Exercise walk-through

Analysis of accounts ▪ 5.5

eXercise

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

Method — Key ratios

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

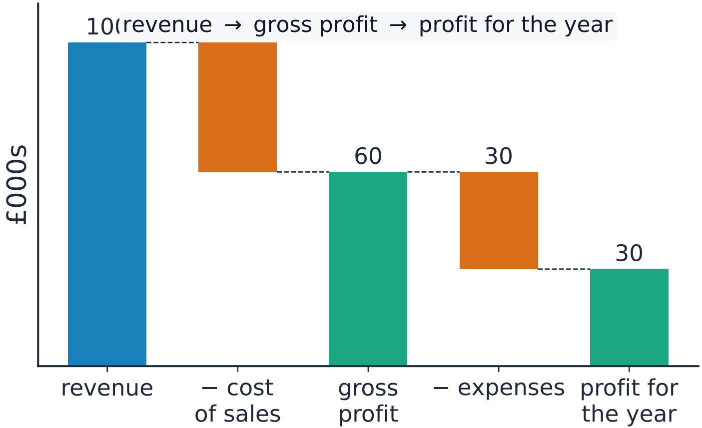
- **Worked GP margin:** gross profit \$80,000, revenue \$200,000 → $\frac{80000}{200000} \times 100 = 40\%$.
- **ROCE 资本回报率** = profit ÷ capital employed × 100 (how well the investment is used).
- **Current ratio 流动比率**: about 1.5–2 is healthy; **acid test 速动比率** leaves out inventory.

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

Method — Key ratios

Investors and banks analyse accounts to make decisions

Method — Key ratios



The income statement steps down from revenue to the profit for the year

Practice 2.1 ▪ 2 marks

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

Solution 2.1

Method: Key ratios

Worked steps

the gross profit as a percentage of revenue — how much gross profit is made from each $1 of sales (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 2 marks

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

Solution 2.2

Method: Key ratios

Worked steps

$\frac{30{,}000}{150{,}000} \times 100\% = 20\%$ (2; award 1 for a correct method with the wrong figure).

Practice 2.3 ▪ 2 marks

State what the **current ratio** measures.

Solution 2.3

Method: Key ratios

Worked steps

whether a business can pay its short-term debts from its current assets (2 for a clear definition; 1 for a partial idea).

Exam-style 3.1 ▪ 2 marks

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

(a) Calculate the current ratio.

(b) Calculate the acid test ratio.

Solution 3.1

Method: Key ratios

Worked steps

(a) current ratio $= \frac{40{,}000}{20{,}000} = 2.0$ (2). (b) acid test $= \frac{40{,}000 - 10{,}000}{20{,}000} = 1.5$ (2; allow follow-through).

Exam-style 3.2 ▪ 6 marks

Explain two reasons why a business calculates profitability ratios.

Solution 3.2

Method: Key ratios

Worked steps

[6] For **each** of two reasons: K 1 + An up to 2 — e.g. *judge performance*: ratios show how much profit is made per $1 of sales → owners see if the firm is doing well. *Compare*: comparing with last year or rivals → managers spot a fall and act. Maximum 3 each.

Exam-style 3.3 ▪ 6 marks

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

Solution 3.3

Method: Key ratios

Worked steps

[6] Both sides + judgement. **Worried (yes):** a falling profit margin means costs are rising faster than sales or prices have been cut → less profit for owners. **Not always:** a temporary fall may be due to a one-off cost or a deliberate price cut to win market share. **Judgement (Ev):** a falling margin is a warning sign, but the owners should find *why* before worrying — a lasting fall is serious, a one-off or strategic fall may not be.