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Introduction

Accounting is among the most important tools which can be used for the purpose of making sure that financial information has been recorded, communicated and effective decisions have been made on the basis of that. Financial statements and ratio analysis help to understand how a business is performing in the market. These tools will be used here to analyse the performance of Kedison PLC and Chocco PLC. The reason for which financial statement balance and what the ratios means about the performance of a business will also be analysed here. The use of these will be helpful to determine the effectiveness of accounting to analyse financial information.

Question 1

Asset, liability and Equity

An asset is a resource that has economic value, from which an individual, company or country can expect future benefits (Wood, 2015, p.14). A liability is something that a company owes to a third party, usually money. The value which a business will have to return to the shareholders if all the assets of the business have been liquidated and debts are paid off is equity (Jones, 2013, p.115). These three items have been reported in the statement of financial position.

a) Profit and loss statement and statement of financial position

Kedison PLC Profit and loss statement For the Year Ended 31 December 2020		
	Amount	Amount
Sales (W1)		£ 827630
(-): Cost of sales		(£ 578650)
Gross Profit		£ 248980
Expenses		
Administrative Expenses	£ 30000	
Distribution Cost	£ 28000	
Ordinary Dividend	£ 20000	
Directors remuneration	£ 5000	
Preference dividend	£ 30000	
Sales Commission	£ 3000	(£ 116000)
Income before interest and tax		£ 132980
(-): Corporation Tax	£ 68000	
Interest	£ 2000	(£ 70000)
Net Income		£ <u>62980</u>

Kedison PLC Statement of Financial Position 31 December 2020			
Assets			
Non-current assets	Amount	Amount	Amount
Plant and equipment		£ 632730	
Stock		£ 330600	£ 963330
Current assets			
Cash at bank		£ 12900	
Debtors	£ 170125		
Add: Credit sales	£ 980	£ 171105	£ 184005
Total Assets			£ 1147335
Equity and Liabilities			
Current Liabilities			
Trade creditors		£ 171355	
Due corporation tax		£ 68000	
Unpaid commission		£ 3000	£ 242355
Non-current liability			£ 0
Total Liabilities			£ 242355
Net Assets			£ 904980
Equity			
Ordinary share		£ 310000	
Preference share		£ 300000	
Debentures		£ 100000	
Retained profit	£ 132000		
Add: Net income	£ 62980	£ 194980	£ 904980
Total liability and equity			£ 1147335

Workings

W1 – Revenue

Sales	£ 826650	
Add: Due sales	£ 980	£ 827630

b) Why does the statement of financial position balance?

The use of the double-entry system and the accounting equation are the reason for which a statement of financial position balance. In this time of recording transaction, a company follows a double-entry system (Wood, 2015, p.13). That means the transaction has been recorded in the account of the parties who are related to it. $A = L + OE$ is the equation that has been followed in a business. The most important aspect of this is that the financial statement will not be correct if this does not happen (Jones, 2013, p.114). That means as per the general rule of accounting financial statements must have to balance. If it does not there must be a mistake in the accounting records. This helps to realise that the accounting principle is the reason for which a statement of financial position must balance.

Question 2

a) Calculating Ratios for Chocco PLC

1 - ROCE				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
“Profit before interest / Assets employed” x 100%	(£ 846 / £7225) x 100%	11.70%	(£730/ £7041) x 100%	10.36%

Workings

Profit before interest (2020) = 805+19+22 = 846

Assets employed (2020) = Total assets – current liabilities
= £ 9736 – £ 2511 = £ 7225

Profit before interest (2019) = 699+5+26 = 730

Assets employed (2019) = Total assets – current liabilities
= £ 10087 – £ 3046 = £7041

2 - ROE				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
Earnings/Ordinary share capital and reserves x 100%	£ 431 / £ 3088 x 100%	13.96%	£ 366 / £ 2912 x 100%	12.57%

3 – Earnings Per Share				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
“Earnings/ Number of ordinary shares”	£ 431/ £ 600	0.72%	£ 366/ £ 600	0.61%
Workings Number of shares = 300 / 0.5= 600				

4 – Net Profit margin				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
“Net profit after tax/Net sales” x 100	£ 431/ £ 6738	6.40%	£ 366/ £ 6441	5.68%

5 – Asset Turnover				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
Turnover / Assets employed	£ 6738 / £ 7225	0.93	£ 6441 / £ 7041	0.91
Working Assets employed (2020) = Total assets – current liabilities = £ 9736 – £ 2511 = £ 7225 Assets employed (2019) = Total assets – current liabilities = £ 10087 – £ 3046 = £ 7041				

6 – Stock Holdings Days				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
(Inventory / cost of sells) x 365 Days	(£ 708/ £ 3235) x 365	79.88 days	(£ 659 / £ 3096) x 365	77.69 days
Working (2020) 708/3235=0.218 x 365=79.88 days (2019) 659/3096=0.21 x 365=77.69 days				

7 – Debtors Collection Period				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
(Trade receivables / Credit sales) x 365	(£ 1249 / £ 6738) x 365	67.66 Days	(£ 1287 / £ 6441) x 365	72.93 Days

8 – Current Ratio				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
“Current assets / Current liabilities”	£2303/ £ 2511	0.92	£ 2355/£ 3046	0.77

9 – Gearing Ratio				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
(Long term liabilities/capital employed) x 100	(£ 4137 / £ 7225) x 100%	57.26%	(£ 4129 / £ 7041) x 100%	58.64%

Workings

Capital employed (2020) = Total assets – current liabilities
= £ 9736 – £ 2511
= £ 7225

Capital employed (2019) = Total assets – current liabilities
= £ 10087 – £ 3046
= £ 7041

10 – Inventory Cover				
Formula	2020		2019	
	Calculation	Results	Calculation	Results
Profit before interest/Interest charges	£ 846/ £ 226	3.74 times	£ 730 / £ 181	4.03 times
Workings Profit before interest (2020) = 805+19+22 = 846 Profit before interest (2019) = 699+5+26 = 730				

b. Financial performance of Chocco PLC

From the ratios which have been calculated it can be said that the financial performance of Chocco PLC has been improved in 2020 than its performance in 2019. The analysis of the ratio which has been calculated will help to analyse that. ROCE is showing that the business performance in terms of increasing return on capital employed has increased because it was 11.70% in 2020 but in 2019 it was 10.3% (McLaney and Atrill, 2016, p.257). That means the business is earning more money from the capital which is employed. In terms of ROE as well, Chocco PLC is doing well in the market because the return on the amount of equity has been increased for the business. EPS is one of the most effective measures which can be used for the purpose of analysing how the business is performing. It can be seen that per-share earnings of the business have been increased. It is good news for the business because it means that more investors will be attracted.

The net profit base is one of the most common ratios that can help to understand the overall profitability of the business. In terms of the ideal ratio, the net profit margin of the business is not good but the performance of the business has been improved in 2020. But the ability to turn the asset into profit has been reduced. This is not a good sign for the business. On average Chocco PLC holds its stock 79.88 days in 2020 which was 77.69 in 2019. In general, it is high. The

debtors' collection period of the business has been reduced which is the sign of increasing financial ability of the business (Wood, 2015, p.156). The current ratio of Chocco PLC is not good although it has been improved in 2020. 2:1 has been considered as a good current ratio but the business does not have that. That means, the business does not have the ability to meet its current obligation. Overall the business has performed better in 2020 than in 2019.

Conclusion

The accounting tools which have been employed here helps to understand the financial performance of both the businesses. From the profit and loss statement which has been prepared, it can be seen that Kedison PLC will make a profit in 2020 which will ensure the sustainability of the business. The ratio analysis which has been conducted by Chocco PLC helps assess the financial performance of the business. From this, it can be said that the use of accounting will help to understand the financial performance of a business and that will be helpful in terms of developing an effective business decision.

References

Jones, M., (2013) Accounting, 3rd Edition, Wiley

McLaney and Atrill, (2016) Financial accounting for decision makers, 10th edition, FT Prentice Hall.

Wood, F., (2015) Frank Wood's Business Accounting, 13th Edition. Pearson Education Limited.