

Annual Report Analysis



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Annual Reports

- Generally, Annual Reports are mostly prepared by Companies.
- In case of other business entities like Partnership Firm, Proprietorship concerns, there would not be any 'separate' Annual Report
- These are basically sent to Shareholders and also submitted to various 'Users' such as Bankers, Investors, Govt. Authorities etc.,
- Covers a financial year period

Annual Report includes

- Summary of Financial Highlights
- Narrative, Text, Graphic and Images related to Operations, Financial Performance, Market Analysis etc.,
- Management's Discussion & Analysis
- Directors' Report showing various reporting compliances under Companies Act
- Auditor's Report
- ***Financial Statements which covers Balance Sheet, Profit & Loss Account, Cash Flow Statement, Explanatory Notes relating to Accounts etc.,***

Statements useful for Analysis

What is Analysis?

Establishing the relationship with each other in such way that the conclusion can be drawn.

Financial Statement Analysis

- Involves gaining an understanding of an organization's financial situation by reviewing its financial reports
- Also involves in interpretation of Financial data
- Results of Analysis can be used to make investment and lending decisions

Objectives of Analysis

- Understand & Diagnose the Financial information with a view to judge profitability and Financial Soundness of the Company.
- Make forecast about the future aspects of the Company
- Assess the operational efficiency and managerial effectiveness
- To assess the solvency position of the firm
- To make Inter-firm comparison.
- To help in decision making and Control.
- To do such other analysis as per the '*User concerned*'

External Users of Annual Report

User	How Used
Investors	Analyze whether the Company is earning sufficient profits and its projections for the future, so as to decide to further invest in the Company or Sell of the Shares they are already holding
Lenders	Whether the Company is capable of repaying the loans, if granted If already granted, how effectively these are being used
Suppliers	Whether the Company is a Sound Company; whether any Credit can be offered to them
Govt.	Whether the Company is regular in paying its Taxes; are there any Defaults; whether financial figures (Sales/ Purchases/Other Income) are in line with various Filings being made to them??

Internal Users of Annual Report

User	How Used
Board of Directors	What are the present Resources available?
	What is the status of present Loans? Are they paid regularly and as per schedule
	What the profitability trend? Based on actuals, what are the future projections
	Whether it is better to expand/buy new assets
	What are the present markets of operations?? Future plans for the same
	Whether it is better to Buy new Lands/Properties or lease them?
	Whether the Company can raise additional loans? If so, how much
	Whether it is better to go for Own production or outsource the function. Examples of Future Group (Heritage), (D Mart) etc.,



Techniques for Financial Statement Analysis

Horizontal Analysis/Trend Analysis.

Vertical Analysis/Common Size Analysis

Ratio Analysis

Horizontal Analysis

- **Horizontal analysis** or **Trend Analysis**, is the process of comparing line items in comparative financial statements or financial ratios across a number of years in an effort to track the history and progress of a company's performance
- Using the previous year's data of a business enterprise, trend analysis can be done to observe percentage changes over time in selected data.
- This is done to compare accounts/performance metrics over time to see if the company is improving or declining.

Horizontal Analysis

Comparative Statement of Profit & Loss

Particulars	2017-18 (₹)	2018-19 (₹)	Absolute Change (₹)	Percentage Change (%)
Revenue from operations	10,00,000	15,00,000	5,00,000	50
Add: Other incomes	2,00,000	3,00,000	1,00,000	50
Total Revenue	12,00,000	18,00,000	6,00,000	50
Less: Expenses	7,00,000	9,00,000	2,00,000	28.57
Profit before tax	5,00,000	9,00,000	4,00,000	80
Less: Tax	90,000	1,20,000	30,000	33.33
Profit after tax	4,10,000	7,80,000	3,70,000	90.24

Vertical Analysis

- Vertical analysis is a percentage analysis of financial statements.
- Each line item listed in the financial statement is listed as the percentage of another line item.
- Vertical analysis makes it much easier to compare the financial statements of one company with another and across industries.

Example for Vertical Analysis:

By showing the various expense line items in the income statement as a percentage of sales, one can see how these are contributing to profit margins and whether profitability is improving over time.

Sales	5,000,000	100%
Cost of goods sold	1,000,000	20%
Gross profit	4,000,000	80%
General and Administrative Expenses	2,000,000	40%
Operating Income	2,000,000	40%
Taxes (%25)	500,000	10%
Net income	1,500,000	30%

Ratio Analysis

- Ratio Analysis is a vital tool for Financial Analysis.
- It is based on the rule that a single accounting figure by itself may not communicate any meaningful information but *when expressed as a relative to some other figure*, it may definitely provide some significant information.
- Ratio Analysis is comparison of different numbers from the balance sheet, income statement and Cash Flow statement against the figures of previous years, other companies, the industry or even the economy in general for the purpose of Financial Analysis.

Importance of Ratio Analysis

- The importance of ratio analysis lies in the fact that it presents facts on a comparative basis and enables drawing of inferences regarding the performance of a Company.
- It is relevant in assessing the performance of a Company in respect of the following aspects:
 - **Liquidity Position** – *how quickly converted to Money*
 - **Long Term Solvency** (*Long Term/Short Term – ILFS case*)
 - **Operating Efficiency** (*How effectively funds are used*)
 - **Overall Profitability** (*Trend over period – when high/low*)
 - **Inter-firm Comparison** (*within same Industry how performed*)

Liquidity Position Ratios

- **Liquidity ratios** are measurements used to examine the ability of an organization to pay off its short-term obligations (*within One Year*)
- These are used by the prospective creditors and lenders to decide whether to extend Credit or Debt respectively, to the companies (*Short Term Funding, Long Term Funding etc*)
- The Higher the ratio, the better the ability of a company of pay off its obligations in a timely manner.

Solvency Ratios

- Solvency ratios show a company's ability to make payments and pay off its long-term obligations to creditors, bondholders, and banks.
- In other words, solvency ratios identify going concern issues and a firm's ability to pay its bills in the long term.
- These are also known as Leverage Ratios
- These are used while availing Long Term Loans from Banks or Financial Institutions (Big Projects/Factories etc.)

One of the most frequently used Ratio is Debt-to-Equity Ratio:

- The (D/E) ratio is calculated by dividing a Company's total liabilities by its shareholder equity.
- The Ratio also helps in identifying how much debt business has raised compared to its Equity Contribution.

$$\text{D/E Ratio} = \text{Total Debt} / \text{Total Equity}.$$

- This is the fundamental Ratio which any Banker will follow while granting loan.
- A good debt to equity ratio is around 1 to 1.5.
- However, the ideal debt to equity ratio will vary depending on the industry because some industries use more debt financing than others.
- Capital-intensive industries like the financial and manufacturing industries often have higher ratios that can be greater than 2.

Balance Sheet as on 31.03.2018 – Actual Figures

Particulars		Amount (Rs.)
LIABILITIES		
I. Capital	4,500,000	4,500,000
II. Reserves & Surplus	1,000,000	1,000,000
III. Non Current Liabilities		
Secured Loans- Term Loan	7,000,000	
Unsecured Loans	4,000,000	11,000,000
IV. Current Liabilities		
Working Capital Loan	2,400,000	
Trade Payables	2,000,000	
Short term provisions	700,000	
Other Current Liabilities	900,000	6,000,000
TOTAL		22,500,000
ASSETS		
I. Non Current Assets		
Land & Building	6,000,000	
Plant & Machinery	5,800,000	
Cap-Ex Advance	4,000,000	15,800,000
II. Current Assets		
Inventory	1,600,000	
Trade Receivables	2,500,000	
Cash & Bank Balances	2,600,000	6,700,000
TOTAL		22,500,000

Ratios	
Debt	11,000,000
Equity	4,500,000
Debt Equity Ratio	2.44
Total Outside Liabilities	17,000,000
Total Net worth	5,500,000
TOL/TNW Ratio	3.09
Current Assets	6,700,000
Current liabilities	6,000,000
Current Ratio	1.12

Balance Sheet as on 31.03.2018 – After Manipulation to suit Eligibility

Particulars	Amount	
LIABILITIES		
I. Capital	7,500,000	7,500,000
II. Reserves & Surplus	1,000,000	1,000,000
III. Non Current Liabilities		
Secured Loans- Term Loan	7,000,000	
Unsecured Loans	1,000,000	8,000,000
IV. Current Liabilities		
Working Capital Loan	2,400,000	
Trade Payables	2,000,000	
Short term provisions	700,000	
Other Current Liabilities	900,000	6,000,000
TOTAL		22,500,000

ASSETS		
I. Non Current Assets		
Land & Building	6,000,000	
Plant & Machinery	5,800,000	
Capex Advance	2,000,000	13,800,000
II. Current Assets		
Inventory	2,600,000	
Trade Receivables	2,500,000	
Cash & Bank Balances	3,600,000	8,700,000

Ratios

Debt	8,000,000
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Equity	7,500,000
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Debt Equity Ratio	1.07
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Total Outside Liabilities	14,000,000
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Total Net worth	8,500,000
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TOL/TNW Ratio	1.65
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Current Assets	8,700,000
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Current liabilities	6,000,000
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Current Ratio	1.45
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ANALYSIS FOR TAXES COLLECTION ANGLE

While most of the Analysis are from Shareholders or Bankers' angle, as Tax Collecting Officers, more emphasis has to be made on following Analysis

- Increase in payment of penalties and fines to the Commercial Taxes Department or any other – Why these are paid?? Are they paid regularly (indicating regular offender)
- Sales and Purchases increased in a particular a manner but the GST output payment on such sales not increased in the same manner. What could be the reasons?
- Security Deposits with Govt and other Statutory Bodies are waived off during the year i.e. may be due to non compliance of such statutory rules. What are the instances?? What could be the reason for the same

ANALYSIS FOR TAXES COLLECTION ANGLE

- **Salary Vs Employees**
- **Salary Vs Provident Fund**
- **Salary Vs TDS**
- **Labour Turnover Vs Professional Taxes**
- Mismatch between filings and Financial Statements – reasons for the same – How many times occurred earlier



THANK YOU

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