

FINANCIAL STATEMENT ANALYSIS

[Basic Tools – Part - 01]

Dr. Hariharan Narayanan

Founder and Director

Shri Academy

Pune, Maharashtra, India

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FINANCIAL STATEMENT ANALYSIS – FSA

Financial Statement of an organization is prepared in order to identify the financial position of an organization over a period of time and also to know the value on a particular date. Hence it does not have a thorough analysis of each component which will help an investor, manager, banker, creditors, readers and all others to take a particular decision about the company. Hence the concept of financial statement analysis comes into picture. Financial Statement Analysis – FSA is the process of reviewing and analyzing a financial statement to plan with respect to income and profit and the overall financial position of an organization. There are various tools used to analyze a financial statement. Analysis can be Horizontal or Vertical in nature. It can be intra company or inter-company analysis. The following will only brief about Comparative Statement analysis, Common Size Statement analysis and Trend Analysis or Ratio Percentages. The expression of an analysis can be given in terms of Value, Times or in Percentage.

1. COMPARATIVE STATEMENT ANALYSIS

1.1. Meaning

Is one where the value of two components are compared and the increase or decrease is identified in value and expressed in terms of percentage. This analysis can be done only with a minimum of two statements. In other words it is a statement where two financial year statements are compared and the difference is expressed in terms of value and percentage. It is a Horizontal analysis. It is calculated for Income Statement and Balance Sheet.

1.2. Purpose – Objectives - Importance

- ✓ To identify the changes of a particular component in financial statement in terms of value and percentage
- ✓ To project for the coming years based on the observed changes
- ✓ To measure the financial performance of the organization
- ✓ To evaluate the financial stability
- ✓ To identify the strength of solvency, liquidity and profitability
- ✓ Help the management to evaluate based on inter-firm comparative statements

1.3. How to Calculate?

1.3.1. For Income Statement and Balance Sheet:

$$\text{Percentage \%} = \frac{\text{Difference Value of the Respective Component}}{\text{First Year Value of the Respective Component}} \times 100$$

Example:

Income Statement

Particulars	2018	2019	Increase / Decrease	Percentage of Change
Sales	10000	15000	(+) 5,000	(+)50%
Depreciation	8000	7000	(-) 1000	(-)12.50%

Balance Sheet

Particulars	2018	2019	Increase / Decrease	Percentage of Change
Stock	10000	12000	(+) 2000	(+)20.00%
Plant and Machinery	150000	143000	(-) 7000	(-)4.67%
Share Capital	125000	135000	(+) 10000	(+)8.00%
Creditors	35000	20000	(-) 15000	(-)42.86%
Total	160000	155000	(-) 5000	(-)3.13%

2. COMMON SIZE STATEMENT ANALYSIS

2.1. Meaning

It is a vertical analysis which is carried on year to year basis. It is prepared for both income statement and balance sheet. A particular component value will be taken as “Base” and will be kept as 100%. In Income statement, Sales or Revenue from Operation will be taken as Base and all components in the income statement should be expressed in terms of % considering sales or revenue from operation as 100% (Base). Whereas in the Balance Sheet the Total of Assets or Liabilities will be taken as Base and all components in the balance sheet should be expressed in terms of % considering total of the balance sheet as 100% (Base). Under common-size statement comparison is always made on percentage basis.

2.2. Purpose – Objectives - Importance

- ✓ It helps to analyze and compare a company's performance over sales
- ✓ Mostly used for inter-firm comparisons
- ✓ It will study the importance of each component in a statement
- ✓ Helps to project the impact if the base component (Sales) of income statement changes in the coming years.
- ✓ Helps to evaluate financial stability

2.3. How to Calculate?

2.3.1. For Income Statement

$$\text{Percentage \%} = \frac{\text{Value of the Respective Component}}{\text{Value of Sales or Revenue from Operations}} \times 100$$

Example:

Particulars	2019	Percentage
Revenue from Operations (Sales)	150000	100%
Cost of Goods Sold	65000	43.33%
Salaries	45000	30%
Profit Before Tax	40000	26.67%

2.3.2. For Balance Sheet

$$\text{Percentage \%} = \frac{\text{Value of the Respective Component}}{\text{Total Value of Balance Sheet (Asset or Liability)}} \times 100$$

Example:

Liabilities	2019	Percentage	Assets	2019	Percentage
Capital	450000	56.25%	Buildings	300000	37.50%
Debentures	250000	31.25%	Plant	425000	53.13%
Bills	100000	12.50%	Bank	75000	9.37%
	800000	100%		800000	100%

3. TREND PERCENTAGES OR RATIO

3.1. Meaning

It is a Horizontal analysis which is carried for number of years. The outcome is expressed mostly in terms of percentage. The first year of the statement is taken as “Base Year” and all component in that particular base year is taken as 100%. In the subsequent years each component is expressed in terms of percentage with respect to the base year component. (Same component is compared with base year and expressed in terms of percentage)

3.2. Purpose – Objectives – Importance

- ✓ It will study the importance of each component in a statement with series of years
- ✓ Easy to apply for many number of years
- ✓ Future is easy to predict based on the Trends calculated
- ✓ It should be calculated for only those components which has logical relationships
- ✓ Price level changes should be given importance
- ✓ Helps to evaluate the financial stability
- ✓ Helps to study the progress of an organization over a period of time with respect to various incomes, expenditures, assets and liabilities

3.3. How to Calculate?

3.3.1. For Income Statement

$$\text{Percentage \%} = \frac{\text{Value of the Respective Component in Current Year}}{\text{Value of the Respective Component in Base Year}} \times 100$$

3.3.2. For Balance Sheet

$$\text{Percentage \%} = \frac{\text{Value of the Respective Component in Current Year}}{\text{Value of Respective Component in Base Year}} \times 100$$

Example:

						TREND PERCENTAGES				
Particulars	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
Sales	10000	12000	8000	10000	7500	100	120%	80%	100%	75%
Purchases	12000	15000	18000	15000	14000	100	125%	150%	125%	116.67%
Share Capital	100000	125000	150000	150000	140000	100	125%	150%	150%	140%
Balance Sheet Total (Assumed)	800000	1000000	1200000	1300000	1100000	100	125%	150%	162.50%	137.50%

Note:

1. 2015 is taken as a Base Year and all values are taken as 100
2. For the years 2016, 2017, 2018 and 2019 the values are converted considering the same value from the base year.

**QUESTIONS ARE MARKED IN
GREEN COLOUR
FOR EASY UNDERSTANDING**