WRITING 'REPORTS' ON RATIOS – YEAR 11

If you are asked to 'comment' or 'write a report' on ratios provided or calculated, you should consider approaching the task in the following way>

1. Break the ratios down into what they are a test of, ie, profitability, liquidity or financial stability.
2. Comment on each profitability ratio (or liquidity or financial stability ratio) and state whether it shows an improvement or a decline on the same ratios in previous years.
3. Comment on any overall change in profitability, liquidity or financial stability.
4. Discuss possible reasons for the changes.
5. Sum up any overall improvement or decline

Example:

The following information is for the business "Ball Sports", which sells basketball and football related goods to Western Australian sporting teams. This information was compiled by the business owner on the 30 June 2025.

BALANCE SHEET EXTRACT		INCOME STATEMENT EXTRACT	
Cash at bank	5 000	Cash sales	123 000
Debtors	22 000	Cost of sales	82 000
Inventory	38 000	Administrative expenses	1 000
Prepaid advertising	3 300	Selling expenses	6 000
Furniture and fittings	96 000	Marketing expenses	5 000
Delivery van	66 000	Financial expenses	7 000
Office equipment	83 000		
Accrued wages	8 900		
Overdraft	7 000		
Creditors	76 000		
Mortgage	129 000		
Total assets at 30 June 2024 = $313 300			

2024 ratio calculations:

Gross profit ratio	=	20%
Expense ratio	=	25%
Rate of return on assets	=	7.0%
Working capital	=	50%
Debt to equity	=	203%

(a) Calculate profitability, liquidity and leverage ratios for the 2025 financial year.

(b) Interpret the results of these calculations for the owner, in comparison to the 2024 information.

(c) Are selling and marketing expenses very different to each other? Which expense ratio is of most concern if these two categories are combined together as "advertising expenses"? Explain.

(a) *Gross profit ratio*

$$\frac{(123\,000 - 82\,000)}{123\,000} \times 100 = 33.3\%$$

$$\text{Profit ratio} = \frac{22\,000 \times 100}{123\,000} = 17.9\%$$

$$\text{Expense ratio} = \frac{19\,000}{123\,000} \times 100 = 15.4\%$$

Rate of return on assets

$$= \left(\frac{22\,000 \times 100}{\frac{323\,200 - 313\,300)}{2}}\right) \times 100$$

$$= \frac{22\,000}{318\,250} = 6.9\%$$

Working capital

$$= \frac{5\,000 + 22\,000 + 38\,000 + 3\,300}{8\,900 + 7\,000 + 76\,000} \times 100$$

$$= \frac{68\,300}{91\,900} = 74.3\%$$

$$\text{Quick asset ratio} = \frac{5\,000 + 22\,000}{8\,900 + 76\,000} \times 100$$

$$= \frac{27\,000}{84\,900} = 84\%$$

Debt to equity

$$= \frac{8\,900 + 7\,000 + 76\,000 + 129\,000}{(313\,300 - 220\,900)}$$

$$= \frac{220\,900}{92\,400} \times 100 = 239\%$$

(b) ***Profitability***

- *Has shown an improvement as the gross profit ratio has increased and the expense ratio decreased.*
- *Needs more investigation. Perhaps sales or sale price have increased, or cost of sales may have decreased.*
- *If expenses decreased, must find out which expenses were affected.*
- *Return on assets has remained the same, indicating assets are being used at the same level of efficiency.*

Liquidity

- *This has improved, moving closer to the desired ratio of at least 100%.*
- *It is still at a concerning level, especially the quick asset ratio, as the business would not be able to quickly pay short term debt.*

Gearing

- *Very high and increasing.*
- *More than $2 liabilities for every $1 of owners equity.*
- *If interest rates are high, this is very concerning.*

(c) *Of the four possible expense ratios, Financial Expenses is currently the highest. If selling and meeting are combined, this would be the highest ratio, and by a large proportion. The business owner needs to be cautious in their interpretation of information, as the real effect of the combined Advertising Expenses is highest and they may miss this fact.*