Financial ratio

Finance

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

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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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