

# [Financial ratio](https://assignbuster.com/financial-ratio/)

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1. A business form common in Europe and Canada, a limited company is a business entity wherein an investor's obligations for the debt of the company is limited to the amount he invested in it (Limited Company n. d.). Some of its accounting and finance features include:
Limited debt of investors - As stated in the definition, one of its financial features is shareholders' limited debt. Unlike sole proprietorship wherein an entrepreneur's debt could be more than what he initially invested, investors' accountability of the company debt is limited to the amount he invested.
Capacity to obtain finances through stocks - By selling shares to people outside it, a limited company can easily acquire the necessary funds for expansion and growth.
Annual disclosure of financial activities - Limited companies are required by law to submit annual accounting and financial reports to the government. This is to regulate its fiduciary activities and to protect the interests of its current and prospective investors (Limited Company 2006).
In the United States, corporations are required to submit their financial reports to the United States Securities and Exchange Commission for the regulation of their financial activities (The Investor's Advocate 2006). In terms of financial reporting, the Federal Accounting Standards Advisory Board is tasked to promulgate accounting standards in the federal government, whereas the Financial Accounting Standards Board makes sure that the financial accounting and reporting standards are enforced.
2. A Cash Flow Statement shows the cash amounts and equivalents flowing in and out of a company. It gives information to businessmen and investors regarding the current status of company operations, where the company is acquiring money and its spending habits (Heakel 2004).
The following are examples of direct and indirect method of computing Cash Flow Statements:
Cash Flow Statement (Direct Method)
ACB Corporation
Sales $I, 800
Accounts Receivable
Beginning $200
Ending 400
B - E -200
Cash received from customers 1, 600
Total operating expenses -1, 400

Depreciation 100
Inventory
Beginning 200
Ending 300
B less E -100
Accounts Payable
Ending$300
Beginning 100
E less B 200
Cash Paid to suppliers and employees -1, 300

Interest income received 20
Interest expense paid 100
Interest tax expense -120
Income taxes payable
Ending $100
Beginning$100
E less B -0-
Income taxes paid 120
Cash flow from operations 200
Purchases of Equipment -100
Proceeds from notes payable 200
Principle payments on notes payable -300

Cash Flow Statement (Indirect Method)
ACB Corporation
Net Income $200
Add: Non-cash items:
Depreciation 100
Accounts Receivable
Beginning $200
Ending 400
B less E-200
Inventory
Beginning 200
Ending300
B less E-100
Accounts Payable
Ending 300
Beginning100
E less B 200
Interest income earned 20
Interest income paid-100
Income taxes payable
Ending$100
Beginning 100
E less B--0--
Income taxes paid120
Cash flow from (used for) operations200
===
Purchases of Equipment -100
Proceeds from note payable 200
Principle payments on notes payable -300

As seen on the examples above, direct method shows the primary sources of gross cash receipts and gross cash payments, whereas in the indirect method, only the net income of the period is written down. The latter also adjusts net income for revenue items that did not give cash or expenses that does not use cash (Nurre n. d.).
3. Financial ratios are figures derived from the computations from the information given in a company's financial statements that can show the current status of a company. Through mathematics, we can objectively interpret these figures. For example if the current ratio is above 1, it implies that the company is mathematically capable of paying its financial obligations (Current Ratio n. d.). With trend analysis, we can use graphs and patterns that we form out of the graph as forecasting tools to predict future prices and business status (Trend Analysis n. d.).
Efficiency ratio is the most important financial ratios category since it explains the effective and efficient use of assets to reach the optimal productivity. Profitability of a company will be enhanced if the company assets are utilized to its optimal level. Also unwanted debts will be reduced if efficiency, as reflected by financial ratios, is realized in a company.
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