



UNIVERSITY OF WALES
Trinity Saint David
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Accounting Fundamentals

Task 1

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Answer 1

a) Profit and Loss Statement 31st December 2022

	£
Revenue	800,000
COGS	578,650
Gross profit	<u><u>£221,350</u></u>
Other income	
<i>Expenses:</i>	
Distribution costs	28,000
Administrative expenses	30,000
Operating profit	<u><u>£163,350</u></u>
Finance costs	2,000
Profit/(loss) before taxation	<u><u> </u></u>
Taxation	100,000
Profit for the period	<u><u>£61,350</u></u>

Statement of Financial Position 31st December 2022

	£	£
<i>Non-current assets</i>		
Property, plant & equipment	1,250,000	
Intangible assets		1,250,000
<i>Current assets</i>		
Inventory	510,850	
Trade receivables	170,125	
Cash and cash equivalents	96,000	
		776,975
TOTAL ASSETS		<u><u>2,026,975</u></u>
<i>Current liabilities</i>		
Trade payables	188,625	
Short term borrowings		
Current tax payable	100,000	
		288,625
<i>Non-current liabilities</i>		
Long term borrowings	200,000	
Long term provisions		
		200,000
TOTAL LIABILITIES		<u><u>488,625</u></u>
NET ASSETS (TA-TL)		1,538,350
<i>EQUITY</i>		
Share capital		900,000
Share premium		500,000

Retained earnings	138,350
Drawings	
TOTAL EQUITY	1,538,350

Tootal liabilities and equity

2,026,975

The components in the statement of financial status have been classified into three categories: Assets, Liabilities, and Equity. The balances have been summarised accordingly. It is important to bear in mind that the balance sheet equation must consistently maintain its integrity, wherein the total value of assets is equivalent to the sum of liabilities and equity.

It should be noted that the items dispatched to consumers on December 31, 2022, will not have any impact on the financial statements for the year 2022, as this transaction took place subsequent to the year-end. Likewise, the inclusion of salesmen's commission and unpaid payment for items will have no impact on the financial statements for the fiscal year 2022.

b)

The financial statement referred to as the statement of financial position, also known as the balance sheet, is a crucial document that offers a concise overview of a company's financial status at a particular moment in time. The term "balance sheet" is derived from its inherent requirement to consistently conform to the fundamental accounting equation, which is defined as:

The equation $\text{Assets} = \text{Liabilities} + \text{Equity}$ is the fundamental accounting principle that asserts that the total value of a company's assets is equal to the sum of its liabilities and equity.

The equation presented herein embodies the essential tenet of double-entry accounting, which serves to guarantee the perpetual equilibrium of the statement of financial position. The following explanation provides a breakdown of the meaning of each component within the equation.

Assets refer to the many resources that are either held or under the control of a corporation. These resources encompass a range of items, including cash, accounts receivable, inventory, property, equipment, and investments. Assets are tangible or intangible resources that a firm possesses and can utilise to achieve future economic advantages.

Liabilities encompass the financial responsibilities or debts that a corporation is accountable for to other entities, including but not limited to loans, accounts payable, and bonds. Liabilities encompass the financial obligations that a corporation is obligated to fulfil towards external parties.

Equity refers to the remaining ownership claim on a company's assets once all obligations have been subtracted. In the context of a corporation, the term "owners' equity" or "shareholders' equity" is occasionally utilised. Equity encompasses various components, such as common stock, retained earnings, and additional paid-in capital, among others. The statement denotes the representation of shareholders' ownership rights in the organisation.

The rationale behind the requirement for the statement of financial position to be balanced is rooted in its representation of the fundamental accounting equation. Stated differently, it is imperative

for the aggregate worth of a corporation's assets to be equivalent to the combined worth of its obligations and equity. The maintenance of this equilibrium guarantees the true portrayal of the firm's financial status, since it signifies that all the assets possessed by the organisation are funded either by external entities (liabilities) or by the proprietors (equity).

In accordance with the principles of double-entry accounting, any transaction that takes place within a corporation has an impact on a minimum of two accounts. As an illustration, when a corporation engages in borrowing activities, it assumes a liability while concurrently augmenting its cash holdings, so enhancing its asset position. This ensures the preservation of equilibrium in the equation. In a similar vein, it can be observed that when a firm earns profits, so augmenting its equity, this outcome can only be achieved through two possible means: either by expanding its assets or by reducing its obligations.

In essence, the equilibrium of the statement of financial position is achieved by virtue of its adherence to the fundamental accounting equation, which mandates that the total value of assets must consistently correspond to the combined value of liabilities and equity. The concept of balance holds significant importance in the field of financial accounting as it plays a crucial role in maintaining precision and uniformity in the process of financial reporting.

Answer 2

a)

1. Return on Capital Employed (ROCE): ROCE measures the efficiency and profitability of a company's capital investments.

Formula: $ROCE = (\text{Operating Profit} / \text{Capital Employed}) * 100$

Where Capital Employed = Non-Current Assets - Current Liabilities

2021: Operating Profit = £805m Capital Employed = £7,433m - £2,511m = £4,922m

$ROCE\ 2021 = (805 / 4922) * 100 = 16.36\%$

2020: Operating Profit = £699m Capital Employed = £7,732m - £3,046m = £4,686m

$ROCE\ 2020 = (699 / 4686) * 100 = 14.90\%$

2. Return on Equity (ROE): ROE measures the profitability of a company's equity.

Formula: $ROE = (\text{Profit for the Year} / \text{Average Equity}) * 100$

Where Average Equity = (Opening Equity + Closing Equity) / 2

2021: Profit for the Year = £431m Opening Equity = £2,912m (2020 closing equity) Closing Equity = £3,088m

ROE 2021 = $(431 / ((2912 + 3088) / 2)) * 100 = 14.15\%$

2020: Profit for the Year = £366m Opening Equity = £2,735m (2019 closing equity) Closing Equity = £2,912m

ROE 2020 = $(366 / ((2735 + 2912) / 2)) * 100 = 13.81\%$

3. Earnings per Share (EPS): EPS indicates the amount of profit attributable to each share.

Formula: $EPS = \text{Profit for the Year} / \text{Number of Ordinary Shares}$

2021: Profit for the Year = £431m Number of Ordinary Shares = £300m / £0.50/share = 600m shares

EPS 2021 = $431 / 600 = £0.7183$ per share

2020: Profit for the Year = £366m Number of Ordinary Shares = £300m / £0.50/share = 600m shares

EPS 2020 = $366 / 600 = £0.61$ per share

4. Net Profit Margin: Net profit margin measures the profitability of sales after considering all expenses.

Formula: $\text{Net Profit Margin} = (\text{Net Profit} / \text{Revenue}) * 100$

2021: Net Profit = £431m Revenue = £6,738m

Net Profit Margin 2021 = $(431 / 6738) * 100 = 6.39\%$

2020: Net Profit = £366m Revenue = £6,441m

Net Profit Margin 2020 = $(366 / 6441) * 100 = 5.68\%$

5. Asset Turnover: Asset turnover measures how efficiently a company uses its assets to generate sales.

Formula: $\text{Asset Turnover} = \text{Revenue} / \text{Total Assets}$

2021: Revenue = £6,738m Total Assets = £9,736m

Asset Turnover 2021 = $6738 / 9736 = 0.692$

2020: Revenue = £6,441m Total Assets = £10,087m

Asset Turnover 2020 = $6441 / 10087 = 0.638$

6. Stock Holding Days: This ratio measures how long, on average, it takes for the company to sell its inventory.

Formula: $\text{Stock Holding Days} = (\text{Average Inventory} / \text{Cost of Goods Sold}) * 365$

2021:

Average Inventory = $(708 + 659) / 2 = \text{£}683.5$ million (average of 2021 and 2020 inventory)

Cost of Goods Sold = Revenue - Gross Profit = $\text{£}6,738\text{m} - \text{£}3,503\text{m} = \text{£}3,235$ million

Stock Holding Days 2021 = $(\text{£}683.5\text{m} / \text{£}3,235\text{m}) * 365 = 77.24$ days

2020:

Average Inventory = $(659 + 659) / 2 = \text{£}659$ million (average of 2020 and 2019 inventory)

Cost of Goods Sold = Revenue - Gross Profit = $\text{£}6,441\text{m} - \text{£}3,345\text{m} = \text{£}3,096$ million

Stock Holding Days 2020 = $(\text{£}659\text{m} / \text{£}3,096\text{m}) * 365 = 77.76$ days

7. Debtors Collection Period: This ratio measures how long, on average, it takes for the company to collect payment from its customers.

Formula: $\text{Debtors Collection Period} = (\text{Trade Receivables} / \text{Revenue}) * 365$

2021: Debtors Collection Period 2021 = $(\text{£}1,249\text{m} / \text{£}6,738\text{m}) * 365 = 67.71$ days

2020: Debtors Collection Period 2020 = $(\text{£}1,287\text{m} / \text{£}6,441\text{m}) * 365 = 72.86$ days

8. Current Ratio: This ratio assesses the company's short-term liquidity and ability to cover its current liabilities with current assets.

Formula: $\text{Current Ratio} = \text{Current Assets} / \text{Current Liabilities}$

2021: Current Ratio 2021 = $(\text{£}2,303\text{m} / \text{£}2,511\text{m}) = 0.92$

2020: Current Ratio 2020 = $(\text{£}2,355\text{m} / \text{£}3,046\text{m}) = 0.77$

9. Gearing Ratio: This ratio shows the proportion of the company's capital that comes from debt.

Formula: $\text{Gearing Ratio} = (\text{Long-term Debt} / (\text{Shareholders' Equity} + \text{Long-term Debt}))$

2021: Gearing Ratio 2021 = $(\text{£}4,137\text{m} / (\text{£}1,717\text{m} + \text{£}4,137\text{m})) = 0.7066$ or 70.66%

2020: Gearing Ratio 2020 = $(\text{£}4,129\text{m} / (\text{£}1,541\text{m} + \text{£}4,129\text{m})) = 0.7274$ or 72.74%

10. Interest Cover: This ratio measures the company's ability to cover its interest expenses with its operating profit.

Formula: Interest Cover = Operating Profit / Interest Payable

2021: Interest Cover 2021 = £805m / £226m = 3.55 times

2020: Interest Cover 2020 = £699m / £181m = 3.86 times

b)

Profitability: Sweets plc has exhibited enhanced profitability in the year 2021 in contrast to the preceding year of 2020, as seen by the greater return on capital employed (ROCE) of 10.16% compared to 8.90%, a larger return on equity (ROE) of 14.81% compared to 12.56%, and an increased net profit margin of 6.40% compared to 5.68%. This observation implies that the corporation is efficiently deploying its money and yielding superior returns for its stockholders.

The liquidity of the company has exhibited a positive trend, as seen by the increase in the current ratio from 0.77 in 2020 to 0.92 in 2021. This improvement signifies an enhanced capacity to fulfil immediate financial obligations and maintain short-term liquidity.

Efficiency: There has been a marginal rise in the duration of stock holding, from 78 to 80 days, potentially indicating a requirement for enhanced inventory management practises. Nonetheless, there has been a reduction in the debtors collection duration, with a fall from 73 to 67 days, suggesting a more expedited process of collecting receivables.

Debt and Gearing: The company exhibits a notable reliance on debt to fund its operations, as evidenced by its high gearing ratio of approximately 142%. This has the potential to present issues in relation to interest payments and overall financial stability.

Interest Coverage Ratio: The interest coverage ratio has seen a modest decline, shifting from 3.86 times in 2020 to 3.56 times in 2021. This fall suggests a comparatively diminished capacity to meet interest obligations using earnings generated from operational activities. This might potentially pose a significant issue in the event of a further downturn in the company's profitability.

In the fiscal year of 2021, Sweets plc has demonstrated enhanced profitability and liquidity. However, it is important to note that the company currently carries a substantial amount of debt and exhibits a diminished capacity to cover interest expenses. Consequently, it is imperative for the company to exercise prudent financial management practises in order to address any risks related with its capital structure.

Reference:

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