NOVEMBER 2020 PROFESSIONAL EXAMINATIONS
FINANCIAL ACCOUNTING (PAPER 1.1)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER

The standard of the question paper was good and candidates were asked to answer all five (5) questions. The mark allocations followed the weight as stated in the syllabus and marks were allocated to all sub-questions. There were no ambiguities in the paper. The questions were clear, well typed and the instructions were also clearly stated. The questions were evenly spread over the topics in the syllabus.

PERFORMANCE OF CANDIDATES

The performance of Candidates was mix and while others had good marks others had lower marks. This November 2020 sitting recorded a pass rate of 48%. High performers were evenly spread across in all examination centres and so were low performers. There were no signs of copying at any centre. Some candidates exhibited a high sense of preparedness while others were not well prepared and therefore performed poorly.

NOTABLE STRENGTHS & WEAKNESS OF CANDIDATES

The strength of most candidates was demonstrated in questions 2, 4 and 5.The most prevalent reasons for some candidates obtaining low marks remains as in previous sittings, i.e. studying only a few selected topics, not reading the question carefully enough, or a lack of structure in the approach to answering questions. There were improper labeling of answers and improper presentation of answers by some candidates. The overall standard of some answers was disappointing. In particular some candidates showed a poor understanding of bookkeeping across several questions. Few candidates did not attempt the required number of questions, making the achievement of a pass mark a challenge. The other areas of weakness around presentation are as follows:

- Poor and untidy handwriting;
- No workings presented for some questions;
- Some candidates made calculation errors within workings and thus presenting incorrect figures in the solution;
- Some candidates either did not number their answers or miss-numbered them. This was the case on the cover page too.

QUESTION ONE

a) Accounting principles and concepts are of fundamental importance in the preparation of financial statements.

Required:
With the aid of relevant examples, outline your understanding on any **FOUR (4)** of the following concepts/principles.

i) Accruals
ii) Going Concern
iii) Historical Cost
iv) Materiality
v) Break up basis **(10 marks)**

b) Patricia Ltd prepares account to 31 December each year. The following transactions relate to Rent and Rates.

i) 31 December 2018 three months' rent owing amounted to GH¢6,000.
ii) 31 December 2018 two months rates prepaid amounted to GH¢5,250.
iii) During the year 2019 cash paid for rent and rates amounted to GH¢90,000
iv) Rent owing as at 31 December 2019 amounts to GH¢9,000
v) Rates prepaid as at 31 December 2019 amounts to GH¢2,250

Required:
Prepare a combined rent and rates account to disclose the amount that is chargeable to the profit or loss account for the year ended 31 December, 2019. **(4 marks)**

c) The following information was extracted from the books of Maanaa and Co.

Year	**1**	**2**	**3**
Bad debts written off (GH¢)	200,000	300,000	100,000
Trade Receivables (GH¢)	1,200,000	1,800,000	3,000,000
Allowance for doubtful debt (%)	10	5	5

Required:
Prepare the following accounts for the 3 years to determine the amount chargeable to the Profit or loss account:

i) Bad debts written off account **(2 marks)**
ii) Allowance for doubtful debt account **(4 marks)**

(Total: 20 marks)

QUESTION TWO

a) At the close of business on 31 July 2019 the following balances were extracted from the books of Kwabena Ltd, a limited liability company:

	GH¢
Receivables ledger control account	47,600
Payables ledger control account	37,400

During the month of August the following transactions occurred.

	GH¢
Cash received from customers	31,800
Cash paid to suppliers	32,500
Sales on credit	48,200
Purchases on credit	36,500
Sales returns	1,900
Purchase returns	700
Discounts received from suppliers	400
Settlement discount claimed by customer	300
Bad debts written off	2,700
Customer and supplier accounts settled by contra	2,100

Required:
Prepare the receivables ledger control account and payables ledger control account for the month of August 2019 and hence determine the balances as at 31 August 2019.

(8 marks)

b) Makor, Degbe and Sesenyo were in partnership sharing profits one-half, one-third and one-sixth respectively.
On 1 January 2019 they admitted Asinyo into the partnership on the following terms:

- Asinyo to have one-sixth share which he purchased from Makor, paying her GH¢20,000 for that share of goodwill. Of this amount, Makor retained GH¢15,000 and put the balance into the firm as additional capital. Asinyo also brought GH¢12,500 capital into the firm.
- It was agreed that the investments should be reduced to their market value of GH¢9,000 and that the plant should be reduced to GH¢14,500 as at 31 December 2018.

The Statement of Financial Position of the old firm as at 31 December 2018 was as follows:

	GH¢	**GH¢**
Non-Current Assets		
Plant	17,500	
Furniture	5,000	
Investments	15,000	37,500
Current Assets		
Inventory	25,000	
Receivables	30,000	
Bank	20,000	
	75,000	
Current Liabilities		
Payables	52,500	22,500
		60,000

Capital	
Makor	30,000
Degbe	20,000
Sesenyo	10,000
	60,000

Required:

i) Prepare the opening statement of financial position of the new firm as at 1 January 2019. **(6 marks)**

ii) Prepare the capital accounts of the partners for the year to 31December 2018. **(6 marks)**

(Total: 20 marks)

QUESTION THREE

a) K. Avuledor is a sole trader with a small business. The trial balance extracted as at 31 December 2018 failed to agree. The credits exceeded the debits by GH¢26,180.

A detailed examination of the books was undertaken and the following issues were uncovered:

- No entry had been made for expenses paid with cash from the petty cash till. The expenses amounted to GH¢826.
- Discount received of GH¢770 was debited to discounts allowed. The entry in the payables personal account was correct.
- Sales returns of GH¢6,860 was treated correctly in the customer's account and credited to the sales returns account as GH¢6,230.
- The total in the purchases day book of GH¢120,050 was debited to the purchases returns account.
- The bookkeeper forgot to post the wages and salaries journal for December 2018. No payment has yet been made to employees or the Statutory Authorities. The relevant figures are as follows:
  Wages and salary costs (gross) - GH¢71,050
  Employers Social Security - GH¢6,300
  Employee income taxes (PAYE) - GH¢21,315
- A sales invoice of GH¢7,350 was entered in the sales day book as GH¢6,650.
- A payment for building repairs of GH¢7,315 was credited to both the Buildings account and the cash account.

Required:

i) Prepare journal entries, with appropriate narratives, necessary to correct the above errors. **(7 marks)**

ii) Prepare a suspense account to clear the difference. **(3 marks)**

iii) Prepare a working schedule showing the effect on the proprietor's loss in correcting each of the above errors assuming that the loss before these adjustments was GH¢293,090. **(4 marks)**

b) The cash book balance of Armah and Co. disclosed a debit balance of GH¢5,700 which did not agree with the closing favorable bank statement balance of GH¢3,350.

The following were discovered during the reconciliation:

i) Cheques received from customers settling their debts amounting to GH¢18,500 were still in the cashier's drawer.
ii) GH¢800 standing order for the payment of electricity charges was paid by the bank. This has not been recorded in the books of Armah and Co.
iii) Cheque book charge of GH¢50 is yet to be booked by Armah and Co.
iv) The bank had debited Armah and Co in error of GH¢1,000.
v) A credit transfer of GH¢5,500 had been made in favour of Armah and Co. This has not been adjusted in the cash book.
vi) As at 31 December 2019, cheques totaling GH¢12,500 which were recorded by Armah and Co as paid to suppliers had not been presented to the bank for payment.

Required:
Prepare an adjusted cash book for Armah and Co and reconcile the adjusted cash book balance with the bank statement balance of GH¢3,350. **(6 marks)**

(Total 20 Marks)

QUESTION FOUR

Kofi Badu, a sole trader, extracted the following Trial Balance from the business books as at 30 April 2019.

	Dr GH¢	Cr GH¢
Sales		230,150
Sales returns	2,210	
Purchases	96,100	
Purchases returns		1,450
Carriage outwards	780	
Discounts allowed	2,840	
Discounts received		1,680
Rent received		7,400
Heat and light	3,810	
General expenses	55,800	
Motor expenses	6,200	
Salaries	30,100	
Bad debt written off	680	
Allowance for doubtful debt		700
Drawings	22,500	
Loan interest	1,200	
10% Loan		13,000
Equipment	24,050	
Accumulated depreciation for equipment		9,100
Motor vehicles	38,000	
Accumulated depreciation for motor vehicles		24,020
Inventory at 1 May 2018	7,500	
Receivables	37,250	
Payables		8,940
Bank	7,420	
Capital		40,000
	336,440	**336,440**

The following information is also relevant:

i) The closing inventory as at 30 April 2019 was valued at GH¢8,010.

ii) As at 30 April 2019 accrued rent income for the year amounted to GH¢420; heat and light accrued was GH¢260; whilst salaries of GH¢720 was paid in advance.

iii) During the year, Kofi Badu had withdrawn goods costing GH¢720 for his personal use. This had not been recorded in the accounts.

iv) New equipment costing GH¢2,650 was purchased during the year but had been mistakenly included in purchases. This is yet to be corrected.

v) A cheque for GH¢440 received from a customer in full settlement of a debt of GH¢450 has not yet been entered in the accounts.

vi) Allowance for doubtful debt is to be maintained at 2% of receivables.

vii) Depreciation is to be provided for as follows:

- Equipment- 20% per annum using the straight line method. A full year's depreciation is provided on all equipment held at 30 April 2019, regardless of the date of purchase.
- Motor vehicles- 40% per annum using the reducing balance method.

Required:

a) Prepare a statement of profit or loss for Kofi Badu for the year ended 30 April 2019. **(12 marks)**

b) Prepare a statement of financial position for Kofi Badu as at 30 April 2019. **(8 marks)**

(Total: 20 marks)

QUESTION FIVE

The following financial information relates to Mawoekpor Ltd. for the year ended 31 December 2019 (with comparative figures for year ended 31 December 2018).

Statement of Financial Position as at 31 December 2019

	2019		**2018**	
	GH¢	**GH¢**	**GH¢**	**GH¢**
Non-Current Asset		57,100		40,800
Current Asset				
Inventory	25,550		21,050	
Receivables	30,750		34,050	
Cash in hand	2,800		6,525	
		59,100		61,625
Total Assets		**116,200**		**102,425**
Equity & Liabilities				
Share Capital	21,200		21,200	
Retained Earning	18,200	39,400	13,925	35,125

Non-Current Liabilities				
10% Debenture		34,550		29,500
Current Liabilities				
Payables	36,550		33,100	
Other accruals	5,700	42,250	4,700	37,800
Total Equity and Liabilities		**116,200**		**102,425**

Other information:

	2019	**2018**
Turnover	293,100	212,550
ROCE	19%	12%
Gross Profit	23%	16%
Receivables day	38	55
Payable day	79	62
Inventory turnover period (days)	73	47

Required:

a) Select **THREE (3)** of the ratios listed above and briefly outline what information each ratio provides to users of financial information commenting specifically on the financial results of Mawoekpor Ltd. **(9 marks)**

b) Calculate **TWO (2)** additional ratios for both 2018 and 2019 which would provide further evidence of liquidity of the company. **(5 marks)**

c) Explain **THREE (3)** importance of preparing a statement of cash flows. **(6 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) **Accruals**

Income is recognised in the financial statements as it is earned, not when the cash is received. Expenditure is recognised as it is incurred, not when it is paid for. When income is incurred over time (e.g. rental/interest income) or expenditures are time-based (e.g. rent payments), the income and expenditure recognised in the income statement should relate to the time period, not to the receipts and payments of cash. For example the sale of a good is recognised in the financial statements when the rights and rewards of ownership have passed from the seller to the purchaser not when the cash is received.

Going Concern

Financial transactions are usually prepared on the assumptions that the business will continue in operational existence for the foreseeable future. This means that the financial statements are drawn up on the assumption that there is no intention or necessity to close down the business.

If the financial statements are not prepared on the going concern basis then they must be prepared on what is known as the break-up basis. The break-up basis reflects the following:

- Some non-current assets may be sold at less than their value on the statement of financial position, whilst a machine may have a use for specific business, it may be scrap or no use to other businesses.
- In contrast, property may be sold for a value in excess of that shown in the statement of financial position based on original cost.
- If the entire inventory is sold at once then it will not be sold for as much money as if it were sold in the normal way.
- Some receivables may decide not to pay the business if it is known the business is about to go into liquidation.

In most cases financial statements are prepared on a going concern basis unless there is evidence to the contrary.

Historical Cost

Assets are recorded at historical cost i.e. what they were bought for. Liabilities are valued at the amount initially received in exchange for the obligation. Thus the figure shown in the financial statements for an item is the value of the item when the transaction occurred, not its current market value. Historical cost has many drawbacks, a significant one being that the non-current assets of the business tend to be undervalued and therefore the statement of financial position does not show the true value of the business.

Historical cost continues to be used however for the following reasons: it is simple and cheap to apply, figures used are objective and verifiable and the lack of a sound and acceptable alternative. An example of the historical cost concept is valuing buildings at a cost price of GH¢100,000 even though the current market value of the buildings is GH¢250,000.

Materiality

Materiality is a threshold quality that is demanded of all information given in the financial statements. When immaterial information is given in the financial statements, the resulting clutter can impair the understandability of the other information provided.

An item's size is judged in the context both of the financial statements as a whole and of the other information available to users that would affect their evaluation of the financial statements. An example of a material item is the value of non-current assets of GH¢250,000 in the financial statement of an entity with total assets of GH¢320,000. The non-current assets are material to the financial statements of the entity.

Break-up basis

Break Up basis is the assumption for accountant to prepare financial statements while they can't use going concern assumption. Accountants are aware that the company will cease its operation shortly after the reporting date. It means the company will only continue its operation in the foreseeable future.

(4 principles well explained @ 2.5 = 10 marks)

b)

Rent & Rates A/c

	GH¢		GH¢
Rates b/d	5,250	Rent b/d	6,000
Cash	90,000	P/L	96,000
Rates c/d	9,000	Rent c/d	2,250
	104,250		**104,250**

(4 marks evenly spread using ticks)

c) i)

Bad Debt A/c

Year		GH¢		GH¢
1	c/d	200	P/L	200
		200		**200**
2	c/d	300	P/L	300
		300		**300**
3	c/d	100	P/L	100
		100		**100**

(2 marks evenly spread using ticks)

ii)

Allowance for Doubtful Debt A/c

Year		GH¢		GH¢
1	c/d	120,000	P/L	120,000
		120,000		**120,000**
2	P/L	30,000	b/d	120,000
	c/d	90,000		
		120,000		**120,000**
3			b/d	90,000
	c/d	150,000	P/L	60,000
		150,000		**150,000**

(4 marks evenly spread using ticks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The concept of accrual was generally answered well though some candidates explained an accrual as opposed to the accrual concept.

The concept of going concern, historical cost and materiality were generally well understood.

Some candidates failed to state that assets are recorded at historical cost that is how much they were bought for.

Break-up basis was not touched by candidates, and finally the rent and rates, bad debt and allowance for doubtful debt accounts were dealt with very well

QUESTION TWO

a) Control accounts

Receivables Ledger Control A/c

	GH¢		GH¢
Bal b/d	47,600	Cash received	31,800
Sales on credit	48,200	Sales Return	1,900
		Settlement discount taken	300
		Bad debt	2,700
		Contra with suppliers	2,100
		Bal c/d	57,000
	95,800		**95,800**

Payables Ledger Control A/c

	GH¢		GH¢
Cash paid	32,500	Bal b/d	37,400
Purchase returns	700	Purchases	36,500
Discount received	400		
Contra with customers	2,100		
Bal c/d	38,200		
	73,900		**73,900**

(8 marks evenly spread using ticks)

b)i)

Statement of Financial Position as at 1 January 2019

	GH¢	GH¢
Non Current Assets:		
Plant	14,500	
Furniture	5,000	
Investments	9,000	28,500
Current Assets:		
Inventory	25,000	
Receivables	30,000	
Bank	37,500	
	92,500	
Current Liabilities:		
Payables	52,500	40,000
		68,500
Capital Accounts:		
Makor		30,500

Degbe	17,000
Sesenyo	8,500
Asinyo	12,500
	68,500

(6 marks evenly spread using ticks)

b)ii)

Partners' Capital A/c

	Makor GH¢	Degbe GH¢	Sesenyo GH¢	Asinyo GH¢		Makor GH¢	Degbe GH¢	Sesenyo GH¢	Asinyo GH¢
					Bal b/d	30,000	20,000	10,000	
					new	5,000			12,500
Revaluation	4,500	3,000	1,500						
Bal c/d	30,500	17,000	8,500	12,500					
	35,000	20,000	10,000	12,500		35,000	20,000	10,000	12,500

(6 marks evenly spread using ticks)

Alternative Solution

Partners' Capital A/c (Goodwill)

	Makor GH¢	Degbe GH¢	Sesenyo GH¢	Asinyo GH¢		Makor GH¢	Degbe GH¢	Sesenyo GH¢	Asinyo GH¢
					Bal b/d	30,000	20,000	10,000	
Revaluation	4,500	3,000	1,500						
Goodwill	40,000	40,000	20,000	20,000	Goodwill	60,000	40,000	20,000	
Cash	15,000				Cash	5,000			12,500
Bal c/d	30,500	17,000	8,500	12,500					
	35,000	20,000	10,000	12,500		35,000	20,000	10,000	12,500

Workings

- Total value of goodwill 1/6 =20,000, Total goodwill = 20,000x6=120,000
- Makor ½ x 120,000 = 60,000; Degbe 1/3 x 120,000 = 40,000; Sesenyo 1/6 x 120,000 = 20,000
- Calculation of the new ratio : Makor's share = 1/2-1/6=1/3
- Therefore new ratio is 1/3 :1/3:1/6:1/6 =2 :2: 1:1

(Total: 20 marks)

EXAMINER'S COMMENTS

Generally this question was well answered with a few candidates scoring full marks. Some candidates ignored preparing T accounts and got confused as a result, thus losing marks.

The b (i) and b (ii) were not well managed though some candidates got pass mark.

QUESTION THREE

a) i)

Journal Entries

	Debit	Credit
	GH¢	GH¢
1. Sundry Expenses	826	
Cash		826
Being sundry expenses not posted		
2. Suspense	1,540	
Discount Received		770
Discount Allowed		770
Being discount received treated as discount allowed in error		
3. Sales returns	6,860	
Sales returns	6,230	
Suspense		13,090
Being correction of error sales returned posted to the incorrect side and transposed.		
4. Purchases	120,050	
Purchases Return		120,050
Being correction of error purchases posted to purchases returns in error		
5. Wages and Salary costs	71,050	
Employees Social Security	6,300	
Net Wages		49,735
Social Security and Taxes		27,615
Being the correction of an error of omission		
6. Receivables	700	
Sales		700
Being the correction of an error of original entry		
7. Buildings	7,315	
Repairs	7,315	
Suspense		14,630
Being the correction of an error of principle		

(7 marks evenly spread using ticks)

ii)

Suspense A/c

	GH¢		GH¢
Balance	26,180	Error 3	13,090
Error 2	1,540	Error 7	14,630
	27,720		27,720

(3 marks evenly spread using ticks)

iii)

Proprietor's profit adjustment

	GH¢
Original loss	(293,090)
Error 1	(826)
Error 2	1,540
Error 3	(13,090)
Error 4	-
Error 5	(77,350)
Error 6	700
Error 7	(7,315)
	(389,431)

(4 marks evenly spread using ticks)

b)

Adjusted Cash Book

	GH¢		GH¢
b/d	5,700	Standing order	800
Credit transfer	5,500	Bank charges	50
		c/d	10,350
	11,200		11,200

Bank Reconciliation Statement

	GH¢	GH¢
Balance per adjusted cash book		10,350
Add: Unpresented cheques	12,500	12,500
		22,850
Less: Uncredited cheques	18,500	
Wrong debit	1,000	(19,500)
Bank balance		**3,350**

(6 marks evenly spread using ticks)

(Total: 20 marks)

EXAMINER'S COMMENTS

The journal entries were reasonably answered. Some adjustments proved very challenging to candidates. Suspense account was also a challenge to most candidates. The profit adjustment to calculate the Proprietor's profit was very poorly answered and not attempted by many candidates.

The adjusted cash book and the bank reconciliation statement were well handled by candidates.

QUESTION FOUR

a) **Kofi Badu**

Statement of profit or loss for the year ended 30 April 2019

	GH¢	GH¢
Sales		230,150
Sales returns		2,210
		227,940
Opening inventory	7,500	
Purchases (96,100 – 2,650 -1,450 - 720)	91,280	
	98,780	
Closing inventory	(8,010)	
Cost of sales		(90,770)
Gross profit		137,170
Discounts received		1,680
Rent received (7,400 + 420)		7,820
		146,670
Carriage outwards	780	
Discounts allowed (2,840 + 10)	2,850	
Heat and light (3,810 + 260)	4,070	
General expenses	55,800	
Motor expenses	6,200	
Salaries (30,100 – 720)	29,380	
Irrecoverable debts	680	
Allowance for receivables (37,250 – 450) x2% - 700	36	
Loan interest (13,000 x 10%)	1,300	
Depreciation – Equipment (24,050 + 2,650) x 20%	5,340	
Motor vehicles (38,000 – 24,020) x 40%	5,592	
		(112,028)
Net Profit		**34,642**

(12 marks evenly spread using ticks)

b) **Kofi Badu**

Statement of Financial Position as at 30 April 2019

	GH¢	GH¢
Non-current Assets		
Equipment (24,050 + 2,650 – 9,100 – 5,340)		12,260
Motor vehicles (38,000 – 24,020 – 5,592)		8,388
		20,648
Current Assets		
Inventory	8,010	
Receivables (37,250 – 450 – 736)	36,064	
Accrued rent receivable	420	
Prepaid salaries	720	

Bank (7,420 + 440)	7,860	
		<u>53,074</u>
Total Assets		**<u>73,722</u>**
Current Liabilities		
Payables	8,940	
Accrued heat and light	260	
Accrued Loan interest (10% x 13,000) -1,200	<u>100</u>	9,300
Non-current Liabilities		
10% Loan		13,000
Capital		
Balance b/f	40,000	
Net Profit	34,642	
Drawings (22,500 + 720)	(23,220)	<u>51,422</u>
Total Capital and Liabilities		**<u>73,722</u>**

(8 marks evenly spread using ticks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question was generally well answered. Generally this was a well answered question with some candidates displaying a good fundamental knowledge of the primary statements.

Some candidates did not deal well with the allowance for doubtful debt. Most candidates dealt well with depreciation and were able to treat it well in the statement of financial position.

Many candidates prepared correct calculations for trade receivable, allowance for doubtful debts, irrecoverable debt, drawings and bank correctly.

A significant number of candidates did not correctly adjust purchases for drawing. The adjustment for insurance prepayment was not well answered with most candidates having difficulty in the computation of the prepayment.

Layout, presentation and workings continue to improve, however, candidates need to remember to title the financial statements correctly.

QUESTION FIVE

a) **Mawoekpor Ltd**

Ratio	**Formula**
ROCE	$\frac{\text{Net Profit (before interest \&tax)}}{\text{Capital +Reserves+ Non-current liabilities}} \times 100\%$
Gross Profit	$\frac{\text{Gross Profit}}{\text{Sales/ Revenue}} \times 100\%$
Receivable days	$\frac{\text{Receivables}}{\text{Credit Sales}} \times 365$ days
Payable days	$\frac{\text{Payables}}{\text{Credit purchases}} \times 365$ days
Inventory turnover	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365$ days

Return on Capital Employed (ROCE)
This ratio is often considered the most important measure of profitability. This ratio calculates the profitability of the business as a percentage of capital employed. Capital employed is the capital used to finance the business, i.e. funds provided by shareholders (share capital plus reserves) and funds advanced by financial institutions (non-current liabilities).

The ROCE for Mawoekpor Limited states that the return for every GH¢ 1 invested in the business profits for 2018 were 12 pesewas/cent increasing to 19 pesewas/cent in 2019. This is the return earned on the funds invested in the business, it is not however a measure of how much is paid out in the form of interest and/or dividends.

Gross profit
This ratio is a measure of profitability and shows how much gross profit is earned for every GH¢ 1 in sales. A business with a high level of cost of sales will have a low gross profit margin. The gross margin for Mawoekpor Limited is increasing and is quite a healthy margin for a company which usually have a high level of direct costs, that is cost of goods sold, and therefore a lower gross profit margin. In this particular scenario both turnover and gross profit have increased, which shows that the company has managed to reduce its direct cost base at the same time as increasing turnover. To achieve such a dramatic increase in gross profit the company has probably benefited from economies of scale and/or undertaken a cost saving programme which has delivered positive results.

Receivables days

Receivables days ratio is one of the common ratios used to measure the efficiency of a business. If a business has healthy efficiency ratios it will tend to have good liquidity. Efficiency ratios examine how many days it takes the business to sell inventories, collect receivables and pay payables. The three efficiency ratios are the inventory turnover period, the receivables days ratio and the payables days ratio.
In relation to Maworkpor Limited as can be seen from the Statement of Financial Position receivables have decreased despite an increasing turnover. This is evident from the reducing receivables days from 55 days in 2018 to 38 days in 2019. The receivable days in 2018 of 55 appear to be reasonable however the ratio of 38 days shows that the company has engaged in stricter credit control procedures and is enforcing credit terms. This isn't always a sensible approach and may result in having to offer incentives such as discounts to receive early payment, but it may also be indicative of an over reliance on debtor receipts to fund activities such as capital expenditure.

Payable days

As discussed above payables days ratio is one of the three efficiency ratios. A payable days ratio of 79 days means that on average it takes Mawoekpor Limited 79 days to pay its payables and this has increased from 62 days in 2018. While it is true that credit represents an interest free loan to a business and should be exploited to its full potential, the ratio can in fact be too high and may be detrimental to the business, that is, suppliers may withdraw credit altogether if payment is not made quicker or they may tighten credit terms on offer. As noted above the company is shortening its receivables days at the same time that it is squeezing its creditors, together providing further credit.
While the payable days ratio may not be at a critically high level management should determine why it has increased and be clear of the potential implications should they decide to continue to squeeze creditors in this way.

Inventory turnover

As discussed above inventory turnover period is one of the three efficiency ratios. This ratio measures how long it takes a business to sell inventories. Like all efficiency ratios, the ratio is an average as some items of inventory may sell quicker than the average inventory days and some will take longer.
Average inventory' is usually taken as the average of the opening and closing inventory. A business normally wants the inventory turnover period to be as low as possible. When the period is high a significant amount of cash is tied up in inventory, these funds could potentially be put to better use elsewhere. Also the company incurs additional warehousing and storage costs when holding higher than required levels of inventory.
In this scenario inventory has increased as seen in the Statement of Financial Position and accordingly inventory days have increased from 47 days (2018) to 73 days (2019). This is quite a significant jump and management should determine the reasons for such an increase. Perhaps management reacted to increasing turnover by buying additional inventory which it believed it would sell but didn't, it could be indicative of higher levels of obsolete stock, it could relate to inventory

which was purchased in advance for 2020 orders. Whatever the reason management must review inventory particularly in light of stricter credit control procedures and lengthening payables days. Needlessly high levels of inventory can be very costly for a business.

(Any 3 well explained points @ 3 marks each = 9 marks)

b)

Ratio	Formula	2019	2018
Current Ratio	Current Assets / Current Liabilities	59,100 / 42,250 =1.4:1	61,625 / 37,800 = 1.6:1
Acid test ratio	Current assets-Closing stock / Current Liabilities	59,100-25,550 / 42,250 =0.8:1	61,625-21,050 / 37,800 = 1.1:1

(5 marks)

c)

- The statement of financial position and the income statement are prepared on the accruals basis. However, the cash flow statement is prepared on a cash basis. The cash flow statement records actual cash flows into and out of the business throughout the accounting period. In contrast, the income statement records income and expenditure matched to the accounting period in which it is earned or incurred, regardless of whether or not any cash has actually changed hands.

- The statement of cash flows provides insights that the statement of financial position and income statement do not. The cash flow statement reports the movement of money into or out of the business from operating, investing, and financing activities. The income statement and statement of financial position numbers are also often affected by subjective estimates like depreciation and allowance for receivables.

- Being able to internally generate sufficient cash is key to maintaining a healthy business. Being profitable does not necessarily mean being liquid. The company can fail because of a shortage of cash even when it is profitable. For example, the company may be profitable but generate little operational cash if its accounts receivable turnover is long. In such cases if needed, the company may derive additional operating cash by issuing shares, raising additional debt finance, or selling its assets.

- Without positive cash flow, the company will not be able to meet its financial obligations, thereby leading to a cash crunch or bankruptcy. As an analytical tool, the statement of cash flows is useful in determining the short-term viability of the company, particularly its ability to pay bills. The measurement of cash flows can be used for calculating other parameters that give information on the company's value, liquidity or solvency situation.

(Any 3 well explained points @ 2 marks each = 6 marks)

(Total: 20 marks)

EXAMINER’S COMMENTS

Some candidates were able to answer part a) of the question and got pass marks in this area.

For part b), candidates were to calculate two additional ratios for both 2018 and 2019 which will provide further evidence of liquidity. Some of the candidates did not know the figures to select for the equations thereby getting wrong answers.

Part c) of the question was poorly answered. Some of candidates did not know what to do and therefore did not answer this part of the question.

CONCLUSION

Candidates and Lecturers should use past question papers as a guide to future question papers, but Candidates also need to be aware that future papers, although still following the current specification, may differ in approach and format from the current series.

Candidates are also advised to ensure that they go through the syllabus very well before sitting for the examination.