THIRD EDITION

FINANCIAL ACCOUNTING *for* MANAGERS

Pearson

Sanjay Dhamija

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FINANCIAL ACCOUNTING
for Managers

Third Edition

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Pearson

Dedication

To my parents and teachers

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Preface

It gives me immense pleasure in presenting the third edition of the book. The earlier two editions received overwhelming responses from both students and teachers. The feedback received from the academic community has therefore been duly incorporated in the revised edition.

Financial accounting and reporting has undergone a major shift in India with the convergence of our accounting standards with the IFRS. The Ministry of Corporate Affairs introduced a new series of accounting standards (called **Ind AS**) which are substantially aligned with the IFRS. The transition to the new Ind AS has begun from the financial year 2016–17. The convergence with the IFRS would substantially improve the reporting and disclosure practices by the Indian companies. The current edition has been thoroughly revised based upon the newly introduced **Ind AS**.

This book is designed to cater to the needs of postgraduate students in the first semester for various universities and institutes. Accounting information is used by functional managers for taking various economic decisions. These managers may not be responsible for the preparation of financial statements but must possess the necessary skill of understanding the information conveyed by the financial statements. Accordingly, this book has been written keeping the users' perspective in focus. It is expected that it will help users understand the contents of financial statements as well as the principles behind these numbers so as to enable them to take informed decisions.

The book is divided into 15 chapters. The first three chapters focus on the basics of accounting, including generally accepted accounting principles, accounting standards, and accounting process leading to the preparation of the profit and loss statement and the balance sheet. The users of financial information may not know the accounting procedure in as much detail as an accountant needs to know; nevertheless, a broad understanding of the accounting cycle and underlying principle is needed to really comprehend the information conveyed by financial statements. The next seven chapters discuss two key financial statements, namely, the balance sheet and the statement of profit and loss, in detail. Four key issues, viz., revenue recognition, inventory accounting and valuation, accounting for fixed assets and depreciation and investments, have been covered in length.

The next chapter focuses on a preparation and analysis of cash flow statement. The information con- tained in the earlier two statements needs to be supplemented by the information about the cash flows of the enterprise during the given a accounting period. The readers will be able to appreciate as to why some profitable enterprises suffer a cash crunch. The chapter will also help the readers to assess the cash-generating ability of an enterprise which forms the basis of a large number of economic decisions.

Chapter Twelve introduces the need and process for the preparation of consolidated financial statements. As large corporations often do business through one or more subsidiaries and joint ventures, it becomes critical to assess the performance of the group as a whole and also the resources it controls. Such information is provided by the consolidated financial statements. This chapter will help the readers differentiate between stand-alone financial statements and consolidated financial statements.

In addition to financial statements, the annual report of a company also contains a large number of additional disclosures. Additional information available in annual reports—both mandatory and voluntary—has been covered in Chapter Thirteen . The readers will learn to use the information contained in various reports like segment reporting, management discussion and analysis, corporate governance report, directors' report, value-added statement and Economic Value-Added (EVA) statement, etc. The next chapter introduces the readers to the analytical tools used for dissecting financial information to understand the financial performance and health of a business enterprise. The readers will learn to use tools like common size financial statements, trend analysis, and ratio analysis.

The last chapter highlights the areas of earnings management whereby unscrupulous management attempt to window dress their financial results. As a number of accounting scams have surfaced in the recent past undermining the reliability of information contained in the financial statements, this chapter illustrates some of the common financial shenanigans deployed for window dressing of financial statements. This will help the readers to be vigilant while using financial statements. The chapter also focuses on ethical issues in accounting.

Keeping in mind that this may be the first exposure to accounting for most of the students, a stepped up approach—from simple to difficult—has been used. A number of solved and unsolved illustrations have been provided to show the application of the concepts used. As a bridge between theory and practice, a number of relevant examples and cases from the annual reports of Indian companies have also been used.

Salient Features:

- In view of the convergences of Indian accounting standards with IFRS, accounting and reporting has been discussed based upon the applicable **Ind AS.**
- Very strong analytical perspective—how to use accounting information as a manager and as an analyst.
- A separate chapter on financial shenanigans make the readers understand the financial gimmicks used by unscrupulous management to mislead investors.
- Concepts discussed in the text have been reinforced with the help of solved illustrations both within the text and at the end of every chapter.
- Unsolved problems against each chapter encourage students to test their understanding.
- Extensive reference to examples from the annual reports of Indian companies.
- Case studies in each chapter to encourage out-of-the-box thinking. Most of the cases are based on information in the annual reports and real-life situations.
- Requirements of the Companies Act 2013 have been suitably incorporated.

FOR WHOM

Financial Accounting for Managers is primarily meant to be used in postgraduate programmes of vari- ous universities and institutions. The book can be used as an introductory course on accounting. It will also be useful in courses where students already know the procedure of accounting, but need to acquire an analytical and user orientation. This book would be helpful to practicing managers—both in finance and non-finance areas—to sharpen their skills in understanding and analyzing financial and accounting information.

Sanjay Dhamija

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I thank all my well wishers who were kind enough to guide and assist me in this endeavour. I am grateful to all my colleagues, friends and students, who extended morale support and helped in preparing manuscript by asking probing questions.

This work would not have been possible without unstinted support of my family. My thanks are due to my family members for their patience and support. I also appreciate the efforts of wonderful people at Pearson Education-editorial team for specific invaluable inputs and bringing this book out in a record time.

I have picked a number of examples from the annual reports of various companies. In addition, references have been made to accounting standards and other reports issued by various institutions and organizations like the Institute of Chartered Accountants of India, the Ministry of Corporate Affairs, KPMG, the Securities Exchange Commission, etc. They have been appropriately acknowledged in the text.

Sanjay Dhamija

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About the Author

Sanjay Dhamija is currently working as a Professor of Finance and Accounting and Dean—MDP and Executive Education at International Management Institute, New Delhi. A doctorate in finance (FPM) from IMI, Delhi, he completed his M.Com from Delhi School of Economics and LLB from Delhi University. He is a Fellow Member of the Institute of Cost Accountants of India (FCMA) and the Institute of Company Secretaries of India (FCS). He is also a Chartered Financial Analyst from ICFAI. He has attended management programs at Harvard Business School, Wharton Business School, and the University of Maryland.

Professor Dhamija has over 32 years of experience, both in industry and academia. He worked in senior positions with ABN AMRO Asia Equities, HSBC Securities and Capital Markets, Escorts Finance Ltd., and MMTC of India Ltd. for more than 16 years.

He has been in academics since 2003, worked with ICFAI Business School and with Management Development Institute (MDI), before joining IMI in 2009. At MDI, he held various positions including Chairperson of Executive Post-Graduate Diploma in Management, Chairperson of Continuing Education, and Chairperson of Finance and Accounting. He has received the 'Excellence in Teaching' award at MDI. He also received the 'Best Trainer' award at IMI.

Professor Dhamija has handled number of consulting and training assignments for many private and public organizations as well as for government sectors. It includes ABB, ABN AMRO Asia Equities, Apollo Tyres, Bharat Electronics, BHEL, Central Electricity Authority, Canara Bank, Department of Telecommunication, Department of Atomic Energy, Engineers India, Ericsson India, Fortis Health Care, Fidelity India, Hindustan Coca Cola, Hindustan Coppers, Hughes Communications India Limited, IBM Daksh, IFFCO, Indian Army, Indian Oil, Jamia Handard University, LIC, NHPC, NTPC, ONGC, Power Grid, Punj Lloyd, Royal Bank of Scotland, Sapient Consulting, SBI Life Insurance, Suzlon Energy, Transition Optical, Virgin Mobiles, etc. He also regularly conducts popular programmes on 'Finance for Non-Finance Executives' and 'Understanding and Analysis of Financial Statements'.

Introduction to Accounting 1

CHAPTER OBJECTIVES

This chapter will help the readers to:

- Understand the meaning and nature of accounting.
- Differentiate between financial accounting and management accounting.
- Identify various users of accounting information.
- Appreciate the need for generally accepted accounting principles (GAAP) and accounting standards (AS).
- Understand the accounting environment and role of various regulatory institutions in India.
- Get an overview of accounting cycle.
- Identify the three basic financial statements and their purposes.

1.1 WHAT IS ACCOUNTING?

Accounting is the language of business; it is the medium through which business organizations communicate information about their financial performance and financial position to the outside world. Financial accounting involves identifying and recording business transactions and summarizing them in rupee terms. The financial information is presented in three basic financial statements—the balance sheet, the profit and loss statement and the cash flow statement. These statements are used to communicate the financial status of the organization to various stakeholders of the business to enable them to take economic decisions. The American Accounting Association defines 'Accounting as the process of identifying, measuring and communicating economic information, to permit informed judgments and decisions by a user of the information'. It is important to note that financial accounting deals only with those business events and transactions that can be expressed in rupee terms, other events howsoever important are not the subject matter of financial accounting.

1.2 USERS OF FINANCIAL ACCOUNTING INFORMATION

The accounting information is used both by internal and external stakeholders. These stakeholders have financial interest in the business, and therefore are keen to know about the financial performance and health of the organization. Financial statements essentially attempt to meet the information needs of these stakeholders.

> ***Accounting information*** *is used both by external users as well as internal users.*

The most predominant group of **external stakeholders** includes the **suppliers of capital**. This group consists of shareholders, lending banks and financial institutions, bond holders and other lenders—both existing and prospective. This group has a direct stake in the financial health of the organization. They use the financial information to assess the risk-return profile of the organization. The information contained in the financial statements helps them to judge the return they can expect from their investment as well as the risk they are exposed to, by investing or lending to the organization. They assess the capacity and ability of the organization to pay interest and repay the principal using financial information. Other entities that facilitate raising of capital, for example, **credit rating agencies** also rely on the information contained in financial statements to form a view about the financial health of the organization. 'The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit.'[1]

Likewise, **suppliers of goods** or services to the organization especially on credit are concerned about the ability of the enterprise to pay their dues. **Customers** also actively watch the financial information especially when they have long-term contracts with the enterprise. The information is useful is judging the continuance of the enterprise.

Tax authorities are also interested in the accounting information. As business units are liable to pay tax on their taxable income, accounting information is used to ascertain the same. However, it must be noted that taxable income is computed in accordance with the provisions of applicable tax laws and these provisions do differ from financial accounting principles. It forces companies to maintain separate accounting records for tax purposes.

> *Tax* ***accounting*** *is a separate branch of accounting as records are kept to meet the requirements of income tax laws.*

Regulatory bodies are the other set of external users of financial information. For example, the Central Bank (Reserve Bank of India) oversees the banks as to profitability, maintenance of capital, credit concentration, asset liability mismatch, etc., using key information derived from financial statements of banks. Likewise, Insurance Regulatory and Development Authority (IRDA) uses the information contained in financial statements of insurance companies for various regulatory purposes. Even **employees and trade unions** actively watch the financial performance of the company to judge the soundness of the enterprise and that they are being properly rewarded. The information may also be used for wage negotiations by the trade unions. In addition **academicians and researchers** use financial accounting information to carry out research about the financial performance and policies of various organizations.

In addition to the external stakeholders, **managers** also use the financial information. In fact, managers have a dual role—they have the responsibility to prepare financial statements and also they are one of the users of the information for performing their roles. Organizational goals are often set in financial terms and managerial performance is assessed against these financial targets. Managers use financial information to ensure that the actual performance is aligned to the set targets. Ability to understand and use financial information is therefore a key skill that each manager must possess. Managers, as users of financial information, may not be proficient in accounting process and preparation of financial statements (that is the role of accountants) but they must understand what these figures actually mean and how their meaning may change under different circumstances.

1.3 FINANCIAL ACCOUNTING VERSUS MANAGEMENT ACCOUNTING

At this stage, it is important to draw a distinction between financial accounting and management accounting. As observed earlier, financial accounting primarily aims at meeting the informational needs of external users though insiders also make use of the information. The management accounting aims at assisting managers in their decision making functions. The primary focus of management accounting is internal planning, control and decision making. The management accounting information is privileged one and is not available to the external users. As the financial accounting information is used by external users, the information is presented in standardized formats to ensure easy comparability. The information is prepared using accounting concepts often called generally accepted accounting principles (GAAP). Information is presented on an aggregate basis for the entity as a whole.

> ***Financial accounting*** *is primarily used by external users.*
> ***Management accounting*** *is exclusively for the internal users.*

Management accounting follows no such formats or accounting rules. The information is broken down product-wise, segment-wise and geographically to help managers in efficient decision making. The information is prepared more frequently—almost on a concurrent basis. In addition to financial information, management accountants also use non-financial data, for example, product demand, quantities of material used, labour hours, capacity utilization, etc. Management accounting is more forward looking and uses financial estimates. The information is less precise though compared to financial accounting information.

Though financial accounting and management accounting are two distinct branches of accounting, they do use common inputs. An integrated accounting system would support both financial accounting and management accounting requirements.

1.4 NEED FOR ACCOUNTING PRINCIPLES—GAAP AND ACCOUNTING STANDARDS

Accounting is a management discipline and not an exact science. The same accounting event is capable of being recorded on different basis by different accountants. How do we ensure the comparability of accounting information as reflected in financial statements? For example, an investor wants to make an investment in equity shares of either Infosys or Wipro. He would like to compare the performance of two companies. If these companies are preparing their financial statements using different accounting policies, performance comparison would not be possible. The need for comparability led to the evolution of GAAP. GAAP are good accounting practices evolved by the accounting profession over a period of time. Financial statements prepared using GAAP are more readily comparable. GAAP do not cover specific accounting situations, but provide broad principles that govern the choice of specific accounting policies. The management, as a preparer of financial statements, always has some latitude in applying these principles in the given situation. It must also be understood that as the business

> ***Accounting principles and standards*** *make financial statements prepared by various entities comparable by reducing management's discretion in choice of accounting treatment.*

environment is getting more and more complex, accounting principles are also evolving to keep pace with the changing environment.

The GAAP are further elaborated by means of **accounting standards (AS)**. Accounting standards are mandatory requirements to be followed while preparing financial statements. In India, the Institute of Chartered Accountants (ICAI) is empowered to prescribe accounting standards. Each AS covers a specific accounting area and provides detailed guidelines to be followed for accounting and disclosure. The GAAP and accounting standards have been discussed in Chapter 2.

1.5 ACCOUNTING CYCLE

The American Institute of Certified Public Accountants provided a functional definition of accounting. 'Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof'. Viewed as a process, financial accounting is shown in Figure 1.1.

The accounting cycle begins with a business transaction that can be expressed in terms of money. Every business transaction is supported by a document called 'voucher'. Vouchers are supporting documents to prove that an accounting transaction has taken place and also for quantifying the monetary value of the transaction. For example, purchase of goods is evidenced by way of a purchase invoice, clearly indicating the value of goods purchased. On the basis of the relevant voucher, an accounting transaction is recorded in the accounting system by was of a **journal entry**. Journal entries are recorded in a chronological order. Transactions recorded by way of journal entries are then classified under various heads called ledger accounts. This process of classification is called **ledger posting**. At the end of the accounting period, these ledgers accounts are balanced to find the balancing figures. The balancing figure in each ledger is summarized by way of a **trial balance**. The trial balance forms the basis of preparation of the three basic **financial statements**, viz., the statement of profit and loss, the balance sheet and the cash flow statement. The information presented in these financial statements can be analyzed using various tools like trend analysis, common size statements and ratio analysis.

Business managers need to have the skill to understand and analyze the information contained in financial statements. However, to fully appreciate financial statements, they must understand the accounting process as well. The accounting cycle has been covered in detail in Chapter 3 whereas financial analysis has been dealt with in Chapter 14. Chapter 15 deals with limitation of accounting information and earnings management.

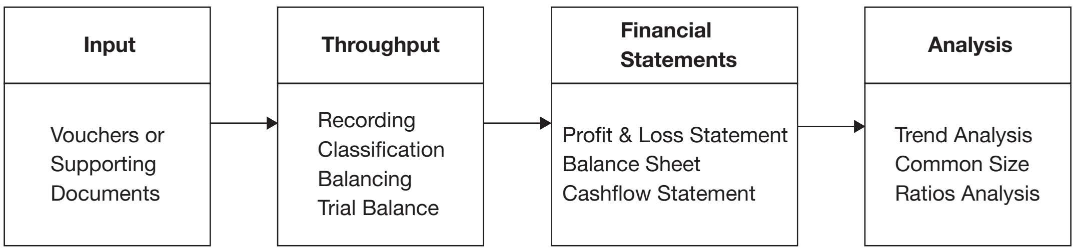

Figure 1.1 Accounting Process

1.6 FINANCIAL STATEMENTS

Financial statements aim to answer three basic questions about a business entity:

1. How much profit was earned by the business during a particular time period?
2. What are the assets and liabilities of the business at the end of the period?
3. What were the sources and uses of cash during a particular period?

The answers to the above questions can be found in three financial statements, namely the statement of profit and loss, the balance sheet and the cash flow statement, respectively.

> 'The ***objective of financial statements*** *is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions'*
>
> ICAI—Framework for the preparation and presentation of financial statements

Statement of profit and loss also called income statement or profit and loss accounts is a summary of incomes and expenses of the business during a period of time (called accounting period). Excess of income over expenses is called profit whereas, if expenses during the accounting period exceeds the income, the same is termed as a loss. All incomes earned and expenses incurred during the accounting period are aggregated and the difference is either profit or loss.

Balance sheet, on the other hand, is a statement of assets and liabilities on a particular day—the last day of the accounting period. It gives a snapshot of what the business owns (assets) and what it owes (liabilities) on a particular date. Assets may be further classified into non-current and current. Liabilities of business are classified into liability to the owners (called capital or equity) and liabilities to the external parties. External liabilities can again be classified as non-current and current based upon their maturity.

The statement of profit and loss, the balance sheet and related disclosures have been discussed in detail in Chapters 4 to 10.

Cash flow statement provides detail about the sources and uses of cash during an accounting period. The balance sheet shows the cash balance on a particular date but it does not explain the change in the cash position since the last balance sheet date. The cash flow statement aims to explain the variation in cash position between two balance sheets by showing the sources and uses of cash. The cash flows are broken under three heads:

(i) Cash flow from operating activities—sources and uses of cash arising directly from the main revenue generating activities of the organization.

(ii) Cash flow from investing activities—sources and uses of cash related to investing in long-term assets including long-term investments. This also includes the income generated from these long-term investments.

(iii) Cash flow from financing activities—sources and uses of cash related to funds raising activities including repayment of loans, payment of interest on borrowed funds and payments of dividends on shares.

Cash flow statement helps the users in understanding the cash generating ability of the business organization. Cash flow statement has been covered in detail in Chapter 11.

As it may not be possible to provide all the requisite details in the main body of these statements, a lot of details is provided by way of **notes to accounts.** The users of financial statements will do well to go through these notes for better understanding of the financial statements. Financial statements are standardized to meet the requirements of a diverse set of external users. Users, therefore, should not expect tailor made solutions to meet their informational requirements rather understand the formats and contents and reclassify the information to suit their requirements. In addition to these financial statements, many progressive companies do provide additional information purely on voluntary basis. Some such practices are discussed in Chapter 13.

1.7 ACCOUNTING ENVIRONMENT

The accounting and disclosure practices are greatly influenced by the regulatory requirements prescribed by various statutes. As discussed earlier, financial statements essentially are used by the external users. To ensure comparability of information provided in financial statements suitable provisions are made in applicable acts. Some of the institutions and statutes, having bearing on the accounting and disclosure practices in India, are discussed below:

1.7.1 Ministry of Corporate Affairs

The Ministry of Corporate Affairs (MCA) is primarily responsible with the administration of the Companies Act, 2013. In addition, it also supervises three professional accounting bodies, namely the Institute of Chartered Accountants of India, the Institute of Cost Accountants of India and the Institute of Company Secretaries of India.

The Companies Act, 2013, governs the creation, continuation and winding up of companies. The Act also has specific provisions regarding the books of accounts to be kept by companies, format of financial statements and authentication of financial statements. It also prescribes the mechanism for notifying accounting standards formulated by the ICAI for compliance by the companies. Some of the important provisions of the act in this regards are given below.

Books of Accounts to be Kept

Every company is required to keep proper books of accounts to give a true and fair view of the state of affairs of the company. The books of accounts have to be kept on accrual basis and according to double entry book-keeping system. The accounts must be kept for all receipts and expenditure, sale and purchase of goods and assets and liabilities. The books of accounts need to be preserved for a period of eight years.

> *The **books of accounts** of a company must be kept on accrual basis following double entry book-keeping system.*

Financial Statements

Every company is required to prepare a balance sheet, a statement of profit and loss and a cash flow statement for each accounting year. The accounts are kept on a financial year basis, i.e., from 1st April to 31st March. These financial statements are required to be laid before the shareholders in the annual general meeting for approval within six months of the end of the accounting year.

To ensure that the information provided in financial statements by various companies is readily comparable by users, formats of the balance sheet and statement of profit and loss have been prescribed by the Companies Act, 2013. The balance sheet of the company at the end of the financial year should be in the format set out in Part I of Schedule III of the Act. The format of the statement of profit and loss is prescribed in Part II of Schedule III. However, Schedule III does not apply to any insurance or banking company or a company engaged in the generation or supply of electricity.

*The **format of financial statements** has been prescribed in Schedule III of Companies Act, 2013.*

Financial statements must give a true and fair view of the state of affairs of the company. They must be approved by the board of directors and signed on behalf by the Board. The signed financial statements are then submitted to auditors for their report.

Compliance with Accounting Standards

Financial statements of the company shall comply with the applicable accounting standards. In case of non-compliance, the company must report the deviation from the accounting standards, the reasons for such deviations and also the financial effect arising due to such deviations.

1.7.2 Reserve Bank of India

The Reserve Bank of India (RBI) is the central bank of the country. It was set up in the year 1934 to regulate the business of banking in India. The Banking Regulations Act, 1949, prescribes requirements relating to financial statements of banking companies. Accordingly, every banking company incorporated in India is required to prepare a balance sheet and a profit and loss account for each accounting period. Banking companies incorporated outside India are also required to prepare similar statements in respect of business transacted through their branches in India. The format for financial statements has been prescribed in the Third Schedule to the Act. Financial statements need to be signed by the prescribed officers of the banking company.

__Financial statements of banking companies__ must be prepared in the format prescribed in the Third Schedule of Banking Regulations Act, 1949.

RBI, as a supervisor of banking companies has, from time to time, issued circulars relating to disclosures in the notes to accounts to the financial statements. These circulars were consolidated and a master circular was issued by RBI prescribing matters to be covered in the notes to accounts.[2] The disclosure requirements cover key areas, like investments, quality of assets, non-performing assets, assets liability management, exposure to sensitive sectors, etc.

1.7.3 Insurance Regulatory and Development Authority (IRDA)

IRDA was established in the year 1999 'to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry' in India.[3] The Insurance Act, 1938 authorises the IRDA to make regulations on various matters including the preparation of balance-sheet, profit and loss account and a separate account of receipts and payments and revenue account. In exercise of its powers, IRDA came out with regulations[4] and has prescribed the format for revenue account, profit and loss account (shareholders' account) and the balance sheet. the regulations also

*The **financial statements of insurance companies** must be prepared in the format prescribed by IRDA Regulations—Schedule A for Life Insurers and Schedule B for General Insurers.*

require that separate revenue account shall be prepared for fire, marine, and miscellaneous insurance business.

In addition, a receipts and payments account is also required to be prepared. The regulations also prescribe the format (Schedule C) for auditors' report on financial statements.

1.7.4 Securities and Exchange Board of India (SEBI)

SEBI was established by an act of parliament in the year 1992 to 'protect the interests of investors in securities and to promote the development of, and to regulate, the securities market.'[5] The Act gives SEBI powers to specify the requirements for listing of securities. Accordingly, SEBI has prescribed the contents of **listing agreement** to be signed between the issuer of securities and the stock exchange where the securities are proposed to be listed. The purpose of the listing agreement is to protect the interest of investors in publically-traded securities. Some of the important provisions in the listing agreement relating to disclosures of financial information are:

__Listing agreement__ is signed between an issuer of securities and stock exchange where the securities are traded.

- A requirement to prepare and file quarterly results has been prescribed. Quarterly results are required to be filed with the stock exchange and also published in newspapers in the prescribed format.
- Quarterly results shall either be audited or be subjected to a limited review by the auditor.
- If the auditor has expressed any qualification or other reservation, such qualification or other reservation and impact of the same on the profit or loss, should also be submitted.

1.7.5 Income Tax Act, 1961

As discussed earlier, financial accounting and tax accounting are two distinct branches of accounting. The taxable income is computed as per the provisions of Income Tax Act, 1961, whereas reported profit for financial accounting is determined based upon the applicable accounting standards and requirements of the Companies Act, 2013. The income tax is computed on a financial year basis (1st April to 31st March). The Companies Act, 2013 requires the companies to keep financial accounts on financial year basis, bringing uniformity in tax accounting and financial accounting.

Summary

1. Financial accounting aims at meeting the informational requirements of both external and internal stakeholders.
2. External stakeholders include shareholders, prospective investors, bond holders, banks, financial institutions and other lenders, suppliers of goods and services, credit rating agencies, tax authorities and other regulators.
3. Managers also use financial accounting information for decision making and to align organizational performance with the targets.
4. To ensure comparability of financial information provided by different organization, they must conform to the applicable GAAP and accounting standards.
5. Three financial statements—statement of profits and loss, balance sheet and cash flow statement help the users in understanding the financial results and health of the organization.
6. The statement of profit and loss contains information about revenue and expenses during an accounting period, difference being called either profit or loss.
7. Balance sheet is a summary of assets and liabilities of the organization on the last day of the accounting period.
8. Cash flow statement reports sources and uses of cash during the accounting period and helps in explaining the change in cash position between two balance sheets dates.
9. Balance sheet and statement of profit and loss of a company must be prepared in the format prescribed in Schedule III of the Companies Act, 2013.
10. Format of financial statements for banking companies has been prescribed in Third Schedule of the Banking Regulations Act, 1949. Likewise, format of financial statements for insurance companies has been laid down by IRDA Regulations, 2002.
11. Companies whose securities are traded on stock exchanges are subject to additional disclosure requirements as per the listing agreement. They also need to prepare and publish quarterly results in the prescribed format.
12. Functional managers must develop the basic skills in understanding and analysis of these financial statements to be better able to use the information available.

Assignment Questions

1. 'Financial accounting information is primarily used by the external users whereas management accounting information is exclusively used by internal users'. Explain.
2. What are the key differences between financial accounting and management accounting?
3. Identify three primary financial statements and state their purposes.
4. The accounting and disclosure requirements are greatly influenced by the regulations. Briefly explain the accounting environment in India.