

ANALYSING FINANCIAL STATEMENTS*

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1 ECONOMIC AND MANAGEMENT SCIENCES

2 Grade 9

3 BUSINESS, CONSUMER AND FINANCIAL KNOWLEDGE AND SKILLS

4 Module 24

5 ANALYSING FINANCIAL STATEMENTS

Financial Statements: Analysis and Use for Decision Making

ACTIVITY 1:

To analyse financial statement[LO 3.5]

Financial statements are used as a way of discovering the financial position and financial results of a business.

Financial figures, contained in the financial statements, usually do not tell outsiders very much. In order for the figure to be of any value, they must be compared with the results of previous years or with the results of other businesses in the same industry.

Financial statements are also used to determine ratios and trends.

The following ratios can be used in decision making:

1. Liquidity:

This is the ability of the business to honour its obligations (pay its bills) and is expressed in the ratio current assets to current liabilities.

Current assets : Current liabilities

40 000 : 16 000

2,5 : 1

This indicates good liquidity, as the norm for businesses is 2:1.

2. Profitability:

This indicates the profitability of the funds invested in the business and is calculated as follows:

$$\frac{\text{Net profit}}{\text{Capital}} \times \frac{100}{1} = \frac{20000}{200000} \times \frac{100}{1} = 10\%$$

If the percentage is significantly higher than the current bank rate of $\pm 15\%$, the profitability is good.

3. Solvency:

This indicates by how much the total assets of the business exceed the total liabilities. It is calculated as follows:

Total Assets : Total Liabilities

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50 000 : 20 000

2,5 : 1

The solvency is good as the norm is 2:1.

ASSIGNMENT:

- Use the information below to determine the following:

(a) Profitability

(b) Solvency

(c) Liquidity

Comment on the answer to each and give reasons why it is good or bad.

- The net profit of the company is R35 000
- The capital is R100 000
- Fixed assets are R90 000
- Current assets are R30 000
- Current liabilities are R10 000

6 Assessment

Learning Outcomes(LOs)
LO 3
MANAGERIAL, Consumer and Financial Knowledge and SkillsThe learner will be able to demonstrate knowledge and the ability to apply responsibly a range of managerial, consumer and financial skills.
Assessment Standards(ASs)
<i>We know this if the learner :</i>
3.1 completes a basic income statement and balance sheet for a service and retail business;
3.2 investigates the public relations, social responsibility and environmental responsibility strategies and actions of different businesses and organisations;
3.3 completes cash and credit transactions in the books of service and retail businesses;
3.4 uses keyboard skills and function keys in developing, storing, retrieving and editing business documentation;
3.5 analyses financial statements for decision-making at a basic level;
3.6 differentiates between the forms of credit purchases.

Table 1

7 Memorandum

ACTIVITY 1

(a) Profitability:

$$\frac{NV}{\text{Capital}} \times \frac{100}{1}$$

$$\frac{35000}{100000} \times \frac{100}{1}$$
$$= 35\%$$

Very good profitability measured against a bank rate of 15%.

(b) Solvability:

Total Assets : Total Liabilities

120 000 : 10 000

12 : 1

A good solvability ratio, as the liabilities are covered 12 times by the assets.

(c) Liquidity:

Current assets : Current liabilities

30 000 : 10 000

3 : 1

A good liquidity ratio measured against the norm of 2:1.