

# **COMPARATIVE STATEMENTS ANALYSIS**

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## **OBJECTIVES**

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After studying this lesson, you should be able to

- \* Understand the comparative statement analysis
- \* Prepare the comparative statement, and interpret the changes efficiently.

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## **STRUCTURE**

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- 16.1 Introduction
- 16.2 Need for Comparative Statement Analysis
- 16.3 Preparation of Comparative Statements : Some points
- 16.4 Comparative Income Statement
- 16.5 Comparative Balance Sheet
- 16.6 Limitations of Comparative Financial Statements
- 16.7 Illustrations
- 16.8 Summary
- 16.9 Self Examination Questions
- 16.10 Glossary
- 16.11 Books for Further Reading

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## **16.1 INTRODUCTION**

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You have learnt the basics of financial statements and analysis and interpretation of the same, in the last lesson. An important technique of financial analysis, i.e., comparative statement analysis, is discussed in this lesson, so as to enable you to undertake the analysis of financial statements of a concern.

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## **16.2 NEED FOR COMPARATIVE STATEMENT ANALYSIS**

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The financial statements viz., the balance sheet and the profit and loss account contain summarised information of the firm's financial affairs organised systematically. The balance sheet indicates the financial position or the state of affairs of a business at a particular moment of time. Similarly, profit and loss account is the "score board" of the

firm's performance during a particular period of time. Although these two statements do inform about financial affairs at a point of time and results of the operations conducted during a year, they do not reveal the periodic changes took place. The periodic changes mean changes in the value of a financial element at a time compared to some previous date. To know the periodic changes in financial variables, the tool 'comparative financial statement' being prepared. This analysis is an example of Horizontal analysis, as it relates to arriving at the change in a single item from one period compared to the other.

In brief, comparative financial statements are those statements which have been designed in a way so as to provide time perspective to the consideration of various elements of financial position embodied in such statements.

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### **16.3 PREPARATION OF COMPARATIVE STATEMENTS : SOME POINTS**

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Comparative financial statements can be prepared by using the financial information from Balance Sheet or from Profit and Loss Account. Comparative statements include, Comparative Balance Sheet and comparative Income Statement. Before describing the two specific statements, a general explanation with reference to the preparation of comparative statements is made in the following paragraphs :

- i. The 'purpose' of preparing comparative financial statements is to facilitate comparison between comparable figures, regarding financial position and profitability. This will be facilitated if the relevant data are laid side by side in a statement in vertical columns. This necessitates changing the already available data of balance sheet and profit and loss account from "T shape" accounts to vertical or single column or statement form.
- ii. Ensure 'uniformity of data'. The financial data relating to a company at two different periods or the data of two companies at a single point of time may not have identical heads of items. Moreover, one company may have certain head which the other company may not have. Therefore, in order to get over this difficulty, the data must be properly set first, before comparative statements are made. In the preparation of comparative financial statements, uniformity is essential. Care must be taken to see that all account heads or groups of terms like "administrative expenses", "fixed assets", "current assets", "long-term funds", "short term funds" etc. have the same connotation. Otherwise, comparison will be vitiated.
- iii. One issue which may crop up is the difference in the 'accounting methods' followed in different years. If one has the knowledge of the varied accounting methods, followed in finalising the accounts pertaining to different time periods, it is better to adjust the figures to make them in line-with.
- iv. Another issue is related to the number or year periods' financial data to be 'tabulated in columns. Comparative statements will contain item atleast for two

periods. If two years data are taken, a periodic change can be calculated. For example, Fixed Assets in 1988, and 1989 are given, change (i.e., absolute and relative) can be calculated for the year 1989 over the year 1988. If more than two years data are taken for preparing comparative statements, more than two periodic changes can be calculated. As the data for more number of years is taken, the number of periodic changes will also increase, which may put the analyst in trouble for effective interpretation of periodic changes.

v. There are two different 'ways of expressing change', i.e., increase and decrease in items of income statement and balance sheet. They are (1) aggregate changes and (2) relative or proportional changes. Aggregate change is nothing but expression of increase or decrease of financial elements in monetary (rupee) terms, whereas, relating the absolute change to the base period value. This relative or proportional change is mathematically presented in terms of percentage. Infact, the relative changes are more important than absolute changes to the analyst. Additional information regarding relative change in financial items might modify the conclusions arrived at based on absolute change. In a comparative statement both ways of expressing change i.e., absolute and relative changes are indicated relating to the financial items.

vi. While 'computing the percentages' the following three important points have to be noted :

1. If a certain item has a value in first year, and the same value continued for the following year there is no change in the item over the period.
2. If a certain item has a value in first year, and none in the next, the percentage of decrease is 100%.
3. But if an item has no value in first year and there exists a value in the second year, no percentage can be shown, because if a number is divided by zero, the quotient is infinity.

vii. Lastly, preparation of comparative financial statements does not add any information to the existing financial statements. What the comparative financial statements do is that they reveal the periodic changes in a more meaningful way, so as to enable us to draw 'conclusions'. As knowledge of the changes is of considerable value in forming an opinion regarding the progress of the business unit, it necessitates comments or the business unit, it necessitates comments of interpretation of the changes that took place.

viii. The 'utility' of preparing the comparative financial statements has also been realised in our country. The companies Act 1956, provides that companies should give figures for different items for the previous period, together with current period figures in their Profit and Loss Account and Balance sheet.

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## **16.4 COMPARATIVE INCOME STATEMENT**

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A comparative income statement will show :

- i. absolute figures for two (or more) periods,
- ii. the absolute change from one period to another and
- iii. the relative/percentage change.

Relating to the items pertaining to income statement viz., net sales, cost of goods sold, gross profit, administrative expenses etc. The reader may quickly ascertain whether the cost goods sold has increased or decreased by just glancing at the statement. A report of interpretation of the changes in various financial items will be much useful in arriving at meaningful conclusions.

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## **16.5 COMPARATIVE BALANCE SHEET**

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Actually speaking, comparative balance sheet will be similar to that of comparative income statement except that it draws its financial items from Balance Sheet pertaining to two different years and tabulated in vertical statement form. Periodic changes are calculated and recorded in different columns of the statement. Interpretation report, similar to the comparative income statement, is arranged at the end for arriving at conclusions.

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## **16.6 LIMITATIONS OF COMPARATIVE FINANCIAL ANALYSIS**

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Though the comparative analysis is more useful technique, an analyst must keep the following limitation in his mind, when this technique is used for analysis of the financial statements.

1. The comparative analysis will be less effective, when the data and accounting methods of different periods or companies are not in uniform.
2. as the data for more number of years/companies is taken, the number of periodic changes will increase and which may put the analyst in trouble for effective interpretation of periodic changes.
3. While computing the percentages, one must be very careful. Otherwise the wrong conclusions may be drawn.
4. The preparation of comparative statement and analysis and interpretation of the same requires some specialised knowledge.

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## **16.7 ILLUSTRATIONS**

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Illustration - 1 : The Balance Sheets of Pinnacle company Ltd., as on 31st March, 1994 and 1995 are given below. Prepare a Comparative Balance Sheet and Comment :

Liabilities	1994	1995	Assets	1994	1995
	Rs.	Rs.		Rs.	Rs.
<u>Share Capital</u>			Fixed Assets	4003	16504
Equity Rs. 10 per share	2400	2500	Less : Depreciation	-43	-873
<u>Reserves &amp; Surplus:</u>			Net fixed assets	39601	5631
Profit & Loss Account	4912	13065	Investments	9366	10271
<u>Loaned funds-secured</u>			<u>Current Assets :</u>		
From Banks	8196	12956	Inventories	11217	13302
From others	26822	26822	Sundry Debtors	219	3031
			Bills of Exchange	350	
			Bank balance	8452	9760
			Current Liabilities	8766	3178
			Misc., Expenses	—	68
<b>Total</b>	<b>42330</b>	<b>55261</b>	<b>Total</b>	<b>42330</b>	<b>55241</b>

Solution : Comparative Balance sheet : Pinnacle Company Ltd. - 31st March 1994 & 1995

Assets	(Rs. in lakhs)			
	as on 31 March		Absolute increase/decrease in 1995	Percentage increase/decrease in 1995
	1994	1995		
Fixed Assets	4003	16504	12501	312.0
Less : Depreciation	-43	-873	-830	1930.0
Net Fixed Assets	<u>3960</u>	<u>15631</u>	<u>11671</u>	<u>294.0</u>
Investments	9366	10271	905	9.6
<u>Current Assets</u>				
Inventories	11217	13302	2085	18.5
Sundry Debtors	219	3031	2812	1284.0
Bills of Exchange	350	—	-350	-100
Bank balance	8452	9760	1308	15.4
Current Liabilities provision	8766	3178	-5588	-63.7
Misc., Expenses	—	68	68	—
Total Current Assets	<u>29004</u>	<u>29339</u>	<u>335</u>	<u>1.15</u>
<b>Total Assets</b>	<b>42330</b>	<b>55241</b>	<b>12911</b>	<b>30.5</b>

Liabilities	as on 31 March		Absolute increase/ decrease in 1995	Percentage increase decrease in 1995
	1994	1995		
<b>Share Capital :</b>				
Equity Capital	2400	2400	—	—
<b>Reserves &amp; Surplus :</b>				
Profit & Loss Account	4912	13065	8153	166.0
<b>Loan funds – Unsecured :</b>				
i. From Banks	8196	12954	4758	58.0
ii. From others	26822	26822	—	—
<b>Total Liabilities</b>	<b>42330</b>	<b>55241</b>	<b>12911</b>	<b>30.5</b>

### Working Notes :

Given information is tabulated in single (vertical) column statement. Financial information pertaining to two year viz., 1994 and 1995 is arranged side by side. Increase/decrease in each of the items in the year 1995 over 1994 are calculated as following :

1. Change in fixed assets in the year 1995 over 1994.

$$\begin{aligned} \text{Absolute change} &= 1650 - 4003 \\ &= 12501 \end{aligned}$$

$$\text{Relative change} = \frac{12501 \times 100}{4003} = 312\%$$

2. Change in the item "Bills of Exchange".

$$\text{Absolute change} = 350 \text{ to nil} = -350$$

$$\text{Relative change} = \frac{-350}{350} \times 100 = -100\%$$

3. Change in Misc. expenses

Absolute change from nil to 68.

$$\text{But relative change is infinite} = \frac{68}{\text{NIL}} \times 100 = \text{infinite.}$$

As infinite change in 'Miscellaneous expense's not giving meaningful conclusion, the change is ignored.

## Interpretation

A careful analysis of the statement given above will reveal the following observations with reference to the period 1994 to 1995.

1. The total capitalisation of the firm has recorded an increase of 30.5 per cent from Rs. 42,330 lakhs in 1994 to Rs. 55,241 lakhs in 1995. Change in net fixed assets (294%) is greater than the change in total current assets. (1.15%).
2. Among current assets the item 'Sundry debtors, has recorded maximum increase in absolute and relative terms. The item Bill of exchange has recorded 100% decrease, where as, a new head miscellaneous expenses has appeared in the year 1995.
3. Regarding the liabilities there was no issue of fresh equity capital by the year 1995. What ever the change in liabilities, is due to two heads viz., profit & loss account, and additional loans from banks. Profit & Loss Account has shown an increase of Rs. 8153 lakhs (or 166%) in 1995. Similarly, the increase in bank loans was Rs. 4758 lakhs, (58%).

[In this way the changes - Both absolute and relative, in assets and liabilities can be shown by preparing a comparative balance sheet].

Illustration - 2 : Prepare a comparative Income Statement from the following Profit and Loss Account of All India Tobacco Co., Ltd., for the year ending 31st March, 1994 & 1995.

Particulars	1994	1995	Particulars	1994	1995
To cost of goods sold	318.70	644.63	By Net sales	362.41	774.33
" <u>Operating Expenses :</u>					
Salaries	20.14	72.95			
Rent	5.95	11.58			
Interest	8.56	14.50			
Selling Expenses	3.50	2.68			
Net Profit	5.56	27.99			
<b>Total</b>	<b>362.41</b>	<b>774.33</b>	<b>Total</b>	<b>362.41</b>	<b>774.33</b>

## Interpretation

A careful analysis of comparative income statement will reveal the following observations with reference to the year 1995 over 1994.

1. There was an increase of Rs. 411.92 lakhs in the item 'Net Sales'. The relative change is 113.6%.

2. In terms of percentage, the increase in Gross Profit (196.7%) is more than that of net sales (113.6%). This has resulted due to a smaller increase in the item cost of goods sold (102.2%) compared to net sales (113.6%).
3. Net Profit has resulted in the highest percentage increase i.e., 403.4%. This has resulted due to small increase of total operating expense (166.6%) as compared to increase of Gross Profit (196.7%).
4. In case of sub items, in the group of operating expenses, salaries increased to Rs. 72.95 lakhs in the year 1995 from Rs. 20.14 lakhs in the year 1994. In terms of percentage it amounts to 26.2. Selling Expenses has shown a decrease of Rs. 0.82 lakhs which was 23.4% decrease compared to 1994.

[Thus, as shown above, comparative financial statements analysis can be undertaken for balance sheets or income statements or both simultaneously, as per requirements and appropriate conclusions can be drawn.]

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## **16.8 SUMMARY**

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Comparative financial statements is an important technique of financial analysis. It provides time perspective to the various elements of financial statements. The data are laid side by side in the statement, in vertical various columns. While preparing the statement, uniformity of data & accounting methods are to be ensured. The changes are to be expressed in absolute and percentage terms. An analysis of comparative income statement and / or help the user, in ascertaining the financial position quickly and arriving at meaningful conclusions effectively and efficiently.

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## **16.9 SELF EXAMINATION QUESTIONS**

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### **Short Type Questions**

1. What do you mean by comparative statement analysis?
2. What is the need for comparative statement analysis?
3. What are the limitations of comparative statements?

### **Essay type questions**

4. What are comparative statements? Explain how comparative statements are useful in financial analysis?
5. What is comparative statement analysis? What points to be considered while preparing comparative statements?



## Exercises

1. From the following Profit & Loss Accounts of Road Master Steel Strips Ltd., for the year ended 31st March 1994 and 1995 you are required to prepare a comparative Income statement and interpret the changes.

(Rupees in Crores)

Particulars	1994	1995	Particulars	1994	1995
To Cost of goods sold	87.6	120.8	By Sales	114.2	154.9
" Personnel expenses	4.7	5.6	By Other Income	1.1	2.3
" Other expenses	10.8	16.8			
" Interest	2.8	4.0			
" Depreciation	1.1	1.9			
" Net Profit	8.3	8.1			
<b>Total</b>	<b>115.3</b>	<b>157.2</b>	<b>Total</b>	<b>115.3</b>	<b>157.2</b>

2. With the help of following financial information pertaining to Hanuman Transport Co., Ltd., you are required to prepared comparative Balance Sheet and comment :

Balance Sheet as on 31st December

Liabilities	1994	1995	Assets	1994	1995
Equity share capital	1,30,000	1,30,000	Land and Building	26,070	34,518
Preference share capital	1,19,175	1,50,000	Motor vehicles	7,10,482	8,00,500
Reserves & Surplus	14,003	45,000	Investments	10,650	15,000
Loans	4,79,600	5,25,300	Materials	6,137	10,300
Bills Payable	2,500	2,000	Books Debts	8,230	8,082
Sundry creditors	11,632	14,750	Prepaid expenses	2,605	1,700
Outstanding expenses	12,774	12,500	Cash and Bank	7,850	9,450
Dividends declared	2,340				
<b>Total</b>	<b>7,72,024</b>	<b>8,79,550</b>	<b>Total</b>	<b>7,72,024</b>	<b>8,79,550</b>

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## **16.10 GLOSSARY**

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**Aggregate change** : Change expressed in monetary terms (rupees)

**Comparative financial statements** : Provide time perspective to the various elements of financial statements

**Periodic Change** : Change in the value of a financial element at a time compared to some previous data.

**Relative/proportional change** : Absolute change expressed in relation to the base period value.

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## **16.11 BOOKS FOR FURTHER READINGS**

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- Hingorani N.L. & Ramanathan A.R. : "Management Accounting" (Sultan Chand & Sons),
- Maheshwari S.N. & Gupta C.B. : "Financial Management and Corporate Planning and policy" (Sultan Chand & Sons).
- Pyer John N. : Financial statement analysis (Prentice Hall of India Pvt. Ltd.)
- Pandey I.M. : "Financial Management" (Vani Educational Books)
- Gupta, S.P. : Management Accounting (Sahitya Bhavan).