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## Financial analysis overview

Financial analysis involves the investigation of financial information in your business. Unless you have experience with financial statements, or unless you are an accountant or similar professional business person, then it is best to leave the financial analysis of your business to your advisers.

Many businesses do not give much attention to the analysis of their financial position. This is usually because the owner is either too involved in the day-to-day operation, which includes giving priority to sales and to payment of accounts, leaving little time for sound analysis. If you are concerned with improving the performance of your business, then you will give financial analysis some emphasis. It will show you how your business is doing and how you can improve it.

The analysis involves an investigation of the financial statements such as profit and loss accounts, balance sheets, cash flow statements and other financial records. By using such things as financial ratios and plotting trends, the business is able to monitor progress and have comparison of the financial figures with past years and with future projections.

### What are financial statements?

As a business owner you need to understand the financial situation of your business at any time. You need to know what is happening and the reasons why it is happening, so that you can put into place necessary changes to reverse the situation. Analysis generally involves the following main financial statements:

**Balance Sheet:** A balance sheet is simply a list of all the balances of the assets and liabilities of the business. When liabilities are deducted from assets, this will equal what is known as the net worth of the business.

**Profit and Loss Statement:** This is a statement that records the income of the business (whether all received or not), as well as the expenses of the business (whether all paid or not). It determines what the profit or loss of the operation is for a particular period by deducting all costs from income.

**Cash Flow Projection:** cash flow has nothing to do with income or expenses but has everything to do with cash flowing in and cash flowing out. Cash flow has nothing to do with profit, they are two different concepts. Cash flow is concerned mainly with the cash balance at the end of a particular period, for example, every month. This is calculated by taking into account the cash that was in at the beginning, adding on the cash that has come in during that period and taking off all the cash that has been paid out during that period. The remaining figure is the end balance which should correspond with the cash that the business has in its bank account or outside its bank account.

### What are financial ratios?

Financial ratios are tools that can be used to help you make a lot of sense out of the financial statements. They are generally used to highlight a particular situation so that decisions can be made. The comparison of the ratios from period to period will determine trends.



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The comparison of ratios to industry statistics will also provide benchmark information.

If the business owner discovers that the ratio is on a negative trend or is not a good benchmark, then strategies can be put into place immediately to improve the operations.

Some common ratios include:

- **Liquidity ratios** – which measure the amount of cash that is available at any time.
- **Profitability ratios** – which measure the profit margins generated, and return on assets and sales.
- **Efficiency ratios** – these highlight such things as the turnover rate of the stock and age of debtors etc. They give you a fair indication of how well your business is being run.

In all cases consult a professional if this is an area that you are not familiar with.

## Further information

The following fact sheets provide further information on these issues:

- Accounting records you should keep
- Balanced scorecard
- Balance sheet ratios
- Break-even point
- Cash flows
- Financial ratios
- Profit and loss ratios