Chapter Review

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**Chapter Review**

Financial analysis is undertaken to assist various stakeholders in taking critical decisions. Balance sheet, income statement and a statement of cash flows are used to analyze the financial performance of a venture over a period of time. A balance sheet is also called a statement of financial position because it depicts the position of a firm at a given point in time. It shows the resources of the business in the form of assets and the sources through which these resources are financed in the form of loans and equity financing. The income statement shows the effects of the day to day operations of the business on its financial position. It shows the gross and net profit earned during the year by the company. The statement of cash flows shows the sources of cash generation and where this cash has been spent. There are three separate sections in the statement of cash flows namely operating, investing and financing activities. Financial statements' analysis is performed to judge the strengths and weaknesses of the company. A common size analysis is performed when a company is compared to another company and these companies are not identical in sizes. The performance of a company can be analyzed over a period of time with the help of financial ratio analysis. Different firms prioritize different sets of ratios for performance assessment. Five major categories for ratio analysis are profitability, liquidity, activity, financing and market ratios. Profitability ratios are concerned with the performance of a company in terms of increase in profit earning capability over a period of time. Major ratios include the gross and net profit margins. Liquidity ratios show the ability of a firm to repay its short term liabilities. Major ratios include the current ratio and quick ratio. Activity ratios show how well a company is managing credit sales. The major ratio includes the accounts receivables turnover ratio. Financing ratios are used to analyze the capital structure of the company. The major ratios include the debt ratio and debt to equity ratio. Market ratios are concerned with the performance of the company’s stocks in the stock market. Major ratios include earnings per share and price earnings ratio. There should be ample care taken in analyzing a firm’s financial ratios because different ratios are useful for different companies. No one set of ratios is sufficient to depict a complete picture.