

# IGCSE Accounting 0452

## Unit no 7: Analysis and interpretation

### Recommended prior knowledge

A synoptic unit where students will be refining/improving their understanding of financial statements.

### Context

Having prepared financial statements i.e. the income statement and the balance sheet the ability to interpret financial information is an important aspect. This involves a detailed review of the information produced in order to assess the business's performance with a previous year, to compare against budget and with other businesses.

### Outline

A further look at accounting ratios, their usefulness and limitations in decision making.

#### 7.1 Learning outcomes

Accounting ratios

- To be able to compute and explain the following ratios:
  - percentage of gross profit to sales
  - percentage of net profit to sales
  - return on capital employed (ROCE)

#### Suggested teaching activities

Visually and verbally demonstrate the following ratios:

- $\text{percentage of gross profit to sales} = \text{gross profit/sales} \times 100$
- $\text{percentage of net profit to sales} = \text{net profit/sales} \times 100$
- $\text{return on capital employed (ROCE)} = \text{net profit/capital} \times 100$
- $\text{current ratio} = \text{current assets /current liabilities}$

#### Learning resources

##### Textbooks

IGCSE & O Level Accounting – Catherine Coucom Chapter 24  
IGCSE & O Level Accounting Workbook – Catherine Coucom Questions 121-125  
Frank Wood's Book-keeping and Accounts – Sheila Robinson & Frank Wood Chapter 39  
Frank Wood's Business Accounting 1  
Frank Wood and Alan Sangster Chapter 47

##### Online

<http://www.bized.co.uk/learn/business/accounting/busaccounts/pizza/pr.htm>  
Past examination question:  
[http://teachers.cie.org.uk/login/login\\_for\\_m?came\\_from=http%3A//teachers.cie.org.uk/index\\_html](http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html)  
P2 May 2009 Q1 (h)

## 7.1 Learning outcomes

current ratio  
quick ratio  
rate of inventory turnover  
collection period for trade receivables  
payment period for trade payables

## Suggested teaching activities

- $quick\ ratio = (current\ assets - stock) / current\ liabilities$
- $rate\ of\ inventory\ turnover = cost\ of\ sales / average\ inventory$   
 $or = average\ inventory / cost\ of\ sales \times 365$
- $collection\ period\ for\ trade\ receivables = trade\ receivables / credit\ sales \times 365$
- $payment\ period\ for\ trade\ payables = trade\ payables / credit\ purchases \times 365$

Students could prepare a presentation for their class on how an organisation can improve profitability and working capital.

Allow students to select their favourite club or shop.

## Learning resources

P2 May 2009 Q3 (d)  
P2 May 2009 Q5 (c), (d)  
P3 May 2009 Q5 (c), (e)  
P2 Oct 2009 Q3 (a)  
P3 Oct 2009 Q3 (b), (c)  
P3 May 2008 Q1 (e), (f)  
P3 May 2008 Q2 (c),(d),(e) (f)  
P2 Oct 2008 Q1 (h)  
P2 Oct 2008 Q4 (a)  
P3 Oct 2008 Q1 (d), (e), (f), (g)  
P3 May 2008 Q4 (e), (f)

## 7.2 Learning outcomes

Interpretation of accounting records

- To be able to prepare and comment on simple statements showing comparison of results for different years
- To be able to make recommendations and suggestions for improving profitability and working capital
- To understand the significance of the difference between the gross profit percentage and the net profit percentage as an indicator of a business efficiency

## Suggested teaching activities

Class to divide into two groups and prepare a set of financial statements. Ask students to prepare ratio analysis on large paper and to compare results. This could take the form of a debate resulting in asking students to vote on the company they would invest in.

Ask students to make short presentations illustrating changes/improvements made to working capital and the overall effect on the business.

## Learning resources

Past examination question:  
[http://teachers.cie.org.uk/login/login\\_for\\_m?came\\_from=http%3A//teachers.cie.org.uk/index\\_html](http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html)  
P3 May 2009 Q5 (a), (d), (f), (g)  
P3 May 2008 3 (d)

<p><b>7.3 Learning outcomes</b></p> <p>Inter-firm comparison</p> <ul style="list-style-type: none"> <li>To understand the problems of inter-firm comparison due to factors such as differing accounting policies</li> <li>To be able to apply accounting ratios to inter-firm comparison</li> </ul>	<p><b>Suggested teaching activities</b></p> <p>Use class activities of two very different businesses to demonstrate the unfairness of this type of comparison.</p>	<p><b>Learning resources</b></p> <p>Past examination question:  <a href="http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html">http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html</a>  P2 Oct 2008 Q4 (b)</p>
<p><b>7.4 Learning outcomes</b></p> <p>Interested parties</p> <ul style="list-style-type: none"> <li>To be able to discuss the uses of accounting by the following interested parties for decision-making <ul style="list-style-type: none"> <li>owners</li> <li>managers</li> <li>creditors</li> <li>bank</li> <li>investors</li> <li>club members</li> <li>other interested parties such as governments, tax authorities, etc</li> </ul> </li> </ul>	<p><b>Suggested teaching activities</b></p> <p>Students should look at all the interested parties to the financial statements and to suggest reasons why they are interested in those statements.</p> <p>Students could take the part of the bank manager and prepare a list of questions for a business seeking a loan.</p>	<p><b>Learning resources</b></p> <p>Past examination question:  <a href="http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html">http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html</a>  P3 Oct 2009 Q2 (c)</p>
<p><b>7.5 Learning outcomes</b></p> <p>Limitations of accounting statements</p> <ul style="list-style-type: none"> <li>To be able to recognise the limitations of accounting statements due to such factors as: <ul style="list-style-type: none"> <li>historic cost</li> <li>difficulties of definition</li> <li>non-financial aspects</li> </ul> </li> </ul>	<p><b>Suggested teaching activities</b></p>	<p><b>Learning resources</b></p> <p>Past examination question:  <a href="http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html">http://teachers.cie.org.uk/login/login_for_m?came_from=http%3A//teachers.cie.org.uk/index_html</a>  P3 May 2009 Q5 (h)</p>