

1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 04 (Class XII, Semester - 2)
Module Name/Title	Analysis of Financial Statement Analysis
Module Id	Leac_ 20402
Pre-requisites	Basic knowledge of Meaning, Objective, Importance & Limitations of Financial Statement Analysis
Objectives	After going through this lesson, the learners will be able to understand: <ul style="list-style-type: none">• Comparative Statements• Common Size Statements• Trend Analysis
Keywords	Financial Statement Analysis, Comparative Statements, Common Size Statements, Trend Analysis

2. Development Team

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1. Tools of Financial Statement Analysis
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1. Tools for Financial Analysis:

Financial statements contain Mute figures. These figures of Assets, Liabilities, Revenues, Expenses, Profit, Loss do not reveal anything on their own. Earning capacity, Liquidity and Financial soundness are not readily understandable to their users unless they are Compared, Analyzed, put to Arithmetical Expression or Formula to present them in simple and understandable form. Various tools for analyzing the financial statements are as follows:

- a) Accounting Ratios
- b) Cash Flow Statement
- c) Comparative Statements
- d) Common Size Statements
- e) Trend Analysis
- f) Break-Even Point Analysis

First two, we will study each of them separately in particular chapter. Next three we will study here and the Last one at Senior levels. In the next session, we will start with Comparative Statements followed by others.

Let us begin with the First one-

(1) Comparative Statements:

When figures for two or more years are placed side-by-side to make a comparison, these are called 'Comparative Financial Statements'. Similar figures Like Revenue from operations

(Sales), Finance charges, Other Expenses, Profits etc. are put side-by-side to compare and draw conclusions about the Profitability and Financial health of the business. It also indicates the Trend, Strong and Weak points of the business enterprise.

(2) Common Size Statements:

Figures are converted into percentages to some common base. Like, in case of Statement of Profit and loss, Revenue from operations figure will be taken as a Base figure of 100 and all other figures in Statement of Profit and loss are expressed as percentage of revenue from operations.

Similarly, in Balance Sheet Total of Assets side is taken as a Base figure of 100 and All Other Individual Assets are expressed as percentage of the Total. Similarly, it can be extended for Liabilities side also.

(3) Trend Analysis:

Most useful form of making comparative study of the financial statements for a number of years. One year is selected as the 'base year'. Every item of that particular base year is taken to be equal to 100 and on that basis the percentage of each item of each year is calculated. This trend percentage is helpful in revealing the increasing or decreasing trend in various items.

TO BE DEALT IN SEPARATE CHAPTERS.

(4) Accounting Ratios:

A ratio is a meaningful comparison & quantitative expression of one number in relation to another related number. Study of these relationships between related items or groups of items is known as 'Ratio Analysis'. It provides useful information regarding the Liquidity, Profitability, Solvency, etc.

(5) **Cash Flow Statement:** This statement shows the Inflows and Outflows of Cash and Cash Equivalents during a particular period and also analyze the reasons for changes in balance of cash between the two balance sheet dates. A firm may earn huge profits yet it may not have sufficient amount of cash or may be, it suffered a loss but may still have Lot of Cash. The reasons for these can be analyzed and understood by preparing cash flow statement.

TO BE DEALT AT HIGHER LEVEL OF STUDY

(6) **Break-Even Analysis:** Break-Even Point is where total costs are exactly equal to the total sales. 'No-profit-No-loss' point. Part of Marginal Cost Analysis and Decision making.

Which of the above tool to select, depends upon the object and the circumstances of the analysis? The tool of analysis should be selected very carefully as a particular tool may be suitable to one investigator but may not be unsuitable to another investigator.

COMPARATIVE STATEMENTS

Comparative study of its financial statements for two or more years becomes essential in order to look into its past performance and to estimate the future progress of a firm. When figures for two or more years are placed side-by-side to facilitate comparison, these are called 'Comparative Financial Statements'.

These statements show the absolute figures of various years and also indicate the increase or decrease in these figures from one year to another. Along with that these statements may also show the changes in percentage form. Comparative statements are of great help in forming the opinion and taking decisions regarding the progress and Future predictions of the enterprise.

Comparison of the same firm is known as **Intra-firm comparison**. When two or more firms are compared, this is known as **Inter-firm comparison**.

Importance of Comparative Statements

(1) **To make data simple and understandable:** The main aim of preparing comparative financial statements is to present the data for a number of years in simple and comparable form.

When data for a number of years are put side-by-side, a comparison becomes easier and it becomes lot more simple to analyze and draw meaningful conclusions about the Operating and Financial health of the business.

(2) **Indicates trend:** Comparative financial statements indicate Trend of change. By putting the figures of Production, Sales, Expenses, Profits, etc. for a number of years' side-by-side, we can easily see Increase or Decrease over a period. And, if Incomes and Profits are increasing over the years, it is an indication of Healthy trend about the growth of the business.

(3) **Indicate the Strong and Weak points of the business:** Comparison for a number of years will indicate the Strong and Weak points of the business firm. Management can investigate and find the reasons for the weak points and can take corrective measures for the Future.

(4) **Comparison with performance of the industry:** Comparative statements help a business firm to compare its performance with the performance of the industry and Evaluates itself and try to improve in Future.

(5) **Forecasting:** Comparative study over a period will help the management in forecasting the future profitability and financial soundness of the business based upon the Previous data.

(6) **Legal Compliance:** Companies Act, 1956 & 2013 (Revised) has made it compulsory to make Statement of Profit & Loss and Balance Sheet of a Company in a comparative format to show the figures of the previous year also along with figures of the current year.

But it should be noted that for a valid comparison of financial statements, the statements should be prepared according to the generally accepted accounting principles & policies and see that the Accounting policies of a firm does not change over the period of comparison, i.e., the method of charging depreciation, valuation of inventory etc. should remain the same, otherwise the comparison will become misleading & lose its significance.

Forms of Presenting Comparative Statements

(1) **Absolute data with increases and decreases in Rupee amount only:**

Only rupee amounts and Increase / Decrease for various periods are shown in the comparative financial statements. Like For example, Sales in 2019 is ₹50,00,000 and in 2020 is ₹55,00,000 and in comparison to 2019, Sales in 2020 increased by ₹5,00,000.

(2) **Increases and Decreases in absolute data & in terms of percentages:** Like in above example, along with Absolute data if we also write Increase /Decrease in their % also, as in comparison to 2019, Sales in 2020 increased by 10%.

(3) **Cumulative figures and averages compared with the individual figure:**

Example, Sales in 2018, 2019, 2020 were ₹5,00,000; ₹8,00,000; ₹11,00,000 respectively.

So, Average Sales = $24,00,000 / 3 = ₹8,00,000$.

Now, this average figure of Sales is used for comparing each individual figure of Sales of each year and deviations are calculated. And what is the % of each item like, cost of production, Expense, etc. is related to Sales.

(4) **Ratios:** Current year data is divided by the data of previous year. Ratio of more than 1 indicate an increase while Ratio of less than 1 will indicate a decrease in the current year in comparison to previous year.

For example, if Sales in 2019 are ₹12,00,000 and Sales in 2020 are ₹18,00,000, the ratio will be 1.5 ($18,00,000 / 12,00,000$)

Generally, the statement of Profit & Loss and Balance sheet are prepared in a comparative form because they are the most important financial statements for a business. Discussed below:

1. Comparative Balance Sheet

It shows Increases / Decreases in the various Assets, Liabilities and Capital.

Advantages of Comparative Balance Sheet:

- (1) Comparative balance sheet also show Increase / Decrease in various items of balance sheet.
- (2) In Comparative balance sheet emphasis is on change.
- (3) A comparative balance sheet enables an analyst to study the Nature, Size and Direction of change, and it may be used to study the trends in business concern.

Content & Format of Comparative Balance Sheet:

It has six columns. In the first column the “Particulars” – Assets, Liabilities names and in the second column, “Note no.” and in the Third column data for “Current year” is shown and in the Fourth column the data for previous year is shown. In the Fifth column, “Absolute Increase or Decreases” is shown in terms of rupee amounts. Lastly, sixth column shows the “Percentage of increase or decrease in absolute data”.

Format of a Comparative Balance Sheet in Vertical form as per Revised Schedule is as under:

COMPARATIVE BALANCE SHEET as on 31st March 2020 and 2019					
Particulars	Note No.	2020	2019	Absolute Inc. or Dec. over 2019	% Inc. or Dec. over 2019
EQUITY AND LIABILITIES:		₹	₹	₹	%
Shareholder’s Funds					
Share Capital	
Reserve and Surplus	
Non-current Liabilities					
Long term Borrowings	
Current Liabilities					
Short term Borrowings	
Trade Payables	
TOTAL					

ASSETS:					
Non-Current Assets:					
Fixed Assets		....	....	....	....
(i) Tangible Assets		....	....	....	....
(ii) Intangible Assets		....	....	....	....
Non-Current Investments					
Current Assets:		....	....	....	....
Inventories		....	....	....	....
Trade Receivables		....	....	....	....
Cash and Cash Equivalents		....	....	....	....
TOTAL					

Let us see the following Questions on the preparation of comparative balance sheet:

Question 1.

Prepare a Comparative Balance Sheet from the following Balance Sheets of Sanjay Pipes Ltd. as on 31st March, 2020 and 2019:

Particulars	Note No.	31.3.2020	31.3.2019
EQUITY AND LIABILITIES:		₹	₹
Shareholder's Funds			
Share Capital		15,00,000	10,00,000
Reserve and Surplus		5,00,000	4,00,000
Non-current Liabilities			
Long term Borrowings		8,00,000	4,00,000
Current Liabilities			
Trade Payables		5,00,000	4,00,000
TOTAL		<u>33,00,000</u>	<u>22,00,000</u>
ASSETS:			

Non-Current Assets:			
Fixed Assets			
	(i) Tangible Assets	18,00,000	12,00,000
	(ii) Intangible Assets	4,00,000	3,00,000
Non-Current Investments			
Current Assets:		8,00,000	
	Inventories	3,00,000	5,00,000
	Cash and Cash Equivalents	<u>33,00,000</u>	2,00,000
TOTAL			<u>22,00,000</u>

Balance Sheet of current year will be given first as per Revised Format.

SOLUTION 1.

COMPARATIVE BALANCE SHEET as on 31st March 2020 and 2019

(1)	Particulars	Note No.(2)	2020 (3)	2019 (4)	Absolute Inc. or Dec. over 2019 (5)	% Inc. or Dec. over 2019 (6)
EQUITY AND LIABILITIES:						
Shareholder's Funds						
	Share Capital					
	Reserve and Surplus					
Non-current Liabilities						
	Long term Borrowings					
Current Liabilities						
	Short term Borrowings					
	Trade Payables					
	TOTAL					

ASSETS:					
Non-Current Assets:					
Fixed Assets					
(i) Tangible Assets					
(ii) Intangible Assets					
Non-Current Investments					
Current Assets:					
Inventories					
Trade Receivables					
Cash and Cash Equivalents					
TOTAL					

Comments: The analysis of the above comparative balance sheets gives following conclusions:

1. Comparative Statement of Profit and Loss or Comparative Income Statement

Comparative statement of profit and loss shows the changes in Net profits for a number of years in Absolute data and in terms of percentages. Comparative statement of profit and loss provides the following information on the Rate of increase or decrease in

- a. Revenue from operations.
- b. Cost of materials consumed.
- c. Incomes / expenses.
- d. Net profit.

Objectives of Comparative Statement of Profit & Loss:

- a) Comparison of various items of income and expenditure for two or more years.
- b) Analyse the increase or decrease in the Income, Expenditure, Profit / Loss in terms of rupee and also in percentage from one year to another.
- c) Forecasting the profitability of the business concern.

Content & Format of Comparative Statement of Profit & Loss:

It has six columns. In the first column the “Particulars” – Income, Expenses names and in the second column, “Note no.” and in the Third Column Absolute data for “Current year” is shown and in the Fourth column the Absolute data for “Previous year” is shown. In the Fifth column, “Absolute Increase or Decreases” is shown in terms of rupee amounts. Lastly, sixth column shows the “Percentage of increase or decrease in absolute data”.

Format of a Comparative Statement of Profit & Loss
COMPARATIVE STATEMENT OF PROFIT & LOSS for year ended 31st March 2020

Particulars	Note No.	Absolute Figures		Change (Base year 2019)	
		31.3.2020	31.3.2019	Absolute Fig	Percentage
		₹	₹	₹	%
I. Revenue from Operations	
II. <i>Add:</i> Other Incomes	
III. Total Revenue I + II		
IV. Less: Expenses					
Cost of Materials Consumed	
Employee Benefit Expenses	
Finance Costs	
Depreciation/Amortization Exp.	
Total		
Expenses	
Profit before Tax (III – IV)	
V. <i>Less:</i> Tax	
Profit after Tax(IV-V)					

Comparative statement of profit & loss has been explained in the following Questions:

QUESTION 2.

Prepare a Comparative Statement of Profit & Loss of Jai Ltd., with the following information:

Particulars	31.3.2020	31.3.2019
Revenue from Operations	₹ 80,00,000	₹ 60,00,000
Depreciation and amortization expenses	3,00,000	2,00,000
Other Expenses		
Finance Costs (60% of Revenue from Operations)	40,000	40,000
Employee Benefit Expenses	7,20,000	6,00,000
Other Income	.8,000	10,000

ANSWER 2.

COMPARATIVE STATEMENT OF PROFIT & LOSS for year ended 31st March 2020

Particulars	Note No.	Absolute Figures		Change (Base year 2019)	
		31.3.2020	31.3.2019	Absolute Fig	Percentage
I. Revenue from Operations		₹	₹	₹	%
II. <i>Add:</i> Other Incomes	
III. Total Revenue I + II	
IV. Less: Expenses					
Cost of Materials Consumed	
Employee Benefit Expenses	
Finance Costs	
	

Depreciation/Amortization Exp.		....	....	....
Total Expenses		....	....	....	....
	
Profit before Tax (III – IV)		....	....	....	....
V. <i>Less:</i> Tax					
Profit after Tax(IV-V)					

Common Size Statements

Meaning: In Common size statements, Individual figures are converted into percentages to one common base. Each individual item shows its relation to its respective total. This is called Vertical Analysis. Common size statements are prepared for balance sheet as well as income statement. Like for the Income Statement items of total revenue is taken as a base and then figures of individual items of Income Statement are converted in Percentage to this common base. Similarly, Absolute figures of individual items of Balance Sheet for two or more successive periods are converted in Percentage to the common base which is the total of assets or liabilities.

Purpose or Utility of Common Size Statements

- 1. To present the change in various items in relation to Total:** Through the preparation of common size statements, one of the major drawbacks of comparative financial statements is removed that of presenting the change in various items in relation to Total revenue, Total assets or Total liabilities.
- 2. To establish a relationship between various items:** A relationship is established between various items of the income statement to total revenue and various items of balance sheet to total assets or total liabilities over a period of Time. Important conclusions can be established by studying the change in such a relationship. For example, if over the years, Wages are 10% of Total Revenue, an increase will need immediate attention and it's causes Analyzed to take Corrective Action.

3. **To provide for a common base for comparison:** Common size statements provide a common base for comparison. Financial statements of different enterprises can be converted into uniform common-size format which will facilitate the comparison of profitability and financial position of two or more businesses over a period of time.

Preparation of Common Size Balance Sheet

Meaning

Common size balance sheet is a statement where total of assets or liabilities is taken as 100 and all the individual figures are expressed as a percentage of the total.

Purpose of Common Size Balance Sheet:

1. Analyze changes in individual items of balance sheet.
2. Analyze Trend in various items of assets and liabilities.
3. Judging the Comparative financial soundness of different enterprises in the same industry
4. Assessing financial strategy adopted by different enterprises in the same industry

Format of a Common Size Balance Sheet
COMMON SIZE BALANCE SHEET as on 31st March 2020 and 2019

Particulars	Note No.	Absolute Amounts		% Balance Sheet Total	
		2020	2019	2020	2019
I. EQUITY AND LIABILITIES:		₹	₹	₹	%
1. Shareholder's Funds					
Share Capital	
Reserve and Surplus	
2. Non-current Liabilities					
Long term Borrowings	
3. Current Liabilities					
Trade Payables	
		100	100

II. ASSETS:					
1. Non-Current Assets:					
Fixed Assets					
Tangible Assets		....	....	....	....
Intangible Assets		....	....	....	....
2. Current Assets:					
Inventories		....	....	....	....
Cash and Cash Equivalents		....	....	....	....
		....	....	100	100

NOTE-Balance Sheet of current year should be presented first and of previous year thereafter.

QUESTION NO. 1. Prepare a common size Balance Sheet from the following:

BALANCE SHEET as on 31st March, 2020 and 2019

Particulars	Note No.	31.3.2020	31.3.2019
I. EQUITY AND LIABILITIES:			
Shareholder's Funds			
Share Capital		10,00,000	5,00,000
Reserve and Surplus		8,00,000	6,00,000
Non-current Liabilities			
Long term Borrowings		4,00,000	4,00,000
Current Liabilities			
Trade Payables		6,00,000	4,00,000
Short term Provisions		2,00,000	<u>1,00,000</u>
TOTAL		<u>30,00,000</u>	<u>20,00,000</u>
II. ASSETS:			
Non-Current Assets:			
Fixed Assets		9,00,000	7,00,000
		3,00,000	5,00,000

Non-Current Investments					
Current Assets:		6,00,000	4,00,000		
Inventory		9,00,000	2,00,000		
Trade Receivables		3,00,000	2,00,000		
Cash & Cash Equivalent		<u>30,00,000</u>	<u>20,00,000</u>		
TOTAL					
Particulars	Note No.	Absolute Amounts	% Balance Sheet Total		
		2020	2019	2020	2019
I. EQUITY AND LIABILITIES:		₹	₹	₹	%
1. Shareholder's Funds					
Share Capital	
Reserve and Surplus	
2. Non-current Liabilities					
Long term Borrowings	
3. Current Liabilities					
Trade Payables	
		100	100
II. ASSETS:					
1. Non-Current Assets:					
Fixed Assets					
Tangible Assets	
Intangible Assets	
2. Current Assets:					
Inventories	
Cash and Cash Equivalents	

		100	100
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Preparation of Common Size Income Statement

Meaning

Income statement where figure of Total Revenue is equal to 100 and all other figures are expressed as percentage of total revenue.

Purpose of Common Size Income Statement:

1. Establish relationship between individual items of income statement and total revenue.

Like, we can observe that with an increase in Total Revenue, selling expenses will certainly increase being Variable but certainly not the Administrative Expenses.

Hence, a relationship can be established between Total Revenue and other items of the income statement which is helpful in analyzing the increase or decrease in the percentage of each item.

2. To judge the relative efficiency of items of the two or more firms in the same industry.

Format of a Common Size Income Statement

COMMON SIZE INCOME STATEMENT for the year ended 31st March, 2020 and 2019

Particulars	Note No.	Absolute Amounts		Percentage of Total Revenue	
		2020	2019	2020	2019
		₹	₹	₹	%
I. Revenue from Operations	
II. Add: Other Incomes	
III. Total Revenue I + II		100	100
IV. Less: Expenses					
Cost of Materials Consumed	
Purchase of Stock in Trade	
Changes in Inventories	
Employee Benefit Expenses	
Finance Costs	
Depreciation and Amortization Exp.	
Other Expenses	
Total Expenses	
Profit before Tax (III – IV)	
V. Less: Tax	

Profit after Tax	
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QUESTION 1.

Prepare a Common Size Income Statement from the following Income information:

Particulars	2020	2019
Revenue from Operations	15,00,000	20,00,000
Cost of Materials Consumed	6,00,000	7,00,000
Employee Benefit Expenses	1,50,000	1,80,000
Financial Cost	75,000	1,20,000
Other Expenses	60,000	90,000
Other Income	5,00,000	8,00,000
Income Tax	40%	35%

SOLUTION.

Particulars	Note No.	Absolute Amounts		Percentage of Total Revenue	
		2020	2019	2020	2019
I. Revenue from Operations		₹	₹	₹	%
II. Add: Other Incomes	
III. Total Revenue I + II		100	100
IV. Less: Expenses					
Cost of Materials Consumed	
Purchase of Stock in Trade	
Changes in Inventories	
Employee Benefit Expenses	
Finance Costs	

Depreciation and Amortization Exp.					....
Other Expenses					....
Total Expenses					....
Profit before Tax (III – IV)					....
V. Less: Tax					....
Profit after Tax					....

Trend Percentage Analysis

Useful in making comparative study of the financial statements for a number of years. These indicate the direction of movement over a long time and help to form an opinion as to whether favorable or unfavorable tendencies exist. This helps in future forecasts & Planning.

Generally, the First year may be taken as the 'Base year' and each item of base year is taken to be =100 and on that basis the percentage of each item of each year is calculated.

QUESTION.

Calculate the trend percentages from the following taking year ending 2017 as the base year:

Current Assets	2017		2018		2019		2020
	2017	2017	2018	2018	2019	2019	
Inventory	1,00,000	100	1,25,000	125%	1,40,000		1,50,000
Trade Receivables	50,000	100	60,000		70,000		1,00,000
Cash and Cash Equivalents	10,000	100	15,000		25,000		20,000
Other Current Assets	40,000	100	30,000		60,000		50,000
	2,00,000		2,30,000		3,00,000		3,20,000

