NCERT Class 12 Accountancy Notes

Part 2 Chapter 4, Analysis of Financial Statements (2026–27 / New NCERT)

12th Accountancy: Company Accounts and Analysis of Financial Statements

Part 2 Chapter 4: Analysis of Financial Statements

Comparative Statements | Common Size Statements | Trend Analysis

Also see for this chapter: NCERT Solutions | Formula Sheet

What this chapter is about

A company prepares two financial statements every year: the **Statement of Profit and Loss** (how much it earned and spent) and the **Balance Sheet** (what it owns and owes on a given date). Raw figures, on their own, do not tell a manager, lender, or investor whether the company is doing well. **Analysis of financial statements** is the set of techniques used to convert those raw figures into ratios, percentages, and trends that reveal profitability, solvency, and operational efficiency.

Contents

1 Meaning, Significance and Objectives

A company's financial statements summarise its operating results and financial position. To compare two years, two companies, or one company against an industry benchmark, an analyst must process those statements further. This section sets out what financial statement analysis is, why each stakeholder relies on it, and the specific objectives it is designed to meet.

1.1 Meaning of Analysis of Financial Statements

Financial statement analysis is the **critical evaluation** of the information contained in the financial statements so as to understand and take decisions regarding the operations of a firm. It is in effect a study of the *relationships* among various financial facts and figures, for example, the ratio of profit to sales, or the share of inventory in total assets, and the **interpretation** of those relationships to judge the profitability, operational efficiency, financial health, and future prospects of the business.

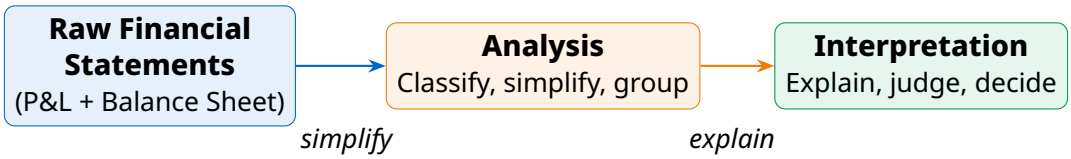
The phrase "financial analysis" really packs two activities into one:

- **Analysis**, breaking down the financial data into smaller, methodically classified groups so that patterns become visible. By itself, analysis only *simplifies* the figures.
- **Interpretation**, explaining what those simplified figures *mean* for the business. Interpretation is what turns numbers into decisions.

The two are complementary. Analysis without interpretation is useless (you simplified the data but never said what it implies); interpretation without analysis is impossible (you cannot explain numbers you have not yet organised).

Two complementary halves

Analysis = simplifying data by methodical classification.
Interpretation = explaining the meaning and significance of that simplified data.
Together they let an analyst estimate the current and past financial position of a firm and forecast the best possible estimates for the future.



The analyst's task is also **judgemental**: two equally trained analysts may read the same statements and reach different conclusions because each weighs different aspects. The primary aim, though, is the same, produce the best possible estimate of the future condition of the enterprise so that decisions involving **cross-sectional comparison** (firm vs other firms) and **time-series comparison** (firm vs its own past) become reliable.

Quick Tip

In a one-mark question, define *Analysis* as "simplifying financial data by methodical classification" and *Interpretation* as "explaining the meaning and significance of the data". The phrasing closely matches NCERT and the markers reward it.

1.2 Significance for Different Users

Different users of financial statements ask different questions, and the same analysis answers each user differently. NCERT lists seven user groups.

User	What the analysis tells them
Finance manager	Studies managerial performance, corporate efficiency, financial strengths and weaknesses, and creditworthiness; supports financial control and review of major deviations.
Top management	Confirms that resources are being used efficiently; appraises the system of internal control and individual performance.
Trade payables (short-term creditors)	Evaluates the firm's *liquidity*, can it pay its short-term obligations on time?
Lenders (long-term debt)	Tests long-term *solvency*, can the firm pay interest and repay principal over many years?
Investors (shareholders)	Look at present and future profitability, capital structure, and whether to buy, sell, or hold the shares.
Labour unions	Judges whether the firm can afford a wage increase, and whether it can absorb it through higher productivity or higher prices.
Others (economists, government, researchers)	Use it for studying business conditions, price regulation, taxation, and policy.

Remember the seven users: FT-T-L-I-L-O

Finance manager, **T**op management, **T**rade payables, **L**enders, **I**nvestors, **L**abour unions, **O**thers. "FT-T-L-I-L-O". Recite them in this order in the long-answer question to avoid skipping a user.

1.3 Objectives of Financial Analysis

NCERT lists four specific objectives. They are common short-answer material.

Four objectives of financial statement analysis

1. To assess the **current profitability** and **operational efficiency** of the firm as a whole as well as its departments, judging the firm's overall financial health.
2. To ascertain the **relative importance** of different components of the financial position.
3. To identify the **reasons for change** in profitability or financial position.
4. To judge the firm's ability to **repay its debt** and to assess its **short- and long-term liquidity**.

Beyond the firm level, the analysis also feeds national decisions. An economist reads industry statements to judge the extent of economic concentration. The government uses the same data for licensing, price ceilings, dividend freezes, tax concessions, and subsidies.

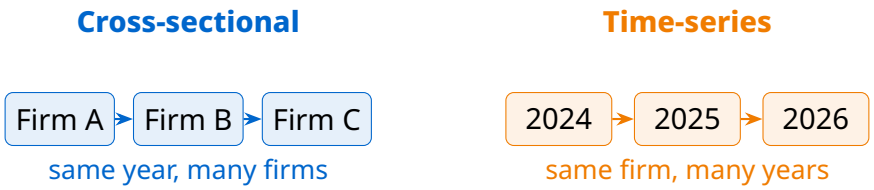
Real-World Application

When the Reserve Bank of India tightens or loosens lending norms for a sector, it does so after analysing the audited financial statements of large companies in that sector, the same Comparative Statements, Common Size Statements, and ratios you will learn in this chapter.

1.4 Cross-Sectional vs Time-Series Analysis

Two directions of comparison underpin every technique in this chapter.

- **Cross-sectional** (inter-firm) analysis, comparing the same period's figures across different firms in the same industry. "Is our gross profit ratio higher or lower than the industry leader's?"
- **Time-series** (intra-firm) analysis, comparing one firm's figures across successive years. "Has our debt-to-equity ratio risen since the demerger?"



The same five techniques (Comparative Statements, Common Size Statements, Trend Analysis, Ratio Analysis, and Cash Flow Analysis) can be applied in either direction. Knowing *which direction* the question is asking about is half the marks.

Memory Aid

C-C-T-R-C, the five-tool stack. **C**omparative, **C**ommon-size, **T**rend, **R**atio, **C**ash-

Flow. The first three live in this chapter; the last two get a chapter each (Chapter 9 and Chapter 10). Recite the chain to be sure no tool slips out of memory in the long-answer.

2 Tools of Financial Statement Analysis

NCERT lists five major tools. The first three (Comparative, Common Size, Trend) are detailed in this chapter; Ratio Analysis is the entire next chapter, and Cash Flow Analysis is covered in Chapter 10.

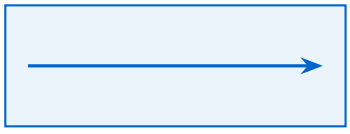
2.1 Overview of the Five Tools

Tool	Also called	What it does
Comparative Statements	Horizontal analysis	Shows absolute and % change in each item between two periods.
Common Size Statements	Vertical analysis / Component percentage statement	Shows each item as a percentage of a common base (Revenue or Total Assets).
Trend Analysis	Index-number analysis	Tracks each item over several years as a percentage of a base year (= 100).
Ratio Analysis	,	Establishes mathematical relationships between two financial items (e.g. Current Ratio, ROCE).
Cash Flow Analysis	,	Studies the inflow and outflow of cash and the net change in cash position.

Horizontal vs Vertical, in one line

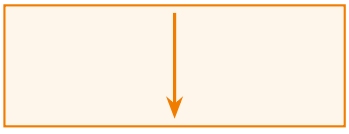
Horizontal analysis runs *across columns* (left → right, year to year). **Vertical** analysis runs *down a column* (each item as % of the base of that column). Comparative = horizontal; Common Size = vertical.

Horizontal (Comparative)

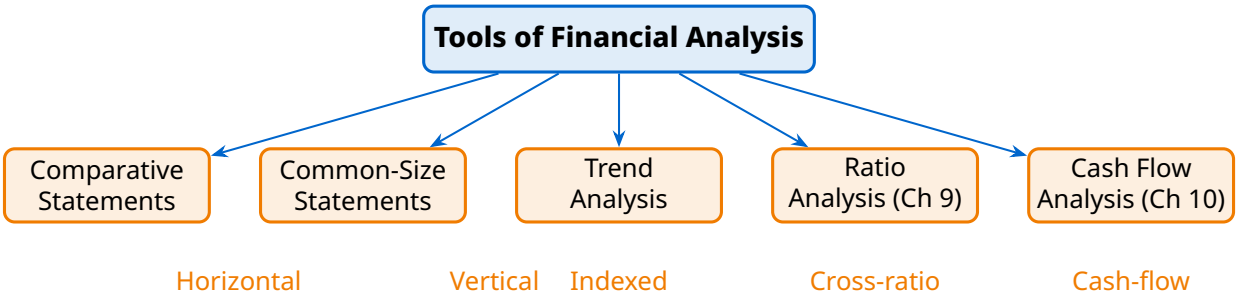


compare years

Vertical (Common Size)



compare items within a year



The five NCERT tools: Comparative and Common-Size produce statement-level analytics; Trend tracks indexed movement over many years; Ratio and Cash-Flow are deep dives that earn full chapters of their own.

2.2 Comparative Statements

A Comparative Statement is a statement of profit and loss *or* a balance sheet prepared by placing the current year and the previous year side-by-side, with two additional columns showing the **absolute change** and the **percentage change**.

Percentage change formula

$$\%\ \text{Change} = \frac{\text{Absolute change}}{\text{First year (base) figure}} \times 100$$

where Absolute change $=$ Second-year figure $-$ First-year figure. A positive value is an increase, a negative value is a decrease (shown in brackets, e.g. $(50,000)$).

The five columns of a Comparative Statement are fixed:

1. Particulars
2. First year (Rs.)
3. Second year (Rs.)
4. Absolute increase $(+)$ or decrease $(-)$ (Rs.)
5. Percentage increase $(+)$ or decrease $(-)$ (%)

Why Comparative Statements matter

Because comparison is built right into the form, an analyst can see *direction* (up or down) and *magnitude* (how much) of every line in one glance. The same data, on a normal Balance Sheet, would need a calculator and a notepad to interpret.

Pre-condition: same accounting principles. The two-year comparison is meaningful only if both statements use the same accounting policies (depreciation method, inventory valuation method, revenue recognition). If a policy changed mid-period, that change must be disclosed in a footnote, otherwise the percentage change is misleading.

2.3 Common Size Statements

A Common Size Statement (also called a Component Percentage Statement) restates each line of the financial statement as a **percentage of a common base**:

- For a Common Size Statement of Profit and Loss, each line is shown as a % of **Revenue from Operations**.
- For a Common Size Balance Sheet, each line is shown as a % of **Total Assets** (or equivalently Total Equity & Liabilities, since the two sides are always equal).

Common Size percentage

$$\text{Common Size \%} = \frac{\text{Individual item}}{\text{Common base for that statement}} \times 100$$

Base = Revenue from Operations for the Statement of P&L; Total Assets for the Balance Sheet.

This makes **inter-firm** comparison possible even when the firms are of very different sizes. A small firm with revenue Rs. 50 lakh and a large firm with revenue Rs. 500 crore can both be compared on "what % of revenue goes to employee benefit expenses".

Real-World Application

Brokerage reports on Nifty 50 stocks routinely tabulate every company's expenses, profit, and assets in common-size form. That is the only way an investor can decide, on the same yardstick, whether HDFC Bank's operating cost ratio is better than ICICI Bank's, despite the two banks differing in size by tens of thousands of crores.

2.4 Trend Analysis

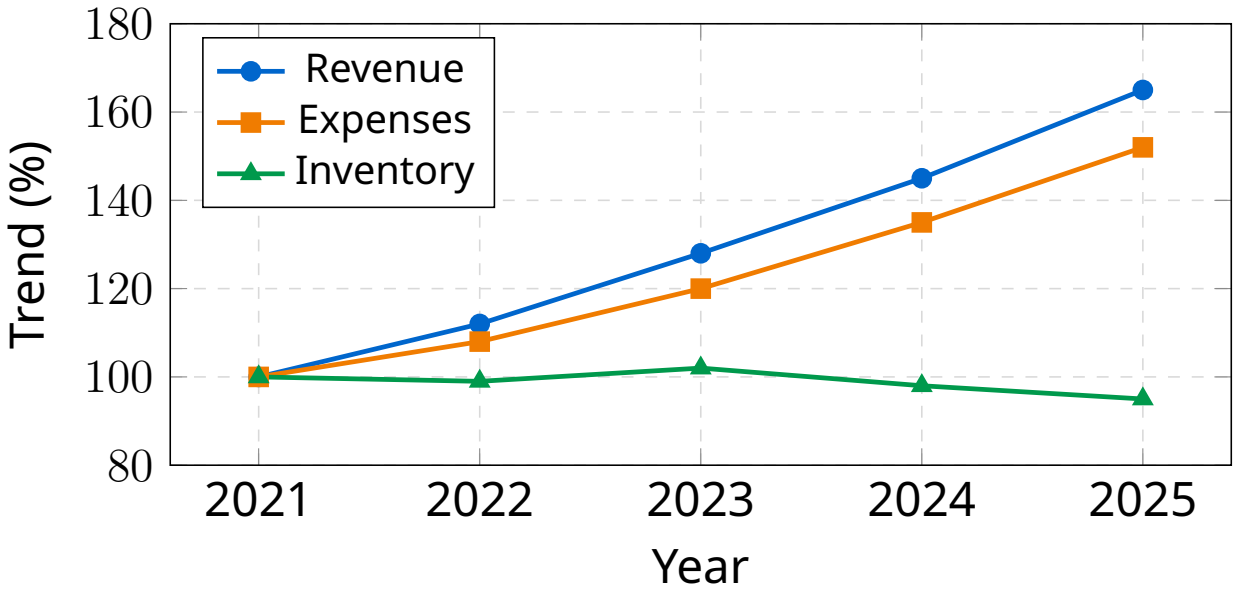
Trend Analysis is the technique of studying a series of years, typically five to ten, by expressing each year's figure for a given item as a percentage of the **base year** (= 100).

Trend percentage

$$\text{Trend \%}_{\text{year } n} = \frac{\text{Figure in year } n}{\text{Figure in base year}} \times 100$$

The base year is normally the earliest year in the series. Its trend percentage is always 100.

Trend analysis answers the long-run question: "Is this item rising, falling, or roughly flat?" By looking at a single line over many years, structural changes in the business become visible, changes that two-year comparative statements would miss because the change is gradual.



Read the chart: Revenue is growing faster than Expenses (good sign for profitability), and Inventory is in effect flat (so the firm is becoming more inventory-efficient).

Quick Tip

In a board question, write the base-year figure as 100, the next year as $(\text{figure} \div \text{base}) \times 100$, rounded to two decimal places. State explicitly which year you chose as the base; markers deduct half a mark when this is missing.

2.5 Ratio Analysis and Cash Flow Analysis (brief)

Ratio Analysis expresses the relationship between two financial items as a quotient (e.g. Current Assets $\div$ Current Liabilities $=$ Current Ratio). Ratios are grouped into four families: *liquidity, solvency, activity, and profitability*. This is the subject of Part 2 Part 2 Chapter 1.

Cash Flow Analysis traces actual cash movements during the year, classifying every cash receipt and payment as Operating, Investing, or Financing. It complements the accrual-based statements by showing whether reported profit translates into real cash. This is the subject of Part 2 Part 2 Chapter 2.

Solve the NCERT Exercises

3 Comparative Statements, Worked Detail

This section builds on Section 2.2 with the precise format and two solved illustrations of the kind you will see in the exam.

Particulars	Year 1	Year 2	Abs. Change	% Change
Share Capital Reserves Long-term Loans Tangible Assets Inventories Cash	Absolute figures (base year)	Absolute figures (current year)	Year 2 minus Year 1	Abs. Change ÷ Year 1 × 100

Comparative Balance Sheet layout: two absolute columns + one absolute-change column + one percentage-change column. Both Equity & Liabilities and Assets totals must tie across all four numeric columns.

3.1 Preparation Steps

Three-step procedure

1. **List** absolute figures of both years in two columns.
2. **Find absolute change** $=$ (Second year $-$ First year). Mark $(+)$ for increase, $(-)$ in brackets for decrease.
3. **Compute percentage change** $= \dfrac{\text{Absolute change}}{\text{First-year figure}} \times 100.$

The percentage change is always taken on the **first year** (earlier year) as the base. A common student error is to take the second year as the base, which inverts the sign and the magnitude.

Common Mistake

"Increase of 50,000 on a base of 2,00,000 is 25%", correct. But *not* "50,000 on a base of 2,50,000", that uses the second year as the base and is wrong. **Always divide by the first-year figure.**

3.2 Solved Illustration, Comparative Statement of P&L

Question (NCERT Illustration 1, BCR Co. Ltd.), prepare a Comparative Statement of Profit and Loss for the year ended 31 March 2024 and 2025, given:

Particulars	2023–24 (Rs.)	2024–25 (Rs.)
Revenue from operations	60,00,000	75,00,000
Other incomes	1,50,000	1,20,000
Expenses	44,00,000	50,60,000
Income tax rate	35%	40%

Solution. Apply the three-step procedure line by line:

Particulars	2023–24	2024–25	Abs. change	% change
I. Revenue from operations	60,00,000	75,00,000	15,00,000	25.00
II. Add: Other incomes	1,50,000	1,20,000	(30,000)	(20.00)
III. Total revenue (I + II)	61,50,000	76,20,000	14,70,000	23.90
IV. Less: Expenses	44,00,000	50,60,000	6,60,000	15.00
Profit before tax (III − IV)	17,50,000	25,60,000	8,10,000	46.29
V. Less: Tax	6,12,500	10,24,000	4,11,500	67.18
Profit after tax	11,37,500	15,36,000	3,98,500	35.03

Working for tax: 35% of $17{,}50{,}000 = 6{,}12{,}500$; 40% of $25{,}60{,}000 = 10{,}24{,}000$.

Interpretation. Revenue rose 25% but profit-after-tax rose only 35%, not a runaway result given expenses grew 15% and the tax rate also climbed five percentage points. The relative slowdown is visible only in the % change column.

3.3 Solved Illustration, Comparative Balance Sheet

Question (NCERT Illustration 3, J. Ltd.), prepare a Comparative Balance Sheet of J. Ltd. as at 31 March 2024 and 2025 (figures in Rs. lakhs).

Particulars	31.3.2024	31.3.2025	Abs. change	% change
I. Equity & Liabilities				
1. Share capital	15	20	5	33.33
2. Reserves & surplus	4	3	(1)	(25.00)
3. Long-term borrowings	6	9	3	50.00
4. Trade payables	2	3	1	50.00
Total	27	35	8	29.63
II. Assets				
1. Tangible fixed assets	15	20	5	33.33
2. Intangible fixed assets	6	9	3	50.00
3. Inventories	4	3	(1)	(25.00)
4. Cash & cash equivalents	2	3	1	50.00
Total	27	35	8	29.63

Read the result:

- Long-term borrowings rose 50%, the firm financed expansion partly through debt.
- Tangible fixed assets rose 33%, consistent with capacity expansion.
- Reserves & surplus *fell* 25%, the firm distributed dividend or absorbed a loss out of retained earnings.
- Inventories *fell* 25%, better inventory turnover or a deliberate de-stocking.

Balance-sheet identity is preserved

Both sides of the Balance Sheet must always tie, so the total for Equity & Liabilities equals the total for Assets in *every* column, including the absolute change and the percentage change. If the totals do not match, recheck the working.

3.4 Interpreting a Comparative Statement

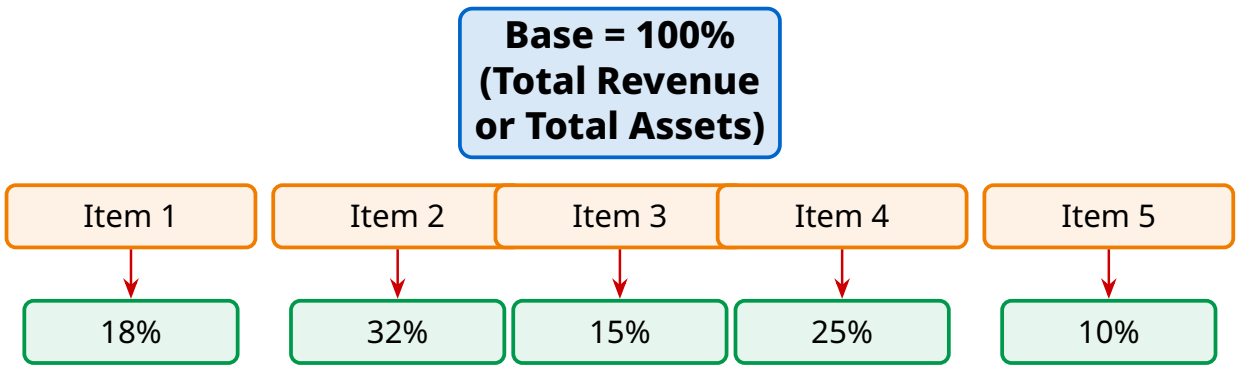
Numbers alone do not earn the interpretation marks. Look for these patterns:

- **Revenue vs Expenses.** If revenue grew faster than expenses, profitability improved; the reverse is a warning.
- **Profit vs Revenue.** If profit grew faster than revenue (% wise), the firm became more efficient; the cost structure improved.
- **Current assets vs Current liabilities.** A faster rise in current liabilities than current assets weakens liquidity.
- **Borrowings vs Equity.** A jump in long-term borrowings without a corresponding rise in equity raises the debt-to-equity ratio, higher financial risk.

Quick Tip

Whenever you present a Comparative Statement in the exam, finish with two or three sentences of *interpretation*. "Revenue increased by 25% while expenses increased by only 15%, indicating improved cost management", that one line lifts the answer from a content score to a top score.

4 Common Size Statements, Worked Detail



Sum of percentages of items that make up the base = 100%

Common-Size Statement structure: one base figure is fixed at 100%, every other line is expressed as a percentage of that base. The result is directly comparable across firms of different sizes.

4.1 Preparation Steps

Three-step procedure

1. **List** absolute figures of both years in two columns.
2. **Choose the base**, Revenue from Operations for the Statement of P&L, Total Assets (or Total Equity & Liabilities) for the Balance Sheet, and set it $= 100$.
3. **Compute each item** as $\dfrac{\text{Item}}{\text{Base}} \times 100$, separately for each year.

The output has four columns: absolute amount (year 1), absolute amount (year 2), % (year 1), % (year 2). Both percentage columns must sum to 100 for the items that make up the base.

4.2 Solved Illustration, Common Size P&L

Question (based on NCERT Illustration 5). Prepare a Common Size Statement of Profit and Loss for the year ended 31 March 2024 and 2025:

Particulars	2023–24 (Rs.)	2024–25 (Rs.)
Revenue from operations	25,00,000	18,00,000
Cost of goods sold	12,00,000	10,00,000
Operating expenses	1,20,000	80,000
Non-operating expenses	15,000	12,000

Solution. The base is Revenue from Operations. Divide every line by the base and multiply by 100.

Particulars	2023–24 Rs.	2024–25 Rs.	2023–24 %	2024–25 %
Revenue from operations	25,00,000	18,00,000	100.00	100.00
(Less) Cost of goods sold	12,00,000	10,00,000	48.00	55.56
Gross profit	13,00,000	8,00,000	52.00	44.44
(Less) Operating expenses	1,20,000	80,000	4.80	4.44
Operating income	11,80,000	7,20,000	47.20	40.00
(Less) Non-operating expenses	15,000	12,000	0.60	0.67
Profit	11,65,000	7,08,000	46.60	39.33

Sample calculation. $\dfrac{12{,}00{,}000}{25{,}00{,}000} \times 100 = 48.00\%$ (Cost of goods sold, 2023–24).

Interpretation. Cost of goods sold rose from 48.00% to 55.56% of revenue, input costs rose faster than selling prices, eroding the gross margin by about 7.5 percentage points. Profit fell from 46.60% to 39.33% of revenue, a clear deterioration in operating efficiency.

4.3 Solved Illustration, Common Size Balance Sheet

Question (based on NCERT Illustration 7, XRI Ltd.). Prepare a Common Size Balance Sheet as at 31 March 2024 and 31 March 2025 (selected items).

Particulars	2024 Rs.	2025 Rs.	2024 %	2025 %
Equity & Liabilities				
Share capital	12,00,000	15,00,000	36.93	36.14
Reserves & surplus	5,00,000	5,00,000	15.38	12.05
Long-term borrowings	5,00,000	6,00,000	15.38	14.46
Trade payables	10,50,000	15,50,000	32.31	37.35
Total	32,50,000	41,50,000	100.00	100.00
Assets				
Plant & machinery (tangible)	8,00,000	14,00,000	24.62	33.73
Goodwill (intangible)	12,00,000	16,00,000	36.92	38.55
Non-current investments	10,00,000	10,00,000	30.77	24.10
Inventories	2,50,000	1,50,000	7.69	3.62
Total	32,50,000	41,50,000	100.00	100.00

Reading the structure. Trade payables rose from 32.31% to 37.35% of the balance sheet, a larger share of the firm is financed by short-term credit, weakening liquidity. Plant & machinery rose from 24.62% to 33.73% of total assets, consistent with a capacity expansion funded partly by drawing down non-current investments (down from 30.77% to 24.10%) and partly by stretching trade credit.

Trick of common-size analysis

The absolute figures *can* both grow, yet the common-size percentage can *shrink*, if total assets grew faster. The structure, not the absolute size, is what common-size analysis shows.

Common Mistake

After computing common-size percentages, students sometimes forget to verify that each column sums to 100. If it does not, you have either dropped an item, double-counted one, or used a wrong base. **Always tally to 100 before finalising the answer.**

5 Trend Analysis, Worked Detail

Trend Analysis isolates the long-run behaviour of an item by treating one specific year as the reference (= 100) and expressing every other year as a percentage of that reference.

5.1 Step-by-Step Procedure

Trend percentage

$$\text{Trend \%}_n = \frac{\text{Figure}_n}{\text{Figure}_{\text{base year}}} \times 100$$

where the base year is normally the *earliest* year in the series.

Worked example. A firm reports Revenue from Operations of Rs. 50, 56, 64, 73, 82 lakhs in the five years 2021 through 2025. Take 2021 as the base.

Year	Revenue (Rs. lakh)	Trend %
2021 (base)	50	100.00
2022	56	112.00
2023	64	128.00
2024	73	146.00
2025	82	164.00

Sample calculation. $\frac{64}{50} \times 100 = 128.00$ for 2023; the firm's revenue in 2023 was 128% of its 2021 revenue (i.e. a 28% rise over four years).

5.2 Reading a Multi-Item Trend

The real power of trend analysis appears when several items are tracked side-by-side. Consider three lines for the same firm:

Item (Trend %)	2021	2022	2023	2024	2025
Revenue	100	112	128	146	164
Cost of goods sold	100	110	125	138	150
Net profit	100	118	140	168	200

Read it. Revenue grew 64% over four years, cost of goods sold grew 50%, but net profit grew **100%** (doubled). That "net profit growing faster than revenue" is the sign of a firm in an improving cost regime, a positive signal that two-year Comparative Statements would have undersold.

5.3 Choosing the Base Year

The base year should be **normal**, a year free of extreme events (lockdowns, demergers, one-off windfalls). If 2020 happens to be the earliest year but it was abnormal (e.g. COVID-affected), use 2021 as the base instead, and note this in a footnote.

Quick Tip

If a question gives you five years and asks for "trend percentages with 2021 as base", *do not* also compute the percentage change from 2020. Stick to the base year specified. Marker deducts for unrequested work.

5.4 Limits of Trend Analysis

- Trend percentages assume that the base year is comparable. If accounting policies or the chart of accounts changed mid-series, the figures may not be on a like-for-like basis.
- Inflation can inflate trend percentages even when the firm is contracting in real terms. A revenue trend of 150% over five years at 8% annual inflation is barely positive in real value.
- Trend analysis alone does not say *why* an item is rising or falling. It must be paired with managerial commentary or with a deeper ratio analysis.

6 Limitations of Financial Analysis

NCERT lists five major limitations. Each is a likely 2- or 3-mark question.

6.1 The Five NCERT Limitations

Five limitations

1. **No adjustment for price-level changes (inflation).** Statements are at historical cost; long-run trends mix real and nominal growth.
2. **Misleading if accounting policies change.** A switch from FIFO to weighted-average inventory valuation, or from SLM to WDV depreciation, distorts the year-on-year comparison.
3. **Only a study of reports.** The analysis is only as good as the published statements, which are summaries; it cannot capture details available only to the management.
4. **Ignores non-monetary aspects.** Quality of management, brand reputation, employee morale, regulatory environment, none of these are in the statements but all affect future performance.
5. **Statements rely on accounting concepts & conventions.** Going concern, conservatism, accrual, materiality, each choice colours the figures; current market position is not necessarily reflected.

Common Mistake

Students sometimes list "window dressing" as a separate limitation. NCERT folds it under "financial statements rely on accounting concepts and conven-

tions" / managerial judgement. Mention window dressing only as an *example* within that point, not as a sixth bullet.

6.2 Other Practical Limits

Beyond the NCERT five, a careful analyst also weighs:

- **Personal judgement.** Two analysts can read the same set of statements and reach different conclusions. The analyst's bias and experience matter.
- **Window dressing.** Management can manipulate year-end balances (e.g. delaying expenses, advancing revenue recognition) to make the statements look healthier than they actually are.
- **Industry context.** A current ratio of 1.2 is dangerous in pharma but normal in retail. Ratios are interpretable only against an industry benchmark.
- **Past data, future decisions.** All analysis looks backward; the firm's environment may have already changed.

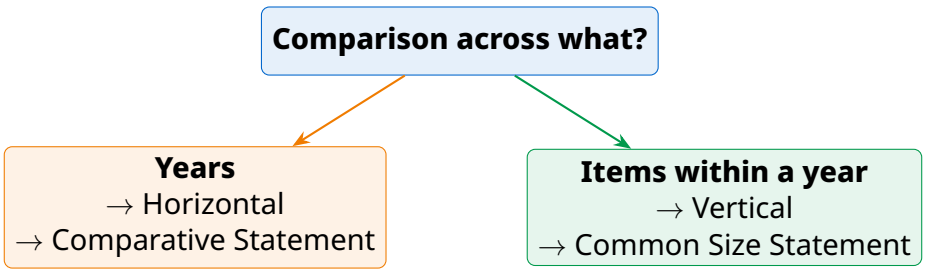
Real-World Application

The collapse of large Indian listed companies (Satyam in 2009, IL&FS in 2018, DHFL in 2019) showed that even *audited* financial statements can be window-dressed for years before the fraud surfaces. That is why analysts now pair statement analysis with non-financial signals: auditor changes, related-party transactions, promoter pledge ratios, and management commentary.

7 JEE/Commerce Aptitude Extensions

7.1 Horizontal vs Vertical, Decision Tree

In MCQs the wording is often subtle. Use this tree.



If the question mentions "each item as a percentage of revenue/total assets" → Common Size. If it mentions "increase/decrease over the year" → Comparative.

7.2 Computing % Change Quickly

Quick Tip

For a clean exam shortcut, write the absolute change first, then divide by the first-year figure in your head:
$\frac{15{,}00{,}000}{60{,}00{,}000} = 0.25 = 25\%$.
Two-digit ratios (15/60, 4/16, 9/36) collapse to one-decimal answers immediately.

7.3 Three Frequently Asked Distinctions

Pair	First	Second
Comparative vs Common Size	Across years; absolute and % change.	Within a year; each item as % of base.
Horizontal vs Vertical analysis	Comparative Statement; row-wise trend.	Common Size Statement; column-wise structure.
Intra-firm vs Inter-firm	One firm, many years (time-series).	Many firms, same year (cross-section).

7.4 Common MCQ Traps

Three MCQ traps

Trap 1. "A Balance Sheet shows the financial position over a period of time", **Wrong**. It shows the position *at a point in time*.
Trap 2. "Comparative statements are a form of vertical analysis", **Wrong**. They are horizontal.
Trap 3. "Cash flow statement is not a tool of financial analysis", **Wrong**. It is one of the five tools.

8 Quick Reference Summary

8.1 One-Page Formula Sheet

All formulas in this chapter

$$\text{Comparative \% Change} = \frac{\text{Second-year} - \text{First-year}}{\text{First-year}} \times 100$$

$$\text{Common Size \%} = \frac{\text{Item}}{\text{Base}} \times 100$$

$$\text{Base for P\&L} = \text{Revenue from Operations}$$

$$\text{Base for Balance Sheet} = \text{Total Assets}$$

$$\text{Trend \%}_n = \frac{\text{Figure in year } n}{\text{Figure in base year}} \times 100$$

8.2 Master Comparison Table

Feature	Comparative	Common Size	Trend
Also called	Horizontal analysis	Vertical / Component %	Index analysis
Comparison	2 years, side by side	Items within one year	Many years vs base year
Base	First year (per item)	Revenue (P&L) / Total Assets (BS)	Base year (= 100)
Output column	Abs. change & % change	% of base for each year	Trend % per year
Best for	Year-to-year change	Structure of statements	Long-run pattern
Direction	Row-wise	Column-wise	Row-wise across many cols

8.3 Glossary, Ten Terms Introduced

Term	One-line meaning
Financial Analysis	Critical evaluation of statements to judge profitability, solvency, and efficiency.
Comparative Statement	Two-year P&L or Balance Sheet with absolute and % change columns.
Common Size Statement	Each item shown as a % of a common base (Revenue or Total Assets).
Trend Analysis	Each year's figure as a % of a chosen base year.
Ratio Analysis	Mathematical relationship between two items of the statements.
Cash Flow Statement	Statement of inflow and outflow of cash, classified into Operating / Investing / Financing.
Intra-firm Comparison	Comparing one firm's figures across years (time-series).
Inter-firm Comparison	Comparing many firms in the same period (cross-section).
Horizontal Analysis	Row-wise comparison across periods (Comparative Statement).
Vertical Analysis	Column-wise comparison within a period (Common Size Statement).

8.4 Likely Exam Questions

- **1-mark.** Define financial analysis. State any two objectives. Name any two tools.
- **3-mark.** Distinguish between Comparative and Common Size statements; or between Horizontal and Vertical analysis.
- **4-mark.** List and briefly explain the limitations of financial analysis.
- **6-mark.** Prepare a Comparative Statement of P&L from given data and write a short interpretation.
- **8-mark.** Prepare a Common Size Balance Sheet from given data and interpret the structural shifts.

Three takeaways for the exam

1. Use the *first* year as the base for Comparative % change; use *Revenue* or *Total Assets* as the base for Common Size; use the *earliest normal year* as the base for Trend analysis.
2. Always finish a numerical answer with a short *interpretation* paragraph, numbers alone do not earn the interpretation marks.
3. Verify totals: Equity & Liabilities $=$ Assets; Common Size column $=$ 100%.

Related Collegedunia Resources

Same chapter — other resources:
- NCERT Solutions
- Formula Sheet
- NCERT Book PDF
- Handwritten Notes

Continue learning:
- Ch 8: Analysis of Financial Statements
- Ch 10: Cash Flow Statement
- Class 12 Accountancy — All Chapters