

Financial Accounting
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Lecture – 87
6.17 Practice Problem – Arithmetic Problems

In this practice problem, we are going to do some arithmetic problems just to reinforce the learnings that we have. This should help set up a link between different kinds of ratios.

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Practice Problem

- ABC Ltd. has inventory of Rs. 20,000, Total liquid assets are Rs. 1,00,000 and quick ratio is 2 : 1.

Calculate current ratio.

$$QR = \frac{2}{1} = \frac{QA}{CL}$$

$$\frac{2}{1} = \frac{100,000}{CL} \Rightarrow CL = 50,000$$

$$CR = \frac{CA}{CL} = \frac{LA + (Stock + prepaid exp)}{CL}$$

$$CR = \frac{1,00,000 + 20,000 + 0}{50,000} = 2.4 : 1$$

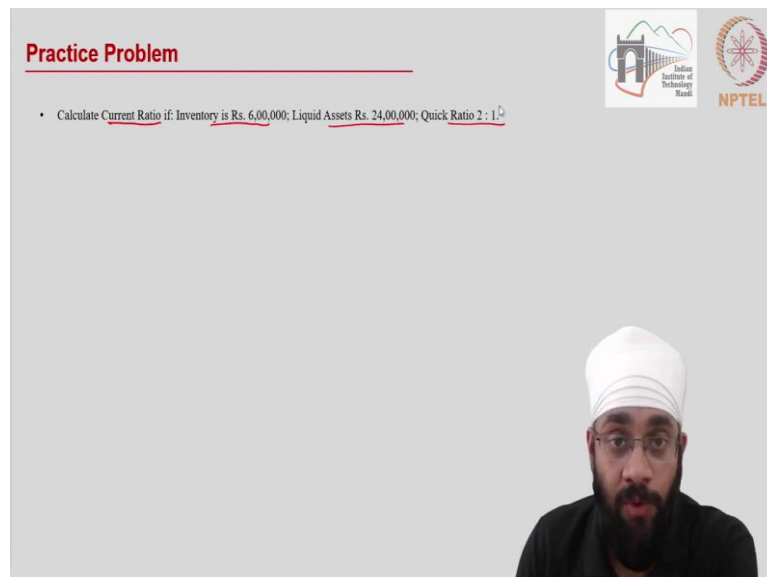
For example, let us look at this practice problem. You have stock given as 20,000; you have liquid assets given as 100,000; and the quick ratio is 2:1. You have to figure out the current ratio. This is a basic mathematical problem; you need to have understood the relationship between the quick ratio and the current ratio.

If you know that then you can figure out the numbers. This will help you reinforce the learnings about the ratios. So, what we know is that the quick ratio is 2:1 and quick ratio is equal to the quick assets, divided by the current liabilities, quick assets are the liquid assets. We have more information: liquid assets or the quick assets are actually 100,000. So, if these are, let me write it here, 100,000 divided by the current liabilities equal to 2 is to 1. Then clearly the current liabilities are equal to 50,000 that is what it means. The liquid assets are 100,000, the current liabilities are 50,000, that is how you have a 2:1 ratio. By the way, the quick ratio is also called the liquid ratio or the acid test ratio.

Now, that you know current liabilities you have to figure out the current ratio. The current ratio is equal to current assets divided by the current liabilities. Current assets are equal to liquid assets plus the stock and the prepaid expenses; we do not have information about the prepaid expenses.

So, we are just going to assume that to be 0, stock on the other hand is given to be 20,000. We write it here; liquid assets are 100,000. Therefore, we have 120,000 as the total current assets and divide that by 50,000 and you have your current ratio. So, the current ratio is equal to 2.4:1; so, a simple arithmetic problem.

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The slide contains the following text:

Practice Problem

- Calculate Current Ratio if: Inventory is Rs. 6,00,000; Liquid Assets Rs. 24,00,000; Quick Ratio 2 : 1

The slide also features logos for the Indian Institute of Technology Mandi and NPTEL in the top right corner. A video feed of a man wearing a white turban and glasses is visible in the bottom right corner of the slide.

I have another problem on the slide. It says current ratio needs to be calculated, the inventory is given, liquid assets are given and quick ratio is given. This is the same as the previous question. You can think about different practice problems, you can also refer to different textbooks to solve some more practice problems. These problems will help you reinforce your learning, and enable thinking through how different indicators, different ratios are related to each other. So, go ahead and solve this question for yourself. Thanks.