

### ***Week 3 - DQ 1***

***What are the limitations of using ratios for financial statement analysis? What are the benefits?***

#### ***Response #1 Limitations of Ratios Analysis:***

1. Limitations of financial statement analysis are based only on the information which has been recorded in the financial statements.
2. Comparative study required are useful in judging the efficiency of the business only when they are compared with the past results of the business.
3. Ratios are only indicators they should not be taken as final regarding a good or bad financial position of a business.
4. Problems of level pricing changes can affect the validity of ratios calculated for different time periods.
5. Lack of inadequate standard which means no fixed standard can be used for ideal ratios.
6. Limited use of single ratios does not convey much sense.
7. personal bias are financial analysis interpreted by different people.
8. Incomparable meaning everything differs when it comes to accounting procedures.

#### ***Advantages:***

1. Simplifies financial statements and the comprehension of the statement itself.
2. Facilitates inter-firm comparison data.
3. Helps in planning and forecasting.
4. Makes inter-firm comparison possible for the performance of different divisions within the firm itself.
5. Helps in making investment decisions.

**Response #2** Using ratios for financial statements analysis can be very difficult in comparing when different accounting policies are used by different organizations. When using ratios the figures in the accounting reports can be fixed to make the organization income statement and balance sheet look better than they really are. Also quality considerations in decision-making are ignored. On the other hand, the use of ratios for financial statement analysis can help in comparing with the competition and past figures, can be used to prepare budgets and to forecast. Ratios make things easy to calculate, easy to understand, and it also simplifies the accounting information.

**Response #3** The limitations of using ratios for financial statement analysis is they explain what factors impact the meaning of such measures and what new practices or theories may be emerging. They emphasize the practical applications and real-world of the ratios. They will include the appendices and properly cite references with are the sources of course materials, magazines, and any other place that you get the information.

**Response #4** Ratios show the relationship between items on the financial statements mathematically, in the form of a percentage or rate. One limitation of using ratios for financial statement analysis is that the ratios are based on historical cost. This can distort the measuring performance by not including fair value information. Another limitation is the comparability of different organizations in the same industry. Companies have different accounting principles and procedures and they may not be comparable to another company's principles and procedures. This is like comparing apples to oranges, which makes it impossible to compare.

***Other differences in accounting are:***

- Inventory valuation (FIFO, LIFO, average cost).
- Depreciation methods.
- Capitalization versus expense of certain costs.
- Capitalization of leases versus no capitalization.
- Investments in common stock carried at equity versus fair value.
- Differing treatments of postretirement benefit costs.
- Questionable practices of defining discontinued operations, impairments, and extraordinary items.

***References: Kieso, D.E., Weygandt, J.J., & Warfield, T.D. (2007). Intermediate accounting (12th. ed.). Hoboken, NJ: John Wiley & Sons.***