**USES & IMPORTANCE OF RATIO ANALYSIS**

**Ratios have wide applications and are of immense use today:**

#### (a) Managerial Uses of Ratio Analysis:

**1. Helps in decision-making:**

Financial statements are prepared primarily for decision-making. But the information provided in financial statements is not an end in itself and no meaningful conclusion can be drawn from these statements alone. Ratio analysis helps in making decisions from the information provided in these financial statements.

**2. Helps in financial forecasting and planning:**

Ratio Analysis is of much help in financial forecasting and planning. Planning is looking ahead and the ratios calculated for a number of years work as a guide for the future. Meaningful conclusions can be drawn for future from these ratios. Thus, ratio analysis helps in forecasting and planning.

**3. Helps in communicating:**

The financial strength and weakness of a firm are communicated in a more easy and understandable manner by the use of ratios. The information contained in the financial statements is conveyed in a meaningful manner to the one for whom it is meant. Thus, ratios help in communication and enhance the value of the financial statements.

**4. Helps in co-ordination:**

Ratios even help in co-ordination which is of utmost importance in effective business management. Better communication of efficiency and weakness of an enterprise results in better co­ordination in the enterprise.

**5. Helps in Control:**

Ratio analysis even helps in making effective control of the business. Standard ratios can be based upon proforma financial statements and variances or deviations, if any, can be found by comparing the actual with the standards so as to take a corrective action at the right time. The weaknesses or otherwise, if any, come to the knowledge of the management which helps in effective control of the business.

**6. Other Uses:**

These are so many other uses of the ratio analysis. It is an essential part of the budgetary control and standard costing. Ratios are of immense importance in the analysis and interpretation of financial statements as they bring the strength or weakness of a firm.

#### (b) Utility to Shareholders/Investors:

An investor in the company will like to assess the financial position of the concern where he is going to invest. His first interest will be the security of his investment and then a return in the form of dividend or interest. For the first purpose he will try to asses the value of fixed assets and the loans raised against them. The investor will feel satisfied only if the concern has sufficient amount of assets.

Long-term solvency ratios will help him in assessing financial position of the concern. Profitability ratios, on the other hand, will be useful to determine profitability position. Ratio analysis will be useful to the investor in making up his mind whether present financial position of the concern warrants further investment or not.

#### (c) Utility to Creditors:

The creditors or suppliers extend short-term credit to the concern. They are interested to know whether financial position of the concern warrants their payments at a specified time or not. The concern pays short- term creditor, out of its current assets. If the current assets are quite sufficient to meet current liabilities then the creditor will not hesitate in extending credit facilities. Current and acid-test ratios will give an idea about the current financial position of the concern.

#### (d) Utility to Employees:

The employees are also interested in the financial position of the concern especially profitability. Their wage increases and amount of fringe benefits are related to the volume of profits earned by the concern. The employees make use of information available in financial statements. Various profitability ratios relating to gross profit, operating profit, net profit, etc. enable employees to put forward their viewpoint for the increase of wages and other benefits.

#### (e) Utility to Government:

Government is interested to know the overall strength of the industry. Various financial statements published by industrial units are used to calculate ratios for determining short-term, long-term and overall financial position of the concerns. Profitability indexes can also be prepared with the help of ratios. Government may base its future policies on the basis of industrial information available from various units. The ratios may be used as indicators of overall financial strength of public as well as private sector, in the absence of the reliable economic information, governmental plans and policies may not prove successful.

#### (f) Tax Audit Requirements:

Section 44 AB was inserted in the Income Tax Act by the Finance Act, 1984. Under this section every assesse engaged in any business and having turnover or gross receipts exceeding Rs. 40 lakh is required to get the accounts audited by a chartered accountant and submit the tax audit report before the due date for filing the return of income under Section 139 (1). In case of a professional, a similar report is required if the gross receipts exceed Rs 10 lakh.