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Module Title: Accounting Fundamentals

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Introduction

A company is able to get success if the accounts department of a company is quite strong. In other words, a good financial department helps to get success in a business. The reputation can be achieved easily if the level of profit keeps increasing day by day. It helps to hold the position in the global market. Any issue regarding the accounts department creates a chance of a complete shutdown of the company. The accounting department is the backbone of a company and helps to gain more profit in progress. In this particular assignment, two questions are solved with the help of the following data in the given table.

Question 1

a) **Preparation of Income Statement**

b)

In the books of Eccles plc				
Income statement				
For the year ended 31st December 2019				
particulars				**2018**
sales				827630
(-)cost of goods sold				-578650
gross profit				248980
(-) distribution expenses			-28000	
(-)administrative expenses			-30000	-58000
operating profit				190980
retained earnings			132000	
dividend paid			-50000	
salesman commission			-3000	
interest paid			-2000	

directors remunaration			-5000	-72000
profit before tax				118980
(-) corporation tax				-68000
profit after tax				50980

Table 1: Income Statement

(Source: Created by Researcher)

b) Reason for balances

Users of financial statement

The financial statement aims to provide information to the users for decision-making. There are several users of the financial statement, which is produced by any organization. The users of the financial statements are the company management, customers, government, investors, rating agencies, unions, suppliers, lenders, investment analysts, employees, and competitors. According to (Liu, 2020, p. 1500) the description of each one of the users in the financial statement is described along with the reasons behind their need for the information.

Company management- The management team is needed for understanding the liquidity, profitability and the cash flow within the organization for every month. The financial statement is required so that they can make the financial as well as the operational decisions regarding the business.

Customers: The customers when they consider the supplier for selecting a contract, they need to review the financial statement firstly. The customers then judge the ability of the supplier for remaining in the business for a long period to provide the services and the goods to be mandated in the contract.

Competitors: The entities, which are competing against the business, are attempted for gaining access to the financial statement. This is required for evaluating the financial condition of prospective competitors. The knowledge that they gained is crucial for assessing the competitive stages.

Employee: The company elects for the provision of the financial statement to the employees that are provided with the explanation of the content of documents. This is used for increasing the employee involvement level and business understanding.

Investment analysts- The investment analysts who are outside are enthusiastic to observe the financial statement for deciding whether they will be recommending the security of the company to the respective client.

Governments- The government under the jurisdiction of whom the company is located can request for the financial statement and thus they can determine if the business can pay the required tax amount. The body of the government within the state, the tax authorities are responsible for especially interesting information about the entity's financial status for regulatory purposes and taxation. The tax is the computer-based for the operational result and a different tax base. The state knows about the economic status of the taxpayer and thus determines the tax (Bhakare, 2020, p. 45).

Investor- The investors are required to know about the provided financial statement. They are owners of the business, and thus, they need to know about investment performance.

Rating agencies- The rating agencies credit is required to know the review of the financial statement for giving the credit rating to the company as the whole or for the security.

Unions- The union wants the statement of financial for evaluating the business ability for paying the compensation and thus benefiting the represented union members.

Lenders- The entity responsible for loaning the amount of money to the organization is called the lender. The person requires the financial statement for estimating the borrowing ability for paying back all the funds that are loaned and those that are related to the interest charges.

Suppliers- The suppliers always require the statements of the finance for deciding if it is safe for extending the company's credit.

General Public- The outsider of the company like the students, researchers or any analysts are interested in the statement of the financial status of the company due to some valid reasons.

The users can be classified as the external user and the internal user:

External users are those which do not only directly involve the company but also they hold for some financial interest. The external users are classified into the users that have a direct interest. The examples of the users with a direct interest in investing in the concerned company are the investors, owners, creditors. The other classified type of the external user is the indirect interest for finance which includes the employees, government, and the customers. The other type is internal users. Those users are those who can use the information of accounting for making the

decisions that are related to the operations of the company. Some examples of internal users are employees, financial managers and many others (Cioca, 2020, p. 75).

b) Explanation of the balancing of the statement of financial position

The statement for the financial position which is also known as the balance sheet presents the position of the finance of the entity for the given date. The balance sheet consists of major three components: Liabilities, assets and equity.

Liability:

The liability is the obligation which the business owes and the settlement which involves any resources or cash transfer. In the financial statement, the liability is classified into non-current liability and current liability. The liability which is going to be settled for a longer period is the non-current liability while the liability which is expected to settle within a year is the current liability. Based on nature, the liability can also be classified within the statement of the financial position as borrowings for a shorter term, borrowings for the longer term, trade as well as other payables, the current tax payables. The borrowings for short term include the overdrafts of the bank. Along with the bank loans which are short-termed with the repayment schedule ranging lower than 12 months. The borrowings for the longer term also include the installments which are left within the first year of the reporting date. The trade as well as other payables is the liabilities, occurred due to the contractors and the suppliers. The current payable tax is the separate item which is the present with the financial statement for the materiality (Albanese *et al.* 2020, p. 20).

Asset:

The asset is the amount which is owned and controlled by the entity for deriving the economic benefits after the proper utilization. Within the balance sheet, the assets can be classified as the non-current asset and current asset, which is dependent on the duration. The asset which requires a larger period for delivering the economic benefits is the non-current asset, while the asset which is expected to realize within a year is the current asset. Based on nature, the asset can be classified in the financial positional statement as the inventories balance, intangible and tangible asset, cash equivalents and cash, trade receivables.

Equity:

The equity is an amount that the owner owes in the business. The equity can be derived after the deduction from the total liability from the asset amount. An asset is thus represented as the residual interest of the owner. In the statement of the financial position, the equity is presented as the retained earnings, the share capital and the revaluation reserve. The retained earnings are the net loss or profit within the business after the amount is distributed to the respective owner. The share capital is the amount which is invested by its owner. The revaluation reserve is the surplus amount, which is the surplus of the upward property revaluation, and equipment revaluation. The revaluation reserve can be recognizable within the equity.

Balancing of the statement of the financial position:

A statement of financial position or a balance sheet is structured in such a way that the asset in the entity is the total of the sum of the equity and liability in the entity. The asset within the entity is financed from the external credit, for example, the trade creditors, bank loan etc. The asset can also be financed from the internal credit, such as the profits, and share capitals. As the capital amount invested by the owner and the borrowings of the owner must equalize the total asset amount within the business. Thus the asset of the business equals the total of liability and equity.

Thus the accounting equation can be written as: Assets= Equity + Liability

Importance of the statement of financial position:

The statement of the financial position or the balance sheet is one of the important elements in the finance of any material. The balance sheet is composed of the three different elements called equity, asset and liability. The three components of the balance sheet are required for making any balance sheet. It is also known that the equity within the balance sheet can be derived after the deduction from the total liability from the asset amount at the balance sheet. The statement for the financial position or more commonly known as the balance sheet is required for understanding the financial situation of the entity. The balance sheet is also required for maintaining the financial position of the entity. The sheet is particularly important for determining the financial risk, business risk, liquidity risk, credit risk of the entity. The conjunction used with the entity's financial statement and the competitors' financial statement, this balance sheet helps in the identification of the trends and relationship's that are indicative of the potential areas of problem for improvement in the future. The analysis of this statement is

used for predicting the timing, amount and volatility of the future earnings of the entity (Fleckenstein and Longstaff, 2018, p. 67).

Question 2

a) Financial ratio

The financial ratio has been divided into 4 categories such as the probability of returning amount, leverage, liquidity, and efficiency. All of them can be estimated with the availability of proper financial values. The financial ratio has been used to compare two financial parameters. It helps to find out the position of a company in the universal business. Also, the company is able to compare itself with the other companies in the marketing sector with the help of financial ratios. The impression and the opinion of a company can be made easier by having a look at the financial ratios by shareholders. The current ratio helps to find the relation of credit amount with the debit amount (Wardand Calabrese, 2018, p. 65). Debit ration helps to get the calculation regarding the balance sheet of the company. The profit edge ratio helps to give ideas about profit and the success of a company.

Ratios help to get an idea about the efficiency, profitability, and performance of the company. Shareholders can easily get the idea of having a look at the financial ratio. The process becomes easier about investing for the company based on observable trends of financial ratios. On the other hand, it helps to get an idea about company performance. The financial ratio helps to get an idea about investment strategy. It can be said that the company follows a good strategy if all of the liquidity ratio, quick ratio comes out with a good result.

Liquidity Ratio	**2019**	**2018**
Current ratio	0.917164	0.773145
Current asset	2303	2355
Current liabilities	2511	3046

quick ratio	0.635205	0.556796
current assets	2303	2355
inventories	708	659
Current liabilities	2511	3046
cash ratio	0.088809	0.066645
cash and cash equivalent	201	177
short term investment	22	26
current liabilities	2511	3046

Table 1: liquidity ratio

(Source: Created by Researcher)

The liquidity ratio comes with the numerical data about the current ratio, cash ratio, and the quick ratio. In this case the liquid ratio of **Chocco plc** has been considered for the period 2018 and 2019. All the numerical data has been given in the question (Bragg, 2016, p.101). The ratio helps to determine the current position and liquid assets available with the company.

Profitability Ratio

profitability ratio	2019	2018
gross profit margin	108.2844	108.0426
gross profit	3503	3345
sales	3235	3096
operating profit margin	24.88408	22.57752
operating profit	805	699
sales	3235	3096
net profit margin	13.32303	11.82171
net income	431	366
sales	3235	3096
return on assets	5.798466	4.733575
net income	431	366
assets	7433	7732

Table 2: profitability ratio

(Source: Created by Researcher)

The profitability ratio comes with the gross profit margin, operating profit margin, and net profit margin. The above table carries all the values about the three mentioned ratios. All of the ratios have been directly linked with the accounts department.

Efficiency Ratio

efficiency ratio	**2019**	**2018**
inventory turnover ratio	4.569209	4.698027
cost of goods sold	3235	3096
average inventory	708	659
Asset Turnover ratio	170.2632	619.2
sales	3235	3096
average total Assets	19	5

Receivable turnover ratio	2.590072	2.405594
credit sales	3235	3096
average accounts Receivable	1249	1287

Table 3: Efficiency ratio

(Source: Created by Researcher)

Efficiency ratio encircles **inventory turnover ratio, Asset Turnover ratio, and Receivable turnover ratio.** All of them are included to measure the efficiency of **Chocco plc**. The performance of the company can be determined well by looking at the efficiency of the company **Chocco plc**.

Inventory turnover ratio, Asset Turnover ratio is seen to be decreased in the year 2019. It indicates the performance has dropped in the year 2019 of the **Chocco plc** company.

Leverage ratio		
Debt Ratio	2.152849741	2.463942
total debt	6648	7175
total equity	3088	2912

debt capital	0.682826623	0.699113
total debt	6648	7175
total equity	3088	3088
debt assets ratio	0.894389883	0.927602
total debt	6648	7175
assets	7433	7735

Table 4: leverage ratio

(Source: Created by Researcher)

b) Evaluation of ratios

The financial ratio gives the knowledge about the position of **chocco plc** in the marketing position. The entire ratio has been determined with the help of data; the ratio indicates that the company chocco plc is good enough about holding the market position. Besides all of that the debt value is seen to be decreased in the year 2019.

The quick ratio can be provided by adding the security amount with the cash account. After that, the result has been divided with the current liabilities. Here the quick ratio becomes 0.635205 for

the year 2019 and the value of the ratio becomes 0.5567896. The current position of Chocco plc Company has been improved in the year of 2019 from the previous year.

Also, the current ratio for the company **Chocco plc** has seen to be improved in the year 2019. The ratio becomes 0.917164 in the year 2019 whereas the ratio has been 0.773145 in the year 2018 (Lallemandand Strauss, 2016, p. 70). That indicates a progression has been done about the company. The progression has been done in a sufficient amount that carries a significant impact on the accounts department of the **Chocco plc** Company.

The cash ratio has also seen to be improved in the year 2019. The cash ratio has been 0.888809 about the year 2019. The cash ratio is 0.666645 in the year 2018. The numerical value of the cash ratio has been seen to be improved in the long term. The company **Chocco plc** is able to get a high position in the marketing sector. The accounts departments get the ability to gain Success in the global market competition as the cash ratio has seen to be improved from the past year.

The gross profit margin has seen to be increased in the small term. The amount of gross profit has been estimated to be 108.2844 in the year 2019 whereas the value has been estimated to be 108.0426 in the year 2018 (Okekeand Nwankpa2017, p. 281). It indicates the company chocco plc is able to hold a great position in the global market sector by reporting an expanded profit base.

The operating profit margin also helps to indicate the current position of a company in the global marketing sector. The numerical value of operating profit margin has been observed to be 24.88408 in the year 2019 whereas the value has been 22.55752 in the year 2018. The position of the company chocco plc becomes stronger in the current situation as the operating profit margin within one year is improved indicating the better performance of operating activities.

The net profit margin has also improved within one year. It increased 13.323303 from the value of 11082171 estimated in 2019. **Chocco plc** Company is surely able to hold the position in a strong way within its operating industry and has demonstrated better progress represented in the form of larger net profit for the current year. The return of assets also has been seen to improve and has been estimated to be 1.066 (approximately). The increasing value of the return on assets ratio implies that the company **Chocco plc** deals with the marketing position and utilizes its assets in a good way. The reputation and the business path of the company are very successful to expand its business in the year 2019 (Monte-Mor*et al.*2018, p. 175).

The leverage ratio comes with the debt ratio, debt capital, and debts assets ratio. All of the ratios have seen to be decreased in the year 2019. It indicates that **chocco plc** is able to increase the market position and as a result profit can be seen about the business process of **chocco plc.**

The efficiency ratio is seen to be decreased in the year 2019. It indicates that the company chocco plc gets difficulty to hold the position in the global market. The business path may get some barriers to gain profit. The quality of the product may get decreased due to the lowest efficiency. It affects the accounts department of chocco plc in an effective way. Success cannot be achieved easily. The reputation of choco plc also gets decreased with poor efficiency (Caswell, 2019, p. 17). The business strategy that has been applied by chocco plc is not good enough for gaining a high profit with comparison to other companies.

Conclusion

The project can be concluded which contains two questions which is solved with the help of the balance sheets and different data provided. The financial statement aims to provide information to the users for decision-making. There are several users of the financial statement, which is produced by any organization.

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profit before tax		118980
(-) corporation tax		-68000
profit after tax		50980

In the books of Eccles plc
balance shhet as on 31st december 2019

Assets	amount	amount
current assets		
cash at bank		171355
non current assets		
plants and equipment		632730
current assets		
debtors		170125
total assets		1304810
liablities		

shareholders fund	
equity capital	610000
non current liablities	
debenture	100000
current liablities	
trade creditor	171355