15.2.1 Comparative Financial Statements

❑ Meaning of Comparative Statements

Statement showing financial data for two or more than two years, placed side by side to facilitate comparison are called Comparative Financial Statements.

Any financial statement that reports the comparison of data of two or more consecutive accounting periods is known as Comparative Financial Statement. Such a statement spot-lights trends and establishes relationship between items that appear on the same row of a Comparative Financial Statement. It discloses changes in items of financial statements over time in both rupees and percentage form. Each item (such as debtors) on a row for one fiscal period is compared with the same item in a different period. The analyst calculates the absolute changes, the difference between the figures of one year and the next and also the percentage change (increase or decrease) from one year to the next, using the earlier year as the base year.

Comparison of financial statements can be 'intra-firm' or 'inter-firm'. When financial statements of two or more years of the same firm are presented and compared, it is referred as *intra-firm* comparison. When financial statements of two or more firms are compared over a number of accounting periods, it is called *inter-firm* comparison.

❑ Purpose or Objectives of Comparative Financial Statements

The main purpose of preparing comparative statements is to get insight into the reasons for changes in financial position and operating results of a business enterprise. In brief, the purposes or objectives of comparative statements may be listed as under :

(1) The comparative statements are prepared to know the strengths and weakness as in various areas of a business.

(2) The comparative statements help us to know the changes in financial position.

(3) The comparative statements help us to develop and know the trend.

(4) Comparative statements are prepared for forecasting the future trends of the business.

(5) To indicate increase or decrease in the various items of financial statements of two or more periods.

(6) To study the effects of changes in profit and loss or assets, liabilities and capital.

Advantages or Utility of Comparative Financial Statements

Following are the advantages of Comparative Financial Statements :

(1) **Easy Comparison** : In comparative statements figures of two or more periods are placed side by side, hence the comparison of various items becomes easy. The *inter-period* and *inter-firm* comparisons are also facilitated from such arrangements.

(2) **Indicate Trend of Progress** : As the comparative statements show sales, cost of goods sold, gross profit, net profit and also the values of different assets and liabilities in a particular form, the performance, efficiency and financial position can easily be evaluated and their trend is easily visible. The common man can form an idea just by a glance on the trend of various items. Thus, they indicate the direction of movement with respect to the financial position and operating results.

(3) **Weakness Easily Diagnosed** : When a comparative study of the two similar firms of two periods is made through the comparative statements, the weaknesses, if any, are diagnosed easily. This enables the management to take corrective action at right time.

(4) **Forecasting :** Comparative financial statements help business undertaking in forecasting the profitability and financial soundness of the enterprise.

(5) **Comparing of Performance :** Comparative financial statements help a business undertaking to compare its performance with the average performance of the industry.

Types of Comparative Statements

There are two *types* of Comparative Statements :

(1) Comparative Income Statement, and (2) Comparative Balance Sheet.

Let us discuss them one by one.

(1) Comparative Income Statement

Income Statement is traditionally known as Profit and Loss Account. The Profit & Loss Account is a summary of the results of operations of a business transacted during a definite period, *i.e.*, a year. It indicates the gross profit and net profit. But a single Profit & Loss Account does not convey any thing about the progress or increase or decrease in the earnings of the business and hence is not of any significance for the purpose of analysis. Hence, Comparative Profit & Loss Accounts for more than one period are prepared to enable the analyst to have definite knowledge about the progress of the business. Thus, *Comparative Profit & Loss Account or Income Statement is a statement of showing results of operations of a business for two or more periods*. Such a statement facilitates the horizontal analysis since each accounting variable is analysed horizontally.

The analysis and interpretation of income statement will involve the following :

- The increase or decrease in sales should be compared with the increase or decrease in cost of goods sold.
- To study the operating profits.
- The increase or decrease in net profit is calculated that will give an idea about the overall profitability of the concern.

❑ Preparation of Comparative Income Statement

The Comparative Profit & Loss Account is prepared showing increase or decrease in the items both in absolute form and in relative form, *i.e.*, showing the change in percentages. It has five columns :

1. First column for items of income or expenses.
2. Second column for previous year's original figures.
3. Third column for current year's original figures.
4. Fourth column for changes in absolute figures.
5. Fifth column shows relative changes (in percentage).

$$\% = \frac{\text{Absolute Change}}{\text{Original figures of Previous year}} \times 100$$

Since the figures for two or more years, are shown side by side, the analyst can quickly ascertain whether sales have decreased or increased, whether cost of sales has decreased or increased and so on. This will help the analyst to derive meaningful conclusions.

(2) Comparative Balance Sheet

In the Comparative Balance Sheets, Balance Sheet prepared at two different dates, the items and data are presented in such a way that the changes in each item between two dates are easily found and determined. According to *Ray A. Foulke, "Comparative Balance Sheet analysis is the study of the trend of same items, group of items, compound items in two or more Balance Sheets of the same business enterprise of different dates."* For inter-firm comparison, Comparative Balance Sheets of two or more business enterprises on a particular date may also be studied.

The Comparative Balance Sheet shows the different assets and liabilities of the firm on different dates to make comparison of balance from one date to another.

❑ Analysis and Interpretation

While interpreting Comparative Balance Sheet the interpreter is expected to study the following aspects :

(1) Current financial position and liquidity position (for this working capital is examined).

(2) Long-term financial position (For this long-term changes in fixed assets and long-term liabilities and capital are examined).

(3) Profitability of the concern (For this increase or decrease in profit is studied).

❑ Preparation of Comparative Balance Sheet

Under this method of analysis of Balance Sheet, there are five columns : (1) First column shows items of assets and liabilities. (2) Second column is meant for previous year's Balance Sheet figures. (3) Third column shows Balance Sheet figures of the current year. (4) Fourth column shows increase or decrease in assets and liabilities in absolute terms. (5) Fifth column (if required) shows the percentage change.

Advantages of Comparative Balance Sheet : Comparative Balance Sheet is a most important tool of financial analysis. It is more suitable for analysing the position on two dates in comparison to the single Balance Sheet which provides information only about the balances of accounts on a particular date. Comparative Balance Sheets are additionally advantageous in the following respects :

(1) Changes are Determined : By Comparative Balance Sheets besides giving balances of accounts at different dates, the changes in such balances between the two different dates are also determined.

(2) More Stress on Changes : The single Balance Sheet lays emphasis on status but in the Comparative Balance Sheet more stress is laid on the changes. These changes are the results of the use of assets and liabilities due to various activities of the concern.

(3) Reflects Trend : The Comparative Balance Sheets not only throw light on the changes in the book values of the assets and liabilities but indicates trends visible in them over a period of time.

(4) Link between Balance Sheet and Profit & Loss Account : Comparative Balance Sheets serve as a link between the Balance Sheet and the Profit & Loss Account.

Illustration 8 (Comparative Balance Sheet)