HOW FINANCIAL STATEMENT ANALYSIS HELPS BUSINESS GROW

Financialstatement analysisrequires a high level of analytical, problem-solving & technical skills. Accountants who are able to provide detailed, quality statement analysis can bring short- and long-term benefits to business, making them a valuable asset to an organization's financial ventures.

WHAT IS FINANCIAL STATEMENT ANALYSIS?

Financial statement analysis, according to Accounting Tools, involves gaining an understanding of an organization's financial situation by reviewing its financial statements.

FINANCIAL STATEMENTS

Usually include the following contents:

- Balance Sheet
- Income Statement
- Statement of Cash Flows
- Supplementary notes

EXTERNAL ANALYSIS

Conducted by outsiders who have access to already published financial statements. Individuals can include:

- Investors
- Creditors
- Government agencies
- Credit agencies
- General Public

INTERNAL ANALYSIS

Conducted by individuals with access to the internal accounting records of a business firm such as:

- Employees
- Executives
- Government agencies

SHORT-TERM ANALYSIS

Considers the firm's liquidity, or ability to pay short-term debts

LONG-TERM ANALYSIS

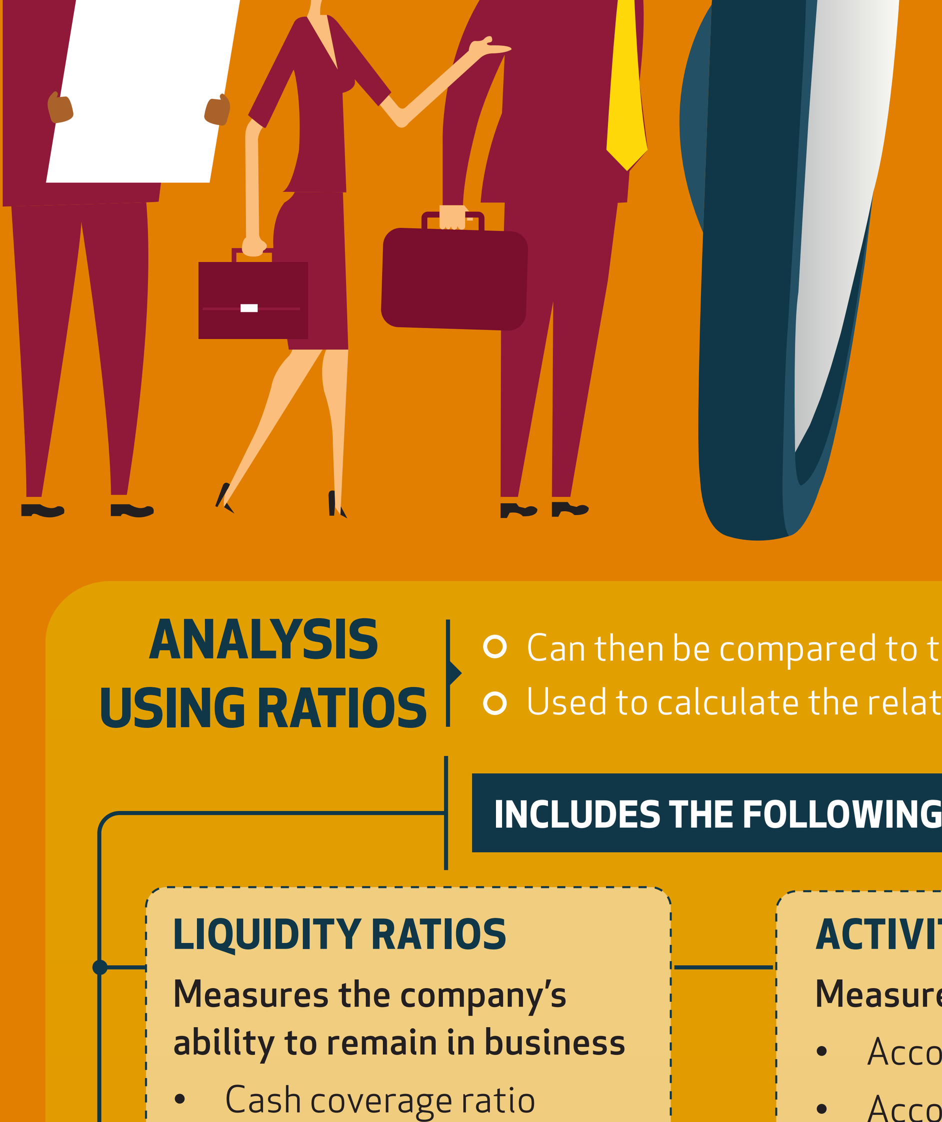
Considers the firm's solvency, or ability to pay long-term debts

TOOLS OR TECHNIQUES USED IN FINANCIAL ANALYSIS:

- Comparative Statement Analysis
- Common-size Statement Analysis
- Trend Analysis
- Fund Flow Analysis
- Cash Flow Analysis
- Net working capital Analysis or Statement Changes in working capital
- Cost Volume Profit Analysis

METHODS OF FINANCIAL STATEMENT ANALYSIS

Financial statement analysis can be broken down into two methods: Horizontal and Vertical analysis, or analysis that uses ratios.



HORIZONTAL ANALYSIS

- Involves comparing financial information over a series of reporting periods
- A base year is chosen as a beginning point for future comparison

VERTICAL ANALYSIS

- Involves a proportional analysis of a financial statement in which every line item is listed as a percentage of another item
- A base is chosen to compare figures of the same year's statement
- Used alongside horizontal analysis, rather than an alternative

ANALYSIS USING RATIOS

- Can then be compared to the ratio for a prior period
- Used to calculate the relative size of one figure in relation to another

INCLUDES THE FOLLOWING CATEGORIES OF RATIOS:

LIQUIDITY RATIOS

Measures the company's ability to remain in business

- Cash coverage ratio
- Current ratio
- Quick ratio
- Liquidity index

ACTIVITY RATIOS

Measures management's performance and quality

- Accounts payable turnover ratio
- Accounts receivable turnover ratio
- Fixed asset turnover ratio
- Inventory turnover ratio
- Sales to working capital ratio
- Working capital turnover ratio

LEVERAGE RATIOS

Measures company's reliance on debt to finance operations

- Fixed charge coverage
- Debt to equity ratio
- Debt service coverage ratio

PROFITABILITY RATIOS

Measures the company's ability to generate profit

- Contribution margin ratio
- Breakeven point
- Margin of safety
- Gross profit ratio
- Net profit ratio
- Return on equity
- Return on net assets
- Return on operating assets

BENEFITS OF ACCURATE FINANCIAL STATEMENT ANALYSIS

Financial Statement Analysis is essential for not only complying with business laws and regulations, but also to meet the needs of various parties and stakeholders. However, conducting accurate financial statement analysis relies on more than following best accounting practices and requires developing skills and intuition.

BENEFITS OF FINANCIAL STATEMENT ANALYSIS

INVESTING DECISIONS

Both internal and external stakeholders should have the opportunity to make an informed decision regarding investing

LENDING DECISIONS

Lending institutions need an unbiased view of a business's financial health

CORPORATE GOVERNANCE

Management and top executives rely on accounting for an accurate depiction of the effects of their decisions and resulting progress.

4 TIPS TO CONDUCTING ACCURATE FINANCIAL STATEMENT ANALYSIS

1 MAINTAIN OBJECTIVITY

Decisions should be based on more than numbers on financial statements

Accountants should also consider intangible variables

EXAMPLE
Employee satisfaction should be considered when planning future financial expenditures

2 AVOID DEVELOPING A FALSE SENSE OF SECURITY

Financial statements can show that the business is stable and profitable

However accountants should also use real-time observations of business activities

EXAMPLE
A dwindling inventory that cannot be easily replaced could be a big challenge in the future

3 STAY FOCUSED ON RELEVANCE

Financial information should be analyzed in light of recent trends

EXAMPLE
A trend favoring a company's product may show higher sales, but won't necessarily provide an accurate comparison to the company's competition

4 TRUST INTUITION

The decision to invest in products should be based on more than numbers

EXAMPLE
Past success anticipating trends should be considered when making future investments

CONCLUSION:

Business growth—regardless of industry—is dependent on timely and accurate analysis of financial statements. The rapid pace of business today is placing greater value on the insights gleaned by accountants. However, developing knowledge will be key to growing a business. A Master's degree in Accounting will serve as a valuable stepping stone for professionals interested in pursuing a career that will make a measurable impact on businesses, investors, and consumers.

SOURCES:
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