CHAPTER – 10

Quick Revision Notes

ACCOUNTING RATIOS

I. LIQUIDITY RATIOS	**II. SOLVENCY RATIO**	**III. ACTIVITY RATIOS**	**IV. PROFITABILITY RATIO**
A. Current Ratio Current Assets Current Liabilities Current assets are those which Can be converted into cash Within one year. Current Assets = Cash + Bank + Stock (Raw Material + Work in Progress + Finished Goods) + Debtors (Less Provision) + Bills Receivable + Short Term Investments (Marketable Securities) + Prepaid Expenses + Loans & Advances + Accrued Incomes Note : Debtors due within six Months are to be included In current assets. Current Liabilities = Creditors + Bills Payable + Outstanding Expenses + Bank Overdraft + Accrued Expenses + Provisions for Taxation + Proposed Dividends + Unclaimed Dividends + Loans payable within	**A.** Debt to Equity Ratio Long Term Debt Shareholders' Fund Long term loans refer to Long term obligations which Have to be paid after 1 Year. Long Term Debt = Debentures + Mortgage Loan + Bank Loan + Loan From financial institution + Public Deposit Shareholder's Funds = Equity Share Capital + Preference Share Capital + Share Premium + Capital Reserve + General Reserve + Other Reserves + Profit and Loss A/c (Credit Balance) - Accumulated Losses - Fictitious Assets. Or Shareholders' Funds = Total assets – Total debt. Or Shareholders fund = Capital employed – Long Term debt	**A.** Inventory Turnover Ratio Cost of Good Sold Average Inventory (at cost) Cost of Goods Sold = Opening Stock + All Direct Expenses i.e. (Purchases + Carriage + Wages + Other Direct Expenses) – Closing Stock. Average Stock / Inventory = Opening Stock + Closing Stock/2 Higher the ratio, better it Is, as it implies efficient Management of Inventories. **B.** Debtors Turnover Ratio Net Credit Sales/ Average Debtors + Average Receivables Higher the ratio, better it Is, since it indicates that Debts are being collected More quickly **C.** Creditors Turnover Ratio Net Credit Purchases = Average Payables + Average Creditors	**A.** Gross Profit Ratio Gross Profit X100 Net Sales Gross Profit = Net Sales Cost of Goods Sold Cost of Goods Sold = Opening Stock + Purchases + All Direct Expenses – Closing Stock Higher the ratio, better it Is, as it implies that the Cost of production is Relatively low. **B.** Operating Ratio Operating Cost & Operating Expenses X100 Net Sales Or Cost of Goods Sold + Operating Expenses X100 Net Sales Operating expenses Includes all administrative Expenses. Lower the ratio, better it Is, which leaves a high margin of profit to meet other non operating expenses.

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A year + Un-expired Income. Current Ratio of 2:1 is Considered an ideal ratio. **B.** Liquid Ratio LIQUID Assets Current Liabilities Liquid Assets = Cash + Bank + Debtors + Bill Receivable + Short term Investment + marketable Securities and Short term Loans and advances Or Liquid Assets = Current Assets – Stock – Prepaid Expenses Liquid ratio of 1:1 is said to Be satisfactory.	Debt Equity Ratio of 2:1 Is considered safe. **B.** Total Assets to Debt Ratio Total Assets Long Term Loan Total Assets or Fixed Assets are net of Depreciation. Higher are ratio, Better it Is, which implies profitable situation of a business concern. **C.** Proprietary Ratio Shareholders' Funds Total Assets It shall be taken as safe if It is above 50 percent. Total Assets = Net fixed assets + Investment + current assets Or = Debts + Shareholders' fund + current liabilities Or = Capital employed + current liabilities	Higher ratio indicates Lesser liquid position and Lower ratio indicates Better liquidity position. **D.** Working Capital Turnover Ratio Sales Net Working Capital Working capital is the Excess of current assets Over current liabilities. Higher the ratio, better it Is. As it shows that Working capital is being Utilized efficiently in Making sales. **E.** Fixed Assets Turnover Ratio Net Sales = Net Fixed Assets Higher the ratio, better it is, It shows that fixed assets Are being utilized efficiently In making sales. **F . Current Assets Turnover Ratio** Net Sales = Current Assets Higher the ratio, better it is, As it indicates optimum Utilization of Current Assets.	**C.** Net Profit Ratio Net Profit = x 100 Net Sales Higher the ratio, better it is, As it indicates efficiency of the business enterprise. **D.** Return on Investment Profit Before Interest, Tax and Dividend X100 Capital Employed Higher the ratio, better it is, As it indicates how Economically and Efficiently funds are being Utilized by the business Enterprise. **E.** Earning Per Share Net Profit after interest Tax & Preference dividend Number of Equity Shares Higher the ratio better it is. **F.** Dividend Per Share Dividend Paid to Equity Shareholders Number of Equity Shares Higher the ratio, better it is. **G.** Price Earning Ratio Market Price Per Share Earning Per Share Higher the ratio, better it is,

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			As it indicates growth and Good earning of the Company. **H.** Earning Yield $\frac{\text{Earning Per Share}}{\text{Market Price Per Share}}$ Higher the ratio better it is.