

Subject: Principles of Accounts

Topic: Ratio analysis

Level of students: S.6

Background information:

This is the third lesson in a series of 6. The extract is from the middle of a double lesson. Students have got worksheets that provide relevant financial information of a company for two years.

Learning objectives:

1. Content:

At the end of the unit, students should be able to evaluate a firm's financial performance and financial position using accounting ratios.

Students should also understand the reasons for the change in Gross Profit Ratio.

2. Language:

Using suitable language to compare and comment such as:

Technical terms in Accounting	sales, asset turnover, profitability, current ratio, quick ratio, liquidity, gearing ratio, interest cover
Verbs	indicates, shows, reveals, suffer, achieve,
Adjectives	corresponding, efficient, inefficient,
Connectives	despite, in contrast to, despite, however, due to,
Probability	might, could, possibly
Comparatives	better, lower, the same, higher, lower, similar to, as compared with
Adverbs of degree	slightly, significantly, marginally,
Other phrases	selling price, bargain price, cost reduction figures further evidence

Describing

The company had a very low _____ and high _____ in both years, which implied long term stability. The gearing ratio and interest cover in 1999 were _____ better than those of 1998.

Comparing

_____ the drop in _____ and _____ in 1999 as compared with 1998, the company performed better in terms of profitability. The _____ in gross profit margin from 40% in 1998 to 50% in 1999 might indicate that the company was successful in raising the _____ of its goods and securing a better _____ from its suppliers.

Describing cause and effect

The increase in net profit ratio from 14.3% in 1998 to 22.2% in 1999 was possibly due to _____ cost control and / or _____ in operating expenses, thus leading to a greater profit. The shareholders might be happy to see the improvement in _____ that the ROCE increased from _____ in 1998 to _____ in 1999.

S.6 Principles of Accounts
Ratio analysis
Worksheet 1

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

Activity 1



Writing

Part I

Given below are the financial ratios of Cosmopolitan Trading Limited for 1998 and 1999.

Financial ratios	1999	1998
Gross profit ratio	50%	40%
Net profit ratio	22.2%	14.3%
Return on capital employed	25.1%	22.7%
Asset turnover	112.9%	159.1%
Current ratio	1.4:1	1.4:1
Quick ratio	0.5:1	0.6:1
Gearing ratio	16.9%	22.6%
Interest cover	18.6 times	12.5 times

You are required to *compare and comment* briefly on the efficiency of operations of the company for the two years in terms of *profitability*, *liquidity* and *long-term solvency* by filling in the gaps in the following passage.

You may find some of the words or phrases given below helpful.

Technical terms in Accounting	sales, asset turnover, profitability, current ratio, quick ratio, liquidity, gearing ratio, interest cover
Connectives	despite, thus
Probability	might, possibly
Comparatives	better, lower
Phrases of comparison	the same
Adverbs of degree	slightly
Other phrases	selling price, bargain price, cost reduction

Cosmopolitan Limited

Profitability

_____ the drop in _____ and _____ in 1999 as compared with 1998, the company performed better in terms of profitability. The _____ in gross profit margin from 40% in 1998 to 50% in 1999 might indicate that the company was successful in raising the _____ of its goods and securing a better **from** its suppliers.

The increase in net profit ratio from 14.3% in 1998 to 22.2% in 1999 was possibly due to _____ cost control and / or _____ in operating expenses, thus leading to a greater profit. The shareholders might be happy to see the improvement in _____ that the **ROCE** increased from _____ in 1998 to _____ in 1999.

Liquidity

The _____ of both years were _____ at 1.4. However, the _____ in 1999 was 0.5, marginally _____ than 0.6 in 1998. This indicates that the company _____ have a _____ problem in paying short term liabilities, as the _____ was below the yardstick of one. The industry norms should be referred to before drawing a conclusion.

Long-term solvency

The company had a very low _____ and high _____ in both years, which implied long term stability. The gearing ratio and interest cover in 1999 were _____ better than those of 1998.

Part II

Given below are the **financial ratios** of Paper Limited for 1998 and 1999.

Financial ratios	1998	1999
Gearing ratio	14%	34%
Interest cover	8 times	4 times
Stock turnover	55 days	71 days
Return on capital employed	14%	22%
Debtors collection period	41 days	46 days
Quick ratio	1.3:1	0.6:1

Write an essay to compare and comment on the efficiency of operations of Paper Limited for these two years in terms of *profitability, liquidity and long-term solvency*. Use the paragraphs above as a model.

You may find the following words/phrases useful:

significantly, slightly, marginally, in contrast to, higher, lower, similar to, corresponding, further evidence indicates, shows, reveals, suffer, achieve, despite, however, efficient, inefficient,

Activity 2



Speaking and Writing

Part I (10 minutes)

Work in groups of four. Discuss the comparative financial performance of the two companies in terms of *profitability* and *liquidity* based **upon** the given ratios.

Financial ratios	Space Ltd	Wagon Ltd
Gross profit ratio	20.8%	12%
Net profit ratio	6.2%	-4%
Return on capital employed	8%	-9.1%
Asset turnover ratio	1.3	2.3
Current ratio	3.6:1	1.1:1
Acid test ratio	1.8:1	0.4:1
Debtors collection period	67.4 days	58.4 days
Creditors repayment period	68.2 days	87.9 days

Your discussion may use the following focal points:

- Classify the ratios into profitability ratios and liquidity ratios
- Compare each ratio for the two companies. For instance, which company has a higher gross profit ratio?
- What are the indications of the difference in the ratios? For instance, the company having a higher gross profit ratio is more profitable.
- What do you think are the reasons for the difference in the ratios? For instance, the company has a higher gross profit ratio because it is successful in securing a better bargain price from its suppliers.

Part II (10 minutes)

Write a short report (*Hint: one paragraph for each ratio*) on the comparative financial performance of the two companies in terms of *profitability* and *liquidity* based upon the given ratios.

You may find the following words/phrases useful:

Significantly, slightly, marginally, in contrast to, higher, lower, similar to, corresponding, further evidence indicates, shows, reveals,

suffer, achieve,

might, could

despite, however, due to

efficient, inefficient,

Can you add other words?

Part III (15 minutes)

Each group should send a representative to present your report in front of the class.

Group members should be prepared to answer queries from the other groups after the presentation.

Consider how far the presentations were:

- clearly expressed;
- easy to understand;
- accurate in terms of the information presented.