kept by public for a fixed period which are unsecured.All Loans, other than Secured Loans, would be shown as Unsecured Loans.

(1) Total Owed Funds = Secured Loans + Unsecured Loans

(2) Total Funds Available = Own Funds + Owed Funds

I. APPLICATION OF FUNDS

1. Fixed Assets:

Following items are included under Fixed Assets (also known as Non-Current Assets):

A. Tangible Assets (at cost less depreciation)

(i) Land and Buildings

(ii) Leasehold Property

(iii) Railway Sidings

(iv) Plant & Machinery

(v) Furniture & Fittings

(vi) Development of Property

(vii) Live Stock

(viii) Vehicles etc.

B. Intangible Assets

(i) Goodwill

(ii) Patents, Copyrights, Trade-marks and designs

Fixed Assets = Tangible Assets (net cost) + Intangible Assets

2. Long Term Investments

Investments may be long-term or short-term. If for example, bonds of an Electricity Undertakinghave to be compulsorily purchased so as to obtain power connection, these will be held as long as the concern exists. Hence these will be Long Term Investments. If any investment represents a Fund shown under Reserves (e.g., Provident Fund Investment), it is adjusted against the balance of the Fund. If the net balance is Debit (i.e., Investment exceeds Fund), only the net Dr. is shown as Investment; if the Fund exceeds Investment the net Cr. balance is shown under Reserves. Short Term Investments are shown as a part of Current Assets.

3. Working Capital

Working Capital means the net current assets or the excess of Current Assets over Current Liabilities.

A. Current Assets:

Current Assets (or Floating Assets) mean those assets which move through the operating cycle of the business viz. through the stages of purchase of raw materials (Stock) production of finished goods (Stock) sales of goods (Cash/Debtors) Realisation of Debtors (cash) and so on. Current assets mean the assets like stock, debtors and cash which move in a cycle. Thus stock is converted by sales into debtors, debtors get converted by realisation of dues into cash, cash is used for buying goods and again the cycle is repeated. Current assets are short term assets unlike fixed assets which are long term assets.

The following item are included under Current Assets:

(a) Stock

1. Stores and spare parts

2. Stock-in-trade

(Raw Materials - Finished Goods + Packing Materials)

3. Work-in-progress.

(b) Debtors

Gross amount

Less : Provision for bad & doubtful debts

(c) Cash and Bank

1. Cash on hand

2. Bank balances

3. Cash Equivalents e.g. liquid deposits

(d) Loans & Advances Given

1. to subsidiaries

2. to firms etc.

(e) Marketable Investments i.e. temporary investments made out of surplus funds.

(f) Other Current Assets

1. Interest accrued on investments

2. Loose tools

3. Bills of exchange

4. Pre-payments (pre- paid expenses, advance for goods, advance tax paid)

5. Balances with customs. Port trust etc. (Payable on demand).

Thus,
Current Assets = Stock + Debtors + Cash and Bank + Loans & Advances+ Marketable Investments + Other Current Assets

Quick Assets :

Quick assets are the following items of Current Assets, which are 'quickly realisable'-

(a) Cash & Bank

(b) Debtors (net) / Trade Receivables

(c) Bills Receivable

(d) Loans

(e) Marketable (Current / Short-term) Investments

(f) Other e.g. Accrued Income

Or

Quick Assets = Current Assets Less Inventories & Pre-payments

(Note: Pre-payments : Pre-paid Expenses, Advances for Goods & Advance tax)

B. Current Liabilities:

Current Liabilities include the following items

(a) Sundry creditors for supply of goods or services (Trade Payables).

(b) Bills Payable

(c) Advances Received

(d) Outstanding expenses

(e) Accrued Interest

(f) Provision for tax

(g) Unclaimed Dividends

(h) Short Term Loans

Notes :

(1) Current maturities of long-term debts e.g. Debentures / Loans (whether Secured or Unsecured) repayable within 1 year should be shown as Current Liabilities

(2) Dividends proposed but not yet approved by shareholders are shown by way of a Note toAccounts. No provision is made for proposed dividends w.e.f. FX. 2016-17 (vide MCA/ICAIAmended Accounting Standard 4)

Quick Liabilities:

Quick Liabilities are those current liabilities which are payable in a short period of time. Bank Overdraft is not, in practice, immediately payable. So,

Quick Liabilities = Current Liabilities - Bank Overdraft

Working Capital = Current Assets - Current Liabilities

Total Funds Applied = Net Fixed Assets + Investments + Working Capital

This is always equal to Total Funds Available.

2.5 INCOME STATEMENT

Vertical Income Statement of ……….. for the year ended …………

Particulars	Amount	Amount	Amount
I. Sales			
Cash Sales		XX	
Credit Sales		XX	
Gross Sales		XX	
Less: Returns and Allowances		(XX)	
Net Sales			XX
Less:			
II. Cost of Goods Sold			
Opening Stock		XX	
Add:			
Purchases	XX		
Direct Expenses	XX		
Carriage Inward/Freight Inward	XX		
Octoroi Duties/Import Duties	XX		
Direct Wages	XX		

Factory lighting	XX		
Fuel, coal, oil	XX		
Depreciation on Plant and Machinery	XX		
Depreciation on Factory Premises	XX	XX	
Less:			
Closing Stock	(XX)		
Goods Damaged by fire	(XX)		
Goods lost by theft	(XX)	(XX)	
Cost of Goods Sold			(XX)
III. Gross Margin (III = I - II)			XX
Add:			
IV. Operating Incomes			
Discount received (on Purchases)		XX	
Bad Debts Recovered		XX	XX
Less:			
V. Operating Expenses			
A. Office and Administrative Expenses			
Salaries	XX		
Rent, Rates and Taxes	XX		
Office Lighting	XX		
Printing and Stationery	XX		
Insurance premium	XX		
Postage	XX		
Depreciation on Furniture	XX		
Depreciation on Office Premises	XX		
Depreciation on Computers/Laptops	XX		
Miscellaneous expenses/General Expenses	XX	XX	
B. Selling and Distribution Expenses			
Salary sales staff	XX		
Commission charges	XX		
Advertising expenses	XX		

Carriage outward	XX		
Packing expenses	XX		
Depreciation on delivery vans	XX		
*Bad Debts	XX	XX	
C. Finance Expenses			
Interest on bank overdraft	XX		
Interest on cash credit	XX		
Discount allowed	XX		
Bank charges	XX		
Bank commission	XX		
**Bad Debts	XX	XX	
Total Operating Expenses			(XX)
VI. Net Operating Profit (VI = III + IV - V)			XX
Less:			
VII. Interest on Long Term Borrowings			
Interest on Loans		XX	
Interest on Debentures		XX	
Interest on Public Deposits		XX	(XX)
VIII. Net Profit (VIII = VI - VII)			XX
Add:			
IX. Non-Operating Income			
Dividend and interest on investments		XX	
Rent received		XX	
Profit on Sale of Investments/Fixed Assets		XX	XX
Less:			
X. Non-Operating Expenses			
Loss on Sale of Investments/Fixed Assets		XX	
Preliminary Expenses written off		XX	
Loss by fire/Theft/Accident		XX	(XX)
XI. Net Profit Before Tax (XI = VIII + IX - X)			XX

Less: Provision for Tax			(XX)
XII. Net Profit After Tax			XX
Add: Opening Balance of Retained Earnings/P&L A/c			(XX)
XIII. Net Profit Available for Appropriations			XX
Less:			
XIV. Appropriations			
Transfer to General Reserve		XX	
Transfer to Reserves		XX	
Dividend on Preference Shares/Equity Shares		XX	
Interim Dividend		XX	(XX)
XV. Closing Retained Earnings (XV = XIII - XIV)			XX

*Bad Debts can be alternatively treated as Financial Expenses.

From the above rearrangement of operating statements, thefollowing accounting equations may be given:

1. Net Sales = Cost of sales + operating expenses + Nonoperating expenses

2. Gross Profit = Net sales – Cost of goods sold

3. Net operating profit = Gross profit – operating expenses

4. Gross Sales:Gross sales also called ‘ Turnover’ is the amountof total sales of goods and services. This includes both cashand credit sales.

Gross sales = Credit sales + cash sales

5. Cost of Goods Sold: This is the cost of purchases or cost ofmanufacturing the goods, which are sold during the year.

Cost of Goods Sold = Opening stock + Purchases + Direct

Expenses + Depreciation – less closing stock

6. Gross Profit:

This is the major source of operating income of anorganization. This is the amount of profit earned on purchases,manufactures and sales of goods and services.

Gross Profit = Net Sales – Cost of goods sold

7. Operating Expenses:These are the expenses incurred in the course of normalconduct of business, which are related to the business

activities.Broadly, operating expenses areclassified into the followingcategories.

a) Administrative Expenses: These are the expenses pertainingto general office administrative of an organization.

b) Selling and Distribution Expenses: These are the expensesincurred for the purpose of increasing and maintaining thesales, distributing and delivering the goods.

c) Finance Charges: This includes: Cash discount, Bad debts (Abnormal), Bank charges, bank Commission.

Operating Expenses = Administrative Expenses + Selling & Distribution Expenses + Finance Expenses

8. Operating Profit: Excess of operating income over operating expenses is called net operating profit. This is the amount of profit earned during the normal course of business.

Operating profit may be:

a) Operating Profit before Interest: Gross Profit - Operating expenses (Before Interest)

b) Operating Profit After Interest : Operating profit (before Interest) – Interest

9. Non-operating Income:Income not related to the ordinary course of business i.e., Interest on investment is not an operating income to a company, which is engaged in buying and selling of goods and services of goods. But for an investment company, interest will be considered as an operating income.

10. Non-Operating Expenses: These are the expenses, which do not relate to day-to-day conduct of business operations. These expenses arise due to certain unusual events and unexpected occurrences.

11. Net Profit: This is the excess of total operating and nonoperating income over the total operating and non-operating expenses. It is therefore, ultimate profit earned by the organization.

a) Net Profit before Tax = Net operating profit + Net non-operating Income

b) Net profit After Tax =Net profit before tax - Income tax

12. Retained Earnings: Net profit after tax - dividend

Illustration 01:

Following is the Profit & Loss Account of Leena Ltd. for the year ended 31s March 2020. You are required to prepare Vertical Income Statement for the purpose of analysis.

Particulars	Amount	Particulars	Amount	Amount
To Opening Stock	14,00,000	By Sales:		
To Purchases	18,00,000	Cash	10,40,000	
To Wages	3,00,000	Credit	30,00,000	
To Factory Expenses	7,00,000	(-) Return & Allowance	40,40,000	
To Office Salaries	1,00,000			
			(20,000)	40,20,000
To Office Rent, Rates & Taxes	78,000			
To Postage and Telegram	40,000			
To Audit Fees	12,000			
To Salesman Salaries	24,000	By Dividend on Investment		1,00,000
To Promotion Expenses	76,000	By Closing Stock		14,00,000
To Delivery Expenses	40,000	By Profit on sale of Machinery		80,000
To Debenture Interest	60,000			
To Depreciation:	-			
On Office Furniture	1,00,000			
On Plant	1,20,000			
On Delivery Van	80,000			
To Loss on Sale of Van	10,000			
To Income Tax	3,50,000			
To Net Profit	3,10,000			
	56,00,000			56,00,000

In the books of Leena Limited

Vertical Income / Revenue Statement as on 31 March 2020

Particulars	Amount	Amount	Amount
SALES			
Cash		10,40,000	
Credit		30,00,000	40,40,000
Less : Returns			(20,000)
Net sales			40,20,000
Less : Cost of goods Sold			
Opening stock		14,00,000	
Add: purchase		18,00,000	
Add: Wages		3,00,000	
Add: Factory Expenses		7,00,000	
Add: Depreciation on plant		1,20,000	
		43,20,000	
Less: Closing stock		(14,00,000)	(29,20,000)
Gross margin / Gross profit			11,00,000
Add: Operating Income			
Less: Operating expenses			
(1) Office & administrative Exp			
Office salary	1,00,000		
Office Rent, Rate & Taxes	78,000		
Postage & telegram	40,000		
Directors fees	12,000		
Depreciation on office furniture	1,00,000	3,30,000	
(2) Selling & Distribution			
Salesmen salary	24,000		
Promotion Expenses	76,000		
Delivery Expenses	40,000		
Dep. On Delivery van	80,000	2,20,000	
(3) Finance Expenses		-	
Total Operating Expenses			(5,50,000)
Operating Profit			5,50,000
Debenture Interest			(60,000)

Net Profit			4,90,000
<u>Add:Non-operating Income</u>			
Dividend on investment		1,00,000	
Profit on sale of furniture		80,000	1,80,000
			6,70,000
<u>Less: Non -operating exp</u>			
Loss in Sale of Van			(10,000)
Net profit before tax			6,60,000
Less: taxation			(3,50,000)
Net profit after tax			3,10,000

Illustration 02:

Profit & Loss account of Dani Ltd. For the year ended 31st October 2020

Particulars	Amount	Particulars		Amount
To Opening Stock	1,98,250	By Sales:	13,26,000	
To Purchases	8,19,650	Less Returns	(26,000)	13,00,000
To Wages	18,200	By Closing Stock		2,56,100
To Staff Salaries	52,000			
To Sales Salaries	39,780			
To Interest	3,120	By Interest on Debenture		3,900
To Office Rent	7,020	By Dividend on Shares		15,860
To Printing and Stationery	6,500	By Profit on sales of shares		10,140
To Carriage Outward	12,220			
To Discount	6,240			
To Depreciation	24,180			
To Insurance	2,600			
To Motor Bill	910			
To Salesmen's Travelling Exp.	5,200			
To Bad Debts	8,840			
To Telephone Expenses	1,950			

To Legal Charges	5,200			
To Director's Fees	11,440			
To Income Tax	1,24,800			
To Loss on Sale of Bond	9,100			
To Provision for claim for damages	10,400			
To Net Profit	2,18,400			
	15,86,000			15,86,000

Convert the above profit & loss A/c. of a company into a vertical revenue statement.

Solution:

In the books of Dani Limited

Vertical Income / Revenue Statement as on 31 March 2020

Particulars	Amount	Amount	Amount
Sales			13,26,000
Less: Returns			(26,000)
Net sales			13,00,000
Less: Cost of goods Sold			
Opening stock		1,98,250	
Add: Purchase		8,19,650	
Add: Wages		18,200	
		10,36,100	
Less: Closing stock		(2,56,100)	(7,80,000)
Gross margin / Gross profit			5,20,000
Add: Operating Income			-
			5,20,000
Less: Operating expenses			
(1) Office & administrative Exp			
Staff salaries	52,000		
Office Rent	7,020		
Printing & Stationery	6,500		
Depreciation	24,180		
Insurance	2,600		
Motor bill	910		
Telephone Expenses	1,950		

Legal Charges	5,200		
Directors Fees	11,440		
Carriage outward	12,220	1,24,020	
(2) Selling & Distribution			
Sales salaries	39,780		
Salesmen's traveling exp	5,200	44,980	
(3) Finance Expenses			
Interest	3,120		
Discount	6,240		
Bad Debts	8,840	18,200	(1,87,200)
Operating Net profit			3,32,800
Add: Non operating Income			
Interest on debenture		3,900	
Dividend on shares		15,860	
Profit on sale of shares		10,140	29,900
			3,62,700
Less: Non operating expenses			
Loss in sale of Bonds		9,100	
Provision for Claim for Damages		10,400	(19,500)
Net profit before tax			3,43,200
Less: taxation			(1,24,800)
Net profit after tax			2,18,400

Illustration 03:

The following information regarding Speed Car Ltd, for the year ended 31 March, 2020 is given to you

Particulars	**Amount Rs.**
Sales	37,50,000
Purchases	25,00,000
Opening Stock (1-4-2014)	2,50,000
Closing Stock (31-3-2015)	3,75,000
Return Inward	37,500
Carriage Outward	28,500
Carriage Inward	25,000
Return Outward	25,000
Salesman Salary	37,500
Advertising and Publicity	1,26,000

Salesman Traveling Allowance	3,750
Office Salary	2,00,000
Computer Repairs & Maintenance	42,000
Rent, Rates, Taxes	2,000
Printing & Stationery	200
Bad Debts	37,875
Purchases of Computer	20,000
Dividend on Shares (Cr.)	5,000
Staff Welfare Expenses	22,000
Interest (Dr.)	25,000
Loss on Sales of Shares	62,500

Rearrange above information in Vertical Form suitable for analysis.

Solution 03:

Vertical Revenue Statement for the year ending 31st March, 2015

Particulars	Amount	Amount
Gross Sales	37,50,000	
Less: Return Inward	(37,500)	
Net Sales		37,12,500
Less: Cost of Goods Sold		
Opening Stock	2,50,000	
Purchases	25,00,000	
Less: Return Outward	(25,000)	
Carriage Inward	25,000	
Less: Closing Stock	(3,75,000)	(23,75,000)
Gross Profit		13,37,500
Less: Operating Expenses		
Administration Expenses		
Office salaries	2,00,000	
Rent, rates and taxes	2,000	
Staff Welfare	22,000	
Printing & Stationery	200	
Computer Repairs & Maintenance	42,000	2,66,200
Selling & Distribution Expenses		
Salaries to salesmen	37,500	

Advertisement and Publicity	1,26,000	
Traveling Allowances	3,750	
Carriage Outward	28,500	
Bad Debts	37,875	2,33,625
Total Operating Expenses		(4,99,825)
Operating Profit before Interest		8,37,675
Less: Interest Paid		(25,000)
Net Profit after Interest		8,12,675
Net Non-operating Income		
Dividends on shares		5,000
Less: Non-Operating Expenses		
Loss on Sale-Shares		(62,500)
Net Non-Operating Income		(57,500)
Net Profit		7,55,175

Illustration 04

Balance sheet of Tanu Ltd. For the year ended 31st March 2020.
(₹ in '000)

Liabilities	**Amount**	**Assets**	**Amount**
	4,200	Trade Investments	1,680
Dividend Equilisation Reserve	588	Patent	252
General Reserve	924	Land and Building (Cost)	2,688
Profit and Loss Account	1,596	Plant and Machinery (Cost)	5,460
6% Debentures	2,100	Cash and Bank Balance	739
Cash Credit	1,260	Closing Stock	2,604
Sundry Creditors	1,764	Sundry Debtors	1,865
Unpaid Dividend	84	Bills Receivable	252
Bills Payable	504	Short Term Deposit with Customers	252
Provision for Tax	1,428	Underwriting Commission	504
Provision for Depreciation		Preliminary Expenses	252
Land and Building	420		
Plant and Machinery	1,680		
	16,548		16,548

Solution 04:

Vertical Balance sheet of Tanu Ltd. For the year ended 31st March 2020.
(₹ in '000)

	Particulars	Amount	Amount	Amount
	SOURCES OF FUND/EQUITY AND LIABILITY			
1	**Shareholders' Funds**			
	Equity Share Capital		4,200	
	Reserves & Surplus			
	Dividend Equalisation Reserve	588		
	General Reserve	924		
	P & LA/ c	1,596	3,108	
	Less: Fictitious Assets			
	Underwriting Commission	504		
	Preliminary Expenses	252	(756)	
	Networth			6,552
2	**Loan Funds**			
	Secured Loans			
	6% Debentures			2,100
	Total Sources of Funds			8,652
	APPLICATION OF FUNDS/ ASSETS			
3	**Fixed Assets**			
	Tangible Fixed Assets			
	Land & Building	2,688		
	Less Provision for Depreciation	(420)	2,268	
	Plant & Machinery	5,460		
	Less Provision for Depreciation	(1,680)	3,780	
	Total Tangible Assets		6,048	
	Intangible Fixed Assets			
	Patents		252	
	Total Fixed Assets			6,300
4	**INVESTMENTS**			
	Trade Investments			1,680

5	**CURRENT ASSETS, LOANS & ADVANCES**			
	Closing Stock	2,604		
	Liquid Assets			
	Sundry Debtors	1,865		
	Cash & Bank	739		
	Bills Receivable	252		
	Short Term Deposits	252		
	Total Current Assets		5,712	
	Less: CURRENT LIABILITIES & PROVISIONS			
	Cash Credit	1,260		
	Quick Liabilities			
	Sundry Creditors	1,764		
	Unpaid Dividend	84		
	Bills Payable	504		
	Provision for Tax	1,428		
	Total Current Liabilities		(5,040)	
	Working Capital			672
	Total Application of Funds			8,652

Illustration 05

The following balances appear in the books of M/s. Krushna & Sons. As on 31st March, 2020. You are required to prepare a Vertical Balance Sheet for financial analysis.

Particulars	**Amount (Rs.)**
Provision for Income Tax	26,000
Advance Tax	29,250
Marketable Investments	16,250
Profit & Loss Account - Credit Balance	26,000
Equity Share Capital	1,30,000
Bank Overdraft	29,250
Loan from Bank	56,875
Machinery	84,500

Preliminary Expenses	4,875
Sundry Debtors	29,250
General Reserve	22,750
Sundry Creditors	13,000
Stock	48,750
Building at Cost Less Depreciation	65,000
Cash and Bank	26,000

Solution 05:

in the books of M/s. Krushna & Sons Balance Sheet as at 31st March, 2014

	Particulars	Amount	Amount	Amount
A	**Sources of Funds**			
	Shareholders Funds			
	Share Capital			
	Equity Share Capital		1,30,000	
	(+) Reserves & Surplus			
	Profit & Loss A/c	26,000		
	General Reserve	22,750	48,750	
	(-) Fictitious Assets			
	Preliminary Expenses		(4,875)	
	Networth			1,73,875
B	Borrowed Funds			
	Loan from Bank			56,875
	Net Borrowings			2,30,750
	Application of Funds			
C	**Fixed Assets**			
	Building (Less : Depreciation)		65,000	
	Machinery		84,500	1,49,500
D	**Investments**			NIL
E	**Working Capital**			
	Current Assets			
	Advance Tax	29,250		
	Marketable Investments	16,250		
	Sundry Debtors	29,250		
	Stock	48,750		
	Cash at Bank	26,000		

	Total Current Assets (A)		1,49,500	
	Less : Current Liabilities			
	Provision for Income Tax	26,000		
	Bank Overdraft	29,250		
	Sundry Creditors	13,000		
	Total Current Liability (B)		(68,250)	
	Working Capital (A-B)			81,250
Total				**2,30,750**

Illustration 06

Following are the balances in the books of Hattrick Ltd., for the year ended 31st March,2020.

Particulars	**Amount Rs.**
11% Preference Share Capital	7,50,000
Administrative Expenses	4,50,000
Cash and Bank	37,500
Marketable Investments	3,00,000
Depreciation	2,62,500
Direct Labour	2,81,250
Equity Share Capital	11,25,000
Fixed Assets	52,50,000
Income Tax	6,63,750
Interest Paid	5,40,000
Inventories	22,50,000
Long Term Investments	1,50,000
Other Current Liabilities	75,000
Other Direct Expenses	1,80,000
Provision for Expenses	2,43,750
Raw Materials Consumed	29,25,000
Reserves and Surplus	2,62,500
Sales	60,00,000
Secured Term Loans	45,00,000
Selling Expenses	97,500
Trade Payables	12,56,250
Trade Receivables	13,87,500
Unsecured Term Loans	5,62,500

You are required to prepare vertical Income Statement for the year ended 31st March, 2020 and vertical Balance Sheet as on that date for analysis.

Solution 06:

Hattrick Ltd. Vertical Income Statement for the year ended 31st March 2020

Particulars	Amount	Amount
Sales	60,00,000	60,00,000
Less: Cost of Goods Sold		
a) Raw Material Consumed	29,25,000	
b) Other Direct Expenses	1,80,000	
c) Direct Labour	2,81,250	
Cost of Goods Sold		(33,86,250)
Gross Profit		26,13,750
Less: Operating Expenses		
a) Administration Expenses	4,50,000	
b) Depreciations	2,62,500	
c) Selling Expenses	97,500	
Total Operating Expenses		(8,10,000)
Operating Profit Before Interest		18,03,750
Less: Interest		-
Net Profit before tax		18,03,750
Less: Income Tax		-
Net Profit After Tax		18,03,750

Particulars	Amount	Amount
SOURCES OF FUND/EQUITY AND LIABILITY		
1 Shareholders Funds		
Equity Share Capital	11,25,000	
11% Prof. Share Capital	7,50,000	18,75,000
Add : Reserve Supluses		2,62,500
P/LA/c (N.P.)		6,00,000
Share Holders Fund		27,37,500
2 Loan Funds		
a) Secured Terms Loan	45,00,000	
b) Unsecured Term Loan	5,62,500	50,62,500
Total Sources of Funds		78,00,000
APPLICATION OF FUNDS/ ASSETS		
I. Fixed Assets		52,50,000
II. Investment		1,50,000
III. Working Capital		
A Current Assets		
Cash and Bank	37,500	
Marketable Investment	3,00,000	
Inventories	22,50,000	
Trade Receivable	13,87,500	39,75,000
B. Less : Current Liabilities		
Other Current Liabilities	75,000	
Provision for Expenses	2,43,750	
Trade Payables	12,56,250	(15,75,000)
Working Capital (A - B)		24,00,000
Total Application of Funds		78,00,000

Illustration 07(Adjustment based sum)

The following figures are related to the Sara Ltd. for the year ended 31st March, 2020.

Particulars	Amount	Particulars	Amount
Sales	14,40,000	Staff Salaries	24,000
Net Block	6,00,000	Advertisement Expenses	36,000
Bills Receivable	2,40,000	Warehouse Rent	18,000
Bills Payable	1,20,000	Depreciation on Plant	30,000
Cash Balance	51,000	Interest on Overdraft	18,000
Bank Overdraft	1,20,000	Share Capital	4,80,000
Purchases	10,80,000	Reserves (1-04-2017)	2,19,000
Other Administrative Exp.	24,000	Stock (1-04-2017)	2,16,000
Legal Charges (Paid)	18,000	Lap Top Repairs	15,000
		Direct Expenses	9,000

Other Information:

i) Make a provision for Income Tax of ₹ 1,44,000.

ii) Provide final dividend ₹ 48,000.

iii) Closing stock on 31st March, 2020 is ₹ 2,40,000.

You are required to prepare Balance Sheet and Income Statement in vertical form suitable for analysis for the year ended 31" March, 2020.

Solution 07:

Sara Ltd. Vertical Income Statement for the year ended 31st March 2020

Particulars	Amount	Amount
Sales		14,40,000
Less: Cost of Goods Sold		
Opening Stock	2,16,000	
Add: Purchases	10,80,000	
	12,96,000	
Less: Closing Stock	(2,40,000)	
	10,56,000	
Direct Expenses	9,000	
Depreciation on Plant	30,000	
Cost of Goods Sold		(10,95,000)
Gross Profit		3,45,000
Less: Administrative Expenses		
Legal Charges	18,000	
Staff Salaries	24,000	
Lap Top Repairs	15,000	
Other Administrative Expenses	24,000	81,000
Less: Selling and Distribution Expenses		
Advertising	36,000	
Warehouse Rent	18,000	54,000
Total Operating Expenses		(1,35,000)
Net Profit before Interest		2,10,000
Less: Interest on Overdraft		(18,000)
Net Profit before Tax		1,92,000
Less: Income Tax		(1,44,000)
Net Profit after Tax		48,000

Vertical Balance Sheet as on 31st March 2020

Particulars	Amount	Amount
SOURCES OF FUND/EQUITY AND LIABILITY		
1. Shareholders Funds		
Share Capital	4,80,000	
Add: Reserve &Surpluses	2,19,000	6,99,000
Total Sources of Fund		6,99,000
APPLICATION OF FUNDS/ ASSETS		
I. Fixed Assets		
Net Block		6,00,000
A. Current Assets		
Bill Receivable	2,40,000	
Closing Stock	2,40,000	
Cash	51,000	
	5,31,000	
B. Less: Current Liabilities		
Bills Payable	1,20,000	
Bank Overdraft	1,20,000	
Provision for Tax	1,44,000	
Bills Payable	48,000	
	(4,32,000)	
Net Current Assets (A - B)		99,000
Total Application of Funds		6,99,000

Note: Contingent liability

Proposed dividend ₹ 48,000

Illustration 08:

From the following balances from the books of Account of Chika Ltd. for the year ended 31-03-2020 you are required to prepare vertical Income statement and vertical Balance Sheet.

Particulars	Amount	Particulars	Amount
Advertising	31,250	Sales Return	12,500
Interest Received	7,500	Bills Payable	53,750
Sales	15,00,000	10% Pref. Share Capital	1,87,500
Equity Share Capital	11,25,000	Debenture Interest	30,000
Salaries	2,25,000	Wages	2,31,250
Furniture and Fixture	2,50,000	Cash and Bank Balance	1,00,000
Outstanding Expenses	31,250	Debtors	2,50,000
P/LA/c (Credit Balance)	4,86,250	Opening Stock	62,500
Bad Debts	6,250	General Reserve	63,750
Purchases	7,50,000	Creditors	1,25,000
Machinery	9,37,500	8% Debentures	5,00,000
Preliminary Expenses	12,500	Income Tax	12,500
Closing Stock on 31-03-2020	1,87,500	Land & Building	8,75,000

Solution 08

Vertical Income Statement for the year ended 31st March, 2020

Particulars	Amount	Amount
Sales	15,00,000	
Less: Returns	(12,500)	
Net Sales		14,87,500
Less: Cost of Goods Sold		
Opening Stock	62,500	
Purchases	7,50,000	
Wages	2,31,250	
Less: Closing Stock	(1,87,500)	8,56,250
GROSS PROFIT		6,31,250
Less: OPERATING EXPENSES		
a) Administration Expenses		
Salaries	2,25,000	
b) Selling & Distribution Expenses		
Advertising	31,250	
Bad Debts	6,250	
	37,500	
Total Operating Expenses		(2,62,500)
Operating Profit Before Interest		3,68,750
Less: Interest on Debentures (WN)		(40,000)

Net Profit After Interest		3,28,750
Add: Non-operating Income		
Interest received		7,500
Net Profit Before Tax		3,36,250
Less: Income Tax		(12,500)
Net Profit After Tax		3,23,750

Vertical Balance Sheet as on 31st March 2020

Particulars	Amount	Amount
SOURCES OF FUND/EQUITY AND LIABILITY		
1 Shareholders Funds		
A Share Capital		
Equity Share Capital	11,25,000	
10% Pref. Share Capital	1,87,500	
		13,12,500
B Reserve & Surplus		
General Reserve	63,750	
Profit & Loss A/c- Cr. Balance	4,86,250	5,50,000
C Less: Fictitious Assets		
Preliminary Expenses		(12,500)
Own Fund/Net Worth		18,50,000
2 Loan Funds		
8% Debentures	5,00,000	
Add: Interest Accrued	40,000	5,40,000
Total Sources of Funds		23,90,000
APPLICATION OF FUNDS		
1 Fixed Assets		
Tangible Assets		
Land & Buildings	8,75,000	
Machinery	9,37,500	
Furniture & Fixtures	2,50,000	20,62,500
2 Working Capital		
A) Current Assets		
a) Quick Assets		
Cash and Bank	1,00,000	

Debtors	2,50,000	
b) Non-Quick Assets		
Inventory	1,87,500	
Total Current Assets (A)		5,37,500
B. Less: Current Liabilities		
a) Quick Liabilities		
Creditors	1,25,000	
Bills Payable	53,750	
Outstanding Expenses	31,250	
Quick / Current Liabilities		(2,10,000)
Working Capital (A - B)		3,27,500
Total		23,90,000

W.N. 1.

Interest on Debentures: 5,00,000 x 8% = 40,000

Illustration 09:

The following balances are extracted from the financial statements of Nano Products Ltd.

Balances as on 31st March, 2020

Particulars	Amount	Particulars	Amount
Bank Loan	4,00,000	Preliminary Expenses (Not yet w/0)	50,000
9% Preference Share Capital (R 100)	10,00,000	Stock (Closing)	8,00,000
Investments	5,00,000	10% Debentures	10,00,000
Trade Receivables	8,00,000	Bills Payable	2,00,000
Trade Payables	6,00,000	Land and Building	20,00,000
Goodwill	5,00,000	Equity Share Capital (R 10 each)	20,00,000
Bills Receivable	5,50,000	Bank Overdraft	1,00,000
Plant and Machinery	12,00,000	Cash and Bank Balance	1,50,000
Profit and Loss A/c (Cr.)	8,00,000	Furniture	8,00,000
Unclaimed Dividend	40,000	General Reserve	8,50,000
Prepaid Expenses	1,00,000	Advance Tax	4,00,000
Provision for Taxation	6,60,000	Cash Credit	2,00,000

You are required to prepare Balance Sheet in vertical form suitable for analysis.

Vertical Balance Sheet of Nano Products Ltd.

Particulars	Amount	Amount	Amount
SOURCES OF FUNDS			
1 Owner's Funds			
A. Capital			
Equity Share Capital (R 10 each)	20,00,000		
9% Preference Share Capital (R 100)	10,00,000	30,00,000	
B. Reserves and Surplus			
General Reserve	8,50,000		
Profit and Loss A/c (Cr.)	8,00,000	16,50,000	
Less : Preliminary Expenses (not w/o)		(50,000)	
Own Funds or Net Worth			46,00,000
II Loan Funds			
10% Debentures		10,00,000	
Bank Loan		4,00,000	14,00,000
Capital Employed [1 + 2]			60,00,000
APPLICATION OF FUNDS			
I Fixed Assets			
A Tangible			
Land and building	20,00,000		
Plant and Machinery	12,00,000		
Furniture	8,00,000		
Net Tangible Assets		40,00,000	
B. Intangible			
Goodwill		5,00,000	45,00,000
Total Fixed Assets			
II Investments			5,00,000
III Working Capital			
A Current Assets			
<u>Quick Assets</u>			
Cash and Bank	1,50,000		
Trade Receivables	8,00,000		
Bills Receivable	5,50,000		
Total Liquid Assets		15,00,000	
<u>Non-Quick Assets</u>			
Stock (closing)	8,00,000		
Prepaid expenses	1,00,000		

Advance tax	4,00,000		
Total Illiquid Assets		13,00,000	
Total Current Assets (A)		28,00,000	
B. Less: Current Liabilities			
<u>Quick Liabilities</u>			
Trade Payables	6,00,000		
Bills Payable	2,00,000		
Provision for Taxation	6,60,000		
Unclaimed Dividend	40,000		
Total Quick Liabilities		15,00,000	
<u>Non-Quick Liabilities</u>			
Bank Overdraft		1,00,000	
Cash Credit		2,00,000	
Total Non-Quick Liabilities		3,00,000	
Total Current Liabilities (B)		(18,00,000)	
Working Capital (A - B)			10,00,000
Capital Employed [1 + 2]			60,00,000

Illustration 10:

Balances as on 31st March, 2020

Liabilities	**Amount**	**Assets**	**Amount**
Bills Payable	32,500	Fixed Assets	1,62,500
Sundry Creditors	65,000	Sundry Debtors	65,000
Debentures	1,30,000	Bank Balance	32,500
Reserves	65,000	Inventory	1,62,500
Equity Share Capital	65,000		
Preference Share Capital	65,000		
	4,22,500		4,22,500

Profit and Loss A/c for the year ended 31-3-2020

Particulars	Amount	**Particulars**	**Amount**
To Opening Inventories	97,500	By Sales	6,50,000
To Purchases	1,95,000	By Closing Inventories	1,62,500
To Manufacturing Expenses	65,000	By Profit on Sale of Shares	32,500
To Direct Wages	1,30,000		
To Administration Expenses	32,500		
To Selling Expenses	32,500		
To Loss on Sale of Asset	35,750		
To Interest on Debentures	6,500		
To Net Profit	2,50,250		
	8,45,000		8,45,000

Solution 10:

In the Books of Srivalli Ltd.

Vertical Income Statement for the Year Ended on 31-3-2020

Particulars	Amount	Amount	Amount
1 Net Sales			6,50,000
2 Less: Cost of Goods Sold :			
Opening Stock	97,500		
Add : Purchases	1,95,000		
Manufacturing Expenses	65,000		
Direct Wages	1,30,000		
Less : Closing Stock		(1,62,500)	
Cost of Goods Sold			(3,25,000)
Gross Profit (1 - 2)			3,25,000
3 Less : Operating Expenses			
Administration Expenses		32,500	
Selling and Distribution Expenses		32,500	(65,000)
4 Operating Profit			2,60,000
5 Less : Interest Paid			
Interest on Debentures			(6,500)
6 Net Profit After Interest			2,53,500

7 Add: Non-operating Income			
Profit on Sale of Shares			32,500
8 Less: Non-operating Expenses			
Loss on Sale of Asset			(35,750)
9 Net Profit befor Tax			2,50,250

Balance Sheet as on 31st March, 2020

Particulars	Amount	Amount	Amount
SOURCES OF FUNDS			
1 Owner's Funds			
A Capital			
Equity Share Capital		65,000	
Preference Share Capital		65,000	1,30,000
B Reserves and Surplus			
General Reserve			65,000
Own Funds / Net Worth			1,95,000
2 Loan Funds			
Debentures or Bonds			1,30,000
Capital Employed			3,25,000
APPLICATION OF FUNDS			
1 Fixed Assets			1,62,500
2 Working Capital			
A Current Assets			
Cash and Bank	32,500		
Debtors	65,000		
Quick Assets	97,500		
Stock	1,62,500		
Total Current Assets (A)		2,60,000	
B Less : Current Liabilities			
Creditors	65,000		
Bills Payable	32,500		
Total Current/Quick Liabilities (B)		(97,500)	
Working Capital (A - B)			1,62,500
Capital Employed			3,25,000

Exercise:

True and False

1. Balance sheet shows result of activities F
2. Subscribed capital is the capital subscribed by the investors. T
3. Goodwill is shown under fictitious assets. F
4. Working capital is equal to capital employed. F
5. All current liabilities are quick liabilities. T
6. Fictitious assets can be converted in cash. F
7. For a petrol company, stock of petrol is liquid asset. F
8. Owed funds comes under internal source of Finance. T
9. Unclaimed Dividends are classified as Quick liabilities in vertical financial statements. F
10. Advance to suppliers for stock classified as current assets in vertical statements. T

SHORT NOTES

1. Financial statement's objectives
2. Users of financial statements
3. Own funds
4. Quick liabilities
5. Working capital
6. Limitations of financial statements
7. Cost of goods sold
8. Operating expenses.
9. Operating profit

Unsolved Illustration

Problem 01:

Following Trial Balance was extracted from the books of M/s. Aisha Pvt. Limited for the year ended 31st Dec 2020.

Particulars	Amount	Particulars	Amount
Land and Building	1,35,000	Sundry Creditors	45,900
Plant and Machinery	2,48,400	Reserves	22,500
Furniture and fittings	5,400	Profit and Loss A/c - 1/1/2020	37,950
Preliminary Expenses	7,350	Creditors for goods	16,770
Calls in Arrears (20per share)	3,750	Return Outwards	7,500
Cash in hand	750	Sales	4,61,700
10% Govt. bonds (F.V.10,000)	14,820	Share Capital	3,00,000
Bills Receivable	34,500	8% Debentures	1,50,000
Delivery Van	4,500		
Goodwill	24,000		
Sundry Debtors	31,200		
Purchases	3,60,000		
Free sample distributed	3,810		
Sales return	10,500		
Legal Fees	1,500		
Carriage Inwards	5,550		
Wages	34,800		
Rent Rates and Insurance	4,350		
Stock	71,400		
Prepaid Expenses	4,200		
Require to Furniture	2,250		
Repairs to plant and Machinery	1,290		
Inteim Dividend Paid	30,000		
Salaries	3,000		
	10,42,320		10,42,320

Additional Notes:

You are requied to prepare Profit and Loss A/c and the Balance Sheet in Vertical Format as per Management Accounting after taking into consideration the following statements.

(1) Charge 5% depreciation on Plant and Machinery, 7.5% on Furniture and Fittings and 20% on delivery van.

(2) Closing Stock was Rs.81,300 as on 31st March,2020

(3) The directors have proposed a final dividend of 6% on paid up share capital.

(4) Interest on Govt. Bonds and Debentures in due for the year 2020.

Problem 02:

Following information regarding M/s. Savita Ltd. for the year ended 31st March, 2020 is given.

Particular	Amount	Particular	Amount
Sales	15,00,000	Return Inwards	37,500
Opening stock of Raw material	82,500	Purchases of Raw material	3,75,000
Staff Salaries	1,12,500	Commission Allowed	3,750
Salesmen Salaries	18,750	Proposed Dividend	1,12,500
Bank Charges	7,500	Exhibition Expenses	26,250
Freight Inwards	30,000	Repairs of Computer	3,750
Office Rent & Insurance	33,750	Closing stock of work-in-progress	30,000
Debenture Interest	37,500	Wages	52,500
Loss on sale of machinery	7,500	Purchases of Finished goods	60,000
Printing & Stationery	3,750	Interest received on Investment	30,000
Direct Expenses	37,500	Provision for Income Tax	1,50,000
Profit & Loss A/c (Credit)	1,80,000	Closing stock of Raw Material	60,000
Depreciation on patterns	7,500	Sale of scrap	15,000
		Depreciation on machinery	15,000

You are required to Rearrange the above information and prepare vertical income statement, suitable for analysis.

Problem 03:

The following balances appear in the books of M/s. Bhavana Ltd. for the year ended 31st March, 2020, you are required to prepare a Revenue statement in vertical form

Dr. Cr.

Particular	Amount	Particular	Amount
Opening Stock	1,06,250	Sales Return	42,500
Net Profit b/f from P.Y.	1,27,500	Profit on Sale of Investment	10,625
Office Rent	10,625	Loss by Fire	10,625
Carriage Inward	42,500	Closing Stock	85,000
General Reserve	85,000	Purchases	4,25,000
Wages	1,53,000	Postage and Telegram	10,625
Octroi	10,625	Provision for Tax	63,750
Office Staff Salaries	85,000	Sales	13,17,500
Audit Fees	42,500	Dividend on Shares Held	53,125
Advertisement	53,125	Carriage Outward	10,625
Finance Expenses	53,125	Warehouse Expenses	10,625
Loss on Sale of Asset	63,750	Import Duty	6,375
Depreciation on:		Proposed Dividend	74,375
Plant and Machinery	31,875		
Furniture	34,000		
Delivery Van	29,750		

Problem 04:

Following is the Profit and Loss Account of Gehna Limited for the year ended 31st March, 2011.

Particular	₹	₹	Particular	₹	₹
To Opening Stock		7,91,000	By Sales		
To Purchase		10,17,000	Cash	5,87,600	
To Wages		1,69,500	Credit	16,95,000	
To Factory Expenses		3,95,500		22,82,600	
To Office Salaries		28,250	Less: Returns & Allowance	(22,600)	22,60,000
To Office Rent		44,070			
To Postage & Telegram		5,650			
To Directors Fees		6,780	By Closing Stock		6,78,000
To Salesman Salaries		13,560	By Dividend on Investment		11,300
To Advertising		20,340	By Profit on sale of Furniture		22,600
To Delivery Expenses		22,600			
To Debenture Interest		22,600			
To Depreciation					
On Office Furniture	11,300				
On Plant	33,900				
On Delivery Van	22,600	67,800			
To Loss on Sale of Van		5,650			
To Income Tax		1,97,750			
To Net Profit		1,63,850			
		29,71,900			29,71,900

You are required to prepare Vertical Income Statement for purpose of analysis.

Problem 05:

The following balances are extracted from the financial statements of Sameer Products Ltd.

Balance Sheet as on 31st March, 2020

Liabilities	Amount	Assets	Amount
Bank Loan	1,50,000	Preliminary Expenses	18,750
(10% preference Share)		(Net yet written off)	
Capital (R 100)	3,75,000	Stock (closing)	3,00,000
Investments	1,87,500	10% Debentures	3,75,000
Trade Receivables	3,00,000	Bills Payable	75,000
Trade Payables	2,25,000	Land & Building	7,50,000
Goodwill	1,87,500	Equity Share Capital « 10 each)	7,50,000
Bills Receivable	2,06,250	Bank Overdraft	1,12,500
Plant & Machinery	4,50,000	Cash & Bank Balance	56,250
Profit & Loss A/c (Cr.)	3,00,000	Furniture	3,00,000
Unclaimed Dividend	15,000	General Reserve	3,18,750
Prepaid Expenses	37,500	Advance Tax	1,50,000
Provision for Taxation	1,72,500	Proposed Dividend	75,000

You are required to Prepare Balance Sheet in vertical form suitable for analysis.

Problem 06:

From the information given below prepare a Balance Sheet in a vertical form suitable for analysis.

Particulars	Amount (₹)
Current Account with IDFC Bank	60,000
Land and Building	9,60,000
Advance Payments	74,400
Stock	3,27,600
Creditors	4,87,200
Debtors	6,27,600
Bills Receivable	25,200
Plant and Machinery	6,52,800
8% Debentures	3,00,000
Loan from a Director	62,400
Equity Share Capital	12,00,000
Profit and Loss Account	2,60,400
Trade Investments	24,000
Proposed Dividend	1,03,200

Advance Tax	1,20,000
Provision for Taxation	3,16,800
Bills Payable	21,600
General Reserve	1,20,000

Problem 07:

The balance sheet of Diana Ltd. is given for the year 2020. Convert them into vertical balance sheet.

Balance Sheet as on 31st March, 2004

Liabilities	Amount	Assets	Amount
Equity Shares	4,39,300	Building	4,60,000
Capital Reserve	1,61,000	Plant and Machinery	1,26,500
Revenue Reserve and Surplus	69,000	Furniture	46,000
Trade Creditors	92,000	Freehold Property	27,600
Bills Payable	1,38,000	Goodwill	69,000
Bank Overdraft	1,84,000	Cash Balance	46,000
Provisions	46,000	Sundry Debtors	80,500
		Inventories	1,31,100
		Investment (Temporary)	96,600
		Bills Receivable	46,000
	11,29,300		11,29,300

Problem 08:

Following is the Trial balance of M/s. Vanraj Ltd. as on 31" March, 2020.

Trial Balance

Particulars	**Amount (₹)**	**Amount (₹)**
Sales	-	2,40,000
Fixed Assets	1,20,000	-
Bills Receivable & Bills Payable	24,000	18,000
Cash and Bank Balance	6,000	-
Opening Stock	12,000	-
Bank overdraft	-	12,000
Purchases	1,50,000	-
Administrative Expenses	3,600	-
Legal Expenses	2,400	-
Salaries	6,000	-
Advertisement	4,800	-
Warehouse Rent	2,400	-
Depreciation on machinery	6,000	-
Interest on Bank overdraft	1,200	-
Equity share capital	-	72,000
General Reserve	-	12,000
Lap Top Repairs	2,400	-
Direct Expenses	2,400	-
Investment	4,800	-
Debtors and creditors	12,000	6,000
Total	3,60,000	3,60,000

Additional Information:

Closing stock on 31st March 2020 was valued at Rs.6,000

Cash sales were 1/3 of credit sales.

You are required to prepare vertical income statement for the year ended 31st March 2020 and

Vertical balance sheet as on that date for financial analysis.

Problem 09:

From the following Trial Balance of Urmila Ltd. as on 31st March, 2020.

Particulars	**Amount Rs.**	**Amount Rs.**
Equity Share Capital	-	25,74,000
Plant and Machinery	28,08,000	-
Sales	-	86,58,000
Purchases	39,78,000	-
Sundry Debtors	21,06,000	-
Sundry Creditors	-	19,89,000
Wages	8,19,000	-
Opening Stock	2,80,800	-
Salaries	4,21,200	-
Advertisement	1,75,500	-
Telephone Charges	81,900	-
Furniture	4,68,000	-
Investment (Long Term)	11,70,000	-
Interest Received	-	93,600
Loss on Sale of Furniture	46,800	-
Commission	1,40,400	-
Profit and Loss A/c	-	2,80,800
Interim Dividend	1,17,000	-
General Reserve	-	2,34,000
Cash At Bank	7,48,800	-
Bills Receivable	4,68,000	-
	1,38,29,400	1,38,29,400

Prepare vertical Revenue statement for the year ended 31st March, 2020 and vertical Balance sheet as on that date after making the necessary adjustments.

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3

COMPARATIVE STATEMENTS, COMMON SIZE STATEMENTS & TREND ANALYSIS COMPARATIVE BALANCE SHEET

Unit Structure

3.0 LEARNING OBJECTIVES

After studying this unit, the learners will be able to:

- Analyses the financial statements.
- Understand the limitations of financial statements.
- Solve the practical problems of analyses.

3.1 INTRODUCTION TO COMPARATIVE STATEMENT

A comparative balance sheet is a statement that shows the financial position of an organization over different periods for which comparison is made or required. The financial position is compared with 2 or more periods to portray the trend, direction of change, analyse and take suitable actions.

Advantages of Comparative Balance Sheet

1. Easy Comparison – It is easy to compare the figures for the current year with the previous years as it gives both the years' figures in one place. It also help in analysing the data of two or more companies or subsidiaries of one company.

2. Indicates Trend – It shows the company's trend by putting several years' financial figures at one place like an Increase or decrease in current assets, current liabilities, profit, loans, reserves & surplus, or any other items that help investors make decision.

3. Ratio Analysis – Financial ratio is obtained from the balance sheet items. The comparative balance sheet's financial ratio of two years of two companies can be derived to analyse the company's financial status. For example, the current ratio is obtained with the help of current assets and current liabilities. If the current ratio of the current year is more than the last year, it shows the company's liabilities have been reduced from last year against the existing assets.

4. Comparison with Industry Performance – Helps to compare one company's performance with another company or the industry's average performance.

5. Helps in Forecasting – It also helps in forecasting because it provides the past trend of the company based on which the management can forecast the company's financial position.

Limitation/Disadvantages

1.Uniformity in Principles and Policy– If two companies have adopted different policies and accounting principles while preparing the balance sheet ,Comparative balance sheet will not give the correct comparison.

2. Inflationary Effect is not Considered – The inflation effect is not considered, while preparing the comparative balance sheet. Therefore, only a comparison with other balance sheets will not give the correct picture of the company's trend.

3. Market Situation and Political Conditions not Considered – While preparing the comparative balance sheet, marketing conditions, political environment, or any factor affecting the company's business are not considered. Therefore, it does not give the correct picture every time. For example, suppose the overall economy is going down in the current year, or the political condition is unstable compared to last year. In that case, it will decrease the demand, and general company sales will experience de-growth, not because of its performance but due to external factors.

4. Misleading Information – Sometimes, it gives misleading information, thus, misguiding the person who reads the comparative balance sheet.

Illustration 01: Following is the Balance Sheet of M/s Rohan Ltd.

Liabilities	2019 ₹	2020 ₹	Assets	2019 ₹	2020 ₹
Share Capital	5,55,000	5,85,000	Fixed Assets	5,70,000	5,25,000
Reserve and Surplus	1,50,000	2,10,000	Investment	1,35,000	1,80,000
Current Liabilities	1,50,000	1,98,600	Current Assets	2,70,000	4,35,000
13 % Debentures	1,20,000	1,46,400			
	9,75,000	11,40,000		9,75,000	11,40,000

Prepare comparative balance sheet from the above in vertical form.

Solution 01

In the books of M/s Rohan Ltd.

Comparative Balance Sheet

Particulars	2019	2020	Absolute Increase/ Decrease	% Increase/ Decrease
I SOURCES OF FUNDS				
1. Owner's Funds				
Capital				
Equity Share Capital	5,55,000	5,85,000	30,000	5.41
Reserves and Surplus				
General Reserve	1,50,000	2,10,000	60,000	40.00
Own Funds or Net Worth	7,05,000	7,95,000	90,000	12.77
2. Loan Funds				
13% Debentures	1,20,000	1,46,400	26,400	22.00
Capital Employed (1 + 2)	8,25,000	9,41,400	1,16,400	14.11
ll. APPLICATION OF FUNDS				
1 Fixed Assets	5,70,000	5,25,000	(45,000)	(7.89)
2 Investments	1,35,000	1,80,000	45,000	33.33
3 Working Capital				
A Current Assets	2,70,000	4,35,000	1,65,000	61.11
B Less: Current Liabilities	1,50,000	1,98,600	48,600	32.40
Working Capital (A - B)	1,20,000	2,36,400	1,16,400	97.00
Capital Employed (1 + 2+3)	8,25,000	9,41,400	1,16,400	14.11

Illustration 02:

Following are the Balance Sheet of Helly Ltd. as on 31st March 2019 and 2020

Liabilities	2020 ₹	2019 ₹	Assets	2020 ₹	2019 ₹
Equity Share Capital	1,68,000	1,68,000	Fixed Assets	2,16,000	1,92,000
11 % Preference share capital	1,44,000	1,20,000	Investment	96,000	1,20,000
General Reserve	57,600	52,800	Current Assets	76,800	1,36,800
10 % Debentures	-	72,000	Preliminary Expenses	19,200	24,000
Current Liabilities	38,400	60,000			
Total	4,08,000	4,72,800	Total	4,08,000	4,72,800

Solution 02:

Particulars	2019	2020	Absolute Increase/ Decrease	% Increase/ Decrease
I. SOURCES OF FUNDS				
1. Shareholder's Fund				
(a) Equity Share Capital	1,68,000	1,68,000	-	-
(b) 11% Preference Share Capital	1,20,000	1,44,000	24,000	20.00
	2,88,000	3,12,000	24,000	8.33
(c) Reserve and Surplus:				
General Reserve	52,800	57,600	4,800	9.09
Owners Funds	3,40,800	3,69,600	28,800	8.45
Less: Preliminary Expenses	24,000	19,200	(4,800)	(20.00)
Net Worth	3,16,800	3,50,400	33,600	10.61
2. Loan Fund				
(a) Secured Loans				
10% Debenture	72,000	0	(72,000)	(100.00)
TOTAL FUNDS AVAILABLE (A)	3,88,800	3,50,400	(38,400)	(9.88)
B APPLICATION OF FUNDS:				
1. Fixed Assets	1,92,000	2,16,000	24,000	12.50
2. Investments	1,20,000	96,000	(24,000)	(20.00)
3. Working Capital	3,12,000	3,12,000	0	0
(i) Current Assets	1,36,800	76,800	(60,000)	(43.86)
(ii) Current Liabilities	60,000	38,400	(21,600)	(36.00)
Working Capital (i - ii)	76,800	38,400	(38,400)	(50.00)
APPLICATION OF FUNDS (B) (a + b + c)	3,88,800	3,50,400	(38,400)	(9.88)

Illustration 03:

Following are the Profit and Loss Accounts of M/s Pari Enterprises for the years ended 31st

Profit & Loss Account for the year ended 31st March 2019 and 2020

Particular	2019 ₹	2020 ₹	Particular	2019 ₹	2020 ₹
To Cost of sales	2,70,000	4,05,000	By Sales	4,05,000	5,40,000
To Salaries	27,000	27,000	By Interest	13,500	27,000
To Office Rent	13,500	20,250			
To Advertisement Expenses	40,500	16,200			
To Travelling Expenses	20,250	40,500			
To Income Tax	6,750	13,500			
To Net Profit c/d	40,500	44,550			
Total	4,18,500	5,67,000	Total	4,18,500	5,67,000

Prepare a comparative Income statement from the above, in vertical form.

Solution 03:

In the books of Helly Ltd.

Comparative Balance Sheet for the year ended:

Particulars	2019	2020	Absolute Increase/ Decrease	% Increase/ Decrease
I SOURCES OF FUNDS				
1 Shareholder's Fund				
(a) Equity Share Capital	1,68,000	1,68,000	-	-
(b) 11% Preference Share Capital	1,20,000	1,44,000	24,000	20.00
	2,88,000	3,12,000	24,000	8.33
(c) Reserve and Surplus:				
General Reserve	52,800	57,600	4,800	9.09
Owners Funds	3,40,800	3,69,600	28,800	8.45
Less: Preliminary Expenses	24,000	19,200	(4,800)	(20.00)
Net Worth	3,16,800	3,50,400	33,600	10.61
2 Loan Fund				
(a) Secured Loans				
10% Debenture	72,000	0	(72,000)	(100.00)

TOTAL FUNDS AVAILABLE (A)	3,88,800	3,50,400	(38,400)	(9.88)
B APPLICATION OF FUNDS:				
(a) Fixed Assets	1,92,000	2,16,000	24,000	12.50
(b) Investments	1,20,000	96,000	(24,000)	(20.00)
(c) Working Capital	3,12,000	3,12,000	0	0
(i) Current Assets	1,36,800	76,800	(60,000)	(43.86)
(il) Current Liabilities	60,000	38,400	(21,600)	(36.00)
Working Capital (i - ii)	76,800	38,400	(38,400)	(50.00)
APPLICATION OF FUNDS (B) (a + b + c)	3,88,800	3,50,400	(38,400)	(9.88)

Illustration 04:

From the following Profit and Loss Account prepare a vertical comparative income statement of Ritesh Ltd.

Particular	2017	2018
Opening Stock of Raw Materials	1,60,000	2,40,000
Purchases	6,00,000	16,00,000
Wages	2,00,000	3,20,000
Factory Expenses	1,60,000	2,00,000
Closing Stock of Raw Materials	2,40,000	6,00,000
Salaries	20,000	24,000
Rent	16,000	20,000
Carriage Outward	24,000	20,000
Delivery Expenses	12,000	6,000
Advertisement Expenses	30,000	20,000
Interest Paid	2,000	6,000
Loss on Sale of Asset	26,000	20,000
Tax Paid	76,000	56,000
Sales	12,00,000	20,00,000
Interest Received on Investment	1,000	1,000

Solution 04:

Comparative Vertical Profit & Loss Statement

Particulars	as on 2017 ₹	as on 2018 ₹	Absolute Increase/ Decrease	% Increase/ Decrease
1 Net Sales	12,00,000	20,00,000	8,00,000	66.67
2 Less: Cost of Goods Sold				
Opening Stock	1,60,000	2,40,000	80,000	50.00
Purchases	6,00,000	16,00,000	10,00,000	166.67
Factory Expenses	1,60,000	2,00,000	40,000	25.00
Wages	2,00,000	3,20,000	1,20,000	60.00
Less: Closing Stock	(2,40,000)	(6,00,000)	(3,60,000)	150.00
	8,80,000	17,60,000	8,80,000	100.00
3 Gross Profit	3,20,000	2,40,000	(80,000)	(25.00)
4 Operating Expenses				
I. Administration Expenses				
Salaries	20,000	24,000	4,000	20.00
Rent	16,000	20,000	4,000	25.00
II. Selling and Distribution Expenses				
Carriage Outward	24,000	20,000	(4,000)	(16.67)
Delivery Expenses	12,000	6,000	(6,000)	(50.00)
Advertisement Expenses	30,000	20,000	(10,000)	(33.33)
5 Add: Operating Expenses	1,02,000	90,000	(12,000)	(11.76)
6 Profit Before Interest	2,18,000	1,50,000	(68,000)	(31.19)
7 Less: Interest Paid	2,000	6,000	4,000	200.00
8 Net Profit After Interest	2,16,000	1,44,000	(72,000)	(33.33)
9 Non-Operating Income				
Interest received on Investments	1,000	1,000	-	-
10 Less: Non-Operating Expenses				
Loss on Sale of Asset	26,000	20,000	(6,000)	(23.08)
11 Net Profit Before Tax	1,91,000	1,25,000	(66,000)	(34.55)
12 Income Tax	76,000	56,000	(20,000)	(26.32)
13 Profit After Tax	1,15,000	69,000	(46,000)	(40.00)

Illustration 05

CIRCLE and SQUARE are carrying on partnership business. Their position as on 31st March 2020 and 2019 is as follows:

(i) The Summarised Balance Sheet

Liabilities	2020 ₹	2019 ₹	Assets	2020 ₹	2019 ₹
Capital Accounts	1,21,975	1,01,150	Fixed Assets	89,250	74,375
Bank Loans	23,800	17,850	Investments	5,950	2,975
Sundry Creditors	65,450	59,500	Stock in Trade	35,700	29,750
			Sundry Debtors	53,550	44,625
			Loans and Advances	23,800	23,800
			Cash and Bank	2,975	2,975
Total	2,11,225	1,78,500	Total	2,11,225	1,78,500

ii) Summarised Income Statement

Particulars	2020 ₹	2019 ₹
Net Sales	71,400	65,450
Less: Cost of sales	53,550	50,575
Gross Margin	17,850	14,875
Operating Expenses	14,875	11,900
Net Profit before Tax	2,975	2,975

Solution 05:

Comparative Balance Sheet

Particulars	as on 2019 ₹	as on 2020 ₹	Absolute Increase/ Decrease	% Increase/ Decrease
I SOURCES OF FUNDS				
1 Owner's Funds	1,01,150	1,21,975	20,825	20.59
2 Loan Funds	17,850	23,800	5,950	33.33
Total Funds Available (1 + 2)	1,19,000	1,45,775	26,775	22.50
II APPLICATION OF FUNDS				
1 Fixed Assets	74,375	89,250	14,875	20.00
2 Investments	2,975	5,950	2,975	100.00
3 Working Capital				
(A) Current Assets				
Stock	29,750	35,700	5,950	20.00
Debtors	44,625	53,550	8,925	20.00
Loans & Advances	23,800	23,800	-	-
Cash/Bank	2,975	2,975	-	-
(A)	1,01,150	1,16,025	14,875	14.71
(B) Less: Current Liabilities				
Creditors	59,500	65,450	5,950	10.00
(B)	59,500	65,450	5,950	10.00
(A - B)	41,650	50,575	8,925	21.43
Total Funds Employed (1 + 2 + 3)	1,19,000	1,45,775	26,775	22.50

Comparative Income Statement

Particulars	as on 2019 ₹	as on 2020 ₹	Absolute Increase/ Decrease	% Increase/ Decrease
1 Sales	65,450	71,400	5,950	9.09
2 Less: Cost of Sales	50,575	53,550	2,975	5.88
3 Gross Profit (1 - 2)	14,875	17,850	2,975	20.00
4 Less: Operating Expenses	11,900	14,875	2,975	25.00
5 Net Profit (3 - 4)	2,975	2,975	-	-

Illustration 06:

Complete the following Comparative Statement of Barkha Products by ascertaining the missing figures.

Particular	Year Ended 31-03-16 ₹	Year Ended 31-03-17 ₹	Increase/ (Decrease) ₹	% Increase/ (Decrease)
Gross Profit	?	?	?	?
Less: Expenses				
- Administrative	1,12,000	?	22,400	20.00
- Selling	56,000	67,200	11,200	?
- Financial	?	28,000	5,600	25.00
Operating Net Profit	?	2,24,000	1,12,000	100.00

Solution 06:

Comparative Statement of Barkha Product

Particular	Year Ended 31-03-16 ₹	Year Ended 31-03-17₹	Increase/ (Decrease) ₹	% Increase/ (Decrease)
Gross Profit	**3,02,400**[6]	**4,53,600**[5]	**1,51,200**[7]	**50.00**
Less: Expenses				
- Administrative	1,12,000	**1,34,400**[1]	22,400	20.00
- Selling	56,000	67,200	11,200	**20.00**[2]
- Financial	**22,400**[3]	28,000	5,600	25.00
Operating Net Profit	**1,12,000**[4]	2,24,000	1,12,000	100.00

Working Note:

1. 1,12,000 + 22,400 = 1,34,400
2. 11,200 ÷ 56,000 x 100 = 20.00
3. 5,600 ÷ 25% or 28,000 – 5,600 = 22,400
4. 1,12,000 ÷ 100% or 2,24,000 - 1,12,000 = 1,12,000
5. 2,24,000 + (1,34,400+67,200+28,000) = 4,53,600
6. 1,12,000[4] + (1,12,000+56,000+22,400) = 3,02,400
7. 4,53,600 – 3,02,400 = 1,51,200
8. 1,51,200 ÷ 3,02,400 = 50.00%

Illustration 07:

Particular	2019 ₹	2020 ₹	Absolute Increase/ (Decrease)	% Increase/ (Decrease)
Sales	?	?	(+) 4,60,000	(+) 25.00%
<u>Cost of Goods Sold</u>				
Opening Stock	92,000	1,38,000	?	?
Purchases	?	?	(+) 2,30,000	(+) 20.00%
Wages	2,76,000	5,06,000	?	?
Less: Closing Stock	?	1,84,000	?	?
Cost of Goods Sold	?	?	?	?
Gross Profit (A - B)	?	?	?	?
<u>Operating Expenses</u>				
(a) Administrative	?	?	(+) 23,000	(+) 20.00%
(b) Selling	57,500	69,000	-	?
(c) Finance	?	?	(+) 5,175	(+) 22.5%
Total Operating Expenses	?	?	?	?
Net Operating Profit (C - D)	?	?	?	?
Add: Non-Operating Income	23,000	1,15,000	?	?
Net Profit Before Tax	?	?	?	?
Less: Provision for Tax	?	?	?	?
Net Profit After Tax	2,41,500	2,70,825	?	?

Solution 07:

Particulars	2019 ₹	2020 ₹	Absolute Increase/ (Decrease)	% Increase/ (Decrease)
Sales	**18,40,000**[1]	**23,00,000**[2]	(+) 4,60,000	(+) 25%
<u>Cost of Goods Sold</u>				
Opening Stock	92,000	1,38,000	**46,000**[3]	**50.00%**[4]
Purchases	**11,50,000**[5]	**13,80,000**[6]	(+) 2,30,000	(+) 20.00%
Wages	2,76,000	5,06,000	**2,30,000**[7]	**83.33%**[8]
Less: Closing Stock	**1,38,000**[9]	1,84,000	**46,000**[10]	**33.33%**[11]
Cost of Goods Sold	**13,80,000**	**18,40,000**	**4,60,000**	**33.33%**
Gross Profit (A - B)	**4,60,000**	**4,60,000**	**-**	**0.00%**
<u>Operating Expenses</u>				
(a) Administrative	**1,15,000**[12]	**1,38,000**[13]	(+) 23,000	(+) 20.00%
(b) Selling	57,500	69,000	**11,500**[14]	**20.00%**[15]
(c) Finance	**23,000**[16]	**28,175**[17]	(+) 5,175	(+) 22.5%
Total Operating Expenses	**1,95,500**	**2,35,175**	**39,675**	**20.29%**
Net Operating Profit (C - D)	**2,64,500**	**2,24,825**	**(39,675)**	**(15.00%)**
Add: Non-Operating Income	23,000	1,15,000	**92,000**	**400.00%**
Net Profit Before Tax	**2,87,500**	**3,39,825**	**52,325**	**18.20%**
Less: Provision for Tax	**46,000**	**69,000**	**23,000**	**50.00%**
Net Profit After Tax	2,41,500	2,70,825	**29,325**	**12.14%**

Working Notes:

1. 4,60,000 ÷ 25% = 18,40,000	12. 23,000 ÷ 20% = 1,15,000
2. 1,840,000 + 4,60,000 = 23,00,000	13. 1,15,000 + 23,000 = 1,38,000
3. 1,38,000 – 92,000 = 46,000	14. 69,000 – 57,500 = 11,500
4. 46,000 ÷ 92,000 = 50%	15. 11,500 ÷ 57,500 = 20.00%
5. 2,30,000 ÷ 20% = 11,50,000	16. 5,175 ÷ 22.50% = 23,000
6. 11,50,000 + 13,80,000	17. 23,000 + 5,175 = 28,175
7. 5,06,000 – 2,76,000 = 2,30,000	
8. 2,30,000 ÷ 2,76,000 = 83.33%	
9. Opening Stock of 2020 is closing stock of 2019.	
10. 1,84,000 – 1,38,000 = 46,000	
11. 46,000 ÷ 1,38,000 = 33.33	

Figures in Bracket indicates negative numbers.

Illustration 08

Complete the following Comparative Statement of Hina Products by ascertaining the missing figures.

Particular	Year Ended 31-03-16	Year Ended 31-03-17	Increase/ (Decrease) ₹	% Increase/ (Decrease) ₹
Share Capital	16,25,000	?	1,00,000	?
Reserve and Surplus	6,25,000	5,00,000	?	?
Debentures	3,75,000	?	(1,25,000)	?
Current Assets	?	7,50,000	1,00,000	?
Long Term Investment	?	?	25,000	10
Current Liabilities	?	5,00,000	(25,000)	?
Fixed Assets	?	?	?	?

Solution 08:

Particulars	2019	2020	Absolute Increase/ Decrease	% Increase/ Decrease
I SOURCES OF FUNDS				
1 Shareholder's Fund				
a Share Capital	16,25,000	17,25,000	1,00,000	6.15
b Reserves and Surplus	6,25,000	5,00,000	(1,25,000)	(20.00)
	56,25,000	55,62,500	(62,500)	(1.11)
2 Loan Fund				
Debentures	3,75,000	2,50,000	(1,25,000)	(33.33)
3 Capital Employed	60,00,000	58,12,500	(1,87,500)	(3.13)
II APPLICATION OF FUNDS				
1 Fixed Assets (CE - Invt. - WC)	22,50,000	19,50,000	(3,00,000)	(13.33)
Investments	2,50,000	2,75,000	25,000	10.00
2 Working Capital				
A Current Assets	6,50,000	7,50,000	1,00,000	15.38
B Less: Current Liabilities	5,25,000	5,00,000	(25,000)	(4.76)
Working Capital (A - B)	1,25,000	2,50,000	1,25,000	100.00
3 Capital Employed	26,25,000	24,75,000	(1,50,000)	(5.71)

Common Size Statement

A common size income statement is an income statement in which each line item is expressed as a percentage of the value of revenue or sales. It is used for vertical analysis, in which each line item in a financial statement is represented as a percentage of a base figure within the statement.

Use of Common Size Income Statement:

It helps the business owner in understanding the following points

1. Whether profits are showing an increase or decrease in relation to the sales obtained.
2. Percentage change in cost of goods that were sold during the accounting period.
3. Variation that might have occurred in expense.
4. If the increase in retained earnings is in proportion to the increase in profit of the business.
5. Helps to compare income statements of two or more periods.
6. Recognises the changes happening in the financial statements of the organisation, which will help investors in making decisions about investing in the business.

Limitations of Common Size Statement

1. It is not helpful in the decision-making process as it does not have any approved benchmark.

2. For a business that is impacted by fluctuations due to seasonality, it can be misleading.

Illustration 09:

Following is the Balance Sheet of Priyanka Ltd. as on 31st March, 2020.

Balance Sheet as on 31st March 2020

Liabilities	₹	Assets	₹
Equity Share Capital	1,50,000	Fixed Assets	2,00,000
8% Preference Share Capital	1,00,000	Investments	75,000
General Reserve	10,000	Stock	12,500
Profit and Loss Account	25,000	Debtors`	37,500
10% Debentures	50,000	Bills Receivable	15,000
Creditors	10,000	Cash	7,500
Bills Payable	3,500	Preliminary Expenses	2,500
Outstanding Expenses	1,500		
	3,50,000		3,50,000

Prepare a Common-size Balance Sheet from the above in vertical form.

Solution 09:

Priyanka LTD.

Particulars	2020	% Increase/ Decrease
I SOURCES OF FUNDS		
1 Owner's Funds		
A Capital		
Equity Share Capital	1,50,000	45.11
8% Preference Share Capital	1,00,000	30.08
	2,50,000	75.19
B. Reserves and Surplus		0.00
General Reserve	10,000	3.01
Profit and Loss A/c	25,000	7.52
	35,000	10.53
Less: Preliminary Expenses	(2,500)	(0.75)
Net Reserves and Surplus	32,500	9.77

Own Funds or Net Worth	2,82,500	84.96
2 Loan Funds		0.00
10% Debentures	50,000	15.04
Capital Employed [1 + 2]	3,32,500	100.00
II APPLICATION OF FUNDS		
1 Fixed Assets	2,00,000	60.15
2 Investments	75,000	22.56
3 Working Capital		
A Current Assets		
Cash	7,500	2.26
Debtors	37,500	11.28
Bills Receivable	15,000	4.51
Total Liquid Assets	60,000	18.05
Stock	12,500	3.76
Total Current Assets	72,500	21.80
B. Less: Current Liabilities		0.00
Creditors	10,000	3.01
Bills Payable	3,500	1.05
Outstanding Expenses	1,500	0.45
Total Current Liabilities	(15,000)	(4.51)
Working Capital [A - B]	57,500	17.29
Capital Employed [1 + 2 + 3]	3,32,500	100.00

Illustration 10:

Following is the Summarised Balance Sheet of M/s. Sana Ltd. as on 31st March, 2020, prepare a Common Size Balance Sheet in vertical form.

Balance Sheet as at 31st March, 2020

Liabilities	□	Assets	□
Equity Share Capital	2,55,000	Fixed Assets	1,95,000
Reserve Fund	81,000	Investment	85,200
Creditors	42,000	Inventory	42,000
Tax Provision	27,000	Debtors	48,000
		Cash	34,800
	4,05,000		4,05,000

Prepare a Common-size Balance Sheet from the above in vertical form.

Solution 10:

Sana Ltd.

Common-Size Balance Sheet

Particulars	Amount	Amount	% Increase/Decrease
I SOURCES OF FUNDS			
1 Owner's Funds			
A Capital			
Equity Share Capital		2,55,000	75.89
B. Reserves and Surplus			
Reserve Fund		81,000	24.11
Own Funds or Net Worth		3,36,000	100.00
2 Loan Funds			
3 Capital Employed		3,36,000	100.00
II APPLICATION OF FUNDS			
1 Net Fixed Assets			
Net Tangible Assets		1,95,000	58.04
2. Long Term Investments			
Trade Investments		85,200	25.36
3. Working Capital			
Current Assets			
Cash	34,800		10.36
Debtors (Net)	48,000		14.29
Total Liquid Assets	82,800		24.64
Inventory	42,000		12.50
a Current Assets	1,24,800		37.14
Less: Current Liabilities			-
Creditors	42,000		12.50
Provision for Tax	27,000		8.04
b Total Quick/Current Liabilities	(69,000)		(20.54)
c Working Capital (a - b)		55,800	16.61
4. Capital Employed		3,36,000	100.00

Illustration 11:

Dr. Trading and Profit and Loss Account for the Year Ended 31st March, Cr.

Particular	□	Particular	□
To Opening Stock	2,25,000	By Sales	45,00,000
To Purchases	24,07,500	By Closing Stock	2,70,000
To Interest on Debentures	1,12,500	By Dividend	29,250
To Depreciation on Furniture	11,250		
To Depreciation on Machinery	22,500		
To Administration Expenses	3,30,750		
To Selling Expenses	5,64,750		
To Carriage Outward	2,36,250		
To Loss by Fire	11,250		
To Wages	2,25,000		
To Provision for Tax	3,26,250		
To Net Profit	3,26,250		
	47,99,250		47,99,250

Solution 11:

Commonsize Income Statement For the Year Ended 31st March 2018

Particulars	2018	Percentage
1 Net Sales	45,00,000	100.00
2 Less: Cost of Goods sold		
A Opening Stock	2,25,000	5.00
B Add: Purchases	24,07,500	53.50
Wages	2,25,000	5.00
Depreciation - Machinery	22,500	0.50
	28,80,000	64.00
C Less: Closing Stock	(2,70,000)	(6.00)
D Cost of Sales	26,10,000	58.00
3 Gross Profit (1 - 2)	18,90,000	42.00
4 Less: Operating Expenses		
I. Administration Expenses		
Depreciation on Furniture	11,250	0.25
Other	3,30,750	7.35
Total Administration Expenses	3,42,000	7.60
I. Selling and Distribution Expenses		

Carriage Outward	2,36,250	5.25
Other	5,64,750	12.55
Total selling and distribution expenses	8,01,000	17.80
Total Operating Expenses (I + I1)	11,43,000	25.40
5 Operating Profit Before Interest (3 - 4)	7,47,000	16.60
6 Less : Interest Paid		
Interest on Debentures	(1,12,500)	(2.50)
7 Net Profit After Interest (5 - 6)	6,34,500	14.10
8 Add : Non-Operating Income		
Dividends	29,250	0.65
9 Less: Non-Operating Expense		
Loss by Fire	(11,250)	(0.25)
10 Net Profit Before Tax (7 + 8 - 9)	6,52,500	14.50
11 Less: Income Tax	(3,26,250)	(7.25)
12 Net Profit After Tax (10 - 11)	3,26,250	7.25

Illustration 12

Following is the Trading and Profit & Loss Account of Daya Ltd. & Radha Ltd. for the year ended 31st March 2020

Trading and Profit and Loss Account for the Year Ended 31st March, 2020

Particular	Daya	Radha	Particular	Daya	Radha
To Opening Stock	25,920	1,03,680	By Sales	1,44,000	7,20,000
To Purchases	1,05,120	3,15,360	By Closing Stock	43,200	2,16,000
To Wages	15,840	95,040			
To Carriage Inward	5,760	21,240			
To Gross Profit c/d	34,560	4,00,680			
	1,87,200	9,36,000		1,87,200	9,36,000
To Operating Expenses	28,800	2,01,600	By Gross Profit b/d	34,560	4,00,680
To Loss on Sale of Asset	7,200	43,200	By Interest on Investment	18,720	29,980
To Income Tax Provision	2,880	28,240			
To Net Profit c/f	14,400	1,74,340			
Total	53,280	4,30,660	Total	53,280	4,30,660

Solution 12:

Commonsize Income Statement For the Year Ended 31st March 2020

Particulars	Daya		Radha	
	Amount	%	Amount	%
1 Net Sales	1,44,000	100.00	7,20,000	100.00
2 Less : Cost of Goods sold				
A Opening Stock	25,920	18.00	1,03,680	14.40
B Add: Purchases	1,05,120	73.00	3,15,360	43.80
Wages	15,840	11.00	95,040	13.20
Carriage Inward	5,760	4.00	21,240	2.95
	1,52,640	106.00	5,35,320	74.35
C Less : Closing Stock	(43,200)	(30.00)	(2,16,000)	(30.00)
D Cost of Sales	1,09,440	76.00	3,19,320	44.35
3 Gross Profit (1 - 2)	34,560	24.00	4,00,680	55.65
4 Less : Operating Expenses	(28,800)	(20.00)	(2,01,600)	(28.00)
5 Operating Profit	5,760	4.00	1,99,080	27.65
6 Add : Non-operating Income				
Interest on Investment	18,720	13.00	29,980	4.16
7 Less : Non-operating Expense	24,480	17.00	2,29,060	31.81
Loss on Sale of Asset	(7,200)	(5.00)	(43,200)	(6.00)
8 Net Profit Before Tax	17,280	12.00	1,85,860	25.81
9 Less : Income Tax	(2,880)	(2.00)	(28,240)	(3.92)
10 Net Profit After Tax	14,400	10.00	1,57,620	21.89

Illustration 13:

Prepare common size Financial Statement in a form suitable for analysis

Summary Balance Sheet as on 31st March, 2020

Liabilities	₹	Assets	₹
	13,650	Cash	8,775
Oustanding expenses	25,350	Debtors	36,075
Loans	73,125	Prepaid Expenses	71,500
Capital	2,13,850	Stock	32,500
Reserves	32,500	Other Current Assets	3,250
		Fixed Assets	2,06,375
	3,58,475		3,58,475

Summary Income Statement for the Year Ending on 31st March, 2020

Particulars	Amount	Particulars	Amount
To Cost of goods sold	2,31,075	By Net Sales	4,12,425
To Selling Overheads	1,17,000	By Other Income	3,900
To Administration and General Expenses	29,900		
To Tax	11,050		
To Loss on sale of Investments	15,600		
To Net Income	11,700		
	4,16,325		4,16,325

Solution 13:

Particulars	Amount	Percentage
I SOURCES OF FUNDS		
1 Shareholders Funds		
Capital	2,13,850	66.94
Reserves	32,500	10.17
Networth	2,46,350	77.11
2 Loan Funds	73,125	22.89
Total Funds Available	**3,19,475**	100.00
II APPLICATION OF FUNDS		
1 Fixed Assets	2,06,375	64.60
2 Working Capital		
A Current Assets		
Cash	8,775	2.75
Debtors	36,075	11.29
Other Current Assets	3,250	1.02
Stock	32,500	10.17
Prepaid Expenses	71,500	22.38
Total (A)	1,52,100	47.61
B Less: Current Liabilities		0.00
Creditors	13,650	4.27
Outstanding Expenses	25,350	7.93
Total (B)	(39,000)	(12.21)
(A-B)	1,13,100	35.40
Total Funds Employed (1+2)	**3,19,475**	100.00

Particulars	Amount	Percentage
1 Net Sales	4,12,425	100.00
2 Less: Cost of goods sold	(2,31,075)	(56.03)
3 Gross Profit (1 - 2)	1,81,350	43.97
4 Less: Operating Expenses:		
(a) Admin & General Expenses	(29,900)	(7.25)
(b) Selling Overheads	(1,17,000)	(28.37)
Total (4)	(1,46,900)	(35.62)
5 Other operating Income	3,900	0.95
6 Net Operating Profit (3 - 4 + 5)	38,350	9.30
7 Less: Non-operating Expenses		
Loss on sale of Investments	(15,600)	(3.78)
8 Net Profit before Tax (6 - 7)	22,750	5.52
9 Less: Taxes	(11,050)	(2.68)
10 Net Profit After Tax (8 - 9)	11,700	2.84

Illustration 14:

Complete the following Common Size Income Statement of Babita Ltd. by ascertaining the missing figures / percentages

Common Size Income Statement as on 31st March, 2020

Particular	₹	₹	%	%
Net Sales		5,00,000		
Less : Cost of Goods Sold				
Opening Stock	?		20.00	
Purchases	?		60.00	
Wages	62,500		?	
Factory Overheads	?		12.50	
	?		105.00	
Less : Closing Stock	1,50,000	?	30.00	75.00
Gross Profit		1,25,000		25.00
Less : Operating Expenses				
(a) Administrative Expenses	?		7.00	
(b) Selling Expenses	12,500		2.50	
(c) Finance Expenses	?	52,500	?	10.50
Operating Profit		?		?
Add : Non-Operating Income		12,500		2.50
Less : Non-Operating Expenses		?		1.00
Net Profit Before Tax		80,000		?

Solution 14:

Common Size Income Statement as on 31st March, 2020

Particular	₹	₹	%	%
Net Sales		5,00,000		100.00
Less: Cost of Goods Sold				
Opening Stock	1,00,000		20.00	
Purchases	3,00,000		60.00	
Wages	62,500		12.50	
Factory Overheads	62,500		12.50	
	5,25,000		105.00	
Less: Closing Stock	(1,50,000)	(3,75,000)	30.00	75.00
Gross Profit		1,25,000		25.00
Less: Operating Expenses				
(a) Administrative Expenses	35,000		7.00	
(b) Selling Expenses	12,500		2.50	
(c) Finance Expenses	5,000	(52,500)	1.00	(10.50)
Operating Profit		72,500		14.50
Add: Non-Operating Income		12,500		2.50
Less: Non-Operating Expenses		(5,000)		(1.00)
Net Profit Before Tax		80,000		16.00

Illustration 15:

From the following information of Gabbar Ltd. prepare Common Size Balance Sheet in Vertical Form as on 31st March 2020.

Particulars	₹
Fixed Assets	510000
Net Worth	510000
Loan Fund	?
Working Capital	340000
Total Capital Employed	850000
Current Liabilities	340000

Solution 15:

In the books of Gabbar Ltd.

Commonsize Balance Sheet as on 31st March 2020

Particulars	as on 2020 ₹	%
I SOURCES OF FUNDS		
1 Shareholders Funds	5,10,000	60.00
2 Loan Fund	3,40,000	40.00
Total Funds Available (1 + 2)	8,50,000	100.00
II APPLICATION OF FUNDS		
1 Fixed Assets	5,10,000	60.00
2 Working Capital		-
A Current Assets	6,80,000	80.00
B Less : Current Liabilities	(3,40,000)	(40.00)
Working Capital (A-B)	3,40,000	40.00
2 Total Funds Employed (1 + 2)	8,50,000	100.00

Trend Analysis

Meaning: Trend Analysis treats year 1 as the base year and compares the figures of all the (year 2/year 3) with those of the base year to find out the trend in figures. Thus trend analysis ofpurchase will reveal whether as compared to the base year, i.e. Year 1, the purchase show atrend increase or decrease in subsequent years, i.e. Year 2, Year 2, Year 3 ..... and so on.

Use: It is useful because: (1) It shows the direction(up or down)of the changes. (2) Trends areeasy to calculate and interpret. (3) It is a quick method of analysis.

Advantages:

(1) Trend Analysis helps in analysing the growth in the financial activities of the firm with abrief look.

(2) Graphical presentation of trend line helps the management to take a quick decision matter.

(3) Trend values also help the management in the controlling process as well.

(4) Trend analysis proves to be very useful for taking rational investment decisions.

Disadvantages:

(1) Choice of Base Year & No. of Years: If different year is chosen as the base year, the trend may be different. Further, the total number of years covered should not be too large (say 30 years) or too small (say 3 years). Data for a large number of years show large variationsdue to inflation and figures for a few years are not representative.

(2) Different Accounting Policies: The trend will give a distorted figure, or a wrong picture ifthe accounting policies in respect of depreciation, valuation of closing stock etc. have changed.

Illustration 16:

M/s. Henry Ltd. Carrying on business, furnished their position as on 31st March, 2018, 2019 and 2020.

Particulars	2018 (Amount in ₹)	2019 (Amount in ₹)	2020 (Amount in ₹)
Assets			
Fixed Assets	60,000	51,000	87,600
Investment	26,000	26,000	36,800
Current Assets	54,000	66,400	37,800
	1,40,000	1,43,400	1,62,200
Liabilities			
Share Capital	66,000	62,700	82,000
Debentures	54,000	56,700	19,000
Liabilities for expenses	20,000	24,000	61,200
	1,40,000	1,43,400	1,62,200

Solution:

In the books of Henry Ltd.

Trend Analysis of Balance Sheet

Particulars	Amount			Trend %		
	2018 ₹	2019 ₹	2020 ₹	2018	2019	2020
I SOURCES OF FUNDS						
Share Capital	66,000	62,700	82,000	100.00	95.00	124.00
Debentures	54,000	56,700	19,000	100.00	100.00	35.00
Capital Employed	**1,20,000**	**1,19,400**	**1,01,000**	**100.00**	**99.50**	**84.00**

II APPLICATION OF FUNDS						
1 Fixed Assets	60,000	51,000	87,600	100.00	85.00	146.00
2 Investments	26,000	26,000	36,800	100.00	100.00	142.00
3 Current Assets	54,000	66,400	37,800	100.00	123.00	70.00
4 Current Liabilities	(20,000)	(24,000)	(61,200)	100.00	120.00	306.00
5 Working Capital (3 - 4)	34,000	42,400	(23,400)	100.00	125.00	(69.00)
6 Capital Employed	**1,20,000**	**1,19,400**	**1,01,000**	**100.00**	**99.50**	**84.00**

Illustration 17:

From the following balance sheet of Sunny Ltd., prepare Trend Percentage Statement in Vertical form:

Balance Sheet as on 31st March

Particulars	2018 (Amount in Rs)	2019 (Amount in Rs)	2020 (Amount in Rs)
Equity and Liability			
Equity Share Capital	2,40,000	2,40,000	2,40,000
8% Preference Share Captial	1,20,000	1,80,000	1,20,000
General Reserve	24,000	26,400	50,400
Debentures	90,000	1,20,000	1,08,000
Bills Payable	6,000	8,400	12,000
Creditors	18,000	12,000	28,800
Total	4,98,000	5,86,800	5,59,200
Assets			
Fixed Assets	1,80,000	2,40,000	2,40,000
Investment	1,20,000	1,80,000	1,20,000
Cash	60,000	30,000	48,000
Debtors	84,000	72,000	75,600
Stock	48,000	60,000	72,000
Preliminary Expenses	6,000	4,800	3,600
Total	4,98,000	5,86,800	5,59,200

Solution 17:

In the books of Sunny Ltd.

Trend Analysis of Balance Sheet

Particulars	Amount			Trend % Base year 2018		
	2018 ₹	2019 ₹	2017 ₹	2,018	2,019	2,017
I SOURCES OF FUNDS						
1 Shareholders' Funds						
a Capital						
Equity Share Capital	2,40,000	2,40,000	2,40,000	100.00	100.00	100.00
8% Pref. Share Capital	1,20,000	1,80,000	1,20,000	100.00	150.00	100.00
Capital	3,60,000	4,20,000	3,60,000	100.00	116.67	100.00
b Reserves and Surplus						
General Reserve	24,000	26,400	50,400	100.00	110.00	210.00
	3,84,000	4,46,400	4,10,400	100.00	116.25	106.88
c Less: Preliminary Expenses.	6,000	4,800	3,600	100.00	80.00	60.00
2 Own Funds	3,78,000	4,41,600	4,06,800	100.00	116.83	107.62
3 Loan Funds						
Debentures	90,000	1,20,000	1,08,000	100.00	133.33	120.00
Capital Employed (2 + 3)	4,68,000	5,61,600	5,14,800	100.00	120.00	110.00
II APPLICATION OF FUNDS						
1 Fixed Assets	1,80,000	2,40,000	2,40,000	100.00	133.33	133.33
2 Investments	1,20,000	1,80,000	1,20,000	100.00	150.00	100.00
3 Working Capital						
a Current Assets:						
Cash	60,000	30,000	48,000	100.00	50.00	80.00
Debtors	84,000	72,000	75,600	100.00	85.71	90.00
Stock	48,000	60,000	72,000	100.00	125.00	150.00
Current Assets (a)	1,92,000	1,62,000	1,95,600	100.00	84.38	101.88
Less: Current Liabilities						
Bills Payable	6,000	8,400	12,000	100.00	140.00	200.00
Creditors	18,000	12,000	28,800	100.00	66.67	160.00
Current Liabilities (b)	24,000	20,400	40,800	100.00	85.00	170.00
Working Capital(a - b)	1,68,000	1,41,600	1,54,800	100.00	84.29	92.14
Capital Employed (1+2+3)	4,68,000	5,61,600	5,14,800	100.00	120.00	110.00

Illustration 18

Following balances are extracted from the books of Naman Ltd.

Balance Sheet as on 31st March

Particulars	2018 (Amount in Rs)	2019 (Amount in Rs)	2020 (Amount in Rs)
Net Sales	1,00,500	1,34,000	1,67,500
Opening Stock	10,050	16,750	23,450
Purchases	56,950	63,650	67,000
Wages	5,025	10,050	6,700
Carriage Inward	6,700	13,400	13,400
Closing Stock	16,750	23,450	20,100
Office Expenses	3,350	4,020	5,025
Selling Expenses	2,345	3,015	3,350
Finance Expenses	2,010	3,350	6,700
Non-Operating Income	2,680	3,015	3,350
Non-Operating Expenses	1,675	1,005	1,675
Tax	40%	40%	40%

You are required to prepare vertical trend analysis Income Statement from the above.

Solution 18:

In the books of Naman Ltd.

Vertical Trend Analysis Income Statement

Particulars	Amount			Trend % Base year 2015		
	2015 ₹	2016 ₹	2017 ₹	2015	2016	2017
1 Net Sales	1,00,500	1,34,000	1,67,500	100.00	133.33	166.67
2 Less: Cost of Goods Sold						
Opening Stock	10,050	16,750	23,450	100.00	166.67	233.33
Purchases	56,950	63,650	67,000	100.00	111.76	117.65
Wages	5,025	10,050	6,700	100.00	200.00	133.33
Carriage Inward	6,700	13,400	13,400	100.00	200.00	200.00
Less: Closing Stock	16,750	23,450	20,100	100.00	140.00	120.00
Cost of Goods sold	61,975	80,400	90,450	100.00	129.73	145.95
3 Gross Profit I1 - 2]	38,525	53,600	77,050	100.00	139.13	200.00
4 Less: Operating Expenses						
Office Expenses	3,350	4,020	5,025	100.00	120.00	150.00
Selling Expenses	2,345	3,015	3,350	100.00	128.57	142.86
Finance Expenses	2,010	3,350	6,700	100.00	166.67	333.33
Operating Expenses	7,705	10,385	15,075	100.00	134.78	195.65
5 Net Profit [3 - 4]	30,820	43,215	61,975	100.00	140.22	201.09
6 Non-operating Income	2,680	3,015	3,350	100.00	112.50	125.00
7 Non-operating Expenses	1,675	1,005	1,675	100.00	60.00	100.00
8 Net Profit Before Tax (5+6-7)	31,825	45,225	63,650	100.00	142.11	200.00
9 Less: Income Tax (40%)	12,730	18,090	25,460	100.00	142.11	200.00
10 Net Profit after Tax [8 - 9]	19,095	27,135	38,190	100.00	142.11	200.00

Illustration 19:

Calculate Trend Percentage from the following information extracted from financial statement of M/s. Lalita Ltd., after arranging in vertical from.

Balance Sheet as on 31st March

Particulars	2018 (Amount in Rs)	2019 (Amount in Rs)	2020 (Amount in Rs)
Assets			
Fixed Assets	32,400	34,020	40,500
Investment	2,700	1,350	2,700
Current Assets	36,450	45,306	52,785
	71,550	80,676	95,985
Liabilities			
Share Capital	39,150	45,900	55,350
Bank Loan	8,100	8,100	10,935
Current Liabilities	24,300	26,676	29,700
	71,550	80,676	95,985

Income Statements for the year ended 31st March

Particulars	2018 (Amount in Rs)	2019 (Amount in Rs)	2020 (Amount in Rs)
Net Sales	30,000	33,000	36,000
Less Cost of Sales	22,500	27,000	27,000
Gross Margin	7,500	6,000	9,000
Less: Operating Expenses	3,000	1,500	2,700
Operating Profit	4,500	4,500	6,300

Solution 19

In the books of Lalita Ltd.

Trend Analysis of Balance Sheet

Particulars	Amount			Trend % Base year 2018		
	2018 ₹	2019 ₹	2020 ₹	2018 ₹	2019 ₹	2020 ₹
I SOURCES OF FUNDS						
Share Capital	39,150	45,900	55,350	100.00	117.24	141.38
Bank Loan	8,100	8,100	10,935	100.00	100.00	135.00
Capital Employed	47,250	54,000	66,285	100.00	114.29	140.29
II APPLICATION OF FUNDS						
1 Fixed Assets	32,400	34,020	40,500	100.00	105.00	125.00
2 Investments	2,700	1,350	2,700	100.00	50.00	100.00
3 Working Capital						
a. Current Assets	36,450	45,306	52,785	100.00	124.30	144.81
b Less: Current Liabilities	(24,300)	(26,676)	(29,700)	100.00	109.78	122.22
c Working Capital (a - b)	12,150	18,630	23,085	100.00	153.33	190.00
4 Capital Employed (1 + 2 + 3)	47,250	54,000	66,285	100.00	114.29	140.29

Income Statements for the year ended 31st March

Particulars	Amount			Trend % Base year 2018		
	2018 ₹	2019 ₹	2020 ₹	2018	2,019	2,020
Net Sales	30,000	33,000	36,000	100.00	110.00	120.00
Less Cost of Sales	22,500	27,000	27,000	100.00	120.00	120.00
Gross Margin	7,500	6,000	9,000	100.00	80.00	120.00
Less : Operating Expenses	3,000	1,500	2,700	100.00	50.00	90.00
Operating Profit	4,500	4,500	6,300	100.00	100.00	140.00

Illustration 20:

From the following information prepare Vertical Balance Sheet for financial analysis and Trend analysis of Fenny Products Ltd. For all the years.

Balance Sheet as on 31st March

Particulars	2018 (Amount in Rs)	2019 Trend %	2020 (Amount in Rs)
Share Capital	1,12,500	120	1,57,500
Reserve and Surplus	22,500	150	45,000
Secured Loans	22,500	100	22,500
Current Liabilities	22,500	150	45,000
Fixed Assets	90,000	110	1,12,500
Investment (Long Term)	22,500	160	45,000
Stock and Debtors	56,250	120	78,750
Bank Balance	11,250	200	33,750

Solution:

Trend Analysis of Balance Sheet

Particulars	Amount			Trend % Base year 2018		
	2018 ₹	2019 ₹	2020 ₹	2018	2019	2020
I SOURCES OF FUNDS						
Share Capital	1,12,500	**1,35,000**	1,57,500	100.00	120.00	**140.00**
Reserves and Surplus	22,500	**33,750**	45,000	100.00	150.00	**200.00**
1 Own Funds	1,35,000	**1,68,750**	2,02,500	100.00	125.00	**150.00**
2 Loan Funds						
Secured Loan	22,500	**22,500**	22,500	100.00	100.00	**100.00**
3 Capital Employed (1 + 2)	1,57,500	**1,91,250**	2,25,000	100.00	121.43	**142.86**
II APPLICATION OF FUNDS						
1 Fixed Assets	90,000	**99,000**	1,12,500	100.00	110.00	**125.00**
2 Long Term Investments	22,500	**36,000**	45,000	100.00	160.00	**200.00**
3 Working Capital						
a Current Assets						
Stock and Debtors	56,250	**67,500**	78,750	100.00	120.00	**140.00**
Bank	11,250	**22,500**	33,750	100.00	200.00	**300.00**
Current Assets	67,500	90,000	1,12,500	100.00	133.33	**166.67**
b. Less: Current Liabilities	22,500	**33,750**	45,000	100.00	150.00	**200.00**
C. Working Capital (a - b)	45,000	**56,250**	67,500	100.00	125.00	**150.00**
4 Capital Employed (1 + 2 + 3)	1,57,500	**1,91,250**	2,25,000	100.00	121.43	**142.86**

Exercise:

TRUE AND FALSE

1. Comparative statement includes comparative income statement and balance sheet. T

2. Common size statement is horizontal analysis. F

3. In Vertical Income Statement, preliminary expenses written off will be shown under Operating Expenses. F

4. Own funds is internal source of finance, whereas Owed funds is an external source of finance. T

5. Comparative financial statements in which each amount is expresses as a percent of a base amount are called Trend statements. F

6. The managerial accounting system produces information for external users. F

7. Vertical analysis is a tool to evaluate each financial item or group of items in terms of a specific base amount.

8. Using the common size statement, a company's net income as a percentage of sales is 20%therefore , the cost of goods sold as a percentage of sale must be 80%. F

9. Liquidity is ability of firm to pay, as and when the debts fall dure for payment. T

10. Currents assets and liabilities are listed in alphabetical order , in vertical balance sheet for financial analysis. F

SHORT NOTES.

Write short note on-

1. Trend analysis.
2. Inter-firm comparisons
3. Inter-period comparisons
4. Advantages of comparative statements
5. Limitations of comparative statements
6. Common size statements
7. Advantages of trend analysis
8. Use of common size statements
9. Disadvantages of trend analysis
10. Limitations of common size statements.

1. Rearrange the Balance Sheets in Vertical form and calculate the trend percentage taking 2017 figures as 100 and briefly comment on the same.

Liabilities	2017 ₹	2018 ₹	2019 ₹	2020 ₹	Assets	2017 ₹	2018 ₹	2019 ₹	2020 ₹
Equity Share Capital	145.00	159.50	174.00	174.00	Land & Building	58.00	58.00	50.75	65.25
12% Pref. Share Capital	29.00	14.50	7.25	7.25	Plant & Machinery	203.00	181.25	159.50	166.75
Reserve & Surplus	108.75	130.50	174.00	188.50	Furniture & Fixture	36.25	43.50	36.25	29.00
13% Debentures	87.00	72.50	36.25	22.00	Current Assets	145.00	166.75	232.00	224.75
Current Liabilities	72.50	72.50	87.00	94.00					
	442.25	449.50	478.50	485.75		442.25	449.50	478.50	485.75

Calculate Trend % to full integer (without decimal points - Figures to be rounded)

2. Rearrange the following summary Balance Sheet in vertical form suitable for analysis and calculate the trend percentage taking 2017 figures as 100 and briefly comment on the same.

Balance Sheet as on 31st December

Liablilities	2017 ₹	2018 ₹	2019 ₹	2020 ₹	Assets	2017 ₹	2018 ₹	2019 ₹	2020 ₹
Share Capital	300	300	400	400	Building	250	300	275	400
Reserve	250	225	100	100	Goodwill	250	225	200	200
Surplus	65	160	155	200	Machinery	100	200	215	250
Debentures	50	100	100	150	Stock	25	75	125	25
Secured Loans	60	40	50	100	Debtors	100	70	75	50
Creditors	30	40	50	15	Cash	25	5	10	75
Bank O/D	5	10	40	20	Preliminary Expenses	15	10	5	-
Other Liabilities	5	10	10	15					
	765	885	905	1,000		765	885	905	1,000

3. You are furnished with the following revenue statements of Piya Ltd. for the year ended March 31st 2020

Particulars	2017 ₹	2018 ₹	2019 ₹	2020 ₹
Sales	37,50,000	45,00,000	54,00,000	64,80,000
Less : Cost of Sales	(24,00,000)	(28,50,000)	(34,50,000)	(42,00,000)
Gross Margin	13,50,000	16,50,000	19,50,000	22,80,000
Management Expenses	2,25,000	2,62,500	3,00,000	3,37,500
Sales Expenses	3,75,000	4,50,000	5,40,000	6,48,000
Interest on Borrowings	2,25,000	3,00,000	3,75,000	4,50,000
Total Expenses	(8,25,000)	(10,12,500)	(12,15,000)	(14,35,500)
Net Profit before Depreciation and Taxation	5,25,000	6,37,500	7,35,000	8,44,500
Depreciation	(3,75,000)	(3,37,500)	(4,50,000)	(4,87,500)
Profit before Taxation	1,50,000	3,00,000	2,85,000	3,57,000
Income Tax	(60,000)	(1,50,000)	(1,38,750)	(1,80,000)
Profit after Tax	90,000	1,50,000	1,46,250	1,77,000

(a) You are asked to prepare trend analysis.

(b) Comment on the same.

4. From the following prepare income statement in vertical form showing trend percentages of M/S Lakhan Traders and comment on gross profit trend.

Particulars	2017 ₹	2018 ₹	2019 ₹	2020 ₹
Sales	5,88,000	7,14,000	7,56,000	8,40,000
Cost of Sales	2,69,500	3,27,250	3,45,800	3,85,000
Administrative Expenses	94,500	94,500	1,05,000	1,05,000
Selling and Distribution Expenses	58,800	71,400	75,600	84,000
Finance Expenses	28,000	28,000	28,000	28,000
Income tax Provision	41,160	57,855	60,270	71,400

5. Hammu and Pammu are partners of a firm carrying on business

(i) Their position as on 31st December 2018, 2019 and 2020 is as follows

Liabilities	2020 ₹	2019 ₹	2018 ₹	Assets	2020 ₹	2019 ₹	2018 ₹
Partners Capitals	8,80,000	7,48,000	6,60,000	Fixed Assets	8,80,000	7,92,000	6,16,000
General Reserve	2,20,000	2,20,000	2,20,000	Current Assets	-	-	-
Secured Loans	1,32,000	1,32,000	1,10,000	Stock	3,52,000	3,30,000	2,97,000
Unsecured Loans	3,52,000	3,96,000	3,08,000	Debtors	4,40,000	3,52,000	3,08,000
Sundry Creditors	3,52,000	1,98,000	99,000	Loans and Advances	2,20,000	1,76,000	1,32,000
				Cash & Bank Balances	44,000	44,000	44,000
	19,36,000	16,94,000	13,97,000		19,36,000	16,94,000	13,97,000

(ii) Summarised Income Statement for the year ended

Particulars	2020 ₹	2019 ₹	2018 ₹
Sales	88,00,000	79,20,000	66,00,000
Less: Cost of Sales	61,60,000	52,80,000	44,00,000
Gross Profit	26,40,000	26,40,000	22,00,000
Less: Expenses	17,60,000	17,60,000	15,40,000
Net Profit	8,80,000	8,80,000	6,60,000

Prepare Trend Statement

6. Calculate Trend Percentage from the following information extracted from Financial Statementsof Vinayak Limited Company. Give your appropriate comments

Particulars	2020 ₹	2019 ₹	2018 ₹	2017 ₹
Sales	32,802	27,290	19,768	18,224
Cost of Sales	29,956	24,982	17,626	14,864
Expenses	178	268	116	90
Interest	1,006	758	412	202
Profit Before Tax	1,662	1,282	1,614	3,068
Tax	788	396	910	1,640
Profit After Tax	874	886	704	1,428
Fixed Assets (Net)	10,978	10,222	9,554	8,972
Working Capital	10,170	9,774	6,596	5,546
Loans	?	?	?	?
Net Worth	13,382	12,034	11,714	11,908

7. From the following prepare income statement in vertical form showing trendpercentages of M/S Ferry Traders and comment on gross profit trend.

Particulars	2017 ₹	2018 ₹	2019 ₹	2020 ₹
Profit and Loss Accounts				
Sales	30,000	33,000	36,000	39,000
Cost of Sales	22,500	24,525	26,550	28,575
Expenses	2,400	2,805	3,420	3,861
Interest	675	900	1,125	1,350
Profit Before Tax	?	?	?	5,214
TaX	1,770	1,908	1,962	2,085
Profit After Tax	2,655	?	?	?
Balance Sheets				
Fixed Assets	?	?	?	?
Current Assets	45,000	?	53,400	?
Current Liabilities	?	32,700	?	38,400
Net Working Capital	15,000	16,500	17,850	19,350
Net Worth	3,00,000	32,100	33,300	34,800
Loans (Liabilities)	15,000	18,000	21,000	24,000

8. Prepare a Comparative Revenue Statement in Vertical Form from the following details

Particular	2019 ₹	2020 ₹	Particular	2019 ₹	2020 ₹
To Opening Stock	3,60,000	4,80,000	By Sales	72,00,000	96,00,000
To Purchases	36,00,000	51,36,000	By Closing Stock	4,80,000	5,76,000
To Interest on Debenture	2,40,000	2,40,000	By Dividend	39,200	62,400
To Depreciation :			By Profit on Sale of Machinery	18,400	
Furniture	24,000	24,000			
Machinery	57,600	48,000			
To Administrative Exp.	4,70,400	7,05,600			
To Selling Expenses	7,29,600	12,04,800			
To Carriage Outward	1,20,000	5,04,000			
To Loss by Fire	-	24,000			
To Wages	3,12,000	4,80,000			
To Provision for Tax	9,12,000	6,96,000			
To Net Profit	9,12,000	6,96,000			
Total	77,37,600	1,02,38,400	Total	77,37,600	1,02,38,400

9. The income statements of a Nisha Ltd. are given for the years ending on 31st March, 2019 and2020. You are required to prepare a comparative income statement and interpret the changes.

Income Statements for the year ending 2019 and 2020

Particulars	2019 ₹	2020 ₹
Sales	487500	543750
Cost of Sales	318750	375000
Gross Profit	1,68,750	1,68,750
Operating Expenses		
Selling & Distribution Expenses	45000	56250
General Expenses	18750	30000
Total Operating Expenses	63,750	86,250
Net Profit during the year	1,05,000	82,500

10. From the following balance sheet as on 31 st March, 2019 and 31st March, 2020 of M/sYahvi Ltd. Prepare Comparative balance sheet for analysis purpose in vertical form.

Particular	31st March 2019 ₹	31st March 2020 ₹
Assets		
Cash and Bank balance	8,40,000	2,80,000
Short term investments	2,80,000	12,60,000
Accounts receivable	18,20,000	14,00,000
Inventories	21,00,000	7,00,000
Prepaid Income Tax	3,50,000	2,80,000
Other Current Assets	4,20,000	3,50,000
	58,10,000	42,70,000
Land and Building	5,60,000	3,50,000
Machinery	8,40,000	7,00,000
Furniture	2,10,000	1,40,000
Leasehold Land	3,50,000	3,50,000
	19,60,000	15,40,000
	77,70,000	58,10,000
Liabilities:		
Bills payable	16,80,000	11,20,000
Accounts payable	14,00,000	7,00,000
Accrued compensation and employee benefit	7,00,000	2,80,000
Income tax payable	2,80,000	1,40,000
	40,60,000	22,40,000
Equity Capital	28,00,000	28,00,000
Reserve	9,10,000	7,70,000
	37,10,000	35,70,000
	77,70,000	58,10,000

11. From the following financial statements of Tappu Limited, prepare financial statements in Vertical Form.

Balance Sheets as at 31st December

Liabilities	31st March 2019 ₹	31st March 2020 ₹	Assets	31st March 2019 ₹	31st March 2020 ₹
Equity Share Capital	6,00,000	6,00,000	Land	3,00,000	3,60,000
9% Preference Share Capital	4,50,000	4,50,000	Factory Plant & Buildings	9,00,000	8,10,000
General Reserves	3,00,000	3,67,500	Stocks	3,00,000	4,50,000
Tax Payable	1,50,000	2,25,000	Debtors	3,00,000	4,50,000
Creditors	3,00,000	4,12,500	Cash	1,50,000	2,10,000
17% Debentures	1,50,000	2,25,000			
	19,50,000	22,80,000		19,50,000	22,80,000

Income Statement for Year Ended 31st December

Expenses	31st March 2019 ₹	31st March 2020 ₹	Income	31st March 2019 ₹	31st March 2020 ₹
Cost of goods sold	9,00,000	11,25,000	Sales	12,00,000	15,00,000
Admn. Expenses	45,000	60,000			
Selling Expenses	30,000	30,000			
Net Profit	2,25,000	2,85,000			
	12,00,000	15,00,000		12,00,000	15,00,000

Briefly comment on the difference between the stated net profit of 2020 and the increment inGeneral Reserves on 31-12-2020 assuming that no amount is paid towards tax in 2020.Also ascertain the quantum of cash gross profit of 2020 assuming that no depreciation is provided on Land.

12. From the following Financial statements of Grishma Limited prepare a common size financialstatement and give your comments on them.

Profit and Loss Account for the year ended 31st March 2020

Particular	₹	Particular	₹
To Opening Stock	4,68,000	By Sales	23,40,000
To Purchases	14,04,000	By Closing Stock	7,02,000
To Wages	2,92,500		
To Factory Overheads	2,92,500		
To G.P. c/d	5,85,000		
	30,42,000		30,42,000
To Administrative Expenses	87,750	By G.P. b/d	5,85,000
To Selling & Distribution Expenses	58,500	By Dividend	35,100
To Depreciation	76,050		
To Interest on Debentures	23,400		
To Net Profit c/d	3,74,400		
	6,20,100		6,20,100
To Preference Dividend Paid	17,550	By Balance b/d	2,34,000
To Provision for Tax	1,22,850	By Net Profit b/d	3,74,400
To Surplus to Balance Sheet	4,68,000		
	6,08,400		6,08,400

Balance Sheet as on 31st March 2013

Liabilities	₹	**Assets**	₹
Equity Share Capital	11,70,000	Goodwill	5,85,000
Preference Share Capital	5,85,000	Plant and Machinery	5,85,000
General Reserve	1,17,000	Land and Building	9,36,000
P and LA/c Balance	4,68,000	Furniture	1,17,000
Provision for Tax	1,22,850	Stock	5,85,000
Bill Payable	2,28,150	Bill Receivable	93,600
Bank Overdraft	1,17,000	Debtors	2,34,000
Creditors	5,85,000	Bank	2,57,400
	33,93,000		33,93,000

13. From the following information of Sahani Enterprises prepare the Common size Revenue Statement with Amountand % for the year ended on 31st March, 2020 in a vertical form suitable for analysis

Particulars	% on net sales of Rs.500000
Opening Stock	2
Closing Stock	2.25
Purchases	51
Office Expenses	4.5
Other Administrative Expenses	6.2
Distribution Expenses	5.7
Selling Expenses	4.65
Interest (Dr.)	1.80
Direct Wages	3.30

Provision for Income tax is to be made @25% on net profit before tax.

❖❖❖❖

4

RATIO ANALYSIS

Unit structure:

4.0 OBJECTIVES:

After studying the unit the students will be able to understand:

- Meaning and definition of ratios
- Advantages of preparing ratios
- Importance of Ratio Analysis
- Limitaions of Ratio Analysis
- Calculate various ratios to assess solvency,liquidity,efficiency and profitability of the firm.
- Apply ratio analysis to evaluate a company’s liquidity, performance & risks.
- Standardize financial information for comparision.
- Compare present performance with past performance.
- Evaluate current operations

4.1 INTRODUCTION

The basis for financial analysis, planning and decision making the financial statements which mainly consist of Balance sheet and profit and loss account.

The profit & loss account shows the operating activites of the concern over a period of time and the balance sheet shows balance activites of assets and liabilities in other words financial position of an organization at a particular point of time.

However, the above statements do not disclose all of the necessary and relevant information. For the purpose of obtaining the material and relevant information necessary for ascertaining the financial strengths and weeknesses of an enterprise, it is necessary to analyse the data depicted in the financial statement.

The financial manager has certain analytical tools which helps in financial analysis and planning . One of the main tool is **Ratio Analysis** let us discuss the Ratio Analysis in this chapter.

4.2 RATIO DEFINITION & MEANING:

Definition of Ratio

A ratio is defined as "the indicated quotient of two mathematical expressions and as the relationship between two or more things." Here, ratio means financial ratio or accounting ratio which is a mathematical expression of the relationship between two accounting figures.

According to Myers,"Ratio Analysis of financial statements is a study of relationship amoung various financial factors in a business as disclosed by a single set of statements and a study of trend of these factors as shown in a series of statements."

According to James C. Van Harne"Ratio is a yardstick used to evaluate the financial condition andperformance of a firm, relating two pieces of financial data to each other."

According to Kohler "The relation of one amountA to another B expressed as the ratioof A to B".

"Ratio is the relationship or proportion that one amount bears to another, the first number being the numerator and the later denominator."

From the above definations we conclude that ratio analysis is gives us idea about company or firms financial position. It is helpful for investors as well as company also for future better performance also they can use it.

Meaning of Ratio analysis

Ratio-Analysis means the process of computing, determining and presenting the relationship of related items and groups of items of the financial statements. They providein a summarized and consise form of fairly good idea about the financial position of a unit. They are important tool for financial analysis.

Ratio is the numericl or as arithmatical relationship between two figures. Ratio is simply one number expressed in terms of another.It is poweful tools of the financial analysis.

The data given in the financial statement does not have any importance unless a relationship is established among them . The ratio used to reveal the relationship of accounting data is called accounting ratio or ratio analysis.

Ratio may be expressed in terms of -
1) Proportion , pure, simple ratio E.g. Current asset:Current liabilities 2:1
2) Rate or times or days or coefficient e.g 5 times
3) In percentage e.g. %
4) In fraction e.g.$1/4^{th}$

Sources required for the Ratio analysis-
1) Annual Report
2) Financial statement
3) notes to accounts
4) statement of cash flow statement

Importance of accounting ratios-

1. Understanding financial statements are important for stakeholders of the company. Ratio analysis helps in understanding the comparison of these numbers: furthermore it helps in estimating numbers from income statements and balance sheets for the future. For e.g. equity shareholders looks into the P/E ratio, the dividend payout ratio etc. while creditors observe debt to equity ratio, gross margine ratio, debt to asset ratio etc.

2. Ratio analysis is important in understanding the compamy's ability to generate profit. Return of asset, return on equity tells us how much profit the company is able to generate over assets of the firm. While gross margin and operating margin ratios tell us the company's ability to generate profit from sales and operating efficiency.

3. From a managemetn and investor point of view ratio analysis helps to understand and estimate the company's future finacials and operations. Ratios formed from past finacial statement analysis helps in estimating future fianacials, budgeting and planning for the future operation of the company.

4. The company operates under various business,market,operations related risks. Ratio analysis help in understanding these risks and helps management to prepare and take necessary actios. Leverage ratios help in preforming sensitivity analysis of various factors affecting the company's profitability like sales, cost, debt, financial leverage ratios like interest coverage ratio and debt coverage ratio tell how much the company is dependant on external capital source.

5. Investor as well as the company's management,makes a comparison with competitiors company to understand efficiency, profitability and market share, ratio analysis is helpful for companies to perfromn SWOT (strengths, weakness,opportunities and threats) analysis in the market. It also tells whether the company is able to perform growth or not over a period from past financials and whether the company's financials and whether the company's financial position is improving or not.

6. A better source of communication with customers, stakeholders, and other outsider who want to invest in the company.

7. Helps in understanding the profitability of the company for decision making purpose.

8. Helps in identifying the business risks of the firm to protrect from furture threats or any losses.

9. Helps in identifying the financial risks of the company for better performance of the company or firm.

10. For planning and future forecasting of the firm ratio analysis helps more.

11. To compare the performance of the firms ratio analysis give brief idea about current position of the company.

12. Ratio analysis makes comparison easy for the user.one ratio is compared with another ratio as it shows efficiecy or utilisation of assets etc.

13. Ratio analysis helps the mangement for future best performance with help of past performance experience.

Limitations of Accounting Ratios-

The limitaions of ratio analysis which arise primarily from the nature of financial statements are as under:

1. Financial statements provide historical information. They do not reflect current conditions. Hence, it is not useful in predicting the future.

2. Correct and standard ratio can be obtained only if we have true, comparable or correct data. Lack of true comparison give false results.

3. Different companies may have differnt accounting methods if two forms follow differnent accounting policies.Different accounting policies regarding valuation of inventories, charging depreciation etc. make the accounting ratios of two firms non-comparable.

4. It is essential to have information about the company regarding its past as well as future transactions to have purposeful analysis. But ratios give informations only about the past

5. Fixed assets show the position statement at cost only. Hence, it does not reflcet the changes in price level. Thus, it makes comparison difficult.

6. Accounting ratios are tools of quantitative analysis only. But it is quite possible that qualitative aspect may be over quantitative aspects. So in this case analysis may get distorted.

7. No fixed standards can be laid down for ideal ratios. Some times ratios may be worked out for insignificant and unrelated figures. Such ratios will be misleading.e.g. current ratio 2:1

8. It might possible that some firms may manipulate the data to bring about changes to the ratio for displaying a better picture of the firn, thus in the ratio analysis there are scope of window dressing.

9. Ratio analysis may be missinterpret at a time because Profit and loss acconut is based on actual numbers and balance sheet data is base on historical so Due to mix of historical and actual numbers it may not give desired results.

10. Ratios are subject to arithmatical accuracy of the financial statements. Moreover, financial statements also include estimated data like provision for depreciation, for bad and doubtful debts etc. hence results revealed by ratios are subject to such estimates.

11. Knowledge of ratios alone is meaningless unless their composition is ascertained.

12. A ratio is a comparison of two figures, a numerator and a denominator. In comparing ratios, it may be difficult to determine whether difference are due to changes in the numerator, or in the denominator or in both.

CLASSIFICATION OF RATIOS

The ratios are used for different purposes, for different users and for different analysis. The ratios can be classified as under:

1. Traditional classification
2. Functional classification
3. Classification from the point of view of users

The above classifications can be elaborated as follows:

- **TRADITIONAL CLASSIFICATION**

Form this point of view the ratios are classifited as follows:

i. **Balance sheet ratios-**

This ratio is also known as financial ratios. The ratios which express relationship between two items or group of items mentioned in the balance sheet at the end of the year, Some examples of balance sheet ratios are as follows:

Current ratio
Quick ratio
Propretary ratio
Stock to working capital
Debt equity ratio
Capital gearing ratio

ii. Income statement ratios-

This ratio is also known as Revenue statement ratios which expressed in relationship between two items or two groups of items which are found in the income statement of the year.

Some examples of income statement ratios are as follows:
Gross profit ratio
Operating cost ratio
Operating profit ratio
Net profit ratio
Stock tournover ratio

iii. Inter statement ratios-

These ratios shows the relationship between two items or two groups of items of which one is from balance sheet and another from income statement(trading a/c and profit & loss a/c and balance sheet)
Somr examples of inter statement ratios are as follows:
Return on investment
Return on equity capital ratio
Trade receivable turnover ratio
Trade payabeles turnover ratio
Fixed assets turnover ratio
Earning per share

- **FUNCTIONAL CLASSIFICATION**

The accounting ratios can also be classified according to their functions as follows:

i. **Liquidity Ratios-**

These ratios shows relationship between current assets and current liabilities:
Some examples of liquidity ratios:
Current Ratio
Quick Ratio

ii. Leverage Ratios/Long term solvency ratios-

These ratios shows relationship between proprietor's fund and debts used in finanacing the assets of the business organization.
Some examples of leverage ratios:
Debt equity ratio
Proprietary ratio
Capital gearing ratio

iii. **Activity Ratios/Turnover ratios-**

This ratio is also known as turnover or productivity ratio or efficiency and performance ratio. These ratio shows relationship between the sales and the assets. These are designed to indicate the efficiency of the firm or company in using funds, degress of efficiency, and its standard of performance of the organization.

Some examples of Activity ratios are as follows:

Stock turnover ratio

Trade receivables turnover ratio

Trade payables turnover ratio

Fixed assets turnover ratio

iv. Profitability ratios-

These ratios show relationship between profits and sales and profit and investments. It reflects overall performance of the organizations, its ability to earn return on capital employed and effectiveness of investment policies

Some example of profitability ratios are as follows:

Gross profit ratio

Operating cost ratio

Operating cost ratio

Net proft ratio

Return on investment

v. Coverage ratios-

These ratios show relationship between profit in hand and claims of outsiders to be paid out of profits.

Some examples of coverage ratios are as follows:.

Dividend payout ratio

Debt service ratio

Debt service coverage ratio

- **CLASSIFICATION FROM THE POINT OF VIEW OF USERS**

Ratios from the users point of view are classified as follows:

i. Shareholder's point of view

These ratios are serve the purpose of shareholders. Shareholders, generally expect the reasonable return on their capital.They are interested in the safety of shareholders investments and interest on it.

Some examples it as follows:

Return of proprietor's fund

Return on capital

Earning per share

ii. Long term creditors

This ratio provides useful information to the long term creditors which include debenture holders,vendors of fixed assets etc. The creditors interested know the ability of repayment of principle sum and periodical interest payments as and when they become due.

Some examples of it are as follows:

Debt equity ratio

Return on capital employed
Proprietary ratio

iii. Short term creditors

The short term creditors are basically interested to know their repayment ability of the firm. Therefore, the creditors has important place on the liquidity aspects of the company's assets.

Some examples of it are as follows:
Current ratio
Debtor's turnover ratio
Stock working capital ratio

iv. Management

Management is interested to use borrowed funds to improve the earnings.

Some examples of its are as follows:
Return on capital employed
Turnover ratio
Operating ratio
Expense ratio

Balance sheet Ratios/ Liquidity Ratios/ Short term solvency Ratios

The term 'liquidity' and 'short-term solvency' are used synonymously.

Liquidity or short-term solvency means ability of the business to pay its short-term liabiliites.Inability to pay-off short-term liabilities affects its credibility as well as its credit rating. Continuous default on the part the business leads to commercial bankruptcy. Eventually such commercial bankruptcy may lead to its sickness and dissolution. Short-term lenders and creditors of a business are very much intersted to know its state of liquidity because of their finaicial stake. Both lack of sufficient liquidity and excess liquidity is bad for the organization.

1. **Current Ratio-** The Currrent Ratio is one of the best known measures of short term solvency. It is the most common measures of short term liquidity.

Current ratio measures whether a firm had enough resources to meet its current obligations.

Formula:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current Assets= Inventories+Sundry Debtors+Cash and Bank Balances+Receivables/Accruals+Loans and advances+Disposable investment+any other current asset.

Current Liabilities= Creditor for goods and services+Short term loans+bank overdraft+cash credit+outstanding expenses+provision for taxation+proposed divided+unclaimed dividend+any other current liabilites.

A generally accepted current ratio is 2:1 But whether or not a specific ratio is satisfactory depends on the nature of the business and the characteristics of its current assets and liabilities.

Example:
Calculate Current Ratio from the following information

Particulaers	Rs.
Inventories	50,000
Trade Receivables	50,000
Advance tax	4,000
Cash and cash equivalent	30,000
Trade payables	1,00,000
Short term borrowings(bank overdraft)	4,000

Solution:
Current Ratio = Current Assets/Current Liabilities

Current Assets = Inventories+Trade receivables+Advance tax+Cash and cash equivalents
=Rs. 50,000+Rs.50,000+Rs.4,000+Rs.30,000
=Rs.1,34,000

Current liabilities = Trade payables+short-term borrowings
=Rs.1,00,000+Rs.4,000
=Rs.1,04,000

Current Ratio = Rs.1,34,000/ Rs.1,04,000 =1.29:1

Since, excess of current asset over current liabilities provide a measures of safety margin available against uncertainty in realisation of current assets and flow of funds.The ratio should be reasonable.It should be neither be very high or very low. Both the situations have their inherent disadvantages. A very high current ratio implies heavy investment in current assets which is not a good sign as it reflects under utilisation or improper utilisation of resources. A low ratio dagerous for business and put it at risk of facing a situation where it will not be able to pay its short-term debt on time.Normally, it is safe to have this ratio within range of 2:1

2. Quick or Liquid ratio-

It is the ratio of quick(or liquid) asset to current liabilities. It is expressed as :

Quick ratio = Quick Asset:Current Liabilities

Or

$$\frac{\text{Quick Assets}}{\text{Current Liabilites}}$$

Quick assets means those assets which are quickly convertible into cash. While calculating quick assets we exclude the inventories at the end and other current assets such as prepaid expenses,advance tax etc. from the current assets. Due to exclusion of non-liquid current assets it is better than current ratio as a measure of liquididty position of the business. It is calculated to serve as a supplimentary check on liquidity position of the business and is therefore,also known as ‘Acid-Test Ratio’.

Illustration:

Calculate quick ratio from the information given in illustration 1

Solution :

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Quick Liabilities}}$$

Quick Assets = Current Assets- (Inventories+Advance tax)

= Rs1,34,000- (Rs.50,000+Rs.4,000)

= Rs 80,000

Quick Liabilities= Rs 1,04,000 – 4,000

$$\text{Quick Ratio} = \frac{\text{Rs.80,000}}{\text{Rs. 1,00,000}} = 0.80:1$$

This Ratio Provides a measures of capacity of the business to meet its short term obligation without any flaw. Normally, it is advovated to be safe to have a ratio of 1:1 as unnecessarily low ratio will be very risky and high ratio suggests unnecessarily deployment of resources in otherwise less profitable short term investments.

3. Proprietary Ratio-

Proprietary ratio express relationship of properietors fund to net assets and its calculated as follows:

$$\text{Properietary ratio} = \frac{\text{Shareholders fund}}{\text{Capital employed/ Net assets}}$$

OR

$$\text{Properietary ratio} = \frac{\text{Proprietary fund}}{\text{Total Assets}}$$

Properietary fund includes equity share capital, preference share capital and reserves and surplus

Total assets exludes fictitious assets and losses

This ratio indicates that the proportion of total assets financed by shareholders. Higher the ratio less risky scenario it shall be

4. Stock Working Capital Ratio-

This ratio is calculated as follows:

$$\text{Stock Working capital ratio} = \frac{\text{Closing Stock}}{\text{Working Capital}}$$

This ratio indicates the extent of working capital turned over in achieving sale of the firm

5. Capital Gearing Ratio-

Capital Gearing ratio is calculated to show the proportion of fixed interest (Dividend) bearing capital to funds belonging to equity shareholders i.e equity funds or net worth again higher ratio may indicate more risk

Capital Gearing ratio =

$$\frac{\text{Preference share capital + Debentures+Other borrowed funds}}{\text{Equity Share Capital+ Reserves and surplus- Losses}}$$

6. Debt Equity Ratio-

$$\text{Debt Equity ratio} = \frac{\text{Long Term Debt}}{\text{Shareholder's Fund}}$$

OR

$$= \frac{\text{Total Outside liabilities}}{\text{Shareholder's Equity}}$$

OR

$$= \frac{\text{Total Debt}}{\text{Shareholder's Equity}}$$

Where:

Shareholder's Funds (Equity) = Share capital+ Reserves and Surplus+ Money received against share warrants + Share application money pending allotment

Share capital = Equity Share capital+ Preference Share capital

OR

Shareholder's Fund(Equity) = Non Current assets + Working capital – Non current liabilities

Working Capital = Current Assets- Current liabilities

Not merely Long term debt i.e both current and non current liabilities
Some times only interest bearing, Long term debt used instead of total liabilities (exclusive of current liabilities)

A high debt to equity ratio means less protection for creditors, a low ratio on the other hand indicates a wider safety for creditors. The ratio indicates the proportion of debt fund in relation to equity. The ratio is used for making capital strucrture decisions such as issue of shares and debentures, lenders are also very eager to know this ratio since it shows relative weights of debt and equity. Debt equity ratio is the indicator of firms financial leaverage.

This ratio measures the degree of indebtedness of an enterprise and gives an idea to the long term lenders regarding extend of security of the debt.

Illustration :
From the following balance sheet of ABC Co. Ltd as on March 31, 2022 Calculate debt equity ratio

Particulars	Amount (Rs)
I. Equity and Liabilities	
1. Shareholder's Fund	
(a) Share capital	12,00,000
(b) Reserves and surplus	2,00,000
(c) Money received against share warrants	1,00,000
2. Non current liabilities	
(a) Lonag term borrowings	
(b) other long term liabilities	4,00,000
(c) long term provisions	40,000
3. Current liabilites	60,000
(a) Short term borrowings	2,00,000
(b) Trade Payables	1,00,000
(c) Other Current Liabilities	50,000
(d) Short Term Provisions	1,50,000
II. Assets	**25,00,000**
1. Non current Assets	15,00,000
(a) Fixed Assets	2,00,000
(b) Non Current Investments	1,00,000
(c) Long Term Loans and advances	
2. Current Assets	1,50,000
(a) Current Investment	1,50,000
(b) Inventories	1,00,000
(c) Trade Receivables	2,50,000
(d) Cash and cash Equivalents	50,000
(e) Short term loans and advances	**25,00,000**

Solution:

Debt Equity Ratio = $\frac{\text{Debts}}{\text{Equity}}$

Debt = Long term borrowings+other long term liabilities+long term Provisons

=Rs.4,00,000+Rs.40,000+Rs.60,000

=Rs.5,00,000

Equity =Share capital+Reserves and surplus+Money received against share warrants

=Rs.12,00,000+Rs.2,00,000+Rs.1,00,000

=Rs.15,00,000

Alternatively,

Equity = Non current assets+working capital-non current liabilities

= Rs.18,00,000+Rs.2,00,000-Rs.5,00,000

=Rs.15,00,000

Working Capital= Current assets-current liabilites

=Rs.7,00,000-Rs.5,00,000

=Rs.2,00,000

Debt Equity Ratio = $\frac{50,000}{1,50,000}$ = 0.33:1

Revenue Statement Ratio

1. Gross Profit Ratio/Gross profit margin-

Gross profit ratio as a percentage of revenu from operations is computed to have an idea about gross proft. It measures the percentage of each sale in rupees remaining after payment for the goods sold.It is calculated as follows:

Gross profit ratio = $\frac{\text{Gross profit}}{\text{Net Revenue of operations}} \times 100$

Or

= $\frac{\text{Gross Profit}}{\text{Sales}} \times 100$

Gross profit margin depends on the relationship between sales price, volume and costs. A high Gross profit margin is a favourable sign of good management.

2. Operating Ratio-

It is computed to analyse cost of operation in relation to revenun from operations. Is is calculated as follow:

Operating Ratio= $\frac{\text{Cost of Revenue from operation+Operating Expenses}}{\text{Net Revenue from operation}} \times 100$

Operating expenses include office expenses, administrative expenses, selling expenses, distribution expeses, Depreciation and employee benefit expenses etc.

Cost of operation is determined by excluding non-operating incomes and expesnses such as loss on sale of assets, interest paid, dividend received, loss by fire, speculation gain and so on.

Operating Profit Ratio

Operating profit ratio is also calculated to evaluate operating performance of business or organisation.

$$\text{Operating Profit Ratio} = \frac{\text{Operating profit}}{\text{Sales}} \times 100$$

Or

$$= \frac{\text{Earning before interest and taxes(EBIT)}}{\text{Sales}} \times 100$$

Where as,

Operating profit=Sales-Cost of Goods Sold(COGS)-Operating expenses

Operating profit ratio measures the percentage of each sale in rupees that remains after the payment of all costs and expenses except for interest and taxes. The ratio is followed closely by analysts because it focuses on operating results.operating profit is often referred to as earning before interest and taxes or EBIT

3. Expense ratios-

Based on different concepts of expenses it can be expressed in different variants as below:

I. Cost of goods sold(COGS)Ratio = $\frac{\text{COGS}}{\text{sales}} \times 100$

II. Operating expenses ratio = $\frac{\text{Administrative exp+selling \& distribution OH}}{\text{Sales}} \times 100$

III. Operating Ratio = $\frac{\text{COGS+ Operarting expenses}}{\text{Sales}} \times 100$

IV. Financial Expenses Ratio = $\frac{\text{Financial expenses}}{\text{Sales}} \times 100$

*It excludes taxes, loss due to theft, goods destroyed by fire etc.

4. Net profit ratio- Net profit ratio is based on all inclusive concept of profit .It relates revenue from operations to net profit after operational as well as non-operational expenses and incomes. It is calculated as under:

Net profit ratio=Net profit/Revene from operations × 100

Or

=Net profit/sales × 100

Or

= Earnings after taxes(EAT)/Sales × 100

Or

Pre-Tax Profit Ratio= Earnings before taxes (EBT)/Sales × 100

Generally, net profit refers to profit after tax (PAT)

It is a measures of net profit margin in relation to revenue from operations. Besides revealing profitability. It is the main variable in computaion of

return on investment. It reflects the overall efficiency of the business,assumes great significance from the point of view of investors.
Net profit ratio finds the proportion of revenue that find its way into profits after meeting all expenses. A high net profit ratio indicates positive returns from the business.

5. Stock turnover ratio

This ratio is a considerable amount of a company's capital may be tied up in the financing of raw materials, work-in-progress and finsihed goods. It is important to ensure that the level of stocks is kept as low as possible , consistent with the need to fulfill customer's orders in time.

$$\text{Stock turnover ratio} = \frac{\text{COGS} \quad \text{or} \quad \text{Sales}}{\text{Average Inventory}}$$

Average inventory = (Opening Stock+Closing Stock)/2

The highest the stock turnover rate or the lower the stock turnover period the better, although the ratios will vary between companies.This ratio measures that how many times stock has been sold during the year.

Combined Ratios

1. **Return on capital employed (ROCE)-** It is another variation of ROI the ROCE is calculated as follow.

$$\text{ROCE(before tax)} = \frac{\text{Earnings before interest and taxes(EBIT)}}{\text{Capital Employed}} \times 100$$

$$\text{ROCE (after tax)} = \frac{\text{EBIT(1-t)}}{\text{Capital Employed}} \times 100$$

Sometimes it also calculated as

$$= \frac{\text{Net profit after taxes (PAT/EAT)}}{\text{Capital Employed}} \times 100$$

Where as
Capital Employed = Total assets-Current liabilities
Or
= Fixed assets+Working capital
Or
= Equity+Long term debt

The return on capital employed should be always higher than the rate at which the company borrows.

Intangible assets should be included in the capital employed.

No fictitious assets should be included in within capital employed.

If there is information available regarding average capital employed shall be taken.

2. Return on proprietor's Fund-

This ratio is important from shareholders point of view in assessing whether their investment in the firm generates a reasonable return or not. It should be higher than the return on investment otherwise it would imply that company's funds have not been employed profitability.

A better measure of profitability from shareholders point of view is obtained by determining return on total shareholder's funds,it is also termed as return on shareholder's fund

Formula:

$$\text{Return on proprietor's fund} = \frac{\text{Profit After Tax}}{\text{Shareholders funds}} \times 100$$

3. Return on equity share capital- Return on equity measures the profitability of equity funds invested in the firm or company. This ratio shows how profitability of the shareholders have been utilised by the company. This ratio also measures the percentage of return generated to equity shareholders

$$\text{ROE} = \frac{\text{Net profit after taxes-prefernce dividend(if any)}}{\text{Net worth/ equity shareholdre's funds}} \times 100$$

4. Debtor's Turnover Ratio(Debtor's Velocity)-

This ratio measures whether the amount or resources tied up in debtors, is reasonable and whether the company has been efficient in converting debtors into cash.

Formula:

$$\text{Debtor's Turnover ratio} = \frac{\text{Credit Sales}}{\text{Average Debtores}} \times 100$$

$$\text{Debtor's Velocity Ratio} = \frac{\text{Average Debtors}}{\text{Credit sales}} \times 365 \text{ days}$$

Average debtors collection period measures how long it takes to collect amounts from this ratio

5. Earning Per share (EPS)

The profitability of a firm from the point of view of ordinary shareholder's can be measured in term of earnings per share basis. It is calculated as follow:

$$\text{EPS} = \frac{\text{Net profit available to equity shareholders}}{\text{Number of equity shares outstanding}}$$

This ratio is very important from equity shareholders point of view and also for the share price in the stock market. This also helps comparision with other to ascertain its reasonableness and capacity to pay dividend.

6. Dividend Payout ratio-

This ratio measures the dividend paid in relation to net earnings. It is determined to see to how much extent earnings per share have been reatined by the management for the business.it is calculated as follows:

Dividend payout ratio = $\frac{\text{Dividend per equity share (DPS)}}{\text{Earning per share (EPS)}}$

7. Price earning ratio-

The price earning ratio indicates the expectation of equity investors about the earnings of the firm. It relates earnings to market price and is generally taken as a summary measure of growth potential of an investment, risk characteristics, shareholders orientation,coperate image and degree of liquidity. It is calculated as

Price-Earnings per share (P/E Ratio) = $\frac{\text{Market price per share (MPS)}}{\text{Earning per share(EPS)}}$

It indicates the payback period of the investor or prospective investors. A higher P/E ratio could either mean that a company's stock is over-valued or the investors are expecting high growth rate in future

Ratios at a glance

Sr. no	Ratio	Formula	Interpretation
1	Current Ratio	$\frac{\text{Current Asset}}{\text{Current Liabilities}}$	A simple measure that estimates whether the business can pay short term debts. Ideal ratio is 2:1
2	Quick Ratio	$\frac{\text{Quick Assets}}{\text{Current Liabilities}}$	It measures the ability to meet current debt immediately. Ideal ratio is 1:1
3	Proprietary Ratio	$\frac{\text{Properietary Fund}}{\text{Total Assets}}$	It measures the proportion of total assets financed by shareholders.
4	Stock working capital ratio	$\frac{\text{Closing Stock}}{\text{Working Capital}}$	This ratio indicates the extent of working capital turned over in achieving sale of the firm
5	Capital gearing ratio	$\frac{\text{(Preference+Debentures+other borowed funds}}{\text{(Equity share capital+Reserves \& Surplus-losses)}}$	It shows the proportion of fixed interest bearing capital to equity shareholder's fund. It also signifies the advantage of financial leverage to the equity shareholders.
6	Debt equity ratio	$\frac{\text{Long Term Debt}}{\text{Shareholder's Fund}}$ OR $\frac{\text{Total Outside Liabilities}}{\text{Shareholder's}}$	This ratio measures the degree of indebtedness of an enterprise and gives an idea to the long term lenders regarding extend of security of the debt.

		Equity OR Total Debt Shareholder's Equity	
7	Gross profit ratio	$\frac{\text{Gross profit}}{\text{Sales}} \times 100$	This ratio tells us something about the business's ability & consistancy to control its production costs or to manage the margins it makes on products it buys and sells.
8	Operating ratio	$\frac{\text{COGS+Operating Expenses}}{\text{Sales}} \times 100$	It measures portion of a particular expenses in comparison to sales
9	Operating Profit ratio	$\frac{\text{Operating profit}}{\text{Sales}} \times 100$ OR $\frac{\text{Earning before interestand taxes (EBIT)}}{\text{Sales}} \times 100$	The ratio is followed closely by analysts becauseit focuses operating results. Operating profitis often referred to as earning before interest and taxes or EBIT
10	Expense ratio	$\frac{\text{Administrative exp+selling \& Distribution OH}}{\text{Sales}} \times 100$	It measures portion of a particular expenses in comparison to sales
11	Net profit ratio	$\frac{\text{Net Profit}}{\text{Sales}} \times 100$	It measures the relationship between net profit and sales of the business
12	Stock turnover ratio	$\frac{\text{COGS}}{\text{Average inventory}}$	This ratio measures that how many times stock has been sold during the year.
13	Return on capital employed	Before tax= $\frac{\text{EBIT}}{\text{Capital Employed}} \times 100$ Afer Tax = $\frac{\text{EBIT (1-t)}}{\text{Capital Employed}} \times 100$	It measures overall earnings(either before or after tax) on total capital employed.
14	Return on Proprietor's Funds	$\frac{\text{Profit after tax}}{\text{Shareholder's fund}} \times 100$	A better measure of profitability from shareholders point of view is obtained by determining

			return on total shareholder's funds.
15	Return on equity share capital	Net profit after taxes-prefernce dividend (if any) × 100 / Net worth/ equity shareholdre's funds	It indicates earnings available to equity shareholder's in comparison to equity shareholder's net worth.
16	Debtor's Turnover ratio	Credit sales × 100 / Average Debtor's	It measures the efficiency at which firm is managing its receivables.
17	Debtor's velocity	Average Debtor's × 365days / Credit Sales	It measures the velocity of collection of receivables.
18	Earning per share	Net profit available to equity shareholders / Number of equity shares outstanding	EPS measures the overall profit generated for each share in existence over a particular period.
19	Dividend payout ratio	Dividend per equity share(DPS) / Equity per share(EPS)	It measures dividend paid based on market price of shares.
20	Price Earning ratio	Market Price Per Share (MPS) / Earning Per Share (EPS)	At any time, the P/E ratio is an indication of how highly the market "rates" or "values" a business. A P/E ratio is best viewed in the context of a sector or market average to get a feel for relative value and stock market pricing.

Exercise with solution

1) The following information available for the year 2021-2022 calculate GP ratio:

Revenue from the operatios:	Cash	25000
	Credit	75000
Purchases	Cash	15000
	Credit	60000
Carrigae inwards		2000
Salaries		25000
Decrease in inventory		10000
Return outwards		2000
Wages		5000

Solution:

Revenue from operations= Cash revenue from operations+Credit revenue from operation

=Rs.25,000+Rs.75,000=Rs1,00,00

Net purchases =Cash purchases+credit purchases-Return outwards

=Rs15000+Rs.60000-Rs.2000=Rs.73000

Cost of revenue from =Purchases+(opening inventory-closing inventory)+Direct operations expenses

=Purchases+Decrease in inventory+Direct Expenses

Rs.73000+Rs10000+(Rs2000+Rs5000)

= Rs 90000

Gross profit = Revenue from operations-Cost of revenue from operations

=Rs100000-Rs90000

= Rs10000

Gross profit ratio= Gross profit/Net revenue from operations 100

= Rs 10000/Rs100000 100

=10%

2) A trader carries an average stock of Rs.80,000. His stock turnover is 8 times. If he sells goods at profit of 20% on sales. Find out the profit.

Solution:
Stock turnover ratio= Cost of goods sold/Average stock
= Cost of goods sold/Rs.80,000

Cost of goods sold = Rs.80,000×8
= Rs.6,40,000

Sales= Cost of goods sold×100/80
= Rs.6,40,000×100/80
= Rs.8,00,000

Gross profit=Sales-Cost of goods sold
=Rs.8,00,000-Rs.6,40,000
=Rs.1,60,000

3) The total sales (all credit) of a firm are Rs.6,40,000. It has a gross profit margin of 15 per cent and a current ratio of 2.5 . The firm's current liabilities are Rs.96000; inventories Rs.48,000 and cash Rs.16,000.

a) Determine the average inventory to be carried by the firm, if an inventory turnover of 5 times is expected?(Assume 360 days a year)

b) Determine the average collection period if the opening balance of debtors is intended to be of Rs.80,000?(Assume 360 days a year).

Solution:

a) Inventory turnover = $\frac{\text{Cost of goods sold}}{\text{Average inventory}}$

Since gross profit margin is 15 per cent, the cost of goods sold should be 85 per cent of the sales.

Cost of goods sold=0.85×Rs.6,40,000=Rs.5,44,000
Thus, Average inventory = COGS/Inventory Turnover
= 5,44,000/5
Average inventory = Rs.1,08,000

b) Average collection period= $\frac{\text{Average receivables} \times 360 \text{ days}}{\text{Credit sales}}$

Averagte receivables= (opening receivables+closing receivables)/2

Closing balance of receivables is found as follows:

Particulars	Rs.	Rs.
Current assets(2.5 of current liabilities)		2,40,000
Less: Inventories	48,000	

Cash	16,000	64,000
Closing Receivables		1,76,000

Average receivables =(Rs.1,76,000+Rs.80,000)/2
=Rs.1,28,000

So, average collection period = $\frac{\text{Rs.1,28,000} \times 360 \text{ days}}{\text{Rs.6,40,000}}$
= 72 days.

4) The following Trading and profit and loss account of fantasy ltd. For the year 31/03/2022 is given below.

Particulars	Rs.	Particulars	Rs.
To Opening stock	76,250	By Sales	5,00,000
To Purchases	3,15,250	By Closing stock	98,500
To Carriage and Freight	2,000		
To Wages	5,000		
To Gross profit c/d	2,00,000		
	5,98,000		5,98,000
To Administration Expenses	1,01,000	By Gross profit b/d	2,00,000
To selling and dist expenses	12,000	By non operating incomes:	
Non operating expenses	2,0000	Interest on securities	1,500
Financial expenses	7,000	Dividend on shares	3,750
Net profit c/d	84,000	Profit on sale of shares	750
	2,06,000		2,06,000

Calculate:
1) Gross profit Margin 2) Expenses ratio 3) Operating ratio 4) Net profit ratio 5) Operating (net) profit ratio 6) stock turnover ratio

Solution:

1) Gross profit margin= $\frac{\text{Gross profit} \times 100}{\text{Sales}}$

$= \frac{2,00,000 \times 100}{5,00,000}$

= 40%

2) Expenses ratio = $\frac{\text{Op. Expenses}}{\text{Net sales}} \times 100$

$= \frac{1,13,000}{5,00,000} \times 100$

$= 22.60\%$

3) Operating ratio = $\frac{\text{Cost of goods sold+op. expenses}}{\text{Net sales}} \times 100$

$= \frac{3,00,000+1,13,000}{5,00,000} \times 100$

$= 82.60\%$

Cost of goods sold = Op. stock+purchases+carriage and freight+wages - Closing stock

= 76,250+3,15,250+2,000+5,000-98,500

= Rs.3,00,000

4) Net profit ratio = $\frac{\text{Net profit}}{\text{Net sales}} \times 100$

$= \frac{84,000}{5,00,000} \times 100$

$= 16.8\%$

5) Operating profit ratio = $\frac{\text{Operating profit}}{\text{Net sales}} \times 100$

Operating profit= sales-(op exp+admin exp)

$\frac{87,000}{5,00,000} \times 100$

$=17.40\%$

6) Stock Turnover ratio = $\frac{\text{Cost of goods sold}}{\text{Avg stock}}$

$\frac{3,00,000}{87,375}$

5) The Balance Sheet of Punjab Auto Limited as on 31-12-2002 was as follows

Particular	Rs.	Particular	Rs.
Equity Share Capital	40,000	Plant and Machinery	24,000
Capital Reserve	8,000	Land and Building	40,000
Capital Reserve	8,000	Furniture & Fixtures	16,000
8% Loan on Mortage	32,000	Stock	12,000
Creditors	16,000	Debtors	12,000
Bank overdraft	4,000	Investment (Short-term)	4,000
Taxation:		Cash in hand	12,000

Current	4,000		
Future	4,000		
Profit and Loss A/c	12,000		
	1,20,000		1,20,000

From the above, compute (a) the Current Ratio, (b) Quick Ratio, (c) Debt-Equity Ratio, and (d) Proprietary Ratio.

Solution:

(Problem related to Balance Sheet Ratio)

1. Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Current Assets= Stock+debtors+Investment (Short term)+ Cash in hand

Current Liabilities=Creditors+bank overdraft+Provision for taxation (Current & Future)

CA =12,000+12,000+4,000+12,000 = 40,000

CL=16,000+4,000+4,000+4,000 = 28,000

$= \frac{40,000}{28,000}$

= **1.43:1**

2. Quick Ratio = $\frac{\text{Quick Assets}}{\text{Quick Liabilities}}$

Quick Assets = Current Assets-Stock

Quick Liabilities = Current Liabilities - (BOD+PFT future)

QA= 40,000-12,000

= 28,000

QL = 28,000-(4,000+4,000)

= 20,000

$= \frac{28,000}{20,000}$

= **1.40:1**

3. Debt-Equity Ratio = $\frac{\text{Long Term Debt (Liabilities)}}{\text{Shareholders Fund}}$

LTL = Debentures + Long term loans

SHF = Eq.Sh.Cap.+ Reserves & Surplus+Preference Sh. Cap. – Fictitious Assets

LTL =32,000

SHF= 40,000+8,000+12,000

= 60,000

$= \frac{32,000}{60,000}$

= **0.53:1**

4. Proprietary Ratio = $\frac{\text{Shareholder's Funds}}{\text{Total Assets}}$

SHF=Eq.Sh. Cap.+ Reserves & Surplus + Preference Sh. Cap.-Fictitous Assets

Total Assets = Total Assets-Fictitious Assets

SHF=40,000+8,000+12,000

= 60,000

TA = 1,20,000

$= \frac{60,000}{1,20,000}$

= **0.5:1**

6) Cash Purchased ratio Rs.1,00,000 cost of goods sold Rs. 3,00,000 opening stock Rs.1,00,000 and closing stock Rs.2,00,000. Creditors turnover ratio 3 times. Calculate the opening and closing creditors if the creditors at the end were 3 times more than the creditors at the begining.

Solution

Total Purchase = Cost of goods sold + closing stock-opening stock

= Rs.3,00,000+2,00,000 – Rs.1,00,000

= Rs.4,00,000

Credit purchase = Total purchase-cash purchase

= Rs.4,00,000-1,00,000

= Rs.3,00,000

Creditor Turnover Ratio = Net Credit Purchase / Average Creditor

Average Creditor = Rs. 3,00,000/ 3

= Rs.1,00,000

(Opening Creditor + Closing Creditor)/2=Rs.1,00,000

Opening Creditor + Closing Creditor) = Rs.2,00,000

(Opening Creditor + (Opening Creditor+3 Opening Creditor)

= Rs.2,00,000

Opening Creditor = Rs.40,000

Closing Creditor = Rs.40,000+(3×Rs.40,000)

= Rs.1,60,000

7) Calculate Gross Profit ratio from the following information:

Opening stock Rs. 50,000; closing stock Rs.75,000; cash sale Rs.1,00,000; credits sales Rs.1,70,000; Returns outwards Rs.15,000; purchased Rs.2,90,000; advertisement expenses Rs.30,000; carriage inwards Rs.10,000

Solution :

Cost of goods sold = Opening stock+net purchase + direct expenses-closing stock

= Rs. 50,000 + (Rs. 2,90,000 – Rs. 15,000) + Rs. 10,000 -Rs.75,000

= Rs. 2,60,000

Total Sales = Cash Sales + Credits Sales

= Rs.1,00,000+Rs.1,70,000

= Rs. 2,70,000

Gross profit= Total Sales-Cost of goods sold
= Rs.2,70,000-Rs.2,60,000
= Rs. 10,000

Gross profit Ratio = $\frac{10,000 \times 100}{2,70,000}$
= **3.704%**

8) M/s. Vinay Ltd. Presents the following Trading and Profit & Loss A/c for the year ended 31.3.2014 and balance sheet as on that date.

Trading and Profit and Loss account for the year ended 31.3.2014

Particulars	Amt	Particulars	Amt
To opening stock	2,00,000	By sales	12,00,000
To purchases	5,00,000	By closing Stock	4,00,000
To Wages	3,00,000		
To Gross Profit c/d	6,00,000		
	16,00,000		16,00,000
To Salaries	1,50,000	By Gross Profit b/d	6,00,000
To Rent	60,000	By Profit on sale of Machinery	5,000
To Commission	12,000	By Interest	15,000
To Advertising	20,000		
To Interest	83,000		
Depreciation	30,000		
To Provision for tax	50,000		
To Net Proft c/d	2,15,000		
	6,20,000		6,20,000
To Proposed	80,000	By balance b/f	1,85,000
To Preference	16,000	By Net profit b/d	2,15,000
To Balance c/d	3,04,000		
	4,00,000		4,00,000

Balance sheet as on 31.3.2014

Liabilities	Amt	Assets	Amt
Equity share capital (Rs.100)	8,00,000	Land and Building	6,00,000
8% Pref. Sh.Capital	2,00,000	Plant and Machinery	5,50,000
Reserve and surplus	3,04,000	Furniture	4,00,000
7% Debentures	5,00,000	Investment	2,70,000

Loan from IDBI	6,00,000	Stock	4,00,000
Creditors	1,50,000	Debtors	2,00,000
Bills Payable	50,000	Bills receivable	1,60,000
Provision for tax	50,000	Advance tax	30,000
Dividend Payable	96,000	Prepaid expenses	40,000
		Cash in Hand	20,000
		Bank Balance	60,000
		Dis. On issue of Debentures	20,000
	27,50,000		27,50,000

Additional information :

1) The Market Price of equally shares as on 31.03.2014 was Rs. 90.
2) Out of total sales, 30% are cash sales and out of total Purchases,50% are credit purhases. You are required to calculate the following Ratios:

a) Return on Capital employed
b) Price earning Ratio
c) Debt Service Ratio
d) Creditors Turnover Ratio
e) Return of equity capital

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Solution:

Return on capital employed	NOPBIT / Capital Employed ×100 NOPBIT Capital Employed	3,28,000 x 100 / 24,04,000 6,00,000-1,50,000-60,000 -12,000-20,000-30,000 8,00,000+2,00,000+3,04,000+5,00,000+6,00.000	13.64%
Creditors Turnover Ratio	Credit Purchase / Avg Creditors + Bills payable	2,50,000 / 2,00,000	1.25 Time
Price Earning Ratio EPS	MPS / EPS Net Profit-Pref. Div / No.of Equity Shares	90 / 24.88 2,15,000-16,000 / 8,000	3.62 24.88
Return on	NPAT - Pref. Div	2,15,000- 16,000 × 100	24.875%

Equity Capital	Eq.Sh Cap	8,00,000	
Debit Equity Ratio	NPBIT / Interest	2,15,000+50,000+83,000 / 83,000	4.19 Times

9) X Co. has made plans for the next year. It is estimated that the company will employ total assets of Rs.8,00,000; 50% of the assets being financed borrowed capital at an interest cost of 8% per year. The direct costs for the year are estimated at Rs. 4,80,000 and all the operating expenses are estimated at Rs.80,000. The goods will be sold to customers at 150% of the direct costs. Tax rate is assumed to be 50%.

You are required to CALCULATE; (i) Operating profit margin (before tax) (ii) net profit margin (after tax) (iii) return an assets (an operating profit after tax); (iv) asset turnover and (v) return on owner's equity.

Solution:
The net profit is calculated as follows:

Particulars	Rs.
Sales (150% of Rs.4,80,000)	7,20,000
Direct costs	(4,80,000)
Gross profit	2,40,000
Operating expenses	(80,000)
Profit before interest and Tax (EBIT)	1,60,000
Interest changes (8% of Rs. 4,00,000)	(32,000)
Profit before taxes	1,28,000
Taxes (@) 50%	(64,000)
Net profit after taxes	64,000

(i) Operating profit margin $= \frac{\text{EBIT}}{\text{Sales}} = \frac{\text{Rs. 1,60,000}}{\text{Rs. 7,20,000}} = 0.2222$ or 22.22%

(ii) Net profit margin $= \frac{\text{Net Profit after taxes}}{\text{Sales}} = \frac{\text{Rs.64,000}}{\text{Rs.7,20,000}} = 0.089$ or 8.9%

(iii) Return on assets $= \frac{\text{EBIT (1-T)}}{\text{Assets}} = \frac{\text{Rs.1,60,000(1-0.5)}}{\text{8,00,000}} = 0.10$ or 10%

(iv) Asset turnover $= \frac{\text{Sales}}{\text{Assets}} = \frac{\text{Rs.7,20,000}}{\text{Rs.8,00,000}} = 0.90x$

(v) Return on equity $= \frac{\text{Net Profit after taxes}}{\text{Owner's equity}} = \frac{\text{Rs.64,000}}{\text{50\% of Rs.8,00,000}}$

$= \frac{\text{Rs. 64,000}}{\text{Rs 4,00,000}} = 0.16$ or 16%

10) From the following ratios and information given below, prepare Trading Account, Profit and Loss Account and Balance Sheet of Hibacus Company.

Fixed Assets	Rs. 40,00,000
Closing Stock	Rs. 4,00,000
Stock turnover ratio	10
Gross profit ratio	25%
Net profit ratio	20%
Net profit to capital	1/5
Capital to total liabilities	1/2
Fixed assets to capital	5/4
Fixed assets/Total cuurent assets	5/7

Solution:

Workings:

i. $\frac{\text{Fixed assets}}{\text{Total current assets}} = \frac{5}{7}$

Or, Total current assets= $\frac{\text{Rs } 40,00,000\times7}{5}$ =Rs.56,00,000

ii. $\frac{\text{Fixed assets}}{\text{Capital}} = \frac{5}{4}$

Or, Capital= $\frac{\text{Rs.}40,00,000\times4}{5}$ = Rs.32,00,000

iii. $\frac{\text{Capital}}{\text{Total liabilities*}} = \frac{1}{2}$

Or,Total liabilities = Rs.32,00,000×2 =Rs 64,00,000

*It is assumed that total liabilities do not include capital.

iv. $\frac{\text{Net profit}}{\text{Capital}} = \frac{1}{5}$

Or, Net profit= Rs.32,00,000×1/5=Rs.6,40,000

v. $\frac{\text{Net profit}}{\text{Sales}} = \frac{1}{5}$

Or, sales =Rs.6,40,000×5= Rs.32,00,000

vi. Gross profit=25% of Rs.32,00,000

vii. Stock Turnover = $\frac{\text{Cost of goods sold(i.e Sales-Gross profit)}}{\text{Average Stock}}$

$10 = \frac{\text{Rs.}32,00,000\text{-Rs.}8,00,000}{\text{Average Stock}}$

Or, Average stock =Rs.2,40,000

Or, $\frac{\text{opening stock+Rs.}4,00,000}{2}$ =Rs.2,40,000

Or,Opening stock =Rs.80,000

Trading Account

Particulars	Rs.	Particulars	Rs.
To opening Stock	80,000	By Sales	32,00,000
To Manufactuing exp/purchases	27,20,000		
To Gross profit b/d	8,00,000	By closing stock	4,00,000
	36,00,000		36,00,000

Profit and loss account

Particulars	Rs.	Particulars	Rs.
To opening expenses (Balancing figure)	1,60,000	By Gross profit c/d	8,00,000
To Net Profit	6,40,000		
	8,00,000		8,00,000

Balance sheet

Capital and liabilities	Rs.	Assets	Rs.
Capital	32,00,000	Fixed assets	40,00,000
Liabilities	64,00,000	Current assets:	
		Closing stock	4,00,000
		Other current assets(bal figure)	52,00,000
	96,00,000		96,00,000

Theory Questions

1) Explain what is the ratio analysis?
2) What is the purpose of liquid ratio?
3) “Ratio analysis is the only tool and not a final decision.” Discuss.
4) Whar are the limitations of ratio analysis?
5) Discuss the benefits of ratios.
6) How are the ratio classified from the point of view of users.
7) Write short notes on

i. Quick ratio
ii. Debtors turnover ratio
iii. Earning per share
iv. Return on equity

Practice Problems

1) From the following balance sheet and other information, calculate following ratios:

Particulars	Rs.
1) Equity and liabilities	
1) Shareholder's fund	
(a)Share capital	10,00,000
(b)Reserves and surplus	7,00,000
(c)Money received against share warrants	2,00,000
2) Non-current Liabilities	
Long term borrowings	12,00,000
3) Current liabilities	
Trade payables	5,00,000
	36,00,000
2) Assets	
1) Non current assets	
Fixed assets	
-tangible assets	18,00,000
2) Current assets	
(a)Inventories	4,00,000
(b)Trade receivable	9,00,000
(c)Cash and cash equivalents	5,00,000
Total	36,00,000

(i) Debt equity ratio
(ii) Working capital turnover ratio
(iii) Trade receivables turnover ratio

Balance sheet as a march 31, 2021
Additional information:Revenue from operation Rs. 18,00,000

(Ans. Debt-Equity Ratio 0.63:1,Working capital turnover ratio 1.38 times, trade receivables turnover ratio 2 times)

2) Cost of revenue from operations is Rs 1,50,000.Operating expenses are Rs.60,000.Revenue from operations is Rs2,50,000.Calculate operating ratio.

(Ans. Operating Ratio 84%)

3)From the following information calculate Gross profit ratio, inventory turnover ratio and trade receivable turnover ratio.

Revenue from operations	Rs.3,00,000
Cost of revenue from operations	Rs.2,40,000
Inventory at the end	Rs.62,000
Gross profit	Rs.60,000
Inventory in the beginning	Rs.58,000
Trade receivables	Rs.32,000

(Ans:Gross profit ratio 20%, Inventory turnover ratio 4 times, Trade receivables turnover ratio 9.375 times.)

4)Compute working capital turnover ratio, debt equity ratio and proprietary ratio from the following information.

Paid up share capital	Rs.5,00,000
Current assets	Rs.4,00,000
Revenue from operations	Rs.10,00,000
13% Debentures	Rs.2,00,000
Current liabilities	Rs.2,80,000

(Ans: Working capital ratio 8.33 times, Debt –Equity ratio 0.4:1, and proprietary ratio 0.71:1)

5)Calculate Debt equity ratio from the following information:

Total assets	Rs.15,00,000
Current liabilities	Rs.6,00,000
Total debts	Rs.12,00,000

(Ans: Debt-Equity Ratio 2:1)

Multiple choice questions

1. Ratio of net sales to net working capital is a:
(a) Profitability ratio
(b) Liquidity ratio
(c) Current ratio
(d) Working capital turnover ratio

2. Long term solvency is indicated by
(a) Debt-equity ratio
(b) Current ratio
(c) Operating ratio
(d) Net profit ratio
3. Ratio of net profit before interest and tax to sales is:
(a) Gross profit ratio
(b) Net profit ratio
(c) Operating ratio
(d) Interest coverage ratio

4. Oberving changes in the financial variables across the year is:
(a) Verticle analysis
(b) Horizontal analysis
(c) Peer-firm analysis
(d) Industry analysis

5. The Receivables-turnover ratio helps management to:
(a) Managing resources
(b) Managing inventory
(c) Managing customer relationship
(d) Managing working capital

6. Which of the following is liquidity ratio?
(a) Equity ratio
(b) Proprietory ratio
(c) Net working capital
(d) Capital gearing ratio

7. Which of the following is not a part of Quick assets?
(a) Disposable investments
(b) Receivables
(c) Cash and cash equivalents
(d) Prepaid expenses

8. Capital gearing ratio is the fraction of:
(a) Preference share capital and debentures to equity share capital and reserves and surplus
(b) Equity share capital and reserves and surplus to prefernece share capital and debentures
(c) Equity share capital to total assets
(d) Total assets to equity share capital

9. From the following information calculate P/E ratio:

Equity share capital of Rs.10 each
Rs.8,00,000

9% Preference share capital of Rs. 10 each
Rs.3,00,000

Profit (after 35% tax)
Rs.2,67,000

Depreciation
Rs.67,000

Market price of equity share Rs.48

(a)15 times
(b)16 times
(c)17 times
(d)18 times

10. A company has average accounts receivable of Rs.10,00,000 and annual credit sales of Rs.60,00,000. Its average collection period would be:
(a) 60.83 days
(b) 6.00 days
(c) 1.67 days
(d) 0.67 days

(Ans: 1 (d) 2(a) 3(c) 4(b) 5(d) 6(c) 7(d) 8(a) 9(b) 10(a)

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5

SOURCES OF FINANCING

Unit Structure

5.0 OBJECTIVES

After studying this unit you willunderstand:

- Meaning offinance
- Need and Importance of Finance
- Sources of long term finance
- Sources of short termfinance

5.1 MEANING OF FINANCE

Finance is a broad term that describes activities associated with banking, leverage or debt, credit, capital markets, money, and investments. Basically, finance represents money management and the process of acquiring needed funds. Finance also encompasses the oversight, creation, and study of money, banking, credit, investments, assets, and liabilities that make up financial systems. It is necessary to raise finance from various sources for implementation of the project. The schemes of finance will be determined after consideration of various aspects attached to different sources of finance as following:

a) Share capital –preference shares and equityshares

b) Debentures

c) Term loan from financial institutions

d) Unsecured loan-banks, promoters,others.

5.1.1 Promoters Contribution

The persons who are involved in implementation of a project are known as promoters .An entrepreneur who promotes the project is also required to participate in the scheme of finance of the project. The extent of promoter's contribution in the project is a sign of interest of the promoters in the project. Promoter's contribution indicates the extent of their involvement the inthe project. The promoters contribution can be provided in the form of subscribing to equity and preference shares issued by the company unsecured loans ,seed capital assistance and internal accrual of funds .The bank and financial institution normally participate in the scheme of project finance and they ask the promoters to bring in a certain portion of funds required which is normally between 25% to 50% of the cost of the project into the equity share capital of the company .The promoters contribution can be arranged from outside sources like friends and relatives. For eligibility of the project financing the financial institution may stipulate minimum promoter's contribution which is to be arranged by the promoters.

5.1.2 Margin money

The banks and financial institutions maintain a margin while financing the project cost. They asked the borrowers to bring a certain amount of the cost of the project cost as margin money to safeguard from the changes in the value of assets that are being financed and provided as a security. The quantum of margin money to depend upon the creditworthiness of the borrower and nature of security provided to the institution. Margin money is one of the important factors which are evaluated by the financial institutions while considering the project for financial assistance. The margin money required for working capital will be provided in the project cost .The RBI guidelines provide the amount of capital brought by the promoters in project financing.

5.1.3 Capital Structure

Capital structure refers to the mix of a firm's capitalization and includes long-term source of fund such as debentures, preference shares, equity share, and retained earnings. The decision regarding the forms of financing their requirements and their relative proportions in total capitalization are known as capital structure decision. A firm has the choice to raise capital for financing its project from different sources in different proportions as follows:

(a) exclusive use of equity capital

(b) Use of equity and preferencecapital

(c) Use of equity and debt capital

(d) Use of equity, preference and debtcapital

(e) Use of a combination of debt, equity and preference capital in differentproportions.

The choice of combination of these sources is called capital structure mix.

5.1.4 Optimum Capital Structure:

The theory of optimal capital structure deals with the issue of right mix of debt and equity in the long term capital structure of a firm. This theory states that if a company takes on debt the value of the firm increases up to a point, beyond that point if debt continues to increases then the value of the firm will start to decrease. if the company is unable to repay the debt within the specified period, then it will affect the goodwill of the company in the market . Therefore, the company should select its appropriate capital structure with due consideration to the factors of debt and equity.

5.1.5 Trading on Equity

The term ‘trading on equity’ is derived from the fact that debts are contracted and loans are raised mainly on the basis of equity capital. The concept of trading on equity provides that the capital structure of a company should include equity as well as debt. Again the proportion of debt in the capital structure should also be optimal. Those who provide debt have a limited share in the firm’s earnings and hence want to be protected in term of earning and values represented by equity capital. Since fixed charges do not vary with the firm’s earnings before interest and tax, a magnified effect is produced on earning per share. The determination of optimal level of debt is a formidable task and is a major policy decision .EBIT-EPS analysis is a widely used tool to determine the level of debt in afirm.

5.2 NEEDS AND IMPORTANCE OF FINANCE

What is the main purpose of business finance? or Why is finance so important?

1. Establishment of Business Enterprises:

The promotion of any establishment or any type of enterprise basically requires finance.

Finance is required at every stage of the business establishment like

a. During registration of the company,

b. At the incorporation stage,

c. For obtaining the certificate for starting the business and

d. also for obtaining various permissions

Besides, expenditure on these requirements, finance is required for arranging the Assets such as working place, plant and machinery, and furniture and equipment, for short term items like working material, furnishing and salaries of the employees.

Thus, finance is required to complete the initial activities of the business enterprise.

2. Proficient Operation of Business

Operations of business cannot be efficiently operated without finance. The activities such as purchase of raw materials, sending of products to the consumers, conversion of raw materials into finished product and sale cannot be done without efficient finance.

3. Development and Expansion of Business

Finances are required for the overall development and extension of all business activities in compatibility with advance technology. With finances, various commodities can be upgraded with the purchases or sold or produced. Besides, finance (capital) is also required for the purchasing of techniques, machinery, and equipment, the establishment of Laboratories, etc.

4. Sound Business Position

Finance is an important measure by which the position of a business is measured i.e. whether it is strong or weak, Few examples of business transactions like payments to the suppliers, remuneration and facilities to the Employees and payment of principal amount and interest can be paid to the lender within due date only when sufficient funds are available.

5. Surviving in the Competition Era

One of the biggest threats to any business units are their competitors. Performing with an aim to meet the expectations of the customers and having edge over the competitors requires finance. To gain such edge one organisation has to look in many aspects. So there should be proper policies and allocation of required funds towards relating advertisement and publicity, production and distribution of commodities and services, incentives to the consumers, sale promotion, providing services and commodities at a fair price are required, to face present-day competitors.

6. Infrastructural Facilities:

Finance is also required for arranging infrastructural facilities which are essential for any business entrepreneurship. The volume of finance required depends upon the nature of the business organisation i.e. Proprietary business, may be high or low, according to the coverage of various Enterprises. Substantial capital is required for all infrastructural facilities, place, land, office site, plant installation for the establishment of industries, place for conversion of raw materials into finished products, water, electricity, telephone, etc.

7. Modernization of Business

In this era there dynamism and ever changing technologies, there is always need for upgradation. Finances are required for technical know-how, research and development, new techniques, new machinery, various new products, and computerization, which are essential for the upgradation, modernization and operation of the business.

8. Labour Welfare and Social Security

For the success of any business or enterprise, human relations between employers and workers should be cordial. In order to ensure the same, entrepreneurs should essentially safeguard the interests of the employees and workers. Employer should proper facilities like – that of housing, primary treatment, health, education, libraries, and reading rooms, travel, etc. In addition, they are also to be provided provident fund, gratuity, pension, old age, personal or group insurance and accidental insurance, etc. All these need a substantial volume of finance.

5.3 SOURCES OF FINANCE

The sources from which a business meets its financial requirements can be classified on the basis oftime, ownership and source of generation as explained in Figure 5.1.

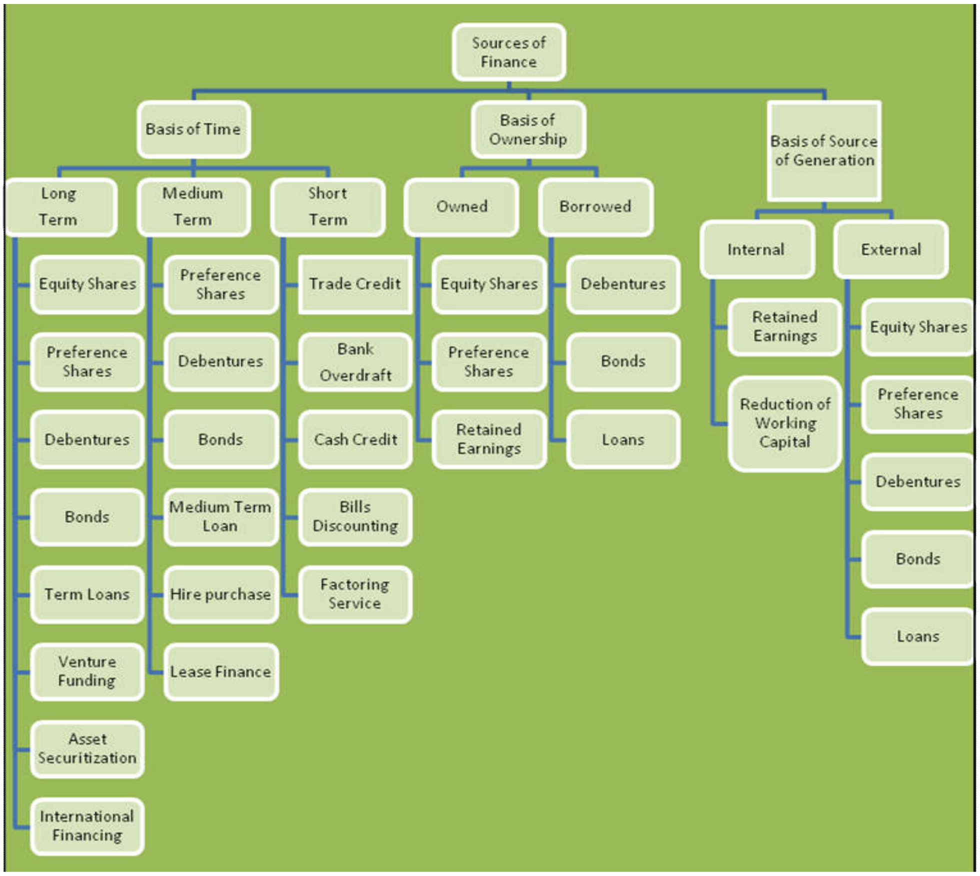


Figure1

5.3.1 Long Term Sources of Finance

Long-term financing means capital requirements for a period of more than 5 years to 10, 15 or 20 years or maybe more depending on other factors.

Capital expenditures in fixed assets like plant and machinery, land and building etc. of a business are funded using long-term sources of finance. Part of working capital which permanently stays with the business is also financed with long-term sources of finance. Long term financing sources can be in form of any of them:

(a) Equity Shares.

(b) Preference Shares.

(c) Debentures

(d) Bonds.

(e) Term Loans.

(f) Venture Funding

(g) Assets Securitization

(h) International Financing

(a) Equity Shares

Equity share is a main source of finance for any company giving investors rights to vote, share profits and claim on assets. We call it stock, ordinary share, or shares, all are one and the same.Normally, a company is started with equity finance as its first source of capital from the owners or promoters of that company. The company then finds an investor in the form of friends, relatives, venture capitalists, mutual funds, or any such small group of investors and issue fresh equity shares to these investors.A point comes where the company reaches a very big level and requires huge capital investment for business growth. It then offers its equity share to the general public. This is called Initial Public Offer (IPO). More such issues in future are called Follow-on Public Offer (FPO).

They are categorized under long-term sources of finance because legally they are irredeemable in nature. For an investor, these shares are certificate of ownership in the company by virtue of which investors are entitled to share the net profits and have a residual claim over the assets of the company in the event of liquidation. Investors have voting rights in the company and their liability to the company is limited to the amount of investment.

Types of Equity Shares

There are various types of equity shares classified based on various things:

i Authorized Share Capital: It is the maximum amount of capital which can be issued by a company. It can be increased from time to time. Some fee is required to be paid to legal bodies accompanied with some formalities.

ii Issued Share Capital: It is that part of authorized capital which is offered to investors.

iii Subscribed Share Capital: It is that part of Issued capital which is accepted and agreed by the investor.

iv Paid Up Capital: It is the part of subscribed capital, the amount of which is paid by the investor.

Normally, all companies accept complete money in one shot and therefore issued, subscribed and paid capital becomes one and the same. Conceptually, paid up capital is the amount of money which is actually invested in the business.

There are other types of equity shares discussed below:

i Rights Share: These are the shares issued to the existing shareholders of a company. Such kind of shares is issued to protect the ownership rights of the investors.

ii Bonus Share: These are the type of shares given by the company to its shareholders as a dividend. There are various advantages and disadvantages of bonus shares like dividend, capital gain, limited liability, high risk, fluctuation in the market, etc.

iii Sweat Equity Share: These shares are issued to an exceptional employees or directors of the company for their exceptional job in terms of providing know-how or intellectual property rights to the company.

Various Prices of Equity Shares

i Par or Face Value: It is the value of a share of which it is accounted in books of accounts.

ii Issue Price: It is the price at which the equity share is actually offered to the investor. Normally, the issue price and face value of a share are same in the case of new companies.

iii Share Premium and Share at Discount: When a share is issued at a price higher than face value, the excess amount is called premium. Contrary to it, if the share is issued at a price lower than face value, it is said to be issued at a discount.

iv Book Value: It is the ratio of the total of paid-up capital and reserves and surplus divided by total no. of shares. This is the balance sheet value of shares.

v Market Value: In the case of companies listed on stock exchanges, the market value of the share is the price at which they are sold currently sold in the market.

Investing and Financing Angle of Equity Shares

When talking about equity shares, there are two angles. One is an investor's angle wherein the investor invests in equity shares and second financing angle where a company accepts the finance in the form of equity. There are pros and cons of both of these as described below.

ADVANTAGES

i Dividend: An investor is entitled to receive a dividend from the company. It is one of the two main sources of return on his investment.

ii Capital Gain: The other source of return on investment apart from dividend is the capital gains. Gains which arise due to rise in market price of the share.

iii Limited liability: Liability of shareholder or investor is limited to the extent of the investment made. If the company goes into losses, the share of loss over and above the capital investment would not be borne by the investor.

iv Exercise control: By investing in the company, the shareholder gets ownership in the company and thereby he can exercise control.

v Claim over Assets and Income: An investor of equity share is the owner of the company and so is the owner of the assets of that company. He also enjoys a share of the incomes of the company.

vi Rights Shares: Whenever companies require further capital for expansion, growth, entering into new areas etc., they tend to issue 'rights shares'. By issuing such shares, ownership and control of existing shareholders are preserved and the investor receives investment priority over other general investors.

vii Bonus Shares: At times, companies decide to issue bonus shares to its shareholders. It is also a type of dividend. Bonus shares are free shares given to existing shareholders and many times they are given in lieu of dividends.

viii Liquidity: The shares of the company which is listed on stock exchanges have the benefit of any time liquidity. The shares can very easily transfer ownership.

ix Stock Split: Stock split means splitting a share into parts. How should an investor be benefited by this? By splitting of share, the per-share price reduces in the market which eventually increases the readability of share. At the end, stock split results in higher volumes with a number of investors leading to high liquidity of the share.

Disadvantages

i Dividend: The dividend which a shareholder receives is neither fixed nor controllable by him. The management of the company decides how much dividend should be given.

ii High Risk: Equity share investment is a risky share compared to any other investment like debts etc. The money is invested based on the faith an investor has in the company. There is no collateral security attached with it.

iii Fluctuation in Market Price: The market price of any equity share has a wide variation. It is always very difficult to book profits from the market. On the contrary, there are equal chances of losses.

iv Limited Control: An equity investor is a small investor in the company, therefore, it is hardly possible to impact the decision of the company using the voting rights.

v Residual Claim: An equity shareholder has a residual claim over both the assets and the income. Income which is available to equity shareholders is after the payment of all other stakeholders' viz. debenture holders etc.

(b) Preference shares:

Preference Shares: Preference shares are one of the special types of share capital having fixed rate of dividend and they carry preferential rights over ordinary equity shares in sharing of profits and also claims over assets of the firm. Preference shares are long-term source of finance for a company. They are neither completely similar to equity nor equivalent to debt. The law treats them as shares but they have elements of both equity shares and debt. For this reason, they are also called 'hybrid financing instruments'

. **Features of Preference Shares Similar to Debt**

i Fixed Dividends: Like debt carries a fixed interest rate, preference shares have fixed dividends attached to them.But the obligation of paying a dividend is not as rigid as debt. Non-payment of a dividend would not amount to bankruptcy in case of preference share.

ii Preference over Equity: As the word preference suggests, these type of shares get preference over equity shares in sharing the income as well as claims on assets. Alternatively, preference share dividend has to be paid before any dividend payment to ordinary equity shares. Similarly, at the time of liquidation also, these shares would be paid before equity shares.

iii No Voting Rights: Preference shares holders normally does not have any voting rights. They are similar to debenture holders and do not have any say in the management of the company.

iv No Share in Earnings: Preference shareholders can only claim two things. One agreed on percentage of dividend and second the amount of capital invested. Equity shares are entitled to share the residual earnings and residual assets in case of liquidation which preference shares are not entitled.

v Fixed Maturity: Just like debt, preference shares also have fixed maturity date. On the date of maturity, the preference capital will have to be repaid to the preference shareholders. A special type of shares i.e. irredeemable preference shares is an exception to this. They do not have any fixed maturity.

Features of Preference Shares similar to Equity Shares:

i Dividend from PAT: Equity share dividend is paid out of the profits left after all expenses and even taxes and same is the case with preference shares. The preference dividend is paid out of the divisible profits of the company. Out of the divisible profits, the preference dividend would be paid first and the remaining profits can be utilized for paying any dividend to equity shareholders.

ii Management Discretion over Dividend Payment: The payment of preference dividend is not compulsory and is a decision of the management. Equity shareholders also do not have any right to ask for dividends, the dividends are paid at the discretion of the management of the company. Unlike debt, the nonpayment of a dividend of preference shares does not amount to bankruptcy.

iii No Fixed Maturity: The maturity of a special variant of preference share is not fixed just like equity shares. This variant is popularly known as irredeemable preference shares.

Types of Preference Shares

There are various Types of Preference Shares with differences in their structure. Some of these are cumulative, non-cumulative, participating, non-participating, redeemable, irredeemable, convertible, non-convertible, callable, adjustable rate preference shares.

i Convertible and Non-Convertible Preference Shares

Convertible preference shareholders possess an option or right whereby they can be converted into an ordinary equity share at some agreed terms and conditions. Non-convertible simply does not have this option but has all other normal characteristics of a preference share.

ii Redeemable and Irredeemable Preference Shares

Redeemable preference share is very commonly seen preference share which has a maturity date on which date the company will repay the capital amount to the preference shareholders and discontinue the dividend payment thereon. Irredeemable preference shares are little different from other types of preference shares. It does not have any maturity date. However after introduction of Companies Act, 2013, no irredeemable preference shares can be issued and even the existing irredeemable preference shares have to be redeemed.

iii Cumulative and Non-Cumulative Preference Shares

If the shares are cumulative preference shares, the dividends are cumulated and therefore paid when the company makes the profit. In short, a dividend of cumulative preference shares will have to be paid as long as the company earns the profit in any year. Whereas, for non-cumulative preference shares, a company can skip the dividend in the year, the company has incurred losses.

iv Preference Shares with Callable Options

These are another innovative preference shares in which the company has an option to buy the share at a predetermined price and on or before a certain date.

v Adjustable Rate Preference Shares

These are some of the innovative types of instruments where the rate of dividend is not fixed and is formulated based on some calculations relating to the current interest rates etc.

BENEFITS OF PREFERENCE SHARE

There are several benefits of a preference share from the point of view of a company which is discussed below:

i No Legal Obligation for Dividend Payment: There is no legal compulsionfor payment of preference dividend. This dividend is not a fixed liability like the interest on the debt which has to be paid in all circumstances.

ii Improves Borrowing Capacity: Preference shares become a part of net worth and therefore reduces debt to equity ratio. This is how the overall borrowing capacity of the company increases.

iii No dilution in control: Issue of preference share does not lead to dilution in control of existing equity shareholders because the voting rights are not attached to the issue of preference share capital. The preference shareholders invest their capital with fixed dividend percentage but they do not get control rights with them.

iv No Charge on Assets: While taking a term loan security needs to be given to the financial institution in the form of primary security and collateral security. There are no such requirements and therefore, the company gets the required money and the assets also remain free of any kind of charge on them.

DISADVANTAGES OF PREFERENCE SHARES

i Costly Source of Finance: Preference shares are considered a very costly source of finance which is apparently seen when they are compared with debt as a source of finance. The interest on the debt is a tax-deductible expense whereas the dividend of preference shares is paid out of the divisible profits of the company i.e. profit after taxes and all other expenses.

ii Skipping Dividend Disregard Market Image: Skipping of dividend payment may not harm the company legally but it would always create a dent on the image of the company.

iii Preference in Claims: Preference shareholders enjoy a similar situation like that of an equity shareholder but still gets a preference in both payment of their fixed dividend and claim on assets at the time of liquidation.

(c) Debentures:

A debenture is a debt instrument used by the companies to raise money for medium to long term at a specified rate of interest. It consists of a written contract specifying the repayment of the principal and the interest payment at the fixed rate. Generally, a debenture is not secured by any collateral and is only backed by the reputation of the issuer.

FEATURES / ATTRIBUTES OF DEBENTURES:

Trust Indenture

It is an agreement which has to be entered into by the 'Issuing Company' and the 'Trust' which is involved in taking care of the interest of the general investors. Normally the trustee is a bank or a financial institution who is appointed by a debenture trust deed.

Coupon Rate

It is the rate of interest which is promised by the company to pay to the debenture holder on a regular interval which may vary from case to case. The rate of interest may be fixed or floating.

Tax Benefit

Most important element from the company point of view is that the interest paid is a tax deductible expense. Effectively, the company will get the tax benefit because the taxable income will be reduced by the extent of interest paid. Due to this, the effective cost of borrowing gets reduced.

Date of Maturity

For all the debentures, the issuing company has to issue repayment to the debenture holders on the date of maturity. This date is also mentioned on the certificates

Security

Here, we should classify debentures into two – secured debentures and unsecured debentures. Secured debentures are secured by some or other immovable assets of the company whereas the unsecured assets are issued based on the general credit of the company. The general legal preference of debt is available to all types of debentures i.e. in the event of liquidation debenture will stand prior to preference shares and ordinary equity shares.

Convertibility

Certain types of debentures are issued with the option of conversion into equity. The ratio of conversion and the time period after which conversion will take place is mentioned in the agreement of debenture. Debentures may be fully or partly convertible in nature.

Credit Rating

Normally, an investor would not go and check the credibility and the risk involved with the debentures. Credit rating agencies are given this task and they rate the debentures and the overall company. Involving a rating agency is compulsory for the issuing company normally in every country.

A debenture is the primary source of long-term capital for companies to fulfill their financial requirements. Other instruments to raise long term capital are bank loans, bonds, and equity shares. Though all these instruments are used widely in different combinations, they differ from each other in many ways. The article clarifies how debenture is different from the bank loan, equity shares, and bonds respectively.

Types of Debentures:

There are various types of debentures like redeemable, irredeemable, perpetual, convertible, non-convertible, fully, partly, secured, mortgage, unsecured, naked, first mortgaged, second mortgaged, the bearer, fixed, floating rate, coupon rate, zero coupon, secured premium notes, callable, puttable, etc.

Redeemable and Irredeemable (Perpetual) Debentures:

Redeemable debentures carry a specific date of redemption on the certificate. The company is legally bound to repay the principal amount to the debenture holders on that date. On the other hand, irredeemable debentures, also known as perpetual debentures, do not carry any date of redemption. However after introduction of Companies Act, 2013, no irredeemable debentures can be issued and even the existing irredeemable debentures have to be redeemed.

Convertible and Non-Convertible Debentures

Convertible debenture holders have an option of converting their holdings into equity shares. The rate of conversion and the period after which the conversion will take effect are declared in the terms and conditions of the agreement of debentures at the time of issue. On the contrary, non-convertible debentures are simple debentures with no such option of getting converted into equity. Their state will always remain of a debt and will not become equity at any point of time.

Fully and Partly Convertible Debentures

Convertible Debentures are further classified into two – Fully and Partly Convertible. Fully convertible debentures are completely converted into equity whereas the partly convertible debentures have two parts. Convertible part is converted into equity as per agreed rate of exchange based on an agreement. Non-convertible part becomes as good as redeemable debenture which is repaid after the expiry of the agreed period.

Secured (Mortgage) and Unsecured (Naked) Debentures

Debentures are secured in two ways. One when the debenture is secured by the charge on some asset or set of assets which is known as secured or mortgage debenture and another when it is issued solely on the credibility of the issuer is known as the naked or unsecured debenture. A trustee is appointed for holding the secured asset which is quite obvious as the title cannot be assigned to each and every debenture holder.

Registered Unregistered Debentures (Bearer) Debenture

In the case of registered debentures, the name, address, and other holding details are registered with the issuing company and whenever such debenture is transferred by the holder; it has to be informed to the issuing company for updating in its records. Otherwise, the interest and principal will go the previous holder because the company will pay to the one who is registered. Whereas, the unregistered commonly known as bearer debenture. can be transferred by mere delivery to the new holder. They are considered as good as currency notes due to their easy transferability. The interest and principal are paid to the person who produces the coupons, which are attached to the debenture certificate. and the certificate respectively.

Fixed and Floating Rate Debentures

Fixed rate debentures have fixed interest rate over the life of the debentures. Contrarily, the floating rate debentures have the floating rate of interest which is dependent on some benchmark rate say LIBOR etc.

Secured Premium Notes / Debentures

These are secured debentures which are redeemed at a premium over the face value of the debentures. They are similar to zero coupon bonds. The only difference is that the discount and premium. Zero coupon bonds are issued at the discount and redeemed at par whereas the secured premium notes are issued at par and redeemed at the premium.

Callable and Puttable Debentures / Bond:

Callable debentures have an option for the company to buyback and repay to the investors whereas, in the case of puttable debentures, the option lies with the investors. Puttable debenture holders can ask the company to redeem their debenture and ask for principal repayment.

(d) Bonds:

Bond is a financial instrument whereby the issuer of the bond raises (borrows) capital or funds at a certain cost for certain time period and pays back the principal amount on maturity of the bond. Interest paid on bonds is usually referred to as coupon. In simple words, a bond is a loan taken at a certain rate of interest for a definite time period and repaid on maturity.

From a company's point of view, the bond or debenture falls under the liabilities section of the balance sheet under the heading of Debt. A bond is similar to the loan in many aspects however it differs mainly with respect to its tradability. A bond is usually tradable and can change many hands before it matures; while a loan usually is not traded or transferred freely.

Common features of bonds and the financial terms related to bonds.

1. Issuer: The entities that borrow money by issuing bonds are called as issuers.
2. Face Value: Every bond that is issued has a face value; which is usually the principal amount that is borrowed and returned on maturity. In layman's term, it is the value of the bond on its maturity.
3. Coupon: The rate of interest paid on the bond is called as a coupon.
5. Rating: Every bond is usually rated by credit rating agencies; higher the credit rating lower will be the coupon required to pay by the issuer and vice versa.
5. Coupon Payment Frequency: The coupon payments on the bond usually have a payment frequency. The coupons are usually paid annually or semi-annually; however, they may be paid quarterly or monthly as well.
6. Yield: The effective return that the investor makes on the bond is called as a return. Assuming a bond was issued for a face value of ₹ 1000 and a coupon rate of 10% on initiation. The Price at a later date may rise or fall and hence the investor who invests at a rate other than ₹ 1000 will still receive a coupon payment of ₹100 (1000 * 10%) but the effective earning shall be different since investment amount is not ₹ 1000. That effective return in layman's term is called as the yield. If the holding period is considered for a year this is referred to as current yield and if it is held to maturity it is referred to as yield to maturity (YTM).

DIFFERENT TYPES OF BONDS

Plain Vanilla Bonds

A plain vanilla bond is a bond without any unusual features; it is one of the simplest forms of bond with a fixed coupon and a defined maturity and is usually issued and redeemed at the face value. It is also known as a straight bond or a bullet bond.

Zero Coupon Bonds

A zero coupon bond is a type of bond where there are no coupon payments made. It is not that there is no yield; the zero coupon bonds are issued at a price lower than the face value (say ₹ 950) and then pay the face value on maturity (₹ 1000). The difference will be the yield for the investor. These are also called as discount bonds or deep discount bonds if they are for longer tenor.

Deferred Coupon Bonds

This type of bond is a blend of a coupon-bearing bond and a zero coupon bond. These bonds do not pay any coupon in the initial years and thereafter pay a higher coupon to compensate for no coupon in the initial years. Such bonds are issued by corporates whose business model has a gestation period before the actual revenues start. Examples of a company which may issue such type of bonds include construction companies.

Convertible Bonds

Convertible bonds are a special variety of bonds which have an inbuilt feature of being converted to equity shares at a specified time at a pre-set conversion price.

Foreign currency convertible Bonds

Foreign currency convertible bond is a special type of bond issued in the currency other than the home currency. In other words, companies issue foreign currency convertible bonds to raise money in foreign currency.

Difference between Debentures & Bonds

Debenture and bond are used often as interchangeable terms. However, there are subtle and noteworthy differences between the two instruments:

- Security: A bond is a more secure instrument than a debenture. A debenture does not have any collateral backing; whereas a bond will always have collateral attached.
- Rate of Interest: Debenture holders are entitled to a higher rate of interest in comparison to bond holders. The reason is that debenture is an unsecured loan and therefore, is riskier than a bond.
- Liability: In a case of a bankruptcy, the company is liable to pay bondholders on priority, whereas debenture holders are paid later.
- Periodical Payments: Debenture holders are paid periodical interest on their loan and the principal is paid back at the completion of the entire term. Bondholders, on the other hand, are not paid any periodical payments. They receive the accrued interest and the principal upon the term completion at one go.

(e) Term Loan:

A term loan provides borrowers with a lump sum of cash upfront in exchange for specific borrowing terms. Term loans are normally meant for established small businesses with sound financial statements. In exchange for a specified amount of cash, the borrower agrees to a certain repayment schedule with a fixed or floating interest rate. Term loans may require substantial down payments to reduce the payment amounts and the total cost of the loan.

Types of Term Loans

Term loans come in several varieties, usually reflecting the lifespan of the loan. These include:

Short-term loans: These loans are generally for a period of less than a 12 months.

Intermediate-term loans: These loans are generally for a period of one to three years.

Long-term loans: These loans last anywhere above three to twemty five years.

(f) Venture Funding:

Venture funding is a funding process in which the venture funding companies manage the funds of the investors who want to invest in new businesses which have the potential for high growth in future. The venture capital funding firms provide the funds to start ups in exchange for the equity stake. Such a startup is generally one that possesses the ability to generate high returns. However, the risk for venture capitalists is high.

There are five stages of venture funding. They are as follows:

Stage 1: Seed Capital

Stage 2: Startup Capital

Stage 3: Early Stage / Second Stage Capital

Stage 4: Expansion Stage

Stage 5: Bridge / Pre IPO Stage

Stage 1: Seed Capital

In this first stage of venture funding, the venture or the startup company in need of the funds contacts the venture capital firm or the investor. The venture firm shall share its idea of business with the investors and convince them to invest in the project. The investor or venture capital firm shall then conduct research on the business idea and analyze its future potential. If the expected returns in future are good, the investor (Venture capitalist) shall invest in the business.

Stage 2: Startup Capital

Startup capital is the second stage of venture funding. If the venture is able to attract the investor, the idea of the business of the venture is brought into reality. A prototype product is developed and fully tested to know the actual potential of the product. Generally, a person from the venture capital firm takes a seat in the management of the business to monitor the operations regularly and keep a check that every activity is done as per the framed plan. If the idea of business meets the requirement of the investor and has sufficient market in the trail run, the investor agrees to participate in the future course of the business.

Stage 3: Early Stage / Second Stage Capital

After the startup capital stage comes the early/first/second stage capital. In this stage, the investor significantly increases the capital invested in the venture business. The capital increase is mainly towards increasing the production of goods, marketing or other expansion say building a network etc. The company with higher capital inflow moves towards profitability as it is able to reach a wide range of customers.

Stage 4: Expansion Stage

This is the fourth stage of venture funding. In this stage, the company expands its business by way of diversification and differentiation of its products. This is possible only if the company is earning good profits and revenue. To reach up to this stage the company needs to be operational for at least 2 to 3 years. The expansion gives the venture new wings to enter into untapped markets.

Stage 5: Bridge / Pre IPO Stage

This is the last stage of venture funding. When the company has developed substantial share in the market with its products, the company may opt for going public. One main reason for going public is that the investors can exit out of the company after earning profits for the risks they have taken all the years. The company mainly uses the amount received by way of IPO for various purposes like merger, elimination of competitors, research and development, etc.

(g) American Depository Receipt

American Depository Receipt represents the shares of a foreign company issued by U.S bank which can be traded in U.S. equity markets.

Meaning of American Depository Receipt

American Depository Receipt (ADR) is a certified negotiable instrument issued by an American bank suggesting the number of shares of a foreign company that can be traded in U.S. financial markets. American Depository Receipts provide US investors with an opportunity to trade in shares of a foreign company.

American Depository Receipt Process

The domestic company, already listed in its local stock exchange, sells its shares in bulk to a U.S. bank to get itself listed on U.S. exchange.

The U.S. bank accepts the shares of the issuing company. The bank keeps the shares in its security and issues certificates (ADRs) to the interested investors through the exchange.

Investors set the price of the ADRs through bidding process in U.S. dollars. The buying and selling in ADR shares by the investors is possible only after the major U.S. stock exchange lists the bank certificates for trading.

The U.S. stock exchange is regulated by Securities Exchange Commission, which keeps a check on necessary compliances that need to be complied by the foreign company.

Advantages of American Depository Receipt

The American investor can invest in foreign companies which can fetch him higher returns.

The companies located in foreign countries can get registered on American Stock Exchange and have its shares trades in two different countries.

The benefit of currency fluctuation can be availed.

It is an easier way to invest in foreign companies as there are no restrictions to invest in ADR.

ADR simplifies tax calculations. Trading in shares of foreign company in ADR would lead to tax under US jurisdiction and not in the home country of company.

The pricing of shares of foreign companies in ADR is generally cheaper. Hence it provides additional benefit to investors.

Disadvantages of American Depository Receipt

Even though the transactions in ADR take place in US dollars, still they are exposed to the risk associated with foreign exchange fluctuation.

The number of options to invest in foreign companies is limited. Only few companies feel the necessity to register themselves through ADR. This limits the choice available to US investor to invest.

The investment in companies opting for ADR often becomes illiquid as investor needs to hold the shares for long term to generate good returns.

The charges for entire process of ADR are mostly transferred on investors by the foreign companies.

Any violation of compliance can lead to strict action by Securities Exchange Commission.

Conclusion:

ADRs provide the US investors with ability to trade in foreign companies shares. ADR makes it easier and convenient for the domestic investors in US to trade in foreign companies shares. ADR provides the investors an opportunity to diversify their portfolio by investing in companies which are not located in America. This eventually leads to investors investing in companies located in emerging markets, thereby leading to profit maximization for investors.

(h) Global Depository Receipt

Global Depository Receipt (GDR) is an instrument in which a company located in domestic country issues one or more of its shares or convertibles bonds outside the domestic country. In GDR, an overseas depository bank i.e. bank outside the domestic territory of a company, issues shares of the company to residents outside the domestic territory. Such shares are in the form of depository receipt or certificate created by overseas the depository bank.

Issue of Global Depository Receipt is one of the most popular ways to tap the global equity markets. A company can raise foreign currency funds by issuing equity shares in a foreign country.

Global Depository Receipt Example

A company based in USA, willing to get its stock listed on German stock exchange can do so with the help of GDR. The US based company shall enter into an agreement with the German depository bank, who shall issue shares to residents based in Germany after getting instructions from the domestic custodian of the company. The shares are issued after compliance of law in both the countries.

Global Depository Receipt Mechanism

The domestic company enters into an agreement with the overseas depository bank for the purpose of issue of GDR.

The overseas depository bank then enters into a custodian agreement with the domestic custodian of such company.

The domestic custodian holds the equity shares of the company.

On the instruction of domestic custodian, the overseas depository bank issues shares to foreign investors.

The whole process is carried out under strict guidelines.

GDRs are usually denominated in U.S. dollars

Advantages of GDR

The following are the advantages of Global Depository Receipts:

GDR provides access to foreign capital markets.

A company can get itself registered on an overseas stock exchange or over the counter and its shares can be traded in more than one currency.

GDR expands the global presence of the company which helps in getting international attention and coverage.

GDR are liquid in nature as they are based on demand and supply which can be regulated.

The valuation of shares in the domestic market increase, on listing in the international market.

With GDR, the non-residents can invest in shares of the foreign company.

GDR can be freely transferred.

Foreign Institutional investors can buy the shares of company issuing GDR in their country even if they are restricted to buy shares of foreign company.

GDR increases the shareholders base of the company.

GDR saves the taxes of an investor. An investor would need to pay tax if he purchases shares in the foreign company, whereas in GDR same is not the case.

Disadvantages

The following are the disadvantages of Global Depository Receipts:

Violating any regulation can lead to serious consequences against the company.

Dividends are paid in domestic country's currency which is subject to volatility in the forex market.

It is mostly beneficial to High Net-Worth Individual (HNI) investors due to their capacity to invest high amount in GDR.

GDR is one of the expensive sources of finance.

(i) Public Fixed Deposits:

Public deposits refer to the unsecured deposits invited by companies from the public mainly to finance working capital needs. A company wishing to invite public deposits makes an advertisement in the newspapers.

Any member of the public can fill up the prescribed form and deposit the money with the company. The company in return issues a deposit receipt. This receipt is an acknowledgement of debt by the company. The terms and conditions of the deposit are printed on the back of the receipt. The rate of interest on public deposits depends on the period of deposit and reputation of the company.

A company can invite public deposits for a period of six months to three years. Therefore, public deposits are primarily a source of short-term finance. However, the deposits can be renewed from time-to-time. Renewal facility enables companies to use public deposits as medium-term finance.

Public deposits of a company cannot exceed 25 per cent of its share capital and free reserves. As these deposits are unsecured, the company having public deposits is required to set aside 10 per cent of deposits maturing by the end of the year. The amount so set aside can be used only for paying such deposits.

Thus, public deposits refer to the deposits received by a company from the public as unsecured debt. Companies prefer public deposits because these deposits are cheaper than bank loans. The public prefers to deposit money with well-established companies because the rate of interest on public deposits is higher than on bank deposits. Now public sector companies also invite public deposits. Public deposits have become a popular source of industrial finance in India.

Merits of Public Deposits:

1. Simplicity:

Public deposits are a very convenient source of business finance. No cumbersome legal formalities are involved. The company raising deposits has to simply give an advertisement and issue a receipt to each depositor.

2. Economy:

Interest paid on public deposits is lower than that paid on debentures and bank loans. Moreover, no underwriting commission, brokerage, etc. has to be paid. Interest paid on public deposits is tax deductible which reduces tax liability. Therefore, public deposits are a cheaper source of finance.

3. No Charge on Assets:

Public deposits are unsecured and, therefore, do not create any charge or mortgage on the company's assets. The company can raise loans in future against the security of its assets.

5. Flexibility:

Public deposits can be raised during the season to buy raw materials in bulk and for other short-term needs. They can be returned when the need is over. Therefore, public deposits introduce flexibility in the company's financial structure.

5. Trading on Equity:

Interest on public deposits is paid at a fixed rate. This enables a company to declare higher rates of dividend to equity shareholders during periods of good earnings.

Public deposits enable a company to build up contacts with a wider public. These contacts prove helpful in the sale of shares and debentures in future.

Demerits of Public Deposits:

1. Uncertainty:

Public deposits are an uncertain and unreliable source of finance. The depositors may not respond when economic conditions are uncertain. Moreover, they may withdraw their deposits whenever they feel shaky about the financial health of the company.

Depositors are entitled to withdraw their deposits at any time after giving prior notice to the company. During times of financial tightness or distress the depositors may get panicked and wish to withdraw their deposits.

Moreover, if a large number of depositors simultaneously withdraw their deposits during slump, the company may find it difficult to repay a huge sum at once. Therefore, public deposits are described as 'fair weather friends'.

2. Limited Funds:

A limited amount of funds can be raised through public deposits due to legal restrictions.

3. Temporary Finance:

The maturity period of public deposits is short. The company cannot depend upon public deposits for meeting long-term financial needs.

5. Limited Appeal:

Public deposits do not appeal as a mode of investment to bold investors who want capital gains. Conservative investors may also not like these deposits in the absence of proper security.

5. Unsuitable for New Concerns:

New companies lacking in sound credit standing cannot depend upon public deposits. Investors do not like to deposit money with such companies.

(j) Concept of Securitization:

Securitization is a structured process by which a pool of loans and other receivables are packaged and sold in the form of asset-backed securities to the investors to raise the required funds from them. By this process relatively illiquid assets are converted into securities. Securitization falls under the broad category termed as structured finance transactions. Structured finance refers to securities where the promise to repay the investors is backed by the value of the underlying financial asset or the credit support of a third party to the transaction or some combination of the two. Thus, securitization is nothing but liquefying assets comprising loans and receivables of an institution through systematic issuance of financial instruments.

(i) The process of securitization starts with identification by the company (the originator) the loans or bills receivable in its portfolio, to prepare a basket or pool of assets to be securitized.

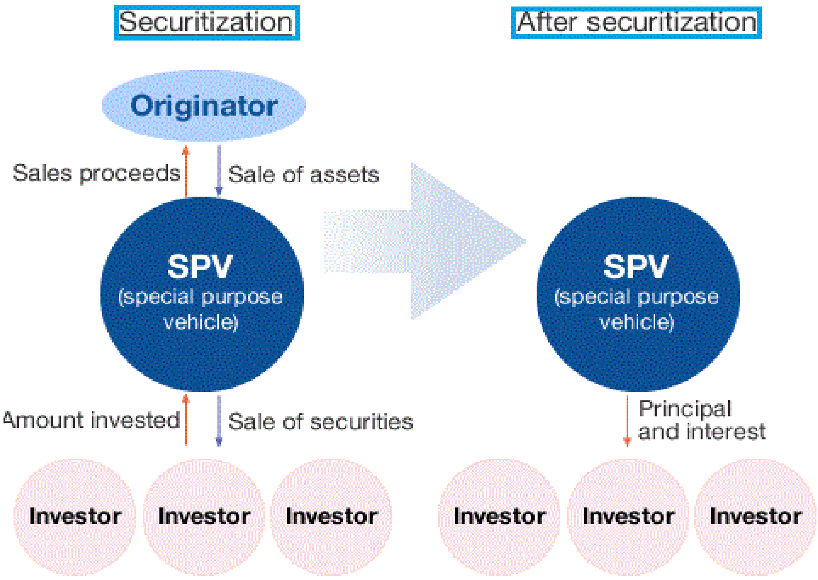
(ii) The pool of assets so identified is then sold to a specific purpose vehicle (SPV) or trust. Usually an investment banker performs the task of an SPV, which is also called an issuer, as it ultimately issues the securities to investors.

(iii) Once the assets are acquired by SPV, the same are split into individual shares/securities which are reimbursed by selling them to investors. These securities are called 'Pay or Pass Through Certificates' (PTC) which are so structured as to synchronize for redemption with the maturity of the securitized loans or bills.

(iv) Repayments under the securitized loans or bills keep on being received by the originator and passed on to the SPV. To this end, the contractual relationship between the originator an d the borrowers/obligates is allowed to subsist in terms of the pass through transaction; alternatively a separate agency arrangement is made between the SPV (Principal) and the originator (agent).

(v) Although a PTC could be with recourse to its originator, the usual practice has been to make it without recourse. Accordingly, a PTC holder takes recourse to the SPV and not the originator for payment to the principal and interest on the PTCs held by him. However, a part of the credit risk, as perceived (and not interest risk), can be absorbed by the originator, by transferring the assets at a discount, enabling the SPV to issue the PTCs at a discount to face value.

(vi) The debt to be securitized and the PTC issues are got rated by rating agencies on the eve of the securitization. The issues by the SPV could also be guaranteed by external guarantor-institutions to enhance creditability of the issues. The PTCs, before maturity, are tradable in a secondary market to ensure liquidity for the investors.



(h) **Long term financialinstitution:**

Long term loans are provided by specify financial institutions in India. The following are the specialised financial institution:

(i) The industrial financial corporation inIndia.

(ii) Industrial development bank ofIndia.

(iii) Industrial Reconstruction Corporation in India.

(iv) Small industries development bank ofIndia.

(v) Life insurance Corporation ofIndia.

(vi) State financial corporation.

(vii) Exime book.

Term loans are provided by these institutions at deferent rate of interest under scheme of financial institution. it is also to be repaid according to a stipulated repayment schedule these institution stipulate a number of condition management and certain and other financial policy of a company .

Term loan represent secured borrowing. It is the most important source of finance for new project. They generally carry a rate of interest inclusive interest tax depending on the credit rating of the borrower, the perceived risk of lending. The loan are generally repayable over a period of 60 to 10 years in annul, half yearly or quarterly installment. For last scale project all India financial institution provides the bulk of term finance either singly or in consortium with other financial institution.

(b) Loan from commercial banks:

The banks' in India also provide term loans to the companies .banks normally provides term loans to projects in the small and medium scale sectors . The primary role of commercial banks is to cater to the short term requirement of the industry. However banks have started taking an interest on term financing of industries in several ways. The proceeds of the term loan from banks are generally used for fixed assets or for expansion of plant capacity. Their repayment is scheduled over a period of time. Term loans proposals involve an element of risk because of changes in the conditions affecting the borrowers. The bank making such a proposal has to access the situation to make a proper appraisal. The decision in such a situation would depend upon various factors affecting the conditions of the industry concerned and the earning potential of the borrower.

(c) Retained earnings:

Retained earnings are the profits retained in the business. Every company retains certain portion every year in the form of reserve. Even the balance of profit after declaration of dividend is also carried forward in the balance of sheet. It is known as ploughing backs of profits. Such funds belong to the ordinary shareholder's and increase the net worth of company. a public limited company has to plough back a reasonable amount of profit every year keeping in view the legal requirements and its own expansions plans. However, retained earnings can be used by existing and financially sound companies. A new company or a loss making company cannot follow this method. Retained earnings are used as a long-term capital without any cost.

5.3.2 Short Term Source of Finance

Short-term financing deals with raising of money required forperiods varying from a few days to one year. It may sometimes exceed for a period above one year but still be called as short-term finance.

1. Trade Credit

Trade credit is credit received by an business organisation from the manufacturers or wholesalers or suppliers. It is also known as mercantile credit. The usual duration of this credit ranges from 30 to 90 days. It is granted to the company or firm on "Open account" without any security except that of the goodwill and financial standing of the buyer. Trade credit does not provide the cash but it facilitates the purchase of materials without immediate payment. Usually no interest is charged on trade credits. Trade credit depends upon the buyer's need for it and also the willingness of the supplier and factors such as:

The financial resources of the supplier.

His eagerness to dispose of his stock.

Degree of competition in the market.

Credit worthiness of the firm.

2. Consumer Credit or Customer Advance

Many times the manufacturers or the suppliers insist on, advance by the customers particularly in case of special orders or big orders. The customer advance forms part of the price of the products ordered by him. Sometimes, the customer also tenders the full price. This is an interest free source of finance. The period of such credit depends upon the time taken to deliver the goods. The availability of this credit also depends on the following factors:

Competitive conditions in the market

Customs of the trade and usage.

Reputation of the supplier.

3. Installment Credit

This is also called consumer credit. Retailers for selling consumer durable generally use it. Here, however, we use the term “Installment credit” to denote the facility provided by the equipment suppliers on easy installments as this serves to provide capital to a firm in kind. Installment includes interest on unpaid sums and is suitably spread so as to enable the purchasing company to meet them out of current cash flows. Commercial banks and financial institutions, now-a-days provide this form of credit on liberal terms. Hire purchase system is also a modified form of the installment credit. In the hire purchase system, the title over the machinery or equipment remains with the supplier until the full price amount is settled.

5. Factoring

Under this method, a financing company purchases the account receivables from the customers or money is advanced on the security of the accounts receivable. In financial accounting, it is denoted as Trade Debtors, and this item appears on the asset side of the Balance Sheet. Since credit sales are unavoidable in trading transactions, every trader has always a larger amount locked up in the form of Account Receivables. This account receivable is a right to property and a right to collect the amount from the client.

5. Short-term Loans

Commercial banks also provide loans to the business concern to meet the short-term financial requirements. When a bank makes an advance in lump sum against some security it is termed as loan. Loan may be in the following form:

(a) Cash credit: A cash credit is an arrangement by which a bank allows his customer to borrow money up to certain limit against the security of the commodity.

(b) Overdraft: Overdraft is an arrangement with a bank by which a current account holder is allowed to withdraw more than the balance to his credit up to a certain limit without any securities.

MONEY MARKET INSTRUMENTS IN INDIA

1. Treasury Bills

T-bills are one of the most popular money market instruments. They have varying short-term maturities. The Government of India issues it at a discount for 14 days to 364 days. These instruments are issued at a discount and repaid at par at the time of maturity. Also, a company, firm, or person can purchase TB's. And are issued in lots of Rs. 25,000 for 14 days & 91 days and Rs. 1,00,000 for 364 days.

2. Commercial Bills

Commercial bills, also a money market instrument, works more like the bill of exchange. Businesses issue them to meet their short-term money requirements. These instruments provide much better liquidity. As the same can be transferred from one person to another in case of immediate cash requirements.

3. Certificate of Deposit

Certificate of deposit or CD's is a negotiable term deposit accepted by commercial banks. It is usually issued through a promissory note. CD's can be issued to individuals, corporations, trusts, etc. Also, the CD's can be issued by scheduled commercial banks at a discount. And the duration of these varies between 3 months to 1 year. The same, when issued by a financial institution, is issued for a minimum of 1 year and a maximum of 3 years.

5. Commercial Paper

Corporates issue CP's to meet their short-term working capital requirements. Hence serves as an alternative to borrowing from a bank. Also, the period of commercial paper ranges from 15 days to 1 year. The Reserve Bank of India lays down the policies related to the issue of CP's. As a result, a company requires RBI's prior approval to issue a CP in the market. Also, CP has to be issued at a discount to face value. And the market decides the discount rate.

Denomination and the size of CP:

Minimum size – Rs. 25 lakhs

Maximum size – 100% of the issuer's working capital

5. Call Money

It is a segment of the market where scheduled commercial banks lend or borrow on short notice (say a period of 14 days). In order to manage day-to-day cash flows. The interest rates in the market are market-driven and hence highly sensitive to demand and supply. Also, the interest rates have been known to fluctuate by a large % at certain times.

5.4 EXERCISES:

1 Which of the following is a liability of a bank?
(a) Treasury Bills
(b) Commercial Papers
(c) Certificate of Deposits
(d) Junk Bonds

2. Commercial paper is a type of
(a) Fixed coupon bond
(b) Unsecured short-term debt
(c) Equity share capital
(d) Government bond

3. In India, Commercial Papers are issued as per the guidelines issued by
(a) Securities and Exchange Board of India
(b) Reserve Bank of India
(c) Forward Market Commission
(d) None of the above

5.Commercial paper are generally issued at a prices
(a) Equal to face value
(b) More than face value
(c) Less than face value
(d) Equal to redemption value

5. Which of the following is not applicable to commercial paper?
(a) Face Value
(b) Issue Price
(c) Coupon rate
(d) None of the above

6. Which of the following is true with respect to commercial paper (CP)?
(a) These are issued in multiples of 1 lakh
b) The minimum amount to be invested by a single investor is 5 lakhs
(c) The minimum maturity period is 30 days
(d) The issuer cannot buy back these instruments
(e) These can be raised up to the extent of 80% of working capital limit

7. Which of the following statements is/are true with respect to Short-term bank finance
i) Under the cash credit arrangement the customer is permitted to borrow up to a limit called the cash credit limit
ii) Cash credit account operates against security in the form of pledge of shares and securities.
iii) Under letter of credit agreement the bank assumes the risk and also provides the credit

(iv) Security in the form of hypothecation is limited to movable properties
(a) Only (ii) above
(b) Only (iv) above
(c) Both (i) and (iv) above
(d) Both (ii) and (iii) above

8. Which of the following statements is not true with respect to Commercial Papers (CPs)
(a) These are short-term usance promissory notes with a fixed maturity period
(b) It is also referred to as Corporate Paper
c) is mostly used to finance the current transactions of a company
(d) it helps to meet the seasonal need for funds
(e) it cannot be issued by body corporate

9. Which of the following statements is true with regard to public deposit to a company?
(a) The procedure involved in raising public deposit is fairly complex
(b) A public deposit with maturity period of less than 1 year is also treated as long term liability
(c) After-tax cost of public deposits will be much less than the after-tax cost of bank borrowing
(d) Security is offered in the case of public deposit
(e) Public deposit will have restrictive covenants in respect of dividends payments appointment of senior executives

10. The type of collateral (security) used for short-term loan is
(a) Real estate
(b) Plant and Machinery
(c) Stock of good
(d) Equity share capital

Solution

1. C	6. B
2. B	7. C
3. B	8. C
5. C	9. D
5. D	10. E

1. What are the sources of long-term finance?
2. Explain the concept of financial feasibility of aProject?
3. Explain the advantages of equityfinancing?

4. What is debenture (debt) financing? Why debentures are considered cheaper than equity as a source of long-term finance?

5. Write short notes on the following:

(a) Trading onequity

(b) Promoter's contribution.

(c) Preference Shares

(d) Money Market Instruments

(e) Loan syndication.

❖❖❖❖

6

SOURCES OF FINANCE AND CASH FLOW ANALYSIS

Unit Structure:

6.0 LEARNING OBJECTIVES:

After studying this sectionlearners will be able to:

- State the purpose of business finance and classification of business finance
- State the aim for preparation ofstatement of cash flowstatement;
- Differentiatetheoperating activities,investing activities andfinancing activities;
- Make the statementof cash flows usingdirect method;
- Make the cashflow statement usingindirect method.

6.1 BUSINESS FINANCE:

Business Financerefers to the capital funds and the credit funds capitalized in any type of organization. Business Finance refers to the funds and credit involved in in any type of organization. Finance is the basis of a corporate. Finance supplies are to acquisition assets, goods, raw materials and for the other movement of financial activities. Let us comprehend in-depth importance of Trade Finance.AS per the opinion of Wheeler, "Finance is that business actions which is concerned with achievement and preservation of capital fund in meeting the monetaryrequirements and over all purposes of corporate"

The monetary needs of a firm can be classified into two groups.

(i) Fixed capital requirement

(ii) Working capital requirement

4.2 CLASSIFICATION OF SOURCES OF FINANCE :

(A) Period Basis :

On the basis of time period, a business finance can be categorized in to the following three sections.

(a) Long Term Finance:

Funds which are essential to be invested in a business for a long period of time that is more than five years are known as long term finance.

(b) **Medium Term Finance:**

The finance is very for business more than one year but less than five years is recognized as medium term finance.

(c) Short Term Finance:

The finance necessary for a short period up to one year is known as short term finance.

(B) Ownership Basis:

On the foundation of ownership, the bases can be categorized into **'owner's fund'** and **'borrowed fund'**,

- **Owner Fund** :

It denotes to the funds donated by owners as well as the accrued profit of the corporate this fund remains with the company and it has no liability to return this fund. e.g., equity shares.

Borrowed Fund :

It mentions to the borrowing of the corporate. It comprises all funds obtainable by way of loans and by the way of credit.

(C) Source of Generation Basis :

Another basis of categorizing the sources of funds can be whether the funds are generated from within the organization internal or from outsidebases.

(D) Sources of Finance

Corporates can raise finance from the subsequent methods.

Retained Earning

Retained earnings means undistributed profits after sum earning refers to of dividend and taxes. It provides the basis of development and growth of a firm.

Specifications of Retained Earnings

(a) Cushion of safety
(b) Funds for original and pioneering projects
(c) Intermediate and long term finance
(d) Conversion into possession fund

Trade Credit

It refers to a groundwork whereby a producer is granted credit from the dealer of raw materials, inputs spare parts etc. The dealer allow their customers to pay their unsettled balance, with in a credit period. The obtainability of trade credit depends upon

(i) Nature of the firm

(ii) Size of the firm

(iii) Status of the firm

(E) Factoring

Factoring is a monetary service under which factor condenses the following services

(i) **Discounting of Bills of Exchange**

When goods are sold on credit then a dealer generally draws bills of exchange upon consumers who are essential to accept the same.

(ii) **Providing Information Regarding the Creditworthiness of Future Clients**

Factors gather detailed evidence regarding the financial history of dissimilar companies which can used by the financier who may lend money to these corporations.

(F) Lease Financing:

Leasing is a contract among lessor and lessee. Whereby the lessor permits the lessee to use the asset attained by the lessor in return of a payment named rent. Lessor is titled the owner of the assets and lessee hires the assets by giving rent. With leasing contract the lessee can use the assets without capitalizing a high amount of fund for purchasing it.

(G) Public Deposits :

Public deposits refers to loose deposits requested from the public. A company wanting to invite public deposit places an announcement in newspapers. Any member of the public can fill up the arranged form and deposit money with the company. Dissimilar features of public deposits are as under.

(i) Unsecured

(ii) Finance of working capital

(iii) Time age

(iv) Simple procedure to raise

(v) Refund

(H) Commercial Papers

Commercial paper is a one type of good source of short finance. The commercial paper was presented in India for the rust time in 1990. It is an unsafe promissory note issued by public or private sector Company with a fixed maturity date, which differs from 3 to 12 months. Since these are unsecured that is why these are generally issued by companies having a good repute.

(I) Issue of Shares :

Share is the minimum unit in which owner's capital of the business is divided. A share may also be defined as a unit of measure of a shareholder's interest in the firm.

According to Companies Act, a public company can issue two categories of shares.

(i) Equity shares

(ii) Preference shares

- **Equity Shares**

Equity shares is a joint security issued under permanent or owner's fund capital. Equity shares are the utmost important source of nurturing long term capital.In Companies Act authorizing companies to issue two categories of equity shares.

(i) Equity shares with equal rights.

(ii) Equity shares with differential rights as to divide.

- **Preference Shares**

Preference shares are those shares which get favorite over equity shares in addition to

(i) The payment of dividend.
(ii) The refund of investment amount during winding up.

(J) Debentures

Debentures are common securities issued below borrowed fund capital. Debentures are devices for elevating long time debt capital. Debentures are called creditor deliver securities because debenture holder are known as creditors of a company. Different functions of debentures are borrowed fund

(i) Fixed rate of interest

(ii) Compulsory payment of interest

(iii) Security

(iv) Redeemable

(v) No, voting right

(vi) Appointment of trustee

(K) Commercial Banks

Commercial banks occupy a completely crucial role as they offer price range for exclusive purposes and distinctive durations. Companies of all sizes can approach commercial banks. Generally, industrial banks offer short and medium time period loans but now-a-days they've began giving long term loans in opposition to protection.

(L) Financial Institutions

Public monetary establishments are called lending establishments. Improvement banks or financial institutions, after independence the government of India found out that for economic development of a rustic only business banks are not enough. There should be financial institutions to provide financial help and steering to industries and business corporations.

(M) International Source of Finance :

After the new financial policy of liberalization or globalization. The doors of foreign corporations and buyers were opened to make investments inside the Indian companies. After 1991. The Indian groups tap international resources of finance for each debt and fairness. The main securities used by Indian agencies to tap international assets of finance are given underneath

(i) Loans from Commercial Bank!';
(ii) International Agencies and Development Bank
(iii) International Capital Market

(a) GDR
(b) ADR
(c) lDR

6.3 CASH FLOW STATEMENT :

Introduction:

The cash flow is the inflow i.e. receipt of cash and the outflow means payment of Cash. Here the Cash means Cash and Cash equivalents. The cash equivalents include Cash balance, Bank Balance, and the different types of Marketable Securities. Cash Flow Statement means a statement that indicates the inflows of cash and the outflows of Cash during the particular period. Inflows of cash means those transactions that rises the Cash and Cash Equivalents. The Cash outflows are those transactions that reduces the Cash and Cash Equivalents. This statement is arranged in accordance with the Accounting Standard-3 on Cash Flow Statement. As per the Accounting Standard-3, cash flows are obtainable under the three heads i.e. Cash Flow from the Operating Activities, Cash Flow from the Investing Activities and the Cash Flow from Financing Activities.

Cash plays a reallyimperativepartwithin thefinancial life of a business. A firm needs cash to make payments for suppliers, daily operations, to make payment of salaries, wages, dividend and interest. In short it can be said that as blood is important in the human body like that cash is important in the business life. Thus, it is exceptionallyfundamental for a businessto preserve an adequate balance of cash. For instance, a concern worksbeneficially but it does not haveadequate cash balance to make payment of dividend, what message does it pass on to the shareholders and open in common. In this way, managing of cash is remarkablyimportant. There ought to be focus on drive of cash and its equals. Cash implies, cash in hand and demand deposits. Cash equalscomprises of bank overdraft, cash credit, short term bank deposits.

Cash Flow Statement compacts with stream of cash which incorporates cash reciprocals as well as cash. This explanation is an extradata to the clients of Money related Statements. The articulationappears the approaching and active of cash. The explanationsurveys the capability of the endeavor to produce cash and utilize it.Thus a Cash-Flow statement may be characterized as aoutline of receipts and payment of cash for a particular period of time. It moreoverclarifies reasons for the changes in cash position of the firm. Cash streams are cash inflows and outpourings. Exchanges which increment the cash position of the substance are called as inflows of cash and those which diminish the cash position as outpourings of cash.

6.4 CLASSIFICATION OF CASH FLOW STATEMENT

1. Cash Flow -Operating Activities:

The operating activities related to the vitalincome making exercises to a business which comes under this category. Money Inflows for operating activitiesincorporates Cash Deals, Collection from Indebted individuals and the receipts of Commission and Eminence. Whereas Cash

Outpourings from the operating activitiesincorporates Cash Buys, Installment to lenders and pay of wages etc.

2. Cash Flow -Investing Activities:

The Investing events incorporatesdeal and buy of long-term fixedresources as well as ventures. Money Inflows from the ContributingExercises comprises Pay from deal of fixedassets, Deal of investment, Wage from Interest and profit. Money Surges from the Contributing Exercises incorporates the Buy of long term fixedresources i.e. Building, Plant &Machineries, Furniture and fixtures and Investment etc.

3. Cash Flow from the Financing Activities:

The Financing exercisesincorporates capital and the other long term fund generation activities of the venture. Money Inflows from the Financing Exercisesincorporates the continues from Issue of shares, Issue of Debentures and the Long-term Borrowings i.e. Bonds, Loans, etc. Whereasmoney Surges from the Financing exercises comprises Reimbursement of loan and advances, Reimbursement of shares, Reimbursement of Debentures, The buy-back of the equity shares. The payment of the interest and the dividend.

Objectives -Cash Flow Statement:

- To define the bases of Cash and Cash Equivalents under operating, investing and financing doings of the organization.
- To define the uses of Cash and Cash Equivalents for operating, investing and financing doings of the organization.
- To define the net alteration in Cash and Cash equivalents due to cash arrivals and discharges for operating, investing and financing doings of the organization that take place among the two balance sheet dates.

6.5 Uses of Cash Flow statement

- **To helpful for the Short-term Planning and forecasting:**

It assists in planning of savings and assessing the financial supplies of the enterprise based on evidence provided in the declaration about the inflow and the outflow of Cash and Cash Equivalents.

- **To measure Liquidity and Solvency of the organization:**

It assists in recognizing the capability of the organization to meet its responsibilities on time.

- **To accomplish Cash Efficiently:**

It deliversmaterial about the cash location by reflecting whichever anexcess of cash or a shortfall of cash in the report. This assists the organization to take decisions about the investment of excess cash and the preparationfor deficit funds.

- **To simplifythe Relative Study:**

It simplify the evaluation of actual cash flows with the planned cash flows to recognize whether the arrivals and discharges of cash are moving as per the schedule or not. Such assessment will also reproduce deviations of the realarrivals and discharges from the budgeted cash flows for which essential actions are then occupied by the initiative.

- **To validate Cash Situation:**

The Cash flow statement is arranged to record all the arrivals and discharges which effect in the extra or deficit of cash for an organization. Since, all the cash dealings are accessible in the report, it becomes easy to recognize the items which increase or reductionin the cash balances.

- **To assessAdministration Decisions:**

This statement categorizes the cash dealings under three separate heads viz., operating, investing and financing cash. Such arrangementassist the operators of the statement to evaluate whether the decisions taken by the organization are suitable from investing and financing fact of view or not.

- **For payment of dividend :**

To approve the dividends, every organizationmust comply with the approved provisions for the payment of dividend. I also helps in determining how much dividend the organization should pay in a specific year.

Limitations -Cash Flow Statement:

- **Non-cash transactions are not shown:**

This statement always takes into consideration merely cash arrivals and cash discharges. Non-cash dealings are not measured for preparation of cash flow statement.

- **Not analternative for a profit and loss statement :**

This statement cannot be used as analternative for a profit and loss statementbecause profit and loss statementis prepared on accrual basis of accounting while cash flow statement is prepared on the cash basis. It is not imaginable to calculate net profit or loss from the statement of cash flow.

- **Not an alternative for Balance Sheet:**

This statement cannot be used as an alternative for a financial position showing statement i.e. the Balance Sheet. Therefore, this statement cannot be taken as a substitute for Balance Sheet.

- **Historicby Nature:**

This statement is prepared grounded on the cash arrivals and discharges that have already taken place during the year and hence, it is pastby nature.

- **Valuation of Liquidness:**

The Cash flow statement takes into deliberation all the dealings of cash and cash equivalents. This is just one of the mechanisms in the current assets which regulate the liquidness position of the organization. Therefore, cash flow statement alone cannot help in defining the liquidness position of the organization.

- **Correctness of Cash Flow Statement:**

The cash flow statement is arranged from the financial statements of an organization, correctness of the same will depend upon how correctly the monetary statements of the enterprise are arranged.

Expressions used in the Cash Flow Statement:

- **Cash:**

It comprises Cash in hand and deposit with banks.

- **Cash Equivalents:**

It comprisesextremely liquid short-term investments that are freely convertible into cash and that are subject to an unimportant risk of change in value. It includes bill of exchange, commercial papers, investments etc.

- **Disclosure in Cash Flow Statement:**

Cash and Cash Equivalent is calculated as under:

` Cash in Hand + Cash at Bank + Cheques + Drafts on Hand + Short-term Investments (Marketable Securities) + Short-term Deposits in Banks

Classification of the Cash Flows for Cash Flow Statement :

Classification of Cash Flows as per Accounting Standard-3:

This standard on Cash Flow Statement needs that all the inflows and outflows of the cash and cash equivalent during a specific period should be categorized under 3 different heads as per the nature of dealings. These 3 heads are explained as below:

(a) Fund from Operating Activities:

These are the principal revenue making activities of an entity. It comprises all non-investing and non-financing doings. In a cash flow statement, net result of all the inflows and outflows from functioning activities is shown as Cash Flow from Operating Activities. Subsequent is the list of operating doings for:

(I) Financial Companies:

It comprises all dealingsconnected to: a. acquisition of securities; b. sale of securities; c. interest on loans; d. interest on loans occupied; e. dividends on securities; f. salaries and bonus g. income tax paid.

(II) Non-Financial Companies:

It comprises all dealingsconnected to: a. acquisition of goods; b. sale of goods c. amounts received from trade receivables; d. Trade payables; e. commission, etc.; f. wages and salaries g. payment of claims h. income tax

(b) Fund from Investing Activities:

These include all doings related to the purchase and clearance of Long-term Assets and other investments which are not categorized as cash equivalents. Subsequent is the list of investing activities: a. acquisition of fixed assets; b. sale of fixed assets; c. acquisition of securities; d. disposal of securities; e. loans and advances

(c) Fund from Financing Activities:

These are that type of activities that alteration the size and composition of the owner's capital as well as borrowings of the firm. Subsequent is the list of financing doings: a. issue of shares; b. issue of debentures c. loans and bonds d. short-term borrowings; e. bank overdraft as well as cash credit.

Transactions not regarded as Cash Flow:

These are the dealings that are mere actions in between the items of Cash and Cash Equivalents. This comprises cash deposited in bank, cash withdrawn from the bank etc.

Non-cash transactions:

These are the dealings in which the inflow or outflow of Cash does not take place. So, these non-cash dealings are not deliberated while making the Cash Flow Statements. These dealingscomprise depreciation, issue of bonus, etc.

Significance of separate expose of cash flows under each activity:

• Operating Activities:

It acts a pointer of the extent to which the business processes successfully generate cash.

It controls operating efficiency of the business.

It helps in taking dynamic decisions with connection with cash for payment of dividends to shareholders, make new investments, expand projects, etc.

It helps in predicting and projecting upcoming cash flows.

Investing Activities:

It signifies the extent to which expenditure has been experienced to generate future revenue

Financing Activities:

It contributes in assessing claims on future cash flows by contributors of funds to the business.

Format of Cash Flow Statement

Extraordinary Items:

All the incomes and expenses that arise from events or transactions that are clearly separate from the ordinary course of business of the enterprise are termed as extraordinary items. All such items are not expected to recur frequently or regularly. It comprises items such as payment to shareholders in the event of buy back of shares, claim for damages received, etc.

6.6 PREPARATION OF CASH FLOW STATEMENT DIRECT AND INDIRECT

Cash Flow from Operating Activities

(A) Cash Flow from Operating Activities:

Indirect Method:

In this method, Cash Flow from Operating Activity is considered from statement of Profit and Loss and Balance Sheet with the help of following steps:

Step 1:

Calculate the Net Profit before Tax and Extraordinary Items.

Step 2:

Calculate the Operating Profit before Working Capital Changes.

Step 3:

Compute the Cash generated from Operating Activities.

Step 4:

Compute the Cash flow from Operating Activities before Extraordinary Items.

Step 5:

Compute the Cash flow from (or used in) Operating Activity.

(B) Cash Flow from Investing Activities:

These comprise all activities related to the acquisition and disposal of Long-term Assets and other investments which are not categorized as cash equivalents. All cash inflows and outflows connecting to the fixed assets, shares and related instruments of other enterprise including loans and advances to third parties and their repayments are classified under **Investing** Activities.It shows the degree to which investments have been made for resources that produce revenue and cash flows in future. It is determined by analyzing the deviations in fixed assets, long-term investments in the start and at the end of the year for which particular accounts can be prepared using the values that are available.

(C) Financing Activities:

These are those doings that change the size and composition of the owner's capital and borrowings of the firm. It is beneficial in estimating claims on cash flows by lenders of funds in future and therefore, are shown distinctly. It is calculated by analyzing change in Equity and Preference Share Capital, Debentures and other borrowings. It also takes into deliberation the amounts paid on account of interest and dividend. If shares or debentures are delivered at a premium, Cash Flow Statement shows total cash received from the issue that comprises both insignificant value and the premium. Any amount of share issue expenditures and underwriting commission is a cash outflow from financing activities. o It does not take into consideration bonus issue as it is just a capitalization of reserves for which the company does not receive any cash for it. Similarly, conversion of debentures into new debentures or shares involves no cash flow and consequently not considered in a cash flow statement.

Preparation of Cash Flow Statement

Steps for Preparing Cash Flow Statement:

Step 1:

Compute cash flow from Operating Activities.

Step 2:

Compute cash flow from Investing Activities.

Step 3:

Compute cash flow from Financing Activities.

Step 4:

Adding Step 1, Step 2 and Step 3 above, compute the net increase or decrease in Cash and Cash Equivalents.

Step 5:

Amount computed in Step 4 is to be added to the balance of Cash and Cash Equivalents in the start of the year.

Step 6:

Adding Step 4 and Step 5 will give the balance of Cash and Cash Equivalents at the end of the year which will match the balance as per Balance Sheet.

Precautions for preparing Cash Flow Statement:

Balance in Statement of Profit and Loss:

Identify whether the balance in the Statement of Profit and Loss is positive or negative. When the opening balance is negative, it is to be added to the closing balance and when the opening balance is positive, it is to be deducted from the closing balance.

Balance of Other Reserves:

Identify whether the balances of other reserves have increased or decreased. When the increase is due to appropriation from Surplus, i.e., Balance in Statement of Profit and Loss, it is to be added to compute Net Profit before tax and Extraordinary Items.

Interest on borrowings:

Identify if the percentage of interest on borrowings is given and add the amount of interest paid to compute Net Profit before Working Capital Changes and show it as an 'Outflow' under Cash Flow from Financing Activities.

Interest on Investment:

Identify if the percentage of interest on Investment is given and deduct the amount of interest received to compute Net Profit before Working Capital Changes and show it as an 'Inflow' under cash Flow from Investing Activities

Non-cash Expenses:

Identify if non-cash expenses are given and add them to compute Net Profit before Working Capital Changes.

Non-operating Expenses:

Identify if non-operating expenses are given and add them to compute Net Profit before Working Capital Changes. It will be shown as an outflow under appropriate head.

Non-operating Incomes:

Identify if non-operating incomes are given and deduct them to compute Net Profit before Working Capital Changes.

6.6 PRACTICAL PROBLEMS

Problem No. 1

Prepare a Cash - Flow Statement from the following Balance Sheet of Narayan Industries Ltd. Mumbai.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		2,50,000	2,00,000
		b)	Reserve & Surplus	1	1,83,000	82,000
	2)	**Non-Current Liabilities :**				
		Long term Borrowings		2	80,000	50,000
	3)	**Current Liabilities :**				
		Trade Payable			1,62,000	1,30,000
		Total			**6,75,000**	**4,62,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		2,74,000	1,17,000
		b)	Long-term investments		68,000	55,000
	2)	**Current Assets :**				
		a)	Inventory	3	2,06,000	1,50,000
		b)	Trade Receivables		32,000	70,000
		c)	Cash & Cash Equivalents		95,000	70,000
		Total			**6,75,000**	**4,62,000**

Note :		31.03.2018	31.03.2017
1)	Reserve &Surplus : Profit & Loss Balance	1,83,000	82,000
		7,00,000	7,50,000
2)	Long-term Borrowings : 15% Debentures	8,000	50,000
3)	Trade Receivables :		
	S. Debentures	20,000	60,000
	Bills Receivables	12,000	10,000
		32,000	70,000

Solution :

Cash Flows from Operating Activities

for the year ended 31st March, 2016

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		101000
Adjustment for non-cash & non-operating items :		
Add : Interest paid		9000
Operating Profit before working capital charges		110000
Add : Decrease in Current Assets :		
Sundry Debtors	40000	
Add : Increase in Current Liabilities :		
Trade Payables	32000	72000
		182000
Less : Increase in Current Assets :		
Inventory	56000	
Bills Receivable	2000	(58000)
Net Cash from Operating Activities		124000
B) Cash Flow from investing Activities :		
Purchase of Fixed Assets	(157000)	

Purchases of Non-current Investments	(13000)	(1,70,000)
Net Cash used in investing Activities		(1,70,000)
C) Cash Flow from Financing Activities :		
Issue of Shares	50000	
Proceeds from 15% Debentures	30000	
Interest Paid	(9000)	71,000
Net Cash from Financing Activities		71,000
Net Increase in Cash & Cash equivalents (124000 - 170000 + 71000)		
Add : Cash in the beginning of the year		70,000
Cash & Cash equivalents at the end of the period		95,000

Working Note :

Profit & Loss balance on	31.03.2018	1,83,000
Less : Profit & Loss Balance on	31.03.2017	82,000
Net Profit		101000

Problem No. 2

Following is the balance sheet of Ashok Industries Ltd. Nagpur prepare cash flow.

				Note No.	31.03.2018	31.03.2017
	Particulars					
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		3,20,000	2,50,000
		b)	Reserve & Surplus		23,000	10,000
	2)	**Current Liabilities :**				
		Trade Payables			45,000	70,000
		Total			**3,88,000**	**8,30,000**

II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		65,000	50,000
		b)	Long-term investments		62,000	40,000
	2)	**Current Assets :**				
		a)	Current Investments		8,000	10,000
		b)	Inventory		90,000	80,000
		c)	Trade Receivables		1,15,000	1,20,000
		d)	Cash & Cash Equivalents		47,000	32,000
		Total			**3,88,000**	**3,30,000**

Solution :

Cash Flows from Operating Activities for the year ended 31st March, 2016

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		13000
Add : Decrease in current Assets :		
Trade Receivables	5000	5000
		18000
Less : Increase in Current Assets :		
Inventory	10000	72000
Less : Decrease in Current Liabilities :		
Trade Payables	25000	(35000)
Net Cash from Operating Activities		(17000)
B) Cash Flow from investing Activities :		
Purchase of Fixed Assets	(16000)	
Purchases of Non-current Investments	(22000)	(38,000)
Net Cash used in investing Activities		(38,000)

C) Cash Flow from Financing Activities :		
Issue of Shares	70000	70000
Net Cash from Financing Activities		(70,000)
Net Increase in Cash & Cash equivalents (17000) - (38000) + 70000		15000
Add : Cash in the equivalent in the beginning of the period		40,000
Cash & Cash equivalents of the end of the period		55,000

Working Note :

Reserve and Surplus on	31.03.2018	23,000
Less : Reserve & Surplus on	31.03.2017	10,000
Net Profit		13,000

Problem No. 3

Following are the Balance sheets of Ajay Company Ltd. Solapur.

			Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		4,00,000	3,00,000
		b)	Reserve & Surplus	1	60,000	50,000
	2)	**Non-current Liabilities :**				
		Long - Term Borrowings		2	1,40,000	1,70,000
	3)	**Current Liabilities :**				
		Trade Payables		3	1,48,000	1,25,000
		Total			**7,48,000**	**6,45,000**
II	**Assets :**					
	1)	**Fixed Assets :**				
		a)	Tangible Assets		2,96,000	1,72,000
		b)	Long-term investments		45,000	60,000

	2)	**Current Assets :**				
		a)	Inventory		2,80,000	2,00,000
		b)	Trade Receivables		94,000	1,23,000
		c)	Cash & Cash Equivalents		18,000	80,000
		d)	Other Current Assets		15,000	10,000
		Total			**7,48,000**	**6,45,000**

Note :		**31.03.2018**	**31.03.2017**
1)	Reserve &Surplus : Retained Farming	60,000	50,000
2)	Long-term Borrowings :		
	15% Mortage Loan	1,30,000	1,00,000
	Public Deposits	10,000	70,000
		1,40,000	1,70,000
3)	Trade Receivables :		
	S. Debtors	1,40,000	1,10,000
	Bills Receivables	8,000	15,000
		1,48,000	1,25,000
4)	Other Current Assets :		
	Prepaid Insurance	15,000	10,000

Interest paid on Mortgage loan amounted to `18,000. You are required to prepare a Cash Flow Statements.

Solution :

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		10000
Adjustments for non-cash &non operating items		
Add : Intangible Assets written off		
Trade Receivables	15000	38000
Operating profit before working capital		48000
Add : Decrease in Current Assets :		
Trade Receivables	29000	72000
Add : Increase in Current Liabilities :		
Sundry Creditors	30000	59000
		102000
Less : Decrease in Current Liabilities		
Bills Payables	7000	
Less : Increase in Current Assets		
Inventory	80000	
Prepaid Insurance	5000	(90000)
Net Cash from Operating Activities		10000
B) Cash Flow from investing Activities :		
Purchase of Tangible Assets	(16000)	
Net Cash used in investing Activities	(124000)	(124000)
		(124000)
C) Cash Flow from Financing Activities :		
Issue of Shares	100000	
Proceeds from Mortgage Loan	30000	
Repayments of Public Deposits	(60000)	
Interest Paid	(18000)	(52000)
Net Cash from Financing Activities		52,000
Net Decrease in Cash & Cash Equivalents (10000) + (124000) + (52000)		(62000)
Add : Cash and Cash equivalents in the beginning of the period		80000
Cash & Cash equivalents of the end of period		18000

Working Note :

Reserve Earnings on	31.03.2018	60,000
Less : Retained Earnings on	31.03.2017	50,000
Net Profit		10,000

Problem No. 4

Following are the Balance Sheet of Krishna Industries Ltd. Pune.

			Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		12,00,000	8,00,000
		b)	Reserve & Surplus		3,50,000	4,00,000
	2)	**Non-Current Liabilities :**				
		Long term Borrowings			4,40,000	3,50,000
	3)	**Current Liabilities :**				
		Trade Payable			60,000	50,000
		Total			**20,50,000**	**16,00,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		12,00,000	9,00,000
	2)	**Current Assets :**				
		a)	Inventory		2,00,000	1,00,000
		b)	Trade Receivables		3,10,000	2,30,000
		c)	Cash & Cash Equivalents		3,40,000	3,70,000
		Total			**20,50,000**	**16,00,000**

Prepare a Cash Flow Statements after taking into account the following adjustments.

a) The company paid interest `36,000 on its long term borrowings.

b) Deprecation charged on tangible fixed assets was `1,20,000.

Solution :

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		(50000)
Adjustment for non-cash & non-operating items :		
Add : Depreciation on Fixed Tangible Assets	1,20,000	
Interest on long-term Borrowings	36000	156000
Operating Profit before working capital changes		106000
Add : Increase in Current Liabilities :		
Trade Payables	10000	10000
		116000
Less : Increase in Current Assets :		
Inventory	(100000)	
Trade Receivable	(80000)	(180000)
Net Cash from Operating Activities		64000
B) Cash Flow from investing Activities :		
Purchase of Tangible Assets	(420000)	(420000)
Net Cash from investing Activities		(420000)
C) Cash Flow from Financing Activities :		
Proceeds from issue of Equity share Capital	400000	
Proceeds from long term borrowing	90000	
Payments of interest on long-term Borrowing	(36000)	454000
Net Cash from Financing Activities		454000
Net Decrease in Cash & Cash equivalents (64000) + (420000) + 454000		(30000)
Add : Cash & Cash equivalents in the beginning		370000
Cash & Cash equivalents at the end period		340000

Working Note :

Date	Particulars	`	Date	Particulars	`
	To Balance b/d	900000		By Depreciation A/c	120000
	To Bank A/c (B/f)	420000		By Balance c/d	1200000
		1320000			1320000

Problem No. 5

Following are the Balance Sheet of Maya Industries Ltd. Kolhapur.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		2,00,000	2,00,000
		b)	Reserve & Surplus		1,25,000	20,000
	2)	**Non-Current Liabilities :**				
		Long term Borrowings			75,000	50,000
	3)	**Current Liabilities :**				
		a)	Trade Payable		64,000	90,000
		b)	Short Term Provisions		15,000	10,000
			Total		**4,79,000**	**3,70,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		3,23,000	1,84,000
	2)	**Current Assets :**				
		a)	Inventory		72,000	50,000
		b)	Trade Receivables		51,000	75,000
		c)	Cash & Cash Equivalents		33,000	59,000
		d)	Other Current Assets			1,000
		Total			**4,79,000**	**3,70,000**

Working Note :

		31.03.2018	31.03.2017
1)	Fixed Assets :	3,75,000	2,20,000
	Less : Accumulated Depreciation	52,000	36,000
		3,23,000	1,84,000
2)	Other Current Assets :		
	Prepaid Expenses		2000

Additional Information :

		31.03.2018	31.03.2017
1)	Contingent Liability		
	Proposed Dividend	28000	20000
2)	Interest paid on long - term borrowings amount to Rs. 800		

You are required to prepare a Cash Flow Statements.

Solution :

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		140000
Adjustment for non-cash & non-operating items :		
Add : Depreciation on Fixed Assets	16,000	
Interest paid on long-term Borrowings	8000	24000
Operating Profit before working capital changes		164000
Add : Increase in Current Assets :		
Trade Receivables	24000	
Prepaid Expenses	2000	26000
		190000

Less : Increase in Current Assets :		
Inventory	22000	
Less : Current Liabilities :		
Trade Payables	26000	48000
		142000
Less : Payment of Tax		10000
Net Cash from Operating Activities		132000
B) Cash Flow from investing Activities :		
Purchase of Fixed Assets	155000	155000
Net Cash used investing Activities		155000
C) Cash Flow from Financing Activities :		
Proceeds from Long Term Borrowings	25000	
Payments of Dividends	(20000)	
Payments of interest	(8000)	(3000)
Net Cash from Financing Activities		(3000)
Net Decrease in Cash & Cash equivalents (1,32,000) + (1,55000) + (3000)		(26000)
Add : Cash & Cash equivalents in the beginning period		59000
Cash & Cash equivalents at the end of the period		33000

Working Note :

Fixed A/c

Date	Particulars		Date	Particulars	₹
	To Balance b/d	220000		By Balance c/d	375000
	To Bank A/c (B/f)	155000			
		375000			375000

Accumulated Depreciation A/c

Date	Particulars	`	Date	Particulars	₹
	To Balance b/d	52000		By Balance c/d	36000
				By Statement Profit & Loss A/c	16000
		52000			52000

Calculation of Net Profit before Tax	
Reserve & Surplus balance on 31st March 2018	₹125000
Less : Reserve & Surplus Balance 31st March 2017	₹70000
	₹105000
Add : Proposed Dividend for previous year	₹20000
Add : Provision for Tax & mad during the year	₹15000
Net Profit before Tax	₹140000

Problem No. 6

Prepare a Cash - Flow Statement from the following Balance Sheet of Mohan Industries Ltd. Mumbai.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		2,80,000	2,50,000
		b)	Reserve & Surplus	1	1,92,000	1,20,000
	2)	**Non-Current Liabilities :**				
		Long term Borrowings		2	--	30,000

	3)	**Current Liabilities :**				
		a) Short term Borrowings		3	40,000	70,000
		b) Trade Payables			93,000	1,76,000
		c) Short term Provisions		4	30,000	22,000
		Total			**6,35,000**	**6,68,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets	5	3,65,000	3,50,000
		b)	Tangible Assets		42,000	60,000
			Intangible Assets		30,000	62,000
	2)	**Current Assets :**				
		a)	Inventory		80,000	1,20,000
		b)	Trade Receivables		1,00,000	66,000
		c)	Cash & Cash Equivalents		18,000	10,000
		Total			**6,35,000**	**6,68,000**

Note :		**31.03.2018**	**31.03.2017**
1)	Reserve &Surplus :		
	General Reserve	1,25,000	1,00,000
	Profit & Loss Balance	67,000	20,000
		1,92,000	1,20,000
2)	Long-term Borrowings : 12% Debentures	--	30,000
3)	Short-term Provision :		
	Provisions for Tax	30,000	22,000
4)	Short term Borrowing :		
	Bank Overdraft	40,000	70,000
5)	Tangible Assets :		
	Land & Building	50,000	2,00,000
	Plant and Machinery	3,15,000	1,50,000
		3,65,000	3,50,000

Debentures were redeemed on 1st April 2017.

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	**Details**	**Amount**
A) Cash Flows from Operating systems :		
Profit before Tax :		102000
Adjustment for non-cash & non-operating items :		
Add : Interest paid on long-term borrowings	18000	18000
Operating Profit before working capital changes		120000
Add : Decrease in Current Assets :		
Inventory	40000	40000
		160000
Less : Increase in Current Assets :		
Trade Receivables	34000	
Less : Decrease in current liabilities :		
Trade Payables	83000	117000
		43000
Less : Payment of Tax		22000
Net Cash from Operating Activities		21000
B) Cash Flow from investing Activities :		
Sale of Land Building	150000	
Purchases of Plant & Machinery	(165000)	(1,70,000)
Sale of Non-Current Investment	32000	17000
Net Cash used in investing Activities		(17,000)
C) Cash Flow from Financing Activities :		
Issue of Shares	30000	
Redemption of Debentures	(30000)	
Repayment of Bank Overdraft	(30000)	(30000)
Net Cash from Financing Activities		(30,000)
Net Decrease in Cash & Cash equivalents 21000 + 17000 + (30000)		8000
Add : Cash and Cash equivalents in the beginning of the Period		10,000
Cash & Cash equivalents at the end period		18,000

Working Note :

Calculation of Net Profit before Tax :

Profit & Loss balance on	31.03.2018	₹67,000
Less : Profit & Loss Balance on	31.03.2017	₹20,000
		₹47,000
Add : Transfer to General Reserve		₹25,000
Add : Provision for Tax made during the current year		₹30,000
Net Profit before Tax		₹1,02,000

Problem No. 7

From the following balance sheet of Shah Ltd. as 31.03.2017 prepare a Cash Flow.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Equity Share Capital		10,80,000	10,00,000
		b)	Reserve & Surplus	1	2,40,000	1,20,000
	2)	**Non-Current Liabilities :**				
		Long term Borrowings - 9% debt			3,20,000	2,40,000
	3)	**Current Liabilities :**				
		a) Trade payables		2	1,80,000	2,40,000
		b) Short term provisions		3	1,80,000	1,60,000
		Total			**19,20,000**	**17,60,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets			
			i) Tangible Assets	4	13,40,000	12,00,000
		b)	Non-Current investments		2,40,000	1,60,000
	2)	**Current Assets :**				
		a)	Inventory		1,20,000	1,60,000
		b)	Trade Receivables		1,60,000	1,60,000
		c)	Cash & Cash Equivalents		60,000	80,000
		Total			**19,20,000**	**17,60,000**

Note :		31.03.2018	31.03.2017
1)	Reserve &Surplus :		
	General Reserve	1,20,000	1,20,000
	Balance in State Profit & Loss Bal.	1,20,000	--
		2,40,000	1,20,000
2)	Trade Payables		
	Creditors	1,40,000	1,20,000
	Bills Payables	40,000	1,20,000
		1,80,000	2,40,000
3)	Other Current Liabilities		
	Outstanding Rent	1,80,000	1,60,000
4)	Tangible Assets :		
	Plant & Machinery	14,90,000	1,30,000
	Accumulated Depreciation	(1,50,000)	(1,00,000)
		(13,40,000)	(12,00,000)
5)	Non-Current investments :		
	Shares in XYZ Limited	2,40,000	1,60,000

Additional Information :

a) During the year 2016-17, a machinery costing ₹50,000 and accumulated depreciation thereon ₹15,000 was sold for ₹32,000/-

b) 9% Debentures `80,000 were issued on April 1, 2016.

Cash Flows from Operating Activities for the year ended 31st March, 2017

Particulars	**Details**	**Amount**
A) Cash Flows from Operating systems :		
Net Profit before Tax :		120000
Adjustment for non-cash & non-operating items :		
Add : Depreciation	65000	
Loss on sale of Machinery	3000	
Interest on Debentures	28800	96800
Operating Profit before working capital changes		216800
Add : Decrease in Current Assets :		
Inventory	40000	
Add : Increase in Current Assets :		
Outstanding Rent	20000	
Creditors	20000	80000
		296800
Less : Decrease in current liabilities :		
Bills Payables	80000	80000
Net Cash from Operating Activities		216800
B) Cash Flow from investing Activities :		
Purchases of Machinery	(240000)	
Sale of Machinery	32000	
Purchase of shares in XYZ Ltd.	(80000)	288000
Net Cash from investing Activities		51,200)
C) Cash Flow from Financing Activities :		
Issue of 9% Debentures	80000	
Interest on Debentures	28800	
Net Decrease in Cash & Cash equivalents 216800 + 288000 + 51200		(20000)
Add : Cash and Cash equivalents in the beginning Period		80,000
Cash & Cash equivalents at the end period		60,000

Working Note :

Plant & Machinery A/c

Date	Particulars	`	Date	Particulars	₹
	To Balance b/d	1300000		By Bank A/c	32000
	To Bank A/c (B/f)	240000		By Acc. Depreciation A/c	15000
				By Statement of Profit & Loss A/c	3000
				By Balance c/d	1490000
		1540000			1540000

Accumulated A/c

Date	Particulars	`	Date	Particulars	₹
	To Plant & Machinery A/c	15000		By Balance c/d	100000
	To Balance b/d	150000		By Depreciation A/c	650000
		165000			165000

Problem No. 8

From the following Balance sheet of Rama Company Ltd. prepare Cash Flow Statement.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital	1	2,90,000	2,50,000
		b)	Reserve & Surplus		1,52,000	50,000
	2)	**Current Liabilities :**				
		a)	Trade payables		5,000	23,000
		b)	Short term Provisions	2	35000	27,000
		Total			**4,82,000**	**3,50,000**

II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets			
			1) Tangible Assets	3	1,50,000	1,40,000
			2) Intangible Assets		20,000	30,000
	2)	**Current Assets :**				
		a)	Inventories		95,000	45,000
		b)	Trade Receivables		2,00,000	1,20,000
		c)	Cash & Cash Equivalents		17,000	15,000
		Total			**4,82,000**	**3,50,000**

Additional Information :

1) Depreciation charged on plant was Rs. 30,000 and on Building Rs. 50,000.

2) Income Tax paid during the year amounted to Rs. 25,000

Note to Accounts :			
1)	Share Capital :		
	Equity Share Capital	2,50,000	2,00,000
	Preference Share Capital	40,000	50,000
		2,90,000	2,50,000
2)	Short term provision :		
	Provision for Tax	35,000	27,000
3)	Tangible Assets :		
	Building	80,000	10,00,000
	Plant	70,000	40,000
		1,50,000	1,40,000

Working Note :

Building Account

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	100000		By Depreciation A/c	50000
	To Bank A/c (B/f)	30000		By Balance c/d	80000
		130000			130000

Plant Account

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	40000		By Depreciation A/c	30000
	To Bank A/c (B/f)	60000		By Balance c/d	70000
		100000			100000

Calculation of Net Profit before Tax :

Reserve and Surplus Balance on	31.03.2018	₹1,52,000
Less : Reserve & Surplus balance	31.03.2017	₹50,000
		₹1,02,000
Add : Transfer to General Reserve		₹33,000
Add : Provision for Tax made during the current year		₹1,35,000
Net Profit before Tax		₹1,02,000

Cash Flows from Operating Activities for the year ended 31st March, 2017

Particulars	**Details**	**Amount**
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		135000
Adjustment for non-cash & non-operating items :		
Add : Depreciation on plant	30000	
Loss on sale of Machinery	50000	
Interest on Debenture	10000	90000
Operating profit before working capital changes :		225000
Less : Increase in current Assets :		
Trade Receivable	80000	
Inventory	50000	
Less : Decrease in Current Liabilities :		
Trade Payable	18000	(148000)
		77000
Less : Income Tax paid for the year 2017		25000
Net Cash from operating		52000
B) Cash Flow from investing Activities :		
Purchase of Building	(30000)	
Purchases of Plant	(60000)	(80,000)
Net Cash used in investing Activities		90,000)
C) Cash Flow from Financing Activities :		
Issue of Equity Shares Capital	50000	
Redemption of preference share capital	(10000)	40000
Net Cash from Financing Activities		40,000
Net Decrease in Cash & Cash equivalents 52000 + (90000) + 40000		(2000)
Add : Cash and Cash equivalents in the beginning of the period		15,000
Cash & Cash equivalents at the end of the period		17,000

Problem No. 9

From the following Balance sheet of Tarun Fashion Ltd. prepare a Cash Flow Statement.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		1,50,000	1,20,000
		b)	Reserve & Surplus		1,78,000	75,000
	2)	**Non-Current Liabilities**				
		Long-term Borrowings		1	-	50000
	3)	**Current Liabilities :**				
		a)	Trade payables		31,500	67,000
		b)	Short term Provision		42,000	30,000
		Total			**4,01,500**	**3,42,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets			
			1) Tangible Assets	2	2,08,000	1,40,000
			2) Intangible Assets	3	35,000	20,000
	2)	**Current Assets :**				
		a)	Inventories		1,05,000	1,20,000
		b)	Trade Receivables		33,500	37,000
		c)	Cash & Cash Equivalents		20,000	25,000
		Total			**4,01,500**	**3,42,000**

Note :		31.03.2018	31.03.2017
1)	Long term Borrowing :		
	15% Debentures	--	50,000
2)	Tangible Assets :		
	Building	80,000	1,00,000
	Plant & Machinery	1,28,000	40,000
		2,08,000	1,40,000
3)	Tangible Assets :		
	Goodwill	35,000	20,000

Additional Information :

	31.03.2018	31.03.2017
1) Proposed Dividend	15000	12000

2) Depreciation of Rs. 10000 was provided on Plant & Machinery.

3) Gain on sale of a part of Building Rs. 25000.

4) Debentures were redeemed on 1st April 2017.

5) Provision for Tax made during the year Rs. 50000.

Working Note :

Building Account

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	100000		By Bank A/c	45000
	To Bank A/c	25000		By Balance c/d	80000
		125000			125000

Plant and Machinery Account

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	40000		By Depreciation A/c	12000
	To Bank A/c (B/f)	98000		By Balance c/d	128000
		138000			138000

Calculation of Net Profit before Tax :

Reserve and Surplus Balance on	31.03.2018	₹1,78,000
Less : Reserve & Surplus balance	31.03.2017	₹75,000
		₹1,03,000
Add : Proposed Dividend for previous year		₹12,000
Provision for Tax made during the current year		₹50,000
Net Profit before Tax		₹1,65,000

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		165000
Adjustment for non-cash & non-operating items :		
Add : Depreciation on plant & machinery	10000	
Less : Gain on Sale of Building	(25000)	(15000)
Operating Profit before Working Capital changes		150000
Add : Decrease in Current Assets		
Trade Receivables	3500	
Inventory	15000	(18500)
		168000
Less : Decrease in current Liabilities :		
Trade Payables	35000	(35000)
		133000
Less : Income Tax paid for the year 2017		38000
Net Cash from Operating Activity		95000)
B) Cash Flow from Inventories Activities :		
Issue of Share Capital	30000	
Redemption of Debentures	(50000)	(80,000)
Payment of Dividend for 2017	(12000)	(32000)
Net Cash From Financing Activities		(32,000)
Net Decrease in Cash & Cash equivalents 95000 + (68000) + 32000		5000
Add : Cash and Cash equivalents in the beginning of the period		25,000
Cash & Cash equivalents at the end of the period		20,000

Problem No. 10

Prepare a Cash - Flow Statement from the following Balance Sheet of Shree Industries Ltd. Pune.

			Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		2,00,000	2,00,000
		b)	Reserve & Surplus	1	84,000	(8,000)
	2)	**Non-Current Liabilities :**				
		Long term Borrowings		2	1,35,000	1,00,000
	3)	**Current Liabilities :**				
		Trade Payables			68,000	62,000
		Total			**4,87,000**	**3,54,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		Fixed Assets		3	1,20,000	1,30,000
	2)	**Current Assets :**				
		a)	Current Investment (Marketable section)		22,000	15,000
		b)	Inventories		61,000	80,000
		c)	Trade Receivables		40,000	29,000
		d)	Cash & Cash Equivalents		2,44,000	1,00,000
		Total			**4,87,000**	**3,54,000**

Note :		31.03.2018	31.03.2017
1)	Long-term Borrowing :		
	General Reserve	24,000	
	Profit & Loss Balance	60,000	(8,000)
2)	Long-term Borrowings : 12% Mortage Loan	135000	1,00,000
3)	Fixed Assets :		
	Machinery	1,45,000	1,60,000
	Less : Accumulated Depreciation	25,000	30,000
		1,20,000	1,30,000

Additional Information :

1) Interest paid on mortage loan amounted to Rs. 14,100.

2) Interim Dividend paid during the year Rs. 20,000.

3) Machinery costing Rs. 40,000

(Accumulated depreciation thereon being Rs. 18,000) was sold for Rs. 5,000.

Working Note :

Machinery Account

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	160000		By Bank A/c (sale)	5000
	To Bank A/c	25000		By Accumulated Dep.	18000
				By Statement of Profit & Loss	17000
				By Balance C/d	145000
		185000			185000

Calculation of Net Profit before Tax :

Profit & Loss Balance on 31st March, 2018	₹60,000
Less : Profit & Loss Balance on 31st March, 2017	₹8,000
	₹68,000
Add : Transfer to General Reserve	₹24,000
Interim Dividend Paid	₹20,000
Net Profit before Tax	₹1,12,000

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		112000
Adjustment for non-cash & non-operating		
Add : Interest paid on mortage loan Loss on sale of Machinery Depreciation	14100 17000 13000	44100
Operating Profit before working capital		156100
Add : Decrease in Current Assets :		
Inventory	19000	
Add : Increase in current Liabilities		
Trade Payable	6000	25000
		181100
Less : Increase in Current Assets :		
Trade Receivables	(11000)	(11000)
Net Cash from Operating Activities		170100
B) Cash Flow from investing Activities :		
Purchases of Machinery	(25000)	
Sale of Building	5000	(20000)
Net Cash from investing Activities		(20,000)
C) Cash Flow from Financing Activities :		
Proceeds of 12% mortage loan	35000	
Interest paid on mortage loan	(14100)	
Interim Dividend paid	(20000)	900
Net Cash from Financing Activities		900

Net Decrease in Cash & Cash equivalents 170000 + (20000) + 900		151000
Add : Cash and Cash equivalents in the beginning of the Period		115000
Cash & Cash equivalents at the end period		260000

Problem No. 11

Prepare a Cash Flow Statement from the following information of Jay Industries Ltd. Mumbai.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		300000	200000
		b)	Reserve & Surplus		65000	50000
	2)	**Current Liabilities :**				
		a) Trade payables			105000	52000
		b) Other Current Liabilities			--	16000
		c) Short Term Provision			20000	2000
		Total			**490000**	**320000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		225000	110000
		b)	Non-Current Investments		55000	60000
	2)	**Current Assets :**				
		a)	Inventories		26000	50000
		b)	Trade Receivables		180000	92000
		c)	Cash & Cash Equivalents		4000	8000
		Total			**490000**	**320000**

Note :		31.03.2018	31.03.2017
1)	Reserve &Surplus :		
	Securities premium Reserve	20000	--
	Profit & Loss Balance	45000	50000
		65000	50000
2)	Trade Payables		
	Sundry Creditors	95000	52000
	Bills Payables	10,000	--
		1,05,000	52000
3)	Other Current Liabilities o/s Salary	--	16000
4)	Short term provision for Doubtful debts	20000	2000

Additional Information :

a) During the year, company said 60% of its original non-current investments at a profit of 25%.

b) Depreciation provided during the year was `35,000.

Working Note :

Fixed Assets Account

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	110000		By Depreciation A/c	35000
	To Bank A/c	150000		By Balance c/d	15000
		260000			260000

Calculation of Net Profit before Tax :

Profit & Loss Balance on 31st March, 2018	Rs. 45000
Less : Profit & Loss Balance 31st March 2017	Rs. 50000
Net Profit before Tax	Rs. (5000)

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Loss during the year		(5000)
Adjustment for non-cash & non-operating items		
Add : Provision for doubtful debts Depreciation	18000 35000	 53000
Operating Profit before working capital change		48000
Add : Decrease in Current Assets :		
Inventory	24000	
Add : Increase in current Liabilities		
Sundry Creditors	43000	
Trade payable	10000	77000
		11600
Less : Increase in Current Assets :		
Trade Receivables	88000	
Less : Decrease in current Liabilities		
Outstanding salaries	16000	(104000)
Net Cash from Operating Activities		12000
B) Cash Flow from investing Activities :		
Purchases of Fixed Assets	150000	
Purchase of non-current investments	31000	
Sale of non-current investments	45000	(136000)
Net Cash from investing Activities		(136000)
C) Cash Flow from Financing Activities :		
Issue of Share Capital	100000	
Securities premium received on issue share	20000	120000
Net Cash from Financing Activities		120000
Net Decrease in Cash & Cash equivalents 12000 + (186000) + 120000		4000
Add : Cash and Cash equivalents in the beginning		8000
Cash & Cash equivalents at the end		4000

Problem No. 12

Prepare a Cash-Flow Statement from the following Balance Sheet of Malhar Industries Ltd. Pandharpur.

				Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**						
	1)	**Share holder'sFunds :**					
		a)	Share Capital			200000	200000
		b)	Reserve and Surplus			107000	25,000
	2)	**Non-Current Liabilities :**					
		a) Long-term Borrowings				1,20,000	--
	3)	**Current Liabilities :**					
		a) Trade payables				1,39,000	90,000
		b) Short term provisions				40,000	30,000
		Total				**6,06,000**	**3,45,000**
II	**Assets :**						
	1)	**Non - Current Assets :**					
		a)	Fixed Assets				
			i) Tangible Assets			1,80,000	1,20,000
			ii) Intangible Assets			34,000	50,000
	2)	**Current Assets :**					
		a)	Inventories			2,10,000	1,00,000
		b)	Trade Receivables			1,20,000	50,000
		c)	Cash & Cash Equivalents			52,000	13,000
		d)	Other Current Assets			10,000	12,000
		Total				**6,06,000**	**3,45,000**

Note :		31.03.2018	31.03.2017
1)	Long term Borrowing 12% Debentures	1,20,000	-
2)	Short-term Provision		
	Provision for Taxation	40,000	30,000

Additional Information :

1) Debentures were issued on 1st October, 2017. Interest has paid-up to date.
2) Machinery whose original cost was Rs. 50,000 (accumulated depreciation there on being Rs. 27,000) was sold for Rs. 35,000.
3) Depreciation on Machinery charged during the year Rs. 15,000.
4) Interim Dividend paid during the year was @ 15% on Share Capital.

Working Note :

Calculation of Net Profit before Tax :

Reserve and Surplus on 31st March, 2018	107000
Less : Reserve and Surplus on 31st March, 2017	25000
	82000
Add : Provision for Taxation for 2018	40000
Interim Dividend	30000
	152000

Calculation of Profit on Sale of Machinery :

Cost of Machinery sold	50000
Less : Accurate Depreciation	27000
Written down value of Machinery	23000
Sale of Amount of Machine	35000
Profit on Sale of Machinery	12000

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	**Details**	**Amount**
A) Cash Flows from Operating systems :		
Net Profit before Tax :		152000
Adjustment for non-cash & non-operating		
Add : Intangible Assets Written off	16000	
Interest on Debentures	7200	
Depreciation on Machinery	15000	
Less : Profit Sale of Machinery	(12000)	26200
Operating Profit before working capital charge		178200
Add : Decrease in current Assets		
Other Current Assets	2000	
Add : Increase in Current Liabilities		
Trade payables	49000	51000
		229200
Less : Decrease in current Assets :		
Trade Receivables	70000	
Inventory	110000	(1800000)
		49200
Less : Income Tax paid for 2017		30000
Net Cash from Operating Activities		19200
B) Cash Flow Investing Activities :		
Sale of Machinery	35000	
Purchase of Tangible Assets	(98000)	(63000)
Net Cash from Investing Activities		(63000)
C) Cash Flow from Financing Activities :		
Proceeds from issue of Debentures	120000	
Interim Dividend paid	(30000)	
Interest on Debentures	(7200)	82800
Net cash from Financing Activities		82800
Net Increase in Cash & Cash equivalents 19200 + (163000) + 82800		39000
Add : Cash and Cash equivalents in beginning Period		13,000
Cash & Cash equivalents at end period		52,000

Problem No. 13

From the following Balance sheet of Krishna Industries Ltd. Pune. You are required to prepare Cash Flow.

			Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		8,00,000	6,75,000
		b)	Reserve & Surplus		1,70,000	91,000
	2)	**Current Liabilities :**				
		a)	Short term borrowings	1	88,000	66,000
		b)	Trade Payables		1,00,000	70,000
		c)	Short term provision	2	34,000	26,000
		Total			**11,92,500**	**9,28,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets			
			1) Tangible Assets	3	3,75,000	5,00,000
	2)	**Current Assets :**				
		a)	Inventories		4,00,000	2,50,000
		b)	Trade Receivables		3,82,000	1,55,000
		c)	Cash & Cash Equivalents		10,000	3,000
		d)	Other Current Assets		25,000	20,000
		Total			**11,92,500**	**9,28,000**

Note :		31.03.2018	31.03.2017
1)	Short term Borrowing :		
	Bank Overdraft	88,000	66,000
2)	Short Term Provisions :		
	Taxation Provisions	34,000	26,000
3)	Other Current Liabilities	1,50,000	2,00,000
	Land	2,25,000	3,30,000
		3,75,000	5,00,000

Additional Information :

1) Interim Dividend paid during the year Rs. 60,000
2) Land was sold at a profit of Rs. 30,000.
3) Plant costing Rs. 20,000 was sold during the year at a loss of Rs. 8,000.

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		173000
Adjustment for non-cash & non-operating items :		
Add : Depreciation on plant	55000	
Loss on sale of plant	8000	63000
		236000
Less : Profit on Sale of Land		30000
Operating Profit before Working Capital changes		206000
Add : Increase in Current Liabilities :		
Trade Payables	30000	30000
		236000
Less : Increase in Current Assets :		
Trade Receivables	227000	
Inventory	150000	
Other Current Assets	5000	382000

		(146000)
Less : Income tax paid for 2017		(26000)
Net Cash from operating activities		(172000)
B) Cash Flow from Investing Activities :		
Sale of Land (50000 + 30000)	80000	
Sale of Plant (20000 - 8000)	12000	92,000
Net Cash From investing Activities		92,000
C) Cash flow from Financing Activities :		
Issue of share capital	125000	
Increase in Bank Overdraft	22000	
Interim Dividend Paid	(60000)	87000
Net Cash from Financing Activities		87000
Net increase in Cash & Cash equivalents (1,72,000) + 92,000 + 87,000		7000
Add : Cash and Cash equivalents in the beginning of the period		3,000
Cash & Cash equivalents at the end of the period		10,000

Working Note :

Calculation of Net Profit before Tax :

Reserve and Surplus on 31st March, 2018	170000
Less : Reserve and Surplus on 31st March, 2017	91000
	79000
Add : Provision for Taxation for 2018	34000
Interim Dividend	60000
	173000

Problem No. 14

From the following Balance Sheet of Alka Industries Ltd. prepare a Cash Flow Statement.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		65000	45000
		b)	Reserve and Surplus	1	42500	25000
	2)	**Current Liabilities :**				
		a) Trade payables			11000	8700
		Total			118500	78700
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		83000	46700
	2)	**Current Assets :**				
		a)	Inventory		13000	11000
		b)	Trade Receivables		20000	19000
		c)	Cash & Cash Equivalents		2500	2000
		Total			**118500**	**78700**

Note :		**31.03.2018**	**31.03.2017**
1)	Reserve & Surplus		
	General Reserve	27500	15000
	Profit & Loss Balance	15000	10000
		42500	25000

Additional Information :

1) Depreciation an fixed Assets for the year 2017-2018 was `14700
2) An interim dividend Rs. 7000 has been paid to the shareholder during the year.
3) Depreciation on Machinery charged during the year Rs. 15,000.
4) Interim Dividend paid during the year was @ 15% on Share Capital.

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating systems :		
Net Profit before Tax :		24500
Adjustment for non-cash & non-operating items		
Add : Dep. on Machinery	80000	
Loss on Sale Machinery	12000	92000
Operating Profit before working capital changes		312000
Add : Increase in current Assets		
Trade Payables	62000	62000
Less : Increase in current Assets :		374000
Trade Receivables	80000	
Inventory	110000	190000
Net Cash from Operating Activities :		184000
B) Cash Flow from Investing Activities :		
Purchase of Machinery	(510000)	
Sale of Machinery	18000	(492000)
Net Cash from Investing Activities		(492000)
C) Cash Flow from Financing Activities :		
Issue of Share Capital	200000	
Payment of proposed dividend	(60000)	140000
Net cash from Financing Activities		140000
Net Increase in Cash & Cash equivalents 38000 + (492000) + 13000		(168000)
Add : Cash and Cash equivalents in beginning of the Period		2000
Cash & Cash equivalents at end of the period		2500

Working Note :

Calculation of Net Profit before Tax :

Net Profit as per Profit & Loss Statement	5000
Less : Transfer to General Reserve	12000
Interim Dividend	7000
	24500

Problem No. 15

The Balance sheet of Jindal Industries Ltd. Aurangabad. Prepare the cash flow statement.

			Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		12,00,000	8,00,000
		b)	Reserve & Surplus	1	(1,70,000)	(2,15,000)
	2)	**Non-Current Liabilities :**				
		Long term Borrowings		2	3,00,000	2,50,000
	3)	**Current Liabilities**				
		Trade Payable			1,90,000	2,70,000
		Total			**15,20,000**	**11,05,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
		a)	Fixed Assets		6,90,000	5,00,000
		b)	Non - Current Investments	3	1,20,000	2,00,000
	2)	**Current Assets :**				
		a)	Inventory		4,60,000	2,80,000
		b)	Trade Receivables		1,80,000	65,000
		c)	Cash & Cash Equivalents		70,000	60,000
		Total			**15,20,000**	**11,05,000**

Note :		31.03.2018	31.03.2017
1)	Reserve &Surplus :		
	Profit & Loss Balance	(1,70,000)	(2,15,000)
2)	Short Term Provisions :		
	12% Public Deposits	3,00,000	2,50,000
3)	Other Current Liabilities		
	Sundry Debtors	1,80,000	50,000
	Bills Receivables	--	15,000
		1,80,000	65,000

Additional Information :

1) New Public deposits were accepted on 1st January, 2018.

2) Machinery Costing Rs. 2,00,000 on which Dep. charged was Rs. 70,000 was sold for Rs. 1,50,000.

3) New Machinery purchased during the year amounted to Rs. 4,00,000.

4) Non-Current Investments were sold at profit of 25%.

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		45000
Adjustment for non-cash & non-operating items :		
Add : Depreciation on plant & machinery	80000	
Loss on sale of machinery	31500	1,11,500
		156500
Less : Profit on Sale of Machinery	20000	30000
Profit on sale of non-current investments	20000	(40000)
Operating profit before working capital changes		116500
Add : Decrease in Current Assets :		
Bills Receivable	15000	15000
		131500

Less : Increase in Current Assets :		
Sundry Debtors	130000	
Inventory	180000	
Less : Decrease in Current Liabilities :		
Trade payables	80000	(390000)
Net Cash from operating activities		(258000)
B) Cash Flow from Investing Activities :		
Sale of Machinery	150000	
Purchase of Fixed Assets	400000	
Sale of Non-Current Investments	100000	(150000)
Net Cash from investing Activities		(150000)
C) Cash flow from Financing Activities :		
Issue of share capital	400000	
Proceeds of Public Deposits	50000	
Interest paid on Public Deposits	(31500)	418000
Net Cash from Financing Activities		418000
Net increase in Cash & Cash equivalents (2,58,500) + (1,50,000) + 4,18,000		10000
Add : Cash and Cash equivalents in the beginning of the period		60,000
Cash & Cash equivalents at the end of the period		70,000

Working Note :

1) Calculation of Net Profit before Tax :

Profit & Loss Balance on 31.03.2018	(170000)
Profit & Loss Balance on 31.03.2017	(215000)
Net Profit before Tax	45000

2) Interest paid on Public Deposits

2,50,000 x 12% for 1 year	30000
50,000 x 12% for 3 months	1500
	31500

Problem No. 16

The Balance sheet of Mamta Company Ltd. Mumbai. Prepare the cash flow statement.

	Particulars			Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**					
	1)	**Share holder'sFunds :**				
		a)	Share Capital		14,00,000	12,00,000
		b)	Reserve & Surplus	1	7,40,000	5,80,000
	2)	**Current Liabilities :**				
		Trade Payables			2,72,000	2,10,000
		Total			**24,12,000**	**19,90,000**
II	**Assets :**					
	1)	**Non - Current Assets :**				
			Fixed Assets		12,00,000	8,00,000
	2)	**Current Assets :**				
		a)	Inventory		3,10,000	2,00,000
		b)	Trade Receivables		5,80,000	5,00,000
		c)	Cash & Cash Equivalents		3,22,000	4,90,000
		Total			**24,12,000**	**19,90,000**

Note :		**31.03.2018**	**31.03.2017**
1)	Reserve &Surplus :		
	General Reserve	4,50,000	4,00,000)
	Profit & Loss Balance	2,90,000	1,80,000
		7,40,000	5,80,000

Additional Information :

	31.03.2018	31.03.2017
i) Contingent Liability proposed Dividend	72000	60000

ii) Depreciation change during the year on plant & machinery amounted to Rs. 80,000.

ii) Machinery costing Rs. 80,000 (Book Value Rs. 30,000) was sold at a loss of 40% on book value.

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		220000
Adjustment for non-cash & non-operating items :		
Add : Depreciation on machinery	80000	
Loss on sale of machinery	12000	92,000
Operating profit before working capital changes		312000
Add : Increase in Current Assets :		
Trade Payables	62000	62000
		374000
Less : Increase in Current Assets :		
Trade Receivables	80000	
Inventory	110000	(1,90,000)
Net Cash from operating activities		(184000)
B) Cash Flow from Investing Activities :		
Purchase of Machinery	510000	
Sale of Machinery	18000	(492000)
Net Cash from investing Activities		(492000)
C) Cash flow from Financing Activities :		
Issue of share capital	200000	
Payment of proposed Dividend	60000	140000
Net Cash from Financing Activities		140000

Net increase in Cash & Cash equivalents 1,84,000) + (4,92,000) + 1,40,000		10000
Add : Cash and Cash equivalents in the beginning of the period		1,68,000
Cash & Cash equivalents at the end of the period		4,90,000
		3,22,000

Problem No. 17

From the following Balance sheet of Rama Ltd. Prepare a cash flow statement.

	Particulars	Note No.	31.03.2018	31.03.2017
I	**Equity &Liabilities :**			
	1) Share holder'sFunds :			
	a) Share Capital		10,00,000	8,00,000
	b) Reserve & Surplus	1	6,40,000	5,59,000
	2) Non-Current Liabilities :			
	Long term Borrowings	2	1,50,000	1,00,000
	3) Current Liabilities			
	Trade Payable		60,000	40,000
	Total		**18,50,000**	**14,99,000**
II	**Assets :**			
	1) Non - Current Assets :			
	a) Fixed Assets			
	i) Tangible Assets		7,50,000	
	ii) Intangible Assets		15,000	
	b) Non - Current Investments	3	1,00,000	
	2) Current Assets :			
	a) Inventory		6,30,000	4,20,000
	b) Trade Receivables		3,20,000	4,94,000
	c) Cash & Cash Equivalents		28,000	20,000
	d) Other current assets		7,000	5,000
	Total		**18,50,000**	**14,99,000**

Note :		31.03.2018	31.03.2017
1)	Reserve &Surplus :		
	General Reserve	5,20,000	4,00,000
	Profit & Loss balance	1,20,000	1,59,000
		6,40,000	5,59,000
2)	Long Term Provisions :		
	8% Debentures	1,50,000	1,00,000
3)	Rate of interest on Non-current investment is10% p.a.		
4)	Other current Liabilities		
	Prepaid Expenses	4000	--
	Bills Receivables	3000	5,000
		7,000	5,000

Additional Information :

1) Depreciation of Rs. 30,000 has been charged on Machinery.
2) Non-current Investments costing Rs. 30,000 were sold for Rs. 40,000 at the end of the year.
3) New Debentures were issued on 1st October, 2017.
4) During the year share issued expenses amounted to Rs. 10,000 & these were written off from statement of profit & loss.

Cash Flows from Operating Activities for the year ended 31st March, 2018

Particulars	Details	Amount
A) Cash Flows from Operating Activities :		
Net Profit before Tax :		81000
Adjustment for non-cash & non-operating items :		
Add : Intangible Assets written off	5000	
Depreciation on machinery	30000	
Interest on debentures	10000	
Share issue Expenses	10000	55000
		136000
Less : Profit on Sale of Non-Current Investments	10000	30000
Interest on non -current investments	3000	(13000)

Operating profit before working capital changes		123000
Add : Decrease in Current Assets :		
Trade Receivable	174000	
Accrued income	2000	
Add : Increase in current liabilities :		
Trade payable	20000	196000
		319000
Less : Increase in Current Assets :		
Prepaid Expenses	4000	
Inventory	210000	(214000)
Net Cash from Operating Activities		(105000)
B) Cash Flow from Investing Activities :		
Purchase of tangible fixed assets	270000	
Purchase of Non-Current Investments	(100000)	
Sale of non-current investments	40000	
Interest on Non-current Investments	3000	327000
Net Cash from investing Activities		327000
C) Cash flow from Financing Activities :		
Issue of share capital	200000	
Issue of Debentures	50000	
Interest paid on Debentures	(10000)	
Share issue Expenses	(10000)	2,30,000
Net Cash from Financing Activities		2,30,000
Net increase in Cash & Cash equivalents (1,05,000) + (3,27,000) + 2,30,000		8000
Add : Cash and Cash equivalents in the beginning of the period		20,000
Cash & Cash equivalents at the end of the period		28,000

Working Note :

1) Calculation of Net Profit before Tax :

Profit & Loss Balance on 31.03.2018	120000
Less : Profit & Loss Balance on 31.03.2017	159000
	(39000)
Add : Transfer to General Reserve	1,20,000
Net Profit before Tax	81000

6.7 SUMMARY:

Business finance, Raising and managing of funds by business organizations. Such activities are usually the concern of senior managers, who must use financial forecasting to develop a long-term plan for the firm. Shorter-term budgets are then devised to meet the plan's goals. When a company plans to expand, it may rely on cash reserves, expected increases in sales, or bank loans and trade credits extended by suppliers. Managers may also decide to raise long-term capital in the form of either debt (bonds) or equity (stock). The value of the company's stock is a constant concern, and managers must decide whether to reinvest profits or to pay dividends. Other duties of financial managers include managing accounts receivable and fixing the optimum level of inventories. When deciding how to deploy corporate assets to increase growth, financial managers must also consider the benefits of mergers and acquisitions, analyzing economies of scale and the ability of businesses to complement each other.

A cash flow statement provides data regarding all cash inflows a company receives from its ongoing operations and external investment sources. The cash flow statement includes cash made by the business through operations, investment, and financing—the sum of which is called net cash flow. The first section of the cash flow statement is cash flow from operations, which includes transactions from all operational business activities. Cash flow from investment is the second section of the cash flow statement, and is the result of investment gains and losses. Cash flow from financing is the final section, which provides an overview of cash used from debt and equity.

6.8 EXERCISE

(A) MCQ type questions:

1. Statement of cash flows includes

A) Financing Activities

B) Operating Activities

C) Investing Activities

D) All of the Above

2. In cash flows, when a firm invests in fixed assets and short-term financial investments

results in …………..

A) Increased Equity

B) Increased Liabilities

C) Decreased Cash

D) Increased Cash

3. A firm that issues stocks and bonds to raise funds results in ……….

A) Decreases Cash

B) Increases Cash

C) Increases Equity

D) Increases Liabilities

6. The purchase value of assets over its serviceable life is categorized as ………….

A) Appreciated Liabilities

B) Appreciated Assets

C) Depreciation

D) Appreciation

5. The basic financial statements include

A) Statement of Cash Flows

B) Statement of Retained Earnings

C) Balance Sheet and Income Statement

D) None of the Above

6. The statement of cash flow clarifies cash flows according to

A) Operating and Non-operating Flows

B) Inflow and Outflow

C) Investing and Non-operating Flows

D) Operating, Investing, and Financing Activities

7. Cash flow example from a financial activity is

A) Payment of Dividend

B) Receipt of Dividend on Investment

C) Cash Received from Customers

D) Purchase of Fixed Asset

8. Cash flow example from an investing activity is

A) Issue of Debenture

B) Repayment of Long-term Loan

C) Purchase of Raw Materials for Cash

D) Sale of Investment by Non-Financial Enterprise

9. Cash flow example from an operating activity is

A) Purchase of Own Debenture

B) Sale of Fixed Assets

C) Interest Paid on Term-deposits by a Bank

D) Issue of Equity Share Capital

10. Which item comes under financial activities in cash flow?

A) Redemption of Preference Share

B) Issue of Preference Share

C) Interest Paid

D) All of the above

11. As per AS-3, Cash Flow Statement is mandatory for

A) All enterprises

B) Companies listed on a stock exchange

C) Companies with a turnover of more than Rs 50 crores

a) Both A and B

b) Both A and C

c) Both C and B

12. Listed Enterprises need to prepare Cash Flow Statement only under indirect method.

a) True

b) False

13. In the case of financial enterprises, the cash flow resulting from interest and dividend

received and interest paid should be classified as cash flow from ………

a) Operating activities

b) Financing activities

c) Investing activities

d) None of the above

16. In case of other enterprises cash flow arising from interest paid should be classified as cash flow from ________ while dividends and interest received should be stated as cash flow from ____.

a) Operating activities, financing activities

b) Financing activities, investing activities

c) Investing activities, operating activities

d) None of the above

15. Issue of bonus shares and conversion of debentures into equity are shown as a footnote to the Cash Flow Statement.

a) True

b) False

16. When a fixed asset is bought as hire purchase, interest element is classified under ______ and loan element is classified under________.

a) Operating activities, financing activities

b) Financing activities, investing activities

c) Investing activities, operating activities

d) None of the above

17. Which of the following statements are false?

A) Old Furniture written off doesn't affect cash flow.

B) Cash flow statement is a substitute for cash account.

C) Appropriation of retained earnings is not shown in Cash flow statement.

D) Net cash flow during a period can never be negative.

a) A, B, C

b) B, C, D

c) C, D, A

d) None of the above

18. Which of the following is not a cash inflow?

a) Decrease in debtors

b) Issue of shares

c) Decrease in creditors

d) Sale of fixed assets

19. Which of the following is not a cash outflow?

a) Increase in Prepaid expenses

b) Increase in debtors

c) Increase in stock

d) Increase in creditors

20. Which of the following is a conventional method of ascertaining cost?

a) Absorption costing

b) Full Costing

c) Both a & b

d) None of the above

Answers

1. D) All of the Above

2. C) Decreased Cash

3. B) Increases Cash

6. C) Depreciation

5. D) None of the Above

6. D) Operating, Investing and Financing Activities

7. D) Purchase of Fixed Asset

8. D) Sale of Investment by Non-Financial Enterprise

9. C) Interest Paid on Term-deposits by a Bank

10. D) All of the above

11. c) Both C and B

12. a) True

13. a) Operating activities

16. b) Financing activities, investing activities

15. a) True

16. b) Financing activities, investing activities

17. b) B, C, D

18. c) Decrease in creditors

19. d) Increase in creditors

20. c) Both a & b

(B) Short Answer Questions

1. What is meant by 'Cash Flows?
2. Give the meaning of 'Cash Equivalents' for the purpose of preparing Cash Flow Statement.
3. How is 'dividend paid' treated by a financial enterprise for the purpose of preparing cash flow statement?
4. When can 'Receipt of Dividend' be classified as an operating activity State. Also give reason in support of your answer.
5. Give any two examples of cash flows from operating activities.
6. What is meant by 'Financing Activities' for preparing Cash Flow Statement?
7. Give any two examples of cash flows from operating activities.
8. What is meant by 'Financing Activities' for preparing Cash Flow Statement?
9. What is mean by investing activities for preparing Cash Flow Statement? State the primary objective of preparing Cash Flow Statement.
10. Interest received and paid is considered as which type of activity by a finance company while preparing the cash flow statement.

(C) Long Answer Questions :

Question 1.

From the following Balance Sheet prepare a Cash Flow Statement:

Balance Sheet as at 31st March, 2018

Particulars	Note No.	31-3-2018 (₹)	31-3-2017 (₹)
I. Equity and liabilities:			
(1) Shareholders' Funds:			
(a) Share Capital	1	7,90,000	5,80,000
(b) Reserves and Surplus		4,60,000	1,20,000
(2) Non-current Liabilities:	2		
Long-term borrowings		5,00,000	3,00,000
(3) Current Liabilities:			
(a) Short-term borrowings	3	1,15,000	42,000
(b) Short-term borrowings	4	1,18,000	46,000
Total		**19,83,000**	**10,88,000**
Assets:			
II. (1) Non-current Assets:			
Fixed Assets:	5	9,80,000	6,35,000
(i) Tangible	6	2,68,000	1,70,000
(ii) Intangible			
(3) Current Assets:		1,40,000	70,000
(a) Current Investments		4,40,000	150,000
(b) Trade Inventories		1,55,000	63,000
(c) Cash & Cash Equivalents			
Total		**19,83,000**	**10,88,000**

Notes to Accounts:

Note No.	Particulars	31.3.2018 (₹)	31.3.2017 (₹)
1.	**Reserved and Surplus**		
	Surplus (Balance in Statement of Profit & Loss)	3,20,000	60,000
	General Reserve	1,40,000	60,000
		4,60,000	**1,20,000**
2.	**Log-term borrowings:**		
	12% Debentures	5,00,000	3,00,000
		5,00,000	**3,00,000**
3.	**Short-term borrowings:**		
	Bank Overdraft	1,15,000	42,000
		1,15,000	**42,000**
4.	**Short-term provisions:**		
	Provision for tax	1,18,000	46,000
		1,18,000	**46,000**

5.	**Tangibble Assets:**		
	Plant and Machinery	11,00,000	7,50,000
	Lesss: Accumulated Depreciations	(1,20,000)	(1,15,000)
		9,80,000	**6,35,000**
6.	**Intangible Assets:**		
	Goodwill	2,68,000	1,70,000
		2,68,000	**1,70,000**

Additional Information:

12% debentures were issued on 1st September, 2017.

(D) Question 2.

From the following Balance Sheet prepare cash flow statement

Particulars	Note No.	31.3.2019 (₹)	31.3.2018 (₹)
I. EQUITY AND LIABILITY :			
1. Shareholder's Fund:		7,00,000	5,00,000
a. Share Capital			
b. Reserve and Surplus		3,50,000	2,00,000
2. Non-Current Liabilities:			
Long Term Borrowings		50,000	1,00,000
3. Current Liabilities:			
a. Trade Payables		1,22,000	1,05,000
b. Short term Provisions (Provision for tax)		50,000	30,000
Total		**12,72,000**	**9,35,000**
II. ASSETS :			
1. Non Current Assets:			
a. Fixed Assets:			
i. Tangible Assets	1	5,00,000	5,00,000
ii. Intangible Assets	2	95,000	1,00,000
b. Non-current Investments		1,00,000	Nil
2. Current Assets:			
a. Inventory		1,30,000	55,000
b. Trade Receivable		1,47,000	80,000
c. Cash and Cash Equivalents		3,00,000	2,00,000
Total		**12,72,000**	**9,35,000**

Note No.	Particulars	31.3.2018 (₹)	31.3.2017 (₹)
1	**Tangible Assets:**		
	Machinery	2,80,000	2,00,000
	Accumulated depreciation	(1,00,000)	(80,000)
		1,80,000	**1,20,000**
2	Equipments	3,20,000	3,80,000
	Intangible Assets :	**5,00,000**	**5,00,000**
	Goodwill	95,000	1,00,000

Additional Information: Machinery of the book value of 80,000 (accumulated depreciation ₹ 20,000) was sold at a loss of ₹ 18,000.

❖❖❖❖