INSIGHT

Trial Exam Paper

2009
ACCOUNTING
Written examination 2

Suggested solutions

This book presents:

- correct solutions
- mark allocations

Question 1

NS Bikes

Nicholas Seoud is the owner and manager of a small business, NS Bikes. At this point in time, he is only selling the Shooting Star X3 and accessories. Nicholas's business maintains a double-entry accrual accounting system, reporting monthly with control accounts for Debtors, Creditors and Stock. The business uses a perpetual inventory recording system with the FIFO (First In First Out) cost assignment method.

1.1 On June 30 2009, Nicholas purchased a Delivery Van from Coopers Cars on credit. The invoice below was issued for the transaction.

COOPER CARS		**Invoice 43**
Tax Invoice		June 30 2009
Charge To: NS Bikes		Terms: n/90
Description		
Delivery Van	37 650	
Painting of Business logo on Van	450	
Bike Rack (including installation)	1 300	
12 Months Registration	900	
Annual Insurance	1 200	
Freight In	400	
Customs Duty	200	
SUB-TOTAL		**42 100**
Plus GST		4 210
TOTAL		**46 310**

Note: the Van has an estimated residual value of $4 000 and a useful life of 6 years. On August 12 2009, NS Bikes will make a payment of $20 000 to Cooper Cars. The final payment to Cooper Cars is due by the end of September.

Required

1.1.1 **Calculate** the cost of the Delivery Van.

Solution 1.1.1

Calculate

Delivery Van + Paint Job + Bike Rack + Freight In + Customs Duty =

37650 + 450 + 1300 + 400 + 200 = 40 000

Cost of Delivery Van: *$40 000*

1 mark

Question 1 – continued

Mark allocation

- 1 mark for correct figure.

1.1.2 **Define** the term ‘cost’ as it applies to a non-current asset.

Solution 1.1.2

Explanation *Cost of a non-current asset includes all costs incurred in order to bring the*
asset into a location and condition ready for use that will provide a benefit for the life of
the asset.

2 marks

Mark allocation

- 1 mark for identifying to bring the asset into a location and condition ready for use.
- 1 mark for providing a benefit for the life of the asset.

1.1.3 Using the information provided in 1.1 above only, **show** how the following items would appear in the Balance Sheet as at July 31 2009.

- Registration
- Delivery Van and depreciation
- Sundry Creditor

Solution 1.1.3

Account	Classification in Balance Sheet	$ Amount
Prepaid Registration	*Current Asset*	*$825*
Delivery Van	*Non-Current Asset*	*$40 000*
Accumulated Depreciation	*Non-Current Asset*	*($500)*
Sundry Creditor – Cooper Cars	*Current Liability*	*$46 310*

4 marks

Mark allocation

- 1 mark per line.
- Note: students must be looking for dates that make questions more difficult than they first seem.

Question 1 – continued

1.1.4 **Explain** the difference between the General Ledger account for 'Creditors Control' and a 'Sundry Creditor'.

Solution 1.1.4

Explanation
Creditors Control represents the balance owing on the credit purchases of stock (Trade
creditors), while Sundry Creditor represents the balance owing on all other items other
than stock that are purchased on credit.

2 marks

Mark allocation

- 1 mark for identifying that Creditors Control represents the credit purchase of stock.
- 1 mark for identifying Sundry Creditor represents the balance on all other items other than stock purchased on credit. (The credit purchase of non-current assets is also acceptable).

1.1.5 **Show** how the payment on 12 August would appear in the Cash Flow Statement for the month ending August 31.

Solution 1.1.5

Operating/Investing/Financing	**Inflow/Outflow**	**Account**
Investing	*Outflow*	*Sundry Creditor – Cooper Cars*

2 marks

Mark allocation

- 1 mark for identifying Investing Outflows.
- 1 mark for *Sundry Creditor – Cooper Cars* title.

On January 1 2010, NS Bikes purchased a new Delivery Van worth $30 000 (plus $3 000 GST) from Cooper Cars (Inv. 163). As a part of the purchase, the firm traded in the Delivery Van for $25 000.

1.1.6 **Show** the General Journal entry to record the trade-in and purchase of the Delivery Vans. (Narrations are **not** required)

Solution 1.1.6

Date 2010	**Particulars**	**General Ledger**		**Subsidiary Ledger**	
		Debit $	**Credit $**	**Debit $**	**Credit $**
1 Jan	*Disposal of Delivery Van*	*40 000*			
	Delivery Van		*40 000*		
	Accumulated Depreciation – Van	*3 500*			
	Disposal of Delivery Van		*3 500*		
	Sundry Creditor – Cooper Cars	*25000*			
	Disposal of Delivery Van		*25000*		
	Loss on Disposal of Van	*6 000*			
	Disposal of Van		*6 000*		
	Delivery Van	*30 000*			
	GST Clearing	*3 000*			
	Sundry Creditor – Cooper Cars		*33 000*		

10 marks

Mark allocation

- 1 mark for each entry (Delivery Van/GST Clearing total 1 mark).
- It is also acceptable to combine the trade-in entry ($25 000) with the purchase of the Delivery Van entry ($33 000), leaving the Sundry Creditor – Cooper Cars entry a credit of $8 000.

Question 1 – continued

1.1.7 **State** what is meant by 'under-depreciation'.

Solution 1.1.7

Under-depreciation *When insufficient depreciation has been allocated over the life of the*
asset, so that the carrying value of the asset is overstated.

1 mark

Mark allocation

- 1 mark for either insufficient depreciation or carrying value is overstated.
- Note: For one mark students should not go into a lengthy discussion of the details required in the following question. Students should have noted this during reading time.

1.1.8 State **two** reasons why scrap value may be overstated.

Solution 1.1.8

Reason 1 *The original estimates did not anticipate damage to the NCA. This would*
decrease scrap value.
Reason 2 *The original estimates did not anticipate that the NCA would be outdated, or*
superseded by a new or superior model, which would decrease scrap value.

2 marks

Mark allocation

- 1 mark for each explanation.

1.2 As at January 1 2010, NS Bikes had 4 Shooting Star X3s valued at $1 680 in total. The following documents relate to the Shooting Star X3.

NS Bikes	**ABN: 313242**				**Invoice 32**
Tax Invoice					January 1 2010
Charge To: Summer Roberts					Terms: 5/7, n/30
Description	**Quantity**	**Each**	**Sub Total**	**GST**	**Total**
Shooting Star X3	2	$650	$1 300	$130	$1 430

Atwood Bikes ABN:114290					**Invoice B3**
Tax Invoice					January 4 2010
Charge To: NS Bikes					Terms: n/30
Description	**Quantity**	**Unit Cost**	**Stock**	**GST**	**Total**
Shooting Star X3	8	$450	$3 600	$360	$3 960

Question 1 – continued

NS Bikes
Cheque 107 January 4 2010 **Paid to:** ExFed Delivery **For:** Delivery of Bikes from Inv. B3 **Amount: $176 (incl. $16 GST)**

NS Bikes		**ABN: 313242**			**Invoice 37**
Tax Invoice					January 10 2010
Charge To: Luke Ward					Terms: 5/7, n/30
Description	**Quantity**	**Each**	**Sub Total**	**GST**	**Total**
Shooting Star X3	3	$650	$1 950	$195	$2 145

NS Bikes ABN: 313242	**Credit Note 10**
	January 15 2010
Returned by: Summer Roberts Item: 1 × Shooting Star X3 – damaged (Inv. 32) **TOTAL CREDIT:** $715	

Atwood Bikes ABN: 114290	**Credit Note F56**
	January 16 2010
Returned by: NS Bikes Item: 2 × Shooting Star X3 $900 and refund for Shipping cost on bikes $40 GST $94 Reason: damaged **TOTAL CREDIT:** $1 034	

NS Bikes
Cheque 110 January 24 2010 **Paid to:** AIG Insurance **For:** Annual Insurance covering 1/2/2010 – 31/1/2011 **Amount: $2200 (incl. $200 GST)**

NS Bikes	**Memo 6**
	31/1/2010
The physical stocktake revealed 7 Shooting Star X3s on hand	

NS Bikes	**Memo 7**
Due to competitors selling cheaper imported bikes, Shooting Star X3s will need to be sold for $500 after $75 of selling expenses and $25 of assembling expenses.	

Question 1 – continued

Required

1.2.1 **Record** all relevant information in the stock cards of Shooting Star X3.

Solution 1.2.1

Shooting Star X3

		IN			OUT			BALANCE		
Date 2010	**Details**	**Qty**	**Unit Cost**	**Value**	**Qty**	**Unit Cost**	**Value**	**Qty**	**Unit Cost**	**Value**
Jan 1	**Balance**							**4**	**420**	**1680**
	Invoice 32				*2*	*420*	*840*	*2*	*420*	*840*
Jan 4	*Invoice B3*	*8*	*450*	*3600*				*2*	*420*	*840*
								8	*450*	*3600*
	Chq. 107	*8*	*20*	*160*				*2*	*420*	*840*
								8	*470*	*3760*
Jan 10	*Invoice 37*				*2*	*420*	*840*			
					1	*470*	*470*	*7*	*470*	*3290*
Jan 15	*CN 10*	*1*	*470*	*470*				*8*	*470*	*3760*
Jan 16	*CN F56*				*2*	*470*	*940*	*6*	*470*	*2820*
Jan 31	*Memo 6*	*1*	*470*	*470*				*7*	*470*	*3290*
	Memo 7				*7*	*70*	*490*	*7*	*400*	*2800*

8 marks

Mark allocation

- 1 mark per line.

Question 1 – continued

1.2.2 Referring to **one** Accounting principle, **explain** why the Shooting Star X3 should be valued at the Lower of Cost and Net Realisable Value on January 31.

Solution 1.2.2

Accounting Principle *Conservatism*
Explanation *Losses should be recorded when probable, so that assets are not overstated*
(Stock Control) and Expenses are not understated (Stock Write Down). As the NRV of the
Shooting Star X3 has fallen below cost price, the business must record this event as soon as
the loss is probable.

3 marks

Mark allocation

- 1 mark for correctly identifying conservatism.
- 1 mark for not overstating assets and not understating expenses.
- 1 mark for link to Shooting Star X3 in the example.

1.2.3 **Show** how Cheques 107 and 110 would be recorded in the Cash Payments Journal.

Solution 1.2.3

Cash Payments Journal

Date 2010	Details	Chq No.	Bank	Disc Rev	Creditors	Stock	Wages	GST	Sundries
Jan 5	*Stock Delivery*	*107*	*176*			*160*		*16*	
Jan 24	*Prepaid Insurance*	*110*	*2200*					*200*	*2000*

2 marks

Mark allocation

- 1 mark for each line.

Question 1 – continued

1.2.4 Using the information in 1.2 above, **show** how the Stock Control account would appear as at January 31 2010. Balance the account.

Solution 1.2.4

STOCK CONTROL

Date 2010	**Cross Reference**	**$**	**Date 2010**	**Cross Reference**	**$**
Jan 1	**Balance**	**1680**	*Jan 31*	*Cost of Sales*	*2150*
Jan 31	*Creditors Control*	*3600*		*Creditors Control*	*940*
	Bank	*160*		*Stock Write Down*	*490*
	Cost of Sales	*470*		*Balance*	*2800*
	Stock Gain	*470*			
		6380			*6380*
Feb 1	*Balance*	*2800*			

6 marks

Mark allocation

- 3 marks for debit side entries Bank, Cost of Sales and Stock Gain.
- 3 marks for credit side entries Cost of Sales, Creditors Control and Stock Write Down.
- 1 mark deducted per entry missing.
- 1 mark deducted per alien entry.
- 1 mark deducted for not Balancing or missing dates.

1.2.5 **Explain** why sales returns are reported separately in the Profit and Loss Statement.

Solution 1.2.5

Explanation *Sales returns are reported separately in the Profit and Loss Statement so that*
the owner can assess the quality and suitability of stock being sold; this will assist
decision-making. If sales returns are high it may indicate customer dissatisfaction with the
goods being sold. This may be because the goods are inferior quality, or simply because
customers have been provided with goods that did not suit their purpose.

2 marks

Mark allocation

- 1 mark for assessing the quality and suitability of stock being sold.
- 1 mark for assist decision-making or other valid point.

Total 45 marks

END OF QUESTION 1

FOR THE PURPOSE OF QUESTION 2 YOU ARE NOT REQUIRED TO CONSIDER GST.

Question 2

Adriano's Amps

Adriano Acquaro is running a trading business called Adriano's Amps. Adriano sells amplifiers and other musical equipment to bands and musicians. His business is based in Melbourne, Victoria. He maintains a double-entry accrual accounting system with control accounts for Debtors, Creditors and Stock. A perpetual inventory system is used with the FIFO (first-in-first-out) method of cost assignment. Reports are to be prepared monthly with balance day falling on the last day of every month.

2.1 On January 1 2009, Adriano is hesitant about whether to prepare budgets for his business, as he thinks they are too time-consuming and have little benefit.

Required

2.1.1 Place these **four** stages of the continuous budgeting process in the order they will occur:

- Variance reports are prepared
- Actual reports are prepared
- Decisions are made
- Budgeted reports are prepared

Solution 2.1.1

1 *Budgeted reports are prepared*
2 *Actual reports are prepared*
3 *Variance reports are prepared*
4 *Decisions are made*

2 marks

Mark allocation

- One mark for every two correct responses. Variations in the terminology used are acceptable.

2.1.2 **Explain** to Adriano one purpose of budgeting and why it will be beneficial for his business.

Solution 2.1.2

Explanation *Budgeting assists planning by pointing out what is expected to occur in the*
future so that the owner can address problems before they occur and take advantage of
possible opportunities.
OR
Budgeting aids decision-making by providing a benchmark against which actual
performance can be measured so problems can be identified and remedial action taken.

2 marks

Question 2 – continued

Mark allocation

- 1 mark for planning and 1 mark for explaining (address problems before they occur). Otherwise, 1 mark for decision making and 1 mark for providing a benchmark.

2.2 After being persuaded by his accountant, Adriano decides to prepare budgets for his business. He has provided the following information detailing what he expects to occur in January 2009:

- Debtors Balance 1 January $3 000.
- He hopes to generate sales of $40 000 with approximately 70% of sales being on credit, where he will offer his customers 30 day credit terms. He will offer a 3% discount for prompt payment and he thinks this will cost him $300 in January.
- Bad Debts are expected to be 5% of the firm's credit sales in the period. The expected amount owed to the firm by debtors at the end of the month is $4000.
- Expected Gross Profit Rate (Gross Profit / Sales) for the month is 60%.
- On 1 January the firm expects to prepay its rent of $3000 for the quarter ending March 31 2009.
- Wages expense for the month is expected to be $1500 and the insurance expense $300.
- On 1 January, the firm will enter into a fixed term-deposit in which it will invest $10 000, with the interest return being at a fixed rate of 6% p.a., payable on 30 June and 31 December each year.
- Drawings for the month are expected to be $2500.

Required

2.2.1 **Reconstruct** the debtors control account to **calculate** budgeted receipts from debtors for the month of January.

Solution 2.2.1

DEBTORS CONTROL

Date 2009	**Cross Reference**	**$**	**Date 2009**	**Cross Reference**	**$**
Jan 1	*Balance*	*3 000*	*31 Jan*	*Bad Debts*	*1400*
31 Jan	*Sales*	*28 000*		*Discount expense*	*300*
				Bank	*25 300*
				Balance	*4000*
		31 000			***31 000***

Budgeted Receipts from Debtors: *$25 300*

4 marks

Question 2 – continued

Mark allocation

- 4 marks for having the correct figure in the receipts from debtors box.
- If this figure is incorrect, 1 mark for sales figure, 1 mark for discount expense and 1 mark for the bad debts expense and closing balance figure (combined – both needed for the one mark).
- Note: Formality of this account (e.g. dates, full titles) not required in an account reconstruction; do not penalise.

2.2.2 **Explain** what is measured by the gross profit ratio and **identify two** strategies the firm may use to improve this ratio.

Solution 2.2.2

Explanation *Gross Profit ratio measures the average mark up by calculating the percentage*
of sales revenue that is retained as gross profit in order to meet other expenses.
Strategy 1 *Increase selling prices by proportionally more than cost prices.*
Strategy 2 *Decrease cost prices by proportionally more than selling prices (cheaper stock).*

3 marks

Mark allocation

- 1 mark for "Gross profit measures average mark up" or percentage of revenue retained to cover other expenses.
- 1 mark for increase selling prices by more than cost prices.
- 1 mark for decrease cost prices by more than selling prices.

Question 2 – continued

2.2.3 **Complete** the Profit and Loss Variance report for the month ending 31 January 2009. Enter the relevant budgeted information for the month into the variance report and then complete the variances. (Note: actual figures have been entered in the variance report in the answer book).

Solution 2.2.3

Adriano's Amps

Profit and Loss Variance report for the month ending 31 January 2009

		Budget	**Actual**	**Variance**	**F / U**
	Revenue				
	Sales	*40 000*	42 000	*2000*	*F*
less	**Cost of Goods Sold**				
	Cost of Sales	*16 000*	16 800	*800*	*U*
	Gross Profit	***24 000***	**25 200**	***1200***	*F*
add	**Other Revenue**				
	Interest Revenue	*50*	50	-	-
		24 050	**25 250**	***1200***	*F*
less	**Other Expenses**				
	Bad Debts expense	*1 400*	2 300	*900*	*U*
	Wages expense	*1 500*	1 550	*50*	*U*
	Insurance expense	*300*	300	-	-
	Rent expense	*1 000*	1 000	-	-
	Discount expense	*300*	310	*10*	*U*
	Net Profit	***19 550***	**19 790**	***240***	*F*

8 marks

Mark allocation

- 1 mark each for Sales, cost of sales, interest revenue, wages expense, insurance expense and rent expense (the bad debt and discount expense figures were required in 2.2.1).
- 2 marks for completing all the variances correctly.
- 1 mark deducted for each mistake in the preparation of the report.

Question 2 – continued

2.2.4 **Explain** to Adriano a benefit of preparing a profit and loss variance report.

Solution 2.2.4

Explanation *The profit and loss variance report can be used for planning and decision*
making. The budgeted figures can be used as a benchmark to compare actual profit figures to
identify problem areas. Also the variances allow trends to be identified. For example, the
firm's sales may have increased and that explains why there has been unfavourable
variances for expenses like cost of sales and wages.

2 marks

Mark allocation

- 1 mark for problem areas to be identified using variances.
- 1 mark for trends (note: an explanation such as increased sales means increased expenses is needed).

2.2.5 Adriano is disappointed that wages expense was higher than expected. **Explain** why Adriano should not be disappointed with this increase in wages.

Solution 2.2.5

Explanation *Adriano should not be disappointed with the increase in sales as the increase in*
wages was proportionally smaller than the increase in sales. In the budgeted P & L
statement, wages was 3.75% of sales (1500 / 40 000) and this decreased to 3.69%
(1550 / 42 000) in the actual report. This indicates better expense control than expected as
wages didn't increase by more than sales. Therefore, Adriano should not be disappointed
with the wages figure being higher than budgeted.

2 marks

Mark allocation

- 1 mark for mentioning that the increase in wages was proportionally smaller than the increase in sales from the budgeted reports to the actual reports.
- 1 mark for stating that this means that expense control was better than was budgeted.

Question 2 – continued

2.2.6 Although sales revenue is higher than expected, the firm's Net Profit Ratio (Net Profit/ Sales revenue) is lower than expected. **Explain** to Adriano why this has occurred and **suggest two** strategies by which he can address this problem.

Solution 2.2.6

Explanation *There is only one reason why the firms NPR is lower than expected, this is*
because bad debts expense was much greater than expected. All other expenses have been
lower than expected (i.e. as a percentage of sales), however bad debts was budgeted as 3.5%
of sales, but was actually 5.5% of sales. Hence management of debtors was much worse than
expected with more debtors not being able to settle their accounts.
Strategy 1 *offer discounts for early repayment OR prompt invoicing OR reminder notices*
Strategy 2 *threats of legal action OR employ a debt collection agency OR extensive credit*
checks

3 marks

Mark allocation

- 1 mark for saying that NPR was lower than expected due to bad debts expense.
- 2 marks for listing two of the strategies mentioned above.

2.3 After a further few months of trading, Adriano has provided the following ratios for the months of March and April 2009.

	March	**April**
Return on Assets (Net Profit / Average total assets)	25%	27%
Net Profit Rate (Net Profit / Sales revenue)	45%	50%
Return on Owner's Investment (Net Profit / Avg Owners' equity)	35%	40%
Asset Turnover (Sales revenue / Avg total assets)	56%	54%

Question 2 – continued

Required

2.3.1 **Explain** why Return on Assets is usually a smaller percentage figure than Return on Owner's Investment.

Solution 2.3.1

Explanation *Return on Assets is never greater than Return on Owner's investment as the*
firm's asset base is larger than the owners' equity of a firm. This can be shown by the
accounting equation A = L + OE. Hence ROA will be smaller and they will only
equal in a firm where there are no liabilities present, which is unlikely. For Return on
Assets, the firm is earning the net profit on an asset base and for ROI, the firm is earning the
same net profit on a smaller base, hence the return on the owner's funds will always
be greater than the return on the firm's assets.

2 marks

Mark allocation

- 1 mark for stating that it is unlikely for OE to be greater than assets.
- 1 mark for stating that for ROI you are earning the same net profit on a smaller base.

2.3.2 **Explain** why Return on Assets has increased from March to April even though the firm's Asset Turnover has decreased.

Solution 2.3.2

Explanation
ROA is dependent both on the ability of a firm to use its assets to earn
revenue (as measured by ATO) and control its expenses (which is measured by NPR). Hence
although the firm's ability to use its assets to earn revenue and ATO has decreased, the
firm's ability to control its expenses and NPR has increased by proportionally more, hence
causing the firm's return on Assets to still increase.

2 marks

Mark allocation

- 1 mark for stating that ROA is dependent on both ATO and NPR.
- 1 mark for mentioning that although ATO decreased, NPR increased by proportionally more, causing the firm's return on assets to increase.

Question 2 – continued

2.3.3 Although the Return on Owner's Investment is improving, **explain** a negative consequence this may have on the firm's liquidity.

Solution 2.3.3

Explanation *The firm's ROI improving indicates that the firm is using the owner's funds*
more efficiently to generate profit. However, this means that the firm may be using external
funds to generate profit, meaning that the chance of liquidity issues arising is increased as
the firm has more short term debts and they will need to make repayments to meet these short
term debts. Also, the firm may need to pay interest on top of these loans.
High drawings by the owner may leave the business with cash shortages.

2 marks

Mark allocation

- 1 mark for stating that the firm may be more reliant on external funds rather than the owner's funds.
- 1 mark for stating it has a negative effect on liquidity as the amount of short term debts is increased and the business will have to repay these extra debts.

2.4 As at 30 April 2009, Adriano provided us with the following ratios in relation to the firm's liquidity.

Working Capital Ratio	Current Assets / Current Liabilities	2:1
Quick Asset Ratio	CAs – stock and prepayments / CLs – bank overdraft	1:1

Required

2.4.1 **Interpret** the Quick Asset Ratio as at 30 April 2009.

Solution 2.4.1

Interpretation *The quick asset ratio shows that for every dollar of immediate (quick) assets*
the firm has one dollar of urgent (quick) liabilities.

1 mark

Mark allocation

- 1 mark for the interpretation of the quick asset ratio given.

2.4.2 **Explain one** possible reason why the firm's Quick Asset Ratio is considerably lower than the firm's Working Capital Ratio.

Solution 2.4.2

Reason *The firm has a large investment in stock. Stock is classified as a current asset but is*
not an immediate asset, hence it is not part of the QAR. This is because there is no guarantee
that stock will be easily liquidated in times of liquidity problems for the firm.
OR *The firm has a large investment in prepaid expenses. These are current assets but again*
are not classified as immediate assets because a lot of these prepaid expenses are contracted
and it is unlikely that the firm will be able to leave these contracts and get a cash refund.

2 marks

Mark allocation

- 1 mark each for mentioning a large investment in stock or prepaid expenses.
- 1 mark for explanation.

2.5 The indicators below relate to the months of March and April.

	March	**April**
Stock Turnover rate (Avg stock × 365 / cost of goods sold)	23 days	19 days
Debtors Turnover rate (Avg debtors × 365 / credit sales)	30 days	35 days
Cash Cycle (Stock Turnover + Debtors Turnover)	53 days	54 days
Creditors Turnover (Avg creditors × 365 / credit purchases)	32 days	35 days

Question 2 – continued

Required

2.5.1 **Explain** what is measured by the stock turnover rate and state **two** ways by which the business can improve this ratio.

Solution 2.5.1

Explanation *The stock turnover measures the average number of days it takes for a*
business to convert its stock into sales.
Strategy 1 *Holding less stock on hand will improve the firm's stock turnover ratio. This*
could be achieved by just-in-time ordering.
Strategy 2 *Increasing the amount of sales. This could be achieved by altering selling prices*
and by undergoing an intense advertising campaign.

3 marks

Mark allocation

- 1 mark for stating what STO measures (the opening sentence).
- 1 mark for each strategy (holding less stock on hand and increasing sales).

2.5.2 **Explain** how the debtors turnover rate has a direct impact on the liquidity of the firm.

Solution 2.5.2

Explanation *Debtors turnover measures the average number of days it takes a business to*
collect cash from its debtors. This will have a significant effect on the liquidity of the firm
because the quicker the firm is able to collect cash from its debtors, the quicker the firm will
be able to meet its short term debts as they fall due. On the other hand, the longer it takes a
firm to collect cash from its debtors, the less able the firm becomes to meet its other debts as
they fall due, as it will not be receiving the funds quick enough to do so.

2 marks

Mark allocation

- 1 mark for stating that the quicker the firm receives cash from debtors the more liquid the firm is OR for stating the longer it takes to receive cash, the less liquid the firm is.
- 1 mark for stating that this cash improves liquidity as the firm becomes more able to meet its short-term debts as they fall due.

Question 2 – continued

2.5.3 The creditors' turnover of Adriano's Amps has increased from March to April. **State one** advantage and **one** disadvantage of this trend.

Solution 2.5.3

Advantage *The firm retains cash longer which can be used for other purposes.*
Disadvantage *Interest charges on late accounts OR removal of credit facilities OR*
reduction in credit rating.

2 marks

Mark allocation

- 1 mark for stating an advantage and 1 mark for stating a disadvantage.

2.5.4 **State one** limitation of using financial indicators to assess the business' performance.

Solution 2.5.4

Limitation *Many indicators rely on averages OR they use historical data OR firms use*
different accounting methods which can undermine the comparability of these indicators

1 mark

Mark allocation

- 1 mark for stating a limitation of using indicators.

2.6 Adriano is a very quiet and timid man. At times, he gets the impression that members of his staff take advantage and do not show respect towards him, and they do not enjoy working for Adriano's Amps.

Required

2.6.1 **State two** non-financial indicators that Adriano could use to assess the firm's relationship with its staff.

Solution 2.6.1

1 *Performance appraisals OR staff turnover / average length of employment*
2 *Number of days lost due to sick leave / industrial action*

2 marks

Mark allocation

- 2 marks for stating two of the three non-financial indicators mentioned.

Total 45 marks

END OF SOLUTIONS