Financial ratio calculations | profitability calculations

Financial ratios are useful indicators of a firm's performance and financial situation. Most ratios can be calculated from information provided by the financial statements. Financial ratios can be used to analyse trends and to compare the firm's financials to those of other firms. Sometimes, ratio analysis can predict future bankruptcy of a business.

As we can see the performance of Systems Integrated PLC is related to the areas of profitability, efficiency and liquidity.

First of all, the profitability of a company is clearly shown through the Return on Capital Employed ratio (R. O. C. E) and the gross profit percentage, the second one is reduced from 2009 to 2010 but about the first we can say that is getting higher. Moreover, we have the gross profit margin ratio and we can see that year by year is getting lower and this is not good for our business . Profitability depends on the obsolescence/damage/theft, or even the under/overvaluation of stock. Also, it depends on the general fall or increase in selling price. Utility companies tend to have low R. O. C. E ratios because of the high investments in fixed assets. For example, a high R. O. C. E may be due to the fact that some firms are using old-aged assets which are almost fully depreciated.

Liquidity

4) Acid Test = (Current Assets – Inventors) / Current Liabilities = (1822 – 935) / 1313 = 0. 67: 1

5) Inventory Holding Period = (Average Inventory / Cost of Sales) * 365

= [(850 + 935) / 2] / 7540 = 43 days

6) Customer Collection Period = (Debtors / Sales) * 365 = (842 / 11178) * 365 = 27 days

7) Current Ratio = Current Assets / Current Liabilities = 1822 / 1313 = 1. 4: 1

8) Suppliers Payment Period = (Suppliers / Purchases) * 365 = (1313 / 7625) * 365 = 63 days

9) Interest Cover = EBIT / Interest Expense = 1366 / 105 = 13 times

Secondly, liquidity is mostly shown by the current ratio and the acid test ratio. A current ratio of 2. 5: 1 is considered to be adequate. In addition to this, a high current ratio indicates that the firm is tying up its resources in unproductive assets. Also, indicates slow moving stock and slow paying customers. The sufficiency of a current ratio depends on the composition of the current assets and how soon the short/long term obligations have to be settled. Also an acid test ratio of 1. 1: 1 is considered to be sufficient, too.

The numerator of a liquidity ratio is part or all of current assets. Possibly the most common liquidity ratio is the current ratio . The problem with the current ratio as a liquidity ratio is that inventories, a current asset, may not be converted to cash for several months, while many current liabilities must be paid within 90 days. Thus a more conservative liquidity ratio is the acid test ratio.

Efficiency

10) Fixed Assets usage = Net Sales / Fixed Assets = 11178 / 2832 = 3. 9 times

11) Total Assets usage = Net Sales / Total Assets = 11178 / 4653. 5 = 2. 4 times

Lastly, efficiency is another important fact in a company. It is combined in three periods: the customer’s collection period, the supplier’s payment period and the inventory holding period. We can see that at the fixed assets usage ratio of System Integrated plc has increased from the 2. 9 of the industry to 3. 9 times. In the second ratio, the total asset usage, System Integrated plc has almost the same percentage with the industry and this is good news for our company because is a very good percentage. The fact that some firms holding period is obsolete and that they have a slow moving stock is completely because of the high inventory holding specific period. Although, these firms aim at reducing this ratio so they could be more efficient and productive.

Accounting is the language of business and its numbers are pertinent convey financial information. A lot of people are confused with the accounting numbers. The importance is high to know and to learn how to find meaning in those numbers because it helps you to understand where your business is going. Measuring accounting numbers and business transactions need a context to be significant. A list of numbers doesn’t mean much without knowing what you are looking at. You can find meaning about the accounting numbers by looking at the description labels, such as customer’s names, account names or vendor names.

Moreover accounting numbers are usually used for analysis and to answer questions. For example if you want to know how much rent expenses you have left in your budget, you need to look at accounting numbers. They can provide you précis information about how much rent you have spent and how much you have left cover. Accounting quantifies operations and gives people the aptitude to see a situation from a different viewpoint. You can make important decisions if you look your sales numbers for the year and when you mix that with expenses, you can gain many issues, such as if the expenses are too high for sales or if payroll its usually low. Furthermore, accounting numbers help us in many ways. For instance by looking at accounting numbers you can easily recognise old accounts receivable that you have to collect and also with the accounts you know who owes you and for how long. These numbers and accounts are helpful and valuable to any organization or a business.

On the other hand, accounting number have their weaknesses too. We consider many reasons and factors for weaknesses in numbers in financial statements. Some factors are: the creative accounting, the off balance sheet financing, bias, the managerial pressures and objectivity. Creative accounting it is a firm of misrepresenting the performance and position of a business.

This means that accountants apply particular accounting methods to a transaction to make statements look the way they want them to look. Companies are free to choose which policies to apply, so there is a space in regulations to perform creative accounting. One of the most important things is that some planned attempts to materially misstate accounting figures are illegal. The most common examples include tax evasion schemes. Besides that, some Off-balance sheet financing issues occur when the accountant does not put everything on the balance sheet. Usually Off-balance sheet financing aims in making the business to seem more valuable by inflating the value of assets and does not include some liabilities. Additionally we have Bias who is causing the nepotism of the preferences or partial. Bias influences with an unfair way users of accounting information. Bias is also broken up in categories of Disclosure bias, Estimation bias, Attributional bias, Judgement bias. Inventors are usually influenced by disclosure bias and estimation bias lead auditors to verify false information. Bias does not affect only numerically but it also affects narrative reporting which represents the image and icon of a business management. Judgement bias affects the financial reporting subliminally, inaccuracies might also occur from unconscious bias. Accounting decisions require professional judgement. Ambiguity builds upon concept of representation and occurs of the representation of accrual accounting and cash flow. The problem that is made by ambiguity is that ambiguity surrounds accounting numbers and so numbers does not actually exist but are estimated.

If you are looking to make your own financial ratio calculations then take a look at ourFinancial Ratio Calculator