Financial statement and operating indicator analysis

Finance

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Financial ment analysis Financial ment analysis Describe one key insight about the difference between financial statement analysis and operating indicator analysis, and explain why both are significant

Financial statement analysis concentrates on assessing the financial condition of an organization, using information contained in the financial statements. The analysis also helps in highlighting critical relationships in financial statements, thus making it easy for users to understand financial statements.

On the other hand, operating indicator analysis explains an organization's financial performance, by utilizing operating data. Such analysis improves internal decision-making process as they depict the ability of the organization to meet its mission. It also gives a summary of the organization's detailed information, thus making it convenient for users to understand the past, as well as present performance of the organization. More to these, the information helps in predicting the growth of the company, possibility of the organization's failure, and the ability to access loan facilities. Consequent to these, the analysis plays a significant role in the management of the organization (Penner, 2004).

Select at least two types of financial ratios and explain what each could tell you about an organization's financial condition

Current ratio

This is a liquidity ratio and indicates the extent to which an organization can cover its short term liabilities by its liquid assets. It is calculated by dividing the total current assets in the organization with the total current liabilities. This ratio gauges the ability of such items as cash, cash equivalents,

receivables, and inventory to pay such liabilities as payables, accrued expenses, and taxes. Higher current assets ratio implies stronger ability of a firm to finance its short-term obligations. A lower current ratio, however, indicates a financial hardship in an organization, as it may not have the capacity to cater for its obligations as they fall due.

Total margin ratio

This ratio seeks to examine the revenue of the organization as a function of its expenses. It includes the revenues of the organization from all sources in its calculation. The ratio is usually derived by dividing the net income of the organization with the total revenue. A high ratio means that the organization can cater for its costs efficiently, and indicates profitability. On the other hand, a lower ratio indicates that an organization could be experiencing financial difficulties, and may not have the ability to give viable returns to investors (Chandra, 2010).

Discuss at least one challenge or limitation of financial statement analysis, and how users of the analysis might account for these limitations

A major challenge concerned with financial statement analysis relates to the inability of the statements to recognize the seasonal qualitative changes, which occur in the course of normal business. These changes include changes in management, government policies, as well as labor strikes. Such changes affect the financial position of the business, thus including them in the financial analysis is significant. Therefore, users of analysis should require financial analysts to assess the implications of such factors on the organization’s profitability, and report to them (“ Foundation of the American College of Healthcare Executives”, 2008).

References

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