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B.Com Honours | Semester III | Calicut University

FINANCIAL STATEMENT ANALYSIS

Course Code: COM3MN204 • Module 1 Notes

Module I: Introduction to Financial Statement Analysis

Financial Statement Analysis involves examining corporate balance sheets and income statements to evaluate profitability, liquidity, solvency, and operational efficiency for strategic decision-making.

Unit 1: Financial Statements – Meaning, Nature, Utility, & Limitations

1. Meaning & Components: Financial statements are formal, periodic reports detailing financial performance (Income Statement / P&L) and financial position (Balance Sheet) under Schedule III of the Companies Act, 2013.
2. Nature & Characteristics: Recorded facts based on past transactions, accounting conventions (conservatism, consistency), and managerial postulates.
3. Limitations: Historical cost bias, ignoring non-monetary qualitative factors (brand value, employee morale), price-level changes (inflation), and vulnerability to window dressing.

Unit 2: Financial Statement Analysis – Meaning & Core Objectives

The systematic process of critical evaluation of financial statements to assess earnings capacity, operational solvency, debt-paying capacity, and managerial efficiency.
Core Objectives: (1) Assessing short-term & long-term liquidity, (2) Evaluating profitability & return on capital, (3) Forecasting future growth trends, and (4) Facilitating inter-firm & intra-firm comparisons.

Unit 3: Uses, Procedures, and Inherent Limitations of Financial Analysis

Stakeholder Utility: Investors (dividend yield & growth), Creditors (repayment solvency), Management (operational control), Employees (wage security), and Tax Authorities (compliance).
Procedures: Re-arranging financial data into standard comparable formats, selecting analytical tools, computing percentages/ratios, and drawing diagnostic conclusions.

Unit 4: Types of Financial Statement Analysis – Horizontal, Vertical, & Trend Analysis

1. Horizontal (Dynamic) Analysis: Compares financial data across multiple years (Comparative Statements).
2. Vertical (Static) Analysis: Evaluates line items as a percentage of a common base item in a single period (Common-Size Statements).
3. Comparative Statement Formulas:

> **Absolute Change = Current Year Amount - Base Year Amount**

> **Percentage Change = (Absolute Change / Base Year Amount) × 100**

Practical Problem 1 (Comparative Balance Sheet Solution): From the following data of Zenith Ltd., prepare a Comparative Balance Sheet as on 31st March 2023 and 2024:
Equity Share Capital: 2023 = Rs. 4,00,00,000; 2024 = Rs. 5,00,00,000. Reserves & Surplus: 2023 = Rs. 1,00,00,000; 2024 = Rs. 1,20,00,000. Long-Term Borrowings: 2023 = Rs. 2,00,00,000; 2024 = Rs. 1,50,00,000. Trade Payables: 2023 = Rs. 1,00,00,000; 2024 = Rs. 1,30,00,000. Fixed Assets: 2023 = Rs. 5,00,00,000; 2024 = Rs. 6,50,00,000. Current Assets: 2023 = Rs. 3,00,00,000; 2024 = Rs. 2,50,00,000.

Comparative Balance Sheet of Zenith Ltd. as on 31st March 2023 & 2024:

Particulars	2023 (Rs.)	2024 (Rs.)	Absolute Change (Rs.)	Percentage Change (%)
I. EQUITY AND LIABILITIES				
1. Share Capital	4,00,00,000	5,00,00,000	+1,00,00,000	+25.00%
2. Reserves & Surplus	1,00,00,000	1,20,00,000	+20,00,000	+20.00%
3. Long-Term Borrowings	2,00,00,000	1,50,00,000	-50,00,000	-25.00%
4. Trade Payables	1,00,00,000	1,30,00,000	+30,00,000	+30.00%
TOTAL LIABILITIES	**8,00,00,000**	**9,00,00,000**	**+1,00,00,000**	**+12.50%**
II. ASSETS				
1. Fixed Assets	5,00,00,000	6,50,00,000	+1,50,00,000	+30.00%
2. Current Assets	3,00,00,000	2,50,00,000	-50,00,000	-16.67%
TOTAL ASSETS	**8,00,00,000**	**9,00,00,000**	**+1,00,00,000**	**+12.50%**