

# Accounting Fundamentals

## Assignment 1



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Module: *Accounting Fundamentals LCBB4001*

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**Question 1 a)****Income statement for the year ended 31<sup>st</sup> December 2021**

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

**Statement of Financial Position as at 31<sup>st</sup> December 2021**

|                                  | £       | £       |
|----------------------------------|---------|---------|
| <b><u>ASSETS</u></b>             |         |         |
| <b><i>Non-current assets</i></b> |         |         |
| Property, plant & equipment      |         | 650,000 |
| <b><i>Current assets</i></b>     |         |         |
| Inventories                      | 330,600 |         |
| Trade and other receivables      | 170,125 |         |
| Cash and cash equivalents        | 76,250  |         |

|                                             |         |           |
|---------------------------------------------|---------|-----------|
|                                             |         | 576,975   |
| <b>Total assets</b>                         |         | 1,226,975 |
| <b><u>LIABILITIES</u></b>                   |         |           |
| <b>Current liabilities</b>                  |         |           |
| Trade and other payables                    | 188,625 |           |
| Interest payable (debenture: 100,000x4/100) | 4,000   |           |
| Corporation tax                             | 100,000 |           |
|                                             |         | 292,625   |
| <b>Non-current liabilities</b>              |         |           |
| Long term borrowings                        | 100,000 |           |
|                                             |         | 100,000   |
| <b>Total liabilities</b>                    |         | 392,625   |
| <b>Net assets</b>                           |         | 834,350   |
| <b><u>EQUITY</u></b>                        |         |           |
| Share capital                               |         | 500,000   |
| Share premium                               |         | 200,000   |
| Retained earnings                           |         | 134,350   |
| <b>Total equity</b>                         |         | 834,350   |

Workings:

Retained earnings:  $132,000 + 52,350 - 20,000 - 30,000 = 134,350$

|                                                  |                |
|--------------------------------------------------|----------------|
| Retained profits at 1 <sup>st</sup> 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)            | <u>134,350</u> |

### Question 1 b)

The key component that contributes to a balance sheet's capacity to be balanced is the accounting notion of double entry. Every transaction recorded in the general ledger generates a corresponding entry in the supporting journal, one that shows where the money is coming from and another that shows where it is going.

### Question 2

#### a) Ratios:

1. ROCE 2020:  $699/(10,087-3,046) \times 100 = 9.93\%$

ROCE 2021:  $805/(9,736-2,522) \times 100 = 11.14\%$

2. ROE 2020:  $366/2,912 \times 100 = 12.57\%$

ROE 2021:  $431/3,088 \times 100 = 13.96\%$

3. Earnings per share 2020:  $366/600 = £0.61$

Earnings per share 2021:  $431/600 = £0.72$

Workings: the number of ordinary shares for 2020 and 2021 is at 50p per share:  
 $£300/£0.5 = 600$  shares

4. Net profit margin 2020:  $699/6,441 \times 100 = 10.85\%$

Net profit margin 2021:  $805/6,738 \times 100 = 11.95\%$

5. Asset turnover 2020:  $6,441/10,087 = 0.64$

Asset turnover 2021:  $6,738/9,736 = 0.69$

6. Stock holding days 2020:  $659/3,096 \times 365 = 78$  days

Stock holding days 2021:  $708/3,235 \times 365 = 80$  days

7. Debtors collection period 2020:  $1,287/6,441 \times 365 = 73$  days

Debtors collection period 2021:  $1,249/6,738 \times 365 = 68$  days

8. Current ratio 2020:  $2,355/3,046 = 0.77$

Current ratio 2021:  $2,303/2,511 = 0.92$

9. Gearing ratio 2020:  $4,129/(4,129+2,912) \times 100 = 58.64\%$

Gearing ratio 2021:  $4,137/(4,137+3,088) \times 100 = 57.26\%$

10. Interest cover 2020:  $699/181 = 3.9$  times

Interest cover 2021:  $805/226 = 3.6$  times

## **b) Comments:**

1. The company has made effective use of its capital as seen by the rise from 9.93% in 2020 to 11.14% in 2021 in its return on capital employed. It means that for every pound of capital used, there is a greater return.

2. Thanks to the recovering economy after COVID-19 and the higher earnings, the return on equity rose from 12.57% in 2020 to 13.96% the following year.

3. Stakeholders will get £0.72 per share invested in 2021, up from £0.68 in 2020. As a result of 2021's improved profits, when the market finally began to recover.

4. The company made a net profit of 11.95% in 2021, which is an increase from 10.85% in 2020. As a result of the rise in revenue, the company is now earning roughly £0.12 for every pound of revenue.

5. As a direct consequence of the organization's successful use of its available resources, asset turnover increased to 0.69 in 2021 from 0.64 the previous year.

6. The business is maintaining inventory for a longer period (80 days in 2021 against 78 days in 2020) because of the increase in inventory. This rise is supported by the accumulation of goods in anticipation of future demand.

7. Because of careful management action, the average collection period for trade receivables will decrease from 73 days in 2020 to 68 days in 2021, therefore boosting the company's liquidity.

8. The current ratio increased to 0.92 in 2021 from 0.77 in 2020 as a result of better debt payment management.

9. The company's gearing ratio dropped from 58.64% in 2020 to 57.26% in 2021 as a result of an increase in retained profits. It's because the firm raised its long-term borrowing in 2021.

10. The company's interest cover ratio decreases from 3.9 in 2020 to 3.6 in 2021, indicating that there will be a less operational profit available to cover interest payments. This is because of the rising cost of borrowing money.

In 2021, the company's financial performance was boosted by the global and market recovery from the COVID-19 epidemic, as well as the associated increase in demand. Stakeholders' money is being well spent, therefore the business is doing well. However, a better liquidity position may be achieved if the firm keeps up with its loan repayments.