Evaluate the adequacy of accounting ratios as a means of monitoring the state of ...

This report will evaluate the adequacy of accounting ratios as a means of monitoring the state of the business in selected organisation, using example. The selected organisation is going to Tesco plc, and it will be evaluating their profitability ratios and Liquidity ratios.

A financial ratio (or accounting ratio) is a relative magnitude of two selected numerical values taken from an enterprise’s financial statements. There are many standard ratios used to try to evaluate the overall financial condition of a corporation form a balance sheet. Financial ratios may be used by managers within a firm, by current and potential shareholders of a firm. Financial analysts use financial ratios to compare the strengths and weaknesses in various companies. Accounting ratios indicates the efficient use of business assets and whether the share price is realistic based on earnings, but some of the critical details that might cause the business to go bankrupt are, liquidity ratios, legal issues, employee issues or funding issues/gearing ratios. Therefore ratios alone are not enough.

However ratios don’t indicate the actual figure that the organisation has made. This is because the ratio is turning into a percentage of the accounting ratios. A business can be regarded as a good business because of their customer service or other departments. If a business is not doing well financially people will still regard certain business as good. For example Tesco is not doing well financially but the customer perception of the business is positive. This indicates that Tesco plc is a good business even though they aren’t doing well financially.

Actual figure is used in Tesco plc in marketing. For example, if Tesco plc were to strengthen their brand Tesco plc will need to invest in to promotion and advertisement for a particular brand they want strengthen. Operations can influence Tesco actual figure in Tesco plc. for example operations tend to be things such as productivity, wastage, quality etc. this is can influence actual figures to decrease these can be expensive to invest in, as operations help the organisations progression.

Human resources can also influence Tesco plc's actual figure in the organisation. For example, Tesco plc will need to invest in employing people and which means also training employees, this can cost a lot, and this will influence their actual figures as this will make it a negative figure because the organisation is taking out money to invest in human sources. Profitability ratiosRatios don't show important factors such as the profitability, in determining the state of a business, even though that the financial side is the main and key factor in determining this. For example, gross profit margin is the overall profit that Tesco plc has made in a year. This is calculated by the gross profit divided by the sales and then multiplied by the 100 to change in to a percentage. For example: This is because it shows the shareholder what Tesco plc's profit is in a percentage, but not the specific amount of profit or sales they have made, however this will make it easier for shareholder to know if the business is right organisation to invest in as they would also look at shareholder ratios.

The calculation below will show the gross profit margin of Tesco plc from the balance sheet. Actual figure indicates how much gross profit the business has gain, this shows how much profit the business has gained or the amount of sales the business has gained from selling products. This shows the actually figures shows much the organisation has actually gained or loss. However actual figures doesn’t give the indication of the performance of the business for example on Tesco plc’s balance sheet it shows that in 2013 they had a total sales of £64, 826m and in 2012 they made a total gross profit of £5, 397m. Actual figures show the aspects that the business has made over the years.

This indicates how much they have gained and loss in the years, which is useful to check the business profit margin and finance.; In comparisons, from the gross profit in 2012 to 2013 their gross margin has gone down in 2013 this because in their gross profit margin in 2012 was 8. 44% and in 2013 they have now got a profit margin of 6. 31% This indicates that their profit margin is gone down because of the gross profit has gone up by 15% this can influence Tesco plc’s shareholders, as they might think that Tesco plc is losing value unless they increase the amount of shares they that they give to shareholder. This is so that they can keep their shareholders or interest shareholders to invest in to the organisation.

Liquidity ratiosRatios help show the financial information but they do not show whole picture for example, a current liability is a company’s debts or obligations that are due within one year. Current liabilities appear on the company’s balance sheet and include short term debt, accounts payable, accrued liabilities and other debts. The Current assets is a balance sheet account that represents the value of all assets that are reasonably expected to be converted into cash within one year in the normal course of business. Current assets include cash, accounts receivable, inventory, marketable securities, prepaid expenses and other liquid assets that can be readily converted to cash. If all other things were equal, a creditor, who is expecting to be paid in the next 12 months, would consider a high current ratio to be better than a low current ratio, because a high current ratio means that the company is more likely to meet its liabilities which fell due in the next 12 months.; The current liabilities (including liabilities of the disposal group classified as held for sales) on Tesco plc's balance sheet show the amount of debt that they owe to other companies.

For example Tesco plc owed £18, 985m in 2013 and in 2012 Tesco plc owed £19, 249m. This indicates Tesco plc owed companies more in 2012 than in 2013 because of the less borrowing they have done in 2012 by £264mThe balance sheet of Tesco plc's current assets (including liabilities of the disposal group and non-current assets classified as held for sale) in 2013 Tesco plc had £13, 096m this because however in 2012 Tesco plc had less money than in 2012 for example they spent £12, 863m, their current assets went up by £233m in a year. This indicates that Tesco plc.'s current assets and current liabilities shows how much they have spent on certain things and what they are paying out to certain things too. In conclusion, the adequacy of accounting in Tesco plc, monitoring their profitability ratios and Liquidity ratios is essential for Tesco plc to be monitored frequently.

This is because not knowing whether the organisation has enough money or doesn't have enough money to invest in the organisation; it is difficult to make decisions if their finances are not monitored.