



Module: ACCOUNTING FUNDAMENTALS

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Answer 1.a.

Wales Plc.

Statement of income for the year ended 31 December 2021		
Details	£	£
Sales	800980	
Less, Cost of sales	579630	
Gross profit		221350
Less, Operating and interest expenses		
Ordinary dividend paid	20000	
Preference dividend paid	30000	
Administrative expenses	30000	
Interest paid	4000	
Director remuneration	5000	
Distribution cost	28000	
Unrecorded sales commission	3000	
Total operating and interest expenses		120000
Profit before tax		101350
Corporation taxes		100000
Retained profit		1350

Statement of financial position as on 31 December 2021		
Details	£	£
Assets		
Non-current assets		
Plant and equipment		632730
Current assets		
Stock as on 31 December 2021	329620	
Trade recivables	171105	
Cash and bank	76250	
Total current assets		576975
Total assets		1209705
Equity and liability		
Current liability		
Trade payables	171355	
Interest payable	2000	
Corporation tax payables	100000	
Sales commission payable	3000	
Total current liability		276355
Non-current liability		
4% debentures		100000
Equity		
Ordinary shares	400000	
10% Preferences shares	300000	
Retained profit	133350	
Total equity		833350
Total equity and liability		1209705

Wales Plc.

Sales for the year ended 31 December 2021	
Details	£
Sales as per trial balance	800000
Sales made on 31 December 2021	980
Total sales	800980

Balance of stock as on 31 December 2021	
Details	£
Closing stock as per trial balance	330600
Less, Unrecorded sales made on 31 December 2021	980
Closing stock as on 31 December 2021	329620

Balance of trade receivables as on 31 December 2021	
Details	£
Trade receivables as per trial balance	170125
Sales made on 31 December 2021	980
Closing trade receivables as on 31 December 2021	171105

Interest expenses for 2021	
Details	£
4% Debenture interest	4000
Less, interest on debenture paid as per trial balance	2000
Unpaid debenture interest	2000

Answer 1.b.

The primary reason for balancing of financial position statement is the double entry system of accounting. Under double entry system of accounting, each financial transaction gets recorded with equal amount of debit and credit effect in at least two different accounts (Sandip 2018). To elaborate the same with an example, a financial transaction of cash purchase of inventories will reduce the cash balance and increase the inventory balance. Hence, the net current asset position of the financial position statement will remain same. Further, where the inventory got purchased in credit, the trade payables amount and inventory amount will rise by same amount. Hence, the current asset position and current liability position reported in the financial position statement will remain same.

From the above discussion, it is clear that, due to double entry system of accounting, the financial position statement gets tallied and if the same does not get tallied then, it is clear that, the accounting process has not been done properly.

Answer 2.a.

Statement of ratio for 2021 and 2020				
Details	Formula	Working	£m/times/%	
			2021	2020
ROCE (%)	EBIT/ (Equity + Long term liability)	2021 - (620+226)/(4137+3088). 2020 - (539+181)/(4129+2912)	11.71%	10.23%
ROE (%)	Net income / Share holder's equity	2021 - 431/3088. 2020 - 366 / 2912	13.96%	12.57%
Earnings per share (£)	Profit for the year / Number of shares	2021 - 431 / (300/0.50). 2020 - 366 / (300/0.50)	0.7183	0.6100
Net profit margin (%)	Net profit / Sales revenue	2021 - 431 / 6738. 2020 - 366 / 6441	6.40%	5.68%
Asset turnover (Times)	Revenue / Total assets	2021 - 6738 / (7433 + 2303). 2020 - 6441 / (7732 + 2355)	0.6921	0.6385
Stock holding days (Days)	(Inventory / Cost of goods sold) * 365 days	2021 - (708 / 3235) * 365 days. 2020 - (659 / 3096) * 365 Days	79.88	77.69
Debtors collection period (days)	(Debtors / Revenue) * 365 Days	2021 - (1249 / 6738) * 365 Days. 2020 - (1287 / 6441) * 365 Days	67.66	72.93
Current ratio (Times)	Current assets / Current liabilities	2021 - 2303 / 2511. 2020 - 2355 / 3046	0.9172	0.7731
Gearing ratio (%)	Long-term liabilities / Capital employed	2021 - 4137 / 3088, 2020 - 4129 / 2912	134%	142%
Interest cover (Times)	EBIT / Interest expenses	2021 - (620+226)/226, 2020 - (539+181)/181	3.7434	3.9779

Answer 2.b.

The analysis of financial performance of the Sweets Plc through financial ratios are given in the below paragraphs (Syriopoulos, Tsatsaronis and Gorila 2020):

ROCE

ROCE shows an entity's ability to generate profitability by using the capital investments. The Return on capital employed position of Sweets plc has been improved in 2021 than 2020. Hence, in terms of ROCE, Sweets plc has performed better.

ROE

ROE determines an entity's attributable profitability towards its equity holders in reference to the equity investments. Sweets plc has improved its ROE in 2021 in comparison to 2020.

Earnings per share

Earning per share is the amount of equity attributable profit for each equity share issued by an entity. The Sweets plc has improved its equity attributable profit in 2021 than 2020 by keeping the number of outstanding equity shares at same level. Hence, the earning per share has been increased in 2021 than 2020.

Net profit margin

Net profit margin determines the percentage of net profit earned by an entity in reference to the revenue generated by the entity. Net profit margin can be improved either by increasing revenue or reducing the operating expenses. Sweets plc has improved its net profit margin in 2021 than 2020.

Asset turnover

Asset turnover ratio determines the amount of revenue generated by an entity by using the assets of the entity. Sweets plc has improved its asset turnover ratio in 2021 in comparison to 2020.

Stock holding days

Stock holding days refers the rate at which an entity replaces its inventory holding. The decreased rate of stock holding is better. Sweets plc has increased its stock holding days in 2021 than 2020. Hence, the stock holding ratio of the entity has been decreased.

Debtors' collection period

Debtors' collection period refers the average periodicity in which an entity recovers its trade receivables. The reduced debtor's collection period is desired. Sweets plc has reduced its debtors collection period in 2021 than 2020 instead of increased credit sales.

Current ratio

Current ratio is liquidity ratio, which shows an entity's ability to pay its current debts using its current assets without raising external funds in the short run. Sweets plc has improved its current ratio in 2021 than 2020.

Gearing ratio

The gearing ratio shows the percentage of long-term debt outstanding for an entity in reference to the equity held by the entity. Lower level of gearing ratio is desirable and Sweets plc has reduced its gearing percentage in 2021 than 2020.

Interest cover

Interest cover ratio shows an entity's ability to pay its debt interest expenses from profits earned. Higher interest cover ratio is desirable. Though, Sweets plc's interest cover ratio has been reduced in 2021 than 2020.

References

Sandip, L., 2018. Migration with Balance Sheet.

Syriopoulos, T., Tsatsaronis, M. and Gorila, M., 2020. The global cruise industry: Financial performance evaluation. *Research in Transportation Business & Management*, p.100558.