Chapter 4: Analysis of Financial Statements

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Exercise 4.1 — Short & Long Answer Questions

Q1 List the techniques of Financial Statement Analysis.

The main techniques of Financial Statement Analysis are: (1) Comparative Statements — showing absolute and percentage changes in figures across two or more periods; (2) Common Size Statements — expressing every item as a percentage of a common base (Revenue from Operations for P&L; Total Assets for Balance Sheet); (3) Trend Analysis — computing index numbers for several years with a base year = 100 to identify directions of change; (4) Ratio Analysis — computing ratios between related financial figures to evaluate liquidity, solvency, profitability, and activity; (5) Cash Flow Analysis — examining the movement of cash under operating, investing, and financing activities.

Q2 Distinguish between Vertical and Horizontal Analysis of financial data.

Horizontal Analysis compares financial data of the same entity across two or more time periods, revealing trends, growth, or decline in absolute and percentage terms — Comparative Statements and Trend Analysis are its tools. Vertical Analysis examines the relationship between different items within a single period's financial statement by expressing each item as a percentage of a common base — Common Size Statements are its tool. In horizontal analysis the time dimension is primary; in vertical analysis the structural composition at a point in time is primary.

Q3 State the meaning of Analysis and Interpretation.

Analysis of financial statements means simplifying complex data by methodically classifying, comparing, and computing ratios, percentages, and trends so that meaningful relationships among figures are established and the financial position and performance of the entity become clear. Interpretation means explaining the significance of those relationships — drawing conclusions, making judgements about the entity's profitability, liquidity, and solvency, and communicating those conclusions to interested parties. Analysis breaks data down; interpretation builds understanding from the results of analysis.

Q4 State the importance of Financial Analysis.

Financial analysis is important for several reasons: (1) It helps management evaluate past performance and plan future operations. (2) It assists investors and creditors in making lending and investment decisions by revealing the entity's profitability and risk. (3) It helps employees and trade unions assess the stability of the organisation. (4) It aids in inter-firm and intra-firm comparison, enabling benchmarking against competitors and tracking improvement over time. (5) It assists government agencies in assessing tax liability and compliance. (6) It provides data for forecasting, budgeting, and policy formulation. Overall, financial analysis converts raw accounting data into actionable information for all stakeholders.

Q5 What are Comparative Financial Statements?

Comparative Financial Statements present the financial data of two or more periods side by side in columns. In addition to the figures for each period, they show (a) the absolute change (current year figure minus previous year figure) and (b) the percentage change relative to the previous year for every line item. The two most common comparative statements are the Comparative Balance Sheet and the Comparative Statement of Profit and Loss. They facilitate horizontal analysis, enabling users to identify trends, growth patterns, and areas of improvement or deterioration over time.

Q6 What do you mean by Common Size Statements?

Common Size Statements express every item in a financial statement as a percentage of a common base figure for that statement. For the Statement of Profit and Loss, the base is Revenue from Operations (Net Sales) = 100%. For the Balance Sheet, the base is Total Assets (= Total Equity and Liabilities) = 100%. By converting all items to percentages, common size statements facilitate vertical analysis and meaningful inter-firm comparison even when the absolute sizes of two entities differ significantly. They highlight the relative composition and structure of a firm's finances rather than absolute amounts.

Q7 Describe the different techniques of financial analysis and explain the limitations of financial analysis.

Techniques of Financial Analysis: (1) Comparative Statements present figures of two or more periods alongside absolute and percentage changes, supporting horizontal analysis. (2) Common Size Statements convert each item to a percentage of a base (Revenue for P&L; Total Assets for Balance Sheet), enabling vertical and inter-firm analysis. (3) Trend Analysis uses index numbers (base year = 100) to reveal long-term tendencies over several years. (4) Ratio Analysis computes relationships between related items to assess liquidity, solvency, profitability, and efficiency. (5) Cash Flow Analysis studies the generation and use of cash under operating, investing, and financing activities. Limitations of Financial Analysis: (a) Financial statements are based on historical cost; they do not reflect current market values, making analysis less meaningful in periods of inflation. (b) Seasonal factors, window dressing, and changes in accounting policies can distort comparisons. (c) Non-financial factors such as management quality, industrial relations, and customer goodwill are ignored. (d) Different firms may follow different accounting methods, reducing the validity of inter-firm comparisons. (e) Future prospects cannot be reliably predicted from past data alone. (f) Analysis is only as reliable as the data in the financial statements; errors or manipulations lead to incorrect conclusions.

Q8 Explain the usefulness of trend percentages in interpretation of financial performance of a company.

Trend percentages (Trend Analysis) express each year's figure as a percentage of the base year's figure (base year = 100), showing the direction and magnitude of change over several accounting periods. Their usefulness includes: (1) Identifying long-run growth or decline in revenue, costs, profits, assets, and liabilities that year-to-year comparison may obscure. (2) Highlighting whether a favourable or unfavourable change is a temporary fluctuation or a sustained trend. (3) Allowing management to project future performance by extrapolating established trends. (4) Facilitating multi-year inter-firm comparison on a consistent percentage basis, irrespective of absolute size differences. (5) Revealing whether cost items are rising faster or slower than sales, thereby indicating pressure on margins. Overall, trend analysis enriches financial interpretation by adding a time-dimension perspective to the static figures in individual financial statements.

Q9 What is the importance of comparative statements? Illustrate your answer with particular reference to comparative income statement.

Importance of Comparative Statements: (1) They facilitate horizontal analysis by juxtaposing figures of different periods, making changes immediately visible. (2) They show both the absolute rupee change and the percentage change for every line item, giving a complete picture of movement. (3) They help identify favourable and unfavourable trends in revenues, costs, and profits. (4) They assist management in performance evaluation and corrective planning. (5) They support intra-firm comparison across time periods. Illustration with Comparative Income Statement: Suppose Revenue from Operations was Rs. 5,00,000 in Year 1 and Rs. 6,50,000 in Year 2 — an absolute increase of Rs. 1,50,000 (+30%). If Cost of Revenue from Operations rose from Rs. 3,50,000 to Rs. 5,00,000 — an increase of Rs. 1,50,000 (+42.86%) — the comparative statement immediately reveals that costs grew faster than revenue, compressing Gross Profit from Rs. 1,50,000 to Rs. 1,50,000 (0% change in absolute terms but a fall in gross margin %). Such insights direct management's attention to cost control and pricing strategy, which would not be apparent from examining either year's statement in isolation.

Q10 What do you understand by analysis and interpretation of financial statements? Discuss its importance.

Analysis of financial statements involves systematically breaking down complex financial data by classifying, rearranging, and computing percentages, ratios, and trends to establish meaningful relationships among the figures. Interpretation involves explaining what those computed relationships mean — drawing inferences about the entity's financial health, profitability, and future prospects — and communicating conclusions clearly. Importance: (1) For Management: Provides a factual basis for planning, budgeting, cost control, and performance appraisal. (2) For Investors and Shareholders: Helps assess return on investment, dividend prospects, and risk before making investment decisions. (3) For Creditors and Banks: Enables evaluation of short-term liquidity and long-term solvency before granting credit or loans. (4) For Employees: Reveals the company's financial stability and ability to pay wages and bonuses. (5) For Government: Assists in tax assessment, regulation, and formulation of industrial policy. (6) For Researchers and Analysts: Provides data for economic studies and industry comparison. Without analysis and interpretation, raw financial data remains incomprehensible to most users and loses its informational value.

Q11 Explain how common size statements are prepared giving an example.

A Common Size Statement is prepared by expressing each line item as a percentage of a chosen base figure. For the Statement of Profit and Loss, the base is Revenue from Operations = 100%. For the Balance Sheet, the base is Total Assets (= Total Equity and Liabilities) = 100%. Steps: (1) Identify the base figure for the statement. (2) Divide each item by the base and multiply by 100 to get the percentage. (3) Present the absolute figures and the computed percentages in parallel columns for easy comparison between two years or two firms. Example — Common Size Statement of Profit and Loss: Suppose Revenue from Operations = Rs. 10,00,000 (100%). Cost of Revenue from Operations = Rs. 7,00,000 → 70.00%. Gross Profit = Rs. 3,00,000 → 30.00%. Operating Expenses = Rs. 1,00,000 → 10.00%. Operating Profit = Rs. 2,00,000 → 20.00%. Other Income = Rs. 20,000 → 2.00%. Profit Before Tax = Rs. 2,20,000 → 22.00%. Tax @ 30% = Rs. 66,000 → 6.60%. Profit After Tax = Rs. 1,54,000 → 15.40%. This format immediately reveals the cost structure and profitability ratios of the business and enables meaningful comparison with another firm regardless of differences in absolute size.

Exercise 4.2 — Numerical Questions

Q1 Following are the balance sheets of Alpha Ltd., as at March 31, 2016 and 2017. You are required to prepare Comparative Balance Sheet.

Particulars | March 31, 2016 (Rs.) | March 31, 2017 (Rs.)
I. Equity and Liabilities
1. Shareholders' Funds
(a) Share Capital | 2,00,000 | 4,00,000
(b) Reserve & Surplus | 1,00,000 | 1,50,000
2. Noncurrent Liabilities
(a) Long Term Borrowings | 2,00,000 | 3,00,000
3. Current Liabilities
(a) Short term borrowings | 50,000 | 70,000
(b) Trade Payables | 30,000 | 60,000
(c) Other Current Liabilities | 20,000 | 10,000
(d) Short Terms Provisions | 20,000 | 20,000
Total | 6,20,000 | 10,20,000
II. Assets
1. Non-Current Assets
(a) Fixed Assets | 2,00,000 | 5,00,000
(b) Non-Current Investments | 1,00,000 | 1,25,000
2. Current Assets
(a) Current Investments | 60,000 | 80,000
(b) Inventories | 1,35,000 | 1,55,000
(c) Trade Receivables | 60,000 | 90,000
(d) Cash and Cash Equivalents | 25,000 | 10,000
(e) Short term Loans & Advances | 40,000 | 60,000
Total | 6,20,000 | 10,20,000

SOLUTION

Alpha Ltd.

Comparative Balance Sheet as at March 31, 2016 and 2017

Particulars	March 31, 2016 (Rs.)	March 31, 2017 (Rs.)	Absolute Change (Rs.)	% Change
I. Equity and Liabilities				
1. Shareholders' Funds				
(a) Share Capital	2,00,000	4,00,000	+2,00,000	+100.00%
(b) Reserve & Surplus	1,00,000	1,50,000	+50,000	+50.00%
2. Noncurrent Liabilities				

Particulars	March 31, 2016 (Rs.)	March 31, 2017 (Rs.)	Absolute Change (Rs.)	% Change
(a) Long Term Borrowings	2,00,000	3,00,000	+1,00,000	+50.00%
3. Current Liabilities				
(a) Short term borrowings	50,000	70,000	+20,000	+40.00%
(b) Trade Payables	30,000	60,000	+30,000	+100.00%
(c) Other Current Liabilities	20,000	10,000	−10,000	−50.00%
(d) Short Terms Provisions	20,000	20,000	0	0.00%
Total	6,20,000	10,20,000	+4,00,000	+64.52%
II. Assets				
1. Non-Current Assets				
(a) Fixed Assets	2,00,000	5,00,000	+3,00,000	+150.00%
(b) Non-Current Investments	1,00,000	1,25,000	+25,000	+25.00%
2. Current Assets				
(a) Current Investments	60,000	80,000	+20,000	+33.33%
(b) Inventories	1,35,000	1,55,000	+20,000	+14.81%
(c) Trade Receivables	60,000	90,000	+30,000	+50.00%
(d) Cash and Cash Equivalents	25,000	10,000	−15,000	−60.00%
(e) Short term Loans & Advances	40,000	60,000	+20,000	+50.00%
Total	6,20,000	10,20,000	+4,00,000	+64.52%

Working Notes:

% Change = (Current Year − Previous Year) / Previous Year × 100

Fixed Assets: (5,00,000 − 2,00,000) / 2,00,000 × 100 = 3,00,000 / 2,00,000 × 100 = 150.00%

Cash and Cash Equivalents: (10,000 − 25,000) / 25,000 × 100 = −15,000 / 25,000 × 100 = −60.00%

Total: (10,20,000 − 6,20,000) / 6,20,000 × 100 = 4,00,000 / 6,20,000 × 100 = 64.52%

Q2 Following are the Balance Sheets of Beta Ltd., as at March 31, 2016 and 2017. Prepare comparative Balance Sheet.

Particulars | March 31, 2016 (Rs.) | March 31, 2017 (Rs.)
I. Equity and Liabilities
1. Shareholders' Funds
(a) Share Capital | 4,00,000 | 3,00,000
(b) Reserves and surplus | 1,50,000 | 1,00,000
2. Non-Current Liabilities
(a) Long term IDBI | 3,00,000 | 1,00,000
3. Current Liabilities
(a) Short term borrowings | 70,000 | 50,000
(b) Trade payables | 60,000 | 30,000
(c) Other current liabilities | 1,10,000 | 1,00,000
(d) Short term provisions | 10,000 | 20,000
Total | 11,00,000 | 7,00,000
II. Assets
1. Non-Current Assets
(a) Fixed Assets | 4,00,000 | 2,20,000
(b) Non-current Investments | 2,25,000 | 1,00,000
2. Current Assets
(a) Current Investments | 80,000 | 60,000
(b) Inventories | 1,05,000 | 90,000
(c) Trade Receivables | 90,000 | 60,000
(d) Cash and Cash Equivalents | 1,00,000 | 85,000
(e) Short term loans & Advances | 1,00,000 | 85,000
Total | 11,00,000 | 7,00,000

SOLUTION

Beta Ltd.

Comparative Balance Sheet as at March 31, 2016 and 2017

Particulars	March 31, 2016 (Rs.)	March 31, 2017 (Rs.)	Absolute Change (Rs.)	% Change
I. Equity and Liabilities				
1. Shareholders' Funds				
(a) Share Capital	4,00,000	3,00,000	−1,00,000	−25.00%
(b) Reserves and surplus	1,50,000	1,00,000	−50,000	−33.33%
2. Non-Current Liabilities				
(a) Long term IDBI	3,00,000	1,00,000	−2,00,000	−66.67%

Particulars	March 31, 2016 (Rs.)	March 31, 2017 (Rs.)	Absolute Change (Rs.)	% Change
3. Current Liabilities				
(a) Short term borrowings	70,000	50,000	−20,000	−28.57%
(b) Trade payables	60,000	30,000	−30,000	−50.00%
(c) Other current liabilities	1,10,000	1,00,000	−10,000	−9.09%
(d) Short term provisions	10,000	20,000	+10,000	+100.00%
Total	11,00,000	7,00,000	−4,00,000	−36.36%
II. Assets				
1. Non-Current Assets				
(a) Fixed Assets	4,00,000	2,20,000	−1,80,000	−45.00%
(b) Non-current Investments	2,25,000	1,00,000	−1,25,000	−55.56%
2. Current Assets				
(a) Current Investments	80,000	60,000	−20,000	−25.00%
(b) Inventories	1,05,000	90,000	−15,000	−14.29%
(c) Trade Receivables	90,000	60,000	−30,000	−33.33%
(d) Cash and Cash Equivalents	1,00,000	85,000	−15,000	−15.00%
(e) Short term loans & Advances	1,00,000	85,000	−15,000	−15.00%
Total	11,00,000	7,00,000	−4,00,000	−36.36%

Working Notes:

% Change = (Current Year − Previous Year) / Previous Year × 100

Share Capital: (3,00,000 − 4,00,000) / 4,00,000 × 100 = −1,00,000 / 4,00,000 × 100 = −25.00%

Long term IDBI: (1,00,000 − 3,00,000) / 3,00,000 × 100 = −2,00,000 / 3,00,000 × 100 = −66.67%

Fixed Assets: (2,20,000 − 4,00,000) / 4,00,000 × 100 = −1,80,000 / 4,00,000 × 100 = −45.00%

Total: (7,00,000 − 11,00,000) / 11,00,000 × 100 = −4,00,000 / 11,00,000 × 100 = −36.36%

Q3 Prepare Comparative Statement of profit and loss from the following information.

Particulars | 2015-16 (Rs.) | 2016-17 (Rs.)
Freight Outward | 20,000 | 10,000
Wages (office) | 10,000 | 5,000
Manufacturing Expenses | 50,000 | 20,000
Stock adjustment | (60,000) | 30,000
Cash purchases | 80,000 | 60,000
Credit purchases | 60,000 | 20,000
Return inward | 8,000 | 4,000
Gross profit | (30,000) | 90,000
Carriage outward | 20,000 | 10,000
Machinery | 3,00,000 | 2,00,000
10% depreciation on machinery | 10,000 | 5,000
Interest on short-term loans | 20,000 | 20,000
10% debentures | 20,000 | 10,000
Profit on sale of furniture | 20,000 | 10,000
Loss on sale of office car | 90,000 | 60,000
Tax rate | 40% | 50%

SOLUTION

Step 1 — Derive Revenue from Operations (Net Sales):

COGS = Purchases (Cash + Credit) + Manufacturing Expenses + Stock Adjustment

2015-16: COGS = (80,000 + 60,000) + 50,000 + (−60,000) = 1,40,000 + 50,000 − 60,000 = 1,30,000

[Stock adjustment (60,000) is a credit/negative entry meaning closing stock exceeds opening stock by 60,000, reducing COGS]

2016-17: COGS = (60,000 + 20,000) + 20,000 + 30,000 = 80,000 + 20,000 + 30,000 = 1,30,000

[Stock adjustment 30,000 is a debit/positive entry meaning opening stock exceeds closing stock, increasing COGS]

Net Sales = COGS + Gross Profit

2015-16: Net Sales = 1,30,000 + (−30,000) = 1,00,000

2016-17: Net Sales = 1,30,000 + 90,000 = 2,20,000

Gross Sales = Net Sales + Return Inward

2015-16: Gross Sales = 1,00,000 + 8,000 = 1,08,000

2016-17: Gross Sales = 2,20,000 + 4,000 = 2,24,000

Step 2 — Operating Expenses (Indirect):

2015-16: Wages (office) 10,000 + Freight Outward 20,000 + Carriage Outward 20,000 + Depreciation on Machinery 10,000 = 60,000

2016-17: 5,000 + 10,000 + 10,000 + 5,000 = 30,000

Step 3 — Finance Costs:

Interest on short-term loans: 20,000	20,000
Interest on 10% debentures (face value 20,000 @ 10%): 2,000	interest on 10,000 @ 10%: 1,000
Total Finance Costs: 22,000	21,000

Step 4 — Other Income / (Loss):

Profit on sale of furniture: 20,000	10,000
Loss on sale of office car: 90,000	60,000

Step 5 — Profit Before Tax:
2015-16: PBT = (−30,000) − 60,000 − 22,000 + 20,000 − 90,000 = −1,82,000 (Net Loss)
2016-17: PBT = 90,000 − 30,000 − 21,000 + 10,000 − 60,000 = −11,000 (Net Loss)
Tax on loss = Nil for both years.

Comparative Statement of Profit and Loss

Particulars	2015-16 (Rs.)	2016-17 (Rs.)	Absolute Change (Rs.)	% Change
I. Revenue from Operations (Gross Sales)	1,08,000	2,24,000	+1,16,000	+107.41%
Less: Return Inward	8,000	4,000	−4,000	−50.00%
II. Net Revenue from Operations	1,00,000	2,20,000	+1,20,000	+120.00%
III. Cost of Revenue from Operations	1,30,000	1,30,000	0	0.00%
Purchases (Cash + Credit)	1,40,000	80,000	−60,000	−42.86%
Manufacturing Expenses	50,000	20,000	−30,000	−60.00%
Stock Adjustment	(60,000)	30,000	+90,000	N/A
IV. Gross Profit (II − III)	(30,000)	90,000	+1,20,000	N/A
V. Operating Expenses	60,000	30,000	−30,000	−50.00%
Wages (office)	10,000	5,000	−5,000	−50.00%
Freight Outward	20,000	10,000	−10,000	−50.00%
Carriage Outward	20,000	10,000	−10,000	−50.00%
Depreciation on Machinery	10,000	5,000	−5,000	−50.00%
VI. Operating Loss (IV − V)	(90,000)	60,000	+1,50,000	N/A
VII. Finance Costs	22,000	21,000	−1,000	−4.55%

Particulars	2015-16 (Rs.)	2016-17 (Rs.)	Absolute Change (Rs.)	% Change
Interest on short-term loans	20,000	20,000	0	0.00%
Interest on 10% Debentures	2,000	1,000	−1,000	−50.00%
VIII. Other Income: Profit on sale of furniture	20,000	10,000	−10,000	−50.00%
IX. Other Expense: Loss on sale of office car	90,000	60,000	−30,000	−33.33%
X. Profit / (Loss) Before Tax	(1,82,000)	(11,000)	+1,71,000	N/A
XI. Less: Tax (40% / 50%)	Nil	Nil	0	—
XII. Profit / (Loss) After Tax	(1,82,000)	(11,000)	+1,71,000	N/A

Note: % Change marked N/A where the base-year figure is negative or zero, as percentage change is not meaningful.

Q4 Prepare Comparative Statement of Profit and Loss from the following information:
Particulars | 2015-16 (Rs.) | 2016-17 (Rs.)
Manufacturing expenses | 35,000 | 80,000
Opening stock | 30,000 | 60% of closing stock
Sales | 9,60,000 | 4,50,000
Returns outward | 4,000 (out of credit purchase) | 6,000 (out of cash purchase)
Closing stock | 150% of opening stock | 1,00,000
Credit purchases | 1,50,000 | 150% of cash purchase
Cash purchases | 80% of credit purchases | 40,000
Carriage outward | 10,000 | 30,000
Building | 1,00,000 | 2,00,000
Depreciation on building | 20% | 10%
Interest on bank overdraft | 5,000 | —
10% debentures | 2,00,000 | 20,00,000
Profit on sale of copyright | 10,000 | 20,000
Loss on sale of personal car | 10,000 | 20,000
Other operating expenses | 20,000 | 10,000
Tax rate | 50% | 40%

SOLUTION

Step 1 — Resolve cross-referenced figures:

2015-16:

Cash purchases = 80% of Credit purchases = 80% × 1,50,000 = 1,20,000
Closing stock = 150% of Opening stock = 150% × 30,000 = 45,000
Returns outward (out of credit purchase) = 4,000
Net Purchases = (1,20,000 + 1,50,000) − 4,000 = 2,70,000 − 4,000 = 2,66,000

2016-17:
Credit purchases = 150% of Cash purchases = 150% × 40,000 = 60,000
Opening stock = 60% of Closing stock = 60% × 1,00,000 = 60,000
Returns outward (out of cash purchase) = 6,000
Net Purchases = (40,000 + 60,000) − 6,000 = 1,00,000 − 6,000 = 94,000

Step 2 — Cost of Revenue from Operations (COGS):
COGS = Opening Stock + Net Purchases + Manufacturing Expenses − Closing Stock
2015-16: 30,000 + 2,66,000 + 35,000 − 45,000 = 2,86,000
2016-17: 60,000 + 94,000 + 80,000 − 1,00,000 = 1,34,000

Step 3 — Gross Profit:
Net Sales (Revenue from Operations) = Sales (no return inward given)
2015-16: 9,60,000 − 2,86,000 = 6,74,000
2016-17: 4,50,000 − 1,34,000 = 3,16,000

Step 4 — Operating Expenses:
Depreciation on Building: 20% × 1,00,000 = 20,000 (2015-16); 10% × 2,00,000 = 20,000 (2016-17)
2015-16: Carriage Outward 10,000 + Depreciation 20,000 + Other Operating Exp 20,000 = 50,000
2016-17: 30,000 + 20,000 + 10,000 = 60,000

Step 5 — Finance Costs:

Interest on bank overdraft: 5,000	Nil
Interest on 10% Debentures: 10% × 2,00,000 = 20,000	10% × 20,00,000 = 2,00,000
Total Finance Costs: 25,000	2,00,000

Step 6 — Other Income / Expense:

Profit on sale of copyright: 10,000	20,000
Loss on sale of personal car: 10,000	20,000

Step 7 — Profit Before Tax:
2015-16: 6,74,000 − 50,000 − 25,000 + 10,000 − 10,000 = 5,99,000
2016-17: 3,16,000 − 60,000 − 2,00,000 + 20,000 − 20,000 = 56,000

Step 8 — Tax and PAT:
2015-16: Tax = 50% × 5,99,000 = 2,99,500; PAT = 5,99,000 − 2,99,500 = 2,99,500
2016-17: Tax = 40% × 56,000 = 22,400; PAT = 56,000 − 22,400 = 33,600

Comparative Statement of Profit and Loss

Particulars	2015-16 (Rs.)	2016-17 (Rs.)	Absolute Change (Rs.)	% Change
I. Revenue from Operations (Net Sales)	9,60,000	4,50,000	−5,10,000	−53.13%
II. Cost of Revenue from Operations	2,86,000	1,34,000	−1,52,000	−53.15%
Opening Stock	30,000	60,000	+30,000	+100.00%
Net Purchases	2,66,000	94,000	−1,72,000	−64.66%
Manufacturing Expenses	35,000	80,000	+45,000	+128.57%
Less: Closing Stock	(45,000)	(1,00,000)	—	—
III. Gross Profit (I − II)	6,74,000	3,16,000	−3,58,000	−53.12%
IV. Operating Expenses	50,000	60,000	+10,000	+20.00%
Carriage Outward	10,000	30,000	+20,000	+200.00%
Depreciation on Building	20,000	20,000	0	0.00%
Other Operating Expenses	20,000	10,000	−10,000	−50.00%
V. Operating Profit (III − IV)	6,24,000	2,56,000	−3,68,000	−58.97%
VI. Finance Costs	25,000	2,00,000	+1,75,000	+700.00%
Interest on Bank Overdraft	5,000	—	−5,000	−100.00%
Interest on 10% Debentures	20,000	2,00,000	+1,80,000	+900.00%
VII. Other Income: Profit on sale of copyright	10,000	20,000	+10,000	+100.00%
VIII. Other Expense: Loss on sale of personal car	10,000	20,000	+10,000	+100.00%
IX. Profit Before Tax (V − VI + VII − VIII)	5,99,000	56,000	−5,43,000	−90.65%
X. Less: Tax (50% / 40%)	2,99,500	22,400	−2,77,100	−92.52%
XI. Profit After Tax	2,99,500	33,600	−2,65,900	−88.78%

Q5 Prepare a Common size statement of profit and loss of Shefali Ltd. with the help of following information:

Particulars | 2015-16 (Rs.) | 2016-17 (Rs.)
Revenue from operations | 6,00,000 | 8,00,000
Indirect expense | 25% of gross profit | 25% of gross profit
Cost of revenue from operations | 4,28,000 | 7,28,000
Other incomes | 10,000 | 12,000
Income tax | 30% | 30%

SOLUTION

Step 1 — Derive intermediate figures:

2015-16:

Gross Profit = Revenue − Cost of Revenue = 6,00,000 − 4,28,000 = 1,72,000
Indirect Expense = 25% × 1,72,000 = 43,000
Profit before tax = 1,72,000 − 43,000 + 10,000 = 1,39,000
Tax = 30% × 1,39,000 = 41,700
Profit after tax = 1,39,000 − 41,700 = 97,300

2016-17:

Gross Profit = 8,00,000 − 7,28,000 = 72,000
Indirect Expense = 25% × 72,000 = 18,000
Profit before tax = 72,000 − 18,000 + 12,000 = 66,000
Tax = 30% × 66,000 = 19,800
Profit after tax = 66,000 − 19,800 = 46,200

Step 2 — Common Size %: each item / Revenue from Operations × 100

Common Size Statement of Profit and Loss — Shefali Ltd.

Particulars	2015-16 (Rs.)	% of Revenue	2016-17 (Rs.)	% of Revenue
I. Revenue from Operations	6,00,000	100.00%	8,00,000	100.00%
II. Cost of Revenue from Operations	4,28,000	71.33%	7,28,000	91.00%
III. Gross Profit (I − II)	1,72,000	28.67%	72,000	9.00%
IV. Indirect Expenses (25% of Gross Profit)	43,000	7.17%	18,000	2.25%
V. Operating Profit (III − IV)	1,29,000	21.50%	54,000	6.75%
VI. Other Incomes	10,000	1.67%	12,000	1.50%
VII. Profit Before Tax (V + VI)	1,39,000	23.17%	66,000	8.25%
VIII. Tax @ 30%	41,700	6.95%	19,800	2.48%
IX. Profit After Tax (VII − VIII)	97,300	16.22%	46,200	5.78%

Verification — 2015-16 key %:

Cost of Revenue: 4,28,000 / 6,00,000 × 100 = 71.33%
Gross Profit: 1,72,000 / 6,00,000 × 100 = 28.67%
Indirect Expense: 43,000 / 6,00,000 × 100 = 7.17%
PAT: 97,300 / 6,00,000 × 100 = 16.22%

Verification — 2016-17 key %:
Cost of Revenue: 7,28,000 / 8,00,000 × 100 = 91.00%
Gross Profit: 72,000 / 8,00,000 × 100 = 9.00%
PAT: 46,200 / 8,00,000 × 100 = 5.78%

Q6 Prepare a Common Size balance sheet from the following balance sheet of Aditya Ltd., and Anjali Ltd.:
Particulars | Aditya Ltd. (Rs.) | Anjali Ltd. (Rs.)
I. Equity and Liabilities
1. Shareholder's Funds
a) Equity share capital | 6,00,000 | 8,00,000
b) Reserves and surplus | 3,00,000 | 2,50,000
2. Current liabilities | 1,00,000 | 1,50,000
Total | 10,00,000 | 12,00,000
II. Assets
1. Non current assets
a) Fixed assets | 4,00,000 | 7,00,000
2. Current assets | 6,00,000 | 5,00,000
Total | 10,00,000 | 12,00,000

SOLUTION

Common Size %: each item / Total Assets (= Total Equity and Liabilities) × 100
Base: Aditya Ltd. = 10,00,000; Anjali Ltd. = 12,00,000

Common Size Balance Sheet as at the same date

Particulars	Aditya Ltd. (Rs.)	Aditya %	Anjali Ltd. (Rs.)	Anjali %
I. Equity and Liabilities				
1. Shareholder's Funds				
a) Equity share capital	6,00,000	60.00%	8,00,000	66.67%
b) Reserves and surplus	3,00,000	30.00%	2,50,000	20.83%
2. Current liabilities	1,00,000	10.00%	1,50,000	12.50%
Total	10,00,000	100.00%	12,00,000	100.00%
II. Assets				

Particulars	Aditya Ltd. (Rs.)	Aditya %	Anjali Ltd. (Rs.)	Anjali %
1. Non-current assets				
a) Fixed assets	4,00,000	40.00%	7,00,000	58.33%
2. Current assets	6,00,000	60.00%	5,00,000	41.67%
Total	10,00,000	100.00%	12,00,000	100.00%

Verification:
Aditya — E&L check: 60% + 30% + 10% = 100% ✓
Anjali — E&L check: 66.67% + 20.83% + 12.50% = 100.00% ✓
Aditya — Assets check: 40% + 60% = 100% ✓
Anjali — Assets check: 58.33% + 41.67% = 100.00% ✓

Key %:
Aditya: Equity share capital 6,00,000 / 10,00,000 × 100 = 60.00%
Anjali: Equity share capital 8,00,000 / 12,00,000 × 100 = 66.67%
Aditya: Fixed assets 4,00,000 / 10,00,000 × 100 = 40.00%
Anjali: Fixed assets 7,00,000 / 12,00,000 × 100 = 58.33%
Aditya: Current assets 6,00,000 / 10,00,000 × 100 = 60.00%
Anjali: Current assets 5,00,000 / 12,00,000 × 100 = 41.67%