

Financial statement analysis



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The table below illustrates a ratio analysis for two companies: Happy Hospital and St Agnes Hospital.

| | Happy Hospital | St. Agnes Hospital |
|--------------------|----------------|--------------------|
| Current Ratio | 2.89 | n/a |
| Quick Ratio | 2.63 | n/a |
| Net Margin | 6.49% | 11.56% |
| Asset Utilization | 63.56% | n/a |
| Financial Leverage | 10.22% | 86.40% |

The current ratio of Happy Hospital was 2.89 and its quick ratio was 2.63. The current ratio reveals whether a company is capable of paying its short term debt. The quick ratio has the same objective, but the measure is more sensitive since it subtracts inventory from the numerator of the formula leaving the most liquid assets available to pay the debt. The general rule is for a current ratio to be good it must be above 1.0. Both the current ratio and quick ratio of the company are excellent. The net margin of Happy Hospital is 6.49%. A net margin measures the profitability of a company. In order to determine whether a net margin is good or not one must consider the industry in which the company participates. A good database to find the industry ratios for different business industries is the Dun & Bradstreet database. If a company has a net margin that is higher than the industry standard this company is performing above the industry norm. Another element to consider is whether a company is a non-profit organization or for-profit company. The net margin in a non-profit organization is irrelevant since the strategy of the company is to break even. On the other hand for-profit organizations seek to maximize its profitability. The asset utilization of Happy Hospital was 63.56%. Firms seek to have high asset utilization because this metric illustrates how much revenues are being generated with the assets of a firm. The financial leverage of Happy Hospital is 10.22%, while the financial leverage of St. Agnes is 86.40%. The financial leverage ratios show how much debt a company is using to finance its operation. The financial leverage position of

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Happy Hospital is much lower than St. Agnes Hospital. A low debt position is a favorable sign due to the fact that lower debt lowers the interest and principal payments a firm is responsible for which allows the firm to have lower operating costs. The financial ratios of companies vary depending in the industry in which a firm operates. For instance the profitability in the supermarket industry is much lower than the profitability of the pharmaceutical industry. There are other accounting conventions that may affect numbers illustrated in the financial statements of a company.

Accountants in the United States follow the generally accepted accounting principles (GAAP) which were created by the Financial Accounting Standards Board (FASB). International accounting standards are created by the International Accounting Standards Board (IASB). In Europe accountants do not follow GAAP; instead they rely on the international financial reporting standards (IFRS). Another important consideration when comparing the financial statements of companies from different parts of the world is the currency of the country. The use of currency exchange converters allows accountants to convert money from one currency to another (Xe, 2011).

References Xe. com (2011). The World's Favorite Currency Site. Retrieved July 9, 2011 from <http://www.xe.com/>