



Prifysgol Cymru
Y Drindod Dewi Sant
University of Wales
Trinity Saint David

ACCOUNTING FUNDAMENTALS

LCBB4001

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Question 1

Wales PLC Income Statement for the Year Ended 31st December 2022

	£
Revenue (800,000 + 980)	800,980
COGS	578,650
Gross profit	<u>222,330</u>
<i>Expenses:</i>	
Distribution costs	28,000
Administrative expenses	30,000
Salesmen commission	3,000
Directors Remuneration	5,000
Operating profit	<u>156,330</u>
Finance costs	
2% Interest (2,000 + 2,000)	4,000
Profit/Loss before taxation	<u>152,330</u>
Taxation	<u>100,000</u>
Profit for the period	<u>52,330</u>

Accruals	Income	Expense
Salesmen Commission		3,000
Goods Sold	980	
2% Interest		2,000
Preference Dividends		20,000

Retained Profit	132,000
Dividends	
Ordinary	(20,000)
Preference (30,000+20,000)	(50,000)
Profit for the Year	<u>52,330</u>
Retained Earning	114,330

Wales PLC Statement of Financial Position as of 31st December 2022

	£	£
<i>Non-current assets</i>		
Property, plant & equipment	1,250,000	1,250,000
<i>Current assets</i>		
Inventory	510,850	
Trade receivables	170,125	
Cash and cash equivalents	96,000	
Accruals	980	
		777,955
TOTAL ASSETS		2,027,955
<i>Current liabilities</i>		
Trade payables	188,625	
Accruals	25,000	
Current tax payable	100,000	
		313,625
<i>Non-current liabilities</i>		
Long term borrowings		
2% Debentures	200,000	
		200,000
TOTAL LIABILITIES		513,625
NET ASSETS (TA-TL)		1,514,330
<i>EQUITY</i>		
Share capital		900,000
Share premium		500,000
Retained earnings		114,330
TOTAL EQUITY		1,514,330
Total liabilities and equity		2,027,955

Why does the Statement of Financial Position Balance?

A statement of financial position, also known as a balance sheet, is a snapshot of a company's financial state at a particular date or at the end of a financial year (AccountingTools, 2023). It is a fundamental tool used to assess the financial capabilities of a company using data sorted into three summed-up categories: assets, liabilities, and equities. On those principles was developed the formula:

$$\text{Assets} = \text{Equity} + \text{Liabilities}$$

- **Assets** – This is everything a company owns and controls, such as cash, properties, inventory, investments, etc. Anything that can bring future profit or improve any aspect of the company is generally considered an asset (Barone, 2023). For the purpose of this assignment, the total assets (both current and non-current assets) of “Wales PLC” are worth £2,027,955.
- **Equity** – Can be described as the monetary value of everything a company owns if all its assets were to be sold and all of its liabilities have been repaid. Equity is also used to determine the financial health and amount of investment in the company (The Economic Times, n.d.). In the case of “Wales PLC”, the total equity of the company is valued at £1,514,330.
- **Liabilities** – These represent the company's debts, obligations, accounts payable, taxes, etc. This is a value that directly represents an external claim over the assets of the company (sumup, n.d.). The current total liabilities of “Wales PLC” are equal to £513,625.

A statement of financial position is only accurate and balances if the data provided is accurate and true. Following the aforementioned formula, we can substitute the terms with the numbers in our spreadsheet and verify if the statement of financial position balances (Qureshi, 2023). Therefore:

$$£2,027,955 = £1,514,330 + £513,625$$

$$£2,027,955 = £2,027,955$$

By proving that the worth of the total assets is equal to the sum of the total equity and total liabilities is equal, we have clearly proven that the statement of financial position balances.

Question 2

Financial Performance and Position of Wales PLC

RATIOS	FORMULA	2021	2020	CHANGE
ROCE	ROCE = (Profit Before Interest / Capital Employed ¹) * 100%	(846 / 7,225) * 100 ≈ 11.70%	(720 / 7,041) * 100 ≈ 10.22%	≈ 1.48%
ROE	ROE = (Earnings / Equity) * 100%	(431 / 3,088) * 100 ≈ 13.95%	(366 / 2,912) * 100 ≈ 12.56%	≈ 1.39%
EARNINGS PER SHARE	EPS = Earnings / Number of Ordinary Shares ²	431 / 600 ≈ £0.71 M	366 / 600 ≈ £0.61 M	≈ £0.10 M
NET PROFIT MARGIN	NPM = (Operating Profit / Sales) * 100%	(805 / 6,738) * 100 ≈ 11.94%	(699 / 6,441) * 100 ≈ 10.85%	≈ 1.09%
ASSET TURNOVER	AT = Revenue / Capital Employment	6,738 / 7,225 ≈ 0.93 times	6,441 / 7,041 ≈ 0.91 times	≈ 0.02 times
STOCK HOLDING DAYS	SHD = (Inventory / Cost of Sales) * 365 days	(708 / 3,235) * 365 ≈ 80 days	(659 / 3,096) * 365 ≈ 78 days	≈ 2 days
DEBTORS COLLECTION PERIOD	DCP = (Trade Receivables / Revenue) * 365 days	(1,249 / 6,738) * 365 ≈ 68 days	(1,287 / 6,441) * 365 ≈ 73 days	≈ -5 days
CURRENT RATIO	CR = Current Assets / Current Liabilities (x:1)	2,303 / 2,511 ≈ 0.91:1	2,355 / 3,046 ≈ 0.77:1	≈ 0.14
GEARING RATIO	GR = [Long Term Debt / (Long Term Debt + Equity)] * 100%	[4,137 / (4,137 + 3,088)] * 100 ≈ 57.25%	[4,129 / (4,129 + 2,912)] * 100 ≈ 58.64%	≈ -1.39%
INTEREST COVER	IC = Profit Before Interest ³ / Interest Charges	846 / 226 ≈ 3.74 times	720 / 181 ≈ 3.97 times	≈ -0.23 times

¹ Capital Employed = Total Assets - Current Liabilities or Equity + Non-Current Liabilities

² Number of Ordinary Shares = Ordinary Share Capital / £0.50 Shares

³ Profit Before Interest = Operating profit + Profit/Loss on Sale of Fixed Assets + Investment Income

Analysis Based on Calculated Ratios

Investment Analysis

- Earnings per Share – By calculating the difference between the EPS for 2020 and 2021 a growth of £0.10M is an indicator that profitability has gone up which in turn serves to reassure investors and shareholders.

Profitability Analysis

- Return on Capital Employed – With a growth of 1.43% from the previous year “Wales PLC” demonstrates a good ability at optimising the use of capital.
- Return on Equity – In relation to equity, the company has a 1.39% rise in profitability from the previous year.
- Net Profit Margin – In relation to its revenue, the profit earned in percentage clearly demonstrates that the company is on a profitable path backed by the 1.09% growth from the previous year.

Efficiency Analysis

- Assets Turnover – With a positive marginal difference of 0.02 times in assets turnover from the previous year, the company shows that it is still effectively using its assets to generate revenue and income.
- Stock Holding Days – By effectively reducing the stock holding days by 2 days from 2020, “Wales PLC” has accelerated the rotation of inventory, which has a direct positive effect on generating revenue.
- Debtors Collection Period – By reducing the approximate average debt collection period by 5 days from the previous year, the company demonstrates a clear ability to improve efficiency at a stable rate.

Liquidity Analysis

- Current Ratio – With an additional growth of 0.14, reaching 0.91:1 in 2021, compared to 0.77:1 in 2020, the company indicates that it has enough resources to meet its short-term obligations. Nevertheless, although the value is positive it is still below 1:1. This might become an issue if there is a rapid growth in demand for the company's products.

Financing Analysis

- **Gearing Ratio** – The ratio that represents the company's ability to fund its short-term liabilities has taken a slight hit, a drop of 1.39% from the previous year which indicates a shift of reliance from borrowed funds to reliance on equity. With a current gearing ratio of 57.25%, considered to be highly geared, the company is at risk if profit declines, or interest rates go up on short notice.
- **Interest Cover** – With the drop from 3.97 times in 2020 in the ability of the company to pay interest on its external debt, to 3.74 times in 2021, and furthermore, taking into account the gearing ratio, "Wales PLC" demonstrates a worrisome trend in its financial management, which might become problematic if the trend persists in the future.

Although "Wales PLC" displays a positive growth in many aspects and has a stable performance in others, the financial aspect of the company should be closely monitored with prudence due to its decline in performance in 2021, compared to its performance in 2020.

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