



Q4. State the importance of Financial Analysis?

Solution:

Financial analysis has a vast importance to various accounting users on various matters. Income statements, balance sheets and other financial data provide information about expenses, sources of income, profit or loss and help in examining the financial position of a business. These financial data are of no use until they are analysed. There are various tools and methods to analyse financial data such as ratio analysis and cash flow statements which make financial data to cater to the varying needs of various accounting users. Reasons in favour of financial analysis:

1. It assists in evaluating the profit earning capacity and financial viability of a business.
2. It assists in evaluating the long-term solvency of the business.
3. It helps in evaluating the relative financial status of a firm in comparison to other competitive firms.
4. It helps the management in the decision-making process, drafting various plans and in establishing an effective controlling system.

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