STATE EXAM

THEORY QUESTION AND ANSWERS

INTERPERTATION OF ACCOUNTS

Questions

2022 – Question 5 - Part C

1. 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

1. 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

1. 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

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

2014 – Question 5 - Part C

1. 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

1. Question on ROCE

2012 – Question 5 - Part C

1. Calculate the gross profit percentage for 2011 (5)

2013 Give 5 different explanations for the decrease/increase in 2011.
(10)

2011 – Question 5 - Part C

1. Explain the limitations of ratio analysis (10)

2010 – Question 5 - Part C

1. Question on advice to a friend

SUGGEST SOLUTIONS

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.

<u>Liquidity</u>

This measures the ability of the company to pay its short term debts as they fall due.

For example - The acid test ratio is a good indicator of liquidity as it includes only liquid assets i.e. cash and debtors.

Solvency

1. This is the ability of a company to pay all of its debts as they fall due for payment (long term).
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 exceed its outside liabilities.

For Example - Debt to equity or total debt to total assets 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	over-value 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

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