

CHAPTER - 8

ANALYSIS OF FINANCIAL STATEMENTS

TEST YOUR UNDERSTANDING I

• Fill in the blanks with appropriate word(s).

Question 1. Analysis simply means----data.

Answer Simplification .

Question 2. Interpretation means-----data.

Answer Explaining

Question 3. Comparative analysis is also known as-----Analysis.

Answer Horizontal

Question 4. Common size analysis is also known as-----Analysis

Answer Vertical

Question 5. The analysis of actual movement of money inflow and outflow in an organisation is called----analysis.

Answer cash flow

DO IT YOURSELF I

From the following balance sheet and income statement of Day Dreaming Co.Ltd., for the year ending 2002 and 2003, prepare the comparative statements.

Income Statement

(₹ in lakhs)

Particulars	2005	2006
Net Sales	900	1,050
Cost of Goods Sold	650	850
Administrative Expenses	40	40
Selling Expenses	20	20
Net Profit	190	140

Balance Sheet

Particulars	2005	2006
Equity Share Capital	600	600
6% Preference Share capital	500	500
Reserves	400	445
Debenture	300	350
Bills Payable	250	275
Creditors	150	200
Tax Payable	150	200
Total Liabilities	2,350	2,570
Land	300	300
Buildings	500	470
Plant	400	470
Furniture	300	340
Stock	400	500
Cash	450	490
Total Assets	2,350	2,570

Answer Comparative Income statement of Day Dreaming Company Limited for the year ended 2005 and 2006

Particulars	2005	2006	Absolute Change	Change in %
Net Sales	900	1050	150	16.67
(-) Cost of Goods Sold	(650)	(850)	(200)	(30.77)
Gross Profit (A)	250	200	(50)	(20.0)
(-) Operating Expenses				
Administrative Expenses	(40)	(40)		
Selling Expenses	(20)	(20)		
Operating Profit (B)	190	140	(50)	(26.31)

Working Note

Absolute change = Current year – Previous year

$$\text{Change in \%} = \frac{\text{Absolute change}}{\text{Previous year}} \times 100$$

Comparative Balance Sheet of Day Dreaming Company Limited as on year ended 2005 and 2006.

Particulars	2005	2006	Absolute Change	Change in %
Assets				
Current Assets				
Stock	400	500	100	25.00
Cash	450	490	40	8.89
Total Current Assets	850	990	140	16.47
Fixed Assets				
Land	300	300		
Building	500	470	(30)	(6.0)
Plant	400	470	70	17.50
Furniture	300	340	40	13.33
Total Fixed Assets	1,500	1,580	80	5.33
Total Assets	2,350	2,570	220	9.36
Liabilities				
Current Liabilities				
Bills Payable	250	275	25	10.00
Creditors	150	200	50	33.30
Tax Payable	150	200	50	33.30
Total Current Liabilities	550	675	125	22.73
Debentures	300	350	50	16.67

Particulars	2005	2006	Absolute Change	Change in %
Total External Liabilities	850	1,025	175	20.59
Equity Share Capital	600	600		
6% Preference Share capital	500	500		
Reserves	400	445	45	11.25
Total Liabilities	2,350	2,570	220	9.36

DO IT YOURSELF II

The following are the Balance Sheets of Harsha Ltd. as on March 31, 2006 and March 31, 2007

Liabilities	2005 (₹)	2006 (₹)	Assets	2005 (₹)	2006 (₹)
Equity Capital	1,00,000	1,65,000	Fixed Assets	1,20,000	1,75,000
Preference Capital	50,000	75,000	Stock	20,000	25,000
Reserves	10,000	15,000	Debtors	50,000	62,500
Profit and Loss Account	7,500	10,000	Bills Receivable	10,000	30,000
Bank Overdraft	25,000	25,000	Prepaid Expenses	5,000	6,000
Creditors	20,000	25,000	Cash at Bank	20,000	26,500
Provision for Taxation	10,000	12,500	Cash in Hand	5,000	15,000
Proposed Dividend	7,500	12,500			
	2,30,000	3,40,000		2,30,000	3,40,000

Prepare common size Balance Sheet and interpret the same.

Answer

Common Size Balance Sheet as on March 31, 2005 and 2006

Particulars	2005		2006	
	Amount	Percentage	Amount	Percentage
Equity Capital	1,00,000	43.48	1,65,000	48.53
Preference capital	50,000	21.74	75,000	22.06
Reserves	10,000	4.35	15,000	4.41
Profit and Loss	7,500	3.26	10,000	2.94
Bank Overdraft	25,000	10.86	25,000	7.35
Creditors	20,000	8.69	25,000	7.35

	2005		2006	
	Amount	Percentage	Amount	Percentage
Provision for Taxation	10,000	4.35	12,500	3.68
Proposed Dividend	7,500	3.27	12,500	3.68
Total Liabilities	2,30,000	100.00	3,40,000	100.00
Fixed Assets	1,20,000	52.17	1,75,000	51.47
Stock	20,000	8.69	25,000	7.35
Debtors	50,000	21.74	62,500	18.38
Bills Receivable	10,000	4.35	30,000	8.82
Prepaid Expenses	5,000	2.18	6,000	1.76
Cash at Bank	20,000	8.69	26,500	7.79
Cash in Hand	5,000	2.18	15,000	4.43
Total Assets	2,30,000	100.00	3,40,000	100.00

TEST YOUR UNDERSTANDING – II

Choose the right answer :

1. The financial statements of a business enterprise include:

- (a) Balance sheet
- (b) Profit and loss account
- (c) Cash flow statement
- (d) All the above

Answer (d) All of above

2. The most commonly used tools for financial analysis are:

- (a) Horizontal analysis
- (b) Vertical analysis
- (c) Ratio analysis
- (d) All the above

Answer (d) All of above

3. An Annual Report is issued by a company to its:

- (a) Directors
- (b) Auditors
- (c) Shareholders
- (d) Management

Answer (c) Shareholders

4. Balance Sheet provides information about financial position of the enterprise:

- (a) At a point in time
- (b) Over a period of time
- (c) For a period of time
- (d) None of the above

Answer (a) At a Point of time

5. Comparative statement are also known as:

- (a) Dynamic analysis
- (b) Horizontal analysis
- (c) Vertical analysis
- (d) External analysis

Answer (b) Horizontal analysis

DO IT YOURSELF III

Question 1. The following data is available from the P&L Account of Deepak Limited

Particulars	2003 (₹)	2004 (₹)	2005 (₹)	2006 (₹)
Sales	3,10,000	3,27,500	3,20,000	3,32,500
Wages	1,07,500	1,07,500	1,15,000	1,20,000
Selling Expenses	27,250	29,000	29,750	27,750
Gross Profit	90,000	95,000	77,500	80,000

Answer

Trend Percentage
(Base year 2003 = 100)

Year	Sales	Trend %	Wages	Trend %	Selling Exp	Trend %	Gross Profit	Trend %
2003	3,10,000	100	1,07,500	100	27,250	100	90,000	100
2004	3,27,500	106	1,07,500	100	29,000	106	95,000	105
2005	3,20,000	103	1,15,000	107	29,750	109	77,500	86
2006	3,32,500	107	1,20,000	112	27,750	102	80,000	89

TEST YOUR UNDERSTANDING III

• State whether each of the following is true or false

(a) The financial statements of a business enterprise include funds flow statement.

Answer False

(b) Comparative statements are the form of horizontal analysis.

Answer True

(c) Common size statements and financial ratios are the two tools employed in vertical analysis.

Answer True

(d) Ratio analysis establishes relationship between two financial statements.

Answer False

(e) Ratio analysis is a total for analysing the financial statements of any enterprise.

Answer True

(f) Financial analysis is used only by the creditors.

Answer False

(g) Profit and loss account shows the operating performance of an enterprise for a period of time.

Answer True

(h) Financial analysis helps an analyst to arrive at a decision.

Answer True

(i) Cash flow statement is a tool of financial statement analysis.

Answer True

(j) In a common size statement each item is expressed as a percentage of some common base.

Answer True

SHORT ANSWER TYPE QUESTIONS

Question 1. List the techniques of Financial Statement Analysis.

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

(i) Ratio Analysis (ii) Cash Flow Statement

(iii) Fund Flow Statement

(iv) Comparative Financial Statements

(v) Common Size Financial Statements

(vi) Trend Analysis

Answer

Basis of Difference	Horizontal Analysis	Vertical Analysis
Meaning/Nature	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 items of the financial statement to the common item of the same accounting period.
Expression of change	In Horizontal Analysis, change in the item is expressed either in absolute figures or in percentage or in both terms.	In Vertical Analysis, change in the item is expressed either in ratio or in percentage terms.
Benefits	The benefit of Horizontal analysis is that it indicates growth or decline of the item.	Vertical Analysis helps in predicting and determining the future relative proportion of an item to the common item.
Purpose	Its purpose is to determine the change in an item during an accounting period.	Its purpose is to determine the proportion of item/items to the common item of the same accounting period.

Question 3. 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.

Question 4. Bring out the importance of Financial Analysis.

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

The following are the reasons that advocate in favour of Financial Analys

- (i) It helps in evaluating the profit earning capacity and financ feasibility of a business.
- (ii) It helps in assessing the long-term solvency of the business.
- (iii) It helps in evaluating the relative financial status of a firm comparison to other competitive firms.
- (iv) It assists management in decision making process, plans and also in establishing an effective controlling

Question 5. What are Comparative Financial Statements?

Answer Those financial statements that enable intra-firm and 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

- (i) Comparative Balance Sheet
- (ii) Comparative Income Statements

Question 6. 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 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' 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.

- (i) Common Size Balance Sheet
- (ii) Common Size Income Statements

LONG ANSWER TYPE QUESTIONS

Question 1. Describe the different techniques of financial analysis and explain the limitations of financial analysis.

Answer The most commonly used techniques of financial analysis are as follows

(i) Comparative Statements: These are the statements showing the profitability and financial position of a firm for different periods of time in a comparative form to give an idea about the position of two or more periods. The financial data will be comparative only when same accounting principles are used in preparing these statements. Comparative figures indicate the trend and direction of financial position and operating results. This analysis is also known as 'horizontal analysis'.

(ii) Common Size Statements: These are the statements which indicate the relationship of different items of a financial statement with some common item by expressing each item as a percentage of the common item. The percentage thus calculated can be easily compared with the results corresponding percentages of the previous year or of some other firms, as the numbers are brought to common base. Such statements also allow an analyst to compare the operating and financing characteristics of two companies of different sizes in the same industry. This analysis is also known as 'Vertical analysis'.

(iii) Trend Analysis :It is a technique of studying the operational results and financial position over a series of years. Using the previous years' data of a business enterprise, trend analysis can be done to observe the percentage changes over time in the selected data. Trend analysis is important because, with its long run view, it may point to basic changes in the nature of the business. By looking at a trend in a particular ratio, one may find whether the ratio is falling, rising or remaining relatively constant. From this observation, a problem is detected or the sign of good management is found. .

(iv) Ratio Analysis :It describes the significant relationship which exists between various items of a balance sheet and a profit and loss account of a firm. As a technique of financial analysis,

accounting ratios measure the comparative significance of the individual items of the income and position statements.

(v) Cash Flow Analysis :It refers to the analysis of actual movement of cash into and out of an organisation. The flow of cash into the business is called as cash inflow or positive cash flow and the flow of cash out of the firm is called as cash outflow or a negative cash flow. The difference between the inflow and outflow of cash is the net cash flow.

Limitations of Financial Analysis

The following are the limitations of Financial Analysis

(i) Ignorance of Price Level Changes :Financial statement is based on historical cost method and 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).

(ii) 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.

(iii) Fail to Provide Final Picture: The financial analysis presents only the interim report and thereby provides incomplete information. They fail to provide the final and holistic picture.

(iv) Consider Only Monetary Aspect: This is one of the limitations of financial analysis that it reveals only the monetary aspects. Only those items are considered here which can be measured in term of money and fail to disclose managerial efficiency, growth prospects, and other non-operational efficiency of a business.

(v) Non-Reliable Conclusions :Conclusion base on financial analysis may be non reliable because financial statement are based on certain concepts and conventions.

(vi) 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.

(vii) 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.

Question 2. 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 Analysis 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

(i) Assists in Forecasting: The trends provided by Trend Analysis help the accounting users to forecast the future trend of the business.

(ii) Percentage Terms: The trends are expressed in percentage terms. Analysing the percentage figures is easy and also less time consuming.

(iii) 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 needs not to have an in-depth and sophisticated knowledge of accounting in order to analyse these percentage trends.

(iv) 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.

Question 3. 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.

- (i) **Make Presentation Simpler** : Comparative statements presents the financial data in a simpler form. On the other hand, an 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.
- (ii) **Help in Drawing Conclusion**: The presentation of comparative statement is so effective that it helps the analyst to draw conclusion quickly and easily and that too without any ambiguity.
- (iii) **Help in Forecasting** :The management may analyse the trend and forecast and draft various future plans and policy measures, with the help of comparative statement:
- (iv) **Help in Detection of Problems** :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. With the help of the comparison of the financial data of two or more years, the financial management can easily detect the problems.

Question 4. What do you understand by analysis and interpretation of financial statements? Discuss their importance.

Answer Financial Analysis has great importance to various accounting users on various matters. Income Statements, Balance Sheets and other financial data provide 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

- (i) It helps in evaluating the profit earning capacity and financial feasibility of a business.
- (ii) It helps in assessing the long-term solvency of the business.
- (iii) It helps in evaluating the relative financial status of a firm in comparison to other competitive firms.
- (iv) It assists management in decision making process, drafting various plans and also in establishing an effective controlling system.

Question 5. Explain how common size statements are prepared giving an example.

Answer Common size statements can be classified into two broad categories

- (i) Common Size Income Statements
- (ii) Common Size Balance Sheet

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

- (a) Particulars Column: This column shows the various financial items under their respective heads.
- (b) Amount Columns : These columns depict the amount of each item, sub-totals and the gross total of a particular year.
- (c) 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 Percentage column is shown beside the amount column of the year to which percentage column belongs.

Particulars	Year (2010) (₹)	%	Year (2011) (₹)	%

Method 2 Amount columns are shown first and their percentage columns are shown after the amount columns.

Particulars	Year (2010) (₹)	Year (2011) (₹)	% 2010	% 2011

Example :From the following information provided by Alfa Limited Prepare the Common Size Statements.

Balance Sheet of Indo Press Limited

Liabilities	2010 (₹)	2011 (₹)	Assets	2010 (₹)	2011 (₹)
Capital	3,30,000	3,60,000	Fixed Assets	3,00,000	3,20,000
Reserves and Surplus	90,000	1,60,000	Investments	2,40,000	2,40,000
Long term Loans	2,10,000	2,00,000	Current Asset	2,10,000	2,40,000
Current Liabilities	1,20,000	80,000			
	7,50,000	8,00,000		7,50,000	8,00,000

**Alfa Limited
Comparative Size Balance Sheet
for the year 2010 and 2011**

Particulars	2010 (₹)	2011 (₹)	% 2010	% 2011
Assets				
Fixed Assets	3,00,000	3,20,000	40	40
Investments	2,40,000	2,40,000	32	30
Current Assets	2,10,000	2,40,000	28	30
	7,50,000	8,00,000	100	100
Liabilities				
Capital	3,30,000	3,60,000	44	45
Reserved Surplus	90,000	1,60,000	12	20
Long Term Loans	2,10,000	2,00,000	28	25
Current Liabilities	1,20,000	80,000	16	10
	7,50,000	8,00,000	100	100

NUMERICAL QUESTIONS

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

Particulars	2011 (₹)	2012 (₹)
Gross Sales	7,25,000	8,15,000
(-) Return	(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 and 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**

Particulars	2011	2012	Absolute Change	Change in Percentage
Gross Sales	7,25,000	8,15,000	90,000	12.41
(-) Return	(25,000)	(15,000)	(10,000)	(40.00)
Net Sales	7,00,000	8,00,000	1,00,000	14.28
(-) Cost of Goods Sold	(5,95,000)	(6,15,000)	(20,000)	(3.36)
Gross Profit	1,05,000	1,85,000	80,000	76.19
(-) Operating Expenses				
Administration Expenses	(12,700)	(12,500)	(200)	(1.57)
Selling and Distribution Expenses	23,000	24,000	1,000	4.34
Total Expenses	35,700	36,500	800	2.24
Income from operations	69,300	1,48,500	79,200	114.28
(+) Non-operating Income	1,200	8,050	6,850	570.83
Total Income	70,500	1,56,550	86,050	122.05
(-) Non-operating Expenses	(1,750)	(1,940)	(190)	(10.85)
Net Profit	68,750	1,54,610	85,860	124.88

Interpretation

- The Net Profit of the company increased.
- Simultaneously the company has tried to reduce its costs to improve its profit margin.
- Profitability of the company has improved over the year.

Working Note

Absolute Change = Current year – Previous year

Change in Percentage = $\frac{\text{Absolute change}}{\text{Previous year}} \times 100$

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

Liabilities			Assets	₹'000	
	2011	2012		2011	2012
Equity Share Capital	400	600	Land and Buildings	270	170
Reserves and Surplus	312	354	Plant and Machinery	310	786
Debentures	50	100	Furniture and 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.

Comparative Balance Sheet of Mohan Limited

Particulars	2011 (₹'000)	2012 (₹'000)	Absolute Change	Change in Percentage
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				
Land 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				
Current Liabilities				
Account Payable	255	117	(-) 138	(-) 54.12
Other Current Liabilities	7	10	+3	+42.86
Total Current Liabilities (A)	262	127	(-) 135	(-) 51.53
Debentures	50	100	+50	+100.00
Long term Loan	150	255	+105	+70.00
Total Long Term External Liabilities (B)	200	355	+155	+77.50
Equity Share Capital	400	600	+200	+50.00
Reserve and Surplus	312	354	+42	+13.46
Shareholders Fund (C)	712	954	+242	+33.99
Total Liabilities and Shareholder Fund (A+B+C)	1,174	1,436	+262	+22.32

Working Note

Absolute Change = Current year – Previous year

Change in Percentage = $\frac{\text{Absolute change}}{\text{Previous year}} \times 100$

Comments

- (i) Decrease in current Liabilities is more than decrease in current assets which indicates that the current ratio has improved.
- (ii) Decrease in cash and bank may result in delay in payments.
- (iii) Fixed Assets have increased along with share capital. It indicates that such asset has been purchased using Long term sources of finance.
- (iv) Increase in reserve and surplus is a healthy indicator.

Question 3. The following are the balance sheets of Devi Company Limited at the end of 2011 and 2012. Prepare a comparative Balance Sheet and study the financial position of the concern.

Liabilities	2011 (₹)	2012 (₹)	Assets	2011 (₹)	2012 (₹)
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 Company Limited**

Particulars	2011 (₹)	2012 (₹)	Absolute Increase (+) or Decrease (-) (₹)	Percentage Increase (+) or Decrease (-) %
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

Comments

- (i) Change in current assets and current Liabilities is almost same. It indicates that ratio is same as of previous year.
- (ii) Fixed Assets have increased along with share capital which shows that assets are purchased with long term sources of finance.
- (iii) The overall financial position of company is satisfactory.

Working Note

Absolute Change = Current year – Previous year

Change in Percentage = $\frac{\text{Absolute change}}{\text{Previous year}} \times 100$

Question 4. Convert the following Income Statement into Common Size Statement and interpret the changes in 2011 in the light of the conditions in 2010.

Particulars	2010 (₹)	2011 (₹)
Gross Sales	30,600	36,720
(-) Return	(600)	(700)
Net Sales	30,000	36,020
(-) Cost of Goods Sold	(18,200)	(20,250)
Gross Profit	11,800	15,770
(-) 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
(+) Non-operating Income	300	400
Total Income	3,100	6,170
(-) Non-operating Expenses	(400)	(600)
Net Profit	2,700	5,570

Answer Common Size Income Statement

Particulars	2010		2011	
	(₹)	%	(₹)	%
Gross Sales	30,600	102.00	36,720	101.94
(-) Return	(600)	(2.00)	(700)	(1.94)
Net Sales	30,000	100.00	36,020	100.00
(-) Cost of Goods Sold	(18,200)	(60.67)	(20,250)	(56.22)
Gross Profit	11,800	39.33	15,770	43.78
(-) 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

Particulars	2010		2011	
	(₹)	%	(₹)	%
Income from operations	2,800	9.33	5,770	16.01
(+) Non-operating Income	300	1.00	400	1.11
Total Income	3,100	10.33	6,170	17.12
(-) Non-operating Expenses	(400)	(1.33)	(600)	(1.66)
Net Profit	2,700	9.00	5,570	15.46

Comment: Company has reduced its cost and expenses which has resulted in increase in income from operations and net profit.

Question 5. Following are the balance sheets of Reddy Limited as on 31 March, 2011 and 2012

Question 5. Following are the balance sheets of Reddy Limited as on 31 March, 2011 and 2012.

Liabilities	2011 (₹)	2012 (₹)	Assets	2011 (₹)	2012 (₹)
Share Capital	2,400	3,600	Land and Buildings	1,620	1,040
Reserves and Surplus	1,872	2,124	Plant and Machinery	1,860	4,716
Debentures	300	600	Furniture and Fixtures	54	108
Long Term Debt	900	1,530	Other Fixed Assets	120	180
Bills Payable	1,530	702	Long Term Loans	276	354
Other Current Liabilities	42	60	Cash and 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 Limited
as on March 11, 2011 and 2012

Particulars	2011		2012	
	(₹)	%	(₹)	%
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

Comments

- (i) In spite of decrease in current assets and current liabilities, the current ratio has improved.
- (ii) Decrease in cash and bank balance indicates that there will be delay in payments.
- (iii) Increase in fixed assets and share capital shows that assets are purchased with long term sources of finance.

Question 6. The accompanying balance sheet and profit and loss account related to SUMO Logistics Private Limited. Convert these into Common Size Statements.

Previous Year = 2010, Current Year = 2011

₹000

Particulars	Previous Year	Current Year
Liabilities		
Equity Share Capital (of ₹ 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

₹ 000

Particulars	Previous Year	Current Year
Gross Sales	370	480
(-) Return	(20)	(30)
Net Sales	350	(450)
(-) Cost of Goods Sold	(190)	(215)
Gross Profit	160	(235)
(-) Selling General and Administration Expenses	(50)	(72)
Operating Profit	110	163
(-) Interest Expenses	(20)	(17)
Earnings Before Tax	90	146
(-) Taxes	(45)	(73)
Earnings After Tax	45	73

Answer

Common Size Balance Sheet of SUMO Logistics Private Limited
as on 2010 and 2011

Particulars	2010		2011	
	₹ ,000	%	₹ ,000	%
Liabilities				
Equity Share Capital (of ₹ 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 Private Limited
For the year ended 2010 and 2011

Particulars	2010		2011	
	₹ 000	%	₹ 000	%
Gross Sales	370	105.71	480	106.67
(-) Return	(20)	(5.71)	(30)	(6.67)
Net Sales	350	100.00	450	100.00
(-) Cost of Goods Sold	(190)	(54.29)	(215)	(47.77)
Gross Profit	160	45.71	235	52.23
(-) Selling, General and Administration Expenses	(50)	(14.28)	(72)	(16.00)
Operating Profit	110	31.43	163	36.23
(-) Interest Expenses	(20)	(5.72)	(17)	(3.77)
Earnings Before Tax	90	25.71	146	32.46
(-) Taxes	(45)	(12.86)	(73)	(16.23)
Earnings After Tax	45	12.86	73	16.23

Question 7. From the following particulars extracted from P&L Account of 'Prashanth Limited, you are required to calculate trend percentages

Year	Sales (₹)	Wages (₹)	Bad Debts (₹)	Profit After Tax (₹)
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 (₹)	Trend (%)	Wages (₹)	Trend (%)	Bad debts (₹)	Trend (%)	Profit after Tax (₹)	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

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

Question 8. Calculate trend percentages from the following figures of ABC Limited, 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	1,160	660
2005	4,000	1,200	700

Answer

Trend Percentages
(Base Year 2000 = 100)

Years	Sales (₹)	Trend (%)	Stock (₹)	Trend (%)	Profit after Tax (₹)	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

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

Interpretations

(i) Sales has exhibited continuous increasing trend over the period.

(ii) The value of stock also increases, with the increase in value of sales.

(iii) 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.

Question 9. From the following data relating to the liabilities side of balance sheet of Madhuri Limited, as on 31st March, 2006, you are required to calculate trend percentages taking 2002 as the base year.

(₹ in lakhs)

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

Answer

Trend Percentage (Base Year 2003 = 100)

Liabilities	2002 (₹) 00,000	Trend (%)	2003 (₹) 00,000	Trend (%)	2004 (₹) 00,000	Trend (%)	2005 (₹) 00,000	Trend (%)	2006 (₹) 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
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 Currents 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

Effects of Revised Schedule VI on Tools of Analysis of Financial Statements As per revised Schedule VI part II the Format of Profit of Loss Statement is as follows.

Name of the Company
Profit and Loss Statement
for the year ended

S.N.	Particulars	Note No	Figures for the Current Reporting Period	Figures for the Previous Reporting Period
1.	Revenue from Operations			
2.	Other Income			
3.	Total Revenue (I + II)			
4.	Expenses			
	Cost of Materials Consumed			
	Purchases of Stock-in-Trade			
	Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade			
	Employee Benefits Expense			
	Finance Costs			
	Depreciation and Amortisation Expenses			
	Other Expenses			
	Total Expenses			
5.	Profit Before Exceptional and Extraordinary Items and Tax (III-IV)			
6.	Exceptional Items			
7.	Profit Before Extraordinary Items and Tax (V-VI)			
8.	Exceptional Items			
9.	Profit Before Tax (VII-VIII)			
10.	Tax Expense			
	(1) Current Tax			
	(2) Deferred Tax			
11.	Profit/(Loss) for the Period From Continuing Operations (VII-VIII)			
12.	Profit/(Loss) from Discontinuing Operations			
13.	Tax Expense of Discontinuing Operations			

S.N.	Particulars	Note No	Figures for the Current Reporting Period	Figures for the Previous Reporting Period
14.	Profit/(Loss) From Discontinuing Operations (after tax) (XII-XIII)			
15.	Profit/(Loss) for the Period (XI-XIV)			
16.	Earnings Per Equity Share (1) Basic (2) Diluted			

Question 10. Prepare comparative statements from the following.

Particulars	31-3-2011	31-3-2012
Revenue from Operations	10,00,000	15,00,000
Expenses	6,00,000	10,50,000
Other Income	2,00,000	1,80,000
Income Tax	50%	50%

Answer

Comparative Statement of Profit and Loss
For the year ended 31st March, 2012

	Particulars	Absolute Figures		Change (Base Year 2010-11)	
		31-3-2011 (₹)	31-3-2012 (₹)	Absolute Figures (₹)	Percentage (%)
I.	Revenue from Operations	10,00,000	15,00,000	5,00,000	50%
II.	(+) Other Incomes	2,00,000	1,18,000	(20,000)	10%
	Total Revenue (I + II)	12,00,000	16,80,000	4,80,000	40%
III.	(-) Expenses	(6,00,000)	(10,50,000)	(4,50,000)	75%
	Profit Before Tax	6,00,000	6,30,000	30,000	5%
IV.	(-) Tax (50%)	(3,00,000)	(3,15,000)	(15,000)	5%
	Profit After Tax	3,00,000	3,15,000	15,000	5%