

CH. 1 - VERTICAL FINANCIAL STATEMENTS

❖ DEFINITION OF 'FINANCIAL STATEMENTS'

The term '**Financial Statements**' refers to two basic statements prepared by the accountant at the end of the accounting period. These are (a) Profit and Loss Account and (b) Balance Sheet.

The Balance sheet is a statement of balance of assets and liabilities as at a particular date.

The Profit and Loss Account is the statement of income. It summarizes the income earned and expenses incurred during a particular period. By matching the revenues earned and costs incurred in the process of earning revenues, it discloses the net profit or net loss for the accounting period.

From the above discussion, it is clear that the Financial Statements are snap shot of the activities of the business concern at the end of a particular period.

They are prepared for the purpose of presenting a periodical review or report on the progress by the management and they deal with the (i) the status of the investments in the business (ii) Results achieved during the period. They reflects the success or failure and efficiency or inefficiency of the management.

VERTICAL FINANCIAL STATEMENTS Vertical Balance Sheet (Triple Column)

Particulars	₹	₹	₹
I SOURCES OF FUNDS			
A. Owners' Funds/Shareholder's Funds: (a+b-c-d)			
a) Share Capital:			
Equity Share Capital (called-up amount)	xx		
Preference Share Capital (called-up amount)	xx		
Less : Calls-in-arrears	xx		
	xx		
Add : Forfeited Shares Account	xx		
	xx	xx	
b) Reserve and Surplus:			
Capital Reserve	xx		
Capital Redemption Reserve	xx		
Share Premium	xx		
General Reserve & Other Revenue Reserves	xx		
Profit and Loss Account (Credit Balance)	xx		
Less: c) Miscellaneous expenditure:		xx	
Preliminary Expenses	xx		
Issue Expenses (Underwriting Commission & Brokerage)	xx		
Discount on Issue of Shares	xx		
Loss on Issue of Debentures	xx		
Less: d) Profit & Loss Account (Debit Balance)		xx	
Owners Funds/Net Worth/ Proprietors' Funds		xx	Xx
B. Owed/Borrowed Funds/Long Term Loans:			
<u>Secured Loans</u>			
Debentures	xx		
Bank Loans	xx	xx	
<u>Unsecured Loans</u>			
Fixed deposits from public	xx		

		xx	xx	Xx
	Other loans			
	Total Funds Employed.....			Xx
II	APPLICATION OF FUNDS (FUNDS EMPLOYED AS UNDER):			
A.	Fixed Assets:			
	Goodwill		xx	
	Trade mark		xx	
	Intangible assets			
	Land & Building		xx	
	Plant & Machinery		xx	
	Furniture & Fixtures		xx	
	Vehicles etc.		xx	Xx
B.	Long Term Investments:			Xx
C.	Working Capital (a - b):			
	a) Current Assets:			
	Debtors	xx		
	Cash and Bank Balances	xx		
	Other C.A. (B.R., Loans Given, etc.)	xx		
	Quick Assets	xx		
	Stock-in-trade (i.e. Inventory)	xx		
	Prepaid Expenses	xx	xx	
Less :	Current Liabilities & Provisions:			
	Bills Payable	xx		
	Creditors (for goods and expenses)	xx		
	Provisions (Prov. for Taxation, Proposed Dividend)	xx		
	Quick Liabilities	xx		
	Bank Overdraft	xx	xx	Xx
	Total Funds Employed.....			Xx

EXPLANATORY NOTES

I. SOURCES OF FUNDS & THEIR COMPONENTS AND EXPLANATION

1 Owner's Funds / Proprietors' funds / Net worth / Shareholder's Funds

- a) **Share Capital** : It represents claims of owners on assets of the concern.
- b) **Reserves & Surplus** : These includes - (i) Capital Reserve; (ii) Capital Redemption Reserve; (iii) Share Premium; (iv) General Reserve; (v) Other Revenue Reserves like Dividend Equalisation Reserve, Investment Fluctuation Reserve.
- c) **Miscellaneous Expenditure** : These include the expenditure incurred but not written off or adjusted like (i) Preliminary Expenditure; (ii) Issue Expenses; (iii) Underwriting commission; (iv) Discount on issue of shares and debentures.

2 Long Term Loans : Secured Loans and Unsecured Loans

This is a second source of finance for a concern, It is a external source of finance. It is also called as Fixed Liabilities. Long Term Loans includes those loans which are repayable after Twelve months from the date of Balance sheet. Any loan which is repayable within Twelve months from the date of Balance sheet is termed as 'Short Term Loan'. In the Vertical Format Short term loans are placed under the head Current Liabilities. Long Term Loans include - (i) Debentures, (ii) Bank Loan, (iii) Public Deposits, (iv) Loans from Financial Institution like IDBI, IFCI, ICICI etc. (v) Term Loans.

II. APPLICATION OF FUNDS & THEIR COMPONENTS AND EXPLANATION

1 **Fixed Assets** : a) Tangible and b) Intangible

2 Long Term Investments or Trade Investment : Investments basically arise out of the idle funds existing with the company. They are liquid dated when the company is in need of liquid funds.

3 Working Capital

A. Current Assets: Current Assets mean those assets like stock which move through the operating cycle of the business. Current assets mean the assets like stock, debtors and cash which move in a cycle. Thus stock is converted by sale into debtors, debtors get converted by realisation of dues into cash, cash is used for buying goods and again the cycle is repeated. Thus current assets are short term assets unlike fixed assets.

The following items are included under Current Assets.

Thus, (i) Stock of Stores and spare parts (ii) Stock-in-trade [Raw materials+finished Goods+Packing Materials] (iii) Stock of Work-in-progress (iv) Debtors Less: Provision for bad & doubtful debts (v) Cash in hand (vi) Bank balances (vii) Loans and Advances to subsidiaries (viii) Loans & Advances to firm etc. (ix) Marketable Investments (i.e. those temporary investments made out of surplus funds). (x) Interest occurred on investments. (xi) Advances recoverable in cash or in kind or for value to be received. (xii) Bills Receivable (xiii) Pre-payments (prepaid expenses, Advance tax paid) (xiv) Balances with customs, Port trust etc. (Payable on demand) (xv) Incomes Receivable. (xvi) Income tax refund due (xvii) Security deposit.

Quick Assets : The following Current Assets are Quick Assets (i.e. Liquid Assets) as they are quickly realisable - (i) Cash and Bank (ii) Debtors (net) (iii) Bills receivable (iv) Loans and advances (v) Interest Accrued/Accrued Income (vi) Marketable Investment (vii) Deposits Receivable on Demand.

B. Current Liabilities : Current Liabilities include the following items: (i) Sundry creditors for supply of goods or services (ii) Bills payable (iii) Income received in advance (iv) Outstanding Expenses (v) Accrued Interest (vi) Provision for tax (vii) Unclaimed Dividends (viii) Proposed Dividends (ix) Bank Overdraft (x) Due to Consigner (xi) TDS on Interest paid.

Quick Liabilities:

Quick Liabilities are those current liabilities which are payable in short period of time. Thus, Bank Overdraft is not, in practice, immediately payable.

Therefore, Q. L. = C.L. Less Bank O D & Income Received in Advance.

VERTICAL PROFIT AND LOSS ACCOUNT (Triple Column)

Particulars	₹	₹	₹
Sales			
Cash sales	xx		
Credit Sales	xx	xx	
(-) Sales return		(xx)	xx
Less: Cost of Goods sold			
Opening Stock		xx	
Purchase	xx		
(-) Purchase Return	(xx)	xx	
Direct Expenses		xx	
Factory Expenses		xx	
(-) Closing stock		(xx)	(xx)
Gross Profit			xx
Add: Opening Income			
Discount Received		xx	
Commission Received		xx	
Bad Debts recovery		xx	xx
			xx
Less: Operating Expenses			
a) Office and administrative expenses			
Salaries	xx		
Insurance	xx		
Rent	xx	xx	
b) Selling and Distribution expenses			
Travelling expenses	xx		
Advertisement	xx		
Carriage outward	xx	xx	
c) Finance expenses			
Bad Debts	xx		
Interest paid	xx		
Discount allowed	xx	xx	(xx)
Net Operating Profit			xx
Add: Non operating Income			
Interest Received		xx	
Profit on sale of Investment		xx	
Dividend Received		xx	xx
			xx
Less: Non operating expenses			
Loss by fire/theft		xx	
Loss on sale of Investment, Fixed Asset		xx	
Donation given		xx	(xx)
Net Profit Before Tax			xx
Less: Income Tax			(xx)
Net Profit After Tax			xx
Add: Opening Balance			Xx
			Xx
Less: Appropriations Transfer to Reserve			
Dividend	xx		
	xx		(xx)

Closing Balances (Retained earning)		xx
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Calculation of Cost of Goods sold and Gross Profit for Manufacturer

Particulars	₹	₹	₹
Sales			
Cash Sales	xx		
Credit Sales	xx	xx	
(-) Sales Returns		(xx)	Xx
Less: Cost of Goods sold			
<u>Raw Material Consumed</u>			
Opening Stock of Raw Material	xx		
(+) Purchases (Raw Material)	xx		
(-) Closing stock of Raw Material	(xx)	xx	
Direct Expenses		xx	
Factory Expenses		xx	
		xx	
(+) Opening stock of work in progress		xx	
(-) Closing stock of work in progress		(xx)	
(-) Sales scrap		(xx)	
COST OF PRODUCTION		xx	
(+) Opening stock of finished goods		xx	
(-) Closing stock of finished goods		(xx)	(xx)
GROSS PROFIT			Xx

EXPLANATORY NOTES

1 Net sales:

In order to arrive at the amount of Net sales, deduct (i) the amount of goods returned by customers; (ii) amount of allowances granted to customers (i.e. reduction in the selling price after the preparation of invoice) and (iii) Sales Tax included in the selling price.

2 Net Purchases:

In order to arrive at the amount of Net purchase, deduct (i) the amount of goods/raw material returned to suppliers; (ii) amount of allowances granted by supplier (i.e. reduction in the purchase price after the preparation of invoice)

3 Direct Expenses:

Expenses incurred to bring raw materials or goods from the place of purchase to the place of consumption or sale are Direct Expenses. It includes Carriage Inward, Freight Inward, Octroi Duty, Import Duty, Loading & Unloading Charges, Transit Insurance and Commission on purchases.

4 Manufacturing or Factory Expenses:

Expenses incurred to convert raw materials into finished products are factory expenses. It includes Direct Wages, Factory Staff Salaries, Factory Rent, Factory Insurance, etc.

5 Stock of Finished Products:

This includes (i) stock of finished goods lying in the godown; (ii) stock with customers on approval basis; (iii) stock with consignee and (iv) stock at branch.

6 Adjustment of Goods:

This includes (i) goods distributed as free samples; (ii) goods taken over by proprietor for personal use; (iii) goods damaged by fire; (iv) goods lost by theft; (v) goods misappropriated by employee; (vi) goods given as charity and (vii) goods damaged by white ants or termites etc.

7 Operating Expenses:

Expenses incurred for day to day operation of the business are known as Operating Expenses. This includes (a) Administrative Expenses, (b) Selling & Distribution Expenses and (c) Finance Expenses.

(a) Administrative Expenses:

Expenses incurred for day to day management and administration of the business are known as Administrative or Office Expenses. This include (i) Office Staff Salaries; (ii) Office Rent; (iii) Office Electricity; (iv) Office Rates and Taxes; (v) Office Insurance; (vi) Printing & Stationary; (vii) Telephone Charges; (viii) Repairs to furniture; (ix) Repairs to office building; (x) Repairs to office equipments; (xi) Petty cash expenses; (xii) Sundry Expenses; (xiii) Director's fees; (xiv) Director's Remuneration; (xv) Audit Fees; (xvi) Legal Fees; (xvii) Professional Charges; (xviii) Depreciation on Office Building, Office Furniture and Office Equipments (xix) Postage and Telegrams (xx) Conveyance.

(b) Selling & Distribution Expenses:

Expenses incurred for marketing and promoting the goods or products are known as Selling expenses while expenses incurred for storage and dispatch of goods or products are known as Distribution Expenses. This include (i) Advertisement; (ii) Commission to Agent for Consignee; (iii) Traveller's Expenses; (iv) Sales Manager's Salary; (v) Salesmen's Salary; (vi) Showroom Rent, Insurance, Repairs and Depreciation; (vii) Free samples Distributed; (viii) Sales Promotion; (ix) After sales service expenses; (x) Expenses during warranty period; (xi) Exhibition Expenses; (xii) Foreign Travelling for Export Sales; (xiii) Bad Debts including provision for Doubtful Debts; (xiv) Discount allowed including provision for discount on debtors; (xv) Warehouse expenses like Warehouse Rent, Warehouse Insurance, Warehouse Repairs, Warehouse Keeper's Salaries and Depreciation; (xvi) Delivery van-Driver's Salaries; (xvii) Upkeep of Delivery van;

(c) Finance Expenses:

Interest on Debentures, Interest on Public Deposits, Interest on Bank Loan, Interest on Overdraft, Interest charged but suppliers, Bank Charges, Bank Commission, Discount on issue of debentures written off, Loss on issue of Debentures written off, Commission to raise finance, Interest on Cash Credit, Discount loss on Discounting of Bills of Exchange.

8 Non-Operating Incomes:

This includes the income arising from the activities other than Trading or Manufacturing or Rendering of services in which the company is dealing. Dividend and Interest received on Investments, Profit on sale of Investments, Profit on sale of Fixed Assets.

9 Non-Operating Expenses:

These cover the expenses not arising in the normal course of business such as (i) Loss on Sale of Fixed Assets; (ii) Loss on Sale of Investments; (iii) Loss by fire, (iv) Loss by theft, (v) Loss by accident; (vi) Compensation to workers.

IMPORTANT ACCOUNTING EQUATION

- 1 **Gross Profit = Net Sales less Cost Of Goods Sold.**
- 2 **Operating Net Profit = Gross Profit less Operating Expenses.**
- 3 **Profit Before Tax (P.B.T.) = Operating Net Profit Add Non-operating Incomes less Non-operating expenses.**
- 4 **Profit After Tax (P.A.T.) = Profit Before Tax less Provision for Income Tax.**
- 5 **Proprietors' Funds = Share Capital Add Reserves & Surplus less Misc. Expenses**
- 6 **Total Funds Employed = Proprietor's Funds Add Long Term Loans.**
- 7 **Working Capital = Current Assets less Current Liabilities.**
- 8 **Quick Assets = Current Assets less Stock and prepaid Expenses.**
- 9 **Quick Liabilities = Current Liabilities less Bank O/D and Income Received In Advance**



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(SINGLE COLUMN)

Particulars		₹
I	SOURCES OF FUNDS	
A.	SHAREHOLDERS' FUNDS	
	Share Capital	
	Equity share capital	xx
	Preference share capital	xx
		(i) xx
	Reserve and Surplus	
	General reserve	xx
	Capital reserve	xx
	Profit and Loss account	xx
		(ii) xx
	Less: Miscellaneous expenditure	
	Preliminary expenses	xx
	Discount on issue of shares	xx
		(ii) xx
		[A=(i)+(ii)+(iii)]
B.	BORROWED FUNDS	
	Secured Loans	
	Debentures	xx
	Bank Loans	xx
		(i) xx
	Unsecured Loans	
	Fixed deposits from public	xx
	Other loans	xx
		(ii) xx
		[B = (i) + (ii)]
		[A + B]
	TOTAL SOURCES OF FUNDS	xx
II	APPLICATION OF FUNDS	
A.	FIXED ASSETS	
	Goodwill	xx
	Patent and Trade marks	xx
	Intangible Assets	xx
	Land and Building	xx
	Plant and Machinery	xx
	Furniture and Fittings	xx
	Vehicles	xx
		(A) xx
B.	INVESTMENTS	(B) xx
C.	WORKING CAPITAL	
	Current Assets	
	Debtors	xx
	Bills receivable	xx
	Cash and Bank	xx
	Loose tools	xx
	Outstanding income	xx
	Quick Assets	xx
	Stock	xx
	Advances	xx
	Prepaid expenses	xx
		(i) xx
Less:	Current Liabilities	
	Creditors	xx
	Bills payable	xx
	Outstanding expenses	xx
	Provision for taxes	xx
	Proposed dividend	xx
	Quick liabilities	xx
	Bank overdraft	xx
		(ii) xx
		[C = (i) - (ii)]
	TOTAL APPLICATION OF FUNDS	[A + B + C]
		xx

VERTICAL PROFIT AND LOSS ACCOUNT (Single Column)

Particulars	₹	₹
SALES	XX	
Less: Returns	XX	
	(A)	XX
Less: COST OF GOODS SOLD		
Opening Stock	XX	
Purchases (net)	XX	
Carriage inwards	XX	
Wages	XX	
Factory expenses	XX	
Depreciation on factory assets	XX	
	XX	
(-) Closing stock	(XX)	
	(B)	XX
GROSS PROFIT	[(A) - (B)]	XX
Add: OPERATING INCOME		
Commission received	XX	
Discount received	XX	
	(C)	XX
Less: OPERATING EXPENSES		
i) Office expenses		
Office salary	XX	
Legal Expenses	XX	
Trade Expenses	XX	
Printing and stationery	XX	
	(i)	XX
ii) Selling expenses		
Advertisements	XX	
Carriage outwards	XX	
Bad debt	XX	
Commission on sales	XX	
	(ii)	XX
iii) Financial expenses		
Interest on loan	XX	
Interest on Debenture	XX	
	(iii)	XX
	D = (i)+(ii)+(iii)	XX
	[C - D]	XX
OPERATING NET PROFIT		XX
Add: NON OPERATING INCOME		
Interest on investments	XX	
Profit on sale of investments	XX	
		XX
Less: NON OPERATING EXPENSES		
Loss on sale of asset	(XX)	
Loss by fire	(XX)	
NET PROFIT BEFORE TAX		XX
Less: Provision for tax		XX
NET PROFIT AFTER TAX		XX
Add: OPENING BALANCE		XX
		XX
Less: APPROPRIATION OF PROFITS		
Transfer to reserve	(XX)	
Proposed dividends	(XX)	
RETAINED EARNINGS		XX
TOTAL RETAINED EARNINGS		XX

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