FINANCIAL STATEMENT ANALYSIS AND FINANCIAL RATIOS

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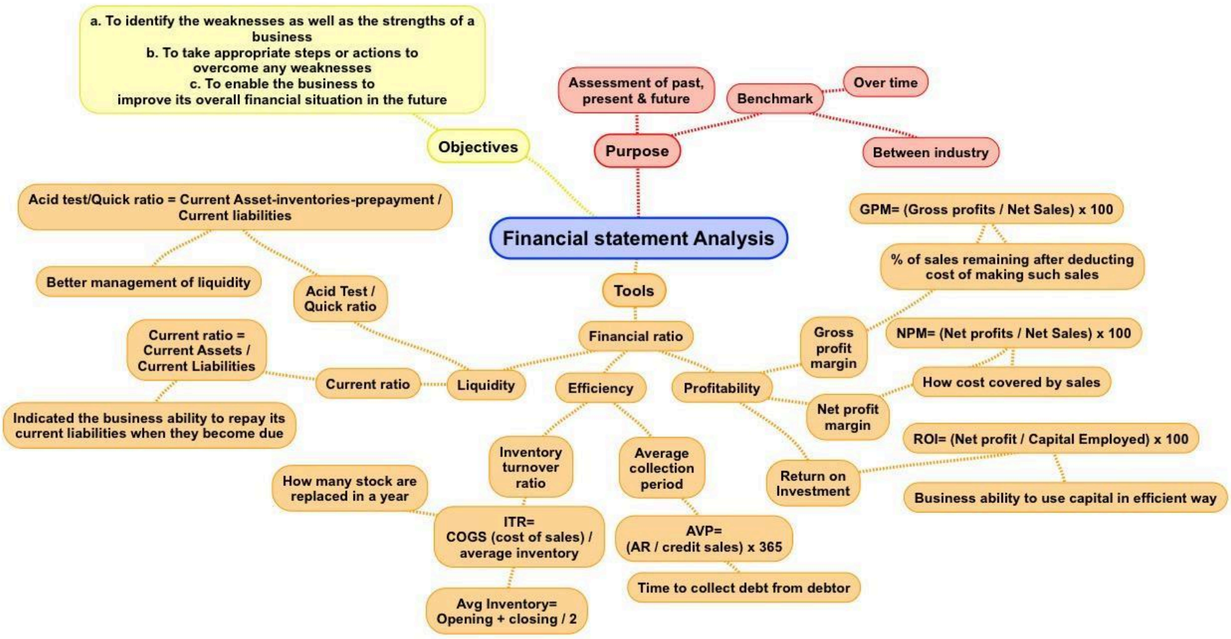
MIND MAP



FINANCIAL STATEMENT ANALYSIS AND FINANCIAL RATIOS

Liquidity ratios – ability of a business to meet its current obligations when they become due	***Current ratio* =** Current Assets/Current liabilities ***Acid Test/Quick Ratio*=** (CA – Inventories – Prepayments) / Current liabilities	Indicated the business ability to repay its current liabilities when they become due Better measurement of liquidity – exclude inventory and prepayment that are less liquid (difficult to convert in cash)
Efficiency ratios – measures the efficiency of a business in managing its assets to generate revenue	***Inventory Turnover Ratio* =** COGS (Cost of sales) / Average inventory Average inventory = opening inventory + closing inventory) / 2 ***Average Collection Period* =** (Accounts Receivable/Credit Sales) *365	● Indicates how many times the inventory has to be replaced ● Gives ideas how fast goods are being sold ● A reduction – inventory is piling up and not being sold ● Represent the length of time a business undertakes to collect money from its debtors ● The shorter the better in terms of liquidity
Profitability ratios – measure the performance of the business in terms of profitability	***Gross Profit margin* =** (Gross Profit / Net Sales) x 100 ***Net Profit Margin*** = (Net Profit/Net Sales) x 100 **Return on Investment =** (Net Profit/Capital Employed) x 100	Reflect the % of sales remaining after deducting the cost of making such sales How far costs are covered by revenue and what is available to the business after considering all expenses incurred for a particular accounting period. The ability of the business to make better use of the capital

PYQ JAN 2018

QUESTION 4

The following is the Statement of Financial Position of Zaheera Enterprise as at 31 December 2017

Zaheera Enterprise
Statement of Financial Position as at 31 December 2017

	RM	**RM**
Non-Current Assets		171,750
Current Assets:		
Inventories	20,000	
Account Receivables	15,000	
Cash at bank	35,000	
Cash in hand	5,000	
Prepaid rental	500	
Prepaid advertising	300	
Prepaid insurance	700	76,500
		248,250
Financed by:		
Capital		195,000
Add: Net profit		25,000
Current liabilities:		
Accounts payables	26,250	
Accrued printing and stationery	2,000	28,250
		248,250

Additional information:

1. Cash sales and credit sales for the year ended 2017 was RM20,000 and RM80,000 respectively.

2. Cost of goods sold was 60% of sales.

Required:

a. Compute the following ratios for Zaheera Enterprise for the year ended 31 December 2017.

   i. Gross profit ratio
   ii. Net profit ratio
   iii. Current ratio
   iv. Quick ratio

(8 marks)

b. Explain the ratios that have been calculated above.

(4 marks)

c. Give **THREE (3)** uses of ratio analysis.

(3 marks)
(Total: 15 marks)

FOR PART a.) i and ii

STEP 1 – MAKE SURE YOU CHOOSE THE CORRECT FORMULA

Profitability ratios – measure the performance of the business in terms of profitability	***Gross Profit margin*** = (Gross Profit / Sales) x 100 ***Net Profit Margin*** = (Net Profit/Sales) x 100

i.) ***Gross Profit margin*** = (Gross Profit / Sales) x 100

STEP 2 – FIND TOTAL SALES

There are no information of sales (total sales) in the question, but these information we do have.

Additional information:
1. Cash sales and credit sales for the year ended 2017 was RM20,000 and RM80,000 respectively.
2. Cost of goods sold was 60% of sales.

Cash sales = 20,000
Credit sales = 80,000
Therefore, Sales = Cash sales + credit sales
= 20,000 + 80,000
= 100,000

STEP 3 – COGS (Cost of good sold)

Now, we can fit the Gross profit.
According to the question COGS is 60% of sales (60% x 100,00) = 60,000

Gross profit = Sales – COGS
= 100,000 – 60,000
= 40,000

STEP 4 – Final step (Calculate the Gross Profit margin)

So,

Gross Profit margin = (Gross Profit / Sales) x 100
= 40,000 / 100,000 x 100
= 40%

Financed by:	
Capital	195,000
Add: Net profit	25,000

ii
STEP 1 – MAKE SURE YOU CHOOSE THE CORRECT FORMULA
STEP 2 – EVERTHING IS GIVEN AND CALCULATED ABOVE, JUST APPLY THE FORMULA

Net Profit Margin = (Net Profit/Sales) x 100
= 25,000 / 100,000
= 25%

FOR PART a.) iii and iv

STEP 1 – MAKE SURE YOU CHOOSE THE CORRECT FORMULA

Liquidity ratios – ability of a business to meet its current obligations when they become due	***Current ratio*** = Current Assets/Current liabilities ***Acid Test/Quick Ratio***= (CA – Inventories – Prepayments) / Current liabilities

STEP 2 – EVERTHING IS GIVEN, JUST APPLY THE FORMULA

Current ratio = Current Assets/Current liabilities
= **76,500 / 28,250**
= **2.71**
So, the ratio is = 2.71 : 1

Current Assets:		
Inventories	20,000	
Account Receivables	15,000	
Cash at bank	35,000	
Cash in hand	5,000	
Prepaid rental	500	
Prepaid advertising	300	
Prepaid insurance	700	76,500
		248,250
Financed by:		
Capital		195,000
Add: Net profit		25,000
Current liabilities:		
Accounts payables	26,250	
Accrued printing and stationery	2,000	28,250
		248,250

Prepaid rental	500
Prepaid advertising	300
Prepaid insurance	700

iv

Acid Test/Quick Ratio
= (CA – Inventories – Prepayments) / Current liabilities
= (76,500 – 20,000 – 1,500) / 28,250
= 1.95
So, the ratio is = 1.95 : 1

FOR PART b.)

Gross Profit margin (ratio)	For every RM1 of sales, Zaheera Enterprise makes RM0.40 of gross profit
Net Profit Margin (ratio)	For every RM1 of sales, Zaheera Enterprise makes RM0.25 of net profit
Current ratio	Zaheera Enterprise has RM2.71 of current assets to pay RM1 of current liabilities
Acid Test/Quick Ratio	Zaheera Enteprise has RM1.95 of liquid assets to pay RM1 of current liabilities

FOR PART c.)

Three uses of ratio:

i.) To assist management in evaluating the performance of the company, the trend and level of profits

ii.) To assist management in monitoring the operations performance against predetermined objective

iii.) To assist management in forecasting, planning and making policies

iv.) To assist Trade creditor in evaluating the company's liquidity in determining the amount and credit period that appropriate for the company

v.) To assist owners in measuring the risk of their investment

vi.) To assist owners in assessing the future performance of a business

vii.) To assist owners in evaluating the worth of their investment in the business