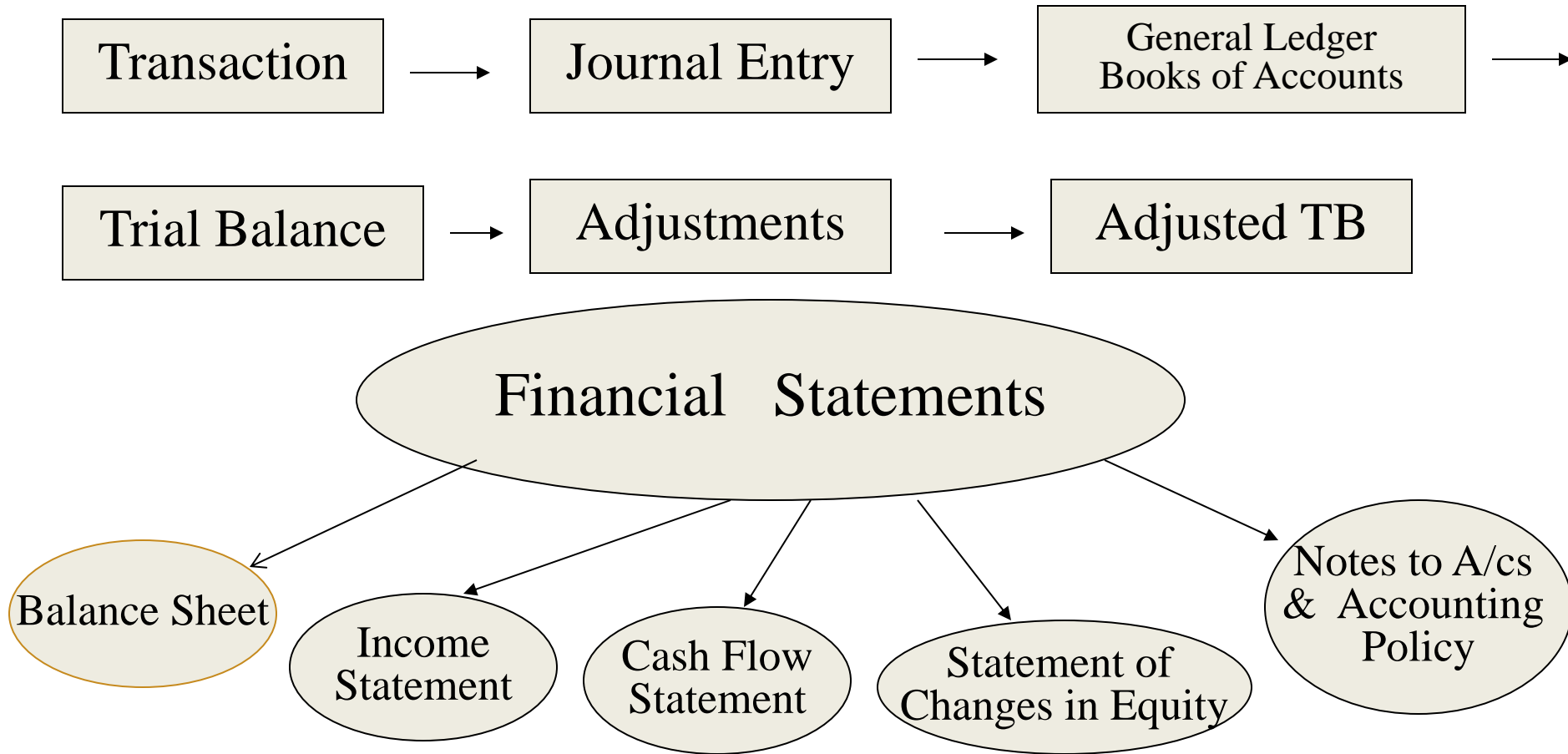


# Accounting Cycle



**Two more** items in the definition of Financial Statements in Section 2(33) of the Companies Act 2017

- **comparative information in respect of the preceding period;**
- **any other statement as may be prescribed**

# Classification of transactions

1. Assets
2. Liabilities
3. Capital
4. Revenue
5. Expenses

Accounting Equation : **Assets** = Capital + Reserves + Liabilities

- the **Assets** represent Resources of a company
- the Liability & Capital side represents Sources of those resource

Rules for Debit and Credit - every transaction has two effect

# FINANCIAL STATEMENTS

- It is a structured financial representation of the:
  - financial position,
  - performance and
  - Changes in financial position of an enterprise.
- **Objective** : is to provide information ....that is useful to a wide range of users in making economic decisions.
- The Board of Directors is **responsible** for preparation and presentation of financial statements. **NOT THE AUDITORS**

# Format of Balance Sheet

Resources	Sources
Intangible Assets	Equity
Goodwill	Capital
Trademark	Reserves
Tangible Assets	(+Profit – Loss)
Land	Liabilities
Building	Long term loans
Machinery	Current Liabilities
Vehicles	Payable to supplies
Computers	Short term financing
Current Assets	Dividend payable
Cash in hand	Taxes payable
Cash at bank	
Debtors	
Stocks in trade	
<b>Total Assets</b>	<b>Liabilities and Equities</b>

# Format of Profit and Loss Account

	Rupees
Sales	xxx
Less: Discounts, rebates, Commission	(xxx)
Net Sales (A)	<b>xxx</b>
Cost of Goods Sold	
Opening Inventory	xxx
Purchases	xxx
Closing Inventory	(xxx)
Cost of Goods Sold (B)	<b>xxx</b>
<b>Gross Profit (C = A – B)</b>	<b>xxx</b>
Less: Marketing Expense (D)	xxx
Administration Expense (E)	xxx
<b>Operating Income (F = C – D – E)</b>	<b>xxx</b>
Less: Financial Charges (G)	xxx
Add: Other Income (H)	xxx
<b>Net Profit (F – G + H)</b>	<b>xxx</b>

# ANALYSIS OF CASH FLOW STATEMENT

Cash inflow and outflow classified into:

- operating,
- investing and
- financing activity

Purpose

- To predict future cash flows
- To evaluate management decisions
- To determine ability to pay interest, dividend, and to creditors.
- To show relationship with net income

Two methods

- Direct
- Indirect

## Case Study

### CASH BALANCES

	Company A	Company B
Opening Balance	500	500
Closing Balance	<u>475</u>	<u>515</u>
Net increase/decrease :	<u>- 25</u>	<u>+15</u>

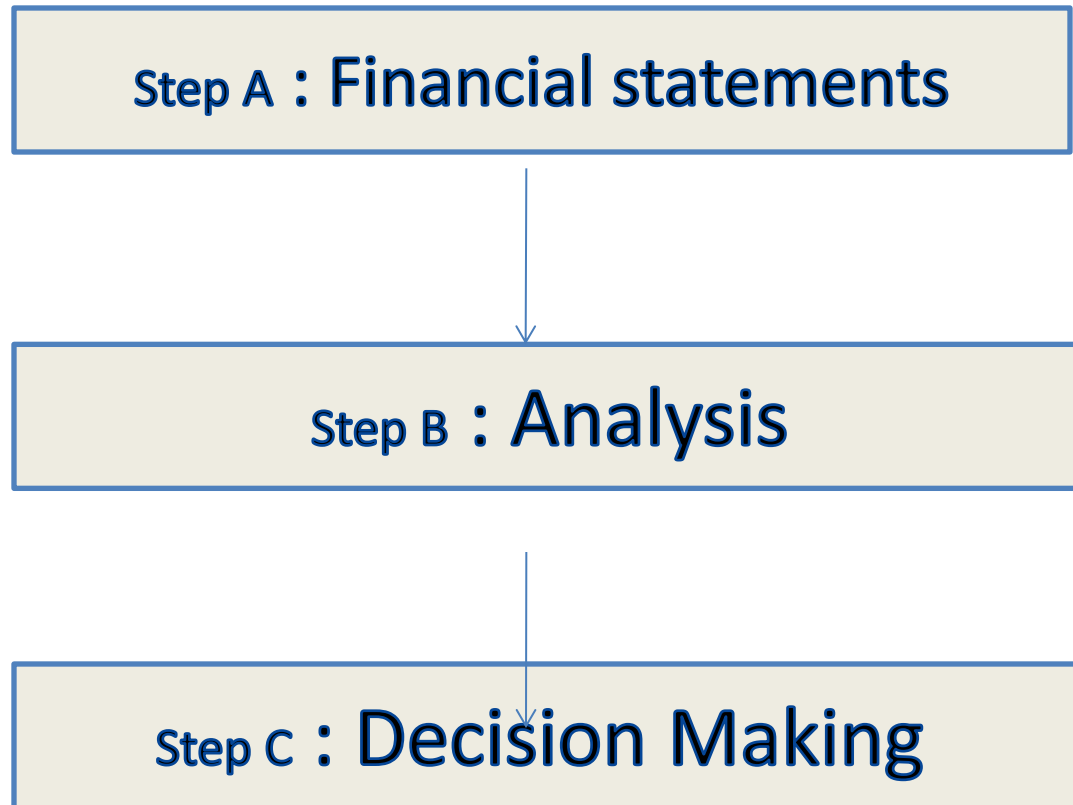
# ANALYSIS OF FINANCIAL STATEMENTS

ANALYSE :

“to examine in detail in order to discover meanings”



# Decision Making - Steps



# Steps

- Read and Understand
- Other Information
  - Within Annual Report
  - Other than Annual Report

# Techniques to analyze

- Horizontal
- Vertical Analysis
- Common-size Financial Statements
- Ratio Analysis

# Financial Ratios

- Liquidity
- Assets Efficiency
- Profitability
- Market ratios
- Capital Structure

# Stakeholders concerned with analysis

- Bankers ----- sanctioning finances
- Creditor ----- Supplying goods at credit
- Investor ----- investing
- Tax authorities--- income is accurately reported

# Vertical Analysis

Vertical analysis is the proportional analysis of a financial statement, where each line item on a financial statement is listed as a percentage of another item.

• Sales	1000	100%
• Cost of Goods Sold	<u>650</u>	<u>65%</u>
• Gross Profit	<u>350</u>	<u>35%</u>
• Administration Exp	100	10%
• Marketing Expenses	150	15%
• Financial Charges	<u>50</u>	<u>5%</u>
	<u>300</u>	<u>30%</u>
• Net Profit	<u>50</u>	<u>5%</u>

# Vertical and Horizontal analysis

## Profit & Loss Account

	Vertical Analysis				Horizontal Analysis	
	Rs	%	Rs	%	increase in	
	2011		2012		Rs	%
Net Sales	32513	100%	48769	100%	16256	50 %
Cost of good sold	19183	59%	28700	61%	9 517	49 %
Gross Profit	13330	41%	20069	39%	6739	50%
Operating Expenses	10558	33%	16541	34%	5983	57%
Interest Expenses	361	1%	517	1%	156	43%
Income before Taxes	2411	7.4%	3011	6.2%	+ 600	+ 25%

# Ratio Analysis

- Ratio is quantitative relation between two amounts showing the number of times one value contains or is contained within the other.
- A ratio can be computed from any pair of numbers. Ratios are generally not significant of themselves but assume significance when they are compared with -----



# Evaluating Debtors

DSO

Aging of Debtors

Exercise : Company A and B have same amount outstanding but aging is different

		<u>Company A</u>		<u>Company B</u>	
AGE OF ACCOUNT			%		%
DAYS					
0-10	Rs. 2,250,000		75%	Rs. 1,200,000	40%
11-30	750,000		25	900,000	30%
31-60	0		0	600,000	20%
60-90	0		0	300,000	10%
Over 90	0		0	0	0
<b>Total receivables</b>	<b>Rs. 3,000,000</b>		<b>100%</b>	<b>Rs. 3,000,000</b>	<b>100%</b>

# Case Study - Inventory Ratios

## Data from FS

	<u>2019</u>	<u>2020</u>
Sales	Rs. 1,200,000	Rs. 1,560,000
Inventory	200,000	284,000
Cost of goods sold	881,000	1,000,000

## Analysis

Inventory turnover	4.4	4.1
Days in inventory	83	89

## Case Study Operating Cycle

M/s Tycon Corporation was formed in 1985 with a share Capital Rs.10 million to start the business of chemical manufacturing and sales. The land, building and machinery cost was Rs.15 million. Therefore sponsors financed shortage of Rs.5 million from acquiring long term loans for GBL Financing Corporation at 8% interest per annum. Now in order to operate the business activities working capital funds were required to finance inventory and receivables.

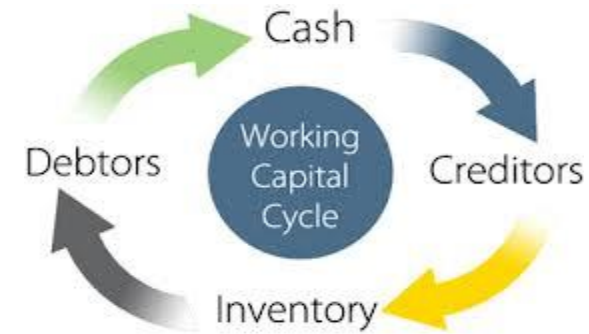
The company generally pays its suppliers six weeks after receiving an invoice, while its debtors usually pay within four weeks of invoicing. Raw materials stocks are held for a week before processing which takes three weeks, begins. Finished goods stay in stock for an average of two weeks.

The size of weekly investment in inventory / receivable is Rs.500,000.

### Required:

- Short term working capital requirement to your bankers

# Case Study-WORKING CAPITAL



How would you analyze implications for working capital policy :

	<u><b>2012</b></u>	<u><b>2013</b></u>
Sales	250,000	288,000
Cost of sales	210,000	248,000
Purchases	140,000	170,000
Debtors	31,250	36,000
Creditors	21,000	30,000
Raw materials	35,000	60,000
Finished goods	40,000	43,000
Work-in-process	17,500	30,000

**Assume all sales and purchases are on credit.**

## CASE STUDY : ASSET-BASED MEASURES

The following is an extract of the balance sheet of Shaheen Ltd., as at June 30 ,2004 :

	Rs'000
Fixed assets (net book value)	45,000
Net current assets	10,000
	<u>55,000</u>
Represented by:	
Rs.100 ordinary shares	20,000
Reserves	25,000
Long Term Loans	<u>10,000</u>
	<u>55,000</u>

You ascertain that :

- a)Market value of good will ( not recorded in the books) is Rs 5m
- b)Current market value of freehold property exceeds book value by Rs.3m
- c)All assets, other than property, are estimated to be realizable at their book value.

## Case Study- BUYING SHARES at Rs 15

ABC Paper & Board Mills Ltd - June 30, 2019 :

	Rs 000's
• Share capital – issued & paid up (no of shares 31421300 ), shares at face value of Rs.10 each	314,213
• Reserves	401,104
• Current Assets	521,703
• Non Current Assets	838,970
• Non Current Liabilities	176,108
• Profit after taxation	95,459
• Dividend per share Rs 2	
• Market value per Share Rs 15/-	

# Develop Balance Sheet from Ratios

## Balance Sheet

Cash	_____	Creditors	_____
Debtors	_____	Long Term Debts	_____
Inventory	_____	Shareholder's Equity	180,000
Fixed Assets			
Total	_____		_____

## DATA

Gross Profit ratio 30% ,	Sales total Rs 1500,000
Credit sales ratio in total sales 75% ,	No of days in a year 360
Total Assets turnover 3 times	Inventory turnover 5 times
Average Collection period 40 days	Debt Equity Ratio 40: 60
Current Ratio 2.1	

# Market ratios for investment

	F	G	K	H	G
MV	115	175	47	45	70
EPS	14	12	7	7	5
P/E ratio	8	14	6.7	7.5	14
Dividend yield	12%	6 %	13%	15 %	6.4%