Australian Government
Registered Organisations Commission

FACT SHEET

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Financial ratios

Financial ratios provide a means of examining an organisation's financial performance and position in detail. Below are some examples of commonly used ratios that could be useful for analysing the financial statements of your organisation. They are identified under the following broad headings:

- financial performance
- financial position
- operating efficiency

Financial performance ratios

These ratios measure performance in generating revenue and managing expenses.
For example:

- how is revenue being sourced?
- is revenue being disbursed efficiently?
- is profit adequate given the level of turnover, the amount of equity?

Financial position ratios

The financial stability of an organisation depends on its ability to meet its financial commitments. This can be assessed by examining the relationship between its assets and its liabilities and predicting its capacity to meet its short-term and long-term financial obligations. For example:

- is there sufficient cash available to meet short-term commitments?
- how much cash is enough?
- is it possible to have too much cash?
- what is an appropriate level of equity?

Operating efficiency ratios

These ratios are used to measure how well an organisation manages its working capital, i.e. the capital that is used for day to day operations (as opposed to the capital used to provide assets such as buildings, equipment, etc.).

The following examples are ratios that provide some further insights into the financial performance, financial position and operation efficiency of an organisation.

This fact sheet provides only a small sample of some of the ratios that can be determined to assist with the analysis of financial statements. Given the many items included in those statements, there is potentially a large number of ratios that can be adopted. The key is to choose those that are most relevant to your organisation and the aspect of financial performance and position you want to examine.

Financial performance ratios

Net profit margin

		Last year		Previous Year	
Net Profit / Total Revenue	X 100	529,000 / 7,797,000	X 100	1,025,000 / 7,701,000	X 100
		= 6.8%		= 13.3%	

Statement of comprehensive income
For the year ended 30 June

	Notes	Last Year $	Previous Year $
Revenue			
Membership subscriptions		6,748,000	6,571,000
Interest		251,000	231,000
Rental income		185,000	244,000
Other revenue	3A	613,000	655,000
Total revenue		**7,797,000**	**7,701,000**
Expenses			
Employee expenses	4A	3,167,000	3,023,000
Capitation fees	4B	830,000	823,000
Affiliation fees	4C	228,000	231,000
Depreciation	4D	97,000	88,000
Administration expenses	4E	1,649,000	1,475,000
Legal costs	4F	296,000	62,000
Donations	4G	77,000	120,000
Motor vehicle expenses	4H	89,000	79,000
Other expenses	4I	835,000	775,000
Total expenses		**7,268,000**	**6,676,000**

	Last Year	Previous Year
Surplus (deficit) for the year	**529,000**	**1,025,000**
Other comprehensive income		
Gain on revaluation – investment property	-	342,000
Total comprehensive income for the year	**529,000**	**1,367,000**

This ratio shows the amount of profit generated as a percentage of total revenue. It's expressed as a percentage and is a measure of how effectively the business is being managed to deliver profits.

For example, last year's figure of 6.8% means that, for every dollar earned by the organisation, after meeting all operating costs, nearly 7 cents is available for re-investment on behalf of the members. This ratio has decreased from 13.3% the previous year because although revenues have increased expenses have increased at a higher rate. Comparison with like organisations would be useful for measuring the adequacy of this ratio.

Risks and issues for future performance:
This is a key ratio and risk indicator for the organisation. A declining ratio would indicate that revenues are not keeping pace with expenses, a trend that could ultimately lead to a loss situation, possibly placing the organisation's future in jeopardy.

Return on equity

		Last year		Previous Year	
Net Profit / Total Equity	X 100	529,000 / 7,447,000	X 100	1,025,000 / 6,918,000	X 100
		= 7.1%		**= 14.8%**	

Statement of comprehensive income
For the year ended 30 June

	Notes	Last Year $	Previous Year $
Surplus (deficit) for the year		**529,000**	**1,025,000**

Statement of financial position
As at 30 June

	Notes	Last Year $	Previous Year $
EQUITY			
Retained earnings		7,105,000	6,576,000
Reserves		342,000	342,000
TOTAL EQUITY		**7,447,000**	**6,918,000**

This ratio measures the net return being produced by the organisation in relation to total equity. Expressed as a percentage, it shows how efficiently funds are being used to generate profits.

Risks and issues for future performance:
As all profits are reinvested, this ratio shows how much the organisation has grown through retained earnings. While maximising growth may not be as crucial for your organisation as it is for a profit enterprise, it is the ability to grow through continuous profits that provides for the replacement of assets, investment in new technology, etc. This contributes to ensuring the ongoing sustainability of the organisation.

Membership subscriptions – Percentage of revenue

		Last year		Previous Year	
Membership subs / **Total Revenue**	X 100	6,748,000 / 7,797,000	X 100	6,571,000 / 7,701,000	X 100
		= 86.5%		**= 85.3%**	

Statement of comprehensive income
For the year ended 30 June

	Notes	Last Year $	Previous Year $
Revenue			
Membership subscriptions		6,748,000	6,571,000
Interest		251,000	231,000
Rental income		185,000	244,000
Other revenue	3A	613,000	655,000
Total revenue		**7,797,000**	**7,701,000**

This ratio indicates the organisation's effectiveness in sourcing funds other than from members. Last year's figure shows that for every dollar of revenue raised, more than 13 cents came from other sources. In other words, members received a dollar of value while contributing less than 87 cents.

Risks and issues for future performance:

The more reliant the organisation is on members' subscriptions, the higher the financial risk if member numbers decline. This risk can be mitigated through diverse revenue streams. In the case of the sample organisation, this ratio has increased marginally from the previous year, thereby slightly increasing the financial risk.

Employee expenses – Percentage of revenue

		Last year		Previous Year	
Employee expenses / **Total revenue**	X 100	3,167,000 / 7,797,000	X 100	3,023,000 / 7,701,000	X 100
		= 40.6%		**= 39.3%**	

Statement of comprehensive income
For the year ended 30 June

	Notes	Last Year $	Previous Year $
Revenue			
Membership subscriptions		6,748,000	6,571,000

Statement of comprehensive income For the year ended 30 June			
Interest		251,000	231,000
Rental income		185,000	244,000
Other revenue	3A	613,000	655,000
Total revenue		**7,797,000**	**7,701,000**
Expenses			
Employee expenses	4A	3,167,000	3,023,000

This is an important ratio, as it shows the proportion of revenue being expended on office holders and other employee's salaries and wages. It is an indication of how efficiently the organisation is being run. Last year's figure shows that 40.6% of revenue raised was spent on employee expenses. While this figure, on its own, might not reveal much, the fact that it has increased from 39.3% from the previous year may be a concern. This increase has come about because employee expenses increased by approximately 4.8% year on year, while revenue increased by only 1.2%.

Risks and issues for future performance:

A trend of increasing salaries and wages places pressure on continuing profitability and sustainability. Given "business as usual", it could reasonably be expected that movements in these costs would align with CPI increases. Any significant increases beyond CPI should raise further questions. For example, were significant increases awarded to staff? Were additional staff employed and, if so, did this relate to an increase in services provided?

Financial position ratios

Current ratio

	Last year	Previous Year
Current Assets **Current Liabilities**	4,029,000 857,000	5,564,000 800,000
	= 4.7%	**= 6.9%**

Statement of financial position
As at 30 June

	Notes	Last Year $	Previous Year $
ASSETS			
Current Assets			
Cash and cash equivalents	5A	3,093,000	4,955,000
Trade and other receivables	5B	528,000	226,000
Other current assets	5C	408,000	383,000
Total Current Assets		**4,029,000**	**5,564,000**
LIABILITIES			
Current Liabilities			
Trade and other payables	7A	337,000	244,000
Employee provisions	7B	520,000	556,000
Total Current Liabilities		**857,000**	**800,000**

Note that this ratio is expressed as a multiple, rather than a percentage. It focuses on the organisation's liquidity, i.e. availability of cash to meet its short-term obligations.

Current Assets are those that are expected to be converted into cash within 12 months, while current liabilities refer to debts required to be paid within 12 months. Clearly, current assets should exceed current liabilities. Last year's ratio of 4.7 means that, for every dollar needed to pay short-term debts, the organisation has, or will have, $4.70 available. This ratio has decreased from 6.9 from the previous year. However overall the organisation has good liquidity.

Risks and issues for future performance:

This is crucial for the organisation's survival because if it fails to pay its debts as and when they fall due it faces possible insolvency. So the ratio should be maintained at greater than 1.0, otherwise it may be necessary to liquidate non-current assets (e.g. sell off furniture or equipment to generate cash to pay invoices, salaries, etc).

On the other hand, having too much cash does not necessarily reflect an efficient operation. Perhaps excess cash could be placed into a longer-term (and higher yielding) investment, or used to acquire other non-current assets. Alternatively, it could mean membership subscriptions are higher than they need to be. Whatever the situation, the current ratio should reflect a good balance between available cash and required cash.

Equity ratio

		Last year		Previous Year	
Total Equity / **Total Assets**	X 100	7,447,000 / 16,444,000	X 100	6,918,000 / 7,843,000	X 100
		= 45.3%		**= 88.2%**	

Statement of financial position
As at 30 June

	Notes	Last Year $	Previous Year $
ASSETS			
Current Assets			
Cash and cash equivalents	5A	3,093,000	4,955,000
Trade and other receivables	5B	528,000	226,000
Other current assets	5C	408,000	383,000
Total Current Assets		**4,029,000**	**5,564,000**
Non-Current Assets			
Land and buildings	6A	10,000,000	-
Plant and equipment	6B	104,000	132,000
Motor vehicles	6C	141,000	147,000
Investment property	6D	2,170,000	2,000,000
Total Non-Current Assets		**12,415,000**	**2,279,000**
TOTAL ASSETS		**16,444,000**	**7,843,000**

LIABILITIES			
Current Liabilities			
Trade and other payables	7A	337,000	244,000
Employee provisions	7B	520,000	556,000
Total Current Liabilities		**857,000**	**800,000**
Non-Current Liabilities			
Borrowings	8A	8,000,000	-
Employee provisions	7B	140,000	125,000
Total Non-Current Liabilities		**8,140,000**	**125,000**
TOTAL LIABILITIES		**8,997,000**	**925,000**
NET ASSETS		**7,447,000**	**6,918,000**
EQUITY			
Retained earnings		7,105,000	6,576,000
Reserves		342,000	342,000
TOTAL EQUITY		**7,447,000**	**6,918,000**

This ratio relates to the organisation's solvency, by measuring the extent to which the organisation's total assets are financed internally, i.e. from members' funds. The ratios for our sample organisation show that assets being financed by internal funds have decreased from 88.2% for the previous year to 45.3% for last year. To take a different view, they reveal that external parties held claims against 54.7% of the assets, compared with 11.8% the previous year.

Risks and issues for future performance:

This ratio, expressed as a percentage, focuses on the organisation's exposure to short-term and long-term debt. It is crucial that an organisation has some positive equity, otherwise it faces insolvency, being wound up and having its assets liquidated.

The higher the equity ratio, the more secure the organisation is in its ability to meet its short and long-term liabilities. On the other hand, accessing funds externally can be an efficient way of sourcing finance, particularly in the form of non-interest-bearing liabilities, such as trade and other payables. There is a need to strike a balance here, with the benefits of using external funds offset by the increased risk associated with them.

Operating efficiency ratios

Receivables collection

		Last year	
Average Receivables **Membership Subs**	X 365	377,000 6,748,000	X 365
		= 20.4 days	

The average receivables is calculated by adding the balance of the trade and other receivables of last year and the previous year and dividing the total by 2 i.e. $528,000 + $226,000 = $754,000/2 = $377,000.

Statement of financial position
As at 30 June

	Notes	Last Year $	Previous Year $
ASSETS			
Current Assets			
Cash and cash equivalents	5A	3,093,000	4,955,000
Trade and other receivables	5B	528,000	226,000
Other current assets	5C	408,000	383,000
Total Current Assets		**4,029,000**	**5,564,000**

Statement of comprehensive income
For the year ended 30 June

	Notes	Last Year $
Revenue		
Membership subscriptions		6,748,000
Interest		251,000
Rental income		185,000
Other revenue	3A	613,000
Total revenue		**7,797,000**

This ratio is expressed as the number of days outstanding, based on the average receivables during the past year. For our sample organisation, based on last year, the average time it takes for invoices to be paid is 20 days. As revenue is derived largely (about 86.5%) from members (see page 4), this is an indication that, on average, members take 20 days to pay their subscriptions.

Risks and issues for future performance:

Strong member numbers could mean good revenue and a healthy profit, however if the organisation is not efficient at collecting outstanding subscriptions it could find itself with a cash flow problem. Whether 20 days is a satisfactory collection period or not depends on the payment terms. If subscriptions are due in 30 days from the invoice date, an average collection period of 20 days would indicate a high proportion of members are paying their subscriptions on time. This is a positive indicator.

As the organisation relies on membership subscriptions as its main source of revenue, unpaid subscriptions would present a risk to the organisation that revenue may not be collected. A rigorous and well implemented collections policy is crucial for cash flow management.

Further information

If you require further assistance regarding the information in this fact sheet please contact the ROC at regorgs@roc.gov.au or call us on **1300 341 665**.

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This fact sheet is not intended to be comprehensive. It is designed to assist in gaining an understanding of the financial statements that registered organisations are required to prepare and lodge with the Registered Organisations Commission. The Registered Organisations Commission does not provide legal advice.