Accounting Analysis and Ratio Tools

**Analysis tools**

Students may use the following ratios for analysis of financial information:

|  |  |  |
| --- | --- | --- |
| Name | Calculation | Expressed as |
| Profitability (Return)For all entities:Return on equity |  | % |
| Return on total assets |  | % |
| Profit margin |  | % |
| Expense |  | % |
| Gross profit margin  |  | % |
| For companies:Earnings per ordinary share |  | $ |
| Earnings yield |  | % |
| Dividend per ordinary share  |  | $ |
| Dividend yield |  | % |
| Financial Stability (Risk)Short Term (Liquidity)Quick ratio (acid test) |  | ratio |
| Working capital (current ratio) |  | ratio |
| Debtors’ turnover |  | times |
| Inventory turnover |  | times |
| Name | Calculation | Expressed as |
| Financial Stability (Risk), continuedLong Term (Solvency)Debt ratio |  | % |
| Debt/equity |  | % |
| Times interest earned |  | times |

\* Averages are used for these values. However, the availability of information may necessitate the use of opening or closing values.

† Net sales should be used, except in the case where a business only provides service.

Accounting reports

| Report and purpose | Information |
| --- | --- |
| Income statementThe measurement of profit or loss | * Components: revenue and expenses
* Classification of the components for service and trading entities
 |
| Balance sheetStatement of financial position | * Components: assets, liabilities, and owner’s equity
* The accounting equation
* The concept of duality, showing the effects of transactions on the balance sheet
* Classification of the components: current and non-current assets, liabilities, and owner’s equity
 |
| Statement of changes in equity | * Components: opening and closing capital, capital contributions, drawings, profit or loss.
 |
| Statement of cash flowsSources of cash inflows and outflows | * Components: cash (sources and uses)
* Differences between net profit and net cash flows in an accrual accounting system
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Links between accounting reports

| Reports  | Links |
| --- | --- |
| Income statement *and* statement of changes in equity | Calculation of profit |
| Income statement *and* balance sheet | Impact of profit on the entity’s equity position |
| Income statement *and* statement of cash flows | Cash versus accrual representation of periodic flows (especially from operations) |
| Balance sheet *and* statement of changes in equity  | End of period equity position of the entity |
| Balance sheet *and* statement of cash flows  | Flow analysis of change in cash position over a period |