Allama Iqbal Open University AIOU BS / ADC/ ADB solved Assignment no 2 Autumn 2025
Code 5418 Financial Accounting

Q.1 (a) What Do You Know About Stockholders' Equity? Explain. Also, Draw the Specimen of the Stockholders' Equity Section of the Balance Sheet

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Introduction

In accounting and business finance, **stockholders' equity** (also called **shareholders' equity** or **owners' equity**) represents the **residual interest of the owners in the assets of a corporation after deducting all liabilities**. It shows the amount that would remain for shareholders if the company's assets were sold and all its obligations were paid off.

Stockholders' equity is an essential part of the **balance sheet** and provides important information about a company's **financial strength, ownership structure, capital formation, and retained profits**. Investors, creditors, management, and regulators all analyze stockholders' equity to assess the long-term stability and growth potential of a business.

Meaning of Stockholders' Equity

Stockholders' equity is the claim of the owners (shareholders) on the net assets of a corporation.

In simple words:

> Stockholders' equity is the difference between total assets and total liabilities of a business.

Accounting Equation

$$
\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}
$$

or

$$
\text{Stockholders' Equity} = \text{Assets} - \text{Liabilities}
$$

This equation highlights that stockholders' equity is the **owners' portion** of the company's total resources.

Nature and Characteristics of Stockholders' Equity

Stockholders' equity has the following important characteristics:

1. It represents **ownership interest** in a corporation
2. It is a **residual claim**, meaning it is paid after liabilities
3. It increases with profits and new share issues
4. It decreases with losses and dividend payments

5. It reflects the **long-term financing** of a business

Components of Stockholders' Equity

Stockholders' equity is not a single item; rather, it consists of several components. These components may vary slightly from company to company, but generally include the following:

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1. Share Capital (Paid-in Capital)

Meaning

Share capital refers to the amount invested in the company by shareholders in exchange for shares.

It is divided into different types depending on the class of shares issued.

(a) Ordinary / Common Share Capital

- Represents ownership in the company
- Shareholders have voting rights
- Dividends are not fixed
- They bear the highest risk

(b) Preference Share Capital

- Have preference over ordinary shareholders in dividend payment
- Dividends are usually fixed
- Usually no voting rights

Importance of Share Capital

- Provides permanent capital
- Forms the financial base of the company
- Enhances creditworthiness

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2. Additional Paid-in Capital (Share Premium)

Meaning

When shares are issued at a price **higher than their par (face) value**, the excess amount is called **share premium** or **additional paid-in capital**.

Example

If a share of face value Rs. 10 is issued at Rs. 15:

- Share Capital = Rs. 10

- Share Premium = Rs. 5

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3. Retained Earnings

Meaning

Retained earnings represent the accumulated profits of the company that have not been distributed as dividends but are reinvested in the business.

Importance

- Indicates profitability over time
- Provides internal financing
- Supports expansion and growth

Formula

[

\text{Ending Retained Earnings} = \text{Beginning

$$\text{Retained Earnings} + \text{Net Income} - \text{Dividends}$$

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4. Reserves

Meaning

Reserves are portions of profits set aside for specific or general purposes.

Types of Reserves

- General reserve
- Capital reserve
- Revaluation reserve
- Legal or statutory reserves

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5. Treasury Stock (If Any)

Meaning

Treasury stock refers to the company's own shares that have been **repurchased** from shareholders but not cancelled.

Effect

- Deducted from stockholders' equity
- Reduces total equity

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6. Accumulated Other Comprehensive Income (AOCI)

Meaning

Includes gains or losses not recognized in net income, such as:

- Revaluation surplus
- Foreign currency translation differences

Importance of Stockholders’ Equity

Stockholders’ equity plays a vital role in business finance and accounting for the following reasons:

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1. Indicator of Financial Strength

A strong equity base indicates:

- Long-term stability
- Lower financial risk
- Ability to absorb losses

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2. Basis for Investor Decisions

Investors analyze equity to assess:

- Net worth of the company
- Growth potential
- Return on investment

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3. Creditworthiness

Lenders prefer companies with:

- High equity
- Low debt-equity ratio

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4. Measure of Profit Retention

High retained earnings show:

- Reinvestment capacity
- Sustainable growth strategy

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5. Legal and Regulatory Importance

- Required disclosure under company law
- Helps ensure transparency

Difference Between Stockholders' Equity and Liabilities

Basis	Stockholders' Equity	Liabilities
Ownership	Owners' claim	Creditors' claim
Repayment	No fixed repayment	Fixed repayment
Risk	High	Low

Return Dividends Interest

Specimen of Stockholders' Equity Section of the Balance Sheet

Below is a **specimen (format)** of the **Stockholders' Equity Section** as it appears in the balance sheet of a corporation:

STOCKHOLDERS' EQUITY

Share Capital:

Ordinary Share Capital

(Authorized: 1,000,000 shares @ Rs.10)

Issued and Paid-up:	
500,000 shares @ Rs.10	Rs. 5,000,000
Add: Share Premium (Additional Paid-in Capital)	1,500,000
Total Paid-in Capital	6,500,000
Reserves:	
General Reserve	800,000
Revaluation Reserve	400,000
Total Reserves	1,200,000
Retained Earnings	2,300,000

Subtotal	9, , , ,
Less: Treasury Stock	(300,000)
Total Stockholders' Equity	Rs. 9,700,000

(Note: Figures are hypothetical and for illustration purposes only.)

Conclusion

Stockholders' equity represents the **ownership interest** of shareholders in a corporation and forms a major part of the balance sheet. It reflects how much of the business is

financed by owners rather than creditors and shows the accumulated performance of the company over time.

Understanding stockholders' equity helps investors, creditors, and management evaluate the **financial position, profitability, and long-term sustainability** of a business. A well-structured and adequately financed equity section is a sign of a **financially sound and stable organization**.

Q.1 (b) Prepare Journal Entries to Record the Following Four Separate Issuances of Stock

1. A corporation issued 2,000 shares of no-par common stock to its promoters in exchange for their efforts, estimated to be worth Rs. 30,000. The stock has no stated value.

Explanation

When **no-par common stock has no stated value**, the **entire value of consideration received** (cash or services) is credited to **Common Stock**. There is **no Share Premium account** in this case.

The promoters' efforts are recorded as an **expense or organizational cost**.

Journal Entry

Promoters' Services / Organization Expense	Dr. 30,000	
Common Stock		Cr. 30,000

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2. A corporation issued 2,000 shares of no-par common stock to its promoters in exchange for their efforts, estimated to be worth Rs. 30,000. The stock has a Rs. 1 per share stated value.

Explanation

When no-par stock has a **stated value**, that stated value is treated like par value.

- Common Stock is credited with the **stated value × number of shares**
- The excess is credited to **Share Premium (Additional Paid-in Capital)**

Calculation

- Stated value = Rs. 1 × 2,000 shares = Rs. 2,000

- Share Premium = Rs. 30,000 − Rs. 2,000 = Rs. 28,000

Journal Entry

Promoters' Services / Organization Expense Dr. 30,000

Common Stock Cr. 2,000

Share Premium – Common Stock Cr. 28,000

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3. A corporation issued 4,000 shares of Rs. 10 par value common stock for Rs. 70,000 cash.

Explanation

When shares are issued **above par value**:

- Common Stock is credited with **par value**
- The excess amount is credited to **Share Premium**

Calculation

- Par value = 4,000 × Rs. 10 = Rs. 40,000
- Share Premium = Rs. 70,000 − Rs. 40,000 = Rs. 30,000

Journal Entry

Cash	Dr. 70,000	
Common Stock		Cr. 40,000
Share Premium – Common Stock		Cr. 30,000

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4. A corporation issued 1,000 shares of Rs. 100 par value preferred stock for Rs. 120,000 cash.

Explanation

Preferred stock issued **above par value** is recorded in the same manner as common stock:

- Preferred Stock is credited with **par value**

- Excess is credited to **Share Premium – Preferred Stock**

Calculation

- Par value = 1,000 × Rs. 100 = Rs. 100,000
- Share Premium = Rs. 120,000 − Rs. 100,000 = Rs. 20,000

Journal Entry

Cash	Dr. 120,000	
Preferred Stock		Cr. 100,000
Share Premium – Preferred Stock		Cr. 20,000

Summary Table (For Quick Revision)

Case	Type of Stock	Credit to Stock	Credit to Share Premium
1	No-par, no stated value	Full amount	Nil
2	No-par, stated value	Stated value	Balance
3	Par value common stock	Par value	Excess
4	Par value preferred stock	Par value	Excess

Q.2 The stockholders' equity of Whiz.com Company at the beginning of February 5

Given:

Account	Amount (Rs.)
Common Stock (Rs. 25 par value, 60,000 shares issued)	1,500,000
Paid-in Capital in Excess of Par, Common Stock	525,000
Retained Earnings	675,000

Total Stockholders' Equity	2,700,000

- Directors declared a **20% stock dividend** on February 5, distributable on February 28.
- Stockholders of record on February 15 will receive the dividend.
- **Market value**: Rs. 40 on Feb 5, Rs. 34 on Feb 28.

Part 1: Prepare Journal Entries for Declaration and Distribution of the Stock Dividend

Step 1: Determine the Dividend Shares and Amount

Number of shares to be issued:

[

\text{Stock Dividend %} = 20% \

\text{Shares outstanding} = 60,000 \

\text{Dividend shares} = 60,000 \times 20% = 12,000 \text{

shares}

]

Market value per share on declaration date (Feb 5):

Rs. 40

Total dividend (at market value):

[

12,000 \times 40 = Rs. 480,000

]

Since the stock dividend is **less than 20–25% of shares outstanding**, it is treated as a **small stock dividend**, and the **retained earnings are reduced at market value**.

Step 2: Journal Entry on Declaration Date (February 5)

Retained Earnings Dr. 480,000

Common Stock Dividend Distributable Cr. 300,000

Paid-in Capital in Excess of Par—Common Stock Cr. 180,000

Explanation:

- **Common Stock Dividend Distributable** = par value × shares issued = 12,000 × 25 = Rs. 300,000

- **Paid-in Capital in Excess of Par** = Total dividend −

  Par value portion = 480,000 − 300,000 = Rs. 180,000

Step 3: Journal Entry on Distribution Date (February 28)

Common Stock Dividend Distributable Dr. 300,000

Common Stock Cr. 300,000

Explanation:

This entry records the **issuance of 12,000 stock dividend shares** to stockholders, moving the amount from the **distributable account** to **Common Stock**.

Part 2: Book Value per Share and Total Book Value for a Stockholder Owning 750 Shares

Step 1: Compute Total Shares and Equity Before Dividend

- **Shares outstanding before dividend**: 60,000
- **Total stockholders' equity before dividend**: Rs. 2,700,000

Stockholder's total book value before dividend:

[

750 \times 45 = Rs. 33,750

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Step 2: Compute Total Shares and Equity After Dividend

Shares outstanding after dividend:

[

60,000 + 12,000 = 72,000 \text{ shares}

]

Total stockholders’ equity after dividend:

- Retained earnings reduced by Rs. 480,000 (declaration of stock dividend)
- Equity remains **2,700,000** (the reduction in retained earnings is offset by increase in Common Stock and Paid-in Capital)

Stockholder’s total book value after dividend:

- New shares received: 20% of 750 = 150 shares
- Total shares now: 750 + 150 = 900 shares

[

900 \times 37.50 = Rs. 33,750

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✅ **Observation:** Total book value remains unchanged;

only book value per share decreases.

Part 3: Compute Total Market Value of Stockholder's Shares

Step 1: Market Value on February 5

- Shares before dividend: 750
- Market price per share: Rs. 40

[

\text{Total Market Value} = 750 \times 40 = Rs. 30,000

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Step 2: Market Value on February 28

- Shares after dividend: 900 (750 + 150)
- Market price per share: Rs. 34

[

\text{Total Market Value} = 900 \times 34 = Rs. 30,600

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✅ **Observation:** Total market value increased slightly due to price adjustment of shares.

Summary Table: Stockholder's Value Before and After Stock Dividend

Item	Before Dividend	After Dividend
Shares Owned	750	900
Book Value per Share	Rs. 45	Rs. 37.50
Total Book Value	Rs. 33,750	Rs. 33,750
Market Value per Share	Rs. 40	Rs. 34

Total Market Value	Rs. 30,000	Rs. 30,600

Key Points to Remember

1. **Stock dividends** do **not reduce total stockholders' equity**, only the composition changes: **retained earnings → common stock & paid-in capital**.
2. **Book value per share** decreases after a stock dividend, but **total book value remains unchanged**.
3. **Market value** is influenced by stock price fluctuations and can differ before and after dividend distribution.
4. Small stock dividends (<25%) are recorded at **market value**, while large stock dividends (>25%) may be recorded at **par value**.

Q.3 Koral Corporation engaged in the transactions listed below. Identify each transaction as (a) an operating activity, (b) an investing activity, (c) a financing activity, (d) a noncash transaction, or (e) not on the statement of cash flows. (Assume the indirect method is used.)

Answer

No.	Transaction	Classification	Explanation
1	Declared and paid a	**c. Financing activity**	Payment of dividends is a **cash outflow to**

	cash dividend		**shareholders**, thus a financing activity.
2	Purchased a long-term investment	**b. Investing activity**	Buying long-term investments requires cash outflow; this is an investing activity.
3	Increased accounts receivable	**a. Operating activity**	Changes in current assets like accounts receivable affect cash from operations under the **indirect method**. An increase in AR **reduces cash flow from operations**.

4	Paid interest	**a. Operating activity**	Under U.S. GAAP, interest paid is usually considered **operating cash outflow**.
5	Sold equipment at a loss	**b. Investing activity**	Cash from sale of equipment is an **investing activity**; the loss is added back in the **indirect method** to net income.
6	Issued long-term bonds for plant assets	**d. Noncash transaction**	No cash exchanged; bonds issued directly for assets. Must be disclosed separately.

7	Increased dividends receivable	**a. Operating activity**	Dividends receivable is a **current asset**, so the increase is a use of cash in operating activities under indirect method.
8	Issued common stock	**c. Financing activity**	Cash inflow from shareholders; financing cash inflow.
9	Declared and issued a stock dividend	**d. Noncash transaction**	No cash is involved; equity is increased via retained earnings to common stock transfer.

10	Repaid notes payable	**c. Financing activity**	Cash outflow to creditors; financing activity.
11	Decreased wages payable	**a. Operating activity**	Payment of accrued wages reduces cash from operations; indirect method adjusts net income.
12	Purchased a 60-day Treasury bill	**e. Not on the statement of cash flows**	Cash equivalent investments (less than 90 days) are classified as **cash equivalents**, not reported separately in investing activities.

1 3	Purchased land	**b. Investing activity**	Cash outflow to acquire long-term asset; investing activity.

Summary Table by Activity Type

Activity Type	Transactions
Operating (a)	3, 4, 7, 11
Investing (b)	2, 5, 13
Financing (c)	1, 8, 10

Noncash (d) 6, 9

Not on Cash Flow 12

Statement (e)

Key Points for Indirect Method

1. **Operating Activities**: Include cash inflows/outflows from day-to-day business (e.g., accounts receivable, wages payable, interest, dividends received). Adjust **net income** for changes in current assets and liabilities.
2. **Investing Activities**: Include cash flows from long-term asset purchases or sales.

3. **Financing Activities**: Include cash flows from equity and debt transactions (e.g., issuing stock, borrowing, dividends paid).
4. **Noncash Transactions**: Significant investing or financing transactions **not involving cash** (must be disclosed separately).
5. **Cash Equivalents**: Short-term highly liquid investments (<90 days) like T-bills are considered part of **cash**, so not shown separately in investing activities.

Q.4 Moss issues bonds with a par value of Rs. 90,000 on January 1, 2021.

Given:

- Par value (Face Value) = Rs. 90,000
- Contract rate (Stated Rate) = 8% annually
- Interest paid semiannually → 4% per period
- Term = 3 years → 6 periods
- Market rate = 10% annually
- Issue Price = Rs. 85,431

Part 1: Calculate Bond Discount

Discount = Par Value − Issue Price

Discount = 90,000 − 85,431

Discount = Rs. 4,569

Journal Entry at Issuance:

Cash	Dr. 85,431	
Discount on Bonds Payable	Dr. 4,569	
Bonds Payable		Cr. 90,000

Part 2: Total Bond Interest Expense

Step 1: Cash Interest per Period

Cash Interest = Par Value × Semiannual Rate

Cash Interest = 90,000 × 4%

Cash Interest = Rs. 3,600 per period

Step 2: Total Cash Interest for 6 periods

Total Cash Interest = 3,600 × 6 = Rs. 21,600

Step 3: Total Bond Interest Expense

Total Interest Expense = Cash Interest + Discount Amortized

Total Interest Expense = 21,600 + 4,569

Total Interest Expense = Rs. 26,169

Semiannual Journal Entry (Straight-Line Method):

- Discount Amortized per period = 4,569 ÷ 6 ≈ 761.50
- Interest Expense per period = 3,600 + 761.50 ≈ 4,361.50

Bond Interest Expense Dr. 4,361.50

Discount on Bonds Payable Cr. 761.50

Cash Cr. 3,600

✅ Summary Table:

Item	Amount (Rs.)
Per Value	90,000
Issue Price	85,431
Discount on Bonds	4,569
Semiannual Cash Interest	3,600
Total Cash Interest	21,600
Total Bond Interest Expense	26,169

Q.5 (a) Define liquidity and efficiency ratios in the context of financial statement analysis. Explain the significance of these ratios in evaluating a company's short-term financial health.

Introduction

Liquidity and efficiency ratios are crucial components of financial statement analysis. They provide insights into a company's ability to meet its short-term obligations and manage resources effectively. Liquidity ratios focus on a company's capacity to convert current assets into cash to cover current liabilities, whereas efficiency ratios evaluate how well a company utilizes its assets to generate revenue. Together, these ratios offer a comprehensive view of a company's financial health and operational

performance, helping investors, creditors, and management make informed decisions.

Liquidity Ratios

Definition:

Liquidity ratios measure a company's ability to pay off its short-term obligations using its current assets. They provide an indication of whether a company can meet its financial commitments without raising external capital or liquidating long-term assets.

Key Liquidity Ratios:

1. **Current Ratio**

   Current Ratio = Current Assets ÷ Current Liabilities

- Measures the company's ability to cover current liabilities with current assets.
- A ratio above 1 indicates adequate liquidity.

2. **Quick Ratio (Acid-Test Ratio)**

   Quick Ratio = (Current Assets − Inventory) ÷ Current Liabilities

- Excludes inventory to focus on the most liquid assets.
- Provides a conservative assessment of liquidity.

3. **Cash Ratio**

   Cash Ratio = (Cash + Cash Equivalents) ÷ Current Liabilities

- Measures the ability to pay short-term liabilities using only cash and cash equivalents.
- The most stringent liquidity measure.

Significance of Liquidity Ratios:

- Ensure the company can meet immediate obligations.
- Maintain creditor and investor confidence.
- Allow the company to handle unexpected financial needs.
- Support operational stability without relying on costly external financing.
- Highlight potential financial stress if liquidity is insufficient.

Efficiency Ratios

Definition:

Efficiency ratios, also called activity ratios, evaluate how effectively a company manages its assets to generate sales and revenue. They provide insight into operational performance and resource utilization.

Key Efficiency Ratios:

1. **Inventory Turnover Ratio**

   Inventory Turnover = Cost of Goods Sold ÷ Average Inventory

- Indicates how efficiently inventory is sold and replaced.
- Higher turnover reflects effective inventory management.

2. **Receivables Turnover Ratio**

   Receivables Turnover = Net Credit Sales ÷ Average Accounts Receivable

- Measures how quickly receivables are collected.
- Higher turnover improves cash flow and liquidity.

3. **Total Asset Turnover Ratio**

   Total Asset Turnover = Net Sales ÷ Average Total Assets

- Shows how effectively total assets are used to generate sales.
- Higher ratio indicates better utilization of assets.

4. **Accounts Payable Turnover Ratio**

   Accounts Payable Turnover = Cost of Goods Sold ÷ Average Accounts Payable

- Measures how quickly the company pays its suppliers.
- Efficient management balances cash outflows with supplier relationships.

Significance of Efficiency Ratios:

- Assess operational effectiveness and resource utilization.
- Indicate the company’s ability to generate cash from operations.
- Help identify inefficiencies in inventory, receivables, and asset management.
- Support decisions related to working capital management and operational planning.
- Indirectly influence liquidity by ensuring consistent cash inflows.

Relationship Between Liquidity and Efficiency Ratios

Liquidity and efficiency ratios are interrelated. Efficient management of assets such as inventory and receivables

enhances liquidity by generating timely cash inflows. For instance:

- High receivables turnover improves cash availability for meeting short-term obligations.
- Efficient inventory management reduces holding costs and frees cash for other uses.
- Inefficient asset management may create liquidity pressures even if current assets appear sufficient.

Conclusion

Liquidity and efficiency ratios are vital for evaluating a company’s short-term financial health. Liquidity ratios provide a snapshot of solvency, indicating the company’s ability to meet obligations, while efficiency ratios measure operational performance and resource utilization.

Together, they allow stakeholders to assess both the financial stability and operational effectiveness of a company. A firm with strong liquidity and efficient asset management is better positioned to maintain smooth operations, support growth, and withstand economic challenges, while a firm with poor ratios may face cash flow problems, reduced profitability, and operational difficulties. Monitoring and analyzing these ratios consistently enables management to make informed decisions, improve performance, and maintain financial stability over time.

Q.5 (b) The following financial data was extracted from the financial statements of three consecutive years of Arshad Trading Cooperative:

Particulars	2022	2023
Sales	3,000,000	3,200,000
Cost of Goods Sold	2,300,000	2,500,000
Current Assets	1,500,000	1,650,000

Current Liabilities	1,100,000	1,150,000
Inventories	750,000	800,000
Accounts Receivable	400,000	450,000
Prepaid Expenses	50,000	40,000

Required: Compute the following ratios for 2022 and 2023 and comment on each for liquidity analysis.

Step 1: Working Capital

Formula:

Working Capital = Current Assets − Current Liabilities

Calculation:

- **2022:** 1,500,000 − 1,100,000 = 400,000
- **2023:** 1,650,000 − 1,150,000 = 500,000

Comment:

Working capital has increased from 400,000 to 500,000, indicating improved liquidity and ability to meet short-term obligations.

Step 2: Current Ratio

Formula:

Current Ratio = Current Assets ÷ Current Liabilities

Calculation:

- **2022:** 1,500,000 ÷ 1,100,000 ≈ 1.36
- **2023:** 1,650,000 ÷ 1,150,000 ≈ 1.43

Comment:

The current ratio has slightly improved, showing that the company has more current assets relative to liabilities and is better positioned to cover short-term debts.

Step 3: Acid Test (Quick) Ratio

Formula:

Quick Ratio = (Current Assets − Inventories − Prepaid Expenses) ÷ Current Liabilities

Calculation:

- **2022:** (1,500,000 − 750,000 − 50,000) ÷ 1,100,000 = 700,000 ÷ 1,100,000 ≈ 0.64

- **2023:** (1,650,000 − 800,000 − 40,000) ÷ 1,150,000 = 810,000 ÷ 1,150,000 ≈ 0.70

Comment:

The quick ratio is below 1 in both years but improved in 2023. This indicates that the company's most liquid assets are insufficient to fully cover current liabilities without relying on inventory, though the trend is positive.

Step 4: Accounts Receivable Turnover Ratio

Formula:

Accounts Receivable Turnover = Net Sales ÷ Average Accounts Receivable

Average Accounts Receivable:

- 2022: Not applicable for first year → use 400,000

- 2023: (400,000 + 450,000) ÷ 2 = 425,000

Calculation:

- **2022:** 3,000,000 ÷ 400,000 = 7.5 times
- **2023:** 3,200,000 ÷ 425,000 ≈ 7.53 times

Comment:

Receivables are being collected slightly faster in 2023, showing efficient credit management.

Step 5: Days' Sales in Receivables

Formula:

Days' Sales in Receivables = 365 ÷ Accounts Receivable Turnover

Calculation:

- **2022:** 365 ÷ 7.5 ≈ 48.7 days

- **2023:** 365 ÷ 7.53 ≈ 48.5 days

Comment:

The company collects receivables in roughly 49 days, which is stable and indicates efficient credit control.

Step 6: Inventory Turnover Ratio

Formula:

Inventory Turnover = Cost of Goods Sold ÷ Average Inventory

Average Inventory:

- 2022: 750,000 (first year)
- 2023: (750,000 + 800,000) ÷ 2 = 775,000

Calculation:

- **2022:** 2,300,000 ÷ 750,000 ≈ 3.07 times

- **2023:** 2,500,000 ÷ 775,000 ≈ 3.23 times

Comment:

Inventory turnover has improved, indicating better inventory management and faster stock movement.

Step 7: Days' Sales in Inventory

Formula:

Days' Sales in Inventory = 365 ÷ Inventory Turnover

Calculation:

- **2022:** 365 ÷ 3.07 ≈ 118.9 days
- **2023:** 365 ÷ 3.23 ≈ 113.0 days

Comment:

The company holds inventory for fewer days in 2023, indicating improved efficiency and reduced holding costs.

Step 8: Operating Cycle

Formula:

Operating Cycle = Days' Sales in Inventory + Days' Sales in Receivables

Calculation:

- **2022:** 118.9 + 48.7 ≈ 167.6 days
- **2023:** 113.0 + 48.5 ≈ 161.5 days

Comment:

The operating cycle has decreased, showing the company converts inventory into cash more quickly in 2023, which is beneficial for liquidity management.

Summary Table of Liquidity and Efficiency Ratios

Ratio / Measure	2022	2023	Comment
Working Capital	400,000	500,000	Improved liquidity
Current Ratio	1.36	1.43	Adequate and improving
Quick Ratio	0.64	0.70	Below 1 but improving
Accounts Receivable Turnover	7.5	7.53	Efficient collections

Days’ Sales in Receivables	48.7	48.5	Stable and efficient
Inventory Turnover Ratio	3.07	3.23	Improved efficiency
Days’ Sales in Inventory	118.9	113.0	Faster inventory conversion
Operating Cycle	167.6	161.5	Shorter cycle, better liquidity

Overall Analysis:

The liquidity of Arshad Trading Cooperative improved from 2022 to 2023, as indicated by higher working capital, a

higher current ratio, and an improved quick ratio. Efficiency ratios also show improvement: inventory turnover increased, days' sales in inventory decreased, and the operating cycle shortened. Accounts receivable management remains stable, with slightly faster collection in 2023. Collectively, these ratios indicate that the company is becoming more efficient in using its assets and has strengthened its short-term financial health, reducing the risk of cash flow problems and enhancing its ability to meet obligations and finance operations.