- **Analysis of Financial Statements:** The analysis of financial statements imply or mean a thorough, systematic, comprehensive, and critical examination of the information contained in the financial statements. This process aims to enhance better understanding, facilitate decision-making based on meaningful conclusions, take planned steps towards development and secure the future of the organisation.

- **Objectives of Financial Statements Analysis:**

1. Financial Statements Analysis presents financial data in a simplified and understandable form, enabling meaningful conclusions to be drawn.

2. It helps in assessing the profitability and operational efficiency of the firm as a whole, as well as of its various departments, to judge the organisation's financial health.

3. It helps in ascertaining the relative importance of different components of the financial position (such as assets, liabilities, owners' equity, etc.) of the firm.

4. It helps in making intra-firm and inter-firm comparisons.

> Comparative Statements: Compare financial data also enabling meaningful conclusions about changes in financial position, and operating results.

5. It helps identify the causes of change in profitability or financial positions of the firm.

6. It assists in assessing future trends, forecasting and preparing budgets.

- **Importance of Financial Statement Analysis:**

  1. **Management:** Financial statement analysis helps management in assessing the profitability, liquidity, and solvency, guiding strategic decisions and taking corrective actions.

  2. **Investors:** Investors use financial statement analysis to gauge earning capacity, growth prospects, and the safety of their investments.

  3. **Creditors:** Financial statement analysis assists creditors in evaluating the liquidity and solvency of a business for making lending decisions.

  4. **Government:** Governments rely on financial statement analysis to understand the profitability for taxation and make decisions about price regulations.

5. Customers: Customers use financial statements to assess the longevity and stability of a business.

6. Employees: Employees leverage financial statements to evaluate company, progress for decisions on bonuses, wage increases, job stability, and satisfaction.

- **Limitations of Financial Statements Analysis:**

(1) Financial statement analysis ignores qualitative information,such as quality of management, labour force, public relations, etc.

(2) It does not disclose the current worth of the business as financial statements of the company are prepared on the historical cost principle.

(3) In many situations, the accountant has to choice out of various alternatives available. He may choose an alternative, which may be beneficial to the company. In such cases, the Financial statements are not free from bias.

(4) Different firms may follow different accounting policies. This may create difficulty in comparing the resultant performance of the two companies.

• **Tools for Analysis of Financial Statements:** Analysis of Financial statements can be carried out using the following tools:

(1) Comparative Statements (Horizontal Analysis).

(2) Common size Statements (Vertical Analysis).

(3) Ratio Analysis.

(4) Cash Flow Statement.

• **Comparative Statements:** Comparative statements compare financial data at two points in time, enabling meaningful conclusions about changes in financial position, and operating results. Statements showing financial data for two or more years, placed side by side to facilitate comparison are called Comparative Financial Statements.

(a) Comparative Balance Sheet

According to Faulke, "Comparative Balance Sheet analysis is the study of the trend of some items or groups of some comprised items in balance sheets of the same business enterprise on different dates."

The Comparative Balance Sheet shows increases and decreases in absolute terms as well as in percentage of various assets, liabilities, and capital. Thus, it provides information regarding the progress of the business firm.

Comparative Balance Sheet of .... Ltd.
as at ....

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Absolute Change (₹)	Percentage Change (%)
1		2	3	4	5
		A	B	(B – A) = C	C/A × 100 = D

I. EQUITY AND LIABILITIES					
1. Shareholders' Funds:					
(a) Share Capital					
(b) Reserves and Surplus					
(c) Money received against Share Warrants					
2. Non-current Liabilities:					
(a) Long-term Borrowings					
(b) Long-term Provisions					
3. Current Liabilities:					
(a) Short-term Borrowings					
(b) Trade Payables					
(c) Other Current Liabilities					
(d) Short-term Provisions					
Total					
II. ASSETS					
1. Non-current Assets:					
(a) Property, Plant & Equipment and Intangible Assets:					
(i) Property, Plant and Equipment					
(ii) Intangible Assets					
(b) Non-current Investments					
(c) Long-term Loans and Advances					
2. Current Assets:					
(a) Current Investments					
(b) Inventories					
(c) Trade Receivables					
(d) Cash and Cash Equivalents					
(e) Short-term Loans and Advances					
(f) Other Current Assets					
Total					

(b) Comparative Statement of Profit & Loss or Comparative Income Statement

The Comparative Statement of Profit and Loss is an income statement prepared in such a form at that reflects the operating activities of a business for two or more accounting periods. It helps in assessing and reviewing the operational efficiency, deciding on future actions and formulating effective plans. The generally accepted format of the Comparative Income Statement is given below:

Comparative Statement of Profit and Loss

Income Statement is given below:

Comparative Statement of Profit and Loss
for the years ended...

Particulars	Note No.	Previous Year (₹)	Current Year (₹)	Absolute change (₹)	Percentage change (%)
		A	B	(B – A) = C	C/A × 100 = D
I. The net Sale (Total sales - Sales returns) is also called Revenue from Operation.					
II. Other Income					
III. Total Revenue (I + II)					
IV. Expenses:					
Cost of material consumed					
Purchases of Stock-in-Trade					
Changes in inventories of Finished Goods, Work-in-Progress and Stock-in-Trade					
Employees Benefit Expenses					
Finance Costs					
Depreciation and Amortisation Expenses					
Other Expenses					
Total Expenses					

V. **Profit before Tax (III–IV)**					
VI. *Less*: Income Tax					
VII. Profit after Tax (V–VI)					

- **Common-Size Statements:** According to *Kohler*, "Common- Size Statements are accounting statements expressed as percentages of the same base rather than in rupees."

Common Size statement
Scan Me!

(a) Common-Size Balance Sheet: In a Common- Size balance sheet, each item on the assets side is converted into a percentage to total assets (i.e., 100) and each item of equity and liabilities is converted into a percentage of the total equity and liabilities (i.e., 100).

Format of Common- Size Balance Sheet as at ....

Particulars	**Note No.**	**Absolute Amounts**		**Percentage of Balance Sheet**	
		Previous Year (₹)	**Current Year (₹)**	**Previous Year (%)**	**Current Year (%)**
(1)	(2)	(3)	(4)	(5)	(6)
I. EQUITY AND LIABILITIES					
1. Shareholders' Funds:					
(a) Share Capital:					
(i) Equity Share Capital		—	—	—	—
(ii) Preference Share Capital		—	—	—	—
(b) Reserves and Surplus		—	—	—	—
3. Non-current Liabilities:		—	—	—	—
(a) Long-term Borrowings					
(b) Long-term Provisions		—	—	—	—
4. Current Liabilities:		—	—	—	—
(a) Short-term Borrowings					
(b) Trade Payables		—	—	—	—
(c) Other Current Liabilities		—	—	—	—
(d) Short-term Provisions		—	—	—	—
		—	—	—	—
Total		—	—	100	100
2. ASSETS:					
1. Non-current Assets:					
(i) Property, Plant and Equipment		—	—	—	—
(ii) Intangible Assets		—	—	—	—
(a) Non-current Investments		—	—	—	—
(b) Long-term Loans and Advances		—	—	—	—
2. Current Assets:					
(a) Current Investments		—	—	—	—
(b) Inventories					
(c) Trade Receivables		—	—	—	—
(d) Cash and Cash Equivalents		—	—	—	—
(e) Short-terms Loans and Advances		—	—	—	—
(f) Other Current Assets		—	—	—	—
		—	—	—	—
		—	—	—	—
Total		—	—	100	100

- **Common- Size Income Statement:** A common- size income statement is a statement in which the figure for net sales is assumed to be equal to 100, and all other figures are expressed as percentage of net sales.

Format of a Common- Size Income Statement
for the years ended ....

Particulars	Note No.	Absolute Amounts		Percentage of Revenue from Operations	
		Previous Year (₹)	Current Year (₹)	Previous Year (%)	Current Year (%)
I. Revenue from Operations II. Other Income					
III. Total Revenue (I + II)					
IV. Expenses: (a) Cost of Materials Consumed (b) Purchase of Stock in-Trade (c) Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade (d) Employees Benefit Expenses (e) Finance Costs (f) Depreciation and Amortisation Expenses (g) Other Expenses					
Total Expenses					
V. Profit before Tax (III–IV) **VI.** *Less*: Income Tax					
VII. Profit (Loss) for the period (V–VI)					