M03 – FUNDAMENTALS OF FINANCIAL ACCOUNTING

ROLE OF FINANCIAL ACCOUNTING IN BUSINESS DECISION-MAKING

A Detailed Project Report

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Abstract

Financial accounting is more than the recording of money received and spent. It is a system for turning a business's everyday transactions into organised information that people can use to understand performance, assess financial health and make decisions. This report examines the role of financial accounting in business decision-making. It explains the meaning, objectives and importance of accounting, considers the information needs of managers, investors, creditors and other stakeholders, and analyses how the main financial statements help users assess profitability, liquidity and financial position. The report uses a qualitative, desk-based approach, drawing on accounting literature, the International Financial Reporting Standards (IFRS) Conceptual Framework and guidance on financial statements from the U.S. Securities and Exchange Commission. An illustrative small retail business is used to show how financial information can guide decisions about pricing, inventory, borrowing, expansion and cash management. The analysis finds that financial accounting supports better decisions by improving accountability, helping users compare results over time and providing a common basis for communication. However, accounting information has limitations: it includes estimates, often reports historical transactions and cannot fully measure non-financial matters such as employee knowledge, customer loyalty or management quality. The report concludes that financial statements are most useful when they are accurate, timely, consistently prepared and interpreted alongside operational and non-financial information. Sound decisions therefore depend not only on the numbers themselves, but also on understanding what those numbers mean and what they leave out.

1. Introduction

1.1 Background to the study

Every business makes decisions, whether it is a small shop deciding how much stock to order or a large company considering whether to open a new branch. These choices involve resources, costs, risks and expected benefits. Managers need to know whether the business is earning enough revenue, whether it can pay its bills, how much it owes and whether its assets are being used effectively. Investors and lenders need similar information before they commit money. Financial accounting helps meet these needs by recording transactions and presenting them in a structured form.

In simple terms, financial accounting is the process of identifying, measuring, recording, classifying and summarising the financial activities of an organisation, then communicating the results to people who need them. Its main output is a set of financial statements and related notes. These statements do not tell users everything about a business, but they provide an important overview of its financial performance, financial position and cash flows. The IFRS Conceptual Framework explains that general-purpose financial reporting is intended to provide useful information to existing and potential investors, lenders and other creditors when they make decisions about providing resources to an entity (IFRS Foundation, 2018).

The value of accounting information becomes clear when a business faces a choice. A manager may want to reduce prices to attract customers, but must first consider the effect on gross profit. A lender may be willing to provide a loan, but will examine the borrower's debt and ability to make repayments. An investor may see that profits are rising, but will also want to know whether the company is generating cash. Financial accounting gives these users a common evidence base for considering such questions.

1.2 Meaning and objectives of financial accounting

Financial accounting focuses on recording and reporting transactions that can be expressed in monetary terms. Typical transactions include sales, purchases, wages, rent, loan repayments, asset purchases and payments to suppliers. These transactions are recorded using an organised system of accounts and summarised for a defined reporting period. The resulting reports are prepared for users inside and outside the organisation, although internal managers may also use the same information as a starting point for more detailed analysis.

The objectives of financial accounting include maintaining reliable records, measuring profit or loss, showing assets and liabilities, reporting cash movements, supporting accountability and helping users make economic decisions. It also helps organisations meet legal, regulatory and contractual reporting obligations. A further objective is stewardship: management is entrusted with resources belonging to owners and other providers of finance, and financial reports help those providers assess how responsibly those resources have been managed.

Financial accounting should not be confused with management accounting. Financial accounting generally produces reports for a broad group of users and follows an established reporting framework. Management accounting is designed mainly for internal use and can include budgets, forecasts, product-cost analyses and department-level performance reports. The two areas overlap. For example, a manager may use financial accounting figures to prepare a budget, but the budget itself is a management accounting tool.

1.3 Importance and scope of the report

Financial accounting is important because business decisions made without dependable information are more likely to rely on guesswork. Proper records help a business understand where its money comes from and where it goes. They can reveal patterns such as rising operating

costs, slow customer payments, excessive stock levels or increasing borrowing. They also allow performance to be compared across periods and, with care, against other organisations.

This report focuses on the connection between financial accounting and business decision-making. It first reviews relevant accounting ideas and the role of financial statements. It then explains the method used, presents findings about the needs of different users and the use of financial measures, and discusses the benefits and limitations of accounting information. A fictional retail business is used as a practical example. The example is illustrative rather than a claim about an actual company; it allows the accounting principles to be demonstrated with clear and consistent figures.

1.4 Research questions

2. Literature Review

2.1 Financial reporting as a source of decision-useful information

The IFRS Conceptual Framework places decision usefulness at the centre of general-purpose financial reporting. Its objective is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in decisions about providing resources to the entity (IFRS Foundation, 2018). Such decisions include buying, selling or holding equity and debt instruments, providing or settling loans, and exercising rights to influence management's use of the entity's resources.

The Framework identifies relevance and faithful representation as the fundamental qualitative characteristics of useful financial information. Information is relevant when it can make a difference to a user's decision. It may have predictive value, confirmatory value or both. Faithful representation means that information should represent the economic substance of what

it claims to represent. Ideally, it is complete, neutral and free from error. Comparability, verifiability, timeliness and understandability are enhancing characteristics that make useful information even more helpful (IFRS Foundation, 2018).

These qualities explain why simply producing a set of numbers is not enough. If a report arrives too late, it may be accurate but less useful for a decision that had to be made earlier. If two businesses classify similar transactions differently, comparison becomes difficult. If important liabilities are left out, users may form an overly positive view of the business. Reliable accounting therefore depends on suitable policies, competent preparation, internal controls and clear disclosure.

2.2 The role of accounting standards

Accounting standards create a shared structure for preparing financial statements. Without common rules, organisations could recognise revenue, measure assets or classify expenses in very different ways, making comparisons unreliable. IFRS Accounting Standards are used in many jurisdictions, while other countries apply their own national standards or U.S. Generally Accepted Accounting Principles (U.S. GAAP). The exact framework depends on the legal and regulatory environment in which an organisation reports.

IAS 1, Presentation of Financial Statements, sets out overall requirements for financial statement presentation, including their structure and minimum content. It describes a complete set of financial statements as including a statement of financial position, a statement of profit or loss and other comprehensive income, a statement of changes in equity, a statement of cash flows and notes (IFRS Foundation, n.d.-a). This structure helps users see different aspects of the same organisation rather than relying on one headline figure.

Standards do not remove all judgement from accounting. Some balances require estimates, such as the useful life of equipment, expected credit losses or the value of certain assets. Standards provide principles and requirements for making and explaining those judgements, but managers and accountants still need to apply them carefully. Users should therefore read the accounting policies and notes, especially where estimates or uncertainty could materially affect reported results.

2.3 The main financial statements

The statement of profit or loss, often called the income statement, reports income and expenses over a period. It helps users assess whether the business generated a profit and how that result was achieved. Revenue is generally recognised when the relevant requirements are met, not necessarily when cash is received. Expenses may also be recognised before or after the related cash payment. This is why profit and cash flow are related but not identical.

The statement of financial position, commonly called the balance sheet, reports assets, liabilities and equity at a particular date. The basic accounting equation is assets equal liabilities plus equity. Assets are resources controlled by the entity as a result of past events; liabilities are present obligations; and equity is the residual interest after liabilities are deducted from assets. The balance sheet gives users a snapshot of resources and claims, including cash, receivables, inventory, property, loans and amounts owed to suppliers.

The statement of cash flows explains movements in cash and cash equivalents during a period. IAS 7 classifies cash flows into operating, investing and financing activities (IFRS Foundation, n.d.-b). Operating cash flows relate to the principal revenue-producing activities of the business. Investing cash flows commonly include purchases and sales of long-term assets and investments. Financing cash flows relate to changes in borrowings and contributed equity. This

statement is particularly important because a profitable business can still experience cash shortages if customers pay slowly or large amounts are spent on stock and equipment.

The statement of changes in equity explains movements in owners' interests, such as profit, dividends, new share issues and other recognised changes. Notes provide accounting policies and additional explanations that help users understand the figures. The U.S. Securities and Exchange Commission (SEC, 2007) similarly explains that balance sheets, income statements and cash flow statements answer different but connected questions about what a company owns and owes, how it performed and how cash moved.

2.4 Accounting information and stakeholder needs

Different users look at the same financial statements from different perspectives. Managers are concerned with operating performance, cost control, cash planning and the use of resources. Investors focus on returns, risk, growth prospects and the quality of reported earnings. Creditors and lenders focus on the organisation's ability to repay principal and interest. Suppliers may consider whether the business can pay invoices on time, while employees may be interested in stability, profitability and the ability to meet payroll obligations.

Government agencies and tax authorities use accounting records to support tax assessment and regulatory oversight. Customers may be interested in whether a supplier is financially stable enough to continue providing goods or services. Communities and other stakeholders may consider the organisation's long-term viability and conduct. Although not every stakeholder has the same access to information or the same decision to make, consistent reporting helps establish a common factual basis for discussion.

2.5 Financial analysis and interpretation

Financial statements become more useful when users analyse relationships between figures. Ratio analysis can summarise profitability, liquidity, efficiency and solvency. For example, the current ratio compares current assets with current liabilities, while the gross profit margin shows the proportion of sales remaining after cost of sales. Ratios are not conclusions by themselves. They need to be compared with previous periods, budgets, industry patterns and the organisation's business model. A current ratio that is normal for a supermarket may be unsuitable for a construction business with a different cash cycle.

Trend analysis examines whether figures are improving or deteriorating over time. Common-size analysis expresses statement items as percentages, allowing users to see changes in cost structure or asset composition. Cash flow analysis examines whether the business can generate cash from operations and whether investment is being funded through internal cash, borrowing or new capital. Used together, these techniques provide a fuller picture than a single profit figure.

2.6 Limitations identified in the literature

Financial statements have limits. They largely report transactions and events that can be measured in monetary terms, so important resources such as staff expertise, customer trust, organisational culture and brand strength may not appear as assets in the way users expect. Many figures are based on historical cost or estimates, and inflation or changing market conditions can reduce the usefulness of older amounts. Accounting policies and estimates can also affect reported results, even when they comply with the relevant standards.

2.7 Summary of the literature review

The literature shows that financial accounting provides a structured way to communicate financial performance, position and cash flows. Its usefulness depends on relevance, faithful representation, comparability, timeliness and clear presentation. Standards help establish consistency, while analysis turns reported figures into insights. At the same time, accounting information is incomplete and often requires judgement. Decision-makers should therefore interpret financial statements in context and combine them with operational, market and non-financial evidence.

3. Methodology

3.1 Research approach

This report uses a qualitative, desk-based approach. It does not collect original survey responses or conduct interviews. Instead, it examines established accounting concepts and guidance, then applies them to a clearly labelled illustrative business case. A desk-based approach is suitable for this assignment because the central aim is to explain how financial accounting works and how different users apply the information when making decisions.

3.2 Sources of information

The main sources are the IFRS Conceptual Framework, IFRS guidance on the presentation of financial statements and cash flow statements, and the SEC's introductory guide to financial statements. These sources were selected because they explain the purpose and structure of financial reporting from recognised standard-setting and regulatory perspectives. Introductory accounting literature is also used to support the explanation of basic accounting and financial analysis concepts.

3.3 Illustrative case method

A fictional business, Green Basket Ltd., is used to demonstrate how accounting information can support practical decisions. Green Basket Ltd. is assumed to be a small retailer selling groceries and household goods. The figures in the appendices are invented solely for teaching purposes; they are not taken from a real company's accounts. The case is deliberately simple so that the links between the income statement, balance sheet, cash flow and management decisions can be followed without specialist software.

3.4 Method of analysis

The report analyses the topic in four stages. First, it identifies the information needs of key stakeholders. Second, it explains what each financial statement contributes. Third, it uses basic ratios and selected figures from the illustrative case to interpret profitability, liquidity and financial position. Finally, it considers how the information could influence decisions and evaluates the limitations of relying on accounting data alone.

3.5 Scope and limitations of the method

4. Findings

4.1 Accounting information supports planning and control

The first finding is that financial accounting provides a foundation for planning and control. Managers can review sales, cost of sales, wages, rent, utilities and other expenses to understand what is driving results. If revenue increases while gross profit falls, the business may be discounting too heavily, paying more for stock or experiencing waste. If operating expenses rise faster than sales, managers can investigate staffing, energy use, delivery costs or other

overheads. Accounting records do not automatically explain why a change occurred, but they help identify where questions should be asked.

4.2 Managers use accounting information for operational decisions

Managers use financial information when setting prices, deciding product ranges, controlling costs and assessing whether a branch or product is performing well. A product with high sales may not be attractive if its gross margin is very low or if it requires expensive storage. Similarly, a department that appears profitable may be using too much working capital because customers take a long time to pay. Managers need to look beyond sales volume and consider the full financial effect of an activity.

4.3 Investors assess returns and risk

Investors use accounting information to consider whether a business is likely to provide an acceptable return for the risk involved. Profitability measures can indicate whether the company converts sales into earnings. The balance sheet can reveal the scale of debt and the resources available to support future activity. Cash flow information helps investors judge whether profits are supported by cash generated from operations. Investors may also compare performance across several years to see whether growth is consistent or whether one strong year is an exception.

4.4 Creditors and suppliers assess repayment capacity

Banks and other lenders use financial statements to assess credit risk. They want to know whether a business can meet interest payments and repay the amount borrowed when due. Measures such as debt-to-equity, interest coverage and operating cash flow can help show the level of financial risk. Lenders may also consider the value and quality of assets that could

provide security. A business with stable operating cash flows and manageable liabilities is generally in a stronger position to negotiate finance than one with repeated losses and overdue obligations.

4.5 Financial statements measure profitability

Profitability is the ability of a business to generate earnings from its sales, assets or owners' investment. The income statement is the main starting point for this assessment. Revenue shows the value of goods or services sold, while cost of sales shows the direct cost associated with those sales. Gross profit is the difference between revenue and cost of sales. Operating expenses are then deducted to determine operating profit, and further items such as finance costs and tax are considered in arriving at profit for the period.

Gross profit margin is calculated by dividing gross profit by revenue and multiplying by 100. It shows how much of each unit of sales remains after direct costs. Operating profit margin measures operating profit as a percentage of revenue and provides insight into the cost of running the business. Net profit margin compares profit after relevant expenses and tax with revenue. A falling margin may indicate increasing purchase costs, discounting, wage pressure or weak cost control. It does not identify the cause on its own, so managers need to investigate the underlying transactions.

4.6 Financial statements measure liquidity

Liquidity concerns the ability to meet short-term obligations as they fall due. A business can be profitable but still struggle to pay suppliers, wages or rent if too much cash is tied up in inventory or unpaid customer invoices. The current ratio compares current assets with current liabilities. The quick ratio is a stricter measure because it excludes inventory and focuses on

assets that are more readily available to meet short-term debts. Working capital is calculated by subtracting current liabilities from current assets.

The cash flow statement is essential to liquidity analysis because it shows actual cash movement during the period. Positive operating cash flow suggests that the core business is generating cash, although the amount and consistency matter. A company might show negative total cash flow because it has purchased equipment or repaid a loan; this is not automatically a sign of weakness. The reason for the movement must be understood. IAS 7's operating, investing and financing categories help users identify where cash was generated and how it was used (IFRS Foundation, n.d.-b).

4.7 Financial statements measure financial position and solvency

Financial position refers to the resources controlled by a business and the claims against those resources at a particular date. The balance sheet shows the mix of current and non-current assets, short-term and long-term liabilities, and equity. This information helps users consider whether the business has enough resources to support its operations and whether it depends heavily on borrowed funds.

Solvency is the longer-term ability to meet financial obligations. A business may have enough cash to pay this month's bills but still face long-term risk if debt is high and earnings are weak. Debt-to-equity and other leverage measures can help users understand how the business is financed. A higher level of borrowing may increase returns to owners when performance is strong, but it also increases fixed payment obligations and can make the business more vulnerable when sales decline.

4.8 Practical findings from the Green Basket Ltd. example

The illustrative Green Basket Ltd. figures in Appendix A show revenue of 500,000 currency units and cost of sales of 320,000, producing gross profit of 180,000. Operating expenses of 130,000 leave operating profit of 50,000. After finance costs and tax of 10,000, the business reports profit for the year of 40,000. Its gross profit margin is 36%, while its net profit margin is 8%. These figures suggest that the business is profitable, but they do not by themselves show whether its margins are adequate. Management would need to compare them with previous periods, its budget and the margins normally achieved in its retail market.

The example also shows current assets of 120,000 and current liabilities of 80,000, giving a current ratio of 1.5 to 1 and positive working capital of 40,000. This indicates that current assets exceed current liabilities at the reporting date. However, 45,000 of current assets is inventory and 35,000 is trade receivables. If stock sells slowly or customers pay late, the business may have less immediately available cash than the current ratio suggests. The quick ratio is therefore 0.94 to 1, which signals that liquidity deserves attention.

The cash flow illustration reports positive operating cash flow of 32,000. This is lower than accounting profit of 40,000, partly because cash is tied up in working capital. Management should examine the collection of receivables and the level of stock held. The business may decide to tighten customer credit checks, follow up overdue invoices and improve stock ordering. It should avoid reducing inventory indiscriminately, because empty shelves could lead to lost sales. The appropriate decision balances liquidity with customer service and sales needs.

4.9 Accounting information and business examples

4.10 Summary of findings

5. Discussion

5.1 Why financial accounting improves decision quality

The findings support the view that financial accounting improves decision quality by replacing incomplete impressions with organised evidence. A manager may feel that sales are strong because the shop is busy, but the income statement may reveal that discounts and supplier costs have reduced the margin. A lender may hear that a business has many customers, but the cash flow statement may show that customers are paying slowly. Accounting information encourages decision-makers to test assumptions against recorded results.

It also improves accountability. Owners and lenders provide resources with the expectation that they will be used responsibly. Regular financial reporting gives them a way to assess what management has achieved and what risks have developed. This is particularly important when owners are not involved in daily operations. A clear reporting system can strengthen trust because management's performance is evaluated using a consistent set of records rather than informal claims.

5.2 The importance of using all three main statements together

A central lesson is that profit, cash and financial position should be considered together. The income statement may show a profit, but the balance sheet may reveal that receivables have increased sharply. The cash flow statement may then show that operating cash is weaker because customers have not yet paid. If a manager looks only at profit, the business may continue

extending credit and eventually face a cash shortage. If the manager looks at all three statements, the need to review credit terms becomes clearer.

5.3 The role of judgement, estimates and ethical conduct

Accounting figures are not always exact measurements. Businesses estimate the useful lives of assets, assess whether receivables will be collected and make judgements about provisions and other uncertain amounts. Reasonable estimates are a normal part of financial reporting, but they should be based on supportable evidence and applied consistently. If management deliberately chooses assumptions to make results appear stronger, the information can become misleading even if the statements look professionally prepared.

Ethical reporting is therefore essential to decision-making. Manipulating revenue, delaying the recognition of expenses, hiding liabilities or presenting one-off gains as normal performance can influence investors and lenders unfairly. Such behaviour can damage trust, lead to poor resource allocation and expose the organisation to legal and reputational consequences. Strong internal controls, segregation of duties, documented approvals, independent review and transparent disclosure help reduce these risks.

5.4 Limitations and the need for non-financial information

Financial accounting is valuable, but it cannot answer every business question. Historical figures do not guarantee future performance. A company may have strong past sales but face new competitors, changing customer preferences or rising input prices. Financial statements may also fail to capture the quality of leadership, staff morale, product reliability, environmental impact or customer satisfaction in a complete way. These factors can influence future results even when they are not fully reflected in current financial figures.

5.5 Interpreting ratios carefully

5.6 Implications for different stakeholders

5.7 Recommendations for effective use of financial accounting

Fourth, managers should review a balanced set of indicators, including profit margins, cash flow, working capital, debt levels and operational measures. Fifth, decision-makers should compare actual performance with budgets and prior periods, then investigate material differences rather than accepting them without explanation. Sixth, organisations should maintain appropriate internal controls, including authorisation limits, separation of duties and independent checks. Finally, users should treat financial statements as one part of a wider evidence base and consider market conditions, customer behaviour and operational risks before making major decisions.

5.8 Overall discussion

Financial accounting does not make decisions on behalf of a business. Instead, it improves the quality of the information on which decisions are based. Its contribution is strongest when the records are reliable, reports are timely, accounting standards are followed and users understand the meaning and limitations of the figures. The Green Basket Ltd. case demonstrates this point: the reported profit suggests that the business is earning money, but liquidity measures and cash flow reveal a need to manage inventory and customer collections. A decision based only on profit would miss that important issue.

The broader implication is that good financial decision-making requires both technical accounting knowledge and practical judgement. Accounting information can show what has happened and help explain why it matters, but managers still need to assess future conditions, choose priorities and accept responsibility for the consequences. Used in this way, financial

accounting is not simply a compliance exercise. It is an essential part of responsible business management.

6. Conclusion

This report has examined the role of financial accounting in business decision-making and has shown that accounting is a practical source of information for managers, investors, creditors and other stakeholders. Financial accounting identifies, records, classifies and summarises financial transactions so that users can understand an organisation's performance, financial position and cash flows. Its objectives include reliable record-keeping, accountability, compliance and the provision of decision-useful information.

The report has explained how the main financial statements contribute to different assessments. The income statement helps users measure profitability and understand the relationship between revenue and expenses. The balance sheet shows assets, liabilities and equity at a particular date, helping users assess financial position and solvency. The cash flow statement explains cash generated and used in operating, investing and financing activities, making it especially important when assessing liquidity. These statements are connected and should be interpreted together.

The stakeholder analysis showed that different users ask different questions of the same information. Managers use it to plan, control costs and evaluate operations. Investors consider profitability, returns and risk. Creditors and suppliers focus on repayment capacity and liquidity. Other stakeholders may use it to assess stability and accountability. The illustrative Green Basket Ltd. case demonstrated how a business can use margins, working-capital measures and cash flow information to identify areas requiring attention, particularly the cash tied up in inventory and receivables.

The report also recognised that financial accounting has limitations. It is largely based on monetary information, often includes estimates and may reflect historical conditions rather than current market realities. It cannot fully measure important non-financial factors such as employee capability, customer loyalty or service quality. Ratios can also be misunderstood if they are used without considering industry, business model and trends.

Overall, financial accounting supports better business decisions by providing a structured and comparable picture of financial activity. Its value depends on accuracy, transparency, timeliness and ethical preparation. Businesses should use financial statements alongside budgets, forecasts and non-financial information, and should investigate rather than simply accept unusual results. When used carefully, financial accounting helps organisations protect resources, build stakeholder confidence and make more informed decisions about their future.

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Appendix A: Illustrative Financial Statements

The following simplified figures are fictional and are included only to demonstrate how financial accounting information can be interpreted. Amounts are stated in currency units (CU).

A1. Green Basket Ltd. – Income Statement for the Year Ended 31 December 20X5

Item	Amount (CU)
Revenue	500,000
Cost of sales	(320,000)
Gross profit	180,000
Operating expenses	(130,000)
Operating profit	50,000
Finance costs	(4,000)
Profit before tax	46,000
Income tax expense	(6,000)
Profit for the year	40,000

A2. Green Basket Ltd. – Statement of Financial Position at 31 December 20X5

Item	Amount (CU)
Cash and cash equivalents	40,000
Trade receivables	35,000
Inventory	45,000
Total current assets	120,000
Property and equipment, net	180,000
Total assets	300,000
Trade payables	50,000
Short-term borrowings	30,000
Long-term loan	70,000
Total liabilities	150,000
Owner's equity	150,000
Total liabilities and equity	300,000

A3. Simplified Cash Flow Summary for the Year Ended 31 December 20X5

Cash flow item	Amount (CU)
Net cash from operating activities	32,000
Net cash used in investing activities	(20,000)
Net cash used in financing activities	(12,000)
Net increase / (decrease) in cash	0

Interpretation: Green Basket Ltd. reports a profit of CU40,000 and positive operating cash flow of CU32,000. The business has CU120,000 in current assets and CU80,000 in current

liabilities. However, a substantial part of current assets is held in inventory and receivables, so management should monitor stock turnover and customer payment times. The cash flow summary is simplified for teaching and does not replace a complete statement prepared under the applicable accounting standards.

Appendix B: Key Financial Ratios and Formulas

Measure	Formula	What it helps assess
Gross profit margin	Gross profit ÷ Revenue × 100	Profit remaining after direct costs
Net profit margin	Profit for the year ÷ Revenue × 100	Profit earned from each unit of revenue
Current ratio	Current assets ÷ Current liabilities	Short-term ability to meet obligations
Quick ratio	(Current assets − Inventory) ÷ Current liabilities	Liquidity excluding inventory
Working capital	Current assets − Current liabilities	Short-term resources after current obligations
Debt-to-equity	Total liabilities ÷ Equity	Relationship between creditor funding and owners' funds

Green Basket Ltd. calculations: gross profit margin = 180,000 ÷ 500,000 × 100 = 36%; net profit margin = 40,000 ÷ 500,000 × 100 = 8%; current ratio = 120,000 ÷ 80,000 = 1.5:1; quick ratio = (120,000 − 45,000) ÷ 80,000 = 0.94:1; working capital = 120,000 − 80,000 = CU40,000; debt-to-equity = 150,000 ÷ 150,000 = 1:1.

Ratios should be interpreted using comparisons with prior periods, budgets and relevant industry information. There is no single ratio that is ideal for every business.