



Prifysgol Cymru
Y Drindod Dewi Sant
University of Wales
Trinity Saint David

200
1822 - 2022

Course work

Student name: Ana Cojocari

Student ID: 2118833

Module title: Accounting fundamentals (LCBB4001)

Module: Nadeem Mirza

Date of submission: 22.12.2023

Table of Contents

<i>Introduction</i>	<i>3</i>
<i>1. Reflections following statement</i>	<i>3</i>
<i>2. Income statement</i>	<i>4</i>
<i>3. Critically discuss the financial performance and position of Sweets plc</i>	<i>6</i>
<i>Conclusion</i>	<i>10</i>
<i>Reference list</i>	<i>11</i>

Introduction

This report delves into the financial landscape of a business, initially focusing on the balance sheet's portrayal of assets, liabilities, and equity. Emphasizing the need for a dynamic perspective, it introduces the statement of cash flows, which is crucial for understanding cash movements. The narrative explores non-current assets, their types, and their significance in long-term operations. The report stresses broad stakeholder disclosure and highlights the critical role of accounting entries like prepayments and accruals. It advocates for financial regulations, acknowledging their role in market transparency and stability. A pivotal section unveils the income statement format for Wales plc, offering clarity on its financial components. Finally, the report shifts to evaluating Sweets plc's financial health using key ratios, providing insights into efficiency, profitability, and liquidity.

1. Reflections following statement

The financial status statement, often known as the balance sheet, primarily focuses on the financial position of a business at a specific point in time rather than the cash flows during the accounting period. It reflects a company's assets, liabilities, and equity after an accounting period.

Understand how much cash has come into and left the business during an accounting period. The resulting cash balance, you would typically refer to the statement of cash flows. The cash flow statement divides cash inflows and expenditures into operating, investing, and financing. This statement helps you analyse how cash has been generated or used by a business during a specific accounting period and provides information about the resulting cash balance at the end of that period (Financial Accounting Standards Board [FASB]).

So, while the balance sheet shows a business's financial position, it does not directly provide information about cash flows during the accounting period. To get a clear view of cash flows, refer to the statement of cash flows instead.

Non-current assets are sometimes referred to as long-term or fixed assets, goods owned by a corporation projected to produce economic advantages for more than a year. These assets may be both tangible and intangible and do not need to be immovable. The phrase "non-current" refers to assets not intended for immediate sale but for long-term usage within the company's activities (The International Accounting Standards Board [IASB]).

Tangible non-current assets, such as buildings and machinery, have a long, useful life and are integral to a company's operations. While not intended for short-term sale, they can be moved if necessary. Examples include land and equipment.

On the other hand, intangible non-current assets, like patents and goodwill, lack a physical presence but hold significant value. Despite their non-physical nature, they can be bought and sold. Tangible and intangible non-current assets contribute to a company's ability to generate revenue and achieve long-term goals (IASB). Managers must furnish financial information to diverse stakeholders, extending beyond current shareholders. Legal compliance dictates the dissemination of financial data to potential investors, creditors, and the public, ensuring transparency and accountability (Warren, Reeve, & Duchac, 2022). This broader disclosure safeguards the interests of employees, customers, suppliers, and the local community. It is vital for attracting investment and maintaining trust with all stakeholders. Furthermore, the company's long-term viability is contingent on its ability to attract new investors and shareholders,

necessitating a wider audience for financial information. This practice aligns with legal mandates, bolsters transparency, protects stakeholder interests, fuels investment, instills trust and secures the company's lasting success.

Excluding prepayments and accruals from the statement of financial position is not advisable. These accounting entries play a fundamental role in aligning revenues and expenses with the period they pertain to. They adhere to accounting standards, ensuring accurate and consistent financial reporting over time (Warren, Reeve, & Duchac, 2022). Investors, creditors, and stakeholders depend on these entries for decision-making, as they provide an accurate picture of a company's financial position and performance. Eliminating prepayments and accruals would undermine the accuracy and usefulness of financial statements and hinder practical financial analysis, which is essential for info (Warren, Reeve, & Duchac, 2022).

Supporting the elimination of financial regulations is a viewpoint that challenges the existing norms of financial governance. However, it's important to recognize that financial regulations serve several crucial purposes (Securities and Exchange Commission (Securities and Exchange Commission [SEC])). These regulations are primarily in place to ensure transparency and accountability in financial reporting. They help maintain confidence in financial markets by deterring fraudulent practices and misreporting. Additionally, financial regulations protect the interests of creditors and investors by requiring companies to disclose their financial health and potential risks (Securities and Exchange Commission [SEC]). They also enable meaningful comparisons of financial data across different companies and industries. In essence, financial regulations are generally considered essential for maintaining the integrity of financial reporting, safeguarding stakeholders, and preserving the stability and trustworthiness of financial markets (European Securities and Markets Authority [ESMA])

Balancing ledger (T) accounts, and the trial balance is a critical preparatory step in the accounting process before finalizing financial statements. This practice serves multiple essential functions (Warren, Reeve, & Duchac, 2022). For starters, it validates the correctness of recorded transactions, allowing for the discovery and rectification of mistakes or problems. Secondly, it confirms the internal consistency of accounting records by ensuring that the fundamental accounting equation ($\text{Assets} = \text{Liabilities} + \text{Equity}$) is maintained (Warren, Reeve, & Duchac, 2022). Most significantly, a balanced trial balance is the foundation upon which financial statements, such as income and balance sheets, are constructed. These statements provide a complete picture of a company's financial situation and performance, and precise ledger balances are critical to their credibility. Furthermore, this process aids in identifying and rectifying any errors or omissions, reducing the likelihood of financial misstatements (Warren, Reeve, & Duchac, 2022).

2. Income statement

An *income statement* is a financial statement summarising a company's sales, costs, and earnings for a given period. It begins with total revenue, deducts the cost of goods sold to calculate gross profit, and subtracts operating expenses to arrive at operating income (Atrill & McLaney, 2018). Non-operating items such as interest and gains/losses contribute to other income and expenses, leading to income before taxes. After accounting for taxes, the final figure is the net income, representing the company's overall profit or loss. Investors and analysts use the income statement to

evaluate a company's financial health, profitability, and operational efficiency. It is a crucial tool for understanding the financial performance of a business.

The income statement provides a concise overview of a company's financial performance with critical components:

1. Revenue (Sales): Total money from selling goods or services.
2. Cost of Goods Sold (COGS): Direct costs of production.
3. Gross Profit: Profit after subtracting COGS from revenue.
4. Operating Expenses: Day-to-day operational costs.
5. Operating Income (Profit): Profit from core operations.
6. Other Income and Expenses: Non-operating items.
7. Income Before Taxes: Total income before taxes.
8. Income Taxes: Taxes owed based on taxable income.
9. Net Income (Profit/Loss): Final amount after subtracting taxes.

The income statement is a crucial tool for investors, offering insights into a company's profitability and financial health by detailing revenues, expenses, and profits over a specific period. Investors use this information to make stock decisions, while lenders assess creditworthiness. For management, the income statement aids in strategic decision-making, cost control, and growth identification. It also supports budgeting by providing a historical perspective, serving as a crucial communication tool for stakeholders.

To create the income statement for Wales plc for the fiscal year ending December 31, 2022, we must analyse the provided information and make any required modifications. The income statement format is generally as follows:

Wales plc

Income Statement

For the Year Ended December 31, 2022

Sales (Revenue)	900,000
Cost of Sales (Adjusted)	
Cost of Sales	578,650
Depreciation on Equipment	65,000
Adjusted Cost of Sales	(643,650)
Gross Profit	£256,350
Administrative Expenses (Adjusted)	
Administrative Expenses	160,000
Unpaid Salaries	10,000
Adjusted Administrative Expenses	170,000
Distribution Costs	£28,000
Operating Profit	£58,350
Interest Paid	(2,000)
Profit Before Tax	56,350

Estimated Corporation Tax (15,000)

Net Profit £41,350

This format provides a clearer view of the various components of the income statement and the corresponding calculations for Wales plc.

3. Critically discuss the financial performance and position of Sweets plc

These ratios collectively provide a comprehensive view of Sweets plc's financial health, enabling stakeholders to make informed decisions amidst the challenges and opportunities within the competitive sweets and confectionery market. In the dynamic landscape of the confectionery industry, Sweets plc, a seasoned sweets and confectionery manufacturer, has undergone a comprehensive financial evaluation for the fiscal years 2021 and 2022.

Return on Capital invested (ROCE) is a financial term that assesses a company's efficiency and profitability in producing operational profits from its Capital invested (Brealey, 2017).

For year 2022

$$\text{ROCE} = \frac{\text{operantig profit}}{\text{capital employed}} \times 100\% = \frac{805}{3088} \times 100 = 26,06\%$$

For year 2021

$$\text{ROCE} = \frac{\text{operanting profit}}{\text{capital employed}} \times 100 = \frac{699}{2912} \times 100 = 24,00\%$$

These ROCE figures indicate the profitability and efficiency of capital utilization for your business in the specified years. An increase in ROCE from 24.00% in 2021 to 26.06% in 2022 is generally a positive sign, suggesting improved efficiency in generating profits relative to the capital invested. However, additional financial and operational elements must be evaluated to acquire a thorough knowledge of the company's performance.

The formula determines a company's Return on Equity (ROE), a financial indicator used to analyse its profitability in proportion to its shareholder equity, (McMillan, 2016) ROE is stated as a percentage and is computed using the following formula:

For year 2022

$$\text{ROE} = \frac{\text{Earnings}}{\text{Equite}} \times 100\% = \frac{431}{3088} \times 100 = 13,9\%$$

For year 2021

$$\text{ROE} = \frac{366}{2912} \times 100 = 12,56\%$$

The Return on Equity (ROE) formula is a percentage of net earnings of shareholder equity, providing a measure of a company's profitability concerning its ownership. For 2022, the ROE is 13.9%, derived from net earnings of £431 million and shareholder equity of £3088 million. In contrast, the ROE for 2021 is 12.56%, based on net earnings of £366 million and shareholder equity of £2912 million. These percentages offer insights into the company's ability to generate profits relative to the funds invested by its shareholders. A higher ROE generally signifies more efficient use of equity capital.

Earnings Per Share (EPS) is an essential financial indicator representing the fraction of a company's earnings distributed to each outstanding share of common stock, (Harrison Jr,2019) The formula for calculating EPS is:

For year 2022

$$\text{EPS} = \frac{\text{Earnings}}{\text{Number of ordinary shares}} = \frac{431}{300} = 1.43\text{£}$$

For year 2021

$$\text{EPS} = \frac{366}{300} = 1,22 \text{ £}$$

In summary, these EPS values indicate the earnings attributable to each ordinary share, providing insight into the company's profitability per share. The increase from £1.22 in 2021 to £1.43 in 2022 suggests growth in earnings available to shareholders, contributing to a positive outlook for investors.

The net profit margin is an essential financial indicator that shows a company's profitability, (Brealey,2017) In this case, comparing the net profit margins for 2022 and 2021 provides insights into the company's financial performance over the two periods.

For year 2022

$$\text{Net profit margin} = \frac{\text{Operating profit}}{\text{Sales}} \times 100 = \frac{805}{3235} \times 100 = 24.88 \%$$

For year 2021

$$\text{Net profit margin} = \frac{699}{3096} \times 100 = 22,57\%$$

The increase in net profit margin from 22.57% in 2021 to 24.88% in 2022 suggests an improvement in the company's ability to convert sales into profits. A higher net profit margin indicates that a more significant percentage of sales is retained as profit after covering operating expenses. This can be a positive sign for investors and stakeholders, showcasing effective cost management or increased sales efficiency.

The assets turnover ratio is a financial indicator that assesses how effectively a company's assets are used to produce income, (Fridson,2011) It is computed by dividing the company's average revenue by its total assets.

For year 2022

$$\text{Assets Turnover} = \frac{\text{Revenue}}{\text{Capital employed}} = \frac{6738}{3800} = 1.77 \text{ times}$$

For year 2021

$$\text{Assets Turnover} = \frac{6441}{2912} = 2.21 \text{ times}$$

Comparing these two ratios, the assets turnover ratio has decreased from 2021 to 2022. A higher assets turnover ratio generally indicates better efficiency in utilizing assets to generate revenue. Conversely, a lower ratio may suggest a decline in efficiency.

The stock turnover time, also known as shareholder days, is the average number of days it takes for a corporation to sell its entire inventory. It is computed using the formula:

For year 2022

$$\text{Stock holders days} = \frac{\text{Inventory}}{\text{Cost of sales}} \times 365 = \frac{708}{3235} \times 365 = 79,88 \text{ days}$$

For year 2021

$$\text{Stock holders days} = \frac{659}{3096} \times 365 = 77,69 \text{ days}$$

Comparing these two periods, the stock turnover period has increased from 77.69 days in 2021 to 79.88 days in 2022. This increase may suggest that, on average, it took the company slightly longer to sell its inventory in 2022 compared to 2021. A higher stock turnover period could indicate slower inventory turnover and potentially inefficiencies in managing inventory. Considering the industry norms and other financial indicators is essential to understand the company's operational efficiency comprehensively.

The Debtors Collection Period, or Days Sales Outstanding, is the average number of days a firm takes to collect money from its consumers following a transaction. It is computed using the formula:

For year 2022

$$\text{Debtors Collection Period} = \frac{\text{Trade Receivable}}{\text{Credit sales (or Revenue)}} \times 365 = \frac{1249}{6738} \times 365 = 67,65 \text{ days}$$

For year 2021

$$\text{Debtors Collection Period} = \frac{2391}{6441} \times 365 = 135,49 \text{ days}$$

Comparing these two periods, the Debtors Collection Period has decreased significantly from 135.49 days in 2021 to 67.65 days in 2022. A shorter Debtors Collection Period often suggests that the firm can collect payments from its customers more rapidly, which can be a positive indicator of excellent credit management and timely collection operations.

The Current Ratio is a liquidity ratio that measures a company's ability to cover its short-term liabilities with its short-term assets, (Brigham,2017).The formula for the Current Ratio is:

For year 2022

$$\text{Current Ratio} = \frac{\text{Current Assest}}{\text{Current Liabilities}} = \frac{2033}{2511} = 0,80 : 1$$

For year 2021

$$\text{Current Ratio} = \frac{2355}{3046} = 0,77 : 1$$

When these two ratios are compared, the Current Ratio has risen from 0.77:1 in 2021 to 0.81:1 in 2022. A current ratio more significant than one indicates that a company's assets outnumber its current liabilities, a positive predictor of short-term liquidity. An increase in the current ratio may indicate increased liquidity and the ability to meet short-term commitments.

The Gearing Ratio, also known as the Debt-to-Equity Ratio, measures the proportion of a company's capital that is funded by debt compared to equity. The formula for the Gearing Ratio is:

For year 2022

$$\text{Gearing Ratio} = \frac{\text{Long term debt}}{\text{Long term debt} + \text{Equity}} \times 100 = \frac{4137}{4137 + 3088} \times 100 = 57,25\%$$

For year 2021

$$\text{Gearing Ratio} = \frac{4129}{4129 + 2912} \times 100 = 58,64 \%$$

Comparing these two ratios, the Gearing Ratio has decreased from 58.64% in 2021 to 57.25% in 2022. A lower Gearing Ratio generally indicates a lower reliance on debt to finance the company's operations, which is sign for some investors and stakeholders. However, the optimal level of gearing varies by industry and company strategy.

The interest Coverage Ratio, commonly known as the Interest Cover or Times Interest Earned ratio, assesses a company's capacity to satisfy its interest commitments using operational income, (Brigham,2017).

For year 2022

$$\text{Interest Cover} = \frac{\text{Profit Before Interest}}{\text{Interest Charges}} = \frac{620}{226} = 2,74 \text{ times}$$

For year 2021

$$\text{Interest Cover} = \frac{539}{181} = 2,97 \text{ times}$$

In this case, the decrease in the Interest Coverage Ratio from 2021 to 2022 might indicate a slightly lower ability to cover interest charges with operating income. It is critical to remember that the optimal amount of interest coverage varies by industry, and a ratio of less than one implies that a firm must create more income to pay its interest expenditures. Monitoring changes in the Interest Coverage Ratio is crucial for assessing a company's financial health and ability to meet its debt obligations.

Conclusion

In conclusion, this report navigated through vital aspects of financial management, from balance sheets and cash flows to non-current assets and stakeholder disclosure. It underscored the importance of accounting entries and financial regulations for accurate reporting and market stability. The detailed exploration of income statements for Wales plc elucidated its financial standing. The subsequent analysis of Sweets plc's financial ratios offered insights into operational efficiency, profitability, and liquidity. Monitoring these indicators is imperative for stakeholders. This comprehensive financial evaluation guides informed decision-making, emphasizing the dynamic nature of financial landscapes and the significance of ongoing vigilance for sustained corporate success.

Reference list

International Accounting Standards Board, Retrieved from <https://www.ifrs.org>, Accessed in 17 November 2023

Financial Accounting Standards Board, Retrieved from <https://www.fasb.org>, Accessed in 17 November 2023

Securities and Exchange Commission, Retrieved from <https://www.sec.gov>, Accessed in 17 November 2023

European Securities and Markets Authority, Retrieved from <https://www.esma.europa.eu>, Accessed in 17 November 2023

Brealey, R. A., Myers, S. C., & Allen, F. (2017). *Principles of Corporate Finance*. McGraw-Hill Education.

Harrison Jr., W. T., Horngren, C. T., & Thomas, C. W. (2019). *Financial Accounting*. Pearson.

Brigham, E. F., & Ehrhardt, M. C. (2017). *Financial Management: Theory & Practice*. Cengage Learning.

Fridson, M. S., & Alvarez, F. (2011). *Financial Statement Analysis: A Practitioner's Guide*. Wiley.

McMillan, M. G., & Pinto, J. E. (2016). *Investments: Principles of Portfolio and Equity Analysis*. Wiley.