

Analyzing Year End Financial Reports to Evaluate the Business

Objectives:

- The student will describe five key factors of year end financial analysis
- The student will use sound guidelines to interpret financial data.
- The student will list and describe three important financial statements necessary to complete a statement of owner's equity and analyze a business.

Five key factors of year end financial analysis

1. Liquidity

- Ability to convert assets to cash to meet financial obligation without disrupting the business
- Primarily measured with the balance sheet using current assets and current liabilities

2. Solvency

- Ability of a business to pay all debts
- Primarily measured with the balance sheet using current assets and current liabilities

3. Profitability

- How a business generates profit or net income from labor, management, and capital
- Primarily measured using revenue and expense information on the income statement

4. Repayment Capacity

- Ability of a business to repay term debt using net income from operation
- Primarily measured using data from the income statement

5. Financial Efficiency

- Measures how efficient labor, management, and capital were used.
- Gross revenue is the primary figure used in measuring financial efficiency

Financial data can be calculated and compared with

- Historical information – data from prior years
- Current data – from this production year
- Projected figures – based on estimated costs and returns

To analyze financial calculations, a business owner can:

- Compare and cross reference financial reports with each other
- Compare the same report and calculations over multiple years

- Compare one business to another business that is similar in size and type
- Compare the business to a completely different business
- Compare financial data to industry standards and benchmarks to determine strengths and weaknesses

Three financial statements are necessary to complete a statement of owner's equity

1. Cash Flows
2. Balance Sheet
3. Profit/Loss (Income) Statement

Cash Flow Statement

- A projected budget of all the financial transactions to be incurred throughout the year
- Normally planned on a monthly basis

Statement of Cash Flows

➤ An analysis and planning tool that organizes information into:

1) Operating activities

2) Investing activities

3) Financing activities

Balance Sheet

- Measures the financial condition of a business at a specific point in time
- A balance sheet totals assets and liabilities, determines net worth, and is used to calculate financial ratios and figures that measure a business

Profit/Loss (Income) Statement

- Used to determine the profit or loss of a business and explain changes in net worth
- Summarizes the income and expense over a given period of time

What is the main purpose of the Statement of Owner's Equity?

- Reconciling or verifying the accuracy of change in net worth and net income with the balance sheet, income statement, and statement of cash flows.