

Chapter 10 · Accounting Ratios

CBSE Class 12 Accountancy (055) · Part B · Unit 3 = 12 marks · every formula on one sheet · Ultimate Revision Sheet

WHICH PART B ARE YOU SITTING? — CHECKED AGAINST THE OFFICIAL 2026-27 CURRICULUM Part B is an *either*

/ or, worth 20 marks whichever you take:

Option 1 — Financial Statement Analysis = Unit 3 Analysis of Financial Statements (12) + Unit 4 Cash Flow Statement (8), with **Part C Project Work** (20).

Option 2 — Computerised Accounting = Unit 4 Computerised Accounting (20), with **Part C Practical Work** (20).

These notes cover **Option 1** (this chapter + Ch 11 Cash Flow), because it is what the overwhelming majority of schools offer. If your school entered you for **Computerised Accounting**, this chapter and Ch 11 are not your paper — confirm with your teacher before you revise from them.

60-SECOND RECALL — the four families

Liquidity	Current Ratio · Quick Ratio → short-term solvency
Solvency	Debt-Equity · Total Assets to Debt · Proprietary · Interest Coverage → long-term solvency
Activity / Turnover	Inventory · Trade Receivables · Trade Payables · Working Capital → efficiency
Profitability	GP · Operating · Operating Profit · Net Profit · ROI → earning capacity
Ideal ratios	Current 2:1 · Quick 1:1 · Debt-Equity 2:1
Golden rule	Turnover ratios use AVERAGE ; liquidity and solvency use CLOSING .

Every ratio in this chapter answers *ONE* of four questions. Find the question, and the family

LIQUIDITY

"can it pay this month?"

Current 2:1 · Quick 1:1

SOLVENCY

"can it survive long-term?"

Debt-Equity 2:1 · Proprietary
Total Assets to Debt

THE GOLDEN RULE

Turnover ratios use
AVERAGE

Everything else uses
CLOSING

ACTIVITY

"how hard do assets work?"

Inventory · Receivables
Payables · Working Capital

PROFITABILITY

"does it actually earn?"

GP · Operating · Net Profit
ROI (on Capital Employed)

Free check:

Operating Ratio
+ Operating Profit Ratio
must equal 100

Short-term vs long-term is the top row; efficiency vs earning is the bottom row.

If a question names an ideal ratio, it is almost always from the top row.

Four families, four questions. Naming the family first stops you reaching for the wrong formula.

1. Liquidity Ratios — short-term solvency

FORMULAS

Current Ratio = Current Assets ÷ Current Liabilities ideal 2 : 1

Quick Ratio = Quick Assets ÷ Current Liabilities ideal 1 : 1

Quick Assets = Current Assets – Inventories – Prepaid Expenses

Current Assets: Inventories, Trade Receivables, Cash & Cash Equivalents, Short-term Loans & Advances, Current Investments, Prepaid Expenses.

Current Liabilities: Short-term Borrowings, Trade Payables, Other Current Liabilities, Short-term Provisions.

TRAP Bank overdraft is a **Current Liability** (Short-term Borrowings). Loose tools and stores & spares are inventories — so they are excluded from quick assets.

2. Solvency Ratios — long-term solvency

FORMULAS

Debt-Equity Ratio = Debt ÷ Equity ideal 2 : 1

Total Assets to Debt Ratio = Total Assets ÷ Debt (Long-term)

Proprietary Ratio = Shareholders' Funds ÷ Total Assets

Interest Coverage Ratio = Net Profit before Interest & Tax ÷ Interest on Long-term Debt (in times)

THE THREE DEFINITIONS EVERYTHING DEPENDS ON

Debt = Long-term Borrowings + Long-term Provisions

Equity (Shareholders' Funds) = Share Capital + Reserves & Surplus
or = Non-Current Assets + Working Capital – Non-Current Liabilities

Capital Employed = Shareholders' Funds + Non-Current Liabilities
or = Non-Current Assets + Working Capital

TRAP Debt means **LONG-TERM** debt only. Current liabilities are **not** included in Debt-Equity. Also, if a question gives Total Debt, subtract current liabilities first.

3. Activity / Turnover Ratios — efficiency

FORMULAS — all use AVERAGE

Inventory Turnover = Cost of Revenue from Operations ÷ Average Inventory

Trade Receivables Turnover = Net Credit Revenue from Operations ÷ Average Trade Receivables

Trade Payables Turnover = Net Credit Purchases ÷ Average Trade Payables

Working Capital Turnover = Revenue from Operations ÷ Working Capital

Average X = (Opening X + Closing X) ÷ 2

THE SUPPORTING FORMULAS

Cost of Revenue from Operations = Opening Inventory + Net Purchases + Direct Expenses – Closing Inventory

or = Revenue from Operations – Gross Profit

Working Capital = Current Assets – Current Liabilities

Average Collection Period = 12 months (or 365 days) ÷ Trade Receivables Turnover

Average Payment Period = 12 months (or 365 days) ÷ Trade Payables Turnover

4. Profitability Ratios

FORMULAS — all as a % of Revenue from Operations, except ROI

Gross Profit Ratio = (Gross Profit ÷ Revenue from Operations) × 100

Operating Ratio = [(Cost of Revenue from Operations + Operating Expenses) ÷ Revenue from Operations] × 100

Operating Profit Ratio = (Operating Profit ÷ Revenue from Operations) × 100 = 100 – Operating Ratio

Net Profit Ratio = (Net Profit after Tax ÷ Revenue from Operations) × 100

Return on Investment (ROI) = (Profit before Interest, Tax & Dividend ÷ Capital Employed) × 100

OPERATING PROFIT — two routes, same answer

Operating Profit = Revenue from Operations – Cost of Revenue – Operating Expenses

Operating Profit = Net Profit + Non-operating Expenses – Non-operating Income

Non-operating expenses: interest on loan, loss on sale of asset. Non-operating income: interest received, dividend received, profit on sale of asset.

TRAP *Operating Ratio + Operating Profit Ratio = 100. If your two answers do not add to 100, one is wrong. Use this as a free check.*

5. Effect of Transactions on Ratios

THE 3-STEP METHOD — this is the 4-marker 1. Note the current ratio's numerator and denominator.

2. Work out the effect of the transaction on each.

3. Decide: Increase / Decrease / No change.

Rule: if numerator and denominator change by the same amount, a ratio above 1 falls and a ratio below 1 rises.

Transaction	Current Ratio (say 2:1)
Cash paid to creditors	Increases (both fall by same amount)
Goods sold at a profit for cash	Increases
Goods sold at cost for cash	No change
Cash collected from debtors	No change (CA composition only)

Purchase of goods on credit	Decreases
Bills payable discharged	Increases
Purchase of machinery for cash	Decreases (CA falls, CL same)
Issue of shares for cash	Increases

6. Question Triggers which formula does the wording want?

If the question says...	Use
"short-term solvency / ability to pay current dues"	Current / Quick ratio
"long-term solvency"	Debt-Equity / Proprietary / Total Assets to Debt
"how many times inventory was sold"	Inventory Turnover
"how fast debtors pay"	Trade Receivables Turnover → collection period
"overall earning on capital employed"	ROI
"operating efficiency"	Operating Ratio
"cost of revenue from operations" given	Inventory Turnover — not receivables
"credit sales" given	Trade Receivables Turnover
"loose tools ₹X"	It is inventory → exclude from quick assets
"bank overdraft ₹X"	Current liability
"what will be the effect on the current ratio?"	3-step method; state Increase / Decrease / No change
"profit before interest and tax"	ROI or Interest Coverage

MOST-ASKED BOARD QUESTIONS

- [3-4M]** Calculate the given ratios from the balance sheet extract.
- [4M]** State with reason the effect of the following transactions on the current / debt-equity ratio.
- [3-4M]** Calculate Inventory Turnover / Trade Receivables Turnover Ratio.
- [3M]** Calculate Operating Ratio and Operating Profit Ratio.
- [1M]** Ideal current ratio? → **2 : 1** · Ideal quick ratio? → **1 : 1**
- [1M]** Which ratio measures long-term solvency? → **Debt-Equity Ratio**

THE HABIT THAT SCORES — Write the **formula first**, then substitute, then compute. A stated formula earns a method mark even when the arithmetic slips. And always state the answer in the right unit — ratios as **X : 1**, turnover as **times**, profitability as **%**.