

Accounting Fundamentals Assessment 1

Student name – DANIEL MIHAI

Student number – 1917723

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Lecturer name – Dr. EMAD ELKHASHEN

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**Income Statement for the year ended
31st December 2019**

Particulars	Amount £m
• Sales	• 30,300
• Cost of sales	• (18780)
• Gross Profit	• 11520
• Distribution Cost	• (2160)
• Administration expense	• (4140)
• Operating Profit	• 5220
• Profit before taxation	• 5220
• Taxation	• (1600)
• Profit for the Year	• 3620

Statement of financial position on 30st

December 2019

	Amount	Amount
	£m	£m
Assets		
Non-current assets		
Property, plant & equipment		49500
Current Assets		
Inventory	3120	
Trade Receivables	7840	
Bank	320	
Total Assets		60780
Current Liabilities		
Trade Payables	4480	
Income tax payable	1600	

Other creditor(provision for receivables, outstanding insurance etc.)	5260	
Long Term Loans		
12% debentures 2024	4000	
Total liability		18400
Equity		
£1 ordinary shares	29000	
Share premium	5000	
Retained earning	11440	42380
Total Liability		60780

Working

1. Depreciation on Building=Cost X rate of depreciation/100

$$\text{So } 16000 \times 2/100 = 320$$

2. Depreciation on Plant

$$25600 \times 10/100 = 2560$$

3. Receivables= $8240 - 240(\text{bad debts}) = 8000 \times 2/100 = 160$ (Deduction as commission)

4. Land revalued at £20,000,000

5. Cost of Goods sold= $16220 + 2560 = 18780$

6. Administration cost= $2920+320+240+160+500=4140$

320 depreciation on building

160 Receivables deduction

240 Bad debts

500 Insurance

7. Equipment, plant and machinery= $20000+11420+18080=49500$

8. Retained profits as on 01/01/2019=8380

Dividend paid (560)

Profit at end =3620

9. 11440

Question 2:

1. Return on capital employed: EBIT/ total assets – current liabilities

Year 2018

$$\text{EBIT} = 26.2$$

$$\text{Capital employed} = \text{total assets} - \text{current liabilities}$$

$$293.8 - 148.4 = 145.4$$

$$\text{ROCE} = 0.18$$

Year 2019

$$\text{EBIT} = 22.8$$

$$\text{Capital employed} = \text{total assets} - \text{current liabilities}$$

$$286.1 - 151.0 = 131.1$$

$$\text{ROCE} = 0.17$$

2. Return on equity = net income / equity

Year 2018:

$$\text{Net income} = 18.3$$

$$\text{Equity} = 80.3$$

$$\text{ROE} = 18.3 / 80.3 = .23$$

Year 2019:

$$\text{Net income} = 12.9$$

$$\text{Equity} = 93.2$$

$$\text{ROE} = .14$$

3. EPS = profit after tax – dividend / number of equity shares

Year 2018:

$$\text{Profit after tax} = 18.3$$

$$\text{Number of equity shares} = 17.8$$

$$\text{EPS} = 1.03$$

Year 2019

$$\text{Profit after tax} = 12.9$$

$$\text{Number of equity shares} = 17.8$$

$$\text{EPS} = .72$$

Gross profit margin : net sales – COGS / Net sales

Year 2018:

$$\text{Net sales} = 486.8$$

$$\text{COGS} = 299.9$$

$$\text{Gross profit margin} = 486.8 - 299.9 / 486.8 = .38$$

Year 2019

$$\text{Net sales} = 501.3$$

$$\text{COGS} = 309.5$$

$$\text{Gross profit margin} = 501.3 - 309.5 / 50.3 = .38$$

3. Assets turnover = Net sales / Total assets

Year 2018 =

$$\text{Total assets} = 293.8$$

$$\text{Net sales} = 486.8$$

$$\text{Assets turnover} = 1.66$$

Year 2019 =

$$\text{Total assets} = 286.1$$

$$\text{Net sales} = 508.3$$

$$\text{Assets turnover} = 1.78$$

4. Year 2019 =

Stock holding period =
Inventory/Cost of sales X 365=
 $38.8/309.5 \times 365=45.76$

Year 2018
 $41.1/299.9 \times 365$
 $=50.02$

- 3) Debtors collection period = (average debtors / credit sales) 365 days
Year 2018 =
 $=114.7/486.8 \times 365=86$ days

Credit sales =Revenue (Assume)

Year 2019
 $= 114.9/501.3 \times 365=83.66$
Credit sales =Revenue (Assume)

- 4) Current ratio = current assets / current liabilities
Year 2018 =
Current assets = 156.5
Current liabilities = 148.4
Current ratio = 1.05

Year 2019 =
Current assets = 153.9
Current liabilities = 151
Current ratio = 1.02

- 5) Gearing ratio = long term debt + short term debt / shareholders equity
Year 2018 =
Long term debt = 65.1

Short term debt = 148.4

Equity = 80.3

Gearing ratio = $148.4 + 65.1 / 80.3 = 2.66$

Year 2019 =

Short term debt = 151

Long term debt = 41.9

Equity = 93.2

Gearing ratio = $151 + 41.9 / 93.2 = 2.07$

6) Interest cover = earnings before interest and tax (EBIT) / INTEREST EXPENSE

Year 2018 =

EBIT = 26.2

INTEREST EXPENSE =

Interest cover ratio =

Year 2019 =

EBIT = 22.8

Interest expense =

Interest coverage ratio =

b) The situation revealed by each ratio is:

- By return in capital employed = there is not much of a difference between the return on capital employed of both the years for 2019 is .17 and for 2018 is .18 so we can say that 2018 was more efficient than 2019.
- Return on equity: generally, the ratio from 15 to 20 % is considered well the ROE of 2018 is 23% and of 2019 is 14% so we can say that in year 2018 the return on equity was better than in year 2019.
- EPS: the EPS calculated shows better in the year 2018 which is 1.03 in comparison to the year 2019 which is .72.

- Gross profit margin: the gross profit margin defines the company's financial health and it is seen that in year 2018 was as same as that in the year 2019 which is 38%.
- Assets turnover: this ratio helps in knowing that the company's revenues are good in accordance with the value of assets thus a higher ratio is much better and it is seen that in year 2019 i.e. 1.78 is higher than in year 2018 i.e.1.66 which is much better.
- Debtors' holding period:
- Debtors collection period:
- Current ratio: a good current ratio must have to be between 1.2 to 2 and it is seen that in year 2018 it is 1.5 and in year 2019 it is 1.2 both are sound ratios but in year 2018 was slightly better than of 2019.
- Gearing ratio : it is used to calculate that how many operations are using debt as their funding the gearing ratio of year 2018 is 2.66 and that of the year 2019 is 2.07 the ratio of year 2018 is much better than the ratio of 2019.

Question 3:

a) The three user groups interested in financial statements are:

- **Management:** the foremost user of the financial statements is the management itself. They prepare the financial statements by themselves but they also needs to use them for a lot of aspects. The most important aspect to them is to check the growth of the company. They looks on the following aspects such as cash flows, liquidity, cash balances etc. through this they knows about the growth and progress of the company and also helps in making accurate decisions for making profit efficiently.
- **Investors:** they are the owners of the company. This is important for them to know the financial performance and overall performance of the company to make the decision to further invest in the same business or not. They remain updated by checking the financial statements of the company. So, they need to check the financial statements regularly (Brown, 2011).
- **Customers:** customers are also interested in checking the financial statements of the company from where they are procuring the goods. It is important for the big clients to keep updated about the financial position of the company to maintain their long-term

relationship with the company. They would only like to work with a company which is financially stable. And only a financially sound company will provide the options of discount and credit sales which are beneficial for the customers.

b) The advantages of the financial reporting regime are:

- Comparability: for the preparer and for the user both this is a great advantage that they can be compared. The companies that use the same standards can be easily comparable. It is more important when there is a comparison of the financial statements across the countries.
- Flexibility: there is the use of principles not the rules and regulations. The principle philosophy states the use of different ways to reach to the accurate valuation, and this is the main aim of each standard (Khan, Ismail & Zakuan, 2013).
- Provides high quality of standards: as it provides the standards which are of high understanding and quality it enhances the performance of the business.

Disadvantages of financial reporting regime are:

- Not universally acceptable: these reporting regimes are not accepted by all the countries. This makes accounting difficult. As one country follows the regimes and other does not. So, they are not universally acceptable.
- Manipulation of the standards: though the flexibility is an advantage but by using the methods by choices financial statements can show different results for different method. This can easily lead to the profit and revenue manipulation.
- Costs are increased: by adopting the financial reporting regimes the costs are defiantly increased. The small companies will have to appoint accountants and personalized person to do the changeovers this will further increase in the costs of the business (Khan, Ismail & Zakuan, 2013).

c) The limitations of financial statements are as follows:

- Based on historical cost: it is important to follow the accounting concerns which say to record all the items on their historical cost but at the time of preparation their market values changes and this could mislead the figures in the balance sheet.
- Do not record intangible assets: intangible assets are ignored but the expenses made on those assets are recorded as expenses. By this the value of the business could be drastically affected.
- Inflation: due to the inflation if the inflation rate is high then the assets and liabilities values will appear low in the balance sheet. This is usually seen in the case of long-term assets (Yongkui, 2013).
- Made for a particular time period: if a user is looking only at one specific period of the financial statement it is possible that he must gain wrong opinion about the financial position of a business. As the financial statements are prepped for only a specific time period.
- Ignorance of non-financial issues: the financial statements only considers the financial issues or the issues which could be monetarily measured but they ignores the issues such as workers are working efficiently or not, environmental issues, disputes between the workers etc.(Yongkui, 2013).
- Personal prejudice: it can be possible that a manager can mislead the figures presented in the financial statements on the bases of personal prejudice. This will lead to wrongful opinion about the financial statements.

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