

1. Meaning & Concept of Depreciation

Definition

- Derived from Latin: “**De**” = decline, “**Pretium**” = price.
- Represents **gradual and permanent decrease** in the value of an asset due to wear and tear, usage, efflux of time, etc.
- As per **Indian Accounting Standard (AS-6)**:
“Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset.”

Key Points

- Expense related to the consumption of economic benefits of an asset.
 - Mandatory for true and fair reporting of financial statements.
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2. Methods of Charging Depreciation

2.1 Straight Line Method (SLM)

- Fixed/Equal Installment Method.
- Same amount of depreciation every year.
- Based on estimated useful life.

2.2 Reducing / Diminishing Balance Method (WDV Method)

- A fixed percentage applied each year on **written-down value**.
- Depreciation amount reduces year after year.

2.3 Double Diminishing Balance Method

- Accelerated depreciation.
- Double the SLM rate is used on written-down values.

2.4 Sum-of-the-Years-Digits (SYD) Method

- Higher depreciation in early years, lower in later years.
- Suitable when productivity reduces with time.

2.5 Machine Hour Rate Method

- Based on actual **machine hours used**.

- Asset cost is allocated proportionate to usage.
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3. Depreciation Under Income Tax Act

3.1 Meaning

- A deduction allowed for reduction in real value of tangible or intangible assets.
- Primarily follows **WDV method**, except for power-generation undertakings.

3.2 Block of Assets

Depreciation is charged on a **block**, which includes:

- **Tangible assets:** Building, machinery, plant, furniture
- **Intangible assets:** Patents, copyrights, trademarks, licenses, etc.

3.3 Conditions for Claiming Depreciation

- Asset must be **owned** (wholly or partly).
- Must be **used for business**.
- If used partly for non-business → depreciation allowed proportionately.
- Depreciation **mandatory** from AY 2002–03.

3.4 Important 180-Day Rule

- Asset used for **<180 days** → only **50%** of eligible depreciation.
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4. Additional Depreciation (Section 32(1)(iia))

Eligibility

- Allowed on **new plant & machinery** (not second-hand).
- Assessee must be engaged in **manufacturing/production**.
- Rate: **20% of actual cost** (or **35%** for specified backward areas).

Special Rule

- If asset used **<180 days** → only **50%** of additional depreciation allowed in that year; the remaining 50% allowed next year.

Cases Where Not Allowed

- Second-hand machinery
- Office appliances, road vehicles

- Machinery in residential/guest-house premises
 - Assets already fully allowed as expense
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5. Unabsorbed Depreciation

Key Rules

- Can be **carried forward indefinitely**.
 - Can be set off against **any income except Salary and Capital Gains**.
 - Set-off order:
 1. Current depreciation
 2. Brought-forward business losses
 3. Unabsorbed depreciation
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6. Depreciation as per Companies Act, 2013

6.1 Important Principles

- Based on **useful life** as per Schedule II.
- No fixed rates—companies must use prescribed useful lives.
- Must depreciate **95% of cost** (5% residual value).

6.2 Transitional Rules

- Existing assets (as on 01.04.2014) must be depreciated based on **remaining useful life**.
- If useful life already exhausted → WDV minus residual value must be written off.

6.3 Other Key Points

- Method change (SLM ↔ WDV) treated as **change in accounting policy** (AS-5).
 - Higher depreciation rates apply for **double** and **triple shifts**.
 - Assets costing ≤ ₹5000 may be fully depreciated.
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7. Accounting Standard (AS-10): Property, Plant & Equipment

7.1 Key Definitions

- **Carrying Amount:** Cost minus depreciation & impairment.
- **Cost:** Purchase price + directly attributable costs.

- **Depreciable Amount:** Cost minus residual value.
- **Property, Plant & Equipment (PPE):** Tangible assets used >12 months.

7.2 Recognition Criteria

An item is recognized if:

- Future economic benefits will flow, and
- Cost can be measured reliably.

7.3 Measurement After Recognition

Two models:

1. **Cost Model** – Cost less depreciation/impairment
2. **Revaluation Model** – Revalued amount less depreciation/impairment

7.4 Depreciation Rules

- Must reflect **pattern of economic benefit consumption**.
- Review method, useful life, and residual value annually.
- Changes treated as **changes in accounting estimates** (AS-5).

8. Summary of Key Differences

(Included for clarity; not directly from text)

Basis	Companies Act 2013	Income Tax Act
Basis of Depreciation	Useful life	Rates on block of assets
Method Allowed	SLM or WDV	Mostly WDV
Residual Value	Fixed at 5%	No specific rule
Additional Depreciation	Not applicable	Allowed u/s 32(1)(iia)
Shift Allowance	Higher depreciation for extra shifts	Not applicable

SUMMARY — VALUATION OF GOODwill

1. Meaning of Goodwill

Goodwill refers to the **good name, reputation, and customer loyalty** of a business. It represents the ability of a firm to earn **higher profits** compared to other similar firms.

Customers return repeatedly due to:

- Good services
- Quality products
- Positive reputation

Thus, goodwill = **value of reputation that enables a business to earn super profits.**

2. Features of Goodwill

1. Intangible Asset

- Cannot be seen or touched; similar to patents, trademarks.

2. Valuable Asset

- Enhances earning capacity.

3. Source of Excess Profits

4. Value Fluctuates Constantly

- Does not depreciate like fixed assets, but its value rises/falls based on business performance.

5. Can Be Sold Only With Entire Business

- Exception: partner admission/retirement.

6. Difficult to Value Precisely

- Subject to internal & external factors.
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3. Types of Goodwill

I. Purchased Goodwill

Goodwill acquired during purchase of a business.

- Arises when purchase consideration exceeds net assets (Assets – Liabilities)
- Recorded in books as consideration is paid
- Shown as an asset
- Amortised

- Value depends on agreement between buyer & seller
- Cannot be sold separately

II. Self-generated (Inherent) Goodwill

Internally created over time by business reputation.

- Not purchased; arises from business performance
 - Cannot determine true cost
 - Not recorded in books (as per AS-26)
 - Value is subjective
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4. Factors Affecting Value of Goodwill

1. **Efficient Management** → Higher profits
 2. **Quality Products** → Repeat customers
 3. **Prime Location** → Attracts higher sales
 4. **Longevity of Business** → Strong customer base
 5. **Monopoly / Special Rights**
 - Patents, trademarks, concessions
 6. **Other Factors**
 - Good industrial relations
 - Favourable regulations
 - Stable political conditions
 - R&D efforts
 - Effective advertising
 - Brand popularity
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5. Need for Valuation of Goodwill

Required when **mutual rights of partners change** and compensation is needed.

Situations include:

- Change in profit-sharing ratio
- Admission of a partner

- Retirement or death of a partner
 - Amalgamation of firms
 - Sale of partnership firm
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6. Methods of Valuation of Goodwill

Three major methods:

- A. Average Profit Method
 - B. Super Profit Method
 - C. Capitalisation Method
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A. Average Profit Method

Goodwill = **Average Profits × Number of Years of Purchase**

Calculation of Average Profits

Average Profits =

Total Profits / Number of Years

Adjustments Before Calculating Average Profits

- Deduct abnormal income
- Add abnormal losses
- Deduct investment income (not earned from business)

Weighted Average Profit Method

Used when profits show a rising or falling trend.

- Assign weights to each year (highest weight → most recent year)
- Weighted Average Profit =

$$\frac{\sum(Profits \times Weights)}{\sum Weights}$$

Goodwill = **Weighted Average Profit × Number of Years of Purchase**

This method is preferred because it reflects future earning potential more accurately.

B. Super Profit Method

Goodwill = Super Profit × Number of Years of Purchase

Where:

Super Profit = Average Profit – Normal Profit

Normal Profit = Capital Employed × Normal Rate of Return

Capital Employed =

- **Capital + Free Reserves – Fictitious Assets**
OR
- **Total Assets – (Goodwill, Fictitious Assets, Non-trade Investments) – Outsider Liabilities**

A business has goodwill only if it earns **more than normal profits**.

C. Capitalisation Method

Goodwill can be computed using either:

a. Capitalisation of Average Profits

1. Calculate **Capitalised Value of Average Profits**:

$$\text{Capitalised Value} = \frac{\text{Average Profits}}{\text{Normal Rate of Return}} \times 100$$

2. Goodwill = **Capitalised Value – Capital Employed**

If capital employed \geq capitalised value → **No goodwill**.

b. Capitalisation of Super Profits

$$\text{Goodwill} = \frac{\text{Super Profits}}{\text{Normal Rate of Return}} \times 100$$

This method directly capitalises the super profits to estimate the goodwill.

SUMMARY — VALUATION OF INVENTORY (PRICING OF MATERIAL ISSUES)

1. Meaning of Inventory Valuation / Pricing of Material Issues

Materials purchased are stored and issued to different jobs/work orders.

Pricing of material issues means determining the **price at which materials are charged** to various jobs.

Since purchase prices may vary over time, a method must be selected to value:

- Issues (material consumed)
- Closing stock

Choice of method depends on:

1. Nature of business
 2. Frequency of purchases
 3. Durability of stock
 4. Inventory turnover
 5. Price fluctuations
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2. Methods of Pricing Material Issues

The document explains **four major methods**:

2.1 FIFO (First In First Out) Method

Concept

- Materials purchased **first** are issued **first**.
- Issues priced at **oldest cost**.
- Closing stock valued at **latest cost**.

Advantages

- Simple & logical
- Reflects chronological flow of goods
- Closing stock shown at recent prices
- Prevents deterioration of old stock

Disadvantages

- Complex when frequent purchases occur at varying prices
- Issue price may not reflect current market price
- Costs appear high during falling prices
- Hard to compare job costs when prices vary

Illustration

Page 5 provides a **complete FIFO Stores Ledger**, showing:

- Issues priced in order of earliest receipts
- Closing balance valued at most recent prices

(Image on page 5 displays the detailed FIFO ledger with quantities, rates, and balances.)

2.2 LIFO (Last In First Out) Method

Concept

- Materials purchased **last** are issued **first**.
- Issues priced at **latest cost**.
- Closing stock valued at **oldest cost**.

Advantages

- Simple to apply
- Matches current cost with current revenue
- Shows realistic profit during rising prices
- Reduces taxable income in inflationary periods

Disadvantages

- Closing stock valued at outdated prices
- Not suitable for perishable items
- Difficult when price fluctuations are frequent
- Job cost comparisons become unreliable

Illustration

The **LIFO ledger on page 6** clearly shows:

- Issues taken from latest batches
- Closing stock representing earliest purchases

2.3 Simple Average Method

Concept

Issues are priced at **average of rates** of materials in stock:

$$\text{Rate of Issue} = \frac{\text{Total of Different Rates}}{\text{Number of Rates}}$$

- Lots already exhausted (as per FIFO logic) are not considered.

Advantages

- Easy to compute
- Works when prices are stable

Disadvantages

- Does not reflect actual cost
- Quantity differences ignored
- Closing stock verification becomes difficult
- Incorrect results when price differences are large

Illustration

The **Simple Average Ledger on page 7** shows:

- Issue prices computed using simple averages
 - Tables and values are visually shown in the image for clarity
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2.4 Weighted Average Method

Concept

Prices are averaged **based on quantities**, giving more accurate results.

$$\text{Rate of Issue} = \frac{\text{Value of Material in Stock}}{\text{Quantity in Stock}}$$

- Weighted average recalculated **after each new receipt**.

Advantages

- Smooths price fluctuations
- Logical and accepted for closing stock
- Easy to operate in stable systems

Disadvantages

- Issue price may not represent actual cost
- More clerical work required
- Not linked to current market price

Illustration

The **Weighted Average Ledger (page 7 image)** shows:

- Changes in weighted average rate with every incoming batch
 - Accurate valuation of issues and balances
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3. Illustrations Provided in the Notes

Illustration 1 (Pages 4–7)

Based on multiple receipts & issues in April.

Store Ledgers prepared under:

- FIFO
- LIFO
- Simple Average
- Weighted Average

Images show detailed tables with quantities, rates, balances.

Illustration 2 (Pages 8–10)

Includes:

- Opening stock
- Stock loss
- Return to stores (with different issue price)

Stores ledgers prepared for:

- FIFO
- LIFO

(Tables clearly depicted in images on pages 9–10.)

Illustration 3 (Pages 10–12)

Receipts and issues for a month with varying prices.

Ledgers prepared under:

- **Simple Average Method**
- **Weighted Average Method**

Notes include formulas for calculating average prices, with workings shown in the tables.

4. Key Takeaways

Method	Issue Price Based On	Closing Stock Based On	Best Used When
FIFO	Oldest cost	Latest cost	When prices fall, perishable goods
LIFO	Latest cost	Oldest cost	When prices rise, to match cost–revenue
Simple Average	Simple average of rates	Not indicative of actual cost	Stable prices
Weighted Average	Quantity-based average	Weighted average	Frequent price changes

1. Introduction: Why Funds Flow Statement is Needed

A **Balance Sheet** provides only a **static view** of financial position on a specific date. It **does not show movement of funds** between two periods.

To analyze:

- Changes in **assets, liabilities, and equity**
- **Sources** from where funds were obtained
- **Uses** where funds were applied

an additional statement is required → **Funds Flow Statement**
(also called **Statement of Sources and Uses of Funds**).

2. Meaning & Concepts of Funds

The term **funds** may mean:

(a) Narrow Sense

Only **cash inflows and outflows**.

(b) Broad Sense

Refers to **all monetary values** in any form.

(c) Popular Sense

Funds = **Working Capital** (Current Assets – Current Liabilities)

Under this interpretation, **Funds Flow = change in Working Capital**.

3. Significance / Importance of Funds Flow Statement

(As summarised on *page 2* and supported by table visuals)

1. **Analysis of financial operations**
Shows net effect of transactions on financial position.
2. **Helps in designing financial policies**
(Dividend, reserve creation, capital planning)
3. **Acts as a control tool**
Highlights inefficiencies and mismanagement.
4. **Evaluates financing pattern**
Shows whether funds were raised wisely and used efficiently.

5. **Assists in future planning**
Guides in forecasting funding needs.
 6. **Shows effectiveness of working capital usage**
 7. **Reveals financial soundness**
Useful for banks, creditors, and financial institutions.
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4. Structure of Funds Flow Statement

As shown in the **table on page 2**, the statement has two parts:

A. Sources of Funds

- Funds from Operations
- Issue of Shares/Debentures/Bonds
- Borrowings from Banks/Institutions
- Sale of Fixed Assets/Investments
- Decrease in Working Capital
- Refund from Income Tax

B. Application of Funds

- Purchase of Fixed Assets/Investments
 - Redemption of Shares/Debentures/Bonds
 - Repayment of Bank Loan
 - Payment of Income Tax
 - Dividends paid
 - Increase in Working Capital
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5. Statement of Change in Working Capital

Formula:

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

Rules (as shown in the table on *page 2*):

Change	Effect on Working Capital
Increase in Current Asset	Increase
Decrease in Current Asset	Decrease
Increase in Current Liability	Decrease
Decrease in Current Liability	Increase

List of Current Assets (page 3)

- Inventory
- Debtors
- Bills Receivable
- Cash & Bank
- Prepaid Expenses
- Accrued Income
- Preliminary Expenses
- Goodwill

List of Current Liabilities (page 3)

- Creditors
 - Bills Payable
 - Outstanding Expenses
 - Advance Income
 - Income Tax
 - Proposed Dividend
-

6. Adjusted Profit & Loss Account

This P&L account determines **Funds from Operations**.

Format shown on *page 3*:

Debit Side

- Loss on sale of fixed assets
- Goodwill written off
- Preliminary expenses written off
- Depreciation
- Income tax paid
- Proposed & interim dividends
- Premium on redemption
- Transfer to reserves

Credit Side

- Opening balance of P&L
 - Profit on sale of assets/investments
 - Discount on issue of shares/debentures
 - **Balancing Figure → Funds from Operation**
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7. Notes on Treatment of Key Items

These sections clarify **whether adjustments appear in Working Capital Statement, Adjusted P&L, or Funds Flow Statement**.

7.1 Provision for Tax & Proposed Dividend

Based on pages 4–6, treatment depends on where they appear:

Case 1: Appears only in Balance Sheet as Current Liability

→ Treat under **Statement of Change in Working Capital**

Case 2: Appears only as Non-Current Liability

→ Include in:

- **Adjusted P&L (current year)**
- **Funds Flow Statement (previous year)**

Case 3: Appears in both Problem + Adjustment

- Open separate accounts (illustrated on *pages 6–7*, including T-formats).
- Use for Funds Flow & Adjusted P&L.
- **Not included in Working Capital Statement.**

Case 4: Appears only in Adjustments

→ Record in:

- Adjusted P&L (Dr.)
- Application of Funds (FFS)

7.2 Treatment of Preliminary Expenses & Goodwill (Page 5)

If Current Year > Previous Year

- Increase → **Use of Funds (Working Capital decrease)**
- Shown in **Working Capital Statement**

If Current Year < Previous Year

- Decrease → **Write-off**
- Shown in **Adjusted P&L (Dr.)**

8. Plant & Machinery Adjustments

Several detailed examples appear on *pages 7–10*, including T-accounts and diagrams.

Case A: Sale at a Loss (Page 7)

Important entries:

- Sale proceeds → **Source of Funds**
- Purchase of new plant → **Application of Funds**
- Depreciation, Loss → **Adjusted P&L (Dr.)**

Case B: Sale at a Profit (Page 8)

- Profit → **Adjusted P&L (Cr.)**
- Sale → Source; Purchase → Application

Case C: When Written Down Value (WDV) is Given (Pages 9–10)

- Use WDV instead of original cost
- Compute profit/loss accordingly
- Include depreciation on opening balance

Tables clearly show how balances are carried forward.

9. Redemption of Debentures and Shares (Page 11)

If debentures are redeemed at premium

- Redemption amount (including premium) → **Application of Funds**
- Premium → **Adjusted P&L (Dr.)**

If preference shares increase

→ Treated as **Issue of Shares (Source of Funds)**

Illustration on page 11 shows:

- Debentures: 10,00,000 → 8,00,000
- Preference Shares: 3,00,000 → 5,00,000

10. Investment & General Reserve Adjustments (Page 11–12)

Scenario: Profit on Sale of Investment transferred to General Reserve

Two accounts are prepared:

- **Investment A/c**
- **General Reserve A/c**

Rules:

- Sale proceeds → **Source of Funds**

- Profit → **Transferred to General Reserve**
- Difference in Reserve → **Adjusted P&L** (if no adjustment given)

The tables on pages 11–12 show full T-account detail.

11. Summary of Key Effects

Transaction	Adjusted P&L	Working Capital	Funds Flow
Profit on sale of asset	Credit	–	Source
Loss on sale of asset	Debit	–	–
Purchase of fixed asset	–	–	Application
Issue of shares	–	–	Source
Redemption of shares/debentures	–	–	Application
Increase in CA	–	Increase	–
Increase in CL	–	Decrease	–

SUMMARY — CASH FLOW STATEMENT (AS-3 Revised / Ind AS 7)

1. Meaning of Cash Flow Statement

A **Cash Flow Statement** shows the **changes in cash and cash equivalents** between two balance sheet dates.

As per **AS-3 (Revised)** and **Ind AS 7**, companies must prepare a cash flow statement each period.

Definitions

- **Cash** → cash in hand + demand deposits with banks.
- **Cash Equivalents** → short-term, highly liquid investments readily convertible into cash.
- **Cash Flows** → inflows & outflows of cash/cash equivalents.

2. Classification of Cash Flows

According to **AS-3 (Revised)** (page 1), cash flows are classified into:

A. Operating Activities

Principal revenue-generating activities of the business.

Cash flows include:

- Cash received from customers
- Cash paid to suppliers/employees
- Cash generated to:
 - maintain operating capability
 - pay dividends
 - repay loans
 - make investments

Indicator of financial health — if a company can sustain operations without external finance.

B. Investing Activities

Acquisition & disposal of **long-term assets** and **investments**.

Examples:

- Purchase of machinery (outflow)
- Sale of machinery or investment (inflow)

Significance: Shows how much the company is investing to generate future growth.

C. Financing Activities

Changes in **shareholders' equity** and **borrowings**.

Examples:

- Issue of shares/debentures (inflow)
- Redemption of shares/debentures (outflow)
- Interest/dividend payments

Significance: Helps predict claims on future cash flows.

3. Need / Importance of Cash Flow Statement

(Discussed on *page 2*)

1. Shows **changes in cash balance** between two periods.
 2. Helps evaluate ability to meet obligations: creditors, bank loans, interest, tax, dividends.
 3. Reveals reasons for **low liquidity despite high profits** or **high liquidity despite losses**.
 4. Helps management control future cash flows.
 5. Shows relation between profitability and liquidity.
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4. Adjustment Accounts Used in Cash Flow Statement

Sections on pages **2–7** repeat the treatment of items also used in Funds Flow, because many adjustments (depreciation, sale of assets, dividends, tax) affect cash flows.

Key Items:

- Provision for tax
- Proposed dividend
- Preliminary expenses & goodwill
- Plant & machinery adjustments
- Redemption of debentures
- Sale of investments

Each item may appear:

- only in the balance sheet
- only in adjustments
- in both (requiring separate ledger accounts)

The notes provide **T-format accounts** (e.g., on pages 4–7), showing how these affect:

- Adjusted P&L
- Cash Flow Statement
- Working Capital (if relevant)

These images show step-by-step adjustments (e.g., for tax paid, dividend paid).

5. Treatment of Provision for Tax & Proposed Dividend

Based on pages **3–5**:

Case 1: Appears as Current Liability only

→ Include in **Statement of Working Capital** (affects operating activities indirectly).

Case 2: Appears as Non-current Liability only

→

- CY value → **Adjusted P&L (Dr.)**
- PY value → **Application of Funds / Cash Flow**

Case 3: Appears in both Problem & Adjustments

→

- Open **separate ledger accounts** (illustrated clearly on page 5).
- Include in **Adjusted P&L** and **Cash Flow Statement**.
- Not included in Working Capital.

Case 4: Appears only in adjustments

→ Record as actual cash outflows.

6. Preliminary Expenses & Goodwill (Page 3)

- If these **increase** → treated as **increase in current assets** → used in working capital changes.
 - If these **decrease** → written off → shown in **Adjusted P&L (Dr.)** → added back in operating activities (non-cash).
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7. Plant & Machinery Adjustments

(Important illustrations on **pages 5–8**)

These include adjustments for:

- Loss on sale
- Profit on sale
- Depreciation
- Written Down Value (WDV)

Each example provides:

- A **proper Plant & Machinery Account** (T-format)
- Allocation into:
 - **Adjusted P&L**
 - **Cash Flow Statement** (Source/Application)

General Rules:

- **Depreciation** → non-cash → added back to Profit before Tax.
 - **Sale proceeds** → investing inflow.
 - **Purchase of new asset** → investing outflow.
 - **Profit/Loss on sale** → adjusted in P&L (profit deducted, loss added back).
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8. Redemption of Debentures & Preference Shares (Page 8)

Example:

- Debentures reduced from 10,00,000 → 8,00,000
- Redeemed at **10% premium**

Treatment:

- Redemption amount + premium → **Financing Outflow**
- Premium → **Adjusted P&L (Dr.)**

Issue of preference shares → **Financing Inflow**

9. Investment & General Reserve Adjustments (Pages 8–9)

If profit on sale of investment is transferred to general reserve:

- Sale proceeds → Investing inflow
- Profit → Added to Reserve; shown in **Adjusted P&L**

Separate **Investment A/c** and **General Reserve A/c** are shown in the images.

10. Format of Cash Flow Statement

(Page 10 image shows the complete template)

A. Cash Flow from Operating Activities

Start with:

1 Net profit after tax & appropriations

Add back:

- Transfer to reserves
- Proposed dividend
- Provision for tax
- Depreciation
- Loss on asset sale
- Preliminary expenses written off
- Premium on redemption
- Interest on debt

Then adjust for **Working Capital Changes**:

- Increase in stock → reduce
- Increase in debtors → reduce
- Increase in creditors → increase
- Increase in bills payable → increase

Less:

- **Income tax paid**

Result → **Net Cash from Operating Activities**

B. Cash Flow from Investing Activities

- Purchase of fixed assets → Outflow
- Sale of machinery → Inflow
- Sale of investments → Inflow

Net result → Cash from / used in Investing Activities

C. Cash Flow from Financing Activities

- Issue of shares → Inflow
- Redemption of debentures (incl. premium) → Outflow
- Interest paid → Outflow
- Dividend paid → Outflow

Net result → Cash from / used in Financing Activities

SUMMARY — COMPARATIVE, COMMON SIZE, TREND & DUPONT ANALYSIS

1. Comparative Analysis

Meaning

A **horizontal analysis** that compares financial statements **across different years** by showing:

- Current year figures
- Previous year figures
- Absolute change
- Percentage change

Features (Page 1)

- Shows **previous results side-by-side**
- Compares **current year vs. base year**
- Useful for **inter-firm & intra-firm comparison**
- Helps in **internal decision making**
- Can be expressed in **percentages and pictorial form**

Limitation

- Does **not show relative importance** of items in the statement.

Examples

Pages **2–9** show several **Comparative Balance Sheets** for:

- Sun Ltd.
- Radha Ltd.

- Blue Bell Ltd.
- Wye Ltd.
- Royal Industries Ltd.

Each example includes:

- Absolute change
- Percentage change
- Comments on financial position
- Tables neatly shown in images (page references: 3, 4, 5, 7, 8).

2. Common Size Analysis

Meaning

A **vertical analysis** that expresses each item as a **percentage of a base item**.

Features (Page 1)

- Compares **figures of the same year**
- Expressed **only in percentages**
- Used mainly for **inter-firm comparison**
- Shows **relative importance** of each figure
- Helps stakeholders analyse structure of financial statements

Common Bases

- For **Income Statement** → Revenue from Operations = 100%
- For **Balance Sheet** → Total Assets/Total Equity & Liabilities = 100%

Examples

Common Size Statements provided for:

- Profit & Loss (Star Ltd.) — page 10
- Income Statement (2018 example) — page 11
- Profit & Loss (Year I & II) — page 12
- Balance Sheet comparison (Sun Ltd. vs. Star Ltd.) — page 12–13

Images show:

- Percentage columns
- Comparative interpretation

Commentary Example (Page 13)

- Star Ltd. has higher share capital proportion.
 - Sun Ltd. retains more reserves.
 - Star Ltd. invests more in fixed assets.
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3. Trend Analysis

Meaning

Evaluates financial data over **multiple periods** (months, quarters, years).

Purpose

- Detect patterns in growth or decline
- Helps forecast future performance
- Measures **amount & percentage change** over time

Steps

1. Select base year
2. Express each year's item as:

$$\text{Trend Percentage} = \frac{\text{Current Year Value}}{\text{Base Year Value}} \times 100$$

Application

Useful for:

- Sales trend
- Cost trend
- Profit trend
- Balance sheet growth trend

(Theoretical coverage only in this file.)

4. DuPont Analysis

Meaning

Developed by **DuPont Corporation (1920)**, it breaks **Return on Equity (ROE)** into **three components**, helping identify **strengths and weaknesses** in profitability, efficiency, and leverage.

Formula

$$ROE = \text{Net Profit Margin} \times \text{Total Asset Turnover} \times \text{Equity Multiplier}$$

Components (Pages 1–2)

A. Net Profit Margin

Measures profitability.

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Total Sales}}$$

Higher margin → better cost control & strong pricing strategy.

B. Total Asset Turnover

Measures efficiency of asset usage.

$$\text{Asset Turnover} = \frac{\text{Total Sales}}{\text{Total Assets}}$$

Higher ratio → better use of assets to generate sales.

C. Equity Multiplier

Measures financial leverage.

$$\text{Equity Multiplier} = \frac{\text{Total Assets}}{\text{Common Equity}}$$

Higher multiplier → more debt financing.
Should be optimum (not excessive).

Purpose of DuPont Analysis

- Identifies **drivers of ROE**
- Helps focus on areas where performance is draining ROE
- Provides deeper insight into:
 - Profitability

- Efficiency
 - Leverage
-

5. Illustrations Included in the Notes

The document contains **9 solved problems**, summarised below:

Problems 1–5

Preparation of **Comparative Balance Sheets**:

- Sun Ltd.
 - Radha Ltd.
 - Blue Bell Ltd.
 - Wye Ltd. (Includes comments)
 - Royal Industries Ltd.
- (These appear between pages 2–9 with detailed tables.)

Problems 6–8

Preparation of **Common Size Income Statements**:

- For 2014–15 & 2015–16
 - For 2018
 - For Year I & Year II
- (Shown on pages 10–12.)

Problem 9

Preparation of **Common Size Balance Sheet** for:

- Sun Ltd. & Star Ltd.
Includes a **commentary** comparing their:
- Capital structure
- Reserves utilisation
- Asset allocation

(Shown on pages 12–13.)

6. Key Differences at a Glance

Method	Type	Purpose	Basis	Useful For
Comparative	Horizontal	Compare changes across years	Absolute & % changes	Trend evaluation
Common Size	Vertical	Show relative proportion of each item	% of base (Sales/Total Assets)	Inter-company comparison
Trend Analysis	Multi-year	Identify long-term patterns	Base year = 100	Forecasting
DuPont	Analytical Model	Break down ROE	$NPM \times TAT \times EM$	Performance diagnostics

SUMMARY — DISCLOSURE OF ACCOUNTING STANDARDS

1. Importance of Disclosure Standards

Financial statements show the **financial position and performance** of an organisation. However, **profits and financial results can vary significantly** depending on the **accounting policies adopted**.

Thus, it is essential to **disclose significant accounting policies** so that users of financial statements can:

- Understand the basis of preparation
- Compare statements across organisations
- Make better decisions

In India, companies now commonly disclose accounting policies in:

- A separate section in annual reports
- Notes to financial statements

However, **there is inconsistency** in how disclosures are made across companies.

2. Fundamental Accounting Assumptions

These assumptions are generally **not disclosed** unless **not followed**:

1. Going Concern

Business will continue operations in the foreseeable future.
No intention to liquidate or reduce scale.

2. Consistency

Same accounting policies followed from one period to another.

3. Accrual

Revenues and expenses are recognised **when earned or incurred**, not when cash is exchanged.

3. Nature of Accounting Policies

Accounting policies include:

- Accounting principles
- Methods used to apply the principles

There is **no single mandatory list** of accounting policies because organisations operate in different environments.

Management must exercise **judgment**.

Efforts by ICAI and regulatory bodies have **reduced alternatives**, especially for corporates, but total elimination is unlikely.

4. Areas Where Different Accounting Policies May Be Followed

Examples (not exhaustive):

- Methods of depreciation, depletion, amortisation
- Treatment of expenditure during construction
- Foreign currency conversion
- Valuation of inventories
- Treatment of goodwill
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long-term contracts
- Valuation of fixed assets
- Treatment of contingent liabilities

(Page 2)

5. Considerations for Selecting Accounting Policies

Policies should result in **true and fair** financial statements.

Key considerations:

1. Prudence

- Do not anticipate profits
- Provide for all known liabilities and losses

- Recognise profits only when earned

2. Substance Over Form

Reflect **economic reality**, not just legal form.

3. Materiality

Financial statements must disclose all **material items** that influence decisions.

6. Disclosure of Accounting Policies

Key requirements:

- All **significant accounting policies** must be disclosed.
 - Disclosures should ideally appear **in one place**.
 - Any **changes** in accounting policies must be disclosed.
 - Impact of such changes should be stated.
 - If impact cannot be quantified → disclose the fact.
 - Disclosure cannot justify **incorrect accounting treatment**.
-

7. International Financial Reporting Standards (IFRS)

Definition

Global accounting standards issued by **IASB** to ensure:

- Consistency
- Transparency
- Comparability

IFRS is used in **167 jurisdictions** including EU.

US uses **GAAP**, not IFRS.

IFRS vs GAAP

- IFRS allows **earlier revenue recognition**.
- IFRS may **capitalise development expenses**, whereas GAAP treats many as expenses.
- Balance sheet structure differs.
- SEC currently does not mandate IFRS for US companies.

IFRS Core Components (Page 5)

- **Statement of Financial Position** (Balance Sheet)
- **Statement of Comprehensive Income** (P&L + Other Income)
- **Statement of Changes in Equity**
- **Statement of Cash Flows**

8. Audit Report

An audit report is a critical output of the audit process.

Importance

- Used by investors, lenders, customers, etc.
- Auditor must remain **objective and unbiased**.
- Mistakes can mislead stakeholders.

Tax audit threshold update

- ₹1 crore → ₹5 crore (AY 2021–22 onwards)
 - Condition: **Cash receipts ≤ 5% & cash payments ≤ 5%**
-

9. Errors in Auditing

Errors are **unintentional mistakes**.

1. Clerical Errors

(Page 6)

A. Errors of Commission

Wrong posting, wrong totals, wrong computation.
Often affect trial balance.

B. Errors of Omission

- **Complete omission** → does NOT affect trial balance
- **Partial omission** → affects trial balance

C. Compensating Errors

Two or more errors cancel each other out; hard to detect.

2. Errors of Principle

Fundamental accounting principles violated.
Example: treating capital expenditure as revenue.
Trial balance does **not** reveal this error.

3. Errors of Duplication

Recording and posting the same transaction twice.
Trial balance remains correct.

10. Types of Frauds

Fraud = **intentional act** to deceive.

Two main categories (Page 8):

A. Misappropriation of Assets

Common among employees.

1. Misappropriation of Cash

Ways:

- Suppressing receipts
- Recording lesser amounts
- Recording fictitious payments
- Fictitious purchases

Auditor checks:

Cash book, receipts, vouchers, registers, invoices, etc.

2. Misappropriation of Goods

Often occurs when goods are high value & small size.

Prevented through:

- Proper stock records
 - Regular stock-taking & inspection
-

B. Falsification or Manipulation of Accounts

Also called **management fraud**.

Methods include:

- Inflating/deflating income or expenses
- Incorrect depreciation
- Incorrect valuation of stock
- Misclassification of expenditure
- Suppressing or inflating sales/purchases

Two major forms:

1. Window Dressing

Showing a **better position** than reality.

Objectives:

- Attract investors
- Obtain loans
- Increase share price
- Earn higher commission

2. Secret Reserves

Showing a **worse position** than reality.

Objectives:

- Reduce tax liability
- Hide true profitability
- Lower share price to buy back cheaply

Detecting such fraud is difficult because:

- Often committed by top management
- Internal controls may be overridden

Auditors must be **vigilant and conduct detailed inquiries**.

SUMMARY — CAPITAL & REVENUE EXPENDITURE (BASIC NOTES + ADDITIONAL NOTES)

1. Capital Expenditure

Meaning

Capital Expenditure (CapEx) is an expenditure whose **benefit lasts for more than one accounting year**.

It results in:

- **Increase in quantity** of fixed assets
- **Increase in quality** of assets
- **Replacement / major improvement** of fixed assets
- **Increasing earning capacity** or reducing operating cost

Important Points (Page 1, Basic Notes)

An expenditure is **not considered capital** merely because:

- Amount is large
- Paid in lump sum
- Receiver uses it to buy an asset

Examples

- Plant & Machinery, Motor Vehicles
- Trademark, Patent, Goodwill
- Expansion expenditure (e.g., adding seats to theatre)
- Development expenses (mines, plantations)
- Research-related development costs
- Installation charges, experimental expenses

Additional Notes (from extended PDF)

CapEx includes expenditure for:

- Land, building, machinery
- Vehicles for business
- Manufacturing equipment
- Computers, furniture
- Factory expansion, new facilities
- Installation & erection costs

Accounting Treatment

- **Capitalised** → shown as **Asset** in Balance Sheet
 - Depreciated over useful life
 - Not fully charged to current year's P&L
-

2. Revenue Expenditure

Meaning

Expenses incurred for **day-to-day operations** to maintain assets in working condition. Benefits last **only for one accounting period**.

Examples

- Rent, salaries, wages
- Repairs & maintenance
- Oil, fuel, consumables
- Selling & distribution expenses (advertising, commission)
- Depreciation, interest, loss on sale of assets

Additional Notes (from extended PDF)

Revenue Expenditure = Operating Expenses (OPEX), including:

- Utilities, taxes, office overheads
- Business travel
- Research & Development
- Property taxes
- Routine repairs

Accounting Treatment

- Fully charged to **Profit & Loss Account**
 - **Tax-deductible** in same accounting year
-

3. Deferred Revenue Expenditure

Meaning (Page 1)

Large revenue expenditure with **benefit extending 3–5 years**.

Not prudent to charge entire cost in one year.

Examples

- Preliminary expenses
- Heavy advertisement
- Brokerage on issue of shares
- Exceptional repairs
- R&D expenditure
- Special losses

Treatment

- Portion charged to **P&L Account**
 - Remaining shown on **Assets side**
-

4. Differences — Capital Expenditure vs Revenue Expenditure

(Combined from tables in *both* PDFs; see pages 1–2 and page 2 of extended notes.)

Capital Expenditure (CapEx)	Revenue Expenditure (RevEx)
Non-recurring in nature	Recurring in nature
Heavy in amount	Small/moderate amounts
Increases earning capacity	Maintains existing capacity
Results in acquisition/improvement of fixed assets	Incurred in daily operations
Appears in Balance Sheet	Appears in Profit & Loss A/c
Decision by top management	Decision by middle/lower management
Not deductible for income tax	Fully deductible
Financed through long-term funds (loans, capital)	Financed through short-term funds

5. Rules for Identifying Capital Expenditure

(Extended notes Pages 2–4)

1. Spent on **acquiring fixed assets** (land, building, machinery).
 2. Spent on **making an asset usable** (installation, major repairs, renovations).
 3. Spent on **improving or extending** business operations.
 4. Benefit extends over **multiple years**.
 5. Expenditure **increases earning capacity** of an asset.
 6. Costs incurred to **raise capital** (underwriting commission, brokerage) are treated as capital expenditure.
-

6. Rules for Identifying Revenue Expenditure

(Extended notes Pages 4–6)

1. Routine operating expenses
 2. Maintenance of fixed assets (normal repairs)
 3. Consumables (raw materials, stationery)
 4. Costs with **benefit limited to one accounting period**
 5. Expenses needed for generating revenue in current period
-

7. Capital Receipts vs Revenue Receipts

(From basic PDF Page 2 + extended notes Pages 8–9)

Capital Receipts

- Money received from **non-operating activities**, such as:
 - Capital contributed by owners
 - Loans from banks/institutions
 - Sale of fixed assets
- Purpose: Establish, expand, or modernise business
- Not credited to P&L Account
- Shown in **Balance Sheet**
- Usually **non-recurring**

Revenue Receipts

- Received from **business operations**
 - Cash from sales
 - Discount received
 - Commission received
 - Interest on investments
- Credited to **Profit & Loss Account**
- Recurring
- Short-term in nature

Table Summary

Basis	Capital Receipt	Revenue Receipt
Meaning	Income from financing/investing	Income from operating activities
Nature	Non-recurring	Recurring
Term	Long-term	Short-term
Shown in	Balance Sheet	Income Statement
Effect	Affects assets/liabilities	Affects profit
Example	Loan, share capital, sale of fixed asset	Sales revenue, commission, interest

8. Additional Concepts from Extended PDF

Capital Gains (Pages 6–7)

- Increase in value of capital asset when sold at a price > purchase price.
- Two types:
 - **Short-term** (held \leq 1 year)
 - **Long-term** (held > 1 year)
- Capital loss arises when sale price < purchase price.

Revenue (Pages 7–8)

- Money generated from **normal business operations**.
- Appears at the **top line** of income statement.
- Can be classified into:
 - **Operating revenue**
 - **Non-operating revenue**
- Not all receipts are revenue (e.g., advance payments).

Examples:

- Sales, service income, rent income (for real estate), government revenue (taxes, fees), NGO donations.
-

9. Key Benefits

Why Capital Expenditure is Important

- Supports long-term growth
- Enhances productivity

- Improves asset base

Why Revenue Expenditure is Important

- Ensures smooth day-to-day operations
 - Maintains efficiency of existing assets
 - Mandatory to keep business functioning
-