
Tipperary BATAI

Accounting Revision Seminar

**Saturday
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Interpretation of Accounts

Question 5

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PAST TOPIC - QUESTION 5

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Bank Manager		Yes					Yes			Yes			Yes			
Shareholders			Yes	Yes	Yes			Yes				Yes			Yes	Yes
Debentures	Yes					Yes								Yes		
Investor									Yes							
Friend											Yes					

NOTE – Investors and Friends can use the same headings as Shareholders.

Remember if asked about granting a loan – you must recalculate the gearing ratio including the increase in the loan

PAST QUESTIONS - QUESTION 5

PART A

	Debentures	Bank Manager	Share Holder	Share Holder	Share Holder	Debenture	Bank Manager	Share Holders	Investor	Bank Manager	Friend	Share Holder	Bank Manger
Part A													
Cash Sales			21		19					14			
Cash Purchases		22				18		16				12	
Opening Stock	23			20					15		13		11
Closing stock							17						
ROCE	23		21		19	18		16		14			
P / E Ratio	23	22	21	20	19	18		16	15	14	13	12	11
Dividend Cover	23	22	21		19			16				12	
Interest Cover			21	20		18	17		15		13	12	
ROSE		22		20			17						
Dividend Yield	23			20	19	18	17	16	15	14	13		11
EPS							17		15	14	13		11
Gearing		22											11

PART B

	Debentures	Bank Manager	Share Holder	Share Holder	Share Holder	Debenture	Bank manager	Share Holders	Investor	Bank Manager	Friend	Share Holder	Bank Manger
PART B													
EPS	23	22	21	20	19	18	17	16	15	14	13	12	11
DPS		22	21	20	19	18	17	16	15	14	13	12	11
Interest Cover	23	22	21	20	19	18	17	16	15	14	13	12	11
Acid Test	23	22	21	20	19	18	17	16	15	14	13	12	11
ROCE		22	21	20	19	18	17	16	15	14	13	12	11
Gearing	23	22	21	20	19	18	17	16	15	14	13	12	11
Dividend Cover	23	22	21	20	19	18	17	16		14	13	12	11
Dividend Yield			21	20	19	18	17	16		14	13	12	11

PART C

	Debenture	Bank Manager	Share Holder	Share Holder	Share Holder	Debenture	Bank manager	Share Holders	Investor	Bank Manager	Friend	Share Holder	Bank Manger
Gross Profit Margin		22										12	
Changes in the GPM		22						16					
Improve the GPM		22											
Reason of increase or decrease in GPM												12	
Lowly Geared								16					
Advantages of gearing			21										
Reduce Gearing			21					16					
Stock Turnover				20									
Current Ratio					19								
Acid Test					19								
Liquidity & Solvency	23				19					14			
Debtor, Creditor Days						18							
Importance of financial information							17						
Limitations of Ratios									15				11
Advice to purchase a business											13		
Prudent Management	23												

IMPORTANT FORMULAS - QUESTION 5

PROFITABILITY			
Return on Capital Employed (ROCE)			
<u>Net Profit (Before Interest and Tax)</u>	x	$\frac{100}{1}$	-
Capital Employed			
Answer In	%		NB
Return on Shareholders' Funds (ROSF)			
<u>Net Profit (After Tax and Preference Dividends)</u>	x	$\frac{100}{1}$	-
Ordinary Shares			
Answer In	%		NB
Gross Profit Percentage (Margin)			
<u>Gross Profit</u>	x	$\frac{100}{1}$	-
Sales			
Answer In	%		NB
Net Profit Percentage (Margin)			
<u>Net Profit</u>	x	$\frac{100}{1}$	-
Sales			
Answer In	%		NB

Gross profit Mark- Up			
	$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times \frac{100}{1}$	x	-
Answer In	%		

LIQUIDITY			
Current Ratio (Liquidity)			
	$\frac{\text{Current Asset}}{\text{Current Liabilities}}$		-
Answer In	02:01		NB
Acid Test Ratio (Liquidity)			
	$\frac{\text{Current Asset - Closing Stock}}{\text{Current Liabilities}}$		-
Answer In	01:01		NB

GEARING AND ACTIVITY			
Fixed Interest Capital to Total Capital (Gearing)			
	$\frac{\text{Loans + Debentures + Preference Shares}}{\text{Capital Employed}}$		-
Answer In	% or Ratio		NB

Fixed Interest Capital to Equity Capital (Gearing)		
-	$\frac{\text{Loans + Debentures + Preference Shares}}{\text{Ordinary Share Capital Issued + Reserves}}$	-
Answer In	% or Ratio	NB
Stock Turnover (Activity)		
	$\frac{\text{Cost of Sales}}{\text{Average stock}} \times \frac{100}{1}$	-
Answer In	Times	NB
Average Stock (Activity)		
	$\frac{\text{Opening + Closing Stock}}{2}$	-
Answer In	€	NB
Period of Credit given to Debtors (Activity)		
	$\frac{\text{Debtors}}{\text{Credit Sales}} \times \frac{365 / 52 / 12}{1}$	-
Answer In	Days / Weeks / months	NB
Period of Credit given to Creditors (Activity)		
	$\frac{\text{Creditors}}{\text{Credit Purchases}} \times \frac{365 / 52 / 12}{1}$	-
Answer In	Days / Weeks / months	NB

Total Capital		
Total Capital =	Equity Capital + Fixed Interest Capital	-
		-
		NB
Equity Capital		
Equity Capital =	Ordinary Share Capital + Reserves	-
		-
		NB
Fixed Interest Capital (Debt)		
Total Capital =	Term Loans + Debentures + Preference Shares	-
		-
		NB

INVESTMENTS		
Earnings Per Share (EPS)		
<u>Net Profit After Preference Dividends</u>	x	<u>100</u>
Ordinary Share Issued		1
		-
Answer In	Cent	NB

Price Earnings Ratio (P/E Ratio)			
-	<u>Market Value per Share</u>		-
	Earnings Per Share		
Answer In	Years		NB
Dividend Per Share (DPS)			
	<u>Ordinary Dividend</u>	x	<u>100</u>
	Ordinary Shares Issued		1
			-
Answer In	€ / Cent		NB
Dividend Cover			
	<u>Net Profit after tax and Preference Dividends</u>		-
	Ordinary Dividend		
Answer In	Times		NB
Dividend Yield			
	<u>Dividend Per Ordinary Share</u>	x	<u>100</u>
	Market Value per share		1
			-
Answer In	%		NB

Period to recoup share price at present pay out rate	
<u>Market value per share</u>	-
Dividend Per Share	
Answer In Years	NB
Projected Market Value for one Ordinary Share	
P/E Ratio x Earnings Per Share	-
	-
	-
Answer In €	NB

Additional Resources

[Click here](#) to access an interactive game to help remember the ratios.

PAST PART A - QUESTION 5

You are required to calculate the following for 2022: (where appropriate calculations should be made to two decimal places).

- (i) The opening stock if the rate of stock turnover is 14 based on average stock
- (ii) Return on capital employed
- (iii) Price earnings ratio
- (iv) Dividend cover
- (v) Dividend yield.

(50)

[2023 – O'Malley](#)

Opening Stock

You are required to calculate the following for 2022: The opening stock if the rate of stock turnover is 14 based on average stock

Formula

Rate of stock turnover $\frac{\text{Cost of Sales}}{\text{Average stock}}$

Activity
Formula

Average stock $\frac{\text{opening stock} + \text{closing Stock}}{2}$

Activity
Formula

Rate of stock turnover $\frac{\text{Cost of Sales}}{\text{Average stock}} = 14$

$\frac{\text{Cost of Sales}}{\text{Average Stock}} = 14$

€560,000 = Average Stock x 14

$\frac{€560,000}{14} = \text{Average Stock}$

$$\begin{aligned} \text{€40,000} &= \frac{\text{Opening} + \text{Closing stock}}{2} \\ \text{€40,000} * 2 &= \text{Opening} + \text{Closing Stock} \\ \text{€80,000} &= \text{Opening} + \text{Closing Stock} \\ \text{€80,000} - &= \text{Opening Stock} + \text{€42,000} \\ \text{€80,000} - \text{€42,000} &= \text{Opening Stock} \\ \text{€38,000} &= \text{Opening Stock} \end{aligned}$$

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ROCE

You are required to calculate the following for 2022: Return on capital employed.

[22023 – O'Malley](#)

Formula

$$\frac{\text{Net Profit Before Interest and Tax}}{\text{Capital Employed}} \times \frac{100}{1}$$
$$= \frac{\text{€104,000} + \text{€32,000}}{\text{€1,028,000}} \times \frac{100}{1}$$
$$= \frac{\text{€136,000}}{\text{€1,028,000}} \times \frac{100}{1}$$
$$= 0.13229 \times 100$$

ROCE = 13.23%

Profitability
Ratios

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Question

You are required to calculate the following for 2020: Return on capital employed.

2021 – Ratio (Fauci PLC)

Formula	<u>Net Profit Before Interest and Tax</u>	X	<u>100</u>
	Capital Employed		1
=	<u>€39,000 + €20,000</u>	x	<u>100</u>
	€621,000		1
=	<u>€59,000</u>	x	<u>100</u>
	€621,000		1
=	0.095	x 100	
ROCE =	9.50%		

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P / E Ratio (Market Price)

You are required to calculate the following for 2022: Price earnings ratio

[2023 – O'Malley](#)

Formula	<u>Market price Per Share</u> Earnings Per Share	Investment Ratios
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NOTE We need to calculate the Earnings per Share figure first.

Formula (EPS)	<u>Net Profit – Preference Dividends</u> Number of Ordinary Share issued	Investment Ratios
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Preference Dividends

4% x €100,000
= €4,000

$$= \frac{€104,000 - €4,000}{€450,000}$$

$$= \frac{€100,000}{€450,000}$$

$$= 0.2222$$

$$= 22.22 \text{ cent}$$

Formula	<u>130</u> 22.22	It will take the investors 5.85 to get their investment back
	= 5.85 years	

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Dividend cover

You are required to calculate the following for 2022: Dividend cover.

[2023 – O'Malley](#)

Formula
$$\frac{\text{Net Profit} - \text{Preference Dividends}}{\text{Ordinary Dividends}}$$

Investment
Ratios

First, we need to calculate the

1. Preference Dividends and
2. Ordinary Dividends

Dividends paid	€40,000	Taken form the Question.
Preference Dividends	<u>€4,000</u>	See working below.
Ordinary Dividends	€36,000	

Preference Dividends

€100,000 * 4% Taken from the question
= €4,000

Ordinary Dividends

Remember the figure for dividends paid is made up of ordinary dividends and preference dividends added together. So, to find ordinary dividends we take the preference dividends figure away from the dividends paid figure.

$$\begin{aligned}
 &= \frac{\text{€104,000} - \text{€4,000}}{\text{€36,000}} \\
 &= \frac{\text{€100,000}}{\text{€36,000}} \\
 &= 2.7777 \\
 \text{Dividend Cover} &= 2.78 \text{ Times}
 \end{aligned}$$

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Dividend Yield

You are required to calculate the following for 2019: Dividend Yield

[2023 – O'Malley](#)

NOTE – Market Price per share is €1.30. as per the question (sometimes you might have to calculate this using the P/E Ratio)

Formula $\frac{\text{Dividend Per Share}}{\text{Market Price Per Share}} \times \frac{100}{1}$

Investment
Ratios

Dividend Per Share

Formula $\frac{\text{Ordinary Dividends}}{\text{Ordinary Shares}}$

Investment
Ratios

Dividends Paid	€40,000	
Preference Dividends	€4,000	
Ordinary Dividends	€36,000	

Preference Dividends

€100,000 * 4% = €4,000

$$\text{DPS} = \frac{€36,000}{€450,000} = 8\text{c}$$

Dividend Yield

$$\begin{aligned} & \frac{8\text{c}}{130\text{c}} \times \frac{100}{1} \\ = & .06153 \times 100 \\ = & 6.15\% \end{aligned}$$

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Question

You are required to calculate the following for 2019: Dividend Yield

[2020 – Robinson PLC](#)

NOTE – Market Price per share is €1.20. It was calculated as part of (iv)

Formula

$$\frac{\text{Dividend Per Share}}{\text{Market Price Per Share}} \times \frac{100}{1}$$

Dividend Per Share

Formula

$$\frac{\text{Ordinary Dividends}}{\text{Ordinary Shares}}$$

Dividends Paid	€48,000	<u>Preference Dividends</u>
Preference Dividends	<u>€12,000</u>	€200,000 * 6% = €12,000
Ordinary Dividends	€36,000	

$$= \frac{\text{€36,000}}{\text{€460,000}}$$

$$\text{DPS} = 7.83\text{c}$$

Dividend Yield

$$\frac{7.83 \text{ c}}{120 \text{ c}} \times \frac{100}{1}$$

$$= .0653 \times 100$$

$$= 6.53\%$$

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REMEMBER

Total Sales = Cash Sales + Credit Sales

Total Sales – Credit Sales = Cash Sales

€908,000 - €690,000 = Cash Sales

€212,000 = Cash Sales

IMPORTANT – You must include the units with your answer – For example if it is €, Times.

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$$\begin{aligned} 80\% &= €70,000 \\ 1\% &= €70,000 / 80 \\ &= €875 \\ 20\% &= €875 * 20 \\ &= €17,500 \end{aligned}$$

$$\text{Cash Purchase} = €17,500$$

IMPORTANT – You must include the units with your answer – For example if it is €, Times

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Question

You are required to calculate the following for 2019: Interest cover. [2020 – Robinson PLC](#)

Using the statements supplied with the 2020 Ratio question calculate the Dividend Cover

Formula	<u>Net Profit Before Interest and Tax</u>
	Interest
=	<u>€104,000 + €16,000</u>
	€16,000
=	<u>€120,000</u>
	€16,000
=	7.5 Times

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Closing Stock

You are required to calculate the following for 2016: The closing stock if the rate of stock turnover is 10 based on average stock.

[2017 – JB PLC](#)

Formula

Activity
Formula

$$\text{Stock Turnover} = \frac{\text{Cost of sales}}{\text{Average stock}}$$

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

$$\frac{\text{Cost of Sales}}{\text{Average Stock}} = 10$$

$$€565,000 = \text{Average Stock} \times 10$$

$$\frac{€565,000}{10} = \text{Average Stock}$$

$$€56,500 = \frac{\text{Opening} + \text{Closing stock}}{2}$$

$$€56,500 \times 2 = \text{Opening} + \text{Closing Stock}$$

$$€113,000 = \text{Opening} + \text{Closing Stock}$$

$$€113,000 - = €73,000 + \text{Closing Stock}$$

$$€113,000 - €73,000 = \text{Closing Stock}$$

$$€40,000 = \text{Closing Stock}$$

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Question

You are required to calculate the following for 2019: Return On Ordinary Shareholders

Funds

[2020 – Robinson PLC](#)

Using the statements supplied with the 2019 Ratio question calculate the Return On Shareholders Funds

$$\frac{\text{Net Profit - Preference Dividends}}{\text{Share holder Funds}} \times \frac{100}{1}$$

$$\begin{aligned} \text{Preference Dividends} & \quad \text{€200,000 * 6\% = €12,000} \\ = & \quad \frac{\text{€104,000 - €12,000}}{\text{€460,000 + €122,000}} \times \frac{100}{1} \\ = & \quad \frac{\text{€92,000}}{\text{€582,000}} \\ = & \quad 15.81\% \end{aligned}$$

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Earnings Per Share

You are required to calculate the following for 2016: Earnings Per Share [2017 – JB PLC](#)

Formula
$$\frac{\text{Net Profit after Preference Dividends}}{\text{Ordinary Share Issued}} \times \frac{100}{1}$$

Preference Dividends

€150,000 * 5%
= €7,500

$$\begin{aligned} & \frac{\text{Net Profit after Preference Dividends}}{\text{Ordinary Share Issued}} \times \frac{100}{1} \\ = & \frac{\text{€114,000} - \text{€7,500}}{\text{€450,000}} \\ = & \frac{\text{€106,500}}{\text{€450,000}} \\ = & 23.67\% \end{aligned}$$

Investment
Ratios

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Gearing

You are required to calculate the following for 2021: Earnings Per Share

[2022 Watson PLC](#)

Formula	<u>Loans + Debentures + Preference Shares</u>	x	<u>100</u>	
	Capital Employed		1	
=	<u>0 + €500,000 + €150,000</u>	x	<u>100</u>	Gearing Ratios
	€1,116,000		1	
=	<u>0 + €650,000</u>	x	<u>100</u>	
	€1,116,000		1	
=	58.24%			

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Question

You are required to calculate the following for 2014: Gearing

[2021 – Ratio \(Fauci PLC\)](#)

Using the statements supplied with the 2020 Ratio question calculate the Gearing

Formula	<u>Loans + Debentures + Preference Shares</u>	x	<u>100</u>
	Capital Employed		1
=	<u>0 + €250,000 + €250,000</u>	x	<u>100</u>
	€1,087,000		1
=	<u>€500,000</u>	x	<u>100</u>
	€1,087,000		1
=	46%		

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PAST COMMENT QUESTIONS - QUESTION 5

DEBENTURES

Remember to use the following headings and ratios when commenting on part B. These will be used from a **Debentures point of view**.

Performance		State of Affairs			Prospectus	
Profitability	Dividend Policy	Liquidity	Gearing	Security	Sector	
1. ROCE	1. Dividend Cover	1. Acid Test	1. Gearing	1. Security	2. Sector	
1. EPS	2. Dividend Pay out		2. Interest Cover			

Try to use the following sentence to help you remember the headings for Debenture comments -

Patricia Doyle Loves Grading In School

NOTE

You might have to calculate some ratios still for part B – calculate them quickly using your calculator and make a record of the figures.

Important Ratios for PART B

- | | |
|---------------------------|-------------------------------|
| 1. Earnings Per Share | 6. Dividend Per share |
| 2. Interest Cover | 7. Acid Test Ratio |
| 3. Market Value per share | 8. Return on Capital Employed |
| 4. Gearing | 9. Dividend Cover |
| 5. Dividend Yield | |

PART B COMMENTING ON THE COMPANY

Using the following figures from the 2023 Exam Paper (O'Malley Ltd)

Ratios and information for year ended 31/12/2022	
ROCE	13.23%
P/E Ratio	5.85 years
EPS	22.22c
Dividend cover	2.78 times
Dividend Yield	6.14%
DPS	8c
Market Share	1.30
Gearing	48.64%
Quick Ratio	1.2 : 1
Interest Cover	425 Times

Ratios and information for year ended 31/12/2021	
EPS	13c
Dividend Cover	2.57 times
Market Share	€1.25
ROCE	14.28%
Gearing	35%
Interest Cover	7.12 Times
Quick Ratio	1.5 : 1
P/E Ratio	5.43 times

PERFORMANCE

PROFITABILITY

ROCE

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Say if the company is profitable – compared to risk free investments.
4. Compared to debenture & preference rates.
5. Would debenture holders be satisfied/dissatisfied? And why

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment

Template

1. In _____ the ROCE is ___%. In _____ the ROCE was ___%
2. **This is an *improvement / dis-improvement of ___%* and is a *positive / negative trend***
3. **The company is *profitable / not profitable* as the return is higher than risk free investment of 0-2%**
4. **The company is borrowing at a rate of ___% (debenture) and getting a return *higher / below this – why borrow at a rate higher than the return.* Preference share capital has a rate of ___%. The company *is / is not* making effective use of resources.**
5. **Debentures holders would be *satisfied / dissatisfied* - as the company is making *more / less* efficient use of its resources available to them.**

Suggested Solution (2023 – O'Malley LTD)

1. In 2022 the ROCE is 13.23%. In 2021 the ROCE was 14.8%
2. **This is a *dis-improvement of 1.05%* and is a *negative trend*.**
3. **The company is profitable as the return is higher than risk free investment of 0-2%**
4. **The company is borrowing at a rate of 8% (debenture) and getting a return *higher*. The company *is not* making effective use of resources. The preference shares capital rate of 4%**
5. **Debenture holders would be *dis-satisfied* - as the company is making *less* efficient use of its resources available to them**

Tip – MUST include the text that is in bold

Earnings Per share

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Would debenture holder be satisfied/dissatisfied?

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment

Template

1. In ____ the EPS is ____c. In ____ the EPS was ____c
2. **This is an *improvement / dis-improvement* of ____c and is a *positive / negative* trend.**
3. **Debenture holders would be *satisfied / dissatisfied* as the management is *using / not using* the resource available to them efficiently.**

Suggested Solution (2023 – O’Malley LTD)

Tip – MUST include the text that is in bold

1. In 2022 the EPS is 22.22 c. In 2021 the EPS was 23 c
2. **This is a *dis-improvement* of .78 c and is a *negative* trend.**
3. **Debenture holders would be *dissatisfied* as the management is not using the resources available to them efficiently.**

DIVIDEND POLICY

Dividend Cover

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Would debenture holders be satisfied/dissatisfied?

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment

Template

1. In _____ the Dividend cover is ____times, In _____ the Dividend cover was _____ times
2. **This is an *improvement / dis - improvement* and is a *positive / Negative* trend. It means *more / less* profit is being retained for expansion purposes and repayment of loans.**
3. **Debenture holders would be *satisfied / dis - satisfied* with this.**

Suggested Solution (2023 – O'Malley LTD)

1. In 2022 the Dividend cover is 2.78 times, In 2021 the Dividend cover was 2.57 times.
2. This is an *improvement* and is a *positive* trend. It means *more* profit is being retained for expansion purposes and repayment of loans.
3. Debenture holders would be *satisfied* with this.

Tip – MUST include the text that is in bold

Dividend Pay-out

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend.
3. Would debentures be satisfied/Dissatisfied?

Template

1. In _____ the Dividend payout is ____%. In _____ the Dividend payout was ____%
2. This is an *improvement* / *dis-improvement* of ____c. This is a *positive* / *negative* trend.
3. Debenture holders would be *satisfied* / *dis - satisfied* with this in the short terms as it indicates how much the company *is* / *is not* retaining for expansion and paying interest.

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment

Suggested Solution (2023 – O'Malley LTD)

1. In 2022 the dividend pay-out is 35.97%. In 2021 the dividend pay-out was 38.9%
2. This is an *improvement* and a *positive* trend.
3. Debenture holders would be *satisfied* with this in the short term as it indicates how much money the company *is* retaining for expansion and paying interest

Tip – MUST include the text that is in bold

Note - This can also be included under Profitability.

Note - Dividend Pay-Out

1. Dividend pay-out should be less than 50% for Debenture holders to be satisfied.
2. If above 50% - they are paying out too much dividend – this means that debenture holders will not be happy as the company is not retaining enough money for expansion and paying interest.
3. If below 50% - Debenture holders would be happy as the company should have enough retained for expansion and paying interest.
4. The formula to calculate Dividend payout is = $\text{DPS/EPS} \times 100/1 = \%$

STATE OF AFFAIRS

LIQUIDITY

Acid Test Ratio

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend (compare to recommended ratio)
3. Does it have a liquidity problem – can they pay debts in the short term.
4. Would Debenture holders be satisfied/dis-satisfied.
5. Will the company be able to pay back the debt if the trends continue.

Template

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment

1. In _____ the acid test ratio is _____. In _____ the acid test ratio was _____
2. This is an *improvement / Dis-improvement* of _____c and is *above / below* the recommended ratio of 1:1
3. _____PLC *does / does not* have a liquidity problem and are *able / not able* to pay their debts as they fall due in the short term. This is because they have €__ in liquid assets for every euro it owes in the short term.
4. Debenture Holders will be *satisfied / dis - satisfied* as _PLC will / will not have problems paying out dividends or other short-term debts as they fall due.
5. If this trend continues, the ability to pay interest *would / would not* come under pressure and funds *would / would not* be available to invest for the purpose of repaying the loan.

Suggested Solution (2023 – O'Malley LTD)

Tip – MUST include the text that is in bold

1. In 2022 the acid test ratio was 1.20:1. In 2021 the acid test ratio was 1.5:1
2. This is a dis-improvement of .30 c but is *above* the recommended ratio of 1:1
3. O'Malley LTD does not have a liquidity problem and will be *able* to pay their debts as they fall due in the short term. This is because they have €1.20 in liquid assets for every euro it owes in the short term.
4. Debenture holders will be satisfied as O'Malley Ltd will not have problems paying out dividends or other short-term debts as they fall due
5. If this trend continues, the ability to pay interest *would* come under pressure and funds *would not* be available to invest for the purpose of repaying the loan.

GEARING

Gearing

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend and is the company a lowly/highly geared company.
3. Does it depend on outside borrowing.
4. Would debenture holders be satisfied/dis-satisfied.

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment.

Template

1. In _____ the gearing ratio is ____%. In ____ the gearing ratio was ____%
2. This is an *improvement / dis - improvement* and is a *positive / negative* trend. But the company is a *lowly / highly* geared company and is finance more by *debt / equity* than by *equity / debt*
3. This means the company is *dependent / less dependent* on outside borrowing and would appear to be *less / more* of a risk from outside investors. Debenture holders would be *satisfied / dis-satisfied* as the business is now *less / more* dependent on outside borrowing and would *will be paying higher / lower* interest payment,
4. There is a *less significant / significant* risk to the firm from outside investors.

Suggested Solution (2023 – O'Malley LTD)

Tip – MUST include the text that is in bold

1. In 2022 the gearing ratio is 48.64 %. In 2021 the gearing ratio was 35 %
2. This is a *dis-improvement* and is a *negative trend*. The company is a *lowly geared company*. But the company is a *lowly geared company* and is finance more by *equity* than by *debt*
3. This means the company is *less dependent on outside borrowing* and would appear to be *more of a risk from outside investors*. Debenture holders would be *satisfied* as the business is now *less dependent on outside borrowing* and would will be paying *lower interest payment*,
4. There is a less significant **risk to the firm from outside investors**.

Interest Cover

Questions to answer

1. Say what you see – compared to previous years.
2. Is this an improvement/dis-improvement, positive or negative trend. It is above/below the recommended ratio of 3:1
3. What does it mean – is there enough money for expansion, paying dividends and interest.
4. Would debenture holders be satisfied/dis-satisfied.
5. Make reference to when the debenture will be paid off.
6. Also make reference to the bank account and debtors

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment.

Template

1. In _____ the Interest Cover is _____ times. In _____ the interest cover was _____ times
2. This is an *improvement / dis-improvement* and is a *positive / negative trend*. It is *above / below* the recommended ratio of **3:1**
3. This means the firm has *more / less* money available for expansion, paying dividends and paying interest/loans.
4. Debenture holders would be *satisfied / dissatisfied* with this. The company is *still / not able* to meet its interest commitments, but the *worsening / improving trend* combined with *good / poor* liquidity would concern debenture holders.
5. The Debentures are not listed for repayment until _____. _____ plc has *enough / not enough* time to put aside resources to be able to repay these when the time comes.

6. **The bank account is / is not overdrawn, and Debtors owe €_. ____PLC should / should not follow this up.**

Suggested Solution (2023 – O'Malley)

Tip – MUST include the text that is in bold

1. In 2022 the Interest Cover is 4.25 times. In 2021 the interest cover was 7.12 times.
2. **This is a *dis-improvement* and is a *negative trend* but is *above* the recommended ratio of 3:1**
3. **This means the firm has *less money* available for expansion, paying dividends and paying interest/loans.**
4. **Debenture holders would be *dissatisfied* with this. The company is *still* able to meet its interest commitments, but the *worsening* trend combined with *poor* liquidity would concern debenture holders.**
5. **The Debentures are not listed for repayment until 2026. O'Malley LTD has *enough* time to put aside resources to be able to repay these when the time comes.**

SECURITY

Security

Questions to answer

1. Say what the fixed assets value is, and the depreciation policy should be questioned.
2. Look at the investment have they improve / dis-improved. Would debenture holders be satisfied / dissatisfied.
3. Is there an existing loan (Debenture), does the value of the tangible asset cover the value. Is there security for a new loan.
4. If the tangible assets are high, they should be questioned.

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment.

Template

1. **Tangible fixed assets including investment are valued at €____. The depreciation policy should be questions to ascertain the true value of tangible assets.**
2. **The investment cost €_____ but now has a value of €____. This shows *efficient / inefficient* investment decision by management. Debenture holders would be *dissatisfied / satisfied* with this.**
3. **There is an existing loan (Debenture) of €_____ to be repaid in _____. The**

value of the tangible assets are *adequate / not adequate* to cover this loan (Debenture).

There *is / is no* security for this loan (Debenture)

4. **The intangible assets figure should be *questioned / not questioned* as they are / are not generating income for a high amount (Only included if the intangible figure is high)**

Suggested Solutions (2023 – O'Malley LTD)

Tip – MUST include the text that is in bold

1. Tangible fixed assets including investment are valued at **€970,000**. The depreciation policy. should be questions to ascertain the true value of tangible assets.
2. The investment cost **€300,000** but now has a value of **€310,000**. This shows *efficient* investment decision by management. Debenture holders would be *satisfied* with this.
3. There is an existing loan (Debenture) of **€400,000** to be repaid in **2026**. The value of the tangible assets in *adequate* to cover this loan (Debenture). There *is* security for this loan (Debenture)

PROSPECTS

SECTOR

Sector

Questions to answer

1. Say what sector the business is.
2. Say what the short-term goals are.
3. Say what the long-term goals are.

Template

1. _____ plc is in the _____ sector / industry.
2. **In the short term this industry is / is not growing as more** _____

3. **In the long term this industry is / is not growing as** _____

Tip – Fill in the blank as per your workings and use the correct statement to complete your comment.

Suggested Solution (2023 – O’Malley LTD)

1. *O’Malley LTD is a retailer in the fast-food industry.*
2. **In the short term this industry is not growing as people become more health conscious and move away to healthier foods.**
3. **In the long term, this industry is not growing as it is a highly competitive industry with many well-known brands to compete against.**

Tip – MUST include the text that is in bold

Note – Make sure to a positive or negative for short term and long term prospectives

OVERALL

The debentures holders would be satisfied with the company. However, they would be concerned with the disimproving trends in certain parts of the company such as in profitability, liquidity and gearing.

Note – Always say if the party (debenture, shareholder, or bank manager) would be satisfied or not satisfied. Marks will be given for this and students leave it out

PAST THEORY QUESTIONS - QUESTION 5

Questions

2023 – Question 5 – Part C

- (i) Distinguish between the terms liquidity and solvency when used in ratio analysis.
- (ii) A rising liquidity ratio is a sign of prudent management. Briefly discuss. (10)

2022 – Question 5 - Part C

The gross profit percentage of Watson plc in 2020 was 36%.

- (i) Calculate the gross profit percentage for Watson plc in 2021.
- (ii) Give possible reasons for the change in gross profit percentage in 2021.
- (iii) Outline how a company could improve their gross profit percentage. (10)

2021 – Question 5 - Part C

- 1. What are the disadvantages to a business of having a high gearing?
- 2. Explain two ways to reduce gearing of a company. (10)

2020 – Question 5 - Part C

- 1. Explain how a faster stock turnover can increase the profitability of a business (10)

2019 – Question 5 - Part C

Shannon plc is considering acquiring a solar panel company, Gener8 Ltd in 2019. Gener8 Ltd has supplied the following balance sheet information for 31/12/2018.

Closing stock	€47,000
Creditors	€45,000
Debtors	€39,000
Expenses accrued	€15,000
Expenses prepaid	€13,000
Bank overdraft	€16,500

Based on the information given in the above table:

- (i) Calculate the current ratio for Gener8 Ltd. Calculate the acid test ratio for Gener8 Ltd.

- (ii) Using the calculated figures explain why it is important for Shannon plc to analyse the liquidity position for Gener8 Ltd. (10)

2018 – Question 5 - Part C

Born2Run plc is considering expansion by purchasing a small sportswear company. It has obtained the following information relating to this company:

	2014	2015	2016	2017
Period of credit allowed to debtors	60 days	54 days	46 days	40 days
Period of credit received from creditors	20 days	26 days	30 days	34 days
Stock turnover	12 times	11 times	9 times	6 times

Having analysed the information in the above table, what advice would you give Born2Run plc regarding this purchase? (10)

2017 – Question 5 - Part C

1. As an employee I would be interested in the financial information for the following reasons
2. Identify two other users of financial information (10)

2016 – Question 5 - Part C

1. Explain the term 'Gearing'.
2. What are the benefits to a business of having a low gearing?
3. State two ways to reduce the gearing of a company. (15)

2015 – Question 5 - Part C

State the limitations of ratio analysis as a financial analysis technique (10)

2014 – Question 5 - Part C

Explain the difference between the terms 'Liquidity' and 'Solvency' when used in Ratio Analysis. Refer to relevant ratios in your explanation (10)

2013 – Question 5 - Part C

Question on ROCE

2012 – Question 5 - Part C

1. Calculate the gross profit percentage for 2011 (5)
2. Give 5 different explanations for the decrease/increase in 2011. (10)

2011 – Question 5 - Part C

Explain the limitations of ratio analysis (10)

2010 – Question 5 - Part C

Question on advice to a friend

Suggested Solutions

2023 – PART C

Distinguish between the terms liquidity and solvency when used in ratio analysis.

Liquidity

1. This measures the ability of the company to pay its short-term debts as they fall due.
2. The acid test ratio is a good indicator of liquidity as it includes only liquid assets

For examples – cash and debtors

Solvency

1. Solvency is the ability of a company to pay all of its debts as they fall due for payment .
2. Solvency is the most important indicator of a business's ability to survive in the long term.
3. A business is solvent if its total assets exceeds its outside liabilities.

For Examples the gearing ratios of debt to equity are good guides.

A rising liquidity ratio is a sign of prudent management. Briefly discuss.

1. Prudent management in accounting refers to the responsible and cautious approach taken by management in financial matters. It involves making decisions and taking actions that prioritise the long-term sustainability and stability of the business.
2. A rising liquidity ratio indicates that is easier for the firm to pay its short-term debts on time and avoiding paying interest or helping to achieve cash discounts for prompt payment.
3. If the ratio is much higher than 1:1 it could mean that the company has too much of its resources tied up in liquid assets when they could be invested in fixed assets enhancing the productive capacity of the business.

2022 – PART C

The gross profit percentage of Watson plc in 2020 was 36%.

Calculate the gross profit percentage for Watson plc in 2021.

$$\text{Formula} \quad \frac{\text{Gross Profit}}{\text{Sales}} \times \frac{100}{1}$$

Formula

$$\begin{aligned} \text{Gross profit} &= \text{Sales} - \text{Cost of Sales} \\ &= 950,000 - 682,000 \\ &= 268,000 \end{aligned}$$
$$\begin{aligned} \text{Gross profit Margin} &= \frac{268,000}{950,000} \times \frac{100}{1} \\ &= .28210 \times 100 \\ &= 28.21\% \end{aligned}$$

Give possible reasons for the change in gross profit percentage in 2021.

Possible reason for this fall could be the following

1. Sales (i) A reduction in selling price to get rid of stock
(ii) Cash sales not being recorded
2. Cost of Sales (i) An increase in the cost of sales – for raw materials (Purchases)
(ii) Theft of opening / closing stock
(iii) Overvaluing opening stock or undervaluing closing stock

Outline how a company could improve their gross profit percentage.

1. Sales (i) Increase the selling price (without increasing the purchase price)
2. Cost of Sales (i) Reduce the cost of sale by shopping around and finding competitive Suppliers
(ii) avail of discounts for bulk buying or paying before the invoice due Date
(iii) Use cash discount instead of relying on credit

2021 – PART C

What are the disadvantages to a business of having a high gearing?

When fixed interest debt is a high proportion of overall capital it has the following disadvantages:

1. High interest repayments mean less profits are available for investment elsewhere in The business
2. Shareholders are less likely to get a good dividend when gearing is high.

3. The business would find it more difficult to raise additional loan finance.
4. There is a higher risk of liquidation due to not being able to make interest payments.

Explain two ways to reduce gearing of a company.

1. Sell more ordinary shares to increase shareholders equity as a proportion of capital employed.
2. Reduce or repay loans to reduce fixed interest debt as a proportion of capital employed.
3. Increase reserves/retained profits to increase shareholders equity as a proportion of capital employed.
4. Convert long-term debt to ordinary shares reducing fixed interest debt and increasing Shareholders equity.

2020 – Part C

Explain how a faster stock turnover can increase the profitability of a business.

1. Each time stock is sold, because it contains a mark-up, profitability increases.
2. If the cost of buying the extra stock increases at a slower rate than the mark-up then profitability increases.
3. The more times the stock is turned over the greater the mark-up and profit will be increased.
4. Where stock turnover is high less stock may be held resulting in reduced stock holding costs (insurance, waste etc.) which could lead to an increase in profitability.
5. A faster stock turnover means that the firm may enjoy economies of scale, such as bulk-buying discounts, which will reduce costs and increase profitability.

2017 – PART C

As an employee I would be interested in the financial information for the following reasons

1. To assess job security.
2. To see if shareholder dividends are increasing which could be used as a negotiation strategy.
3. To see if the company can continue to pay existing wage rates or can it afford a pay rise.
4. To see if the company plans to expand and thereby assess the prospects for promotion.
5. To assess pension security.

Identify two other users of financial information

1. Lending institutions
2. shareholders,
3. competitors
4. Trade creditors
5. The revenue,
6. Directors.

2016 – Part C

Explain Gearing

1. This is a measure of how a business is financed on a long-term basis.
2. It measures the relationship between fixed interest debt (loans/debentures + preference shares) and total capital employed/equity.
3. When this is less than 50%/100%, the business is lowly geared. Above 50%/100% is highly geared. Low gearing is preferable.

What are the Benefits of a low gearing Company?

When fixed interest debt is a small proportion of overall capital it has the following benefits:

1. Low interest repayments mean more profits are available for investment elsewhere in the business.
2. Shareholders are more likely to get a dividend when gearing is low.
3. The business should find it easier to raise additional loan finance.
4. Less risk of liquidation due to not being able to make interest payments.

State two ways to reduce gearing in a company

Possible ways to reduce gearing includes the following

1. Sell more ordinary shares.
2. Reduce or repay loans.
3. Increase reserves/retained profits.
4. Convert long-term debt to ordinary shares.

2015 – Part C

State the limitations of ratio analysis as a financial analysis technique

1. It analyses past figures only and these figures are quickly out of date (historical). It merely gives us clues to the future.
2. Ratios do not show seasonal fluctuations
3. Firms use different accounting bases and therefore company comparisons are not accurate
4. Financial Statements do not reveal other important aspects of a company
5. Accounts alone cannot measure aspects which may be extremely significant such as monopoly position, economic climate, staff morale and management/staff relationships.

2014 – Part C

Explain the difference between the terms ‘Liquidity’ and ‘Solvency’ when used in Ratio Analysis. Refer to relevant ratios in your explanation.

Liquidity

3. This measures the ability of the company to pay its short-term debts as they fall due.
4. The acid test ratio is a good indicator of liquidity as it includes only liquid assets

For examples – cash and debtors

Solvency

4. Solvency is the ability of a company to pay all of its debts as they fall due for payment .
5. Solvency is the most important indicator of a business’s ability to survive in the long term.
6. A business is solvent if its total assets exceeds its outside liabilities.

For Examples the gearing ratios of debt to equity are good guides.

2012 – Part C

Calculate the gross profit percentage for 2011.

Gross Profit percentage = 24.68%

Give 5 different explanations for the decrease/increase in 2011

Cash losses	cash sales not recorded
Stock losses	pilferage of stock or obsolescent stock
Change in sales mix	more sales of low markup goods
Mark downs	during sales to get rid of out-of-date stock
Incorrect valuation of stock	overvalue of opening stock, undervalue of closing stock
Increased cost of sales	without an increase in sales price
Falling sales price	without corresponding drop in cost of sales

2011 – Part C

Explain the limitations of ratio analysis

State the limitations of ratio analysis as a financial analysis technique

1. It analyses past figures only and these figures are quickly out of date (historical). It merely gives us clues to the future.
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