

CORPORATE FINANCE FINANCIAL STATEMENTS: BALANCE, INCOME, CASH FLOW,
AND EQUITY

Financial Statement Analysis: How It's Done, by Statement Type

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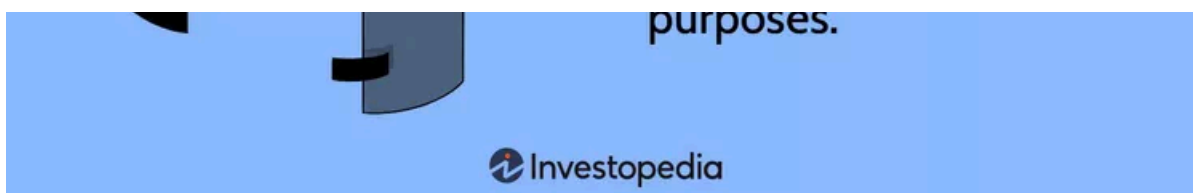


What Is Financial Statement Analysis?

understand the overall health of an organization and to evaluate financial performance and business value. Internal constituents use it as a monitoring tool for managing the finances.

KEY TAKEAWAYS

- Financial statement analysis is used by internal and external stakeholders to evaluate business performance and value.
- Financial accounting calls for all companies to create a balance sheet, income statement, and cash flow statement, which form the basis for financial statement analysis.
- Horizontal, vertical, and ratio analysis are three techniques that analysts use when analyzing financial statements.



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How to Analyze Financial Statements

past, current, and projected performance.

In general, financial statements are centered around [generally accepted accounting principles \(GAAP\)](#) in the United States. These principles require a company to create and maintain three main financial statements: the balance sheet, the income statement, and the cash flow statement. Public companies have stricter standards for financial statement reporting. Public companies must follow GAAP, which requires accrual accounting.^[1] Private companies have greater flexibility in their financial statement preparation and have the option to use either accrual or cash accounting.^[2]

Several techniques are commonly used as part of financial statement analysis. Three of the most important techniques are [horizontal analysis](#), [vertical analysis](#), and [ratio analysis](#). Horizontal analysis compares data horizontally, by analyzing values of line items across two or more years. Vertical analysis looks at the vertical effects that line items have on other parts of the business and the business's proportions. Ratio analysis uses important ratio metrics to calculate statistical relationships.

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Balance Sheet

The balance sheet is a report of a company's financial worth in terms of book value. It is broken into three parts to include a company's [assets](#), [liabilities](#), and [shareholder equity](#). Short-term assets such as cash and accounts receivable can tell a lot about a company's operational efficiency; liabilities include the company's expense arrangements and the debt capital it is paying off; and shareholder equity includes details on equity capital investments and retained earnings from periodic net income. The balance sheet must balance assets and liabilities to equal shareholder equity. This figure is considered a company's

to [operating profit](#), which subtracts indirect expenses like marketing costs, general costs, and depreciation. Finally, after deducting interest and taxes, the [net income](#) is reached.

Basic [analysis of the income statement](#) usually involves the calculation of gross profit margin, operating profit margin, and net profit margin, which each divide

Cash Flow Statement

The cash flow statement provides an overview of the company's [cash flows](#) from operating activities, investing activities, and financing activities. Net income is carried over to the cash flow statement, where it is included as the top line item for operating activities. Like its title, investing activities include cash flows involved with firm-wide investments. The financing activities section includes cash flow from both debt and equity financing. The bottom line shows how much cash a company has available.

Free Cash Flow and Other Valuation Statements

Companies and analysts also use free cash flow statements and other valuation statements to [analyze the value of a company](#). Free cash flow statements arrive at a [net present value](#) by discounting the free cash flow that a company is estimated to generate over time. Private companies may keep a valuation statement as they progress toward potentially going public.

the statement are influencing results. Finally, [ratio analysis can be used to isolate](#) some performance metrics in each statement and bring together data points across statements collectively.

Below is a breakdown of some of the most common ratio metrics:

- **Income statement:** This includes gross profit margin, operating profit margin, net profit margin, tax ratio efficiency, and interest coverage.
- **Cash flow:** This includes cash and [earnings before interest, taxes, depreciation, and amortization \(EBITDA\)](#). These metrics may be shown on a per-share basis.
- **Comprehensive:** This includes [return on assets \(ROA\)](#) and [return on equity \(ROE\)](#), along with [DuPont analysis](#).

What are the advantages of financial statement analysis?

The [main point of financial statement analysis](#) is to evaluate a company's performance or value through a company's balance sheet, income statement, or statement of cash flows. By using a number of techniques, such as horizontal, vertical, or ratio analysis, investors may develop a more nuanced picture of a company's financial profile.

What are the different types of financial statement analysis?

Most often, analysts will use three main techniques for analyzing a company's

Finally, ratio analysis, a central part of fundamental equity analysis, compares line-item data. Price-to-earnings (P/E) ratios, earnings per share, or dividend yield are examples of ratio analysis.

What is an example of financial statement analysis?

value. For instance, gross profit margin will show the difference between revenues and the cost of goods sold. If the company has a higher gross profit margin than its competitors, this may indicate a positive sign for the company. At the same time, the analyst may observe that the gross profit margin has been increasing over nine fiscal periods, applying a horizontal analysis to the company's operating trends.

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or subsidiaries associated with a single parent company. [more](#)

What Is Accrual Accounting, and How Does It Work?

Accrual accounting is where a business records revenue or expenses when a transaction occurs using the double-entry accounting method. [more](#)

Revenue Definition, Formula, Calculation, and Examples

What Is Fiscal Year-End? Definition, Examples, and vs. Calendar-Year End

The term "fiscal year-end" refers to the last day of a one-year or 12-month accounting period. It is used to calculate annual financial statements. [more](#)

What Is Diluted EPS? Definition, Formula, and Example

Diluted EPS is a performance metric used to assess a company's earnings per share if all convertible securities were exercised. [more](#)

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Accrual Accounting

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What Is Accrual Accounting, and How Does It Work?

Close-up of a businessman's hands with a pen, papers, and a

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Free Cash Flow vs. EBITDA: What's the Difference?

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