



FINANCIAL ACCOUNTING FOR MANAGEMENT

An Analytical Perspective

FIFTH EDITION

AMBRISH GUPTA

Senior Professor
Finance and Accounts
FORE School of Management
New Delhi

PEARSON

Delhi • Chennai

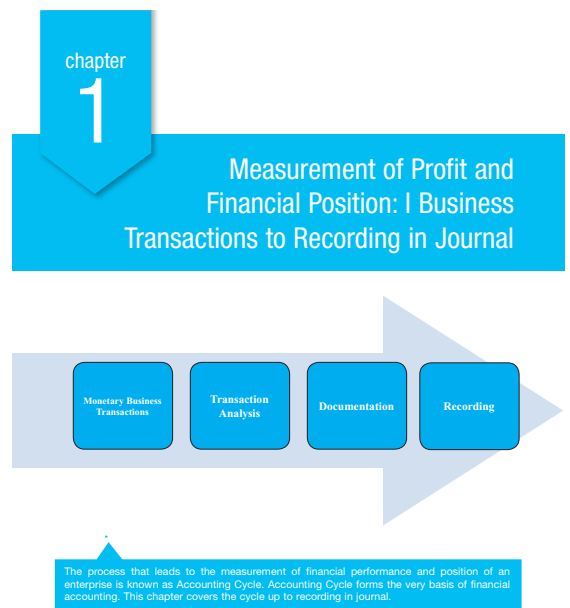
CONTENTS

Outstanding Pedagogical Features xxvii
*List of Companies Whose Cases and Financial Practices/Information Have
 Been Incorporated in This Book* xxxv
Preface to the Fifth Edition xxxvii
Preface xli
About the Author xlv

PART 1: THE FOUNDATION

Chapter 1 Measurement of Profit and Financial Position: I Business Transactions to Recording in Journal 2

Introduction	3
India—The Place of Origin of Modern Accounting	4
The Anatomy of Business	5
Assets	5
Liabilities	6
Financial Position	7
Income	7
Expenses	7
Financial Performance	7
The Accounting Process	8
Analysis, Documentation and Recording of Business Transactions	9
Analysis	9
Wonderland of Debit and Credit	10
Dual Aspect Concept	12
Accrual Concept/Mercantile System of Accounting	14
Documentation: Voucher	17
Recording: Journal	17
Application of the Fundamental Accounting Concepts	22
A. Dual Aspect Concept	22
B. Business Entity Concept	22
C. Accrual Concept	22
Application of Other Fundamental Accounting Concepts	26
Cost Concept	26
Business Entity Concept Further Illustrated	26
Concluding Remarks	27
<i>Keywords</i>	27
<i>References</i>	27
<i>Exercises</i>	28



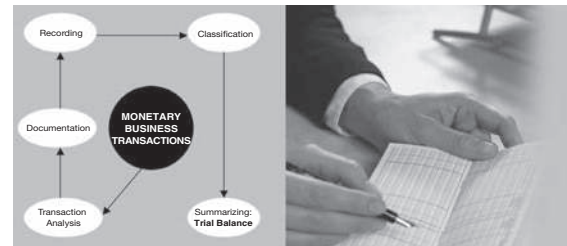
Chapter 2 Measurement of Profit and Financial Position: II Journal to Trial Balance

Introduction	32
Classifying Business Transactions	33
Summarising Business Transactions	36
Application of Other Fundamental Accounting Concepts	43
Realisation Concept	43
Money Measurement Concept	43
Further Illustration of Some Fundamental Accounting Concepts	47
Note on Computerized Accounting System	53
Alternative Presentation of Ledger Using Tally	54
Concluding Remarks	55
<i>Keywords</i>	55
<i>Exercises, Cases</i>	55

chapter

2

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

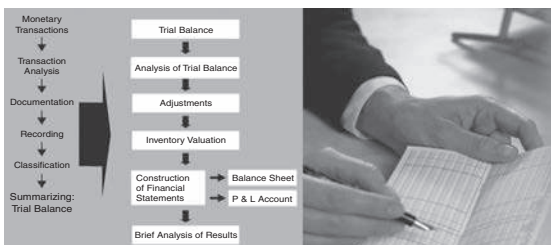


The process that leads to the measurement of financial performance and position of an enterprise is known as Accounting Cycle. Accounting Cycle forms the very basis of financial accounting. This chapter covers the cycle up to trial balance.

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

3

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



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

Introduction	59
Measurement of Business Income and Financial Position	60
Trial Balance to Balance Sheet and Profit and Loss Account	60
Analysis of Trial Balance	61
Need for Adjustments	61
Inventory Valuation	62
Construction of Balance Sheet and Profit and Loss Account	63
General Instructions and Observations for Preparing the Two Financial Statements	64
Brief Analysis of the Financial Statements of Bharat Scientific Products Enterprise	65
Recap of Fundamental Accounting Concepts	67
Recap of Adjustments	70
Concluding Remarks	70
<i>Keywords</i>	71
<i>Exercises, Cases</i>	71

Chapter 4 Measurement of Profit and Financial Position: IV Corporate Entities

Introduction 76

Basic Features of the Company form of Business 78

 Organization 78

 Registration Under the Companies Act 79

 Types of Companies 80

 Preliminary Expenses 80

 Board of Directors 80

Financial Statements of Companies 80

 Share Capital 81

 Public Issue Expenses 83

 Accounting Treatment of Share Capital 83

 Form of Financial Statements 98

 Some Features of Financial Statements 99

 Issue of Shares at a Premium 106

 Bonus Shares 107

 Recap of Adjustments 117

 Concluding Remarks 118

Keywords 118

References 119

Exercises 120

75

4

Measurement of Profit and Financial Position: IV Corporate Entities

	2015-16	2016-17	2017-18	2018-19	2019-20
1. SEGMENT REVENUE:					
(i) Sale of Petroleum Products	8819.51	7258.52	29855.58	24326.35	30489.04
(ii) Sale of Petrochemicals	2316.37	864.78	3147.04	3298.84	3147.04
(iii) Other Business Activities	8108.39	5448.18	29189.81	24212.82	16722.86
Sub-total	19224.27	13671.48	62192.43	51838.01	50358.94
Less: Inter-segment Revenue	1572.23	415.58	3895.28	1717.48	985.34
TOTAL REVENUE	17652.04	13255.90	58297.15	50120.53	49373.60
2. SEGMENT RESULTS:					
(i) Profit Before Tax, Interest Income, Interest expense and Dividend from each segment	4831.88	7486.23	11524.82	13846.80	13987.89
(ii) Sale of Petroleum Products	(187.33)	78.77	(1706.22)	458.26	(1738.22)

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

5

Vertical Financial Statements of Corporate Entities

SHASHAANK INDUSTRIES LTD.		
BALANCE SHEET AS AT 31-03-20CV		
	Note No.	Amount (₹)
EQUITY AND LIABILITIES		
Shareholders' Funds		
Share capital	1	14,85,000
Reserves and surplus	2	1,22,570
Sub-total.....		16,07,570
Non-current Liabilities		
Long-term borrowings	3	5,85,000
Other Long-term liabilities		—
Long-term provisions		—
Sub-total.....		5,85,000
Current Liabilities		
Short-term borrowings		9,85,250
Trade payables		6,45,540
Other current liabilities		1,15,761
Short-term provisions		2,46,143
Sub-total.....		19,92,694
TOTAL.....		41,85,264

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

Chapter 5 Vertical Financial Statements of Corporate Entities 128

Introduction 129

Vertical Form of Financial Statements 129

Key Distinctive Features of the New Format 131

Process of Construction of Financial Statements in the New Form 132

Vertical Financial Statements of Shashaank Industries Ltd. 133

Merits and Demerits of Vertical Format 138

Treatment of 'Miscellaneous Expenditure Not W/O' and 'Debit Balance of Statement of Profit and Loss' 139

Treatment of Tax Expenses 139

Concluding Remarks 139

Keywords 140

References 140

Exercises 140

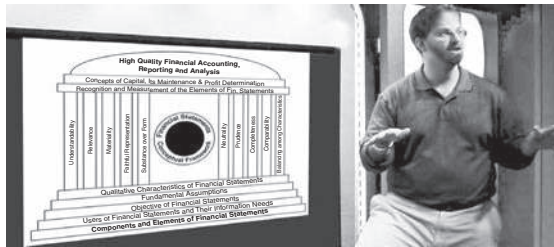
Chapter 6 Specific Day Books	141
Introduction	142
Specific Daybooks/Journals	142
Purchase Book/Purchase Day Book/Purchase Journal	142
Sales Book/Sales Day Book/Sales Journal	146
Cash Book/Cash Day Book/Cash Journal	149
Concluding Remarks	156
Keywords	157
Exercises	157

PART 2: CONCEPTS AND PRINCIPLES

Chapter 7 Conceptual Framework of Financial Statements	162
Introduction	163
Purpose of the Framework	164

7

Conceptual Framework of Financial Statements



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

Scope and Coverage	164
Components of Financial Statements	165
Research in Financial Reporting	165
Objective of Financial Statements	167
Users and Their Information Needs	168
Assumptions Underlying Preparation of Financial Statements	170
Qualitative Characteristics of Financial Statements	171
Constraints on Qualitative Characteristics	173
True and Fair View	173
Definitions, Characteristics, Recognition and Measurement of the Elements of Financial Statements	174
Concepts of Capital and Capital Maintenance	174
Concluding Remarks	174
Keywords	175
References	175
Exercises	176

6

Specific Day Books

An example of the SALES Day Book (page 26)

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

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

Chapter 8 Generally Accepted Accounting Principles	177
Introduction	178
Sources of GAAPs	178
Conceptual Framework of Financial Statements	178
Accounting Concepts and Principles Other than Those Covered by the Framework	179
Requirements of the Companies Act	179
Vertical Financial Statements of Nestle India Ltd.	182
Accounting Standards Formulated by ICAI	182
Convergence with International Financial Reporting Standards (IFRSs)	184
Requirements of SEBI	185
Requirements of Income Tax Act	186
ICAI's Standard on Accounting Policies: The Mother Standard	187
AS-5: Net Profit or Loss for the Period, Prior Period and Changes in Accounting Policies	187
Research in Financial Reporting	188
Concluding Remarks	190
<i>Keywords</i>	190
<i>References</i>	190
<i>Exercises</i>	191

8

Generally Accepted Accounting Principles



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

PART 3: ASSET VALUATION

9

Valuation of Tangible Fixed Assets



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

Chapter 9 Valuation of Tangible Fixed Assets	194
Introduction	195
Valuation of Fixed Assets	195
Meaning, Identification and Significance of Fixed Assets	195
Research in Financial Reporting	196
Scope and Coverage	198
Principles and Norms of Standard Accounting Treatment	198
Determinants of Value of Fixed Assets	198
Valuation of Fixed Assets in Special Cases	201
Identification of Certain Specific Fixed Assets	203
Revaluation of Fixed Assets	204
Retirements and Disposals	205
Disclosures in Financial Statements	205
Impact of Government Grants and Borrowing	206
Costs on Fixed Assets Valuation	206
Accounting for Government Grants	206
Borrowing Costs	209

Corporate Financial Practices	213
Valuation of Wasting, Non-Regenerative, Assets	215
Corporate Financial Practices	215
Concluding Remarks	217
<i>Keywords</i>	217
<i>References</i>	217
<i>Exercises, Cases</i>	218

Chapter 10 Depreciation on Fixed Assets 222

Introduction	223
Depreciation Accounting	223
Meaning and Significance of Depreciation	224
Research in Financial Reporting	224
Scope and Coverage	225
Principles and Norms of Standard Accounting	
Treatment	225
Determinants of Depreciation	226
Methods of Depreciation	226
Statutory Requirements and Compliance	231
Book Profit and Taxable Profit	234
<i>MAT and Deferred Tax</i>	235
Consistency Principle: Change in Method	235
Depreciation Charge in Special Cases	237
Revaluation of Fixed Assets and Depreciation	237
Profit/Loss on Disposal of Fixed Assets	240
Disclosures in Financial Statements	241

10

Depreciation on Fixed Assets



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

11

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



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

Corporate Financial Practices	241
Depletion of Wasting, Non-regenerative, Assets	243
Corporate Financial Practices	243
Concluding Remarks	244
<i>Keywords</i>	244
<i>References</i>	244
<i>Exercises, Cases</i>	245

Chapter 11 Valuation of Assets under Finance Lease and Intangible Assets, Amortization and Asset Impairment 248

Introduction	249
Assets Under Finance Lease	249
Meaning of Lease and Finance Lease	249
Substance over Form	250
Principles and Norms of Standard Accounting	
Treatment	250
Disclosures in Financial Statements	255
Corporate Financial Practices	256

Position Under the Income Tax Act	258
Intangible Assets and Their Amortisation	259
Goodwill	259
Meaning and Significance of Intangible Assets	259
Principles and Norms of Standard Accounting Treatment	262
Rates of Depreciation as Per Appendix I—Rule 5 of the Income Tax Rules	267
Disclosures in Financial Statements	267
Corporate Financial Practices	268
Impairment of Assets	270
Meaning and Significance	270
Principles and Norms of Standard Accounting Treatment	271
Disclosures in Financial Statements	274
Corporate Financial Practices	275
Concluding Remarks	277
<i>Keywords</i>	277
<i>References</i>	277
<i>Exercises, Cases</i>	278
Chapter 12 Valuation of Inventories	280
Introduction	281
Valuation of Inventories	281
Meaning and Significance of Inventories	282
Research in Financial Reporting	283
Scope and Coverage	285
Construction Contracts	285
Service Providers	285
Shares etc. held as Stock-in-Trade	286
Livestock and Agricultural etc. Products	286
Principles and Norms of Standard	
Accounting Treatment	286
Valuation Policy	286
Cost of Inventories	286
Cost Formulas	289
Illustrations on the Methods of Valuation	291
FIFO	291
LIFO	293
WAC	293
Impact of the Three Methods of Valuation on COGs,	
Gross Profit and Net Profit: A Comparison	294
Impact on COGS and Gross Profit	294
Impact on Net Profit	294
Techniques for the Measurement of Cost	295
Net Realisable Value	296
NRV and ITS Impact on Valuation of Inventory,	
COGs, Gross Profit and Net Profit	298

12

Valuation of Inventories



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

Disclosures in Financial Statements	300
Corporate Financial Practices	300
Concluding Remarks	302
<i>Keywords</i>	302
<i>References</i>	303
<i>Exercises, Cases</i>	304
Chapter 13 Valuation of Investments	308
Introduction	309
Valuation of Investments	310
Meaning and Significance of Investments	310
Research in Financial Reporting	310
Scope and Coverage	313
Forms of Investments and Establishment of their Market Values	314
Active Market or Absence Thereof	314
Principles and Norms of Standard Accounting Treatment	314
Classification of Investments	314
Cost of Investments	315
Valuation/Carrying Amount of Investments in the Balance Sheet	318
Reclassification of Investments	320
Determination of Cost of Investments in Cases of Rights Issue	321
Disposal of Investments	323
Shares and Other Securities held as Stock-in-Trade	324
Disclosures in Financial Statements	324
Investments in Subsidiary/Associate Companies	325
Corporate Financial Practices	325
Investments in Jointly Controlled Entities	329
Corporate Financial Practices	330
Concluding Remarks	333
<i>Keywords</i>	333
<i>References</i>	333
<i>Exercises, Cases</i>	334

13

Valuation of Investments



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

PART 4: UNDERSTANDING THE ANNUAL REPORT

Chapter 14 Corporate Financial Statements of Nestle India Ltd Along With Notes to Accounts and Significant Accounting Policies

340

Introduction	341
Brief Profile of Nestle India Ltd.	342
Financial Statements of Nestle India Ltd.	343
Balance Sheet	344
Statement of Profit and Loss	345
Features of the Financial Statements	346
Understanding the Inter-Linkage of the Financial Statements	346
Understanding the Various Accounts of Balance Sheet and Notes Thereto	347
Shareholders' Funds	347
Current Liabilities	352
Non-current Assets	354
Current Assets	359
Understanding the Various Accounts of the Statement of Profit and Loss and Notes Thereto	363
Revenue from Operations	363
Cost of Materials Consumed	364
Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade	365
Employee Benefits Expense	365
Depreciation	366
Impairment loss on Fixed Assets	367
Profit from Operations	368
Other Income	368
Finance Costs	369
Employee Benefit Expense Due to Passage of Time	369
Net Provision for Contingencies (Others)	370
Profit before Corporate Social Responsibility Expenses, Exceptional Items and Taxation	370
Corporate Social Responsibility Expenses	371
Exceptional Items	371
Profit before Taxation	371
Tax Expense	371
Profit after Taxation	372
Earnings per Share	372
A Brief on Deferred Tax Assets and Liabilities	372
Purpose Served by AS-22	374
Concluding Remarks	374

14

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

NESTLE INDIA LIMITED				
Balance Sheet as on December 31, 2014				
Notes	2014 (₹ in Millions)	2013 (₹ in Millions)	2012 (₹ in Millions)	2011 (₹ in Millions)
EQUITY AND LIABILITIES				
SHAREHOLDERS' FUNDS				
Share capital	1	964.2	964.2	964.2
Reserves and surplus	2	27,407.9	28,379.1	22,723.3
				23,687.5
NON-CURRENT LIABILITIES				
Long-term borrowings	3	164.6	11,894.6	
Deferred tax liabilities (net)	4	2,227.2	2,154.7	
Long-term provisions	5	13,888.6	16,260.4	25,983.4
CURRENT LIABILITIES				
Short-term borrowings	6	41.1	0.1	
Trade payables	7	7,287.1	6,330.4	
Other current liabilities	8	4,085.7	5,002.5	
Short-term provisions	9	2,130.6	2,138.8	13,471.8
Total		58,195.0	58,195.0	63,142.7
ASSETS				
NON-CURRENT ASSETS				
Fixed assets	10			
Tangible assets		31,766.4	33,693.1	
Intangible assets		2,447.8	2,947.3	
Capital work-in-progress		54,214.0	36,640.2	

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

<i>Keywords</i>		374
<i>References</i>		375
<i>Exercises, Cases</i>		375
Appendix		377
Employee Stock Option Plans		377
Chapter 15 Other Mandatory Financial Reports		389
Introduction	390	
Auditors' Report	391	
Requirements of the Companies Act	391	
Companies (Auditors' Report) Order, 2003 or CARO	392	
Corporate Financial Practices	396	
Review of the Auditors' Report of Nestlé	399	
Directors' Report	400	
Requirements of the Companies Act	400	
Corporate Financial Practices	401	
Review of the Directors' Report of Nestlé	402	
Corporate Governance Report	402	
Objective and Importance of Corporate Governance	402	
Suggested List of Items for Corporate Governance Report	403	
Non-mandatory Requirements	405	
Review of Nestlé's Report on Corporate Governance	405	
Management Discussion and Analysis Report	405	
Report and Its Contents	405	
Significance of MD&A	406	
Review of Nestlé's MD&A Report	406	
Report on Corporate Social Responsibility (CSR) Activities	407	
Requirements of the Companies Act, 2013	407	
Review of Nestlé's Report on CSR Activities	408	
Concluding Remarks	409	
<i>Keywords</i>		409
<i>References</i>		410
<i>Exercises, Cases</i>		410

15

Other Mandatory Financial Reports



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

PART 5: FINANCIAL STATEMENT ANALYSIS

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

Introduction 415
 Quality of Earnings 415
 Limitations of Financial Statements 416
 Leverage Provided by GAAPs 416
 Window Dressing 417
 Creative Accounting/Creative Financial Practices 417
 Non-provision of Diminution in the Value of Long-term Investments 417
 Changes in Accounting Policies 419
 Extending the Accounting Year 421
 Non-provisioning of Expenses and Doubtful/Disputed Debts 421
 Contingent Liabilities Not Provided for Impact of Other Income and Exceptional/Extraordinary Items 422
 Some More Cases 425
 Beating Window Dressing 426
 Further Care in Analysis 426
 Regulatory Efforts in Ensuring Quality of Earnings 427
 ICAI Awards for Excellence in Financial Reporting 427

16

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



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

17

Financial Statement Analysis and the Tool Kit of the Analyst: I Multi-step, Horizontal, Vertical and Trend Analyses and Analytical Balance Sheet

Background 427
 Objective 428
 Categories of the Awards 428
 Awards to be Distributed 428
 Important Factors for Selection of Awardees 428
 Award Winners 430
 Concluding Remarks 431
 Keywords 431
 References 431
 Exercises, Cases 432

Chapter 17 Financial Statement Analysis and the Tool Kit of the Analyst: I Multi-step, Horizontal, Vertical and Trend Analyses and Analytical Balance Sheet 436

Introduction 437
 Objectives of Analysis 437
 Various Stakeholders and Their Interests 438
 Tool Kit of the Financial Analyst 438

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

Particulars	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-2001	2001-2002
RESULTS FOR THE YEAR								
Sales & Other Income	3041.07	4470.50	5398.03	6689.78	7067.54	7812.33	8520.00	7352.16
Index	1.00	1.47	1.78	2.20	2.32	2.50	2.80	2.42
Profit before Depreciation & Tax	890.25	1019.22	1038.72	1126.84	1270.35	1713.95	1482.77	1083.07
Index	1.00	1.14	1.17	1.27	1.43	1.94	1.66	1.22
Profit before Tax	892.49	862.13	892.30	971.48	1040.43	896.73	955.35	786.27
Index	1.00	1.07	1.07	1.18	1.26	1.24	1.20	0.98
Profit after Tax	627.56	744.02	731.20	756.46	897.97	740.73	698.19	620.36
Index	1.00	1.19	1.17	1.21	1.34	1.18	0.94	0.99
Equity Dividend (total outlay)	-	157.68	258.01	254.01	278.85	380.25	228.15	253.50

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

Tools and Techniques	439
Multi-step Statement of Profit and Loss	439
The Tool	439
Format of Multi-step Statement of Profit and Loss	439
Analysis of Multi-step Income Statement of Bajaj Auto Ltd.	444
Horizontal Analysis	444
The Tool	444
Horizontal Analysis of Bajaj Auto Ltd.	448
Balance Sheet	449
Overall Assessment	449
Common-sized Analysis	450
The Tool	450
Comparative Common-sized Analysis of Bajaj Auto Ltd. and TVS Motor Company Ltd.	456
Statement of Profit and Loss	456
Balance Sheet	457
Overall Assessment	458
Trend Analysis	459
The Tool	459
Trend Analysis of Liberty	459
Quantitative Details	462
Position at The Year End	462
Overall Assessment	462
Analytical Balance Sheet	462
The Tool	462
Review of Analytical Balance Sheet of Shopper's Stop Ltd.	464
Concluding Remarks	464
<i>Keywords</i>	465
<i>References</i>	465
<i>Exercises, Cases</i>	465

Chapter 18 Financial Statement Analysis and the Tool Kit of the Analyst: II Earnings Per Share (EPS) Analysis 476

Introduction	477
Earnings Per Share	477
Significance of EPS	478
Scope and Coverage	478
Principles and Norms of Standard Accounting	
Treatment	479
Presentation of BEPS and DEPS	479
Measurement of BEPS	479
Measurement of DEPS	486
An Illustration Now Follows to Clarify the Above Discussion	487
Restatement of EPS Consequent to Issue of Non-resource Generating Equity Shares After the Balance Sheet Date	493

18

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



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

Per Share Information Other Than BEPS and DEPS Disclosures in Financial Statements	494
Concluding Remarks	495
<i>Keywords</i>	495
<i>References</i>	495
<i>Exercises, Cases</i>	496
Chapter 19 Financial Statement Analysis and the Tool Kit of the Analyst: III Ratio Analysis	498
Introduction	499
Ratio Analysis	499
Classification of Ratios	500
Structure of Discussion of Ratios	500
Background Note on Innovative Approach towards Deriving Various Ratios	501
Return on Investment (ROI) Ratios	504
ROI Ratios of Grasim Industries Ltd.	508
Solvency Ratios	509
Solvency Ratios of Grasim Industries Ltd.	512
Liquidity Ratios	514
Liquidity Ratios of Grasim Industries Ltd.	518
Resources' Efficiency or Turnover Ratios	520
Resources Efficiency Ratios of Grasim Industries Ltd.	522
Profitability/Profit Margin Ratios	523
Multi-step Profit Margin(s) to Net Revenue from Operations Ratios of Grasim Industries Ltd.	524
Ratios of Individual 'Other Expenses' to Net Revenue from Operations (%) of Grasim Industries Ltd.	527
Ratios of Other Income (non-operating), Exceptional/Extra-ordinary Items and Effective Tax Rate to PBT of Grasim Industries Ltd.	530
DU Pont Analysis	530
DU Pont Analysis of Grasim Industries Ltd.	532
Valuation or Capital Market Ratios	533
Valuation Ratios of Grasim Industries Ltd.	536
Overall Ratio Analysis of Grasim Industries Ltd.	538
Industry Benchmarking	539
Analysis of Grasim vis-à-vis industry	539
Core Ratios	540
Concluding Remarks	541
<i>Keywords</i>	541
<i>References</i>	542
<i>Exercises, Cases</i>	542

19

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

GRASIM INDUSTRIES LTD.
ROI RATIOS

Ratio	Formula	2011-12		2010-11		Comparison 2011-12/2010-11	
		₹ crores	Result- %	₹ crores	Result- %	Change	Direction of change
1. RONW	N PBT X100	1177.00 x 100	13.86%	1181.71 x 100	15.47%		
D	Net Worth:-						
	Equity	91.72		91.71			
	Plus: Reserves and surplus	8,524.85		7,847.85			
2. EPS	N PAT	1,177.00	128.39	1,181.71	128.87	-0.40%	Down
D	Wtd. Av. No. of Eq. Shares O/S-Crores	9.17		9.17			
3. CEPS	N PAT	1,177.00	144.08	1,108.71	148.09	-2.30%	Down
D	Plus: Non cash changes	144.20		176.29			
	Wtd. Av. No. of Eq. Shares O/S-Crores	9.17		9.17			

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

Chapter 20 Construction and Analysis of Corporate Cash Flow Statement 548

Introduction	549
Features of Cash Flow Statement Nestle	552
Reporting Cash Flow Statement	553
Meaning and Significance of Cash Flow Statement	553
Scope and Coverage	554
Principles and Norms of Standard	554
Accounting Treatment	554
Cash and Cash Equivalents and Accounting Policy on Their Composition	554
Basis for Classification of Activities	555
Operating Activities	555
Investing Activities	556
Financing Activities	557
Methods of Reporting Cash Flows	557
Issues Requiring Special Considerations	559
Non-cash Investing and Financing Transactions	560
Restricted Cash and Cash Equivalents	561
Additional Information	561
Disclosures in Cash Flow Statement	561

Construction of Cash Flow Statement from Abridged

Balance Sheet When No Additional Information is Provided:

Indirect Method

562

Construction of Cash Flow Statement from The Abridged Balance Sheet When More Notes and Additional Information is Provided: Indirect Method

575

Analysis of Cash Flow Statements

593

Concluding Remarks

594

Keywords

594

References

594

Exercises, Cases

595

21

Model for Strategic and Integrated Managerial Financial Analysis of Annual Report



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

20

Construction and Analysis of Corporate Cash Flow Statement

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

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

Chapter 21 Model for Strategic and Integrated Managerial Financial Analysis of Annual Report 606

Introduction	607
Objectives of Strategic and Integrated Analysis	607
Model Framework for Integrated Analysis	608
Detailed Model	608
Concluding Remarks	613
<i>Keywords</i>	613
<i>References</i>	613
<i>Exercises</i>	614

PART 6: MORE ON FINANCIAL REPORTING AND ANALYSIS

Chapter 22 Analysis of Information from Sources Other than Annual Reports and Inter-company Comparison 616

Introduction	617
Significance of Other Sources	617
Details of Other Sources of Financial Information	617
Study of Some Samples	618
Research Report from <i>Capital Market</i>	618
News Items from <i>The Economic Times</i>	620
CFDS Portal: Corporate Filing and Dissemination System	624
Inter-Company Comparative Analysis and Analysis Against Industry Aggregates	625
Concluding Remarks	626
Keywords	627
References	627
Exercises, Cases	628

22

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



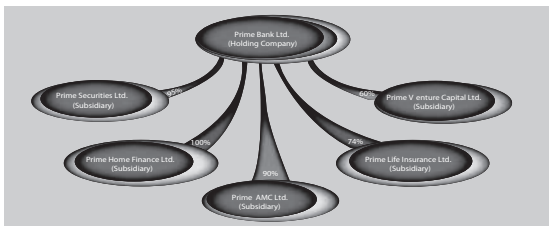
Virtually endless sources of financial information are available outside the published annual report. The continuous availability of financial and business information after its publication is most crucial for an analyst to keep himself updated. These sources fill this gap, that too with accompanied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

Chapter 23 Analysis of Group Performance: Consolidated Financial Reporting 632

Introduction	633
Consolidation of Subsidiaries	634
Consolidated Financial Statements	634
Meaning of Consolidated Financial Statements	634
Significance of Consolidated Financial Statements	635
Scope and Coverage	635
Parent, Subsidiary and Group Control	635
Principles and Norms of Standard Accounting Treatment	636
Global Consolidation	636
The Process of Consolidation	637
Minority Interest as on 31-03-2007	655
Status of the Consolidated Financial Statements	657
Application of Other Accounting Standards	657
Disclosures in Financial Statements	657
Consolidation of Associates	659
Accounting for Investments in Associates in Consolidated Financial Statements	659
Associate and Significant Influence	659

23

Analysis of Group Performance: Consolidated Financial Reporting



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

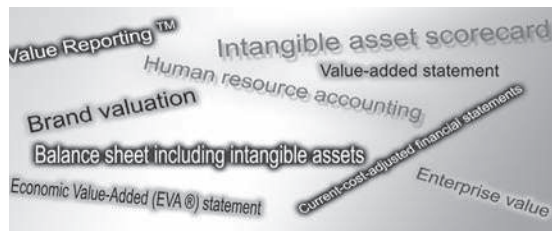
Principles and Norms of Standard Accounting Treatment	659
The Equity Method	660
Further Issues	664
Disclosures in Consolidated Financial Statements	664
Consolidation of Joint Ventures	665
Financial Reporting of Interests in Joint Ventures	665
Types of Joint Ventures	666
Jointly Controlled Operations	666
<i>Nature of the Joint Venture</i>	666
Principles and Norms of Standard Accounting Treatment	666
Jointly Controlled Assets	667
<i>Nature of the Joint Venture</i>	667
Principles and Norms of Standard Accounting Treatment	667
Jointly Controlled Entities	668
<i>Nature of the Joint Venture</i>	668
Principles and Norms of Standard Accounting Treatment	668
Disclosures in Financial Statements	669
Associates and Joint Ventures	673
Analysis of Performance of ICICI Bank Ltd. As a Group	675
Concluding Remarks	676
<i>Keywords</i>	677
<i>References</i>	677
<i>Exercise</i>	678

24 Emerging Dimensions in Voluntary Financial Reporting: Contemporary Analytical Techniques 679

Introduction	680
Need for Voluntary Information	681
Growing Complexity of Financial Statements	681
Emergence of Contemporary Techniques	681
Value Reporting™	682
The Value Reporting™ paradigm	683
The Value Reporting™ Disclosure Model	683
Intangible Assets Score Sheet	684
Intangible Assets	685
Human Resources	685
Intellectual Property Assets	685
Internal Assets	685
External Assets	685
The Score Sheet	685
Analysis (As Per Annual Report)	685
Infosys Intangible Assets Score Sheet	686
Human Resources Valuation	688
Value-added Statement	689
Brand Valuation	691

24

Emerging Dimensions in Voluntary Financial Reporting: Contemporary Analytical Techniques



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

The Strength of the Invisible	691
Valuing the Brand	691
Methodology	691
Brand Valuation	692
Balance Sheet (Including Intangible Assets)	693
Current-cost-adjusted Financial Statements	694
Balance Sheet	694
Profit and Loss Account	695
Economic Value-added (EVA [®]) Statement	697
Economic Value-added Analysis	697
Concluding Remarks	699
<i>Keywords</i>	699
<i>References</i>	699
<i>Exercises</i>	700

Appendix 1 Present Value of An Annuity of Rupee 1 Paid at The Year End	702
---	------------

Appendix 2 Present Value Factor of A Lump Sum (PVF) of Re 1	703
--	------------

<i>Index</i>	679
--------------	------------

APPENDICES

APPENDIX 1: PRESENT VALUE OF AN ANNUITY OF RUPEE 1 PAID AT THE YEAR END
APPENDIX 2: PRESENT VALUE FACTOR OF A LUMP SUM (PVF) OF RE 1