

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 = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$
= $\frac{\$47\,000}{\$19\,000}$
= 2.47

[2]

(b) (ii) Acid-Test ratio = $\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$
= $\frac{\$(47\,000 - 35\,000)}{\$19\,000}$
= 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 $[(35\,000 / 47\,000) \times 100]$. [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 \times 15\% = \942 [1]

(c) Calculate the amount of cash discount at July 28.

$\$(2425/97\% \times 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]

Answers

1 (a)

Tulip Ltd

Statement of financial performance for the year ended 31 July 2024

	\$	\$
Sales revenue	[1]	402 645
less Sales returns	[1]	30 246
Net sales returns		372 399
less Cost of sales	[1]	209 856
Gross profit		162 543
less Other Expenses		
Rent	37 000	
Salaries (80 388 + 700)	81 088	[1]
Interest on bank loan (2% x 50 000)	1 000	[1]
Insurance (17 600 /15 x12)	14 080	[1]
Depreciation of office furniture (40 300 x 10%)	4 030	[1]
Depreciation of motor vehicle [(120 800 – 30 200) x 20%]	18 120	[1]
Impairment loss on trade receivables [2200 – (2300 – 326)]	226	[1]
		155 544
Profit for the year	OF [1]	6 999

Tulip Ltd

Statement of financial position as at 31 July 2024

	\$	\$	\$
Assets			
Non-current assets	Cost	Acc Dep	NBV
Motor vehicles (AD + 18 120) [1]	120 800	48 320	72 480
Office furniture (AD + 4030) [1]	40 300	8 060	32 240
Total Non-Current Assets	161 100	56 380	104 720
Current assets			
Inventory		11 920	
Trade receivables (– 326)	14 994	[1]	
less Allowance for impairment of TR	2 200		
Net trade receivables		12 794	[1]
Prepaid insurance		3 520	[1]
Total current assets			28 234
Total assets			132 954
Equity and Liabilities			
Shareholders' equity			
Share capital, 100 000 ordinary shares		50 000	
Retained earnings (20 000 + 6999 – 5000)		21 999	[1]
Total equity			71 999
Non-current liabilities			
Long-term borrowings (– 30 000)		[1]	20 000

Current liabilities			
Trade payable		2 543	
Current portion of long-term borrowings		30 000	
Salaries payable		700	[1]
Dividends payable (100 000 x 0.05)		5 000	[1]
Short-term borrowings		2 212	
Interest payable (1000 – 500)		500	[1]
Total Current liabilities			40 955
Total equity and liabilities			132 954

2(a)(i) Cost of sales = $\$25\,800 / 0.25 = \$103\,200$ [1]

2(a)(ii) Net sales revenue = $\$(103\,200 + 25\,800) = \$129\,000$ [1]

2(a)(iii) Gross profit margin = $\$(25\,800 / 129\,000) \times 100\% = 20\%$ [1]

(a)(iv) Profit margin = $20\% - 5\% = 15\%$ [1]

(a)(v) Return on equity = $\$[(25\,800 - 6450) / 215\,000] \times 100\% = 9\%$ [1]

2(b) Lamech's gross profit margin of 20% is worse than Japheth's gross profit margin of 22%. This may be due to a more expensive supply of goods for Lamech.

Lamech has a better profit margin of 15% than Japheth's profit margin of 12%.

This suggests that Lamech is more efficient in the management of expenses to generate sales.

Lamech's better return on equity of 9% suggests that Lamech is better at generating profits for his investors.

[2 marks each – Comparison followed by explanation]

2(c) Encourage sales through advertising.

Offer trade discounts to encourage bulk purchases.

Source for a cheaper supply of goods.

Increase the selling price for its products.

[Any two]

2(d) Review its credit policy for customers.

Look for a cheaper source of finance.

Reduce utilities, advertising, rent, or wages expenses to cut costs.

[Any two]

3(a) Inventory turnover rate for the year ended 30 April 2024

= Cost of sales / Average inventory [1]

= \$350 000 / [\$(80 000 + 100 000)/2] [1]

= 3.9 times

3(b) The inventory turnover rate has worsened over the 2 years [1] by 4.1 times from 8 times in 2023 to 3.9 times in 2024. [1]

This means the business is taking a longer time to replenish goods. [1] It could be because the business is holding too much inventory or the business is not selling goods fast enough.

3(c)

Inventory

Date	Particulars	Debit (\$)	Credit (\$)	Balance (\$)	
2024					
May 1	Balance b/d			1 800 Dr	
5	Cash at bank	1 500		3 300 Dr	
13	Cash at bank	1 950		5 250 Dr	
25	Cash at bank	1 400		6 650 Dr	
31	Cost of sales (1800 + 1500 + 1950)		5 250 [1]	1 400 Dr	[1]
June 1	Balance b/d [1]			1 400 Dr	[OF]

[3]

3(d) Inventory is valued at cost or net realisable value, whichever is lower. [1]

Prudence concept states that a business must report and adjust for losses that it is likely to incur even when these losses are not confirmed yet. [1] However, the business does not record profits that are likely to occur. Profits are recorded only when they are actually earned.

3(e)

	Gross Profit	Profit for the year
30 April 2023	No effect	Overstated by \$300
30 April 2024	Understated by \$300	Understated by \$300

3(f)

2024		Debit	Credit
		\$	\$
May 31	Impairment loss on inventory [1]	5 200	
	Inventory [1]		5 200

- 4(a) Expenses incurred must be matched against income earned in the same accounting period to determine the profit for that period. **[1]**
- 4(b) Credit note **[1]**
- 4(c) No effect **[1]**
- 4(d) Casper has gone bankrupt and the amount owed had to be written off. **[1]**
- 4(e)

Buster Boy Toys		
Statement of Financial Performance as at 31 December 2023 (extract)		
	\$	\$
less Other Expenses		
Impairment loss on trade receivables (reversal) [1]	(4 100) [1]	

- 4 (f) Buster Boy Toys should grant the extension to Best Gifts. **(1 decision)**
 Best Gifts is a bigger customer compared to Novelty Hub due to higher sales revenue made to Best Gifts. **(1 basic statement)**
 It would be good for Buster Boy Toys so that Best Gifts will choose to continue buying from Buster Boy Toys instead of turning to other suppliers. **(1 development)**
 Best Gifts is popular with working adults whereas Novelty Hub is popular with students. **(1 basic statement)**
 Working adults have the ability to spend more than students. This could lead to higher revenue for Best Gifts which will help them to pay Buster Boy Toys promptly. **(1 development)**
 Best Gifts has been in business for a longer time compared Novelty Hub. **(1 basic statement)**
 Best Gifts is more stable compared to Novelty Hub and will be less likely to make late payments to Buster Boy Toys in the long run. **(1 development)**
 Best Gifts has a stable rent expense compared to Novelty Hub. **(1 basic statement)**
 Even though Best Gifts' rent is higher than Novelty Hub, it has been stable for the past 5 years unlike Novelty Hub' rent. Best Gifts will be able to manage their liquidity more easily and minimise late payments to Buster Boy Toys. **(1 development)**

OR

Buster Boy Toys should grant the extension to Novelty Hub. **(1 decision)**
 Novelty Hub has a shorter repayment history. **(1 basic statement)**
 As they are relatively prompt with payment compared to Best Books, it would be less risky to grant them the credit extension. **(1 development)**
 Novelty Hub' online store will be ready next month, whereas Best Gifts has no plans to set up one. **(1 basic statement)**
 An online shop will help Novelty Hub to have a wider reach of customers which will help boost their sales. They will therefore be less likely to make late payments to Buster Boy Toys in the long run. **(1 development)**
 Novelty Hub pays lower rent compared to Best Gifts. **(1 basic statement)**
 With lower operational expenses, Novelty Hub is better able to pay Buster Boy Toys promptly. **(1 development)**