2.4 Ratio Analysis: Liquidity, Efficiency and Gearing Ratios: Test Pack

AQA 7132 · Calculators not allowed · about 15 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer ALL questions in the spaces provided. Show your working for every calculation. The fictional business GreenTech Components and its financial extracts are used throughout this pack.

1 Which one of the following is the correct formula for the current ratio used to assess short-term liquidity for a business such as GreenTech Components?

- ☐ A) Current assets / Current liabilities
- ☐ B) Current liabilities / Current assets
- ☐ C) (Current assets - Inventory) / Current liabilities
- ☐ D) Non-current liabilities / (non-current liabilities + equity) x 100

(Total for Question 1 is 1 mark)

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2 State the formula for inventory turnover (times per year) commonly used in efficiency analysis for a business such as GreenTech Components.

(Total for Question 2 is 1 mark)

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3 Explain what a current ratio of 2.0, as calculated for GreenTech Components, suggests about the company's short-term liquidity. Give up to two developed points.

(Total for Question 3 is 3 marks)

4 Analyse what the set of ratios calculated for GreenTech Components (current ratio 2.0; acid test 1.33; inventory turnover 6.86 times; receivable days 27; payable days 38; asset turnover 0.95; gearing 26.7%) collectively suggest about the company's liquidity, operational efficiency and financial risk. Use figures in your answer.

(Total for Question 4 is 6 marks)

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Mark scheme · 2.4 Ratio Analysis: Liquidity, Efficiency and Gearing Ratios: Test Pack

Question 1

A cao **B1**

Answer: A

Question 2

inventory turnover = cost of sales / average inventory cao **B1**

Answer: Inventory turnover = Cost of sales / Average inventory

Question 3

identifies that a ratio of 2.0 means current assets are twice current liabilities **B1**

develops point, e.g. this suggests the company should be able to meet short-term obligations comfortably **B1**

additional development, e.g. however excess current assets could include inventory which may not be immediately convertible, so liquidity might be overstated **B1**

Answer: A current ratio of 2.0 means current assets are twice current liabilities, suggesting GreenTech Components should be able to meet short-term obligations comfortably. However some current assets are inventory, which may not be quickly converted to cash, so the apparent liquidity may be overstated.

Question 4

states a liquidity point using figures, e.g. current ratio 2.0 and acid test 1.33 show good short-term liquidity **B1**

develops liquidity point, e.g. acid test above 1.0 indicates sufficient quick assets excluding inventory to meet liabilities **B1**

states an efficiency point using figures, e.g. inventory turnover 6.86 times and receivable days 27 show reasonable inventory movement and fast collections **B1**

develops efficiency point, e.g. combined with payable days 38 this suggests the firm converts stock to cash faster than it pays suppliers, aiding working capital **B1**

states a risk/solvency point using figures, e.g. gearing 26.7% indicates moderate reliance on long-term debt **B1**

develops risk point, e.g. gearing under 30% suggests limited financial risk from debt but asset turnover 0.95 suggests assets could be better used to improve returns **B1**

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