



# Collegedunia NCERT Notes

The Ultimate NCERT Revision Guide for Class 12 Accountancy (2026-27)

## Part 2 Chapter 3: Financial Statements of a Company

**What this chapter covers:** the meaning and nature of financial statements; objectives of preparing the Balance Sheet and Statement of Profit and Loss for a corporate entity; form and content of these two statements as per the revised **Schedule III to the Companies Act, 2013**; rounding-off rules; uses and importance of financial statements for various stakeholders; and the limitations one must be aware of. Session 2026-27.

Also see for this chapter: [NCERT Solutions](#) | [Formula Sheet](#)

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**1 Introduction and Meaning of Financial Statements**

After studying how a company raises capital through shares (Part 2 Chapter 1) and debentures (Part 2 Chapter 2), the natural next step is to learn how the company *reports* the result of using that capital to its owners and other stakeholders. That report-card is the set of **financial statements**.

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various external parties, investors, lenders, tax authorities, the government, employees and the public at large. They are the **end-product of the accounting process**, prepared by summarising and classifying every transaction recorded during the year.

**Definition – The Three Statements**

For a company governed by the Companies Act, 2013, the financial statements include:

1. **Balance Sheet** as at the end of the accounting period, a *position statement*.
2. **Statement of Profit and Loss** for the period, a *performance statement*.
3. **Cash Flow Statement** for the period (covered in Part 2 Chapter 2).

Together with the **Notes to Accounts** and the **auditor’s report**, these form the company’s annual financial reporting package.

**1.1 The accounting process flow**

It helps to visualise where financial statements sit in the broader accounting cycle.

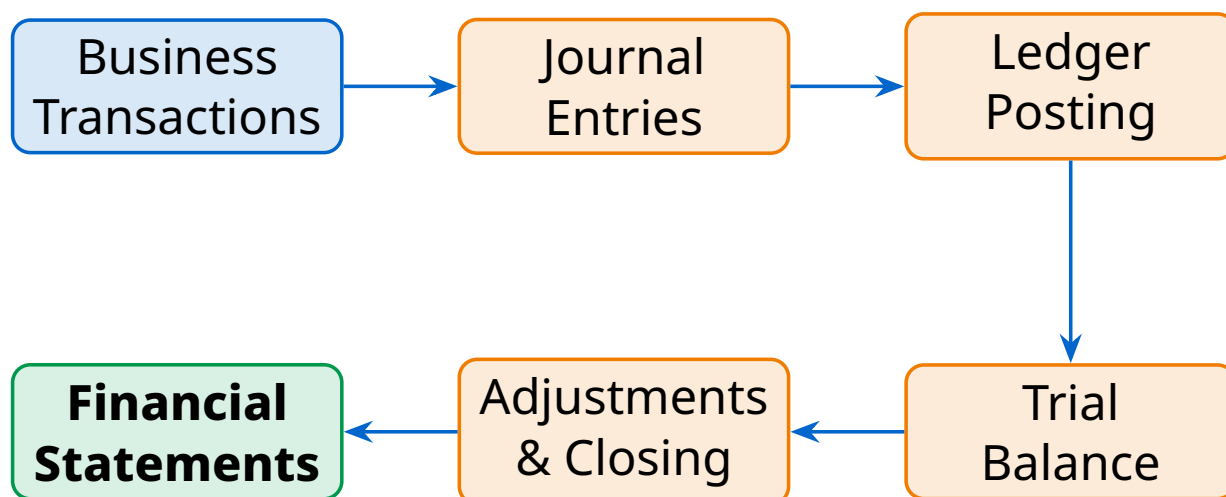


Figure 1: Financial statements are the final output of a year-long sequence, every journal entry, every ledger posting, every adjustment ultimately funnels into the Balance Sheet and the Statement of Profit and Loss.

### Real-World Application

When you read the **annual report** of a listed company like Reliance Industries or Tata Motors, the financial statements section is what tells you whether the company actually earned a profit, how much it owes to lenders, and whether it has enough cash to keep operating. The rest of the report – chairman’s letter, business outlook, risk factors – is commentary; the numbers in the Balance Sheet and Statement of Profit and Loss are the verifiable record.

## 2 Nature of Financial Statements

Financial statements reveal the financial position as on a date and the financial results obtained during a period. The American Institute of Certified Public Accountants describes them as “statements prepared for the purpose of presenting a periodical review of report on progress by the management and deal with the status of investment in the business and the results achieved during the period under review.” They are a combination of four building-blocks.

### Four Building-Blocks of Financial Statements

1. **Recorded Facts.** Numbers come from the books of account, historical cost data. Fixed assets, debtors, cash are reported at recorded cost, not at market value.
2. **Accounting Conventions.** Inventory at *cost or NRV, whichever is lower*; materiality (small items expensed); conservatism (do not anticipate profit, do anticipate loss).
3. **Postulates (basic assumptions).** Going concern, money measurement, realisation, accrual, consistency, periodicity.
4. **Personal Judgements.** Estimating useful life for depreciation, percentage of provision for doubtful debts, valuation of inventory close to obsolescence.

### 2.1 What “recorded facts plus convention plus judgement” really means

Take a simple example. A factory building was bought in 2008 for Rs. 20,00,000. Its market value today is Rs. 65,00,000. In the Balance Sheet, it is still shown at Rs. 20,00,000 less accumulated depreciation – a *recorded fact* (the original purchase) constrained by a *convention* (historical cost), with a *judgement* layered on (the depreciation rate). This is why financial statements are described as a mix and not a pure photograph of economic reality.

**Quick Tip**

In a 1- or 3-mark theory question on “nature of financial statements”, list **all four** building-blocks. Examiners count the count – skipping “personal judgements” is the most common reason students lose the last mark.

### 3 Objectives of Financial Statements

#### Six Objectives – NCERT List

The primary objective is to **assist users in decision-making**. The specific objectives are:

1. Provide information about **economic resources and obligations** of the business.
2. Provide information about the **earning capacity** of the business.
3. Provide information about **cash flows**.
4. Help judge the **effectiveness of management**.
5. Report activities of business **affecting society**.
6. Disclose the **accounting policies** followed.

#### 3.1 Stakeholder map – who uses financial statements and why

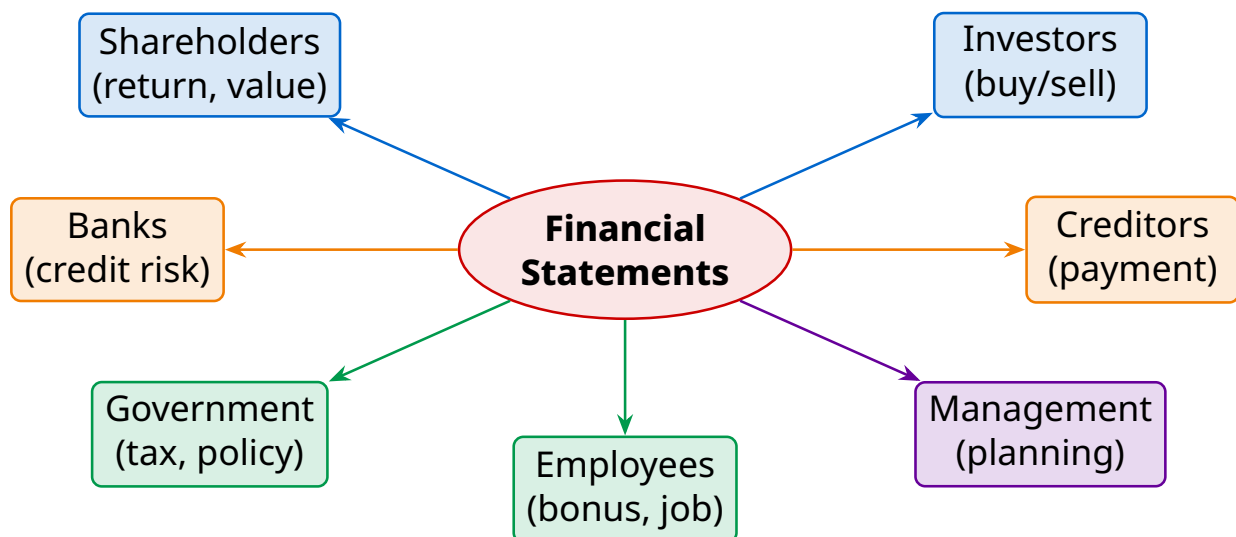


Figure 2: Each stakeholder reads the same financial statements with a different lens – a banker tracks coverage ratios, a shareholder tracks EPS and dividend.

**Memory Aid**

**“SIRE-MG”** for the seven main users – **S**hareholders, **I**nvestors, **R**egulators

(govt/SEBI), **E**mloyees, **M**anagement, **G**overnment + creditors. Helpful when you have to list users in a 3-mark theory question.

## 4 Types of Financial Statements – Schedule III Set of rules

Every company registered under the Companies Act, 2013 must prepare its Balance Sheet, Statement of Profit and Loss and notes to accounts in the manner prescribed in the **revised Schedule III to the Companies Act, 2013**. Schedule III replaces the older Schedule VI of the Companies Act, 1956 and is designed to align disclosures with Indian Accounting Standards.

### Schedule III – Important Features at a Glance

1. Applies to all Indian companies preparing financial statements.
2. Does **not** apply to (i) Insurance or Banking companies, (ii) Companies for which a format is specified under any other Act.
3. Accounting Standards **prevail over** Schedule III in case of conflict.
4. **Vertical** format is prescribed (horizontal/T-format not allowed).
5. Disclosure either on the face of the statement **or** in notes to accounts is mandatory.
6. Current and non-current **bifurcation** of assets and liabilities is compulsory.
7. Debit balance of P&L is shown as a **negative figure under “Reserves and Surplus”**, not on the asset side.
8. Old terms *Sundry Debtors* and *Sundry Creditors* are replaced by **Trade Receivables** and **Trade Payables**.
9. Share application money pending allotment is disclosed separately on the face of the Balance Sheet.

### 4.1 Rounding-off rule – Box 1 of NCERT

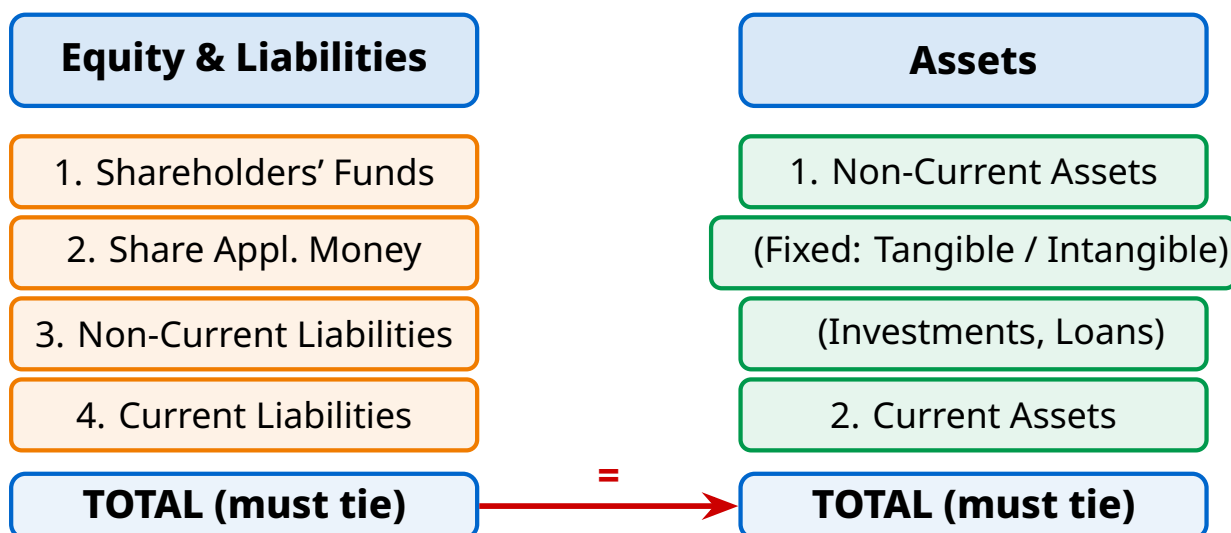
#### Rounding-off Based on Turnover

- Turnover < **Rs. 100 crore**: nearest hundreds, thousands, lakhs, millions or decimal thereof.
- Turnover ≥ **Rs. 100 crore**: nearest lakhs, millions or crores or decimal thereof.

Once a rounding policy is chosen, it must be applied *consistently* throughout the financial statements.

## 5 Form and Content of Balance Sheet (Schedule III, Part I)

The Balance Sheet shows the financial position of the company *as at* a specific date (usually 31st March). The vertical format has two main heads: **Equity and Liabilities** (sources of funds) and **Assets** (application of funds). The two totals must always agree.



*Schedule III Balance Sheet layout: four heads on the Equity & Liabilities side, two heads on the Assets side; the two totals must agree before the statement is final.*

### 5.1 Master format – Balance Sheet as per Schedule III

Particulars	Note No.	Current Yr	Previous Yr
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against share warrants			
<b>2. Share Application Money pending allotment</b>			
<b>3. Non-Current Liabilities</b>			
(a) Long-term Borrowings			
(b) Deferred Tax Liabilities (net)			
(c) Other Long-term Liabilities			
(d) Long-term Provisions			
<b>4. Current Liabilities</b>			
(a) Short-term Borrowings			
(b) Trade Payables			
(c) Other Current Liabilities			
(d) Short-term Provisions			

<b>TOTAL</b>			
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
(a) Fixed Assets			
(i) Tangible Assets			
(ii) Intangible Assets			
(iii) Capital Work-in-Progress			
(iv) Intangible Assets under Development			
(b) Non-current Investments			
(c) Deferred Tax Assets (net)			
(d) Long-term Loans and Advances			
(e) Other Non-current Assets			
<b>2. Current Assets</b>			
(a) Current Investments			
(b) Inventories			
(c) Trade Receivables			
(d) Cash and Cash Equivalents			
(e) Short-term Loans and Advances			
(f) Other Current Assets			
<b>TOTAL</b>			

## 5.2 Current vs Non-current – the operating-cycle rule

Schedule III defines an item as **current** if any one of the following is satisfied; otherwise it is non-current.

### Definition – Current Asset / Current Liability

An **asset** is current if:

1. It is expected to be realised in the company's normal operating cycle, OR
2. It is held primarily for trading, OR
3. It is expected to be realised within **12 months** after the reporting date, OR
4. It is cash or a cash equivalent not restricted in use.

A **liability** is current if:

1. It is expected to be settled in the normal operating cycle, OR
2. It is held primarily for trading, OR
3. It is due to be settled within **12 months**, OR
4. The company has no unconditional right to defer settlement beyond 12 months.

Operating cycle = time between acquisition of inputs for processing and their realisation in cash. If undetermined, treat as **12 months**.

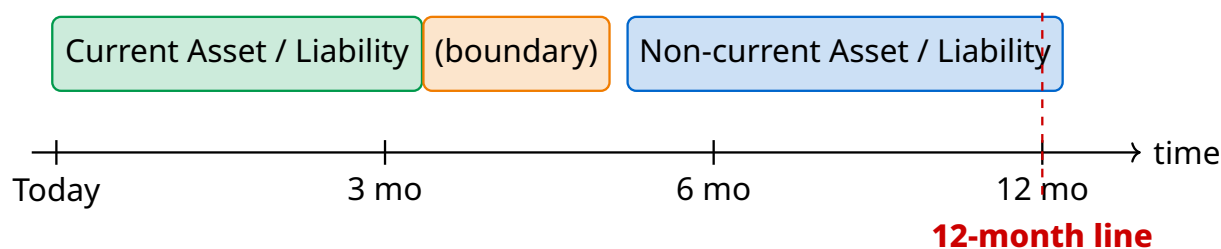


Figure 3: The 12-month line is the default cut-off when operating cycle is not separately determinable.

### Common Mistake

“Bank overdraft” is a **short-term borrowing (Current Liability)**, not part of cash. Many students net it against “Cash and Cash Equivalents” on the asset side. Schedule III requires gross presentation.

## 5.3 Heads on the Equity and Liabilities side – detailed treatment

**(1) Shareholders’ Funds.** The owners’ stake. It splits into:

- **Share Capital** – equity and preference, classified into authorised, issued, subscribed, called-up and paid-up. Notes to accounts must disclose, for each class: opening and closing number of shares; rights, preferences and restrictions; holdings of subsidiary or holding companies; names of shareholders holding more than 5%; and a 5-year reconciliation of bonus, buy-back and shares issued for non-cash consideration.
- **Reserves and Surplus** – *Capital Reserve, Capital Redemption Reserve, Securities Premium, Debenture Redemption Reserve, Revaluation Reserve, Share Options Outstanding A/c, General Reserve, Surplus (i.e. balance of Statement of P&L)*. Negative surplus is shown as a deduction.
- **Money received against share warrants** – amount received against issued warrants that are convertible into equity within a specified period.

**(2) Share Application Money pending allotment.** Application money received *for which shares have not yet been allotted*. If refund is due or the company is required to refund (rules not complied with), it is reclassified as a liability under “Other Current Liabilities”.

**(3) Non-Current Liabilities.** Long-term sources of funds that do not need to be paid within 12 months.

- Long-term Borrowings: debentures, term loans from banks and financial institutions, public deposits, loans from related parties, etc.
- Deferred Tax Liabilities (net): timing differences creating tax payable in the future.
- Other Long-term Liabilities: trade payables outside the operating cycle, deposits from customers, etc.

- Long-term Provisions: provision for employee benefits (gratuity), provision for warranty extending beyond a year.

**(4) Current Liabilities.** Obligations due within 12 months / operating cycle.

- Short-term Borrowings: bank cash credit, overdraft, loans repayable on demand, current maturities of long-term debt.
- Trade Payables: amounts due to suppliers of goods/services (replaces “Sundry Creditors”).
- Other Current Liabilities: current maturities of long-term debt, interest accrued but not due, unpaid dividend, unclaimed matured debentures, statutory dues, etc.
- Short-term Provisions: provision for tax, proposed dividend (if approved before reporting date), provision for employee benefits payable within 12 months.

**Quick Tip**

**Securities Premium** sits under **Reserves and Surplus** – not under *Share Capital*. Likewise, **Calls-in-Advance** is a *Current Liability* (Other Current Liabilities), while **Calls-in-Arrears** is shown as a *deduction from Subscribed and Called-up Capital*.

## 5.4 Heads on the Assets side – detailed treatment

**(1) Non-Current Assets.**

- **Fixed Assets:** *tangible* (land, building, plant, machinery, furniture, vehicles, office equipment), *intangible* (goodwill, brands, patents, copyrights, computer software, mastheads, mining rights), *capital work-in-progress*, *intangible assets under development*.
- Non-current Investments: long-term equity, debentures, mutual funds.
- Deferred Tax Assets (net): future tax savings.
- Long-term Loans and Advances: capital advances, security deposits, loans to related parties.
- Other Non-current Assets: long-term trade receivables, others.

**(2) Current Assets.**

- Current Investments: investments expected to be realised within 12 months.
- Inventories: raw materials, WIP, finished goods, stock-in-trade, stores and spares, loose tools.
- Trade Receivables: outstanding for  $\leq 6$  months and  $> 6$  months disclosed separately; secured / unsecured / doubtful split; provision for doubtful debts shown as a deduction.
- Cash and Cash Equivalents: cash in hand, balances with banks (current and deposits maturing  $\leq 3$  months), cheques and drafts in hand, earmarked balances.

- Short-term Loans and Advances: prepaid expenses, advance tax, advances to suppliers.
- Other Current Assets: accrued interest, unbilled revenue, etc.

### Memory Aid

“**SS-NC**” for the order of Equity & Liabilities: **S**hareholders’ funds → **S**hare application money → **N**on-current liabilities → **C**urrent liabilities. The asset side mirrors it bottom-up: Non-current first, then Current.

## 5.5 Comparative table – old vs Schedule III terminology

Old (Schedule VI / Trader’s Book)	Schedule III (Companies Act, 2013)
Sundry Debtors	Trade Receivables
Sundry Creditors	Trade Payables
Loans & Advances (asset side, mixed)	Split: Long-term Loans & Advances / Short-term
Investments (single head)	Split: Non-current Investments / Current Investments
Miscellaneous Expenditure (asset side)	Not allowed; preliminary exp etc. written off against Securities Premium / Surplus
Profit & Loss A/c (Dr. balance on asset side)	Shown as negative figure under Reserves and Surplus
“Horizontal” or “T” format permitted	Only <b>vertical</b> format permitted
Stock	Inventories
Cash and Bank balances	Cash and Cash Equivalents

## 6 Worked Example – Balance Sheet Preparation

**Illustration (based on NCERT Q3, Numerical):** From the following information, prepare the Balance Sheet of Gitanjali Ltd. as per Schedule III:

Item	Rs.	Item	Rs.
Equity Share Capital	20,00,000	Inventories	14,00,000
Preference Share Capital	12,00,000	Plant & Machinery	10,00,000
Debenture Redemption Reserve	6,00,000	Land & Building	20,00,000
Public Deposits (long-term)	12,00,000	Current Investments	8,00,000
Outstanding Expenses	3,00,000	Cash Equivalents	10,00,000
Proposed Dividend	5,00,000	Short-term loan from holding co.	4,00,000

### Solution – Balance Sheet of Gitanjali Ltd. as at 31st March, 20XX

Particulars	Note No.	Rs.
<b>I. EQUITY AND LIABILITIES</b>		
1. Shareholders' Funds		
(a) Share Capital (Eq. 20,00,000 + Pref. 12,00,000)	1	32,00,000
(b) Reserves and Surplus (DRR)	2	6,00,000
3. Non-Current Liabilities		
(a) Long-term Borrowings (Public Deposits)	3	12,00,000
4. Current Liabilities		
(a) Short-term Borrowings (loan from holding co.)	4	4,00,000
(c) Other Current Liabilities (Outstanding Expenses)		3,00,000
(d) Short-term Provisions (Proposed Dividend)	5	5,00,000
<b>TOTAL</b>		<b>62,00,000</b>
<b>II. ASSETS</b>		
1. Non-Current Assets		
(a) Fixed Assets - Tangible (Plant + Land&Building)	6	30,00,000
2. Current Assets		
(a) Current Investments		8,00,000
(b) Inventories		14,00,000
(d) Cash and Cash Equivalents		10,00,000
<b>TOTAL</b>		<b>62,00,000</b>

**Quick Tip**

**Proposed Dividend** is treated as a *Short-term Provision* under Schedule III (NCERT 2024-26 syllabus follows this treatment for board exams). Under Ind AS, it would be disclosed only in notes until declared – but **follow the NCERT treatment in board exams.**

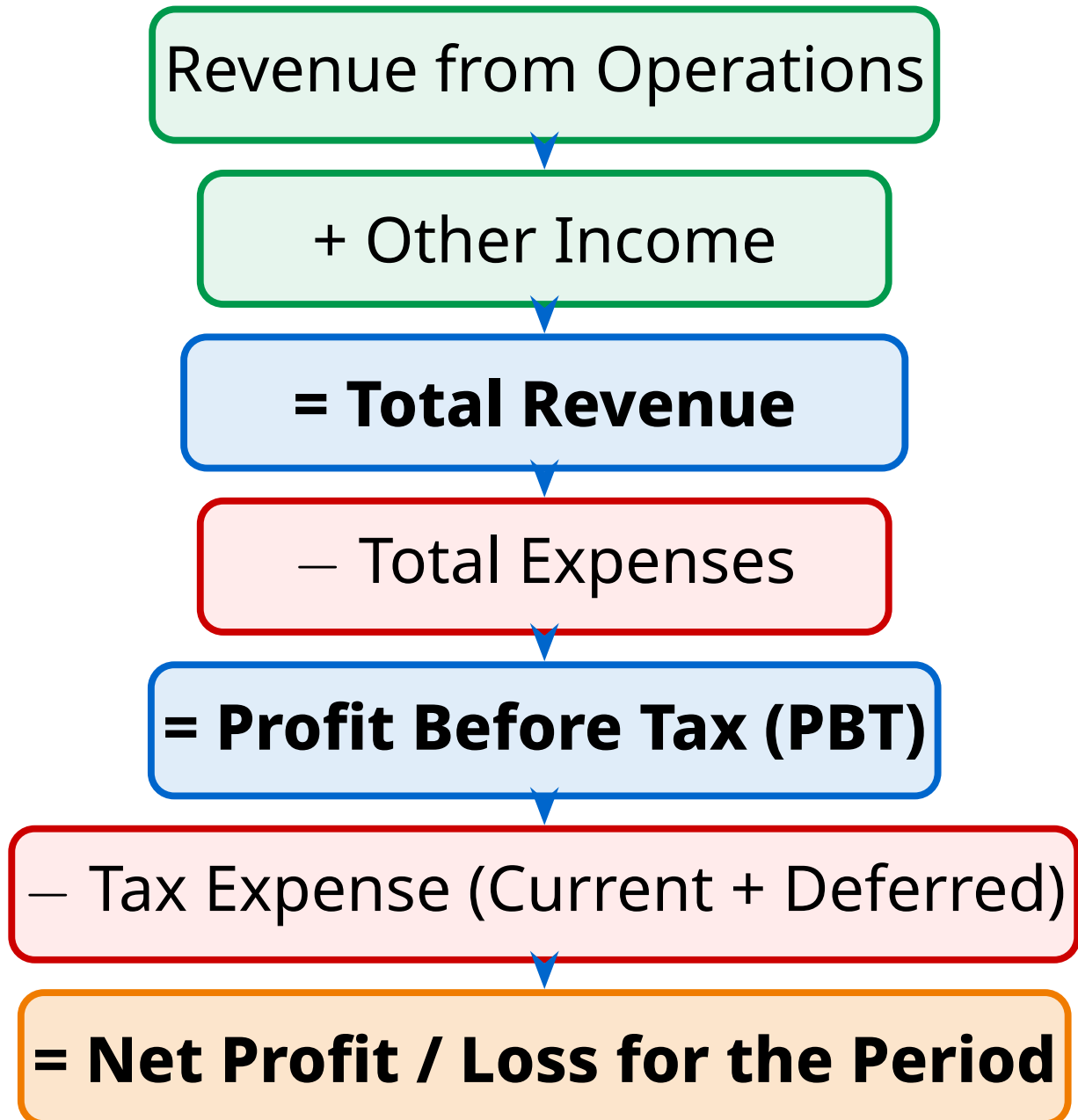
**Solve the NCERT Exercises with Step-by-Step Solutions** □

## 7 Form and Content of Statement of Profit and Loss (Schedule III, Part II)

The Statement of Profit and Loss (the new name for the company's "Income Statement") reports the financial *performance* for the year. Schedule III prescribes a single vertical format with five income-and-expense bands.

## 7.1 Master format – Statement of P&L

Particulars	Note	Current Yr	Previous Yr
I. Revenue from Operations			
II. Other Income			
<b>III. Total Revenue (I + II)</b>			
IV. Expenses: Cost of Materials Consumed Purchases of Stock-in-Trade Changes in Inventories of FG, WIP and S-i-T Employee Benefits Expense Finance Costs Depreciation and Amortisation Expense Other Expenses <b>Total Expenses</b>			
V. Profit before exceptional, extraordinary items and tax (III – IV)			
VI. Exceptional Items			
VII. Profit before extraordinary items and tax (V – VI)			
VIII. Extraordinary Items			
<b>IX. Profit before Tax (VII – VIII)</b>			
X. Tax Expense: (1) Current tax (2) Deferred tax			
XI. Profit/(Loss) from Continuing Operations (IX – X)			
XII. Profit/(Loss) from Discontinuing Operations			
XIII. Tax expense of Discontinuing Operations			
XIV. Profit/(Loss) from Discontinuing Operations (after tax) (XII – XIII)			
<b>XV. Profit/(Loss) for the Period (XI + XIV)</b>			
XVI. Earnings per Equity Share: (1) Basic (2) Diluted			



*Schedule III Statement of P&L: revenue minus expenses gives PBT; deduct tax to land on net profit. Discontinuing-operations and EPS disclosures (lines XII-XVI) sit below this core stack.*

## 7.2 Heads explained – what goes under each line

**I. Revenue from Operations.** The income that arises from the *principal* business activity. For a manufacturing or trading company:

- Sale of products
- Sale of services
- Other operating revenues (scrap sale, freight charged, recoveries directly linked to the operating activity)

For a finance company, revenue from operations includes interest income, dividend income and revenue from other financial services. *Excise duty / GST collected on behalf of the government is excluded.*

**II. Other Income.** Income unrelated to operations:

- Interest income (for a non-finance company)
- Dividend income
- Net gain / loss on sale of investments
- Other non-operating income net of directly attributable expenses

**IV. Expenses.** Seven sub-heads, each disclosed on the face of the statement.

Expense Head	What it includes
Cost of Materials Consumed	Opening RM + Purchases of RM – Closing RM (manufacturing companies only)
Purchases of Stock-in-Trade	Goods purchased for resale (trading companies)
Changes in Inventories of FG, WIP, S-i-T	Opening – Closing of finished goods, WIP, stock-in-trade
Employee Benefits Expense	Wages, salaries, bonus, gratuity, leave encashment, staff welfare, ESI, PF
Finance Costs	Interest on borrowings (only the interest part); other charges like bank fees go under "Other Expenses"
Depreciation & Amortisation	Depreciation on tangible assets + amortisation on intangibles
Other Expenses	Power and fuel, rent, rates and taxes, insurance, repairs, travel, audit fees, etc.

### Common Mistake

**Finance Costs** include *only the interest portion* on borrowings. Bank commission, processing charges and forex differences go to "Other Expenses" – not to Finance Costs. Misclassification will skew the **interest coverage ratio** students compute later in Part 2 Part 2 Chapter 1.

## 7.3 Worked example – NCERT Illustration 8

**Question:** From the following particulars, prepare the Statement of Profit and Loss for the year ending 31st March, 2017, showing profit before tax as per Schedule III of the Companies Act 2013.

Balances	Dr. (Rs.)	Cr. (Rs.)
Plant and Machinery	1,60,000	
Land	6,74,000	
Depreciation on Plant and Machinery	16,000	
Purchases (Adjusted)	4,00,000	
Closing Stock	1,50,000	
Wages	1,20,000	
Sales (Net)		10,00,000
Salaries	80,000	
Bank Overdraft		2,00,000
10% Debentures (issued 1 April 2016)		1,00,000
Equity Share Capital (Rs. 100 each, fully paid)		2,00,000
6% Preference Share Capital (Rs. 100 each, fully paid)		1,00,000
<b>Total</b>	<b>16,00,000</b>	<b>16,00,000</b>

### Solution – Statement of Profit and Loss for the year ending 31 March 2017:

Particulars	Note	Rs.
I. Revenue from Operations (Sales)		10,00,000
<b>Total Revenue</b>		<b>10,00,000</b>
II. Expenses:		
Cost of Materials Consumed (Adjusted Purchases)		4,00,000
Employee Benefits Expense (Wages 1,20,000 + Salary 80,000)	1	2,00,000
Finance Cost (10% on Rs. 1,00,000 debentures)		10,000
Depreciation and Amortisation		16,000
<b>Total Expenses</b>		<b>6,26,000</b>
<b>Profit before Tax (I – II)</b>		<b>3,74,000</b>

**Note 1 – Employee Benefits Expense:** Wages Rs. 1,20,000 plus Salaries Rs. 80,000 equals Rs. 2,00,000.

#### Quick Tip

**Adjusted Purchases** = Opening Stock + Purchases – Closing Stock. When the question gives “Purchases (Adjusted)”, closing stock has already been adjusted – do **not** treat closing stock separately under “Changes in inventories”.

## 7.4 Income vs Expense – direction-of-flow visual

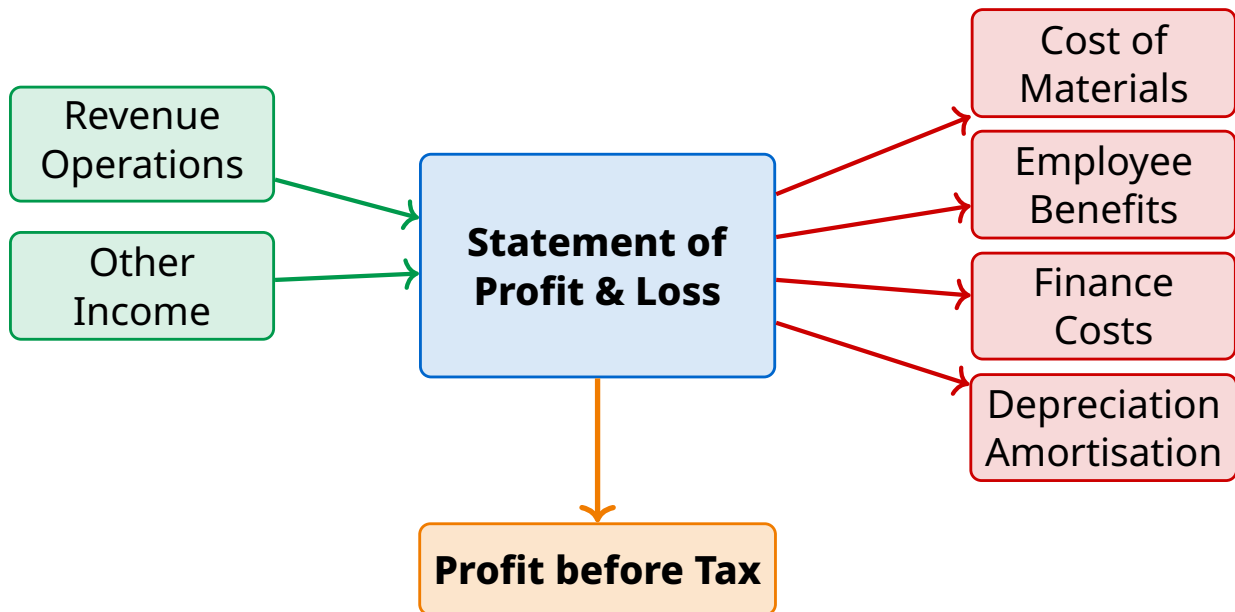


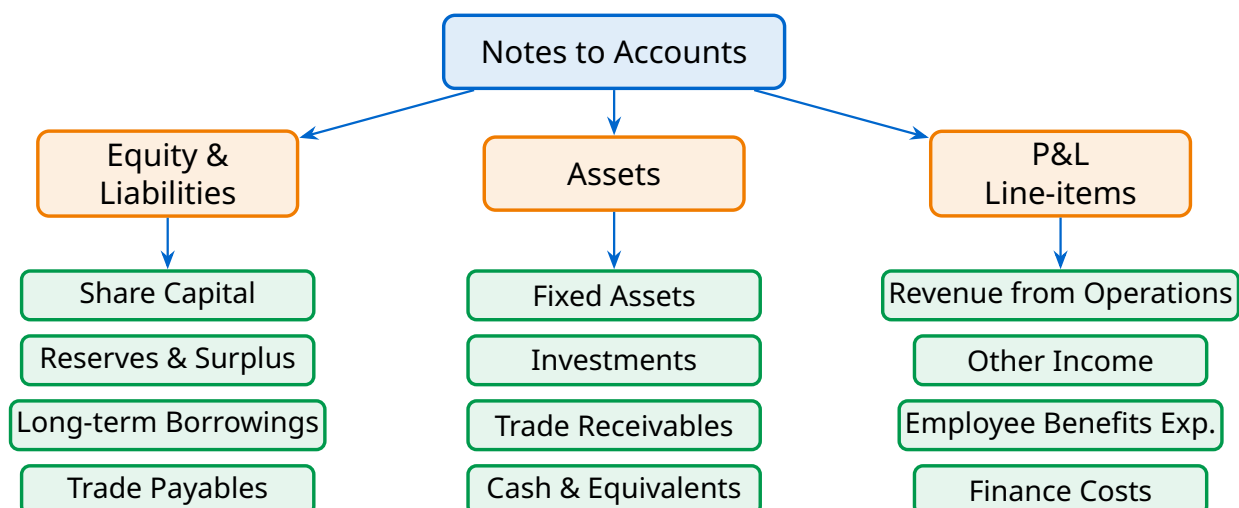
Figure 4: Green arrows are revenue inflows; red arrows are expense outflows; the orange arrow shows the net profit derivation.

## 8 Notes to Accounts – The Real Backbone

Notes to accounts are the second half of the financial statements. Items on the face of the Balance Sheet or P&L are usually *single-line totals*; the breakup, method and disclosures all sit in notes.

### Why Notes Matter for Exam Marking

Board examiners award **separate marks** for “proper notes to accounts”. A correct total on the face of the Balance Sheet with missing or wrong notes typically loses 1–2 marks even when the arithmetic is right. Always prepare at least the major sub-head notes – Share Capital, Reserves & Surplus, Long-term Borrowings, Trade Payables, Fixed Assets, Trade Receivables.



*Notes to Accounts schema: each face-of-statement line that totals a sub-group has a matching note that breaks down the figure. Three groups (Equity & Liabilities, Assets, P&L line-items) cover every disclosure.*

## 8.1 Sample Note format – Share Capital

### Note: Share Capital

Particulars	Rs.
<b>Authorised:</b> X equity shares of Rs. Y each	XX
<b>Issued:</b> P equity shares of Rs. Y each	PP
<b>Subscribed and Fully Paid-up:</b> Q equity shares of Rs. Y each	QQ
<b>Subscribed but not Fully Paid-up:</b> R equity shares of Rs. Y each, Rs. Z called up Less: Calls in Arrears	RR (CC)
<b>Add:</b> Forfeited Shares Account	FF
<b>Total</b>	TT

## 8.2 Sample Note format – Reserves and Surplus

### Note: Reserves and Surplus

Particulars	Rs.
Capital Reserve	XX
Capital Redemption Reserve	XX
Securities Premium	XX
Debenture Redemption Reserve	XX
Revaluation Reserve	XX
Share Options Outstanding A/c	XX
General Reserve	XX
Surplus (Statement of Profit and Loss balance)	XX
<b>Total</b>	TT

### 8.3 Which side, which note – quick disposal table for board-exam classification

Item	Major Head	Sub-head / Note
Equity Share Capital	Shareholders' Funds	Share Capital
Securities Premium	Shareholders' Funds	Reserves and Surplus
Capital Redemption Reserve	Shareholders' Funds	Reserves and Surplus
Debenture Redemption Reserve	Shareholders' Funds	Reserves and Surplus
Calls-in-Arrears	Shareholders' Funds	Deduct from Subscribed Capital
Forfeited Shares A/c	Shareholders' Funds	Add to Subscribed Capital
Calls-in-Advance	Current Liabilities	Other Current Liabilities
10% Debentures (long-term)	Non-current Liabilities	Long-term Borrowings
Bank Loan repayable in 4 years	Non-current Liabilities	Long-term Borrowings
Public Deposits (3 yrs)	Non-current Liabilities	Long-term Borrowings
Provision for Gratuity	Non-current Liabilities	Long-term Provisions
Bank Overdraft / Cash Credit	Current Liabilities	Short-term Borrowings
Trade Creditors / Bills Payable	Current Liabilities	Trade Payables
Outstanding Expenses	Current Liabilities	Other Current Liabilities
Unclaimed Dividend	Current Liabilities	Other Current Liabilities
Provision for Tax (current year)	Current Liabilities	Short-term Provisions
Proposed Dividend	Current Liabilities	Short-term Provisions
Land & Building	Non-current Assets	Fixed Assets – Tangible
Plant & Machinery, Furniture	Non-current Assets	Fixed Assets – Tangible
Goodwill, Patents, Brands	Non-current Assets	Fixed Assets – Intangible
Computer Software	Non-current Assets	Fixed Assets – Intangible
Capital Work-in-Progress	Non-current Assets	Fixed Assets
Investment in subsidiary (long-term)	Non-current Assets	Non-current Investments
Security Deposits paid	Non-current Assets	Long-term Loans & Advances
Marketable Securities (held < 12m)	Current Assets	Current Investments
Inventory of FG, WIP, RM, Loose Tools	Current Assets	Inventories
Trade Debtors / Bills Receivable	Current Assets	Trade Receivables
Cash, Bank, Cheques in hand	Current Assets	Cash and Cash Equivalents
Prepaid Expenses, Advance Tax	Current Assets	Short-term Loans & Advances
Accrued Income	Current Assets	Other Current Assets

#### Memory Aid

**“Where does it sit?”** If you forget any classification in the exam, ask three questions in order: **(1) Who owes / owns?** (Shareholders / Outsiders / Self), **(2) Within 12 months?** (Yes → Current, No → Non-current), **(3) Trade or Other?** (Operating cycle = Trade, else Other). These three filters classify any item.

## 9 Uses and Importance of Financial Statements

NCERT lists seven uses. Each connects to a specific user-group from Section 3.

### Seven Uses of Financial Statements

1. **Report on stewardship function** – communicates management’s performance to the shareholders who entrusted them with capital.
2. **Basis for fiscal policies** – corporate financial performance is an input to the Government’s taxation, industrial and economic policies.
3. **Basis for granting credit** – banks and financial institutions assess loan-worthiness from the statements.
4. **Basis for prospective investors** – both short-term and long-term investors evaluate solvency, liquidity and profitability.
5. **Guide to value of existing investment** – shareholders decide to hold, add or exit.
6. **Aid to trade associations** – helps members design uniform accounts and benchmark ratios.
7. **Aid to stock exchanges** – enables transparent pricing and protection of investor interest.

### Real-World Application

When SEBI investigates a corporate fraud (Satyam 2009, IL&FS 2018, Yes Bank 2020), the first document forensic auditors pull is the company’s audited financial statements. The story of what went wrong is always hidden in a corner of the Balance Sheet – a related-party loan misclassified, a contingent liability not disclosed, a one-time gain inflating revenue.

### Real-World Application

Every listed company in India files quarterly results in this same Schedule III template within 45 days of quarter-end (regulation 33, SEBI LODR). When CNBC or Moneycontrol headlines “TCS posts Rs. 12,000 crore net profit”, the underlying number comes from line XV (“Profit/(Loss) for the Period”) of the Schedule III Statement of P&L you are studying. The exam template is the live business document.

## 10 Limitations of Financial Statements

Even properly prepared financial statements have inherent limitations. Understanding them is examined often and is also the foundation for “Analysis of Financial Statements” in the next chapter.

### Seven Limitations

1. **Do not reflect current situation** – historical-cost basis ignores changing purchasing power and market values.
2. **Assets may not realise** – liquidation values can be far below book values.
3. **Bias** – personal judgements (depreciation life, provision rates) inject subjectivity.
4. **Aggregate information** – single line “Trade Receivables” hides customer-wise risk.
5. **Vital information missing** – loss of markets, expiry of patents, departure of key staff are not captured.
6. **No qualitative information** – workforce morale, R&D quality, brand strength are not in the numbers.
7. **Interim in nature** – a one-period snapshot cannot show earning capacity over time.

### Common Mistake

A common 1-mark CBSE *distractor*: “Financial statements give true and fair view” is **partially true** – they give a true and fair view of the *recorded* financial facts, **not** of the current economic value. The statement is true only when qualified.

## 11 JEE-not-applicable but Competitive: CUET-relevant Extensions

Class 12 Accountancy is widely tested in **CUET, B.Com entrance tests, CMA / CS Foundation**, and increasingly in entry-level commerce internships. The following are common “beyond NCERT” items worth knowing.

## 11.1 Difference: Financial Statements under Schedule III vs Ind AS

Aspect	Schedule III Division I (Indian GAAP)	Schedule III Division II (Ind AS)
Balance Sheet	2 broad heads (E&L, Assets)	Statement of Financial Position; same heads with finer disclosures
P&L statement	Statement of Profit and Loss	Statement of Profit and Loss + Other Comprehensive Income (OCI)
Proposed Dividend	Short-term Provision (when proposed)	Disclosed in notes; recognised only when declared by shareholders
Revaluation of Fixed Assets	Optional (cost model is default)	Allowed under Ind AS 16 with detailed disclosures
Order of items on B/S	Liquidity-based	Liquidity-based, but additional bifurcations under each head

## 11.2 Earnings Per Share – the disclosure “XVI” line

Schedule III mandates EPS disclosure (basic and diluted) at the bottom of the Statement of P&L.

### Earnings Per Share

**Basic EPS** =  $\frac{\text{Profit after Tax} - \text{Preference Dividend (if any)}}{\text{Weighted Avg. number of equity shares outstanding}}$

**Diluted EPS** adjusts the numerator and denominator for potential dilutive securities – convertible debentures, employee stock options, warrants.

*Unit:* Rupees per share (carried to two decimals).

**Example.** A company has PAT Rs. 9,00,000, pays preference dividend Rs. 1,00,000, and has 4,00,000 equity shares outstanding throughout the year.

$$\text{Basic EPS} = \frac{9,00,000 - 1,00,000}{4,00,000} = \frac{8,00,000}{4,00,000} = \text{Rs. 2.00}$$

### 11.3 Operating cycle - visual

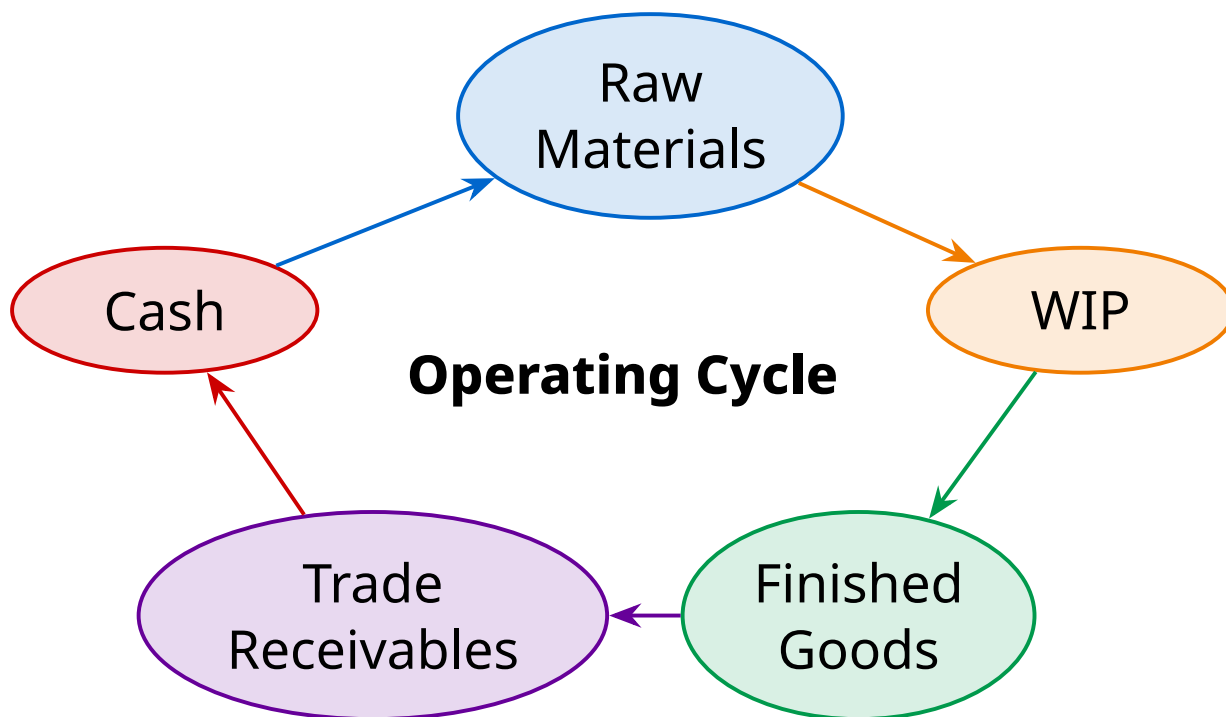


Figure 5: The operating cycle drives the current vs non-current classification under Schedule III. Cash → RM → WIP → FG → Trade Receivables → Cash.

## 12 Important Differences – Comparison Pack

### 12.1 Balance Sheet vs Statement of P&L

Basis	Balance Sheet	Statement of P&L
Nature	Position statement	Performance statement
Time frame	As at a date	For a period (usually year)
Items	Assets, Liabilities, Equity	Income, Expenses, Profit
Equation	Assets = Liab + Equity	Income – Expense = Profit
Carry-forward	Closing balances → next year opening	Closed every year to “Surplus”
Real vs Nominal	Real and Personal accounts	Nominal accounts

## 12.2 Provision vs Reserve

Basis	Provision	Reserve
Purpose	Specific known liability or estimated loss	Strengthening financial position
Charge / Appropriation	Charge against profit	Appropriation of profit
Created when	Even in loss year	Only out of profits
Dividend distributable	No	Yes (mostly)
B/S disclosure	As current or long-term provision / deduction from asset	Reserves and Surplus
Example	Provision for Doubtful Debts, Tax	General Reserve, Securities Premium

## 12.3 Capital Reserve vs Revenue Reserve

Basis	Capital Reserve	Revenue Reserve
Source	Capital profits (premium on shares, profit on sale of fixed assets)	Trading / operating profits
Use for dividend	Not generally distributable	Distributable as dividend
Examples	Securities Premium, Capital Redemption Reserve	General Reserve, Dividend Equalisation Reserve

## 13 High-Yield Exam Questions

The following question patterns recur across CBSE board papers and CUET in the Financial Statements area.

- Classification under Schedule III (1, 3, 4 marks).** List of 5–10 items, classify under correct Major Head and Sub-head. *Almost guaranteed in every board paper.*
- Prepare Balance Sheet from given balances (6 marks).** 12–15 items mixed; full vertical Schedule III format expected with at least 2 notes.
- Prepare Statement of P&L (4 or 6 marks).** Often combined with interest on debentures, depreciation on a fixed asset, tax provision.
- Theory of nature / objectives / limitations (3 or 4 marks).** Pure NCERT bullet recall; six or seven points expected.
- Distinguish-between table (3 or 4 marks).** Provision vs Reserve, Capital vs Revenue Reserve, Balance Sheet vs P&L are favourites.
- Single-item disclosure with full notes (3 marks).** “Show Share Capital in the Balance Sheet from following data including notes.”

### Quick Tip

**Examiner pattern observed across CBSE 2018–2024:** the Q3 / Q4 6-mark

question in the Financial Statements section gives you 10–15 items but only *some* contain a hidden “catch” (Securities Premium, Calls-in-Advance, Loose Tools, Unpaid Dividend). **Underline each tricky item** on the question paper before drafting the Balance Sheet – saves 4–5 marks.

## 14 Additional Worked Example – Multi-Item Classification

**Question:** Show how the following items will appear in the Balance Sheet of Black Swan Ltd. as at 31 March 2017, as per Schedule III.

Item	Rs.	Item	Rs.
General Reserve	3,000	6% Preference Share Capital	5,000
10% Debentures	3,000	Cash and Cash Equivalents	6,100
Surplus in Statement of P&L	1,200	Gross Block of Fixed Assets	9,000
Depreciation on Fixed Assets	700	Preliminary Expenses	300
Current Liabilities	2,500		

### Solution – Balance Sheet of Black Swan Ltd. as at 31 March 2017

Particulars	Note	Rs.
<b>I. EQUITY AND LIABILITIES</b>		
1. Shareholders' Funds		
(a) Share Capital – Preference	1	5,000
(b) Reserves and Surplus	2	3,900
3. Non-current Liabilities		
(a) Long-term Borrowings – 10% Debentures	3	3,000
4. Current Liabilities		2,500
<b>TOTAL</b>		<b>14,400</b>
<b>II. ASSETS</b>		
1. Non-current Assets		
(a) Fixed Assets – Tangible (9,000 – 700)	4	8,300
2. Current Assets		
(d) Cash and Cash Equivalents		6,100
<b>TOTAL</b>		<b>14,400</b>

### Notes to Accounts:

- Share Capital: 6% Preference Share Capital Rs. 5,000.
- Reserves and Surplus: General Reserve 3,000 + Surplus 1,200 – *Preliminary Expenses written off* 300 = Rs. 3,900.
- Long-term Borrowings: 10% Debentures Rs. 3,000.
- Fixed Assets: Gross Block 9,000 less Accumulated Depreciation 700 = Rs. 8,300.

**Watch out:** under Schedule III, **Preliminary Expenses** cannot appear on the asset side. They must be *written off*, usually against Securities Premium first; if unavailable, then against Surplus. In the question above, since there is no Securities Premium, the entire Rs. 300 is netted against Reserves and Surplus.

## 15 Past Paper Trends – CBSE 2018 to 2024

Year	Marks	Question Type
2018	1 + 3	Classification (1m) + Prepare Note on Reserves & Surplus (3m)
2019	4	Balance Sheet preparation from 10 items
2020	1 + 4	Classification + Statement of P&L preparation
2021 (Term-1 MCQ)	6 × 1	Six classification MCQs spread across the paper
2022 (Term-2)	6	Full Balance Sheet with two notes
2023	3 + 6	Distinguish (Reserve vs Provision) + Balance Sheet
2024	1 + 6	Single-item classification + Schedule III preparation

**Pattern takeaways:** A 1-mark classification appears *every* year. A 4- or 6-mark preparation question appears in most years. The theory portion (nature, objectives, limitations) appears once every 2–3 years as a 3- or 4-marker.

## 16 Quick Reference Summary

### 16.1 One-line definitions

- **Financial Statements:** Formal annual reports communicating the financial position and performance of a company to its stakeholders.
- **Balance Sheet:** Statement showing assets, liabilities and equity as at a specified date.
- **Statement of P&L:** Statement showing revenue, expenses and profit/loss for a specified period.
- **Schedule III:** The format prescribed under the Companies Act, 2013 for preparing the Balance Sheet and Statement of P&L.
- **Operating Cycle:** Period between acquisition of inputs and realisation in cash from sale of output; default 12 months.
- **Trade Receivable:** Amount owed by customers for goods/services in the ordinary course of business.
- **Trade Payable:** Amount owed to suppliers for goods/services in the ordinary course of business.
- **EPS:** Profit attributable to equity shareholders divided by weighted average num-

ber of equity shares.

## 16.2 Order of items on the Balance Sheet (memorise)

The order is fixed by Schedule III, Part I; do not rearrange. Examiners deduct presentation marks if Reserves & Surplus is written before Share Capital, or Current Assets before Non-current Assets.

### Fixed order on each side

#### Equity & Liabilities side (top to bottom):

1. Shareholders' Funds (Share Capital, Reserves & Surplus, Money on share warrants)
2. Share Application Money pending allotment
3. Non-current Liabilities (Long-term Borrowings, Deferred Tax Liabilities, Other Long-term Liabilities, Long-term Provisions)
4. Current Liabilities (Short-term Borrowings, Trade Payables, Other Current Liabilities, Short-term Provisions)

#### Assets side (top to bottom):

1. Non-current Assets (Fixed Assets, Non-current Investments, Deferred Tax Assets, Long-term Loans & Advances, Other Non-current Assets)
2. Current Assets (Current Investments, Inventories, Trade Receivables, Cash & Cash Equivalents, Short-term Loans & Advances, Other Current Assets)

### Quick Tip

Memory cue: each side moves from **longest-life** items at the top to **shortest-life** items at the bottom. On the Equity & Liabilities side, owner capital lives longest, current liabilities shortest; on the Assets side, land and buildings live longest, cash already *is* liquid. The Schedule III order tracks this maturity gradient.

## 16.3 Key Schedule III facts – bullet recap

- Format is **vertical only**.
- **Bifurcate** every asset and liability as current / non-current.
- “Sundry Debtors / Creditors” renamed **Trade Receivables / Trade Payables**.
- Debit balance of P&L = negative figure under *Reserves and Surplus*.
- **Preliminary Expenses** not allowed on asset side.
- Accounting Standards override Schedule III in conflict.
- Rounding-off mandatory and consistent.

## 16.4 Recap of seven NCERT objectives, seven uses, seven limitations

Six Objectives	Seven Uses	Seven Limitations
1. Economic resources & obligations	1. Stewardship reporting	1. No current value
2. Earning capacity	2. Fiscal policy basis	2. Assets may not realise
3. Cash flows	3. Granting of credit	3. Bias
4. Effectiveness of management	4. Prospective investors	4. Aggregate, not detailed
5. Social impact information	5. Value of existing investment	5. Vital qualitative info missing
6. Disclosing accounting policies	6. Aid to trade associations	6. No qualitative information
	7. Aid to stock exchanges	7. Interim in nature

## 16.5 Exam-day mental check

1. Read the chapter heading on the Balance Sheet / P&L: “as at” for B/S, “for the year ending” for P&L.
2. Check that every item has a **Note No. column** – mark even “–” if no note.
3. Both totals on the Balance Sheet must agree before you write the answer down.
4. For each long-term item, ask: “does any portion mature within 12 months?” – that portion is *current maturity*.
5. Preliminary expenses, discount on issue, underwriting commission → write off; never put on the asset side.

## 17 Connection with the Wider Syllabus

This chapter is a **prerequisite for the remaining three chapters** of Class 12 Accountancy Part II:

- **Part 2 Chapter 4 – Analysis of Financial Statements:** comparative and common-size statements derive directly from the Balance Sheet and Statement of P&L learnt here.
- **Part 2 Part 2 Chapter 1 – Accounting Ratios:** every ratio (current, quick, debt-equity, interest coverage, gross profit, etc.) plucks numerators and denominators from the heads classified in this chapter.
- **Part 2 Part 2 Chapter 2 – Cash Flow Statement:** the operating, investing and financing classifications hinge on the current vs non-current bifurcation introduced here.

A solid grip on Schedule III classification thus pays dividends through the rest of the Part II syllabus and well into the first year of B.Com / BBA programmes that build on Companies Act reporting.

**Related Collegedunia Resources****Same chapter — other resources:**

- [NCERT Solutions](#)
- [Formula Sheet](#)
- [NCERT Book PDF](#)
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- [Ch 10: Cash Flow Statement](#)
- [Class 12 Accountancy — All Chapters](#)