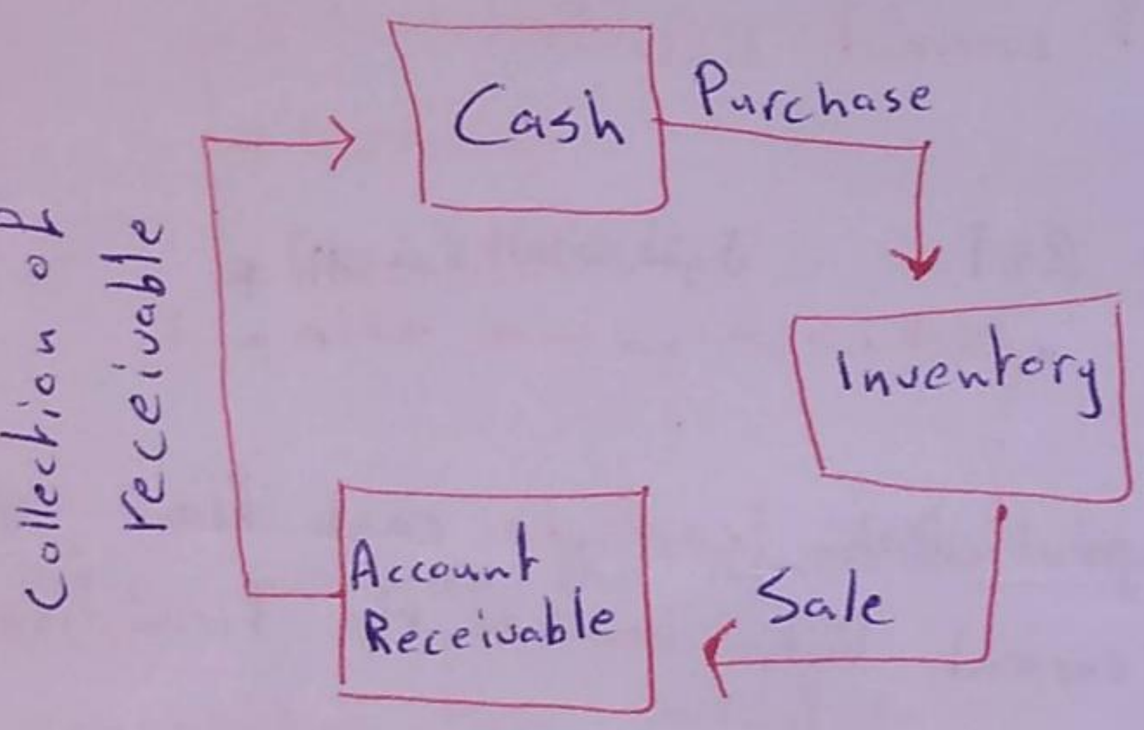
Ch. 6

liquidity of short-term Asset; Related Debt-paying Ability

لـ سيولة الأصول قصيرة الأجل ; والقدرة على سداد الديون المرتبطة

Operating Cycle : الدورة التشغيلية

↳ The time period between the aquisition of goods and the Final cash realization from sales [Cash to cash cycle]



*Working Capital رأس المال العامل

↳ Safety cushion to creditors. وسادة أمان للدائنين

working Capital = Current Assets - Current liabilities

WC = CA - CL

CA: الأصول المتوقع تحويلها لنقد خلال سنة أو دورة تشغيلية أيهما أطول

CL: الالتزامات الواجب سدادها خلال سنة أو دورة تشغيلية أيهما أطول.

* Current Ratio النسبة الحالية

↳ تحدد القدرة على سداد الديون قصيرة الأجل
"Determine short-term debt-paying ability"

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}} = \$X$$

There is $X of current Asset for each dollar of current liabilities

* القاعدة العامة تقول 2:1 نسبة ~~XXXX~~ مرضية في حال ليس هناك معطيات أخرى للحكم.

* A very low Current Ratio leads to cash flow anxiety → lower liquidity
* A very hight current Ratio leads to the firm isn't managing its current asset properly.
"كما يجب"

Considerations:
① Quality of [inventory and receivables] ضمن الأصول قصيرة الأجل "CA"

② Inventory cost flow assumptions ← FIFO, LIFO, Average Cost

Acid-Test (Quick) Ratios

Inventory باستثناء لكن ~~xxxx~~ Current Ratio ← تشبه

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current liabilities}}$$

Current Asset →
- Cash and Cash equivalents
- Marketable securities
- Inventory
- Receivables

Quick ratio measures the immediate liquidity of the Firm

↳ More conservative than current ratio.
"محافظ"

* القاعدة العامة تقول 1:1 نسبة مرضية ع حل ليس هناك معطيات أخرى للحكم.

A very low Quick ratio leads to:

① lower liquidity and inability to pay off debts on time.
"current debts"

② Firm have difficulty borrowing short-term fund

* Cash Ratio → Extremely conservative "محفظة للغاية"

Receivables, Inventor لم تكون مناسبة بالنسبة للشركات التي لديها slow-moving بطيئة الحركة

$$\text{Cash Ratio} = \frac{\text{Cash Equivalents} + \text{Marketable securities}}{\text{Current liabilities}}$$

* Sales to working Capital [Working capital turnover]

↳ Measures the turnover of working capital per year

$$\text{Sales to working capital} = \frac{\text{Sales}}{\text{Average working capital}}$$

* low working Capital turnover ratio indicates an unprofitable use of working capital [Sales are not adequate in relation to the available working capital]

High working capital turnover ratio indicates that the firm is undercapitalized [overtrading] that maybe leads to liquidity problems

(5)

Activity Ratios نسب النشاط

↳ used to determine how quickly various accounts are converted into sales or cash.

***Receivables issues**

① Account Receivable turnover = $\frac{\text{Net Sales}}{\text{Average Gross Receivables}}$

Average ↳ $\left[\frac{\text{Beg.} + \text{End}}{2}\right]$

Indicate the liquidity of ↵ the receivables.

The accounts receivable turnover gives the number of times accounts receivables is collected during the year

*The higher A/R turnover is better but it may be indicate that the firm credit policy is too stringent.

② Account Receivable turnover in days [Average collection period]

Average collection period = $\frac{365 \text{ days}}{\text{A/R turnover}}$ = X days

The average collection period gives the number of days it takes to collect on receivables.

[It takes almost X days for a sales to be converted into cash]

* Inventory Issues

Inventory: Held for sale in the normal course of business.

Trading Business → Single inventory account [merchandise]

Manufacturing Business →
- Raw Materials inventory
- work in process inventory
- Finished goods inventory

Inventory Records →
- perpetual system — نظام الجرد الدائم
- periodic system — نظام الجرد الدوري

* Using the perpetual system the firm maintains a continuous record of physical quantities in its iventory.

لـ يعني الشركة بتظل كنت حساب COGS في كل عملية بيع وشراء

* Using the periodic system physical count are taken periodically at least once a year.

Inventory Cost Flow Assumption →
- FIFO
- LIFO
- Average cost

* First In First Out [FIFO]

الأكثر منطقية → الوارد أولاً يُباع أولاً

COGS → oldest cost

Ending Inventory → latest cost

* Last In First Out [LIFO] الوارد آخراً يُباع أولاً

COGS → latest cost

Ending Inventory → Oldest Cost

* Average Cost

لما بو جد متوسط التكلفة لكل فترات الشراء

LIFO profit generally less than FIFO

Inventory بناءً على Historical Data لكن إذا
بتم تقييم FMV للبضاعة أقل تجب تسجيلها بالقيمة الأقل بناءً على
كانت [lower-of-cost-or-Market]

Inventory Ratios:

① Inventory turnover = $\frac{\text{Cost of Good Sold (COGS)}}{\text{Average Inventory}}$

* High inventory turnover indicates that the firm is operating effectively regarding the inventory But if that very high it may suggest that the firm is not keeping sufficient inventory on hand to meet sales requirements [stock-outs].

* Inventory turn-over depends on → Type of Firm
→ Cost Flow Assumption

② Inventory turnover in days = $\frac{365 \text{ days}}{\text{Inventory turnover}}$ = X days

كل ما قل أحسن

Deteriorating : تدهور

* Low inventory turnover indicates that a high amount of inventory on hand ~~xxxx~~, slow sales and high carrying costs for the inventory and that could increase the firm expesure to future financing problems.

Operating cycle :

Operating * cycle = A/R turnover in days + Inventory turnover in days

كل ما قلت أحسن

* Normal Financial statement Effects of Rising Prices

	FIFO	LIFO
Cost of Good Sold	lower	higher
Net Income	higher	Lower
Income taxes	higher	Lower
Inventory on Balance sheet	higher	Lower

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