Unit V: Ratio Analysis

1. What is the primary purpose of ratio analysis?
a) To calculate net profit
b) To understand the financial position and performance of a business
c) To record transactions in the ledger
d) To prepare the balance sheet
Answer: b) To understand the financial position and performance of a business

2. Ratio analysis involves comparing:
a) Debits and credits
b) Two or more related financial variables
c) Current and fixed assets
d) Cash flow and inventory
Answer: b) Two or more related financial variables

3. Which of the following is NOT a feature of ratio analysis?
a) Simplifies financial data
b) Ensures complete accuracy of accounts
c) Aids in decision-making
d) Helps in trend analysis
Answer: b) Ensures complete accuracy of accounts

4. The calculation of financial ratios is based on data from:
a) Ledger accounts
b) Trial balance
c) Financial statements
d) Tax reports
Answer: c) Financial statements

5. Ratio analysis helps to identify:
a) Mistakes in journal entries
b) Business performance trends
c) Exact tax liabilities
d) Value of stock
Answer: b) Business performance trends

6. Which of the following is a key use of ratio analysis?
a) Preparing trial balance
b) Comparing performance with competitors
c) Reducing production costs
d) Automating financial records
Answer: b) Comparing performance with competitors

7. Ratio analysis is crucial for evaluating:
a) Non-financial data
b) Long-term profitability and short-term liquidity
c) Human resource efficiency
d) Marketing strategies
Answer: b) Long-term profitability and short-term liquidity

8. Who primarily uses financial ratios for investment decisions?
a) Employees
b) Shareholders and investors
c) Customers
d) Suppliers
Answer: b) Shareholders and investors

9. Which of the following is a liquidity ratio?
a) Current ratio
b) Gross profit ratio
c) Debt-to-equity ratio
d) Return on investment (ROI)
Answer: a) Current ratio

10. The debt-to-equity ratio is an example of a:
a) Liquidity ratio
b) Profitability ratio
c) Solvency ratio
d) Activity ratio
Answer: c) Solvency ratio

11. Which ratio measures a company's efficiency in using its assets to generate revenue?
a) Current ratio
b) Inventory turnover ratio
c) Gross profit ratio
d) Equity ratio
Answer: b) Inventory turnover ratio

12. Return on Investment (ROI) is classified as a:
a) Activity ratio
b) Profitability ratio
c) Solvency ratio
d) Liquidity ratio
Answer: b) Profitability ratio

13. The quick ratio is also known as the:
a) Gross margin ratio
b) Acid-test ratio
c) Debt ratio
d) Equity multiplier
Answer: b) Acid-test ratio

14. A high gross profit ratio indicates:
a) Inefficient cost management
b) Effective cost control and high profitability
c) Poor liquidity
d) Over-leveraging
Answer: b) Effective cost control and high profitability

15. Which ratio assesses a company's ability to cover its interest obligations?
a) Interest coverage ratio
b) Operating ratio
c) Quick ratio
d) Debt ratio
Answer: a) Interest coverage ratio

16. The fixed assets to proprietor's fund ratio is categorized as a:
a) Liquidity ratio
b) Solvency ratio
c) Activity ratio
d) Profitability ratio
Answer: b) Solvency ratio

17. The formula for the current ratio is:
a) Current Assets ÷ Current Liabilities
b) Current Liabilities ÷ Current Assets
c) Net Income ÷ Sales
d) Current Assets ÷ Total Assets
Answer: a) Current Assets ÷ Current Liabilities

18. Earnings Per Share (EPS) is calculated as:
a) Net Profit ÷ Total Sales
b) Net Profit ÷ Number of Outstanding Shares
c) Gross Profit ÷ Equity
d) Net Assets ÷ Number of Debtors
Answer: b) Net Profit ÷ Number of Outstanding Shares

19. If a company's current assets are ₹1,00,000 and current liabilities are ₹50,000, the current ratio is:
a) 0.5:1
b) 1:1
c) 2:1
d) 3:1
Answer: c) 2:1

20. A company has net sales of ₹5,00,000 and gross profit of ₹2,00,000. The gross profit ratio is:
a) 20%
b) 25%
c) 40%
d) 50%
Answer: c) 40% *(Gross Profit Ratio = (Gross Profit ÷ Net Sales) × 100)*

1. Which of the following is a liquidity ratio?
a) Gross profit ratio
b) Quick ratio
c) Debt-to-equity ratio
d) Return on assets
Answer: b) Quick ratio

2. The formula for the current ratio is:
a) Current Assets ÷ Current Liabilities
b) Current Liabilities ÷ Current Assets
c) Net Sales ÷ Current Liabilities
d) Net Income ÷ Total Assets
Answer: a) Current Assets ÷ Current Liabilities

3. What is another name for the quick ratio?
a) Debt ratio
b) Gross margin ratio
c) Acid-test ratio
d) Turnover ratio
Answer: c) Acid-test ratio

4. A quick ratio of less than 1 indicates:
a) Strong liquidity
b) Weak liquidity
c) High profitability
d) Efficient inventory management
Answer: b) Weak liquidity

5. Which of the following is excluded from quick assets when calculating the quick ratio?
a) Cash
b) Accounts receivable
c) Marketable securities
d) Inventory
Answer: d) Inventory

6. If a company has current assets of ₹80,000 and current liabilities of ₹40,000, its current ratio is:
a) 0.5:1
b) 1:1
c) 2:1
d) 4:1
Answer: c) 2:1

7. The inventory turnover ratio is calculated as:
a) Cost of Goods Sold ÷ Average Inventory
b) Net Sales ÷ Total Assets
c) Gross Profit ÷ Inventory
d) Total Purchases ÷ Opening Stock
Answer: a) Cost of Goods Sold ÷ Average Inventory

8. A high inventory turnover ratio indicates:
a) Poor inventory management
b) Excess inventory on hand
c) Efficient inventory utilization
d) Reduced sales
Answer: c) Efficient inventory utilization

9. The formula for accounts receivable turnover ratio is:
a) Net Credit Sales ÷ Average Accounts Receivable
b) Average Accounts Receivable ÷ Net Credit Sales
c) Gross Profit ÷ Net Credit Sales
d) Total Assets ÷ Accounts Receivable
Answer: a) Net Credit Sales ÷ Average Accounts Receivable

10. If a company has cost of goods sold of ₹4,00,000 and average inventory of ₹50,000, the inventory turnover ratio is:
a) 6
b) 8
c) 10
d) 12
Answer: b) 8 *(Inventory Turnover Ratio = Cost of Goods Sold ÷ Average Inventory)*

11. The fixed assets turnover ratio is used to assess:
a) Liquidity
b) Asset utilization efficiency
c) Leverage
d) Profitability
Answer: b) Asset utilization efficiency

12. Which of the following is NOT a turnover ratio?
a) Inventory turnover ratio
b) Fixed assets turnover ratio
c) Gross profit ratio
d) Accounts payable turnover ratio
Answer: c) Gross profit ratio

13. Which of the following is a profitability ratio?
a) Current ratio
b) Net profit ratio
c) Debt-to-equity ratio
d) Inventory turnover ratio
Answer: b) Net profit ratio

14. The formula for gross profit ratio is:
a) Gross Profit ÷ Net Sales × 100
b) Net Profit ÷ Net Sales × 100
c) Gross Profit ÷ Total Assets × 100
d) Operating Profit ÷ Net Sales × 100
Answer: a) Gross Profit ÷ Net Sales × 100

15. Return on investment (ROI) measures:
a) Liquidity
b) Efficiency
c) Profitability
d) Solvency
Answer: c) Profitability

16. Earnings per share (EPS) is calculated as:
a) Net Income ÷ Number of Outstanding Shares
b) Gross Profit ÷ Net Sales
c) Net Profit ÷ Total Liabilities
d) Operating Income ÷ Total Assets
Answer: a) Net Income ÷ Number of Outstanding Shares

17. If a company's gross profit is ₹2,00,000 and net sales are ₹5,00,000, the gross profit ratio is:
a) 20%
b) 30%
c) 40%
d) 50%
Answer: c) 40%

18. Net profit ratio indicates:
a) Overall efficiency of production
b) Profitability of the company after all expenses
c) Relationship between sales and inventory
d) Ability to pay short-term liabilities
Answer: b) Profitability of the company after all expenses

19. Which ratio is used to evaluate shareholder returns?
a) Debt-to-equity ratio
b) Return on equity (ROE)
c) Quick ratio
d) Inventory turnover ratio
Answer: b) Return on equity (ROE)

20. A company's net profit is ₹1,00,000, total sales are ₹5,00,000, and total equity is ₹2,00,000. The ROE is:
a) 20%
b) 25%
c) 50%
d) 10%
Answer: b) 25% *(ROE = Net Profit ÷ Equity × 100)*

1. The proprietary ratio is calculated as:
a) Proprietor's Fund ÷ Total Liabilities
b) Proprietor's Fund ÷ Total Assets
c) Current Assets ÷ Current Liabilities
d) Fixed Assets ÷ Proprietor's Fund
Answer: b) Proprietor's Fund ÷ Total Assets

2. A high proprietary ratio indicates:
a) Strong dependence on external funds
b) High equity participation in financing assets
c) Poor financial stability
d) High debt financing
Answer: b) High equity participation in financing assets

3. Which of the following is included in the proprietor's fund for calculating the proprietary ratio?
a) Equity capital and retained earnings
b) Long-term loans and debentures
c) Current liabilities
d) Marketable securities
Answer: a) Equity capital and retained earnings

4. A proprietary ratio of 0.8:1 indicates:
a) 80% of the company’s assets are financed by the proprietor’s funds
b) 80% of the liabilities are current
c) The company has high solvency
d) 80% of the debt is external
Answer: a) 80% of the company’s assets are financed by the proprietor’s funds

5. Proprietary ratio is primarily used to measure:
a) Liquidity
b) Solvency
c) Profitability
d) Efficiency
Answer: b) Solvency

6. The debt-to-equity ratio measures:
a) Liquidity
b) Relationship between debt and shareholders' equity
c) Profitability
d) Asset turnover
Answer: b) Relationship between debt and shareholders' equity

7. The formula for the debt-to-equity ratio is:
a) Total Assets ÷ Total Liabilities
b) Total Liabilities ÷ Shareholder’s Equity
c) Fixed Assets ÷ Proprietor’s Fund
d) Net Profit ÷ Shareholder’s Equity
Answer: b) Total Liabilities ÷ Shareholder’s Equity

8. A high debt-to-equity ratio indicates:
a) Financial risk due to high debt dependency
b) Strong liquidity
c) High equity participation
d) High profitability
Answer: a) Financial risk due to high debt dependency

9. Which of the following is a solvency ratio?
a) Quick ratio
b) Interest coverage ratio
c) Gross profit ratio
d) Inventory turnover ratio
Answer: b) Interest coverage ratio

10. The interest coverage ratio is calculated as:
a) EBIT ÷ Interest Expense
b) Net Profit ÷ Interest Expense
c) Gross Profit ÷ Total Sales
d) Current Assets ÷ Current Liabilities
Answer: a) EBIT ÷ Interest Expense

11. A low interest coverage ratio indicates:
a) High ability to cover interest expenses
b) Inability to meet interest obligations comfortably
c) High profitability
d) Strong solvency
Answer: b) Inability to meet interest obligations comfortably

12. Solvency ratios assess a company's ability to:
a) Pay its short-term obligations
b) Cover its long-term debts
c) Generate profits
d) Manage inventory
Answer: b) Cover its long-term debts

13. Leverage ratios primarily measure:
a) Liquidity
b) Use of debt to finance assets
c) Asset efficiency
d) Operational profitability
Answer: b) Use of debt to finance assets

14. Operating leverage focuses on the relationship between:
a) Fixed costs and sales revenue
b) Variable costs and total sales
c) Current liabilities and total assets
d) Debt and equity
Answer: a) Fixed costs and sales revenue

15. Financial leverage is calculated as:
a) EBIT ÷ Fixed Costs
b) EBIT ÷ EBT
c) Total Assets ÷ Total Liabilities
d) Total Sales ÷ Gross Profit
Answer: b) EBIT ÷ EBT

16. A high degree of financial leverage indicates:
a) More use of equity in financing
b) Greater reliance on debt financing
c) Improved liquidity
d) Low solvency
Answer: b) Greater reliance on debt financing

17. Total leverage is the combined effect of:
a) Operating leverage and financial leverage
b) Debt-to-equity ratio and proprietary ratio
c) Liquidity ratio and solvency ratio
d) Current assets and liabilities
Answer: a) Operating leverage and financial leverage

18. The formula for total leverage is:
a) Degree of Operating Leverage × Degree of Financial Leverage
b) EBIT ÷ Fixed Costs
c) Proprietor's Fund ÷ Total Assets
d) Gross Profit ÷ Net Sales
Answer: a) Degree of Operating Leverage × Degree of Financial Leverage

19. If a company's EBIT is ₹5,00,000, fixed costs are ₹2,00,000, and EBT is ₹4,00,000, the degree of financial leverage is:
a) 1.5
b) 2.0
c) 1.25
d) 2.5
Answer: c) 1.25 *(Financial Leverage = EBIT ÷ EBT = 5,00,000 ÷ 4,00,000)*

20. Leverage ratios are particularly useful for:
a) Assessing profitability
b) Evaluating a company's capital structure
c) Measuring liquidity
d) Analyzing inventory turnover
Answer: b) Evaluating a company's capital structure

1. What is the primary purpose of interpreting financial ratios?
a) Recording daily transactions
b) Identifying trends and insights for decision-making
c) Preparing trial balance
d) Automating financial reporting
Answer: b) Identifying trends and insights for decision-making

2. If a company's current ratio is consistently below 1, it indicates:
a) Strong short-term liquidity
b) Poor short-term liquidity
c) High profitability
d) Efficient asset utilization
Answer: b) Poor short-term liquidity

3. A gross profit ratio of 60% means:
a) 60% of the sales revenue is gross profit
b) 60% of the total assets are financed by equity
c) 60% of the liabilities are short-term
d) 60% of the profit is net profit
Answer: a) 60% of the sales revenue is gross profit

4. A company has net sales of ₹5,00,000 and gross profit of ₹2,00,000. The gross profit ratio is:
a) 25%
b) 40%
c) 50%
d) 60%
Answer: b) 40% *(Gross Profit Ratio = (Gross Profit ÷ Net Sales) × 100 = (2,00,000 ÷ 5,00,000) × 100)*

5. If a company's EBIT is ₹4,00,000 and its interest expense is ₹1,00,000, the interest coverage ratio is:
a) 2 times
b) 3 times
c) 4 times
d) 5 times
Answer: c) 4 times *(Interest Coverage Ratio = EBIT ÷ Interest Expense = 4,00,000 ÷ 1,00,000)*

6. A company's current assets are ₹1,20,000 and current liabilities are ₹60,000. What is the current ratio?
a) 0.5:1
b) 1:1
c) 2:1
d) 3:1
Answer: c) 2:1 *(Current Ratio = Current Assets ÷ Current Liabilities = 1,20,000 ÷ 60,000)*

7. If a company's net profit is ₹90,000 and total sales are ₹6,00,000, the net profit ratio is:
a) 10%
b) 12%
c) 15%
d) 20%
Answer: b) 15% *(Net Profit Ratio = (Net Profit ÷ Net Sales) × 100 = (90,000 ÷ 6,00,000) × 100)*

8. A company's cost of goods sold is ₹3,00,000, and its average inventory is ₹50,000. What is the inventory turnover ratio?
a) 5 times
b) 6 times
c) 7 times
d) 8 times
Answer: b) 6 times *(Inventory Turnover Ratio = Cost of Goods Sold ÷ Average Inventory = 3,00,000 ÷ 50,000)*

9. If a company's total liabilities are ₹4,00,000 and shareholder's equity is ₹6,00,000, the debt-to-equity ratio is:
a) 0.5:1
b) 1:1
c) 0.67:1
d) 1.5:1
Answer: c) 0.67:1 *(Debt-to-Equity Ratio = Total Liabilities ÷ Shareholder's Equity = 4,00,000 ÷ 6,00,000)*

10. A company has a quick ratio of 1.2:1, and its current liabilities are ₹80,000. What is the value of its quick assets?
a) ₹60,000
b) ₹80,000
c) ₹96,000
d) ₹1,20,000
Answer: c) ₹96,000 *(Quick Ratio = Quick Assets ÷ Current Liabilities → 1.2 = Quick Assets ÷ 80,000 → Quick Assets = 1.2 × 80,000)*

11. If a company's inventory turnover ratio increases, it usually indicates:
a) Slower sales
b) Efficient inventory management
c) Increased liabilities
d) Decreased production
Answer: b) Efficient inventory management

12. Over a three-year period, a company's gross profit ratio decreased from 40% to 30%. This could be due to:
a) Decreased operating costs
b) Reduced sales revenue
c) Increased cost of goods sold
d) Improved liquidity
Answer: c) Increased cost of goods sold

13. If a company's interest coverage ratio decreases, it usually signals:
a) Improved profitability
b) Increased interest obligations or reduced earnings
c) Improved liquidity
d) Decreased operating leverage
Answer: b) Increased interest obligations or reduced earnings

14. A decline in the current ratio over time might indicate:
a) Improved short-term liquidity
b) Poor management of working capital
c) Increased profitability
d) Better efficiency in inventory turnover
Answer: b) Poor management of working capital

15. If the debt-to-equity ratio is consistently high, it could imply:
a) Greater financial stability
b) Higher financial risk and reliance on debt
c) High liquidity
d) Low leverage
Answer: b) Higher financial risk and reliance on debt

16. A company's fixed assets are ₹5,00,000, proprietor's funds are ₹10,00,000, and total assets are ₹15,00,000. What is the fixed assets to proprietor's fund ratio?
a) 0.3:1
b) 0.5:1
c) 1:1
d) 2:1
Answer: b) 0.5:1 *(Fixed Assets to Proprietor's Fund Ratio = Fixed Assets ÷ Proprietor's Funds = 5,00,000 ÷ 10,00,000)*

17. If a company's EBIT is ₹6,00,000 and EBT is ₹4,00,000, what is the degree of financial leverage?
a) 1.5
b) 2
c) 1.2
d) 0.8
Answer: a) 1.5 *(Degree of Financial Leverage = EBIT ÷ EBT = 6,00,000 ÷ 4,00,000)*

18. A company has total assets of ₹12,00,000, total liabilities of ₹5,00,000, and proprietor's funds of ₹7,00,000. What is the proprietary ratio?
a) 0.4
b) 0.5
c) 0.6
d) 0.7
Answer: c) 0.6 *(Proprietary Ratio = Proprietor's Funds ÷ Total Assets = 7,00,000 ÷ 12,00,000)*