and nature of analysis. The following illustrations make clear understanding :

Illustration 1

From the following Profit and Loss Account and Balance Sheet of Ramco Ltd. for the year ended 2009 and 2010, you are required to prepare a comparative income statement and a comparative Balance Sheet.

PROFIT AND LOSS ACCOUNT

	2009	2010		2009	2010
	Rs.	Rs.		Rs.	Rs.
To Cost of Goods sold	6,000	7,500	By Net Sales	8,000	10,000
To Operating Expenses :					
Administrative	200	200			
Selling	300	400			
To Net Profit	1,500	1,900			
	8,000	10,000		8,000	10,000

BALANCE SHEET as on 31st December

	2009	2010		2009	2010
Bills Payable	500	750			
Sundry Creditors	1,500	2,000	Cash	1,000	1,400
Tax Payable	1,000	1,500	Debtors	2,000	3,000
6% Debentures	1,000	1,500	Stock	2,000	3,000
10% Preference Capital	3,000	3,000	Land	1,000	1,000
Equity Capital	4,000	4,000	Buildings	3,000	2,700
Reserves	2,000	2,450	Plant	3,000	2,700
			Furniture	1,000	1,400
	13,000	15,200		13,000	15,200

(*B.Com. MS*)

Solution:

RAMCO Limited
COMPARATIVE INCOME STATEMENT
For the years ended 31st Dec. 2009 and 2010

	2009	2010	Increase (+) or Decrease (–) Absolute 2010	Increase (+) or Decrease (–) Percentage 2010
Net Sales	8,000	10,000	+ 2,000	+ 25
Less : Cost of goods sold	6,000	7,500	+ 1,500	+ 25
Gross Profit	2,000	2,500	+ 500	+ 25
Less : Operating Expenses:				
Administrative	200	200	—	—
Selling	300	400	+ 100	+ 33.3
Total Operating Expenses	500	600	+ 100	+ 20
Operating Profit	1,500	1,900	+ 400	+ 26.7

The above statement shows that though the sales have gone up in 2010, the rate of gross profit remains at 25%. The cost of goods sold and its percentage remains at 75%. Administrative expenses remains the same, but selling expenses have been increased. This is due to the increase in sales. The rate of net profit is also increased.

RAMCO Ltd.
COMPARATIVE BALANCE SHEET
As on 31st Dec. 2009 and 2010

	2009	2010	Increase (+) or Decrease (–) Absolute 2010	Increase (+) or Decrease (–) Percentage 2010
Assets:				
Current Assets :				
Cash	1,000	1,400	+ 400	+ 40
Debtors	2,000	3,000	+ 1,000	+ 50
Stock	2,000	3,000	+ 1,000	+ 50
Total Current Assets :	5,000	7,400	+ 2,400	+ 48
Fixed Assets :				
Land	1,000	1,000	—	—
Buildings	3,000	2,700	– 300	– 10
Plant	3,000	2,700	– 300	– 10
Furniture	1,000	1,400	+ 400	+ 40
Total Fixed Assets	8,000	7,800	– 200	– 2.5
Total Assets	13,000	15,200	+ 2,200	+ 17
Liabilities and Capital				
Current Liabilities :				
Bills Payable	500	750	+ 250	+ 50
Sundry Creditors	1,500	2,000	+ 500	+ 33.3

Taxes Payable	1,000	1,500	+ 500	+ 50
Total Current Liabilities	3,000	4,250	+ 1250	+ 41.7
Long-term Liabilities :				
6% Debentures	1,000	1,500	+ 500	+ 50
Total Liabilities	4,000	5,750	+ 1,750	+ 43.75
Capital and Reserves :				
10% Preference Capital	3,000	3,000	—	—
Equity Capital	4,000	4,000	—	—
Reserves	2,000	2,450	+ 450	+ 22.5
Total Shareholders Funds	9,000	9,450	+ 450	5
Total Liabilities and Capital	13,000	15,200	2,200	17

Common Size Statement

Financial statements when read with absolute figures are not easily understandable. They are even misleading. Each item of assets is converted into percentage to Total Assets and each item of Capital and Liabilities is expressed to Total Liabilities and Capital Fund. Thus the whole Balance Sheet is converted into percentage form. Such converted Balance Sheet is known as Common-Size Balance Sheet. When Balance Sheets of the same concern for several years or when Balance Sheets of two or more than two concerns for the same year are converted into percentage form and presented as such, they are known as Comparative Common-Size Balance Sheets. Again, in Profit and Loss Account Sales figure is assumed to be equal to 100 and all other figures are expressed as percentage to sales. Similarly, in Balance Sheet the total of assets or liabilities is taken as 100 and all the figures are expressed as percentage of the total.

Illustration 2

The following is the Profit and Loss Account of Sun Ltd. for 2009 and 2010 :

PROFIT AND LOSS ACCOUNT
for the year ended 31st December

	2009	*2010*		*2009*	*2010*
	Rs.	*Rs.*		*Rs.*	*Rs.*
To Cost of Sales	4,63,250	4,83,899	By Sales	7,21,456	8,34,250
To Administrative Expenses	46,531	54,137	*Less*: Returns	11,588	13,903
				7,09,868	8,20,347
To Selling Expenses	91,823	1,15,632	By Other Incomes :		
To Interest Paid	4,275	3,500	Interests	3,795	2,620
To Loss on sale of fixed items	1,254	350	Discounts	4,250	3,792
			Profit on sale (Land)	3,000	—
To Income Tax	43,038	80,390			
To Net Profit	70,742	88,851			
	7,20,913	8,26,759		7,20,913	8,26,759

Prepare the above data in a suitable comparative form both in absolute way and in common size.

(*B.Com. Madurai*)

Solution :

(a) COMPARATIVE PROFIT AND LOSS ACCOUNT

	2009 Rs.	2010 Rs.	Increase (+)/Decrease (–) Amount Rs.	%
Sales	7,21,456	8,34,250	+ 1,12,794	+ 15.7
Less : Returns	11,588	13,903	+ 2,315	+ 20.0
	7,09,868	8,20,347	+ 1,10,479	+ 15.6
Less : Cost of sales	4,63,250	4,83,899	+ 20,649	+ 4.5
Gross Margin	2,46,618	3,36,448	+ 89,830	+ 36.4
Less : Administrative Expenses	46,531	54,137	+ 7,606	+ 16.3
Balance	2,00,087	2,82,311	+ 82,224	+ 41.0
Less: Selling Expenses	91,823	1,15,632	+ 23,809	+ 25.9
Net operating profit	1,08,264	1,66,679	+ 58,415	+ 54.0
Add : Other Incomes	11,045	6,412	– 4,633	– 42.0
	1,19,309	1,73,091	+ 53,782	+ 45.0
Less: Other Expenses	5,529	3,850	–1,679	– 30.0
Net profit before tax	1,13,780	1,69,241	+ 55,461	+ 48.7
Less: Tax	43,038	80,390	+ 37,352	+ 86.8
Net profit after tax	70,742	88,851	+ 18,109	+ 25.6

(b) COMPARATIVE COMMON SIZE PROFIT AND LOSS ACCOUNT

	2009		2010	
	Amount	% Rs.	*Amount*	% Rs.
Sales	7,21,456	101.6	8,34,250	101.7
Less: Returns	11,588	1.6	13,903	1.7
Net Sales	7,09,868	100.0	8,20,347	100.0
Less: Cost of Sales	4,63,250	65.3	4,83,899	59.0
Gross Margin	2,46,618	34.7	3,36,448	41.0
Less: Administrative Expenses	46,531	6.5	54,137	6.6
Balance	2,00,087	28.2	2,82,311	34.4
Less: Selling Expenses	91,823	12.9	1,15,632	14.0
Net Operating Profit	1,08,264	15.3	1,66,679	20.4
Add: Other Incomes	11,045	1.6	6,412	0.7
	1,19,309	16.9	1,73,091	21.1
Less: Other expenses	5,529	0.8	3,850	0.5
Net Profit before Tax	1,13,780	16.1	1,69,241	20.6
Less: Income Tax	43,038	6.0	80,390	9.8
Net Profit After Tax	70,742	10.1	88,851	10.8

Illustration 3

From the following Balance Sheet, prepare a Common-size statement :

	2009 Rs.	2010 Rs.
Assets :		
Cash	27,000	31,500
Debtors	2,20,000	2,11,000

Stock	1,00,000	1,26,000
Prepaid Expenses	11,000	21,000
Bills Receivables	10,000	10,500
Fixed Assets	6,35,000	6,50,000
	10,03,000	10,50,000
Liabilities & Capital:		
Share Capital	6,58,000	7,00,000
Long-term Debt	2,25,000	2,00,000
Sundry Creditors	42,000	50,000
Other Liabilities	78,000	1,00,000
	10,03,000	10,50,000

(B.Com. M.

Solution :

COMPARATIVE COMMON-SIZE BALANCE SHEET

	2009	*2010*
Assets :		
Current Assets :		
Cash	2.7	3.0
Debtors	21.9	20.1
Stock	10.0	12.0
Prepaid Expenses	1.1	2.0
Bills Receivables	1.0	1.0
Total Current Assets	36.7	38.1
Fixed Assets	63.3	61.9
Total Assets	100.0	100.0
Liabilities & Capital :		
Current Liabilities:		
Sundry Creditors	4.2	4.8
Other Liabilities	7.8	9.5
Total Current Liabilities	12.0	14.3
Long-Term Liabilities :		
Long Term Debt	22.4	19.0
Capital & Reserves :	34.4	33.3
Share Capital	65.6	66.7
Total Liabilities & Capital :	100.0	100.0

Illustration 4

The summary of Balance Sheet data in respect of A Ltd. and B Ltd. is as under :

	A Ltd.	*B Ltd.*
	Rs.	*Rs.*
Buildings	1,00,000	4,50,000
Machinery	3,00,000	7,50,000
Share Capital	4,50,000	14,50,000
Retained Earnings	50,000	33,000
Debtors	1,15,000	1,60,000
Stocks	60,000	2,17,000
Cash	10,000	5,000
Prepaid Expenses	5,000	3,000

Creditors	91,000	1,00,000
Liability for Expenses	9,000	17,000
Preliminary Expenses	10,000	15,000

Prepare Common-size Balance Sheets

Solution :

COMPARATIVE COMMON-SIZE BALANCE SHEETS

	A Ltd.	*B Ltd.*
Assets :		
Current Assets :		
Cash	1.7	0.3
Debtors	19.1	10.0
Prepaid Expenses	0.8	0.2
Stocks	10.0	13.6
Total Current Assets	31.6	24.1
Fixed Assets :		
Buildings	16.7	28.1
Machinery	50.0	46.9
	98.3	99.1
Preliminary Expenses	1.7	0.9
Total Assets	100.0	100.0
Liabilities and Capital :		
Current Liabilities		
Creditors	15.2	6.3
Liability for Expenses	1.5	1.0
Total Current Liabilities	16.7	7.3
Capital and Reserves :		
Share Capital	75.0	90.6
Retained Earnings	8.3	2.1
Total Capital & Reserves	83.3	92.7
Total Liabilities & Capital	100.0	100.0

Trend Analysis

The Comparative and Common-size statements suffer from a major limitation *i.e.*, absence of a basic standard to indicate whether the proportion of an item is normal or abnormal. Trend analysis overcomes this limitation. This method is also an important and useful technique of financial statement analysis. The calculation of trend ratio involves the ascertainment of arithmetical relationship which each item of several years to the same item of base year. Thus, one particular year out of many years is taken as base. The value of one particular item out of several items shown in the financial statements are converted into ratio or percentage taking of that item in base year as equal to 100.

Illustration 5

From the following data relating to the purchase of a firm, prepare Trend Percentages and Trend Ratios.

Year	*Purchases ('00,000)* *Rs*
2005	1,672
2006	1,789

2007	1,873
2008	1,923
2009	2,123
2010	1,463

Solution :

(a) Trend Percentages :

Year	*Decrease/Increase (in %)* *(Base Year = 2005)*
2005	—
2006	+ 7
2007	+ 12
2008	+ 15
2009	+ 27
2010	– 12.5

The above type of analysis cannot be regarded as good in the sense that it contains plus and minus signs. A better way will be to express the figures for each year as a percentage to the value of base year.

(b) Trend Ratios :

Year	*Trend Ratios (in %)*
2005	100
2006	107
2007	112
2008	115
2009	127
2010	87.5

Illustration 6

From the following figures, compute trend percentage and comment, using 2005 as the base year :

Year	*Sales*	*Cost of goods sold*	*Profit before tax*
	Rs.	*Rs.*	*Rs.*
2005	600	360	120
2006	680	414	138
2007	840	512	186
2008	960	574	204
2009	1040	600	228
2010	1200	666	300

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Solution :

TREND PERCENTAGE (Base year : 2005)

Year	Sales		Cost of goods sold		Profit before Tax	
	in Rs.	*Trend %*	*in Rs.*	*Trend %*	*in Rs.*	*Trend*
2005	600	100	360	100	120	100
2006	680	113	414	115	138	115
2007	840	140	512	142	186	155

2008	960	160	574	159	204	170
2009	1040	173	600	167	228	190
2010	1200	200	666	185	300	250

Comments :

1. There is steady growth in sales and profit before tax, after the base year.
2. The increase in sales and profit is satisfactory. The increase in profit is more than proportionate to the increase in sales. A minute study of trend shows that the profitability is sound.

(A) Choose the correct answer to the following :

1. Financial accounts provide a summary of :
(a) Assets.
(b) Liabilities.
(c) Accounts.

2. Financial statements are :
(a) Estimates of facts.
(b) Recorded facts.
(c) Anticipated facts.

3. Retained earnings statements depicts :
(a) Appropriation of profits.
(b) Estimated profits.
(c) Estimated costs.

4. The term current assets does not include :
(a) Payments in advance.
(b) Bills Receivables.
(c) Long term deferred charges.

5. The fixed assets include :
(a) Stock-in-trade.
(b) Furniture.
(c) Payments in advance.

6. Operating profit to sales gives us :
(a) Gross Profit Ratio.
(b) Net Profit Ratio.
(c) Operating profit ratio.

7. Financial statements convey to different parties :
(a) Financial information.
(b) Market information.
(c) Price information.

8. The tools of financial statement analysis are :
(a) Comparative financial statement.
(b) Commonsize statement.
(c) Trend ratio.
(d) All these.

Ans: **1.** (c) **2.** (b) **3.** (a) **4.** (c) **5.** (b) **6.** (c) **7.** (a) **8.** (d)