

**Course
&
Test Series**

Advance Accounting - Module 15

 **CBSE**

 **ICSE**

 **NTSE**

 **Banking & Insurance**

 **Central Govt. Service**

 **State Govt. Services**

 **LAW Entrance**

 **MBA Entrance**

 **Railways & Metro Services**

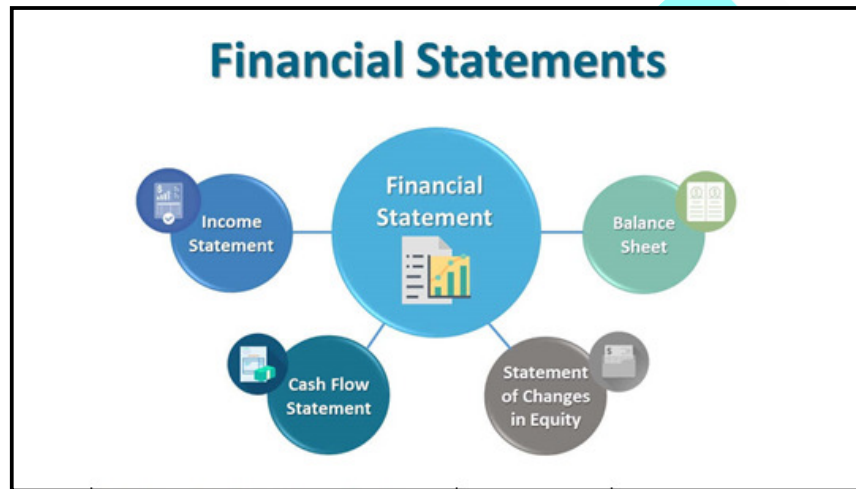
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Analysis of Financial Statements

Financial Statements: The three main types of financial statements are the balance sheet, the income statement, and the cash flow statement.

- These three statements together show the assets and liabilities of a business, revenues, and costs, as well as its cash flows from operating, investing, and financing activities.



Analysis of Financial Statements is the process of examining a company's financial documents to understand its overall financial health and make informed decisions. These documents include things like the balance sheet, income statement, and cash flow statement, which show how much money a company has, how much it owes, how much it earns, and how it spends its money. This analysis helps investors, managers, and others understand how well a company is doing and make decisions about the future.

Key Concepts of Financial Statement Analysis:

1. Tools of Analysis of Financial Statements:

- Various tools and techniques like ratio analysis, trend analysis, and comparative analysis are used to assess a company's performance and financial position.

2. Limitations of Financial Analysis:

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○ Financial analysis has its limits, such as relying on historical data, not considering market conditions, and sometimes being subject to different accounting practices.

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Significance of Financial Analysis:

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Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationships between the various items of the balance sheet and the statement of profit and loss.

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Financial analysis can be undertaken by management of the firm, or by parties outside the firm, viz., owners, trade creditors, lenders, investors, labour unions, analysts and others. The nature of analysis will differ depending on the purpose of the analyst.

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A technique frequently used by an analyst need not necessarily serve the purpose of other analysts because of the difference in the interests of the analysts. Financial analysis is useful and significant to different users in the following ways:

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Management: Helps company leaders understand if they are using resources efficiently, how well the company is performing, and where they might need to improve.

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Finance manager: Financial analysis focusses on the facts and relationships related to managerial performance, corporate efficiency, financial strengths and weaknesses and creditworthiness of the company.

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- A finance manager must be well-equipped with the different tools of analysis to make rational decisions for the firm. The tools for analysis help in studying accounting data so as to determine the continuity of the operating policies, investment value of the business, credit ratings and testing the efficiency of operations.

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- The techniques are equally important in the area of financial control, enabling the finance manager to make constant reviews of the actual financial operations of the firm to analyse the causes of major deviations, which may help in corrective action wherever indicated.

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Top management: The importance of financial analysis is not limited to the finance manager alone. It has a broad scope which includes top management in general and other functional managers.

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- Management of the firm would be interested in every aspect of the financial analysis. It is their overall responsibility to see that the resources of the firm are used most efficiently and that the firm's financial condition is sound.
- Financial analysis helps the management in measuring the success of the company's operations, appraising the individual's performance and evaluating the system of internal control

Trade Payables: These are the companies or people the business owes money to. They look at financial statements to see if the company can pay its short-term debts and if it will be able to continue doing so in the future.

Lenders: These are the banks or other institutions that have given long-term loans to the company. They are interested in whether the company can continue to make profits and pay back the loans with interest over time.

Labour Unions: These groups represent the workers. They look at financial statements to see if the company can afford to raise wages or improve working conditions.

