

QUESTION 50

[Memo p175; Ex Bk p98]

Ratio analysis (51 marks; 30 minutes)

Jambo Stationers main line of business is the sale of books and stationery. They mark up their stock by 75% on cost. You have been asked to analyse and comment on their financial results, giving advice where necessary.

REQUIRED:

Using the given information answer the questions that follow.

INFORMATION:

JAMBO STATIONERS INCOME STATEMENT/STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.9:

	20.9	20.8
Sales/Turnover	1 280 000	1 118 000
Cost of sales	(800 000)	(650 000)
Gross profit	480 000	468 000
Other income	29 200	27 500
Rent income	26 000	24 000
Commission income	3 200	3 500
Gross operating income	509 200	495 500
Operating expenses	(118 800)	(106 590)
Wages	82 000	78 000
Telephone	9 000	8 000
Advertising	15 000	10 000
Other operating expenses	12 800	10 590
Operating profit	390 400	388 910
Interest income	-	4 000
Net profit before interest expense	390 400	392 910
Interest expense	(850)	(900)
Net profit for the year	389 550	392 010

ITEMS EXTRACTED FROM THE BALANCE SHEETS/STATEMENTS OF FINANCIAL POSITION OF JAMBO STATIONERS:

	20.9	20.8
Tangible/Fixed assets	R1 673 000	R1 439 500
Financial assets (Investment)	-	50 000
Current assets	89 500*	45 000
Owners equity	1 727 500	1 500 000
Non-current liabilities	10 000	12 000
Current liabilities	25 000	22 500

*This amount includes trading stock valued at R75 000.

Financial indicators for the year ended 30 June 20.8:

Mark-up achieved	: 72%
Gross profit on turnover	: 41.9%
Operating profit on turnover	: 34.8%
Net profit on turnover	: 35.1%
Operating expenses on turnover	: 9.5%
Current ratio	: 2 : 1
Acid test ratio	: 1.1 : 1
Return on owner's equity	: 25%

Questions:

- 50.1 Calculate the following ratios for the year ended 30 June 20.9:
- 50.1.1 Mark-up achieved (3)
 - 50.1.2 Gross profit on turnover (3)
 - 50.1.3 Operating profit on turnover (3)
 - 50.1.4 Net profit on turnover (3)
 - 50.1.5 Operating expenses on turnover (3)
- 50.2 Compare the profitability financial indicators for 20.9 year with those of 20.8 and comment on the profitability of the business. Also explain why you think the profitability has changed from the previous year to the current year. (10)
- 50.3 Calculate the following ratios on 30 June 20.9:
- 50.3.1 Current ratio (3)
 - 50.3.2 Acid-test ratio (3)
- 50.4 You told the owner that you were not very happy with the liquidity position of his business. As the owner has very little knowledge of Accounting terminology he asked you to explain the meaning of the term 'liquidity'. (2)
- 50.5 Explain why the acid-test ratio is generally regarded as the more reliable ratio. (2)
- 50.6 Refer to the relevant Balance Sheet figures for 20.8 and the relevant financial indicators for 20.8 to calculate the amount of trading stock on 30 June 20.8. (4)
- 50.7 The owner is unsure as to whether his investment in this business is still worth his while.
- 50.7.1 Use an appropriate calculation to determine his return on his investment in 20.9. (4)
 - 50.7.2 Comment on whether you think the owner will be pleased with this return. (2)
- 50.8 During 20.9 the owner increased his capital as follows:
Cash R30 000
Equipment R18 000
Bearing this in mind, calculate the amount withdrawn (drawings) by the owner during 20.9. (6)

QUESTION 50*[Study Guide p81; Memo p175]***Ratios analysis
(51 marks; 30 minutes)**

50.1	50.1.1 Mark-up achieved	(3)
	50.1.2 Gross profit on turnover	(3)
	50.1.3 Operating profit on turnover	(3)
	50.1.4 Net profit on turnover	(3)
	50.1.5 Operating expenses on turnover	(3)
50.2	Compare the profitability financial indicators for 20.9 year with those of 20.8 and comment on the profitability of the business. Also explain why you think the profitability has changed from the previous year to the current year.	(10)
50.3	Calculate the following ratios on 30 June 20.9:	
	50.3.1 Current ratio	(3)

	50.3.2 Acid-test ratio	(3)
50.4	You explained to the owner that you were not very happy with the liquidity position of his business. As the owner has very little knowledge of Accounting terminology he asked you to explain the meaning of the term 'liquidity'.	(2)
50.5	Explain why the acid-test ratio is generally regarded as the more reliable ratio.	(2)
50.6	Refer to the relevant Balance Sheet figures for 20.8 and the relevant financial indicators for 20.8 to calculate the amount of trading stock on 30 June 20.8.	(4)
50.7	50.7.1 Use an appropriate calculation to determine his return on his investment in 20.9.	(4)
	50.7.2 Comment on whether you think the owner will be pleased with this return.	(2)
50.8	Calculate the amount withdrawn (drawings) by the owner during 20.9.	(6)

QUESTION 50

[Study Guide p81; Ex Bk p98]

Ratios analysis

(51 marks; 30 minutes)

50.1	50.1.1 Mark-up achieved	(3)
$\frac{480\,000 \checkmark}{800\,000 \checkmark} \times \frac{100}{1} = \underline{60\% \checkmark}$		
	50.1.2 Gross profit on turnover	(3)
$\frac{480\,000 \checkmark}{1\,280\,000 \checkmark} \times \frac{100}{1} = \underline{37.5\% \checkmark}$		
	50.1.3 Operating profit on turnover	(3)
$\frac{390\,400 \checkmark}{1\,280\,000 \checkmark} \times \frac{100}{1} = \underline{30.5\% \checkmark}$		
	50.1.4 Net profit on turnover	(3)
$\frac{389\,550 \checkmark}{1\,280\,000 \checkmark} \times \frac{100}{1} = \underline{30.4\% \checkmark}$		
	50.1.5 Operating expenses on turnover	(3)
$\frac{118\,800 \checkmark}{1\,280\,000 \checkmark} \times \frac{100}{1} = \underline{9.3\% \checkmark}$		
50.2	Compare the profitability financial indicators for 20.9 year with those of 20.8 and comment on the profitability of the business. Also explain why you think the profitability has changed from the previous year to the current year.	(10)
<ul style="list-style-type: none"> • Mark-up achieved decreased by 12%; cost of sales increased; possible theft, incorrect mark-up calculations, excessive trade discounts, etc. ✓✓ • Gross profit on turnover decreased by 4.4%; sales have increased but the increase in cost price may have resulted in this slight decrease. ✓✓ • Operating profit on turnover decreased by 4.3%; expenses have increased; more advertising may have resulted in the increase in turnover. ✓✓ • Net profit on turnover decreased by 4.7%; no interest income in 20.9 as the investment has matured; increase in expenses; the decrease in net profit is small. ✓✓ • Expenses on turnover decreased slightly by 0.2%; increase in turnover in 20.9 may have resulted in the small decrease. ✓✓ <p><i>Any other appropriate comments.</i></p>		
50.3	Calculate the following ratios on 30 June 20.9:	
	50.3.1 Current ratio	(3)
$89\,500 \checkmark : 25\,000 \checkmark = \underline{3.6 : 1 \checkmark}$		
	50.3.2 Acid-test ratio	(3)
$89\,500 - 75\,000 \checkmark : 25\,000 \checkmark = \underline{0.6 : 1 \checkmark}$		
50.4	You told the owner that you were not very happy with the liquidity position of his business. As the owner has very little knowledge of Accounting terminology he asked you to explain the meaning of the term 'liquidity'.	(2)
<p>The ability of a business to pay its short-term debts. ✓✓</p>		
50.5	Explain why the acid-test ratio is generally regarded as the more reliable ratio.	(2)
<p>Trading stock is the least liquid of the current assets. ✓✓ Trading stock sold may not realise sufficient cash to pay debts.</p>		

50.6	Refer to the relevant Balance Sheet figures for 20.8 and the relevant financial indicators for 20.8 to calculate the amount of trading stock on 30 June 20.8.	(4)
$\frac{2 - 1.1}{2} \times \frac{45\,000}{1} = \underline{R20\,250}$ <p>OR</p> $22\,500 \times 1.1 = R24\,750$ $45\,000 - 24\,750 = \underline{R20\,250}$		
50.7	50.7.1 Use an appropriate calculation to determine his return on his investment in 20.9.	(4)
$\frac{389\,550}{\frac{1}{2}[1\,727\,500 + 1\,500\,000]} \times \frac{100}{1}$ $\frac{389\,550}{1\,613\,750} \times \frac{100}{1} = \underline{24.1\%}$		
	50.7.2 Comment on whether you think the owner will be pleased with this return.	(2)
<p>Yes. Decrease of almost 1% but the return is still higher than the current bank rate. ✓✓</p> <p>No. Profitability has decreased. <i>Any other appropriate reason.</i></p>		
50.8	Calculate the amount withdrawn (drawings) by the owner during 20.9.	(6)
$1\,500\,000 + 389\,550 + 30\,000 + 18\,000 - x = 1\,727\,500$ $x \text{ (Drawings)} = \underline{R210\,050}$		