Company Accounts and Analysis of Financial Statements Chapter 4

Analysis of Financial Statements

Short answers numerical questions long answers : Solutions of Questions on Page Number : 232

Q1 :

List the techniques of Financial Statement Analysis.

Answer :

The following are the commonly used techniques of Financial Statement analysis :

1. Comparative Financial Statements
2. Common Size Financial Statements
3. Trend Analysis
4. Ratio Analysis
5. Cash Flow Statement
6. Fund Flow Statement

The above listed techniques can be classified on the following basis:

A. <u>On the basis of Comparison</u>

1. ***Inter-firm Comparison***

    a) Comparative Statement (Balance Sheet, Profit and Loss Account)

    b) Common size Statement (of the same period)

    c) Ratio of two or more Competitive Firms (of the same period)

    d) Cash Flow Statement of two or more Competitive firms

e) Polygon, Bar Diagram

2. ***Intra-firm Comparison***

a) Comparative Statement (Balance Sheet, Profit and Loss Account)

b) Common size Statement (of the same period)

c) Ratio of two or more Competitive Firms (of the same period)

d) Cash Flow Statement of two or more Competitive firms

e) Polygon, Bar Diagram

3. ***Horizontal Comparison***

4. ***Vertical Comparison***

B. <u>On the basis of Time</u>

1. ***Inter-period Comparison***

a) Comparative statement (two or more periods)

b) Cash Flow statement (two or more period) etc.

2. ***Cross Sectional (Intra-period) Comparison***

a) Common size statement

b) Ratio Analysis

C. <u>Horizontal Analysis</u>

1. ***Time series***

2. ***Bar Diagram***

3. ***Polygon***

4. ***Comparative statement***

5. ***Ratio Analysis***

D. <u>Vertical Analysis</u>

1. ***Common size statement***

2. ***Pie Diagram***

Q2 :

From the following information of Narsimham Company Ltd., prepare a Comparative Income Statement for the years 2004-2005

Particulars	**2004** **Rs**	**2005** **Rs**
Gross Sales	7,25,000	8,15,000
Less : Returns	25,000	15,000
Net Sales	7,00,000	8,00,000
Cost of Goods Sold	5,95,000	6,15,000
Gross Profit	1,05,000	1,85,000
Other Expenses		
Selling & distribution Expenses	23,000	24,000
Administration Expenses	12,700	12,500
Total Expenses	35,700	36,500
Operating Income	69,300	1,48,500
Other Income	1,200	8,050
	70,500	1,56,550
Non Operating Expenses	1,750	1,940
Net Profit	68,750	1,54,610

Answer :

Comparative Income Statement of Narsimham Company Ltd.

for the year ended 2004 and 2005

Particulars	**2004**	**2005**	**Absolute Increase (+) or Decrease (â€“)**	**Percentage Increase (+) or Decrease**
	Rs	**Rs**	**Rs**	**%**
Gross Sales	7,25,000	8,15,000	+ 90,000	+ 12.41
Less: Return	25,000	15,000	(â€“) 10,000	(â€“) 40.00
Net Sales	7,00,000	8,00,000	+ 1,00,000	+ 14.28
Cost of Good Sold	5,95,000	6,15,000	+ 20,000	+ 3.36
Gross Profit	1,05,000	1,85,000	+ 80,000	+ 76.19
Other Expenses				
Selling & distribution Expenses	23,000	24,000	+ 1,000	+ 4.35
Administration Expenses	12,700	12,500	(â€“) 200	(â€“) 1.57
Total Expenses	35,700	36,500	+ 800	+ 2.24
Operating Income	69,300	1,48,500	+ 79,200	+ 114.29
Other Income	1,200	8,050	+ 6,850	+ 570.83
	70,500	1,56,550	+ 86,050	+ 122.06
Non Operating Expenses	1,750	1,940	+ 190	+ 10.86
Net Profit	68,750	1,54,610	+ 85,860	+ 124.89

1) Absolute Increase or Decrease = Current Year - Previous Year

$$2)\ \text{Percentage Increase or Decrease} = \frac{\text{Absolute Increase or Decrease}}{\text{First year absolute figure}} \times 100$$

Q3 :

Describe the different techniques of financial analysis and explain the limitations of financial analysis.

Answer :

The various techniques used in financial analysis are as follows:

1. ***Comparative Statements***: These statements depict the figures of two or more accounting years simultaneously that help to access the profitability and financial position of a business. The Comparative Statements help us in analysing the trend of the financial position of the business. These statements also enable us to undertake various types of comparisons like inter-firm comparisons and intra-firm comparisons. It presents the change in the financial items both in absolute as well as percentage terms. Therefore, these statements help in measuring the efficiency of the business in relative terms. The analyses based on these statements are known as Horizontal Analysis.

2. ***Common Size Statements:*** These statements depict the relationship between various items of financial statements and some common items (like Net Sales and the Total of Balance Sheet) in percentage terms. In other words, various items of Trading and Profit and Loss Account such as Cost of Goods Sold, Non-Operating Incomes and Expenses are expressed in terms of percentage of Net Sales. On the other hand, different items of Balance Sheet such as Fixed Assets, Current Assets, Share Capital, etc. are expressed in terms of percentage of Total of Balance Sheet. These percentage figures are easily comparable with that of the previous years' (i.e. inter-firm comparison) and with that of the figures of other firms in the same industry (i.e. inter-firm comparison) as well. The analyses based on these statements are commonly known as Vertical Analysis.

3. ***Trend Analysis***: This analysis undertakes the study of trend in the financial positions and the operating performance of a business over a series of successive years. In this technique, a particular year is assumed to be the ***base year*** and the figures of all other years are expressed in percentage terms of the base year's figures. These trends (or the percentage figures) not only helps in assessing the operational efficiency and the financial position of the business but also helps in detecting the problems and inefficiencies.

4. ***Ratio Analysis***: This technique depicts the relationship between various items of Balance Sheet and the Income Statements. It helps in ascertaining the profitability, operational efficiency, solvency, etc of a firm. The analysis expresses financial items in terms of percentage, fraction, proportion and as number of times. It enables budgetary controls by assessing the qualitative relationship among different financial variables. This analysis provides vital information to different accounting users regarding the financial position, viability and performance of a firm. It also facilitates decision making and policy designing process.

5. ***Cash Flow Analysis***: This analysis is presented in the form of a statement showing inflows and outflows of cash and cash equivalents from operating, investing and financing activities of a

company during a particular period of time. It helps in analysing the reasons of receipts and payments in cash and change in the cash balances during an accounting year in a company.

Limitations of Financial Analysis

The limitations of Financial Analysis are :

1. ***Ignores Changes in the Price level***

The financial analysis fails to capture the change in price level. The figures of different years are taken on nominal values and not in real terms (i.e. not taking price change into considerations).

2. ***Misleading and Wrong Information***

The financial analysis fails to reveal the change in the accounting procedures and practices. Consequently they may provide wrong and misleading information.

3. ***Interim and Final Picture***

The financial analysis presents only the interim report and thereby provides incomplete information. They fail to provide the final and holistic picture.

4. ***Ignores Qualitative and Non-monetary Aspects***

The financial analysis reveals only the monetary aspects. In other words, these analyses consider only that information that can be expressed only in monetary terms. These analyses fail to disclose managerial efficiency, growth prospects, and other non-operational efficiency of a business.

5. ***Accounting Concepts and Conventions***

The financial analysis are based an accounting concepts and conventions. Therefore, the analysis and conclusions based on such analyses may not be reliable. For example, the analysis considers only the book-value of various items (i.e. according to the Going Concept) and consequently ignores the present market value of those items. Hence, the analysis may not be realistic.

6. ***Involves Personal Biasness***

The financial analysis reflects the personal biasness and personal value judgments of the accountants and clerks involved. There are different techniques used by different personnel for charging depreciation (original cost or written-down value method) and also for inventory valuation. The use of different techniques by different people reduces the effectiveness of the financial analysis.

7. ***Unsuitable for Comparisons***

Due to the involvement of personal value judgment, personal biasness and use of different techniques by different accountant, various types of comparisons such as inter-firm and intra-firm comparisons may not be possible and reliable.

Q4 :

Distinguish between Vertical and Horizontal Analysis of financial data.

Answer :

Basis of Difference	**Horizontal Analysis**	**Vertical Analysis**
Meaning	It refers to the comparison of an item of the financial statement of one period or periods to its corresponding item of the base accounting period.	It refers to the comparison of itemitems of the financial statement to the common item of the same accounting period.
Purpose	Its purpose is to determine the change in an item during an accounting period. The change in the item is expressed either in absolute figures or in percentage or in both terms.	Its purpose is to determine the proportion of item/items to the common item of the same accounting period. The change in the item is expressed either in ratio or in percentage terms.
Usefulness	It indicates growth or decline of the item.	It helps in predicting and determining the future relative proportion of an item to the common item.

Q5 :

Explain the usefulness of trend percentages in interpretation of financial performance of a company.

Answer :

The Trend Analysis presents each financial item in percentage terms for each year. These Trend Analyses not only help the accounting users to assess the financial performance of the business but also assist them to form an opinion about various tendencies and predict the future trend of the business.

Usefulness and Importance of Trend Analysis

The following are the various importance of Trend Analysis:

1. ***Assists in forecasting***

The trends provided by Trend Analysis help the accounting users to forecast the future trend of the business.

2. ***Percentage Terms***

The trends are expressed in percentage terms. Analysing the percentage figures is easy and also less time consuming.

3. ***User Friendly***

As the trends are expressed in percentage figures, so it is the most popular financial analysis to analyse the financial performance and operational efficiency of the company. In other words, one need not to have an in-depth and sophisticated knowledge of accounting in order to analyse these percentage trends.

4. ***Presents a Broader Picture***

The trend analysis presents a broader picture about the financial performance, viability and operational efficiency of a business. Generally, companies prefer to present their financial data for a period of 5 or 10 years in forms of percentage trends, whereas the other techniques of Financial Analysis lack this popularity.

Q6 :

Explain the meaning of Analysis and Interpretation.

Answer :

Analysis and Interpretation refers to a systematic and critical examination of the financial statements. It not only establishes cause and effect relationship among the various items of the financial statements but also presents the financial data in a proper manner. The main purpose of Analysis and Interpretation is to present the financial data in such a manner that is easily understandable and self explanatory. This not only helps the accounting users to assess the financial performance of the business over a period of time but also enables them in decision making and policy and financial designing process.

Country Man Ltd Comparative statement as on March 31, 2010 and 2011

Particular	**2009â€“10**	**2010â€“11**	**Absolute Change**	**% Change**
Sales	1,00,000	1,50,000	50,000	50
Less: Cost of Goods Sold	60,000	78,000	18,000	30
Gross Profit	40,000	72,000	32,000	80
Less: *Operating Expenses*:				
Office and Administrative Exp.	8,000	10,000	2,000	25
Selling and Distribution Exp.	5,000	6,000	1,000	20
Operating Profit	27,000	56,000	29,000	107.4
Add: Other Income	3,000	4,800	1,800	60
Less: Non-operating Expenses	4,000	4,800	800	20
Profit Before Interest and Tax	26,000	56,000	30,000	115.38
Interest	2,000	1,800	(200)	(10)
Profit before Tax	24,000	54,200	30,200	125.83
Less: 50% Income Tax	12,000	27,100	15,100	125.83
	12,000	27,100	15,100	125.83

$$\text{Percentage Change} = \frac{\text{Absolute Change}}{\text{Base Year of 2009-10}}$$

Interpretation:

1. Sales of the company have increased by 50% during the year 2010 - 11 whereas the cost of goods sold has also increased but at a lesser rate. From this, we can infer that the company has followed an efficient sales strategy consequent of which the gross profit of the company has increased by 80% compared to the previous year (2009-10).

2. In 2010 - 11, operating expenses have also increased but on the contrary operating profit has increased at a higher rate than the rate of operating expenses.

3. Profit before interest and tax has also increased by 115.38% during these two years. This indicates the improvement in the operating efficiency of the company.

Q7 :

What is the importance of comparative statements? Illustrate your answer with particular reference to comparative income statement.

Answer :

The following are the importance of Comparative Statements.

1. ***Simple Presentation***

The Comparative Statements present the financial data in a simpler form. Moreover, the year-wise data of the same items are presented side-by-side, which not only makes the presentation clear but also enables easy comparisons (both intra-firm and inter-firm) conclusive.

2. ***Easy for Drawing Conclusion***

The presentation of comparative statement is so effective that it enables the analyst to draw conclusion quickly and easily and that too without any ambiguity

3. ***Easy to Forecast***

The comparative analysis of profitability and operational efficiency of a business over a period of time helps in analysing the trend and also assists the management to forecast and draft various future plans and policy measures accordingly.

4. ***Easy Detection of Problems***

By comparing the financial data of two or more years, the financial management can easily detect the problems. While comparing the data, some items may have increased while others have decreased or remained constant. The comparative analysis not only enables the management in locating the problems but also helps them to put various budgetary controls and corrective measures to check whether the current performance is aligned with that of the planned targets.

Q8 :

Bring out the importance of Financial Analysis

Answer :

Financial Analysis has great importance to various accounting users on various matters. Income Statements, Balance Sheets and other financial data provides information about expenses and sources of income, profit or loss and also helps in assessing the financial position of a business. These financial data are not useful until they are analysed. There are various tools and methods such as Ratio Analysis, Cash Flow Statements that make the financial data to cater varying needs of various accounting users.

The following are the reasons that advocate in favour of Financial Analysis:

1. It helps in evaluating the profit earning capacity and financial feasibility of a business.

2. It helps in assessing the long-term solvency of the business.

3. It helps in evaluating the relative financial status of a firm in comparison to other competitive firms.

4. It assists management in decision making process, drafting various plans and also in establishing an effective controlling system.

Q9 :

What do you understand by analysis and interpretation of financial statements? Discuss their importance.

Answer :

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4. It assists management in decision making process, drafting various plans and also in establishing an effective controlling system.

Q10 :

What are Comparative Financial Statements?

Answer :

Those financial statements that enable intra-firm and inter-firm comparisons of financial statements over a period of time are called Comparative Financial Statements. In other words, these statements help the accounting users to evaluate and assess the financial progress in the relative terms. These statements express the absolute figures, absolute change and the percentage change in the financial items over a period of time. Comparative Financial Statements present the financial data in such a manner that is easily understandable and can be analysed without any ambiguity. If the accounting policies and practices for the treatment of the items are same over the period of study, only then the Comparative Financial Statements enable meaningful comparisons.

The following are the two Comparative Financial Statements that are commonly prepared:

1. Comparative Balance Sheet

2. Comparative Income Statements

Q11 :

Explain how common size statements are prepared giving an example.

Answer :

The two Common Size Statements that are most commonly prepared are as follows.

1. Common Size Balance Sheet

2. Common Size Income Statements

Common Size Statement is prepared in a columnar form for analysis. In a Common Size Statement each item of the financial statements is compared to a common item. The analyses based on these statements are commonly known as Vertical Analysis.

The following are the columns prepared in a Common Size Statement.

1. ***Particulars Column***: This column shows the various financial items under their respective heads.

2. ***Amount Columns***: These columns depict the amount of each item, sub-totals and the gross total of a particular year.

3. ***Percentage or Ratio Columns***: These columns show the proportion of each item to the common item either in terms of percentage or ratio.

The Common Size Statements can be presented in the following two ways.

Method 1

1. Percentage Column is shown beside the Amount Column of the year to which percentage column belongs.

Particulars	**Year (2007)** **Rs**	**%**	**Year (2006)** **Rs**	**%**

Method 2

Amount Columns are shown first and their percentage columns are shown after the Amount Columns.

Particulars	**Year (2007)** **Rs**	**Year (2008)** **Rs**	**% 2007**	**% 2008**

The preparation of the Common Size Statements can be better understood by the help of the following example.

Balance Sheet of Indo Press Ltd.

Liabilities	**2007** **Rs**	**2008** **Rs**	**Assets**	**2007** **Rs**	**2008** **Rs**
Capital	1,00,000	1,50,000	Fixed Assets	2,00,000	2,40,000
Reserves and Surplus	80,000	1,20,000	Investments	1,20,000	1,50,000
Long term Loans	2,00,000	1,50,000	Current Asset	1,80,00	2,10,000
Current Liabilities	1,20,000	1,80,000			
	5,00,000	6,00,000		5,00,000	6,00,000

Indo Press Ltd.

Comparative Size Balance Sheet for the year 2007 and 2008

Particulars	**2007** **Rs**	**2008** **Rs**	**%** **2007**	**%** **2008**
Assets:				
Fixed Assets	2,00,000	2,40,000	40	40
Investments	1,20,000	1,50,000	24	25
Current Assets	1,80,000	2,10,000	36	35
	5,00,000	**6,00,000**	**100**	**100**
Liabilities:				
Capital	1,00,000	1,50,000	20	25
Reserved Surplus	80,000	1,20,000	16	20
Long terms loans	2,00,000	1,50,000	40	25
Current liabilities	1,20,000	1,80,000	24	30
	5,00,000	**6,00,000**	**100**	**100**

<u>Preparation</u>

Step 1: Title of the Common Size Statement, i.e. 'Common Size Balance Sheet' is written on the top of the statement.

Step 2: In the 'Particulars' column, the various items of the Balance Sheet are shown under the headings of 'Assets' and 'Liabilities'.

Step 3: In the 'Amount' column, amount of the items are shown in the 'Year' column to which they belong

Step 4: The Assets and Liabilities are totaled and are shown separately for each year.

Step 5: In the 'Percentage' column, the percentage of each item in comparison to the Total of Balance Sheet are shown, i.e. for year 2007, the common base is Rs 5,00,000 and for the year 2008, the common base is Rs 6,00,000. The percentage change in each item is calculated by the help of the following formula.

$$\text{Percentage Change} = \frac{\text{Item}}{\text{Common Base (Total of Balance Sheet)}} \times 100$$

$$\text{For 2007} = \frac{\text{Item}}{5{,}00{,}000} \times 100$$

$$\text{For 2008} = \frac{\text{Item}}{6{,}00{,}000} \times 100$$

Q12 :

What do you mean by Common Size Statements?

Answer :

These statements depict the relationship between various items of financial statements and some common items (like Net Sales and the Total of Balance Sheet) in percentage terms. In other words, various items of Trading and Profit and Loss Account such asCost of Goods Sold, Non-Operating Incomes and Expenses are expressed in terms of percentage of Net Sales. On the other hand, different items of Balance Sheet such as Fixed Assets, Current Assets, Share Capital etc. are expressed in terms of percentage of Total of Balance Sheet. These percentage figures are easily comparable with that of the previous years' (i.e. inter-firm comparison) and with that of the figures of other firms in the same industry (i.e. inter-firm comparison) as well.

The analyses based on these statements are commonly known as Vertical Analysis.

The following are commonly prepared Common Size Statements.

1. Common Size Balance Sheet

2. Common Size Income Statements

Numerical questions : Solutions of Questions on Page Number : 233

Q1 :

The following are the Balance Sheets of Mohan Ltd., at the end of 2004 and 2005.

Rs'000

Liabilities	2004	2005	Assets	2004	2005
Equity Share Capital	400	600	Land & buildings	270	170
Reserves & Surplus	312	354	Plant & Machinery	310	786
Debentures	50	100	Furniture & Fixtures	9	18
Long-term Loans	150	255	Other Fixed Assets	20	30
Accounts Payable	255	117	Loans and Advances	46	59
Other Current Liabilities	7	10	Cash and Bank	118	10
			Account Receivable	209	190
			Inventory	160	130
			Prepaid Expenses	3	3
			Other current Assets	29	40
	1,174	1,436		1,174	1,436

Prepare a Comparative Balance Sheet and study the financial position of the company.

Answer :

Comparative Balance Sheet of Mohan Ltd.

Particulars	2004	2005	Absolute Increase (+) or Decrease (-)	Percentage Increase (+) or Decrease (-)
	Rs'(000)	Rs'(000)	Rs'(000)	%
Assets:				

Current Assets				
Cash and Bank	118	10	(-) 108	(-) 91.52
Account Receivable	209	190	(-) 19	(-) 9.09
Inventory	160	130	(-) 30	(-) 18.75
Prepaid Expenses	3	3	-	-
Loan and Advances	46	59	+ 13	+ 28.26
Other current Assets	29	40	+ 11	+ 37.93
Total Current Assets (A)	565	432	(-) 133	(-) 23.54
Fixed Assets:				
Loan and Buildings	270	170	(-) 100	(-) 37.04
Plant and Machinery	310	786	+ 476	+153.54
Furniture and Fixtures	9	18	+ 9	+ 100.00
Other Fixed Assets	20	30	+ 10	+ 50.00
Total Fixed Assets (B)	609	1,004	+ 395	+ 64.86
Total Assets (A+B)	1,174	1,436	+ 262	+ 22.32
Liabilities:				

Q2 :

The following are the balance sheets of Devi Co. Ltd at the end of 2002 and 2003. Prepare a Comparative Balance Sheet and study the financial position of the concern.

Liabilities	**2002** **Rs**	**2003** **Rs**	**Assets**	**2002** **Rs**	**2003** **Rs**
Equity Capital	1,20,000	1,85,000	Fixed Assets	1,40,000	1,95,000
Preference Capital	70,000	95,000	Stock	40,000	45,000
Reserves	30,000	35,000	Debtors	70,000	82,500
P&L	17,500	20,000	Bills Receivables	20,000	50,000
Bank overdraft	35,000	45,450	Prepaid Expenses	6,000	8,000
Creditors	25,000	35,000	Cash at bank	40,000	48,500
Provision for Taxation	15,000	22,500	Cash in hand	5,000	29,000
Proposed Dividend	8,500	20,050			
	3,21,000	4,58,000		3,21,000	4,58,000

Answer :

Comparative Balance Sheet of Devi Co Ltd.

Particulars	**2002**	**2003**	**Absolute Increase (+) or Decrease (â€“)**	**Percentage Increase (+) or Decrease (â€“)**
	Rs	Rs	Rs	%
Assets:				
Current Assets				
Stock	40,000	45,000	+ 5,000	+ 12.50
Debtors	70,000	82,500	+ 12,500	+ 17.86
Bills Receivables	20,000	50,000	+ 30,000	+ 150.00
Prepaid Expenses	6,000	8,000	+ 2,000	+ 33.33
Cash at Bank	40,000	48,500	+ 8,500	+ 21.25
Cash in hand	5,000	29,000	+ 24,000	+ 480.00
Total Current Assets (A)	1,81,000	2,63,000	+ 82,000	+ 45.30
Fixed Assets (B)	1,40,000	1,95,000	+ 55,000	+ 39.29
Total Assets (A+B)	3,21,000	4,58,000	+ 1,37,000	+ 42.68
Liabilities:				
Current Liabilities				
Bank Overdraft	35,000	45,450	+ 10,450	+ 29.86
Creditors	25,000	35,000	+ 10,000	+ 40.00
Provision for Taxation	15,000	22,500	+ 7,500	+ 50.00
Proposed Dividend	8,500	20,050	+ 11,550	+ 135.88
Total Current Liabilities (A)	83,500	1,23,000	+ 39,500	+ 47.31
Equity Capital	1,20,000	1,85,000	+ 65,000	+ 54.17

Preference Capital	70,000	95,000	+ 25,000	+ 35.71
Reserves	30,000	35,000	+ 5,000	+ 16.67
P&L	17,500	20,000	+ 2,500	+ 14.29
Shareholder Fund (B)	2,37,500	3,35,000	+ 97,500	+ 41.05
Total Liabilities and Shareholder Fund (A+B)	3,21,000	4,58,000	+ 1,37,000	+ 42.68

Interpretation

1) The comparative balance sheet of a company reveals that during the year 2003, there has been an increase in fixed asset by 55,000 i.e. 39.29% while equity Capital increase by 65,000 i.e. 54.17 and preference capital increase by 25,000 i.e. 35.71. It shows that company purchase fixed assets from long term source of finance, which does not affect the working capital.

2) The current assets have increased by 82,000 i.e. 42.30% and current liabilities have increased by 39,500 i.e. 47.31. It shows ratio between current assets and current liabilities more or less should be same compare to previous year.

3) The overall financial position of a company is satisfactory.

Working Notes

$$1)\ \text{Absolute Increase or Decrease} = \overline{\text{Current Year- Previous Year}}$$

$$2)\ \text{Percentage Increase or Decrease} = \frac{\text{Absolute Increase or Decrease}}{\text{First year absolute figure}} \times 100$$

Q3 :

Convert the following Income Statement into Common Size Statement and interpret the changes in 2005 in the light of the conditions in 2004.

	2004	**2005**

	Rs	Rs
Gross Sales	30,600	36,720
Less : Returns	600	700
Net Sales	30,000	36,020
Less : Cost of Goods Sold	18,200	20,250
Gross Profit	11,800	15,770
Less **: Operating Expenses**		
Administration Expenses	3,000	3,400
Sales Expenses	6,000	6,600
Total Expenses	9,000	10,000
Income from Operations	2,800	5,770
Add : Non-operating Income	300	400
Total Income	3,100	6,170
Less : Non-operating Expenses	400	600
Net Profit	2,700	5,570

Answer :

Common Size Income Statement

Particulars	2004		2005	
	Rs	**%**	**Rs**	**%**
Gross Sales	30,600	102.00	36,720	101.94
Less: Return	600	2.00	700	1.94
Net Sales	30,000	**100.00**	36,020	**100.00**
Less: Cost of Goods Sold	18,200	60.67	20,250	56.22
Gross Profit	11,800	39.33	15,770	43.78
Less: Operating Expenses				
Administration Expenses	3,000	10.00	3,400	9.43
Sales Expenses	6,000	20.00	6,600	18.32
Total Expenses	9,000	30.00	10,000	27.75
Income from operations	2,800	9.33	5,770	16.01
Add: Non-operating Income	300	1.00	400	1.11
Total Income	3,100	10.33	6,170	17.12
Less: Non-operating Expenses	400	1.33	600	1.66
Net Profit	2,700	9.00	5,570	15.46

Interpretation:

1) The Net Profit of the company increased from 9% to 15.46 % as the income from operations has increased from 9.15% to 15.71%.

2) Simultaneously the company has tried to reduce its costs to improve its profit margin.

3) Profitability of the company has improved over the year.

Q4 :

Following are the balance sheets of Reddy Ltd. as on 31 March 2003 and 2004.

Liabilities	2004	2005	Assets	2004	2005
Share Capital	2,400	3,600	Land & buildings	1,620	1,040
Reserves & Surplus	1,872	2,124	Plant & Machinery	1,860	4,716
Debentures	300	600	Furniture & Fixtures	54	108
Long-term Debt	900	1,530	Other Fixed Assets	120	180
Bills Payable	1,530	702	Long-terms Loans	276	354
Other Current Liabilities	42	60	Cash & Bank Balances	708	60
			Bill Receivable	1,254	1,120
			Stock	960	780
			Prepaid Expenses	18	18
			Other Current Assets	174	240
	7,044	8,616		7,044	8,616

Analyse the financial position of the company with the help of the Common Size Balance Sheet.

Answer :

Common Size Balance Sheet of Reddy Ltd.

as on March 31, 2003 and 2004

Particulars	2003		2004	
	Rs	%	Rs	%
Fixed Assets:				
Land and Building	1,620	23.00	1,040	12.07
Plant and Machinery	1,860	26.41	4,716	54.73
Furniture and Fixtures	54	0.77	108	1.25
Other Fixed Assets	120	1.70	180	2.09
Total Fixed Assets (A)	3,654	51.88	6,044	70.14
Investments (B)				
Long Term Loan	276	3.91	354	4.12
Current Assets:				
Cash and Bank Balances	708	10.05	60	0.70
Bill Receivable	1,254	17.80	1,120	13.00
Stock	960	13.63	780	9.05
Prepaid Expenses	18	0.26	18	0.21
Other current Assets	174	2.47	240	2.78
Total current Assets (c)	3,114	44.21	2,218	25.74
Total Assets (A+B+C)	7,044	100.00	8,616	100.00
Current Liabilities:				
Bills Payable	1,530	21.72	702	8.14
Other current Liabilities	42	0.59	60	0.70
Total Current Liabilities	1,572	22.31	762	8.84
Long Term External Liabilities				
Debentures	300	4.26	600	6.96
Long Term Debt	900	12.77	1,530	17.76
Total Long Term External Liabilities	1,200	17.03	2,130	24.72
Share Holders Fund				
Share Capital	2,400	34.07	3,600	41.78

Reserve and Surplus	1,872	26.57	2,124	24.66
	4,272	60.64	5,724	66.44
Total Liabilities	7,044	100.00	8,616	100.00

Interpretation:

1) The Current Assets has decreased from 44.21% to 25.74% i.e. by 18.47% and the Current Liabilities has reduced from 22.31% to 8.84% i.e. by 13.47%. Despite the decrease in the Current Assets and the decrease in the Current Liabilities, the Current Ratio has improved.

2) Fixed Assets, Long term External Debts and the Share Capital have increased from 51.88% to 70.14%, 17.03% to 24.72%, 34.07% to 41.78% respectively. Thus from this, it can be inferred that the company had purchased fixed assets from long-term source of finance. As the fixed assets were financed through the long-term debts, so the company's working capital remained unaffected.

3) Analysing the reducing figures of the Cash and Bank Balances, it can be inferred that the company has a poor cash management policy. Thus we can predict that the company may face an acute liquidity problem.

Q5 :

The accompanying balance sheet and profit and loss account related to SUMO Logistics Pvt. Ltd. Convert these into Common Size Statements.

Previous Year = 2005, Current Year = 2006

Rs'000

	Previous Year	Current Year
Liabilities		
Equity Share Capital (of Rs 10 each)	240	240
General Reserve	96	182
Long Term loans	182	169.5
Creditors	67	52
Outstanding expenses	6	-
Other Current liabilities	9	6.5
Total Liabilities	**600**	**650**
Assets		
Plant assets net of accumulated less depreciation	402	390
Cash	54	78
Debtors	60	65
Inventories	84	117
Total Assets	**600**	**650**

Income Statement for the year ended

Rs'000

	Previous Year	Current Year
Gross Sales	370	480
Less : Returns	20	30
Net Sales	350	450
Less : Cost of goods sold	190	215
Gross Profit	160	235
Less : Selling general and administration expenses	50	72
Operating profit	110	163
Less : Interest expenses	20	17
Earnings before tax	90	146
Less : Taxes	45	73
Earnings After Tax	45	73

Answer :

Common Size Balance Sheet of SUMO Logistics Pvt. Ltd.

As on 2005 and 2006

Particulars	2005		2006	
	Rs'000	**%**	**Rs'000**	**%**
Liabilities:				
Equity Share Capital (of Rs 10 each)	240	40	240	36.92
General Reserve	96	16	182	28
Long-term Loan	182	30.33	169.5	26.08
Creditors	67	11.17	52	8
Outstanding Expenses	6	1	-	
Other Current Liabilities	9	1.5	6.5	1
Total Liabilities	**600**	**100**	**650**	**100**
Assets:				
Plant *less* Accumulated Depreciation	402	67	390	60
Cash	54	9	78	12
Debtors	60	10	65	10
Inventories	84	14	117	18
Total Assets	**600**	**100**	**650**	**100**

Common Size Income Statement of SUMO Logistics Pvt. Ltd.

For the year ended 2005 and 2006

Particulars	2005		2006	
	Rs'000	**%**	**Rs'000**	**%**
Gross Sales	370	105.71	480	106.67
Less: Returns	20	5.71	30	6.67
Net Sales	**350**	**100.00**	**450**	**100.00**
Less: Cost of Goods Sold	190	54.29	215	47.77
Gross Profit	160	45.71	235	52.23
Less: Selling General and Administration Expenses	50	14.28	72	16.00
Operating Profit	110	31.43	163	36.23
Less: Interest Expenses	20	5.72	17	3.77
Earnings Before Tax	90	25.71	146	32.46
Less: Taxes	45	12.86	73	16.23
Earnings After Tax	45	12.86	73	16.23

Q6 :

From the following particulars extracted from P&L A/c of Prashanth Ltd., you are required to calculate trend percentages

Year	Sales Rs	Wages Rs	Bad Debts Rs	Profit after tax Rs
2003	3,50,000	50,000	14,000	16,000
2004	4,15,000	60,000	26,000	24,500
2005	4,25,000	72,200	29,000	45,000
2006	4,60,000	85,000	33,000	60,000

Answer :

Trend Percentages (Base Year 2003 = 100)

Year	Sales Rs	Trend %	Wages Rs	Trend %	Bad debts Rs	Trend %	Profit after Tax Rs	Trend %
2003	3,50,000	100.00	50,000	100.00	14,000	100.00	16,000	100.000
2004	4,15,000	118.57	60,000	120.00	26,000	185.71	24,500	153.125
2005	4,25,000	121.43	72,200	144.40	29,000	207.14	45,000	281.250
2006	4,60,000	131.43	85,000	170.00	33,000	235.71	60,000	375.000

$$\text{Trend Percentage} = \frac{\text{Present Year Value}}{\text{Base Year Value}} \times 100$$

Q7 :

Calculate trend percentages from the following figures of ABC Ltd., taking 2000 as base and interpret them.

Year	Sales	Stock	Profit before tax
2000	1,500	700	300
2001	2,140	780	450
2002	2,365	820	480
2003	3,020	930	530
2004	3,500	1160	660
2005	4000	1200	700

Answer :

Trend Percentages (Base Year 2000 = 100)

Years	Sales Rs	Trend %	Stock Rs	Trend %	Profit after Tax Rs	Trend %
2000	1,500	100.00	700	100.00	300	100.00
2001	2,140	142.67	780	111.43	450	150.00
2002	2,365	157.67	820	117.14	480	160.00
2003	3,020	201.33	930	132.86	530	176.67
2004	3,500	233.33	1,160	165.71	660	220.00
2005	4,000	266.67	1,200	171.43	700	233.33

$$\text{Trend Percentage} = \frac{\text{Present Year Value}}{\text{Base Year Value}} \times 100$$

Interpretation

1) Sales has exhibited continuous increasing trend over the period.

2) The value of stock is also increase, with the increase in value of sales.

3) Profit increase more in earlier years as compare to later years. It implies cost of goods, sold and operating expenses are increased in later years.

Q8 :

From the following data relating to the liabilities side of balance sheet of Madhuri Ltd., as on 31st March 2006, you are required to calculate trend percentages taking 2002 as the base year.

(Rs in lakhs)

Liabilities	**2002**	**2003**	**2004**	**2005**	**2006**
Share capital	100	125	130	150	160
Reserves & Surplus	50	60	65	75	80
12% Debentures	200	250	300	400	400
Bank overdraft	10	20	25	25	20
Profit & Loss A/c	20	22	28	26	30
Sundry Creditors	40	70	60	70	75

Answer :

Trend Percentage (Base Year 2003 = 100)

Liabilities	**2002 Rs'00,000**	**Trend %**	**2003 Rs'00,000**	**Trend %**	**2004 Rs'00,000**	**Trend %**	**2005 Rs'00,000**	**Trend %**	**2006 Rs'00,000**	**Trend %**
Share Capital	100	100	125	125	130	130	150	150	160	160
Reserve and Surplus	50	100	60	120	65	130	75	150	80	160
Profit and Loss Account	20	100	22	110	28	140	26	130	30	150
Shareholders Fund	170	100	207	121.76	223	131.18	251	147.65	270	158.82
Long Term Debt:										
12% Debentures	200	100	250	125	300	150	400	200	400	200
	200	100	250	125	300	150	400	200	400	200
Current Liabilities:										
Bank Overdraft	10	100	20	200	25	250	25	250	20	200
Sundry Creditors	40	100	70	175	60	150	70	175	75	187.5
Total Current Liabilities	50	100	90	180	85	170	95	190	95	190
Total Liabilities	420	100	547	130.24	608	144.76	746	177.62	765	182.14