

Introduction

The emergence of **financial analysis** began during the **global recession of the 1930s**, when many projects faced financial failure, liquidation, or reorganization.

Analyzing the **financial position** of an enterprise involves studying four sub-areas:

1. **Funding decisions**
2. **Investment decisions**
3. **Liquidity analysis**
4. **Profitability analysis**

Investors need financial statements to know the **history, current situation, and future expectations** of the enterprise.

The **CFO** also uses them to study the **sources and uses of funds** and to ensure their **appropriateness**.

Financial analysis helps determine whether the enterprise achieves a **return consistent with its level of risk**, enabling the investor to make a **rational investment decision**.

1. Financial Statements Used in Financial Analysis

There are **four types** of financial statements used for **internal and external analysis**:

1. **Operating Calculation:** Shows the **cost of industrial production** and **finished goods** over a period.
2. **Trading Account:** Determines the **final result of trading operations** during the period.
3. **Profit and Loss Account (Income Statement):** Shows **sales, costs, expenses, revenues, and net distributable profit**.
4. **Budget (Financial Position Statement):** Lists **assets and liabilities** at a specific date.

Usually, analysis focuses on two main lists:

- **List of Business Results**
- **List of Budgets**

From the viewpoint of financial analysis, **current assets and balances** are placed on the **asset side**, followed by **fixed and intangible assets**; while **liabilities** are divided into **current liabilities** and **credits due within a year**.

Financial analysis depends on **historical data** to reveal the **strengths and weaknesses** of the project's financial position.

2. What is Financial Analysis?

Financial analysis is a **technical process** that examines financial statements and data of an enterprise over time to **deduce information** about its progress and to **predict future outcomes**.

Although it is widely practiced, it is often done **superficially**, without the **analytical depth** needed for useful results.

A **financial analyst** must find **interdependence** between different elements and understand the **scientific basis** of **project management**.

The **aim** of financial analysis is to assess the **relationship between financial decisions and their consequences**, ensuring that the entity achieves its **planned objectives** through **sound financial decisions** in **finance and investment**.

The **financial position** under analysis includes:

- A set of financial decisions
- A set of financial goals or results

There is a **reciprocal relationship** between them: **sound financial decisions** lead to achieving **planned objectives**, and these objectives guide **decision-makers** in choosing the right **financial actions**.

Financial analysis reviews **companies, programs, expenditures, and other activities** to assess **performance and appropriateness**. It is used to determine whether an enterprise is **stable, solvent, liquid, or competitive** enough to warrant **monetary investment**.

3. Significance of Analysis of Financial Statements

Financial analysis identifies the **financial strengths and weaknesses** of a firm by establishing **relationships** between items in the **balance sheet** and **profit and loss statement**. It can be performed by **management** or **external parties** such as owners, creditors, lenders, investors, labor unions, and analysts.

Each analyst may have **different objectives**, depending on their purpose.

Importance for different users:

- **(a) Finance Manager:**
Focuses on **managerial performance, corporate efficiency, financial strengths, weaknesses, and creditworthiness**.
Financial tools help study **accounting data**, assess **operating policies, investment value, credit ratings, and efficiency of operations**.
Techniques also aid in **financial control** by analyzing **deviations** and taking **corrective actions**.

- **(b) Top Management:**

Financial analysis helps ensure that **resources** are used **efficiently** and that the firm's **financial condition** is **sound**.

- **(c) Lenders:**

Concerned with **long-term solvency and survival**. They analyze **profitability, cash generation, interest payment, and principal repayment** capabilities, along with **fund sources** to assess **future solvency**.

- **(d) Investors:**

Interested in the **firm's earnings, present and future profitability, and capital structure** to evaluate **risk and return**. They also assess **management efficiency** and decide whether a **change** is needed.

4. Tools of Analysis of Financial Statements

1. **Comparative Statements:**

Compare financial results of different periods side by side to identify changes in profitability and financial position, ensuring consistent accounting methods.

2. **Common Size Statements:**

Show each item as a percentage of a base figure (like total assets or sales) for easy comparison between years or companies.

3. **Trend Analysis:**

Examines percentage changes in financial data over several years to reveal upward, downward, or stable trends and assess management performance.

4. **Ratio Analysis:**

Evaluates relationships between financial statement items to measure profitability, solvency, and operational efficiency.

5. **Cash Flow Analysis:**

Tracks cash inflows and outflows to determine net cash flow, showing how cash is generated and used during a specific period.