

OUTSTANDING PEDAGOGICAL FEATURES

The outstanding pedagogical features in the book have been designed to chart a clear and well-targeted route map for students' understanding and knowledge enhancement. These features are:

1. Chapter Openers

Every chapter opens with a pictorial/diagrammatic presentation and a nugget description of what lies ahead in the chapter. Openers will initiate and stimulate the students' interest.

2. Chapter Objectives

An exhaustive list of chapter objectives provides details of the issues whose knowledge and understanding the students are expected to develop by the time they finish a particular chapter.

CHAPTER OBJECTIVES

This chapter seeks to enable you to develop knowledge and understanding of:

- 1 What is quality of earnings and its significance in evaluating corporate performance.
- 2 Limitations of financial statements caused by leverage provided by GAAPs and window dressing.
- 3 Creative accounting/creative financial practices resorted to by the corporates.
- 4 Impact of other income/extraordinary items on profits and corporate financial practices in respect thereof.
- 5 How to beat window dressing.
- 6 Some specific issues in quality of disclosures in reported earnings.
- 7 Care in financial analysis needed to be taken by the analyst.
- 8 The regulatory efforts in ensuring quality of earnings.

So that you are in a position to effectively carry out financial analysis.

3. Bird's Eye View Box

Regular bird's eye view boxes, which provide a snapshot of the subject matter covered, enable students to know the coverage of a particular section and help them in quick revision.

CHAPTER

17

Quality of Earnings: Window Dressing, Creative Financial Practices and Issues Related to Quality of Disclosures in Reported Earnings



Window dressing of financial statements is resorted to by the managements to portray a rosier performance and financial position of the company than actuals to suit their motives. An analyst needs to beat window dressing for a meaningful assessment of the quality of earnings.

BIRDS EYE VIEW

The Anatomy of Business

- Assets
 - Fixed assets
 - Current assets
 - Investments
- Liabilities
 - Long term liabilities
 - Current liabilities
- Financial Position
- Income
- Expenses
- Financial Performance

4. Web site Resource Box


During the course of discussion, regular references have been provided, side-by-side, to the Web site resources on the subject matter covered to enable the students to know more on the subject.



Interested in seeing the full listing agreement? Visit www.nseindia.com. Click: Equity – Listing.

5. Publication Resource Box

Likewise, regular references have been provided, side-by-side, to the related books on the subject matter covered to enable the students to further enhance their knowledge.



Want to know more about the history of accounting? Refer to Chapter 1 of this treatise.

6. Before You Move Further, Stop... Box

These boxes, containing discussion questions, have been provided at regular intervals in the chapters. The objective is to enable the students test and firm up the knowledge acquired by them in a particular section before moving over to the next. It will encourage sharing of knowledge and help them widen their horizons.

Before You Move Further...

STOP Think, Discuss and Debate in Small Groups

1. Are you convinced about India being the birth place of modern accounting?
2. Are you clear how business is structured and how financial accounting is related to it? Narrate.
3. Why should assets be equal to liabilities? What does the basic accounting equation convey?

To enrich your discussion, add your own ideas, thoughts and practical inputs.

7. Chapter Illustrations

A large number of illustrations are provided in the text of each chapter. These illustrations aim at supporting the conceptual input provided during the text of the chapters with the practicals and prepare the students to effectively handle the chapter-end exercises.

CASE 2 Horizontal Financial Statements of Bajaj Auto Ltd.

The profit and loss account and balance sheet of **Bajaj Auto Ltd.** for the year ended 31st March 2007, readied for horizontal analysis as discussed above, are presented in illustration 2.1 and 2.2.

ILLUSTRATION 2.1 Horizontal Profit and Loss Account For the year ended 31st March 2007

	BAJAJ AUTO LTD.			
	2007	2006	Increase/Decrease over 2006	
	(Rs. in million)	(Rs. in million)	(Rs. in million)	%age
Gross sales	106060.90	85498.60	20562.30	24.04
Less: Excise duty	13138.60	10804.80	2333.80	21.59
Net Sales	92922.30	74693.80	18228.50	24.40
Materials cost	69010.10	53246.00	15764.10	29.60
Other expenses	12344.80	10118.40	2226.40	22.00
Less: Expenses, included in above items, capitalised	(320.50)	(248.10)	(72.40)	29.18
(+)Other income (Operating):				
Wind power generated, mainly captively consumed	330.50	199.50	131.00	65.66
Other operating income	1047.10	88.37	958.73	1084.90
	1377.50	287.87	1089.63	378.51

A. Case Studies A large number of case studies have been illustrated and analysed during the text throughout the book. A vast number of illustrations are case-centric. What is more, barring one case, all others represent real life case studies of a large number of leading Indian corporates and MNCs. The cases seek to illustrate to the students analysis of complex financial accounting issues through real life business situations and appropriate decision-making.

B. Corporate Financial Practices These are again leading corporates' case studies, in large numbers, illustrated to drive home some complex issue but whose analysis has been left to the students.

CORPORATE FINANCIAL PRACTICES
SATYAM COMPUTER SERVICES LIMITED
Annual Report 2000-01

Management's Discussion and Analysis

Industry Structure and Development

The Indian software industry has demonstrated impressive growth in the last decade, with software revenue registering a Compounded Annual Growth Rate (CAGR) of 56.5% in the last five years (Source: NASSCOM). India's share in the global software market is considerably low, despite this growth. Nevertheless, India enjoys a relatively favourable position in the world market as it offers low development costs without sacrificing the quality of software developed. These factors have earned the Indian software industry a good reputation, a reputation that should stand it in good stead in the future.

Opportunities and Threats

Strong customer base: With over 300 global customers of which 40 are Fortune 500 companies, the Company continues to strengthen its account management and business development approach across the 35 countries in which it has a presence. **Wide technology portfolio**—Over the past year, the Company has been assiduously building alliances with best-of-breed global vendors to offer end-to-end IT solutions across a range of technologies and platforms. Partnerships with enterprise technology vendors like i2, Ariba, Siebel, Vignette and SAP have helped win new projects and increase market share at existing accounts.

The strategic joint venture and alliances with global corporations provide us ample scope to enhance our IT capabilities in terms of both domain and technology expertise.

C. Corporate Window Dressing/Creative Financial Practices These illustrations are again drawn from real life practices of leading corporates to show how the financial statements are *window dressed* to present a position rosier than reality to suit the motives of the management. These are titled as '*Creative Financial Practices*' and presented in Chapter 17.

CREATIVE FINANCIAL PRACTICES
LIBERTY SHOES LTD.
Annual Report 1999–2000
Extracts from the Directors' Report

EXTENSION OF THE ACCOUNTING YEAR

FINANCIAL HIGHLIGHTS:
The financial results as on 30th June, 2000 are for the period of 15 months as compared to the previous 12 months period ended on 31st March, 1999 and are therefore not comparable. The intention of extending the financial year by 3 months from 31st March to 30th June was to implement the then ongoing restructuring programme. However, considering its complexity and financial burden on the company, this programme has been postponed for the time being but will be pursued again at the earliest possible opportunity.

EXHIBIT 12.1		NESTLÉ INDIA LTD. PROFIT AND LOSS ACCOUNT		
FOR THE YEAR ENDED DECEMBER 31, 2001				
		2001 (Rs. in thousands)	2000 (Rs. in thousands)	
INCOME	SCHEDULE			
Domestic sales		16,110,845	14,119,411	
Exports	J	3,099,146	2,655,126	
Others	K	<u>162,321</u>	<u>106,895</u>	
		<u>19,372,312</u>	<u>16,881,432</u>	

D. Exhibits Chapters 11, 12 and 14 contain exhibits representing balance sheet, profit and loss account, cash flow statement and all schedules to accounts from the annual report of *Nestle*. These have been discussed and analysed for a systematic and integrated *reading and understanding of the entire annual report*.

E. Computational/Numerical Illustrations The main focus of these illustrations, accompanied by computer icon, is on demonstrating to and guiding the students in the core accounting treatment of various issues, say, preparation of balance sheet, income statement and cash flow statement, valuation of assets and computation of ratios, etc. They contain some *analytical elements* as well.

ILLUSTRATION
6

ARPIT INDUSTRIES LTD.
PROFIT/LOSS ON DISPOSAL OF FIXED ASSETS
CARRIED AT HISTORICAL COST

Let us continue with illustration 1 of *Arpit Industries Ltd.* following SLM depreciation. Assume that the company sold the machine at the end of 2½ years for Rs. 28,50,000. Determine the profit/loss on disposal and its treatment. Also show how the disposed machine will be treated in the financial statements.

SOLUTION		Amount (Rs.)	
Cost			52,00,000
Accumulated depreciation:			
Accumulated depreciation as at the beginning of the 3rd year (end of 2nd year)	19,76,000		
Add: depreciation for current ½ year (Rs. 9,88,000/2)		4,94,000	24,70,000
Net book value at the end of 2½ years			27,30,000
Selling price of the machine			28,50,000
Profit on disposal			1,20,000

F. Analytical Illustrations The main focus of these illustrations, accompanied by analysis icon, is on demonstrating to and guiding the students to carry out financial analysis of the information generated/given in the illustration, put the analysis crisply and make appropriate decisions. They contain some *numerical elements* as well.

ILLUSTRATION
3

LEPICIER CYRILLE COSMETICS LTD.
COMPARATIVE STUDY OF STATUTORY DEPRECIATION PROVISIONS
BOOK PROFIT AND TAXABLE PROFIT

Lepicier Cyrille Cosmetics Ltd. purchases a machine costing Rs. 150 lacs and factory building for Rs. 5 lacs on 1st April 2006. Assume that the company does not own any other depreciable asset. Work out the **first year depreciation** as per SLM and WDV methods for all the three shifts under the Companies act and as per the Income Tax act. Also work out the book profit and taxable profit for the year 2006–07 assuming that the profit before depreciation but after providing for all other expenses for the year was Rs. 80 lacs. Analyse the results.

		SOLUTION					
		First Year Depreciation	Income Tax Act (WDV)	Companies Act			WDV
				SLM SHIFTS				SHIFTS
		Single	Double	Triple	Single	Double	Triple
Rates of depreciation:							
■ Factory building	10%		3.34%				10%
■ Machine	15%	4.75%	7.42%	10.34%	13.91%	20.87%	27.82%
Amount of depreciation (Rs.):							
■ Factory building	50,000	16,700	16,700	16,700	50,000	50,000	50,000

Analysis:

- Companies act depreciation is higher than Income Tax act depreciation only in cases of double and triple shift working as per WDV. Hence the book profit is lower than the taxable profit in these two situations.
- Income Tax act depreciation is higher than Companies act depreciation in all other situations. Hence the book profit is higher than the taxable profit in all other situations.

RESEARCH IN FINANCIAL REPORTING Select Indian Corporates Across Industry Sectors							
INTANGIBLE ASSETS AND OTHER RELATED DETAILS AS ON 31 MARCH 2006.							
Sl. No.	Company	Industry	Tangible Fixed Assets	Intangible Assets	Intangible Assets to Tangible Fixed Assets	Amortisation on Intangible Assets for the year	PBT for the year
1	Asian Hotels Ltd.	Hotel – Tourism	565	...	...	...	87
2	Bharti Airtel Ltd.	Telecom	13,735	1,613	12%	135	2,286
3	Indraprastha Medical Corporation Ltd.	Hospital – Healthcare	166	0.33	0.20%	0.50	22
4	Indraprastha Gas Ltd.	Natural Gas	395	...	...	...	160
5	Infosys Technologies Ltd.	Information Technology	2,133	...	...	...	2,724
6	ITC Ltd.	FMCG	4,333	72	2%	13	3,269
7	JK Cement Ltd.	Cement – Hosing related	949	6	0.60%	1	52
8	Ranbaxy Laboratories Ltd.	Healthcare	1,572	61	4%	25	190
9	Reliance Energy Ltd.	Power	2,866	8	0.30%	4	781
10	Reliance Industries Ltd.	Oil and Gas	61,558	1,117	2%	141	10,704
11	Shopper's Stop Ltd.	Retail	119	4	3%	1	40

Notes:

- Data derived from respective annual reports.
- All tangible fixed assets: Net of accumulated depreciation and inclusive of capital work-in-progress.
- All intangible assets: Net of accumulated amortisation.
- Ranbaxy Laboratories Ltd.: Year ended 31-12-2005.

G. Research in Financial Reporting This feature has been introduced to emphasize and bring home the significance of the financial issues under discussion for a true and fair reporting of corporate performance and financial position and other aspects. In most cases, it culls out relevant data from select Indian corporates across industry sectors and analyses the same to arrive at meaningful conclusions. It is accompanied with the icon of a microscope.

The top left-hand icon signifies that the data has been extracted from individual company's annual reports.

H. IFRS Convergence India is moving towards convergence with International Financial Reporting Standards (IFRS). Institute

of Chartered Accountants of India (ICAI) has developed and submitted to the ministry of corporate affairs a set of 35 IFRS converged Indian Accounting Standards (Ind ASs). Their implementation was initially planned to be w.e.f. 1.04.2011 in a phased manner. However, the ministry has deferred their implementation until various issues including tax-related issues are resolved with the concerned departments and, therefore, the date of implementation of the Ind ASs will be notified at a later date. *In the meantime, to keep the students in readiness for full-fledged understanding of IFRS converged Ind ASs when implemented, key distinctive features thereof versus existing accounting standards have been explained in the text at relevant places in various chapters.* A template has been developed for this purpose, an example of which appears, as shown here. *The icon on the top-left is symbolic of Convergence.*

I. New Format of Financial Statements Ministry of Corporate Affairs (MCA) has issued new vertical format of Balance Sheet and introduced the format of the vertical Statement of Profit & Loss, both put together, popularly known as Schedule VI to the

IFRS CONVERGENCE

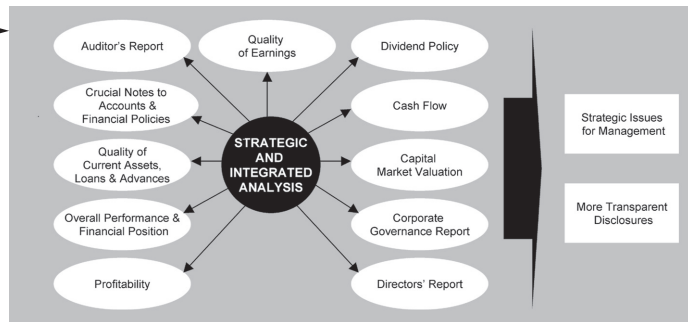
Now follow key distinctive features of IFRS Converged Indian Accounting Standard (Ind AS) on the subject:

IFRS CONVERGED IND AS 16 VS EXISTING AS 10	
PROPERTY, PLANT AND EQUIPMENT	
The IFRS converged Ind AS 16 corresponding to existing AS 10 on Accounting for Fixed Assets is titled as 'Property, Plant and Equipment'. Key distinctive features of Converged Ind AS 16 are as under:	
1	Converged Ind AS 16 is based on the component approach. Under this approach, each major part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately. As a corollary, cost of replacing such parts is capitalized. The cost of replacing those parts which have not been depreciated separately is also capitalized with the consequent derecognition of the replaced parts.
2	Converged Ind AS 16 requires an entity to choose, after initial recognition, either the cost model or the revaluation model as its accounting policy and to apply that policy to an entire class of property, plant and equipment. It requires that under revaluation model, revaluation be made with reference to the fair value of items of property, plant and equipment. It also requires that revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Existing AS 10 also recognizes revaluation of fixed assets. However, the revaluation approach adopted therein is ad hoc in nature, as it does not require the adoption of fair value basis as its accounting policy or revaluation of assets with regularity. It also provides an option for selection of assets within a class for revaluation on systematic basis.
3	Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
4	Further, converged Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' provides that an entity shall measure a non-current asset (or a group of assets) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

RELIANCE INDUSTRIES LTD.			
NEW FORMAT			
BALANCE SHEET AS AT 31st MARCH, 2011			
(Rs. In Crore)			
	Note No.	As at 31st March 2011	As at 31st March 2010
I. EQUITY AND LIABILITIES			
1 Shareholders' Funds			
a	Share capital	3,273.37	3,270.37
b	Reserves and Surplus	1,51,038.84	1,36,331.15
c	Money received against share warrants	—	—
	Sub-total....	1,54,312.21	1,39,601.52
2 Share Application Money Pending Allotment			
		—	—
3 Non-current Liabilities			
a	Long-term borrowings	54,437.34	55,796.31
b	Deferred tax liabilities (Net)	11,561.80	10,926.30
c	Other Long term liabilities	—	—
d	Long-term provisions	245.55	329.21
	Sub-total....	66,244.69	67,051.82
4 Current Liabilities			

Companies Act. The new format is applicable to those companies whose accounting period starts 1.04.2011 onwards. Thus, first corporate financial statements in the new format will be available after 31.03.2012. However, for the benefit of the students, the **new appendix 6** discusses the new format of financial statements and restates the 2010–11 old format financial statements of **Reliance Industries Ltd.** for a comparative assessment of the utility of the new format.

J. Integrated Project This is a *research-based integrated project*. Chapter 22 is devoted to developing a model for strategic and integrated managerial financial analysis of annual report of Nestlé and Chapter 23 to illustrating the elaborate analysis based on the model. The students will be enormously benefited by this project in developing and analysing an integrated project of some other corporate of their choice as per the exercises given in chapters 22 and 23.



K. Examples of Leading Companies in the Running Text The discussion on the conceptual issues in the running text has been further enriched by giving large number of examples of leading corporates with their names **emboldened**. It will help the readers establish connectivity between the concepts and the corporate practices.

Further suppose, in a public issue, valuation report was submitted to the client on 28th February and prospectus filed on 15th April. Cost of services rendered during March in the preparation of prospectus represents work-in-progress for **SBI Capital Markets Ltd.** which it should ideally recognize in its financial statements drawn for the year ended 31st March since the part of the service has already been rendered for which fee will be received thereafter. AS-2 does not apply to such inventory of work-in-progress of service providers. A perusal of the 2005–06 annual reports of **SBI Capital Markets Ltd., Satyam Computer Services Ltd., Infosys Technologies Ltd.** and **TATA Consultancy Services Ltd.** reveals that none of these companies has recognised work-in-progress on this count. The sample suggests that Indian service providing industry does not recognize revenue for services rendered but remaining unpaid as on the balance sheet date.

Consistency principle not violated Consistency principle is not supposed to have been violated when different methods of depreciation are used for:

- *Different kind of assets*, **for example**, SLM for buildings and WDV for machinery or SLM for one kind of machinery and WDV for another kind. We have noted earlier that *type of asset* is one of the determinants of the method of depreciation to be adopted.
- *Similar assets* acquired up to a particular date and thereafter, **for example**, SLM on machinery acquired up to 31-03-2005 and WDV for that acquired on or after 1-04-2005.
- *Similar assets* located in different geographical regions, **for example**, WDV for machines in Delhi plant and SLM for same machines at Mumbai plant. This case is however questionable.

L. Example / For Example Emboldened in the Text A large number of examples have been given in the running text. The words 'Example'/'For example', 'Examples' have been emboldened to catch the attention of the students.

8. Keywords Keywords, provided at the end of each chapter, will help the students recap the subject faster and enhance their accounting and financial vocabulary.



KEYWORDS

- | | | |
|----------------------------|----------------------------------|-------------------------|
| ■ Account Heads | ■ Cash Credit | ■ Expenses |
| ■ Account/A/C | ■ Company | ■ Financial Accounting |
| ■ Accounting Process/Cycle | ■ Computerised Accounting System | ■ Financial Performance |
| ■ Accrual Concept | ■ Cost Concept | ■ Financial Position |
| | | ■ Financial Statements |

REFERENCES

9. References Next to keywords is given the consolidated list of all the resources, referred to in a chapter, sorted out according to the sources of referenced material. This feature has a lot of recall and recap value. It includes:

- Web sites
- Books and Magazines
- Annual Reports
- Newspapers
- CFDS Portal



- The Stock Exchange, Bombay, www.bseindia.com
- The National Stock Exchange, www.nseindia.com
- Capital Market*, fortnightly magazine, www.capitalmarket.com
- SEBI, www.sebi.gov.in
- Capitaline database, www.capitaline.com
- www.indiaonline.com



- Capital Market*, investment fortnightly:
- Torrent Cables Ltd.
 - Corporate Scoreboard—54 FOOD-PROCESSING—MNC



- Colgate-Palmolive (India) Limited**, Annual Report, 2006–07.
- ICICI Bank Ltd.**, Annual Report, 2006–07.
- Larsen & Toubro Ltd.**, Annual Report, 2005–06.
- NTPC Ltd.**, Annual Report, 2006–07.
- Titan Industries Ltd.**, Annual Report, 2006–07.



- The *Economic Times*, business daily:
- Hindustan Lever Ltd.
 - ITC Ltd.

CFDS
PORTAL

Company Information.

10. Chapter-end Exercises A large number of exercises are given at the end of each chapter. Suitable icons representing their characteristics accompany almost all of them. These aim to develop wide and varied skill sets in the students.

EXERCISES

CASE



A. Case Studies A large number of blue chip corporates' case studies, on the lines of cases illustrated and expanded further, are the major highlights of chapter-end exercises. Like illustrations, exercises are also *case-centric*. The cases are *well structured, elaborate, objective-oriented* and *to the point*. All these cases seek to develop an *integrated competency set* of core numerical skills, financial analysis, evaluation of financial policies and practices, appropriate decision-making and crisp report writing in the students.



B. Integrated Group Projects Group project exercises start from Chapter 12 and continue all through the text there onwards. These are *basically research based* and well structured. The purpose behind the group projects is to facilitate the students apply the knowledge, gained by them through the case of Nestle, to some other prominent corporates of their choice and thus build up a strong understanding of the financial and other reports and develop competencies in analysing and interpreting them strategically and integratively for necessary decision-making.



C. Computational/Numerical Exercises The main focus of these exercises is on developing *core computational skills* in the students for accounting treatment of various matters on the lines of computational/numerical illustrations. They contain some *analytical elements* as well. Numerical illustrations will help the students handle these exercises well.



D. Analytical Exercises The main focus of these exercises, on the lines of analytical illustrations, is on developing the student's skill to carry out *financial analysis, appropriate decision-making* and *crisp report writing* to enhance written analysis and communication skills. They contain some *numerical elements* as well. Analytical illustrations will help the students handle these exercises well.



E. WAC (Written Analysis and Communication) Exercises A general 'Written Analysis and Communication (WAC)' paper is taught as a core paper in MBA programmes in a large number of institutes and universities. These exercises seek to enhance the *WAC skills* of the students *with respect to accounting and financial information*, an essential aspect of the corporate finance professionals' day-to-day activity. Hence, exercises on WAC in a large number of chapters.



F. MOC (Managerial Oral Communication) Exercises Further to WAC, a general 'Managerial Oral Communication (MOC)' paper is also taught as a core paper in MBA programmes. These exercises seek to *enhance the MOC and PowerPoint Presentation skills* of the students *with respect to accounting and financial information*. These exercises have been set in a collaborative environment. Inter-group competition is an integral part of these exercises. In most chapters, MOC presentation requirements by the student groups on group project exercises also follow the latter. This will help all groups to learn from each other about the financial practices of a large number of corporates across industries.

G. Capitaline Plus/CMIE Prowess Data-based Exercises These exercises, in chapters 11 and 24, seek to encourage the students search the above mentioned major financial databases of our country built on and around corporate annual reports and other related voluminous information, for example, the industry information, newspaper clippings and share prices. They seek to develop a research orientation among the students.

H. Open Exercises These exercises, in chapters 25, 26 and 28, seek to encourage the students to explore a wide open field comprising Web sites, CFDS Portal system, newspapers, magazines, etc. to find out financial and business information, analyse the same and thus widen their horizons.

I. Integration of Exercises Through Various Chapters

To provide a holistic view of and to take a particular exercise to its logical conclusion, wherever required, such exercises have been integrated through various chapters. For example, the case of Hero Honda Motors Ltd. is spread over chapters 14, 18, 20 and 21.