

Procedure for Analysis and Interpretation

To make an effective analysis and interpretation of financial statements, the following groundwork are required to be completed.

1. The objectives of financial statement analysis is the basis for the selection of techniques of analysis. Hence, the organization should decide the purpose of financial statement analysis.

2. The extent of interpretation is also decided to select right type of techniques of financial statement analysis.

3. The financial statements are prepared on certain assumptions, principles and practices which are ascertained to understand their significance.

Objectives of Analysis and Interpretation

Many interested parties of financial statements are analyzed and interpreted according to their varied objectives. In spite of the variations in the objectives of analysis and interpretation by various classes of people, there are some common objectives of interpretation which are presented below.

1. To **examine the earning capacity and efficiency** of various business activities with the help of income statements.
2. To **measure the managerial efficiency** under various business situations.
3. To **estimate the performance evaluation** of different departments over a period of time.

4. To **measure short term and long term solvency position** of the business organization with the help of Balance Sheet.

5. To **examine the source of finance** and way of utilizing the available finance.

6. To **determine earning capacity** and future prospects of the business concern.

7. To **identify the way of utilizing fixed assets** and the role of fixed assets on maintaining the earning capacity of the business concern.

8. To **investigate the future potential** of the business concern.

9. To **compare operational efficiency** of similar concerns engaged in the same industry.

10. To **identify the growth trend** of the business organization.

Meaning of Analysis

Analysis means the process of splitting or broken up of the contents of financial statements into many parts for getting meaningful information at the maximum.

Meaning of Interpretation

Interpretation means explaining the meaning and significance of the rearranged and/or modified data of the financial statements.

Importance of Analysis and Interpretation

All the quantitative information i.e. financial accounting information are intelligibly analyzed and interpreted so that significant facts and relationship concerning various aspects of financial life of a business concern is known to everybody. In this way, various factors have increased the importance of the analysis and interpretation of financial statements.

1. Wrong and defective decisions are taken by the top management in the absence of analysis and interpretation.
2. Sometimes, hasty and intuitive decisions are also taken by the various responsible executives.

3. Everybody has limited experience in business activities. Hence, one can **easily understand the complexities of business activities** through analysis and interpretation.

4. If any decision is taken on the basis of intuition or conclusion derived, there is no meaning in decision and nobody understand the decision. In other words, if the decisions are **based on scientific analysis and interpretation**, everybody understand the decision very easily.

5. Analysis and interpretation are necessary to **verify and examine the correctness and accuracy of the decisions** already taken on the basis of intuition.