

SAMPLE RATIO QUESTION:

The summarised results for Munster Motor Company Limited for the years ended 31st March 2010 and 2009 are set out below:

PROFIT AND LOSS ACCOUNT	2010 €	2009 €
Sales	1,460,000	1,314,000
Cost of Sales	<u>958,000</u>	<u>876,000</u>
Gross Profit	502,000	438,000
Overhead Expenses	<u>372,000</u>	<u>365,000</u>
Net Profit	130,000	73,000
Balance on Profit & Loss b/fwd	<u>320,000</u>	<u>247,000</u>
Balance on Profit & Loss c/fwd	<u>450,000</u>	<u>320,000</u>

BALANCE SHEET as at 31st March:

	2010 €	2009 €		2010 €	2009 €
SHARE CAPITAL	100,000	100,000	FIXED ASSETS	850,000	600,000
BAL ON P&L A/C	450,000	320,000			
TERM LOANS	450,000	350,000			
CURRENT LIABILITIES:			CURRENT ASSETS:		
Creditors	105,000	120,000	Stocks	140,000	90,000
Bank Overdraft	125,000		Debtors	240,000	180,000
			Bank	20,000	
	<u>1,230,000</u>	<u>890,000</u>		<u>1,230,000</u>	<u>890,000</u>

a. Compute for each year:-

- Current Ratio
- Acid Test Ratio
- Period of Credit Allowed
- Period of Credit Taken
- Stock Turnover
- Gross Margin
- Net Margin
- Average monthly overhead

(16 marks)

b. Using your computations at a. above, comment on the change in the solvency and profitability of the company.

(9 marks)

Total 25 MARKS

SOLUTION:

A. Computation of ratios:

RATIO	FORMULA	2010	2009
Current Ratio	CA/CL (ideal 2)	1.65	2.42
Acid Test Ratio	(CA – Stock)/CL (ideal 1)	1.04	1.67
Period of Credit Allowed	(Debtors/Sales)x365	60 days	50 days
Period of Credit Taken	(Creditors/Cost of Sales)x365	40 days	50 days
Stock Turnover	Cost of Sales / Closing Stock	6.8 times	9.7 times
Gross Margin	Gross Profit/Sales %	34%	33%
Net Margin	Net Profit/Sales %	8.9%	5.5%
Average monthly overhead	overheads / 12	31000	30400

B. Comments should include at least 3 of the following:

- Fixed Assets have increased by 250,000. However, these have been only partly funded by long term finance (Loan Finance has increased by only 100,000). Some additional loan finance should be obtained to replenish the bank balance which is significantly overdrawn.
- Debtors Days has increased which may suggest that credit control is poor. The list of debtors should be reviewed for existence of any bad debts and credit control reviewed to determine why customers are paying more slowly.
- Creditors Days has decreased and therefore the company is not availing of the credit facilities it had in 2009. Enquiries should be made as to why the company is not getting the same credit from suppliers.
- Stock turnover has decreased and the stocks should be reviewed for quality. Explanation should be obtained as to why stocks have built up.
- Gross Margin is consistent and on line with previous years.
- Overheads have no increased significantly while sales have grown 10% suggesting that the company is enjoying economies of scale.