Achievable

ACCA FINANCIAL ACCOUNTING DUMP SHEET

Ratio analysis

Profitability ratios

Ratio	Formula	Interpretation
Gross profit margin	Gross profit ÷ revenue × 100	Higher = better cost control in production
Operating profit margin	PBIT ÷ revenue × 100	Higher = better control of operating expenses
Net profit margin	Profit after tax ÷ revenue × 100	Higher = more efficient after interest and tax
Return on capital employed (ROCE)	PBIT ÷ capital employed × 100, where capital employed = total equity + NCL (or total assets − current liabilities)	Higher = more efficient use of long-term capital
Return on equity (ROE)	(PAT − preference dividends) ÷ total equity (share capital + reserves) × 100	Higher = better returns for equity shareholders
Asset turnover	Revenue ÷ capital employed (times)	Higher = more revenue generated per $ of capital

Key relationship: $\text{ROCE} = \text{operating profit margin} \times \text{asset turnover}$

Liquidity ratios

Ratio	Formula	Benchmark and interpretation
Current ratio	Current assets ÷ current liabilities	~2:1 generally expected; too high may mean excess idle assets
Quick ratio (acid test)	(Current assets − inventory) ÷ current liabilities	Rule of thumb ~1:1 (varies by industry); excludes inventory as less liquid; too low = liquidity risk

If the current ratio rises more than the quick ratio, inventory is building up. If the quick ratio is close to the current ratio, little inventory is held

Efficiency (activity) ratios

Ratio	Formula	Interpretation
Inventory turnover	Cost of sales ÷ average inventory (times)	Higher = faster stock turnover; lower may signal slow-moving stock
Inventory days	(Average inventory ÷ cost of sales) × 365	Fewer days = faster conversion to sales
Receivables collection period	(Trade receivables ÷ credit sales) × 365	Fewer days = faster cash collection from customers
Payables payment period	(Trade payables ÷ credit purchases) × 365	More days = longer credit taken; better for cash flow

Cash operating cycle $= \text{inventory days} + \text{receivables days} - \text{payables days}$; lower = better working capital management

Gearing (financial leverage) ratios

Ratio	Formula	Interpretation
Capital gearing ratio	Long-term debt ÷ (equity + long-term debt) × 100	> 50% = highly geared (more debt than equity); more financial risk
Debt to equity ratio	Long-term debt ÷ equity	Higher = more reliant on debt financing
Interest cover	PBIT (profit before financing and income taxes) ÷ finance costs (times)	Higher = more comfortable ability to service debt; rule of thumb: above 3× is usually considered safe

- **High gearing** = higher financial risk (fixed interest payments), but potential tax benefits
- **Low gearing** = lower risk, more equity financed