

Analysis of Financial Statement by using the Technique of ratio analysis

Abstract

Financial statements are summaries of the operating, financing, and investment activities of a business. Financial statements should provide information useful to both investors and creditors in making credit, investment, and other business decisions.

And this usefulness means that investors and creditors can use these statements to predict, compare, and evaluate the amount, timing, and uncertainty of potential cash flows. In other words, financial statements provide the information needed to assess a company's future earnings and therefore the cash flows expected to result from those earnings. In this chapter, we discuss the four basic financial statements: the balance sheet, the income statement, the statement of cash flows, and the statement of shareholders' equity.

The accounting data in financial statements are prepared by the firm's management according to a set of standards, referred to as generally accepted accounting principles (GAAP). The financial statements of a company whose stock is publicly traded must, by law, be audited at least annually by independent public accountants (i.e., accountants who are not employees of the firm). In such an audit, the accountants examine the financial statements and the data from which these statements are prepared and attest—through the published auditor's opinion—that these statements have been prepared according to GAAP. The auditor's opinion focuses on whether the statements conform to GAAP and that there is adequate disclosure of any material change in accounting principles.

Objectives

1. First type is the primary data which was collected personally to be used and studied to prepare and reach the objectives already mentioned.
2. The secondary data which was already prepared so these data was only used to reach the aims and objectives of this project. These data has been collected from the financial reports of the company.

How the data was collected

The sources of collecting the primary data was through interviews, observation and questionnaire, however the secondary one was collected from the financial statements already available to the employees of the company and some of which was published.

A) Questionnaire:

This method of data collection is quite popular. In this method a questionnaire – which consists a set of questions in a definite form -is send to the person concerned with a request to answer the questions and return the questionnaire. The respondents have to answer the questions on their own.

B) Personal Interview:

Personal Interview method requires a person known as the interviewer asking questions generally in a face to face contact to the other person or persons.

C) Printed and Digital Sources:

The secondary data I collected was through the study of the financial statements already existed in the company in form of printed files or digital files reserved in the company for further references. I had chosen these files because of the reliability and suitability of these information which I was also sure about the accuracy of them.

These files consist of:

1. Annual report of the company
2. Financial balance sheets
3. Income statements
4. Financial reports
5. Different reports prepared by Finance Department

Introduction

Ratio analysis is such a significant technique for financial analysis. It indicates relation of two mathematical expressions and the relationship between two or more things. Financial ratio is a ratio of selected values on an enterprise's financial statement.

There are many standard ratios used to evaluate the overall financial condition of a corporation or other organization. Financial ratios are used by managers within a firm, by current and potential stockholders of a firm, and by a firm's creditor. Financial analysts use financial ratios to compare the strengths and weaknesses in various companies.

Values used in calculating financial ratios are taken from balance sheet, income statement and the cash flow of company, besides Ratios are always expressed as a decimal values, such as 0.10, or the equivalent percent value, such as 10%.

Essence of ratio analysis:

Financial ratio analysis helps us to understand how profitable a business is, if it has enough money to pay debts and we can even tell whether its shareholders could be happy or not.

Financial ratios allow for comparisons:

1. between companies

2. between industries
3. between different time periods for one company
4. between a single company and its industry average

To evaluate the performance of one firm, its current ratios will be compared with its past ratios. When financial ratios over a period of time are compared, it is called time series or trend analysis. It gives an indication of changes and reflects whether the firm's financial performance has improved or deteriorated or remained the same over that period of time. It is not the simply changes that has to be determined, but more importantly it must be recognized that why those ratios have changed. Because those changes might be result of changes in the accounting polices without material change in the firm's performances.

Another method is to compare ratios of one firm with another firm in the same industry at the same point in time. This comparison is known as the cross sectional analysis. It might be more useful to select some competitors which have similar operations and compare their ratios with the firm's. This comparison shows the relative financial position and performance of the firm. Since it is so easy to find the financial statements of similar firms through publications or Medias this type of analysis can be performed so easily.

To determine the financial condition and performance of a firm, its ratios may be compared with average ratios of the industry to which the firm belongs. This method is known as the industry analysis that helps to ascertain the financial standing and capability of the firm in the industry to which it belongs.

Industry ratios are important standards in view of the fact that each industry has its own characteristics, which influence the financial and operating relationships. But there are certain practical difficulties for this method. First finding average ratios for the industries is such a headache and difficult. Second, industries include companies of weak and strong so the averages include them also. Sometimes spread may be so wide that the average may be little utility. Third, the average may be meaningless and the comparison not possible if the firms with in the same industry widely differ in their accounting policies and practices. However if it can be standardized and extremely strong and extremely weak firms be eliminated then the industry ratios will be very useful.

What does ratio analysis tell us?

After such a discussion and mentioning that these ratios are one of the most important tools that is used in finance and that almost every business does and calculate these ratios, it is logical to express that how come these calculations are of so importance.

What are the points that those ratios put light on them? And how can these numbers help us in performing the task of management?

The answer to these questions is: We can use ratio analysis to tell us whether the business

1. is profitable
2. has enough money to pay its bills and debts
3. could be paying its employees higher wages, remuneration or so on
4. is able to pay its taxes
5. is using its assets efficiently or not
6. has a gearing problem or everything is fine
7. is a candidate for being bought by another company or investor

Reference :

- Financial Management by Prasanna Chandra
- www.indiainfoline.com
- www.geojit.com
- www.icicidirect.com
- www.moneycontrol.com
- www.nseindia.com
- www.bseindia.com
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