

Unit 2 – P6 Ratio

In this assignment I will illustrate in a report the financial state of Domestic Dog Homes by use of accounting ratios.

The ratios I will be using are:

- Solvency
- Profitability
- Performance

Businesses use ratios to find out how solvent they are.

Solvency Equation

Current Ratio

To find the **Current Ratio** we have to divide the current assets with the current liabilities. The Current ratio formulae show us how many assets a business owns in compared to their liabilities.

Current Ratio formulae:

Current Ratio = Current assets / Current liabilities

Domestic Dog Homes current ratio:

$$2.46 = 40,275 / 16,367$$

Acid test ratio

To find the **Acid test ratio** we have to take away the stock from the current assets and divide it by current liabilities. The Acid test ratio formulae show us how the business can pay its liabilities without selling stock.

Acid test ratio formulae:

Acid test ratio = Current assets – Stock / Current liabilities

Domestic Dog Home Acid test ratio:

$$1.46 = 40275 - 16300 / 16367$$

Profitability Equation

Gross Profit Percentage

To work out the Gross profit percentage you have to divide the gross profit with the turnover and multiply it by 100. The Gross Profit Percentage shows how well the business is managing its spending on stock.

Gross profit percentage formulae:

$$\text{Gross profit percentage} = \text{Gross profit} / \text{Turnover} \times 100$$

Domestic Dog Home Gross profit percentage:

$$42\% = 102250 / 244600 \times 100$$

Net Profit Percentage

To work out the Net Profit Percentage you have to divide the Net profit with the turnover and multiply it by 100. The Net profit percentage shows the profit as a percentage of turnover after all expenses have been taken out.

Net profit percentage formulae:

$$\text{Net profit percentage} = \text{Net profit} / \text{Turnover} \times 100$$

Domestic Dog Home Net profit percentage:

$$18\% = 42850 / 244600 \times 100$$

Return on capital employed (ROCE)

To work out the return on capital employed you have to divide the net profit with capital employed (including shareholder funds) and multiply it by 100. The purpose of this ratio is to show to money an investor is receiving back on capital as a percentage.

ROCE formulae:

$$\text{ROCE} = \text{Net profit} / \text{Capital employed} \times 100$$

Domestic Dog Home ROCE:

$$30\% = 42850 / 142408 \times 100$$

Performance Equation

Performance ratios are used by businesses to determine performance.

Stock Turnover

There are two ways to work out the stock turnover. 1) To work out the stock turnover you divide the cost of sales with average stock (number of times). 2) To work out stock turnover (days) you divide average stock with cost of sales and then multiply it with 365.

Stock turnover formulae:

$$1) \text{ Cost of sales} / \text{Average stock (number of times)} = \text{Stock Turnover}$$

$$2) \text{ Average stock} / \text{Cost of sales} \times 365 = \text{Stock Turnover (days)}$$

Debtor's Collection Period

This ratio looks at the link between number of debtors and how long the average it takes the business to collect its debts. To work out the total number of days it takes to pay debtors you have to divide the debtors with the credit sales and multiply it by 365.

Debtor's Collection Period formulae:

$$\text{Debtors} / \text{Credit sales} \times 365 = \text{Total number of days it takes to pay debtors.}$$

Domestic Dog Home Debtor collection period:

$$23850 / 244600 \times 365 = \mathbf{37}$$

Assets Turnover

This ratio looks at the total assets that a business owns. To work out the Assets turnover you have to divide sales with total assets.

Assets turnover formulae:

$$\text{Sales} / \text{Total Assets} = \text{Asset Turnover}$$

Domestic Dog Home Asset turnover:

$$250000 / 191775 = \mathbf{1.30}$$

This can be broken down further into:

$$\text{Sales} / \text{Fixed Assets} \quad \text{and} \quad \text{Sales} / \text{Current Assets}$$

The fixed asset turnover shows how much the business has invested in land and buildings. The current asset turnover shows how many sales are produced per £ of current assets.