

5.5 Analysis of accounts

Name: _____ Class: _____ Date: _____

Total: 22 marks

KEY WORDS ratios • current ratio • profit margin • roce
• profitability

Objective

Build the skills to answer exam questions on the **analysis of accounts** –
profitability ratios (gross profit margin, profit margin, ROCE)
and **liquidity** ratios (current ratio, acid test).

You must be able to:

- calculate profitability and liquidity ratios
- explain what each ratio shows
- analyse a business's performance and who uses the ratios

1 Key knowledge and worked examples

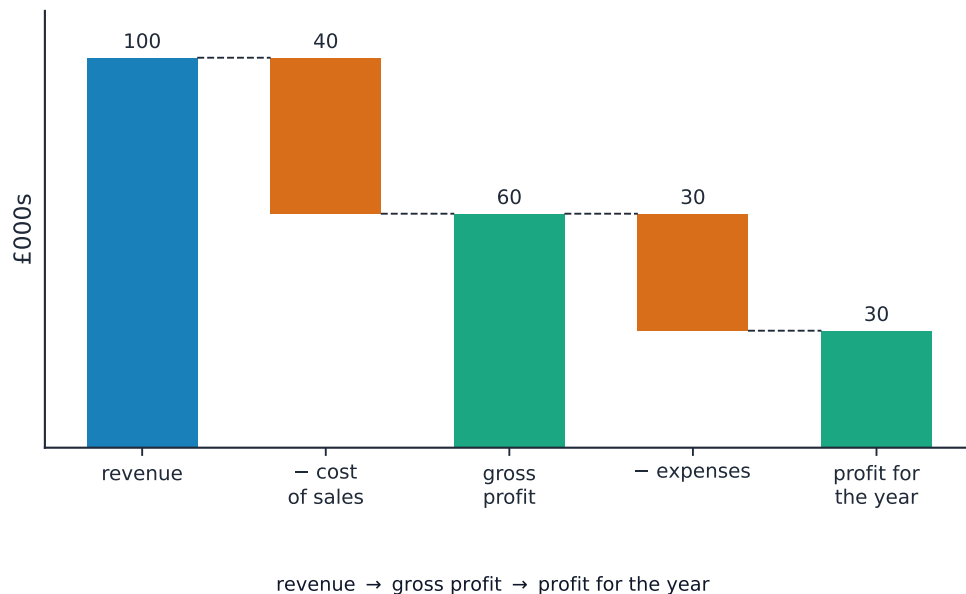
■ Key ratios



A ratio compares two figures from the accounts

$$\text{gross profit margin} = \frac{\text{gross profit}}{\text{revenue}} \times 100\% \quad \text{current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

- **Worked GP margin:** gross profit \$80,000, revenue \$200,000 $\rightarrow \frac{80000}{200000} \times 100 = 40\%$.
- **ROCE** = profit $\div$ capital employed $\times 100$ (how well the investment is used).
- **Current ratio** : about 1.5–2 is healthy; **acid test** leaves out inventory.



Profitability ratios (gross/net margin, ROCE) are read straight off the income statement

Answer shapes: K + App + An + Ev (a justified judgement, for “do you think” questions).

2 Practice

2.1 State what the **gross profit margin** measures.

[2]

2.2 A business has a profit of \$30,000 and capital employed of \$150,000. Calculate the ROCE.

[2]

2.3 State what the **current ratio** measures. [2]

3 Exam-style questions

3.1 A business has current assets of \$40,000 (including \$10,000 inventory) and current liabilities of \$20,000.

(a) Calculate the current ratio. [2]

(b) Calculate the acid test ratio. [2]

3.2 Explain two reasons why a business calculates profitability ratios. [6]

3.3 A business's profit margin has fallen this year. Do you think the owners should be worried? Justify your answer. [6]
