**Question 4**

Noreen is a sole trader and the following are results for her second year of trading:

**Income Statement of Noreen for the year ended**

**31 December Year 2**

|  |  |
| --- | --- |
|  | £ |
| Sales Revenue | 180,000 |
| Less Cost of Sales | 120,000 |
| GROSS PROFIT | 60,000 |
| Less Expenses | 29,000 |
| PROFIT FOR THE YEAR | 31,000 |

* 90% of sales revenue is on credit.
* Purchases amounted to £122,000 with 75% being on credit.

**Statement of Financial Position of Noreen as at 31 December Year 2**

|  |  |  |
| --- | --- | --- |
|  | £ | £ |
| Non-current Assets |  | 80,000 |
| Current Assets |  |  |
| Inventory | 12,000 |  |
| Trade Receivables | 6,000 |  |
| Cash and Cash Equivalents | 75,000 |  |
|  | 93,000 |  |
| Less Current Liabilities |  |  |
| Trade Payables | 14,000 | 79,000 |
|  |  | 159,000 |
| Financed by: |  |  |
| Equity |  | 138,000 |
| Add Profit for the Year |  | 31,000 |
|  |  | 169,000 |
| Less Drawings |  | 10,000 |
|  |  | 159,000 |

A comparison with Year 1 shows that:

* Inventory had increased by £2,000
* Trade receivables had decreased by £8,000
* Trade payables had increased by £4,000

The following information relates to Noreen’s first year of trading:

|  |  |  |
| --- | --- | --- |
| 1. Gross Profit percentage | | 28·57% |
| 1. Profit for the Year percentage | | 11·43% |
| 1. Rate of Inventory Turnover | | 8 times |
| 1. Return on Equity Employed | | 12·3% |
| 1. Trade Receivables Collection Period | | 43·45 days |
| 1. Trade Payables Payment Period | | 39·82 days |
| 1. Current Ratio | | 2·6:1 |
| 1. Acid Test Ratio | | 1·2:1 |
| 1. Non-current Asset**:**Turnover | | 2:1 |
| 1. Expenses Ratio | | 17·14% |
|  |  | |

1. **You are required** to calculate each of the above ratios for Year 2   
   (to two decimal places). **20**
2. Give a reason for the difference between Year 1 and Year 2 for each of the following ratios:
3. The Gross Profit percentage **1**
4. Trade Receivables Collection Period **1**
5. Rate of Inventory Turnover **1**
6. Return on Equity Employed **1**
7. Current Ratio **1**
8. In which year is Noreen in a better position to meet short-term debts? Give a reason for your answer. **1**
9. **“The trial balance that Noreen also prepares is limited as a checking device.”**

Give **two** examples which illustrate this statement. **2**

1. Why might Noreen offer the following to other firms:
2. Trade discount **1**
3. Cash discount **1**

**Total marks (30)**

|  |  |  |  |
| --- | --- | --- | --- |
| **Question** | **Expected answer(s)** | **Max mark** | **Additional guidance** |
| **4 (a)** | 1) Gross Profit percentage = £60,000 x 100 = 33·33% **(1)**  £180,000  2) Profit for the Year % = £31,000 x 100 = 17·22% **(1)**  £180,000  3) Rate of Inventory £120,000 = 10·91 (1) times **(1)**  Turnover = £11,000  Average Inventory = £10,000 + £12,000 **(1)**  2 **(1)**  4) Return on Equity £31,000 x 100 = 22·46% **(1)**  Employed = £138,000  5) Trade Receivables £10,000 x 365 = 22.53 days **(1)**  collection period = £162,000  Average Receivables = £14,000 + £6,000 **(1)**  2 **(1)**  Credit Sales = £180,000 x 90% **(1)**  6) Trade Payables £12,000 x 365 = 47·87 days **(1)**  payment period = £91,500  Average Payables = £10,000 + £14,000 **(1)**  2 **(1)**  Credit Purchases = £122,000 x 75% **(1)**  7) Current Ratio = £93,000 : £14,000 = 6·64:1 **(1)**  8) Acid Test = £81,000\* : £14,000 = 5·79:1 **(1)**  \* £93,000 - £12,000 **(1)** | **20** | Accept rounding difference of 0·01% either way.  **1 mark** for ALL correct labelling of ratios, ie “:1”, “%”, etc.  Candidate must round to two decimal places, to gain mark for labels. |
| **Question** | **Expected answer(s)** | **Max mark** | **Additional guidance** |
| **4 (a) cont.** | 9) Non-current  AssetTurnover = £180,000:£80,000 = 2·25:1 **(1)**  10) Expenses Ratio = £29,000 x 100 = 16·11% **(1)**  £180,000  Labels **(1)** |  |  |
| **4**  **(b) (i)** | Change in the gross profit percentage could be due to:   * increase in the mark-up * lower purchase prices * buying in bulk * less shrinkage/wastage * increase in selling price | **1** | Any one for **1 mark.**  Accept any other relevant answer. |
| **4**  **(b) (ii)** | Change in the trade receivables collection period could be due to:   * a cash discount being offered to credit customers * factoring debts * better credit control * more efficient invoicing | **1** | Any one for **1 mark.**  Accept any other relevant answer. |
| **4**  **(b) (iii)** | Change in rate of inventory turnover could be due to:   * more popular/faster-selling goods * reducing inventory holding * sales promotions * greater advertising to sell stock quicker | **1** | Any one for **1 mark**.  Accept any other relevant answer. |

|  |  |  |  |
| --- | --- | --- | --- |
| **Question** | **Expected answer(s)** | **Max mark** | **Additional guidance** |
| **4**  **(b) (iv)** | Change in return on equity employed could be due to:   * higher profit for the year * better control of expenses * more efficient use of resources | **1** | Any one for **1 mark**.  Accept any other relevant answer. |
| **4**  **(b) (iv)** | Change in current ratio could be due to:   * much higher cash and cash equivalents figure * may have sold non-current assets * more equity injected into the business | **1** | Any one for **1 mark**.  Accept any other relevant answer. |
| **4 (c)** | Year 2 because current ratio/acid test is higher. | **1** | Watch for consequentiality.  Must refer to current ratio/acid test or liquidity in answer. |
| **4 (d)** | There could be:   * errors of omission or a description or an example * errors of commission or a description or an example * errors of principal or a description or an example * errors of original entry or a description or an example * complete reversal or a description or an example * compensating errors or a description or an example | **2** | Any two for **1 mark** each. |
| **4**  **(e) (i)** | Trade discount could:   * encourage customer loyalty * encourage bulk buying * encourage new customers | **1** | Any one for **1 mark.**  Accept any other relevant answer. |
| **4**  **(e) (ii)** | Cash discount could:   * encourage debtors to pay quickly * help cash flow/liquidity | **1** | Any one for **1 mark**.  Accept any other relevant answer. |