

Table Showing Summary of Accounting Ratios

Title of the Ratio	Formula	Significance	How Expressed	Remarks
<p>1. <b>Current Ratio</b></p>	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	<p><b>I. LIQUIDITY RATIOS</b>                      This ratio shows short-term financial soundness of the business. Higher ratio means better capacity to meet its current obligation. <i>The ideal Current Ratio</i> is 2 : 1. In case it is very high it shows the idleness of funds.</p>	<p>Pure Ratio</p>	<p>Current Assets = Current Investments + Inventories (Excluding Stores and Spares and Loose Tools) + Trade Receivables (Net of Provision for Doubtful Debts) + Cash and Cash Equivalents + Short-term Loans and Advances + Other Current Assets                      Current Liabilities = Short-term Borrowings + Trade Payables + Other Current Liabilities + Short-term Provisions.</p>
<p>2. <b>Liquid Ratio/Acid Test Ratio/Quick Ratio</b></p>	$\frac{\text{Liquid Assets or Quick Assets}}{\text{Current Liabilities}}$	<p>Liquid Ratio is a fairly stringent measure of liquidity. It is based on those current assets which are highly liquid, i.e., can be converted into Cash and Cash Equivalents quickly. Quick Ratio of 1 : 1 is considered as ideal. Higher the Quick Ratio better the short-term financial position.</p>	<p>Pure Ratio</p>	<p>Quick Assets = Current Assets – Inventories – Prepaid Expenses                      Current Liabilities have same meaning as in Current Ratio.  <b>Note:</b> Inventories and prepaid expenses are not considered as Quick Assets.</p>
<p>1. <b>Debt to Equity Ratio</b></p>	$\frac{\text{Debt}}{\text{Equity (Shareholders' Funds)}}$	<p><b>II. SOLVENCY RATIOS</b>                      This ratio assesses the long-term financial position and soundness of enterprises. In general, lower the Debt to Equity Ratio higher the degree of protection enjoyed by the lenders.</p>	<p>Pure Ratio</p>	<p>Debt = Long-term Borrowings, (i.e., debentures, mortgage, public deposits) + Long-term Provisions                      Shareholders' Funds = Share Capital + Reserves and Surplus                      Or                      Non-current Assets (Tangible Assets + Intangible Assets + Non-current Investments + Long-term Loans and Advances) + Working Capital – Non-current Liabilities (Long-term Borrowings + Long-term Provisions).                      Working Capital = Current Assets – Current Liabilities</p>
<p>2. <b>Total Asset to Debt Ratio</b></p>	$\frac{\text{Total Assets}}{\text{Debt}}$	<p>This ratio measures the safety margin available to lenders of long-term debts. It measures the extent to which debt is being covered by assets.</p>	<p>Pure Ratio,                      e.g., 2 : 1</p>	<p>Total Assets = Non-current Assets (Tangible Assets + Intangible Assets + Non-current Investments + Long-term Loans and Advances) + Current Assets [Current Investments + Inventories (including Stores and Spares and Loose Tools) + Trade Receivables + Cash and Cash Equivalents + Short-term Loans and Advances + Other Current Assets]                      Debt = Long-term Borrowings + Long-term Provisions</p>



3. <b>Proprietary Ratio</b>	$\frac{\text{Shareholders' Funds or Proprietors' Funds or Equity}}{\text{Total Assets}}$	This ratio shows the extent to which total assets have been financed by the proprietor. Higher the ratio, higher the safety margin for lenders and creditors.	Fraction	Shareholders' Funds = Share Capital + Reserves and Surplus Total Assets has the same meaning as in Total Assets to Debt Ratio.
4. <b>Interest Coverage Ratio</b>	$\frac{\text{Profit before Interest and Tax}}{\text{Interest on Long-term Debt}}$	This ratio shows how many times the interest charges are covered by the profits available to pay interest. Higher the ratio, more secure the lender is in respect of payment of interest regularly.	Times	Profit before Interest and Tax = Profit after Tax + Tax + Interest
<b>III. ACTIVITY RATIOS/TURNOVER RATIOS</b>				
1. <b>Inventory Turnover Ratio</b>	$\frac{\text{Cost of Revenue from Operations (Cost of Goods Sold)}}{\text{Average Inventory}}$	This ratio measures how fast Inventory is moving and generating sales. Higher the ratio, more efficient management of inventories and vice versa.	Times	Average Inventory = $\frac{\text{Opening Inventory} + \text{Closing Inventory}}{2}$ Trade Receivables means debtors plus bills receivable. Provision for Doubtful Debts is not deducted.
2. <b>Trade Receivables Turnover Ratio</b>	$\frac{\text{Credit Revenue from Operations}}{\text{Average Trade Receivables}}$	This ratio shows efficiency in the collection of amount due from trade receivables. Higher the ratio, better it is since it indicates that debts are being collected more quickly.	Times	Average Trade Receivables = $\frac{(\text{Opening Debtors} + \text{Opening Bills Receivable}) + (\text{Closing Debtors} + \text{Closing Bills Receivable})}{2}$ Trade Payables means creditors plus bills payable.
3. <b>Trade Payables Turnover Ratio</b>	$\frac{\text{Net Credit Purchases}}{\text{Average Trade Payables}}$	It shows the number of times the creditors are turned over in relation to purchases. A high turnover ratio or shorter payment period shows the availability of less credit or early payments.	Times	Average Trade Payables = $\frac{(\text{Opening Creditors} + \text{Opening Bills Payable}) + (\text{Closing Creditors} + \text{Closing Bills Payable})}{2}$
4. <b>Working Capital Turnover Ratio</b>	$\frac{\text{Revenue from Operations}}{\text{Working Capital}}$	This ratio shows the number of times working capital has been employed in the process of carrying on business. Higher the ratio, better the efficiency in the utilisation of working capital.	Times	Working Capital = Current Assets - Current Liabilities Current Assets and Current Liabilities have same meaning as in Current Ratio.



#### IV. PROFITABILITY RATIOS

<p><b>7. Gross Profit Ratio</b></p>	$\frac{\text{Gross Profit}}{\text{Revenue from Operations}} \times 100$	<p>This ratio indicates the relationship between gross profit and net sales. Higher the Ratio, lower the cost of goods sold.</p>	<p>Gross Profit = Revenue from Operations – Cost of Revenue from Operations          Cost of Revenue from Operations          = Opening Inventory (excluding Stores and Spares and Loose Tools) + Net Purchases + Direct Expenses – Closing Inventory (excluding Stores and Spares and Loose Tools)          Or          Cost of Materials Consumed + Purchases of Stock-in-Trade + Changes in Inventories of Finished Goods, WIP and Stock-in-Trade + Direct Expenses.          If direct expenses are not given, assume them to be nil.</p>
<p><b>Operating Ratio</b></p>	$\frac{\text{Cost of Revenue from Operations} + \text{Operating Expenses}}{\text{Revenue from Operations}} \times 100$	<p>This ratio is calculated to assess the operational efficiency of the business. A decline in the operating ratio, is better because it means higher margin, and thus, more profit.</p>	<p>Cost of Revenue from Operations          = Opening Inventory (excluding Stores and Spares and Loose Tools) + Net Purchases + Direct Expenses – Closing Inventory (excluding Stores and Spares and Loose Tools)          Or          Cost of Materials Consumed + Purchases of Stock-in-Trade + Changes in Inventories of Finished Goods, WIP and Stock-in-Trade + Direct Expenses.          Or          Revenue from Operations – Gross Profit          If Direct Expenses are not given, assume them to be nil.          Operating Expenses = Employees Benefit Expenses + Depreciation and Amortisation + Other Expenses (Other than Non-operating Expenses)          Revenue from Operations = Sales – Sales Return</p>
<p><b>Operating Profit Ratio</b></p>	$\frac{\text{Operating Profit}}{\text{Revenue from Operations}} \times 100$	<p>The objective of computing this ratio is to determine the operational efficiency of management.</p>	<p>Operating Profit          = Net Profit (Before Tax) + Non-operating Expenses – Non-operating Income          Or          = Gross Profit + Operating Income – Operating Expenses          Non-operating Expenses = Interest on Long-term Borrowings + Loss on Sale of Fixed Assets or Non-current Assets          Non-operating Income = Interest received on investments + Profit on Sale of Fixed Assets or Non-current Assets</p>
<p><b>Net Profit Ratio</b></p>	$\frac{\text{Net Profit after Tax}}{\text{Revenue from Operations}} \times 100$	<p>It indicates overall efficiency of the business. Higher the net profit ratio, better the business.</p>	<p>Net Profit after Tax = Gross Profit + Other Income – Indirect Expenses – Tax</p>
<p><b>Return on Investment or Return on Capital Employed</b></p>	$\frac{\text{Profit before Interest, Tax and Dividend}}{\text{Capital Employed}} \times 100$	<p>It assesses the overall performance of the enterprise. It measures, how efficiently the resources entrusted to the business are used.</p>	<p>Capital Employed: <i>Liabilities Approach</i>: Share Capital + Reserves and Surplus + Long-term Borrowings + Long-term Provisions  <i>Assets Approach</i>: Non-current Assets (Tangible Assets + Intangible Assets) + Non-current Investments + Long-term Loans and Advances) + Working Capital.          Working Capital = Current Assets – Current Liabilities          (Assume that all Non-current Investments are Trade Investments)          (Interest on Non-trade Investments should be deducted from Profit before Interest, Tax and Dividend.)</p>