

Accounting Fundamentals

Assignment 1

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Module: Accounting Fundamentals

Module code: LCBB4001

Lecturer – Nadeem Mirza

Question 1

a)

Income statement for the year ended 31st December 2021

	£
Revenue	800,000
Cost of sales	(578,650)
Gross profit (800,000-578,650=221,350)	221,350
Distribution costs	(28,000)
Administration expenses	(30,000)
Directors remuneration	(5,000)
Operating profit (221,350-28,000-30,000-5,000=158,350)	158,350
Finance costs	(2,000)
Interest payable (100,000x4%=4,000)	(4,000)
Profit before tax (158,350-2,000-4,000=152,350)	152,350
Taxation (corporation tax)	(100,000)
Profit for the period (152,350-100,000=52,350)	<u>52,350</u>

Statement of Financial Position as at 31st December 2021

	£	£
<u>ASSETS</u>		
Non-current assets		
Property, plant & equipment	650,000	
		650,000
Current assets		
Inventories	330,600	
Trade and other receivables	170,125	
Cash and cash equivalents	76,250	
		576,975
Total assets		1,226,975
<u>LIABILITIES</u>		
Current liabilities		
Trade and other payables	188,625	

Interest payable	4,000	
Corporation tax	100,000	
		292,625
Non-current liabilities		
Long term borrowings	100,000	
		100,000
Total liabilities		392,625
Net assets		834,350
<u>EQUITY</u>		
Share capital		500,000
Share premium		200,000
Retained earnings		134,350
Total equity		834,350

Workings:

Retained earnings:

	£
Retained profits at 1 st January 2021	132,000
Profit for the year	52,350
Ordinary dividend paid	20,000
Preference dividend paid	30,000
Result (132,000+52,350-20,000-30,000)	134,350

Interest payable from debentures: £100,000x4%=£4,000

b) The balance sheet is balanced because the accountant transactions are following the accounting principle of double entry. Also, a balance sheet serves to confirm the accuracy of the accounting practices.

Question 2

a) Ratios

Ratio	Workings (2021)	2021	2020
ROCE	805/(9,736-2,511)X100	11.14%	9.93%
ROE	431/3,088X100	13.96%	12.57%
Earnings per share	431/600 Ordinary share at 50p 300/0.5=600 shares	£0.72	£0.61

Net profit margin	805/6,738	11.95%	10.85%
Asset turnover	6,738/9,736	0.69	0.64
Stock holding days	708/3,235X365	80 days	78 days
Debtors collection period	1,249/6,738X365	68 days	73 days
Current ratio	2,303/2,511	0.92	0.77
Gearing ratio	4,137/(4,137+3,088)	57.26%	58.64%
Interest cover	805/226	3.6 times	3.9 times

b) Comments

- ✓ There is an increase in the return on capital employed from 9.93% in 2020 to 11.14% which means that the company use efficiently the capital and made a profit.
- ✓ The return on equity increased from 12,57% in 2020 to 13,96% due to the increase in earnings which follow the market trends recovering from the Covid-19 pandemic.
- ✓ The shareholders gain 18% more per share in 2021 compared with 2020 which gives them for every share invested £0.72 in 2021 from £0.61 in 2020. This is due to an increase in the revenue followed by the recovery of the market.
- ✓ The company's net income has increased in 2021 to 11.95% from 10.85% in 2020 which shows that for every £1 of sales the company has £0.12 in 2021 respectively £0.11 in 2020. This is due to the increase in revenue, cost of sales, distribution costs, marketing costs and a slight decrease in administrative expenses.
- ✓ The market growth is helping the company to have more earnings in 2021 which improve the asset turnover from 0.69 in 2021 to 0.64 in 2020 showing better use of the assets.
- ✓ There is an increase in the stock held and this impact the stock holding period from 78 days in 2020 to 80 days in 2021. This is an inefficient increase that is due to the amount of stock produced but this is made in the event of a higher increase in sales.
- ✓ The amount of time that the trade receivable is coming back to the company has improved to 68 days in 2021 from 73 days in 2020 mainly due to an increase in the cost of sales.
- ✓ The current ratio improved from 0.77 in 2020 to 0.92 in 2021 this is due to the improvement in the liquidity assets of the company.
- ✓ The gearing ratio of the company improved from 58.64% in 2020 to 57.26% in 2021 due to an increase in the retained profits but still putting the company at higher financial risk.
- ✓ Due to the increase in the financial costs and almost similar loans remaining in 2021 the company interest covering decreased to 3.6 from 3.9.

The company's financial performance overall improved in 2021 compared to 2020 mainly due to the market recovery after the Covid-19 pandemic but must repay the long-term loan to improve its liquidity and not put the company at risk.