

Is the business doing well, and can it pay its debts? Reading the ratios

Syllabus section 5.5 Analysis of accounts: profitability, liquidity and users of accounts

Dr Moaz Tariq · Cambridge O Level Business 7081

Running case: McDonald's · 55 minutes

How this topic is examined

Paper 1 • Short answer and data response

Define [2] • Calculate a ratio [2]

Outline [4] • Explain [6]

Explain two... Which is most important? [6]

Do you think... Justify your answer [6]

Paper 2 • Case study

Using the ratios, explain two reasons why the directors should be concerned... [8]

Consider three ways to improve liquidity. Which should the business choose? [12]

Typical questions on this topic

Define 'liquidity' or 'gross profit margin'. [2]

Calculate the acid test ratio / profit margin for [business]. Show your working. [2]

Outline two ways [business] could improve its gross profit margin. [4]

Explain why two stakeholder groups might be interested in [business]'s accounts. [6]

Do you think the acid test ratio is a better measure of liquidity than the current ratio? [6]

Consider two ways to improve profitability. Which should [business] choose? [12]

By the end of this lecture you can...

- 1 Explain the difference between profitability and liquidity.
- 2 Calculate and interpret gross profit margin, profit margin and ROCE.
- 3 Calculate and interpret the current ratio and acid test ratio.
- 4 Explain ways to improve profitability and liquidity.
- 5 Explain how different users of accounts use them.
- 6 Explain the limitations of ratio analysis.

END OF PREVIEW

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