**Analysis & Comparison of different Financial Statements**

BACHELOR OF TECHNOLOGY in COMPUTER SCIENCE & ENGINEERING

**Synopsis for Project Work - 2**

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**Analysis & Comparison of Financial Statements**

***Abstract:***

The main purpose of this study is to analyze and compare different financial statements or reports i.e., the income statement and the balance sheet to infer or conclude about a company’s current financial status and predict its future scope. The analysis will help to conclude important financial indicators such as the liquidity ratios, profitability ratios and the long-term solvency ratios. The tool will help to analyze the financial reports, that are then be used by managers, shareholders, investors and all other interested parties regarding the company’s state. To potential investors, the analysis and comparison of the financial statements is very important, because, first they want to know the actual state of the company and then decide whether to invest, and in which instrument to invest.

***Introduction:***

Financial Statement provides an overview of a business financial condition in both short and long term. In financial statement, all the relevant financial information of a business enterprise is presented in a structured manner and in the form of easy to understand. Financial statement analysis is a judgmental process which aims to estimate current and past financial positions and the results of the operation of an enterprise, with primary objective of determining the best possible estimates and predictions about the future conditions. The purpose of the financial analysis is to provide information to financial managers and analysts to make thorough decisions about their business, strengths and weaknesses.

Financial statements are not prepared to satisfy the requirements of all stakeholders related to the business enterprise. Information published in financial statements may not be sufficient from the view point of all stakeholders. Different stakeholders are interested in arriving at conclusions for their own purposes based on information included in the financial statements, and information may not be readily available. For example, we cannot know directly the real profitability, liquidity, and solvency of the business from the financial statements. For this purpose, information contains in financial statements is to be analyzed based on the figures of financial statements and other related supplementary information.

## *Financial Statement Analysis & Parties interested:*

The term financial statements analysis is also known as analysis and interpretation of financial statements. It establishes meaningful relationship between various items of the two financial statements or attributes especially income statement and balance sheet. It determines the financial strength and weaknesses of the business.

*Thus, financial statements analysis is the systematic numerical calculation of the relationship between one fact with other to measure the liquidity, profitability, and solvency of the business.*

### Parties Interested in Analysis:

* Company’s Management
* Shareholders
* Debenture Holders
* Credit Institutions
* Workers
* Government
* Taxation Authorities
* Economist and Researchers
* Society or Public

## *Types of Financial Analysis:*

1. On the basis of Material Used:
   1. External Analysis
   2. Internal Analysis
2. On the basis of Modus Operandi
   1. Horizontal Analysis
   2. Vertical Analysis

### On the basis of Material Used:

***External Analysis -*** Analysis done by outsiders (investors, credit agencies, government agencies) who cannot get the internal records of the company is called external analysis. This analysis is made on the basis of published financial statements, reports and information so that, it becomes useful for limited purposes.

***Internal Analysis –*** This type of analysis is undertaken by those persons, who are able to access the books of accounts and other information of the company. This analysis is done by the executives and employees of the company. This type of analysis is object-oriented. It is useful to know the strengths and weaknesses of the business and it also suggests suitable measures fort future growth.

### On the basis of Modus Operandi:

***Horizontal Analysis –*** The financial statements for a number of years are studied and analyzed. The current year’s figures are compared with the standard or base year. It includes figures for two or more years and the changes are presented relating to each item from the base year in the form of percentage. It is also known as “Dynamic Analysis”.

***Vertical Analysis –*** The study is made for quantitative relationship of the various items of financial statements on a particular date. It is useful to compare the performance of several companies in the same industry or various departments in the same company. This analysis is also known as “Static Analysis” because it is based on data for one accounting period.

## *Statements to Analyze:*

***Income Statement* –** Statement shows the financial result of a firm over a period of time (monthly, quarterly or annual). It summarizes the incomes and expenditures incurred for the creation of such income.

**Income *–*** represents the amount of assets generated through business operations.

**Expenditure *–*** represents the amount of assets consumed during the business operation. The difference between income and expenditure represents the net income or net profit.

***Balance Sheet* –** The report is a summarized form of the balances of the assets, capital and liabilities accounts at the date of its establishment for a specified period of time. The balance sheet denomination comes from the assumption that between the total assets on one side and the total of capital and liabilities on the other hand, there must be a balanced state. Consequently, the total assets in the balance sheet must be equal to the total of liabilities and capital.

This equilibrium is expressed through the equation:

### Assets = Liabilities + Capital (Equity)

***Financial Analysis Indicators:***

#### *Liquidity Analysis –*

A company’s liquidity refers to its ability to settle short-term liabilities when they mature. So, liquidity is the ability to convert activities into cash or make money in another way.

### Liquidity analysis is done mainly in two ways:

**Working Capital –** From creditor’s point of view, working capital is always from the first indicators to be considered. This is because the creditor always seeks to find and read safety in the financial statements. Working Capital is calculated as the difference between short-term assets and short-term liabilities.

**“**Working Capital = short term assets – short term liabilities”

**Current Ratio –** Current ratio shows a direct proportion between short term assets and short-term liabilities. Through this, it is measured the ability of a firm to pay short-term liabilities at the maturity date (expiry date of payment).

Current ratio = Short term assets

Short- term liabilities

A higher ratio means the company has more assets than its liabilities. For example, a current ratio of 4 means the company could technically pay off its current liabilities four time over. Generally, having a ratio between 1 and 3 is ideal.

## *Profitability Analysis:*

The fundamental purpose of every business is to make profit. These reports show how reasonable decisions are that the organization has made for investments. Profitability reports express exactly what the organization wins over its sales, assets or capital.

#### *Profitability analysis is done mainly in 2 ways:*

**Return over Assets (ROA) –** It shows a direct proportion between net profit and total assets. The return on total assets is a ratio that measures the effectiveness of using total assets to generate net profit.

Return over Assets (ROA) = Net Profit

Total Assets

**Return over Equity –** It measures the profit made from investments of regular shareholders in the company’s assets. In other words, the rate of return on share capital is the rate of return from regular shares invested by the owners of the enterprise.

Return over Equity = Net Profit

Equity

By factoring in the ROE of a company, investors can pick a profitable investment option. ROE also helps in estimating the growth rate, gauging sustainability of growth etc. A robust ROE indicates that a company is utilizing the fund generated through shareholder’s investment efficiently.

## *Long-term Solvency Analysis:*

Solvency reports measure the enterprise’s ability to pay long-term debts on their maturity date. While liquidity refers to the enterprise’s ability to pay short-term debt, solvency means the enterprise’s ability to maintain financial stability in meeting long- term liabilities.

Method to perform long-term solvency analysis is-

**Debt ratio over Equity –** It is the ratio of long-term debt to total invested capital (capitalization) or the total equity / share capital.

Debt ratio over Equity = Total Debt

Share Capital