

Accounting Fundamentals

Module LCBB4001

Lecturer Rita Ukachi-Lois

Assignment -A1

Student ID 1918685

Carlos Jimenez Carrasco

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Question 1

1a. Income statement and Statement of financial position

Income Statement of Wales PLC for the year ended 31.12.21

<u>Particulars</u>	<u>£</u>	<u>£</u>
Sales	800,000	
(+) Credit Sales	980	
Cost of Sales		800,980
		(578,650)
Gross Profit		222,330
<u>Operation Costs</u>		
Salesman commission	(3000)	
Directors remuneration	(5000)	
Distribution cost	(28,000)	
Administrative expenses	(30,000)	
Ordinary dividend paid	(20,000)	
Preference dividend paid	(30,000)	
		(116,000)
Operating profit		106,330
Interest paid		(2,000)
		104,330
Tax expenses		(100,000)
Profit for the year		4,330

Workings:

1. Trade receivables = 170,125

(+) Additional sales on credit = 980

£171,105

2. Retained profits

Retained profits at 1 st Jan 2021 =	132,000
(+) Tax =	<u>100,000</u>
	232,000
(+) Profit for the period =	<u>4,330</u>

£236,330

Statement of Financial position of Wales PLC as on 31.12.2021

<u>Particulars</u>	<u>£</u>	<u>£</u>
<u>Non-Current assets</u>		
Property, plant and equipment		650,000
<u>Current assets</u>		330,600
Inventory		171,105
Trade receivables		76,250
Cash and Bank		
		5 7 7 ,
Total assets		955
<u>Current Liabilities</u>		
Trade payables		12,27,955
Others creditors		
		(188,625)
<u>Non-Current Liabilities</u>		(3,000)
Loans and other borrowings (4% debenture)		
		(191,625)
Net assets		
<u>Equity</u>		(100,000)
Ordinary share capital		
Retained profits		936,330
		700,000
		236,330
		936,330

1b. Why does the statement of financial position balance?

The statement of financial position or else balance sheet of an organisation helps to determining the position of the business for a respective time period. It is underpinned that this particular statement always balances because every transaction occurring within a business directly impact the asset side and the liability side of the statement (Lee, *et al.*, 2022). Therefore, it is evident that it measures or reveal about the money from where it is generating and how it has been utilised following the system of double entry system of accounting. Thus, the entire transaction is nullified and for this reason, it is always the same.

Question 2

a) Calculation of accounting ratios of Sweets Plc. for the financial years 2020 and 2021

<u>Name of Ratio</u>	<u>Formula</u>	<u>2021(£m)</u>	<u>2020(£m)</u>
ROCE	Net Profit / C a p i t a l Employed * * C a p i t a l Employed = Total Assets – C u r r e n t Liabilities	= 431 / (9736 – 2511) = 431 / 7225 = 0.06 (approx.)	=366 / (10087 – 3046) = 366 / 7041 = 0.05 (approx.)
ROE	Net Profit / Shareholders’ Equity	= 431 / 3088 = 0.14 (approx.)	= 366 / 2912 = 0.13(approx.)
Earnings per share	Net Profit / Outstanding Shares	= 255 / 300 =£0.85 (approx.)	= 242 / 300 =£0.81(approx.)
Net Profit margin	(Net Profit / Revenues) * 100	= (431 / 6738) * 100 = 6 . 4 % (approx.)	= (366 / 6441) * 100 = 5 . 6 8 % (approx.)
Asset Turnover	Revenues / Total Assets	= 6738 / 9736 = 0.69 (approx.)	= 6441 / 10086 = 0.64 (approx.)
Stock Holding days	(Cost of Goods S o l d / Inventory) * 365	= (708 / 3235) * 365 = 8 0 days(approx.)	= (659 / 3096) * 365 = 7 8 days(approx.)
D e b t o r s C o l l e c t i o n Period	(T r a d e Receivables / Revenues) * 365	= (1249 / 6738) * 365 = 6 8 d a y s (approx.)	= (1249 / 6441) * 365 = 7 1 d a y s (approx.)
Current Ratio	Current Assets / C u r r e n t Liabilities	= 2303 / 2511 = 0 . 9 2 time(approx.)	= 2355 / 3046 = 0.77time(approx.)
Gearing Ratio	Total Debts / Shareholders’ Equity ** Total Debts = C u r r e n t Liabilities + Non -Current Liabilities	= 6648 / 3088 = 2.15 (approx.)	= 7175 / 2912 = 2.46(approx.)

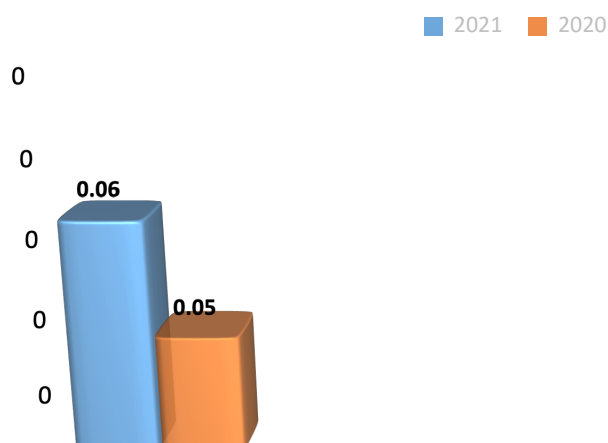
I n t e r e s t Coverage Ratio	EBIT / Interest Expenses	= 805 / 226 = 3.57 (approx.)	= 699 / 181 = 3.86 (approx.)
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b) Interpretation of the ratios of Sweets Plc. for 2020-2021

1. ROCE (Return on Capital Employed)

Year	2021	2020
Figure	0.06 (approx.)	0.05 (approx.)

ROCE (Return on Capital Employed)

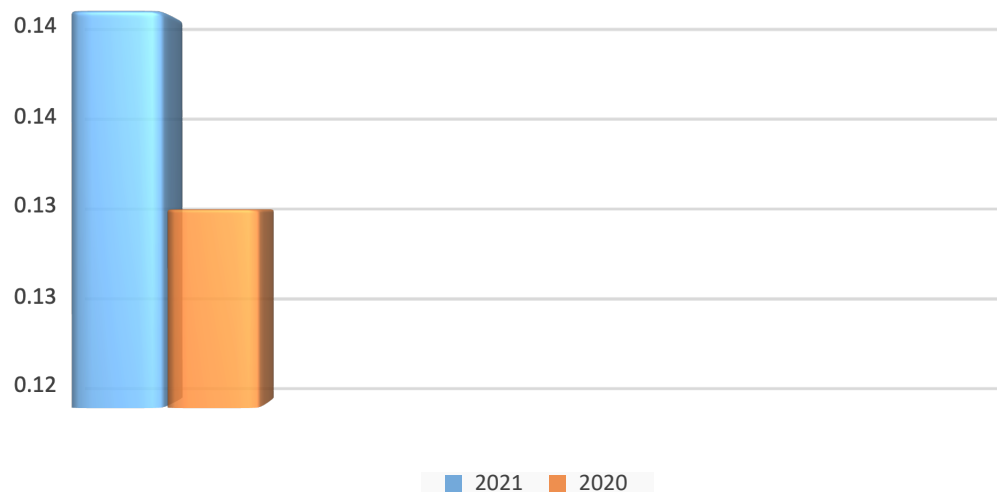


It is a financial metric, which is used in assessing a firm's profit-making ability and efficiency in the usage of its capital. It is a financial parameter for the potential investors, shareholders and other stakeholders to understand the financial standpoint of a firm and assist in making future investing decisions towards it. The derivation shows a similar trend in the 2 years calculated. Sweets Plc. has failed to maintain the industry average in this metric, which is around 0.15 in UK. This shows that the firm has not been effective in optimum utilization of its capital resources. It has to reduce costs of operations, re-finance at lower rates, or restructure its debt policy as some of the ways to improve this.

2. ROE (Return on Equity)

Year	2021	2020
Figure	0.14 (approx.)	0.13 (approx.)

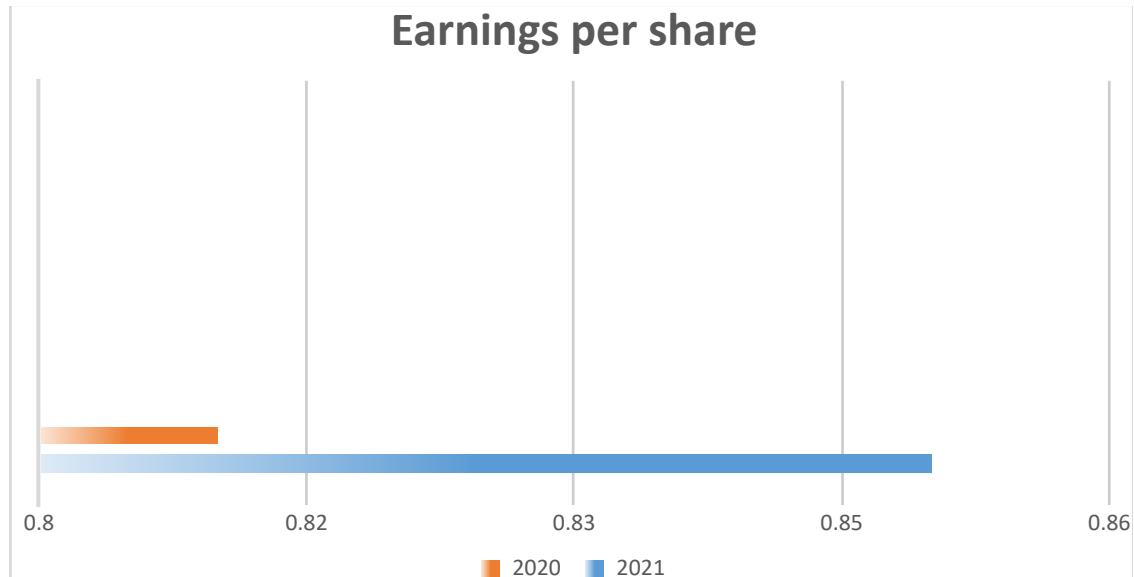
ROE (Return on Equity)



It is a standard metric for analysing the performance of a firm financially where the efficiency with which it has been able to generate profits is measured. The higher the ratio is the better the firm is placed at generating profits and developing from the financing of equity (de Vasconcelos and Forte, 2022). The return on equity derivation shows a similar value in the 2 years calculated. The firm has to prevent mismanagement and also prevent reinventing of earnings towards assets which are non-productive.

3. Earnings per share

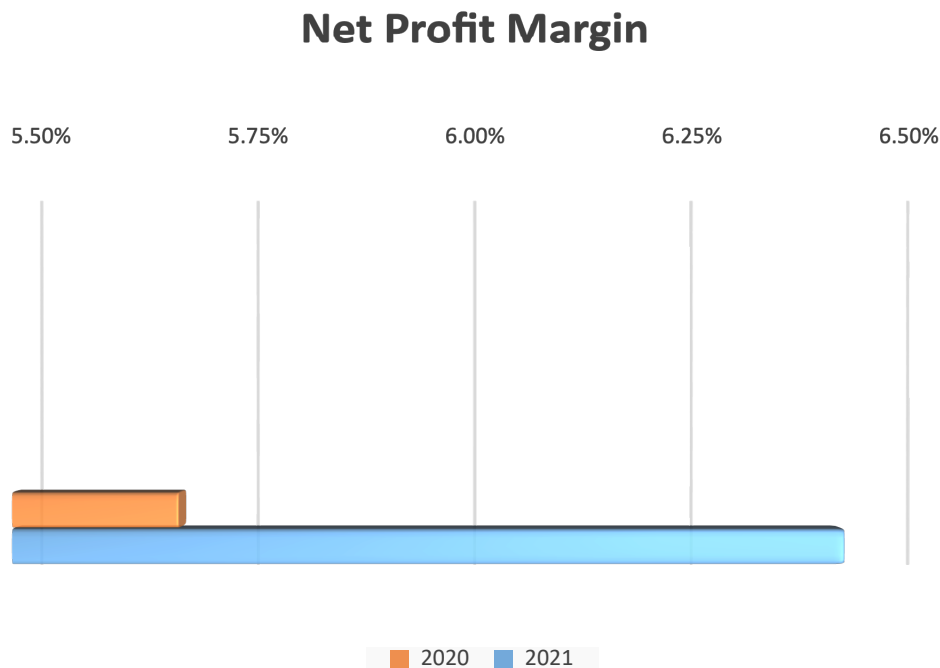
Year	2021	2020
Figure	£0.85(approx.)	£0.81(approx.)



It is a financial measurement, which makes indications towards the amount of money, which a firm makes for each share of the stocks, it has. This helps towards the estimation of corporate value (Gray, 2022). The higher the EPS is for a firm the better value gets shown as the investors are willing to make pay for the shares if they believe that the firm has higher profits compared to the share price. The firm had a slightly less productive 2020 compared to 2021 resulting in a figure of £242 million compared to £255 million.

4. Net Profit Margin

Year	2021	2020
Figure	6.4 % (approx.)	5.68 % (approx.)

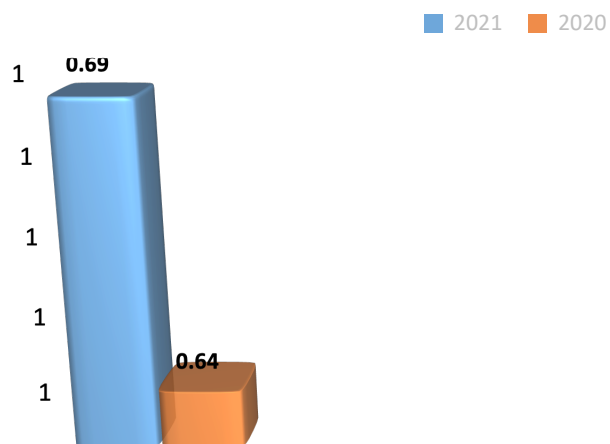


The margin of net profit is a metric, which is one of the most critical financial tools to judge the financial health of a firm. It indicates how much profit gets translated from the utility of each pound (Hertina, *et al.*,v2022). The industry average in the UK sweets shop industry is 10% or more depending on the scale and volume of operations. The reasons for the lower net profit margin of 5.68% in 2020 compared to 6.4 % the following financial year can be attributed to sales being of lower volume. The amount of administrative expense was also higher. This could be due the effects of the pandemic Covid-19 in 2020 in UK which derailed operations in sweets and other industries in UK and globally.

5. Asset Turnover Ratio

Year	2021	2020
Figure	0.69(approx.)	0.64(approx.)

Asset Turnover Ratio

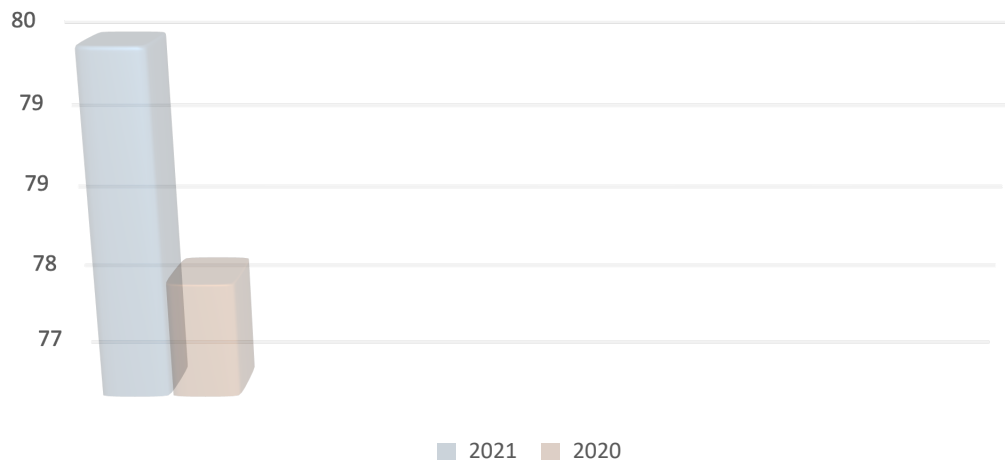


It is a financial metric which indicates the degree of efficiency with which a firm has been successful or fails to use its assets towards the generation of revenues (Limbongand Malau,2022). The sales in 2020 was lower compared to 2021 due to the effects of the pandemic, Brexit and other issues in UK. This resulted in the asset turnover being lower compared to 2021. The firm is improving in this trend and has to maintain a high asset turnover ratio for continued success.

6. Stock Holding Days

Year	2021	2020
Figure	80 days(approx.)	78 days(approx.)

Stock Holding Days

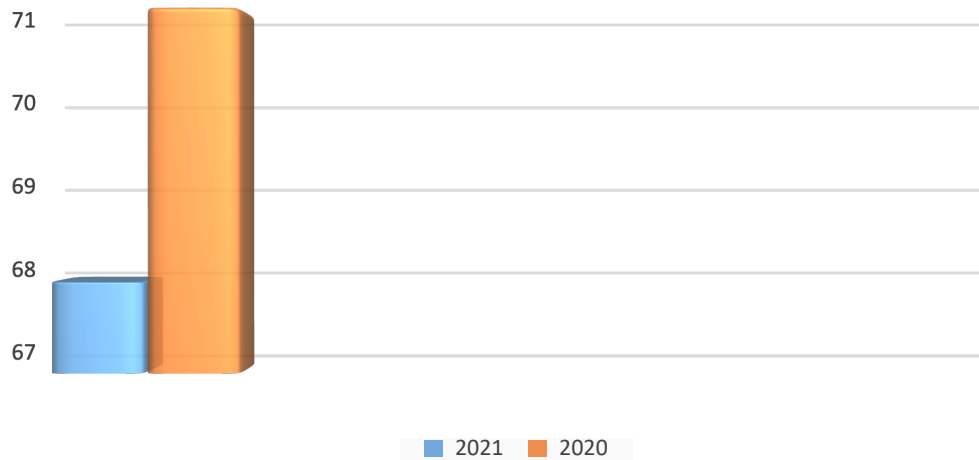


It is a financial measurement, which shows the number of days a firm is taking to convert its stocks to sales. This ratio helps a firm in aiding a firm towards the making of better decisions on pricing, marketing, manufacturing and the purchases of new inventory (Karpman, *et al.*,2022). Sweets Plc. needs to maintain a low stock holding days period as it would improve the efficiency of the firm taking less time towards the realization of the income from sales. The calculations indicate the firm taking more time in 2021 compared to 2020which is a worrying trend.

7. Debtors Collection Period

Year	2021	2020
Figure	68 days (approx.)	71 days (approx.)

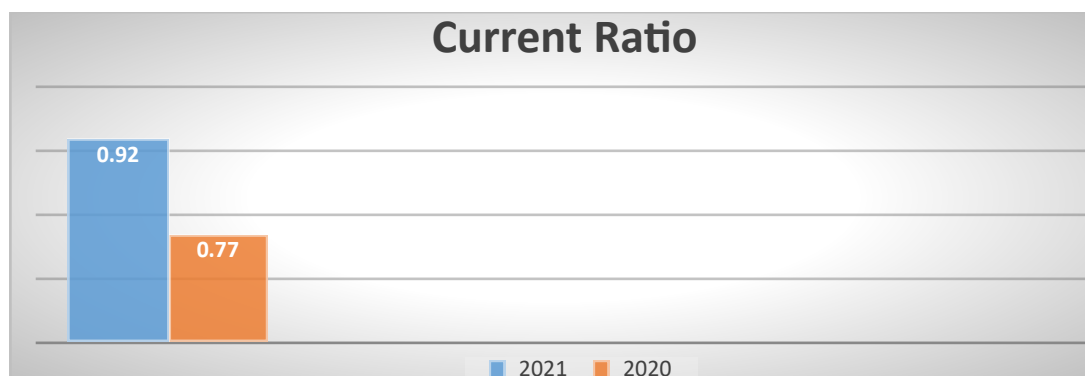
Debtors Collection Period



It is the period that is required by a firm in collecting back the payments, which it owes, from its clients and debtors. This period is an indication of the practices of accounts receivables of a firm and firms rely heavily on this aspect as it affects the cash flows (Sah, 2022). The lower a firm takes to collect back its debts the better it is which is the case in case of Sweets Plc. and is a progressive trend where the collection period has reduced from 71 days in 2021 to 68 days in 2020. It will improve the efficiency of the firm and improve solvency.

8. Current Ratio

Year	2021	2020
Figure	0.92 time(approx.)	0.77 time(approx.)

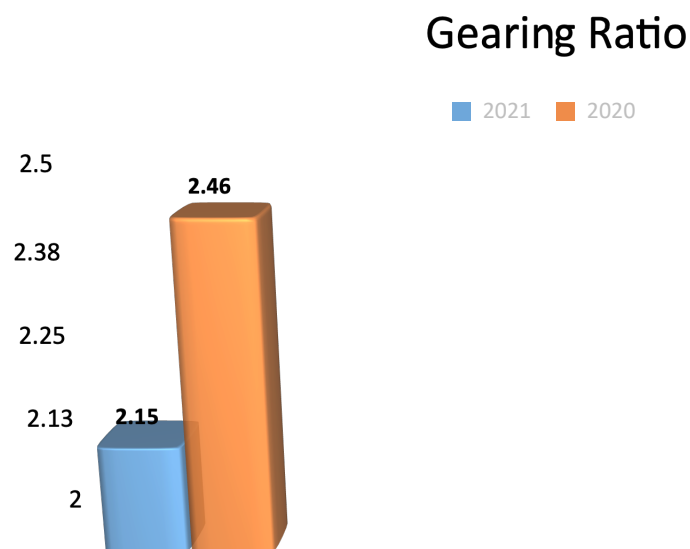


Current ratio is a liquidity ratio, which is used as a measuring parameter towards the measurement of the ability of a firm in paying off its short-term debts with the optimum

utilization of its short-term assets within the period of one financial year (Lartey, *et al.*, 2022). The industry average in UK for this parameter is 1.5 times and it is interpreted that the company has earned a current ratio of 0.92 times in the year 2021. This reveals that from the past year 2020, the company has strategized to increase the sales and has increased their cash balance as asset. The reduction in the value of creditors of the company has also resulted in increased balance of current ratio, which indicates the company will attain a financial leverage in the forthcoming accounting year.

9. Gearing Ratio

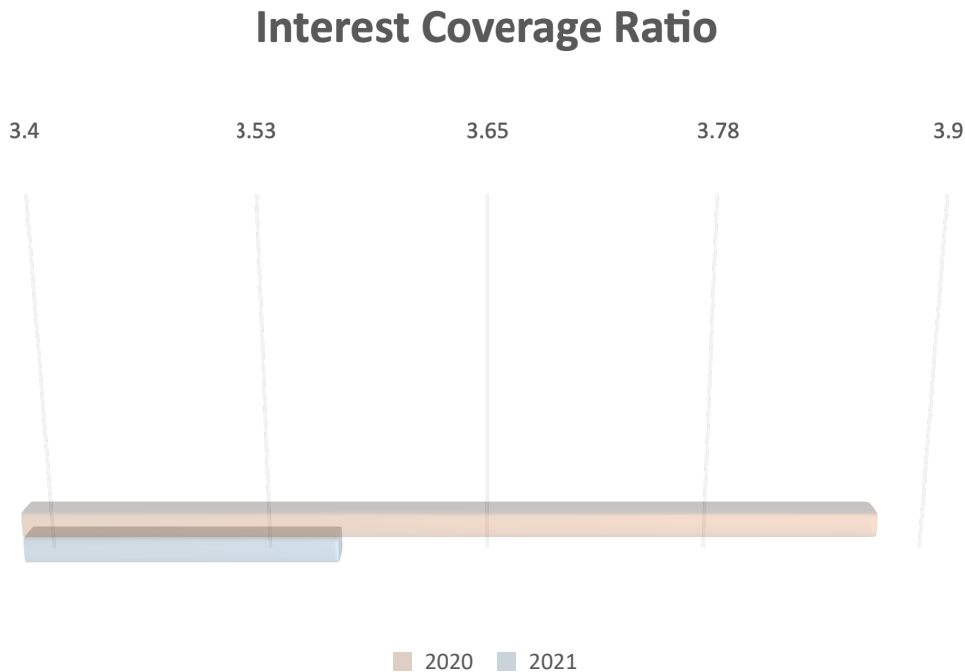
Year	2021	2020
Figure	2.15 (approx.)	2.46 (approx.)



This ratio is a financial standard, which has evaluated Sweets Plc.'s degree of operations financing with the debts in terms of the equity that it has accumulated (Elmarzouky, *et al.*, 2022). For every 1 pound of equity, Sweets Plc. has incurred 2.15 pounds of debts in 2021 and 2.46 pounds of debts the previous financial year in 2020. This indicates that the firm is reducing its debt value and increasing the equity which highlights a positive influence for undertaking business. The only positive is that it is declining slowly which show the firm has been working on its debt structure.

10. Interest Coverage Ratio

Year	2021	2020
Figure	3.57 (approx.)	3.86 (approx.)



It is a financial metric, which shows the potential of a firm in paying off the interest from the debts outstanding. The higher it is the better it for a firm. The less the ratio is the more ways a firm will feel the burden of expenses of debts and the less amount of capital that it has in using in different ways (Wilson,*et al.*, 2022). Sweets Plc. has been able to maintain interest coverage of more than 1.5, which is the UK industry average in the concerned sector. This is a positive trend. The earnings before interest and tax were lower in 2020 leading to higher interest coverage in 2020 compared to 2021. The creditors of a firm look at this ratio with high interest as it defines whether or not to provide loans to the firm and judges its credit worthiness through it. This is a positive trend also for potential investors of Sweets Plc.

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