

CHAPTER 10

Financial Statement of Companies

Basic Financial Statement also called Final Accounts

1. Income Statement :- It show the net result of business operation i.e. Net/profit/Net loss during an accounting period (or Trading and profit & loss A/c)

FORM OF BALANCE SHEET

Name of the Company

Balance Sheet as at

Particulars	Note No.	Fig. for the Current Year	Fig. for the Previous Year
I. EQUITY AND LIABILITIES			
(i) Shareholders' Fund			
(ii) Share Application pending allotment			
(iii) Non Current Liabilities			
(iv) Current Liabilities			
Total			
II. ASSETS			
(i) Non-Current Assets			
(ii) Current Assets			
Total			

Hence we see that there are only four major headings under equity and liability side whereas Asset side consist of only two major heading
Subheading under various major heading

Equity and Liability

(1) Shareholder's Fund

- (a) Share Capital
- (b) Reserves and Surplus
- (c) Money received against share warrants

(2) Non Current Liabilities

- (a) Long term borrowings - Bonds, Debenture, loans from Banks etc are included.
- (b) Deferred tax liabilities.
- (c) Other long term liabilities - It include trade payable which outstanding for more than 12 months.

(3) Current Liabilities

- (a) Short term borrowings
- (b) Trade Payables (Creditors and Bills Payable)
- (c) Other Current Liabilities - Include current maturities of long-term debt., Interest accrued but not due & interest acerued and due on borrowings, outstanding expenses, calls in advance, unclaimed dividents etc.

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ASSETS

(1) Non Current Assets

- (a) Fixed Assets :- This subheading is divided into tangible, Intangible Assets and Capital-work-in-progress.
- (b) Non-Current Investments.
- (c) Deferred Tax Assets
- (d) Long term Loans and Advances
- (e) Other Non-Current Assets

(2) Current Assets

- (a) Current Investment (i.e. upto one year)
- (b) Inventories - Raw material, stock in trade work in progress, stores and spares and loose tools etc. are also included alongwith the finished goods
- (c) Trade Receivables - Sunday Debtors, BIR
- (d) Cash and Cash Equivalents
- (e) Short term loan and advances
- (f) Other current Assets - It include prepaid expenses, interest ocerued on investments etc.

Note- 1. Miscellaneous Expenditure and the Debit Balance of Profit and Loss A/c are not shown separately.

2. Profit & Loss A/c - Debit Balance is shown as a minus item under Reserve and Surplus.

3. Miscellaneous Expenditure items are subtraeted from the security premium on the equity and liability heading and in the absenace of such a reserve these are shown as a other Non-Current Assets or other current Assets as per instructions.

Contingent Liabilities :-

These are the liabilities which are not liabilities on the date but may arise upon the happening of a certain event. These are not added in the Amount of liabilities and are shown only as footnotes.

Remember some examples :-

- Disputed claims not as knowledge as debts on that date
- Uncalled liability on partly paid shares
- Arrears of dividends on cumulative preference shares.
- Bills discounted but not matured
- Guarantee for loans

Some Example of Miscellaneous Expenditure (Must Remember) :-

- Preliminary Expenses
- Expenses on issue of shares on debentures
- Discount allowed on the issue of shares/deb.
- Development expenditure not adjusted.
- Interest paid out of capital during construction period.

Some Important Items normally asked in the Exam :

Equity and Liability head

S. No.	Items	Major Heading	Subheading
1.	Proposed Dividend	Current Liability	Short-term Provision
2.	Unclaimed Dividend	Current Liability	Other Current Liabilities
3.	Bills Payable	Current Liability	Trade Payable

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4.	Provision for Tax	Current Liability	Short-term Provision
5.	Outstanding Salaries	Current Liability	Other Current Liabilities
6.	Preliminary Expenses	Shareholders' Fund	Subtracted from security premium under Reserve and Surplus.
7.	Authorised Capital	Shareholder's Fund	Share Capital
8.	Debenture	Non-Current Liabilities	Long-term Borrowings
9.	Sinking Fund	Shareholder's Fund	Reserve and Surplus
10.	Provision for Provident Fund	Non-Current Liabilities	Long-term provision
11.	Security Premium	Shareholders' fund	Reserve and Surplus
12.	Creditors	Current Liabilities	Trade Payable

Assets head

S. No.	Items	Major Heading	Subheading
1.	Patents and Trade Marks	Non-Current Assets	Intangible Assets
2.	Bills Receivables & Debtors	Current Assets	Trade Receivable
3.	Prepaid Expenses	Current Assets	Other Current Assets
4.	Advances Recoverable in Cash	Current Assets	Short-term Loans and Advances
5.	Goodwill	Non-Current Assets	Intangible Assets
6.	Loose Tools	Current Assets	Inventories
7.	Bank/Cash Balance	Current Assets	Cash & Cash Equivalents
8.	Investments	Non-Current Assets	Non-Current Investment
9.	Work-in progress	Current Assets	Inventories
10.	Govt. Securities	Non Current Assets	Non-Current Investment

Financial Statement Analysis

Meaning - In the words of Finney and miller 'Financial Analysis consists in separating facts according to some definite plan arranging them in groups according to certain circumstances and then presenting them in a convenient and easily readable and understandable form.'

Objectives/Need

- To measure the profitability of the business
- To measure the financial strength of the business
- To make comparative study within the firm and with other forms
- To judge the efficiency of Management
- To provide useful information to the Management
- To find out the capability of payment of interest, dividend etc.
- To find out the trend of the business

Significance or Importance of Financial Analysis

For Management - To know the profitability, liquidity and solvency condition to measure the effectiveness of own decision taken and take corrective measure in future.

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For Investors :- Want to know the earning capacity and future growth prospects of the business which helps in assessing the safety of their investment and reasonable return.

For Creditors :- Short term creditors want to know the liquidity condition of the business where as long term creditors want to know the solvency will be able to pay the interest constantly.

For Govt. :- To know the profitability condition for taking taxation decision and to find out the company.

For Employees :- To know the progress of the company for assessing Bonus, increase in wages and ensure stability of their job.

Limitation of Financial Analysis

- Based on basic financial statement which themselves suffer from certain limitations.
- Don't reflect changes in price level.
- Affected by the personal ability and bias of the Analyst.
- Lack of qualitative analysis as only those transaction and events are recorded which can be measured in terms of money.
- When different accounting policies are followed then the comparison of two financial statement becomes unreliable.
- Single years' Analysis of financial statement have limited use.

Types of financial Analysis

Horizontal Analysis :- In this, figure for two or more years are compared and analyzed. It is also called dynamic Analyses.

Examples :- Comparison of sales, profits, cost of goods sold for two or more than 2 years.

Vertical Analysis :- In this type, Financial Statement for a single year is analyzed. It involves the study of relationship between two quantities of balance sheet or P & L A/c of a single years or period.

Example :- Common size statements.

Tool of Financial Analysis

Comparative Statement :- Financial Statement of two years is compared. Absolute change and then the percentage change in figure are calculated. It is a form of **Horizontal Analysis**

Common Size Statement : Various figure of single year Financial Statement are converted in to percentage with respect to some common base. In **Income Statement sales** is taken as base (i.e.100) where as in **Balance Sheet total assets** are taken as base.

Trend Analysis :- Here trend percentage are calculated for a number of years taking one year as a base year. This helps in assessing the trend of increase or decrease in various items.

Accounting Ratios :- Study of relationship between various items is known as Ratio analysis.

Cash Flow Statement :- It shows the inflow and outflow of cash and cash equivalents during a particular period which helps in finding out the causes of changes in cash between the two dates.

Fund Flow Statement :- It indicates the reasons of changing in working capital during a particular time period. It shows sources (inflow) and Applications (Outflow) of funds.

Break - even Analysis :- It is a point where total of sales is exactly equal to the total of cost to the total of cost of sales i.e. the firm has neither any profit nor any loss. **It is also**

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called as No Profit-No Loss Point.

Comparative Statement Preparation :-

Steps :-

- Put the fig. of Financial Statement of two year side by side (previous year amount in the 1st column)

- In the next column write the difference of the two fig. For increase with respect to the previous year's (+) sign and Decrease put (-) sign.

- Percentage increase or decrease is calculated by the formula given below :-

Absolute increase or decrease * 100

Fig. for the previous year

Format for Comparative Balance Sheet

COMPARATIVE BALANCE SHEET

As at 31st March, 2010 and 2011

Particulars	2002	2003	Absolute increase or Decrease over 2010	% Increase or decrease in relation to 2011
	Rs.	Rs.	Rs.	%
Fixed Assets (A)	—	—	—	
Investment (B)				
Working Capital				
Current Assets (i)	—	—	—	
Current Liabilities(ii)	—	—	—	
Working Capital (i-ii)	—	—	—	
Capital Employed (A+B+C+)				
Less : Long-term Debts (e.g. debentures)	— —	— —	— —	
Shareholder's Funds				
Represented by :				
Preference Share Capital	—	—	—	
+ Equity Share Capital	—	—	—	
+ Net Reserve and Surplus	—	—	—	
	—	—	—	

Example 1.

From the following information, prepare Balance Sheet of X Ltd. :-

Particulars	31.03.2006	31.03.2007
	Rs.	Rs.
Current Assets	13,00,000	18,20,000
12% Debentures	5,00,000	4,00,000
Equity Share Capital	10,00,000	10,00,000

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Fixed Assets	15,00,000	20,00,000
Investments	2,00,000	50,000
Current Liabilities	9,00,000	12,70,000
Reserves and Surplus	6,00,000	12,00,000

Solution :

COMPARITIVE BALANCE SHEET OF X LTD.

As on 31st March 2006 & 2007

Particulars	2002	2003	Increase or decrease over 2006	% Increase or decrease in relation to 2011
	Rs.	Rs.	Rs.	%
Fixed Assets (A)	15,00,000	20,00,000	+5,00,000	+33.33
Investments (B)	2,00,000	50,000	-1,50,000	-75
Working Capital :-				
Current Assets (1)	13,00,000	18,20,000	+5,20,000	+40
Current Liabilities (2)	9,00,000	12,70,000	+3,70,000	+41.11
Working Capital (c) (1-2)	4,00,000	5,50,000	+1,50,000	+37.50
Capital Employed (A+B+C)	21,00,000	26,00,000	+5,00,000	+23.81
Less : 12% Debenture	5,00,000	4,00,000	-1,00,000	-20
Shareholder's Funds	16,00,000	22,00,000	+6,00,000	+37.50
Represented by :-				
Equity Share Capital	10,00,000	10,00,000	-	-
+Reserve and Surplus	6,00,000	12,00,000	+6,00,000	+100
Shareholder's Funds	16,00,000	22,00,000	+6,00,000	+37.50

Format of a Comparative Income Statement

COMPARATIVE INCOME STATEMENT

For the year ended 31st March, 2010 and 2011

Particulars	2010	2011	Absolute increase or decrease over 2010	% Increase or decrease in relation to 2011
	Rs.	Rs.	Rs.	%
Net sales	—	—	—	—
Less : Cost of goods sold	—	—	—	—
Gross Profit (A)	—	—	—	—
Less : Operating Expenses :				
(See note 1)				
Office & administration Expenses				
Selling & distribution expenses				

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Total operating expenses (B)				
Operating profit (A-B)	—	—	—	—
Add : Non-Operating Income (note2)				
Total Income	—	—	—	—
Less : Non-Operating Expenses	—	—	—	—
(See note 3)				
Net Income (profit) before tax				
Less : tax				
Net Income (profit) after tax				

Note (1) Operating Expenses : These refer to the indirect expenses relating to the principal revenue generating activities of the enterprise. These include :

- Office and Administrative expenses such a salary, postage, depreciation etc.
- Selling and Distribution expenses
- Cash discount allowed to customers
- Bad debts and Provision for doubtful debts.
- Interest on short term debts

(2) Non-operating Incomes : These refer to the incomes which are not from the principal revnue producing activities. These include :

- Interest and dividend received on long term investments
- Rent received
- Profit on sale of fixed assets
- Compensation for acquisition of land

(3) Non-operating Expenses : These refer to the expenses and losses which are not related to the operating activities. These include :

- Interest on long term debts
- Loss on sale of fixed assets
- Intangible assets written off such as goodwill, patents etc.
- Fictitious assets written off such as preliminary expenses, underwriting commission, discount on issue of share of debentures etc.

Example 2. Prepare a Comparative Income statement Ahmed Ltd., with the help of the following information :-

	31.03.2000	31.03.2001
	Rs.	Rs.
Sales	5,00,000	8,00,000
Cost of Goods Sold	3,00,000	5,00,000
Direct Expenses	40,000	20,000
Indirect Expesnes	30,000	40,000
Income Tax	40%	50

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(C. B. S. E. 2002)

SOLUTION : COMPARATIVE INCOME STATEMENT

Particulars	31.03.2000 Rs.	31.03.2001 Rs.	Absolute Change Rs.	% Change
Sales	5,00,000	8,00,000	3,00,000	60.00
Less : Cost of goods sold	<u>3,00,000</u>	<u>5,00,000</u>	<u>2,00,000</u>	66.67
Gross Profit	2,00,000	3,00,000	1,00,000	50.00
Less : Indirect Expenses	<u>30,000</u>	<u>40,000</u>	<u>10,000</u>	33.33
Net Profit before tax	1,70,000	2,60,000	90,000	52.94
Less : Income tax	<u>68,000</u>	<u>1,30,000</u>	<u>62,000</u>	91.18
Net Profit after tax	<u>1,02,000</u>	<u>1,30,000</u>	<u>28,000</u>	27.45

Importance of Comparative Statement

- To make the data simple and more understandable.
- To indicate the trend with respect to the previous year.
- To compare the firm performance with the performance of other firm in the same business.

Common Size Statement Preparation

STEPS

- Put the absolute amounts of two years side by side. Previous year's amount in the first column and current year in the 2nd column.
- Calculate the percentage of each items w.r.t the common base by using the formula

$$\text{Percentage of the item} = \frac{\text{Absolute figure of the item of the year} \times 100}{\text{Base figure of that year}}$$
- Base figure for the **Income statement** is taken as total sales whereas for **Balance Sheet** it is **total assets**.
- 3rd column is for Previous year's Percentage and 4th column is for current year's percentage.

Format of Balance Sheet As at 31st March 2010 & 2011

Particulars	Absolute Amounts		Percentage & Balance Sheet Total	
	2010 Rs.	2011 Rs.	2010 %	2011 %
Equity and Liabilities				
Equity Share Capital	—	—	—	—
Preference Share Capital	—	—	—	—
Reserve and Surplus (Net)	—	—	—	—
Non-Current Liabilities	—	—	—	—
Current Liabilities	—	—	—	—
Short-term Provisions	—	—	—	—
Total	—	—	—	—
Assets				
Non-Current Assets	—	—	—	—
Non-Current Investments	—	—	—	—
Current Assets	—	—	—	—
Total	—	—	—	—

Note - Net Reserve and Surplus means total of all reserves less Miscellaneous Expenditure

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Example 3 :- Prepare a common size balance sheet from the following data :-

Balance Sheet as on 31st March 2010 and 2012

Particulars

	31.03.2010 (Rs.)	31.03.2011 (Rs.)
Equity and Liabilities		
Equity Share Capital	6,00,000	6,00,000
Reserve and Surplus		
General Reserve		
	<u>6,80,000</u>	<u>10,00,000</u>
10% Debentures	3,00,000	3,00,000
Bills Payable	84,000	1,40,000
Creditors	3,28,000	4,50,000
Outstanding Expenses	<u>8,000</u>	<u>10,000</u>
Total	<u>20,00,000</u>	<u>25,00,000</u>
ASSETS :-		
Land and Building	8,00,000	7,50,000
Plant & Machinery	3,00,000	5,00,000
Furniture	1,00,000	1,06,250
Stock-in-trade	4,50,000	6,25,000
Sundry Debtors	2,55,000	4,10,000
Cash at Bank	<u>95,000</u>	<u>1,08,750</u>
Total	<u>20,00,000</u>	<u>25,00,000</u>

SOLUTION

COMMON SIZE BALANCE SHEET

As at 31st March 2010 and 2011

Particulars	Absolute Amounts		Percentage & Balance Sheet Total	
	2010 Rs.	2011 Rs.	2010 %	2011 %
Equity and Liabilities				
Equity Share Capital	6,00,000	6,00,000	30	24.00%
Reserve and Surplus	6,80,000	10,00,000	34	40.00
Non Current Liabilities (Debentures)	3,00,000	3,00,000	15	12.00
Current Liabilities	4,20,000	6,00,000	21	24.00
Total	20,00,000	25,00,000	100	100.00
Assets				
Non Current Assets	12,00,000	13,56,250	60	54.25
Current Assets (Stock, Debtors & Cash)	8,00,000	11,43,750	40	45.75
Total	20,00,000	25,00,000	100	100.00

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Format of a Common Size Income Statement

COMMON SIZE INCOME STATEMENT

For the year ended 31st March, 2010 and 2011

Particulars	Absolute Amounts		Percentage & Balance Sheet Total	
	2010 Rs.	2011 Rs.	2010 %	2011 %
Net Sales	—	—	—	—
Less : Cost of Goods Sold	—	—	—	—
Gross Profit (A)	—	—	—	—
Less : Operating Expenses :	—	—	—	—
Office & Administration Expenses	—	—	—	—
Selling & Distribution Expenses	—	—	—	—
Total Operating Expenses (B)	—	—	—	—
Operating Profit (A-B)	—	—	—	—
Add : Non-Operating Incomes	—	—	—	—
Total Income	—	—	—	—
Less : Non-operating Expenses	—	—	—	—
Net Income (Profit) before tax	—	—	—	—
Less : Tax	—	—	—	—
Net Income (Profit) after tax	—	—	—	—

Example 4 : Prepare a Common Size of Income Statement from the following Statement :-

Particulars	2007 Rs.	2008 Rs.	Particular	2007 Rs.	2008 Rs.
To Cost of Goods Sold	60,000	60,000	By Net Sales	1,00,000	1,20,000
To Gross Profit c/d	40,000	54,000			
	1,00,000	1,20,000		1,00,000	1,20,000
To Office and Admn. Exp.	12,000	12,000	By Gross Profit b/d	40,000	54,000
To Selling and Distribution Exp.	5,000	9,600			
To Net Profit	23,000	32,400			
	40,000	54,400		40,000	54,000

COMMON SIZE INCOME STATEMENT

Particulars	Absolute Amounts		Percentage of Net Sales	
	2007	2008	2007	2008
Net Sales	1,00,000	1,20,000	100	100
Less : Cost of Goods Sold	60,000	66,000	60(1)	55(4)
Gross Profit	40,000	54,000	40(2)	45(5)
Less : Operating Expenses :-				
Office and Administration Exp.	12,000	12,000	12(3)	10(6)
Selling and Distribution Exp.	5,000	9,600	5	8
Operating Income	23,000	32,400	23	27

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All percentage will be calculated on the basis of Net Sales. Calculating of Percentages is as follows :

Year 2007

Note : (1) $60,000 \times 100 / 1,00,000 = 60\%$

(2) $40,000 \times 100 / 1,00,000 = 40\%$

(3) $12,000 \times 100 / 1,00,000 = 12\%$

Year 2008

(4) $66,000 \times 100 / 1,20,000 = 55\%$

(5) $54,000 \times 100 / 1,20,000 = 45\%$

(6) $12,000 \times 100 / 1,20,000 = 10\%$

Importance of Common Size Statements

- Provides common base for comparison irrespective of the size of individual item.
- It presents the change in various items in relation is net sales, total assets or total liabilities.
- It establish the trend in various items of financial statements.

