

Subject: Principles of Accounts

Topic: Accounting ratios and the interpretation of accounts

Level: S.4

Learning objectives:

1. Content

Students should be able to:

Explain what ratio analysis is used for

Define different ratios used to analyse business performance

2. Language

Students should be able to:

Use “It is used to” to write the uses of ratios used to analyse business performance

This activity was produced by a teacher of S.T.F.A. Lee Shau Kee College

Module: Strategies for English Medium Teaching and Learning (ENG0146E), Learning Activity 1

Activity adapted from: Nov 2004

Defitions and formula adapted from: Frank Wood's Principles of Accounts for Hong Kong Vol 1 & 2 (5th Edition, Longman) I

S.4 Principles of Account
Accounting ratios and the interpretation of accounts
Worksheet 1

Name : _____ Class: _____ No.: _____ Date: _____

Financial statements can be interpreted by using ratio analysis. Ratios should always be compared with other ratios which set the standard for comparison, i.e. we should compare the results of a business with another organization in the same sector.

Ratio analysis is used to _____ according to 3 criteria as follows:

Ratios	{		indicates the ability of the business _____.
			indicates _____.
			_____.

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Worksheet 2

Name : _____ Class: _____ No.: _____ Date: _____



Individual work

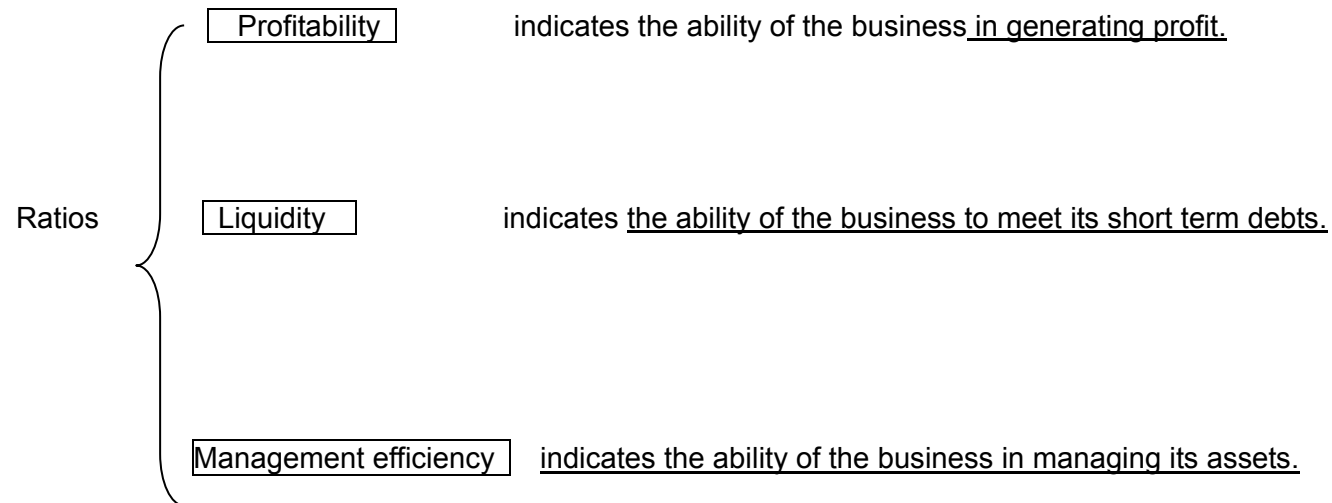
Complete the table to show the uses of different ratios

Ratio	<i>shows</i>	<i>It is used to</i>	<i>The ratio is stated as:</i>
Profitability			
Gross Profit Ratio	how much gross profit has been made for every \$100 of sales.	It is used to evaluate the profitability of the business	<u>Gross profit</u> x 100% sales
Net Profit Ratio			
Return on capital employed			
Liquidity			
Current Ratio			
Quick Ratio			
Management Efficiency			
Stock Turnover			
Debtors Turnover			
Creditors Turnover			

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Answers for Worksheet 1 & 2

Financial statements can be interpreted by using ratio analysis. Ratios should always be compared with other ratios which set the standard for comparison, i.e. comparing a business result with another organization in the same sector.

Ratio analysis is used to evaluate a company's financial position and performance under 3 aspects as follows:



Ratio	<i>shows</i>	<i>It is used to evaluate the..... of the business</i>	<i>The ratio is stated as:</i>
Profitability			
Gross Profit Ratio	how much gross profit has been made for every \$100 of sales.	profitability	$\frac{\text{Gross profit}}{\text{sales}} \times 100\%$
Net Profit Ratio	how much net profit has been made for every \$100 of sales	profitability	$\frac{\text{Net profit}}{\text{sales}} \times 100\%$
Return on capital employed	how much net profit has been made for every \$100 of capital invested.	profitability	$\frac{\text{Net profit}}{\text{Capital invested}} \times 100\%$
Liquidity			
Current Ratio	the ability of a business to meet its short-term liabilities out of its current assets	liquidity	$\frac{\text{Current assets}}{\text{Current liabilities}} : 1$
Quick Ratio	the ability of a business to meet its short-term liabilities out of current assets which can be changed into cash very quickly	liquidity	$\frac{\text{Current assets} - \text{stock}}{\text{Current liabilities}} : 1$
Management Efficiency			
Stock Turnover	the number of time the average stock is being sold in a period	management efficiency	$\frac{\text{Costs of sales}}{\text{Average stock}} \text{ times}$
Debtors Turnover	the number of time the average debtors related to the sales for the year	management efficiency	$\frac{\text{Sales}}{\text{Average debtors}} \text{ times}$
Creditors Turnover	the number of time the average creditors related to the purchases for the year	management efficiency	$\frac{\text{purchases}}{\text{Average creditors}} \text{ times}$

