

Accounting Fundamentals

Assessment A1



University of Walls Trinity Saint Davis London

Name : Nedelcho Vichev

ID : 2229924

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Lecturer : Hossein Shokri

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1.Introduction

This report will answer the questions with fundamental accounting technique and models such a income statement, financial statement, and ratios calculation the financial performance and situation of the companies in the tasks. The report will comment the financial position following the provided information of the company and will explain how and why.

2.Question One

2.1.Income Statement

Income statement is one of the three basic statement which based on the provided information simply substrate the revenue for the expenses and display the gross profit, operation profit and the net period by end of the period (Atrill, 2016).

Subheadings 1 show us what is the corporation tax of £100 000 for the year which we need to subtract from the operation profit.

Subheading 2 According to Walker (2009) the salesman commission is a expenses and variable cost which we add to the operation expense, because is a percentage of the sales and usually is addition to the base salary.

Subheading 3 The money from trading goods £980 are included in the revenue from this period even if they are receive it in next period (British Business Bank plc, 2022). In that case sales of goods for £980 are made before end of the period which mean that we add £980 to the sales of this period in the income statement. In the balance sheet the trade receivable will increase with £980 and and stock at 31/12/23 will decrease with £980, because they selling goods from their stock.

Wels plc Income Statement for period end 31/12/23

	£	
Sales	800980	
Cost of sales	578,650	
Gross Profit		222330
Distribution costs	28000	
Administration expenses	30000	
Director remuneration	5000	
Salesman Comision(operating expense)	3000	
Interest Paid (operating expense)	2000	
Total expense		68000
Operation profit		154330
Tax expense		100000
Net Profit		54330

Statement of Financial position for the period end 31/12/22 for Wels pls

	Amount in £	Amount in £
Assets:		
Current assets:		
Cash and bank		96000
Stock at 31/12/22		509870
Trade receivables		172085
Total Current Assets:		777955
Non-Current assets:		
Plant and equipment		1250000
Total Assets:		2027955
Liability		
Current liability :		
Trade payables		188625
Salesman commission		3000
Corporation Tax		100000
Total current liability		291625
Non-current liability:		
2% debentures		200000
Total Liability		491625
Equity		
£1 ordinary shares	900000	
10% £1 preference shares	500000	
Retained profit 1/1/22		132000
Net profit for 31/12/22		54330
Ordinary dividends paid	20000	880000
Preference dividends paid	30000	470000
Total Equity		1536330
Total Liability and Equity		2027955

2.2.Statement of Financial Position

According to Atrill P. (2016) trade receivables are very common current asset, because they are money which the company will receive in short term or less than one year and they convert to cash which can be used for buying more goods. Adding Cash and Bank and the Stock at 31st December 2022 give us Total Current Assets of £777,955 plus the Non-Current Assets (Plant & Equipment) £1,250,000.

$£777,955 + £1,250,000 = £2,027,955$ Total Assets.

The Salesman commission is an expense which is recorded under Current Liability (Wood And Sangster 2021). All together with the Corporation tax and Trade payable (the money which the company will receive in the future), the total Current Liability is £291,625. We adding £200,000 in Non-Current Liability from 2% debenture, because it is a long term borrowing and that give us Total Liability of £491,625.

In Equity we sum together the Retained profit from 01/01/22 with the Net Profit from 31/12/22 which we got from the Income statement. The company paid the ordinary and preference dividends from the ordinary and preference shares and record them on credit and debit side for balance equation. Respectively £1 ordinary shares £900,000 - £20,000 ordinary shares paid = £880,000

10% £1 preference shares £500,000 - £30,000 Preference dividend paid = £470,000.

When we sum all that give us £1,536,330 total equity amount.

Following the basic accounting balance recording transactions, and the accounting fundamental equation we can see that both sides are equal (Wood And Sangster ,2021).

$\pounds 2,027,955 \text{ Assets} = \pounds 1,536,330 \text{ Equity} + \pounds 491,625 \text{ Liability}$
total (£2,027,955).

3.Question 2

According to Wood and Sangster (2021) ratio is the next action after the financial statement, because it help to investigate the financial health of the company. Nevertheless, can help managers to make future plans and decision based on wide variety of specification such as profitability, efficiency, liquidity, financing structure and investment ratio.

A) Required

ROCE (Return on Capital Employed) = Profit before interest / Capital Employed x100%

To complete the formula we need to find how much is the Capital Employed which is the Total Assets - Current Liability .

Capital Employed

2021 9736 - 2511 = 7225

2021 ROCE = $805 / 7225 \times 100\% = 11.14\%$

2020 Capital Employed 10 087 - 3 046 = 7041

2020 ROCE = $699 / 7041 \times 100\% = 9.92\%$

ROE (Returning Equity) = Profit of the year / Equity x100%

2021 ROE = $431 / 3088 \times 100\% = 13.95\%$

2020 ROE = $366 / 2912 \times 100\% = 12.56\%$

Earning per share = Net income / Number of ordinary shares

2021 EPS = $431/300 = \text{£}1.44$

2020 EPS = $366/300 = \text{£}1.22$

Net Profit Margin = Operating profit / Revenue

2021 NPM = $805/6738 \times 100\% = 11,94\%$

2020 NPM = $699/6441 \times 100\% = 10.84\%$

Asset Turnover = Revenue / Capital Employed

2021 AT = $6738 / 7225 = 0.93$

2020 AT = $6441 / 7041 = 0.914$

Stock Holding days = Inventory / Cost of sales $\times 365$

2021 SHD = $708 / 3235 \times 365 = 77.91$

2020 SHD = $659 / 3096 \times 365 = 75.77$

Debtors Collection Period = Trade Receivables / Revenue $\times 365$

2021 DCP = $1249 / 6738 \times 365 = 67.65$ days approx. 68 days

2020 DCP = $1287 / 6441 \times 365 = 72.93$ days approx. 73 days

Current Ratio = Current Asset / Current liability

2021 CR = $2303 / 2511 = 0.917$

2020 CR = $2355 / 3046 = 0.77$

Gearing Ratio = Long term debt / Long term debt + Equity $\times 100\%$

2021 GR = $4137 / 4137 + 3088 \times 100\% = 57.25\%$

2020 GR = $4129 / 4129 + 2912 \times 100\% = 58.64\%$

Interest Cover = Profit before Interest / Interest Charges

2021 IC = $805 / 226 = 3.56$

2020 IC = $699 / 181 = 3.86$

In the Additional information i tell us that dividends are paid respectively 2021 - £255 000 000 and 2020 - £242 000 000 . That information mean that we need to substrate the dividends from the equity, because that is the money which are paid for investors as a award for the investing (Atrill & McLaney, 2006).

Moreover, that will change some of the ratio results such as Gearing ratio and Return on Equity.

i. $3088 - 255 = 2833$ Equity for 2021

$2912 - 242 = 2670$ Equity for 2020

Gearing Ratio = $4137 / 4137 + 2833 \times 100\%$

$= 4137 / 6970 \times 100\% = 0.593 \times 100\% = 59.35\%$ for 2021

$4129 / 4129 + 2670 \times 100\% = 4129 / 6799 \times 100\% = 0.607 \times 100\% = 60.7\%$ for 2020

As we see here the after the dividends paid the gearing ratio increase with around 2% which indicate that the company increase the level of debt. Therefore, that increase the risk of financial risk for the company with 2% , but of course that depend from the business model of the company (Weetman, 2013).

Let's have look how Return on Equity will change:

ROE

$431 / 2833 \times 100\% = 0.152 \times 100\% = 15.21\%$ for 2021

$366 / 2670 \times 100\% = 0.137 \times 100\% = 13.70\%$ for 2020

After the calculation with the additional information we see that Return on equity increasing. That it reflect to the company to add value which attract more shareholders.

ii. Addition information: the average price for 2021 is £5.12 per share and £4 per share for 2020.

According to Walker (2009) the average shares price is based on the market price and is not related to the nominal value of the share in this case 50p per share. This information is typically recorded as a note to the financial statement as a **average trading price per share**. To find investment ratio such as Price Earning we gonna use the formula :

Price Earning = Current share price / Earning per share

PE = $5.12 / 1.44 = 3.55$ times for 2021

PE = $4 / 1.22 = 3.27$ times for 2020

B) Based on the informal from the calculation above and financial statement for Sweet plc we can see that the company have growth from 2020 to 2021 and performing well. The equation between Assets = Liability + Equity show us that the company is in good financial health as well. The profitability ratios show us capital and equity return which can attract more shareholders or investors. Efficiency ratio provide prove that the debtors money collection and stock holding is less than 3 months, which is a evidence of demands of the market for the products and loyal debtors without causing many problems. Moreover, from investment point of view the ratios provide information that earning per share is 3.27 times for each share and increase to 3.55 in next year which show us that the company is in favourable environment to run more performance in the long term activity. Speaking for long term activity Gearing Ratio is something which bring my concern. From the provided information the company operating with around 60% in debt with money borrowed from the bank. That put the company in a higher financial risk and may scare or repel some future shareholders and investors. If the owners or investors in the company would like company growth in long term in my opinion they should reduce the dividends paid and keep more money in the capital for future

investment or cover the long term borrowing as quickly as possible that will help them to reduce the interest with company have to pay to the bank and will increase their profit in the future. Another reason why they want to reduce the dividends is they may pay more tax and instead of that they can invest that money to expand the business (Walker, 2009). However, there is some problem and limitation with that the ratio calculation can cause (Walker, 2009). For example, the calculation from question 2 is based only on the information of 2020 and 2021. We don't know how was the company performance in the previous years or we can't predict any future inflations that may impact in the company profitability. So, the managers and directors who make plans and take decisions based on the ratios information need to bear in mind that ratios don't reveal all changes and number of events which may impact to the profitability of the company.

3.References

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