## II Solvency Ratios

1. Debt - Equity Ratio $= \dfrac{\text{Debt (long term)}}{\text{Equity (sh. holder's funds)}}$

$$= \frac{\text{Deb}^n + \text{Mortgage} + \text{public Deposits} + \text{loans}}{\text{Eq sh. Cap} + \text{pref sh.} + \text{R\&S surplus} - \text{fictitious Assets}}$$

This ratio judges the long term financial position and soundness of the long term financial policies of the firm. In general lower the debt-eq. ratio higher the degree of protection enjoyed by the lenders.

2. Total Assets to Debt Ratio

$$= \frac{\text{Total Assets}}{\text{long-term debts}}$$

This ratio measures the safety margin available to the suppliers of long term debts. It measures the extent to which debt is being covered by assets.

3. Proprietary Ratio = $\frac{\text{Shareholder's funds}}{\text{Total Assets}}$

This ratio shows the extent to which the total assets have been financed by the proprietor. Higher the ratio, greater the satisfaction for lenders & creditors.

4. Interest Coverage Ratio = $\frac{\text{PBIT}}{\text{Interest}}$

This ratio shows how many times the interest charges are covered by the profits available to pay interest charges. The higher the ratio, more secure the lender is in respect of payment of interest regularly. The ideal int. coverage ratio is 6 to 7 times.

# SOLVENCY RATIOS

**Ques 1** Calculate the Debt Equity Ratio from the following data:

i) Total Assets Rs. 125 000
ii) Total Debt Rs. 100 000
iii) Current Liabilities Rs. 50 000

**Ques. 2** On the basis of the following information, calculate the Total Assets to Debt Ratio:

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| Capital Employed | 22 20 000 | Cash & Cash Eq. | 150 000 |
| Trade Investment | 105 000 | Equity Sh. capital | 10 50 000 |
| Land | 900 000 | 8% Debentures | 300 000 |
| Trade Receivables | 2 25 000 | Balance of P&L A/c | (30 000) |
| Capital Reserve | 2 40 000 | | |

**Ques 3** Profit before interest but after Tax is Rs 10,20,000, the Tax provision amounts for Rs. 3 30 000 and company has 15% Debentures worth Rs. 15 00 000. Calculate the interest coverage ratio.

Ans. 1) D/E Ratio = 2:1

2) Total Assets to Debt Ratio = 1.44 : 1

3) Int. Coverage Ratio = 6 Times