Unit :3

ANALYSIS OF FINANCIAL STATEMENTS

Part-A (2 MARKS)

1.Explain the methods or tools of financial statement analysis.

There are around six techniques of analyzing the Financial Statements. They are:

1. Comparative Financial Statements
2. Common size Financial Statements
3. Trend Analysis
4. Ratio Analysis
5. Funds Flow
6.Cash Flow Analysis

2. What is ratio analysis?

'Ratio: is defined as an arithmetical/quantitative/ numerical relationship between two numbers.A ratio expresses simply in one number the result of a comparison between two figures. It is calculated by dividing one figure by the other.

3. State the significance of cash flow statement.

1. It enables the effective planning and coordination of financial operations.
2. It enables proper allocation of cash among the various activities of the firm.
3. It aids the management in its investment decision.
4. It enables the management in properly analyzing the past business activities and plan for future.
5. It gives the liquidity picture of the concern

4.List out the significance of ratio analysis

- Ratios can judge financial performance of the enterprise over a period of time.
- The efficiency of the enterprise can also be judged against the industry average.
- In vertical analysis ratios help the analyst to form a judgment whether performance of the firm at a point of time is good, questionable or poor.
- Horizontal analysis indicates whether the financial condition of the firm is improving or deteriorating and whether the cost, profitability or efficiency is showing an upward or downward trend.

5. What is trend analysis?

Trend analysis is being used to predict the future, with the help of a base year. An extrapolation of a historical time series will not necessarily yield a valid prediction of the future. Thus, a considerable amount of additional research should accompany trend analysis when using it to make predictions.

6. What is financial statement analysis?

Financial statement analysis is the process of analyzing a company's financial statements for decision-making purposes. External stakeholders use it to understand the overall health of an organization as well as to evaluate financial performance and business value. Internal constituents use it as a monitoring tool for managing the finances.

7.Write a note on Liquidity and solvency

Liquidity, means is to get money at the time of need, i.e. it is the company's ability to cover its financial obligations in the short run. Solvency refers to the firm's ability of a business to have enough assets to meet its debts as they become due for payment.

8. What do you mean by ROI

Return on Investment (ROI) is a performance measure used to evaluate the efficiency of an investment or compare the efficiency of a number of different investments. ROI tries to directly measure the amount of return on a particular investment, relative to the investment's cost.

9. What are all the uses of solvency ratios ?

Solvency ratios measure the ability of a business to survive for a long period of time. These ratios are very important for stockholders and creditors. Solvency ratios are normally used to:

- Analyze the capital structure of the company
- Evaluate the ability of the company to pay interest on long term borrowings
- Evaluate the ability of the company to repay principal amount of the long term loans .
- Evaluate whether the internal equities (stockholders' funds) and external equities (creditors' funds) are in right proportion

10. **Highlights the main objectives of financial statement analysis ?**

- To draw information to facilitate decision making
- To evaluate the strength and the weakness of a business
- To determine the earning capacity
- To provide insights on liquidity, solvency and profitability
- To decide the future prospects of a business entity.

11. What is Statement of Changes in Working Capital?

The objective of this analysis is to extract the information relating to working capital. The amount of net working capital is determined by deducting the total of current liabilities from the total of current assets. The statement of changes in working capital provides the information in relation to working capital between two financial periods.

12.List out the uses of different types of Ratios

- Profitability ratios measure the firm's use of its assets and control of its expenses to generate an acceptable rate of return.
- Liquidity ratios measure the availability of cash to pay debt.
- Activity ratios, also called efficiency ratios, measure the effectiveness of a firm's use of resources, or assets.
- Debt, or leverage, ratios measure the firm's ability to repay long-term debt.
- Market ratios are concerned with shareholder audiences. They measure the cost of issuing stock and the relationship between return and the value of an investment in company's shares.

13.Define fund flow

In the words of Anthony "The funds flow statement describes the sources from which additional funds were derived and the use to which these sources were put."

14.Define cash flow

According to Khan and Jain:

"Cash Flow statements are statements of changes in financial position prepared on the basis of funds defined as cash or cash equivalents."

15.What is fund from operations?

It refers to the funds or loss, which is generated or suffered in the business as a result of its regular operations during the period. The funds from operation is an important source of fund. It is determined by adjusting the firm's net income in a statement called the statement of funds from operations. In this statement, the items such as non-operating incomes and non-cash expenses are adjusted while determining the amount of funds(loss) from operations.

16.What does retained earning mean?

Retained earnings is the cumulative profits and losses of a corporation less its dividends paid to shareholders. In other words, it's the cumulative amount of money left over after all of the expenses and dividends are paid.

Part-B

13 Mark Questions

1.Explain in detail about uses and limitation of ratio analysis

Uses of ratio analysis

There are various uses of Ratio analysis, some of which are as follows:
- It helps in managerial decision making.
- It helps in financial forecasting and planning.
- It helps in communicating the financial strength of a concern.
- It helps in control.
- It is an essential part of budgetary control and standard costing.
- It helps an investor/prospective investor in decision making.
- It provides information to the creditors about the solvency of the firm.

Limitations of Ratio Analysis:

In spite of the various uses of ratio analysis, it suffers from certain limitations, some of which are given below.

1. **Limited use of a single ratio**: A single ratio does not convey any meaning. Ratios are useful only when calculated in sufficient nos.
2. **Lack of adequate standards**: It is difficult to set ideal ratios for each firm/industry. And also setting of standard ratios for all the firms in every industry is also difficult.
3. **Inherent limitations of accounting**: As Ratio analysis is based on financial statements, the analysis suffers from the limitations of financial statements.
4**. Change of accounting procedure**: If different methods are followed by different firms for their valuation, comparison will practically be of no use.
5. **Window dressing**: Ratios based on dressed up (manipulated) financial information are not of much use as they show unreliable position of the firm
6. **Personal bias**: Different people will interpret the same ratio in different ways. Thus, there is always the possibility that interpretation of the data may be different for different people, and this in turn may result in many inferences for the same data, which may be confusing.
7. **Price level changes** are not provided for in ratio analysis which may lead to a misleading interpretation of business operations.

8. **Ignorance of qualitative factors**: Ratios are tools of quantitative analysis only and normally qualitative factors which may generally influence the conclusions are ignored while they are calculated.

2. Differentiate fund flow statements and cash flow statements.

Cash Flow Statement Vs Funds Flow Statement:

Both the Funds Flow Statement and the Cash Flow Statement give almost similar picture of the firm. They don't differ much from each other. However, some of the differences between each other are as follows:

1. The Funds Flow Statement is much wider in purview than the Cash Flow Statement as it indicates the changes in the Working Capital whereas the Cash Flow Statement indicates the inflow and outflow of cash which is only one of the components of the Working Capital.
2. Funds Flow Analysis is based on mercantile system of accounting whereas Cash Flow Analysis is based on cash system of accounting.
3. Funds Flow Analysis is useful for long term planning as it provides more comprehensive information than the Cash Flow Analysis which is more useful for short term planning.
4. Funds Flow Analysis traces the inflows and outflows of funds whereas Cash Flow Analysis traces the inflows and outflows of cash within the firm.

5. Funds Flow Analysis analyses the changes in the Working capital under a separate statement known as schedule for changes in working capital whereas in Cash Flow Analysis, the changes in both current and non-current items are done in a single statement.

3.Draw the format for Comparative Balance sheet

Format for Comparative Balance sheet

Particular	Previous yr(I yr)	Current yr(II yr)	Amt of increase or decrease	% of increase or increase
ASSET				
Current Assets				
Cash in hand	***	***	***	***
Cash at bank	***	***	***	***
Bills receivable	***	***	***	***
Debtors	***	***	***	***
Stock	***	***	***	***
Prepaid expenses	***	***	***	***
Stores & spare parts	***	***	***	***
Loose tools	***	***	***	***
Preliminary expenses	***	***	***	***
Total CA(1)	***	***	***	***
Fixed Assets				
Land	***	***	***	***
Building	***	***	***	***
Plant	***	***	***	***
Machinery	***	***	***	***
Furniture & Fittings	***	***	***	***
Lease hold premises	***	***	***	***
Vehicle	***	***	***	***
Fixtures	***	***	***	***

Total FA(2)	***	***	***	***
Total Asset(1+2)	***	***	***	***
LIABILITY				
Current liability				
Bills Payable	***	***	***	***
Creditors	***	***	***	***
Outstanding expenses	***	***	***	***
Short term loan	***	***	***	***
Bank overdraft	***	***	***	***
Provision for tax, contingency, insurance etc	***	***	***	***
Total CL(1)	***	***	***	***
Long term Liability				
Debenture	***	***	***	***
Bond	***	***	***	***
Long term loan on Mortgage	***	***	***	***
Long term loan	***	***	***	***
Total LTL(2)	***	***	***	***
Total liability(I+2)	***	***	***	***
Capitals & Reserves				
Preference share capital	***	***	***	***
Equity share capital	***	***	***	***
Capital reserve	***	***	***	***
Reserves & surplus	***	***	***	***
Total capital& Reserve	***	***	***	***

4. Explain about the methods and format for preparing fund flow statement

Fund flow statement includes

1. Schedule of changes in working capital
2. Schedule of changes in fixed asset
3. Statement showing Adjusted profit and loss account
4. Preparation of fund flow statement

1. **Schedule of changes in working capital**

Working capital = Current asset- Current liability

Particular	Current year	Previous year	Increase	Decrease

List of Current asset	***	***	***	***
Less : list of Current liability	***	***	***	***
Increase/ Decrease in Working capital	***	***	***	***

2. Preparation of schedule of changes in fixed assets is optional. Preparation of this statement is based on the question.

3. Format for adjusted profit and loss account

Dr **Adjusted Profit and Loss account** Cr

Particular	**Amount**	**Particular**	**Amount**
To depreciation	*****	By opening balance	*****
To Goodwill , patent , trademark, copyright written off	*****	By dividend received	*****
To general reserve	*****	By interest on investment	*****
To current years' outstanding expenses	*****	By profit on sale of asset	
To expenses paid in advance during last year	*****	By current years outstanding income	*****
To dividend	*****	By income received in advance during last year	*****
To proposed dividend(if not taken as current liability)	*****	By fund from operation (balancing figure)	*****
To provision for taxation(if not taken as current liability)	*****		
To closing balance (P\L a\c)	*****		
To fund lost in operation(B/F in case credit side exceeds the debit side)			
	*****		*****

4. Fund flow statement includes answers from all the above statements and remaining items from the question (i.e)yet to include for calculation. It consists of sources of fund and application of fund.

Sources of fund

1. Issue of shares and debentures
2. Long term and medium term borrowings
3. Sale of fixed asset and long term investment
4. Fund from operation or trading income
5. Non trading income such as income from investment, gift, damages awarded from legal actions etc
6. Decrease in working capital

Application of fund

1. Redemption of shares and debentures
2. Repayment of long term and medium loan
3. Purchase of fixed asset and long term investment
4. Fund lost in operation or trading loss

5. Non trading loss such as loss of cash by fines etc
6. Increase in working capital

5.Draw a specimen form of cash flow statement as per Accounting Standard 3 (AS-3)
Format for cash flow as per AS-3

I.Cash flow from operating activities

1. Cash receipt from sale of goods and services

2. Cash receipt from royalties, fees, commission and other revenue

3. Cash payment to suppliers of goods and services

4. Cash payment to employees

5. In case of insurance company cash receipts and payments for premium received and claims and other benefits to policy holders.

6. Payment and refund of income tax

7. Cash receipts and payments relating to futures and options contracts taken up for trading purpose.

II.Cash flow from investing activities

1. Purchase of fixed assets including intangibles and payments relating to capitalized research and development cost and self constructed fixed assets
2. Cash receipts from sale of fixed assets including intangibles
3. Purchase of securities such as shares warrants and debt instruments of other enterprises
4. Sale of securities for cash
5. Loans and advances given to third parties
6. Loans and advances collected from third parties
7. Cash receipts and payments relating to futures and options contracts entered into for investment purposes

III.Cash flow from financing activities

1. Cash receipts from the issue of shares and other similar instruments

2. Cash receipt from the issue of debentures, bonds or other short term borrowing

3. Redemption of shares and repayment of amount borrowed

6. Explain in detail about advantages and disadvantages of Fund Flow Statement

Advantages of Funds Flow Statement:

Funds flow statement presents the following advantages:

(a) Fund Generating Capacity:

With the helps of fund flows from operating activities a Funds Flow Statement helps to understand the fund generating capacity of the firm which ultimately provides valuable information to the management for taking future courses of action.

(b) Changes in Working Capital position:

A Funds Flow Statement presents either the increase in Working Capital or Decrease in Working Capital with the helps of 'A statement of exchanges in Working Capital' which helps to know from which sources the additional Capital has -been procured or the application of such funds.

(c) Projected Funds Flow Statement:

A firm can prepare its expected inflows and outflows of cash for future with the help of a Projected Funds Flow Statement.

(d) Highlights the Causes of Changes:

A Funds flow statement highlights the significant causes of changes in Working Capital position between two accounting period revealing the effect for the same on the liquidity and solvency position of a firm.

(e) Evaluation of Credit Worthiness:

Credit Granting Agencies after careful analysis of a Funds Flow Statement, can evaluate the credit-worthiness of a firm which helps them to understand the liquidity position.

Limitations of Funds Flow Statement:

The funds flow statement is also not free from limitations.

a) A funds flow statement cannot present a continuous change of financial activities including the changes of working capital.
(b) Since it is based on financial statement (i.e., Income Statement and Balance Sheet), it is not an original statement.
(c) A projected funds flow statement does not always present much accurate estimates about the financial position since it is a historic one.
(d) It is not a substitute of financial statements, i.e. Income Statement and Balance Sheet. It simply supplies information about the change of Working Capital position which, again, depends on the data presented by the financial statements.

7. Describe the merits and demerits of cash flow statement

Merits of Cash Flow Statement:

The merits of Cash Flow Statement are:

(a) Ascertaining Liquidity and Profitability Positions:

Since Cash Flow Statement presents the cash position of a firm at the time of making payment it directly helps to ascertain the liquidity position, the same is also applicable in case of profitability. Profitability position depends also on cash earning capacity.

(b) Ascertaining Optimum Cash Balance:

Cash Flow Statement helps also to ascertain the optimum cash balance of a firm. If optimum cash balance can be determined, it is possible for a firm to ascertain the idle and/or excess and/or shortage of cash position.

(c) Cash Management:

Proper management of cash is possible if cash flow statement is properly prepared. The management can prepare an estimate about the various inflows of cash and outflows of cash so that it becomes very helpful for them to make plans for the future.

(d) Capital Budgeting Decisions:

Since capital budgeting relates to the decision of capital expenditure in various forms on a long-term basis cash flow timing is very important for this purpose.

(e) Superiority over Accrual Basis of Accounting:

No doubt, Cash Flow Statement or cash basis of accounting is more reliable or dependable than accrual basis of accounting as a number of technical adjustments are made in the latter case. Cash flow accounting is free from such snags.

(f) Planning and Co-ordination:

Cash Flow Statement is prepared on an estimated basis meant for the successing/next year which helps the management to know how much funds are required for what purposes, how much cash is generated from internal sources, how much cash can be procured from outside the business.

(g) Movement of Cash:

Cash Flow Statement presents the management the flows in and flows out of cash for various purposes on the basis of which future estimates can be prepared.

(h) Performance appraisal:

By comparing the actual Cash Flow Statement with the projected Cash Flow Statements, the management can evaluate or appraise the performances regarding cash. If any unfavourable variance is found, the reason for such variation is located and rectified accordingly.

Limitations of Cash Flow Statement:

Some of the limitations are:

(a) Fails to present Net Income:

Cash flow statement actually fails to present the net income of a firm for a period since it does not consider non-cash items which can easily be ascertained by an Income Statement. It can be used as a supplement to Income Statement.

(b) Fails to Assess the Liquidity and Solvency Position:

Proper liquidity position cannot be assessed from the cash flow statement which presents only the cash position at the end of the period. It only helps how much amount of obligation can be met i.e. cash flow statement does not represent the real liquidity position.

(c) Neither a substitute of Funds Flow Statement nor Income Statement:

Cash flow statement is neither a substitutes of funds flow statement nor a substitute of income statement. The functions which are performed by a funds flow statement or Income statement cannot be done by a cash flow statement.

(d) Not to Assess Profitability:

Practically, cash flows from operation does not help to assess profitability of a firm since it neither considers the costs nor revenues.

(e) Does not Conform with Companies Act:

The provision which are made by the companies' Act is in conformity with Profit and Loss Account and Balance Sheet and not in conformity with cash flow statement which is prepared as per AS- 3.

(f) Does not Assess Future Cash Flows:

Since cash flow statement is prepared on the basis of historical cost and, as such, it does not help to know the future/projected cash flows.

(g) Inter-Industry Comparison not possible:

Since cash flow statement does not measure the economic efficiency of a firm, in-comparison with other inter-industry comparison is not possible, e.g., a firm having less capital investment will have less cash flow than the firm which has more capital investment having a higher cash flow.

8. Explain in detail about the types of ratios or Classify a financial ratio based on what it measures in a company

Generally, financial ratios are classified on the basis of function or test, on the basis of financial statements, and on the basis of importance. These three classifications are briefly discussed below:

1.Classification of financial ratios on the basis of function:

On the basis of function or test, the ratios are classified as liquidity ratios, profitability ratios, activity ratios and solvency ratios.

a.Liquidity Ratios:

Liquidity ratios measure the adequacy of current and liquid assets and help evaluate the ability of the business to pay its short-term debts. The ability of a business to pay its short-term debts is frequently referred to as short-term solvency position or liquidity position of the business.

Short-term creditors like suppliers of goods and commercial banks use liquidity ratios to know whether the business has adequate current and liquid assets to meet its current obligations. Financial institutions hesitate to offer short-term loans to businesses with weak short-term solvency position.

Four commonly used liquidity ratios are given below:

1. Current ratio
2. Quick ratio or acid test ratio
3. Absolute liquid ratio
4. Current cash debt coverage ratio

Liquidity ratios are not true measure of liquidity because they tell about the quantity but nothing about the quality of the current assets and, therefore, should be used carefully. For a useful analysis of liquidity, these ratios are used in conjunction with activity ratios (also known as current assets movement ratios). Examples of activity ratios are receivables turnover ratio, accounts payable turnover ratio and inventory turnover ratio etc.

b.Profitability ratios:

Profit is the primary objective of all businesses. All businesses need a consistent improvement in profit to survive and prosper. A business that continually suffers losses cannot survive for a long period.

Profitability ratios measure the efficiency of management in the employment of business resources to earn profits. These ratios indicate the success or failure of a business enterprise for a particular period of time. Profitability ratios are used by almost all the parties connected with the business. Creditors, financial institutions and preferred stockholders expect a prompt payment of interest and fixed dividend income if the business has good profitability position..

Some important profitability ratios are given below:

1. Net profit (NP) ratio
2. Gross profit (GP) ratio
3. Price earnings ratio (P/E ratio)
4. Operating ratio
5. Expense ratio
6. Dividend yield ratio
7. Dividend payout ratio
8. Return on capital employed ratio
9. Earnings per share (EPS) ratio
10. Return on shareholder’s investment/Return on equity
11. Return on common stockholders’ equity ratio

c.Activity ratios:

Activity ratios (also known as turnover ratios) measure the efficiency of a firm or company in generating revenues by converting its production into cash or sales. Generally a fast conversion increases revenues and profits.

Some important activity ratios are:

1. Inventory turnover ratio
2. Receivables turnover ratio
3. Average collection period
4. Accounts payable turnover ratio
5. Average payment period
6. Asset turnover ratio
7. Working capital turnover ratio
8. Fixed assets turnover ratio

d.Solvency ratios:

Solvency ratios (also known as long-term solvency ratios) measure the ability of a business to survive for a long period of time. These ratios are very important for stockholders and creditors.Solvency ratios are normally used to:

- Analyze the capital structure of the company
- Evaluate the ability of the company to pay interest on long term borrowings
- Evaluate the ability of the company to repay principal amount of the long term loans (debentures, bonds, medium and long term loans etc.).
- Evaluate whether the internal equities (stockholders' funds) and external equities (creditors' funds) are in right proportion.

Some frequently used long-term solvency ratios are given below:

1. Debt to equity ratio
2. Times interest earned (TIE) ratio
3. Proprietary ratio
4. Fixed assets to equity ratio
5. Current assets to equity ratio
6. Capital gearing ratio

2.Classification on the basis of financial statements:

Classification on the basis of financial statements includes the following types

a.Income statement/profit and loss ratios:

Income statement/profit and loss account ratios are those ratios that are calculated by using the items of income statement/profit and loss account of a particular period only, it includes the following

1. Net profit ratio,
2. Gross profit ratio, operating ratio,
3. Times interest earned ratio etc.

b.Balance sheet ratios:

Balance sheet ratios are those ratios that are calculated by using figures from the balance sheet only. The figures must be used from the balance sheet of the same period. Examples of balance sheet ratios are current ratio, liquid ratio, and debt to equity ratio etc.

c.Composite ratios:

These ratios are calculated by using the items of both income statement and balance sheet for the same period. Composite ratios are, therefore, also known as mixed ratios and inter-statement ratios. Numerous composite ratios are computed depending on the need of analyst. Some examples are

1. Inventory turnover ratio,

2. Receivables turnover ratio,

3.accounts payable turnover ratio, and

4. working capital turnover ratio etc.

3.Classification on the basis of importance:

On the basis of importance or significance, the ratios are classified as primary ratios and secondary ratios. The most important ratios are called primary ratios and less important ratios are called secondary ratios. Secondary ratios are usually used to explain the primary ratios. Examples of primary ratios for a commercial undertaking are return on capital employed ratio and net profit ratio because the basic purpose of these undertakings is to earn profit.

Importance of ratios significantly varies among industries therefore each industry has its own primary and secondary ratios. A ratio that is of primary importance in one industry may be of secondary importance in another industry. Classification of ratios on the basis of importance or significance is very useful for inter-firm comparisons.

9. Elucidate the most common ratio types and the various formulas within each category

Here are five of the most common ratio types and the various formulas includes the following,

- Liquidity ratios
- Profitability ratios
- Leverage ratios
- Turnover ratios
- Market value ratios

1.Liquidity ratios

These ratios are used to calculate how capable a company is of paying debts, usually by measuring current liabilities and liquid assets. This determines how likely that business will be able to pay off short-term debts. These are some common liquidity ratios:

- **Current Ratio = Current Assets/Current Liabilities**. The purpose of this ratio is to measure how the company can currently pay off short-term debts by liquidating its assets.
- **Quick Ratio = Quick Assets/Current Liabilities**. This ratio is similar to the current ratio, except that to measure "quick" assets, it only consider accounts receivable plus cash plus marketable securities.
- **Net Working Capital Ratio = (Current Assets - Current Liabilities)/Total Assets**. By calculating the net working capital ratio, the company can calculate the liquidity of its assets. An increasing net working capital ratio indicates that business is investing more in liquid assets than fixed assets.
- **Cash Ratio = Cash/Current Liabilities**. This ratio tells how capable the business is covering debts using only cash. No other assets are considered in this ratio.
- **Cash Coverage Ratio = (Earnings Before Interest and Taxes + Depreciation)/Interest**. The cash coverage ratio is similar to the cash ratio, but it calculates how likely that business can pay its debts' interest.

2.Profitability ratios

Accountants use these ratios to measure a business's earnings versus its expenses. These are some common profitability ratios:

- **Return on Assets = Net Income/Average Total Assets**. The return on assets ratio indicates how much profit businesses make compared to their assets.
- **Return on Equity = Net Income/Average Stockholder Equity**. This ratio shows business's profitability from its stockholders' investments.
- **Profit Margin = Net Income/Sales**. The profit margin is an easy way to tell how much of income comes from sales.

- **Earnings Per Share = Net Income/Number of Common Shares Outstanding**. The earnings per share ratio is similar to the return on equity ratio.

3.Leverage ratios

A leverage ratio is a good way to easily see how much company's capital comes from debt, and how likely that the company can meet its financial obligations.

- **Debt to Equity Ratio = Total Debt/Total Equity**. This ratio measures company's leverage by comparing liabilities, or debts, to its value as represented by stockholders' equity.

- **Total Debt Ratio = (Total Assets - Total Equity)/Total Assets**. Total debt ratio is a quick way to see how much of assets are available because of debt.
- **Long-Term Debt Ratio = Long-Term Debt/(Long-Term Debt + Total Equity)**. Similar to the total debt ratio, this formula used to see that assets available because of debt for longer than a one-year period.

4.Turnover ratios

Turnover ratios are used to measure the income against its assets. There are many different types of turnover ratios. Here are some common turnover ratios:

- **Inventory Turnover Ratio = Costs of Goods Sold/Average Inventories**. The inventory turnover rate shows how much inventory sold in a year or other specified period.
- **Assets Turnover Ratio = Sales/Average Total Assets**. This ratio is a good indicator of how good company is using its assets to produce revenue.
- **Accounts Receivable Turnover Ratio = Sales/Average Accounts Receivable**. This ratio evaluate how quickly that the company is able to collect funds from its customers.

5.Market value ratios

Market value ratios deal entirely with stocks and shares. Many of these ratios are used by investors to determine the stocks are overpriced or underpriced. These are a couple of common market value ratios:

- **Price-to-Earnings Ratio = Price Per Share/Earnings Per Share**. Investors use the price-to-earnings ratio to see how much they're paying for each rupee earned per stock.
- **Market-to-Book Ratio = Market Value Per Share/Book Value Per Share**. This ratio compares company's historic accounting value to the value set by the stock market.

10. Explain in detail about the tools that can be used to analyse the financial statement

The most commonly used techniques of financial analysis are as follows:

1. **Comparative Statements**

2. **Common Size Statements**
3. **Trend Analysis**
4. **Ratio Analysis**
5. **Cash Flow Analysis**
6. **Fund flow Analysis**

1. Comparative Statements:

These are the statements showing the profitability and financial position of a firm for different periods of time in a comparative form to give an idea about the position of two or more periods. It usually applies to the two important financial statements, namely, balance sheet and statement of profit and loss prepared in a comparative form. Comparative figures indicate the trend and direction of financial position and operating results. This analysis is also known as 'horizontal analysis'.

2.Common Size Statements:

These are the statements which indicate the relationship of different items of a financial statement with a common item by expressing each item as a percentage of that common item. The percentage thus calculated can be easily compared with the results of corresponding percentages of the previous year or of some other firms, as the numbers are brought to common base. Such statements also allow an analyst to compare the operating and financing characteristics of two companies of different sizes in the same industry. Thus, common size statements are useful, both, in intra-firm comparisons over different years and also in making inter-firm comparisons for the same year or for several years. This analysis is also known as 'Vertical analysis'.

3.Trend Analysis:

It is a technique of studying the operational results and financial position over a series of years. Using the previous years' data of a business enterprise, trend analysis can be done to observe the percentage changes over time in the selected data. The trend percentage is the percentage relationship, in which each item of different years bear to the same item in the base year. Trend analysis is important because, with its long run view, it may point to basic changes in the nature of the business. By looking at a trend in a particular ratio, one may find whether the ratio is falling, rising or remaining relatively constant.

4.Ratio Analysis:

It describes the significant relationship which exists between various items of a balance sheet and a statement of profit and loss of a firm. As a technique of financial analysis, accounting ratios measure the comparative significance of the individual items of the income and position statements. It is possible to assess the profitability, solvency and efficiency of an enterprise through the technique of ratio analysis.

5.Cash Flow Analysis

It refers to the analysis of actual movement of cash into and out of an organisation. The flow of cash into the business is called as cash inflow or positive cash flow and the flow of cash out of the firm is called as cash outflow or a negative cash flow. The difference between the inflow and outflow of cash is the net cash flow. Cash flow statement is prepared to project the manner in which the cash has been received and has been utilised during an accounting year as it shows the sources of cash receipts and also the purposes for which payments are made.

6.Fund flow Analysis

Fund Flow Statement represents, "from where the funds are received and where the funds are utilised" by the company during a particular period. The word 'fund' refers to a sum of money, which is used to finance the firm's day to day operations and acquire assets for the business. The flow of funds represents the movement of funds, i.e. the change in economic resources, from one asset or liability to another. In this way, the fund flow statement implies a method of analysing the changes in the firm's financial position, between two balance sheet dates.

11.Explain in detail about the advantages and dis advantages of financial statement Analysis

Advantages of financial statement analysis-

(1) It helps in measuring the profitability : Financial statement analysis helps to know whether the business is making profits or losses. It also helps to know whether the profits/losses of the firm are increasing or decreasing. It also helps to know the business organisation's ability to pay interest on loans taken and its ability to pay dividend to its shareholders.

(2) It helps to measure the overall financial strength : Financial statement analysis helps to understand the overall financial strength of the business. It also helps to take decisions regarding funds available for purchase of assets, payment of liabilities, etc. It also helps to know whether company's internal sources of funds (retained earnings of past years) are sufficient or a loan would be required.

(3) It helps to know the efficiency of management : Financial statement analysis help to know the efficiency of management in running the business. It helps to know whether financial policies followed by management are proper or not.

(4) It helps to know the trend of business : Financial statement analysis help to know the business trends by comparing various types of data such as net profit, sales, purchases, etc. for two or more years. This helps to know how much the progress business is doing.

Limitations of Financial Analysis

Limitations of financial analysis are:

1. Financial analysis does not consider price level changes.

2. Financial analysis may be misleading without the knowledge of the changes in accounting procedure followed by a firm.

3. Financial analysis is just a study of reports of the company.

4. Monetary information alone is considered in financial analysis while non-monetary aspects are ignored.

5.The financial statements are prepared on the basis of accounting concept, as such, it does not reflect the current position.