Question	Option - I	Option - II	Option - III	Option - IV	Answer
In lease system, interest is calculated on	Cash down payment	Cash price outstanding	Hire purchase price	first instalment	Cash price outstanding
If cash discount is offered to customers, then which of the following would increase?	Sales	Debtors	Debt collection period	Creditors	Sales
Which of the following is true?	Retained earnings are cost free	External Equity is cheaper than Internal Equity	Retained Earnings are cheaper than External Equity	Retained Earnings are costlier than External Equity	Retained Earnings are cheaper than External Equity
Inventory Turnover measures the relationship of inven-tory with:	Average Sales	Cost of Goods Sold	Total Purchases	Total Assets	Cost of Goods Sold
Which of the following is not a standard method of inventory valuation?	First in First out	Standard Cost	Average Pricing	Realizable Value	Average Pricing
A short-term lease which is often cancellable is known as	Finance Lease	Net Lease	Operating Lease	Leverage Lease	Operating Lease
If the sales of the firm are 60,00,000 and the average debtors are 15,00,000 then the receivables turnover is	4 times	25%	400%	0.25 times	4 times
General Profitability ratios are based on	Investments	Sales	Expenses	Purchases	Sales
Inventory is generally valued as lower of	Market Price and Replacement Cost	Cost and Net Realizable Value	Cost and Sales Value	Sales Value and Profit	Cost and Net Realizable Value
Under the provisions of AS-19 'Leases', a leased asset is shown is the balance sheet of	Manufacturer	Lessor	Lessee	Financing bank	Lessee
If a company sells its receivable to another party to raise funds, it is known as	Securitization	Factoring	Pledging	Budgeting	Factoring
Prepaid insurance given in trial balance will appear in ____________	Trading a/c	Profit & Loss a/c	Balance sheet	Bank a/c	Balance sheet
Which of the following is not included in cost of inventory?	Purchase cost	Transport in Cost	Import Duty	Selling Costs	Selling Costs
A lease which is generally not cancellable and covers full economic life of the asset is known as	Sale and leaseback	Operating Lease	Finance Lease	Economic Lease	Finance Lease
Receivables Management deals with	Receipts of raw materials	Debtors collection	Creditors Management	Inventory Management	Debtors collection
Depreciation is charged to which one of the asset _________	Land	Machinery	Sundry debtors	Investments	Machinery
One difference between Operating and Financial lease is:	There is often an option to buy in operating lease	There is often a call option in financial lease	An operating lease is generally cancellable by lease	A financial lease in generally cancellable by lease	An operating lease is generally cancellable by lease
Which of the following is related to Receivables Management?	Cash Budget	Economic Order Quantity	Ageing schedule	Factoring	Ageing schedule
Which Accounting Standard is a deal with Intangible Assets?	AS - 3	AS - 6	AS - 26	AS - 11	AS - 26
Income tax paid is appeared in__________	Trading a/c	Profit & Loss a/c	Balance sheet	Trial balance	Profit & Loss a/c
Which of the following regarding retained earnings is false?	Retained earnings is increased by net income	Retained earnings is a component of stockholders' equity on the balance sheet	Retained earnings is an asset on the balance sheet	Retained earnings represents earning not distributed to stockholders in the form of dividends	Retained earnings is an asset on the balance sheet
Which of the following accounts normally has a debit balance?	Unearned Revenue	Retained Earnings	Rent expense	Sales Revenue	Retained Earnings
Goodwill is ___________	Current account	Fictitious asset	Tangible asset	Intangible asset	Intangible asset
Accounts receivable normally has _________ Balance	Credit	Debit	Favorable	Negative	Debit
Bills receivable is a ________	Tangible asset	Intangible asset	Fixed asset	Current asset	Current asset
_______ is the major source of revenue of any business.	Investment	Advances	Loan	Sales	Sales
____________ refers the amount invested by the owner into business.	Loan	Advance	Capital	Prepaid expences	Capital
Aseets having definite shape and physical existensce are called……….	Tangible asset	Intangible asset	Wasting asset	Fictitious asset	Tangible asset
Assets which get exhausted to the extent of extraction are called ……….	Tangible asset	Intangible asset	Wasting asset	Fictitious asset	Wasting asset
________ is an example for fictitious asset.	Machinery	Stock	Patent	Preliminary expenses	Preliminary expenses
The receivables turnover ratio is defined as:	sales divided by receivables;	receivables divided by sales;	receivables divided by one days' sales;	receivables plus bad debt allowances.	sales divided by receivables;
221. In ABC inventory management system, class A items may require	Higher Safety Stock	Frequent Deliveries	Periodic Inventory system	Updating of inventory records	Higher Safety Stock
EOQ is the quantity that minimizes	Total Ordering Cost	Total Inventory Cost	Total Interest Cost	Safety Stock Level	Total Ordering Cost
Inventory is generally valued as lower of	Market Price and Replacement Cost	Cost and Net Realizable Value	Cost and Sales Value	Sales Value and Profit	Cost and Net Realizable Value
What is Economic Order Quantity?	Cost of an Order	Cost of Stock	Reorder level	Optimum order size.	Optimum order size.
A short-term lease which is often cancellable is known as	Finance Lease	Net Lease	Operating Lease	Leverage Lease	Operating Lease
Which of the following is not a usual type of lease arrangement?	Sale & leaseback	Goods on Approval	Leverage Lease	Direct Lease	Goods on Approval
Under the provisions of AS-19 'Leases', a leased asset is shown is the balance sheet of	Manufacturer	Lessor	Lessee	Financing bank	Lessee
Lease which includes a third party (a lender) is known as	Sale and leaseback	Direct Lease	Inverse Lease	Leveraged Lease	Leveraged Lease
One difference between Operating and Financial lease is:	There is often an option to buy in operating lease	There is often a call option in financial lease.	An operating lease is generally cancelable by lease	A financial lease in generally cancelable by lease.	An operating lease is generally cancelable by lease
From the point of view of the lessee, a lease is a:	Working capital decision	Financing decision	Buy or make decision	Investment decision	Financing decision
For a lesser, a lease is a	Investment decision	Financing decision	Dividend decision	Working capital decision	Investment decision
Which of the following is not true for a "Lease decision for the lessee"?	Helps in project selection	Helps in project financing	Helps in project location	Helps in Working capital decision	Helps in project financing
Which of the following statements is correct?	A Higher Receivable Turnover is not desirable,	Interest Coverage Ratio depends upon Tax Rate,	Increase in Net Profit Ratio means increase in Sales,	Lower Debt-Equity Ratio means lower Financial Risk.	Lower Debt-Equity Ratio means lower Financial Risk.
Which of the following is not a technique of receivables Management?	Funds Flow Analysis	Ageing Schedule	Days sales outstanding	Collection Matrix	Funds Flow Analysis
If the closing balance of receivables is less than the opening balance for a month then which one is true out of	Collections>Current Purchases	Collections>Current Sales	Collections<Current Purchases	Collections < Current Sales.	Collections>Current Sales
Securitization is related to conversion of	Receivables	Stock	Investments	Creditors	Receivables
80% of sales of 10,00,000 of a firm are on credit. It has a Receivable Turnover of 8 What is the Average collection period (360 days a year) and Average Debtors of the firm?	45 days and 1,00,000	360 days and 1,00,000	45 days and 8,00,000	360 days and 1,25,000	45 days and 1,00,000
If a company sells its receivable to another party to raise funds, it is known as	Securitization	Factoring	Pledging	None of the above	Factoring
If the sales of the firm are . 60,00,000 and the average debtors are . 15,00,000 then the receivables turnover is	4 times	25%	400%	0.25 times	4 times
Intangible assets usually fall in the category of:	Current assets	Fixed assets	Semi fixed assets	Current Liability	Fixed assets
An example of fixed asset is	Live stock	Value stock	Income stock	Depreciation expenses	Live stock
In depreciation calculation, the useful life of a fixed asset is:	a certain figure	an estimate	a predetermined figure for all fixed assets	Actual life	an estimate
Depreciable amount + Residual value of a fixed asset =?	Depreciation expenses	Accumulated depreciation	Cost of the fixed asset	Future economic benefits of a fixed asset	Cost of the fixed asset
Cost of a fixed asset – Accumulated depreciation expenses of the fixed asset=?	Book value of a fixed asset	Market value of a fixed asset	Historical cost of a fixed asset	Recoverable amount of a fixed asset	Book value of a fixed asset
Which of the following fixed assets is not depreciated in the ordinary circumstances?	Plant and machinery	Building	Land	Equipments	Land
Under which method of depreciation the amount of depreciation expenses remains constant throughout the useful life of a fixed asset	Reducing balance method	Unit of activity method	Straight line method	Annuity Method	Straight line method
Which of the following is related to Receivables Management?	Cash Budget	Economic Order Quantity	Ageing schedule	Fund flow Analysis	Ageing schedule
Which of the following is not true for a "Lease decision for the lessee?	Helps in project selection	Helps in project financing	Helps in project location	Helps in Working capital decision	Helps in project financing
One advantage of a financial lease is that	it has a shorter maturity than term loans.	it never appears as a liability on the balance sheet.	it eliminate the needs to make periodic payments.	it provides a way to indirectly depreciate land.	it provides a way to indirectly depreciate land.

UNIT-IV

SYLLABUS

Analysis & Interpretation of Financial Statements: Ratio Analysis – Liquidity, Solvency, Activity & Profitability Analysis, Comparative & Common Size Analysis (Vertical & Horizontal Analysis) - Financial Statement Variation by Type of Industry.

RATIO ANALYSIS

Financial ratios are usually expressed as a percent or as times per period.

1. Liquidity ratios measure a firm's ability to meet its current obligations. They may include ratios that measure the efficiency of the use of current assets and current liabilities.
2. Borrowing capacity (leverage) ratios measure the degree of protection of suppliers of long-term funds
3. Profitability ratios measure the earning ability of a firm. Discussion will include measures of the use of assets in general
4. Investors are interested in a special group of ratios, in addition to liquidity, debt, and profitability ratios
5. Cash flow ratios can indicate liquidity, borrowing capacity, or profitability.

A ratio can be computed from any pair of numbers. Given the large quantity of variables included in financial statements, a very long list of meaningful ratios can be derived. A standard list of ratios or standard computation of them does not exist. Each author and source on financial analysis uses a different list and often a different computation of the same ratio. This book presents frequently utilized and discussed ratios.

CLASSIFICATION OF RATIOS:-

In ratio analysis the ratios may be classified into the four categories as follows;

- Liquidity Ratios
- Profitability Ratios
- Activity Ratios
- Solvency Ratios

LIQUIDITY RATIOS

"Liquidity" refers to the ability of the firm to meet its current liabilities. The liquidity ratios, therefore, are also called 'Short-term Solvency Ratios.' These ratios are used to assess the short-term financial position of the concern. They indicate the firm's ability to meet its current obligations out of current resources.

In the words of Salomon J. Flink, "Liquidity is the ability of the firm to meet its current obligations as they fall due.

In the words of Herbert B. Mayo, "Liquidity is the ease with which assets may be converted into cash without loss.

Short-term creditors of the firm are primarily interested in the liquidity ratios of the firm as they want to know how promptly or readily the term can meet its current liabilities. If the term wants to take a short-term loan from the bank, the bankers also study the liquidity ratios of the firm in order to assess the margin between current assets and current liabilities.

Liquidity ratios include two ratios: -

1. Current Ratio
2. Quick Ratio

Current Ratio: The ratio is used to assess the firm's ability to meet its short-term liabilities on time. It is generally believe that 2:1 ratio shows a comfortable working capital position. However this rule should not be taken as a hard and fast rule, because ratio that is satisfactory for one company may not be satisfactory for other. It means that current assets of a business should, at least be twice of its current liabilities. The reason of assuming 2: 1 as the ideal ratio is that the current assets includes such assets as stock, debtors etc, from which full amount cannot be realized in case of need. Hence, even if half the amount is realized from the current assets on time, the firm can still meet its current liabilities in full.

Current Ratio: Current Assets / Current Liabilities

Current Assets = Cash & Bank Balance + Stock + Debtors + Bills Receivable + Prepaid Expenses + Investments readily convertible into cash + Loans and Advances

Current Liabilities = Creditors + Bills Payable + Bank Overdraft + Unclaimed dividend + Provision for Taxation + Proposed Dividend.

Quick Ratio: Quick or Acid Test indicates whether the firm is in a position to pay its current liabilities within a month or immediately.

An ideal acid test ratio is said to be 1:1. The idea is that for every rupee or current liabilities, there should at least be one rupee of liquid assets. This ratio is better test for short-term financial position of the company than the current ratio. Liquid assets are obtained by deducting stock-in-trade and prepaid expenses from current assets. Stock is not treated as a liquid asset because it cannot be readily converted into cash as and when required. The current ratio of a business does not reflect the true liquid position, if its current assets consist largely of stock-in-trade.

The liquid liabilities are obtained by deducting bank overdraft from current liabilities. Bank overdraft is not included in liquid liabilities because bank overdraft is not likely to be called on demand and is treated as a sort of permanent mode of financing. Hence, it is not treated as a quick liability. If the liquid assets are equal to or more than liquid liabilities, the condition may be considered as satisfactory. Liquid ratio can be calculated as follows

Liquid ratio : Liquid Assets / Liquid Liabilities

PROFITABILITY RATIOS

The main object of all the business concerns is to earn profit. Profit is the measurement of the efficiency of the business. Equity shareholders of the company are mainly interested in the profitability of the company.

Profitability ratios include the following: -

1. Gross Profit Margin Ratio

2. Operating Profit Margin Ratio
3. Net Profit Margin Ratio
4. Return on Capital Employed Ratio
5. Return on Net worth Ratio
6. Earning per Share Ratio

Gross Profit Margin Ratio: - This ratio measures the margin of profit available on sales. The higher the gross profit ratio, the better it is. No ideal standard is fixed for this ratio; but the gross profit ratio should be adequate enough not only to cover the operating expenses but also to provide for depreciation, Interest on loans, dividends and creation of reserves.

Gross Profit Margin Ratio: Gross Profit / Net Sales x 100

The ratio is compare with earlier years ratio and important conclusions are drawn from such comparison.

Operating Profit Margin Ratio: - This ratio measures the proportion of an enterprise's. Cost of sales and operating expenses in comparison to its sales"

Operating Profit Margin Ratio: EBIT / Sales EBIT = Earning Before Interest and Taxes.

Operating Ratio is a measurement of the efficiency and profitability of the business enterprise. The ratio indicates the extent of sales that is absorbed by the cost of goods 62 sold and operating expenses. Lower the operating ratio, the better it is, because it will leave higher margin of profit on sales.

Net Profit Margin Ratio: - This ratio measures the rate of net profit earned on sales. It helps in determining the overall efficiency of the business operation. An increase in the ratio over the previous year shows improvement in the overall efficiency of the business.

Net Profit Margin Ratio: Net Profit / Net Sales x100

Earning per Share Ratio: - It measures the profit available to the equity share holders on a per share basis, i.e. the amount that they can get on every share held. It is calculated by dividing the profits available to the equity shareholders by the number of the outstanding shares. The profits available to the ordinary shareholders are represented by net profits after taxes and preference dividend. Thus,

EPS : Net Profit available to equity holder / Number of Ordinary shares outstanding

As a profitability ratio, the EPS can be used to draw inferences on the basis of i) Its trend over a period of time, ii) comparison of the EPS of the other firms, iii) comparison with the industry average.

ACTIVITY RATIOS

These ratios are calculated on the basis of 'cost of sales' or 'sales'; therefore, these ratios are also called as 'Turnover Ratios'. Turnover indicates the speed or number of times the capital employed has been rotated in the process of doing business. In other words, these ratios indicate how efficiently the capital is being used to obtain sales; how efficiently the fixed assets are being used to obtain sales; and how efficiently the working capital and stock is being used to obtain sales. Higher turnover ratios indicate the better use of capital or resources and in turn lead to higher profitability. Turnover ratios include the following

1. Inventory Turnover Ratio
2. Debtors Turnover Ratio
3. Fixed Assets Turnover Ratio
4. Investment Turnover Ratio

Inventory Turnover Ratio: - It is computed by dividing the cost of goods sold by average inventory. Thus,

Inventory Turnover Ratio : Cost of Goods sold / Average Inventory

The cost of goods sold means sales minus gross profit. The average inventory refers to the simple average of the opening and closing inventory. The ratio indicates how fast inventory is sold. A high ratio is good from the view point of liquidity and vice versa. A low ratio would signify that inventory does not sell fast and stays on the shelf or in the warehouse for a long time. This ratio indicates the number of times inventories replaced during the year. It measures the relationship between the cost of goods sold and the inventory level.

Debtors Turnover Ratio: - This ratio indicates the relationship between credit sales and average debtors during the year.

Debtors Turnover Ratio : Net Credit Sales / (Average Debtors + Average Bills Receivable)

Bill receivable is added in debtors for the purpose of calculation of this ratio. This ratio indicates the speed with which the amount is collected from debtors. The higher the ratio, the better it is, since it indicates that amount from debtors is being collected more quickly. The more quickly the debtors pay, the less the risk from bad debts, and so the lower the expenses of collection and increase in the liquidity of the firm. A lower debtor turnover ratio will indicate the inefficient credit sales policy of the management.

Fixed Asset Turnover Ratio: - This ratio is also known as the investment turnover ratio. It is based on the relationship between the cost of goods sold and assets of a firm. A reference to this was made while working out the overall profitability of a firm as reflected in its earning power.

Fixed Asset Turnover Ratio: Cost of Goods / Average Fixed Assets

SOLVENCY RATIOS

These ratios are calculated to assess the ability of the firms to meet its long-term liabilities as and when they become due. Long term creditors including debenture holders are primarily interested to know whether the company has ability to pay 60 regularly interest due to them and to repay the principal amount when it becomes due. Solvency ratios disclose the firm’s ability to meet the interest costs regularly and long-term indebtedness at maturity. Solvency ratios include the following ratios; -

1. Debt-Equity Ratio
2. Interest Coverage Ratio

Debt- Equity Ratio: - This, ratio establishes relationship between the outside long-term liabilities and owners' funds. It shows the proportion of long-term External Equities and Internal Equities i.e. proportion of funds provided by long-term creditors and that provided by shareholders or proprietors. A higher ratio means that outside creditors has a larger claim than the owners of the business. The company with high debt position will have to accept stricter conditions from the lenders while borrowing money. If this ratio is lower, it is not profitable from the viewpoint of equity shareholders, as benefit of trading on equity is not availed of and the rate of equity dividend will be comparatively lower.

Debt- Equity Ratio: (Long term Liability + Current Liability) / Share holder Funds

External Equities = All Long term liabilities+ Current Liabilities Internal Liabilities= Equity share+ Preference share + Reserves & Surplus + P & L A/c- Intangible or Fictitious Assets **Interest Coverage Ratio: -** It is also known as 'time-interest-earned ratio'. This ratio measures the debt servicing capacity of a firm in so far as fixed interest on long-term loan is concerned. It is determined by dividing the operating profits or earning before interest and taxes (EBIT) by the fixed interest charges on loans. Thus,

Interest Coverage: EBIT / Interest

It should be noted that this ratio uses the concept of net profits before taxes because interest is tax-deductible so that tax is calculated after paying interest on long-term loan. This ratio, as the name suggests, indicates the extent to which a fall in EBIT is tolerable in that the ability of the firm to service its interest payments would not be adversely affected.

COMPARATIVE STATEMENT

Comparative statements are financial statements that cover a different time frame, but are formatted in a manner that makes comparing line items from one period to those of a different period an easy process. This quality means that the comparative statement is a financial statement that lends itself well to the process of comparative analysis. Many companies make use of standardized formats in accounting functions that make the generation of a comparative statement quick and easy.

Importance and Uses

The benefits of a comparative statement are varied for a corporation. Because of the uniform format of the statement, it is a simple process to compare the gross sales of a given product or all products of the company with the gross sales generated in a previous month, quarter, or year. Comparing generated revenue from one period to a different period can add another dimension to analyzing the effectiveness of the sales effort, as the process makes it possible to identify trends such as a drop in revenue in spite of an increase in units sold.

Along with being an excellent way to broaden the understanding of the success of the sales effort, a comparative statement can also help address changes in production costs. By comparing line items that catalogue the expense for raw materials in one quarter with another quarter where the number of units produced is similar can make it possible to spot trends in expense increases, and thus help isolate the origin of those increases. This type of data can prove helpful to allowing the company to find raw materials from another source before the increased price for materials cuts into the overall profitability of the company.

A comparative statement can be helpful for just about any organization that has to deal with finances in some manner. Even non-profit organizations can use the comparative statement method to ascertain trends in annual fund raising efforts. By making use of the comparative statement for the most recent effort and comparing the figures with those of the previous year's event, it is possible to determine where expenses increased or decreased, and provide some insight in how to plan the following year's event.

Features of Comparative Statements:

1) A comparative statement adds meaning to the financial data.
2) It is used to effectively measure the conduct of the business activities.
3) Comparative statement analysis is used for intra firm analysis and inters firm analysis.
4) A comparative statement analysis indicates change in amount as well as change in percentage.
5) A positive change in amount and percentage indicates an increase and a negative change in amount and percentage indicates a decrease.

6) If the value in the first year is zero then change in percentage cannot be indicated. This is the limitation of comparative statement analysis. While interpreting the results qualitative inferences need to be drawn.

7) It is a popular tool useful for analysis by the financial analysts.

8) A comparative statement analysis cannot be used to compare more than two years financial data.

COMMON SIZE FINANCIAL STATEMENTS

Common size ratios are used to compare financial statements of different-size companies or of the same company over different periods. By expressing the items in proportion to some size-related measure, standardized financial statements can be created, revealing trends and providing insight into how the different companies compare.

The ratios often are expressed as percentages of the reference amount. Common size statements usually are prepared for the income statement and balance sheet, expressing information as follows:

•Income statement items - expressed as a percentage of total revenue.

•Balance sheet items - expressed as a percentage of total assets.

The common size statements are prepared in a vertical analysis, referencing each line on the financial statement to a total value on the statement in a given period.

The ratios in common size statements tend to have less variation than the absolute values themselves, and trends in the ratios can reveal important changes in the business. Historical comparisons can be made in a time-series analysis to identify such trends. Common size statements also can be used to compare the firm to other firms.

Comparisons between Companies

Common size financial statements can be used to compare multiple companies at the same point in time. A common-size analysis is especially useful when comparing companies of different sizes. It often is insightful to compare a firm to the best performing firm in its industry (benchmarking). A firm also can be compared to its industry as a whole. To compare to the industry, the ratios are calculated for each firm in the industry and an average for the industry is calculated. Comparative statements then may be constructed with the company of interest in one column and the industry averages in another. The result is a quick overview of where the firm stands in the industry with respect to key items on the financial statements.

FEATURES OF COMMON SIZE STATEMENT

1. A common size statement analysis indicates the relation of each component to the whole.
2. In case of a Common Size Income statement analysis Net Sales is taken as 100% and in case of Common Size Balance Sheet analysis total funds available/total capital employed is considered as 100%.
3. It is used for vertical financial analysis and comparison of two business enterprises or two years financial data.
4. Absolute figures from the financial statement are difficult to compare but when converted and expressed as percentage of net sales in case of income statement and in case of Balance Sheet as percentage of total net assets or total funds employed it becomes more meaningful to relate.
5. A common size analysis is a type of ratio analysis where in case of income statement sales is the denominator (base) and in case of Balance Sheet funds employed or total net assets is the denominator (base) and all items are expressed as a relation to it.
6. In case of common size statement analysis the absolute figures are converted to proportions for the purpose of inter-firm as well as intra-firm analysis.

FINANCIAL STATEMENT VARIATION BY TYPE OF INDUSTRY

The components of financial statements, especially the balance sheet and the income statement, will vary by type of industry.

Merchandising (retail-wholesale) firms sell products purchased from other firms. A principal asset is inventory, which consists of merchandise inventories. For some merchandising firms, a large amount of sales may be for cash. In such cases, the receivables balance will be relatively low. Other merchandising firms have a large amount of sales charged but also accept credit cards such as VISA, so they also have a relatively low balance in receivables. Other firms extend credit and carry the accounts receivable and thus have a relatively large receivables balance. Because of the competitive nature of the industry, profit ratios on the income statement are often quite low, with the cost of sales and operating expenses constituting a large portion of expenses. A service firm generates its revenue from the service provided. Because service cannot typically be stored, inventory is low or nonexistent. In people-intensive services, such as advertising, investment in property and equipment is also low compared with that of manufacturing firms.

A manufacturing firm will usually have large inventories composed of raw materials; work in process, and finished goods, as well as a material investment in property, plant, and equipment. Notes and accounts receivable may also be material, depending on the terms of sale. The cost of sales often represents the major expense.

POSSIBLE QUESTIONS

Part - B

1. State the meaning of Ratio analysis.
2. Give any two examples of Liquidity ratios.
3. State the meaning of Comparative Statements.
4. State the meaning of Common size analysis.

Part - C

5. What do you understand by a) Activity Ratios and b) Profitability ratios.
6. Define Current ratio and evaluate it as a tool of short-term financial solvency of a company.
7. How many ratios are used in profitability ratios and explain about it.
8. Explain i) Current ratio ii) Liquidity ratio iii) Absolute liquid ratio

Question	Option - I	Option - II	Option - III	Option - IV	Answer
In Current Ratio, Current Assets are compared with:	Current Profit	Current Liabilities	Fixed Assets	Equity Share Capital	Current Liabilities
___________analysis is useful in comparing performance of several companies in the same group, or division or department of the same company.	Vertical analysis	Horizontal analysis	External analysis	Internal Analysis	Vertical analysis
In Ratio Analysis, the term Capital Employed refers to	Equity Share Capital	Net worth	Shareholders' Funds	Net worth +Total Debt	Net worth +Total Debt
A Current Ratio of Less than One means:	Current Liabilities < Current Assets	Fixed Assets > Current Assets	Current Assets < Current Liabilities	Share Capital > Current Assets	Current Assets < Current Liabilities
Common size income statements make it easier to compare firms___________.	That use different inventory valuation methods	in different industries	with different degree of leverage	of different sizes	of different sizes
Which among the following is an example for horizontal analysis?	Comparative balance sheet	Ratio Analysis	common size statements	Extra Value Analysis	Comparative balance sheet
In Net Profit Ratio, the denominator is	Net Purchases	Net Sales	Credit Sales	Cost of goods sold	Net Sales
Which of the following helps analysing return to equity Shareholders?	Return on Assets	Earnings Per Share	Net Profit Ratio	Return on Investment	Earnings Per Share
In ___________type of analysis, financial statements for a number of years are reviewed and analyzed.	Internal analysis	Horizontal analysis	External analysis	None of these	Horizontal analysis
______________are statements of financial position at different periods	Comparative statements	common size statements	Both of these	Income statement	Comparative statements
Inventory Turnover measures the relationship of inven-tory with:	Average Sales	Cost of Goods Sold	Total Purchases	Total Assets	Cost of Goods Sold
Return on Assets and Return on Investment Ratios be-long to:	Liquidity Ratios	Profitability Ratios	Solvency Ratios	Turnover	Profitability Ratios
Common size financial statements make it easier to compare firm's ___________.	of different sizes	in different industries	with different degree of leverage	that use different inventory valuation methods	of different sizes
Total asset turnover, receivables turnover and inventory turnover ratios measure:	Liquidity	profitability	efficiency	debt	efficiency
The term 'EVA' is used for:	Extra Value Analysis	Economic Value Added	Expected Value Analysis	Engineering Value Analysis	Economic Value Added
What does Debt-Equity Ratio help to study?	Solvency	Liquidity	Profitability	Turnover	Solvency
In Inventory Turnover calculation, what is taken in the numerator?	Sales	Cost of Goods Sold	Opening Stock	Closing Stock	Cost of Goods Sold
Common size balance sheets make it easier to compare firms ___________.	with different degree of leverage	of different sizes	in different industries	that use different inventory valuation methods	of different sizes
Identify the item that is not taken into account in computing the current ratio.	Bank overdraft	Bank	Stock	Cash	Bank overdraft
Recording of capital contributed by the owner as liability ensures the adherence of principle of	Consistency	going concern	Separate entity	Materiality	Separate entity
The sale of inventory on account will cause the quick ratio to	Decrease	Increase	Not change	Become zero	Increase
Price-earning ratio is equal to market price per equity share divided by ___	Earning per share	Current assets	Current liabilities	Liquid assets	Earning per share
Return on total assets ratio is equal to _____ divided by total asset	Current liabilities	Net income before preference dividend and interest paid	Current assets	Earning per share	Net income before preference dividend and interest paid
If the stock turnover ratio is 4 times and the collection period is 30 days the operating cycle would be	30 days	60 days	90 days	120 days	90 days
The stock turnover ratio is ____	Financial ratio	Activity ratio	Solvency ratio	Profitability ratio	Activity ratio
The stock turnover ratio may be calculated as ___	Cost of goods sold / Average stock	Turnover at cost / stock at cost	Turnover at selling price / Stock at selling price	Turnover at Cost/ Average Stock	Cost of goods sold / Average stock
In the debt equity ratio, external equity refers to	Only Debentures	Only current liabilities	Debentures and current liability	Reserves	Debentures and current liability
The days' sales in inventory ratio formula uses which of the following:	Current year sales	Beginning inventory	Prior year sales	Ending inventory	Ending inventory
ABC Ltd. has a Current Ratio of 1.5: 1 and Net Current Assets of Rs. 5,00,000. What are the Current Assets?	Rs. 5,00,000	Rs. 10,00,000	Rs. 15,00,000	Rs. 25,00,000	Rs. 15,00,000
There is deterioration in the management of working capital of XYZ Ltd. What does it refer to?	That the Capital Employed has reduced	That the Profitability has gone up	That debtors collection period has increased	That Sales has decreased	That debtors collection period has increased
Which of the following does not help to increase Current Ratio?	Issue of Debentures to buy Stock	Issue of Debentures to pay Creditors	Sale of Investment to pay Creditors	Avail Bank Overdraft to buy Machine.	Avail Bank Overdraft to buy Machine.
Debt to Total Assets Ratio can be improved by:	Borrowing More	Issue of Debentures	Issue of Equity Shares	Redemption of Debt	Redemption of Debt
Ratio of Net Income to Number of Equity Shares known as:	Price Earnings Ratio	Net Profit Ratio	Earnings per Share	Dividend per Share	Earnings per Share
Trend Analysis helps comparing performance of a firm	With other firms	Over a period of firm	With other industries	None of the above	Over a period of firm
A firm has Capital of Rs. 10,00,000; Sales of Rs. 5,00,000; Gross Profit of Rs. 2,00,000 and Expenses of Rs. 1,00,000. What is the Net Profit Ratio?	20%	50%	10%	40%.	20%
Suppliers and Creditors of a firm are interested in__________	Profitability Position	Liquidity Position	Market Share Position	Debt Position	Liquidity Position
An association of cement manufacturers is an example of–	Diagonal combination	Vertical combination	Horizontal combination	Lateral combination	Horizontal combination
Which of the following statements is correct?	A Higher Receivable Turnover is not desirable	Interest Coverage Ratio depends upon Tax Rate	Increase in Net Profit Ratio means increase in Sales	Lower Debt-Equity Ratio means lower Financial Risk	Lower Debt-Equity Ratio means lower Financial Risk
Return on Assets and Return on Investment Ratios be-long to:	Liquidity Ratios	Profitability Ratios	Solvency Ratios	Turnover	Profitability Ratios
The assets of a business can be classified as	Only fixed assets	Only current assets	Fixed and current assets	Fixed asset or Current Asset	Fixed and current assets
Ratio Analysis can be used to study liquidity, turnover, profitability, etc. of a firm. What does Debt-Equity Ratio help to study?	Solvency	Liquidity	Profitability	Turnover	Solvency
Current assets does not include :	Cash	Stock	Debtors	Furniture	Furniture
Which one of the following is shown first when the assets are arranged in the order of their liquidity?	Cash in hand	Debtors	Investment	Bills receivable	Cash in hand
Which of the following statements are true?	Vertical Analysis is also termed as dynamic analysis.	Horizontal analysis is also termed as dynamic analysis.	Static Analysis	long-term financial planning	Horizontal analysis is also termed as dynamic analysis.
Which of the following statements are true about Horizontal Analysis?	It do not examines the periodical trend	It is useful for long-term analysis.	It is useful for Short –term planning.	It is useful for Short-term analysis.	It is useful for long-term analysis.
Which of the following statements are true?	Comparative financial statement is an example of horizontal analysis.	Trend Analysis is an example of vertical analysis.	Vertical Analysis is also termed as dynamic analysis.	Revenue has no impact on sahares holders equity	Comparative financial statement is an example of horizontal analysis.
A technique uses in comparative analysis of financial statement is	graphical analysis	preference analysis	common size analysis	returning analysis	common size analysis
A techniques uses to identify financial statements trends are included	Average Analysis	percent change analysis	returning ratios analysis	Static Analysis	percent change analysis
Revenue __________	causes a decrease in shareholder's equity	causes a decrease or an increase in shareholder's equity	has no impact on shareholder's equity	causes an increase in shareholders' equity	causes an increase in shareholders' equity
The process of comparing various financial factors of a company over a period of time is known as …	Inter-firm comparison	Ratio Analysis	Intra-firm comparison	Inter-industry comparison	Intra-firm comparison
Which technique used for figures of two or more periods are placed side by side to facilitate easy and meaningful comparisons?	Comparative statement	Common-size statement	Trend Analysis	Ratio Analysis	Comparative statement
______________ measure the earning ability of a firm.	Profitability ratios	Cash flow ratios	Ratio Analysis	Static Analysis	Profitability ratios
___________ of the firm are primarily interested in the liquidity ratios of the firm as they want to know how promptly or readily the term can meet its current liabilities.	Short-term creditors	Long term Creditors	Short term Debtors	Long Term Debtors	Short-term creditors
Current Ratio is equal to __________	Current Liability/ Current Asset	Current assets / Net Profit	Current Assets / Current Liabilities	Net Profit/ Current Asset	Current Assets / Current Liabilities
An ideal acid test ratio is said to be ______________	1:1	1<n	1<n	0	1:1
Net Profit Margin Ratio:	Gross Profit / Net Sales x100	Net Profit / Net Sales x100	Net Profit / Gross Profit x100	Net Profit / Gross Profit	Net Profit / Net Sales x100
__________________measures the profit available to the equity share holders on a per share basis	Number of Ordinary Per share	Price per share	Ratio Analysis	Earning per Share Ratio	Earning per Share Ratio
_________________ ratio is also known as the investment turnover ratio	Investment Turnover Ratio	Fixed Assets Turnover Ratio	Debtors Turnover Ratio	Inventory Turnover Ratio	Fixed Assets Turnover Ratio
___________is the ability of the firm to meet its current obligations as they fall due	Liquidity	Creditors	Profitability	Debtors	Liquidity
Operating Profit Margin Ratio is equal to_____________	Net Profit / Gross Profit	Sales/ EBIT	EBIT / Sales	Netprofit / Sales	EBIT / Sales

UNIT-V

SYLLABUS

Expanded Analysis: Financial Ratios Used in Annual Reports, Management's Use of Analysis - Graphing Financial Information - Accounting Standards in India & IFRS Basic Framework

FINANCIAL RATIOS USED IN ANNUAL REPORTS

Financial ratios are used to interpret and explain financial statements. Used properly, they can be effective tools in evaluating a company's liquidity, debt position, and profitability. Probably no tool is as effective in evaluating where a company has been financially and projecting its financial future as the proper use of financial ratios.

A firm can use its annual report effectively to relate financial data by the use of financial ratios. To determine how effectively firms use ratios to communicate financial data, the annual reports of 100 firms identified in the Fortune 500 industrial companies were reviewed. The 100 firms represented the first 20 of each 100 in the Fortune 500 list. The objective of this research project was to determine:

Which financial ratios were frequently reported in annual reports, where the ratios were disclosed in the annual reports, what computational methodology was used to compute these ratios.

Figure indicates the ratios disclosed most frequently in the annual reports reviewed and the section of the annual report where the ratios were located. The locations were the president's letter, management discussion, management highlights, financial review, and financial summary. In many cases, the same ratio was located in several sections, so the numbers under the sections in Figure do not add up to the total number of annual reports where the ratio was included.

Seven ratios appeared more than 50% of the time in one section or another. These ratios and the number of times found were earnings per share (100), dividends per share (98), book value per share (84), working capital (81), return on equity (62), profit margin Ratios Disclosed Most Frequently in Annual Reports (58), and effective tax rate (50). The current ratio was found 47 times, and the next ratio in order of disclosure, the debt / capital ratio, appeared 23 times. From this listing, we can conclude that profitability ratios and ratios related to investing were the most popular. Figure excludes ratios not disclosed at least five times.

Logically, profitability ratios and ratios related to investing were the most popular for inclusion in the annual report. Including ratios related to investing in the annual report makes sense because one of the annual report's major objectives is to inform stockholders.

A review of the methodology used indicated that wide differences of opinion exist on how some of the ratios should be computed. This is especially true of the debt ratios. The two debt ratios most frequently disclosed were the debt / capital ratio and the debt / equity ratio. This book does not cover the debt / capital ratio. It is similar to the debt / equity ratio, except that the denominator includes sources of capital, in addition to stockholders' equity.

The annual reports disclosed the debt / capital ratio 23 times and used 11 different formulas. One firm used average balance sheet amounts between the beginning and the end of the year, while 22 firms used ending balance sheet figures. The debt / equity ratio was disclosed 19 times, and 6 different formulas were used. All firms used the ending balance sheet accounts to compute the debt / equity ratio.

In general, no major effort is being made to explain financial results by the disclosure of financial ratios in annual reports. Several financial ratios that could be interpreted as important were not disclosed or were disclosed very infrequently. This is particularly important for ratios that cannot be reasonably computed by outsiders because of a lack of data such as accounts receivable turnover.

At present, no regulatory agency such as the SEC or the FASB accepts responsibility for determining either the content of financial ratios or the format of presentation for annual reports, except for the ratio earnings per share. Many practical and theoretical issues relate to the computation of financial ratios. As long as each firm can exercise its opinion as to the practical and theoretical issues, there will be a great divergence of opinion on how a particular ratio should be computed.

MANAGEMENT'S USE OF ANALYSIS

Financial ratio analysis helps a business in a number of ways. The importance and advantages of financial ratios are given below:

(i) Ratios help in analyzing the performance trends over a long period of time.

(ii) They also help a business to compare the financial results to those of competitors.

(iii) Ratios assist the management in decision making.

(iv) They also point out problem and weak areas along with the strength areas.

(v) Ratios to help to develop relationships between different financial statement items.

(vi) Ratios have the advantage of controlling for differences in size. For example, two businesses may be quite different in size but can be compared in terms of profitability, liquidity, etc., by the use of ratios.

The Advantages of Financial Ratios

Financial ratios are tools used to assess the relative strength of companies by performing simple calculations on items on income statements, balance sheets and cash flow statements. Ratios measure company's operational efficiency, liquidity, stability and profitability, giving investors more relevant information than raw financial data. Investors and analysts can gain profitable advantages in the stock market by using the widely popular, and arguably indispensable, technique of ratio analysis.

Comparison

Financial ratios provide a standardized method with which to compare companies and industries. Using ratios puts all companies on a relatively equal playing field in the eyes of analysts; companies are judged on their performance rather than their size, sales volume or market share. Comparing the raw financial data of two companies in the same industry offers only limited insight. Ratios go beyond the numbers to reveal how good a company is at making a profit, funding the business, growing through sales rather than debt and a wide range of other factors. An older company, for example, might boast 50 times the revenue of a new small business, which would make the older company seem stronger at first glance. Analyzing the two companies with ratios such as return on equity (ROE), return on assets (ROA) and net profit margin may reveal that the smaller company operates much more efficiently, generating substantially more profit per dollar of assets employed.

Industry Analysis

Ratios can reveal trends in particular industries, creating benchmarks against which the performance of all industry players can be measured. Small businesses can use industry benchmarks to craft organizational strategy and clearly measure their own performance against the industry as a whole. As an example, analysis may reveal that the average debt-to-equity ratio in the widget industry is .85; a company with a debt-to-equity ratio of 1.3 would be much more heavily leveraged than other widget manufacturers, even though its total debt may be vastly smaller than larger players

Stock Valuation

The common language and understanding of ratios helps investors and analysts to evaluate and communicate the strengths and weaknesses of individual companies or industries. Fundamental analysis is the term given to the use of financial ratios in determining the relative strength of companies for investing purposes. A careful analysis of company ratios can reveal which companies have the fundamental strength to increase their stock value over time potentially profitable opportunity while pointing out the weaker players in the market as well.

Planning and Performance

Ratios can provide guidance to entrepreneurs when creating business plans or preparing presentations for lenders and investors. Using industry trends as a baseline, small-business owners can set time-bound performance goals in terms of specific ratios to give investors a glimpse into the potential of the new company. Ratios can also serve as an impetus for strategic change within an organization, providing management with relevant guidance and feedback as ratio valuations shift in response to organizational changes. Ratios keep managers on their toes by revealing financial weaknesses and opportunities.

GRAPHING OF FINANCIAL INFORMATION

It has become very popular to use graphs in annual reports to present financial information. Graphs make it easier to grasp key financial information. Graphs can be a better communicative device than a written report or a tabular presentation because they communicate by means of pictures and, thus, create more immediate mental images. There are many forms of graphs. Some popular forms used by accountants are line, column, and pie graphs.

Graphing is one of the most effective ways to display datasets, financial scenarios, and statistical functions in a way that can be understood easily by the users. When you give an individual a list of 40 different numbers and ask him or her to draw a conclusion, it is not only difficult, it may be impossible without the use of extra functions. However, if you provide the same individual a graph of the numbers, they will most likely be able to notice trending, dataset size, frequency, and so on. Despite the effectiveness of graphing and visual modelling, financial and statistical graphing is often overlooked in Excel due to difficulty, or lack of native functions.

Charting financial frequency trending with a histogram

Frequency calculations are used throughout financial analysis, statistics, and other mathematical representations to determine how often an event has occurred. Determining the frequency of financial events in a transaction list can assist in determining the popularity of an item or product, the future likelihood of an event to reoccur, or frequency of profitability of an organization. Excel, however, does not create histograms by default.

In this recipe, you will learn how to use several functions including bar charts and FREQUENCY functions to create a histogram frequency chart within Excel to determine profitability of an entity.

Getting ready

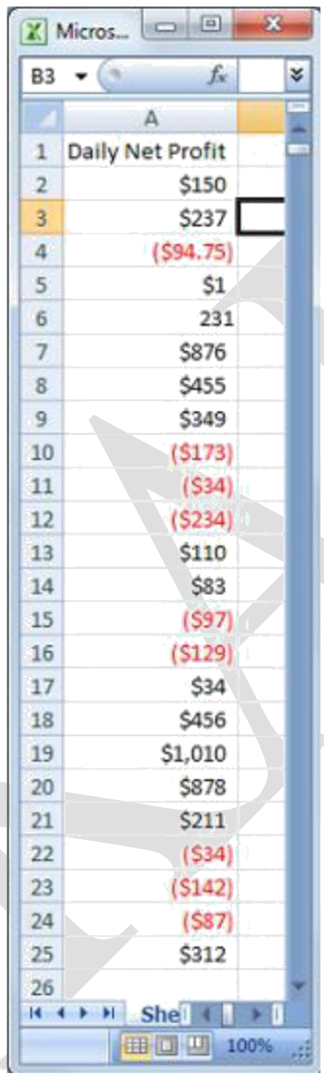
When plotting histogram frequency, we are using frequency and charting to determine the continued likelihood of an event from past data visually. Past data can be flexible in terms of what we are trying to determine; in this instance, we will use the daily net profit (Sale income Versus Gross expenses) for a retail store. The daily net profit numbers for one month are as follows:

$150, $237, -$94.75, $1,231, $876, $455, $349, -$173, -$34, -$234, $110, $83, -$97, -$129, $34, $456, $1010, $878, $211, -$34, -$142, -$87, $312

How to do it...

Utilizing the profit numbers from above, we will begin by adding the data to the Excel worksheet:

1. Within Excel, enter the daily net profit numbers into column A starting on row 2 until all the data has been entered:

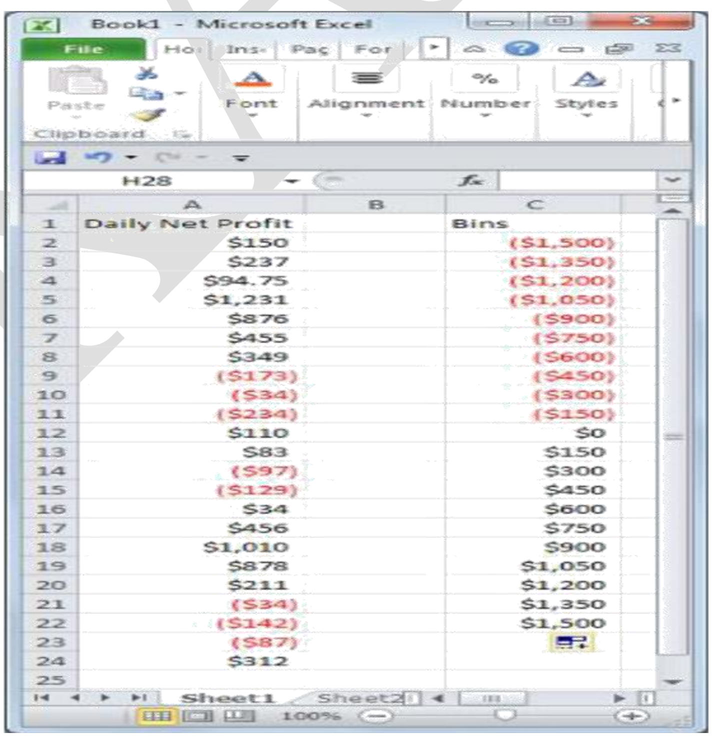


We must now create the boundaries to be used within the histogram. The boundary numbers will be the highest and the lowest number thresholds that will be included within the graph. The boundaries to be used in this instance will be of $1500, and -$1500.

These boundaries will encompass our entire dataset, and it will allow padding on the higher and lower ends of the data to allow for variation when plotting larger datasets encompassing multiple months or years worth of profit.

We must now create bins that we will chart against the frequency. The bins will be the individual data-points that we want to determine the frequency against. For instance, one bin will be $1500, and we will want to know how often the net profit of the retail location falls within the range of $1500. The smaller the bins chosen, the larger the chart area.

2. Enter the chosen bin number into the worksheet in Column C. The bins will be a $150 difference from the previous bin. The bin sizes needed to include an appropriate range in order to illustrate the expanse of the dataset completely. In order to encompass all appropriate bin sizes, it is necessary to begin with the largest negative number, and increment to the largest positive number:

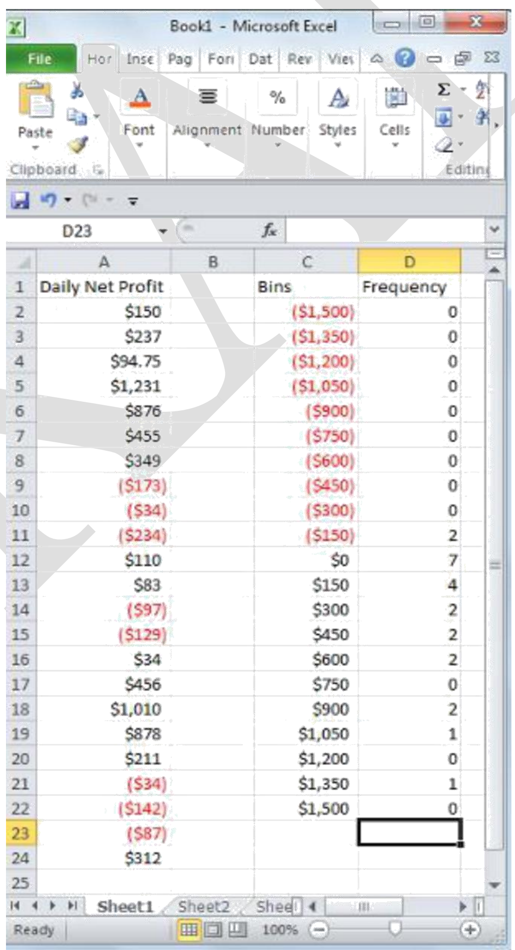


The last component for creating the frequency histogram actually determines the frequency of net profit to the designated bins. For this, we will use the Excel function **FREQUENCY**.

3. Select rows D2 through D22, and enter the following formula: =FREQUENCY(A:A,C2:C22)

4. After entering the formula, press *Shift* + *Ctrl* + *Enter* to finalize the formula as an array formula.

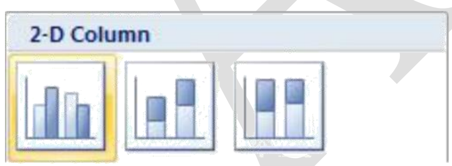
Excel has now displayed the frequency of the net profit for each of the designated bins:



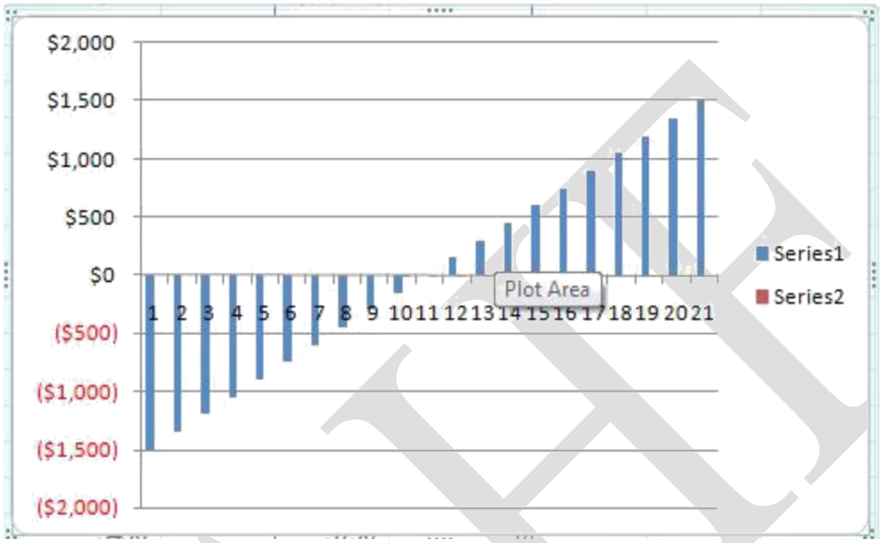
The information for the histogram is now ready. We will now be able to create the actual histogram graph.

5. Select rows C2 through D22.
6. With the rows selected, using the Excel ribbon, choose **Insert | Column**:

7. From the **Column** drop-down, choose the **Clustered Column** chart option:



Excel will now attempt to determine the plot area, and will present you with a bar chart. The chart that Excel creates does not accurately display the plot areas, due to Excel being unable to determine the correct data range:



ACCOUNTING STANDARDS (AS) IN INDIA

Indian Accounting Standard (abbreviated as Ind-AS) is the Accounting standard adopted by companies in India and issued under the supervision and control of Accounting Standards Board (ASB), which was constituted as a body in the year 1977. ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICAI, representatives from ASSOCHAM, CII, FICCI, etc.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS). National Advisory Committee on Accounting Standards (NACAS) recommends these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India. As on date MCA has notified 41 Ind AS. This shall be applied to the companies of financial year 2015-16 voluntarily and from 2016-17 on a mandatory basis. Based on the international consensus, the regulators will separately notify the date of implementation of Ind-AS for the banks, insurance companies etc. Standards for the computation of Tax has been notified as ICDS in February 2015.

List of Mandatory Accounting Standards

- AS 1 Disclosure of Accounting Policies
- AS 2 Valuation of Inventories (amended)
- AS 3 Cash Flow Statements
- AS 4 Contingencies and Events Occurring after the Balance Sheet Date
- AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies
- AS 6 Depreciation Accounting (withdrawn)
- AS 7 Construction Contracts (revised 2002)
- AS 8 Accounting for Research and Development (withdrawn for AS 26)
- AS 9 Revenue Recognition
- AS 10 Accounting for Fixed Assets (amended)
- AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003)
- AS 12 Accounting for Government Grants
- AS 13 Accounting for Investments (amended)
- AS 14 Accounting for Amalgamations (amended)
- AS 15 Employee Benefits (revised 2005)
- AS 16 Borrowing Costs
- AS 17 Segment Reporting
- AS 18 Related Party Disclosures
- AS 19 Leases
- AS 20 Earnings Per Share
- AS 21 Consolidated Financial Statements (amended)
- AS 22 Accounting for Taxes on Income
- AS 23 Accounting for Investments in Associates in Consolidated Financial Statements
- AS 24 Discontinuing Operations

- AS 25 Interim Financial Reporting
- AS 26 Intangible Assets
- AS 27 Financial Reporting of Interests in Joint Ventures
- AS 28 Impairment of Assets
- AS 29 Provisions, Contingent Liabilities and Contingent Assets (amended)

IFRS (INTERNATIONAL FINANCIAL REPORTING STANDARDS)

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB).

The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting.

Having an international standard is especially important for large companies that have subsidiaries in different countries. Adopting a single set of world-wide standards will simplify accounting procedures by allowing a company to use one reporting language throughout. A single standard will also provide investors and auditors with a cohesive view of finances.

Currently, over 100 countries permit or require IFRS for public companies, with more countries expected to transition to IFRS by 2015. Proponents of IFRS as an international standard maintain that the cost of implementing IFRS could be offset by the potential for compliance to improve credit ratings.

IFRS is sometimes confused with IAS (International Accounting Standards), which are older standards that IFRS has replaced.

LIST of International Financial Reporting Standards

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement
IFRS 14	Regulatory Deferral Accounts
IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases
IFRS 17	Insurance Contracts

POSSIBLE QUESTIONS

Part - B

1. Write about graphing financial information.
2. What is mean by Financial Ratios?
3. Give a short note on Accounting Standard -1.
4. Write a note on IFRS.

Part - C

5. What do you understand by Accounting standard and discuss its objectives.
6. Explain in detail about any three financial ratios used in Annual reports.
7. How to present profit of the company for five years through graphs.
8. Briefly explain any three Accounting Standards issued by ICAI.

Question	Option - I	Option - II	Option - III	Option - IV	Answer
The receivables turnover ratio is defined as	sales divided by receivables	receivables divided by sales	receivables divided by one days' sales	receivables plus bad debt allowances	sales divided by receivables
The annual reports are presented in the form of chart is called as	Accounting	auditing	graphing	disclosing	graphing
The underlying assumption that presumes a company will continue indefinitely is	Periodicity	Going concern	Economic entity	Monetary unit	Going concern
In Current Ratio, Current Liabilities are compared with:	Current Profit	Current Assets	Fixed Assets	Equity Share Capital	Current Assets
Accounting for Intangible Assets are related to	AS - 10	AS – 12	AS - 24	AS - 26	AS - 26
In Net Profit Ratio, the denominator is	Net Purchases	Net Sales	Credit Sales	Cost of goods sold	Net Sales
While calculating Gross Profit ratio __________	Closing stock is deducted from cost of goods sold	Closing stock is added to cost of goods sold	Closing stock is ignored	Opening stock is ignored	Closing stock is deducted from cost of goods sold
In the debt equity ratio, external equity refers to	Only Debentures	Only current liabilities	Debentures and current liability	Reserves	Debentures and current liability
The financial information is presented in the form of graph is __________	Presenting data	graphing of financial information	giving data	accounting	graphing of financial information
AS – 14 is meant for _________	Disclosure of Accounting Policies	Accounting for Fixed Assets	Discounting operations	Accounting for Amalgamation	Accounting for Amalgamation
The primary objective of the matching principle is to	Provide timely information to external decision-makers	Provide full disclosure	Recognize expenses in the same period as the related revenue	Provide timely information to Governmnet Bodies	Recognize expenses in the same period as the related revenue
Recording of capital contributed by the owner as liability ensures the adherence of principle of	Consistency	going concern	Separate entity	Materiality	Separate entity
Net income divided by shareholders' equity is the definition of	return on sales	return on assets	return on equity	asset turnover	return on equity
Return on Assets and Return on Investment Ratios be-long to:	Liquidity Ratios	Profitability Ratios	Solvency Ratios	Turnover	Profitability Ratios
Accounting standards are statements prescribed by	Law	Govt. regulatory bodies	Bodies of share holders	Professional accounting bodies	Professional accounting bodies
Return on assets is defined as:	operating income divided by owners' equity	operating income divided by sales	operating income divided by total assets	operating income divided by long-term assets	operating income divided by total assets
The IFRSs are issued by __________	ASB	ICAI	IASB	IASC	IASB
International Accounting Standard Boards came into being in _________	2000	2001	2002	2003	2000
AS – 1 is meant for _________	Disclosure of Accounting Policies	Accounting for Fixed Assets	Discounting operations	Depreciation	Disclosure of Accounting Policies
Return on sales, return on assets and return on equity are examples of	liquidity ratios	profitability ratios	debt ratios	efficiency ratios	profitability ratios
Earnings per share is affected by:	net income	number of shares	dividends	a & b, but not c	a & b, but not c
Accounting Standards in India are issued by _________	IASB	Council of ICAI	IASC	IFRS	Council of ICAI
IFRS – 1 deals with ____________	Leases	Segment reporting	first time adoption of IFRS	Intangible assets	first time adoption of IFRS
AS-19 deals with	Borrowing Costs	Earning Per share	Leases	Segment Reporting	Leases
Indian Accounting Standard – 28 is related to–	Accounting for taxes on income	Financial Reporting of Interests in Joint Venture	Impairment of Assets	Provisions, Contingent Liabilities and Contingent Assets	Impairment of Assets
AS 26 deals with	Intangible Assets	Depreciation	Cash fow statements	Inventories	Intangible Assets
AS 2 deals with	Intangible Assets	Depreciation	Cash fow statements	Inventories	Inventories
According to going concern concept a business entity is assumed to have–	A long life	A small life	A very short life	A definite life	A long life
The stock turnover ratio may be calculated as ___	Cost of goods sold / Average stock	Turnover at cost / stock at cost	Turnover at selling price / Stock at selling price	Turnover at selling price / Average stock	Cost of goods sold / Average stock
Which of the following regarding GAAP is true?	GAAP is an abbreviation for generally applied accounting principles	Changes in GAAP always affect the amount of income reported by a company	GAAP is the abbreviation for generally accepted accounting principles	Changes to GAAP must be approved by the Senate Finance Committee	GAAP is the abbreviation for generally accepted accounting principles
Which of the following is true?	FASB creates SEC	GAAP creates FASB	SEC creates CPA	FASB creates GAAP	FASB creates GAAP
What financial ratio helps management evaluate profits available for dividends?	Retention rate	Debt ratio	Debt service coverage ratio	Cash ratio	Retention rate
Earnings per share shows investors the __________ earned per outstanding share of stock.	Operating income	Income before taxes	Net income	Income before interest and taxes	Net income
AS – 6 deals with _________	Disclosure of Accounting Policies	Accounting for Fixed Assets	Discounting operations	Depreciation	Depreciation
The dividend payout ratio is calculated by dividing total dividends by:	Operating income	Income before taxes	Income before interest and taxes	Net income	Net income
Dividend Payout Ratio is	PAT÷ Capital	DPS ÷ EPS	Pref. Dividend ÷ PAT	Pref. Dividend ÷ Equity Dividend	
Net Profit Ratio Signifies	Operational Profitability	Liquidity Position	Big-term Solvency	Profit for Lenders	Operational Profitability
Working Capital Turnover measures the relationship of Working Capital with:	Fixed Assets	Sales	Purchases	Stock	Fixed Assets
In Ratio Analysis, the term Capital Employed refers to	Equity Share Capital	Net worth	Shareholders' Funds	Net worth +Total Debt	Net worth +Total Debt
In Net Profit Ratio, the denominator is	Net Purchases	Net Sales	Credit Sales	Cost of goods sold	Net Sales
Which of the following is a measure of Debt Service capacity of a firm?	Current Ratio	Acid Test Ratio	Interest Coverage Ratio	Debtors Turnover	Interest Coverage Ratio
Current assets does not include :	Cash	Stock	Debtors	Furniture	Furniture
Gross Profit Ratio for a firm remains same but the Net Profit Ratio is decreasing. The reason for such behavior could be:	Increase in Costs of Goods Sold	If Increase in Expense	Increase in Dividend	Decrease in Sales	If Increase in Expense
Which of the following helps analysing return to equity Shareholders?	Return on Assets	Earnings Per Share	Net Profit Ratio	Return on Investment	Earnings Per Share
Accounting standards are seen to be political because	They can create wealth transfers between different groups in society	They can affect the competitiveness of organisations	They can influence perceptions about organisations	All of the above	All of the above
The interest cover ratio measures:	the leverage of the company;	the efficiency of debt;	the weighted average cost of capital;	the relationship between interest and profit;	the relationship between interest and profit;
Total asset turnover, receivables turnover and inventory turnover ratios measure:	liquidity;	profitability;	efficiency;	debt;	efficiency;
The dividend cover ratio is defined as:	dividend divided by net income;	dividend less interest paid and taxes;	operating income divided by dividend;	net income divided by dividend;	net income divided by dividend;
In financial statement the stock is valued at cost or market price whichever is less on the basis of…	Accounting concepts	Accounting conventions	Accounting principles	Dual Concept	Accounting conventions
IFRS 3 explains about	First-time Adoption of IFRS	Share-based Payment	Business Combinations	Insurance Contracts	Business Combinations
IFRS 1 deals with	First-time Adoption of IFRS	Share-based Payment	Business Combinations	Insurance Contracts	First-time Adoption of IFRS
Trend percentages and trend ratios are used in	Static Analysis	Dynamic Analysis	Horizontal Analysis	Vertical Analysis	Static Analysis
IFRS 6 related to	First-time Adoption of IFRS	Share-based Payment	Exploration for and Evaluation of Mineral Resources	Insurance Contracts	Exploration for and Evaluation of Mineral Resources
Accounting Standards Board (ASB), which was constituted as a body in the year _____________	1975	1976	1977	1978	1977
ICAI stands for _______________.	Institute of Chartered Accountants of India	Inter of Chartered Accountants of India	Institute of Company Accountants of India	Institute of Chartered Arts of India	Institute of Chartered Accountants of India
IFRS stands for ____________	International Financial Resource Standards	International Financial Reporting Standards	Indian Financial Reporting Standards	International Financial Reporting Statement	International Financial Reporting Standards
IFRS 2 explain of International Financial Reporting Standards is____________	Financial Instruments	Operating Segments	Business Combinations	Share-based Payment	Share-based Payment
IFRS 16 explain of International Financial Reporting Standards is____________	Financial Instruments	Leases	Business Combinations	Share-based Payment	Leases
"First-time Adoption of International Financial Reporting Standards" was listed under_______	IFRS 1	IFRS 2	IFRS 3	IFRS 4	IFRS 1
"Financial Instruments" was listed under_______	IFRS 6	IFRS 7	IFRS 8	IFRS 9	IFRS 9

UNIT-I

SYLLABUS

Basis of Financial Reporting: Purpose of Financial Reporting, Users of Financial Reports, Conceptual Framework for Financial Statements.

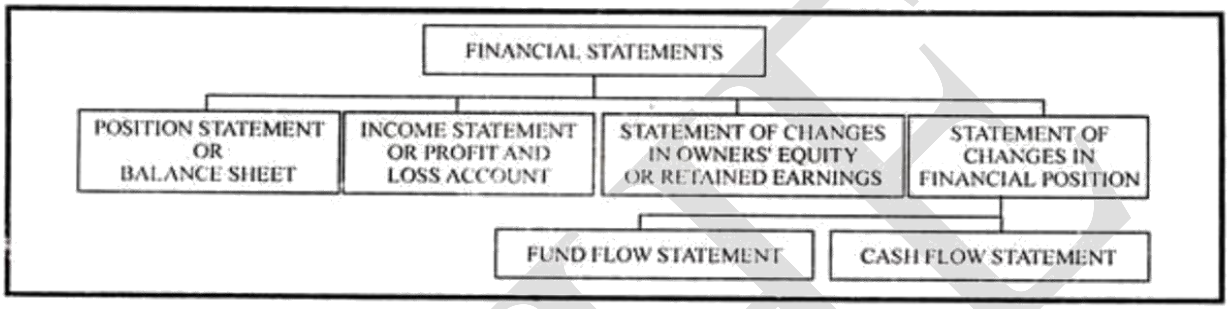
FINANCIAL REPORTING

Financial statements (or financial report) are a formal record of the financial activities and position of a business, person, or other entity. Financial statements are a useful tool in analysing your company's financial position and performance. Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, a statement of profit and loss (also known as 'income statement'), a cash flow statement and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about business and geographical segments, and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report.

<u>Components of Important Financial Statements</u>

Components of a financial statement can be described as the building blocks used for constructing the financial statement and these items represent, in words and numbers, various resources, claims to those resources, and any transactions that create changes in those resources and claims.

Below is a list of components of the most important financial statements – balance sheet, profit and loss (P&L) statement and cash flow statement – and their importance.



1. Balance Sheet

Balance Sheet is a statement of the assets, liabilities, and capital of an organization at one particular point in time. This statement gives an idea as to what the company owns and owes and also the amount of shareholding. The critical components of this statement are as below.

Assets:

An asset can be tangible or intangible and is often owned or controlled with the belief that it would provide some future benefit and can be tangible or intangible. While the former includes current assets and fixed assets, the latter refers to rights and other non physical resources that provide value to the business. Current assets consist of inventory, accounts receivables and other short term investments. Fixed assets could be buildings, equipment and other physical resources. Intangible assets usually include goodwill, copyright, trademarks and patents.

Liabilities:

Liabilities are a company's legal debts or obligations that might arise during the course of business operations. These are usually settled over time through the transfer of economic benefits like cash, goods or services. Liabilities include accounts payable, salaries or wages payable, interest due, customer deposits and other such obligations to third parties. Liabilities might be of two types – current or long term. While the former could be liquidated within a year, the latter can be repaid only in the long term (more than a year). Long-term liabilities include long-term bonds issued by the firm, notes payables, leases, pension obligations, and long-term product warranties.

Equity or owner's equity:

It is the residual assets of an entity that remain after deducting liabilities. Theoretically, this is the capital available for distribution to shareholders. Hence, from a company's liquidation perspective, equity would be considered the residual claim on the assets of a business, available to shareholders, after liabilities have been paid. For instance, if Company X has Rs. 3,000,000 as assets and Rs.800,000 as liabilities, then equity would be Rs.2,200,000 (=Rs.3,000,000 – Rs.800,000). Equity usually comprises funds contributed by shareholders, reserves and retained earnings. Therefore, the only way to increase the amount of owners' equity is by either getting more funds from investors or by increasing profits.

Profit and Loss Statement:

This statement is a summary of the financial performance of a business over time. This is usually prepared after every quarter or year. The components in this statement include:

Revenues: The amount of cash that a company actually receives during a specific period, through the sale of goods or services, is referred to as the company's revenue. This would include discounts and deductions for returned merchandise. Revenues would also include the amount received as a result of using the capital or assets of the business as part of the operations of the business. Revenue is the "top line" or "gross income" of the business.

Expenses: The outflow of money or incurring of liabilities (or a combination of both) through production of goods, rendering services, or carrying out any activity that would form a part of the business's operations, are the expenses of the company. Typical business expenses include wages or salaries, utilities such as rent, depreciation of capital assets, and interest paid on loans. The purchase of an asset such as a building or equipment is not an expense. Expenses also include the Cost of Goods Sold (COGS), which is the cost incurred for selling goods during the period, and includes import duties, freight, handling and other costs for converting inventory to finished goods.

Gains: A company's gain is an increase in equity through peripheral or incidental transactions by a firm, other than those from revenue or investments by owners (shareholders). It refers to any economic benefit that is outside the normal operations of a business. Typically, gains refer to unusual and nonrecurring transactions, such as gain on sale of land, change in a stock's market price or a gift. It is often shown in the P&L statement as non-operating income.

Losses: A company's losses are decreases in equity through peripheral or incidental transactions carried out by the firm, other than those from expenses or distributions to owners. This could be loss on sale of an asset, writing down of assets or a loss from lawsuits. It could also include costs that give no benefit. It is often shown in the P&L statement as non-operating expense.

3. Cash Flow statement:

This statement is a summary of the actual or anticipated inflows and outflows of cash in a firm over an accounting period. This could be prepared at the end of a month, quarter or year.

The cash flow statement would reflect the liquidity position of the business. This is used as the basis for budgeting and business-planning. The components in this statement include:

Cash Flow from Operating Activities:

Operating activities of a business refer to the production, sales and delivery of the finished product and collection of payment from customers. Cash outflows here could include purchasing raw materials, advertising, and cost of shipping the product. They might not include payment to suppliers, employees and interest payments. Depreciation and amortization are also included in the cash flow statement. Cash inflows here consist of receipt from sale of goods and services and interest received.

Cash Flow from Investing Activities:

These are cash flows related to investments and include purchase of assets, gains or losses through investments in the financial market or in subsidiaries, and other related items.

Cash Flow from Financing Activities:

This would account for activities that aid a firm in raising capital and repaying investors. The cash flow might include cash dividends, adding or changing loans or issue of stock. Cash flow from financing activities reveals the company's financial strength. Financing activities that produce positive cash flow include cash from issued stocks and bonds. Financing activities that produce negative cash flow include cash for repurchasing stock, paying off debt or interest or payment of dividend to shareholders. Every item in financial statements is important and provides insights into the workings and performance of the firm. These components are useful to all stakeholders including the management, employees, suppliers and shareholders, for putting in place sound business plans and following a financially viable strategy.

4. Notes to the financial statements

The notes to the financial statements usually begin with a section on accounting policies. This is where the reader looks to see what accounting policies have been chosen for the company. For example, this section will explain whether shares that a company owns in other companies are recorded at cost or at fair market value. The type of valuation basis used can make a large difference to the values reported on the balance sheet.

The notes also include disclosures about the risks faced by the company, related party transactions (which can be transacted at a different amount than if they were with a party at arm's length), tax values of the capital stock, or loan repayment terms. These disclosures can be critical to understanding how the business has been operating and how it will operate in the coming year. For example, the disclosures may refer to a loan that has been repaid in previous years at Rs. 5,000 per month, but will need to be repaid in full in the coming year. This kind of information can help explain why the company has significantly more cash on hand this year compared to the year before.

PURPOSE OF FINANCIAL REPORTING

According to International Accounting Standard Board (IASB), the objective of financial reporting is "to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions."

The following points sum up the objectives & purposes of financial reporting –

1. Providing information to management of an organization which is used for the purpose of planning, analysis, benchmarking and decision making.

2. Providing information to investors, promoters, debt provider and creditors which is used to enable them to male rational and prudent decisions regarding investment, credit etc.
3. Providing information to shareholders & public at large in case of listed companies about various aspects of an organization
4. Providing information about the economic resources of an organization, claims to those resources (liabilities & owner's equity) and how these resources and claims have undergone change over a period of time.
5. Providing information as to how an organization is procuring & using various resources.
6. Providing information to various stakeholders regarding performance of management of an organization as to how diligently & ethically they are discharging their fiduciary duties & responsibilities.
7. Providing information to the statutory auditors which in turn facilitates audit.
8. Enhancing social welfare by looking into the interest of employees, trade union & Government.

IMPORTANCE OF FINANCIAL REPORTING

The importance of financial reporting cannot be over emphasized. It is required by each and every stakeholder for multiple reasons & purposes. The following points highlights why financial reporting framework is important,

1. In helps and organization to comply with various statues and regulatory requirements. The organizations are required to file financial statements to ROC, Government Agencies. In case of listed companies, quarterly as well as annual results are required to be filed to stock exchanges and published.
2. It facilitates statutory audit. The Statutory auditors are required to audit the financial statements of an organization to express their opinion.
3. Financial Reports forms backbone for financial planning, analysis, bench marking and decision making. These are used for above purposes by various stakeholders.

4. Financial reporting helps organizations to raise capital both domestic as well as overseas.
5. On the basis of financials, the public in large can analyse the performance of the organization as well as of its management.
6. For the purpose of bidding, labour contract, government supplies etc., organizations are required to furnish their financial reports & statements

USERS OF THE FINANCIAL STATEMENTS

The main users (Stakeholders) of financial statements are commonly grouped as follows:

Investors and potential investors: They are interested in their potential profits and the security of their investment. Future profits may be estimated from the target company's past performance as shown in the income statement. The security of their investment will be revealed by the financial strength and solvency of the company as shown in the statement of financial position. The largest and most sophisticated groups of investors are the institutional investors, such as pension funds and unit trusts.

Employees: Employees and trade union representatives need to know if an employer can offer secure employment and possible pay rises. They will also have a keen interest in the salaries and benefits enjoyed by senior management. Information about divisional profitability will also be useful if a part of the business is threatened with closure.

Lenders: Lenders need to know if they will be repaid. This will depend on the solvency of the company, which should be revealed by the statement of financial position. Long-term loans may also be backed by 'security' given by the business over specific assets. The value of these assets will be indicated in the statement of financial position.

Government agencies: need to know how the economy is performing in order to plan financial and industrial policies. The tax authorities also use financial statements as a basis for assessing the amount of tax payable by a business.

Suppliers: need to know if they will be paid. New suppliers may also require reassurance about the financial health of a business before agreeing to supply goods.

Customers: need to know that a company can continue to supply them into the future. This is especially true if the customer is dependent on a company for specialised supplies.

The public: may wish to assess the effect of the company on the economy, local environment and local community. Companies may contribute to their local economy and community through providing employment and business for local suppliers. Some companies also run corporate responsibility programmes through which they support the environment, economy and community by, for example supporting recycling schemes.

Management and competitors: would also use the financial statements of a business to make economic decisions. Management, however, would predominantly use monthly management accounts as their main source of financial information. It is also unlikely that a business would prepare financial statements for the purpose of aiding competitors.

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

The first chapter of the conceptual framework establishes the objective of general purpose external financial reporting by business entities in the private sector. (Throughout the framework, the term entities [or entity] refers to business entities [or entity] in the private sector.) The objective of financial reporting is the foundation of the framework. Other aspects of the framework—qualitative characteristics, elements of financial statements, definition of a reporting entity, recognition and measurement, and presentation and disclosure—flow logically from the objective. Those aspects of the framework help ensure that financial reporting achieves its objective to the maximum extent feasible.

The objective of general purpose external financial reporting is to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions.

Information Useful in Assessing Cash Flow Prospects

To help achieve its objective, financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing, and uncertainty of the entity's future cash inflows and outflows (the entity's future cash flows) That information is essential in assessing an entity's ability to generate net cash inflows and thus to provide returns to investors and creditors.

An entity's investors and creditors (both present and potential) are directly interested in the amounts, timing, and uncertainty of their cash flows from dividends, interest, and the sale, redemption, or maturity of securities or loans. However, the prospects for those cash flows depend on the entity's present cash resources and, more importantly, on its ability to generate enough cash to pay its employees and suppliers and satisfy its other operating needs, to meet its obligations when due, to reinvest in operations, and to distribute cash to owners (for example, to pay cash dividends). The judgments of capital market participants about the entity's ability to generate net cash inflows affect the values of debt or equity interests. Therefore, those judgments also may affect cash flows to investors and creditors through sale of their interests.

In a cash-based exchange economy like those that generally exist in parts of the world in which financial reporting is important, cash (or its equivalent) is the medium of 1 exchange, as well as the store of value. In such an economy, most goods and services have money prices, and cash (including currency, coins, and money on deposit in financial institutions) is prized because of what it can buy. Members of the society carry out their consumption, saving, and investment decisions by allocating their present and expected cash resources. Thus, discussion of the objective focuses on an entity's cash-generating ability and on cash returns to investors and creditors. However, an entity might provide a return in ways other than by distributing cash. One example is a dividend-in-kind, which is a dividend distributed to owners in the form of noncash resources such as inventory. Investors and creditors may be indifferent about whether a return to them is in the form of cash, another asset that can be converted into the same amount of cash, or in some other form. The objective of financial reporting could have been stated in terms of cash, cash equivalents, or other resources that can be converted to cash or the like. The role of cash as a medium of exchange and store of value, and therefore the ultimate interest of investors and creditors in cash, makes it unnecessary to use such an unwieldy term.

Potential Users of Financial Reports and their Information Needs

Financial reporting is not an end in itself. It is a means of communicating to the users of financial reports information that is useful in making choices among alternative uses of scarce resources. Thus, the objective stems largely from the needs and interests of those users. Potential users of financial reports and their information needs include:

a. Equity investors: Equity investors in an entity are interested in the entity's ability to generate net cash inflows because their decisions relate to the amounts, timing, and uncertainties of those cash flows. To an equity investor, an entity is a source of cash in the form of dividends (or other cash distributions) and increases in the prices of shares or other ownership interests. Equity investors are directly concerned with the ability of the entity to generate net cash inflows and also with how the perception of that ability affects the prices of its equity interests.

b. Creditors. Creditors, including purchasers of traded debt instruments, provide financial capital to an entity by lending cash (or other assets) to it. Like investors, creditors are interested in the amounts, timing, and uncertainty of an entity's future cash flows. To a creditor, an entity is a source of cash in the form of interest, repayments of borrowings, and increases in the prices of debt securities.

c. Suppliers. Suppliers provide goods or services rather than financial capital. They are interested in assessing the likelihood that amounts an entity owes them will be paid when due.

d. Employees. Employees provide services to an entity; employees and their representatives are interested in evaluating the stability, profitability, and growth of their employer. They are interested in information that helps them to assess the entity's continuing ability to pay salaries and wages and to provide incentive payments and retirement and other benefits.

e. Customers. To its customers, an entity is a source of goods or services. Customers are interested in assessing the entity's ability to continue to provide those goods or services, especially if they have a long-term involvement with, or are dependent on, the entity.

f. Governments and their agencies and regulatory bodies. Governments and their agencies and regulatory bodies are interested in the activities of an entity because they are in various ways responsible for seeing that economic resources are allocated efficiently. They also need information to help in regulating the activities of entities, determining and applying taxation policies, and preparing national income and similar statistics.

g. Members of the public. An entity may affect members of the public in a variety of ways. For example, an entity may make a substantial contribution to the local economy by providing employment opportunities, patronizing local suppliers, paying taxes, and making charitable contributions. Financial reporting may assist members of the public and their representatives by providing information about the trends and recent developments in the entity's prosperity and the range of its activities, as well as the entity's ability to continue to undertake those activities.

As used in the framework, the term investors refers to equity investors and includes present and potential holders of equity securities, holders of partnership interests, and other owners; as well as their advisors. The term creditors as used in the framework include present and potential institutional and individual lenders and their advisors. (Investors and creditors include both those who obtain their interests from the entity and those who obtain their interests from other holders of the entity's equity or debt instruments. In other words, a party may become an entity's investor or creditor either directly or indirectly.)

Both investors and creditors generally provide cash to an entity with the expectation of receiving a return on, as well as a return of, the cash provided; in other words, they expect to receive more cash than they provided. Suppliers, employees, customers, governmental agencies, or others also often have claims to cash payment by the entity. For example, at a given date, a supplier might have a right to payment for goods delivered, a customer might have a right to a cash refund, or a governmental agency might have a right to payment for taxes due. However, claims by such parties are not included in the category creditors because those parties have dual roles in relation to an entity. For instance, customers' rights to receive goods or services may be more important to them than any right to receive a cash refund or other cash payment. Nevertheless, information that satisfies the needs of investors and creditors is likely to be useful to those parties as well.

Management and the governing board of an entity are also interested in the entity's ability to generate net cash inflows because that is a significant part of management's responsibility and accountability to the entity's owners. However, management is responsible for preparing financial reports; management is not their intended recipient. In addition, management is able to prescribe the form and content of the information it needs in satisfying its responsibility to owners.

General Purpose External Financial Reporting

The information provided by general purpose external financial reporting is directed to the needs of a wide range of users rather than only to the needs of a single group. (Throughout the framework, the terms financial reports or financial reporting refer to general purpose external financial reports or reporting.) Accordingly, financial reports reflect the perspective of the entity rather than only the perspective of the entity's owners (existing common shareholders or common shareholders of the parent entity in consolidated financial statements) or any other single group of users. However, adopting the entity perspective as the basic perspective underlying financial reporting does not preclude also including in financial reports information that is primarily directed to the entity's owners or to another group of users. For example,

financial reports include earnings per (common) share, which may be of interest largely to holders and potential purchasers of those shares. Financial statements generally also report separately the amount of earnings, which may be termed comprehensive income, profit or loss, or the like, attributable to holders of common shares in the parent entity and the amount attributable to holders of non-controlling interests in subsidiaries. That information, however, is in addition to—not a replacement for—information prepared in accordance with the entity perspective.

The objective of financial reporting stems from the information needs of external users who lack the ability to prescribe all the financial information they need from an entity and therefore must rely, at least partly, on the information provided in financial reports. Information needed to satisfy the specialized needs of management and other potential users, such as tax authorities or other governmental agencies that are able to prescribe the information they need from an entity is beyond the scope of the framework.

Investors and creditors (and their advisors) are the most prominent external groups who use the information provided by financial reporting and who generally lack the ability to prescribe all of the information they need. Investors' and creditors' decisions and their uses of information have been studied and described to a greater extent, and thus are better understood, than those of other external groups. In addition, information that meets the needs of investors and creditors is also likely to be useful to members of other groups who are interested in an entity's ability to generate net cash inflows. Thus, the primary users of general purpose financial reports are present and potential investors and creditors (and their advisors).

Present and potential investors and creditors have a common interest in the ability of an entity to generate net cash inflows. Accordingly, information about that ability is the primary focus of financial reporting because it helps satisfy the needs of investors and creditors. Other potential users of financial reports discussed in paragraph also have either a direct interest or an indirect interest in an entity's ability to generate net cash inflows. For example, although an entity is not a direct source of cash flows to its 4 customers, an entity can continue to provide goods or services to customers only by generating sufficient cash to pay for the resources it uses and to satisfy its other obligations. Thus, information that meets the needs of investors and creditors is also likely to be useful to members of other groups who are interested in an entity's ability to generate net cash inflows. By focusing primarily on the needs of present and potential investors and creditors, the objective of financial reporting encompasses the needs of a wide range of users.

Limitations and Evolution of General Purpose External Financial Reporting

Financial reporting is but one source of information needed by those who make investment, credit, and similar resource allocation decisions. Users of financial reports also need to consider pertinent information from other sources, for example, information about general economic conditions or expectations, political events and political climate, or industry outlook.

Users of financial reports also need to be aware of the characteristics and limitations of the information in them. To a significant extent, financial reporting information is based on estimates, rather than exact measures, of the financial effects on entities of transactions and other events and circumstances that have already happened or that already exist. The framework establishes the concepts that underlie those estimates and other aspects of financial reports. The concepts are the goal or ideal toward which standard setters and preparers of financial reports should strive. Like most goals, the framework's vision of the ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because of considerations of technical feasibility and cost. In some areas, users of financial reports (and standard setters) may need to continue to accept estimates based more on accounting conventions than on the concepts in the framework. Nevertheless, establishing a goal toward which to strive is essential if financial reporting is to evolve in a common direction that improves the information provided to investors, creditors, and others for use in making resource allocation decisions

Financial Statements and Financial Reporting

Financial statements, including the accompanying notes, are a central feature of financial reporting. However, the objective pertains to all of financial reporting, not just financial statements, because some types of both financial and nonfinancial information may best be communicated by means other than traditional financial statements. Corporate annual reports, prospectuses, and annual reports filed with governmental agencies in some jurisdictions are common examples of reports that include financial statements, other financial information, and nonfinancial information. News releases, management's forecasts or other descriptions of its plans or expectations, and descriptions of an entity's social or environmental impact are examples of reports giving financial information other than financial statements or giving only nonfinancial information.

POSSIBLE QUESTIONS

Part - B

1. What do you understand from the term financial reporting?
2. State the difference between financial reporting and the financial statement.
3. Give any two importance of financial reporting.
4. What is Income statement?
5. State the primary objective of financial reporting.

Part - C

1. Draw the pro-forma of the Balance Sheet of a Company.
2. What is financial statement? And explain the components of financial statements.
3. What is Income statement? What are all the items to be appeared in this statement?
4. Explain Financial Statements and Financial Reporting. Discuss the Limitations and Evolution of General Purpose External Financial Reporting
5. Analyze the purposes of financial reporting to the various users.
6. Describe the various Potential Users of Financial Reports and their Information Needs.
7. Explain cash flow and its various activities.
8. Discuss how financial reporting Information useful in Assessing Cash Flow Prospects?
9. Discuss the various importance of financial reporting to users.
10. Write shorts on:

    i) Revenue

    ii) Expenses

    iii) Losses

    iv) Gain

Question	Option - I	Option - II	Option - III	Option - IV	Answer
Dividend received is	Direct income	Indirect income	Direct expenses	Indirect expenses	Indirect income
Cash Credit (CC) is	Current Asset	Fixed Asset	Current Liability	Fixed Liability	Current Liability
A statement which presents the revenues and expenses of an enterprise for an accounting period is	Trading A/c	Profit & Loss A/c	Balance Sheet	Cash flow statement	Profit & Loss A/c
Which one is financial report	Ledger	Trial Balance	Balance sheet	Sales account	Balance sheet
Goodwill is a _____________	a fixed asset	a current asset	a tangible asset	an intangible asset	an intangible asset
The term current asset doesn't cover	Car	Debtors	Stock	Prepaid expenses	Car
Wages paid to workers is	Direct income	Direct expenses	Indirect income	indirect expenses	Direct expenses
Shares which have no preferential rights over other class of shares is	Preference shares	Equity shares	Debentures	Loans & advances	Equity shares
IASB stands for	Indian Accounting Standard Board	International Accounting Standard Board	International Accounting Service Board	Indian Accounting Service Board	International Accounting Standard Board
An obligation to transfer economic benefit as a result of past transactions or events is called	Asset	Liability	Purchase	Trading	Liability
The process of recording, classifying, analyzing and communicating the financial transactions is called as	single entry	accounting	journalising	ledger	accounting
Accounting Standard-3 (AS-3), issued by The Institute of Chartered Accountants of India (ICAI) deals with the preparation and presentation of ……………….	Trial Balance	Balance Sheet	Profit and loss a/c	Cash Flow statement	Cash Flow statement
Accounting Standard 3 deals with	Depreciation	Cash Flow Statement	Disclosures	Foreign Exchange	Cash Flow Statement
Fixed Assets is ______________	Cash at bank	Land	Sundry Debtors	Short term investments	Land
Owner's funds otherwise known as	Debt	Equity	Loan	Dividend	Equity
Financial reporting information is based on………………, of the financial effects on entities of transactions and other events and circumstances that have already happened or that already exist.	Exact measures	Scientific	Accurate	Estimates	Estimates
Income statement otherwise known as	Profit & Loss Statement	Balance sheet	Profit & Loss Statement appropriation Account	Cash flow statement	Profit & Loss Statement
The statement containing various ledger balances on a date is known as ---------------	Trial balance	balance sheet	profit/loss a/c	net profit	Trial balance
A statement of financial position of an enterprise at a given date is called as	Trading A/c	Profit & Loss A/c	Balance Sheet	Cash flow statement	Balance Sheet
Which one is a source of cash?	Dividend paid	Redemption of debenture	Tax paid	Issue of shares	Issue of shares
Accounting Standard 6 deals with	Depreciation	Cash Flow Statement	Disclosures	Foreign Exchange	Depreciation
One of the current assets is	Stock	Machinery	Land	Sale	Stock
Dividends are usually paid on	Authorised capital	Issued capital	Paid-up capital	called up capital	Paid-up capital
Application of Cash is __________	Dividend paid	Sale of assets	Cash from operation	Loans received from bank	Dividend paid
Recording of capital contributed by the owner as liability ensures the adherence of principle of______________	Consistency	Going concern	Separate entity	Materiality	Separate entity
Which of the following is not one of the four basis financial statements?	The balance Sheet	The audit Report	The income statement	The statement of cash flows	The audit Report
Which of the following is true regarding the income statement?	The income statement is sometimes called the statement of operations	The income statement reports revenue, expenses, and liabilities	The income statement only reports revenue for which cash was received at the point of sale	The income statement reports the financial position of a business at a particular point in time.	The income statement is sometimes called the statement of operations
Which of the following is false regarding the balance sheet?	The accounts shown on a balance sheet represent the basic accounting equation for a particular business.	The retained earning balance shown on the balance sheet must agree with the ending retained earning balance shown on the statement of retained earnings.	The balance sheet summarizes the net changes in specific account balances over a period of time.	The balance sheet reports the amount of assets, liabilities, and stockholders equity of a business at a point in time	The balance sheet summarizes the net changes in specific account balances over a period of time.
Which of the following would not be a goal or external users reading a company's financial statements?	Understanding the current financial state of the company	Assessing the company's contribution to social and environmental polices	Predicting the company's future financial performance	Evaluating the company's ability to generate cash from sales	Assessing the company's contribution to social and environmental polices
Balance sheet is also called as	Profit & Loss Statement	Statement of financial changes	Profit & Loss Statement appropriation Account	Cash flow statement	Statement of financial changes
Which of the following items is not specific account in a company's accounting record?	Accounts Receivable	Net Income	Sales Revenue	Unearned Income	Net Income
Which account is least likely to be debited when revenue is recorded?	Account Payable	Accounts receivable	Cash	Unearned	Account Payable
What financial statement lists assets from current to long term?	Balance Sheet	Income Statement	Cash Flow Statement	Statement of Retained Earnings	Balance Sheet
Income statement format that separates cost of goods sold into categories?	Standard	Detailed	Expanded	Multi-Step	Multi-Step
Net income equals:	Total revenues minus cost of goods sold	Total revenues minus total expenses	Operating revenues minus operating expenses	Revenues minus expenses plus income taxes	Total revenues minus total expenses
Which financial statement represents the accounting equation "assets = liabilities + owners' equity"	Trading account	Profit &loss account	Balance sheet	Statement of cash flows	Balance sheet
"Business unit separate and distinct from the owner of it ",is based on:	Money measurement	Going concern concept	Business entity concept	Dual aspect concept	Business entity concept
_______ principle requires that the same method should be used from one accounting period to the next .	Conservation	Business entity	Consistency	Money measurement	Consistency
Following is not the example of external users	Government	Management	Investors	Suppliers and other creditors	Management
_________ are liabilities which become due and payable within a short period	Fixed liabilities	Long term liabilities	Current liabilities	Contingent liabilities	Current liabilities
According to the conceptual framework the primary objective of financial information is	Decision Usefulness	Prediction	Stewardship	Accountability	Decision Usefulness
The constraints on financial reporting identified under the conceptual framework are:	Cost versus benefit	Timeliness and neutrality	Understandability and materiality	Understandability and cost versus benefit	Cost versus benefit
EOQ Stands for	Eligible order quantity	Economic ordering quantity	Economic outstanding quantity	Eligible outstanding quantity	Economic ordering quantity
Which of the following elements in the financial statement is NOT defined by reference to other elements?	Equity	Expenses	Liabilities	Income	Liabilities
The assessment of financial statements by a shareholder is an example of	Vertical Analysis	Horizontal Analysis	Internal Analysis	External Analysis	External Analysis
_______________residual assets of an entity that remain after deducting liabilities	Asset	Liability	Equity	Profit and Loss Statement	Equity
________________Cash outflows could include purchasing raw materials, advertising, and cost of shipping the product.	Cash Flow from Operating Activities	Cash Flow from Investing Activities	Cash Flow from Financing Activities	Not in Cash Flow statement	Cash Flow from Operating Activities
The objective of financial reporting is "to provide information about the financial position, performance and _____________ of an enterprise that is useful to a wide range of users in making economic decisions."	changes in financial position	changes in financial report	changes in Management	changes in Cash position	changes in financial position
forms backbone for financial planning, analysis, bench marking and decision making.	Financial Statement	Financial Reports	Cash Flow Statemtent	Balance Sheet	Financial Reports
users need to know if they will be paid	Lendors	Customers	Investors	Suppliers	Suppliers
______________ users need to know if they will be repaid	Lendors	Customers	Investors	Suppliers	Lendors
_____________ users need to know that a company can continue to supply them into the future.	Lendors	Customers	Investors	Suppliers	Customers
Which of the following is not available in the financial statements of a company ________________	Sales	Purchase	Management decisions	Cash	Purchase
Management Accounting is primarily concerned with the supply of information which is useful to ___________	Suppliers	Employees	Management	Supervisors	Management
Current asset is ____________	Cash balance	Furniture	Investments	Closing stock	Cash balance
The example of intangible asset is___________	Land	Building	Furniture	Patents.	Patents.
Which of the following is correct__________	Asset = Liabilities – Capital	Capital = Assets – Liabilities	Capital = Assets + Liabilities	Capital = Asset	Capital = Assets – Liabilities
The amount which the proprietor has invested in the business is ___________	Capital	Liabilities	Assets	Fund	Capital
Balance sheet is a ___________	Statement	Account	Ledger	Transaction	Statement
__________is a current liability	Plant	Machinery	Sundry Creditors	Building	Sundry Creditors

UNIT-II

SYLLABUS

Understanding Financial Statements Structure of Financial Statements: Introduction - Statement of Financial Position (Balance Sheet)- Statement of Earnings (Income Statement), - Cash Flow Statement - Additional Disclosure Statements Need for Additional Statements-Auditor's Report - Director's Report - Funds Flow Statement - Electronic Dissemination- Corporate Governance.

STATEMENT OF FINANCIAL POSITION

The statement of financial position, often called the balance sheet, is a financial statement that reports the assets, liabilities, and equity of a company on a given date. In other words, it lists the resources, obligations, and ownership details of a company on a specific day. You can think of this like a snapshot of what the company looked like at a certain time in history.

This definition is true in the sense that this statement is a historical report. It only shows the items that were present on the day of the report. This is in contrast with other financial reports like the income statement that presents company activities over a period of time. The statement of financial position only records the company account information on the last day of an accounting period.

In this sense, investors and creditors can go back in time to see what the financial position of a company was on a given date by looking at the balance sheet.

Example

Let's take a look at a statement of financial position example.

Paul's Guitar Shop, Inc.
Statement of Financial Position
December 31, 2015

Assets	
Current Assets	
Cash	32,800
Inventory	39,800
Total Current Assets	72,600
Fixed Assets	
Leasehold Improvements	100,000
Accumulated Depreciation	(2,000)
Total Fixed Assets	98,000
Other Assets	
Trademarks	20,000
Accumulated Amortization	(8,000)
Total Other Assets	12,000
Total Assets	182,600
Liabilities	
Current Liabilities	
Accounts Payable	49,000
Accrued Expenses	1,000
Total Current Liabilities	50,000
Long-term Liabilities	25,000
Total Liabilities	75,000
Owner's Equity	
Owner's Equity	
Common Stock	20,000
Retained Earnings	87,600
Total Owner's Equity	107,600
Total Liabilities and Owner's Equity	182,600

As you can see from our example template, each balance sheet account is listed in the accounting equation order. This organization gives investors and creditors a clean and easy view of the company's resources, debts, and economic position that can be used for financial analysis purposes.

Investors use this information to compare the company's current performance with past performance to gauge the growth and health of the business. They also compare this information with other companies' reports to decide where the opportune place is to invest their money.

Creditors, on the other hand, are not typically concerned with comparing companies in the sense of investment decision-making. They are more concerned with the health of a business and the company's ability to pay its loan payments. Analyzing the leverage ratios, debt levels, and overall risk of the company gives creditors a good understanding of the risk involving in loaning a company money.

Obviously, internal management also uses the financial position statement to track and improve operations over time.

Now that we know what the purpose of this financial statement is, let's analyze how this report is formatted in a little more detail.

Format

The statement of financial position is formatted like the accounting equation (assets = liabilities + owner's equity). Thus, the assets are always listed first.

Assets Section

Assets are resources that the company can use to create goods or provide services and generate revenues. There are many ways to format the assets section, but the most common size balance sheet divides the assets into two sub-categories: current and non-current. The current assets include cash, accounts receivable, and inventory. These resources are typically consumed in the current period or within the next 12 months.

The non-current assets section includes resources with useful lives of more than 12 months. In other words, these assets last longer than one year and can be used to benefit the company beyond the current period. The most common non-current assets include property, plant, and equipment.

Liabilities Section

Liabilities are debt obligations that the company owes other companies, individuals, or institutions. These range from commercial loans, personal loans, or mortgages. This section is typically split into two main sub-categories to show the difference between obligations that are due in the next 12 months, current liabilities, and obligations that mature in future years, long-term liabilities.

Current debt usually includes accounts payable and accrued expenses. Both of these types of debts typically become due in less than 12 months. The long-term section includes all other debts that mature more than a year into the future like mortgages and long-term notes.

Equity Section

Equity consists of the ownership of the company. In other words, this measures their stake in the company and how much the shareholders or partners actually own. This section is displayed slightly different depending on the type of entity. For example a corporation would list the common stock, preferred stock, additional paid-in capital, treasury stock, and retained earnings. Meanwhile, a partnership would simply list the members' capital account balances including the current earnings, contributions, and distributions.

In the world of non-profit accounting, this section of the statement of financial position is called the net assets section because it shows the assets that the organization actually owns after all the debts have been paid off. It's easier to understand this concept by going back to an accounting equation example. If we rearrange the accounting equation to state equity = assets – liabilities, we can see that the equity of a non-profit is equal to the assets less any outstanding liabilities.

INCOME STATEMENT

The Income Statement is one of a company's core financial statements that show their profit and loss over a period of time. The profit or loss is determined by taking all revenues and subtracting all expenses from operating and non-operating activities.

The income statement is one of three statements used in both corporate finance (including financial modelling) and accounting. The statement displays the company's revenue, costs, gross profit, selling and administrative expenses, other expenses and income, taxes paid and net profit in a coherent and logical manner.

The statement is divided into time periods that logically follow the company's operations. The most common periodic division is monthly (for internal reporting), although certain companies may use a thirteen-period cycle. These periodic statements will be aggregated into total values for quarterly and full year results.

FINANCIAL STATEMENTS	Historical Results				
	2012	2013	2014	2015	2016
Income Statement					
Revenue	102,007	118,086	131,345	142,341	150,772
Cost of Goods Sold (COGS)	39,023	48,004	49,123	52,654	56,710
Gross Profit	62,984	70,082	82,222	89,687	94,062
Expenses					
Salaries and Benefits	26,427	22,658	23,872	23,002	25,245
Rent and Overhead	10,963	10,125	10,087	11,020	11,412
Depreciation & Amortization	19,500	18,150	17,205	16,544	16,080
Interest	2,500	2,500	1,500	1,500	1,500
Other	8,820	6,225	1,659	3,911	5,996
Total Expenses	68,210	59,658	54,323	55,977	60,233
Earnings Before Tax	(5,226)	10,424	27,899	33,711	33,829
Taxes	1,120	4,858	8,483	10,908	11,598
Net Earnings	(6,346)	5,566	19,416	22,802	22,231

This statement is a great place to begin the financial model, as it requires the least amount of information from the balance sheet and cash flow statement. Thus, in terms of information, the income statement is a predecessor to the other two core statements.

The components of an Income Statement

The income statement may have minor variations between different companies, as expenses and income will be dependent on the type of operations or business conducted. However, there are several generic line items that are commonly seen in the income statement. The most common income statement items include:

Revenue/Sales

Sales Revenue is the company's revenue from sales or service is displayed at the very top of the statement. This value will be gross of the costs associated in creating the goods sold, or in providing the service.

Cost of Good Sold (COGS)

Cost of Goods Sold (COGS) is a line-item that aggregates the direct costs associated with achieving the revenue. Fixed costs and overhead are excluded.

Gross Profit

Gross Profit Gross profit is found by subtracting COGS from Sales or Revenue.

Selling General and Administrative

SG&A Expense includes the selling, general and administrative section will contain all other indirect costs associated with running the business. This includes salaries of management, advertising expenses, travel expenses, and sometimes depreciation and amortization, among others. Entities may, however, elect to separate out depreciation and amortization in its own section.

EBITDA

EBITDA, while not present in all income statements, stands for Earnings before Interest, Tax, Depreciation, and Amortization is calculated by subtracting SG&A expenses (excluding amortization and depreciation) from gross profit.

Depreciation & Amortization

Depreciation and amortization are non-cash expenses that are created by accountants to spread out the cost of capital assets such as Property, Plant, and Equipment (PP&E).

EBIT

EBIT, while not present in all income statements, stands for Earnings before Interest and Tax and is calculated by subtracting depreciation and amortization from EBITDA.

Interest

Interest Expense. It is common for companies to split out interest expense and interest income as a separate line item in the income statement. This is done to be able to reconcile the difference between EBIT and EBT. Interest expense is determined through the debt schedule.

EBT (pre-tax income)

EBT stands for Earnings Before Tax or pre-tax income is found by subtracting interest expense from EBIT. This is the final subtotal before finding net income.

Income Taxes

Income Taxes refer to the relevant taxes charged on pre-tax income. The total tax expense can consist of both current taxes and future taxes.

Net Income

Net Income is calculated by deducting income taxes from pre-tax income. This is the amount that flows into retained earnings on the balance sheet, after deductions for any dividends.

CASH FLOW STATEMENT

Till now you have learnt about the financial statements being primarily inclusive of Position Statement (showing the financial position of an enterprise as on a particular date) and Income Statement (showing the result of the operational activities of an enterprise over a particular period). There is also a third important financial statement known as Cash flow statement, which shows inflows and outflows of the cash and cash equivalents. This statement is usually prepared by companies which come as a tool in the hands of users of financial information to know about the sources and uses of cash and cash equivalents of an enterprise over a period of time from various activities o*f an enterprise.*

Accounting Standard-3 (AS-3), issued by The Institute of Chartered Accountants of India (ICAI) deals with the preparation and presentation of Cash flow statement. The revised AS-3 has made it mandatory for all listed companies to prepare and present a cash flow statement along with other financial statements on annual basis. A cash flow statement provides information about the historical changes in cash and cash equivalents of an enterprise by classifying cash flows into operating, investing and financing activities. It requires that an enterprise should prepare a cash flow statement and should present it for each accounting period for which financial statements are presented.

Objectives of Cash Flow Statement

A Cash flow statement shows inflow and outflow of cash and cash equivalents from various activities of a company during a specific period. The primary objective of cash flow statement is to provide useful information about cash flows (inflows and outflows) of an enterprise during a particular period under various heads, i.e., operating activities, investing activities and financing activities.

This information is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

Benefits of Cash Flow Statement

Cash flow statement provides the following benefits :

1. A cash flow statement when used along with other financial statements provides information that enables users to evaluate changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timings of cash flows in order to adapt to changing circumstances and opportunities.
2. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises.
3. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

4. It also helps in balancing its cash inflow and cash outflow, keeping in response to changing condition. It is also helpful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and impact of changing prices.

Cash and Cash Equivalents

As stated earlier, cash flow statement shows inflows and outflows of cash and cash equivalents from various activities of an enterprise during a particular period. As per AS-3, 'Cash' comprises cash in hand and demand deposits with banks, and 'Cash equivalents' means short-term highly liquid investments that are readily convertible into known amounts *of cash and which are subj*ect to an insignificant risk of changes in value.

Classification of Activities for the Preparation of Cash Flow Statement

Cash from Operating Activities

Operating activities are the activities that constitute the primary or main activities of an enterprise. For example, for a company manufacturing garments, operating activities are procurement of raw material, incurrence of manufacturing expenses, sale of garments, etc. These
are the principal revenue generating activities (or the main activities) of the enterprise and these activities are not investing or financing activities. The amount of cash from operations' indicates the internal solvency level of the company, and is regarded as the key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, paying dividends, making of new investments and repaying of loans without recourse to external source of financing.

Cash flows from operating activities are primarily derived from the main activities of the enterprise. They generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

Cash Inflows from operating activities

- Cash receipts from sale of goods and the rendering of services.
- Cash receipts from royalties, fees, commissions and other revenues.

Cash Outflows from operating activities

- Cash payments to suppliers for goods and services.
- Cash payments to and on behalf of the employees.
- Cash payments to an insurance enterprise for premiums and claims, annuities, and other policy benefits.
- Cash payments of income taxes unless they can be specifically identified with financing and investing activities.

Cash from Investing Activities

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Investing activities relate to purchase and sale of long-term assets or fixed assets such as machinery, furniture, land and building, etc. Transactions related to long-term investment are also investing activities. Separate disclosure of cash flows from investing activities is important because they represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

Cash Outflows from investing activities

- Cash payments to acquire fixed assets including intangibles and capitalised research and development.
- Cash payments to acquire shares, warrants or debt instruments of other enterprises other than the instruments those held for trading purposes.
- Cash advances and loans made to third party (other than advances and loans made by a financial enterprise wherein it is operating activities).

Cash Inflows from Investing Activities

- Cash receipt from disposal of fixed assets including intangibles.
- Cash receipt from the repayment of advances or loans made to third parties (except in case of financial enterprise).
- Cash receipt from disposal of shares, warrants or debt instruments of other enterprises except those held for trading purposes.
- Interest received in cash from loans and advances.
- Dividend received from investments in other enterprises.

Cash from Financing Activities

As the name suggests, financing activities relate to long-term funds or capital of an enterprise, e.g., cash proceeds from issue of equity shares, debentures, raising long-term bank loans, repayment of bank loan, etc. As per AS-3, financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in case of a company) and borrowings of the enterprise. Separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise. Examples of financing activities are:

Cash Inflows from financing activities

- Cash proceeds from issuing shares (equity or/and preference).
- Cash proceeds from issuing debentures, loans, bonds and other short/long-term borrowings.

Cash Outflows from financing activities

- Cash repayments of amounts borrowed.
- Interest paid on debentures and long-term loans and advances.
- Dividends paid on equity and preference capital.

Pro-forma of Cash from Operation

CASH FROM OPERATION

Particulars	Rs.	Rs.
Profit made during the year **Add:** Decrease in Debtors Increase in Creditors Increase in outstanding expenses Decrease in prepaid expenses		
Less: Increase in Bills receivable Decrease in bills payable Increase in Accrued income Decrease in interest received in advance Cash from operations		

Pro-forma of Cash Flow Statement

CASH FLOW STATEMENT

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Particulars	Rs.	Rs.
Cash Flows from Operating Activities		
Cash from Operations		
Cash Flows from Investing Activities		
Purchase of Fixed Assets		
Proceeds from Sale of Equipment		
Interest Received		
Dividends Received		
Cash from Investing Activities (2)		
Cash flows from Financing Activities		
Proceeds from issuance of Share Capital		
Proceeds from Long-term Borrowings		
Repayment of Long-term Borrowings		
Interest Paid		
Dividends Paid		
Cash from Financing Activities(3)		
Net Increase in Cash and Cash Equivalents		
Cash and Cash Equivalents at the beginning of the period		
Cash and Cash Equivalents at the end of the period		

Repayment of Long-term Borrowings

Interest Paid

Dividends Paid

Cash from Financing Activities(3)

Net Increase in Cash and Cash Equivalents

Cash and Cash Equivalents at the beginning of the period

Cash and Cash Equivalents at the end of the period

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ADDITIONAL DISCLOSURE STATEMENTS

Notes to the financial statement present all such information which cannot be presented on the face of income statement, balance sheet, statement of cash flows and statement of changes in equity.

Typical notes to the financial statement are:

1. An introduction of the business outlining its legal status, its country of incorporation and the name of its parents if any and a statement about the company's areas of business and its operations.
2. A summary of accounting policies related to revenue recognition, inventories, property, plant and equipment, financial instruments, etc.
3. A schedule of property plant and equipment showing the addition and deletion of assets, related movement in the accumulated depreciation account and book value.
4. A breakup of cost of sales, selling expenses and administrative expenses.
5. A detailed disclosure of different classes of financial instruments and their related risks.
6. A breakup of the gross amounts and present values of lease obligations of the business.
7. A detail of transactions with related parties.
8. A detail of contingencies that may affect the business in future, for example legal proceedings against the business.
9. A description of major events that occurred after the balance sheet date, etc.

Disclosures in Financial Reports: Supplementary Items

The financial report of a business includes more than just the financial statements; a financial report also needs information called *disclosures*. Supplementary items such as financial schedules and tables provide one form of disclosure in financial reports.

A wide variety of other information is also presented, some of which is required if the business is a public corporation subject to federal regulations regarding financial reporting to its stockholders. Other information is voluntary and not strictly required legally or according to GAAP.

In addition to the financial statements and footnotes to the financials, public corporations typically include some or all the following disclosures in their annual financial reports to their stockholders:

- **Cover (or transmittal) letter:** A letter from the chief executive of the business to the stockholders, which usually takes credit for good news and blames bad news on big government, unfavorable world political developments, a poor economy, or some other thing beyond management's control.
- **Management's report on internal control over financial reporting:** An assertion by the chief executive officer and chief financial officer regarding their satisfaction with the effectiveness of the internal controls of the business, which are designed to ensure the reliability of its financial reports (and to prevent financial and accounting fraud).
- **Highlights table:** A table that presents key figures from the financial statements, such as sales revenue, total assets, profit, total debt, owners' equity, number of employees, and number of units sold (such as the number of vehicles sold by an automobile manufacturer). The idea is to give the stockholder a financial thumbnail sketch of the business.

- **Management discussion and analysis (MD&A):** Deals with the major developments and changes during the year that affected the financial performance and situation of the business. The SEC requires this disclosure to be included in the annual financial reports of publicly owned corporations.
- **Segment information:** A report of the sales revenue and operating profits (before interest and income tax, and perhaps before certain costs that cannot be allocated among

different segments) for the major divisions of the organization, or for its different markets (international versus domestic, for example).

- **Historical summaries:** A financial history that extends back beyond the years (usually three) included in the primary financial statements.
- **Graphics:** Bar charts, trend charts, and pie charts representing financial conditions; photos of key people and products.
- **Promotional material:** Information about the company, its products, its employees, and its managers, often stressing an overarching theme for the year. Most companies use their annual financial report as an advertising opportunity.
- **Profiles:** Information about members of top management and the board of directors. Of course, everyone appears to be well qualified for his or her position. Negative information (such as prior brushes with the law) is not reported.
- **Quarterly summaries of profit performance and stock share prices:** Shows financial performance for all four quarters in the year and stock price ranges for each quarter (required by the SEC).
- **Management's responsibility statement:** A short statement indicating that management has primary responsibility for the accounting methods used to prepare the financial statements, for writing the footnotes to the statements, and for providing the other disclosures in the financial report. Usually, this statement appears near the independent CPA auditor's report.
- **Independent auditor's report:** The report from the CPA firm that performed the audit, expressing an opinion on the fairness of the financial statements and accompanying disclosures. Public corporations are required to have audits; private businesses may or may not have their annual financial reports audited.
- **Company contact information:** Information on how to contact the company, the Web site address of the company, how to get copies of the reports filed with the SEC, the stock transfer agent and registrar of the company, and other information.

Managers of public corporations rely on lawyers, CPA auditors, and their financial and accounting officers to make sure that everything that should be disclosed in the business's annual financial reports is included, and that the exact wording of the disclosures is not misleading, inaccurate, or incomplete. This is a tall order. The field of financial reporting disclosure changes constantly.

AUDITORS REPORT

TO THE MEMBERS OF TATA MOTORS LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of **TATA MOTORS LIMITED** ("the Company"), which comprise the Balance Sheet as at March 31, 2015, the Statement of Profit and Loss, the Cash Flow Statement for the year then ended, and a summary of the significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

The Company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We have taken into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act and the Rules made there under.

We conducted our audit in accordance with the Standards on Auditing specified under Section 143(10) of the Act. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and the disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the Company's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on whether the Company has in place an adequate internal financial controls system over financial reporting and the operating effectiveness of such controls. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by the Company's Directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the financial statements.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31, 2015 and its loss and its cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2015 ("the Order"), issued by the Central Government of India in terms of sub-section (11) of Section 143 of the Companies Act, 2015, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

2. As required by Section 143 (3) of the Act, we report that:
    a. We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit.
    b. In our opinion, proper books of account as required by law have been kept by the Company so far as it appears from our examination of those books.
    c. The Balance Sheet, the Statement of Profit and Loss, and the Cash Flow Statement dealt with by this Report are in agreement with the books of account.
    d. In our opinion, the aforesaid financial statements comply with the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014.
    e. On the basis of the written representations received from the directors as on March 31, 2015 taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 2015 from being appointed as a director in terms of Section 164 (2) of the Act.

For **DELOITTE HASKINS & SELLS LLP**
Chartered Accountants
(Firm's Registration No. 117366W/W-100018)
B. P. SHROFF
Partner
MUMBAI, May 26, 2015 (Membership No. 34382)

DIRECTOR'S REPORT

Dear Members,

Your Directors are pleased to present the Forty first Annual Report and the Company's audited financial statement for the financial year ended March 31, 2015.

1. Financial Results

2. Dividend
3. Management's Discussion and Analysis Report
4. Consolidated Financial Statement
5. Subsidiaries, Joint Ventures and Associate Companies
6. Directors' Responsibility Statement
7. Corporate Governance
8. Business Responsibility Report
9. Contracts and Arrangements with Related Parties
10. Corporate Social Responsibility (CSR)
11. Risk Management
12. Internal Financial Controls
13. Directors and Key Managerial Personnel
14. Employees' Stock Option Scheme
15. Auditors and Auditors' Report
16. General

ELECTRONIC DISSEMINATION

Data dissemination is the distribution or transmitting of statistical, or other, data to end users. There are many ways organisations can release data to the public, i.e. electronic format, CD-ROM and paper publications such as PDF files based on aggregated data. The most popular dissemination method today is the 'non-proprietary' open systems using internet protocols. "They are used in data dissemination through various communication infrastructures across any set of interconnected networks." Data is made available in common open formats.

Some organisations choose to disseminate data using 'proprietary' databases in order to protect their sovereignty and copyright of the data. Proprietary data dissemination requires a specific piece of software in order for end users to view the data. The data will not open in common open formats. The data is first converted into the propitiatory data format and specifically designed software is provided by the organisation to users.

Dissemination formats and standards Under the Special Data Dissemination Standard, the formats are divided into two categories: "hardcopy" and "electronic" publications

Some examples of Hardcopy publications:

- yearbook
- panorama of municipalities
- monthly review
- trends
- pocketbook
- periodical

Some examples of electronic copy publications:

- CD Rom
- Webpage
- PDF
- Downloadable Databases for private use in 3rd party software applications

CORPORATE GOVERNANCE

Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

Corporate governance of INFOSYS

Corporate governance is about maximizing shareholder value legally, ethically and on a sustainable basis. At Infosys, the goal of corporate governance is to ensure fairness for every stakeholder – our customers, investors, vendor-partners, the community, and the governments of the countries in which we operate. We believe that sound corporate governance is critical in enhancing and retaining investor trust. It is a reflection of our culture, our policies, our relationship with stakeholders and our commitment to values. Accordingly, we always seek to ensure that our performance is driven by integrity.

Our Board exercises its fiduciary responsibilities in the widest sense of the term. Our disclosures seek to attain the best practices in international corporate governance. We also endeavour to enhance long-term shareholder value and respect minority rights in all our business decisions.

We continue to be a pioneer in benchmarking our corporate governance policies with the best in the world. Our efforts are widely recognized by investors in India and abroad. We have been audited for corporate governance by the Investment Information and Credit Rating Agency (ICRA) and have been awarded a rating of Corporate Governance Rating 1 (CGR 1).

We are also in compliance with the recommendations of the Narayana Murthy Committee on Corporate Governance, constituted by the Securities and Exchange Board of India (SEBI).

Corporate governance philosophy

Our corporate governance philosophy is based on the following principles:

- Satisfying the spirit of the law and not just the letter of the law
- Going beyond the law in upholding corporate governance standards
- Maintaining transparency and a high degree of disclosure levels
- Making a clear distinction between personal convenience and corporate resources
- Communicating externally in a truthful manner about how the company is run internally
- Complying with the laws in all the countries in which the company operates
- Having a simple and transparent corporate structure driven solely by business needs
- Embracing a trusteeship model in which the management is the trustee of the shareholders' capital and not the owner
- Driving the business on the basis of the belief, 'when in doubt, disclose'

POSSIBLE QUESTIONS

Part - B

1. What is Corporate Governance?
2. What do you understand from the term "Electronic dissemination"?
3. Auditor's report – Explain.
4. What is Cash from operation?
5. Expand and explain **EBITDA.**

Part - C

1. Draw the specimen of Income statement and explain it.
2. What is a 'Fund Flow Statement'? What are the various sources and uses of Funds?
3. How is the 'Balance sheet' prepared? Give its basic format with some items of Assets and Liabilities.
4. What is Additional disclosure of statements and state the needs for additional disclosure.
5. Write short notes on
   i) EBIT
   ii) Cash and Cash Equivalents
   iii) **Cost of Good Sold (COGS)**
6.

Question	Option - I	Option - II	Option - III	Option - IV	Answer
The term 'Financial Statement' covers	Profit & Loss Statement	Balance sheet and Profit & Loss Statement appropriation Account	Profit & Loss Statement and Balance sheet	Profit & Loss Statement appropriation Account	Profit & Loss Statement and Balance sheet
__________ of the cash flow generated by the firm's operations, investments and financial activities.	The balance sheet is a report	The income statement is a report	The statement of cash flows is a report	The auditor's statement of financial condition is a report	The statement of cash flows is a report
ABC Ltd. has a Current Ratio of 1.5: 1 and Net Current Assets of Rs. 5,00,000. What are the Current Assets?	Rs. 5,00,000	Rs. 10,00,000	Rs. 15,00,000	Rs. 25,00,000	Rs. 15,00,000
__________ of the profitability of the firm over a period of time such as a year.	The balance sheet is a summary	The income statement is a summary	That statement of cash flows is a summary	The audit report is a summary	The income statement is a summary
__________ a snapshot of the financial condition of the firm at a particular time.	The balance sheet provides	The income statement provides	The statement of cash flows provides	The audit report is a summary	The balance sheet provides
Which of the following ratios gives information on the amount of profits reinvested in the firm over the years?	Sales/total assets	Debt/total assets	Debt/equity	Retained earnings/total assets	Retained earnings/total assets
The overall net increase or decrease in working capital is found out by preparing ________	Fund flow statement	Cash flow statement	Schedule of changes in working capital	Income statement	Schedule of changes in working capital
Economic value added (EVA) is also known as	excess capacity	excess income	accounting value added	residual income	residual income
Which of the financial statements recognizes only transactions in which cash changes hands?	Balance Sheet	Income Statement	Statement of Cash Flows	Balance Sheet, and Income Statement	Statement of Cash Flows
The goal of corporate governance and business ethics education is to_________	Teach students their professional accountability and to uphold their personal Integrity to society	Change the way in which ethics is taught to students	Create more ethics standards by which corporate professionals must operate	Increase the workload for accounting students	Create more ethics standards by which corporate professionals must operate
The form of balance sheet is	Vertical	Horizontal	Horizontal and vertical	Horizontal or vertical	Horizontal or vertical
As per Accounting Standard-3, Cash Flow is classified into	Operating activities and investing activities	Investing activities and financing activities	Operating activities and financing activities	Operating activities, financing activities and investing activities	Operating activities, financing activities and investing activities
As per AS-3,_________means short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.	Cash in Hand	Demand Deposit in Bank	Cash equivalents	Building	Cash equivalents
Which one of the following contains Auditor's report ?	Creditors responsibility	share holder's responsibility	Bankers responsibility	Auditor's responsibility	Auditor's responsibility
A large amount spent on special advertisement is–	Capital Expenditure	Revenue Expenditure	Revenue Loss	Deferred Revenue Expenditure	Deferred Revenue Expenditure
Double Entry System was introduced in–	America	Japan	India	Italy	Italy
What does management audit imply ?	Complete audit	Detailed audit	Efficiency audit	Interim audit	Efficiency audit
Which one of the following statements is correct ?	Internal audit and Management audit are the same	Internal audit and statutory audit are the same	Internal audit is compulsory in all cases	Statutory audit of company accounts is compulsory	Statutory audit of company accounts is compulsory
The assets of a business can be classified as	Only fixed assets	Only current assets	Fixed and current assets	Equity	Fixed and current assets
Which of the following is the test of the long term liquidity of a business?	Interest coverage ratio	Stock turnover ratio	Operating ratio	Current ratio	Interest coverage ratio
ROI stands for?	Return on Investment	Ratio of Investment	Return of Income	None of these	Return on Investment
Which of the following is not one of the items required to be shown in the heading of a financial statement?	The Financial statement prepares name	The title of the financial report	The financial reporting date or period	The name of the business entity	The Financial statement prepares name
Which of the following is not an asset?	Cash	Land	Equipment	Contributed Capital	Contributed Capital
Which of the following statements describe transactions that would be recorded in the accounting system?	An exchange of an asset for a promise to pay	An exchange of an promise for another promise to pay	Both of the above	None of the above	An exchange of an asset for a promise to pay
Total assets on a balance sheet prepared on any date must agree with which of the following?	The sum of total liabilities and net income as shown on the income statement	The sum of total liabilities and contributed capital	The sum of total liabilities and contributed capital	The sum of total liabilities and contributed capital and retained earnings	The sum of total liabilities and contributed capital and retained earnings
The T-account is used to summarize which of the following?	Increases and decrease to a single account in the accounting system	Debits and credits to a single account in the accounting system	Changes in specific account balance over a time period	All of the above describe how T-accounts are used by accountants	All of the above describe how T-accounts are used by accountants
The statement of financial position is formed like accounting equation as	Asset = Liability + Owners equity	Asset = Liability – Creditors	Asset = Liability + Creditors	Asset = Liability – Owners equity	Asset = Liability + Owners equity
Which of the following describes how assets are listed on the balance sheet?	In alphabetical order	In order of magnitude, lowest value to highest value	In the order they will be used up or turned in cash	From least current to most current	In the order they will be used up or turned in cash
Which is not a cash activity listed on the cash flow statememt?	Operating activities	Investing activities	Purchasing activities	Financing activities	Purchasing activities
The primary stakeholders are:	Customers.	Suppliers.	Shareholders.	Creditors.	Shareholders.
Plant & Machinery is	Fixed asset	Current asset	Fictitious asset	Intangible asset	Fixed asset
Depreciations arises because of :	Fall in the market value of the asset	Fall in the value of money	Physical wear and tear of asset	Inflation in the market	Physical wear and tear of asset
Capital expenditure are recorded in the _________	Balance sheet	Profit & loss account	Trading account	Manufacturing account	Balance sheet
Carriage outward is debited to ______________	Trading account	P/L account	Profit and loss appropriation account	Balance sheet	P/L account
Which of the following is correct?	Capital = Asset – Liabilities	Capital = Asset + Liabilities	Asset = Liabilities – capital	Liabilities = Asset + capital	Capital = Asset – Liabilities
Wages and salary is debited to:	Trading account	P/L Account	Profit and loss appropriations account	Balance sheet	Trading account
Land & building is a ………………………………	Fixed asset	Current asset	Fictitious asset	Intangible asset	Fixed asset
Which of the following account will have credit balance?	Bank over draft	Carriage inwards	Prepaid expenses	Bills receivable	Bank over draft
Assets acquired for long use in the business are called ………………….	Fixed assets	Current assets	Fictitious asset	Liquid asset	Fixed assets
Assets acquired for short term use in the business are called……………..	Fixed assets	Current assets	Fictitious assets	Liquid assets	Current assets
Which of the following transactions will result in inflow of funds?	Issue of debentures	Conversion of debentures into equity shares	Redemption of long term loan	Creation of General Reserve	Issue of debentures
Which of the following transactions will result in outflow of funds?	Issue of debentures	Conversion of debentures into equity shares	Redemption of long term loan	Creation of General Reserve	Redemption of long term loan
The analysis and interpretations of the financial statement will reveal …	the financial position & the profibility	Budget	Sources of fund	Fund flow statement	the financial position & the profibility
The process of explaining the meaning, significance and relationship between two financial factors is called …	Summarisation	Analysis	Interpretation	Reporting	Interpretation
Increase in working capital is ____________	Sources of Fund	Uses of fund	source of cash	uses of cash	Sources of Fund
EBIT stands for	Earnings before Interest and Tax	Earnings before Income and Tax	Expenses before Interest and Tax	Equity before Income and Tax	Earnings before Interest and Tax
Which of the following is not one the underlying principles of the corporate governance Combined Code of Practice?	acceptability	openness	integrity	accountability	acceptability
External audit of the accounts of a limited company is required	because it is demanded by the company's bankers	to detect fraud	at the discretion of the shareholders	by the Companies Act 2006	by the Companies Act 2006
Directors' responsibilities are unlikely to include	a duty to keep proper accounting records	a duty to propose high dividends for shareholders	a duty of care	a fiduciary duty	a duty to propose high dividends for shareholders
A company may become insolvent if it	cannot pay creditors in full after realisation of its assets	cannot meet its budgeted level of profit	has negative working capital	makes a loss	cannot pay creditors in full after realisation of its assets
Which one of these is not a mechanism for ensuring good corporate governance?	Requiring periodic reports by directors to shareholders on governance issues and practices	Ensuring the topic is an explicit part of the responsibilities of each director	Publishing a statement of corporate responsibility principles	Requiring certain actions to be approved by shareholders	Publishing a statement of corporate responsibility principles
Effective tool of excellent corporate governance corporation are	Board of directors	Common stock shareholders	Top executive officers	Lenders	Board of directors
A letter from the ___________ of the business to the share holder which usually takes credit for good news and bad news or some other things beyond management control.	Union	Governmnet	Employees	Chief Executive	Chief Executive
A financial hisory that extend back beyond the years included int the primary financial statement is ______	Promotinal Materials	Segment information	Historical summary	Profiles	Historical summary
Most companies uses their annual financial report as an ______________	Promotional Material	Segment Information	Profile Information	History	Promotional Material
Standard on Auditing specified under Section ______________ of the Act.	Sec 142 (10)	Sec 142 (12)	Sec 143 (10)	Sec 143 (12)	Sec 143 (10)
____________ is the distribution or transmitted of statistical or other data to end users.	Electronic Dissemination	Auditor Report	Financial Statement	employee Stoc options scheme	Electronic Dissemination
Electronic copy publication is________________	Year book	Monthly review	CD Rom	Pocket Book	CD Rom
Hardcopy publications is ________________	Periodical	CD ROM	Web page	PDF	Periodical
_____________ provides the framework for attaining a company objectives, it encompasses practically every sphere of management, from action plan and internal controls to performance management and corporate disclosure.	Corporate objectives	Corporate Governance	Auditors Report	Balance Sheet	Corporate Governance

UNIT-III

SYLLABUS

Components of Financial Statements: Inventories – Receivables - Assets (Fixed Tangible, Intangible), Leases – Revenue - Income-Tax - Retained Earnings

INVENTORIES

Every enterprise needs inventory for smooth running of its activities. It serves as a link between production and distribution processes. There is, generally, a time lag between the recognition of need and its fulfilment. The greater the time-lag, the higher the requirements for inventory.

The investment in inventories constitutes the most significant part of current assets/working capital in most of the undertakings. Thus, it is very essential to have proper control and management of inventories. The purpose of inventory management is to ensure availability of materials in sufficient quantity as and when required and also to minimize investment in inventories.

Meaning and Nature of inventory

In accounting language it may mean stock of finished goods only. In a manufacturing concern, it may include raw materials, work in process and stores, etc. Inventory includes the following things:

Raw Material: Raw material form a major input into the organization. They are required to carry out production activities uninterruptedly. The quantity of raw materials required will be determined by the rate of consumption and the time required for replenishing the supplies. The factors like the availability of raw materials and government regulations etc. too affect the stock of raw materials.

Work in Progress: The work-in-progress is that stage of stocks which are in between raw materials and finished goods. The raw materials enter the process of manufacture but they are yet to attain a final shape of finished goods. The quantum of work in progress depends upon the time taken in the manufacturing process. The greater the time taken in manufacturing, the more will be the amount of work in progress.

Consumables: These are the materials which are needed to smoothen the process of production. These materials do not directly enter production but they act as catalysts, etc. Consumables may be classified according to their consumption and criticality.

Finished goods: These are the goods which are ready for the consumers. The stock of finished goods provides a buffer between production and market. The purpose of maintaining inventory is to ensure proper supply of goods to customers.

Spares: Spares also form a part of inventory. The consumption pattern of raw materials, consumables, finished goods are different from that of spares. The stocking policies of spares are different from industry to industry. Some industries like transport will require more spares than the other concerns. The costly spare parts like engines, maintenance spares etc. are not discarded after use, rather they are kept in ready position for further use.

Purpose/Benefits of Holding Inventors

There are three main purposes or motives of holding inventories:

- **The Transaction Motive** which facilitates continuous production and timely execution of sales orders.
- **The Precautionary Motive** which necessitates the holding of inventories for meeting the unpredictable changes in demand and supplies of materials.
- **The Speculative Motive** which induces to keep inventories for taking advantage of price fluctuations, saving in re-ordering costs and quantity discounts, etc.

Inventory Management

It is necessary for every management to give proper attention to inventory management. A proper planning of purchasing, handling storing and accounting should form a part of inventory management. An efficient system of inventory management will determine (a) what to purchase (b) how much to purchase (c) from where to purchase (d) where to store, etc.

There are conflicting interests of different departmental heads over the issue of inventory. The finance manager will try to invest less in inventory because for him it is an idle investment, whereas production manager will emphasize to acquire more and more inventory as he does not want any interruption in production due to shortage of inventory. The purpose of inventory management is to keep the stocks in such a way that neither there is over-stocking nor under-stocking. The over-stocking will mean reduction of liquidity and starving of other production processes; under-stocking, on the other hand, will result in stoppage of work. The investments in inventory should be kept in reasonable limits.

Objects of Inventory Management

The main objectives of inventory management are operational and financial. The operational objectives mean that the materials and spares should be available in sufficient quantity so that work is not disrupted for want of inventory. The financial objective means that investments in inventories should not remain idle and minimum working capital should be locked in it. The following are the objectives of inventory management:

(1) To ensure continuous supply of materials spares and finished goods so that production should not suffer at any time and the customers demand should also be met.

(2) To avoid both over-stocking and under-stocking of inventory.

(3) To keep material cost under control so that they contribute in reducing cost of production and overall costs.

(4) To minimise losses through deterioration, pilferage, wastages and damages.

(5) To ensure perpetual inventory control so that materials shown in stock ledgers should be actually lying in the stores.

(6) To ensure right quality goods at reasonable prices.

(7) To maintain investments in inventories at the optimum level as required by the operational and sales activities.

(8) To eliminate duplication in ordering or replenishing stocks. This is possible with help of centralizing purchases.

(9) To facilitate furnishing of data for short term and long term planning and control of inventory.

(10) To design proper organisation of inventory. A clear cut accountability should be fixed at various levels of management.

VALUATION OF INVENTORIES ACCORDING TO AS 2:

Inventories should be valued at the lower of cost and net realisable value.

Cost: The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

i). Costs of Purchase

The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

ii). Costs of Conversion

The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Net Realizable Value

The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs necessary to make the sale have increased. The practice of writing down inventories below cost to net realizable value is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use.

RECEIVABLES

Receivables mean amounts owed to the company by others. Accounts Receivable are receivables resulting from the company rendering services or selling products to the public. The company bills its customers/clients. There is no formal debt instrument.

Notes Receivable are amounts owed to the company from promissory notes, which are formal written debt instruments that usually bear interest. Sometimes when customers are slow to pay their accounts receivable, the account receivable is converted into a promissory note that bears interest.

Valuing Accounts Receivable:

A company reports the face value of its accounts receivable on its balance sheet. A principle of GAAP is conservatism. We don't want to show an account receivable as an asset when the company doesn't think that it will be collected. This is misleading to people looking at the balance sheet.

A second GAAP principle involved in this topic is matching rule. Under the matching rule, during a period a company should report all of the expenses that helped generate the revenue reported during that period. The fact that some revenue from credit sales will not be collected is considered a Bad Debts expense, and it should be recorded in the year of the sale in question.

Two methods are used to write off bad accounts receivable and record the bad debts expense. The two methods are (i), the direct method (also called the direct charge-off method or direct write-off method), and (ii) the allowance method. The allowance method is GAAP. The direct method is not.

GAAP also has another principle which is materiality. If something is not a material amount, then you can report it the wrong way. Since it isn't material, the thought is that no one is harmed by doing it wrong. Something is material if a person's actions would have been different if he or she had known of the item in question.

Therefore, if a company's bad accounts receivable are so small that they are not a material amount, then you can use the direct method to write off uncollectible accounts.

FIXED ASSETS

Fixed assets, also known as Property, Plant and Equipment, are tangible assets held by an entity for the production or supply of goods and services, for rentals to others, or for administrative purposes.

These assets are expected to be used for more than one accounting period. Fixed assets are generally not considered to be a liquid form of assets unlike current assets. Examples of common types of fixed assets include buildings, land, furniture and fixtures, machines and vehicles.

The term 'Fixed Asset' is generally used to describe tangible fixed assets. This means that they have a physical substance unlike intangible assets which have no physical existence such as copyright and trademarks.

Fixed assets are not held for resale but for the production, supply, rental or administrative purposes. Assets that held for resale must be accounted for as inventory rather than fixed asset. So for example, if a company is in the business of selling cars, it must not account for cars held for resale as fixed assets but instead as inventory assets. However, any vehicles other than those held for the purpose of resale may be classified as fixed assets such as delivery trucks and employee cars.

Fixed assets are normally expected to be used for more than one accounting period which is why they are part of Non Current Assets of the entity. Economic benefits from fixed assets are therefore derived in the long term.

In order for fixed assets to be recognized in the financial statements of an entity, the basic criteria for the recognition of assets laid down in the IASB Framework must be met:

- The inflow of economic benefits to entity is probable; and
- The cost/value can be measured reliably.

TANGIBLE ASSETS

Assets with a physical existence that can be touched and felt are tangible assets. They are used primarily in the operation of the business to produce products or services. Since tangible assets are often purchased, they are much more easily valued than intangible assets.

Tangible assets can be accounted for as either long-term or current assets depending on their estimated life. These types of assets include buildings, automobiles, physical inventory, furniture and machines. They depreciate in value over time.

INTANGIBLE ASSETS

Intangible assets do not have a physical character. Yet, they are essential to the continued operation of a business. These types of assets can have either a definite or indefinite life depending on the type of asset. Examples of intangible assets include goodwill, intellectual property (patents, copyrights and trademarks), brand names, customer relationships, contracts and non-compete agreements. Intangible assets have the ability to appreciate in value.

Patents have a definite life because they come with an expiration date. Brand names have an indefinite life because they can last for the entire life of the company.

Some economists feel that intangible assets are much more valuable than tangible assets especially as we continue to transition from a "financially-based" to a "knowledge-based" economy.

A **patent** is the right to manufacture, sell or use a particular product or process exclusively for a limited period of time.

A **trademark** or **trade name** is the right to use exclusively a name, or symbol, to identify the business.

A **copyright** is the right to reproduce or sell an artistic or published work.

A **franchise** is the right to operate a business under the trade name of the franchisor.

Goodwill is an intangible asset equal to the excess that one company pays to acquire the net assets of another company.

Recording intangible assets:

Like all other assets, intangible assets are recorded at their acquisition costs. However, what is included as an acquisition cost can vary given the type of intangible asset and how it is acquired. In general, if an intangible asset is acquired through an external transaction, its cost is the purchase price.

- A common example of an intangible that is created through an external transaction is¬ goodwill.
- Goodwill is created when one company buys another company and pays more than the value of the net assets of the purchased company.

Goodwill is an intangible asset equal to the excess that one company pays to acquire the net assets of another company. Goodwill created internally by a company cannot be recorded as an asset because its cost cannot be reliably determined.

LEASE

Lease: A lease is an agreement whereby the Lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

Finance lease: IAS 17 defines a finance lease as a lease that 'transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.'

Finance leases are also sometimes referred to as capital or financial leases. A lease that is not a finance lease is an operating lease.

Operating lease: Indeed, IAS 17 defines an operating lease as 'a lease other than a finance lease'. An operating lease does not transfer substantially all the risks and rewards incidental to ownership of the asset to the lessee.

1. Financial Lease

Financial leasing is a contract involving payment over a longer period. It is a long-term lease and the lessee will be paying much more than the cost of the property or equipment to the lessor in the form of lease charges. It is irrevocable. In this type of leasing the lessee has to bear all costs and the lessor does not render any service.

2. Operating Lease

In an operating lease, the lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice. In this type of leasing

- lessor bears all expenses
- lessor will not be able to realize the full cost of the asset
- specialized services are provided by the lessor.

This kind of lease is preferred where the equipment is likely to suffer obsolescence.

3. Leveraged and non-leveraged leases

In leveraged and non-leveraged leases, the value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So, the lessor involves one more financier who will have charge over the leased asset.

4. Conveyance type lease

In Conveyance type lease, the lease will be for a long-period with a clear intention of conveying the ownership of title on the lessee.

5. Sale and leaseback

In a sale and leaseback, a company owning the asset sells it to the lessor. The lessor pays immediately for the asset but leases the asset to the seller. Thus, the seller of the asset becomes the lessee. The asset remains with the seller who is a lessee but the ownership is with the lessor who is the buyer. This arrangement is done so that the selling company obtains finance for running the business along with the asset.

6. Full and non pay-out lease

A full pay-out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay-out lease, the lessor leases out the same asset over and over again.

7. Specialized service lease

The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only leases out but also gives specialized personal service to the lessee. Examples are electronic goods, automobiles, air-conditioners, etc.

8. Net and non-net lease

In non-net lease, the lessor is in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with the above maintenance expenditure. The lessor confines only to financial service.

9. Sales aid lease

In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

10. Cross border lease

Lease across national frontiers are called cross border lease, Shipping, air service, etc., will come under this category.

11. Tax oriented lease

Where the lease is not a loan on security but qualifies as a lease, it will be considered a tax oriented lease.

12. Import Lease

In an Import lease, the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

13. International lease

Here, the parties to the lease transactions may belong to different countries which is almost similar to cross border lease.

REVENUE

Revenues or revenue in business is the gross income received by an entity from its normal business activities before any expenses have been deducted. Income may be received as cash or cash equivalent and is typically generated from the sale of goods or the rendering of services for a particular period of time.

Revenue – Expenses = Net Profit

Types of 'revenue' in accounting

Business revenue is gross income generated from the normal/ordinary activities for a given corporation, company, partnership, or sole-trader.

Sale of goods - Businesses such as manufacturers, wholesalers and retailers, most revenue is generated from the sale of goods.

Providing services - Service businesses on the other hand that don't sell goods such as accounting firms, doctors and hairdressers generate most of their revenue from providing (rendering) services.

Lending fees and investments - Financial services businesses such as car rentals and banks receive most of their revenue from fees and interest generated by lending assets to other organizations or individuals or even royalties earned from the use of intellectual property. Investment firms may receive revenue from dividends paid to them by other companies based on their shareholdings.

Other - Non-profit organizations will generate revenue that includes donations from individuals and corporations, support from governments, income from fundraising activities or membership dues. Other income in for-profit businesses could be the profit on the sale of assets.

INCOME TAX

There are two types of taxes in India – direct and indirect.

A direct tax is a tax you pay on your income directly to the government. Indirect tax is a tax that restaurants, theatres and e-commerce websites charge you on for goods or a service. This tax is, in turn, passed down to the government. Indirect taxes take many forms: service tax on restaurant bills and movie tickets, value added tax or VAT on goods such as clothes and electronics.

Goods and services tax, which is scheduled to roll out in July 2017, is going to be a unified tax that will replace all the indirect taxes that business owners have to deal with.

Income tax is type of direct tax levied by a government on businesses. Income tax due in a period is calculated by applying the applicable tax percentage to the taxable income of the business.

Taxable income is the net income calculated in accordance with the tax laws. Taxable income = taxable revenues – tax-deductible expenses – tax exemptions

RETAINED EARNINGS

Retained earnings represent the cumulative total of all net income that has been reinvested into the company. Many companies retain some of their annual profit to fund the expansion (replacement) of assets to reduce their reliance on outside capital markets. The annual addition to retained earnings is equal to:

Retained earnings = Net income - Dividends paid.

Retained earnings on the balance sheet are equal to the prior year's retained earnings balance plus this year's addition to retained earnings.

Financial ratio analysis helps a business in a number of ways. The importance and advantages of financial ratios are given below:

(i) Ratios help in analyzing the performance trends over a long period of time.

(ii) They also help a business to compare the financial results to those of competitors.

(iii) Ratios assist the management in decision making.

(iv) They also point out problem and weak areas along with the strength areas.

(v) Ratios to help to develop relationships between different financial statement items.

(vi) Ratios have the advantage of controlling for differences in size. For example, two businesses may be quite different in size but can be compared in terms of profitability, liquidity, etc., by the use of ratios.

The Advantages of Financial Ratios

Financial ratios are tools used to assess the relative strength of companies by performing simple calculations on items on income statements, balance sheets and cash flow statements. Ratios measure companies operational efficiency, liquidity, stability and profitability, giving investors more relevant information than raw financial data. Investors and analysts can gain profitable advantages in the stock market by using the widely popular, and arguably indispensable, technique of ratio analysis.

Comparison

Financial ratios provide a standardized method with which to compare companies and industries. Using ratios puts all companies on a relatively equal playing field in the eyes of analysts; companies are judged on their performance rather than their size, sales volume or market share. Comparing the raw financial data of two companies in the same industry offers only limited insight. Ratios go beyond the numbers to reveal how good a company is at making a profit, funding the business, growing through sales rather than debt and a wide range of other factors. An older company, for example, might boast 50 times the revenue of a new small business, which would make the older company seem stronger at first glance. Analyzing the two companies with ratios such as return on equity (ROE), return on assets (ROA) and net profit margin may reveal that the smaller company operates much more efficiently, generating substantially more profit per dollar of assets employed.

Industry Analysis

Ratios can reveal trends in particular industries, creating benchmarks against which the performance of all industry players can be measured. Small businesses can use industry benchmarks to craft organizational strategy and clearly measure their own performance against the industry as a whole. As an example, analysis may reveal that the average debt-to-equity ratio in the widget industry is .85; a company with a debt-to-equity ratio of 1.3 would be much more heavily leveraged than other widget manufacturers, even though its total debt may be vastly smaller than larger players

Stock Valuation

The common language and understanding of ratios helps investors and analysts to evaluate and communicate the strengths and weaknesses of individual companies or industries. Fundamental analysis is the term given to the use of financial ratios in determining the relative strength of companies for investing purposes. A careful analysis of a company ratios can reveal which companies have the fundamental strength to increase their stock value over time potentially profitable opportunity while pointing out the weaker players in the market as well.

Planning and Performance

Ratios can provide guidance to entrepreneurs when creating business plans or preparing presentations for lenders and investors. Using industry trends as a baseline, small-business owners can set time-bound performance goals in terms of specific ratios to give investors a glimpse into the potential of the new company. Ratios can also serve as an impetus for strategic change within an organization, providing management with relevant guidance and feedback as ratio valuations shift in response to organizational changes. Ratios keep managers on their toes by revealing financial weaknesses and opportunities.

POSSIBLE QUESTIONS

Part - B

1. What do you mean by ‘Income Tax’?
2. State the meaning of Leases.
3. Define Inventory.
4. Describe about Intangible Assets.

Part - C

5. State the meaning of following terms i) Retained earnings ii) Income Tax and iii) Inventories.
6. Give details on various inflows and outflows of cash.
7. Define Inventory. Why proper inventory valuation is important?
8. Define the term Intangible Assets. Also discuss its characteristics.