

Accounting Fundamental

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Question 1:

Part A):

Financial statements such as balance sheet, income statements and the cash flow statements are very essential for the company to grow their business operations because with the help of the same the inventory and other analyst can get an idea about the financial performance and the position of the company as compared to the peers companies operating in the same industry. The management of the company with the help of the income statement can get identify the issues or the problems at the early stage so that they can mitigate the impact of the same on the business operations. It has been seen and analyzed that the company that have high quality of the financial statements will be able to get the capital funded from various sources such as equity and the debt. However, they have their own advantages and the disadvantages and the management of the business or the company should know them so that they can take the maximum benefits from the same (Naseem 2018).

Income statement: It is also known as the statement of the financial performance because it shows the financial performance of the company over the period of time when the company compares the same with the industry average or the sector average. It consists of the income and the expenses of the company and also helps the analyst to calculate the various types of financial ratios such as net profit margin, gross profit margin and the operating profit margin (Ward 2020). These types of margin ratios measure the company's ability to generate the profits from the revenue from operations of the company. These are very important financials of the company and with the help of the same they can mitigate the risk such as solvency risk, liquidity and the operational risk on the business operations of the company. It helps the company to get an idea about the peers companies operating in the same industry. Below shows the working of the income statement of the Kedison Plc company (Garten 2021).

Profit and loss statement	
Particular	Amount
Revenue from operations	826650
Cost of goods sold	578650
Gross profit	248000

Margin %	30.00%
Total expenses	68000
Administrative expenses	30000
Direct commission	5000
Distribution cost	28000
Commission	3000
Interest	2000
Profit before tax	180000
Tax	68000
Profit after tax	112000

From the above income statement, it has been seen and analyzed that the total expenses of the company is 6800 and the profits of the company are 112000. The profit of the company are positive which is the good sign for the management of the company. However, this is the relative amount which means it should not see in the isolation. They should be compares with the sector average number. Tax is the compulsory payment made by the company to the government authority. It is the fiduciary duty of the company which should be done.

Balance sheet: It is also know as the statements of the financial position which measures the position of the company at the point of time. It has been seen and analyzed that the company that have increased the balance sheet assets that it have achieved there all financial and the economic goals. It is the based on the accounting equations which states the assets is equal to the sum of the equity and the liability. For example, if the amount of the equity is 100 and the liability is of 500 then the total assets of the company should be as per the equation is 600. The amount of both the items should be match so that they can ensure that all the items on the balance sheet are in line with the trail balance or the ledgers account. Current assets include items which can be converted into the cash within one years. Entity such as assets management companies or the bank have high percentage of liquid assets or the current assets as compares to the total assets because they need the cash in hand. It can be compares using the industry average so that they can get an idea about

how the peers companies are changing there policy. They may lowers their cost of operation by increasing the interest income of the company by investing in the productivity assets. Below shows the working of the balance sheet of the Kedison Plc company:

Balance sheet	
Total assets	815755
Current assets	183025
Debtor	170125
Cash and bank	12900
Non-current assets	632730
Plant and equipment	632730
Total liability and equity	815755
Current liability	171355
Creditors	171355
Non-current liability	0
Equity	644400

The non-current liability which consists of the long-term debt of the company is not there in the balance sheet. It means that the company major source of funding is equity and not debt. It is the good sign for the management of the company because there are various disadvantage of raising the capital from the debt and some of them are that it increases the liability of the company which means that it looks unattractive balance sheet. Another disadvantage can be in the form of interest payment which is the direct expenses to the company. If the debt level within the company increases, then it means that the liability of the company have increased which is not a negative sign for the management of the company. It has been seen and analysis that the current assets of the company were 183025 and current liability were 171355 and the working capital will be 11670.

It is also the positive number which means that the company have higher level of current assets as compares to the current liability.

Part B): Interpretation of the financial ratios:

Return on capital employed as of the company have improved from financial year 2019 to 2020 (9.93% to 11.14%) which means that the company is now able to generate more cash or net profit from the promoters equity. It should be compared with the peer companies operating in the same industry. Return on equity of the company have also improved from 12.57% to 13.96% from financial year 2019 to financial year 2020 which means that the companies profit generating capacity have also improved. They can now increase the net profit from the revenue from operations. Earnings per share represent the per share earnings that the investor can expect from the investment. It has also increased from 4.88 to 7.35 which is the good sign for the management of the company as it will attract new investors and analyst. Net profit margin which is one of the most important financial ratio have also improved in value from 5.68% to 6.40%. Companies efficacy as suggested by the Asset turnover ratio, Stock holding days and debtor collection showed the mixed results because assets turnover ratio have increased in value which means that the assets efficiency have increased in value. However, inventory holding days have increased which means that the now company takes more then usually time to sell there inventory which is not a good sign from the liquidity view point. Current ratio of the company have increased in value from financial year 2019 to financial year 2020 which means that the liquidity power of the company have improved. Now they can paid off more liability from the current assets of the company. Gearing ratio has declined in value which means that the debt of the company have reduced as compares to the total equity of the company. Investor cover ratio which measures the companies ability to pay dividend from the operating profit have decline declined in value because operating profit of the company have raised more as compares to the dividends. It is the positive sign, however, may give the negative signal to the investor that they are cutting the dividends of the company.

From the above analysis, it has been found that the financial performance and the position of the company have improved from financial year 2019 to financial year 2020 which is very positive sign for the management of the company because with the help of the same they can increase the capital base of the company because new investor will join the shareholding and it also helps the

company to increase the productivity of the worker working in the organization. It means that now they will produce more by taking the same amount of time.

Part B):

A statement of financial position in the company should always balance in order to base certain facts over the assets and liabilities of the company in the certain period and it should be in relation to the equities of the shareholders. This plays an essential part in relation to the future decisions of the company in which balance sheet assets will be assessed in terms of what company owns in the period. It also states the level of amount the company owes to its lenders or other key people in the period. Retained earnings and capital which have been employed in relation to the equality in the figures which have been recorded in the company (Boeckx et al., 2017).

There's a major reason behind the balancing of the transactions in order to fulfil the requirements of the accounting principle in relation to the double entry system of the accounting transactions in the company. This states that every transaction which is being held in the organization should affect two different accounts at the same time in the particular period and simultaneously checks for the accuracy and consistency of the transactions in the period.

Statement of the financial position in the company plays an important role in the organization in relation to the assessment of critical documents in order to keep the owners of the company be informed of the process and maintaining the practicality of the financial transactions in the period. Balancing of the statement of financial position helps in the examination of the financial position for the period and financial health improvisation in the period. This process might help the accuracy of the transactions and position of the business in the period. This might help the business finances and certain trends with relationships with the customers and various supplies in the period. This helps in getting an insight over the financial health of the different transactions on the basis of what company currently have in terms of the payment capacity in the period. This is also in relation to the recording of transactions which is possible at the end of the period and relevancy of the transactions in the period (Thakur 2020).

Statement of financial position is in relation to the reporting of financial statement in relation to the condition in the period and information relevance which is connected to the financial stability and performances of the organization in the specific period (Choudhry, 2020).

Question 2:

Part A): Financial ratios are very important tool and technique which helps the company to analysis the profit generating projects and the listed company so that they can increase the interest income of the company by investing the same in the corporate (Woodruff 2017). It has been seen and analyzed that the company that have high quality of financial performance and position have the good numbers of financial ratios. However, the management of the company should be aware about the limitations of the financial ratios and some of them are: they are affected by the window dressing, they includes the past information which can be impacted by the management manipulation and the management of the company should not see these number in the isolation. It should be compared with the peers' companies operating in the same industry or the time series analysis. They cannot estimate the future of the company and should disclose the financial performance and the position. There are various types of ratios and some of them are profit ability ratio, efficiency ratio, liquid ratios and the solvency ratio. These ratios measures the companies ability to generate the profits for the corporate, measures and monitor the efficiency of the management in checking the assets and liability of the company, measures the liquidity and solvency generating capacity of the company respectively. Below shows the working of the balance sheet financial ratios:

Ratios calculations			
Return on capital employed			
Formula:	EBIT / Total assets - current liability		
2019		2020	
EBIT	699	EBIT	805
Total assets	10087	Total assets	9736
Current liability	3046	Current liability	2511
Return on capital employed	9.93%	Return on capital employed	11.14 %

Return on equity			
Formula:	Net income / Average shareholder equity		
2019		2020	
Net income	366	Net income	431
Shareholder equity	2912	Shareholder equity	3088
Return on equity	12.57%	Return on equity	13.96%
Earnings per share			
Formula:	Net income / Number of share outstanding		
2019		2020	
Net income	366	Net income	431
Share outstanding	75	Share outstanding	58.59
Earnings per share	4.88	Earnings per share	7.356204
Net profit margin			
Formula	Net income / revenue		
2019		2020	
Revenue	6441	Revenue	6738
Net income	366	Net income	431
Net profit margin	5.68%	Net profit margin	6.40%
Assets turnover ratio			

Formula	Revenue / total assets		
2019		2020	
Revenue	6441	Revenue	6738
Total assets	10087	Total assets	9736
Assets turnover ratio	0.638545	Assets turnover ratio	0.692071
Stock holding days			
Formula	365/ Inventory turnover ratio		
2019		2020	
Average inventory	659	Average inventory	708
Cost of good sold	3096	Cost of good sold	3235
Inventory turnover ratio	4.698027	Inventory turnover ratio	4.569209
Stock holding days	77.69218	Stock holding days	79.88253
Debtor collection period			
Formula	365/Receivable turnover ratio		
2019		2020	
Avareg receivable	1287	Average receivable	1249
Revenue	6441	Revenue	6738
Receivable turnover ratio	5.004662	Receivable turnover ratio	5.394716
Debtor collection period	72.932	Debtor collection period	67.6588

Current ratio			
Formula	Current assets/ Current liability		
2019		2020	
Current assets	2355	Current assets	2303
Current liability	3046	Current liability	2511
Current ratio	0.773145	Current ratio	0.917164
Gearing ratio			
Formula	Total debt / total equity		
2019		2020	
Total debt	4129	Total debt	4137
Total equity	2912	Total equity	3088
gearing ratio	1.417926	Gearing ratio	1.339702
Investor cover			
Formula	Dividend / operating profit		
2019		2020	
Dividend	242	Dividend	255
Operating profit	699	Operating profit	805
Inventor cover	34.62%	Inventor cover	31.68%

Return on capital employed: It measures the company's ability to generate the profit from its total assets minus the current liability. It is one of the most important financial ratio of the company as the operating profit is the essential for the management of the company.

Return on equity: It also measures the company's ability to generate the profits from the shareholder equity or the capital that the promoters of the company have deploy in the business. Its formula is Net income divided by the total shareholders equity.

Net profit margin: It measures the company's ability to generate the net income by the revenue from operations. Beasley net income is the bottom-line of the company as they do there operations just to increase there net income. Other simpler margins are operating profit margin, gross profit margin and the net profit margin. Its formula is net income dividend by the revenue from operations (Bragg 2021).

Assets turnover ratio: It is considered as the efficiency ratio as it measures how well the company are managing its assets so that it is increasing the efficiency of the assets as compares to the revenue from operations. Its formula is revenue dividend by the total assets.

Stock holding days: It is also considered as the efficiency ratio which measures the management efficiency in managing and monitoring the inventory and how much the company are taking to sell there inventory. It should be low for the high quality growth of the company. Its formula is 365 dividend by the inventory turnover ratio. From the liquidity perspective, this ratio should be low.

Debtor collection period: It measures the time taken by the company to pay to there debtor. From the liquidity view point, this ratio should be low as it is good for the company. They should employee the policy in such a way so that they can increase the collection period efficiency (Bragg 2021).

Current ratio: This ratio measures the liquidity of the company. Its formula is current assets over the current liability. Current assets are the assets which can be converted into cash within one year or one business cycle whichever is more and current liability are the liability which can be paid-off by the company within one year or business cycle which ever is high. This ratio measures the short-term ability to pay there liability with the assets.

Gearing ratio: This measures the solvency of the company. Its formula is total debt divided by the total equity of the company. For high quality company, this ratio should be low as the company's management do not prefer to have the high debt as compared to the equity.

Inventor cover ratio: The formula of the ratio is Operating profit divided by the dividend of the company. This ratio measures the how many times the company can pay dividend from its operating profit. This ratio is good for the old age equity investor which are more considered of dividend rather then capital gains. One reasons could be due to the high capital gain tax as compares to the dividend tax.

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