ASSIGNMENT No. 02

Financial Accounting (5418) Bs Accoiuting and Finance

Spring, 2025

Q. 1 Modern Technology Company was established in August, 2018 with the following authorized capital: -

Common Stock of Rs. 10 each	**500,000 shares**
10% Preferred Stock of Rs. 50 each	**200,000 shares**

The Company issued shares as under:-

10-09-2018	**60,000 Common Stock at Rs. 10 each**
20-12-2018	**50,000 Common Stock at Rs. 12 each**
15-09-2019	**30,000 Common Stock at Rs. 9 each**
10-10-2019	**40,000 10% Preferred Stock at Rs. 60 each**
12-10-2019	**100,000 10% Preferred Stock for Plant and Equipment valuing Rs. 6,000,000**
30-06-2020	**Earned a profit of Rs. 900,000 during the year 2019-2020 The closing balance of Accounts Receivable amounted to Rs. 600,000 and Inventories amounted to Rs. 400,000**
30-06-2020	**Declared 10% dividend on Preferred and 8% dividend on Common Stock. The Accounts Payable at year-end amounted to Rs. 100,000**
25-07-2020	**Paid dividend to 10% Preferred and Common Stockholders**

Required:

A) Pass necessary journal entries until 30 June 2020.

B) Prepare a balance sheet as of 30 June 2020

C) Pass necessary accounting entries for payment of Dividends on 10% Preferred and Common Stocks on 25 July 2020. (20)

A) Necessary Journal Entries until 30 June 2020

1. Issuance of Common Stock:

- **Entry for issuance on 10-09-2018:**

CopyDate: 10-09-2018

Debit: Cash (60,000 shares x Rs. 10) Rs. 600,000

Credit: Common Stock (60,000 x Rs. 10 par) Rs. 600,000

(Issued 60,000 common shares at Rs. 10 each)

- **Entry for issuance on 20-12-2018:**

CopyDate: 20-12-2018

Debit: Cash (50,000 shares x Rs. 12) Rs. 600,000

Credit: Common Stock (50,000 x Rs. 10 par) Rs. 500,000

Credit: Additional Paid-in Capital Rs. 100,000

(Issued 50,000 common shares at Rs. 12 each)

- **Entry for issuance on 15-09-2019:**

CopyDate: 15-09-2019

Debit: Cash (30,000 shares x Rs. 9) Rs. 270,000

Credit: Common Stock (30,000 x Rs. 10 par) Rs. 300,000

Credit: Additional Paid-in Capital Rs. 30,000

(Issued 30,000 common shares at Rs. 9 each)

2. Issuance of Preferred Stock:

- **Entry for issuance on 10-10-2019:**

CopyDate: 10-10-2019

Debit: Cash (40,000 shares x Rs. 60) Rs. 2,400,000

Credit: Preferred Stock (40,000 x Rs. 50 par) Rs. 2,000,000

Credit: Additional Paid-in Capital Rs. 400,000

(Issued 40,000 preferred shares at Rs. 60 each)

- **Entry for issuance on 12-10-2019 for Plant and Equipment:**

CopyDate: 12-10-2019

Debit: Plant and Equipment Rs. 6,000,000

Credit: Preferred Stock (100,000 x Rs. 50 par) Rs. 5,000,000

Credit: Additional Paid-in Capital Rs. 1,000,000

(Issued 100,000 preferred shares for plant and equipment valued at Rs. 6,000,000)

3. Profit Earned during the Year 2019-2020:

CopyDate: 30-06-2020

Debit: Income Summary Rs. 900,000

Credit: Retained Earnings Rs. 900,000

(To close the income summary to retained earnings)

4. Declaration of Dividends:

- **Preferred Dividend:**

CopyDate: 30-06-2020

Debit: Retained Earnings Rs. 500,000

Credit: Dividends Payable – Preferred Stock Rs. 500,000

(Declared 10% dividend on preferred stock)

Calculation: 200,000 shares x Rs. 50 par x 10% = Rs. 1,000,000 (Only considering 40,000 shares issued; Rs. 2,000,000 x 10% = Rs. 200,000)

- **Common Dividend:**

CopyDate: 30-06-2020

Debit: Retained Earnings Rs. 384,000

Credit: Dividends Payable – Common Stock Rs. 384,000

(Declared 8% dividend on common stock)

Calculation: (60,000 + 50,000 + 30,000) shares x Rs. 10 par x 8% = 140,000 x Rs. 10 x 8% = Rs. 112,000

B) Prepare a Balance Sheet as of 30 June 2020

Balance Sheet of Modern Technology Company as of 30 June 2020

Assets	
Current Assets:	
- Accounts Receivable (at year-end)	Rs. 600,000
- Inventories	Rs. 400,000
Total Current Assets	Rs. 1,000,000
Plant and Equipment	Rs. 6,000,000
Total Assets	**Rs. 7,000,000**
Liabilities	
Current Liabilities:	
- Accounts Payable	Rs. 100,000
- Dividends Payable – Preferred Stock	Rs. 500,000
- Dividends Payable – Common Stock	Rs. 384,000
Total Liabilities	Rs. 984,000

Assets	
Stockholders' Equity	
Common Stock	Rs. 1,450,000
Preferred Stock	Rs. 7,000,000
Additional Paid-in Capital	Rs. 1,500,000
Retained Earnings	Rs. 900,000
Total Stockholders' Equity	Rs. 7,000,000
Total Liabilities and Stockholders' Equity	**Rs. 7,000,000**

C) Accounting Entries for Payment of Dividends on 25 July 2020

1. Payment of Preferred Stock Dividends:

CopyDate: 25-07-2020

Debit: Dividends Payable – Preferred Stock Rs. 500,000

Credit: Cash Rs. 500,000

(Paid dividend to 10% preferred stockholders)

2. Payment of Common Stock Dividends:

CopyDate: 25-07-2020

Debit: Dividends Payable – Common Stock Rs. 384,000

Credit: Cash Rs. 384,000

(Paid dividend to common stockholders)

Summary

The above entries reflect the financial activities of Modern Technology Company from its establishment through the fiscal year ending on 30 June 2020, including share issuances, financial performance, dividend declarations, and payments. The balance sheet and journal entries provide a comprehensive view of the company's financial standing at several key points in time.

Q. 2 Subhan Industries, Jhelum was established about 10 years ago with an authorized capital of 500,000 Common Stock of Rs. 100 each. The Company had issued 300,000 Common Stocks at Rs. 130 each in the past. The balance of revenue reserves and retained earnings as appearing in the equity section of the balance sheet amounted to Rs. 800,000 and Rs. 650,000 respectively apart from the Premium on the Common Stock Account. The Company last year purchased its common stock of 50,000 at Rs. 125 each and retained it. During the current year the Board of Directors decided to retire the common stock equivalent to the purchase quantum as the volume of business was facing a market slump.

Required:

a) Prepare necessary accounting entries for the purchase of own common stock by the company from the market as of last year.
b) During the current year prepare necessary accounting entries for retirement of the common stock purchased during the last year.
c) Prepare the equity section of the balance sheet of the company separately as of the last year after the purchase of common stock and the current year after the retirement of a certain portion of the common stock of the company. (20)

a) Accounting Entries for Purchase of Own Common Stock

Journal Entries for the Purchase of Common Stock

Date	Account Title	Debit	Credit
Last Year Date	Common Stock (50,000 shares x Rs. 100)	Rs. 5,000,000	
	Premium on Common Stock (50,000 shares x (Rs. 130 - Rs. 100))	Rs. 1,500,000	
	Cash (50,000 shares x Rs. 125)		Rs. 6,250,000
	To record the purchase of own common stock from the market		

b) Accounting Entries for Retirement of Common Stock Purchased

Journal Entries for the Retirement of Common Stock

Date	Account Title	Debit	Credit
Current Year Date	Common Stock (50,000 shares x Rs. 100)	Rs. 5,000,000	
	Premium on Common Stock	Rs. 1,500,000	
	Retained Earnings	Rs. 750,000	
	Cash		Rs. 6,250,000
	To record the retirement of common stock bought back previously		

c) Equity Section of the Balance Sheet

Equity Section of the Balance Sheet After Purchase of Common Stock

Equity Section	
Common Stock (Issued)	Rs. 30,000,000
Premium on Common Stock	Rs. 1,500,000

Equity Section	
Retained Earnings	Rs. 650,000
Revenue Reserves	Rs. 800,000
Less: Treasury Stock (50,000 shares x Rs. 125)	(Rs. 6,250,000)
Total Equity After Purchase	**Rs. 26,650,000**

Equity Section of the Balance Sheet After Retirement of Common Stock

Equity Section	
Common Stock (Issued)	Rs. 25,000,000
Premium on Common Stock	Rs. 0
Retained Earnings	Rs. 900,000
Revenue Reserves	Rs. 800,000
Total Equity After Retirement	**Rs. 26,700,000**

Summary

- The first set of entries records the purchase of common stock, impacting the common stock, premium on common stock, and cash accounts.
- The second set of entries records the retirement of the previously purchased common stock, impacting the common stock, premium on common stock, and retained earnings.
- The equity sections of the balance sheets reflect the company's position before and after the stock repurchase and retirement. These changes give a clear picture of the company's equity status through its ownership transaction history.

Q. 3 Zoobi Manufacturing Company is planning to introduce a new product for which it requires funds amounting to Rs. 3.000 million for the purchase of some plant and factory buildings. A friend of the owner of the company has suggested he meet the funds requirement through the issuance of Bonds. Accordingly, on 01 April 2020 the Company issued 3,000 bonds of Rs. 1,000 each at par value carrying 10% interest payable semi-annually over a period of 03 years.

Required:

a) Record the issuance of Bonds.
b) Record the interest accrued at the end of each financial year and payment of interest as per terms of the bond over its life.
c) Presentation of Bonds and their accrued interest at the financial year-end.
d) Retirement of bonds upon expiry of its tenure. (20)

Let's go through the requirements step by step for Zoobi Manufacturing Company based on the issuance and financial treatment of bonds.

a) Record the Issuance of Bonds

Journal Entry for Issuance of Bonds on 01 April 2020

Date	Account Title	Debit	Credit

Date	Account Title	Debit	Credit
01-Apr-2020	Cash	Rs. 3,000,000	
	Bonds Payable		Rs. 3,000,000
	To record the issuance of 3,000 bonds at par (Rs. 1,000 each)		

b) Record the Interest Accrued and Payment of Interest

Interest Payment Entries

Interest for each bond is calculated as follows:

- Bond Value: Rs. 1,000
- Interest Rate: 10% per annum
- Semi-annual Interest = 10% / 2 = 5% of Rs. 1,000 = Rs. 50
- Total interest payment for 3,000 bonds = 3,000 x Rs. 50 = Rs. 150,000 every six months.

The entries will be made as follows:

1. Interest Accrued Entry (30 September 2020)

Date	Account Title	Debit	Credit
30-Sep-2020	Interest Expense	Rs. 150,000	
	Interest Payable		Rs. 150,000
	To record the interest accrued for the first half of the year		

2. Interest Payment Entry (01 October 2020)

Date	Account Title	Debit	Credit
01-Oct-2020	Interest Payable	Rs. 150,000	
	Cash		Rs. 150,000
	To record the payment of interest for the first half of the year		

3. Repeat the entries for subsequent periods:

- Interest Accrued on 30 March 2021:

Date	Account Title	Debit	Credit

Date	Account Title	Debit	Credit
30-Mar-2021	Interest Expense	Rs. 150,000	
	Interest Payable		Rs. 150,000

- Interest Payment on 01 April 2021:

Date	Account Title	Debit	Credit
01-Apr-2021	Interest Payable	Rs. 150,000	
	Cash		Rs. 150,000

- Repeat until 30 March 2023 (accrued interest) and payment on 01 April 2023.

c) Presentation of Bonds and their Accrued Interest at the Financial Year-End

Financial Position as of 31 March for Each Year

1. As of 31 March 2021:

Account	**Amount (Rs.)**
Bonds Payable	Rs. 3,000,000
Interest Payable	Rs. 150,000
Total Liabilities	**Rs. 3,150,000**

2. As of 31 March 2022:

Account	**Amount (Rs.)**
Bonds Payable	Rs. 3,000,000
Interest Payable	Rs. 150,000
Total Liabilities	**Rs. 3,150,000**

3. As of 31 March 2023:

Account	**Amount (Rs.)**
Bonds Payable	Rs. 3,000,000
Interest Payable	Rs. 150,000
Total Liabilities	**Rs. 3,150,000**

d) Retirement of Bonds Upon Expiry of Its Tenure

On the maturity date, the following entry is made to retire the bonds.

Journal Entry for Retirement of Bonds on 01 April 2023

Date	Account Title	Debit	Credit

Date	Account Title	Debit	Credit
01-Apr-2023	Bonds Payable	Rs. 3,000,000	
	Cash		Rs. 3,000,000
	To record the retirement of bonds on maturity		

Summary

This breakdown covers the issuance of the bonds, the regular interest accrual and payments, the presentation of the bonds and interest payable at the end of each financial year, and the final retirement of the bonds upon maturity. Each step ensures compliance with accounting principles related to liabilities.

Q. 4 Define the cash flow statement, and describe the items of cash inflows and cash outflows of the operating, investing and financing activities of the cash flow statement. (20)

Definition of Cash Flow Statement

The cash flow statement is a financial report that provides a detailed analysis of the cash inflows and outflows during a specific period. It is an essential component of the financial statements, alongside the balance sheet and income statement. The cash flow statement helps stakeholders assess the liquidity, solvency, and overall financial health of a company. By illustrating how cash moves in and out of the business, it enables investors, creditors, and management to understand the company's operational efficiency and its ability to meet short-term obligations.

Importance of Cash Flow Statement

The cash flow statement is crucial for various stakeholders. Investors use it to evaluate the company's ability to generate cash and maintain operations, check for dividend payments and potential growth opportunities. Creditors analyze cash flows to assess repayment capabilities and overall financial viability. For management, the cash flow statement is vital in decision-making processes, providing insights into cash management, identifying future cash needs, and planning for investments. Overall, this financial statement is a key indicator of a company's financial performance.

Operating Activities Defined

Operating activities refer to the core business operations that generate revenue for the company. This section of the cash flow statement details cash transactions related to the distribution of goods or services, essentially reflecting the daily operational activities that directly affect net income. Cash flows from operating activities typically come from sales of goods and services and are essential for tracking the cash used in running the business.

Cash Inflows from Operating Activities

Cash inflows from operating activities generally include receipts from customers for goods sold or services rendered, interest and dividends received from investments, and other operating revenue. These inflows represent actual cash received during the fiscal period, which can be utilized for other operational expenses or reinvestment in the business. They provide a clear insight into the company's efficiency in converting sales into cash, showcasing how well management utilizes its sales efforts to generate liquid funds.

Cash Outflows from Operating Activities

Cash outflows from operating activities consist of payments made to suppliers and employees, as well as cash paid for other operational expenses such as rent, utilities, and maintenance. This section includes cash outflows related to inventory purchases, which are critical for understanding how much cash is tied up in daily operations. Monitoring these outflows allows management to assess operating efficiency and make necessary adjustments to improve cash management.

Investing Activities Defined

Investing activities encompass cash transactions related to the acquisition and disposal of long-term assets, such as property, plants, equipment, and investments in other businesses. This section reflects how a company invests its resources for future growth and expansion. Cash flows from investing activities indicate whether a company is investing in its future operational capability, and understanding this component is essential for stakeholders looking to evaluate long-term sustainability.

Cash Inflows from Investing Activities

Cash inflows from investing activities often arise from the sale of physical assets, such as machinery or land, and the liquidation of investments, such as selling stocks or bonds in other companies. These cash inflows are essential components that contribute to a company's cash position, highlighting overall investment efficiency. A positive cash flow from investing activities may indicate that a company is effectively managing its assets and generating returns from its investments.

Cash Outflows from Investing Activities

Cash outflows related to investing activities include the purchase of fixed assets, acquisitions, and capital expenditures. These expenditures are vital for the operation and growth of the business and often involve substantial cash outlays. While high cash outflows in this category can signal expansion efforts on the part of the company, they must be managed wisely to ensure that investments yield appropriate returns and do not overly strain the company's cash position.

Financing Activities Defined

Financing activities involve cash transactions resulting from external financing. This section includes transactions related to the raising of capital through debt or equity. It reflects how a company finances its operations and growth, including how it manages its capital structure to ensure sustainability and profitability. A clear understanding of financing activities is crucial for evaluating a company's long-term financial strategy and solvency.

Cash Inflows from Financing Activities

Cash inflows from financing activities typically include proceeds from issuing stocks or bonds and loans from financial institutions. This inflow indicates how much capital a company has raised to fund operations, pay off debt, or invest in its expansion. Stakeholders closely monitor these inflows, as they reflect the company's ability to attract capital and the terms under which such financing has been secured.

Cash Outflows from Financing Activities

Cash outflows in financing activities primarily consist of payments made to repay borrowed funds, including principal repayments on loans and interest payments. Additionally, this section may include dividends paid out to shareholders. Monitoring these outflows is critical for understanding the company's obligations and financial flexibility. High cash outflows in financing activities can indicate significant debt repayments, which may affect a company's ability to fund future investments.

Conclusion: Comprehensive Overview of Cash Flow Activities

In conclusion, the cash flow statement provides a comprehensive overview of a company's cash activities across operating, investing, and financing activities. It serves as a vital tool for management, investors, and creditors to assess the company's liquidity, operational efficiency, and overall financial stability. By understanding the various components of cash inflows and outflows, stakeholders can make informed decisions regarding the company's financial health and future strategies. The cash flow statement, therefore, is not just a reflection of past transactions but a roadmap for future financial direction and success.

Q. 5 (a) What do you understand by the analysis of financial statements narrate the objectives and benefits of analyzing the financial statements. (20)

Understanding the Analysis of Financial Statements

The analysis of financial statements involves the systematic evaluation of a company's financial reports, including the balance sheet, income statement, and cash flow statement. This process aims to assess the firm's financial performance, operational efficiency, and overall financial health. Financial statement analysis can be quantitative and qualitative, using ratios, trends, and comparisons with industry benchmarks to provide insights into various aspects of a company's operations. By analyzing financial statements, stakeholders such as investors, creditors, management, and regulators can make informed decisions based on accurate financial data.

Objectives of Analyzing Financial Statements

One of the primary objectives of analyzing financial statements is to evaluate the financial performance of a company over a specific period. This involves assessing profitability, revenue growth, and cost management. Stakeholders seek to understand how well the company has performed in generating profits and managing expenses. By evaluating profitability ratios, such as gross margin and net profit margin, analysts can determine the effectiveness of management strategies and operational decisions.

Another key objective is to assess the company's liquidity position. Liquidity analysis focuses on a company's ability to meet its short-term obligations and manage its cash flow efficiently. This involves calculating liquidity ratios, such as the current ratio and quick ratio, to determine if the company can effectively cover its liabilities with its available assets. Understanding liquidity helps stakeholders assess the firm's financial stability and ability to withstand unexpected financial pressures.

Furthermore, the analysis of financial statements aims to evaluate the company's solvency and financial structure. Solvency analysis determines whether a company can meet its long-term obligations and sustain its operations over time. Key ratios, such as the debt-to-equity ratio and interest coverage ratio, provide insights into the company's capital structure and reliance on debt versus equity financing. This analysis helps stakeholders gauge the long-term viability of the business, as excessive debt can pose risks to financial stability.

Benefits of Analyzing Financial Statements

One of the significant benefits of analyzing financial statements is that it provides insights into a company's financial health, allowing stakeholders to make informed investment decisions. Investors use financial analysis to identify potential opportunities and assess the risks associated with their investments. By understanding a company's financial position, they can gauge whether to buy, hold, or sell shares based on expected future performance.

Additionally, financial statement analysis helps creditors evaluate the creditworthiness of a company. Lenders analyze financial statements to assess the likelihood of repayment and to determine suitable lending terms. This helps mitigate the risk of default when providing loans or extending credit. By scrutinizing financial indicators like cash flow sufficiency and debt management, creditors can make informed lending decisions that align with their risk tolerance.

Moreover, financial statement analysis assists management in internal decision-making. By analyzing the financial statements, management can identify trends, assess operational efficiency, and pinpoint areas for improvement. This analysis aids in budget planning, resource allocation, and strategic decision-making, ultimately enhancing the organization's performance and ensuring alignment with long-term goals.

Financial analysis also plays a crucial role in benchmarking performance against industry peers. By comparing financial ratios and metrics with those of similar companies, stakeholders can assess relative efficiency and competitiveness. This comparative analysis provides valuable insights into market position, operational strengths, and weaknesses, enabling firms to adjust strategies to enhance performance.

Furthermore, stakeholders use financial statement analysis to comply with regulatory requirements and foster transparency. Publicly traded companies must adhere to strict reporting standards and disclose their financial position to shareholders and regulatory bodies. Analyzing financial statements ensures compliance with accounting principles and helps maintain stakeholder trust and confidence.

Improving Strategic Planning Through Financial Analysis

In addition, financial statement analysis enhances strategic planning and forecasting. By scrutinizing past financial performance and trends, companies can project future revenues, expenses, and cash flow. This forecasting supports better strategic planning, enabling management to set realistic goals, identify potential challenges, and formulate action plans to achieve desired outcomes.

Lastly, the benefits of analyzing financial statements are not limited to external stakeholders; it also empowers employees and other internal stakeholders. Employees can gain insights into the company's financial health, which can influence their understanding of job security, performance incentives, or potential promotions. A transparent view of financial statements can encourage a sense of ownership and responsibility among employees, fostering a culture of accountability.

Conclusion

In conclusion, the analysis of financial statements is a vital practice that serves multiple stakeholders, including investors, creditors, management, and regulatory authorities. Its objectives are centered around assessing financial performance, liquidity, and solvency, while the benefits encompass informed decision-making, improved strategic planning, and compliance with regulatory standards. By systematically evaluating financial statements, stakeholders can gain invaluable insights that guide their actions and enhance overall financial stability and growth. Ultimately, effective financial statement analysis is essential for robust financial management and the sustained success of any organization.

(b) The following financial data was extracted from the financial statements of three consecutive years of Arshad Trading Corporative: -

	2021	2022	2023
Sales	Rs.2,600,000	Rs.2,400,000	Rs.2,500,000
Cost of Sales	2,000,000	2,100,000	1,900,000
Current assets	1,200,000	1,300,000	1,200,000
Current liabilities	950,000	1,050,000	1,000,000
Inventories	650,000	700,000	600,000
Accounts Receivables	320,000	400,000	350,000
Prepaid expenses	Rs.20,000	Rs.25,000	Rs.30,000

Required:

Compute the following ratios for the years 2022 and 2023 and comment on each to ascertain liquidity analysis: -

a) Working Capital
b) Current Ratio
c) Acid Test ratio
d) Days sales in Receivables
e) Accounts Receivable Turnover ratio
f) Days sales in inventories
g) Inventory turnover ratio
h) Operating cycle

To compute the required financial ratios for Arshad Trading Corporative, we will use the financial data provided for 2022 and 2023. Each ratio will be calculated and commented on concerning liquidity analysis.

a) Working Capital

Formula:
Working Capital = Current Assets - Current Liabilities

- **For 2022**:

Current Assets = Rs. 1,300,000
Current Liabilities = Rs. 1,050,000
Working Capital (2022) = Rs. 1,300,000 - Rs. 1,050,000 = Rs. 250,000

- **For 2023**:

Current Assets = Rs. 1,200,000
Current Liabilities = Rs. 1,000,000
Working Capital (2023) = Rs. 1,200,000 - Rs. 1,000,000 = Rs. 200,000

Comment:
The working capital decreased from Rs. 250,000 in 2022 to Rs. 200,000 in 2023, indicating a slight decrease in liquidity position. This reduction suggests that the company may face tighter liquidity in financing short-term obligations, which could become a concern if the trend continues. A positive working capital is still an indicator of financial stability, but a declining trend signals the need for cautious liquidity management.

b) Current Ratio

Formula:
Current Ratio = Current Assets / Current Liabilities

- **For 2022**:

Current Assets = Rs. 1,300,000
Current Liabilities = Rs. 1,050,000
Current Ratio (2022) = 1,300,000 / 1,050,000 ≈ 1.24

- **For 2023**:

Current Assets = Rs. 1,200,000
Current Liabilities = Rs. 1,000,000
Current Ratio (2023) = 1,200,000 / 1,000,000 = 1.20

Comment:
The current ratio slightly decreased from approximately 1.24 in 2022 to 1.20 in 2023. While this ratio is still above 1, indicating that the firm has sufficient current assets to cover current liabilities, the decline reflects a slight erosion in liquidity. A current ratio around 1.2 is generally considered acceptable, but it suggests that the company needs to monitor its working capital closely to ensure it can meet its short-term obligations.

c) Acid Test Ratio

Formula:
Acid Test Ratio = (Current Assets - Inventories) / Current Liabilities

- **For 2022**:

Current Assets = Rs. 1,300,000
Inventories = Rs. 700,000
Current Liabilities = Rs. 1,050,000
Acid Test Ratio (2022) = (1,300,000 - 700,000) / 1,050,000 ≈ 0.57

- **For 2023**:

Current Assets = Rs. 1,200,000
Inventories = Rs. 600,000
Current Liabilities = Rs. 1,000,000
Acid Test Ratio (2023) = (1,200,000 - 600,000) / 1,000,000 = 0.60

Comment:
The acid test ratio increased from approximately 0.57 in 2022 to 0.60 in 2023. Although both values are below 1, indicating that the company does not have enough liquid assets (excluding inventories) to cover current liabilities, the slight improvement is a positive sign. It demonstrates an enhanced ability to meet short-term obligations using only cash and cash equivalents or receivables.

d) Days Sales in Receivables

Formula:
Days Sales in Receivables = (Accounts Receivable / Sales) × 365

- **For 2022**:

Accounts Receivable = Rs. 400,000
Sales = Rs. 2,400,000
Days Sales in Receivables (2022) = (400,000 / 2,400,000) × 365 ≈ 61.67 days

- **For 2023**:

Accounts Receivable = Rs. 350,000
Sales = Rs. 2,500,000
Days Sales in Receivables (2023) = (350,000 / 2,500,000) × 365 ≈ 51.10 days

Comment:
There was a decrease in Days Sales in Receivables from approximately 61.67 days in 2022 to about 51.10 days in 2023. This decline is favorable as it indicates that the company has improved its efficiency in collecting receivables, allowing for better liquidity as cash inflows are realized sooner.

e) Accounts Receivable Turnover Ratio

Formula:
Accounts Receivable Turnover Ratio = Sales / Accounts Receivable

- **For 2022**:

Sales = Rs. 2,400,000
Accounts Receivable = Rs. 400,000
Accounts Receivable Turnover Ratio (2022) = 2,400,000 / 400,000 = 6

- **For 2023**:

Sales = Rs. 2,500,000
Accounts Receivable = Rs. 350,000
Accounts Receivable Turnover Ratio (2023) = 2,500,000 / 350,000 ≈ 7.14

Comment:
The Accounts Receivable Turnover Ratio improved from 6 in 2022 to approximately 7.14 in 2023. This increase suggests that the company is more efficient in collecting outstanding receivables, which contributes positively to its liquidity position. A higher turnover indicates quicker collection periods, leading to enhanced cash flow.

f) Days Sales in Inventories

Formula:
Days Sales in Inventories = (Inventories / Cost of Sales) × 365

- **For 2022**:

Inventories = Rs. 700,000
Cost of Sales = Rs. 2,100,000
Days Sales in Inventories (2022) = (700,000 / 2,100,000) × 365 ≈ 121.67 days

- **For 2023**:

Inventories = Rs. 600,000
Cost of Sales = Rs. 1,900,000
Days Sales in Inventories (2023) = (600,000 / 1,900,000) × 365 ≈ 113.42 days

Comment:
The Days Sales in Inventories decreased from approximately 121.67 days in 2022 to about 113.42 days in 2023. This reduction indicates that the company is managing its inventory levels more

effectively and selling inventory more quickly. Improved inventory turnover contributes positively to liquidity, as it reduces excess holding costs and improves cash flow.

g) Inventory Turnover Ratio

Formula:
Inventory Turnover Ratio = Cost of Sales / Inventories

- **For 2022**:

Cost of Sales = Rs. 2,100,000
Inventories = Rs. 700,000
Inventory Turnover Ratio (2022) = 2,100,000 / 700,000 = 3

- **For 2023**:

Cost of Sales = Rs. 1,900,000
Inventories = Rs. 600,000
Inventory Turnover Ratio (2023) = 1,900,000 / 600,000 ≈ 3.17

Comment:
The Inventory Turnover Ratio improved from 3 in 2022 to approximately 3.17 in 2023. This increase suggests that the company is selling its inventory more frequently, which is a positive indicator of operational efficiency. Higher turnover rates are beneficial as they indicate effective inventory management, leading to better liquidity.

h) Operating Cycle

Formula:
Operating Cycle = Days Sales in Receivables + Days Sales in Inventories

- **For 2022**:

Days Sales in Receivables = 61.67 days
Days Sales in Inventories = 121.67 days
Operating Cycle (2022) = 61.67 + 121.67 = 183.34 days

- **For 2023**:

Days Sales in Receivables = 51.10 days
Days Sales in Inventories = 113.42 days
Operating Cycle (2023) = 51.10 + 113.42 = 164.52 days

Comment:
The Operating Cycle decreased from approximately 183.34 days in 2022 to about 164.52 days in 2023. This reduction indicates an overall improvement in the efficiency of cash flow management. A shorter operating cycle suggests that the company has reduced the time taken to convert inventory and receivables into cash, which positively impacts liquidity and operational efficiency.

Summary of Liquidity Analysis

Overall, the liquidity analysis of Arshad Trading Corporative for the years 2022 and 2023 shows a positive trend. Key ratios such as the current ratio, acid test ratio, days sales in receivables, and operating cycle have all exhibited improvements or favorable trends, indicating enhanced liquidity management and operational efficiency. By effectively managing working capital components, the company appears to be in a stable position to meet its short-term obligations, although continued monitoring is advisable to maintain this trend.