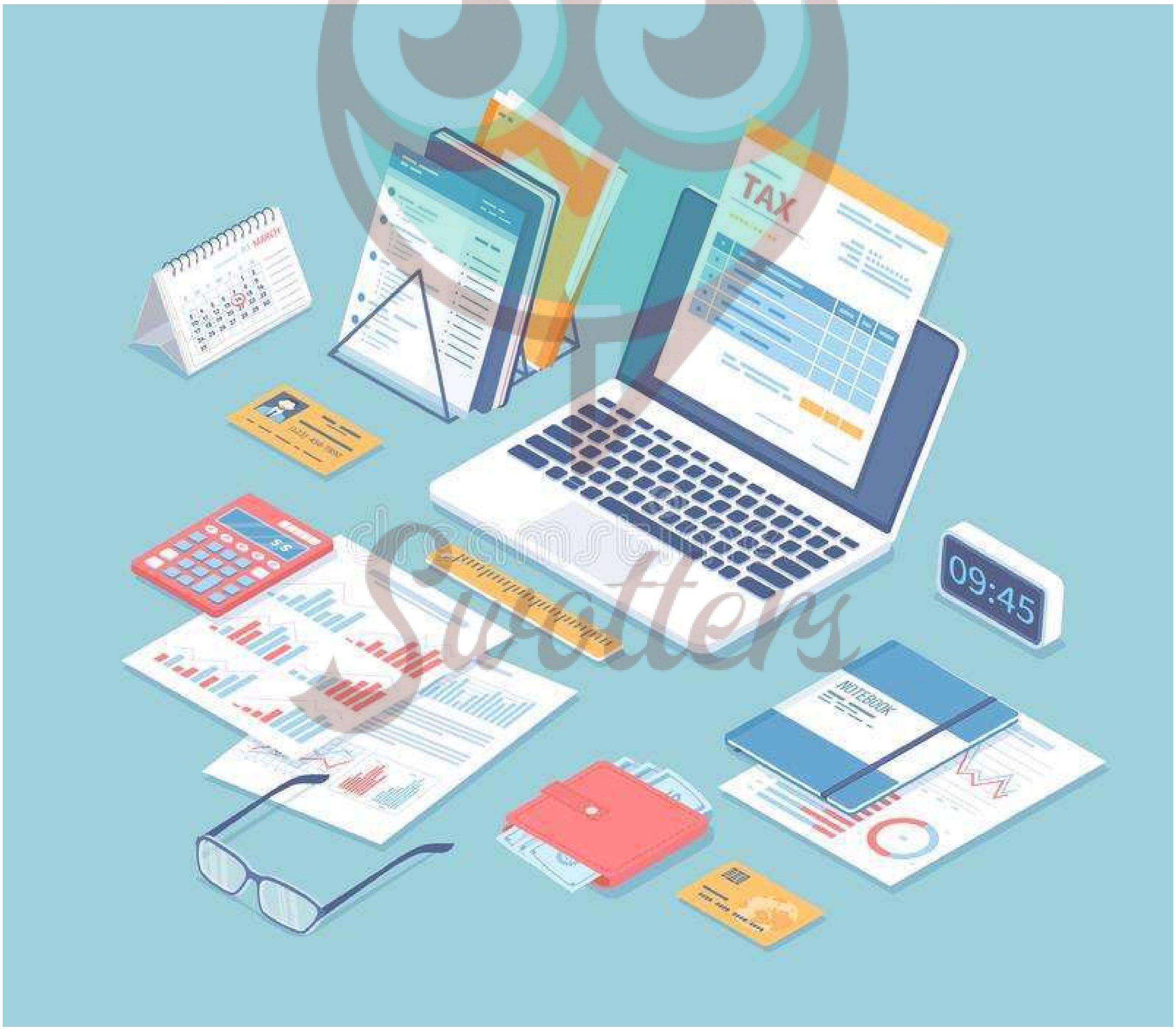
ACCOUNTANCY



Important Questions

Multiple Choice questions-

Question 1. Which of the following is not recognized as tool for the analysis of financial statements?
(a) Cash Flow Statement
(b) Funds Flow Statement
(c) Trend Analysis
(d) Statement showing distribution of dividends
Question 2. Which of the following is the objective of comparative statement?
(a) To making data simple
(b) To make data comparative
(c) To help in forcasting
(d) To detect financial irregularities
Question 3. Which of the following is not a tool of financial statement analysis?
(a) Cash Flow Statement
(b) Statement showing distribution of dividend
(c) Ratio Analysis
(d) Comparative Financial Statements
Question 4. Which of the following objectives is not met by comparative statement of Profit and Loss?
(a) It helps to compare the figures of atlest two years
(b) It helps to assess absolute changes
(c) It helps to know the changes in the financial position
(d) It helps to know the percent changes in the statement of Profit and Loss
Question 5. Financial analysis can be done with which of the following tool?
(a) Ratio Analysis
(b) Cash Flow Statement
(c) Comparative Statements
(d) All of the above
Question 6. Analysis of financial statements for two or more years is known as
(a) Horizontal analysis
(b) External analysis
(c) Vertical analysis
(d) Internal analysis
Question 7. Which of the following is not an objective of financial statement analysis?
(a) Efficiency of the Management
(b) Price Level Changes
(c) Profitability of the Enterprise

(d) Solvency of the Enterprise
Question 8. Who of the following has no financial interest in the analysis of financial statements?
(a) Management
(b) Debtor
(c) Creditor
(d) Investor
Question 9. Who has the interest in long-term solvency position of the firm?
(a) Creditors
(b) Bankers providing overdraft facilities
(c) Financial Institutions
(d) Short-term money lenders
Question 10. Which of the following is not a limitation in the analysis of financial statements?
(a) Ignores Price Level Changes
(b) Window Dressing
(c) Financial performance of the firm
(d) Bias of the Analyst

Very Short Questions-

1. State any one limitation of Financial Statement Analysis.
2. State any one objective of analysis of financial statements.
3. State the type of Financial Statement Analysis in which figures of the same items of various years are compared.
4. Which type of financial statement analysis helps a company to establish the relationship between different items financial statement of a same year?
5. "One of the objectives of Financial Statement Analysis is to assess solvency of business". What does the term 'solvency' mean here ?

Short Questions-

1. List the techniques of Financial Statement Analysis.
2. Distinguish between Vertical and Horizontal Analysis of financial data.
3. State the meaning of Analysis and Interpretation.
4. State the importance of Financial Analysis?
5. What are Comparative Financial Statements?

Long Questions-

1. Describe the different techniques of financial analysis and explain the limitations of financial analysis.

2. Explain the usefulness of trend percentages in interpretation of financial performance of a company.

3. What is the importance of comparative statements? Illustrate your answer with particular reference to comparative income statement.

4. What do you understand by analysis and interpretation of financial statements? Discuss its importance.

Assertion Reason Questions-

1. For two statements are given-one labelled Assertion and the other labelled Reason. Select the correct answer to these questions from the codes (a), (b), (c) and (d) as given below.

    a. Assertion and Reason both are correct and Reason is the correct explanation of assertion
    b. Assertion and Reason both are correct but Reason is not correct explanation of assertion
    c. Only Assertion is correct.
    d. Reason is correct but Assertion is not correct.

Assertion (A): When financial statements of several years are compared against a chosen base year, it is called Dynamic Analysis.

Reason (R): Horizontal analysis is made to review and analyze the financial Statements for a number of years and it is also known as Time Series Analysis.

2. For two statements are given-one labelled Assertion and the other labelled Reason. Select the correct answer to these questions from the codes (a), (b), (c) and (d) as given below.

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Assertion: Vertical or static Analysis is made to review and analyse the financial statements of one year only, to compare the performance of other firms of the same type or divisions or departments of one firm.

Reason (R): It is a Time Series Analysis

MCQ Answers-

1. Answer: (d) Statement showing distribution of dividends
2. Answer: (d) To detect financial irregularities
3. Answer: (b) Statement showing distribution of dividend
4. Answer: (c) It helps to know the changes in the financial position
5. Answer: (d) All of the above
6. Answer: (a) Horizontal analysis
7. Answer: (b) Price Level Changes
8. Answer: (b) Debtor
9. Answer: (c) Financial Institutions
10. Answer: (c) Financial performance of the firm

Very Short Answers-

1. Answer: Historical Analysis of financial Statement.
2. Answer: To measure earning capacity of business.
3. Answer: Horizontal analysis.
4. Answer: Vertical analysis.
5. Answer: Solvency means ability to pay the debts.

Short Answers-

1. **Most commonly used techniques are:**
   i. Common Size Financial Statements
   ii. Trend Analysis
   iii. Comparative Financial Statements
   iv. Cash Flow Statement
   v. Fund Flow Statement

vi. Ratio Analysis

2.

Basis of Comparison	Horizontal Analysis	Vertical Analysis
Meaning	It is the comparative evaluation of a financial statement of two or more periods, for calculating relative and absolute variances for every line of item	It is the analysis of financial data which is independent of time and items relating to financial information of company and its impact on the performance of the company.
Purpose	To specify changes in financial performance between two comparable accounting periods	To compare a financial item as a percentage of base figure
Comparison of	Intra-firm comparison	Both intra and inter firm comparison
Usefulness	Growth or decline of an item is represented here	Is useful in predicting and determining the relative proportion of an item of the financial statement to a common item in the financial statement

3. It is a critical and systematic examination of the financial statement. It presents the financial data in a systematic manner and also establishes a cause and effect relationship with all the items of financial statements. Analysis and interpretation is all about presenting financial data which is self-explanatory and easy to understand. It helps users of accounting information in assessing the status of financial performance of the business for a time period and enables them to take proper decision regarding finance policy of the firm.

4. Financial analysis is of great importance for the various users of accounting information. Financial statements such as Balance Sheets, Income sheets and other sources of financial data provide ample information on the various expenses and sources of profit, loss and income which is helpful in determining the financial status of a business. Financial data is not making any meaningful contribution until it is analysed. There are various methods which help in analysing financial statement and make it useful for various accounting users.

   Following reasons are essential for performing financial analysis:

   i. It is very helpful in determining the financial viability and profit earning capacity of the firm.

ii. It is helpful in evaluating the business solvency in the long term.

iii. It is useful in comparing the financial status of a firm in comparison to other competitor firms.

iv. It helps management in decision making, drafting plan and also establish a robust and effective control mechanism.

5. Comparative financial statements refer to statements which enable comparison that is both intra and inter firm and is based over a period of time. These statements help various users of accounting information in evaluating financial progress of a firm in relative terms. These statements express the data in absolute figures or as percentage change and absolute change that occurs in the item of the financial statement over a period of time. The data presented in financial statements are self-explanatory and easy to understand. When items of the financial statement are treated with the same accounting policies and practices over a fixed period of time, then the comparative data derived from such statements bear meaningful comparisons.

   Two common types are:

   i. Comparative Income Statement

   ii. Comparative Balance Sheet

Long Answers-

1. **Following different techniques are used for financial analysis:**

   i. **Cash Flow Analysis:** This analysis focuses on the inflow and outflow of cash and cash equivalents from the various activities of a business namely, investing, operating and financing activities during an accounting period. This helps in analysing cash payments and reason of receipt and the respective changes in cash balances during the accounting year.

   ii. **Ratio Analysis:** This method highlights the relationship between items of Balance Sheet and Income Statements. It is helpful in determining efficiency, profitability and solvency of a firm. This analysis expresses the financial items as fraction, percentage or proportion. Also, it determines the qualitative relationship among different financial variables. It also serves as a source of information regarding the performance, viability and financial position of a firm.

   iii. **Trend Analysis:** This technique studies the trends in operating performance and financial position of the business over a period of many years in succession. In such study, any particular year is considered as base year and the rest years are expressed as percentage of the base year's figures. It helps in identifying problems and inefficiency along with detecting operating efficiency and financial position of the firm.

iv. **Comparative Statements:** These statements use figures from two accounting periods that helps determine financial position and profitability. It also enables to do intra and inter firm comparison and therefore determine the efficiency of firm in relative terms. It uses both percentage as well as absolute terms. This analysis is known as Horizontal analysis.

v. **Common size Statements:** Common Size Statements are those statements where the items are displayed as percentages of a common base figure instead of absolute figures. It is helpful for proper analysis between companies (inter-firm comparison) or between time periods of the same company (intra-firm comparison). In these statements the relationship between items present in financial statements and common items like balance sheet total and net sales are highlighted in percentage. The analysis based on these statements is called as Vertical Analysis.

It has following limitations:

i. It fails to depict changes in accounting policy and procedures

ii. These statements provide the interim report and hence have incomplete information.

iii. These statements lack the qualitative aspect like growth prospects, managerial efficiency and express only in monetary terms

iv. Financial analysis is based on accounting concepts and conventions and hence are not reliable as it does not take the current market value of items.

v. It involves personal biasness and judgements of the accountant for example in case of depreciation different methods can be charged for same item.

vi. It does not take into account the change in price level. Only nominal values are considered.

2. Trend analysis is a form of analysing financial data and it is expressed as percentage for each year. It helps the accounting user in evaluating financial performance of the business and also form opinion of various tendencies by which businesses can predict future trends.

Importance of trend analysis:

i. Predicting of the trends of business which is forecasting of future trends in business.
ii. Trends are expressed as percentages which is less time consuming and easy to follow.
iii. It becomes a popular financial analysis method due to trends being expressed in percentages which makes evaluating financial performance and operating efficiency of the firm relatively simpler.

iv. It presents a broader picture of the performance of company in terms of finance, viability and efficiency.

3. **Comparative statements have the following importance:**

   i. It presents financial data in a simple form, with year wise data being presented in side by side fashion making the presentation neat and enabling intra and inter-firm comparisons more conclusive.

   ii. Presentation is very effective for drawing insights quickly and easily.

   iii. It assists the management in drafting future plans and forecast trends which is acheived by analysing profitability and operating efficiency of a business over time.

   iv. Comparative analysis helps easy detection of problems. Early detection helps take corrective measures and align the business in meeting the desired target.

4. Financial analysis is of great importance for the various users of accounting information. Financial statements such as Balance Sheets, Income sheets and other sources of financial data provide ample information on the various expenses and sources of profit, loss and income which is helpful in determining the financial status of a business. Financial data is not making any meaningful contribution until it is analysed. There are various methods which help in analysing financial statement and make it useful for various accounting users.

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