March 30 – April 3, 2020

Definition of Terms:

1. Ratio – is a mathematical relationship between two numbers, and commonly expressed in percentages or decimals
2. Financial ratio – is the ratio of one item in the financial statement to another item in the same financial statement
3. Liquidity – is the ability of the company to settle its currents obligations as they fall due
4. Solvency – is the ability of the company to settle its non-current or long term obligations and the interest related to those obligations
5. Profitability – is the ability of the company to generate adequate profits to sustain the operations of the business as return of the investment of the owner
6. Stability – is the ability of the company to withstand financial reverses or survivability in the event of crisis

Kinds of Financial Ratios

1. Income Statement Ratio – the ratio of one item in the income statement to another item in the same income statement
2. Balance Sheet Ratio – the ratio of one item in the balance sheet to another item in the same balance sheet
3. Inter-Statement Ratio – the ratio of one item in the income statement to another item in the balance sheet
4. Trend Ratio – the ratio of one item to the same item of different periods

Uses of Financial Ratio

1. To determine the business' financial strengths and weaknesses and should be used with the other techniques of analyzing financial statement
2. It can be used for performance evaluation
3. It can be used for making plans in the future

Common Types of Liquidity Ratios

1. Current ratio –measures the ability to pay its of short term-obligation as they fall due

Formula: Current Ratio = Current Assets / Current Liabilities

2. Quick Ratio or Acid Test Ratio - measures the ability to pay current liability with the most liquid assets

Formula: Quick Ratio = Cash + Marketable Securities + Receivables / Current Liabilities

3. Receivable Turnover – measures the efficiency of the collection activity

Formula: Receivable Turnover = Net Credit Sales / Average Trade Receivables
Average Trade Receivables = Beginning Trade Receivable + Ending Trade Receivable / 2

4. Average Collection Period or Age of Receivables – is the approximate number of days it takes the company to collect its receivables

Formula: Average Collection Period = 360 / Receivable Turnover

5. Inventory Turnover – measures the number of times a company's inventory is sold and replaces during the year

Formula: Inventory Turnover = Cost of Goods Sold / Average Inventory

Average Inventory = Beginning Inventory + Ending Inventory / 2

6. Average Sales Period or Age of Inventory – is the average time to convert inventory to sales

Formula: Average Sales Period = 360/ Inventory Turnover

7. Net Working Capital – measures the short term liquidity of a company in meeting short-term obligations

Formula: Net Working Capital = Current Assets – Current Liabilities

8. Net Monetary Assets – measure of immediate short term solvency of the company

Formula: Net Monetary Assets = Quick Assets – Current Liabilities

References: Simplified Accounting by Nelson Abeleda pp.241-245
Fundamentals of Accountancy, Business, and Management 2 by Flocer Lao Ong and Janelle Gomendoza pp. 93 – 99