

BA Business Management (BABM)

Accounting Fundamentals

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Introduction

Business management is the aggregation of all activities that entail coordinating and organising the business activities. Normally, there is accounting, finance, management, marketing, manufacturing, etc. These are several different parts of an organisation. And if it is to be thought about these components separately then there will be a long thing to know and to understand. To operate a business, all of these sectors or departments are required. For reporting and analysing the transactions, accounting is required, for taking finance and investment decision, finance is required, for managing and coordinating all the activities of different departments, management is required, to promote the business and to reach to consumers, marketing is required, etc. (Libby et al, 2012). So, the whole business management basically comprises of these sectors or departments.

In this report, in the first part, financial statements, Statement of Income and Statement of Financial Position, have been prepared for Wales Plc. Then the reason for financial position balancing has been discussed. In the second part, ten financial ratios have been calculated to analysis the financial position of Sweet Plc. Both the requirements are related to accounting and finance and these helps the management to prepare future plan for the company.

Question 1

Requirement a

Statement of income is the part of financial statements that give the figure of profit or loss. Basically, in this statement, all kinds of revenue and costs/expenses are considered to determine the profit or loss. This statement is also considered for determining the financial performance of an organisation (Scott and O'Brien, 2013). If a company has profit, then the company is financially performing well. Sometimes the management of the company performs trend analysis to determine whether the company has more or less profit than the prior year. On the other hand, if a company has a loss or less profit compared to the prior year, then the company is not financially performing well.

Statement of financial position provides total asset and total liability value for the end of the day of the financial year. At the closing of the financial year, the company needs to prepare this statement to figure out how much assets and how much liabilities it has at the end of the year. This statement is not prepared for during the year rather it is prepared for the end of the day of the financial year.

In the given case, the trial balance of Wales Plc has been given with some adjustments. For Wales Plc. Statement of Income and Statement of financial position have been prepared below:

Wales Plc.'s

Statement of Income

For the year ended at 31st December 2021

	Amount	Amount	Amount
Sales	800,000.00		
(+) Unrecorded sales	<u>980.00</u>		
		800,980.00	
Less: Cost of sales		<u>- 578,650.00</u>	
Gross Profit			222,330.00
Less: Operating expenses			
Administrative expenses		- 30,000.00	
Interest paid	- 2,000.00		
(+) Accrued interest	<u>- 2,000.00</u>		
		- 4,000.00	
Directors' remuneration		- 5,000.00	
Distribution costs	- 28,000.00		
(+) Accrued commission	<u>- 3,000.00</u>		
		- 31,000.00	
Ordinary dividend paid		- 20,000.00	
Preference dividend paid		<u>- 30,000.00</u>	
Total operating costs			<u>- 120,000.00</u>
Profit before tax			102,330.00
Corporate tax			<u>- 100,000.00</u>
Profit after tax			2,330.00
Retained profit B/F			<u>132,000.00</u>
Retained profit C/F			<u>134,330.00</u>

Wales Plc.'s

Statement of Financial Position

As at 31st December 2021

	Amount	Amount	Amount
Assets			
Current assets:			
Cash and bank		76,250.00	
Closing stock		330,600.00	
Trade receivables	170,125.00		
(+) Unrecorded sales	<u>980.00</u>		
		<u>171,105.00</u>	
Total current assets			577,955.00
Non-current assets:			
Plant and equipment			<u>650,000.00</u>
Total assets			<u>1,227,955.00</u>
Liabilities and Equity			
Current liabilities:			
Trade payables		188,625.00	
Accrued Tax		100,000.00	
Accrued interest		2,000.00	
Accrued commission		<u>3,000.00</u>	
Total current liabilities			293,625.00
Non-current liabilities:			
4% Debentures			100,000.00
Equity:			
£1 ordinary shares		500,000.00	
10% £1 preference shares		200,000.00	
Retained profit C/F		<u>134,330.00</u>	
Total equity			<u>834,330.00</u>

Total liability and equity			<u>1,227,955.00</u>
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Requirement b

The main reason for balancing the financial position is double entry. Double entry is the system of bookkeeping where it states that each and every financial transaction has equal and opposite effects in at least two different accounts. For example, sales in cash have equal and opposite effects on two accounts. One is the revenue has been increased due to the sales and on the other hand, for the reason of selling in cash, cash (asset) has been increased. The double entry system basically satisfies one equation that is called the accounting equation and that is:

$$\text{Asset} = \text{Liability} + \text{Equity} \text{ (Harrison et al, 2014)}$$

This equation is basically $\text{Asset} = \text{Liability}$ where liability means internal and external both. Internal is from the owners. This equation has also several other forms also where the part of equity has been divided into core elements like revenue, expenses, and drawings. The ultimate impact is for any type of transaction, this equation will be equal.

For example, a company has purchased an asset in cash at £1000. Here, an asset has been increased so, A will be increased and due to purchase on cash, A has been decreased. So, there is an impact on one side. Due to this one side impact, the equation is zero. Again, if the transaction happened at credit, then A will increase due to the purchase of asset and liability will be increased due to purchase on credit, so L will be increased. So, there is the impact on both sides with the same amount and the equation is 1,000 on the both sides.

Question 2

Financial ratios help the management to analysis the figures in the financial position. It also helps in trend analysis of the figures. There are different types of ratios like operating ratios, efficiency ratios, performance ratios, current ratios, debt-equity ratio, etc. Ten of the ratios have been calculated below for Sweet Plc.:

ROCE – Return on Capital Employed

Return on capital employed considers total capital employed and how much return has been earned for each pound is calculated by using this ratio.

Given information,

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	1,717	1,541
Loans and other borrowings	4,137	4,129
Operating profit	805.00	699.00
Profit/loss on sale of fixed assets	19.00	- 5.00
Investment income	22	26

Formula of ROCE = Profit before interest and tax / Shareholder's equity + Long term debt
(Warren et al, 2020)

Workings:

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	1,717	1,541
Loans and other borrowings	4,137	4,129
Total capital employed	7,225.00	7,041.00
Operating profit	805.00	699.00
Profit/loss on sale of fixed assets	19.00	- 5.00
Investment income	22	26
Profit before interest and tax	846.00	720.00
Profit before interest and tax/ Total Capital employed	12%	10%

ROE – Return on Equity

Return on equity helps to determine the return of each pound of equity.

Given information,

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	1,717	1,541
Net profit	431	366

Formula of ROE = Net Profit / Total Equity (Needles and Powers, 2019)

Workings:

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	1,717	1,541

Total Equity	3,088.00	2,912.00
Net Profit	431	366
Net Profit/ Total Equity	14%	13%

Here, ROE is higher in the year 2021 than in the year 2020 because the company has utilised the increased equity to generate more profit.

EPS – Earnings Per Share

Earnings per share provide the value of earnings for each shareholder. Normally shareholders are the owners of the company and they have the sole right to the earnings. So, it is necessary to consider how much a share has earned for the particular financial year.

Given information,

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Per share price	0.50	0.50
Net profit	431	366

Formula of EPS = Net income / Outstanding Shares (Pratt and Peters, 2020)

Workings:

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Per share price	0.50	0.50
Outstanding shares = Total share/Per share price	600.00	600.00
Net Profit	431	366
Net Profit/Outstanding shares	0.72	0.61

Normally the formula of EPS considers the preferred income and deducts this income from net income before considering the earnings of ordinary shareholders. But there is no preferred income and preferred share so this has not been considered. On the other hand, weighted average shares are considered but there are only one types of shares. Here, EPS is higher in the year 2021.

Net Profit Margin

Net profit margin is the profitability ratio where the ratio is determined by dividing the net income with total sales revenue.

Given information,

Description	2021	2020
Revenue	6,738	6,441
Net profit	431	366

Formula of Net Margi = Net profit / Sales revenue (Libby et al, 2012)

Workings:

Description	2021	2020
Revenue	6,738	6,441
Net profit	431	366
Net profit/ Sales revenue	6.40%	5.68%

Here, net margin is higher in the year 2021 because of the higher net profit.

Asset Turnover

Asset turnover determines the value of a company's sales compared to its assets.

Given information,

Description	2021	2020
Revenue	6,738	6,441

Total assets	9,736	10,087
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Formula of asset turnover = Net sales/ Total assets (Scott and O'Brien, 2013)

Workings:

Description	2021	2020
Revenue	6,738	6,441
Total assets	9,736	10,087
Net sales/ Total assets	69.21%	63.85%

Stock holding days

It is an efficiency ratio that determines the day for which a company holds its inventory or stock.

Given information,

Description	2021	2020
Inventory	708	659
Cost of sales	3,235	3,096

Formula of stock holding days = (Inventory/ Cost of sales) *365 (Needles and Powers, 2019)

Workings:

Description	2021	2020
Inventory	708	659
Cost of sales	3,235	3,096
(Inventory/ Cost of sales) *365	79.88	77.69

Debtors Collection Period

Debtors' collection period determines the average period or days within which a company is able to collect the cash from the receivables.

Given information,

Description	2021	2020
Trade receivables	1,249	1,287
Revenue	6,738	6,441

Formula of Debtors' collection period = $(\text{Receivables} / \text{Sales}) \times 365$ (Harrison et al, 2014)

Workings:

Description	2021	2020
Trade receivables	1,249	1,287
Revenue	6,738	6,441
$(\text{Receivables} / \text{Sales}) \times 365$	67.66	72.93

Current ratio

Current ratio is a liquidity ratio that states a company's liquid position and also determines a company's capability to pay its current debts.

Given information,

Description	2021	2020
Current assets	2,303.00	2,355.00
Current Liabilities	2,511.00	3,046.00

Formula of Current ratio = $\text{Current assets} : \text{Current liabilities}$ (Scott and O'Brien, 2013)

Workings:

Description	2021	2020
Current assets	2,303.00	2,355.00
Current Liabilities	2,511.00	3,046.00
Current assets: Current liabilities	0.91: 1	0.77: 1

Gearing ratio

Gearing ratio provides the ratio of a company's total equity and total debt.

Given information,

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	1,717	1,541
Loans and other borrowings	4,137	4,129

Formula of Gearing ratio = Total debt/ Total Equity (Warren et al, 2020)

Workings:

Description	2021	2020
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	1,717	1,541
	3,088.00	2,912.00
Loans and other borrowings	4,137	4,129
Total debt/ Total equity	134%	142%

Interest Cover

Interest cover is the ratio that determines how much a company is capable of paying its due interest.

Given information,

Description	2021	2020
Operating profit	805.00	699.00
Profit/loss on sale of fixed assets	19.00	- 5.00
Investment income	22	26
Interest payable	226	181

Formula of Interest cover = Profit before interest and tax/ Interest (Libby et al, 2012)

Workings:

Description	2021	2020
Operating profit	805.00	699.00
Profit/loss on sale of fixed assets	19.00	- 5.00
Investment Income	22	26
	846.00	720.00
Interest payable	226	181
Profit before interest and tax/ Interest	3.74	3.98

The company is performing well but it should give attention to the gearing of the company, liquidity of the company, and also efficiency in terms of collection and inventory holding need to be improved.

Conclusion

After analysing the ratios of Sweet Plc., it can be observed that some of the areas like gearing, liquidity, efficiency, etc. need to be considered with higher importance. In this way, ratio analysis helps the management to find out the area of attention and afterward, they can

take proper steps to solve the issue. And financial reporting helps the company to report all of its financial transactions to the related parties.

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