Financial Reporting & Cost Accounting

EPBM-32 | IIM Calcutta x TimesPro | Prof. Manju Jaiswall | 2026

104	315	4	10	12
Pages	Practice Questions	Sessions Covered	Manager Takeaways	Exam Traps

SESSION 1

Understanding Financial Statements I

- The Wake-Up Call & real corporate disasters
- The Accounting Equation (5 elements defined)
- Six Friends: all 8 transactions built live
- Income Statement, Balance Sheet, Cash Flow
- Depreciation: SLM & WDV with worked tables
- Four Foundational Assumptions
- Reading real company financials (Infosys, HUL)
- 30 MCQs with answers and explanations

SESSION 2

Understanding Financial Statements II

- Depreciation deep-dive (real-life issues)
- Reading real balance sheets & Schedule III
- Income Statement unpacked (7 account heads)
- Richie Advisors February & March -- 12 transactions
- Cash Flow: Direct vs Indirect method
- Key formulas for Sessions 1 and 2
- 20 True/False + 35 MCQs with explanations

SESSION 3

Understanding & Managing Cost

- Two arms: financial vs management accounting
- Cost object, direct vs indirect costs
- Fixed, variable & mixed -- splitting method
- CVP analysis: break-even from first principles
- Margin of safety, sensitivity, multi-product BEP
- Prestige Telephone: full shutdown case (4 Qs)
- Key formulas for Session 3
- 20 True/False + 35 MCQs with explanations

SESSION 4

Analysing Financial Statements

- Share capital: bonus, splits & buybacks
- Horizontal, trend & vertical analysis
- Window 1: Liquidity ratios
- Window 2: Efficiency & Cash Conversion Cycle
- Window 3: Profitability on sales & investment
- Window 4: Leverage & ROE amplification
- Master Reference: all ratios by window
- 20 True/False + 35 MCQs with explanations

QUESTION BANK
S1: 30 | S2: 55 | S3: 55 | S4: 55
Bank: 120 | Total: 315 questions

FORMULA SHEET
Every formula from all 4 sessions in one reference

EXAM STRATEGY
12 common traps, 6-step decision framework

MANAGER TAKEAWAYS
10 real-world application boxes with product/service examples

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HOW TO USE THIS DOCUMENT

1

READ LIKE A STORY -- SESSION BY SESSION

This document is written as a narrative, not a textbook. Every concept appears only when the story demands it. Read each session from start to finish the first time -- do not jump around. Each session builds on the previous one: Session 1 gives you the foundation, Session 2 accelerates with real cases, Session 3 turns you into an internal decision maker, and Session 4 teaches you to analyse and compare.

2

USE SECTION HEADINGS TO REVISE

After your first read, use numbered section headings for targeted revision. Each session ends with a Key Formulas table -- use it to test your recall. Then go to the Practice Question Bank at the end of this document: start with the session-specific questions, then tackle the Master MCQ Bank for cross-session practice. If you can explain WHY each answer is correct, you are ready.

3

ATTEMPT EVERY MCQ BEFORE READING THE ANSWER

The document has 315 practice questions across all sessions. The only way they work is if you genuinely attempt each question before reading the answer. Cover the answer line with your finger, think it through, then check. Wrong answers are more valuable than right ones -- they show you where your mental model is off. For each wrong answer, read the explanation and trace it back to the concept in the session.

4

MANAGER TAKEAWAY BOXES ARE FOR YOUR JOB, NOT JUST THE EXAM

Throughout the document you will see amber/gold boxes labelled MANAGER TAKEAWAY. These are the bridge between accounting concepts and the decisions you make as a manager. Read them even for concepts you already understand -- they give you the language to USE the concept in a meeting, a business proposal, or a client conversation. The takeaways are based on real Indian business situations.

5

THE NIGHT BEFORE THE EXAM -- READ ONLY THREE THINGS

Before the exam, do NOT try to re-read the full document. Instead, read only: (1) The 12 Common Traps in the Exam Strategy section -- these are the exact mistakes that cost marks. (2) The Master Formula Sheet -- every formula from all 4 sessions. (3) The 6-Step MCQ Decision Framework -- this is how to approach every question on paper. Then attempt the MCQ Question Bank (120 questions) the evening before and check your answers.

COLOUR-CODED BOX GUIDE

KEY INSIGHT	EXAM TIP	CONCEPT TRAP	MANAGER TAKEAWAY
Core principle -- the one thing from this section to remember	Directly exam-relevant -- tested frequently by Prof. Jaiswall	The most common mistake on this concept -- read carefully	How this concept applies to your actual job right now

1 SESSION 1: Understanding Financial Statements -- I

Why every manager must understand financial numbers -- with real Indian corporate disasters as proof

This session introduces the complete foundation of financial reporting. It is written as a story -- every concept appears only when the narrative demands it. Read from start to finish the first time. Use chapter headings to revise before your MCQ exam. No finance background required.

1 The Wake-Up Call

"How many of you had to make a decision involving more than Rs.5 crore last year? How many of you actually evaluated the ROI of that decision before recommending it?"

-- Prof. Jaiswall's opening challenge to the room

Most hands went up for the first question. Far fewer for the second. That gap -- making large financial decisions without evaluating returns -- is exactly what these four sessions are designed to close.

Financial numbers are early warning signs. Like a fever before an illness becomes serious, they signal the health of a business long before a crisis hits. You do not need to be a Chartered Accountant. You just need to learn the language.

"Whatever function you are in -- HR, marketing, operations, sales -- every decision has financial implications. You better understand those implications before they become bad and something which cannot be salvaged."

-- Prof. Manju Jaiswall

What happens when the language is ignored

Company	What went wrong -- and the consequence
IndusInd Bank (2025)	Rs.1,960 crore derivative accounting error -- stock fell 27% in a single day, CEO resigned
DHFL	Rs.30,000+ crore diverted via shell companies -- bankruptcy, near-total equity destruction
Yes Bank	Non-performing loans under-reported for years -- stock collapsed 90%, required RBI bailout
Gensol / BluSmart (2025)	Rs.262 crore alleged fund diversion -- operations disrupted, investor trust collapsed
ABG Shipyard	India's largest bank fraud -- fake contracts, misused loans totalling Rs.22,842 crore, criminal case ongoing

KEY INSIGHT

All of the above were visible in the financial statements to those who knew how to read them. Financial literacy is a leadership responsibility, not just a finance team skill.

MANAGER TAKEAWAY -- Reading Warning Signs Before They Become Crises

Every financial disaster in the table you just read above had early signals visible in the numbers -- before the collapse, before the fraud became public. Managers who caught them early did two things: they read the financials regularly, and they asked uncomfortable questions when the numbers did not make sense.

PRODUCT COMPANY EXAMPLE -- Manufacturing / Pharma: A quality manager notices inventory days rising from 45 to 90 over three quarters without a corresponding sales increase. The instinct is to ignore it. The right move: ask why. In several documented Indian cases, rising inventory has masked batch rejections sitting on the books. Catching it at 90 days costs Rs.50 lakh in write-offs. Catching it at 180 days costs a regulatory shutdown and investor exodus.

SERVICE COMPANY EXAMPLE -- IT / Financial Services: A delivery head notices that unbilled revenue (work completed, invoice not raised) is growing every quarter while cash collections hold steady. This is a classic signal of revenue being pulled forward without billing. One check of the ageing analysis versus project completion reports surfaces it. If not caught early, it becomes a restatement. IndusInd Bank Rs.1,960 crore derivative accounting error was visible in the hedging disclosures two quarters before the stock fell 27% in a single day.

The rule: if any number moves more than 20% in one quarter without a business reason you can articulate clearly, that number needs an explanation before the next board meeting.

2 The Financial Reporting System

Before examining any statement, understand the system that produces them. Think of any factory: raw material in, processing, finished product out. The financial reporting system works identically.

Stage	What it is	Examples
Input	Business activities -- everything the business does	Raising funds, buying assets, selling goods, paying staff
Processing	The accounting process -- classifies, records, and organises all activities using standard rules	Double-entry recording, trial balance, period-end adjustments
Output	Financial statements -- the finished product that tells the complete financial story	Balance Sheet, Income Statement (P&L;), Cash Flow Statement

Test: Does this activity affect the financials of the business? If YES -- it enters the accounting system and gets recorded. If NO -- it is just information, not yet recorded.

Now -- who actually reads this output? Two completely different groups. And here is why this matters: the same financial statement tells a completely different story depending on who is reading it and what question they are trying to answer. An HR Manager reading the annual report asks something entirely different from a bank deciding whether to give a loan. The table below shows who uses financial statements and the specific question each user is trying to answer:

Category	User	Key question they are asking
INTERNAL	HR Manager	Can we afford to give employees a pay raise this year?
INTERNAL	Marketing Head	Which product line is most profitable? How should I price to maximise margin?

Category	User	Key question they are asking
INTERNAL	Finance Team	Do we have enough cash to pay dividends to shareholders?
INTERNAL	CEO / Management	Is the business performing as planned? What decisions are required?
EXTERNAL	Investors / Shareholders	Is this company earning satisfactory returns? Should I buy, hold or sell?
EXTERNAL	Banks / Creditors	Can this company repay its debt when it falls due?
EXTERNAL	Tax Authorities	Is the company paying the correct amount of tax?

3 Three Business Activities

Activity	What it means	Direction
1. Financing Activities	Raising funds -- equity from owners or debt from banks. Also includes repaying loans and returning capital to owners.	Both in and out
2. Investing Activities	Deploying raised funds into long-term assets: machinery, vehicles, buildings. Creating the infrastructure the business needs to operate.	Both in and out
3. Operating Activities	Running the business using those assets: buying inventory, selling goods, paying staff, earning revenue. This is where profit or loss is generated.	Both in and out

EXAM TIP -- The Logical Sequence

FIRST finance (raise money), THEN invest (build assets), THEN operate (run the business). You cannot invest what you have not raised. You cannot operate without infrastructure. This sequence is frequently tested.

4 The Accounting Equation

ASSETS = LIABILITIES + OWNERS EQUITY

This is not merely a formula. It is a statement about reality. Every resource a business has (assets) was funded either by outsiders -- banks, suppliers (liabilities) -- or by the owners (equity). The two sides must always balance. Always.

Asset

What it means: Anything that gives the business a future benefit. If you own or control something today that will give you value in the future -- it is an asset.

Example: Cash (will be used for payments), inventory (will be sold), machinery (will produce goods), debtors (customers will pay you), advance deposit paid (you will get it back). All = future value = all assets.

Liability

What it means: A future sacrifice of benefit. Something the business will have to give up -- usually cash -- to settle an existing obligation.

Example: Bank loan (repay at maturity), creditors/suppliers (pay in 60 days), accrued salary (pay employees next week). All = future payment committed = all liabilities.

Owners Equity

What it means: The residual -- what belongs to the owners after all liabilities are settled. OE = Assets minus Liabilities. Two parts: (1) Share Capital -- what owners invested, and (2) Retained Earnings -- profits kept in the business over time.

Example: Assets Rs.89L minus Liabilities Rs.55.2L = Owners Equity Rs.33.8L. This Rs.33.8L belongs to the shareholders.

Revenue / Income

What it means: Inflows from the business's core operations. Revenue INCREASES Owners Equity -- specifically the Retained Earnings component.

Example: Sales for a trading company. Interest income for a bank. Service fees for a consultant. Note: interest on an FD is "other income" for a manufacturer -- not revenue -- because banking is not their core business.

Expense

What it means: Outflows incurred while running core operations. Expenses DECREASE Owners Equity -- specifically Retained Earnings. Dividends are NOT an expense -- they reduce Retained Earnings directly.

Example: Cost of goods sold, salaries, rent, depreciation, interest on loans, marketing costs. All reduce the owners' share of value in the business.

KEY INSIGHT -- Retained Earnings is the Bridge

Revenue and Expenses both flow through Retained Earnings -- the second part of Owners Equity. Revenue increases RE. Expenses decrease RE. Whatever RE remains after dividends stays in the business. RE is the bridge connecting the Income Statement to the Balance Sheet.

Principle	What it means	Example
Separate Entity Principle	The business and its owners are always completely separate. Never mixed.	A founder's personal car is not a business asset. When they invest capital, the business records it as equity -- money it OWES the owner.
Double-Entry System	Every business activity creates exactly two impacts on the accounting equation. Always.	Quick tip: whenever there is cash coming in or going out, do the cash entry first. That is one impact done. Then figure out the second impact.

5 The Six Friends Story

Six friends start a consumer durables trading company on 1st January 2026. Each puts in Rs.5 lakhs. Total Share Capital = Rs.30 lakhs. We follow every transaction -- building the financial statements live. After each transaction a running balance shows ASSETS on the LEFT and LIABILITIES + OWNERS EQUITY on the RIGHT. Both sides must always be equal.

Transaction 1 -- Share capital invested: Rs.30 lakhs

Activity: Financing | Owners providing own funds

The business is born. Rs.30L flows in from the six founders. The business has cash -- and it owes this money back to the owners (Separate Entity Principle). The owners are the FIRST creditors of their own business.

Impact	Account affected	Change	Side of equation
1st impact	Cash (Asset)	+Rs.30L	LEFT -- Assets increase

Impact	Account affected	Change	Side of equation
2nd impact	Share Capital (Owners Equity)	+Rs.30L	RIGHT -- OE increases

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.30L	Share Capital (OE): Rs.30L
BOTH SIDES BALANCE = Rs.30L	

Transaction 2 -- Bank loan: Rs.20 lakhs

Activity: Financing | Borrowed funds coming in

Cash rises -- but so does a liability. The business now owes Rs.20L to the bank. Note: both sources of funding -- owners (Rs.30L) and bank (Rs.20L) -- end up on the RIGHT side.

Impact	Account affected	Change	Side of equation
1st impact	Cash (Asset)	+Rs.20L	LEFT -- Assets increase
2nd impact	Bank Loan (Liability)	+Rs.20L	RIGHT -- Liability appears

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.50L	Bank Loan: Rs.20L
BOTH SIDES BALANCE = Rs.50L	

Transaction 3 -- Showroom rented: Rs.5L security deposit. Monthly rent = Rs.1L

Activity: Operating setup | CONCEPT TRAP -- this is not an expense yet

The Rs.5L deposit is REFUNDABLE -- it will be returned at end of lease. Future benefit = Asset, NOT expense. The rent for this month will be paid next month -- but since the space has NOT been used yet, no rent expense is recorded today. Accounting records what HAS HAPPENED, not what will happen.

Impact	Account affected	Change	Side of equation
1st impact	Cash (Asset)	-Rs.5L	LEFT -- Cash goes out
2nd impact	Security Deposit (Asset)	+Rs.5L	LEFT -- New asset (both on LEFT, net = zero)

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.45L	Bank Loan: Rs.20L
Security Deposit: Rs.5L	Share Capital: Rs.30L
BOTH SIDES BALANCE = Rs.50L	

CONCEPT TRAP -- Asset vs Expense Rule

Pay for something with future benefit (deposit to be returned, machine used for years) = ASSET.

Pay for something fully consumed this period (this month's salary for work done) = EXPENSE.

Security deposit will be returned = ASSET. Monthly rent when the space is USED = EXPENSE.

KEY INSIGHT -- Recording What Has Happened

Accounting records what HAS HAPPENED -- not what will happen. You have not incurred rent yet because the showroom has not been used. You paid a deposit -- money you will get back. Future benefit = Asset.

Transaction 4 -- Furniture purchased: Rs.5 lakhs cash

Activity: Investing | Creating infrastructure

One asset (cash) converts to another asset (furniture). No change to liabilities or equity. Both impacts are on the LEFT side -- net change to the equation is zero.

Impact	Account affected	Change	Side of equation
1st impact	Cash (Asset)	-Rs.5L	LEFT -- Cash goes out
2nd impact	Furniture (Fixed Asset)	+Rs.5L	LEFT -- New long-term asset

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.40L	Bank Loan: Rs.20L
Furniture: Rs.5L	Share Capital: Rs.30L
BOTH SIDES BALANCE = Rs.50L	

Transaction 5 -- Inventory: Rs.60L purchased (50% cash, 50% credit -- 60 days)

Activity: Operating | Buying stock is the core activity for a trading firm

Rs.30L paid in cash. The remaining Rs.30L is due to the supplier in 60 days -- creating a LIABILITY called Trade Payables (also known as Creditors or Sundry Creditors). This transaction touches THREE accounts simultaneously.

Impact	Account affected	Change	Side of equation
1st impact	Inventory (Asset)	+Rs.60L	LEFT -- New asset: stock to sell
2nd impact A	Cash (Asset)	-Rs.30L	LEFT -- Cash paid to supplier
2nd impact B	Trade Payables / Creditors (Liability)	+Rs.30L	RIGHT -- Owe supplier in 60 days

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.10L	Trade Payables: Rs.30L
Inventory: Rs.60L	Bank Loan: Rs.20L
Furniture: Rs.5L	Share Capital: Rs.30L
BOTH SIDES BALANCE = Rs.80L	

Transaction 6 -- Goods sold: Rs.50L (cost Rs.40L) -- Rs.30L cash + Rs.20L credit

Activity: Operating | Three new concepts emerge from this one transaction

This is the most complex transaction so far. Five account changes. Revenue Rs.50L: the business has EARNED Rs.50L by delivering goods -- recorded because service is performed. COGS Rs.40L: inventory that was sold had cost Rs.40L -- once sold, no more future benefit -- the asset converts to expense. Debtors Rs.20L: sold on credit -- sale happened so revenue IS recorded, but cash has not arrived yet -- we create a new asset

called Trade Receivables / Debtors. Net check: Left side +30+20-40 = +10. Right side +50-40 = +10. Balanced.

Impact	Account affected	Change	Side of equation
Cash sale	Cash (Asset)	+Rs.30L	LEFT -- Cash received
Credit sale	Trade Receivables / Debtors (Asset)	+Rs.20L	LEFT -- Collect later
Revenue	Sales Revenue -- increases OE / RE	+Rs.50L	RIGHT -- OE increases
COGS	Inventory consumed -- Asset reduces	-Rs.40L	LEFT -- Asset consumed
Expense	COGS Expense -- decreases OE / RE	-Rs.40L	RIGHT -- OE decreases

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.40L	Trade Payables: Rs.30L
Debtors: Rs.20L	Bank Loan: Rs.20L
Inventory: Rs.20L (Rs.60L - Rs.40L used)	Share Capital: Rs.30L
Furniture: Rs.5L	RE so far: Rs.10L (50-40)
BOTH SIDES BALANCE = Rs.90L	

> *"When I sell inventory, the asset converts into an expense -- Cost of Goods Sold. It was an asset because it had future benefit. Once sold, that benefit is realised and gone. Same logic as depreciation: the asset is being gradually consumed."*
>
> **-- Prof. Manju Jaiswall**

Transaction 7 -- Month-end: Rs.5.2L in expenses incurred but not yet paid

Activity: Operating | Introduces the ACCRUAL CONCEPT

Salaries Rs.2L, advertisement Rs.2L, rent Rs.1L, interest Rs.0.2L -- all incurred this month, NONE paid yet. The Accrual Concept says: record expenses when INCURRED (benefit received / obligation created), not when cash is paid. The staff worked. The ad ran. These obligations exist. Since not paid yet, the Rs.5.2L becomes a LIABILITY -- Expenses Payable / Accrued Liabilities.

Impact	Account affected	Change	Side of equation
Expense incurred	Salaries, Advertisement, Rent, Interest -- decreases OE / RE	-Rs.5.2L	RIGHT -- OE decreases
Not paid yet	Expenses Payable / Accrued Liabilities (Liability)	+Rs.5.2L	RIGHT -- New liability
Cash impact?	NONE -- no cash moved this month	Zero	Cash unchanged -- pure accrual

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.40L	Trade Payables: Rs.30L
Debtors: Rs.20L	Expenses Payable: Rs.5.2L
Inventory: Rs.20L	Bank Loan: Rs.20L
Furniture: Rs.5L	Share Capital: Rs.30L
Security Deposit: Rs.5L	RE: +10-5.2 = Rs.4.8L

BOTH SIDES BALANCE = Rs.90L

KEY INSIGHT -- Accrual Concept: Why Profit (Rs.4.8L) Differs from Cash (Rs.40L)

Record revenue when EARNED and expenses when INCURRED -- regardless of when cash moves. This is why Profit (Rs.4.8L) and Cash in the bank (Rs.40L) are completely different numbers. The Cash Flow Statement in the next section reconciles this gap. This is exactly why we need THREE statements, not just one.

Transaction 8 -- Dividend paid to shareholders: Rs.1 lakh

Activity: Financing | Dividend is NOT an expense -- it reduces Retained Earnings directly

The six friends take Rs.1L out as a dividend. CRITICAL: dividends are NOT an expense. They do NOT appear in the Income Statement. Dividends reduce Retained Earnings directly on the Balance Sheet. Cash goes out. RE goes down.

Impact	Account affected	Change	Side of equation
1st impact	Cash (Asset)	-Rs.1L	LEFT -- Cash goes out
2nd impact	Retained Earnings (Owners Equity)	-Rs.1L	RIGHT -- OE decreases directly

ASSETS (Left Side)	LIABILITIES + OWNERS EQUITY (Right Side)
Cash: Rs.39L	Trade Payables: Rs.30L
Debtors: Rs.20L	Expenses Payable: Rs.5.2L
Inventory: Rs.20L	Bank Loan: Rs.20L
Furniture: Rs.5L	Share Capital: Rs.30L
Security Deposit: Rs.5L	Retained Earnings: Rs.3.8L
BOTH SIDES BALANCE = Rs.89L	

MANAGER TAKEAWAY -- Cash vs Profit -- The Manager's Daily Reality

You now understand why the most dangerous sentence in any business review is: "we are profitable." After 8 transactions, our business has Profit of Rs.4.8L but Cash of Rs.39L -- very different numbers. As a manager, always ask for BOTH the P&L; and the cash position.

The practical test: CFO (Cash from Operations) vs Net Income. If CFO is consistently lower than Net Income, your business is not collecting what it earns. That is a credit management problem. If CFO is negative, the business is consuming cash to survive -- a much more urgent problem than a net loss.

6 The Three Financial Statements

Order	Statement	Why this order?
Step 1 -- FIRST	Income Statement (P&L; Account)	Calculates Net Income. Without knowing profit, you cannot find closing Retained Earnings.
Step 2 -- SECOND	Retained Earnings Statement	Opening RE + Net Income - Dividends = Closing RE. This flows into the Balance Sheet.
Step 3 -- THIRD	Balance Sheet	Closing RE from Step 2 goes into Owners Equity. Balance Sheet cannot balance without it.

> *"You have to prepare the P&L; first. Intuitively -- if you don't know your performance, how can you know your financial position? Financial position is a consequence of performance. P&L; first. Always."*
>
> **-- Prof. Manju Jaiswall**

Statement 1: Income Statement | Month ending 31-01-2026 (Rs. Lakhs)

Line item	Rs.L	What it means
Revenue from Operations (Sales)	50.0	The top line -- all income from selling goods
Less: Cost of Goods Sold (COGS)	(40.0)	Cost of inventory sold -- asset converting to expense
= Gross Profit	10.0	Pricing power -- before operating overheads
Less: Salaries	(2.0)	Staff cost -- accrued (work done this month)
Less: Advertisement	(2.0)	Marketing cost -- accrued
Less: Rent	(1.0)	Showroom rent -- accrued (space used this month)
= EBITDA	5.0	Earnings Before Interest, Tax, Depreciation -- operating cash proxy
Less: Depreciation	0.0	Non-cash -- covered in Chapter 7 below
Less: Interest Expense	(0.2)	Cost of the bank loan -- financing charge
= Profit Before Tax (PBT)	4.8	True profitability before government share
Less: Tax	0.0	First month -- assumed nil for simplicity
= Profit After Tax (PAT) -- The Bottom Line	4.8	What the business earned for shareholders

Statement 2: Balance Sheet | As at 31-01-2026 (Rs. Lakhs)

Watch how Retained Earnings (Rs.3.8L) flows from the P&L; into the Equity section:

Equity & Liabilities	Rs.L	Assets	Rs. L
EQUITY		FIXED ASSETS	
Share Capital	30.0	Furniture	5.0
Retained Earnings (from P&L;)	3.8	CURRENT ASSETS	
Total Owners Equity	33.8	Security Deposit	5.0
NON-CURRENT LIABILITIES		Inventory (unsold)	20.0
Bank Loan	20.0	Trade Receivables (Debtors)	20.0
CURRENT LIABILITIES		Cash and Bank	39.0
Trade Payables (Creditors)	30.0		
Expenses Payable (Accrued)	5.2		
TOTAL	89.0	TOTAL	89.0

Statement 3: Cash Flow Statement | Why Cash (Rs.39L) differs from Profit (Rs.4.8L)

Activity	Cash inflows Rs.L	Cash outflows Rs.L
FINANCING: Equity from 6 founders	30.0	
FINANCING: Bank loan raised	20.0	
FINANCING: Dividend paid to shareholders		(1.0)
INVESTING: Security deposit paid		(5.0)
INVESTING: Furniture purchased		(5.0)
OPERATING: Cash received from customers (30L; not 50L as 20L is still in Debtors)	30.0	
OPERATING: Cash paid to inventory supplier (30L; the other 30L is still owed)		(30.0)
TOTALS	80.0	(41.0)
NET CLOSING CASH BALANCE (80-41)	Rs.39L	

KEY INSIGHT -- Cash Rs.39L vs Profit Rs.4.8L: Four Reasons

(1) Rs.20L of sales NOT yet collected -- sitting in Debtors (accrual said record revenue, cash not here yet)

(2) Rs.5.2L of expenses accrued but unpaid -- cash will leave next month

(3) Rs.50L came in from FINANCING (equity + loan) -- this is funding, NOT income

(4) Rs.10L went into INVESTING (furniture + deposit) -- productive deployment, NOT expense

The Cash Flow Statement makes ALL FOUR of these visible and traceable.

7 Depreciation

Inventory was sold and converted from an asset into an expense (COGS). But what about the furniture bought for Rs.5L? It will be used for years. We cannot charge the full Rs.5L as an expense in month one -- that would make month one look terrible and the next 59 months artificially perfect.

Depreciation: the systematic allocation of the original cost of an asset to the periods in which it provides benefit. Furniture Rs.5L lasts 5 years: Rs.1L depreciation expense each year. Total over 5 years = Rs.5L. Key point: **depreciation is a NON-CASH EXPENSE.** No cash goes out -- you already paid. But profit reduces each year.

Decision	Plain English	Example
1. Useful Life	How long will the asset last? Management judgement -- government gives guidance but you are not bound.	Furniture estimated to last 5 years in the showroom
2. Residual / Salvage Value	What can it be sold for at end of life? Net Depreciable Cost = Cost minus Residual Value.	Old furniture can be sold for Rs.1,000 as scrap
3. Method	How to spread the cost over the useful life? Two main methods.	SLM for a table; WDV for a computer

Method 1 -- Straight Line Method (SLM): Same charge every year

Formula: Annual Depreciation = (Cost - Residual Value) / Useful Life in Years

The same depreciation amount is charged every single year. The assumption: you use the asset uniformly throughout its life.

Example: Asset costs Rs.11,000 crore. Residual value Rs.1,000 crore. Life 10 years. Annual depreciation = (11,000 - 1,000) / 10 = Rs.1,000 crore per year.

Year	Gross Book Value	Annual Depreciation	Accumulated Depreciation	Net Book Value
Year 1	Rs.11,000 cr	Rs.1,000 cr	Rs.1,000 cr	Rs.10,000 cr
Year 2	Rs.11,000 cr	Rs.1,000 cr	Rs.2,000 cr	Rs.9,000 cr
Year 3	Rs.11,000 cr	Rs.1,000 cr	Rs.3,000 cr	Rs.8,000 cr
Year 5	Rs.11,000 cr	Rs.1,000 cr	Rs.5,000 cr	Rs.6,000 cr
Year 10 (final)	Rs.11,000 cr	Rs.1,000 cr	Rs.10,000 cr	Rs.1,000 cr (= residual)

Method 2 -- Written Down Value (WDV): Higher early, lower later

WDV Rate formula: Rate = 1 - (Residual Value / Cost) raised to power (1/n), where n = useful life in years.

Instead of applying the rate on the original cost each year, WDV applies it on the NET BOOK VALUE at the START of that year. Since NBV falls every year, depreciation charge also falls -- higher in early years when the asset is new, lower as it ages.

> *"Straight line for a table is fine. You use the table the same way every day. But a high-end computer used for coding? In year one you are running the latest software on it. By year four, better machines exist and you use it less. That is not straight line usage."*
>
> **-- Prof. Manju Jaiswall**

Law / Context	Which methods are allowed?
Companies Act (for financial statements shown to investors)	Both SLM and WDV -- company chooses based on which best reflects actual usage
Income Tax Act (for calculating tax payable to government)	ONLY WDV -- Income Tax Act does not permit straight line

KEY INSIGHT -- Same Total, Different Timing

Both SLM and WDV produce the EXACT SAME TOTAL DEPRECIATION over the full life of the asset. The difference is only in TIMING -- how that total is spread year by year. WDV takes a bigger bite early, SLM takes equal bites throughout. Because early years have higher depreciation under WDV, profit is lower and tax is lower in those years. That is why method choice matters for tax planning.

EXAM TIP -- Deferred Tax

This creates a timing difference: your published accounts may use SLM but your tax return uses WDV. The difference gives rise to DEFERRED TAX on the Balance Sheet. Deferred Tax Liability (DTL): when book profit > taxable profit (SLM in books, WDV for tax in early years) -- tax saved today will be paid in the future = future liability.

Deferred Tax Asset (DTA): when taxable profit > book profit -- tax paid today in excess = future benefit.

MANAGER TAKEAWAY -- Depreciation as a Business Tool

Depreciation method is not just an accounting choice -- it is a cash flow decision. WDV front-loads the expense, which means lower taxable profit in early years and real cash tax savings exactly when a new investment needs cash the most.

PRODUCT COMPANY EXAMPLE -- Manufacturing (CNC Machine Replacement): Your factory manager proposes replacing CNC machines at Rs.8 crore. Under WDV at 25% rate: Year 1 depreciation = Rs.2 crore, tax saving at 30% = Rs.60 lakh in Year 1 alone. Under SLM over 10 years: Year 1 = Rs.80 lakh, tax saving = Rs.24 lakh. The WDV advantage in Year 1: Rs.36 lakh extra cash in hand. Over 5 years, WDV consistently saves more tax in the early years when the machine is new and capex needs are highest. This Rs.36 lakh year-1 saving should be explicitly shown in every capex approval note.

SERVICE COMPANY EXAMPLE -- SaaS / Tech Company: Your team spends Rs.1.5 crore building a new product module. Under SLM over 3 years: Rs.50 lakh per year -- simple and predictable. Under WDV at 40%: Year 1 = Rs.60 lakh, Year 2 = Rs.36 lakh, Year 3 = Rs.21.6 lakh. WDV Year 1 saves you Rs.3 lakh in taxes (Rs.10 lakh more depreciation × 30% tax rate). For a startup or early-stage product, that Rs.3 lakh is real runway. The argument for SLM in SaaS: if the module is equally valuable in Year 3 as in Year 1 (stable subscription revenue), SLM better matches the economic reality.

The practical rule: for assets that lose economic value quickly (computers, tech) use WDV and capture the tax benefit early. For assets with uniform utility (buildings, furniture), SLM is simpler and equally valid.

8 Four Foundational Assumptions

Everything we have done rests on four assumptions. Understanding these answers most "why is accounting done this way?" questions.

Assumption	What it means	Example
1. Separate Entity Concept	The business is completely separate from its owners -- financially, legally, and in accounting records. They are never mixed.	A founder's personal car is not a business asset. When they invest capital, the business records it as equity -- money it owes the owner.
2. Money Measurement Concept	Only transactions expressible in monetary terms are recorded. Things without a clear monetary value cannot appear in financial statements.	Employee morale, brand loyalty, customer trust -- all real and valuable, but NOT on the Balance Sheet. Exception: purchased goodwill when acquired.
3. Going Concern Concept	The business is assumed to continue operating into the foreseeable future -- not about to shut down or be liquidated.	This is why we depreciate assets over useful life. If shutting down tomorrow, assets would be valued at fire-sale prices, far lower.
4. Accounting Period Concept	A business's infinite life is divided into regular time periods for reporting. This creates the need for accruals.	India's financial year: April 1 to March 31 -- mandated by the Companies Act. Creates the need for accrual-based accounting.

9 Reading Real Company Financials

"The vocabulary is standardised. They are all following the same Indian Companies Act. So if you understand the vocabulary, you can read all firms' financials -- NTPC, Infosys, Nestle, Asian Paints, HUL, RIL, IOCL. Whichever you pick up, it is the same language."

-- Prof. Manju Jaiswall

Company	Capital structure observation	Why it makes sense
Power Grid Corporation	Very debt-heavy. Capital Employed >> Net Worth. D/E ratio ~2:1.	Massive power infrastructure requires enormous upfront capital. Stable regulated returns make high leverage viable.
Oil India	Low debt. Net Worth close to Capital Employed.	Strong internal cash flows from exploration. Less need to borrow externally.
IOCL	Moderate debt. Between Power Grid and Oil India.	Refinery capex is large but trading revenues are strong enough to service moderate debt.
Airtel	High but managed debt.	5G spectrum auctions cost tens of thousands of crores. Infrastructure-heavy businesses need debt. Airtel's scale can service it.
Vodafone Idea	Extremely stressed, very high debt.	Same spectrum costs as Airtel but with shrinking subscriber base. Classic negative leverage.
MTNL	No debt, but persistent large operating losses.	Avoided the debt trap but also avoided the investment needed to stay competitive. Debt-free is NOT automatically better.

10 Class Exercise -- TTK Inc.

The Problem: TTK Inc. starts the year with Assets of Rs.2,80,000 and Liabilities of Rs.1,20,000. At year-end, Assets are Rs.4,00,000 and Liabilities are Rs.1,40,000. During the year: new share capital was issued of Rs.40,000 and dividends of Rs.48,000 were paid. Required: Calculate Net Income for the year.

Step	Calculation	Result
Opening OE	Assets - Liabilities = Rs.2,80,000 - Rs.1,20,000	Opening OE = Rs.1,60,000
Closing OE	Assets - Liabilities = Rs.4,00,000 - Rs.1,40,000	Closing OE = Rs.2,60,000
Total change in OE	Closing - Opening = Rs.2,60,000 - Rs.1,60,000	Change = +Rs.1,00,000
OE change formula	Change in OE = New Share Capital + Net Income - Dividends	Rs.1,00,000 = Rs.40,000 + NI - Rs.48,000
Solve for Net Income	NI = Rs.1,00,000 - Rs.40,000 + Rs.48,000	Net Income = Rs.1,08,000

EXAM TIP -- TTK Trap

COMMON TRAP: the change in OE includes BOTH new share capital AND net income. You MUST strip out the new investment (Rs.40,000) to isolate Net Income. Formula: Net Income = (Closing OE - Opening OE) + Dividends Paid - New Capital Invested.

11 Vocabulary Quick Reference

Term	One-line meaning	Where it appears
Net Worth / Owners Equity	Share Capital + Retained Earnings. What belongs to owners after settling all debts.	Balance Sheet -- equity side
Capital Employed	Net Worth + Long-term Debt. Total funds working in the business.	Computed from Balance Sheet
Working Capital	Current Assets minus Current Liabilities. Short-term liquidity buffer.	Computed from Balance Sheet

Term	One-line meaning	Where it appears
Gross Block / Net Block	Gross = original cost of all fixed assets. Net = Gross minus accumulated depreciation.	Balance Sheet -- non-current assets
EBITDA / PBIDT	Earnings Before Interest, Tax, Depreciation, Amortisation. Operating cash proxy.	Income Statement
EBIT / PBIT	Earnings Before Interest and Tax. Operating profit after depreciation.	Income Statement
PBT / EBT	Profit Before Tax. After interest expense, before income tax.	Income Statement
PAT / EAT / Net Income	Profit After Tax. The bottom line. What the company earned for shareholders.	Income Statement -- final line
Retained Earnings	Opening RE + Net Income - Dividends = Closing RE. Bridge from P&L; to Balance Sheet.	P&L; then Balance Sheet
Trade Receivables / Debtors	Money owed by customers for credit sales. Future benefit = asset.	Balance Sheet -- current assets
Trade Payables / Creditors	Money owed to suppliers. Future sacrifice = liability.	Balance Sheet -- current liabilities
Accrued Expenses	Expenses incurred but not yet paid. Recorded on accrual basis.	Balance Sheet -- current liabilities
COGS	Cost of Goods Sold. Cost of inventory sold. Asset converting to expense.	Income Statement -- first deduction from sales
Gross Profit	Sales minus COGS. Profit before operating expenses. Measures pricing power.	Income Statement
EPS	Earnings Per Share = PAT / Shares outstanding. Profit per share.	Below Income Statement
Deferred Tax (DTL/DTA)	Timing difference between book profit and taxable profit (from depreciation method mismatch). DTL = future outflow. DTA = future benefit.	Balance Sheet
CWIP	Capital Work-in-Progress. Assets under construction, not yet in use. No depreciation yet.	Balance Sheet -- non-current assets
Exceptional Items	One-time, non-recurring items shown separately to reveal normalised performance.	Income Statement -- separate line
OCI	Other Comprehensive Income. Items excluded from regular P&L;, e.g. fair value changes.	Below PAT in Ind-AS statements

SESSION 1 -- 30 Practice MCQs (with answers and explanations)

Q1. Which of the following is NOT an asset?

A. Cash in hand

B. Inventory waiting to be sold

C. Salary payable to employees

D. Money owed by customers

Answer: C

Salary payable is a liability -- a future sacrifice. Cash, inventory and debtors all have future benefit = assets.

Q2. The accounting equation is:

A. Assets = Revenue minus Expenses

B. Assets = Liabilities + Owners Equity

C. Assets = Liabilities minus Owners Equity

D. Revenue = Assets + Liabilities

Answer: B

The fundamental equation: every resource (assets) was funded by outsiders (liabilities) or owners (equity). Both sides must always balance.

Q3. A company buys a machine for Rs.10L cash. What is the double-entry impact?

A. Machine +10L, Cash +10L

B. Machine +10L, Cash -10L

C. Machine +10L, Equity +10L

D. Cash -10L, Liability +10L

Answer: B

One asset (cash) converts to another asset (machine). Both impacts on the left side -- net change = zero. Equation stays balanced.

Q4. Retained Earnings is part of:

A. Liabilities

B. Assets

C. Owners Equity

D. Revenue

Answer: C

RE is the second component of Owners Equity (first = Share Capital). It represents accumulated profits kept in the business.

Q5. Which statement shows performance OVER A PERIOD?

A. Balance Sheet

B. Income Statement (P&L;)

C. Both A and B

D. Neither

Answer: B

The Income Statement covers a period ('for the year ended'). The Balance Sheet is a point-in-time snapshot ('as at'). Frequently tested distinction.

Q6. A refundable security deposit for a rented showroom is recorded as:

A. Rent expense

B. An asset -- security deposit

C. A liability

D. Owners equity

Answer: B

The deposit will be returned -- future benefit = Asset. Rent expense is only recorded when the space is actually used (Accrual Concept).

Q7. Which is a financing activity?

A. Buying machinery

B. Selling goods to customers

C. Taking a bank loan

D. Paying salaries

Answer: C

Taking a loan = raising funds = financing. Buying machinery = investing. Selling goods and paying salaries = operating.

Q8. Under the Accrual Concept, expenses are recorded when:

A. Cash is paid

B. They are incurred -- benefit received

C. The financial year ends

D. The auditor approves

Answer: B

Record when incurred (benefit received), not when cash moves.

Q9. Capital Employed equals:

A. Share Capital only

B. Net Worth only

C. Net Worth + Long-term Debt

D. Current Assets minus Current Liabilities

Answer: C

Capital Employed = Net Worth + Long-term Debt. Total funds deployed in the business.

Q10. Working Capital is:

A. Total Assets minus Total Liabilities

B. Current Assets minus Current Liabilities

C. Fixed Assets minus Long-term Debt

D. Revenue minus Expenses

Answer: B

Working Capital = Current Assets minus Current Liabilities. Measures short-term liquidity.

Q11. Dividends paid appear in the financial statements as:

A. An expense in the Income Statement

B. A reduction of Retained Earnings in the Balance Sheet

C. An asset in the Balance Sheet

D. They do not appear anywhere

Answer: B

Dividends are not an expense -- not in the P&L.; They reduce Retained Earnings on the Balance Sheet and appear under Financing in the Cash Flow Statement.

Q12. Under Going Concern, assets are recorded at:

A. Liquidation value

B. Current market value

C. Historical cost, depreciated over useful life

D. Replacement cost

Answer: C

Going Concern assumes the business will continue -- assets recorded at cost and depreciated over useful life, not at fire-sale value.

Q13. COGS stands for:

A. Cost Of Gross Sales

B. Cost Of Goods Sold

C. Cash Or Goods Settlement

D. Cost Of General Supplies

Answer: B

COGS = Cost of Goods Sold. Revenue minus COGS = Gross Profit.

Q14. EBITDA stands for:

A. Earnings Before Interest, Tax, Depreciation, Amortisation

B. Earnings Before Income Tax, Dividends and Assets

C. Equity-Based Interest Tax, Dividends and Allowances

D. None of the above

Answer: A

EBITDA strips out non-cash charges and financing costs -- useful proxy for operating cash generation.

Q15. Correct sequence for preparing financial statements:

A. Balance Sheet, P&L;, Cash Flow

B. Cash Flow, P&L;, Balance Sheet

C. P&L;, Retained Earnings, Balance Sheet

D. Any order works

Answer: C

P&L; first (Net Income), then RE Statement (closing RE), then Balance Sheet (closing RE flows in). Each feeds the next.

Q16. Under Straight Line Method, the annual depreciation charge is:

A. Higher in early years

B. Same every year

C. Based on actual usage

D. On current market value

Answer: B

SLM: (Cost minus Residual) / Useful Life = same charge every year. WDV gives higher early, lower later.

Q17. Deferred Tax arises due to:

A. Late payment of taxes

B. Timing differences between book and taxable profit

C. Non-payment of dividends

D. Foreign currency transactions

Answer: B

Timing differences -- typically from different depreciation methods for Companies Act (SLM) vs Income Tax Act (WDV only).

Q18. Trade Receivables / Debtors are classified as:

A. Non-current assets

B. Current liabilities

C. Current assets

D. Owners equity

Answer: C

Money owed by customers for credit sales -- expected within the operating cycle = Current Assets.

Q19. The Separate Entity Concept means:

A. Each product line is a separate business

B. Business and owners are financially separate

C. Each department has its own accounts

D. International subsidiaries are independent

Answer: B

Business is a separate legal and financial entity. Owner's personal transactions never mix with business transactions.

Q20. Which is an investing activity?

A. Issuing new shares

B. Buying a delivery vehicle for business

C. Paying supplier invoices

D. Receiving customer payments

Answer: B

Buying a long-term asset = investing. Issuing shares = financing. Paying suppliers and collecting from customers = operating.

Q21. Net Worth equals:

A. Total Assets

B. Share Capital + Retained Earnings

C. Total Assets minus Current Liabilities

D. Revenue minus Expenses

Answer: B

Net Worth = Share Capital + Retained Earnings = Owners Equity. The owners' total stake in the business.

Q22. CWIP stands for:

A. Cash Withdrawn In Previous years

B. Capital Work-In-Progress

C. Current Working Investment Pool

D. Cost of Wages Including Provident fund

Answer: B

Assets under construction -- not yet ready for use. Once commissioned, they move to Fixed Assets and depreciation begins.

Q23. The Money Measurement Concept means:

A. All transactions in USD

B. Only monetary transactions are recorded

C. Money counted physically each month

D. Profits measured in real terms

Answer: B

Only what can be expressed in money terms goes into the accounting books.

Q24. Revenue Rs.100L, COGS Rs.60L. Gross Profit is:

A. Rs.160L

B. Rs.60L

C. Rs.40L

D. Rs.100L

Answer: C

Gross Profit = Revenue minus COGS = Rs.100L minus Rs.60L = Rs.40L.

Q25. Total Assets Rs.500L, Total Liabilities Rs.320L. Owners Equity is:

A. Rs.820L

B. Rs.320L

C. Rs.500L

D. Rs.180L

Answer: D

OE = Assets minus Liabilities = Rs.500L minus Rs.320L = Rs.180L.

Q26. PBT stands for:

A. Profit Before Transfers

B. Profit Before Tax

C. Prior Balance of Trade

D. Provisional Book Total

Answer: B

PBT = Profit Before Tax. After interest, before income tax. Also called EBT.

Q27. Which concept divides business life into reporting periods?

A. Going Concern

B. Separate Entity

C. Accounting Period

D. Money Measurement

Answer: C

The Accounting Period Concept -- creates the need for accrual-based accounting.

Q28. EPS is calculated as:

A. EBITDA / Total Shares

B. PAT / Number of Shares Outstanding

C. Revenue / Share Price

D. Net Worth / Number of Shares

Answer: B

EPS = PAT / Shares outstanding. Measures profit earned per share.

Q29. Under WDV, depreciation in early years is:

A. Lower than SLM

B. Same as SLM

C. Higher than SLM

D. Zero in first year

Answer: C

WDV front-loads depreciation. Total over the asset's life is the same as SLM -- only timing differs.

Q30. The Cash Flow Statement has which three sections?

A. Revenue, Expenses, Profit

B. Assets, Liabilities, Equity

C. Operating, Investing, Financing

D. Short-term, Medium-term, Long-term

Answer: C

Exactly the three business activities: Operating (CFO), Investing (CFI), Financing (CFF).

2 SESSION 2: Understanding Financial Statements -- II

Depreciation in depth, real balance sheets, Richie Advisors case, and the Cash Flow Statement

Session 2 picks up exactly where Richie's startup story begins -- on the same day India reports its first COVID-19 case. You will learn how to read a real company's balance sheet, why depreciation exists, how the income statement tells you more than just profit, and why a profitable company can still run out of money. Every concept is introduced through a story, not a textbook. No finance background required.

1 Where We Left Off

> *"If you are able to read one balance sheet, you are able to read all of them. The format is the same. The language is the same. Come to any annual report and you will find your way."*
>
> **-- Prof. Manju Jaiswall**

Session 1 built the complete foundation. You built all three financial statements from scratch using a single fictional business -- the six-friends company. Today, Session 2 does not restart. It accelerates. The hypothetical business is behind you. Today you will read real balance sheets from Infosys, Nestle, BEL, and IOCL. You will meet Richie Ranchordas -- a brand new Chartered Financial Planner who starts his company on the same day India reports its first COVID-19 case.

Term	Plain English meaning	Where it lives
Asset	Something the business owns that will give future benefit	Left side of the Balance Sheet
Liability	Something the business owes to outsiders	Right side of the Balance Sheet
Owners Equity	What is left for the owners after all debts are paid	Right side of the Balance Sheet
Revenue	Money earned from running the business (on accrual)	Top of the Income Statement
Expense	Cost of running the business (on accrual)	Income Statement -- reduces profit
Double Impact	Every transaction changes at least two accounts -- always	The rule behind every journal entry

EXAM TIP

The accounting equation is not just a formula -- it is a statement about reality. If it ever does not balance, something has been recorded incorrectly. Always check.

2 Depreciation

Imagine you spend Rs.20,000 buying a table for your office today. You plan to use that table for the next five years. Should you put Rs.20,000 as an expense in this year's P&L;? That would make your profit look terrible this year and artificially perfect in the four years that follow. That is unfair and misleading. Depreciation is the mechanism that solves this problem.

Depreciation: The systematic spreading of an asset's cost over the years it benefits the business. Instead of taking the full hit in year one, you take a fraction each year -- matching the cost to the period that gets the benefit.

Example: Rs.20,000 table, 5-year life, zero scrap value: Rs.4,000 depreciation expense each year for 5 years. Total over 5 years = Rs.20,000. Exactly the full cost -- just spread out.

Notice what depreciation is not: it is not cash going out of the bank. You already paid for the table on day one. Depreciation is simply a book entry -- you are converting an asset (the table) into an expense (its cost) gradually.

Input needed	Plain English	Example
Cost of the asset	Everything you spent to get the asset ready for use -- purchase price, installation, transport	Table costs Rs.20,000 including delivery
Residual (scrap) value	What you expect to sell it for at the end of its useful life. If you expect nothing, use zero.	Old table can be sold for Rs.1,000 as scrap
Useful life	How many years you expect to use the asset. You decide this -- government gives guidance.	5 years
Method of depreciation	The formula you choose to spread the cost. Two popular methods: SLM and WDV.	SLM for a table; WDV for a computer

The **depreciable amount** is always: Cost minus Residual Value. That is the total you will spread over the asset's life.

Method 1 -- Straight Line Method (SLM)

Divide the depreciable amount equally by the useful life. Same depreciation charge, every single year. The assumption: you use the asset uniformly throughout its life.

> *"Straight line for a table is fine. You use the table the same way every day. But a high-end computer used for coding? In year one you are running the latest software on it. By year four, better machines exist and you use it less. That is not straight line usage."*
>
> **-- Prof. Manju Jaiswall**

Formula: Annual Depreciation = (Cost - Residual Value) / Useful Life

Year	Gross Book Value	Depreciation	Net Book Value
Year 1	Rs.11,000 cr	Rs.1,000 cr	Rs.10,000 cr
Year 2	Rs.11,000 cr	Rs.1,000 cr	Rs.9,000 cr
Year 3	Rs.11,000 cr	Rs.1,000 cr	Rs.8,000 cr
Year 10 (final)	Rs.11,000 cr	Rs.1,000 cr	Rs.1,000 cr (= residual)

Method 2 -- Written Down Value (WDV)

WDV Rate formula: Rate = 1 - (Residual Value / Cost) raised to power (1/n), where n = useful life.

Instead of applying the rate on the original cost every year, you apply it on the **net book value at the start of that year.** Since the net book value falls every year, the depreciation charge also falls -- higher in early years, lower as the asset ages.

Year	Net Book Value (start)	Depreciation (NBV x Rate)	Net Book Value (end)
Year 1	Rs.11,000 cr (original cost -- highest)	Highest -- large bite early	Falls sharply
Year 2	Lower than Year 1	Also lower than Year 1	Falls again
Year 5	Much lower	Much smaller charge	Continues falling
Year 10	Near residual	Tiny charge	Reaches Rs.1,000 cr

KEY INSIGHT -- Same Total, Different Timing (Reinforcement from Session 1)

As established in Session 1 -- both SLM and WDV produce the EXACT SAME TOTAL depreciation over the full asset life. The difference is only in timing -- how that total is spread year by year. WDV takes a bigger bite early. SLM takes equal bites throughout. Because early years have higher depreciation under WDV, profit is lower and tax is lower in those years. That is why method choice matters.

Law / Context	Which methods are allowed?
Companies Act (financial statements for investors)	Both SLM and WDV -- company chooses based on which best reflects actual usage
Income Tax Act (tax payable to government)	ONLY WDV -- income tax does not permit straight line

EXAM TIP -- Three Important Real-World Issues

(1) DIFFERENT USEFUL LIFE ASSUMPTIONS: both can be correct, provided assumption reflects actual usage.

(2) ASSET USED BEYOND DEPRECIATED LIFE: once NBV reaches zero, simply STOP recording depreciation. Asset continues in use for free.

(3) REVISING USEFUL LIFE MID-WAY: apply the change PROSPECTIVELY -- take current NBV and spread over revised remaining life. Do NOT restate prior statements.

(4) CHANGING DEPRECIATION METHOD: requires strong justification that new method better reflects actual usage. Must be disclosed to shareholders. NOT allowed as a routine practice.

3 Reading a Real Balance Sheet

"If you understand one balance sheet, you can read all of them. Because the format is mandated -- Schedule III of the Companies Act. Infosys, Nestle, BEL, Asian Paints, IOCL -- same structure, every time."

-- Prof. Manju Jaiswall

Asset type	Plain English test	Real examples
Current Assets	Will this convert to cash, be sold, or be consumed within 12 months?	Inventory, debtors (customers who will pay), cash in bank, prepaid expenses
Non-Current: Tangible Fixed Assets	Physical assets used for more than one year -- depreciated	Machinery, buildings, computers, office furniture, vehicles
Non-Current: Intangible Fixed Assets	Non-physical assets used for more than one year -- amortised	Software, patents, trademarks, licences, goodwill
Non-Current: Investments	Money the business has parked outside its core operations	Equity shares, mutual funds, bonds, stakes in subsidiaries or JVs
Capital Work in Progress (CWIP)	Fixed assets being built or installed but not yet ready to use	A factory under construction that is 80% complete at year-end

KEY INSIGHT -- Fixed Assets vs Investments

If your investments outside the business are earning more than your fixed assets inside the business, something is fundamentally wrong. Why are you running this business at all? You would do better just closing it and investing the money. Fixed assets MUST generate more -- they are the reason the business exists.

Where Does Goodwill Come From?

Purchased Goodwill is the ONLY kind allowed on a balance sheet. It arises when Company A acquires Company B and pays MORE than the book value of Company B. That extra payment -- the premium -- is recorded as Goodwill. It is objective because an arm's-length transaction actually occurred.

Example: Tata Tea acquires Tetley. Tetley's book value = Rs.200 cr. Tata Tea pays Rs.250 cr. The Rs.50 cr premium = Goodwill on Tata Tea's balance sheet. RULE: whenever you see Goodwill, the company has done an M&A; and paid above book value.

Liability type	Plain English	Examples
Current Liabilities	Obligations the business will settle within the next operating cycle (typically within 12 months)	Trade payables, accrued expenses, unearned revenue, short-term bank borrowings
Non-Current: Secured Loans	Long-term loans backed by collateral. Lower interest rate.	Mortgage loans, equipment-backed term loans
Non-Current: Unsecured Loans	Long-term loans with no collateral. Higher interest rate.	Unsecured debentures, clean term loans

EXAM TIP

Net Block = Gross Block minus Accumulated Depreciation. The Gross Block is what you paid. Accumulated Depreciation is the total depreciation charged since purchase. Net Block is what the asset is worth in your books today. Gross Block Rs.100 cr with Accumulated Depreciation Rs.60 cr means Net Block = Rs.40 cr.

MANAGER TAKEAWAY -- How to Read a Balance Sheet in 90 Seconds

You do not need to read every line. The 90-second scan gives you 80% of the insight. Read in this order: OE vs Capital Employed (debt level), CWIP (expansion phase), Current Ratio (liquidity), Goodwill (M&A; history), Net Block age (capex timing).

PRODUCT COMPANY EXAMPLE -- Evaluating a New Distributor for Rs.1.5 Crore Credit: Pull their latest balance sheet before extending credit. Current Ratio = 0.7 (current liabilities exceed current assets): red flag -- they are already cash-stretched. CWIP = Rs.3 crore (building new warehouse): more cash tied up in construction. Goodwill = Rs.2 crore: they did an acquisition -- is it performing, or is a write-off coming? Decision: offer Rs.30 lakh credit with 30-day terms, not Rs.1.5 crore on 90 days. Review again after the warehouse is complete and Current Ratio recovers above 1.2.

SERVICE COMPANY EXAMPLE -- Evaluating an Acquisition Target at Rs.30 Crore: IT services firm has zero long-term debt (good), but Investments = Rs.12 crore (40% of total assets parked in mutual funds). Question: is the business generating cash faster than it can deploy it, or has growth stalled and they are parking idle cash? CWIP = Rs.0: no expansion happening. Net Block = Rs.2 crore: entirely asset-light. You are paying Rs.28 crore for people, client relationships, and reputation. If any of the top 3 clients leave post-acquisition, that Rs.28 crore vaporises. Build that into your valuation.

4 The Income Statement Unpacked

Session 1 gave you five account heads: Assets, Liabilities, Owners Equity, Revenue, and Expenses. Session 2 adds two more -- Gains and Losses.

Head	Arises from	When recognised	Example
Revenue (Income)	Core operations of the business	ACCRUAL -- when earned, not when cash arrives	Advisory fee earned in March (even if paid in April)
Expense	Core operations of the business	ACCRUAL -- when incurred, not when cash leaves	February rent -- used in February, paid in March
GAIN	Investing activities (selling assets / investments)	REALISATION -- only when the transaction is completed	Sold old machinery for Rs.6L when book value was Rs.5L: Rs.1L gain
LOSS	Investing activities	REALISATION -- only when the transaction is completed	Raghu cannot pay his Rs.5,000 fee: bad debt loss written off

KEY INSIGHT

Depreciation is an EXPENSE -- not a loss. It arises from operations (using the asset in the business). A loss on the SALE of that same asset -- getting less cash than the book value -- is a GAIN or LOSS, because it comes from an investing activity. This distinction is tested.

Step	Line Item	What it tells you
1	Net Sales (Top Line)	How much the business sold -- its scale
2	Minus Cost of Goods Sold	What it cost to produce what was sold
3=	GROSS PROFIT	How much is left after covering direct production costs -- pricing power
4	Minus Operating Expenses (Admin + Selling)	What it costs to run and market the business
5=	OPERATING PROFIT (EBIT / PBIT)	How efficiently the CORE business runs -- before financing decisions
6	Plus/Minus Other Income, Gains, Losses	Non-operating items -- investing activity outcomes
7	Minus Interest (Finance Cost)	Cost of debt -- a financing decision, not an operating one
8=	EBT (Earnings Before Tax)	Pre-tax profit
9	Minus Tax	Government's share
10=	PAT / Net Income (Bottom Line)	What belongs to the owners

The Misra Company Exercise -- Why Net Profit Alone is Misleading

Prof. Manju showed the class a company whose Net Profit Margin fell from 5% last year to 3.1% this year. One participant (Sumit, a manager with a P&L; background) immediately said: this is a cause for concern. Another participant (Vinish) said: wait, look at the multi-step journey first.

When they looked at the full multi-step statement, they saw that the ENTIRE fall was explained by a single item: a loss on disposal of plant assets worth Rs.83.5. This is an investing activity -- a one-time decision to dispose of old equipment. It is NOT a reflection of how well the business was operated that year. If you add back this non-recurring loss, the effective Net Profit Margin becomes approximately 7.1% -- actually BETTER than the prior year.

> *"Do not just look at Net Profit as a magic number for a business. How you got to Net Profit is important. The journey from Operating Profit to Net Profit is what tells you the real story."*
>
> **-- Prof. Manju Jaiswall**

5 Richie Advisors: February 2020

30th January 2020. Richie Ranchordas walks out of IIM Calcutta with his Chartered Financial Planner degree. On the same day, India confirms its first COVID-19 case. The stock market is bleeding. Every rational person would wait. Richie does the opposite. His reasoning: when markets panic, investors need advice the most. Two days later -- 1st February 2020 -- Richie Advisors Private Limited is born.

Four New Concepts -- Understand These Before the Transactions

Concept	What it means	The Richie Advisors example
Revenue Recognition	Revenue is only recorded when the service is actually PERFORMED. Cash timing is irrelevant.	Babu pays Rs.4,000 in February for March service. February = Liability. March (work done) = Revenue.
Unearned Revenue (Advance from Customer)	Cash received before service is performed = liability until the work is done.	Babu's Rs.4,000 advance = Unearned Revenue (liability) in February. Becomes Revenue in March.
Prepaid Expense	Cash paid today for future benefit spanning multiple periods. Un-consumed portion = Asset.	Magazine subscription Rs.6,000 for 12 months. February: Rs.500 expense + Rs.5,500 Prepaid (asset).
Bad Debt / Write-Off	When a debtor is confirmed to never pay: remove receivable from assets, record as Bad Debt Expense. Original revenue NOT reversed.	Richie did work for Raghu in February (Rs.5,000 revenue correct). In March, Raghu vanishes. March: Bad Debt Expense Rs.5,000.

February Transactions -- Walked Through One by One

Transaction F1 -- Company incorporated (1 February)

Activity: Financing | Owners invest capital

Richie and friends deposit Rs.10,00,000 into the company's bank account in exchange for 1,00,000 equity shares at Rs.10 each. Cash goes up (the company now has money). Share Capital goes up (the company now owes that money to its shareholders). Classic double impact.

Impact	Account affected	Change	Side of equation
1st impact	Bank / Cash (Asset)	+Rs.10,00,000	LEFT -- company gains cash
2nd impact	Share Capital (Owners Equity)	+Rs.10,00,000	RIGHT -- owners now have a claim

Transaction F2 -- Office rented (1 February)

Activity: Operating setup | Two accounting treatments

The office requires a refundable security deposit of Rs.60,000 and a monthly rent of Rs.20,000. The deposit is refundable -- future benefit = Asset. The rent for February will be paid at the start of March. The office WAS used in February, so the rent expense IS February's expense. But since no cash left in February, it becomes Rent Payable (liability).

Impact	Account affected	Change	Side of equation
Security deposit	Cash (Asset)	-Rs.60,000	LEFT -- cash leaves for deposit
Security deposit	Security Deposit (Asset)	+Rs.60,000	LEFT -- new asset: refundable future benefit
Feb rent (accrual)	Rent Expense (reduces OE)	-Rs.20,000	RIGHT -- OE decreases: benefit consumed
Feb rent (accrual)	Rent Payable (Liability)	+Rs.20,000	RIGHT -- obligation to pay on 1 March

CONCEPT TRAP

No cash left for February rent -- so why is it an expense? Because the office WAS USED in February. The accrual concept says: record the expense when the benefit is consumed, not when the cash is paid.

Transaction F3 -- Supplies and first employee (2 February)

Activity: Operating

Stationery Rs.6,000 and four calculators Rs.1,000 = Rs.7,000 total purchased. At month-end, Rs.5,600 worth remains -- only Rs.1,400 was consumed = expense. Rs.5,600 stays as Supplies on Hand (current asset). An employee hired at Rs.10,000/month, paid at month-end -- expense and cash out simultaneously.

Transaction F4 -- Hardware and software (mid-February)

Activity: Investing | Fixed asset purchase

Computer hardware Rs.3,60,000 + software Rs.1,08,000 = Rs.4,68,000 total. Half (Rs.2,34,000) paid immediately. Half owed next month = Trade Creditor (liability). Expected life: 3 years, zero residual value. Monthly depreciation = Rs.4,68,000 / 36 months = Rs.13,000. This Rs.13,000 is a NON-CASH expense -- reduces the asset's book value and reduces profit, but no cash leaves.

Item	Amount
Total asset cost	Rs.4,68,000
Paid now (50% cash)	Rs.2,34,000
Owed next month (Trade Creditor)	Rs.2,34,000
Monthly depreciation (Rs.4,68,000 / 36 months)	Rs.13,000
Net Fixed Asset at end of February (Rs.4,68,000 - Rs.13,000)	Rs.4,55,000

Transaction F5 -- Revenue events (mid-February)

Activity: Operating | FOUR different situations -- each treated differently

Client	What happened	How to record it	Why
Individual client	Paid Rs.13,000 cash for advisory service -- done immediately	Revenue + Cash	Service performed AND cash received
Mutual fund commission	Earned Rs.2,000 commission on fund sold; cash arrives next month	Revenue + Commission Receivable (Asset)	Service done this month, accrual applies

Client	What happened	How to record it	Why
Babu	Paid Rs.4,000 advance for March service	Unearned Revenue (LIABILITY) -- NOT revenue yet	Cash received, but service NOT yet provided
Raghu	Service done worth Rs.5,000; will pay next month	Revenue + Raghu Receivable (Asset)	Service done this month, accrual applies

MOST COMMON MISTAKE

Babu's Rs.4,000 must NOT be recorded as revenue in February. Cash received does not equal revenue earned. Babu paid in advance -- Richie still owes Babu the service (or a refund). Until the service is done, this sits as a LIABILITY on the balance sheet.

Transaction F6 -- Operating expenses (February)

Activity: Operating

Expense	Amount	Treatment
Electricity	Rs.3,000	Full expense -- paid this month
Internet and telephone	Rs.4,000	Full expense -- paid this month
Cable television	Rs.1,000	Full expense -- paid this month
Water	Rs.2,000	Full expense -- paid this month
Magazine subscription Rs.6,000 total	Rs.500 is Feb expense (1/12)	Rs.5,500 = Prepaid Expense (Asset -- 11 months remaining)

Transaction F7 -- Salaries (end of February)

Activity: Operating

Richie (Rs.40,000) + Employee 1 (Rs.10,000) = Rs.50,000 total, paid at month-end. Cash leaves and OE decreases simultaneously. Note: Richie's 10% profit incentive is calculated on the full-year net profit ending 31 March 2021. It does NOT apply to these two months -- no accrual for the incentive in February or March.

February 2020 -- Income Statement

Line Item	Working	Amount (Rs.)
Fee revenue -- individual client (cash)	Service done, cash received	13,000
Commission revenue	Earned; cash arrives March (accrual)	2,000
Fee revenue -- Raghu	Service done; Raghu pays March (accrual)	5,000
Babu advance	EXCLUDED -- service not yet done = Unearned Revenue (Liability)	--
TOTAL REVENUE		20,000
Salaries	Richie Rs.40k + Employee Rs.10k	50,000
Rent expense	Accrued -- paid 1 March	20,000
Depreciation	Rs.4,68,000 / 36 months = Rs.13,000	13,000

Line Item	Working	Amount (Rs.)
Electricity	Paid cash	3,000
Internet and telephone	Paid cash	4,000
Cable television	Paid cash	1,000
Water	Paid cash	2,000
Magazine expense	Rs.6,000 x 1/12 = Rs.500 (1 month consumed)	500
Supplies consumed	Rs.7,000 purchased - Rs.5,600 remaining = Rs.1,400 used	1,400
TOTAL EXPENSES		94,900
NET LOSS -- February 2020	Rs.20,000 - Rs.94,900	(74,900)

February 2020 -- Balance Sheet

ASSETS	Rs.	LIABILITIES + OWNERS EQUITY	Rs.
Net Fixed Assets (Rs.4,68,000 - Rs.13,000)	4,55,000	Share Capital	10,00,000
Security Deposit	60,000	Retained Earnings (Feb Net Loss)	-74,900
Prepaid Magazine Subscription	5,500	Total Owners Equity	9,25,100
Supplies on Hand	5,600	Trade Creditor (hardware balance)	2,34,000
Commission Receivable	2,000	Rent Payable (accrued)	20,000
Raghu Receivable	5,000	Unearned Revenue -- Babu	4,000
Cash / Bank	6,50,000		
TOTAL ASSETS	11,83,100	TOTAL LIABILITIES + OE	11,83,100

WHY THE FEBRUARY LOSS IS NOT ALARMING

Cash fell from Rs.10 lakh to Rs.6.5 lakh. Should Richie's investor friends worry? No.

Rs.2.34 lakh went into productive assets -- computers and software that will generate revenue for 3 years.

Rs.60,000 is a refundable deposit.

The Rs.74,900 loss is almost entirely fixed costs (salaries, rent, depreciation) incurred in a startup month with very little revenue.

February was the setup month. March will tell a completely different story.

6 Richie Advisors: March 2020

March 2020 was the month the world held its breath. On 13th March, Indian stock exchanges halted trading for the first time in 12 years. Sensex fell 9.4%. Nifty dropped 10.07%. Clients were nervous. And yet, word-of-mouth had been spreading about Richie's advisory service -- the very volatility that scared other investors was bringing new ones to Richie's door. Revenue in March: Rs.2,24,000 -- compared to Rs.20,000 in February. An 11x jump in a single month.

March Transactions -- One by One

Transaction M1 -- Clear February obligations (1 March)

Activity: Clearing liabilities from the prior month

Two payments go out on the first day of March. The February rent of Rs.20,000 (accrued as a liability) is now paid -- Cash down, Rent Payable cleared. The hardware supplier's balance of Rs.2,34,000 is also settled -- Cash down, Trade Creditor cleared. Both were February liabilities; paying them in March simply removes the obligation.

Transaction M2 -- New employee and bank loan (1 March)

Activity: Financing (bank loan) | Operating (new hire)

A second employee is hired at Rs.15,000/month. A bank loan of Rs.5,00,000 is raised at 12% per annum. Interest is payable quarterly -- on April 1, July 1, October 1, January 1. March interest = Rs.5,00,000 x 12% x 1/12 = Rs.5,000. NOT paid in March but INCURRED in March. Accrual.

Item	Working	Entry
Bank loan received	Rs.5,00,000 from the bank	Cash +Rs.5,00,000 | Bank Loan (Liability) +Rs.5,00,000
March interest expense (accrued)	Rs.5,00,000 x 12% x 1/12 = Rs.5,000	Interest Expense (reduces OE) | Interest Payable (Liability) +Rs.5,000

Transaction M3 -- Revenue in March

Activity: Operating | Multiple revenue streams

Event	Amount	Treatment	Why
Fees from many clients	Rs.2,00,000	Revenue + Cash	Services done, cash received
Babu service completed	Rs.4,000	Unearned Revenue (liability) converts to Revenue	Service now done -- cash came in February, revenue recognised in March
April services advance	Rs.30,000	Unearned Revenue (new liability) -- NOT revenue yet	Cash received but service not yet performed
Commission from fund sales	Rs.20,000	Revenue + Commission Receivable	Earned in March; cash from fund houses arrives in April
Feb commission collected (Rs.2,000)	Rs.2,000	Cash + | Commission Receivable -	No new revenue -- just converting a Feb receivable to cash

> *"Babu paid in February. The service was done in March. Revenue is recognised in March -- not February. Cash and revenue lived in different months. That is the Revenue Recognition principle doing exactly what it is designed to do."*
>
> **-- Prof. Manju Jaiswall**

Transaction M4 -- Raghu written off as Bad Debt

Activity: Operating expense

The company cannot trace Raghu. He will not pay his Rs.5,000 fee. The February receivable must be removed from the books. This is a Bad Debt Expense in March -- a new expense, NOT a reversal of February's revenue. The February revenue was correctly recorded (service WAS performed). The failure to collect is a separate event in March.

EXAM TIP

Two-month net effect of Raghu: Feb +Rs.5,000 revenue, March -Rs.5,000 bad debt expense = ZERO over the combined period. This is the correct economic outcome -- Richie did the work but collected nothing.

Transaction M5 -- March operating expenses and adjustments

Activity: Operating

Item	Amount	Notes
Electricity	Rs.6,000	Paid cash
Internet and telephone	Rs.7,000	Paid cash
Cable television	Rs.1,000	Paid cash
Water and beverages	Rs.5,000	Paid cash
Supplies consumed	Rs.4,400	Opening Rs.5,600 - Closing Rs.1,200 = Rs.4,400 used
Magazine expense	Rs.500	Month 2 of 12; Prepaid falls to Rs.5,000
Salaries (all three)	Rs.65,000	Richie Rs.40k + Employee 1 Rs.10k + Employee 2 Rs.15k
Rent accrued	Rs.20,000	Same as February -- used in March, paid 1 April
Depreciation	Rs.13,000	Month 2 of 36 months
Interest expense (accrued)	Rs.5,000	Rs.5,00,000 x 12% x 1/12 -- payable 1 April, accrued now
Web portal contract given	No entry	Contract given but portal not delivered -- nothing to record yet

March 2020 -- Income Statement

Line Item	Working	Amount (Rs.)
Fee revenue -- cash	From multiple clients	2,00,000
Babu revenue recognised	Feb Unearned Revenue -- service completed in March	4,000
Commission revenue	Earned; receivable from fund houses	20,000
April advance	EXCLUDED -- Unearned Revenue (service in April)	--
TOTAL REVENUE		2,24,000
Salaries	Rs.40k + Rs.10k + Rs.15k	65,000
Rent expense	Accrued, payable 1 April	20,000
Depreciation	Month 2 of 36	13,000
Bad Debt Expense	Raghu write-off	5,000
Electricity		6,000
Internet and telephone		7,000
Cable television		1,000
Water and beverages		5,000
Magazine expense	Month 2 of 12	500

Line Item	Working	Amount (Rs.)
Supplies consumed	Rs.5,600 - Rs.1,200	4,400
Interest expense	Rs.5,00,000 x 12% x 1/12 (accrued)	5,000
TOTAL EXPENSES		1,31,900
NET INCOME -- March 2020	Rs.2,24,000 - Rs.1,31,900	92,100

March 2020 -- Balance Sheet

ASSETS	Rs.	LIABILITIES + OWNERS EQUITY	Rs.
Net Fixed Assets (Rs.4,68,000 - Rs.26,000 acc. dep)	4,42,000	Share Capital	10,00,000
Security Deposit	60,000	Retained Earnings (cumulative: -74,900+92,100)	17,200
Prepaid Magazine Subscription	5,000	Total Owners Equity	10,17,200
Supplies on Hand	1,200	Bank Loan	5,00,000
Commission Receivable (March)	20,000	Rent Payable (payable Apr 1)	20,000
Cash / Bank	10,44,000	Interest Payable (payable Apr 1)	5,000
		Unearned Revenue -- April advances	30,000
TOTAL ASSETS	15,72,200	TOTAL LIABILITIES + OE	15,72,200

Two-Month Summary

Metric	February 2020	March 2020	What it tells us
Total Revenue	Rs.20,000	Rs.2,24,000	11x growth -- business gaining fast momentum
Total Expenses	Rs.94,900	Rs.1,31,900	Fixed cost base set; marginal cost of extra revenue is low
Net Income / (Loss)	(Rs.74,900)	Rs.92,100	Loss in month 1 is a startup phenomenon. Profitable by month 2.
Cumulative Net Income	(Rs.74,900)	+Rs.17,200	Positive over two months -- company is already building equity
Cash / Bank	Rs.6,50,000	Rs.10,44,000	Strong cash position -- loan + revenue covered all outflows
Total Assets	Rs.11,83,100	Rs.15,72,200	Balance sheet growing rapidly in just two months
Owners Equity	Rs.9,25,100	Rs.10,17,200	Higher than the Rs.10 lakh invested -- shareholders are ahead

THE VERDICT FOR RICHIE'S INVESTOR FRIENDS

In just two months, Richie Advisors turned from a startup with a Rs.74,900 loss into a profitable company with Rs.17,200 cumulative net income.

Revenue grew 11x in month two alone.

The balance sheet shows Rs.10.17 lakh in owners equity -- HIGHER than the Rs.10 lakh they invested.

The business model is validated. The volatility that scared the market was Richie's opportunity.

MANAGER TAKEAWAY -- Reading a Startup's Financials -- What the Loss Means

Apply the Richie Advisors framework when evaluating a new venture, division, or project:

(1) Is the loss from unavoidable fixed costs in early months (setup phenomenon) or from variable costs that will persist?

(2) Is the breakeven achievable with reasonable volume growth?

(3) Is the cash position sustainable until breakeven?

The same logic applies when you are asked to approve a new product launch that will lose money in Q1 and Q2.

7 The Cash Flow Statement

Can a profitable company go bankrupt? Yes -- and it happens more often than you would think. Profit is calculated on accrual. A company can show excellent profits on paper while its bank account drains because customers are not paying, or because it is investing heavily in assets.

"Do not underestimate the need for managing your cash well. You need cash for everything in the business -- buying assets, paying expenses, settling liabilities, paying dividends, paying taxes, servicing debt. Even with good profits, if the cash is not there, the business does not survive."

-- Prof. Manju Jaiswall

Section	Abbreviation	What it captures	Why it matters
Cash Flow from Operating Activities	CFO	Cash generated from the core business -- collecting from customers, paying suppliers and staff	MOST IMPORTANT section. If CFO is consistently negative, the business cannot sustain itself.
Cash Flow from Investing Activities	CFI	Cash spent on buying long-term assets (or received from selling them)	Negative CFI usually means the business is GROWING -- spending on capex.
Cash Flow from Financing Activities	CFF	Cash raised from owners or banks -- and returned to them	Includes share issues, loans received, repayments, dividends paid.

Company	Net Income	Operating Cash (CFO)	What it says
Tata Steel	Rs.7,316 cr	Rs.7,397 cr	Healthy -- cash matches profit well

Company	Net Income	Operating Cash (CFO)	What it says
HUL	Rs.3,025 cr	Rs.2,028 cr	CFO slightly below -- normal working capital timing
Reliance Industries	Rs.23,010 cr	Rs.17,427 cr	Large capex-heavy business -- some lag expected
Suzlon Energy	Rs.876 cr (profit)	Rs.-267 cr (NEGATIVE)	RED FLAG -- profitable on paper, burning cash. Classic divergence.
HPCL	Rs.-3,306 cr (loss)	Rs.521 cr (positive)	TURNAROUND signal -- despite accounting loss, generating real cash

Now apply this to Richie Advisors specifically. Every transaction we walked through in February and March belongs in one of the three buckets. The classification rule is simple: **will this asset or payment benefit the business for longer than one operating cycle?** Yes = Investing. No = Operating. Raising or returning money = Financing.

Transaction	Goes to	Why
Fees collected from clients	CFO (Operating)	Core revenue-generating activity
Computer hardware and software purchased	CFI (Investing)	Long-term non-current asset -- lasts 3 years
Bank loan received	CFF (Financing)	Change in borrowings -- financing activity
Interest paid on loan	CFO (Operating) under Indian GAAP (AS 3)	AS 3 allows interest paid as CFO or CFF; most Indian companies use CFO
Security deposit paid to landlord	CFO (Operating)	Refundable within short notice -- near-current
Stationery purchased	CFO (Operating)	Consumed within the operating cycle -- not a long-term asset

EXAM TIP -- CFO vs CFI Classification Test

The key question: will this asset benefit the business for LONGER THAN ONE OPERATING CYCLE? YES = Investing activity (CFI). NO = Operating activity (CFO). Stationery: consumed in months. CFO. Computer: used for 3 years. CFI.

8 Key Formulas

Formula	Expression
Accounting Equation	Assets = Liabilities + Owners Equity
SLM Annual Depreciation	(Cost - Residual Value) / Useful Life in Years
WDV Depreciation Rate	1 - (Residual Value / Cost) raised to power (1 / n) where n = useful life
WDV Depreciation (any year)	Net Book Value at START of that year x WDV Rate
Net Block on Balance Sheet	Gross Block - Accumulated Depreciation
Gross Profit	Net Sales - Cost of Goods Sold
Operating Profit (EBIT)	Gross Profit - Operating Expenses
Net Profit (PAT)	EBIT - Interest Expense - Tax

Formula	Expression
Cash Flow Statement	CFO + CFI + CFF = Net Change in Cash
Retained Earnings (closing)	Opening RE + Net Income - Dividends Paid
Monthly Depreciation	Annual Depreciation / 12
Supplies Consumed	Opening Stock + Purchases - Closing Stock

The Balance Sheet Format -- Schedule III

The Companies Act mandates the presentation format through Schedule III. The structure is always the same: Sources of Funds on one side, Application of Funds on the other. Once you know this structure, you can navigate any Indian annual report immediately.

Section	What goes here
Shareholders' Funds (Equity)	Share capital + Reserves and surplus (or "Other Equity" under new rules)
Non-Current Liabilities	Long-term loans -- both secured and unsecured
Current Liabilities	Trade payables, accrued expenses, unearned revenue, short-term borrowings
Non-Current Assets	Net Block (Gross Fixed Assets minus Accumulated Depreciation), CWIP, long-term investments, long-term loans and advances
Current Assets	Inventory, trade receivables, cash, short-term investments, prepaid expenses

As India's accounting rules have converged with international standards (called **Ind AS / IFRS**), some terminology has changed. "Fixed assets" is now "Property, Plant and Equipment." "Reserves and surplus" is now "Other equity." A new line -- **Right of Use Assets** -- appears for assets taken on long-term leases. The structure is the same; only the labels have evolved.

Direct Method vs Indirect Method

There are two ways to calculate Cash Flow from Operations. You need to know the difference, because every Indian annual report uses one of them -- and the exam tests whether you understand why:

Method	How it works	Who uses it in practice?
Direct Method	Lists every major cash receipt and payment directly -- cash collected from customers, cash paid to suppliers, cash paid to employees. Clear and intuitive.	Rarely used in practice -- harder to prepare from accounting records.
Indirect Method	Starts from Net Profit and works backwards: adds back non-cash charges (depreciation, amortisation), removes investing-related gains and losses, then adjusts for changes in working capital (how debtors, creditors, and inventory changed).	EVERY Indian annual report you will read uses this method.

SESSION 2 -- True / False Practice (20 Checks)

1. Machinery is a fictitious asset.

Answer: FALSE

Machinery is a tangible FIXED ASSET -- real, physical, depreciable.

2. Creditors (trade payables) represent a long-term liability.

Answer: FALSE

Suppliers are paid within the operating cycle (typically 60-90 days) -- CURRENT LIABILITY.

3. Investment in a 5-year government bond is always a current asset.

Answer: FALSE

Depends on maturity: current if matures within 12 months; non-current otherwise.

4. Salary payable to employees is both an expense and a current liability.

Answer: TRUE

Expense (reduces OE) when incurred. Current liability (obligation to pay) if unpaid at period end.

5. Interest on a loan taken is income.

Answer: FALSE

Interest PAID on debt taken = finance cost (EXPENSE). Interest EARNED on deposits/investments = income.

6. Share capital is an asset.

Answer: FALSE

Share capital is Owners Equity -- a SOURCE of funds on the right side. Not an asset.

7. Interest earned on a mutual fund is an expense.

Answer: FALSE

It is INCOME -- other income from an investing activity.

8. Inventory is a non-current asset.

Answer: FALSE

Inventory is held for sale within the operating cycle -- CURRENT ASSET.

9. SLM and WDV produce the same TOTAL depreciation over the full life.

Answer: TRUE

Total depreciable amount (Cost - Residual) is fixed. Only the ANNUAL ALLOCATION differs.

10. A company can freely switch between SLM and WDV whenever it chooses.

Answer: FALSE

Requires strong justification and disclosure to shareholders. Not a routine practice.

11. If Net Book Value reaches zero, the asset must be disposed of.

Answer: FALSE

NBV = zero means fully depreciated in books. Physical asset can still be in use -- just stop recording depreciation.

12. Unearned Revenue is a liability.

Answer: TRUE

Cash received before service is performed = obligation to perform or refund = LIABILITY until the service is done.

13. A bad debt write-off reverses the original revenue.

Answer: FALSE

Original revenue STANDS -- correctly recognised when service was performed. Write-off = new separate expense in the period of write-off.

14. Goodwill on a balance sheet always means the company has done an M&A; transaction.

Answer: TRUE

Only PURCHASED goodwill is permitted. Arises only when a premium is paid above book value in an actual acquisition.

15. CFO should ideally be higher than Net Income for a healthy business.

Answer: TRUE

Depreciation (non-cash) adds back to cash; good collections mean cash comes in faster than accrual revenue.

16. Depreciation is a cash outflow.

Answer: FALSE

Non-cash book entry. Cash left when the asset was PURCHASED. Depreciation just spreads that historical cost.

17. A profitable company can go bankrupt.

Answer: TRUE

Profit is on accrual. If cash is not collected, a business can run out of money despite reporting paper profits.

18. The Income Tax Act allows both SLM and WDV.

Answer: FALSE

Income Tax Act allows ONLY WDV. Companies Act allows both.

19. A change in depreciation estimate (useful life) requires restating prior financial statements.

Answer: FALSE

Changes in accounting ESTIMATES are applied PROSPECTIVELY only. No restatement of prior periods.

20. Babu's advance payment to Richie in February should be recorded as February revenue.

Answer: FALSE

Cash received does not equal revenue earned. Service not yet done = Unearned Revenue = LIABILITY.

SESSION 2 -- Practice MCQs (35 Questions)

Q1. Asset costs Rs.11,000 cr, residual Rs.1,000 cr, life 10 years, using SLM. Annual depreciation is:

A. Rs.1,100 cr

B. Rs.1,000 cr

C. Rs.900 cr

D. Rs.500 cr

Answer: B

SLM = (Cost - Residual) / Useful Life = (11,000 - 1,000) / 10 = Rs.1,000 cr per year.

Q2. After 6 years of SLM depreciation (Q1 above), Net Book Value is:

A. Rs.5,000 cr

B. Rs.6,000 cr

C. Rs.4,000 cr

D. Rs.1,000 cr

Answer: A

NBV = Gross Block - Accumulated Dep = 11,000 - (1,000 x 6) = 11,000 - 6,000 = Rs.5,000 cr.

Q3. Under WDV, compared to SLM, profit in the EARLY YEARS will be:

A. Higher

B. Lower

C. The same

D. It depends on the asset type

Answer: B

WDV front-loads depreciation. Higher depreciation early = lower profit early. Tax benefit in early years is why companies use WDV for tax.

Q4. Richie computer: cost Rs.4,68,000, life 36 months, zero residual. Monthly depreciation is:

A. Rs.15,600

B. Rs.13,000

C. Rs.9,360

D. Rs.10,400

Answer: B

Monthly depreciation = (4,68,000 - 0) / 36 = Rs.13,000.

Q5. Richie pays Rs.60,000 security deposit for his office. This is recorded as:

A. Rent Expense Rs.60,000

B. Security Deposit (Asset) Rs.60,000

C. Prepaid Rent Rs.60,000

D. Cash Loss Rs.60,000

Answer: B

Refundable deposit = future benefit = ASSET called Security Deposit. Not rent expense.

Q6. A client pays Rs.4,000 in February for advisory work to be done in March. In February, record:

A. Revenue Rs.4,000 + Cash Rs.4,000

B. Unearned Revenue (Liability) Rs.4,000 + Cash Rs.4,000

C. Prepaid Expense Rs.4,000 + Cash Rs.4,000

D. No entry until March

Answer: B

Cash DOES come in = Cash UP. But service not done = Unearned Revenue (LIABILITY). Revenue only when service is performed in March.

Q7. When the advisory work is done in March (Q6 above), the entry is:

A. Revenue +4,000; Cash +4,000

B. Unearned Revenue -4,000; Revenue +4,000

C. Revenue +4,000; Debtors +4,000

D. Prepaid Expense -4,000; Revenue +4,000

Answer: B

The liability (Unearned Revenue) is now discharged because the service is done. Revenue is finally recognised. Cash is not involved (it came in February).

Q8. Magazine subscription Rs.6,000 for 12 months. After 4 months, Prepaid Expense on balance sheet is:

A. Rs.6,000

B. Rs.4,000

C. Rs.2,000

D. Rs.0

Answer: B

4 months consumed = Rs.2,000 expense. 8 months remaining = Rs.4,000 Prepaid Expense (asset).

Q9. Richie performs work for Raghu (Rs.5,000) in February. Raghu vanishes in March. Two-month combined P&L; effect is:

A. +Rs.5,000 net (revenue only, no expense)

B. Zero (revenue in Feb cancels expense in Mar)

C. -Rs.5,000 net (net loss)

D. +Rs.10,000 (double count)

Answer: B

Feb: +Rs.5,000 revenue. Mar: -Rs.5,000 bad debt expense. Net = zero. Correct economic outcome -- did the work, collected nothing.

Q10. Richie's February revenue is Rs.20,000. This EXCLUDES:

A. Rs.13,000 individual client cash payment

B. Rs.2,000 commission (accrual)

C. Rs.5,000 Raghu (accrual)

D. Rs.4,000 Babu advance

Answer: D

Babu's Rs.4,000 is EXCLUDED from revenue because the service is not done yet. It is Unearned Revenue (liability). The other three ARE revenue in February.

Q11. Richie's February Net Loss is Rs.74,900. The PRIMARY reason is:

A. Very high variable costs

B. Large one-time investment losses

C. Fixed costs (salaries, rent, depreciation) with only Rs.20,000 revenue in a startup month

D. Poor pricing strategy

Answer: C

February was setup month. Fixed costs (salaries Rs.50k, rent Rs.20k, depreciation Rs.13k) alone = Rs.83,000 against revenue of only Rs.20,000. Classic startup pattern.

Q12. In March, Babu's Rs.4,000 converts from Unearned Revenue to Revenue because:

A. Richie received additional payment from Babu

B. The advisory service was actually performed in March

C. 30 days passed since the advance

D. Babu confirmed satisfaction

Answer: B

Revenue recognition: ONLY when service is PERFORMED. The time lapse or confirmation does not matter -- performance matters.

Q13. Richie raises a Rs.5,00,000 bank loan at 12% p.a. in March. March interest expense is:

A. Rs.60,000

B. Rs.15,000

C. Rs.5,000

D. Rs.12,000

Answer: C

Monthly interest = 5,00,000 x 12% / 12 = Rs.5,000. It is ACCRUED in March (payable April 1st) but recorded as March expense.

Q14. March interest is not paid until April 1st. The March balance sheet shows:

A. No interest entry

B. Interest Expense reduces OE + Interest Payable (liability)

C. Prepaid Interest as asset

D. Interest reduces cash

Answer: B

Accrual concept: interest is INCURRED in March (used the money in March) so recorded as expense and matching liability (Interest Payable) until paid.

Q15. March revenues grew 11x from February. This proves:

A. The business model is working; volatility brought clients to Richie

B. February's loss was a strategic error

C. Richie overcharged in March

D. The financial statements for February were incorrect

Answer: A

Richie's thesis was correct: market panic = high advisory demand. February was setup cost. March validated the model.

Q16. Richie's equipment cost Rs.4,68,000. Half was paid cash, half as Trade Creditor. Cash Flow Statement classification:

A. Full Rs.4,68,000 in CFO

B. Rs.2,34,000 in CFI (investing), Rs.2,34,000 in CFF

C. Rs.2,34,000 in CFI (cash paid for asset). Creditor portion = non-cash, not in CFS

D. Full Rs.4,68,000 in CFI

Answer: C

Only actual cash movements appear in the Cash Flow Statement. Rs.2,34,000 paid = CFI outflow. The Rs.2,34,000 on credit = non-cash transaction, shown as supplementary disclosure.

Q17. HPCL shows accounting losses but positive CFO. This is BEST described as:

A. The accountants made an error

B. A turnaround signal -- generating real cash despite accounting losses

C. Proof the business is failing

D. Normal for all oil companies

Answer: B

Positive CFO despite accounting loss often means business is operationally sound; accounting loss may be from non-cash charges (large depreciation) or accounting timing differences.

Q18. Goodwill Rs.200 crore appears on Tata Tea's balance sheet after acquiring Tetley. Tetley's book value was Rs.150 crore. Tata Tea paid:

A. Rs.150 crore

B. Rs.200 crore

C. Rs.350 crore

D. Rs.50 crore

Answer: C

Goodwill = Purchase Price - Book Value. So Purchase Price = Goodwill + Book Value = 200 + 150 = Rs.350 crore.

Q19. Which of the following is a CURRENT LIABILITY?

A. 10-year debenture issued 2 years ago

B. Mortgage loan secured against factory

C. Advance received from customer for delivery next month

D. Unsecured term loan payable in 2030

Answer: C

Advance from customer = Unearned Revenue = obligation to perform or refund within the next cycle = CURRENT LIABILITY. All others are non-current (long-term).

Q20. The Indirect Method of computing CFO starts with:

A. Cash received from customers

B. Net Profit After Tax

C. Total Revenue

D. EBITDA

Answer: B

Indirect Method: Start with PAT, add back non-cash charges (depreciation), adjust for changes in working capital. Most Indian annual reports use this method.

Q21. Richie's April services advance of Rs.30,000 received in March is recorded as:

A. Revenue Rs.30,000 in March

B. Unearned Revenue (Liability) Rs.30,000 in March

C. Deferred Tax Asset

D. Capital Receipt

Answer: B

Cash received in March but service in April = Unearned Revenue (liability) in March. Revenue only in April when service is performed.

Q22. A company's Gross Block is Rs.200 crore, Accumulated Depreciation is Rs.75 crore. Net Block is:

A. Rs.275 crore

B. Rs.200 crore

C. Rs.125 crore

D. Rs.75 crore

Answer: C

Net Block = Gross Block - Accumulated Depreciation = 200 - 75 = Rs.125 crore.

Q23. Which of the following best indicates a company generating strong cash quality?

A. CFO much lower than Net Income

B. CFO roughly equal to or higher than Net Income

C. Large negative CFI

D. Large positive CFF

Answer: B

CFO >= Net Income signals that reported profits are converting to real cash (good collections, depreciation add-back). CFO much lower than NI = profit quality concern.

Q24. Company A: Net Income Rs.50L, Depreciation Rs.10L, Debtors decreased Rs.5L. Approximate CFO is:

A. Rs.35L

B. Rs.50L

C. Rs.65L

D. Rs.55L

Answer: C

CFO = NI + Dep + Decrease in Debtors = 50 + 10 + 5 = Rs.65L. Debtors decreasing means cash was collected (adds to cash).

Q25. The Misra Company's net profit margin fell from 5% to 3.1%. After reviewing the multi-step P&L;, the correct decision is:

A. Immediately reduce headcount

B. Investigate operating cost structure

C. Identify whether the fall is from a one-time non-recurring item before drawing conclusions

D. Raise prices immediately

Answer: C

Multi-step P&L; revealed the entire fall was one-time loss on asset disposal (investing decision). Always decompose the journey from operating profit to net profit before concluding.

Q26. Which is TRUE about changing a depreciation method?

A. Companies can change freely every year to reduce tax

B. Requires strong justification and disclosure; not allowed as a routine practice

C. Must be approved by the government

D. Changes must be applied retrospectively (restate all prior years)

Answer: B

Strong justification + disclosure required. Changes in accounting ESTIMATES (like useful life) apply prospectively. Not a routine practice.

Q27. A company uses SLM for its published accounts but WDV for its tax return. In early years, this creates:

A. Higher published profit, lower taxable profit -- and a Deferred Tax Liability

B. Lower published profit, higher taxable profit

C. Identical profits in both

D. A legal compliance violation

Answer: A

WDV gives higher depreciation early = lower taxable profit = less tax now. SLM gives lower depreciation early = higher published profit. Tax saved today will reverse later = Deferred Tax Liability (DTL).

Q28. Assets remaining useful beyond their fully depreciated NBV should be:

A. Immediately written off

B. Sold immediately at scrap value

C. Continued in use with no further depreciation charge

D. Revalued to current market value

Answer: C

When NBV reaches zero (or residual value), simply STOP recording depreciation. Asset continues in use. It is "free" in accounting terms.

Q29. Richie's February balance sheet shows Cash Rs.6,50,000. Which transaction contributed Rs.4,000 to this cash that students often miss?

A. Commission receivable

B. Raghu's receivable

C. Babu's advance (cash came in despite being Unearned Revenue)

D. Security deposit refund

Answer: C

Babu's Rs.4,000 IS a cash inflow in February -- it physically arrives in the bank. But it is classified as Unearned Revenue (LIABILITY) because the service is not done. Cash in = yes. Revenue = no.

Q30. Two companies with identical revenues. Company A has COGS 80% of sales, Company B has COGS 55%. Who has more pricing power?

A. Company A -- higher costs mean higher quality

B. Company B -- retains more per rupee of sales after direct costs

C. Both the same -- revenue is equal

D. Cannot determine without knowing absolute profit

Answer: B

Gross margin: A = 20%, B = 45%. B retains significantly more after direct costs -- better pricing, lower input costs, or more efficient production.

Q31. A machine is purchased for Rs.5,00,000. Installation cost Rs.50,000. Transport Rs.25,000. The COST for depreciation purposes is:

A. Rs.5,00,000 only

B. Rs.5,50,000

C. Rs.5,75,000

D. Rs.5,25,000

Answer: C

Cost = ALL expenditure to get the asset ready for use: purchase + installation + transport = 5,00,000 + 50,000 + 25,000 = Rs.5,75,000.

Q32. Which statement about the Balance Sheet is FALSE?

A. It is prepared at a specific point in time

B. Total Assets always equal Total Liabilities plus Owners Equity

C. It shows how much profit was earned during the year

D. It shows what the company owns and what it owes

Answer: C

Profit earned DURING the year is shown on the INCOME STATEMENT. The balance sheet shows the financial POSITION at a specific DATE -- a snapshot, not a movie.

Q33. Richie's March cumulative net income over two months is Rs.17,200. This means shareholders who invested Rs.10,00,000:

A. Have lost money

B. Have broken even

C. Have owners equity of Rs.10,17,200 -- slightly ahead of their investment

D. Will receive Rs.17,200 as dividends

Answer: C

Owners equity = Share Capital (Rs.10,00,000) + Retained Earnings (Rs.17,200) = Rs.10,17,200. Higher than invested. Business model validated in 2 months.

Q34. Which goes in CFI (Investing activities) in Richie's Cash Flow Statement?

A. Salaries paid Rs.50,000

B. Computer hardware purchased Rs.2,34,000 cash

C. Rent paid Rs.20,000

D. Commission collected Rs.2,000

Answer: B

Computer hardware = long-term asset (3+ years) = INVESTING activity. All others = operating.

Q35. Interest paid by Richie on his bank loan is classified under which section in Indian GAAP (AS 3)?

A. CFI -- Investing activities

B. CFO -- Operating activities

C. CFF -- Financing activities

D. Not classified -- it is a non-cash expense

Answer: B

Under Indian GAAP (AS 3), interest paid is classified as CFO for most companies. Interest IS cash (paid quarterly). Under IFRS/Ind-AS, companies have a choice between CFO and CFF.

3 SESSION 3: Understanding & Managing Cost

Inside the business -- cost objects, fixed vs variable, CVP, break-even, Prestige Telephone

Sessions 1 and 2 taught you to read a company from the OUTSIDE -- as an investor, banker, or regulator. Session 3 turns the camera around. Now you are INSIDE the business as a manager who needs to plan budgets, set prices, decide whether to launch a product, figure out when a business stops losing money, and evaluate whether to shut down a division.

Financial Accounting (Sessions 1 & 2)	Management / Cost Accounting (Session 3)
External audience: shareholders, banks, regulators	Internal audience: managers, decision makers inside the firm
Standardised by ICAI -- no discretion allowed	No standard format. You design what you need, the way you need it.
Auditor holds your hand -- errors get caught	No auditor here. A wrong analysis costs you the business.

Financial Accounting (Sessions 1 & 2)	Management / Cost Accounting (Session 3)
Post-facto -- records what already happened	Forward-looking -- helps you decide BEFORE you act
Annual report: publicly available, formal	Internal reports: private, flexible, purpose-built

> *"The mother system is the same financial reporting system. But today we are looking at its other arm. The target audience is you -- the internal decision maker."*
>
> **-- Prof. Manju Jaiswall, opening Session 3**

KEY INSIGHT -- No Safety Net in Cost Accounting

In financial accounting, a wrong entry gets caught by the auditor. In cost accounting, a wrong analysis costs you a wrong price, a failed product launch, or a bad shutdown decision. There is no safety net. The quality of your business decisions depends directly on how well you understand your costs.

3.1 Understanding Cost -- Three Classification Frameworks

Start Here: What is a Cost Object?

Before you classify a single rupee, you need to decide: WHAT are you measuring cost for? That thing -- the product, the batch, the programme, the project, the customer, the department -- is called the cost object. Everything that follows depends on defining this clearly first.

> *"Cost does not exist in a vacuum. It always exists with regard to a specific context -- a product, an industry, a business. Define the cost object first. Everything else follows."*
>
> **-- Prof. Manju Jaiswall**

Classification 1 -- Direct vs Indirect Costs

	Direct Costs	Indirect Costs (Manufacturing Overhead)
Definition	Traced DIRECTLY and conveniently to the cost object	Cannot be easily traced -- must be ALLOCATED using a cost driver
Correlation	High, clear correlation between input and output	The link is indirect -- you need a proxy to distribute the cost fairly
Examples	Plastic to make a computer. Study material for EPBM Batch 32.	Factory rent. Supervisor salary. Factory insurance. Machinery depreciation.
How assigned	No allocation needed -- directly measured and assigned	Needs a cost driver: number of computers, machine hours, number of participants

KEY INSIGHT -- Why the Driver Choice Matters More Today

In earlier decades, manufacturing overhead was only ~20% of total cost -- a wrong cost driver barely mattered. Today, automation has reduced direct labour sharply. Overhead is now 40-50% of total cost in many industries. A wrong driver choice on a large overhead base produces large errors in cost estimates -- and those flow directly into wrong prices and wrong strategic decisions.

The Three Boxes of Manufacturing Cost

Box 1: Direct Material	Box 2: Direct Labour + Direct Expenses	Box 3: Manufacturing Overhead
Raw material that physically BECOMES part of the product	Labour and expenses directly tied to MAKING the product	ALL indirect manufacturing costs -- pooled together
Plastic for computers. Cloth for shirts.	Assembly workers. Machine operators. Direct electricity for machines.	Factory rent. Supervisor salary. Electricity for factory lighting.
No driver needed -- directly traced	No driver needed -- directly traced	Needs a cost driver to allocate fairly per unit

Box 1 + Box 2 + Box 3 = Total Manufacturing Cost of the product.

Classification 2 -- Product Cost vs Period Cost

	Product Costs	Period Costs
Timing	Attached to the product -- travel WITH it through inventory	Go DIRECTLY to the income statement in the period they are incurred
Expense recognition	Only become an expense (COGS) when the product is SOLD	Hit the income statement IMMEDIATELY -- no balance sheet detour through inventory
Examples	Direct material, direct labour, manufacturing overhead (all three boxes)	Selling expenses (advertising, commissions), administrative expenses (head office)
Number example	Spend Rs.5L making 100 computers, sell 80. 80% of cost (Rs.4L) = COGS on P&L.; Remaining Rs.1L = Inventory on Balance Sheet.	Spend Rs.50,000 on advertising, sell 80 of 100 computers. FULL Rs.50,000 hits the P&L; -- regardless of how many were sold.

CONCEPT TRAP -- Product Cost vs Manufacturing Cost

Product cost is NOT the same as manufacturing cost. Manufacturing cost = what it costs to MAKE the product (all three boxes). Product cost = manufacturing cost that has been EXPENSED -- it becomes product cost ONLY when units are sold. Before that, it sits as INVENTORY (an ASSET) on the balance sheet.

Period costs always hit the P&L; immediately in full -- even if zero units are sold.

3.2 Fixed, Variable, and Mixed Costs -- How Costs Behave as Volume Changes

Cost Type	Total Amount as volume rises	Per Unit Amount as volume rises	Example
FIXED	CONSTANT -- same at any volume	FALLS as more units spread the same total	Factory rent Rs.50,000/month. At 100 units: Rs.500/unit. At 200 units: Rs.250/unit.
VARIABLE	RISES proportionally	CONSTANT -- same per unit always	Plastic at Rs.100/computer. 100 computers: Rs.10,000 total. 200: Rs.20,000 total. Always Rs.100/computer.

EXAM TIP -- Four Statements, ALL True, ALL Tested

(1) Fixed cost TOTAL is constant as volume changes.

(2) Fixed cost PER UNIT falls as volume rises.

(3) Variable cost PER UNIT is constant regardless of volume.

(4) Variable cost TOTAL rises proportionally with volume.

All four together form the complete cost behaviour framework.

Mixed Costs -- Splitting Fixed and Variable Components

Many real-world costs are PARTLY fixed and PARTLY variable. Your electricity bill has a fixed standing charge every month PLUS a variable charge per unit consumed. For CVP analysis, every mixed cost MUST be split into its fixed and variable parts.

The Simultaneous Equation (High-Low) Method: Use two months of data. Set up two equations. Solve for fixed component (X) and variable rate (Y). Here is the Prestige Telephone example:

Month	Power Cost	Chargeable Hours	Equation
January	$1,633	361 (329 revenue + 32 service)	1,633 = X + (Y x 361)
February	$1,592	348 (316 revenue + 32 service)	1,592 = X + (Y x 348)
Subtract equations:	$41 difference	13 hours difference	41 = 13Y => Y = $3.15/hr
Substitute back:	X = 1,633 - (3.15 x 361)	X = ~$499	However: average of all three pairs ~$4/hr (see note)

CLARIFICATION -- Why the Answer is $4/hr (Not $3.15)

Using ONLY the January-February pair gives Y = 41/13 = $3.15/hr (rounds to $3). However, Prof. Jaiswall's class derived the variable rate by averaging THREE data pairs: Jan-Feb ($3.15), Feb-Mar, and Jan-Mar. The average of all three pairs converges to approximately $4/hr. The class answer is $4/hr. If an exam question gives you a single data pair, use that calculation precisely. If Prof. Jaiswall's Prestige case is cited directly, use $4/hr as the established class answer.

KEY INSIGHT -- Total Variable Cost Per Revenue Hour at Prestige

Total variable cost per revenue hour = ~$28 ($4 power + $24 operations salary). This is tiny relative to the $800 commercial rate. Contribution per commercial hour = $800 - $28 = $772. Every hour the machine runs for a commercial client, it throws $772 toward fixed costs. The problem is NOT the cost structure -- it is not selling enough hours.

3.3 The Contribution Income Statement -- The Format That Enables Decisions

"I could have just given you the CVP formulas. But I want you to understand the contribution income statement first -- because once you have that, the model falls out naturally."

-- Prof. Manju Jaiswall

	Traditional Format	Contribution Format
Revenue	Sales	Sales

	Traditional Format	Contribution Format
Cost deduction	Less: COGS (MIX of fixed + variable)	Less: ALL Variable Costs (variable COGS + variable selling)
Sub-total	= Gross Profit	= CONTRIBUTION MARGIN (the key line)
Next deduction	Less: Selling & Admin (MIX of fixed + variable)	Less: ALL Fixed Costs (fixed COGS + fixed selling)
Bottom line	= Net Profit	= Net Profit (EXACTLY the same number!)
Purpose	Separates costs by FUNCTION (production vs overhead)	Separates costs by BEHAVIOUR (fixed vs variable)
Limitation	Cannot answer: what if I sell 50 more?	Directly answers: profit = (CM per unit x units) - fixed costs

EXAM TIP -- Contribution Format is MANDATORY for CVP

The contribution format is the MANDATORY PREREQUISITE for CVP analysis. You cannot do break-even analysis, target profit analysis, or any decision modelling without first separating costs into fixed and variable. Traditional format = external reporting. Contribution format = internal decisions.

3.4 CVP Analysis -- Building the Model from First Principles

Step	Expression	Plain English meaning
Start with	Revenue - Cost = Profit	The universal truth for any business
Expand	(P x Q) - (V x Q) - F = Profit	Separate fixed (F) from variable (V x Q). P = selling price, Q = units, V = variable cost per unit.
At break-even	Set Profit = 0	The point where you are neither making nor losing money -- all costs exactly covered.
Break-even UNITS	Q = F / (P - V)	P - V is CONTRIBUTION per unit -- the rate at which each unit fills the fixed cost hole.
Break-even SALES (amount)	Fixed Costs / CS Ratio	CS Ratio = Contribution per unit / Selling price per unit. Expressed as a percentage.
Target profit UNITS	Q = (F + Target Profit) / (P - V)	Add the target profit to the numerator. Same model, one line change.

KEY INSIGHT -- Understanding Why Break-Even Works

You just DERIVED the break-even formula from pure logic -- no memorisation needed. The DENOMINATOR (P-V) = contribution per unit = the rate at which each unit fills the fixed cost hole. The NUMERATOR (F) = the size of the hole. Divide hole size by fill rate = units needed to completely fill it. That is break-even. Once you see it this way, you will never need to memorise the formula.

The Yule Inc Surfboard Example -- Worked Through Completely

Item	Value	How it flows into the model
Selling price per surfboard	$500	P in the formula
Variable cost per surfboard	$300	V in the formula
Contribution per surfboard (P - V)	$200	Each board throws $200 into the fixed cost hole

Item	Value	How it flows into the model
CS Ratio ($200 / $500)	40%	40 cents of every dollar of sales is contribution
Total fixed costs per month	$80,000	The hole size -- must be filled before any profit exists
Break-even units ($80,000 / $200)	400 boards	Must sell exactly 400 to cover all costs; zero profit
Break-even sales ($80,000 / 40%)	$200,000	$200,000 of sales covers all costs exactly
Current sales	500 boards	100 boards above break-even
Current net profit (500 x $200 - $80,000)	$20,000	Contribution $100,000 minus fixed $80,000
Target profit $100,000: units needed	900 boards	($80,000 + $100,000) / $200 = 900. Need 400 more.

MANAGER TAKEAWAY -- CVP -- The Manager's Most Powerful Three Lines

Break-even analysis is not a finance exercise. It is the first question before any investment, launch, or expansion. Three numbers: fixed cost, variable cost, price. Everything else follows.

PRODUCT COMPANY EXAMPLE -- New Product Line Approval: Your team proposes a health snack product. Variable cost per unit: Rs.1,200. Selling price: Rs.2,000. CM = Rs.800. CS Ratio = 40%. Monthly fixed overhead: Rs.4,00,000. Break-even = Rs.4,00,000 / Rs.800 = 500 units/month. Break-even revenue = Rs.4,00,000 / 40% = Rs.10,00,000/month. Ask your sales head: can we commit to 500 units/month by Month 4? If yes -- approve. If not -- reduce fixed overhead or raise price before launch.

SERVICE COMPANY EXAMPLE -- New Consulting Service Line: Your firm launches an internal audit review service. Variable cost per engagement: Rs.40,000 (consultant time + travel). Price per engagement: Rs.1,00,000. CM = Rs.60,000. CS Ratio = 60%. Monthly fixed overhead: Rs.4,80,000 (2 dedicated consultants + tools). Break-even = Rs.4,80,000 / Rs.60,000 = 8 engagements/month. Ask BD: can we win 8/month by Quarter 2? If uncertain -- reduce the fixed team size before committing.

Discipline: never recommend a product launch, service expansion, or new geography without computing break-even and stress-testing the volume assumption.

MANAGER TAKEAWAY -- The Prestige Framework -- The Right Way to Evaluate Any Division That Is Losing Money

Never close a business because the P&L; shows a loss. Close it only when the avoidable costs you save exceed the contribution margin you lose. The Prestige case teaches the most important four words in managerial accounting: relevant costs only.

PRODUCT COMPANY EXAMPLE -- Specialty Chemicals Division: Division P&L; shows net loss of Rs.80 lakh/year. CFO wants to close it. Before deciding, separate costs into avoidable and unavoidable: Avoidable if closed: dedicated staff Rs.30 lakh + raw materials Rs.15 lakh + marketing Rs.5 lakh = Rs.50 lakh. Unavoidable (keep running regardless): allocated factory lease Rs.40 lakh + shared R&D; Rs.15 lakh = Rs.55 lakh. Division revenue = Rs.60 lakh/year. Impact of closing: lose Rs.60 lakh revenue, save Rs.50 lakh costs, still pay Rs.55 lakh overhead. Net impact: WORSE by Rs.10 lakh. The correct decision: KEEP the division open. The Rs.80 lakh loss on the P&L; overstates the cost of staying open.

SERVICE COMPANY EXAMPLE -- IT Managed Services Practice: Practice P&L; loss: Rs.60 lakh/year. Avoidable if closed: dedicated team Rs.40 lakh + specific tools Rs.8 lakh = Rs.48 lakh. Unavoidable: shared infrastructure Rs.20 lakh + allocated HQ overhead Rs.15 lakh = Rs.35 lakh. Practice revenue: Rs.45 lakh. Impact of closing: lose Rs.45 lakh revenue, save Rs.48 lakh costs = net benefit Rs.3 lakh. But you STILL pay the Rs.35 lakh unavoidable overhead. Overall net: closing SAVES Rs.3 lakh vs the current Rs.60 lakh loss -- a Rs.57 lakh improvement. In this case, CLOSE the practice. The math is different from the chemicals example.

The takeaway: the decision is NOT about the P&L; loss. It is about the incremental cash flow impact of closing. That requires separating avoidable from unavoidable costs -- every time.

3.5 CVP in Action -- Margin of Safety, Sensitivity, Multi-Product Break-Even

The Margin of Safety -- How Far Are You From the Loss Zone?

Margin of Safety = Current (Actual) Sales - Break-Even Sales. It tells you how much sales could fall before you start making losses. It is both a formula and a risk measure -- low MOS means you are close to the edge.

Yule Example: Break-even = $200,000. Current sales = $250,000. Margin of Safety = $50,000 (or 100 boards).

Powerful shortcut: Profit = Margin of Safety Sales x CS Ratio. $50,000 x 40% = $20,000. Why? Beyond break-even, every extra dollar of sales contributes the CS ratio as pure profit.

Scenario	The Decision	Analysis	Verdict
1	Raise advertising by $10,000 to grow sales from 500 to 540 boards?	Incremental contribution = 40 extra boards x $200 = $8,000. Incremental cost = $10,000. Net impact = -$2,000.	REJECT. But any spend UNDER $8,000 would still improve profit.
2	Variable cost rises from $300 to $310. New break-even?	New contribution = $500 - $310 = $190. New break-even = $80,000 / $190 = 422 boards (up from 400).	Every rupee of cost inflation TIGHTENS break-even. Monitor carefully.
3	Next year: 525 boards, contribution $190/unit, fixed costs $90,000. Profit?	Total contribution = 525 x $190 = $99,750. Less fixed costs $90,000. Profit = $9,750.	The contribution framework gives instant answers to "what if" questions.

Multi-Product Break-Even -- When You Sell More Than One Thing

For multiple products, you need a WEIGHTED-AVERAGE contribution, weighted by the actual sales mix. Two steps: (1) find total break-even using weighted CM; (2) split by sales mix for individual break-evens.

Product	Selling Price	Variable Cost	CM per unit	Units Sold	Sales Mix	Weighted CM
Surfboards	$500	$300	$200	500	62.5% (500/800)	$200 x 62.5% = $125.00
Sailboards	$1,000	$450	$550	300	37.5% (300/800)	$550 x 37.5% = $206.25
COMBINED				800	100%	$125.00 + $206.25 = $331.25

Assume total fixed costs = $170,000

Step	Calculation	Result
Step 1: Total break-even combined units	$170,000 / $331.25 (weighted CM)	514 combined units to break even
Step 2: Surfboard break-even	514 x 62.5% (sales mix)	321 surfboards
Step 2: Sailboard break-even	514 x 37.5% (sales mix)	193 sailboards

Why 514 and not 513? The arithmetic gives 513.2. For break-even, always round UP -- not to the nearest integer. At 513 units, contribution = 513 x $331.25 = $169,931 -- still $69 short of covering fixed costs. The 514th unit closes the gap. Break-even means fully covered, never nearly covered.

3.6 Prestige Telephone Company -- The Shutdown Decision

Prestige Telephone Company is a regulated utility in 1999. The government controls its prices. President Daniel Rowe had an idea: the mainframe computer needed to run telephone operations sat idle for most of the day. Why not sell those idle hours to outside businesses? The subsidiary -- Prestige Data Services -- was set up. Commercial rate: $800/hour. Intracompany rate: $400/hour. But three years in, the subsidiary has NEVER had a profitable month. It is April 2003. Should Rowe shut it down?

Hour Type	January	February	March	What to notice
Intracompany (revenue hours)	206	181	223	Recovering -- strong in March
Commercial (revenue hours)	123	135	138	Rising slowly -- right direction
Service / maintenance (unavoidable)	32	32	40	Machine must be serviced -- a fixed necessity
Idle (earning nothing)	223	164	143	FALLING FAST -- the key positive signal

Question 1: Should Rowe Shut It Down? -- Avoidable vs Unavoidable

The accounting report shows losses. Instinct says close. But that answers the WRONG QUESTION. The right question: will Rowe be financially BETTER OFF with the subsidiary open or closed?

Cost Item	Monthly ($)	Goes away if closed?	Why
Computer lease	95,000	NO	Non-cancelable, 4 years left. Prestige pays this regardless.
Rent + custodial services	9,240	NO	Paid TO the parent company. Money stays in the group.
Depreciation	26,180	NO	Non-cash book entry. Equipment already purchased and paid for.

Cost Item	Monthly ($)	Goes away if closed?	Why
Corporate services (parent staff allocated)	~15,300	Largely NO	Parent staff remain employed regardless.
All subsidiary staff salaries	~62,000	YES	Hired specifically for this subsidiary. They leave if it closes.
Maintenance + power + materials	~17,000	YES	Only consumed when the machine actually runs.
Sales and marketing	~7,700	YES	Discretionary spend -- stops immediately upon closure.

THE VERDICT -- Do NOT Shut Down

Avoidable costs if closed: ~$87,000/month (staff + maintenance + marketing). But closing ALSO eliminates ALL revenue (~$200,000+/month from commercial + intracompany). The inescapable costs (lease $95,000 + rent $9,240 + depreciation $26,180 = ~$130,000) keep running either way. You lose the revenue but KEEP the big costs. Rowe would be SIGNIFICANTLY WORSE OFF by closing.

CONCEPT TRAP -- The P&L; Loss Is the Wrong Number for Shutdown

The ACCOUNTING LOSS of $21,438 in March is real but it is the WRONG NUMBER for the shutdown decision. The income statement answers: "how much profit did the subsidiary make?" Rowe's question is: "am I better off with it or without it?" Relevant cost analysis -- NOT the income statement -- answers Rowe's question. The two analyses give OPPOSITE conclusions. Never use a P&L; loss as the sole basis for shutdown.

Question 2: Break-Even Commercial Hours

Calculation	Amount
Total monthly fixed costs (Q1 2003 average)	~$213,000
Contribution from intracompany (205 hrs x $372/hr contribution)	~$76,260
Remaining gap -- must be filled by commercial hours	~$136,740
Commercial contribution per hour ($800 revenue - $28 variable cost)	$772/hr
Break-even commercial hours ($136,740 / $772)	~177 hrs/month
Actual commercial hours (Q1 2003 average)	~132 hrs/month
GAP TO CLOSE	~45 hrs/month -- very specific, solvable target

45 extra commercial hours per month at $772 contribution each = problem identified and quantified. This is not a cost problem -- it is a SALES problem with a clear, achievable target.

Question 3: The Four Options

Option	The Change	Impact on Monthly Profit	Verdict
A: Raise price to $1,000/hr	Demand drops 30%. Hours fall from 132 to 92.	LOSE: 40 hrs x $772 = $30,880 contribution lost. GAIN: $200 more on 92 hrs = $18,400. Net: WORSE by ~$12,480.	REJECT

Option	The Change	Impact on Monthly Profit	Verdict
B: Cut price to $600/hr	Demand rises 30%. Hours rise to 172.	Marginal worsening (~$600/month). Volume gain almost offsets price cut. Borderline.	STUDY FURTHER -- not clearly beneficial
C: Invest in marketing for +30% hours at $800/hr	Commercial hours rise to 172. Price unchanged.	Extra contribution from 40 additional commercial hours = $30,880. Given current monthly losses of ~$21,000-$22,000, net surplus before marketing = ~$9,000. Can afford up to ~$8,000-$9,000 in additional marketing and reach overall subsidiary break-even for the first time. (For the marginal MCQ question: any spend below $30,880 improves profit vs doing nothing.)	BEST OPTION -- highest impact, preserves price integrity
D: Two-shift operations	Commercial hours FALL 20% to 106. Fixed lease unchanged.	Lose 26 hrs x $772 = $20,072. Barely any cost saving. Loss worsens by ~$18,000.	WORST OPTION -- avoid

Question 4: Six Reporting Improvements Prof. Jaiswall Recommended

#	Change	Why it matters
1	Rebuild as contribution P&L; (separate fixed and variable)	Current traditional P&L; hides strong contribution. Shows the loss is from UNAVOIDABLE fixed costs, not a broken business model.
2	Label avoidable vs unavoidable costs explicitly	The $95,000 lease (unavoidable) and $7,700 marketing (avoidable) look identical on paper. They are not.
3	Separate revenue by customer type (commercial vs intracompany)	$800/hr commercial and $400/hr intracompany are completely different profit contributors.
4	Put idle hours prominently at the TOP of every report	223 idle hours in January = $178,400 of unrealised revenue. Make it impossible for management to miss.
5	Flag internal transfers separately	$9,240 rent is paid TO the parent. No cash leaves the group. Treating it as an external cost is misleading.
6	Add break-even tracker to every report	One line: Break-even commercial hours: 177. Actual: 132. Gap: 45. An operational target, not just a loss number.

MANAGER TAKEAWAY -- The Prestige Reporting Lesson -- Six Fixes for Any Management Report

The six improvements recommended for Prestige apply to every management report. If your monthly P&L; does not answer what your team is actually asking, the report is not doing its job.

PRODUCT COMPANY EXAMPLE -- Manufacturing Plant Monthly Report: Current report: total cost Rs.4 crore, revenue Rs.3.8 crore, loss Rs.20 lakh. Apply the fixes: Rebuild as contribution P&L; -- contribution Rs.1.2 crore, fixed overhead Rs.1.4 crore = loss Rs.20 lakh. Now you can see the contribution is healthy. The fixed base is the problem. Add machine utilisation at the top: 62% vs 78% target. The management conversation shifts from "we made a loss" to "fix utilisation by 16 points." That is an actionable target.

SERVICE COMPANY EXAMPLE -- SaaS Product Line Report: Standard: revenue Rs.1 crore, costs Rs.1.3 crore, loss Rs.30 lakh. Apply the fixes: separate variable costs (server + support Rs.15 lakh) from fixed (engineering team Rs.1.15 crore). Contribution = Rs.85 lakh (85% margin -- outstanding unit economics). Loss is a fixed-cost problem, not a pricing or product problem. Add a break-even MRR tracker: need Rs.19 lakh MRR, current Rs.8.3 lakh, gap = 107 more seats at current ARPU. Now the team has an operational target.

Rule: every management report must include the gap to break-even expressed as a specific operational action.

SESSION 3 -- True / False Practice (20 Checks)

1. Total fixed cost stays constant regardless of production volume.

Answer: TRUE

By definition. Same Rs.50,000 rent whether 100 or 1,000 units are produced.

2. Fixed cost per unit stays constant as volume rises.

Answer: FALSE

Fixed TOTAL is constant. Per-unit fixed cost FALLS as more units spread the same fixed total.

3. Variable cost per unit rises as you produce more.

Answer: FALSE

Variable cost PER UNIT is CONSTANT. Only the total rises proportionally with volume.

4. Management accounting is regulated by ICAI like financial accounting.

Answer: FALSE

No regulation, no standard format. For internal use only.

5. A cost object must always be a physical product.

Answer: FALSE

A cost object can be a product, batch, programme, department, project, or customer.

6. Direct costs always need a cost driver to be allocated.

Answer: FALSE

Direct costs are TRACED, not allocated. Only INDIRECT costs need a driver.

7. Contribution margin is Revenue minus all Fixed Costs.

Answer: FALSE

Contribution = Revenue minus all VARIABLE COSTS. Fixed costs come after contribution.

8. A business can have positive contribution margin and still make a net loss.

Answer: TRUE

If total fixed costs exceed total contribution, the business is below break-even -- loss despite positive CM.

9. Beyond break-even, each extra unit contributes its full selling price to profit.

Answer: FALSE

Beyond BEP, each unit contributes its CONTRIBUTION MARGIN (price minus variable cost), not full price.

10. CS Ratio = 40% means 40 paise of every rupee of sales is contribution.

Answer: TRUE

CS Ratio = Contribution / Sales. Exactly what it means.

11. Margin of safety = current sales minus TARGET sales.

Answer: FALSE

MOS = Current Sales minus BREAK-EVEN Sales. Target is not involved.

12. A product with a LOWER margin of safety ratio is LESS risky.

Answer: FALSE

Lower MOS = closer to break-even = MORE risky, not less.

13. For multi-product BEP, use a simple average of all product contributions.

Answer: FALSE

Use a WEIGHTED AVERAGE with sales mix proportions. Simple average ignores relative volumes.

14. The high-low method assumes a linear cost-volume relationship.

Answer: TRUE

It draws a straight line between two data points. Non-linear behaviour produces only an approximation.

15. Depreciation is a relevant cost when deciding to shut down a subsidiary.

Answer: FALSE

Depreciation is non-cash. Equipment already bought. Closing saves nothing on depreciation. IRRELEVANT.

16. A non-cancelable lease is irrelevant to the shutdown decision.

Answer: TRUE

Paid regardless -- same cost in every scenario. Irrelevant to the shutdown choice.

17. A client at $500/hr should be rejected if the standard price is $800/hr.

Answer: FALSE

If the machine is otherwise idle, ANY price above variable cost ($28/hr) generates contribution. $500 passes easily.

18. Contribution analysis requires the income statement in traditional format.

Answer: FALSE

Traditional format MIXES fixed and variable. Need the contribution format with costs split by BEHAVIOUR.

19. Period costs are capitalised as inventory until the product is sold.

Answer: FALSE

PRODUCT costs are capitalised. Period costs go DIRECTLY to the income statement -- no inventory detour.

20. Manufacturing overhead can include both fixed and variable components.

Answer: TRUE

Supervisor salary (fixed), factory electricity (partly variable), equipment insurance (fixed) -- all overhead.

SESSION 3 -- Practice MCQs (35 Questions)

Q1. Which of the following is a DIRECT cost for a computer manufacturer?

A. Factory supervisor salary

B. Factory rent

C. Processor chips used in each computer

D. Factory electricity

Answer: C

Processor chips physically become part of each computer -- directly traceable = DIRECT COST. Factory supervisor, rent, and electricity benefit multiple products = INDIRECT (overhead).

Q2. Factory electricity is Rs.5,000/month fixed standing charge plus Rs.2/unit consumed. This is a:

A. Fixed cost

B. Variable cost

C. Mixed (semi-variable) cost

D. Period cost

Answer: C

Fixed component (Rs.5,000) + variable component (Rs.2/unit) = MIXED COST. Must be split before CVP analysis.

Q3. Product A costs Rs.800 per unit to make, selling price Rs.1,200. Fixed costs Rs.4,00,000. Break-even units:

A. 333 units

B. 500 units

C. 1,000 units

D. 800 units

Answer: C

CM = 1,200 - 800 = Rs.400. BEP = 4,00,000 / 400 = 1,000 units.

Q4. Using Q3 data: CS Ratio is:

A. 67%

B. 33%

C. 40%

D. 50%

Answer: B

CS Ratio = CM / Selling Price = 400 / 1,200 = 33.3%. Approximately 33%.

Q5. Using Q3 data: Break-even SALES VALUE is:

A. Rs.8,00,000

B. Rs.12,00,000

C. Rs.4,00,000

D. Rs.16,00,000

Answer: B

BEP Sales = Fixed Costs / CS Ratio = 4,00,000 / (1/3) = Rs.12,00,000. Check: 1,000 units x Rs.1,200 = Rs.12,00,000.

Q6. Using Q3 data: how many units to earn Rs.1,00,000 target profit?

A. 1,000 units

B. 1,250 units

C. 1,500 units

D. 2,000 units

Answer: B

Target units = (FC + Target Profit) / CM = (4,00,000 + 1,00,000) / 400 = 5,00,000 / 400 = 1,250 units.

Q7. Using Q3 data: current sales are 1,200 units. Margin of Safety in units is:

A. 200 units

B. 400 units

C. 800 units

D. 1,200 units

Answer: A

MOS = Current - BEP = 1,200 - 1,000 = 200 units.

Q8. Using Q3 data: current profit at 1,200 units (using MOS shortcut):

A. Rs.80,000

B. Rs.60,000

C. Rs.40,000

D. Rs.1,00,000

Answer: A

MOS = 200 units x Rs.1,200 = Rs.2,40,000. Profit = MOS Sales x CS Ratio = 2,40,000 x (1/3) = Rs.80,000. Check: (1,200 x 400) - 4,00,000 = Rs.80,000.

Q9. Fixed costs rise from Rs.4,00,000 to Rs.4,80,000. New break-even units (CM unchanged at Rs.400):

A. 1,000 units

B. 1,200 units

C. 1,100 units

D. 1,400 units

Answer: B

New BEP = 4,80,000 / 400 = 1,200 units. Every Rs.80,000 rise in fixed costs requires 200 more units just to break even.

Q10. The contribution income statement differs from the traditional income statement because:

A. It uses different revenue figures

B. It shows Gross Profit instead of Contribution Margin

C. Costs are separated by BEHAVIOUR (fixed vs variable) not FUNCTION (production vs overhead)

D. It is only for external reporting

Answer: C

Traditional = costs by function. Contribution = costs by behaviour (all variable then all fixed). Only contribution format enables CVP analysis.

Q11. A company operates at 60% capacity with profit of Rs.2,00,000 and FC of Rs.8,00,000. CM is:

A. Rs.6,00,000

B. Rs.10,00,000

C. Rs.2,00,000

D. Rs.8,00,000

Answer: B

Profit = CM - FC. So CM = Profit + FC = 2,00,000 + 8,00,000 = Rs.10,00,000.

Q12. The high-low method: January power cost $1,633 (361 hrs), February $1,592 (348 hrs). Variable rate per hour:

A. $3/hr

B. $4/hr

C. $5/hr

D. $2/hr

Answer: B

Using Jan-Feb pair: (1,633 - 1,592) / (361 - 348) = 41 / 13 = $3.15/hr. However, the Prestige class answer is $4/hr, derived by averaging all three available data pairs. If asked for Prestige specifically, use $4/hr.

Q13. Using Q12: Fixed power cost per month is approximately:

A. $100/month

B. $200/month

C. $300/month

D. $450/month

Answer: B

Using the $4/hr class answer: Fixed = Total cost - (Variable rate x hours) = 1,633 - (4 x 361) = 1,633 - 1,444 = $189 approximately $200/month.

Q14. Prestige Data Services: commercial rate $800/hr, variable cost $28/hr. Contribution per commercial hour:

A. $800

B. $828

C. $772

D. $400

Answer: C

Commercial CM/hr = $800 - $28 = $772. Every commercial hour throws $772 toward fixed costs.

Q15. Prestige: total fixed costs $213,000, intracompany contribution $76,260/month. Remaining fixed cost gap:

A. $289,260

B. $136,740

C. $76,260

D. $213,000

Answer: B

Gap = Total FC - Intracompany contribution = 213,000 - 76,260 = $136,740. This gap must be covered by commercial hours.

Q16. Prestige break-even commercial hours: gap $136,740, commercial CM $772/hr:

A. 130 hours

B. 150 hours

C. 177 hours

D. 267 hours

Answer: C

BEP commercial = $136,740 / $772 = 177 hours/month.

Q17. Prestige Option C: marketing increases commercial hours from 132 to 172 at $800/hr. Max marketing budget that still improves profit:

A. $8,000

B. $20,000

C. $30,880

D. $772

Answer: C

Extra contribution = 40 extra hours x $772 = $30,880. Any marketing spend below $30,880 would improve profit. Above $30,880 = worse off.

Q18. Which Prestige option is the WORST choice?

A. Raise price to $1,000/hr

B. Cut price to $600/hr

C. Invest in marketing for +30% hours

D. Two-shift operations

Answer: D

Option D reduces commercial hours by 20% (to 106) with barely any cost saving. Loss worsens by ~$18,000. Worst outcome.

Q19. An idle machine can process client orders at $500/hr. Variable cost $28/hr. Should Richie accept this order?

A. No -- below standard $800/hr

B. Yes -- any price above variable cost generates contribution when machine is idle

C. Only if the client agrees to long-term contract

D. No -- it sets a bad price precedent

Answer: B

When the machine is IDLE, the relevant comparison is: price vs variable cost. $500 > $28. Contribution = $472/hr. ACCEPT. Standard price irrelevant for idle capacity decisions.

Q20. Product Cost vs Period Cost: Rs.2,000 advertising expense for a product that partly remains unsold. Advertising hits the P&L;:

A. Only when the product is sold (proportionally)

B. Immediately in full, regardless of units sold

C. Spread over 12 months regardless

D. Added to inventory value

Answer: B

Advertising = PERIOD COST. Hits P&L; IMMEDIATELY in full. NOT apportioned between sold and unsold units.

Q21. Manufacturing overhead includes which of the following?

A. Sales commissions paid to agents

B. CEO's salary (head office)

C. Factory supervisor salary

D. Advertising campaign costs

Answer: C

Factory supervisor salary is an INDIRECT MANUFACTURING cost = part of Manufacturing Overhead (Box 3). Sales commissions, CEO salary, advertising = PERIOD COSTS.

Q22. Company spends Rs.5L making 1,000 units. Sells 700 units at Rs.800 each. COGS on P&L; is:

A. Rs.5,00,000

B. Rs.3,50,000

C. Rs.5,60,000

D. Rs.2,40,000

Answer: B

Cost per unit = Rs.500. 700 units sold x Rs.500 = Rs.3,50,000 COGS on P&L.; Rs.1,50,000 remains as inventory (asset).

Q23. Which statement is TRUE about the contribution margin?

A. Contribution = Revenue - All Fixed Costs

B. Contribution is always positive

C. Contribution per unit = Selling Price - Variable Cost per unit

D. Contribution equals profit

Answer: C

CM per unit = P - V. It is what each unit contributes toward covering fixed costs and then profit. Can be zero or negative if price < variable cost.

Q24. Product X: Selling price Rs.200, variable cost Rs.150, FC Rs.50,000. Currently selling 800 units. Proposal: reduce price to Rs.180 and increase volume to 1,000 units. Net impact on profit:

A. Profit increases by Rs.3,000

B. Profit worsens by Rs.10,000

C. No change

D. Profit increases by Rs.5,000

Answer: B

Current CM = (200-150)x800 = 40,000. Proposed CM = (180-150)x1,000 = 30,000. Fixed costs same. Net change in profit = 30,000-40,000 = -Rs.10,000. Proposed situation is worse.

Q25. Multi-product: Product A (CM Rs.100, 600 units) and Product B (CM Rs.200, 400 units). Weighted CM is:

A. Rs.150

B. Rs.140

C. Rs.120

D. Rs.160

Answer: B

Mix: A = 60%, B = 40%. Weighted CM = (100x0.60) + (200x0.40) = 60 + 80 = Rs.140.

Q26. Using Q25 data: Fixed costs Rs.1,40,000. Break-even combined units:

A. 1,000 units

B. 1,200 units

C. 800 units

D. 933 units

Answer: A

BEP = 1,40,000 / 140 = 1,000 combined units.

Q27. Prestige's depreciation of Rs.26,180/month is IRRELEVANT to the shutdown decision because:

A. It is too small to matter

B. It is a non-cash charge and the equipment is already purchased -- closing saves nothing

C. It is a variable cost

D. It is paid to the parent company

Answer: B

Non-cash, sunk cost. Whether open or closed, depreciation runs on already-purchased equipment. IRRELEVANT to any forward-looking decision.

Q28. Total fixed costs are Rs.3,00,000/month. CS ratio is 30%. Break-even sales value:

A. Rs.10,00,000

B. Rs.90,000

C. Rs.3,00,000

D. Rs.1,00,000

Answer: A

BEP Sales = FC / CS Ratio = 3,00,000 / 0.30 = Rs.10,00,000.

Q29. At break-even point, the margin of safety is:

A. Equal to current sales

B. Positive and large

C. Zero

D. Equal to fixed costs

Answer: C

At BEP: Current sales = Break-even sales. MOS = Current - BEP = zero. You are exactly at the edge -- one unit below = loss.

Q30. A company's profit is Rs.60,000 and CS ratio is 40%. Margin of Safety SALES value is:

A. Rs.1,50,000

B. Rs.24,000

C. Rs.60,000

D. Rs.2,40,000

Answer: A

Profit = MOS Sales x CS Ratio. So MOS Sales = Profit / CS = 60,000 / 0.40 = Rs.1,50,000.

Q31. Which cost is RELEVANT to a make-vs-buy decision?

A. Depreciation on existing factory machinery

B. Sunk cost of prior investment

C. Avoidable labour and material cost if buying externally

D. Head office rent that continues regardless

Answer: C

Relevant costs = future, avoidable, differential. Avoidable labour/material if you buy externally = relevant. Depreciation and head office rent = unavoidable = irrelevant.

Q32. Fixed costs per unit FALL as production volume RISES. This explains:

A. Why variable costs are unpredictable

B. The economic logic of economies of scale

C. Why companies prefer variable costs

D. Why break-even is different for every company

Answer: B

Fixed costs spread over more units = lower fixed cost per unit = lower total cost per unit = ECONOMIES OF SCALE.

Q33. Prestige intracompany rate is $400/hr. Commercial rate is $800/hr. Both have variable cost $28/hr. Intracompany CM vs Commercial CM:

A. Intracompany $372/hr vs Commercial $772/hr

B. Intracompany $400/hr vs Commercial $800/hr

C. Both $772/hr

D. Intracompany $372/hr vs Commercial $800/hr

Answer: A

CM = Price - Variable Cost. Intracompany: $400-$28=$372. Commercial: $800-$28=$772. Commercial generates $400 more contribution per hour.

Q34. Rowe should NOT shut Prestige Data Services in April 2003 because:

A. The subsidiary is profitable on paper

B. The unavoidable fixed costs (lease, depreciation, rent) keep running after closure but revenue disappears

C. The employees would sue

D. The regulator would object

Answer: B

Relevant cost analysis: close = lose ALL revenue (~$200k+) but keep unavoidable costs (~$130k). Net impact of closing = WORSE.

Q35. Variable cost per unit is Rs.50. Selling price is Rs.120. Target profit is Rs.2,00,000. Fixed costs are Rs.1,00,000. Units required:

A. 2,857 units

B. 4,286 units

C. 1,429 units

D. 3,000 units

Answer: B

CM = 120-50=Rs.70. Units = (FC + Target) / CM = (1,00,000 + 2,00,000) / 70 = 3,00,000/70 = 4,286 units.

4 SESSION 4: Analysing Financial Statements

Share capital mechanics, horizontal/trend/vertical analysis, and the Four Window ratio approach

This is the final session of the module. Sessions 1-2 taught you to read financial statements. Session 4 asks the harder question: how do you USE them to make better decisions? The question shifts from "how do I read a balance sheet?" to "what is this balance sheet telling me about whether to invest, lend, promote, or restructure?"

> *"What you have seen in balance sheet and P&L; -- you have understood the absolute numbers. But just reading those numbers is not enough for you as a decision maker. You need to go beyond. And we will look at how to do that today."*
>
> **-- Prof. Manju Jaiswall, opening Session 4**

KEY INSIGHT -- Four Ways to Compare Financial Data

(1) The company's OWN PAST performance over time.

(2) COMPETITORS in the same industry.

(3) Broader INDUSTRY or economy benchmarks.

(4) The company's own BUDGET -- planned vs actual, with variance explanation.

Each answers a different management question. The tools in this session make all four rigorous.

4.1 Share Capital Deep Dive -- Bonus Shares, Stock Splits, and Buybacks

Term	What it means	Relationship to others
Authorised	Maximum own-fund capital the company is PERMITTED to issue -- registered with the Registrar of Companies. The absolute ceiling.	LARGEST -- superset of all others
Issued	Amount actually offered to investors. Cannot exceed authorised.	Subset of authorised
Subscribed	Amount investors AGREED to take. For most large listed companies, equals issued.	Usually = issued
Paid-Up	Amount actually received in cash. For established companies all three converge.	Usually = subscribed = issued

Bonus Shares -- Mechanics, the Wealth Unlock, and the Trap

In a bonus issue, a company capitalises its accumulated reserves. Share Capital goes UP; Reserves and Surplus goes DOWN by the SAME AMOUNT. Total Owner's Equity is COMPLETELY UNCHANGED. No cash enters or leaves the company.

Item	Pre-Bonus	Post-Bonus (1:1)	Change
Share Capital	Rs.250 crore	Rs.500 crore	Doubled
Reserves and Surplus	Rs.750 crore	Rs.500 crore	Halved
Total Owner's Equity	Rs.1,000 crore	Rs.1,000 crore	UNCHANGED
Number of Shares	25 crore	50 crore	Doubled
Book Value per Share	Rs.40	Rs.20	Halved
Market Price per Share (actual)	Rs.100	Rs.70 (typical, not Rs.50)	Falls but NOT to the mathematical split

Why does the price settle at Rs.70 instead of the mathematical Rs.50? The very act of declaring a bonus is a signal from majority shareholders that they are confident enough to PERMANENTLY capitalise more reserves. Markets read that confidence, demand rises, and the price settles above the mathematical split. This is called **unlocking of shareholder wealth**.

Example: Govind held 100 shares at Rs.100 (investment = Rs.10,000). Post-bonus, he holds 200 shares at Rs.70 (value = Rs.14,000). Wealth grew by Rs.4,000 -- not from any operational change, but from a positive market signal.

CONCEPT TRAP -- Bonus Euphoria

The premium over the mathematical split is driven by market SENTIMENT -- transient. It could settle at Rs.70, Rs.65, or Rs.55. A bonus does not create permanent fundamental value. The BUSINESS has not changed operationally. It is a signal worth analysing in context, not a trigger to blindly chase the stock.

Stock Splits -- The Liquidity Tool

In a stock split, the face value of each share is reduced proportionally (e.g., a Rs.10 share splits into two Rs.5 shares). Share capital total, reserves, and total OE are all UNCHANGED. The primary driver: LIQUIDITY. When a share price climbs to Rs.10,000, an investor who wants to deploy Rs.8,000 per month is completely priced out. A split brings the price into an accessible range.

Share Buybacks -- The Undervaluation Signal

A buyback is the reverse of a share issue. The company uses its OWN CASH to repurchase shares from existing shareholders and CANCELS them. Correct motivation: management believes shares are undervalued.

After buyback:	Before buyback	After buyback (20 shares cancelled)
Total shares outstanding	100 shares	80 shares
Shareholder with 5 shares (did NOT sell)	5/100 = 5.0% stake	5/80 = 6.25% stake

After a buyback, remaining shareholders' percentage ownership RISES without any additional investment. Accounting impact: Cash DOWN. Share Capital DOWN by the face value of cancelled shares. Premium paid above face value reduces Reserves and Surplus. Total OE DECREASES (cash has permanently left).

MANAGER TAKEAWAY -- Corporate Actions -- Reading the Signal Behind the Announcement

Bonus shares, splits, and buybacks send signals. Reading the signal correctly separates informed executives from reactive ones. The three questions: Is the underlying business fundamentally improving? For buybacks -- is the price sensible vs intrinsic value? What happens to EPS and ROE after the action?

PRODUCT COMPANY EXAMPLE -- FMCG Company Bonus Issue: A leading FMCG company announces a 1:2 bonus. Stock jumps 12% in two days. Before reacting: check the 3-year EBITDA margin trend. If expanding: management confidence is backed by operations -- genuine signal. If flat or declining: the bonus capitalises reserves but the business has not improved. The Govind example from class: his Rs.10,000 became Rs.14,000 post-bonus because the market read genuine confidence from management who know the growth pipeline. That Rs.4,000 gain was a market signal reward, not an accounting outcome.

SERVICE COMPANY EXAMPLE -- Infosys Rs.9,300 Crore Buyback (2022): Infosys bought back shares at Rs.1,539 per share. The quality check: Infosys had Rs.27,000+ crore in cash, generating Rs.15,000+ crore annual free cash flow, with no major capex requirement in sight. Returning capital at below-intrinsic-value prices is shareholder-accretive. Remaining shareholders' ownership rose from 5% to 6.25% without additional investment. The test: would management personally invest at that price? For Infosys in 2022, yes -- which is exactly why the buyback created value.

Before any corporate action response: run the three questions. Sentiment without fundamentals reverses in 3-6 months.

MANAGER TAKEAWAY -- Ratios as a Management Scoreboard -- By Industry, By Function

Ratios are not just for investors and auditors. They are the diagnostic tools that tell you which part of the business is under-performing before it shows up as a large number on the P&L.; The Four Window framework turns a static balance sheet into a dynamic management conversation.

PRODUCT COMPANY EXAMPLE -- Manufacturing (Auto Components or FMCG): Liquidity: Current Ratio below 1.2 for two consecutive quarters = cash stress signal. Efficiency: Inventory Turnover below 4x (90+ days of inventory) = investigate immediately. Is it finished goods piling up (demand problem) or raw material overstocking (procurement problem)? Each needs a different fix. Profitability: Gross Margin falling while Operating Margin holds = input cost pressure being absorbed. How long can it continue? Leverage: If ROTA < cost of debt, every additional rupee of debt destroys equity value. Stop the borrowing, fix the asset productivity first.

SERVICE COMPANY EXAMPLE -- IT Services or SaaS: Liquidity: Less critical than for manufacturing (no inventory). Focus on DSO (Days Sales Outstanding): below 45 days = healthy collections. Above 75 days = either clients are unhappy and delaying payment, or your billing process is broken. Profitability: For a SaaS business, track Gross Margin separately from EBITDA. Gross Margin below 60% for SaaS = unit economics problem. EBITDA negative on high revenue = fixed cost base growing faster than revenue. Leverage: For IT services (asset-light, human capital), ROCE should comfortably exceed 15-18%. If ROCE < bank FD rate (currently 7%), the business is value-destroying and should return capital rather than reinvest.

The discipline: run the Four Window check quarterly for your own business unit as a manager, not just annually when the accountants present it.

4.2 Tools of Financial Analysis -- Horizontal, Trend, and Vertical

Horizontal Analysis -- Reading Across Time

Formula: Percentage Change = (Amount of Change / Base Year Amount) x 100. You compare each line item between two periods -- reading across the ROWS. Hence "horizontal."

Starbucks P&L; Example from Class: Net revenues grew 20.9% year-on-year. But Cost of Sales grew 25.8% -- FASTER than revenue. That single comparison is the critical signal: the business is producing more, but the cost of production is growing faster than the revenue it generates. Gross margin grew only 17.5%, below revenue growth.

Management implication: Do not just note the number -- find out WHY and fix accountability. Was it the purchasing manager buying in bulk but storing poorly? Input quality deterioration? The tool surfaces the question. The MANAGER finds the answer.

Trend Analysis -- Reading Across Multiple Years

Trend analysis is horizontal analysis extended across 5+ years. Method: Pick Year 1 as the BASE. Set every base year number to 100. Express each subsequent year as (value / base year value) x 100. Creates an INDEX -- a trend line for each variable showing directional change over time.

Starbucks 5-Year Example: Net Revenues went from index 100 to 230.9 (Year 5). Operating Income went from 100 to 244.9 -- growing FASTER than revenue. This means costs were disciplined and the business became more profitable per rupee of sales over time.

EXAM TIP -- Trend Analysis Rules

BASE YEAR = ALWAYS Year 1. Any other choice loses data points.

Trend analysis = index-based analysis.

Key check: is Operating Income index pulling AHEAD of or FALLING BEHIND Revenue index? Ahead = improving profitability per rupee of sales. Behind = cost pressure building.

Vertical Analysis (Common-Size Statements) -- Removing Size Bias

Pick an ANCHOR number, set it to 100%, and express every other item as a percentage of it. For the P&L;: anchor = Net Sales. For the Balance Sheet: anchor = Total Assets. The power: removing size bias. A company with Rs.15 crore sales and Rs.12 crore COGS is not directly comparable to one with Rs.8 crore sales and Rs.4.8 crore COGS. Common-size both: Company X has COGS 80% of sales. Company Y has COGS 60%. Company Y is more efficient. Now you can compare fairly.

The Industry Character Test -- Two Anonymised Balance Sheets from Class

Feature	Company A (% of total assets)	Company B (% of total assets)	Implication
Inventory / Total Assets	~17.7% -- significant	~0.15% -- near zero	A holds physical stock; B does not
Fixed Assets (Net Block)	High -- heavy PP&E;	Very low -- asset-light	A is capital-intensive
Long-term Debt	Material	Near zero	B does not need debt to fund assets
Investments outside core	Moderate	High -- surplus cash deployed	B has excess cash earning externally
VERDICT	Manufacturing company	IT services company	Industry DNA is visible

KEY INSIGHT -- Industry DNA in Common-Size Statements

IT companies have near-zero long-term debt because their primary asset is HUMAN CAPITAL (people), which does not require debt financing. Their working capital is funded by long-term contract advances. A bank cannot be Company B -- a bank's customer deposits ARE its liabilities. Common-size analysis makes industrial DNA visible without needing the company name.

4.3 The Four Window Approach to Ratio Analysis

Window	The Central Question It Answers
1. LIQUIDITY	Can the business meet its SHORT-TERM obligations? Will it survive the next 12 months without running out of cash?
2. EFFICIENCY	How productively is the business using its assets to generate sales? Is capital working hard or sitting idle?
3. PROFITABILITY	How much profit does every rupee of sales generate? How much return does every rupee of capital deployed earn?
4. LEVERAGE	How does the mix of debt and equity affect the return to shareholders? Is borrowing working for or against the owners?

4.4 Window 1 -- Liquidity

Ratio	Formula	What it measures	Good direction
Current Ratio	Current Assets / Current Liabilities	Primary liquidity gauge. Can short-term obligations be met from current assets?	Adequate -- not too high, not too low
Quick Ratio (Acid Test)	(Current Assets - Inventory) / Current Liabilities	Stricter test -- excludes inventory, which may not liquidate quickly in a downturn.	Above 1.0 comfortable
Financial Slack	(Cash and Bank / Total Assets) x 100	Ready cash as a % of total assets. Immediate dry powder for emergencies.	More = more flexibility

CONCEPT TRAP -- Higher Liquidity is NOT Always Better

Current assets (cash, receivables, inventory) generate ZERO to LOW return. Non-current assets (plant, machinery, technology) generate HIGH returns. A very HIGH current ratio means more money locked in low-return assets and less in productive ones -- it is OVER-LIQUID.

HUL has NEGATIVE working capital -- current liabilities exceed current assets. Alarming? No. HUL collects cash from retailers BEFORE it pays suppliers. The cash conversion cycle is negative. This is market power and operational excellence, not financial stress.

4.5 Window 2 -- Efficiency

Ratio	Formula	What it diagnoses	Direction
Total Asset Efficiency	Sales / Total Assets	Overall efficiency -- revenue per rupee of ALL assets	Higher
Fixed Asset Efficiency	Sales / (Net Block + CWIP)	Are productive assets -- plant, machinery -- utilised hard enough?	Higher
Inventory Turnover	COGS / Average Inventory	Times inventory is sold and replaced. Use COGS (not revenue).	Higher = sell faster
Debtors Turnover	Credit Sales / Average Debtors	Speed of collection from customers.	Higher = collect faster
Creditors Turnover	Credit Purchases / Average Creditors	Speed of payment to suppliers. LOWER is better -- use full credit terms.	Lower = pay later

The Cash Conversion Cycle (CCC)

CCC = DIO + DSO - DPO where DIO = Days Inventory Outstanding (365 / Inventory Turnover), DSO = Days Sales Outstanding (365 / Debtors Turnover), DPO = Days Payable Outstanding (365 / Creditors Turnover). CCC = the net number of days cash is tied up in working capital.

Business Type	DIO	DSO	DPO	CCC	Verdict
Typical business	20 days	15 days	10 days	25 days	Cash tied up 25 days before recovered
Strong negotiator	20 days	15 days	40 days	-5 days	Suppliers fund the business -- outstanding
HUL / Amazon type	Low	Low	Very high	Strongly negative	Market power -- operating on suppliers' money

> *"Shareholder wealth maximisation is the objective. Supplier wealth maximisation is not. HUL does not owe its vendors a fast payment. Stretching payables to the maximum term allowed is exactly what a well-run business should do."*
>
> **-- Prof. Manju Jaiswall, on working capital cycle management**

4.6 Window 3 -- Profitability

Ratio	Formula	What it measures
Gross Profit Margin	(Gross Profit / Sales) x 100	Profit after direct cost of production. Measures pricing power and production efficiency.
Operating Profit Margin	(Operating Profit / Sales) x 100	Margin after ALL operating expenses. Reflects management of both production costs and overhead.
Net Profit Margin (PAT Margin)	(PAT / Sales) x 100	The final bottom line. Truest measure of what the business KEEPS per rupee of revenue.
ROTA (Return on Total Assets)	(PBIAT / Total Assets) x 100 where PBIAT = PAT + Interest x (1-tax rate)	Uses ALL assets as denominator -- funding-neutral. What the asset base earns REGARDLESS of capital structure.
ROCE / ROI	(Operating Profit / Capital Employed) x 100	Capital Employed = Equity + Long-term Debt. Return on all permanent capital.
ROE / RONW	(PAT / Net Worth) x 100	Equity investor's return. Smallest denominator. When leverage works: ROE > ROCE > ROTA.
EPS	(PAT - Preference Dividends) / Weighted Average Shares	Profit per equity share. Most widely quoted market profitability metric.
Payout Ratio	(Proposed Dividend / PAT) x 100	Fraction of profit distributed now vs retained for future reinvestment.

KEY INSIGHT -- ROTA vs ROCE vs ROE

All three have the SAME NUMERATOR (profit) but progressively SMALLER DENOMINATORS: Total Assets > Capital Employed > Owners Equity. ROE should be HIGHEST because it has the smallest denominator. The business earns a return on ALL assets but that return flows to EQUITY holders only. Debt AMPLIFIES the return on equity -- this is the leverage effect, which is Window 4.

ROTA formula expanded: PBIAT = PAT + [Interest x (1 - Tax Rate)]. Example: PAT = Rs.20L, Interest = Rs.5L, Tax rate = 30%. PBIAT = 20 + (5 x 0.7) = 20 + 3.5 = Rs.23.5L. If Total Assets = Rs.200L, then ROTA = 23.5/200 x 100 = 11.75%.

4.7 Window 4 -- Leverage

The leverage window asks: should a business use debt, and what happens to shareholder returns when it does? The class unanimously said yes, take debt. Then Prof. Jaiswall challenged them: "So why do TV channels celebrate a debt-free company as something virtuous?"

Why Debt is Cheaper Than Equity

Debt is ALWAYS cheaper than equity because: (1) An equity investor demands returns well ABOVE the risk-free rate -- equity is riskiest (last in line in liquidation, no guaranteed return). If bank charges 11%, equity investor demands 14-18%. (2) Interest is TAX-DEDUCTIBLE -- reduces taxable profit. Equity dividends are paid from post-tax profit with no tax benefit.

The Leverage Effect on ROE

Scenario	Total Assets	Equity	Debt	EBIT	Interest (11%)	Approx PAT	ROE
All Equity	Rs.100	Rs.100	Rs.0	Rs.15	Rs.0	Rs.15	15.0%
50% Debt	Rs.100	Rs.50	Rs.50	Rs.15	Rs.5.5	Rs.9.5	19.0%
70% Debt	Rs.100	Rs.30	Rs.70	Rs.15	Rs.7.7	Rs.7.3	24.3%

CONCEPT TRAP -- Leverage Only Works When ROTA > Cost of Debt

If ROTA = 8% and debt costs 11%, every rupee of debt DESTROYS equity value -- negative leverage. The optimal capital structure balances the amplification benefit against solvency risk. Debt-free forgoes an advantage. Debt-loaded beyond earnings capacity is FAR WORSE.

Ratio	Formula	What it monitors
Debt-Equity Ratio	Long-term Debt / Equity	How much debt for every rupee of equity. Context-dependent optimal.
Interest Coverage	(PBT + Interest) / Interest	Number of times EBIT covers the interest bill. Close to 1.0 signals distress. Above 2.0 comfortable.
DSCR (Debt Service Coverage)	Operating Cash Flow After Tax / (Interest + Principal)	Can operating cash flows cover FULL debt service? Above 1.0 means obligations met.
Debt Ratio	(Long-term Debt / (LT Debt + Equity)) x 100	Debt as a % of total permanent capital.

BRINGING IT TOGETHER -- The Four Window Multiplier

LIQUIDITY keeps the business solvent in the short run.

EFFICIENCY ensures every asset works hard to generate sales.

PROFITABILITY ensures those sales translate into profit.

LEVERAGE ensures profit generates the maximum possible return to equity holders.

A company with excellent profitability but poor liquidity may default before it profits. A company with strong liquidity but terrible efficiency is wasting capital. Ratio analysis tells you WHICH WINDOW needs attention -- and that is exactly its purpose.

8 Exam Practice -- Master Reference: Key Ratios by Window

Prof. Jaiswall confirmed: the exam is MCQ format, drawn entirely from class discussions across all four sessions. No negative marking. Calculators available via the online interface. The exam tests contextual understanding -- not formula memorisation in isolation.

Window	Ratio	Formula	Direction
Liquidity	Current Ratio	CA / CL	Adequate -- not too high, not too low
Liquidity	Quick Ratio	(CA - Inventory) / CL	Stricter test
Liquidity	Financial Slack	(Cash / Total Assets) x 100	More = more dry powder

Window	Ratio	Formula	Direction
Efficiency	Total Asset Turnover	Sales / Total Assets	Higher is better
Efficiency	Fixed Asset Turnover	Sales / Net Block	Higher is better
Efficiency	Inventory Turnover	COGS / Avg Inventory	Higher (sell faster)
Efficiency	Debtors Turnover	Credit Sales / Avg Debtors	Higher (collect faster)
Efficiency	Creditors Turnover	Credit Purchases / Avg Creditors	Lower (pay later)
Efficiency	Cash Conversion Cycle (CCC)	DIO + DSO - DPO	Negative or lower is better
Profitability	Gross Profit Margin	(GP / Sales) x 100	Higher is better
Profitability	Operating Profit Margin	(Op. Profit / Sales) x 100	Higher is better
Profitability	Net Profit Margin	(PAT / Sales) x 100	Higher is better
Profitability	ROTA	(PBIAT / Total Assets) x 100 | PBIAT = PAT + [Interest x (1-Tax Rate)]	Higher is better
Profitability	ROCE / ROI	(Op. Profit / Capital Employed) x 100	Higher is better
Profitability	ROE / RONW	(PAT / Net Worth) x 100	Should exceed ROCE when leverage works
Leverage	Debt-Equity Ratio	LT Debt / Equity	Context-dependent optimal
Leverage	Interest Coverage	(PBT + Interest) / Interest	Higher -- above 2.0 comfortable
Leverage	DSCR	Op. CF AT / (Interest + Principal)	Above 1.0 means obligations met
Leverage	Debt Ratio	(LT Debt / (LT Debt + Equity)) x 100	Context-dependent

SESSION 4 -- True / False Practice (20 Checks)

1. Trend analysis can use any convenient year as the base year.

Answer: FALSE

Base year = Year 1 ALWAYS. Any other choice loses data points unnecessarily.

2. Vertical analysis removes the size bias between companies.

Answer: TRUE

Common-sizing sets the anchor to 100% -- absolute size becomes irrelevant to comparison.

3. A bonus issue increases Total Owner's Equity.

Answer: FALSE

SC up and RE down by the SAME AMOUNT. Total OE is COMPLETELY UNCHANGED.

4. Bonus shares benefit shareholders via unlocking of shareholder wealth.

Answer: TRUE

Positive confidence signal drives demand and price above the mathematical split.

5. Stock splits and bonus issues produce broadly similar economic outcomes.

Answer: TRUE

Different mechanics (face value vs reserves), but market effects are broadly similar.

6. A buyback is motivated by a desire to gain management control.

Answer: FALSE

Correct motivation: shares are undervalued and the company has available cash.

7. In a buyback, the full purchase price reduces Share Capital.

Answer: FALSE

Face value reduces SC. The PREMIUM over face value reduces Reserves and Surplus.

8. Higher current ratio always signals better financial health.

Answer: FALSE

Excess liquidity = idle capital in low-return assets. Higher is NOT always better.

9. HUL's negative working capital signals financial stress.

Answer: FALSE

It signals market power -- collects before it pays. A STRENGTH, not a weakness.

10. Inventory is excluded from Quick Ratio because it generates no return.

Answer: FALSE

Excluded because it may NOT convert to cash quickly in a downturn.

11. Days Payable Outstanding should be minimised for best efficiency.

Answer: FALSE

DPO should be MAXIMISED within agreed terms -- pay as late as possible.

12. Cash Conversion Cycle = DIO + DSO + DPO.

Answer: FALSE

Correct: DIO + DSO MINUS DPO. Longer payables REDUCE the cycle.

13. COGS is the correct numerator for Inventory Turnover.

Answer: TRUE

Inventory is held at cost -- COGS is the matching metric.

14. ROTA will always be higher than ROE for the same business.

Answer: FALSE

ROE has a smaller denominator (equity only) -- ROE is typically HIGHER.

15. Debt is cheaper than equity because lenders face lower risk.

Answer: TRUE

Lenders have priority claim in liquidation; equity is residual and riskier. Lower risk = lower required return.

16. A debt-free company is always better for shareholders.

Answer: FALSE

If ROTA > cost of debt, leverage AMPLIFIES ROE. Debt-free forgoes this genuine benefit.

17. Interest Coverage of 1.0 means the business is in trouble.

Answer: TRUE

EBIT barely covers interest. No buffer for principal, tax, or any operating downturn.

18. Horizontal analysis works column by column down the statement.

Answer: FALSE

Horizontal works ROW BY ROW -- comparing the same line item across DIFFERENT PERIODS.

19. Ratio analysis is the primary PURPOSE of financial statements.

Answer: FALSE

Statements are for reporting. Ratio analysis is the USER'S tool applied on top of them.

20. A common-sized balance sheet can reveal the industry of an anonymous company.

Answer: TRUE

IT, manufacturing, banking, FMCG all have distinctive asset and liability profiles visible in common-size format.

SESSION 4 -- Practice MCQs (35 Questions)

Q1. Company ABC: SC Rs.250 cr, Reserves Rs.750 cr, 25 cr shares. A 1:2 bonus (1 bonus for every 2 held) is announced. Post-bonus Share Capital is:

A. Rs.250 cr

B. Rs.375 cr

C. Rs.500 cr

D. Rs.1,000 cr

Answer: B

1:2 bonus = add 50% more shares. New shares = 25 x 50% = 12.5 cr at face value Rs.10 = Rs.125 cr added to SC. New SC = 250 + 125 = Rs.375 cr. Reserves fall by Rs.125 cr.

Q2. In a stock split of 2:1 (each share splits into 2), Total Owners Equity:

A. Doubles

B. Halves

C. Remains completely unchanged

D. Increases by face value

Answer: C

Stock split: face value halved, shares doubled. SC total = same. Reserves = same. Total OE = unchanged.

Q3. A company buys back 1,000 shares at Rs.150 each (face value Rs.10 each). Impact on Reserves and Surplus:

A. Increases by Rs.1,50,000

B. Decreases by Rs.1,40,000 (premium above face value)

C. No impact

D. Decreases by Rs.10,000

Answer: B

Face value portion (1,000 x Rs.10 = Rs.10,000) reduces Share Capital. Premium (1,000 x Rs.140 = Rs.1,40,000) reduces Reserves and Surplus. Total cash out = Rs.1,50,000.

Q4. Year 1 Net Revenue = Rs.100 cr. Year 3 = Rs.145 cr. Year 5 = Rs.230 cr. Trend index for Year 5 is:

A. 230

B. 130

C. 185

D. 58

Answer: A

Trend index = (Value / Base Year 1 Value) x 100 = (230/100) x 100 = 230. Base year (Year 1) = 100 always.

Q5. Starbucks: Revenues grew 20.9%, Cost of Sales grew 25.8%. What does horizontal analysis reveal?

A. Business is performing excellently

B. Cost of production is growing faster than revenue -- margin pressure

C. Tax is too high

D. The company is over-invested in assets

Answer: B

Cost growing faster than revenue = gross margin falling. Even though absolute revenue grew, the business retained less per rupee of sales. Action needed on cost structure.

Q6. A common-size balance sheet shows Company X with Inventory 18% of total assets and Company Y with Inventory 0.1%. Company Y is most likely:

A. A manufacturing company

B. A retail chain

C. An IT services or consulting firm

D. A pharmaceutical company

Answer: C

IT/consulting = no physical inventory. Knowledge-based businesses have near-zero inventory.

Q7. Current Assets Rs.80L, Current Liabilities Rs.50L, Inventory Rs.20L. Quick Ratio is:

A. 1.6

B. 1.2

C. 0.8

D. 2.0

Answer: B

Quick Ratio = (CA - Inventory) / CL = (80 - 20) / 50 = 60/50 = 1.2.

Q8. Current Assets Rs.60L, Current Liabilities Rs.80L. Working Capital is:

A. +Rs.20L (positive)

B. -Rs.20L (negative)

C. Rs.140L

D. Rs.0

Answer: B

WC = CA - CL = 60 - 80 = -Rs.20L. NEGATIVE working capital. May indicate market power (like HUL) or liquidity concern -- context determines which.

Q9. Company A Current Ratio = 3.5. Company B Current Ratio = 1.3 (same industry). Better investment is likely:

A. Company A -- more liquid, safer

B. Company B -- leaner, more capital deployed productively

C. Equal -- ratio does not matter

D. Depends only on profits

Answer: B

Current ratio 3.5 means significant idle capital in low-return assets. Company B (1.3) has more capital in productive assets.

Q10. Sales Rs.500 cr, Avg Inventory Rs.50 cr, COGS Rs.350 cr. Inventory Turnover is:

A. 10 times

B. 7 times

C. 5 times

D. 3.5 times

Answer: B

Inventory Turnover = COGS / Avg Inventory = 350 / 50 = 7 times. Use COGS (not revenue) because inventory is valued at cost.

Q11. Using Q10 data: Days Inventory Outstanding (DIO) is approximately:

A. 36 days

B. 52 days

C. 73 days

D. 100 days

Answer: B

DIO = 365 / Inventory Turnover = 365 / 7 = 52.1 approximately 52 days.

Q12. Debtors Turnover = 8 times, Creditors Turnover = 6 times, Inventory Turnover = 10 times. CCC is:

A. 61 days

B. 107 days

C. 24 days

D. 45 days

Answer: C

DIO = 365/10 = 36.5, DSO = 365/8 = 45.6, DPO = 365/6 = 60.8. CCC = DIO + DSO - DPO = 36.5 + 45.6 - 60.8 = 21.3 approximately 21 days (closest option = 24 days).

Q13. Gross Profit Rs.40L, Sales Rs.100L. Gross Profit Margin is:

A. 40%

B. 60%

C. 25%

D. 150%

Answer: A

GPM = (Gross Profit / Sales) x 100 = (40/100) x 100 = 40%.

Q14. Operating Profit Rs.20L, Sales Rs.100L. Operating Profit Margin is:

A. 80%

B. 25%

C. 20%

D. 5%

Answer: C

OPM = (20/100) x 100 = 20%.

Q15. PAT Rs.15L, Sales Rs.100L. Net Profit Margin is:

A. 85%

B. 15%

C. 6.67%

D. 25%

Answer: B

NPM = (15/100) x 100 = 15%.

Q16. Total Assets Rs.200L, PAT Rs.20L, Interest Rs.5L, Tax Rate 30%. ROTA is approximately: [CORRECTED IN v4]

A. 10%

B. 12%

C. 17.5%

D. 7%

Answer: B

CORRECTED CALCULATION: PBIAT = PAT + [Interest x (1 - Tax Rate)] = 20 + [5 x 0.7] = 20 + 3.5 = Rs.23.5L. ROTA = 23.5 / 200 x 100 = 11.75% approximately 12%. Answer B.

Q17. Capital Employed Rs.100L, Operating Profit Rs.18L. ROCE is:

A. 18%

B. 12%

C. 5.5%

D. 0.18%

Answer: A

ROCE = (Operating Profit / Capital Employed) x 100 = 18/100 x 100 = 18%.

Q18. Net Worth Rs.50L, PAT Rs.10L. ROE is:

A. 5%

B. 500%

C. 20%

D. 10%

Answer: C

ROE = (PAT / Net Worth) x 100 = (10/50) x 100 = 20%.

Q19. EBIT Rs.30L, Interest Rs.5L. Interest Coverage Ratio is:

A. 6 times

B. 25 times

C. 5 times

D. 0.17 times

Answer: A

Interest Coverage = (PBT + Interest) / Interest = (25 + 5) / 5 = 30/5 = 6 times.

Q20. Long-term Debt Rs.60L, Equity Rs.40L. Debt-Equity ratio is:

A. 0.67

B. 1.5

C. 0.40

D. 2.5

Answer: B

D/E = Long-term Debt / Equity = 60 / 40 = 1.5.

Q21. ROTA = 14%, cost of debt = 10%. Adding more debt will:

A. Destroy equity value -- negative leverage

B. Amplify ROE positively -- positive leverage

C. Have no effect on ROE

D. Reduce the company's ROTA

Answer: B

ROTA (14%) > Cost of Debt (10%) = positive leverage. Borrowing at 10%, earning 14% on assets = difference flows to equity holders as higher ROE.

Q22. Govind held 100 shares at Rs.100 each (Rs.10,000 investment). After 1:1 bonus, shares at Rs.70. His wealth change is:

A. -Rs.3,000 (loss)

B. No change (Rs.10,000 still)

C. +Rs.4,000 gain

D. +Rs.7,000 gain

Answer: C

Post-bonus: 200 shares x Rs.70 = Rs.14,000. Original investment = Rs.10,000. Gain = Rs.4,000. Market settled at Rs.70 (not mathematical Rs.50) due to confidence signal.

Q23. Which metric tells you how quickly a company can pay off its interest from earnings?

A. Debt-Equity Ratio

B. Interest Coverage Ratio

C. Current Ratio

D. DSCR

Answer: B

Interest Coverage = EBIT / Interest. Tells how many times current earnings can cover the interest bill. Close to 1.0 = danger zone.

Q24. Amazon imposes 90-day payment terms on sellers. This is reflected as:

A. Low DPO -- Amazon pays quickly

B. High DPO -- Amazon pays late, using sellers' money

C. Low CCC -- Amazon collects slowly

D. High DSO -- Amazon gives long credit

Answer: B

Amazon's market power = suppliers cannot push back on long payment terms. High DPO = negative CCC = suppliers funding Amazon's operations.

Q25. Year 1 Operating Income index = 100. Year 5 = 285. Revenue index Year 5 = 230. This means:

A. Costs are growing faster than revenue

B. Operating income is growing faster than revenue -- improving margin

C. Revenue and costs are growing equally

D. The company is taking on more debt

Answer: B

Operating Income index (285) > Revenue index (230). Profit growing faster than sales = improving profitability per rupee of sales.

Q26. Company X common-size: Fixed Assets 65% of total assets, Debt 55% of capital. Company Y: Fixed Assets 5%, Debt 0%. Most likely industries:

A. X = IT services, Y = Power utility

B. X = Power utility, Y = IT services

C. Both manufacturing

D. Both financial services

Answer: B

Power utility = massive fixed assets (transmission lines, equipment), high debt needed for infrastructure. IT services = asset-light (people), near-zero debt.

Q27. Which statement about DPO is CORRECT?

A. Lower DPO is always better for the buyer

B. Higher DPO means the buyer is paying suppliers too slowly

C. Higher DPO means the buyer is using supplier credit efficiently (free financing)

D. DPO has no impact on working capital

Answer: C

Higher DPO = stretching supplier credit = free funding from suppliers = reduces net cash needed. Within agreed terms, higher is better for the buyer.

Q28. Profitability on INVESTMENT ratios use which denominator?

A. Revenue

B. Cost of sales

C. Various asset/capital measures (Total Assets, Capital Employed, or Equity)

D. Total liabilities

Answer: C

Return on Total Assets uses Total Assets. ROCE uses Capital Employed (NW + LT Debt). ROE uses Net Worth (equity only). All three have the same numerator -- profit -- but different denominators.

Q29. Interest Coverage = 5.0 means:

A. The company can service its debt 5 times over from current earnings

B. Interest is 5% of revenue

C. 5 years until the loan matures

D. Debt is 5 times equity

Answer: A

IC = EBIT / Interest = 5.0. EBIT can cover interest 5 times over. Comfortable buffer. IC close to 1.0 = barely covering interest = distress signal.

Q30. Horizontal analysis of Infosys: Revenue +12%, COGS +8%, Operating Expenses +15%. Quick conclusion:

A. All trends are positive -- good company

B. Revenue growing healthily; COGS controlled; but operating expenses growing faster than revenue -- needs attention

C. Company should cut COGS immediately

D. Nothing useful can be concluded

Answer: B

Revenue 12% > COGS 8% = good (improving gross margin). But Operating Expenses 15% > Revenue 12% = operating margin pressure. Drill down: which operating expense is growing fastest?

Q31. A buyback is done at Rs.500/share when management believes fair value is Rs.650/share. This is:

A. A good use of cash -- buying undervalued shares at a discount to fair value

B. A destruction of shareholder value

C. Irrelevant to shareholders

D. A regulatory violation

Answer: A

If management believes Rs.650 is fair value but shares trade at Rs.500, buying at Rs.500 = buying Rs.650 of value for Rs.500 = excellent investment for remaining shareholders.

Q32. The FOUR Windows of ratio analysis in correct multiplier order:

A. Profitability - Leverage - Liquidity - Efficiency

B. Liquidity - Efficiency - Profitability - Leverage

C. Leverage - Profitability - Efficiency - Liquidity

D. Efficiency - Liquidity - Leverage - Profitability

Answer: B

The logical sequence: LIQUIDITY (survive short-term) enables EFFICIENCY (assets work hard) which generates PROFITABILITY (sales become profit) amplified by LEVERAGE (into higher equity returns).

Q33. ROE > ROCE > ROTA. This is observed when:

A. The company has no debt

B. ROTA is less than cost of debt

C. ROTA is greater than cost of debt (positive leverage)

D. The company is unprofitable

Answer: C

When business earns more on assets (ROTA) than debt costs, the surplus flows to equity holders alone (smaller denominator) amplifying ROE above ROCE above ROTA.

Q34. A vertical analysis balance sheet shows Debt 0%, Investments 40% of assets. This company most likely:

A. Is a startup with high growth needs

B. Is a mature company with surplus cash and strong operational cash flows, no need for debt

C. Is in financial distress

D. Is over-leveraged

Answer: B

Zero debt + high investments = generating cash well beyond operational needs. Likely mature, cash-generative business like TCS or Infosys.

Q35. Which ratio would BEST tell you whether a company's operations can cover its full debt repayment (principal + interest)?

A. Interest Coverage

B. Debt-Equity Ratio

C. DSCR

D. Current Ratio

Answer: C

DSCR = Operating CF After Tax / (Interest + Principal Repayment). Tells whether operational cash can fully service all debt obligations -- the most comprehensive debt repayment measure.

Q MCQ QUESTION BANK

Cross-session practice -- attempt before reading the answer

This Question Bank contains 120 practice questions covering all four sessions. Sections A through D draw from all session topics. Section E contains advanced analytical and case-based questions. Attempt each question before reading the answer. Wrong answers with clear explanations are more valuable than right answers guessed.

Exam format: MCQ, NO negative marking (attempt every question). Calculators available online. Questions test contextual understanding. This bank covers all four sessions with a mix of conceptual and calculation questions.

Q1. Which of the following events is NOT recorded in the accounting system?

A. Taking a Rs.10L bank loan

B. Signing an employment contract (before work begins)

C. Paying staff salaries

D. Buying machinery

Answer: B

Signing a contract has no financial impact yet. Record when value is exchanged, not when contracts are signed.

Q2. A company buys goods on credit Rs.50,000. Cash has not moved. The TWO impacts are:

A. Inventory +50,000 and Cash -50,000

B. Inventory +50,000 and Trade Payables +50,000

C. Cash +50,000 and Trade Payables +50,000

D. Inventory +50,000 only

Answer: B

Goods received = Inventory UP (asset). Payment not made = Trade Payables UP (liability). Cash unchanged.

Q3. A company earns Rs.80L revenue, incurs Rs.55L expenses. Dividends paid Rs.5L. Closing RE (opening was Rs.10L):

A. Rs.30L

B. Rs.35L

C. Rs.25L

D. Rs.40L

Answer: A

Net Income = 80-55=25L. RE = Opening 10 + NI 25 - Dividends 5 = Rs.30L.

Q4. Which financial statement would you read FIRST to understand HOW a company performed in a year?

A. Balance Sheet

B. Cash Flow Statement

C. Income Statement (P&L;)

D. Notes to Accounts

Answer: C

P&L; = performance over the period. Balance Sheet = position at a date. Cash Flow = cash movements. P&L; first, always.

Q5. Assets Rs.500L, Liabilities Rs.320L, Net Income Rs.40L (included in OE), Dividends Rs.10L. Share Capital is:

A. Rs.180L

B. Rs.150L

C. Rs.140L

D. Rs.170L

Answer: B

OE = 500-320=180. OE = SC + RE. RE = NI - Dividends = 40-10=30. SC = OE - RE = 180-30=Rs.150L.

Q6. Machinery Rs.10L, 5-year life, Rs.1L residual, SLM. Net Book Value after 3 years: [CORRECTED IN v4]

A. Rs.10L

B. Rs.4.6L

C. Rs.4.0L

D. Rs.5.2L

Answer: B

CORRECTED: Annual dep = (10-1)/5 = Rs.1.8L per year. After 3 years: accumulated dep = 1.8 x 3 = Rs.5.4L. NBV = 10 - 5.4 = Rs.4.6L. Answer B.

Q7. Which of the following is a NON-CASH expense?

A. Salaries paid to employees

B. Interest paid on bank loan

C. Depreciation on machinery

D. Rent paid to landlord

Answer: C

Depreciation = book entry only. Cash left when asset was PURCHASED. No cash movement when depreciation is recorded.

Q8. The Accrual Concept requires recording Rs.20,000 January rent as an expense when:

A. The cash is paid on February 1st

B. The office is occupied and benefit is consumed in January

C. The landlord sends the invoice

D. The auditor approves

Answer: B

Record when INCURRED (benefit consumed) = January. Cash timing is irrelevant for expense recognition.

Q9. A company's CFO is Rs.60L, CFI is -Rs.80L, CFF is Rs.30L. Closing cash (opening Rs.20L):

A. Rs.50L

B. Rs.30L

C. Rs.110L

D. Rs.10L

Answer: B

Net change = 60-80+30=+10L. Closing cash = 20+10=Rs.30L.

Q10. A company reports Rs.100L profit but CFO is Rs.20L. The gap is BEST explained by:

A. The company is committing fraud

B. Significant credit sales not yet collected, large non-cash charges, or heavy investing

C. Accounting errors

D. Management incompetence

Answer: B

Profit (accrual) vs cash is always different. Large gap = significant debtors (sales not collected), depreciation add-back, or investing activities.

Q11. A company's Gross Profit Margin is 40%, Operating Profit Margin is 15%, Net Profit Margin is 10%. Interest and tax together consume what % of sales?

A. 5%

B. 15%

C. 10%

D. 30%

Answer: A

OPM 15% - NPM 10% = 5% consumed by interest + tax. GPM 40% to OPM 15% = 25% = operating expenses.

Q12. Infosys vs a steel manufacturer. Common-size: which company has near-ZERO inventory?

A. Both have similar inventory

B. Steel manufacturer -- processes quickly

C. Infosys (IT services) -- provides knowledge/services, not physical goods

D. Depends on the year

Answer: C

IT services = no physical product = near-zero inventory.

Q13. A company retains 60% of its PAT every year (payout ratio 40%). This is BEST for shareholders when:

A. The company needs cash for dividends

B. The company can invest retained earnings at returns ABOVE what shareholders could earn elsewhere

C. The stock price is falling

D. The company has excess cash

Answer: B

Retaining earnings makes sense if ROTA > shareholders' required return. Otherwise, return it as dividends.

Q14. Revenue recognition: a software company signs a Rs.12L annual support contract on October 1st. Revenue in Year 1 (ending March 31st):

A. Rs.12L (full contract)

B. Rs.0 (wait until contract completes)

C. Rs.6L (6 months of service rendered)

D. Rs.2L (deposit only)

Answer: C

Accrual: recognise revenue as service is PERFORMED. October 1 to March 31 = 6 months. Revenue = 12L x 6/12 = Rs.6L.

Q15. A company's Capital Employed is Rs.200L and ROCE is 18%. Its Operating Profit is:

A. Rs.18L

B. Rs.36L

C. Rs.200L

D. Rs.3,600L

Answer: B

ROCE = OP / CE. OP = ROCE x CE = 18% x 200 = Rs.36L.

Q16. Purchased Goodwill is different from internally-generated goodwill because:

A. Purchased goodwill is larger

B. Purchased goodwill arises from an actual M&A; transaction with a verifiable price (objective measurement)

C. Only purchased goodwill is tax-deductible

D. Internally-generated goodwill is more valuable

Answer: B

Money Measurement Concept: only record what can be objectively measured. M&A; = actual transaction = objective price = allowed on balance sheet.

Q17. A manager asks: "What will our profit be if we sell 500 more units next month?" This CANNOT be answered from:

A. The contribution income statement

B. The traditional income statement (which mixes fixed and variable by function)

C. Knowledge of CM per unit

D. The break-even analysis

Answer: B

Traditional format mixes fixed and variable in COGS and in Selling & Admin. You cannot isolate how much cost changes with 500 more units.

Q18. TTK Inc: closing OE = Rs.2,60,000, opening OE = Rs.1,60,000, new share capital Rs.40,000, dividends Rs.48,000. Net Income is:

A. Rs.80,000

B. Rs.1,08,000

C. Rs.60,000

D. Rs.1,48,000

Answer: B

Change in OE = 2,60,000 - 1,60,000 = 1,00,000. NI = Change + Dividends - New SC = 1,00,000 + 48,000 - 40,000 = Rs.1,08,000.

Q19. Which item in the Balance Sheet is the BRIDGE connecting it to the Income Statement?

A. Share Capital

B. Total Assets

C. Retained Earnings

D. Bank Loans

Answer: C

Retained Earnings = Profits accumulated over time. P&L; feeds NI into RE. RE sits on the Balance Sheet. Without RE, the balance sheet cannot balance.

Q20. Going Concern is violated when:

A. The company reports a loss for one year

B. The company's CFO is temporarily negative

C. The business intends to cease operations or is forced to liquidate

D. The stock price falls significantly

Answer: C

Going Concern = assume business continues. If the business IS shutting down, assets must be valued at liquidation prices (much lower), not historical cost minus depreciation.

Q21. Variable cost per unit is Rs.80. Selling price Rs.200. FC Rs.2,40,000. Break-even in sales rupees:

A. Rs.4,00,000

B. Rs.3,00,000

C. Rs.2,40,000

D. Rs.2,00,000

Answer: A

CM = 200-80=120. CS Ratio=120/200=60%. BEP Sales=2,40,000/0.60=Rs.4,00,000.

Q22. Using Q21: current sales Rs.5,00,000. Margin of Safety is:

A. Rs.1,00,000

B. Rs.2,40,000

C. Rs.5,00,000

D. Rs.4,00,000

Answer: A

MOS = Current - BEP = 5,00,000 - 4,00,000 = Rs.1,00,000.

Q23. Using Q21: current profit is:

A. Rs.1,00,000

B. Rs.60,000

C. Rs.2,40,000

D. Rs.80,000

Answer: B

Profit = MOS x CS Ratio = 1,00,000 x 60% = Rs.60,000. Check: contribution (5,00,000 x 60% = 3,00,000) - FC (2,40,000) = Rs.60,000.

Q24. FC Rs.5,00,000, CM/unit Rs.25, target profit Rs.2,50,000. Units required:

A. 20,000

B. 30,000

C. 10,000

D. 40,000

Answer: B

Units = (FC + Target) / CM = (5,00,000 + 2,50,000) / 25 = 7,50,000 / 25 = 30,000 units.

Q25. A factory has FC Rs.10L and produces 10,000 units. FC per unit = Rs.10. If production doubles to 20,000 units:

A. FC per unit stays Rs.10

B. FC per unit rises to Rs.20

C. FC per unit falls to Rs.5

D. FC total doubles to Rs.20L

Answer: C

Fixed TOTAL stays Rs.10L. But per unit = Rs.10L / 20,000 = Rs.5. Fixed cost per unit HALVES as volume doubles.

Q26. A company's CS ratio is 35%. At current sales, MOS ratio is 20%. Net profit margin is:

A. 7%

B. 35%

C. 55%

D. 15%

Answer: A

Profit % = MOS ratio x CS ratio = 20% x 35% = 7% of sales.

Q27. Prestige commercial hours: Jan=123, Feb=135, Mar=138. Average growth per month is approximately:

A. 5 hours/month

B. 7.5 hours/month

C. 15 hours/month

D. 3 hours/month

Answer: B

From 123 to 138 over 2 months = 15 hours in 2 months = 7.5 hours/month average growth.

Q28. At Prestige, Option B (reduce price to $600) produces only marginal worsening. This means:

A. Price reduction is always bad

B. The volume increase from lower price almost fully compensates the price cut

C. Variable costs are too high

D. Fixed costs should be reduced first

Answer: B

Volume increase (30% more hours) x lower CM approximately equals current contribution. Near-neutral.

Q29. A company accepts a special order at Rs.150/unit when standard price is Rs.200/unit. Variable cost Rs.90/unit. The company has spare capacity. This decision is:

A. Wrong -- always sell at standard price

B. Right -- contribution of Rs.60/unit is positive and helps cover fixed costs

C. Wrong -- it undercuts the market

D. Right -- variable cost is covered

Answer: B

With spare capacity, the relevant comparison is price vs variable cost. Rs.150 > Rs.90 = Rs.60 contribution per unit. ACCEPT.

Q30. Which cost is IRRELEVANT to ALL future decisions?

A. Future variable costs

B. Avoidable fixed costs

C. Sunk costs (already spent, cannot be recovered)

D. Opportunity costs

Answer: C

Sunk costs are past, irrecoverable. They are IDENTICAL in all future scenarios = irrelevant to decisions.

Q31. High-low: December power $1,850 (480 hrs), June power $1,250 (180 hrs). Variable rate per hour:

A. $1/hr

B. $2/hr

C. $3/hr

D. $4/hr

Answer: B

Variable rate = (1,850-1,250) / (480-180) = 600/300 = $2/hr.

Q32. Using Q31: Fixed power cost per month: [CORRECTED IN v4]

A. $250/month

B. $650/month

C. $890/month

D. $450/month

Answer: C

CORRECTED: Fixed = Total cost - (Variable rate x Hours) = 1,250 - (2 x 180) = 1,250 - 360 = $890/month. Answer C. (Previous version incorrectly stated B.)

Q33. A factory shuts down for a week. Which cost is ZERO during shutdown?

A. Rent for the factory building

B. Supervisors' monthly salary

C. Raw material consumed

D. Depreciation on machinery

Answer: C

Raw material is consumed ONLY when producing. Zero production = zero raw material consumed. Rent, salaries, and depreciation continue regardless.

Q34. Product mix: 60% Product A (CM Rs.80/unit), 40% Product B (CM Rs.120/unit). Weighted CM:

A. Rs.96/unit

B. Rs.100/unit

C. Rs.80/unit

D. Rs.104/unit

Answer: A

Weighted CM = (80x0.60) + (120x0.40) = 48 + 48 = Rs.96/unit.

Q35. A company currently loses Rs.5L per month on a division. Avoidable costs = Rs.3L/month. Unavoidable costs = Rs.4L/month. Revenue = Rs.2L/month. Closing the division:

A. Saves Rs.5L/month

B. Makes the company Rs.1L/month WORSE off

C. Saves Rs.2L/month

D. Is clearly the right decision

Answer: B

If closed: Revenue 0, Avoidable 0, Unavoidable still -Rs.4L/month. Closed = -Rs.4L vs Open = -Rs.5L. Closing makes things Rs.1L worse. Keep open.

Q36. CS Ratio = 45%. Fixed Costs = Rs.9,00,000. Break-even sales value is:

A. Rs.20,00,000

B. Rs.4,05,000

C. Rs.9,00,000

D. Rs.45,00,000

Answer: A

BEP Sales = FC / CS Ratio = 9,00,000 / 0.45 = Rs.20,00,000.

Q37. Two products: X (CM Rs.60, 700 units), Y (CM Rs.100, 300 units). Total FC Rs.70,000. Are we above or below break-even?

A. Above -- making profit

B. Below -- making loss

C. Exactly at break-even

D. Cannot determine

Answer: A

Total contribution = (60x700)+(100x300) = 42,000+30,000=72,000. FC=70,000. Profit=Rs.2,000. ABOVE break-even.

Q38. The Prestige case teaches managers that before shutting a division, they should ask:

A. What does the P&L; show?

B. What are avoidable costs vs revenue lost, and what is the net financial impact?

C. What do employees think?

D. What will the media say?

Answer: B

The correct question = relevant cost analysis: will closing make me BETTER or WORSE off financially?

Q39. Advertising spend of Rs.40,000 increases contribution by Rs.55,000. Net impact on profit:

A. -Rs.15,000

B. +Rs.55,000

C. +Rs.15,000

D. Rs.40,000

Answer: C

Net = Incremental Contribution - Incremental Cost = 55,000 - 40,000 = +Rs.15,000. ACCEPT.

Q40. If a company's CS ratio is 30% and it wants to earn Rs.90,000 profit with FC of Rs.2,10,000, required sales are:

A. Rs.7,00,000

B. Rs.3,00,000

C. Rs.10,00,000

D. Rs.70,000

Answer: C

Required sales = (FC + Target) / CS Ratio = (2,10,000 + 90,000) / 0.30 = 3,00,000 / 0.30 = Rs.10,00,000.

Q41. Sales Rs.300L, COGS Rs.180L, Operating Exp Rs.60L, Interest Rs.15L, Tax Rs.15L. Gross Profit Margin:

A. 40%

B. 50%

C. 30%

D. 60%

Answer: A

GP = 300-180=120. GPM = 120/300 = 40%.

Q42. Using Q41: Operating Profit Margin:

A. 40%

B. 20%

C. 15%

D. 30%

Answer: B

OP = GP - OpEx = 120-60=60. OPM = 60/300 = 20%.

Q43. Using Q41: Net Profit Margin:

A. 20%

B. 15%

C. 10%

D. 5%

Answer: C

PAT = OP - Interest - Tax = 60-15-15=30. NPM = 30/300 = 10%.

Q44. Total Assets Rs.400L, PAT Rs.30L. ROTA (using PAT as approximate, no interest/tax data given):

A. 15%

B. 7.5%

C. 10%

D. 12%

Answer: B

ROTA = PAT / Total Assets = 30/400 = 7.5%. (Note: strictly ROTA uses PBIAT. When interest and tax data are not given, PAT/Total Assets is used as an approximation.)

Q45. Capital Employed Rs.300L (Equity Rs.200L + LT Debt Rs.100L), PAT Rs.30L. ROE is:

A. 10%

B. 15%

C. 20%

D. 7.5%

Answer: B

ROE = PAT / Equity = 30/200 = 15%. Note: ROE (15%) > ROTA (7.5%) demonstrates positive leverage effect.

Q46. ROE = PAT / Net Worth = 30/200 = 15%. ROTA = PAT / Total Assets = 30/400 = 7.5%. The pattern ROE > ROTA shows:

A. Negative leverage

B. Positive leverage -- debt is amplifying returns to equity holders

C. No leverage effect

D. The company is unprofitable

Answer: B

ROE (15%) > ROTA (7.5%). The debt in the capital structure is working in favour of equity holders.

Q47. Days Inventory Outstanding: 40 days. Days Sales Outstanding: 30 days. Days Payable Outstanding: 60 days. CCC:

A. 130 days

B. 10 days

C. 70 days

D. -10 days

Answer: B

CCC = DIO + DSO - DPO = 40 + 30 - 60 = 10 days.

Q48. Company A: CCC = -15 days. Company B: CCC = +45 days. Who manages working capital better?

A. Company B -- more positive is safer

B. Company A -- negative CCC means suppliers fund operations

C. Equal -- both above zero

D. Cannot compare

Answer: B

Negative CCC = collect cash before paying suppliers = free funding = excellent working capital management.

Q49. A company's ROTA = 12% and interest rate on new debt = 9%. Should it take more debt?

A. No -- debt always increases risk

B. Yes -- ROTA > cost of debt creates positive leverage, amplifying ROE

C. Only if revenue is growing

D. Only if current ratio is above 2.0

Answer: B

ROTA (12%) > Debt Cost (9%) = positive leverage. Extra returns go to equity holders.

Q50. Horizontal analysis: Year 1 COGS Rs.50L, Year 2 Rs.65L. Revenue Year 1 Rs.100L, Year 2 Rs.120L. Key insight:

A. Both COGS and Revenue grew -- good news

B. COGS grew 30% but Revenue grew only 20% -- gross margin is shrinking

C. Revenue growth was too slow

D. COGS growth is acceptable

Answer: B

COGS growth (30%) > Revenue growth (20%) = gross margin declining. Need to investigate cost of production.

Q51. A company's bond (long-term debt) matures in 8 months. On the balance sheet, it should appear as:

A. Non-current liability

B. Current liability (matures within 12 months)

C. Owners equity

D. Non-current asset

Answer: B

When long-term debt falls within 12 months of maturity, it is RECLASSIFIED as a current liability.

Q52. An IT company acquires a manufacturing company for Rs.200 cr (book value Rs.150 cr). Post-acquisition Goodwill is:

A. Rs.200 cr

B. Rs.150 cr

C. Rs.50 cr

D. Rs.350 cr

Answer: C

Goodwill = Purchase Price - Book Value = 200 - 150 = Rs.50 cr.

Q53. A company's common-size P&L; shows: COGS 55%, Operating Expenses 25%, Interest 5%, Tax 3%. Net Profit Margin:

A. 17%

B. 12%

C. 15%

D. 20%

Answer: B

Net PM = 100 - 55 - 25 - 5 - 3 = 12%. All items expressed as % of sales.

Q54. Interest Coverage falls from 8x to 2.5x over 3 years. This trend suggests:

A. The company is improving

B. Rising debt or falling EBIT -- increasing financial risk

C. Tax rates are rising

D. Working capital is improving

Answer: B

IC falling sharply = EBIT declining relative to interest, or interest rising faster than EBIT. Financial risk increasing.

Q55. Company X has Debt-Equity ratio of 0.8. Company Y has 2.5 (same industry). Which carries MORE financial risk?

A. Company X

B. Company Y

C. Equal

D. Depends on the interest rate

Answer: B

Higher D/E = more debt relative to equity = more financial obligation = higher solvency risk.

Q56. A company announces a bonus issue. Before investing based on the price increase, you should:

A. Buy immediately -- bonus always means good news

B. Check whether the price premium reflects genuine operational improvement or just sentiment

C. Short the stock

D. Wait for the next quarterly results

Answer: B

Prof. Jaiswall's lesson: bonus is a SIGNAL, not a fundamental value creation event. The premium above mathematical split is sentiment-driven and transient.

Q57. HUL's current ratio is less than 1.0. As an analyst, you should:

A. Immediately flag as high risk of default

B. First understand HUL's cash conversion cycle -- negative CCC means it collects before it pays, indicating market power

C. Recommend selling the stock

D. Contact the company for clarification

Answer: B

Context first. HUL's negative WC = collects from retailers before paying suppliers. Negative CCC = market power. This is a STRENGTH.

Q58. Which company would typically have the HIGHEST gross profit margin?

A. A commodity steel manufacturer

B. A software company selling proprietary enterprise solutions

C. A grocery retailer

D. A raw material trading company

Answer: B

Software = near-zero variable cost per sale. Margins 60-80%+ typical. Steel, grocery, trading = commodity/low-margin businesses.

Q59. ROE is 25%, ROCE is 18%, ROTA is 12%. What does this pattern tell you?

A. The company has no debt

B. Positive leverage -- ROTA > cost of debt, so debt is amplifying equity returns

C. The company is losing money

D. Liquidity is a concern

Answer: B

ROE (25%) > ROCE (18%) > ROTA (12%) = classic positive leverage pyramid. Debt is working FOR the shareholders.

Q60. A company improves its DPO from 30 days to 50 days (within supplier terms). CCC impact:

A. CCC increases by 20 days

B. CCC decreases by 20 days

C. CCC is unchanged

D. Cannot determine without DIO and DSO

Answer: B

CCC = DIO + DSO - DPO. DPO increases by 20 days. Since DPO is SUBTRACTED, higher DPO = lower CCC. CCC falls by 20 days.

Q61. A manager says: "We should close the loss-making product line immediately." As a finance-literate colleague, your FIRST response is:

A. Agree -- P&L; loss is clear evidence

B. Ask: what are the avoidable costs vs fixed costs allocated? Will closing actually improve overall profit?

C. Disagree -- never close any product

D. Refer to the auditor

Answer: B

Relevant cost thinking: the P&L; shows allocated costs. The shutdown decision needs AVOIDABLE vs UNAVOIDABLE analysis.

Q62. A startup shows a Net Loss of Rs.2L in Month 1 but positive CFO of Rs.0.5L. This MOST LIKELY means:

A. The company is in trouble despite positive cash

B. High non-cash charges (depreciation) and good collections make cash better than profit

C. The accounts are incorrect

D. Revenue is overstated

Answer: B

Positive CFO despite loss = non-cash charges (large depreciation) being added back. The business is operationally generating cash.

Q63. Richie Advisors: In February, Babu pays Rs.4,000 in advance. In March, Richie does the work. Across both months, total revenue recognised from Babu:

A. Rs.8,000 (Rs.4,000 each month)

B. Rs.4,000 (in March only)

C. Rs.4,000 (in February only)

D. Rs.0 (advance payments are not revenue)

Answer: B

Revenue recognised ONCE in March when service is performed. February = Unearned Revenue (liability). Total = Rs.4,000 recognised.

Q64. Using the contribution format, a company reports: Sales Rs.10L, Variable Costs Rs.6L, Fixed Costs Rs.3L. If sales rise by Rs.1L (all variable costs increase proportionally), new profit is:

A. Rs.1.4L

B. Rs.2L

C. Rs.1.6L

D. Rs.3L

Answer: A

Current CM = 4L, Profit = 1L. CS ratio = 40%. Extra contribution from Rs.1L extra sales = 1L x 40% = Rs.0.4L. New profit = 1 + 0.4 = Rs.1.4L.

Q65. A company has zero goodwill on its balance sheet. This means:

A. The company has no brand value

B. The company has not done an M&A; where it paid above book value

C. The company's brand is worthless

D. The company's assets are understated

Answer: B

Goodwill on balance sheet = PURCHASED goodwill only. Zero goodwill = no qualifying M&A; done. Says nothing about brand value.

Q66. Which of the following would INCREASE Retained Earnings?

A. Paying a dividend

B. Reporting a net loss

C. Reporting net income

D. Issuing new shares

Answer: C

RE = Opening RE + Net Income - Dividends. Net income INCREASES RE. Loss decreases it. Dividends decrease it. New shares increase Share Capital, not RE.

Q67. A company has very HIGH inventory days (DIO = 120 days). This might indicate:

A. Excellent sales -- products moving fast

B. Slow-moving or obsolete inventory, or over-purchasing

C. Efficient production management

D. Low cost of goods

Answer: B

High DIO = inventory sitting for long time = potential obsolescence, poor demand forecasting, or over-purchasing.

Q68. Which of the following would NOT appear on a company's income statement?

A. Depreciation expense

B. Interest on bank loan

C. Dividend paid to shareholders

D. Bad debt expense

Answer: C

Dividends are NOT an expense -- they do not go through the P&L.; They reduce Retained Earnings on the Balance Sheet.

Q69. A company's 5-year revenue trend is: 100, 108, 118, 130, 145. Operating income trend: 100, 105, 115, 125, 150. Which trend is accelerating relative to the other?

A. Revenue growing faster

B. Operating income growing faster (especially in Year 5)

C. They are growing at the same rate

D. Cannot tell

Answer: B

Year 5: Revenue index 145, Operating income index 150. Operating income growing faster = improving profitability per rupee of sales.

Q70. Fixed costs Rs.2,00,000, Variable Cost per unit Rs.30, Selling Price Rs.80, actual sales 6,000 units. Margin of Safety ratio is:

A. 33%

B. 50%

C. 40%

D. 25%

Answer: A

CM = 80-30=50. BEP = 2,00,000/50=4,000 units. Actual=6,000. MOS=2,000 units. MOS ratio=2,000/6,000=33.3%.

Q71. Richie's February net loss is Rs.74,900 on initial capital of Rs.10L. As a shareholder, should you panic?

A. Yes -- a Rs.74,900 loss is catastrophic

B. No -- February was a setup month. March showed 11x revenue growth. Owners equity still Rs.9.25L.

C. Yes -- the loss means the business model is broken

D. Only if the second month also shows a loss

Answer: B

Context: Rs.74,900 loss on Rs.10L capital = 7.5% in Month 1. February costs were almost entirely fixed startup costs. March validated the business model completely.

Q72. A lender evaluating whether to give a 5-year loan would MOST focus on:

A. Current ratio

B. Gross profit margin

C. Interest Coverage and DSCR (long-term debt serviceability)

D. Dividend payout ratio

Answer: C

Lender's concern: will I get my principal and interest back? Long-term: DSCR and Interest Coverage.

Q73. Which statement about the Cash Flow Statement is TRUE?

A. It is easier to manipulate than the P&L;

B. It shows only non-cash transactions

C. Cash in the bank is a fact -- it is harder to manipulate than accrual profit

D. CFO should always be negative for a growing company

Answer: C

Cash is a fact. Accrual accounting involves judgment. This is why cash flow is crucial for fraud detection.

Q74. Company A's trend: current ratio rising, inventory days rising, debtors days rising. This is:

A. Purely positive

B. Concerning -- rising liquidity ratio driven by deteriorating asset quality (slow moving stock, slow collecting)

C. No signal either way

D. A sign of rapid growth

Answer: B

Higher current ratio driven by higher inventory days (slow-moving stock) and higher debtors days (slow collections) = quality of current assets is deteriorating.

Q75. A product's CS ratio is 60%. If fixed costs increase by Rs.1,20,000, the break-even sales increase by:

A. Rs.72,000

B. Rs.2,00,000

C. Rs.1,20,000

D. Rs.48,000

Answer: B

BEP Sales = FC / CS Ratio. Increase in BEP Sales = 1,20,000 / 0.60 = Rs.2,00,000.

Q76. A company's debt-equity ratio is 2.0. For every Rs.100 of equity, total assets funded by debt are:

A. Rs.100

B. Rs.200

C. Rs.300

D. Rs.50

Answer: B

D/E = 2.0 means Rs.200 debt per Rs.100 equity. Total capital = 200+100=300. Debt = Rs.200.

Q77. Prestige Data Services idle hours fell from 223 (Jan) to 143 (Mar). Commercial hours rose from 123 to 138. The BEST conclusion for Daniel Rowe is:

A. Shut down -- still losing money

B. Continue -- trend is clearly positive; need only 45 more commercial hours/month to break even

C. Raise commercial price to $1,000

D. Cut staff immediately

Answer: B

Direction: losses narrowing, commercial hours rising, idle hours falling. Gap to break-even = 45 hours/month. Specific, achievable target.

Q78. Which ratio measures "for every rupee of equity invested, how much profit did equity holders earn"?

A. ROTA

B. ROCE

C. ROE / RONW

D. EPS

Answer: C

ROE = PAT / Net Worth (Equity). Directly measures return on equity holders' investment.

Q79. In year 1: Profit Rs.50L, Depreciation Rs.15L, Capex Rs.80L. In year 5: same profit, depreciation Rs.25L, Capex Rs.20L. Which year has BETTER cash quality?

A. Year 1 -- higher profit

B. Year 5 -- same profit but lower capex and higher depreciation add-back = higher free cash flow

C. Equal

D. Cannot determine

Answer: B

Year 5: CFO approx 50+25=75L. Capex Rs.20L. Free cash flow approx Rs.55L. Year 1: CFO approx 65L, Capex Rs.80L. Negative free cash flow. Year 5 = far better cash quality.

Q80. A company earns Rs.1,000 revenue. COGS Rs.600. Selling expenses Rs.100. Admin expenses Rs.80. Interest Rs.30. Tax rate 30%. PAT is:

A. Rs.133

B. Rs.190

C. Rs.270

D. Rs.100

Answer: A

GP=400. OP=400-100-80=220. EBT=220-30=190. PAT=190x0.70=133.

Q81. A trading company pays Rs.5 lakhs as a refundable security deposit. Impact on the accounting equation:

A. Total assets decrease Rs.5L; OE decreases Rs.5L

B. Cash decreases Rs.5L; Security Deposit (asset) increases Rs.5L -- total assets unchanged

C. Total liabilities increase Rs.5L; total assets increase Rs.5L

D. OE decreases and liabilities increase, both by Rs.5L

Answer: B

The deposit is REFUNDABLE -- future benefit = Asset. Cash (asset) OUT, Security Deposit (asset) IN. Both on the LEFT side. Net change to the equation = zero.

Q82. Which accounting principle governs recording salary payable of Rs.2 lakhs not yet paid in cash?

A. Going Concern

B. Money Measurement

C. Accrual Concept / Matching Principle

D. Historical Cost

Answer: C

Accrual Concept: record the expense when the obligation is INCURRED (employees worked this month), not when cash is paid.

Q83. A company earns net profit Rs.4.8L and pays dividends Rs.1L. How does this flow across statements?

A. Net profit appears in CFO; dividends reduce balance sheet asset

B. Net profit feeds into Retained Earnings on the balance sheet; dividends reduce Retained Earnings

C. Net profit reduces liabilities; dividends increase OE

D. Net profit increases cash directly; dividends are income in P&L;

Answer: B

Sequence: P&L; Net Profit INCREASES Retained Earnings (Owners Equity on BS). Dividends DECREASE Retained Earnings directly. They are NOT an expense on the P&L.;

Q84. Which is correctly classified on a balance sheet?

A. A 5-year bond purchased 3 months ago is non-current

B. Salary payable is a long-term liability

C. Creditors for goods on 60-day credit are current liabilities

D. Share capital is an asset

Answer: C

Trade creditors on 60-day terms = settled within the operating cycle = CURRENT LIABILITY. Share capital = Owners Equity, not an asset.

Q85. Company A depreciates machinery over 3 years (SLM); Company B over 5 years (SLM). Same cost, zero residual. In Year 2, Company A vs Company B:

A. Higher net profit and higher net asset value

B. Lower net profit AND lower net asset value

C. Lower net profit but identical net asset value

D. Higher net profit but lower net asset value

Answer: B

A: dep = 10/3 = Rs.3.33L/yr. B: dep = 10/5 = Rs.2L/yr. A charges MORE depreciation = LOWER profit. A has MORE accumulated dep = LOWER NBV. Both metrics worse for A in Year 2.

Q86. In the Six Friends case, closing cash is Rs.39L yet profit is only Rs.4.8L. PRIMARY reason:

A. Company understated its expenses

B. Capital raised from equity (Rs.30L) and debt (Rs.20L) are in cash but NOT in profit

C. Credit sales counted twice

D. Depreciation incorrectly excluded

Answer: B

Rs.50L of FINANCING inflows (equity + loan) appear in the bank balance but never in the P&L.; Profit and cash measure completely different things.

Q87. Under WDV vs SLM, TOTAL depreciation over the full asset life is:

A. Higher under WDV

B. The SAME total under both

C. Lower under WDV

D. Indeterminate

Answer: B

Both methods depreciate (Cost minus Residual Value) in total. The only difference is TIMING -- WDV front-loads it, SLM spreads it equally.

Q88. TTK Inc. Opening Assets $280K, Liabilities $120K. New capital $40K, dividends $48K. Closing Assets $400K, Liabilities $140K. Net income is:

A. $68,000

B. $88,000

C. $108,000

D. $128,000

Answer: C

Opening OE = 160K. Closing OE = 260K. Change = +100K. NI = 100K + 48K - 40K = $108,000. Must strip out new capital and add back dividends.

Q89. NTPC: net profit fell 19% despite operating margin expanding to 26.6%. Best explanation:

A. Higher interest, depreciation, and lower other income compressed profit below the EBIT level

B. Lower sales reduced gross profit

C. Higher tax rates offset gross margin improvement

D. A one-time gain inflated prior year profit

Answer: A

Operating margin UP = better core business. But BELOW EBIT: interest, depreciation, and lower other income drag net profit down. Classic multi-step income statement divergence.

Q90. Which item would NOT be included in "Operating Expenses" for a manufacturing company?

A. Selling and marketing expenses

B. General and administrative expenses

C. Interest expense on term loans

D. R&D; costs

Answer: C

Interest expense is a FINANCING decision, not an operational one. It sits BELOW Operating Profit (EBIT) in the multi-step format. That is why EBIT = Earnings Before INTEREST and Tax.

Q91. Infosys: "Profit for the period" Rs.14,702 cr vs "Total Comprehensive Income" Rs.14,781 cr. The Rs.79 cr difference is:

A. Dividends paid

B. OCI -- fair value changes and remeasurements not routed through P&L;

C. Prior period error

D. Deferred tax adjustments

Answer: B

OCI (Other Comprehensive Income) captures items that bypass the regular P&L; -- fair value changes, actuarial gains/losses. Total Comprehensive Income = PAT + OCI.

Q92. For HDFC Bank, which is "Revenue from Operations" (core operating income)?

A. Profit on sale of branch building

B. Interest income from loans advanced to customers

C. Dividend from equity investments

D. FX gain on treasury

Answer: B

For a bank, LENDING is the core business. Interest income on loans = Revenue from Operations. The others are gains, other income, or treasury activity.

Q93. Under Schedule III (Indian GAAP), "Capital Work in Progress" is classified as:

A. Current Asset

B. Non-current Asset under Fixed Assets

C. Intangible Asset

D. Liability

Answer: B

CWIP is a fixed asset under construction -- it will become a productive asset once commissioned. Non-Current Asset. No depreciation until ready for use.

Q94. MTNL: Working Capital = -Rs.1,121 cr. Vodafone = +Rs.4,273 cr. Negative WC for MTNL signals:

A. MTNL is highly profitable

B. Potential short-term liquidity stress -- CL exceed CA

C. MTNL efficiently deployed capital into long-term assets

D. Conservative accounting

Answer: B

Negative WC = current liabilities exceed current assets. For HUL or Amazon this is market power. For MTNL with declining revenues -- liquidity stress. Context is everything.

Q95. Infosys: Share Capital Rs.2,076 cr, Other Equity Rs.85,256 cr (ratio 1:41). Other Equity primarily represents:

A. Loans from financial institutions

B. Accumulated retained earnings built over decades of profitable operations

C. Revaluation of fixed assets

D. Preference share capital

Answer: B

Infosys has been profitable since 1981. Decades of retained earnings compound into "Other Equity." Share Capital stays at the par value of original issuance.

Q96. Company uses WDV for tax, SLM for financial statements. In EARLY years:

A. Tax dep < Book dep → lower taxable income → Deferred Tax Asset

B. Tax dep > Book dep → lower taxable income → Deferred Tax Liability

C. Tax dep > Book dep → higher taxable income → Deferred Tax Asset

D. Tax and book depreciation always equal

Answer: B

WDV gives HIGHER depreciation in early years. Tax dep (WDV) > Book dep (SLM) → lower taxable income today → less tax paid today → Deferred Tax LIABILITY (future obligation).

Q97. CASE: Fortis Healthcare -- Net sales Rs.512 cr, operating margin 9.1%, interest Rs.66 cr, depreciation Rs.83.8 cr, loss before tax Rs.90 cr. Structural issue:

A. Revenue too low to be viable

B. Debt servicing and depreciation exceed operating profit -- over-leverage relative to revenue

C. Operating margin is negative

D. Tax provision is the cause

Answer: B

EBIT = 512 x 9.1% = Rs.46.6 cr. Interest alone = Rs.66 cr, which EXCEEDS EBIT. Even before depreciation, debt servicing kills the profit. Classic over-leveraged infrastructure acquisition.

Q98. CASE: Power Grid -- CFO Rs.6,402 cr, CFI -Rs.15,834 cr, D/E ratio 2.1. Strategic reading:

A. Financial distress -- investing outflows far exceed operating inflows

B. Aggressive infrastructure expansion, funded through debt and operations -- consistent with a regulated utility

C. Should immediately stop all investments

D. D/E 2.1 means technically insolvent

Answer: B

Regulated utilities have GUARANTEED returns on infrastructure investment. High capex funded by stable CFO and debt = the business MODEL. Not distress -- disciplined expansion.

Q99. CASE: Six Friends -- buys Rs.60L inventory, sells Rs.40L worth (cost) for Rs.50L. Gross margin and closing inventory:

A. 10% margin; Rs.10L inventory

B. 20% margin; Rs.20L inventory

C. 25% margin; Rs.20L inventory

D. 16.7% margin; Rs.20L inventory

Answer: B

Revenue Rs.50L. COGS = Rs.40L (cost of goods SOLD). GP = Rs.10L. Margin = 10/50 = 20%. Closing inventory = 60L bought - 40L sold at cost = Rs.20L.

Q100. CASE: IndusInd Bank Rs.1,960 cr derivative accounting error; 27% crash. Which principle was violated?

A. Going Concern

B. Full Disclosure and Fair Presentation -- positions not properly valued or disclosed

C. Money Measurement

D. Separate Entity

Answer: B

Derivatives have measurable value (mark-to-market). The violation was NOT disclosing or properly valuing them. Financial statements must faithfully represent the true position.

Q101. CASE: Coal India EPS Rs.15.2, IPO price Rs.225. P/E = 14.8x vs sector average 12x. Implication:

A. Stock is undervalued

B. Priced at PREMIUM to peers -- market expects higher growth or scarcity premium

C. Stock will definitely underperform

D. P/E above average always indicates manipulation

Answer: B

P/E > sector average = premium pricing. Reasons: Coal India is the only large investable coal company (scarcity), government backing, or expected earnings growth.

Q102. CASE: Acme Consulting -- Transaction 5 shows +$5,000 cash +$5,000 AR +$10,000 OE (Revenue). Student says profit = $10,000. Correct?

A. Yes -- revenue equals profit

B. No -- salaries, rent, utilities must be deducted from revenue

C. No -- only cash revenue counts

D. Yes -- OE increased $10,000 so profit is $10,000

Answer: B

Revenue is the TOP LINE. Profit = Revenue MINUS ALL EXPENSES. One transaction cannot tell you profit. You need the full P&L; for the period.

Q103. CASE: IOCL PBT fell 70% while revenue fell only 2.4%. Most likely reason:

A. Revenue declined too sharply

B. Massive increase in cost of materials squeezed margins despite stable revenues

C. Extraordinary dividends

D. Deferred tax reversal inflated FY24

Answer: B

Revenue -2.4% but profit -70% = extreme margin compression. For a petroleum refiner, crude oil is 60-70% of revenue. Even a small input cost rise wipes out thin margins.

Q104. CASE: HUL Goodwill Rs.17,316 cr + Intangibles Rs.27,900 cr (exceeding current assets Rs.16,049 cr). Analyst risk:

A. No risk -- intangibles are more valuable for FMCG

B. Goodwill and intangibles may be IMPAIRED if acquisitions underperform -- wiping out reported equity

C. Large intangibles mean dividends will always be higher

D. Intangibles eliminate business risk

Answer: B

Goodwill is tested for impairment annually. If acquired businesses underperform, write-down directly reduces Owners Equity. Analyst must ask: are the acquired brands actually performing?

Q105. Company reports assets at historical cost despite market value appreciation. Justification:

A. Going Concern

B. Historical Cost Convention

C. Conservatism

D. Separate Entity

Answer: B

Historical Cost: assets recorded at original cost, not revalued upward. Ensures objectivity and verifiability.

Q106. Asset life was 10 years (SLM). After 4 years, revised to 3 more years (not 6). Accounting impact:

A. Prior years must be restated

B. Revised estimate applied PROSPECTIVELY -- higher annual dep going forward, no restatement

C. Must switch to WDV

D. No change -- only affects disposal entry

Answer: B

Changes in accounting ESTIMATES are PROSPECTIVE only. Take current NBV, spread over revised remaining life. No restatement of prior statements.

Q107. A credit rating agency evaluating debt downgrade needs which statement MOST?

A. Income Statement -- revenue trends

B. Statement of Changes in Equity

C. Cash Flow Statement -- CFO and debt service coverage

D. Notes on Accounting Policies

Answer: C

Rating agencies care: can this company PAY ITS DEBT? That requires CASH, not just profit. CFO and DSCR (Debt Service Coverage Ratio) are the primary tests.

Q108. RIL issues equity Rs.5,000 cr and uses proceeds to acquire a competitor. CFS classification:

A. Both Operating

B. Equity issuance = Financing; acquisition = Investing

C. Both Financing

D. Both Investing

Answer: B

Equity issuance = raising FUNDING = Financing Activity (CFF). Acquisition of a company = deploying into a long-term asset = Investing Activity (CFI).

Q109. Net profit grew 30%, Cash from Operations fell 15%. Most concerning interpretation:

A. Aggressive working capital investment -- positive

B. Possible earnings manipulation through aggressive revenue recognition or understated provisions

C. Depreciation declined boosting profit

D. More dividends paid

Answer: B

Profit up, cash down = widening accrual-cash gap. Red flag: revenue recognised before earned, or provisions understated. One of the earliest fraud signals.

Q110. Nestle income statement: "Changes in Inventories: -Rs.627 cr." This means:

A. Inventory decreased -- less cost charged

B. Inventory INCREASED -- excess cost deferred to balance sheet

C. Inventory destroyed

D. Raw material consumption less than purchases

Answer: B

When inventory INCREASES, company produced MORE than it sold. Unsold production cost is NOT charged to P&L; -- deferred to balance sheet as inventory (asset). The -627 adjustment REDUCES cost charged this period.

Q111. Owner's equity is best described as:

A. Total cash invested at incorporation

B. Market capitalisation

C. Residual interest in assets after deducting all liabilities

D. Sum of all dividends paid historically

Answer: C

OE = Assets minus Liabilities. The RESIDUAL belonging to owners after all outsiders (banks, suppliers) are paid. Includes Share Capital plus Retained Earnings.

Q112. Asian Paints: EBITDA Rs.7,855 cr, Revenue Rs.30,850 cr (25.5% margin), Raw materials Rs.13,418 cr. If raw materials rise 10%, new EBITDA margin is approximately:

A. ~21.2%

B. ~23.0%

C. ~25.5% (unchanged)

D. ~19.5%

Answer: A

RM increase = 13,418 x 10% = Rs.1,342 cr. New EBITDA = 7,855 - 1,342 = Rs.6,513 cr. New margin = 6,513 / 30,850 = 21.1% ≈ 21.2%. A 10% raw material rise cuts margin by 4.4 percentage points.

Q113. Company records salary expense Rs.2L as payable (not yet paid in cash). Effect on accounting equation:

A. Assets decrease Rs.2L; Liabilities increase Rs.2L

B. Assets unchanged; Liabilities increase Rs.2L; OE decreases Rs.2L

C. Assets decrease Rs.2L; OE decreases Rs.2L

D. Liabilities decrease Rs.2L; OE increases Rs.2L

Answer: B

No cash leaves (assets unchanged). Obligation arises (Salary Payable = Liability +Rs.2L). Expense reduces OE (Retained Earnings -Rs.2L). Equation: both sides of the right side move, netting to zero change.

Q114. RIL Non-Current Investments Rs.3,01,400 cr in standalone but largely disappear in consolidated. Why:

A. Reclassified as current assets

B. Intercompany investments eliminated against subsidiaries' equity; actual assets and liabilities reported instead

C. Consolidated statements exclude financial assets

D. RIL writes off investments in acquisition year

Answer: B

Consolidation combines parent and subsidiaries as ONE entity. Parent's investment in subsidiary is eliminated against the subsidiary's equity. Actual assets, liabilities, revenues of ALL entities reported directly.

Q115. Kingfisher Airlines unable to pay debts. Auditor applying Going Concern should:

A. Continue applying since all companies are assumed ongoing

B. DISCLOSE in audit report that going concern may not be appropriate; assets potentially at liquidation values

C. Switch to cash basis immediately

D. Ignore as temporary

Answer: B

Going Concern is an ASSUMPTION that can be violated. If doubtful, auditor MUST disclose prominently. Assets then valued at forced-sale (liquidation) prices, not cost minus depreciation.

Q116. NTPC income statement includes "Exceptional Item" Rs.1,363 cr reducing profit. Rationale:

A. Exceptional items not subject to taxation

B. Separating unusual, non-recurring items allows better assessment of RECURRING business performance

C. Must always be presented below the tax line

D. Regulators require items above Rs.1,000 cr to be exceptional

Answer: B

Transparency: if a one-time charge is mixed into operating expenses, users overestimate the structural cost base. Separating it lets investors judge recurring profit correctly.

Q117. Company X: Net Profit Rs.100 cr, Sales Rs.2,000 cr, Total Assets Rs.1,000 cr, Equity Rs.400 cr. ROE is:

A. 10%

B. 15%

C. 25%

D. 5%

Answer: C

ROE = PAT / Net Worth = 100 / 400 = 25%. Note: Net Profit Margin is only 5% (100/2000). Leverage amplifies the equity return -- the business earns on Rs.1,000 cr total assets but only Rs.400 cr of equity holders bear that risk.

Q118. RIL (total assets ~Rs.9.6 lakh cr) does not separately disclose a Rs.50,000 stationery expense. Convention:

A. Conservatism

B. MATERIALITY -- omission could not influence economic decisions of users

C. Historical Cost

D. Separate Entity

Answer: B

Materiality: disclose only information whose omission could affect a reasonable user's decisions. Rs.50,000 on Rs.9.6 lakh crore of assets = 0.000005%. Immaterial.

Q119. CASE: Tarech Corp -- Revenue $4,800, Expenses $2,450, Dividends $410. Cash $1,890, Other assets $1,000, Payables $450, Common Stock $500. Balance sheet total:

A. $2,890 on each side, Retained Earnings $1,940

B. $2,890 on each side, Retained Earnings $2,350

C. $3,300 on each side, Retained Earnings $2,350

D. $2,890 on each side, Retained Earnings $410

Answer: A

NI = 4,800-2,450 = $2,350. RE = 2,350-410 = $1,940. Assets = 1,890+1,000 = $2,890. L+OE = 450+500+1,940 = $2,890. Both sides balance. Answer A.

Q120. CASE: Startup CFO chooses between SLM and WDV for delivery vehicles (Rs.10 cr, 5-yr, residual Rs.1 cr) to attract equity investors. Strategically preferable:

A. WDV -- higher early depreciation conserves cash

B. SLM for financial statements (higher reported profit attracts investors); WDV separately for IT filing (cash tax savings)

C. SLM -- always lower total depreciation

D. WDV -- produces same profit as SLM in all years

Answer: B

KEY INSIGHT: Indian companies can use DIFFERENT methods for financial statements (Companies Act) and tax returns (Income Tax Act). SLM in books = higher profit = better P&L; for investors. WDV in IT return = lower taxable income = real cash tax savings. Best of both worlds.

6 MASTER FORMULA SHEET

Every formula from all 4 sessions -- organised by topic

Accounting Fundamentals

Formula Name	Expression
Accounting Equation	Assets = Liabilities + Owners Equity
Owners Equity / Net Worth	Share Capital + Retained Earnings
Retained Earnings (closing)	Opening RE + Net Income - Dividends Paid
Capital Employed	Net Worth + Long-term Debt
Working Capital	Current Assets - Current Liabilities
Net Income from OE change	(Closing OE - Opening OE) + Dividends Paid - New Capital Invested
Gross Profit	Net Sales - Cost of Goods Sold (COGS)
Operating Profit (EBIT)	Gross Profit - Operating Expenses
EBT (Earnings Before Tax)	EBIT - Interest Expense
PAT (Profit After Tax)	EBT - Tax
Cash Flow Identity	CFO + CFI + CFF = Net Change in Cash

Depreciation

Formula Name	Expression
Depreciable Amount	Cost - Residual (Scrap) Value
SLM Annual Depreciation	(Cost - Residual Value) / Useful Life in Years
Monthly SLM Depreciation	Annual Depreciation / 12

Formula Name	Expression
WDV Rate	1 - (Residual Value / Cost) raised to power of (1/n), where n = useful life
WDV Depreciation (any year)	Net Book Value at START of that year x WDV Rate
Net Block	Gross Block - Accumulated Depreciation
Accumulated Depreciation	Sum of all depreciation charged since asset was purchased

Cost and CVP Analysis

Formula Name	Expression
Contribution per Unit	Selling Price per Unit - Variable Cost per Unit
CS Ratio (Contribution-to-Sales)	Contribution per Unit / Selling Price per Unit (expressed as %)
Break-even Units	Fixed Costs / Contribution per Unit
Break-even Sales (Amount)	Fixed Costs / CS Ratio
Units for Target Profit	(Fixed Costs + Target Profit) / Contribution per Unit
Margin of Safety (Amount)	Actual Sales - Break-even Sales
Margin of Safety Ratio	Margin of Safety / Actual Sales
Profit via Margin of Safety	Margin of Safety Sales x CS Ratio
Weighted-Average CM (multi-product)	Sum of (CM per unit x Sales Mix %) for each product
Multi-product Break-even	Total Fixed Costs / Weighted-Average CM per unit
High-Low Variable Rate (Y)	(Cost at high volume - Cost at low volume) / (High volume - Low volume)
High-Low Fixed Cost (X)	Total cost at either data point - (Y x Volume at that point)
Supplies Consumed	Opening Stock + Purchases - Closing Stock

Ratio Analysis -- All Four Windows

Window	Ratio Name	Formula	Direction
LIQUIDITY	Current Ratio	Current Assets / Current Liabilities	Adequate
LIQUIDITY	Quick Ratio (Acid Test)	(Current Assets - Inventory) / Current Liabilities	Above 1.0
LIQUIDITY	Financial Slack	(Cash and Bank / Total Assets) x 100	More = more dry powder
EFFICIENCY	Total Asset Turnover	Sales / Total Assets	Higher
EFFICIENCY	Fixed Asset Turnover	Sales / Net Block	Higher
EFFICIENCY	Inventory Turnover	COGS / Average Inventory	Higher
EFFICIENCY	Debtors Turnover	Credit Sales / Average Debtors	Higher
EFFICIENCY	Creditors Turnover	Credit Purchases / Average Creditors	Lower (pay later)
EFFICIENCY	DIO	365 / Inventory Turnover	Lower
EFFICIENCY	DSO	365 / Debtors Turnover	Lower
EFFICIENCY	DPO	365 / Creditors Turnover	Higher

Window	Ratio Name	Formula	Direction
EFFICIENCY	Cash Conversion Cycle (CCC)	DIO + DSO - DPO	Negative or lower
PROFITABILITY	Gross Profit Margin	(Gross Profit / Sales) x 100	Higher
PROFITABILITY	Operating Profit Margin	(Operating Profit / Sales) x 100	Higher
PROFITABILITY	Net Profit Margin	(PAT / Sales) x 100	Higher
PROFITABILITY	ROTA	(PBIAT / Total Assets) x 100 where PBIAT = PAT + [Interest x (1-Tax Rate)]	Higher
PROFITABILITY	ROCE / ROI	(Operating Profit / Capital Employed) x 100	Higher
PROFITABILITY	ROE / RONW	(PAT / Net Worth) x 100	Should exceed ROCE
PROFITABILITY	EPS	(PAT - Pref. Div) / Weighted Avg Shares	Higher
PROFITABILITY	Payout Ratio	(Proposed Dividend / PAT) x 100	Context-dependent
LEVERAGE	Debt-Equity Ratio	Long-term Debt / Equity	Context-dependent
LEVERAGE	Interest Coverage	(PBT + Interest) / Interest	Above 2.0
LEVERAGE	DSCR	Operating CF After Tax / (Interest + Principal)	Above 1.0
LEVERAGE	Debt Ratio	(LT Debt / (LT Debt + Equity)) x 100	Context-dependent

Financial Analysis Tools

Formula Name	Expression
Horizontal Analysis -- % Change	(Amount of Change / Base Year Amount) x 100
Trend Index	(Current Year Value / Base Year 1 Value) x 100
Book Value per Share	Net Worth (Total OE) / Number of Shares Outstanding
PBIAT (for ROTA calculation)	PAT + [Interest x (1 - Tax Rate)]
Leverage Condition (positive)	ROE > ROCE > ROTA when ROTA > Cost of Debt
Leverage Condition (negative)	ROTA < Cost of Debt = every rupee of debt destroys equity value

ROTA FORMULA -- CORRECTLY EXPANDED (v4 correction)

ROTA = (PBIAT / Total Assets) x 100

PBIAT = PAT + [Interest x (1 - Tax Rate)]

Example: PAT = Rs.20L, Interest = Rs.5L, Tax = 30%.

PBIAT = 20 + [5 x 0.7] = 20 + 3.5 = Rs.23.5L.

ROTA = 23.5 / 200 x 100 = 11.75%.

NEVER calculate ROTA as: (PAT + Interest) x (1 - Tax Rate) / Total Assets. That is incorrect.

7 EXAM STRATEGY FOR SUNDAY

How to approach the MCQ, the 12 biggest traps, and your day-by-day plan

Parameter	Detail
Format	MCQ (Multiple Choice Questions)
Negative Marking	NONE -- attempt EVERY question even if completely unsure. A guess beats zero.
Calculators	Available via the online exam interface
Coverage	All four sessions -- Foundations, Real Statements, Cost Management, Financial Analysis
Question style	Contextual understanding + some calculation. Not pure formula recall.
What Prof. Jaiswall has consistently tested	Understanding WHY accounting works the way it does, not just the rules.

The 12 Biggest Traps -- Things Prof. Jaiswall Specifically Flagged

Trap 1: Babu's Advance	Cash received does NOT equal revenue earned. If the service is not yet done, it is Unearned Revenue (LIABILITY). This is the single most commonly answered question wrong. Cash received in advance = Liability until service is performed.
Trap 2: Depreciation is NOT cash	It is a non-cash BOOK ENTRY. Cash left when the asset was PURCHASED on Day 1. Depreciation just spreads that historical cost over the useful life. Stop treating it as cash going out.
Trap 3: Dividend is NOT an expense	Dividends do NOT go on the P&L.; They reduce Retained Earnings directly on the Balance Sheet. They appear as Financing outflow in the Cash Flow Statement.
Trap 4: Security deposit is NOT rent	The deposit is REFUNDABLE = future benefit = ASSET. Rent is only an expense when the space is actually USED (accrual). These are two completely different accounting treatments.
Trap 5: High current ratio is not always better	Excess liquidity = idle capital in low-return assets. Over-liquid businesses underperform. HUL has NEGATIVE working capital and is one of India's most successful companies. Higher is NOT always better.
Trap 6: P&L; loss does not automatically mean shutdown	The income statement answers "how much profit?" -- not "am I better off open or closed?" These are different questions. Relevant cost analysis (avoidable vs unavoidable) answers the shutdown question. The two analyses can give OPPOSITE conclusions.
Trap 7: Bonus issue does not create new value	Total Owner's Equity is UNCHANGED after a bonus. SC up, Reserves down by the same amount. Any market price rise above the mathematical split is sentiment-driven and transient.

Trap 8: DPO should be maximised, not minimised	You WANT to pay suppliers as LATE as possible (within agreed terms). Stretching payables = suppliers funding your business = good. Low DPO means you are giving up free credit unnecessarily.
Trap 9: Bad debt write-off does NOT reverse revenue	The original revenue was CORRECTLY recorded when service was performed. The write-off is a NEW separate expense in the period the debt is confirmed uncollectable.
Trap 10: WDV vs SLM total is identical	Both methods produce IDENTICAL total depreciation over the full life of the asset. The ONLY difference is timing -- WDV front-loads it. The Income Tax Act allows ONLY WDV. Companies Act allows both.
Trap 11: Interest paid vs interest earned	Interest PAID on debt = Finance Cost (EXPENSE, reduces profit). Interest EARNED on deposits/investments = Income (increases profit). Easy to mix up under exam pressure.
Trap 12: Fixed cost per unit confusion	Fixed cost TOTAL is constant. Fixed cost PER UNIT falls as volume rises. Variable cost PER UNIT is constant. Variable cost TOTAL rises. All four statements together are the complete framework.

6-Step Decision Framework for Every MCQ Question

Step 1	Read the question TWICE. Identify what type it is: concept question, formula/calculation question, or classification question.
Step 2	For CONCEPT questions: recall the core principle (accrual? going concern? relevant cost? contribution behaviour?). Apply the principle. The answer follows from the principle.
Step 3	For FORMULA questions: WRITE DOWN the formula first, then plug in numbers. Never attempt to do it in your head under exam pressure.
Step 4	For CLASSIFICATION questions (current/non-current, CFO/CFI/CFF, direct/indirect, product/period): ask the TEST QUESTION. "Will this benefit last more than one operating cycle?" YES = non-current/CFI. NO = current/CFO.
Step 5	Eliminate the clearly WRONG options first. Usually 2 can be eliminated immediately. Then choose between the remaining 2 based on the principle.
Step 6	If still unsure: STILL ATTEMPT IT. NO negative marking. A 50% guess beats zero. Never leave a question blank.

Day-by-Day Revision Plan: Friday, Saturday, Sunday

When	What to do	Why
Friday evening (2 hrs)	Read the About section and opening paragraphs of Sessions 1-4 in this master document. Get the story arc in your head.	Primes your brain for the concepts. You are not memorising -- you are reconnecting with the narrative.

When	What to do	Why
Friday evening (1.5 hrs)	Do all 80 MCQs in the Master MCQ Bank WITHOUT looking at answers. Mark every unsure one.	Identifies your weak spots before Saturday. You have time to fix them.
Friday evening (30 min)	Check every answer. For every WRONG one: understand WHY, not just what the right answer is.	Wrong answers without understanding why = same mistake on Sunday.
Saturday morning (1 hr)	Read ALL the True/False checks (Sessions 2, 3, 4) at the end of each session. Cover the answers. Test yourself.	T/F checks are rapid-fire concept verification. Great for building confidence.
Saturday afternoon (1 hr)	Read through the 12 Common Traps above carefully. For each one, think of a specific example from the session notes.	Traps are the difference between 70% and 90% on an MCQ exam.
Saturday evening (45 min)	Read the Master Formula Sheet. For any formula you are not fully comfortable with, trace it back to the first-principles explanation in the session.	Formulas make sense when you know WHY they are derived that way.
Sunday morning (30 min before exam)	Re-read just: (1) the 4-session intro paragraphs, (2) the 12 Common Traps, (3) the 6-Step Decision Framework.	Light activation, not heavy cramming. Get into exam mode calmly.
During the exam	Read each question twice. Eliminate 2 wrong options. Apply the relevant principle. Attempt every question.	No negative marking. Systematic approach beats rushing through.

FINAL MESSAGE:

Prof. Jaiswall has been consistent throughout four sessions: the exam rewards people who UNDERSTAND why accounting works the way it does -- not people who memorised formulas in isolation. When you see a question, ask: what is the underlying PRINCIPLE here? Accrual? Going concern? Relevant cost? Contribution behaviour? Leverage effect? The answer follows naturally from the principle.

You already have everything you need. Go get it.

All the best, Abhinav.

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