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ACME Company Liquidity Analysis

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Introduction

Liquidity of the company involves how it the affirms ability to clear short term debts using the available assets, which can be converted into cash quickly. Analyzing the company's liquidity challenges is one of the most effective ways to help improve the company's financial position, reducing the cost of production and ensuring that company resources are utilized maximumly. This report will critically analyze the financial challenges that Acme company faces and identify the critical areas to focus on to minimize the liquidity challenges. The report will also give a detailed recommendation of how the company will act to minimize the challenges. A detailed priority of essential steps that the company should take to minimize these challenges will be discussed based on the materiality, time or resources required to rectify the situation.

The key challenges

Several factors affect the flow of cash in and out of the company. These are the key areas that the company needs to focus on because they affect its cashflows. They include bad debts, obsolete inventories, tight credits.

Bad debts

Bad debts refer to the number of debts that business grants to creditors, such as goods sold to customers on credit and there are few chances that those debts will be paid. For example, if the company sold goods on credit to a customer and the debtor dies or is declared bankrupt by the court of law before clearing the amount owed to the company(Sharma, 2016). Similarly, the business may have much money owed by the debtor in which the company is not sure whether creditors will pay them due to the behaviours of the debtors. These kinds of debts are called doubtful debts. There is that amount in which the firm is not sure that the debtors will clear their debts in total amount or half amount.

The amount of bad debts and doubtful debts affects the liquidity of the firm's cash flows by affecting the firm's financial position. The amount of bad and doubtful debts affects that amount of cash either at the bank or cash at hand on the balance sheet by reducing the amount of cash available on the balance sheet. (Badawi, 2017). The reduction of the amount available in the balance sheet contributes to a negative image of the firm statement of financial position. This affects the liquidity position of the company negatively.

Obsolete inventories

Obsolete refers to inventory that, for an extended period, the inventory has not been used by the company. In most cases, this inventory is at the end of its useful life. Obsolete inventory harms its liquidity position because it is sold at a lower price than it should (Almeida, 2016). The company should reduce the number of obsolete inventories to get positive inventories. Obsolete inventories can cause the firm to incur huge losses, which affects the amount of cash available at a given period or making the company unable to clear its short-term obligation within a short period using its assets.

Tight credits

The company can have several short-term obligations that need to be cleared within a short time. When the amount of short term creditors of a firm surpasses the number of current assets of the firm, the firm is likely to have a negative liquidity image. In the case of ACME company, the ratio of current liabilities to current assets shows that the company may incur difficulties in satisfying current liabilities. In other words, the company currents assets cannot fully satisfy the current liabilities.

Recommendations

Considering the materiality and the available time to rectify the liquidity of the firm, Acme company should first focus on;

The company should check the number of bad debts available on the firm and apply various strategies to reduce bad debts because bad debts reduce that amount of cash available in the firm to clear short term liabilities. One of the strategies that ACME company should use is to conduct a credit check on new customers. Carrying out the credit check helps verify the customers' creditworthiness to avoid giving goods on credits to unworthy customers (Aydemir & Guloglu, 2017). The firm should inspect the firm's financial position before giving credits to customers to avoid the occurrence of bad debts.

ACME company should also develop procedures to minimize those cases of obsolete inventories, such as the application of auto-replenishment systems. The use of auto replenishes systems will help minimize that rare of uncertainties hence preventing obsolete inventories. Auto replenishment systems help to reduce the number of obsolete inventories available in the firm. Obsolete inventories reduce that amount of current assets, reducing the firm's working capital, making it hard for the firm to meet its short-term obligations. The firm should adopt the use of the auto-replenishment technique to avoid having access to inventories.

Conclusion

`Bad debts, obsolete inventories, and tight credits are significant factors that affect the ACME firm's liquidity and overall financial position. The firm should minimize the number of bad debts by applying policies like inspecting the credit worth ness on the first clients. ACME company should also develop procedures to minimize those cases of obsolete inventories, such as the application of auto-replenishment systems. The use of auto replenishes systems will help minimize that rare of uncertainties hence preventing obsolete inventories.

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