

UNIT 8

FINANCIAL STATEMENT ANALYSIS



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Points to recall

The following points are to be recalled before learning financial statement analysis:

- ◇ Accounting principles
- ◇ Indian Accounting Standards
- ◇ Preparation of profit and loss account and balance sheet



Learning objectives

- To enable the students to
- ◇ Understand the meaning and objectives of financial statement analysis
 - ◇ Understand the tools of financial statement analysis
 - ◇ Apply the tools to analyse the financial statements

Key terms to know

- ◇ Financial statements
- ◇ Financial statement analysis
- ◇ Common size statement
- ◇ Comparative statement
- ◇ Trend analysis

8.1 Introduction

Business concerns prepare income statement and balance sheet at the end of an accounting period to ascertain the profitability and the financial position respectively. These statements give the totals of different expenditures, revenues and the net result, namely, profit or loss during the given period and balances of assets and liabilities and capital as on the last date of the accounting period. Thus, financial statements are sources of financial information. However, these statements do not give the relationship among the various items or the reasons for changes in the amounts of these items between two dates and the effect of such changes. For this purpose, different tools of financial statement analysis are used.

8.2. Financial statements

8.2.1 Meaning of financial statements

Financial statements are the statements prepared by the business concerns at the end of the accounting period to ascertain the operating results and the financial position. The basic financial statements prepared by business concerns are income statement and balance sheet. Income statement includes manufacturing account and trading and profit and loss account. It shows the net results of business activities during an accounting period. Balance sheet is a statement of assets and liabilities which shows the financial position as on a particular date.

Apart from these two basic statements, business concerns may also prepare cash flow statement, funds flow statement and statement of changes in financial position.

8.2.2 Features of financial statements

Following are the features of financial statements:

- (i) Financial statements are generally prepared at the end of an accounting period based on transactions recorded in the books of accounts.
- (ii) These statements are prepared for the organisation as a whole.
- (iii) Information is presented in a meaningful way by grouping items of similar nature such as fixed assets and current assets.
- (iv) Financial statements are prepared based on historical cost.
- (v) Financial statements are prepared based on accounting principles and Accounting Standards, which make financial statements comparable and realistic.
- (vi) Financial statements involve personal judgement in certain cases. For example, selection of method of depreciation, percentage of reserve, etc.

8.2.3 Significance of financial statements

Financial statements reveal the operating results and financial position of the business concern. The significance of financial statements to various stakeholders is as follows:

- (i) **To management:** Financial statements provide information to the management to take decision and to have control over business activities, in various areas.

- (ii) **To shareholders:** Financial statements help the shareholders to know whether the business has potential for growth and to decide to continue their shareholding.
- (iii) **To potential investors:** Financial statements help to value the securities and compare it with those of other business concerns before making their investment decisions.
- (iv) **To creditors:** Creditors can get information about the ability of the business to repay the debts from financial statements.
- (v) **To bankers:** Information given in the financial statements is significant to the bankers to assess whether there is adequate security to cover the amount of the loan or overdraft.
- (vi) **To government:** Financial statements are significant to government to assess the tax liability of business concerns and to frame and amend industrial policies.
- (vii) **To employees:** Through the financial statements, the employees can assess the ability of the business to pay salaries and whether they have future growth in the concern.

8.2.4 Limitations of financial statements

Following are the limitations of financial statements:

- (i) **Lack of qualitative information:** Qualitative information that is non-monetary information is also important for business decisions. For example, efficiency of the employees, efficiency of the management, etc. But, this is ignored in financial statements.
- (ii) **Record of historical data:** Financial statements are prepared based on historical data. They may not reflect the current position.
- (iii) **Ignore price level changes:** Adjustments for price level changes are not made in the financial statements. Hence, financial statements may not reveal the current position.
- (iv) **Lack of consistency:** Different business concerns may use different accounting methods. Hence, comparison between two business concerns becomes difficult.
- (v) **Give only interim reports:** Financial statements are prepared at the end of every accounting period. But, the actual position of the business can be known only when the business is closed. Hence, financial statements may not reveal the exact position of the business concern.
- (vi) **Limited access to external users:** The external users do not have detailed and frequent information of financial results as they have limited access.
- (vii) **Influenced by personal judgement:** Preparation of financial statements may be influenced by personal judgements and therefore these are not free from bias.

8.3 Financial statements of companies

Following provisions of the Indian Companies Act, 2013 have to be followed while preparing the financial statements of a company:

- (i) As per Section 2 (40), financial statements include balance sheet, profit and loss account / income and expenditure account, cash flow statement, statement of changes in equity and any explanatory note annexed to the above.
- (ii) Section 129 (1) of the Indian Companies Act, 2013 states that the financial statements shall give a true and fair view of the state of affairs of the company and shall comply with the Accounting Standards notified under section 133.

- (iii) Section 129 (1) also states that the financial statements shall be prepared in the form provided in schedule III of Indian Companies Act, 2013.



Where the financial statements of a company do not comply with the Accounting Standards referred to in Section 129 (1) of the Companies Act, 2013, the company shall disclose in its financial statements, the deviation from the Accounting Standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.



Student activity 8.1

Invite an auditor to your class to discuss about the preparation of financial statements of different forms of business.

Note: Statement of profit and loss (Part II of Schedule III) and Balance Sheet (Part I of Schedule III) have been given only for understanding purpose and not for examination.

Schedule III of the Companies Act, 2013

PART II – STATEMENT OF PROFIT AND LOSS

Name of the Company

Profit and loss statement for the year ended

(Rupees in)

Particulars		Note No.	Figures for the current reporting period	Figures for the previous reporting period
1		2	3	4
I	Revenue from operations		xxx	xxx
II	Other income		xxx	xxx
III	Total Revenue (I+II)		xxx	xxx
IV	Expenses:			
	Cost of materials consumed		xxx	xxx
	Purchase of Stock-in-Trade		xxx	xxx
	Changes in inventories of finished goods		xxx	xxx
	Work-in-progress and		xxx	xxx
	Stock-in-trade		xxx	xxx
	Employee benefits expenses		xxx	xxx
	Finance costs		xxx	xxx
	Depreciation and amortisation expenses		xxx	xxx
	Other expenses		xxx	xxx
	Total expenses		xxx	xxx

V	Profit before exceptional and extraordinary items and tax (III-IV)		XXX	XXX
VI	Exceptional items		XXX	XXX
VII	Profit before extraordinary items and tax (V-VI)		XXX	XXX
VIII	Extraordinary items		XXX	XXX
IX	Profit before tax (VII-VIII)		XXX	XXX
X	Tax expense:			
	(1) Current tax		XXX	XXX
	(2) Deferred tax		XXX	XXX
XI	Profit (Loss) for the period from continuing operations (VII-VIII)		XXX	XXX
XII	Profit (Loss) from discontinuing operations		XXX	XXX
XIII	Tax expense of discontinuing operations		XXX	XXX
XIV	Profit (Loss) from discontinuing operations (after tax) (XII-XIII)		XXX	XXX
XV	Profit (Loss) for the period (XI+XIV)		XXX	XXX
XVI	Earnings per equity share:			
	(1) Basic		XXX	XXX
	(2) Diluted		XXX	XXX

PART I – BALANCE SHEET

Name of the Company.....

Balance Sheet as at.....

(Rupees in.....)

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
1	2	3	4
I. EQUITY AND LIABILITIES			
1. Shareholders' funds			
a) Share capital			
b) Reserves and Surplus			
c) Money received against share warrants			
2. Share application money pending allotment			
3. Non-current liabilities			
a) Long-term borrowings			
b) Deferred tax liabilities (Net)			
c) Other long term liabilities			
d) Long-term provisions			
4. 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 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 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 <div style="text-align: right;">Total</div>			
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As per Schedule III of the Companies Act, 2013, depending upon the turnover of the company, the figures appearing in the financial statements may be rounded off as given below:

Turnover	Rounding off
(a) less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
(b) one hundred crore rupees or more	To the nearest lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it shall be used uniformly in the financial statements.

8.4 Financial statement analysis

8.4.1 Meaning of financial statement analysis

Financial statement analysis is comparison of the various items in the financial statements by establishing and evaluating relationships among them so that, it gives a better understanding of the performance and financial status of the business concern.

It involves rearrangement of data in accordance with the purpose of analysis, application of financial tools, evaluating the relationship among the component parts and drawing conclusion based on the analysis. Thus, financial statement analysis includes both analysis and interpretation.

Analysis refers to examination of the figures computed and comparison of the same to establish relationship among them and identifying the reasons for the performance or changes. Interpretation refers to elucidation and explanation of the results of analysis.

8.4.2 Objectives of financial statement analysis

Financial statement analysis may be done with any of the following objectives:

1. To analyse the profitability and earning capacity
2. To study the long term and short term solvency of the business
3. To determine the efficiency in operations and use of assets
4. To determine the efficiency of the management and employees
5. To determine the trend in sales, production, etc.
6. To forecast for future and prepare budgets
7. To make inter-firm and intra-firm comparisons.



Intra-firm comparison is comparison within the organisation among different departments, divisions, etc.

Inter-firm comparison is comparison of one firm with other firm or firms in the industry.

8.4.3 Limitations of financial statement analysis

Following are the limitations of financial statement analysis:

1. All the limitations of financial statements such as ignoring non-monetary information, ignoring price level changes, etc., are applicable to financial statement analysis also.
2. Financial statement analysis is only the means and not an end, that is, it is only a tool in the hands of management and other shareholders. Interpretation of the results has to be done only by the financial analysts with due regard to the internal and external environmental factors.
3. Expert knowledge is required in analysing the financial statements.
4. Interpretation of the analysed data involves personal judgement as different experts may give different views.

8.5 Tools of financial statement analysis

Different tools are used for analysing the financial statements. The tool is selected based on the purpose of analysis. Following are the commonly used tools of financial statement analysis:

(i) Comparative statement

A statement giving comparison of net increase or decrease in the individual items of financial statements of two or more years of a business concern is called comparative statement. It shows the actual figures at different periods of time, the increase or decrease in these figures

in absolute terms and the percentages of such increase or decrease. The two basic comparative statements prepared are comparative income statement and comparative balance sheet.

(ii) Common-size statements

The common-size statements show the relationship of various items with some common base, expressed as percentage of the common base. The common bases are total of assets or total of equity and liabilities or revenue from operations (net sales). The common size statements include common-size income statement and common-size balance sheet.

In the common-size income statement, revenue from operations is taken as 100 and various expenses and incomes are expressed as a percentage to the revenue from operations. In the common-size balance sheet, the total of balance sheet, that is, the total of assets or total of equity and liabilities is taken as 100 and various assets and liabilities are expressed as a percentage of the total of assets or total of equity and liabilities.

The common-size statements can be compared with those of previous years. They can also be compared with those of other similar businesses with similar accounting policies.

(iii) Trend analysis

Trend refers to the tendency of movement. Trend analysis refers to the study of movement of figures over a period. The trend may be increasing trend or decreasing trend or irregular. When data for more than two years are to be analysed, it may be difficult to use comparative statement. For this purpose, trend analysis may be used. One year, generally, the first year is taken as the base year. The figures of the base year are taken as 100. The figures for the other years are expressed as a percentage to the base year and the trend is determined.

(iv) Funds flow analysis

The term 'fund' refers to working capital. Working capital refers to the excess of current assets over current liabilities. The term 'flow' means movement and includes both 'inflow' and 'outflow'. Funds flow analysis is concerned with preparation of funds flow statement which shows the inflow (sources) and outflow (applications) of funds in a given period of time. Funds flow analysis is useful in judging the credit worthiness, financial planning and preparation of budgets.

(v) Cash flow analysis

Cash flow analysis is concerned with preparation of cash flow statement which shows the inflow and outflow of cash and cash equivalents in a given period of time. Cash includes cash in hand and demand deposits with banks. Cash equivalents denote short term investments which can be realised easily within a short period of time, without much loss in value. Cash flow analysis helps in assessing the liquidity and solvency of a business concern.

8.6 Preparation of comparative statements

A comparative statement has five columns. Following are the steps to be followed in preparation of the comparative statement:

- (i) Column 1: In this column, particulars of items of income statement or balance sheet are written.
- (ii) Column 2: Enter absolute amount of year 1.
- (iii) Column 3: Enter absolute amount of year 2.
- (iv) Column 4: Show the difference in amounts between year 1 and year 2. If there is an increase in year 2, put plus sign and if there is decrease put minus sign.
- (v) Column 5: Show percentage increase or decrease of the difference amount shown in column 4 by dividing the amount shown in column 4 (absolute amount of increase or decrease) by column 2 (year 1 amount). That is,

$$\text{Percentage increase or decrease} = \frac{\text{Absolute amount of increase or decrease}}{\text{Year 1 amount}} \times 100$$

Format of comparative statement

Particulars	Year 1	Year 2	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹	₹	
(1)	(2)	(3)	(4)	(5)



Horizontal analysis

When figures relating to several years are considered for the purpose of analysis, the analysis is called horizontal analysis. Generally, one year is taken as the base year and the figures relating to the other years are compared with that of the base year. Comparative statements and trend percentages are examples of horizontal analysis.

Vertical analysis

When figures relating to one accounting year alone are considered for the purpose of analysis, the analysis is called vertical analysis. Here, relationship is established among items from various financial statements relating to the same accounting period. Preparation of common size statements and computation of ratios are examples of vertical analysis.

Illustration 1

From the following particulars, prepare comparative income statement of Tharun Co. Ltd.

Particulars	2016-17	2017-18
	₹	₹
Revenue from operations	2,00,000	2,50,000
Other income	50,000	40,000
Expenses	1,50,000	1,20,000

Solution

Comparative income statement of Tharun Co. Ltd for the years ended 31st March, 2017 and 31st March, 2018

Particulars	2016-17	2017-18	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹	₹	
Revenue from operations	2,00,000	2,50,000	+50,000	+25
Add: Other income	50,000	40,000	-10,000	-20
Total revenue	2,50,000	2,90,000	+40,000	+16
Less: Expenses	1,50,000	1,20,000	-30,000	-20
Profit before tax	1,00,000	1,70,000	+70,000	+70

Tutorial note: Computation of percentage increase for revenue from operations

$$\frac{\text{Absolute amount of increase or decrease}}{\text{Year 1 amount}} \times 100 = \frac{50,000}{2,00,000} \times 100 = 25\%$$



Student activity 8.2

While comparing the current year's income statement with that of the previous year, it is found that profit before tax has increased by 70%. Think of any three possible reasons for this increase.

Illustration 2

From the following particulars, prepare comparative income statement of Abdul Co. Ltd.

Particulars	2015-16	2016-17
	₹	₹
Revenue from operations	3,00,000	3,60,000
Other income	1,00,000	60,000
Expenses	2,00,000	1,80,000
Income tax	30%	30%

Solution

Comparative income statement of Abdul Co. Ltd for the years ended 31st March, 2016 and 31st March, 2017

Particulars	2015-16	2016-17	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹	₹	
Revenue from operations	3,00,000	3,60,000	+60,000	+20
Add: Other income	1,00,000	60,000	-40,000	-40
Total revenue	4,00,000	4,20,000	+20,000	+5
Less: Expenses	2,00,000	1,80,000	-20,000	-10
Profit before tax	2,00,000	2,40,000	+40,000	+20
Less: Tax (30%)	60,000	72,000	+12,000	+20
Profit after tax	1,40,000	1,68,000	+28,000	+20

Illustration 3

From the following particulars, prepare comparative income statement of Mary Co. Ltd.

Particulars	2015-16	2016-17
	₹	₹
Revenue from operations	4,00,000	5,00,000
Operating expenses	2,00,000	1,80,000
Income tax (% of the profit before tax)	20	50

Solution

**Comparative income statement of Mary Co. Ltd for the years ended
31st March, 2016 and 31st March, 2017**

Particulars	2015-16	2016-17	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹		
Revenue from operations	4,00,000	5,00,000	+1,00,000	+25
Less: Operating expenses	2,00,000	1,80,000	-20,000	-10
Profit before tax	2,00,000	3,20,000	+1,20,000	+60
Less: Income tax*	40,000	1,60,000	+1,20,000	+300
Profit after tax	1,60,000	1,60,000	-	-

*** Note: Calculation of income tax:**

For 2015-16: $2,00,000 \times 20\% = ₹ 40,000$

For 2016-17: $3,20,000 \times 50\% = ₹ 1,60,000$

Illustration 4

From the following balance sheet of Chandra Ltd, prepare comparative balance sheet as on 31st March 2016 and 31st March 2017.

Particulars	31 st March 2016	31 st March 2017
	₹	₹
I EQUITY AND LIABILITIES		
Shareholders' fund	1,00,000	2,60,000
Non-current liabilities	50,000	60,000
Current liabilities	25,000	30,000
Total	1,75,000	3,50,000
II ASSETS		
Non-current assets	1,00,000	2,00,000
Current assets	75,000	1,50,000
Total	1,75,000	3,50,000

Solution

Comparative balance sheet of Chandra Ltd as on 31st March 2016 and 31st March 2017

Particulars	2015-16	2016-17	Absolute amount of increase (+) or decrease (–)	Percentage increase (+) or decrease (–)
	₹	₹	₹	
I EQUITY AND LIABILITIES				
Shareholders' fund	1,00,000	2,60,000	+1,60,000	+160
Non-current liabilities	50,000	60,000	+10,000	+20
Current liabilities	25,000	30,000	+5,000	+20
Total	1,75,000	3,50,000	+1,75,000	+100
II ASSETS				
Non-current assets	1,00,000	2,00,000	+1,00,000	+100
Current assets	75,000	1,50,000	+75,000	+100
Total	1,75,000	3,50,000	+1,75,000	+100

Illustration 5

From the following particulars, prepare comparative balance sheet of Malar Ltd as on 31st March 2016 and 31st March 2017.

Particulars	31 st March 2016	31 st March 2017
	₹	₹
I EQUITY AND LIABILITIES		
1. Shareholders' fund		
a) Share capital	2,00,000	2,50,000
b) Reserves and surplus	50,000	50,000
2. Non-current liabilities		
Long-term borrowings	30,000	60,000
3. Current liabilities		
Trade payables	20,000	60,000
Total	3,00,000	4,20,000
II ASSETS		
1. Non-current assets		
a) Fixed assets	1,00,000	1,50,000
b) Non - current investments	50,000	75,000
2. Current assets		
Inventories	75,000	1,50,000
Cash and cash equivalents	75,000	45,000
Total	3,00,000	4,20,000

Solution

Comparative balance sheet of Malar Ltd as on 31st March 2016, and 31st March 2017

Particulars	2015-16	2016-17	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹	₹	
I EQUITY AND LIABILITIES				
1. Shareholders' Fund				
a) Share capital	2,00,000	2,50,000	+50,000	+25
b) Reserves and surplus	50,000	50,000	-	-
2. Non-current liabilities				
Long-term borrowings	30,000	60,000	+30,000	+100
3. Current liabilities				
Trade payables	20,000	60,000	+40,000	+200
Total	3,00,000	4,20,000	+1,20,000	+40
II ASSETS				
1. Non-current assets				
a) Fixed assets	1,00,000	1,50,000	+50,000	+50
b) Non-current investments	50,000	75,000	+25,000	+50
2. Current assets				
Inventories	75,000	1,50,000	+75,000	+100
Cash and cash equivalents	75,000	45,000	-30,000	-40
Total	3,00,000	4,20,000	+1,20,000	+40



Student activity 8.3

Group activity: Collect published financial statements of similar businesses, from newspapers or business magazines or websites. Compare and analyse them.

8.7 Preparation of common-size statements

Common-size statement can be prepared with three columns. Following are the steps to be followed in preparation of common-size statement:

- Column 1:** In this column, particulars of items of income statement or balance sheet are written.
- Column 2:** Enter absolute amount.
- Column 3:** Choose a common base as 100. For example, revenue from operations can be taken as the base for income statement and total of balance sheet can be taken as the base for balance sheet. Work out the percentage for all the items of column 2 in terms of the common base and enter them in column 3.

Format of common-size statement

Particulars	Absolute amount	Percentage

Illustration 6

From the following particulars of Kumar Ltd, prepare a common-size income statement for the year ended 31st March, 2018.

Particulars	2017-18
	₹
Revenue from operations	5,00,000
Other income	20,000
Expenses	3,00,000

Solution

Common-size income statement of Kumar Ltd for the year ended 31st March, 2018

Particulars	Absolute amount	Percentage of revenue from operations
	₹	
Revenue from operations	5,00,000	100
Add: Other income	20,000	4
Total revenue	5,20,000	104
Less: Expenses	3,00,000	60
Profit before tax	2,20,000	44

Note: Computation of percentage for other income

$$\frac{20,000}{5,00,000} \times 100 = 4\%$$

Illustration 7

From the following particulars of Mani Ltd and Kani Ltd prepare a common-size income statement for the year ended 31st March, 2019.

Particulars	Mani Ltd	Kani Ltd
	₹	₹
Revenue from operations	2,00,000	2,50,000
Other income	30,000	25,000
Expenses	1,10,000	1,25,000

Solution

Common-size income statement for the year ended 31st March, 2019

Particulars	Mani Ltd		Kani Ltd	
	Absolute amount	Percentage of revenue from operations	Absolute amount	Percentage of revenue from operations
	₹		₹	
Revenue from operations	2,00,000	100	2,50,000	100
Add: Other income	30,000	15	25,000	10
Total revenue	2,30,000	115	2,75,000	110
Less: Expenses	1,10,000	55	1,25,000	50
Profit before tax	1,20,000	60	1,50,000	60

Illustration 8

From the following particulars of Siva Ltd, prepare common size income statement for the years ended 31st March, 2016 and 31st March, 2017.

Particulars	2015-16	2016-17
	₹	₹
Revenue from operations	2,00,000	3,00,000
Other income	25,000	75,000
Expenses	2,50,000	1,50,000
Income tax %	40	40

Solution

Common-size income statement of Siva Ltd for the year ended 31st March, 2016 and 31st March, 2017

Particulars	Absolute amount 2015-16	Percentage of revenue from operations for 2015-16	Absolute amount 2016-17	Percentage of revenue from operations for 2016-17
	₹		₹	
Revenue from operations	2,00,000	100.00	3,00,000	100
Add: Other income	25,000	12.50	75,000	25
Total revenue	2,25,000	112.50	3,75,000	125
Less: Expenses	2,50,000	125.00	1,50,000	50
Profit / loss before tax	-25,000	-12.50	2,25,000	75
Less: Income tax (40%)	-	-	90,000	30
Profit after tax	-25,000	-12.50	1,35,000	45

Illustration 9

Prepare common-size balance sheet of Maria Ltd. as on 31st March, 2018.

Particulars	31 st March 2018
	₹
I EQUITY AND LIABILITIES	
Shareholders' funds	4,00,000
Non-current liabilities	3,20,000
Current liabilities	80,000
Total	8,00,000
II ASSETS	
Non-current assets	6,00,000
Current assets	2,00,000
Total	8,00,000

Solution

Common-size balance sheet of Maria Ltd as on 31st March, 2018

Particulars	Absolute amount	Percentage of total assets
	₹	
I EQUITY AND LIABILITIES		
Shareholders' funds	4,00,000	50
Non-current liabilities	3,20,000	40
Current liabilities	80,000	10
Total	8,00,000	100
II ASSETS		
Non-current assets	6,00,000	75
Current assets	2,00,000	25
Total	8,00,000	100

Illustration 10

Prepare common-size balance sheet of Sharmila Ltd. and Sangeetha Ltd. as on 31st March, 2019.

Particulars	Sharmila Ltd	Sangeetha Ltd
	₹	₹
I EQUITY AND LIABILITIES		
Shareholders' funds	5,00,000	11,00,000
Non-current liabilities	4,00,000	7,00,000
Current liabilities	1,00,000	2,00,000
Total	10,00,000	20,00,000
II ASSETS		
Non-current assets	6,50,000	18,00,000
Current assets	3,50,000	2,00,000
Total	10,00,000	20,00,000

Solution

Common-size balance sheet of Sharmila Ltd and Sangeetha Ltd as on 31st March, 2019

Particulars	Sharmila Ltd		Sangeetha Ltd	
	Absolute amount	Percentage of total assets	Absolute amount	Percentage of total assets
	₹		₹	
I EQUITY AND LIABILITIES				
Shareholders' funds	5,00,000	50	11,00,000	55
Non-current liabilities	4,00,000	40	7,00,000	35
Current liabilities	1,00,000	10	2,00,000	10
Total	10,00,000	100	20,00,000	100
II ASSETS				
Non-current assets	6,50,000	65	18,00,000	90
Current assets	3,50,000	35	2,00,000	10
Total	10,00,000	100	20,00,000	100

Illustration 11

Prepare common-size statement of financial position of Saleem Ltd as on 31st March, 2017 and 31st March, 2018.

Particulars	31 st March 2017	31 st March 2018
	₹	₹
I EQUITY AND LIABILITIES		
1. Shareholders' fund		
a) Share capital	5,00,000	6,00,000
b) Reserves and surplus	4,00,000	3,60,000
2. Non-current liabilities		
Long-term borrowings	8,00,000	2,40,000
3. Current liabilities		
Trade payables	3,00,000	-
Total	20,00,000	12,00,000
II ASSETS		
1. Non-current assets		
a) Fixed assets	10,00,000	6,00,000
b) Non – current investments	5,00,000	2,40,000
2. Current assets		
Inventories	3,00,000	1,20,000
Cash and cash equivalents	2,00,000	2,40,000
Total	20,00,000	12,00,000

Solution

Common-size balance sheet of Saleem Ltd as on 31st March, 2017 and 31st March, 2018

Particulars	Absolute amount on 31 st March 2017	Percentage of total assets on 31 st March 2017	Absolute amount on 31 st March 2018	Percentage of total assets on 31 st March 2018
	₹		₹	
I EQUITY AND LIABILITIES				
1. Shareholders' fund				
a) Share capital	5,00,000	25	6,00,000	50
b) Reserves and surplus	4,00,000	20	3,60,000	30
2. Non-current liabilities				
Long-term borrowings	8,00,000	40	2,40,000	20
3. Current liabilities				
Trade payables	3,00,000	15	-	-
Total	20,00,000	100	12,00,000	100
II ASSETS				
1. Non-current assets				
a) Fixed assets	10,00,000	50	6,00,000	50
b) Non – current investments	5,00,000	25	2,40,000	20
2. Current assets				
Inventories	3,00,000	15	1,20,000	10
Cash and cash equivalents	2,00,000	10	2,40,000	20
Total	20,00,000	100	12,00,000	100

8.8 Trend analysis

The following steps can be followed to compute trend percentages:

- Take the earliest year as the base year.
- Take the figures for the base year as 100.
- Express the figures for the other years as a percentage to the base year and determine the trend.

Illustration 12

Calculate trend percentages for the following particulars of Kurinji Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	120	132	156
Other income	50	38	65
Expenses	100	135	123

Solution

Trend analysis for Kurinji Ltd

Particulars	₹ in thousands			Trend percentages		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	120	132	156	100	110	130
Add: Other income	50	38	65	100	76	130
Total revenue	170	170	221	100	100	130
Less: Expenses	100	135	123	100	135	123
Profit	70	35	98	100	50	140

Note: Computation of trend percentage for revenue from operations:

$$\text{For 2016-17: } \frac{132}{120} \times 100 = 110\%$$

$$\text{For 2017-18: } \frac{156}{120} \times 100 = 130\%$$

Illustration 13

From the following information, calculate trend percentages for Mullai Ltd.

Particulars	₹ in lakhs		
	2015-16	2016-17	2017-18
Revenue from operations	100	120	160
Other income	20	24	20
Expenses	20	14	40
Income tax	30%	30%	30%

Solution

Trend analysis for Mullai Ltd

Particulars	₹ in lakhs			Trend percentages		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	100	120	160	100	120	160
Add: Other income	20	24	20	100	120	100
Total revenue	120	144	180	100	120	150
Less: Expenses	20	14	40	100	70	200
Profit before tax	100	130	140	100	130	140
Less: Income tax (30%)	30	39	42	100	130	140
Profit after tax	70	91	98	100	130	140

Illustration 14

From the following particulars of Neithal Ltd, calculate trend percentages.

Particulars	₹ in lakhs		
	2015-16	2016-17	2017-18
Revenue from operations	150	135	90
Other income	25	5	15
Expenses	125	75	50
Income tax	40%	40%	40%

Solution

Trend analysis for Neithal Ltd

Particulars	₹ in lakhs			Trend percentages		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	150	135	90	100	90	60
Add: Other income	25	5	15	100	20	60
Total revenue	175	140	105	100	80	60
Less: Expenses	125	75	50	100	60	40
Profit before tax	50	65	55	100	130	110
Less: Income tax (40%)	20	26	22	100	130	110
Profit after tax	30	39	33	100	130	110

Illustration 15

Calculate trend percentages for the following particulars of Palai Ltd.

Particulars	₹ in lakhs		
	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES			
Shareholders' fund	250	275	300
Non-current liabilities	100	125	100
Current liabilities	50	40	80
Total	400	440	480
II ASSETS			
Non-current assets	300	360	390
Current assets	100	80	90
Total	400	440	480

Solution

Trend analysis for Palai Ltd

Particulars	₹ in lakhs			Trend percentages		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES						
Shareholders' fund	250	275	300	100	110	120
Non-current liabilities	100	125	100	100	125	100
Current liabilities	50	40	80	100	80	160
Total	400	440	480	100	110	120
II ASSETS						
Non-current assets	300	360	390	100	120	130
Current assets	100	80	90	100	80	90
Total	400	440	480	100	110	120

Illustration 16

Compute trend percentages for the following particulars of Boomi Ltd.

Particulars	₹ in lakhs		
	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES			
1. Shareholders' fund			
a) Share capital	200	254	212
b) Reserves and surplus	60	60	90
2. Non-current liabilities			
Long-term borrowings	140	154	168
3. Current liabilities			
Trade payables	40	60	80
Total	440	528	550
II ASSETS			
1. Non-current assets			
a) Fixed assets	200	236	206
b) Non - current investments	80	100	120
2. Current assets			
Inventories	120	132	144
Cash and cash equivalents	40	60	80
Total	440	528	550

Solution

Trend analysis for Boomi Ltd

Particulars	₹ in lakhs			Trend percentages		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES						
1. Shareholders' fund						
a) Share capital	200	254	212	100	127	106
b) Reserves and surplus	60	60	90	100	100	150
2. Non-current liabilities						
Long-term borrowings	140	154	168	100	110	120
3. Current liabilities						
Trade payables	40	60	80	100	150	200
Total	440	528	550	100	120	125
II ASSETS						
1. Non-current assets						
a) Fixed assets	200	236	206	100	118	103
b) Non- current investments	80	100	120	100	125	150
2. Current assets						
Inventories	120	132	144	100	110	120
Cash and cash equivalents	40	60	80	100	150	200
Total	440	528	550	100	120	125



Student activity 8.4

Record minimum 4 of your class test marks for Accountancy and other subjects. Analyse your marks using trend percentages.

Points to remember

- ❖ The term financial statements generally refer to two basic statements, income statement and balance sheet.
- ❖ Notes and schedules also form part of financial statements.
- ❖ The tools of financial statement analysis include Comparative statement, Common size statement, Trend analysis, Funds flow analysis and Cash flow analysis.
- ❖ A statement giving comparison of net increase or decrease in the individual items of financial statements of two or more years of a business concern is called comparative statement.

- ❖ The common-size statements show the relationship of various items with some common base, expressed as percentage of the common base.
- ❖ Trend analysis refers to the study of movement of figures over a period.

Self-examination questions

I Multiple choice questions

Choose the correct answer

1. Which of the following statements is not true?
 - a) Notes and schedules also form part of financial statements.
 - b) The tools of financial statement analysis include common-size statement
 - c) Trend analysis refers to the study of movement of figures for one year
 - d) The common-size statements show the relationship of various items with some common base, expressed as percentage of the common base
2. Balance sheet provides information about the financial position of a business concern
 - a) Over a period of time
 - b) As on a particular date
 - c) For a period of time
 - d) For the accounting period
3. Which of the following tools of financial statement analysis is suitable when data relating to several years are to be analysed?
 - a) Cash flow statement
 - b) Common size statement
 - c) Comparative statement
 - d) Trend analysis
4. The financial statements do not exhibit
 - a) Non-monetary data
 - b) Past data
 - c) Short term data
 - d) Long term data
5. Which of the following is not a tool of financial statement analysis?
 - a) Trend analysis
 - b) Common size statement
 - c) Comparative statement
 - d) Standard costing
6. The term 'fund' refers to
 - a) Current liabilities
 - b) Working capital
 - c) Fixed assets
 - d) Non-current assets
7. Which of the following statements is not true?
 - a) All the limitations of financial statements are applicable to financial statement analysis also.
 - b) Financial statement analysis is only the means and not an end.
 - c) Expert knowledge is not required in analysing the financial statements.
 - d) Interpretation of the analysed data involves personal judgement.
8. A limited company's sales has increased from ₹ 1,25,000 to ₹ 1,50,000. How does this appear in comparative income statement?
 - a) + 20 %
 - b) + 120 %
 - c) - 120 %
 - d) - 20 %

9. In a common-size balance sheet, if the percentage of non-current assets is 75, what would be the percentage of current assets?
a) 175 b) 125 c) 25 d) 100
10. Expenses for a business for the first year were ₹ 80,000. In the second year, it was increased to ₹ 88,000. What is the trend percentage in the second year?
a) 10 % b) 110 % c) 90 % d) 11%

Answers	1. (c)	2. (b)	3. (d)	4. (a)	5. (d)	6. (b)	7. (c)	8. (a)	9. (c)	10. (b)
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II Very short answer questions

- What are financial statements?
- List the tools of financial statement analysis.
- What is working capital?
- When is trend analysis preferred to other tools?

III Short answer questions

- 'Financial statements are prepared based on the past data.' Explain how this is a limitation.
- Write a short note on cash flow analysis.
- Briefly explain any three limitations of financial statements.
- Explain the steps involved in preparing comparative statement.
- Explain the procedure for preparing common-size statement.

IV Exercises

Comparative statement analysis

- From the following particulars, prepare comparative income statement of Arul Ltd.

Particulars	2015-16 ₹	2016-17 ₹
Revenue from operations	50,000	60,000
Other income	10,000	30,000
Expenses	40,000	50,000

(Answer: Revenue from operations: 20%; Other income: 200%;
Total revenue: 50%; Expenses: 25%; Profit before tax: 100%)

- From the following particulars, prepare comparative income statement of Barani Ltd.

Particulars	2016-17 ₹	2017-18 ₹
Revenue from operations	30,000	45,000
Other income	4,000	6,000
Expenses	10,000	15,000
Income tax	30%	30%

(Answer: Revenue from operations: 50%; Other income: 50%; Total revenue: 50%; Expenses:
50%; Profit before tax: 50%; Tax: 50% ; Profit after tax: 50%)

3. From the following particulars, prepare comparative income statement of Daniel Ltd.

Particulars	2015-16 ₹	2016-17 ₹
Revenue from operations	40,000	50,000
Operating expenses	25,000	27,500
Income tax (% of the profit before tax)	30	30

(Answer: Revenue from operations: 25%; Expenses: 10%; Profit before tax: 50%;
Tax: 50%; Profit after tax: 50%)

4. From the following particulars, prepare comparative statement of financial position of Muthu Ltd.

Particulars	31st March, 2017 ₹	31st March, 2018 ₹
I EQUITY AND LIABILITIES		
Shareholders' Fund	4,00,000	4,40,000
Non-current liabilities	1,50,000	1,65,000
Current liabilities	75,000	82,500
Total	6,25,000	6,87,500
II ASSETS		
Non-current assets	5,00,000	6,00,000
Current assets	1,25,000	87,500
Total	6,25,000	6,87,500

(Answer: Shareholder's fund: 10%; Non-current liabilities: 10%; Current liabilities: 10%;
Total equity and liabilities: 10%; Non-current assets: 20%; Current assets: -30%; Total assets: 10%)

5. From the following particulars, prepare comparative statement of financial position of Kala Ltd.

Particulars	31st March, 2017 ₹	31st March, 2018 ₹
I EQUITY AND LIABILITIES		
1. Shareholders' Fund		
a) Share capital	3,00,000	3,60,000
b) Reserves and surplus	50,000	50,000
2. Non-current liabilities		
Long-term borrowings	50,000	40,000
3. Current liabilities		
Trade payables	20,000	12,000
Total	4,20,000	4,62,000

II ASSETS		
1. Non-current assets		
a) Fixed assets	2,50,000	2,90,000
b) Non - current investments	50,000	40,000
2. Current assets		
Inventories	80,000	1,00,000
Cash and cash equivalents	40,000	32,000
Total	4,20,000	4,62,000

(Answer: Share capital: 20%; Reserves and surplus: Nil; Non-current liabilities: -20%; Current liabilities: -40%; Total equity and liabilities: 10%; Fixed assets: 16%; Non- current investments: - 20%; Inventories: 25%; Cash and cash equivalents: -20%; Total assets: 10%)

Common-size statement

6. Prepare common-size income statement for the following particulars of Raja Ltd. for the year ended 31st March, 2017

Particulars	2016-17
	₹
Revenue from operations	4,50,000
Other income	67,500
Expenses	1,35,000

(Answer: 2016-17: Other income: 15%; Total revenue: 115%; Expenses: 30%; Profit before tax: 85%)

7. From the following particulars of Maria Ltd. and Kala Ltd. prepare a common-size income statement for the year ended 31st March, 2019.

Particulars	Maria Ltd	Kala Ltd
	₹	₹
Revenue from operations	1,00,000	2,00,000
Other income	10,000	30,000
Expenses	70,000	1,20,000

(Answer: Maria Ltd: Other income: 10%; Total revenue: 110%; Expenses: 70%; Profit before tax: 40%
Kala Ltd: Other income: 15%; Total revenue: 115%; Expenses: 60%; Profit before tax: 55%)

8. Prepare common-size income statement for the following particulars of Sam Ltd.

Particulars	2015-16	2016-17
	₹	₹
Revenue from operations	4,00,000	5,00,000
Other income	80,000	50,000
Expenses	2,40,000	2,50,000
Income tax	30%	30%

(Answer: 2015-16: Other income: 20%; Total revenue: 120%; Expenses: 60%; Profit before tax: 60%; Tax: 18%; Profit after tax: 42%; 2016-17: Other income: 10%; Total revenue: 110%; Expenses: 50%; Profit before tax: 60%; Tax: 18%; Profit after tax: 42%)

9. Prepare Common-size balance sheet of Meena Ltd. as on 31st March, 2018.

Particulars	31 st March 2018
	₹
I EQUITY AND LIABILITIES	
Shareholders' funds	2,00,000
Non-current liabilities	1,60,000
Current liabilities	40,000
Total	4,00,000
II ASSETS	
Non-current assets	3,00,000
Current assets	1,00,000
Total	4,00,000

(Answer: Shareholder's fund: 50%; Non-current liabilities: 40%; Current liabilities: 10%;
Non-current assets: 75%; Current assets: 25%)

10. Prepare common-size statement of financial position for the following particulars of Rani Ltd.

Particulars	31st March, 2016	31st March, 2017
	₹	₹
I EQUITY AND LIABILITIES		
Shareholders' Fund	5,40,000	6,00,000
Non-current liabilities	2,70,000	2,50,000
Current liabilities	90,000	1,50,000
Total	9,00,000	10,00,000
II ASSETS		
Non-current assets	7,20,000	8,00,000
Current assets	1,80,000	2,00,000
Total	9,00,000	10,00,000

(Answer: 2015-16: Shareholder's fund: 60%; Non-current liabilities: 30%; Current liabilities: 10%; Non-current assets: 80%; Current assets: 20%; 2016-17: Shareholder's fund: 60%; Non-current liabilities: 25%; Current liabilities: 15%; Non-current assets: 80%; Current assets: 20%)

11. Prepare common-size statement of financial position for the following particulars of Yasmin Ltd. and Sakthi Ltd.

Particulars	Yasmin Ltd.	Sakthi Ltd.
	₹	₹
I EQUITY AND LIABILITIES		
1. Shareholders' Fund		
a) Share capital	2,00,000	3,00,000
b) Reserves and surplus	50,000	60,000
2. Non-current liabilities		
Long-term borrowings	1,50,000	1,80,000
3. Current liabilities		
Trade payables	1,00,000	60,000
Total	5,00,000	6,00,000

II ASSETS		
1. Non-current assets		
a) Fixed assets	2,00,000	3,00,000
b) Non - current investments	50,000	1,20,000
2. Current assets		
Inventories	2,00,000	90,000
Cash and cash equivalents	50,000	90,000
Total	5,00,000	6,00,000

(Answer: Yasmin Ltd: Share capital: 40%; Reserves and surplus: 10%; Non-current liabilities: 30%; Current liabilities: 20%; Fixed assets: 40%; Non- current investments: 10%; Inventories: 40%; Cash & cash equivalents: 10% Sakthi Ltd: Share capital: 50%; Reserves and surplus: 10%; Non-current liabilities: 30%; Current liabilities: 10%; Fixed assets: 50%; Non- current investments: 20%; Inventories: 15%; Cash & cash equivalents: 15%)

Trend analysis

12. From the following particulars, calculate the trend percentages of Kala Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	400	500	600
Other income	100	150	200
Expenses	200	290	350

(Answer: 2016-17: Revenue from operations: 125%; Other income: 150%; Total revenue: 130%; Expenses: 145%; Profit before tax: 120% 2017-18: Revenue from operations: 150%; Other income: 200%; Total revenue: 160%; Expenses: 175%; Profit before tax: 150%)

13. From the following particulars, calculate the Trend percentages of Kavitha Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	100	125	150
Other income	20	25	30
Expenses	100	120	80
Income tax	30%	30%	30%

(Answer: 2016-17: Revenue from operations: 125%; Other income: 125%; Total revenue: 125%; Expenses: 120%; Profit before tax: 150%; Tax: 150%; Profit after tax: 150%; 2017-18: Revenue from operations: 150%; Other income: 150%; Total revenue: 150%; Expenses: 80%; Profit before tax: 500%; Tax: 500%; Profit after tax: 500%)

14. From the following particulars, calculate the trend percentages of Kumar Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	300	270	150
Other income	50	80	60
Expenses	250	200	125
Income tax %	40	40	40

(Answer: 2016-17: Revenue from operations: 90%; Other income: 160%; Total revenue: 100%; Expenses: 80%; Profit before tax: 150%; Tax: 150%; Profit after tax: 150%; 2017-18: Revenue from operations: 50%; Other income: 120%; Total revenue: 60%; Expenses: 50%; Profit before tax: 85%; Tax: 85%; Profit after tax: 85%)

15. From the following particulars, calculate the trend percentages of Anu Ltd.

Particulars	₹ in thousands		
	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES			
Shareholders' Fund	500	550	600
Non-current liabilities	200	250	240
Current liabilities	100	80	120
Total	800	880	960
II ASSETS			
Non-current assets	600	720	780
Current assets	200	160	180
Total	800	880	960

(Answer: Year 2: Shareholder's fund: 110%; Non-current liabilities: 125%; Current liabilities: 80%; Total equity and liabilities: 110%; Non-current assets: 120%; Current assets: 80%; Total assets: 110%; Year 3: Shareholder's fund: 120%; Non-current liabilities: 120%; Current liabilities: 120%; Total equity and liabilities: 120%; Non-current assets: 130%; Current assets: 90%; Total assets: 120%)

16. From the following particulars, calculate the trend percentages of Babu Ltd.

Particulars	₹ in thousands		
	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES			
1. Shareholders' Fund			
a) Share capital	100	127	106
b) Reserves and surplus	30	30	45
2. Non-current liabilities			
Long-term borrowings	70	77	84
3. Current liabilities			
Trade payables	20	30	40
Total	220	264	275
II ASSETS			
1. Non-current assets			
a) Fixed assets	100	118	103
b) Non current investments	40	50	60
2. Current assets			
Inventories	60	66	72
Cash and cash equivalents	20	30	40
Total	220	264	275

(Answer: Year 2: Share capital: 127%; Reserves and surplus: 100%; Non-current liabilities: 110%; Current liabilities: 150%; Total equity and liabilities: 120%; Fixed assets: 118%; Non-current investments: 125%; Inventories: 110%; Cash & cash equivalents: 150%; Total assets: 120%; Year 3: Share capital: 106%; Reserves and surplus: 150%; Non-current liabilities: 120%; Current liabilities: 200%; Total equity and liabilities: 125%; Fixed assets: 103%; Non-current investments: 150%; Inventories: 120%; Cash & cash equivalents: 200%; Total assets: 125%)

CASE STUDY

Ravi and Raheem entered into a partnership business of buying and selling of electronic goods. Their business was successful. They wanted to expand their business. But, they did not have enough money to do so. Hence, they converted it into a private limited company and registered it as Ravi and Raheem Ltd. In the first two years, they were busy with the legal formalities, recruitment of staff and maintenance of many accounting records. They prepared financial statements as prescribed by the Companies Act, 2013. After five years, they were so curious to know if the business was performing well. They compared their business results with that of a sole trader's business.

Now, discuss the following:

Who would be interested to assess Ravi and Raheem Ltd's financial statements and why?

Why does Ravi and Raheem Ltd need to follow Companies Act, 2013, in the preparation of financial statements?

Suggest some tools for Ravi and Raheem Ltd to analyse its financial statements.

Which would be the best tool to analyse, if Ravi and Raheem Ltd wants to compare data of more than three years?

Ravi and Raheem Ltd wants to know if their employees are skilled and motivated. Is it possible to analyse this from its financial statements?

What do you think of Ravi and Raheem Ltd's decision of comparing its results with that of a sole trader? Will it give a fair result?

To explore further

Is it possible to combine the numerous figures in the financial statements under common heads and analyse financial statements?

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