Ratio Analysis of Current Assets, Fixed Assets and Total Assets

(A Case Study of IFFCO Ltd.)

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Abstract: **Current assets have immense importance for almost all the organizations, as current assets have vital role to play, in day-to-day working of any organization. The importance also stems out from the reason that current assets are for the purpose of conversion to cash at the end of each operating cycle. Current assets have their indispensible contribution in increasing the shareholders' wealth. Inefficient management of current assets lands the business organization into bankruptcy. Profit of the firm is generated from the optimum use of current assets. The amount needed to be invested in current assets must be calculated accurately, as it would help in sound financial management as well.**

Ratios as financial analytical tool are easy to calculate and simple to understand. This article discusses the ratio of current assets to fixed assets, percentage of current assets in total assets and percentage of net current assets to total assets, for eleven financial years, 2005-06 to 2015-16. This analysis helps the organization to judge its financial health.

Keywords: **Current assets, Fixed assets, Total assets, Net current assets, Ratio analysis.**

1. INTRODUCTION

Current assets are the lifeline of any business organization. Current assets are essential to utilize the fixed assets owned by the organization [1]. The organization requires current assets for smooth conduct of day-to-day functions. Effective management of current assets ensures the success of business. Analysis of current assets is equally important to internal as well as external agencies as current assets ultimately culminate into cash. One important attribute of current assets is their convertibility into cash within one operating cycle. During cash to cash journey, various components of current assets are the routing partners. Cash is used to purchase raw material. Raw material is transformed into finished goods. Finished goods are sold either for cash or on credit giving way to receivables. Receivables are converted into cash. This cash to cash journey of current assets is the secret of financial success of any firm [2]. If cash is held up in form of current assets, the organization has to arrange for extra cash, which not only increases cost but also increases losses. Due to this convertibility attribute, current assets are also known as circulating assets.

2. CURRENT ASSETS, FIXED ASSETS AND TOTAL ASSETS

The total assets comprise of current assets and fixed assets. Current assets and fixed assets, both are complementary to each other. In the absence of one, the other has zero utility. A substantial portion of total assets is formed by current assets. The issues involved in the management of current assets differ from those involved in the management of fixed assets. Fixed assets are acquired with the objective of long-term retaining in the business and are utilized throughout their economic life [3]. Thus, most noticeable feature of management of current assets is their shorter life span. While managing current assets, time value of money concept is not that much significant, as the life of current assets in either one operating cycle or one accounting period. Management of current assets has the objective of striking proper balance between liquidity and profitability. If more money is blocked in current assets, it will increase liquidity but adversely affect profitability. With the employment of lesser funds in current assets, there may arise a situation of over-trading. Management of current assets and fixed assets, along with consideration of current liabilities, in order to calculate net current assets, in unavoidable for any business, as return on current assets (ROCA), return on fixed assets (ROFA) and return on total assets (ROTA) are important indicators of financial health [4].

Objectives of the study

The present study has been undertaken with the following objectives:

(I) Calculation and analysis of current assets to fixed assets ratio.

(ii) Calculation and analysis of percentage of current assets to total assets.

(iii) Calculation and analysis of percentage of net current assets to total assets.

Table - 1 Calculation of Ratios

(Rs in Crore)

	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06
Fixed Assets	5107.88	4715.50	4833.49	5023.62	4894.46	4953.68	5157.28	5256.82	5169.79	5039.01	4869.92
Current Assets	19871.51	15915.38	13608.05	15061.79	15650.54	13146.2	13353.79	15225.94	7192.47	6812.43	5525.14
Total Assets	24979.39	20630.88	18441.54	20085.41	20545	18099.88	18511.07	20482.76	12362.26	11851.44	10395.06
Ratio of Current Assets to Fixed Assets (in times)	3.89	3.38	2.82	3.00	3.20	2.65	2.59	2.90	1.39	1.35	1.13
Average	2.57										
% of Current Assets to Total Assets	79.55	77.14	73.79	74.99	76.18	72.63	72.14	74.34	58.18	57.48	53.15
Average	69.96										
Current Liabilities	2854.63	2626.38	2034.46	2719.96	1574.77	1975.19	2191.62	3182.89	1371.57	1201.23	1361.59
Net Current Assets (CA - CL)	17016.88	13289	11573.59	12341.83	14075.77	11171.01	11162.17	12043.05	5820.9	5611.2	4163.55
% of Net Current Assets to Total Assets	68.12	64.41	62.76	61.45	68.51	61.72	60.30	58.80	47.09	47.35	40.05
Average	58.23										

Source of Table : Annual Reports of IFFCO Ltd. from 2005-06 to 2015-16

3. METHODOLOGY

Ratio analysis is a universally used analytical technique to investigate the financial health of the organization. It is a major technique to review the picture portrayed by the financial statements of the organization [5]. It helps in analyzing the financial health, growth and development and the other related issues. Ratio analysis is a multidimensional tool for analyzing the assets utilization. Ratio analysis is not merely the calculation but also the interpretation of numerical relationship between various financial items. Ratios gained significance due to the fact that they can be used summarize briefly the results of business operations in easily understandable form. Ratios are useful particularly for the purpose of comparison of financial performance. In the present study, ratio of current assets to fixed assets along with percentage of current assets to fixed assets and current assets to total assets have been calculated. Ratio of current assets to fixed assets tells about the relationship of current assets and fixed assets. Percentage of current assets to total assets is helpful in understanding the proportion of current assets in total assets. Incorporating the effect of current liabilities and calculating the percentage of net current assets in total assets provides a picture of the financial security as well as the situation of over or under trading [6].

4. RATIO ANALYSIS OF IFFCO LTD.

With reference to Table 1, it can be noted that the average ratio of current assets to fixed assets is 2.57, during the 11 years of study. This implies that for each rupee invested in fixed assets, Rs 2.57 has been invested in current assets. On the higher side ratio is 3.89 during 2015-16. The management needs to take it seriously as the ratio has reached to this height from 1.13 in 2005-06. Here, it becomes imperative to check the components of current assets so as to identify which component is increasing and whether the increase is justified. If receivables are increasing, then a great care is required to reach to safer levels. If cash is increasing, there may be a situation of over trading. If inventory is increasing effective inventory management techniques need to be applied. If all components are increasing then this increase must be supported by increase in sales. Here, it may also be analyzed that the fixed assets are not being over exploited.

From Table 1, it is observed that current assets are almost 70% of total assets on average. On the higher side, this figure is 79.55% during the year 2015-16. At the lower side, the percentage of current assets to total assets is 53% in 2005-06. It is also noted that there is decrease in fixed assets in the year 2013-14. Still the percentage of current assets in total assets is substantial. During 2014-15 and 2015-16, current assets have grown by 17% and 25% respectively, while fixed assets increased by 8% only in 2015-16. These figures are supported by the ratios of current assets to fixed assets. Here, it is seen that current assets in total assets rise from 53% to almost 80%. This is alarming and it now becomes unavoidable to find out the cause of such a noticeable rise. As discussed in preceding paragraph, detailed analysis of components of current assets is required at this stage.

It is not possible to overlook current liabilities. Deductions of current liabilities from current assets give the figure of net current assets. This is a smart way to count the money actually available to the business. Considering that discharging the financial liabilities on time and timely fulfillment of such obligations is the prime responsibility of any business, it is advisable to analyze the net current assets and thus the percentage of net current assets in total assets has been calculated. Net current assets to total assets are 68% on higher side on 2015-16 and 40% on lower in 2005-06. The average figure is 58%. Current liabilities have increased by 8.69%in 2015-16 while net current assets increased by 28% in the same year. This indicates that current assets have also increased disproportionately. Though, this is a good sign that the current liabilities are on a lower side but mismatch increase in current liabilities should be analyzed and reasons for the same need to be identified.

5. FINDINGS

During the 11 years of study, it is found that current assets are on higher side. This shows mismanagement of current assets to some degree. For each rupee invested as fixed assets, Rs 2.57 is invested as current assets on average, which has increased from 1.13 to 3.89 times. There can be a situation of over utilization of fixed assets. Almost 70% of total assets are in the form of current assets and on higher side the figure is 80% rising from 53% during the period of study. This calls for the need to analyze the composition of total assets. Current liabilities are less in terms of the amount involved. Thus, net current assets are also more than significance, in terms of the amount involved.

6. CONCLUSION

Current assets are those assets which during the ordinary course of business will be converted into cash within one accounting year, without decrease in value and without disturbing the business operations of the firm [7]. Effective management of current assets is really significant due to the fact that current assets play pivotal role in keeping the wheels of a business running. Current assets are concerned with the short-term financial decisions. Mismanagement of current assets can lead to the failure of business. The correct mix of current assets and fixed assets is of crucial importance due to the fact that these are complementary to each other. Under utilization of currents assets will lead to lower return on current assets (ROCA) and lower return on total assets (ROTA), which would ultimately result into a lower return on capital employed (ROCE) [8]. It is also true that substantial funds are employed as current assets and thus any mismanagement of current assets leads to increase in cost of funds. It may result into crisis of funds. Thus, in order to maintain financial discipline, it is imperative that current assets are managed efficiently and effectively.

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