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Citi Services Ltd. intends to issue debentures to public for subscription. The advisors have suggested to review the profitability since the debentures interest will have to be paid, which will effect the profit earned. The company has assigned you to do the analysis and has given the following incomplete information for two years of Statement of Profit & Loss:

Particulars		Note	Absolute Amounts		Percentage of Revenue from	
		110.			Operations (Net Sales)	
			31st March,	31st March,	31st March,	31st March,
			2022 (₹)	2023 (₹)	2022 (%)	2023 (%)
I.	Revenue from Operations (Net Sales)		20,00,000	25,00,000	100.00	100.00
II.	Expenses					
	(a) Purchases of Stock-in-Trade		14,40,000	?	72.00	69.60
	(b) Change in Inventories of Stock-in-Trade		60,000	(40,000)	3.00	(1.60)
	(c) Depreciation Expenses		40,000	?	2.00	2.40
	(d) Other Expenses		60,000	?	3.00	4.00
	Total Expenses		16,00,000	18,60,000	?	74.40
III.	Profit before Tax (I – II)		4,00,000	6,40,000	20.00	25.60
IV.	Less: Income Tax		1,20,000	?	6.00	7.68
V.	Profit after Tax (III – IV)		2,80,000	?	14.00	17.92

You are to do the analysis explaining the reason for your observations.

Answer

The data given by the company being incomplete shall have to be completed first both in terms of absolute amounts and percentage so that complete Statement of Profit & Loss is before us to do the analysis. Since the focus is on profitability, we shall be computing Gross Profit Ratio, Operating Ratio, Operating Profit Ratio and Net Profit Ratio. Thereafter, comments shall be made on the basis of above calculations.

Completed Common Size Statement of Profit & Loss is as follows:

Particulars		Note No.	Absolute Amounts		Percentage of Revenue from Operations (Net Sales)	
			31st March,	31st March,	31st March,	31st March,
			2022 (₹)	2023 (₹)	2022 (%)	2023 (%)
I.	. Revenue from Operations (Net Sales)		20,00,000	25,00,000	100.00	100.00
II.	Expenses					
	(a) Purchases of Stock-in-Trade		14,40,000	17,40,000	72.00	69.60
	(b) Change in Inventories of Stock-in-Trade		60,000	(40,000)	3.00	(1.60)
	(c) Depreciation Expenses		40,000	60,000	2.00	2.40
	(d) Other Expenses		60,000	1,00,000	3.00	4.00
	Total Expenses		16,00,000	18,60,000	80.00	74.40
III.	Profit before Tax (I – II)		4,00,000	6,40,000	20.00	25.60
IV.	Less: Income Tax		1,20,000	1,92,000	6.00	7.68
V.	Profit after Tax (III – IV)		2,80,000	4,48,000	14.00	17.92

Calculation of Ratios

(i) Gross Profit Ratio

Gross Profit = Revenue from Operations – Cost of Revenue from Operations (Direct Cost) or Cost of Goods Sold (COGS)

		Year ended 31st March,			
		2022	2023		
Revenue from Operations	=	₹20,00,000	25,00,000		
Cost of Revenue from Operations or Direct Cost		₹15,00,000	17,00,000		
or Cost of Goods Sold (COGS)		(₹ 14,40,000 + ₹ 60,000)	(₹ 17,40,000 – ₹ 40,000)		
Gross Profit (Revenue from Operations less					
Cost of Revenue from Operations)	=	₹ 5,00,000	₹ 8,00,000		
$Gross Profit Ratio = \frac{Gross Profit \times 100}{Revenue from Operations}$	=	25%	32%		

(ii) Operating Ratio

Operating Patio -	Operating Cost × 100			
	Revenue from Operations			
Operating Cost		=	₹ 16,00,000	₹18,60,000
Therefore, Operating Ratio		_	₹ 16,00,000 × 100	₹ 18,60,000 × 100
		_	₹ 20,00,000	₹ 25,00,000
		=	80%	74.40%

Note: In the absence of Non – trading Expenses being not given, Other Expenses are taken as Operating Expenses.

(iii) Operating Profit Ratio

Operating Profit = Revenue from Operations - Operating Cost

Operating Cost = Cost of Revenue from Operations + Operating Expenses

	Operating Profit Ratio - Operating Profit × 10	Operating Profit × 100		₹ 6,40,000 × 100 ₹ 25,00,000	
	Revenue from Operation		₹ 20,00,000		
		=	20%	25.6%	
	Alternatively				
	Operating Profit Ratio = 100 – Operating Ratio)			
	Therefore, Operating Profit Ratio	=	100 - 80 = 20%	100 - 74.4 = 25.6%	
(iv)	Net Profit Ratio				
	Net Profit = Net Profit after Tax (Given)	=	₹2,80,000	₹ 4,48,000	
	Net Profit Ratio = $\frac{\text{Net Profit after Tax} \times 100}{\text{Revenue from Operations}}$	=	14%	17.92%	

Various ratios calculated are tabulated below:

Ratios	31st March, 2022 (%)	31st March, 2023 (%)
Gross Profit Ratio	25	32.00
Operating Ratio	80	74.40
Operating Profit Ratio	20	25.60
Net Profit Ratio	14	17.92

All the Profitability ratios calculated above show improved performance in the year ended 31st March, 2023 as compared to results of the year ended 31st March, 2022.

Gross Profit Ratio has increased by 7%. It means better sales realisation or lower operating cost or it is the result of both the factors, *i.e.*, higher sales realisation and lower Operating Cost. The calculations indicate that improved Gross Profit Ratio is mainly because of lower Operating Cost which has reduced by 5.60% from 80% to 74.4%. As a result of this Operating Profit Ratio has improved by 5.60%.

Net Profit Ratio has not increased by the same percentage as Gross Profit Ratio because of higher tax for the year ended 31st March, 2023 which increased by 1.78%.

Summarising the above, the company's performance has improved on all accounts.