SCHOOL OF STUDIES IN COMMERCE

VIKRAM UNIVERSITY, UJJAIN (M.P.)

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SUBJECT : PROJECT MANAGEMENT

TOPIC : FINANCIAL ANALYSIS

TEACHER'S NAME : DR. KAYNAT TAWAR

TOPICS

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INTRODUCTION

The success of an enterprise depends upon the entrepreneur doing the right thing at the right time. Starting a new venture is a very challenging and rewarding task. A businessman has to take numerous decisions, right from the conception of a business idea, upon the start of production. Hence, the identification of the project to be undertaken, requires an analysis of the project in depth. Therefore, a financial analysis of the project has to be undertaken.

Financial analysis is defined as the process of discovering economic facts about an enterprise and/or a project on the basis of an interpretation of financial data. Financial analysis also seeks to look at the capital cost, operations cost and operating revenue. The analysis decisively establishes a relationship between the various factors of a project and helps in maneuvering the project's activities. It also serves as a common measure of value for obtaining a clear-cut understanding about the project from the financial point of view.

An analysis of several financial tools provide an important basis for valuing securities and appraising managerial programmes. Financial analysis is vital in the interpretation of financial statements. It can provide an insight into two important areas of management— return on investment and soundness of the company's financial position.

Internal management accounts provide information which is valuable for the purpose of control. The information is made available in the form of accounting data, which may be manifested as financial and accounting statements. A financial analysis reveals where the company stands with respect to profitability, liquidity, leverage and an efficient use of its assets. Financial reports provide the framework within which business planning takes place. They are the key through which an effective control of a business enterprise is exercised. It is the process of determining the significant financial characteristics of a firm. It may be external or internal. The external analysis is performed by creditors, stockholders and investment analysis. The internal analysis is performed by various departments of a firm.

SIGNIFICANCE OF FINANCIAL ANALYSIS

Financial analysis primarily deals with the interpretation of the data incorporated in the proforma financial statements of a project and the presentation of the data in a form in which it can be utilized for a comparative appraisal of the projects. It is, in effect, concerned with the development of the financial profile of the project. Its purpose is to find out whether the project is attractive enough to secure funds needed for its various constituent activities and once having secured the funds, whether the project will be able to generate enough economic values to achieve the objectives for which it is sought to be implemented. It deals not only with the financial aspects of a project but also with its operational aspects. As such, it is necessary to undertake such an analysis not only in the case of industrial projects but also in the case of non-industrial projects.

Analysis of financial statements has become very significant due to the widespread interest of various parties in the financial results of a company. In recent years, the ownership of capital of most public companies has become broad-based. A number of parties and bodies, including creditors, potential suppliers, debenture-holders, credit institutions like banks, industrial finance corporations, potential investors, employees, trade unions, important customers, economists, investment analysts, taxation authorities and government have a stake in the financial results of a company. Various people look at the financial statements from various angles. A number of techniques have been developed to undertake analysis of financial statements in order to reach conclusions about the financial health, profitability and efficiency of an enterprise and also to compare an enterprise with other similar undertakings. The technique of ratio analysis is the most important tool of financial analysis. It helps in comparing the performance of various companies and judge their financial soundness.

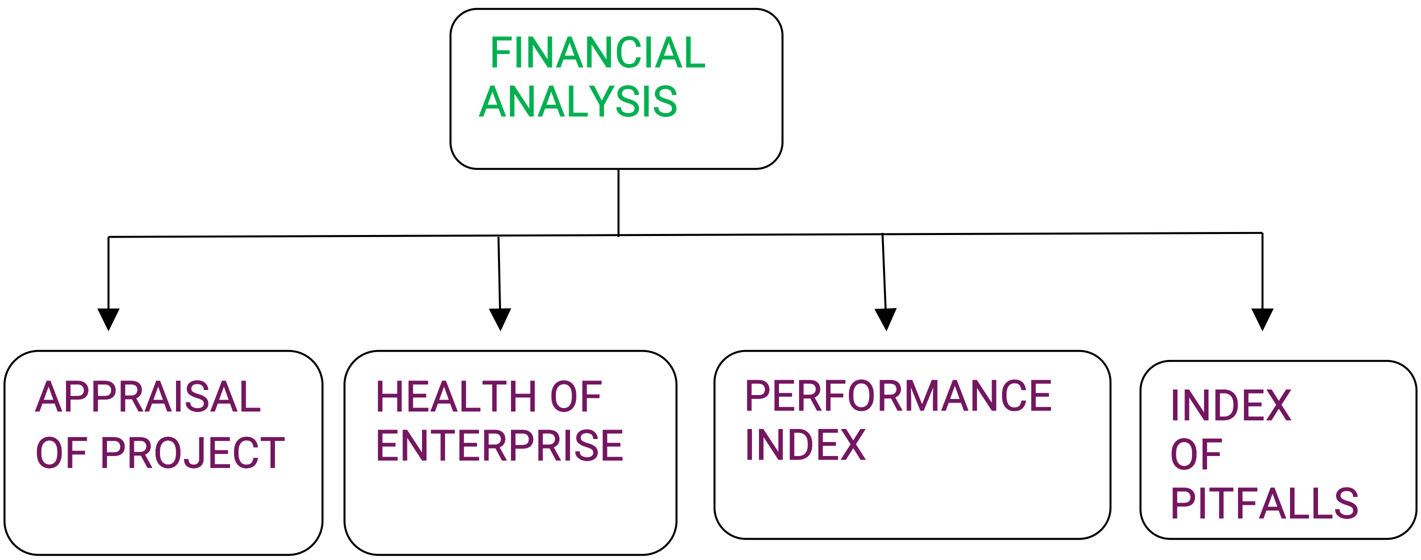

Fig. 1. Utility of financial analysis

UTILITY OF FINANCIAL AND ACCOUNTING STATEMENTS

Financial statements play a vital role in the internal financial control of an enterprise. These should, therefore, the properly constructed, analyzed and interpreted by executives, bankers, creditors and investors.

The entire future of a company hinges on the manager's ability to decide relevant financial data with a view to planning profit ability moves. Learning to read financial statements is the first essential element in any businessman's attempt to acquire financial management skills. The change in the elitism of stock ownership to broad public ownership has necessitated a concomitant change in the entire process of reporting corporate financial results. The role of management in the matter of preparation of financial statements is to add understanding to these statements, the fairness of which is to be viewed through the eye of the user, while that of the accountant is to close the communication gap and of the auditor to add credibility to them. For evolving a good economic information system, accounting innovations are of great economic information system. Without these, communication with the financial community would be difficult, the interest of present and future potential investors would not be served, the ability of the company to raise additional capital would be impaired and the government's regulatory measures and policies would not serve the best interest of society. Though a financial statement reveals less than it conceals, it provides the indicators of the enterprise's performance during the year.

Financial analysis seeks to spotlight the significant facts and relationships concerning managerial performance, viz., corporate efficiency, financial strengths and weaknesses and creditworthiness of the enterprise.

SUMMARY

Financial analysis seeks to look at the operating cost, operating revenue and capital cost. The purpose of financial analysis is to find out whether the project is attraction enough to secure funds needed for its various constituent activities and once having secured the funds, whether the project will be able to generate enough economic values to achieve the objectives for which it is sought to be implemented. The future of a company depends on the manager’s ability to decide relevant financial data with a view to profitability planning. A financial statement reveals less than it conceals, it provides the indicators of the performance of the enterprise during the year.

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