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COMMUNICATING WITH FINANCIAL DATA

BBA Semester 1 – Calicut University

MODULE 1: UNDERSTANDING COST, REVENUE AND PROFIT

Expenses, Income and Profit

Expenses

1. Costs incurred to earn revenue.
2. Reduce business profit.
3. Examples: Salary, Rent, Electricity, Advertising.

Income

1. Money earned from business activities.
2. Increases owner's wealth.
3. Examples: Sales revenue, Commission received, Interest received.

Profit

1. Excess of income over expenses.
2. Formula: **Profit = Income – Expenses**

Types of Profit

1. **Accounting Profit:** Profit shown in financial statements.
2. **Economic Profit:** Profit after considering both explicit and opportunity costs.

Significance

1. Indicates business performance.
2. Helps measure success and growth.

Cost and Revenue

Cost

1. Amount spent to produce goods or provide services.

Types of Cost

1. **Fixed Cost:** Remains constant regardless of output.
Examples: Rent, Insurance.
2. **Variable Cost:** Changes with production level. Examples:
Raw materials, Direct labour.

Revenue

1. Income earned from selling goods or services.

Types of Revenue

1. **Operating Revenue:** Revenue from main business activities.
2. **Non-Operating Revenue:** Revenue from secondary sources. Examples: Interest received, Rent received.

Importance

1. Revenue generates profit.
2. Cost affects profitability.

Important Differences

Finance vs Accounting

| Finance | Accounting |
|----------------------|------------------------|
| Managing money | Recording transactions |
| Future-oriented | Past-oriented |
| Investment decisions | Financial reporting |

Cost vs Expense

| Cost | Expense |
|---------------------------------|----------------------------------|
| Amount spent to acquire benefit | Cost consumed to earn income |
| May become asset | Charged to Profit & Loss Account |

Expense vs Expenditure

| Expense | Expenditure |
|-----------------|---------------------------|
| Used up benefit | Amount spent |
| Revenue nature | Capital or revenue nature |

Accounting Profit vs Economic Profit

| Accounting Profit | Economic Profit |
|--------------------------|-------------------------------------|
| Revenue – Explicit Costs | Revenue – Explicit & Implicit Costs |
| Used in accounting | Used in economics |

Basic Accounting Terms

1. **Assets:** Resources owned by a business. Examples: Cash, Machinery, Furniture, Debtors.
2. **Liabilities:** Amounts owed to outsiders. Examples: Loans, Creditors, Outstanding expenses.
3. **Equity:** Owner's claim on business assets. Formula:
Equity = Assets – Liabilities
4. **Revenue:** Income earned from operations.
5. **Expenses:** Costs incurred to earn revenue.

Principles of Accounting and Accounting Standards

Accounting Principles

1. **Business Entity:** Business and owner are separate.
2. **Going Concern:** Business will continue in future.
3. **Money Measurement:** Only monetary transactions are recorded.
4. **Cost Principle:** Assets recorded at purchase cost.
5. **Dual Aspect:** Every transaction has two effects.

Accounting Standards

1. Rules ensuring consistency and comparability in accounting.
2. Improve reliability of financial statements.

Accounting Equation

1. The foundation of accounting: **Assets = Liabilities + Equity**

Components

1. **Assets:** Resources owned.
2. **Liabilities:** Obligations owed.
3. **Equity:** Owner's interest in business.

Example

Assets = ₹1,00,000
Liabilities = ₹40,000
Equity = ₹60,000
Every transaction keeps the equation balanced.

MODULE 2: RECORDING EXPENSES AND INCOME OF A SOLE PROPRIETORSHIP

Journal Entries and Ledger Accounts

Journal

1. Book of original entry.
2. Transactions recorded in chronological order.

Basic Rule

1. Debit what comes in.
2. Credit what goes out.

Example

Purchased furniture for cash ₹10,000
Furniture A/c Dr ₹10,000
To Cash A/c ₹10,000

Ledger

1. Classified record of transactions.
2. Each account has a separate ledger account.
3. Examples: Cash Account, Sales Account, Purchases Account.

Preparation of Accounts (Simple Problems)

Steps

1. Identify accounts involved.
2. Apply debit and credit rules.
3. Record journal entry.
4. Post to ledger.
5. Calculate balances.

Purpose

1. Maintain proper accounting records.
2. Prepare financial statements later.

Trial Balance

1. Statement showing balances of all ledger accounts.
2. Prepared to check arithmetic accuracy.

Features

1. Debit total must equal credit total.
2. Prepared before final accounts.

Uses

1. Detects errors.
2. Basis for financial statements.

Format

| Account | Debit | Credit |
|---------|-------|--------|
| | | |

Depreciation, Provisions and Reserves

Depreciation

1. Reduction in value of fixed assets over time.
2. Examples: Machinery, Vehicles.

Provision

1. Amount set aside for expected future losses.
2. Example: Provision for doubtful debts.

Reserve

1. Portion of profit retained for future needs.
2. Examples: General Reserve, Capital Reserve.

Difference

| Provision | Reserve |
|-----------------------|--------------------------|
| For expected loss | For future strengthening |
| Charged before profit | Created from profit |

MODULE 3: FINANCIAL PERFORMANCE AND POSITION OF A BUSINESS

Income Statement

1. Statement showing profit or loss for a period.
2. Also called Profit and Loss Account.

Main Components

1. **Revenue:** Sales, Commission received.
2. **Expenses:** Salary, Rent, Depreciation.

Formula

$Profit = Total\ Income - Total\ Expenses$
 $Loss = Total\ Expenses - Total\ Income$

Purpose

1. Measures financial performance.

Balance Sheet

1. Statement showing financial position on a specific date.

Structure

1. **Assets:** Current Assets, Fixed Assets.
2. **Liabilities:** Current Liabilities, Long-Term Liabilities.
3. **Capital:** Owner's equity.

Purpose

1. Shows what business owns and owes.

Formula

$Assets = Liabilities + Capital$

Cash Flow Statement

1. Shows movement of cash during a period.
2. Explains cash inflows and outflows.

Cash Inflows

1. Cash sales.
2. Loan received.
3. Asset sales.

Cash Outflows

1. Purchases.
2. Salary payments.
3. Loan repayment.

Importance

1. Measures liquidity.
2. Helps cash planning.
3. Shows ability to meet obligations.

MODULE 4: READING AND INTERPRETING FINANCIAL REPORTS

Income Statement Ratios

Gross Profit Ratio

1. Shows gross profit earned from sales.
2. Formula: **Gross Profit Ratio = (Gross Profit ÷ Net Sales) × 100**

Operating Profit Ratio

1. Shows profit from normal business operations.
2. Formula: **Operating Profit Ratio = (Operating Profit ÷ Net Sales) × 100**

Net Profit Ratio

1. Shows overall profitability.
2. Formula: **Net Profit Ratio = (Net Profit ÷ Net Sales) × 100**

Interpretation

1. Higher ratios generally indicate better profitability.

Tax Efficiency Ratio

1. Measures how effectively a business manages tax burden.
2. Formula: **Tax Efficiency Ratio = Net Profit After Tax ÷ Net Profit Before Tax**

Interpretation

1. Higher ratio means lower tax burden relative to profit.

Interest Coverage Ratio

1. Measures ability to pay interest obligations.
2. Formula: **Interest Coverage Ratio = EBIT ÷ Interest Expense**

Interpretation

1. Higher ratio indicates better ability to pay interest.

Balance Sheet Ratios

Used to assess liquidity, solvency and efficiency.

Liquidity Ratios

Measure short-term financial strength.

1. **Current Ratio:** Current Ratio = Current Assets ÷ Current Liabilities. Indicates ability to pay short-term debts.
2. **Liquid Ratio (Quick Ratio):** Quick Ratio = (Current Assets - Inventory) ÷ Current Liabilities. Excludes inventory from current assets. Measures immediate liquidity.

Solvency Ratios

Measure long-term financial stability.

1. **Debt to Equity Ratio:** Debt to Equity Ratio = Total Debt ÷ Shareholders' Equity. Shows relationship between debt and owner's funds.
2. **Debt Ratio:** Debt Ratio = Total Debt ÷ Total Assets. Indicates percentage of assets financed through debt.

Turnover Ratios

Measure efficiency in using resources.

1. **Inventory Turnover Ratio:** Shows how quickly inventory is sold.
2. **Debtors Turnover Ratio:** Measures speed of collecting receivables.
3. **Creditors Turnover Ratio:** Measures speed of paying suppliers.
4. **Asset Turnover Ratio:** Measures efficiency of asset utilization.
5. **Working Capital Turnover Ratio:** Measures efficiency of working capital usage.
6. Higher turnover ratios generally indicate better efficiency.

Return on Investment (ROI) and Return on Equity (ROE)

Return on Investment (ROI)

1. Measures return earned on total investment.
2. Formula: $\text{ROI} = (\text{Profit} \div \text{Investment}) \times 100$

Return on Equity (ROE)

1. Measures return earned on owner's funds.
2. Formula: $\text{ROE} = (\text{Net Profit} \div \text{Shareholders' Equity}) \times 100$

Interpretation

1. Higher ROI indicates better investment performance.
2. Higher ROE indicates better utilization of owner's funds.