**APPLICATION EXERCISE 9 – SUGGESTED SOLUTION**

**Discuss whether the liquidity of Holly’s Hats has improved or worsened over time**

The trend in the Inventory Turnover is favourable as it is faster (taking fewer days) for Holly’s Hats to sell their inventory. This means that Holly’s Hats is converting its inventory into cash slightly faster which is making it easier for them to meet its short-term debts as they fall due.

However, the trend in the Accounts Receivable Turnover is unfavourable as it is slower (taking more days) for Holly’s Hats to collect cash from their outstanding Accounts Receivable balances. This will have a negative impact on the liquidity of Holly’s Hats as the business is going to have less cash available to meet its short-term debts as they fall due, especially given that the average number of days exceeds the credit terms offered.

The trend in the Accounts Payable Turnover is favourable as Holly’s Hats is paying their outstanding Accounts Payable balances faster. However, this may in fact have a negative impact on liquidity as the Accounts Payable balances are being paid well within the credit terms of 21 days without taking advantage of the discount terms which may make it difficult to repay other short-term debts as they fall due.