ACS Barker

1 Naomi's financial year ends on 30 September. The following information was provided.

	2021	2022	2023
	$	$	$
<u>Current Assets</u>			
Inventory	8 000	15 000	35 000
Trade receivables	5 000	7 000	12 000
Cash at bank	4 000	600	
Total current assets	17 000	22 600	47 000
<u>Current Liabilities</u>			
Short-term borrowings			10 000
Trade payables	3 000	7 500	9 000
Total current liabilities	3 000	7 500	19 000

REQUIRED

(a) Explain what is meant by the liquidity of a business. **[2]**

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(b) Calculate the following ratios for the year ended 30 September 2023. Your answers should be corrected to **two** decimal places.

(i) Working capital (current) ratio **[2]**

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(ii) Quick (acid test) ratio **[2]**

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The following information relates to the three years ended 30 September 2021 and 2022.

		2021	2022
1	Working capital (current) ratio	5.67	3.01
2	Quick (acid test) ratio	3.00	1.01

(c) Taking into account the above information and your answers to **(a)(i) and (ii)**,

(i) Comment on the liquidity position of Naomi's business for the year ended 30 September 2023. [5]

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(ii) Suggest **two** reasons to explain the liquidity position of Naomi's business for the year ended 30 September 2023. **[2]**

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(d) Advise Naomi on **two** measures she may take to improve her liquidity position. **[2]**

(e) Explain why the quick (acid test) ratio is a more accurate measure of the liquidity than the working capital (current) ratio. **[2]**

The business profit has remained the same over the three years ended 30 September 2021, 2022 and 2023.

REQUIRED

(f) Advise Naomi why the liquidity of the business has changed even though profit has remained the same over the three years. **[2]**

Naomi is considering comparing the profitability of her business with that of a competitor.

REQUIRED

(g) Name **one** profitability ratio which Naomi could use. **[1]**

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[Total: 20]

2 Abrahm runs a retail business with a financial year end of 31 July. The following ledger account has been prepared at 31 July 2024.

Sale of motor vehicles

Date		Debit	Credit	Balance
2024		$	$	$
July 31	Motor vehicles	24 000		24 000 Dr
	Accumulated depreciation of motor vehicles		11 712	12 288 Dr
	Other receivables: Hybrid		10 800	1 488 Dr
	Income summary		1 488	-

REQUIRED

(a) Interpret **each** of the entries in the sale of motor vehicles account.

(i) Motor vehicles **[1]**

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(ii) Accumulated depreciation of motor vehicles **[1]**

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(iii) Other receivables: Hybrid **[1]**

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(iv) Income summary **[1]**

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During the year Abrahm had extended his shop premises at a cost of $17 500, which included $1500 for repairs to the existing shop premises. He had included the total cost in the business's statement of financial performance.

REQUIRED

(b) State the effect and amount of including the cost of the shop extension in the statement of financial performance on the following:

(i) Profit for the year **[2]**

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(ii) Non-current assets **[2]**

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[Total: 8]

3 Emmie is a sole trader. Her business buys and sells on credit.

The following information relates to Mattie's account in Emmie's ledger for the month of July.

During July, Emmie's business had the following transactions with Mattie.

2024		
July	1	Mattie owed Emmie, $1567.
	5	Emmie sold goods to Mattie at a list price of $6280 less 15% trade discount.
	14	Mattie returned goods bought on July 5, $1950, as faulty. This is the value **after** taking into account the trade discount.
	28	Mattie paid a cheque for $2425 after deducting 3% cash discount.

REQUIRED

(a) State one reason why Emmie offered Mattie a trade discount on July 5. **[1]**

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(b) Calculate the amount of trade discount at July 5. **[1]**

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(c) Calculate the amount of cash discount at July 28. **[1]**

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(d) Prepare Mattie's account for the month of July 2024 in Emmie's ledger. **[6]**

Mattie

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(e) State **three** reasons why a cheque would be returned by the bank as dishonoured.

[3]

1 ....

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3 ....

[Total: 12]

ANSWERS

1 (a) Liquidity is the ability of the business to repay its current liabilities out of current assets when they fall due. [1]

Liquidity measures how able a business is to convert current assets into cash to pay for current liabilities. [1]

(b) (i) Current Ratio = Current Assets / Current Liabilities
= \$47 000 / \$19 000
= 2.47

[2]

(b) (ii) Acid-Test ratio = $\dfrac{\text{Current Assets – Inventory}}{\text{Current Liabilities}}$
= \$(47 000 – 35 000) / \$19 000
= 0.63

[2]

(c)(i) Although the working capital ratio deteriorated from 5.67 in 2021 to 3.01 in 2022 and to 2.47 in 2023 it is still above the benchmark of 2.

Naomi's business is still more than able to meet its current liabilities with its current assets.
Her business is making better use of its resources, it has less idle resources in 2023.

The quick ratio has deteriorated over the three years from 3 in 2021 to 1.01 in 2022 which is the benchmark for quick ratio and then fell below the ideal ratio in 2023 when it decreased to 0.63. This is because the amount of inventory as a proportion of current assets has increased over the years. Inventory holdings have increased from \$8000 in 2021 to \$15 000 in 2022 to \$35 000 in 2023. Increasing inventory may mean funds are tied up in inventory.

The trade receivables position has worsened as trade receivables have increased each year from \$5000 in 2021 to \$7000 in 2022 to \$12 000 in 2023.
Increasing trade receivables runs the risk of a possible loss on impairment of trade receivables.
Increasing trade receivables may mean that funds are less readily available.

The bank balance has deteriorated each year from \$4000 in 2021 to \$600 in 2022 to an overdraft of \$10 000 in 2023.

The trade payables position has worsened as it has increased each year from \$3000 in 2021 to \$7500 in 2022 to \$9000 in 2023.
An increase in trade payable may affect the ability to obtain credit.
An increase in trade payables may affect the relationship with suppliers if unable to pay invoices on time.

Cash may have been used over the three years to purchase or place a deposit on non-current assets.

Naomi would have difficulties servicing her short-term debts when payments are due and payment for daily operating expenses may also be compromised.
Max of 5

(c)(ii) A substantial amount of Naomi's funds was tied up in inventory (less liquid asset) which amounted to $35 000, which is 75% of total current asset [(35 000 / 47 000) x 100]. [1]

Naomi has no cash in the bank account, where cash is the most liquid asset. [1]
An increase in Trade payable of 67% from 2021 [1].
Max of 2

(d) Contribute more capital to the company.
Sell off surplus non-current assets for cash.
Take additional bank loan
Any 2

(e) Quick ratio is a better indicator as it does not include inventory and prepayments [1] in the calculation but uses only liquid assets which can be easily converted into cash.[1]

Inventory is not regarded as a liquid asset as a buyer has to be found and time taken for money to be collected. [1]
Quick ratio is a better indicator as it shows whether the business will have any surplus liquid funds if all the current liabilities were paid immediately from the liquid assets. [1]
Max of 2

(f) Naomi might have increased her cash drawings over the period.
This will reduce cash but not profit.

The business might have spent cash to purchase non-current assets.
This will decrease liquidity but have no impact on profit.

The business might have high sales revenue but make most of its sales on credit.
This may mean a high profit but low levels of cash.

There are non-cash items in the statement of financial performance (eg depreciation, payables and accounting adjustments which can affect profit but have no effect on cash) and income/expenses are accounted for following the matching concept.

This means that income/expenses are not the same as cash paid out.

Interest on the long-term borrowings might have remained the same.

Profit will therefore not be affected, but portions of the loan are becoming payable within 12 months which increases current liabilities and reduces the current ratio.

(g) Gross profit margin
Mark-up on cost
Profit margin
Return on equity

2 (a) Interpret **each** of the entries in the sale of motor vehicles account.

(i) Motor vehicles
The cost of buying the motor vehicles sold. [1]

(ii) Accumulated depreciation of motor vehicles
The total depreciation to date on the motor vehicles sold. [1]

(iii) Other receivables: Hybrid
Disposal proceeds of the motor vehicles sold on credit to Hybrid. [1]

(iv) Income summary
Loss made on sale of motor vehicles. [1]

(b) State the effect and amount of including the cost of the shop extension in the statement of financial performance on the following:

(i) Profit for the year
Profit for the year has been understated by $16 000. [2]

(ii) Non-current assets
The value of non-current assets has been understated by $16 000. [2]

[Total: 8]

3 (a) State one reason why Emmie offered Mattie a trade discount on July 5.
To encourage Mattie to bulk buy.
For Emmie to clear out excess / outdated inventory.
To reward Mattie for continuing to purchase from Emmie [Any 1]

(b) Calculate the amount of trade discount at July 5.
$6280 x 15% = $942 [1]

(c) Calculate the amount of cash discount at July 28.
$(2425/97% x 3%) = $75 [1]

(d) Mattie

		Dr	Cr	Bal
2024		$	$	$
July 1	Balance b/d			1 567 Dr
5	Sales revenue	5 338	[1]	6 905 Dr
14	Sales returns	[1]	1 950	4 955 Dr
28	Cash at bank	[1]	2 425	2 530 Dr
28	Discount allowed	[1]	75	2 455 Dr
Aug 1	Balance b/d	[1]	[1]	2 455 Dr

[6]

(e) State **three** reasons why a cheque would be returned by the bank as dishonoured.
Cheque is over 6 months old / cheque is post-dated / cheque is unsigned / information on cheque is incomplete / information on cheque is inconsistent / insufficient funds to pay the cheque. [any 3]