



BA Business Management

Accounting Fundamentals

Assessment 1

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Question 1

Income statement for Wales plc

The income statement, which summarises a company's profits and losses over a certain time period, is an essential piece of financial documentation for every company. Determine all operational and non-operating costs, then subtract those costs from all operating income. The income statement is one of three primary financial statements used in both business finance and accounting (Drury, 2019). When the financial statement is prepared in accordance with generally accepted accounting standards (GAAP), it includes all of the company's costs and revenues as well as the costs and profits it generates, as well as any other sources of income or expenses it may have. Companies' income statements are designed to offer an evaluation of the firm's financial performance over a certain period of time. It tells the story of a company's financial activities. An income statement includes all of a person or organization's revenue and expense accounts for a certain period of time (Garrison, Noreen and Brewer, 2019). Accountants may utilise trial balances obtained at any two points in time to build income statements. A number of modifications have also been made in compliance with the income statement's standards. Owners may use an income statement to analyse if they may raise profits by increasing sales or decreasing expenses or both of these aspects at the same time. Additional to this, it shows the organization's ability to successfully execute its financial strategy at the beginning of each fiscal year (Libby, Libby and Hodge, 2020). This document may be used by the company's owners to see whether the methods are working. Based on their research, they can come up with the best ways for increasing revenues. The following is the profit and loss statement for Wales PLC for the year ending December 31, 2021:

Wales plc

Income Statement

For the Year Ended 31st December 2021

Particulars	Amount (£)	Amount (£)
Revenue:		
Sales	800,000	
Add: Sales on credit	980	800,980
Less: Cost of goods sold		
Cost of sales	578,650	
Add: Cost of sales on credit	980	<u>579,630</u>
Gross profit		221,350
Less: Operating expense		
Administrative expenses	30,000	
Interest (£2,000+ £2,000)	4,000	
Directors remuneration	5,000	
Distribution costs	28,000	
Accrued sales commission	3,000	
Total operating cost		<u>70,000</u>
Profit before tax		151,350
Corporate tax		<u>100,000</u>
Profit after tax		51,350
Less: Dividend		
Ordinary dividend paid	20,000	
Preference dividend paid	30,000	<u>50,000</u>
Retained profit for the year		1,350

Statement of financial position for Wales plc

An annual presentation of a set of financial statements is made to the investors and companies to supply them with knowledge about the company's financial performance as well as its financial condition. The statement of financial position is one of the elements that make up the whole set of financial statements. It provides information on the firm's equity, liabilities that are owed by the business, and assets that are owned by the company (Libby, Libby and Hodge, 2020). The status of these items may be seen in the company's balance sheet that was created at the conclusion of the reporting period. It must be produced on an annual basis, but it also may be done on a semi-annual or quarterly basis, depending on the circumstances. Stakeholders like shareholders, the government, and analysts are capable of understanding the state of the company's finances as a result of this statement, and they are also able to correlate the data with that of the previous years or with that of other companies operating in an industry that is comparable (Scott and O'Brien, 2020). The objective of the statement of financial position (SFP) is to provide accurate information on the assets, debts, and equity held by the firm. It is beneficial in that it sheds light on the financial situation of the organisation as of a certain date.

The information that is included in the statement provides shareholders with assistance for doing financial analysis, on the basis of which they decide which investments to make. In addition, investors may determine the extent of the variance by comparing the statement of financial condition at the conclusion of the current fiscal year with the statement from the previous fiscal year (Elliott and Elliott, 2019). They could have a better knowledge of how the firm is doing as a result of this. The financial statement of the firm may also be contrasted to the statements of other businesses operating in the same industry to determine whether or not the company is in a better position financially than the other businesses. The following are the components of Wales plc's statement of financial position:

Wales plc

Statement of Financial Position

For 31st December 2021

Particulars	Amount (£)		
Assets			
<u>Non-current assets:</u>			
Plant and equipment			650,000
<u>Current assets:</u>			
Cash and bank		76,250	
Year-end stocks	330,600		
Less: Sales on credit	<u>980</u>	329,620	
Trade receivables	170,125		
Add: Sales on credit	<u>980</u>	171,105	
Total current asset			<u>576,975</u>
Total assets			<u>1,226,975</u>
Liabilities and shareholder's equity			
Non-current liabilities			
4% debentures		100,000	
Current liabilities			
Interest payable	2,000		
Corporate tax payable	100,000		
Accrued sales commission	3,000		
Trade payable	<u>188,625</u>		
Total current liabilities		293,625	
Total liabilities		393,625	
Share capital:			
£1 ordinary shares	500,000		
10% £1 preference shares	<u>200,000</u>		
Total share capital	700,000		
Reserves:			
Retained profit c/d	<u>133,350</u>		
Total shareholder's equity		833,350	
Total liabilities and shareholder's equity			<u>1,226,975</u>

The reasons behind balancing the statement of financial position

The balance sheet of a firm may also be referred to by its other term, the statement of financial condition. It discloses what the company has, which are referred to as its resources, how much more it owes, which are known as its liabilities, and the worth that would be restored to the

shareholders if the company were to go out of business and be dissolved (Elliott and Elliott, 2019). At the conclusion of an accounting period, which is normally a year, a statement of financial position is generated. This statement offers a snapshot of the entire financial status of the firm at a certain point in time and is written by accountants. Contrast this with an income statement that reveals where money is spent on a regular basis. Owners of businesses, investors, and management may rapidly receive an insight into the financial strengths and possibilities of a firm by using a statement of financial position (SFP). The statement is used by many stakeholders as a reference for making financial choices for the future.

The totals on a balance sheet must always add up to zero. The concept that a company's assets will always equal its total liabilities and stockholders' equity that has been distributed is where the term "balance sheet" derives from. The accounting concept of double entry is the primary factor that contributes to a balance sheet's ability to be accurate. As a result of the fact that this accounting system logs all activities in at least two distinct accounts, it also serves as a check to ensure that the entries are accurate (Kieso, Weygandt and Warfield, 2019). The total amounts of assets, liabilities, and equity all have to equal each other on the balance sheet in order to satisfy the fundamental accounting formula. Because both liabilities and equity have an effect on assets, and assets have an effect on liabilities, when one side of the equation changes, the other side also changes. This partly explains why a single commercial transaction impacts not just one account but rather two accounts instead of just one. Therefore, in accordance with the accounting equation and the concept of double entry, the balance sheet should always be equal.

Question 2

The calculations of ratios including the formulas and workings ROCE

The formula for calculating ROCE is:

$$\text{ROCE} = \text{EBIT} / \text{Capital Employed}$$

To calculate the following calculation is required,

Capital employed by Sweet's plc (2021) = Total Assets – Current Liabilities

$$= £9,736 - £2,511$$

$$= £7,225$$

Capital employed by Sweets plc (2020) = £10,087 - £3,046

$$= £7,041$$

The calculation of the ROCE for Sweet's plc for 2021 and 2020 is given below:

ROCE of Sweet plc for 2021 = EBIT / Capital Employed

$$= £620 / £7,225$$

$$= 0.086$$

ROCE of Sweet plc for 2020 = EBIT / Capital Employed

$$= £539 / £7,041$$

$$= 0.077$$

ROE

The formula for calculating ROE is:

Return on Equity = Net Income / Average Stockholder Equity

ROE for Sweet plc for 2021 = £431 / £300

$$= 1.45$$

ROE for Sweets plc for 2020 = £366 / £300

$$= 1.22$$

Earnings per share

The formula for calculating Earnings per share is:

Earnings per share = Net income / Number of Common Share Outstanding

Earnings per share of Sweets plc (2021) = £431 / 600

$$= £0.72$$

Earnings per share of Sweets plc (2020) = £366 / 600

$$= £0.61$$

Net Profit Margin

The formula for calculating net profit margin is:

Net profit margin = Net income / sales

A net profit margin of Sweets plc (2021) = £431 / £6,738

$$= 0.063$$

A net profit margin of Sweets plc (2020) = £366 / £6,441

$$= 0.057$$

Asset turnover

The formula for calculating asset turnover is:

Assets turnover ratio = Sales / Average total assets

Assets turnover ratio for Sweets plc for 2021 = £6,738 / £9,912

$$= 0.68$$

Assets turnover ratio for Sweets plc for 2020 = £6,441 / £10,087

$$= 0.64$$

Stock holding days

The formula for calculating Stock holding days is:

$$\text{Stock holding days} = \text{Average inventory} / \text{Cost of goods sold} * 365$$

$$\begin{aligned}\text{Stock holding days for Sweets plc for 2021} &= (£684 / £3,235) * 365 \\ &= 77.17 \text{ days}\end{aligned}$$

$$\begin{aligned}\text{Stock holding days for Sweets plc for 2020} &= (£659 / £3,096) * 365 \\ &= 77.69 \text{ days}\end{aligned}$$

Debtors' collection period

The formula for calculating the debtor collection period is:

$$\text{Debtor collection period} = \text{Debtors} / \text{Sales revenue} * 365$$

$$\begin{aligned}\text{Debtor collection period for Sweets plc for 2021} &= (£1,249 / £6,738) * 365 \\ &= 67.66 \text{ days}\end{aligned}$$

$$\begin{aligned}\text{Debtor collection period for Sweets plc for 2020} &= (£1,287 / £6,441) * 365 \\ &= 72.93 \text{ days}\end{aligned}$$

Current ratio

The formula for calculating the current ratio is:

$$\text{Current ratio} = \text{Current assets} / \text{Current liabilities}$$

$$\begin{aligned}\text{Current ratio for Sweets plc for 2021} &= £2,303 / £2,511 \\ &= 0.92\end{aligned}$$

$$\begin{aligned}\text{Current ratio for Sweets plc for 2020} &= £2,355 / £3,046 \\ &= 0.77\end{aligned}$$

Gearing ratio

The formula for calculating the gearing ratio is:

Gearing ratio = Total debt/ Total equity

Gearing ratio for Sweets plc for 2021 = £6,648 / £3,088

= 2.15

Gearing ratio for Sweets plc for 2020 = £7,175/ £2,912

= 2.46

Interest cover

The formula for calculating the Inventory coverage ratio is:

Interest cover = EBIT / Interest expenses

Interest cover for Sweets plc for 2021 = £846 / £226

= 3.74

Interest cover for Sweets plc for 2020 = £730 / £181

= 4.03

Financial performance and position of Sweet plc

At first, the ROCE ratio is calculated as per the information of Sweet plc. The ROCE of Sweet plc rose from 0.077 to 0.086 throughout this time period. It is a reference to an increase in the amount of money that the company has made. The company may potentially make a greater profit with the cash that it has already invested. In the year 2020, the company recorded a return on equity of 1.22%. (ROE). By the year 2021, it is anticipated that ROE would have increased to 1.45, which would translate to 1.45 pounds of revenue for every pound investment in the business. That suggests that the company will earn more money for each pound that is invested in it.

In 2020 and 2021, the firm earned 0.61 and 0.72 GBP per share, respectively, in terms of revenue. The number of shares that were actively traded did not change during either of the two years. As a direct result of this, the profit of the firm, as well as the income per share, have both increased (Needles and Powers, 2012). The percentage of total sales that contributed to the net profit of the firm is shown by the net profit margin of the company. For the year 2021, Sweet plc had a rise in its profit margin, from 0.057 to 0.063 percentage points. This suggests that sales have made a

greater contribution to the net income. The ratio of assets being turned over increased from 0.64 to 0.68 as well. It demonstrates that the corporation places its primary emphasis on income earned from the assets it already has.

The inventory holding period describes the length of time during which a company keeps its goods before the inventory is turned into sales (Scott and O'Brien, 2020). The price of one share of Sweet plc has dropped from 77.69 to 77.17. It gives the impression that the corporation can make sales more swiftly now than in the past. Because of this, the expenses of maintaining the inventory were reduced as well. The amount of time it takes to collect payment from a debtor is a significant indication for ensuring the smooth operation of the company's cash flow (Libby, Libby and Hodge, 2020). The amount of time it took Sweet plc to recover debt from customers in 2020 was 72.93 days, but that number dropped to 67.66 days the following year. It suggests that the efficiency of the company's cash collecting efforts has worsened in recent times. As a direct result of this, the company has seen a reversal in their cash stream, and they are unable to employ its finances as efficiently as it once did.

The current ratio is one sign that a company utilises its existing assets to pay its financial short-term commitments (Garrison, Noreen and Brewer, 2019). This may be seen when a company has a positive value. In 2020, the current ratio for Sweet plc was 0.77, and it increased to 0.92 in 2021. It demonstrates that the current assets of the company are insufficient to pay the liabilities that it now has. Despite this, it has seen a considerable improvement in its liquidity. The gearing ratio is the proportion of a shareholder's stake to the total capital of a lending firm. The gearing ratio for Sweet plc was decreased from 2.46 to 2.15. It is evident that the duties of the firm have decreased, and that it is now increasingly reliant on the equity contributions of its shareholders for financing.

The Sweet plc inverter cover ratio is now 3.74, which is a lower value than the previous 4.03 value. This indicates that the company's capacity to pay its profit interest has dropped as a result of the situation. In addition, the interest expense of the firm accounts for around 25 per cent of EBIT, which indicates that approximately one-quarter of the company's profits are utilised to meet its interest charges. The fact that Sweet plc's sales went up by around 4.6 per cent is indicative of a significant rise in revenue. In addition to that, the company's overall sales saw an increase of around 4.7 per cent. On the other hand, the growth in net profit was an impressive 18.57 per cent. It is evident that the corporation has reduced its expenditures in an effort to increase its sales. It is

possible that the overall situation of the firm as well as its performance might be deemed to be satisfactory.

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