

Chapters10

Tools for financial statement analysis

The various tools used for analysis of financial statements are :

Comparative Statement: Financial Statements of two years are compared and changes in absolute terms and in percentage terms are calculated. It is a form of Horizontal Analysis.

Common Size statement: Figures of Financial statements are converted it to percentage with respect to some common base.

In Common size Income Statement **Sales/Revenue from Operations** is taken is common base where as in Common size Balance Sheet Total assets or **Total Equity and Liabilities** are taken as common base.

Ratio Analysis: It is a technique of Study of relationship between various items in the Financial Statements. There are mainly four types of ratios-

- 1) liquidity ratio
- 2) solvency ratio
- 3) activity ratio
- 4) profitability ratio

Cash Flow Statement : It is a statement that shows the inflow and outflow of cash and cash equivalents during a particular period which helps in finding out the causes of changes in cash position between the two balance sheet dates. It is prepared under accounting standard 3

Comparative Statements

It is a statement that shows changes in each item of the financial statement in absolute amount and in percentage, taking the amounts of the preceding as counting period as the base.

Types of Comparative Statements :

1. Comparative Balance Sheet; and
2. Comparative Statement of Profit and Loss.

Comparative Balance Sheet : It shows the increases and decreases in various items of assets, equity and liabilities in absolute term and in percentage term by taking the corresponding figures in the previous year's balance sheet as a base.

Format for a Comparative Balance Sheet
Comparative Balance Sheet of Ltd.
As at 31st March 2014 and 2015

Particulars	2014 Rs. (previous year)	2015 Rs (current year).	Absolute Change Rs.(current year- previous year)	Percentage Change %
1. EQUITY AND LIABILITIES				
(1) Shareholders' funds				
(a) Share capital				
(b) Reserves and surplus				
(2) Non-current Liabilities				
(a) Long-term borrowings				
(b) Other Long term liabilities				
(c) Long-term provisions				
(3) Current liabilities				
(a) Short-term borrowings				
(b) Trade payables				
(c) Other Current liabilities				
(d) Short-term provisions				
Total				
II. ASSETS				

(1) Non-current assets				
(a) Fixed assets				
(b) Non-current investments				
(c) Long-term loans and advances				
(2) Current Assets				
(a) Current investments				
(b) Inventories				
(c) Trade receivables				
(d) Cash and cash equivalents				
(e) Short term loans and advances				
(f) Other current assets				
Total				

*Percentage change = absolute change/ previous year *100
for example –

particulars	note no	2016 (A)	2017 (B)	absolute change C= B-A	percentage C/A*100
share holder fund		500000	300000	200000	40
current liabilities		30000	20000	10000	50
total liabilities		530000	320000	210000	40.38
assets					

fixed assets		220000	200000	20000	9.09
current assets		310000	120000	190000	61.29
total assets		530000	320000	210000	40.38

COMPARATIVE STATEMENT OF PROFIT AND LOSS/COMPARATIVE INCOME STATEMENT

Comparative Income Statement: It shows the increases and decreases in various items of income Statement in absolute amount and in percentage amount by taking the corresponding figures in the previous year's Income Statement as a base.

Format for a Comparative Statement of Profit and Loss

Comparative Statement of Profit and Loss

For the years ended on 31st March, 2014 and 2015

Particulars	2014 Rs. (previous year)	2015 Rs. (current year)	Absolute Change Rs.(current year- previous year)	Percentage Change %
I. Revenue form operations				
II. Other Income				
III. Total Revenue (I+II)				
IV. Expenses :				
a. Cost of Material consumed				
b. Purchases of Stock-in-Trade				
c. Changes in Inventories of Finished Goods, Work-in-progress and Stock-in-trade				
d. Employees Benefit Expenses				
e. Finance Cost				
f. Depreciation & Amortisation				

Expenses				
g.Other Expenses				
Total Expenses				
V. Profit before Tax (III-IV)				
Less : Income Tax				
VII. Profit after Tax				

percentage = absolute change/ previous year*100

Importance of Comparative Statement

To make the data simple and more understandable.

To indicate the trend with respect to the previous year.

To compare the firm performance with the performance of other firm in the same business.

PARTICULARS	2016 (A)	2017 (B)	ABSOLUTE CHANGE (B-A)	PERCENTAGE C/A*100
revenue from operation	10,00,000	30,00,000	20,00,000	200
total income (A)	10,00,000	30,00,000	20,00,000	200
cost of production	2,00,000	3,00,000	1,00,000	50
other expenses	1,00,000	2,00,000	1,00,000	100
total expenses(B)	3,00,000	5,00,000	2,00,000	66.7
profit (A-B)	7,00,000	25,00,000	18,00,000	257.14
-TAX	(1,00,000)	(5,00,000)	4,00,000	400
PROFIT AFTER TAX	6,00,000	20,00,000	14,00,000	233.3

Common Size Statement

Common Size Financial Statements are the statements in which amounts of the various items of financial statements are converted into percentages to a common base.

Types of Common Size statements :

1. Common Size Balance sheet; and
2. Common Size Statement of Profit and Loss.

Common Size Balance sheet : It is a statement in which every item of assets, equity and liabilities is expressed as a percentage to the total of all assets or to the total of Equity and Liabilities.

Format for a Common Size Balance Sheet :

Common Size Balance Sheet of.....Ltd.

As at 31st March, 2014 and 2015

note – all the items are divided by the total of balance sheet to calculate the percentage.

particulars	note no	2016 (A)	2017 (B)	PERCENTAGE 2016 (divide by total 530000)	percentage 2017 (divide by total 320000)
share holder fund		500000	300000	94.3	93.75
current liabilities		30000	20000	5.7	6.25
total liabilities		530000	320000	100	100
assets					
fixed assets		220000	200000	41.50	62.5
current assets		310000	120000	58.49	37.5

total assets		530000	320000	100	100
--------------	--	--------	--------	-----	-----

Common Size Income Statement or Statement of Profit and Loss: It is a statement in which every item of Statement of Profit and Loss is expressed as a percentage to the amount of Revenue from Operations.

Format for a Common Size Statement of Profit and Loss:

Common Size Statement of Profit and Loss

For the years ended on 31st March, 2014 and 2015

Particulars	Absolute Amounts		Percentage of Revenue from operation (Net Sales)	
	2014 Rs.	2015 Rs.	2014 Rs.	2015 Rs.
I. Revenue from operations				
II. Add : Other Income				
III. Total Revenue (I+II)				
IV. Expenses :				
a. Cost of Material consumed				
b. Purchases of Stock-in-Trade				
c. Changes in Inventories of Finished Goods, Work-in-progress and Stock-in-trade				
d. Employees Benefit Expenses				
e. Finance Cost				
f. Depreciation				

g. Other Expenses				
Total Expenses				
V. Profit before Tax (III-IV)				
Less : Income Tax				
VII. Profit after Tax				

note- all the items are divided by revenue from operations of that year to calculate the percentages.

PARTICULARS	2016 (A)	2017 (B)	PERCENTAGE 2016 (divide by 10,00,000)	PERCENTAGE 2017 (divide by 30,00,000)
revenue from operation	10,00,000	30,00,000	100	100
total income (A)	10,00,000	30,00,000	100	100
cost of production	2,00,000	3,00,000	20	10
other expenses	1,00,000	2,00,000	10	6.67
total expenses(B)	3,00,000	5,00,000	30	16.67
profit (A-B)	7,00,000	25,00,000	70	83.3
-TAX	(1,00,000)	(5,00,000)	10	16.67
PROFIT AFTER TAX	6,00,000	20,00,000	60	66.67

Comparative Statements

Also known as 'horizontal analysis, are financial statements showing financial position & profitability at different periods of time. These statements give an idea of the [enterprise](#) financial position of two or more periods. Comparison of financial statements is possible only when same accounting principles are used in preparing these statements.

-

Comparative Balance Sheet

The progress of the [company](#) can be seen by observing the different [assets and liabilities](#) of the firm on different dates to make the comparison of balances from one date to another. To understand the comparative balance sheet, it must have two columns for the data of original balance sheets. A third column is used to show increases/decrease in figures. The fourth column gives percentages of increases or decreases.

By comparing the balance sheets of different dates, one can observe the following aspects

- Current financial position and Liquidity position
- Long-term financial position
- Profitability of the concern

Comparative Income Statement

Traditionally known as trading and profit and loss A/c. Net sales, cost of goods sold, selling expenses, office expenses etc are important components of an income statement. To compare the [profitability](#), particulars of profit & loss are compared with the corresponding figures of previous years individually. To analyze the profitability of the business, the changes in money value and percentage is determined.

By comparing the profits of different dates, one can observe the following aspects:

- The increase/decrease in gross profit.
- The study of operational [profits](#).
- The increase or decrease in net profit
- Study of the overall profitability of the business.

Common Size Statements

Common size statements are also known as 'Vertical analysis'. Financial statements, when read with absolute figures, can be misleading. Therefore, a vertical analysis of financial information is done by considering the percentage form. The balance sheet items are compared:

- to the total assets in terms of percentage by taking the total assets as 100.

- to the total liabilities in terms of percentage by taking the total liabilities as 100.

Therefore the whole Balance Sheet is converted into percentage form. And such converted Balance Sheet is known as Common-Size Balance Sheet. Similarly profit & loss items are compared:

- to the total incomes in terms of percentage by taking the total incomes as 100.
- to the total expenses in terms of percentage by taking the total expenses as 100.

Therefore the whole Profit & loss account is converted into percentage form. And such converted profit & loss account is known as Common-Size Profit & Loss account. As the numbers are brought to a common base, the percentage can be easily compared with the results of corresponding percentages of the previous year or of some other firms.

Trend Analysis

Also known as the Pyramid Method. Studying the operational results and financial position over a series of years is trend [analysis](#). Calculations of ratios of different items for various periods is done & then compared under this analysis. Whether the enterprise is trending upward or backward, the analysis of the ratios over a period of years is done. By observing this analysis, the sign of good or poor management is detected.

To assess the profitability, solvency, and efficiency of a business, management can go through the technique of ratio analysis. It is an attempt at developing a meaningful relationship between individual items (or group of items) in the [balance sheet](#) or profit and loss account.

Changing your Tomorrow