

## Paul Robbins training and consultancy

### Credit Management

### Working Capital Cycle

### Worked Example **Model Answer**

You have been provided with the following extract from the latest Financial Statements of Seaford Ltd.

<b>Statement of Profit or Loss (Extract)</b>		
	£	£
<b>Sales</b>		<b>275,000</b>
<b>Less Cost of Sales</b>		
<b>Opening Inventory</b>	<b>38,000</b>	
<b>Purchases</b>	<b>126,000</b>	
	<b>164,000</b>	
<b>Closing Inventory</b>	<b>(44,000)</b>	
		<b>120,000</b>
<b>Gross Profit</b>		<b>155,000</b>

<b>Statement of Financial Position (Extract)</b>		
	£	£
<b>Current Assets</b>		
<b>Inventory</b>	<b>44,000</b>	
<b>Trade Receivables</b>	<b>39,000</b>	
<b>Cash</b>	<b>6,000</b>	
		<b>89,000</b>
<b>Current Liabilities</b>		
<b>Trade Payables</b>		<b>21,000</b>

You should calculate the Inventory Holding Period, Accounts Receivable Collection Period and Accounts Payable Payment Period ratios and use your answers to calculate the working capital cycle.

Note that all sales and purchases are made on credit and that you should use the closing inventory value to calculate the Inventory Holding Period ratio.

You should express your answers to the nearest whole day.

**Inventory Holding Period**

$$= (\text{Inventory} / \text{Cost of Sales}) \times 365$$

$$= (£44,000 / £120,000) \times 365$$

$$= 134 \text{ days}$$

**Accounts Receivable Collection Period**

$$= (\text{Trade Receivables} / \text{Sales}) \times 365$$

$$= (£39,000 / £275,000) \times 365$$

$$= 52 \text{ days}$$

**Accounts Payable Payment Period**

$$= (\text{Trade Payables} / \text{Cost of Sales}) \times 365$$

$$= (£21,000 / £120,000) \times 365$$

$$= 64 \text{ days}$$

**Working Capital Cycle**

$$= \text{Inventory Holding Period} + \text{Accounts Receivable Collection Period} - \text{Accounts Payable Payment Period}$$

$$= 134 \text{ days} + 52 \text{ days} - 64 \text{ days}$$

$$= 122 \text{ days}$$