

- 4 Adya is a trader. She buys and sells one type of good only. She has provided the following information.

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For the year to 31 October 2022	
Revenue	98 000
Purchases	62 305
Expenses	31 188
Other income	4 630

At 31 October 2022

Inventory	7 500
Trade receivables	9 240
Trade payables	5 365
Bank overdraft	5 135

The inventory quantity and valuation at 31 October 2022 are double those at 31 October 2021.

REQUIRED

- (a) Complete the following tables.

Gross margin	
Working	Answer (correct to two decimal places)

Profit margin	
Working	Answer (correct to two decimal places)

Rate of inventory turnover	
Working	Answer (correct to two decimal places)

Liquid (acid test) ratio	
Working	Answer (correct to two decimal places)

[9]

Adya's purchases price has remained constant throughout both years ended 31 October 2021 and 31 October 2022. The following information relates to Adya's business for the year ended 31 October 2021.

Gross margin	37.60%
Profit margin	14.85%
Rate of inventory turnover	12 times
Liquid (acid test) ratio	1.15:1

REQUIRED

(b) Comment on the changes in:

(i) gross margin

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..... [2]

(ii) the liquid (acid test) ratio.

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Adya is concerned about the increase in inventory over the year to 31 October 2022. She is considering reducing her selling price to increase the quantity of goods she can sell.

REQUIRED

(c) Advise Adya whether she should reduce her selling price. Justify your answer.

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One of the limitations of financial statements is that there is a gap between the end of the financial year and the preparation of the financial statements.

REQUIRED

(d) Explain how this limitation may influence Adya's decision about whether or not to reduce her selling price.

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..... [2]

[Total: 20]

Question	Answer	Marks
4(a)	<p>Gross margin [Cost of sales = 3750 + 62 305 – 7500 = 58 555] Gross profit = 98 000 – 58 555 = 39 445 (1)</p> <p>$\frac{39\,445}{98\,000} \times \frac{100}{1}$ (1)OF whole formula = 40.25% (1)OF</p> <p>Profit margin Profit for year = 39 445OF – 31 188 + 4630 = 12 887OF</p> <p>$\frac{12\,887}{98\,000}$ (1)OF $\times \frac{100}{1}$ = 13.15% (1)OF</p> <p>Rate of inventory turnover $\frac{58\,555}{(3750 + 7500) / 2} = \frac{58\,555}{5625}$ } (1)OF = 10.41 times (1)OF</p> <p>Liquid (acid test) ratio 9240 : (5365 + 5135) = 9240 : 10 500 (1) whole formula = 0.88:1 (1)OF</p>	9
4(b)(i)	<p>Answers based on answer to 4 (a) Gross margin has improved (1)</p> <p>The selling price has increased/trade discount allowed has decreased (1) Cost of sales has decreased/increase in inventory (1) Max (1)</p>	2

Question	Answer	Marks
4(b)(ii)	<p>Answers based on answer to 4 (a) The liquid (acid test) ratio has worsened (1)</p> <p>More funds are tied up in inventory (1) Increase in current liabilities (1) Decrease in liquid current assets (1) Max (1)</p>	2
4(c)	<p>For reducing selling price Should increase total quantity sold (1) Reduce inventory (1) Should improve rate of inventory turnover (1) Should reduce the risk of un-saleable inventory (damage/deterioration) (1) May reduce storage costs if have less inventory (1) May increase total cash received from sales/reduce bank overdraft /improve liquid (acid test) ratio (1) Max (2)</p> <p>Against reducing selling price Would reduce gross margin (1) Less cash received from each unit sold (1) Customer may be unwilling to pay the full price in future (1) Max (2)</p> <p>Accept other valid points</p> <p>Recommendation (1)</p>	5
4(d)	<p>Need to consider the amount of profit made since the end of the last financial year (1) Need to consider the amount of inventory held at the present date (1)</p>	2