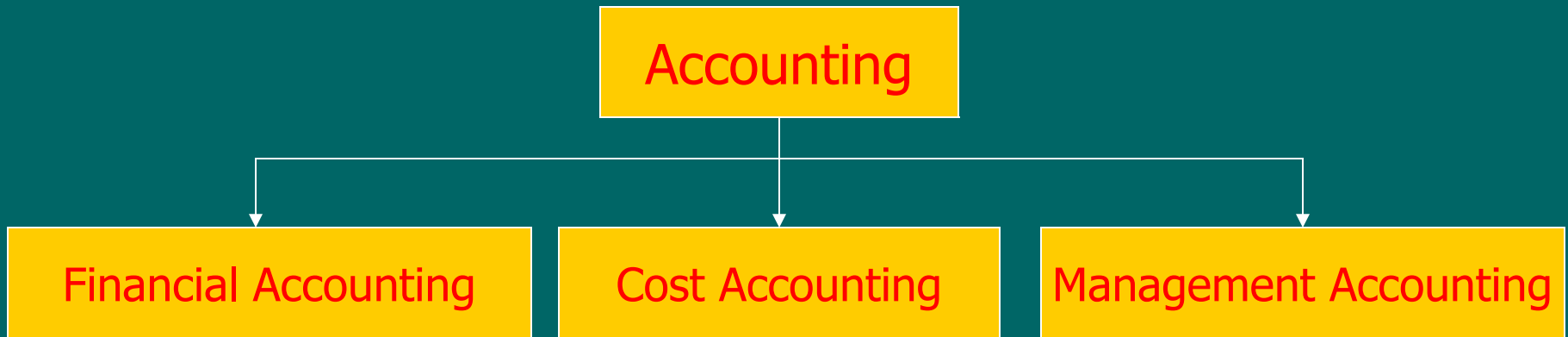


# Accounting For Managers

Prof. Deepak Ukidave

# Classification of Accounting



## Types of Financial Statements

- Profit and Loss Account
- Balance Sheet
- Cash Flow Statement

# Users of Financial Statements

- Shareholders
- Lenders- Banks, Financial Institutions
- Government Agencies
- Financial Analysts
- Vendors
- Customers
- Employees/Management
- Auditors

# Uses of Financial Statements

- To know Financial Performance of the Co.
- To know Financial position of its assets & liabilities
- To know the reasons for movement of cash between the two balance sheet dates.
- Compliance- Statutory Requirement

# Fundamental Accounting Assumptions

- Going Concern
- Consistency
- Accrual

## Accounting Concepts and Conventions

- Business Entity Concept
- Conservatism
- Materiality

## Accounting Policies

- Depreciation
- Valuation of Inventories
- Treatment of Goodwill
- Recognition of Profit on Long Term contracts.
- Treatment of Retirement Benefits.

# Accounting Standards

- Issued by ICAI
- Mandatory
- Represents ideal practice of Accounting
- Consistency in presentation of Financial Statements.
- Ensures comparability of Accounts.
- Disclosure of Accounting Policies.

# International Accounting Standards

## Importance

- Globalization of the economy – Indian Companies going Global.
- Appreciation by the Foreign Investors for Accounts following IAS norms.

## Convergence to International Financial Reporting Standards (IFRS)

# Contents of Annual Reports

- Financial Statements
- Notes to Accounts
- Schedules to Accounts
- Statement of Significant Accounting Policies
- Auditor's Report
- Chairman's Statement
- Directors Report
- M D and A Section
- EVA at a Glance



# Balance Sheet As On.....

Liabilities		Assets	
Equity Share Capital	XXX	Goodwill	XXX
Preference Share Capital	XXX	Fixed Assets	XXX
Reserves & surplus	XXX	Investments	XXX
Secured Loans	XXX	Current Assets	XXX
Unsecured Loans	XXX	Miscellaneous Expenses (To The Extent Not Written Off)	XXX
Current Liabilities & Provisions	XXX		

# Trading, P&L A/C

Particulars	Rs.	Particulars	Rs.
To O/P Stock	XXX	By Sales	XXX
To Purchases	XXX	By C/L Stock	XXX
To Gross Profit c/f	<b>XXX</b>		
	<b>XXX</b>		<b>XXX</b>
To Expenses / depreciation / interest / administrative expenses, etc..	XXX	By Gross Profit b/d	<b>XXX</b>
		By income from investment	XXX
To Provision for tax	XXX		
To Net Profit c/f	XXX		
	<b>XXX</b>		<b>XXX</b>

# P&L Appropriation A/C

Particulars	Rs.	Particulars	Rs.
To Proposed Dividend	XXX	By Net Profit b/d	XXX
To Transfer to General Reserve	XXX		
To Net Profit transferred to			
Balance sheet	XXX		
	<b>XXX</b>		<b>XXX</b>

# Income Statement (Vertical Form)

Income Statement for the year ended 31<sup>st</sup> March, 2010

Sales		Xxxxx
Less : Cost of Sales		Xxxxx
		-----
Gross Profit		Xxxxx
Less : Operating Expenses		
Administrative Expenses	xxxxx	
Depreciation	xxxxx	
	-----	-----
Operating Profit		Xxxxx
Add : Non-operating incomes (dividend received)		Xxxxx
		-----
		xxxx
Less : Interest paid		Xxxx
		-----
Profit before Tax		xxxx
Less : Income Tax		xxxx
		-----
Profit after tax		xxxxx
		=====

# Financial Analysis & control

## 4 Important tools in the hands of management

- Financial Ratios
- Duo – Pont Analysis
- Fund Flow Statement
- Cash Flow Statement

# Financial Ratio Analysis

- **Liquidity ratios**
- **Profitability or Efficiency ratios.**
- **Ownership ratios**
  - \* **Earnings ratios**
  - \* **Dividend ratios**
  - \* **Leverage ratios**
    - **Capital structure ratios**
    - **Coverage ratios**
- **Turnover Ratios**

# Liquidity ratios

- Current ratio

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

- Quick ratio (Acid-test ratio)

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

\* Quick assets = Current Assets - Inventories

# Profitability or Efficiency ratios

- Gross Profit Margin Ratio (GPM)

Gross Profit

Net Sales

\* Net Sales = Sales – Excise Duty

- Net Profit Margin Ratio (NPM)

Net Profit

Net Sales



# Ownership ratios

## 1. Earning ratios

- **Earning per share (EPS)**

$$\frac{\text{Net income (PAT)}}{\text{No. of outstanding shares}}$$

- **Price earning ratio (P/E multiple)**

$$\frac{\text{Market price of the share}}{\text{Earning per share}}$$

## 2.Dividend ratio

- Dividend pay-out ratio

Dividend per share

Earning per share

- Dividend yield

Dividend per share

Market price of the share

### 3. Leverage ratios

#### \* Capital structure ratios

$$\text{Debt-equity ratio} = \frac{\text{Debt}}{\text{Equity}}$$

$$\text{Debt-assets ratio} = \frac{\text{Debt}}{\text{Assets}}$$

## \*Coverage ratios

### Interest coverage ratio

“gives the relationship between the financial charges of a firm and its ability to service them”.

EBIT

Interest expense

## Debt service coverage ratio

PAT+ Depreciation+ other non-cash charges + Interest on term loan

Interest on term loan + Repayment of the term loan

# Turnover ratios

## Accounts receivable turnover ratio

$$= \frac{\text{Net credit sales}}{\text{Average accounts receivable}}$$

## Average collection period

$$= \frac{360}{\text{Av. accounts receivable turnover}}$$

$$= \frac{\text{Av. accounts receivable}}{\text{Av. daily sales}}$$

$$\frac{\text{Sales}}{\text{Av. assets}} = \text{Asset turnover ratio}$$

$$\frac{\text{Cost of goods sold}}{\text{Av. Inventory}} = \text{Inventory turnover ratio}$$

# Duo – Pont Analysis

$$\text{Return on assets} = \frac{\text{Net profit}}{\text{Av. Assets}}$$

or

$$\text{Return on assets} = \frac{\text{Net profit / sales}}{\text{Av. Assets / sales}}$$

$$= \text{Net profit margin} * \text{Av. Asset turnover}$$



# Current Developments

## Gross Value-added of a manufacturing company

Particulars	Rs	Rs
Sales	--	
Add: Royalties & other income	--	
Less: Material and services used	(--)	
Value-added by trading activities		--
Add: Investment income	--	
Gross value added		
Applied as follows:	--	
To employees as salaries, wages etc	--	
To Govt. as taxes, duties	--	
To financiers as interest on borrowings	--	
To shareholders as dividends	--	
To retained earnings including depreciation	--	

# Economic Value Addition

$$EVA = NOPAT - WACC$$

- \* NOPAT – Net Operating Profit After Tax
- \* WACC – Weighted Average Cost of Capital

# Capital Asset Pricing Method

$$K_e = R_f + (R_m - R_f) * \text{Beta}$$

Where,

$R_f$  = Risk free return

$R_m$  = Expected market return

Beta = Beta of the security (Market risk)

# Cash Flow Statement (Traditional method)

<b>Cash Balance as on XX-XX-XXXX</b> <b>(Opening Balance)</b>		<b>XXXX</b>
<b>ADD: Sources</b>	XX	
Cash From Operations	XX	
Loan From Bank	XX	
Sale Of Machinery	XX	XXX
		XXX
<b>LESS : Application</b>		
Purchase Of Assets	XX	
Loan Repaid	XX	
Drawings	XX	XXX
<b>Cash Balance as on XX-XX-XXXX</b> <b>(closing Balance)</b>		<b>XXX</b>

# Cash Flow Statement

(As Per AS-3)

# Cash Flow Statement

Particulars	Rs	Rs
<b><u>Cash From Operating Activities</u></b>		
<b>Net Profit During The Year</b>	<b>XXX</b>	
<b><u>ADD:</u></b>		
Depreciation	XX	
Provision For Tax	XX	
Loss on Sale of Assets	XX	
Premium on Redemption Of Debentures	XX	
Preliminary Expenses Written off	XX	
<b>Operating Profit</b>	<b>XXX</b>	
Less increase in Debtors	XX	
Add Increase in Creditors	XX	
<b>Cash Before Tax</b>	<b>XXX</b>	
Less Tax Paid During the year	XX	
<b>Cash From Operating Activities</b>	<b>XXXX</b>	<b>XXXX</b>

# Cash Flow Statement

Particulars	Rs	Rs
<b><u>Cash From Operating Activities</u></b>		<b>XXXX</b>
<b><u>Cash From Investing Activities</u></b>		
Purchase Of Fixed Assets	(XX)	
Sale of Investment	XX	
<b>Cash From Investing Activities</b>	<b>XXX</b>	<b>XXX</b>
<b><u>Cash From Financing Activities</u></b>		
Issue Of Share Capital	XX	
Redemption Of Debentures	(XX)	
Dividend Paid	(XX)	
<b>Cash From Financing Activities</b>	<b>XXX</b>	<b>XXX</b>
Cash Flow During the Year		XXX
Cash Balance in the beginning		XXX
<b>Cash Balance at the end</b>		<b>XXX</b>

# Fund Flow Statement

- Long Term Financial Position of the company
- Wider Concept
- Includes Cash Flow

Following Statements to be made.....

- Statement Of Changes in Working Capital
- P&L A/C – Shows Funds From Operation
- Statement of Sources & Application Of Funds



# Sources & Application of Funds

Sources Of Funds	Rs	Application Of Funds	Rs
Bank Loan	XXX	Purchase of Assets	XXX
Sale of Investment	XXX	Investments	XXX
Sale Of Assets	XXX	Dividend Paid	XXX
Decrease in Working Capital	XXX	Tax Paid	XXX
		Increase in Working Capital	XXX
	<b>XXX</b>		<b>XXX</b>

# Statement of Changes in Working Capital

<b>Current Assets</b>	<b>O/P Bal</b>	<b>C/L Bal</b>
Stock	XXX	XXX
Debtor	XXX	XXX
Cash	XXX	XXX
	<b>XXX</b>	<b>XXX</b>
<b>Less Current Liabilities</b>	XXX	XXX
	XXX	XXX
Increase / Decrease in Working Capital		<b>XXXX</b>

# Significant Insights provided by Funds Flow Statement:

## **1. Detection of imbalances & Appropriate action**

- Detection of Inefficiencies in inventory management.

## **2. Divisional Performance appraisal**

- Funds flow statement of individual divisions will enable management to judge the performance based on funds committed to a division.

# Significant Insights provided by Funds Flow Statement:

## 3. Evaluation of firm's financing

- ❑ Monitor Mix of short term & long term finance of the company.
- ❑ Analysis of liquidity-profitability of company.

## 4. Planning of future financing

- ❑ Analysis of Funds Flow statement will reveal :-
  - The firms' requirements of funds in future
  - How to finance this need
  - The component of assets for which financing is required.

# Income Statement

Sales	XXX
Less Variable Cost	XXX
<b>Contribution</b>	<b>XXX</b>
Less Fixed Cost	XXX
<b>Operating Profit</b> <b>(Earning Before Interest &amp; Tax)</b>	<b>XXX</b>
Less Interest on debt	XXX
<b>Earning Before Tax</b>	<b>XXX</b>
Less Tax	XXX
<b>Profit After Tax</b>	<b>XXX</b>
Less Preference Dividend	XXX
<b>Profit Available to</b> <b>equity Share holder</b>	<b>XXX</b>

# Leverage

- Influence / Power of one financial variable on the other related variable
- Operating Leverage
- Financial Leverage
- Total Leverage

- Operating Leverage (Operating Risk)  
= Contribution / EBIT

- Financial Leverage (Financial Risk)  
= EBIT/EBT

- Total Leverage (Combined Risk)  
= Contribution/EBT

OR

= Operating Leverage \* Financial Leverage



# Implication

- Higher degree of Operating Leverage indicates Higher Business Risk
- Higher degree of Financial Leverage indicates

↓  
Increased Use of Debt Financing

↓  
Increased Financial Risk

↓  
Increased Fluctuation in Return on Equity

↓  
Increased Interest Rate on Debt

Highly Financially Leveraged Firms  
are Perceived by lenders of debt  
as risky

**THANK YOU**