

Accounting fundamentals

Assignment 1

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Module: Accounting Fundamentals

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Question 1:

- a) Prepare an income statement for the year ended 31st December 2021 for Wales plc and a statement of financial position as at that date.

INCOME STATEMENT FOR THE YEAR ENDED 31st December 2021

	£'000
Revenue	800,000
Cost of sales	<u>(578,650)</u>
Gross profit	221,350
Distribution costs	(28,000)
Administration expenses	<u>(30,000)</u>
Operating profit	163,350
Finance costs	<u>(55,000)</u>
Interest payable	<u>(2000)</u>
Profit before tax	
Profit for the period	<u><u>106,350</u></u>

STATEMENT OF FINANCIAL POSITION AS AT 31st December 2021

	£'000	£'000
<u>ASSETS</u>		
Non current assets		
Property, plant & equipment	1,250,000	
		1,250,000
Current assets		
Inventories	430,600	
Trade and other receivables	970,125	
Cash and cash equivalents	<u>176,250</u>	
		<u>1,576,975</u>
Total assets		<u>2,826,975</u>
<u>LIABILITIES</u>		
Current liabilities		
Trade and other payables	767,275	
Other creditors	118,000	
		885,275
Non-current liabilities		
Long term borrowings	200,000	
		<u>200,000</u>
Total liabilities		<u>1,082,275</u>
Net assets		<u>1,741,700</u>
<u>EQUITY</u>		
Share capital		1,000,000
Share premium		400,000
Retained earnings		<u>132,000</u>
Total equity		<u>1,532,000</u>

- b) The statement of financial position or balance sheet has to be equal.
Both sides – liabilities and assets have to be equal. If they are not equal, you can spot a mistake from the principal of double entry.**

Question 2:

- a) Calculate the following ratios for Sweets plc for 2021 and 2020, showing the formulas and workings:

1. ROCE

$$\text{ROCE} = \frac{\text{Profit before interest}}{\text{Assets employed}} \times 100\%$$

Profit before interest = operating profit + profit/loss on sale of fixed assets + investment income

Assets employed = total assets – current liabilities

2020

Profit before interest = 699 - 5 + 26 = 720

Assets employed = 10,087 – 3046 = 7041

$$\text{ROCE} = \frac{720}{7041} \times 100\% = 10.22\%$$

2021

Profit before interest = 805 + 19 + 22 = 846

Assets employed = 9736 – 2511 = 7225

$$\text{ROCE} = \frac{846}{7225} \times 100\% = 11.7\%$$

2. ROE

$$\text{ROE} = \frac{\text{Earnings}}{\text{Ordinary share capital + reserves}} \times 100\%$$

Earnings = profit for the year

We can take retained profits as a reserves.

2020

$$\text{ROE} = \frac{366}{300+1541} \times 100\% = 19.88\%$$

2021

$$\text{ROE} = \frac{431}{300+1717} \times 100\% = 21.36\%$$

3. Earnings per share

$$\text{Earnings per share} = \frac{\text{Earnings}}{\text{Number of ordinary shares}}$$

2020

$$\text{Earnings per share} = \frac{366}{300} = \text{£1.22 per share}$$

2021

$$\text{Earnings per share} = \frac{431}{300} = \text{£1.44 per share}$$

4. Net profit margin

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}} \times 100\%$$

2020

$$\text{Net Profit Margin} = \frac{366}{6441} \times 100\% = 5.68\%$$

2021

$$\text{Net Profit Margin} = \frac{431}{6738} \times 100\% = 6.40\%$$

5. Asset turnover

$$\text{Asset turnover} = \frac{\text{Sales}}{\text{Assets employed}}$$

2020

$$\text{Asset turnover} = \frac{6441}{7041} = 0.91$$

2020

$$\text{Asset turnover} = \frac{6738}{7225} = 0.93$$

6. Stock holding days

$$\text{Stock holding period} = \frac{\text{Inventory}}{\text{Cost of sales}} \times 365$$

2020

$$\text{Stock holding period} = \frac{659}{3096} \times 365 = 77.7 \text{ days}$$

2021

$$\text{Stock holding period} = \frac{708}{3235} \times 365 = 79.9 \text{ days}$$

7. Debtors collection period

$$\text{Debtors collection period} = \frac{\text{Trade receivables}}{\text{Credit sales}} \times 365$$

We are assuming that the credit sales are trade receivables.

2020

$$\text{Debtors collection period} = \frac{1287}{1287} \times 365 = 365 \text{ days}$$

2021

$$\text{Debtors collection period} = \frac{1249}{1249} \times 365 = 365 \text{ days}$$

8. Current ratio

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

2020

$$\text{Current ratio} = \frac{2355}{3046} = 0.77$$

2021

$$\text{Current ratio} = \frac{2303}{2511} = 0.91$$

9. Gearing ratio

$$\text{Gearing Ratio} = \frac{\text{Debt}}{\text{Debt} + \text{Equity}} \times 100\%$$

2020

$$\text{Gearing Ratio} = \frac{4129}{4129+2912} \times 100\% = 58.64\%$$

2021

$$\text{Gearing Ratio} = \frac{4137}{4137+3088} \times 100\% = 57.25\%$$

10. Interest cover

$$\text{Interest cover} = \frac{\text{Profit before interest}}{\text{Interest charges}}$$

2020

$$\text{Interest cover} = \frac{720}{181} = 3.97$$

2021

$$\text{Interest cover} = \frac{846}{226} = 3.74$$

b) Using the information in the financial statements and the ratios you have calculated, comment on the financial performance and position of Sweets plc:

1. In 2021 the ROCE – (Return on capital employed) is with higher value. This means that the capital was used more efficiently, and the profitability is higher in 2021 than 2020.
2. The profit has improved slightly. They have the resources that can be distributed and the company is doing good.
3. For every ordinary share held in the company for 2020, it earns 1.22£ of net profit. For year 2021 – 1.44£. The improvement shows that the company is more reliable to be invested in for the year 2021.
4. Net profit margin also increased in year 2021. The company is doing better than the previous year with turning sales into profit.
5. The company was not using their assets optimally in year 2020. The next year we can see slightly improvement, however the turnover is still low. We can say that the company was using their assets more efficiently in year 2021.
6. The stock holding period was better in year 2020. The company was holding stocks for more days in year 2021, which means they had to tie up money in inventory and could not make them into profits.
7. We assumed that the credit sales are the trade receivables, which led to the same collection period for years 2020 and 2021 – and exactly 1 year. This could be a good thing if the company policy is to collect their debts for the same time every year. It means that the company is flexible.
8. The ability of the company to pay their current liabilities improved slightly but in 2021 is still low. In year 2020 they have 0.77 available current assets to pay for 1 current liabilities and in year 2021 – 0.91. This shows that in both years the company had less current assets than current liabilities, but still shows improvement.
9. There is improvement in the debt. In year 2021 it has dropped by 1.39%.
10. We can see more sufficient profit in year 2020. It has dropped slightly in year 2021. In year 2020 the company were able to meet its interest payments 3.97 times and in year 2021 the number dropped to 3.74.

