**Question 22** (12 marks)

Balance Sheet for Chalker Pty Ltd
as at year ending 30 June 2012

| | | |
|---|---|---|
| *Current Assets* | $ | $ |
| Cash | 8 000 | |
| Receivables | 12 000 | |
| Inventories | 15 000 | 35 000 |
| *Non-Current Assets* | | |
| Property, Plant and Equipment | | 33 000 |
| Total Assets | | **68 000** |
| *Current Liabilities* | | |
| Creditors | | 14 000 |
| *Non-Current Liabilities* | | |
| Loan | | 20 000 |
| *Owners Equity* | | |
| Capital | 15 000 | |
| Retained Net Profit | 19 000 | 34 000 |
| Total Liabilities and Owners Equity | | **68 000** |

(a) Calculate the current ratio (current assets ÷ current liabilities) of this business. Show all working. **2**

Current ratio = $\frac{35000}{14000}$

= 2.5:1

(b) Calculate the debt to equity ratio (total liabilities ÷ total equity) of this business. Show all working. **2**

Debt to equity = $\frac{34000}{15000}$

= 2.26

= 2.27:1

**Question 22 continues on page 11**

Question 22 (continued)

(c) Why is it important for a business to control its debt to equity ratio? **4**

It is important for businesses to control their D to E ratio so that they do not exceed their debts which can lead to liquidity and possibly bankruptcy. By using more of their equity, they are guaranteed a higher return than debt as they have to repay interests. Therefore, it is crucial to control how debt and equity are used.

(d) Explain the interdependence of finance and operations in a business. Support your answer with relevant examples. **4**

Finance gives funds for operation processes to obtain raw materials (energy & labour etc) and convert it into outputs. As these are costly, operations need to communicate with finance their needs through budgets and statements. Hence, there is a strong independence between the two. This can be seen in businesses such as Billabong who needs funds from various institutions shares for the production of surfwear & accessories.

**End of Question 22**