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18/SMS01/013

SOCIAL AND MANAGEMENT SCIENCES ECONOMICS DEPARTMENT

ACCOUNTING 202 ASSIGNMENT

a) Profitability ratio b) liquidity c) Working capital efficiency ratio

A) comment on the liquidity of Ajahaku plc stating the refund point to which relevant ratio can be compared.

Profitability ratio return on capital

employed

$$ROCE = \frac{\text{Profit before interest and taxation}}{\text{capital employed}} * 100$$

220,000

$$ROCE = \frac{220,000}{700,000} * 100 = 31.4$$

b) Return on equity/ return on share holder capital

$$ROE/ROSE = \frac{\text{PROFIT AFTER TAXATION AND PREFERENCE DIVIDEND}}{\text{SHARE CAPITAL AND RESERVES EXCLUDING PREFERENCE SHARE CAPITAL}} * 100$$

112,000 / 112,000

$$700,000 * 100 = 16 \quad \text{C] Operating profit margin} = \frac{112,000}{1,120,000} * 100 = 9.9$$

5.6

500,000

$$d] \text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Revenue/sales}} * 100 = \frac{500,000}{2,000,000} * 100 = 25$$

2] Liquidity ratio current ratio = $\frac{\text{Current assets}}{\text{Current liability}}$

760,000

700,000

1.086

1.09

1 1.09:1

LIQUIDITY RATIO = $\frac{\text{Current asset - inventories}}{\text{Current liabilities}}$

260,000

$$\text{Current liabilities } 760,000 - 500,000 = \frac{260,000}{700,000} = 0.37$$

3]

Working capital ratio

Average collection period = $\frac{\text{Trade receivable}}{\text{Credit sales}} * 365 \text{ days}$

200,000

$$\frac{200,000}{2,000,000} * 365 \text{ days} = 36.5$$

365=37days

$$\begin{aligned} \text{Average payable period} &= \frac{\text{Trade payables}}{\text{purchases}} * 365 \\ &= \frac{172,800}{1,080,000} * 365 \text{days} \\ &= 58 \text{days} \end{aligned}$$

$$\begin{aligned} \text{c] inventory Turnover period} &= \frac{\text{inventory}}{\text{cost of sale}} * 365 \\ &= \frac{500,000}{1,500,000} * 365 \text{days} \\ &= 122 \text{days} \end{aligned}$$

Profitability Ratio

Ajanuku plc's return on capital employed, return on equity and gross profit margin are very high. The profit margin shows that the business is making a good profit And this could be due to successful marketing or due to the low cost price.

Working capital efficiency ratio

The ratio appears to be good by the general standard acceptable inventory turnover period. Which means that the business inventory turnover period is too high hence it is inefficient.

Liquidity ratio

The current and the quick[acid test] ratios are below the standard industry averages this implies that Ajanaku plc is either short of liquidity resources or is managing its working capital.

Comparison

Liquidity ratio is low in comparison with a profitable ratio. The lower the liquidity ratio the lower the profitability ration in the sense that this because Ajanuku plc doesn't have enough current asset to cover its debt even though they make profit. The profit won't be enough because they have to set aside some as reserves.

Liquidity ratio is low in comparison with working capital ratio because the liquidity is below standard the industry resource which affects the working capital because it has less liquidity resources which is unable to make debt payments

In conclusion, there is a strong profit but there are weaknesses in both the liquidity and working capital efficiency ratio. These problem need to be attended to if the business wants to remain strong and grow.

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