

University of Wales Trinity St David

Component 1:
Coursework

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Module: Accounting Fundamentals

LCBB4001

Question 1:

Required: Comment on each of the following statements, going into as much detail as you can (100-150 words each (30 marks))

A) The assumption that the balance sheet displays how much cash enters and exits a corporation throughout an accounting period, as well as the resulting amount at the conclusion of the period, is false. While the balance sheet provides an important snapshot of the company's financial health at a given point in time, it does not immediately reflect cash flow (Horngren, Sundem, & Elliott, 2019).

The balance sheet's principal purpose is to highlight three critical features of a business:

-Cash, receivables, inventory, property, and equipment are examples of assets

-Liabilities are the amounts owed to creditors by the company, which include short-term obligations, long-term loans, and accrued expenses

-Shareholders' Equity is the amount of money invested by the company's owners (Financial Accounting Standards Board, 2023).

While cash may be included as an asset on the balance sheet as of the reporting date, this only reflects the ending balance and not the movement of cash over the period. The cash flow statement is used to precisely comprehend cash inflows and outflows over a certain time period.

B) The statement that non-current assets are immovable is incorrect and misleading. While "physical immovability" may be a feature of some non-current assets, it does not define the category as a whole.

Here's a breakdown of the statement's inaccuracies:

Non-current assets are long-term economic resources that a company has and expects to benefit it for more than one accounting period (usually one year)

Physical movement is not mentioned in this definition.

Many non-current assets are physically portable. Vehicles, computers, and machinery are examples (Financial Accounting Standards Board, 2023). These assets can be shifted and moved as needed.

Non-current assets are distinguished by their estimated lifespan and contribution to the firm. They are projected to benefit the organisation across numerous accounting periods, as opposed to current assets such as inventories or cash, which can be converted into cash within a year.

C) It is too simple and not true to say that managers should only give financial details to "current" owners of a company. There are some things to think about when deciding who can see certain kinds of financial information. However, limiting all information to present shareholders would hurt many people and raise ethical issues. These are the problems with this statement:

1. Not Enough Openness and Market Efficiency:

Only letting current shareholders see financial information could slow down the market and make it hard for possible buyers to decide whether to buy or sell shares. Because there isn't enough information out there, the company could be undervalued or overvalued, which would hurt clients now and in the future. (Institute of business ethics, 2023)

Stockholders of publicly traded companies owe it to the market as a whole to provide useful financial data so that trading can run smoothly and fairly. Most regulatory groups require some amount of disclosure to make sure that everyone can get the information they need.

2. Not caring about the needs of other stakeholders:

People who have a role in a company's finances aren't just shareholders. Creditors, wholesalers, workers, and even people in the neighbourhood can be affected by how well the business does financially. Not letting them see important information can cause them to make bad choices that have bad results for everyone.

If you only give information to present shareholders, people who know inside information might get an unfair benefit.

D) There is no truth to the assumption that prepayments and accruals shouldn't be on the statement of financial situation (balance sheet). Both are needed to give a full and correct picture of a business's finances at a certain point in time. Here's why, with points to back it up:

Prepayments:

Show things that have been paid for ahead of time but haven't been used. (Horngren, Sundem, & Elliott, 2019). Things like paid-in-advance rent, insurance, and ads are examples.

Financial Accounting Standard board says that the company should increase the part of its balance sheet that lists its current assets to show the economic benefits it will receive in the future and leaving them out could underestimate the total assets.

Accruals:

Show costs or income that have been spent but not yet paid or received (Horngren, Sundem, & Elliott, 2019). Paid salaries, interest costs, or sales fees made but not yet received are all examples of accrued costs. Depending on the type of payment, it will either change the current expenses or the current assets. The Financial Accounting Standards Board (2023) says that accrued costs show up as liabilities and accrued income shows up as assets.

E) People who say "don't need regulation over financial accounts" have good points on both sides of the issue.

Arguments against total deregulation:

Unstable finances: Markets that aren't controlled are more likely to rise, fall, and crash, which is bad for investors and the economy (Minsky, 2008).

People with no morals could change the markets, trade on inside information, or do other illegal crimes that hurt investors and hurt the integrity of the financial system.

Protecting consumers: We need to stop predatory loans, unfair fees, and misleading financial products. Regulations keep things fair and protect people who are weak.

Reasons for reducing regulations:

Complex rules: Too many rules can stop new ideas from happening, make businesses work harder, and cost a lot to set up and police.

Market efficiency: Laws that are too strict can make it hard for businesses to get money, which slows down economic growth.

Outdated laws: Since tools and the market change, so do the laws that govern them. Over time, strict rules may stop being useful and helpful.

It is very important to find the right mix between enough government control and a free market. Laws must be made that protect customers, uphold the purity of the market, and limit systemic risks without stopping economic growth and new ideas.

F) Before making financial records, it is important to make sure that the ledger (T) accounts and the trial balance are equal. This makes sure that the data is correct and complete, which makes these important reports more reliable in the long run. The Financial Accounting Standards Board (FASB) says this is why:

Double-entry accounting: T-account balance makes sure that the double-entry principle is followed, which says that each transaction should have equal debits and credits in different accounts. This internal consistency is very important for having correct records and making financial statements. Finding and fixing mistakes: Comparing the trial balance and the T-accounts helps find and fix any mistakes, like missed entries, wrong calculations, or wrong postings, before they affect the final statements.

Question 2:

A profit and loss (P&L) statement, also called an income statement or statement of operations, is a key financial record that shows how much money a company made and how much it spent over a certain time period, usually a quarter or a year. In the end, it shows whether the business made a profit or a loss by showing how much money it made and how much it spent during that time.

Why does it matter to have an income statement?

It gives a quick look at how well a company did financially during a certain time period.

It shows investors, suppliers, and other important people how well the business is running and making money.

The results can be used to see how well a business is doing compared to its rivals or to its own past success.

It's necessary to figure out how profitable a business is and make smart financial choices.

Income Statement

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Wales PLC

For the year ended:
December 31, 2022

	£
Revenue	901,000
Cost of Sales	578,650
Depreciation of equipment	65,000
<u>Gross Profit</u>	257,350
<u>Different expenses :</u>	
Distribution costs	28,000
Sales commission	2,000
Administrative costs	160,000
Directors remuneration	5,000
<u>Total expenses</u>	195,000
<u>Total after expenses</u>	62,250
Interest	4,000
<u>Gross income</u>	57,350
Tax	15,000
<u>Net Profit</u>	42,350

1,000 as the
sale was made
in 2022.

Revenue - (Cos + Depreciation of equipment)

All the expense together
gross profit - expenses

4% of 100,000
so it's 4,000 it's been
paid but it's still an expense

Total expenses - interest

Gross income - tax

Total profit
for the year

Question 3:

Calculate the following ratios for sweets plc for 2022 and 2021, showing the formulas and workings:

A) ROCE

Operating profit / capital employed x 100

Capital employment = £9736 - £2511 = £7225

Year 2021

$$699 / 7225 \times 100 = 9.93\%$$

Year 2022

$$805 / 7225 \times 100 = 11.1\%$$

B) ROE

Net profit / equity x 100

Equity = (3088/2912) / 2 = £3000

Year 2021

$$366 / 3000 \times 100 = 12.2\%$$

Year 2022

$$431 / 3000 \times 100 = 14.4\%$$

C) Earnings per Share

Net profit / Number of Shares

$$600 \text{ Shares} = 300 / 0.5$$

Year 2021

$$366 / 600 \times 100 = 61\text{p}$$

Year 2022

$$431 / 600 \times 100 = 72\text{p}$$

D) Net Profit Margin

Net profit / revenue x 100

Year 2021

$$366/6441 \times 100 = 5.6\%$$

Year 2022

$$431 / 6738 \times 100 = 6.4\%$$

E) Asset Turnover

Revenue / total assets

$$\text{Total assets} = 9736 + 10,087 / 2 = 9911.5$$

Year 2021

$$6441 / 9911.5 = 0.65$$

Year 2022

$$6738 / 9911.5 = 0.68$$

F) Stock holding days.

Inventory / cost of sales x 365

$$\text{Inventory} = 708 + 659 / 2 = 683.5$$

Year 2021

$$683.5 / 3096 \times 365 = 81 \text{ days}$$

Year 2022

$$683.5 / 3235 \times 365 = 77 \text{ days}$$

G) Debtor collection period

Trade receivables/ revenue x 365 days

$$\text{Trade receivables} = 1249 + 1287 / 2 = 1268$$

Year 2021

$$1268 / 6441 \times 365 = 72 \text{ days}$$

Year 2022

$$1268 / 6738 \times 365 = 69 \text{ days}$$

H) Current ratio

Current assets / current liabilities

Year 2021

$$2355 / 3046 = 0.77$$

Year 2022

$$2303 / 2511 = 0.92$$

I) Gearing ratio

Total liabilities / total equity

Year 2021

$$(\text{£}3046 + 4129) / 2912 = 2.46$$

Year 2022

$$(\text{£}2511 + \text{£}4137) / \text{£}3088 = 2.15$$

J) Interest cover

Earnings before interest / interest

Year 2021

$$699/181 = 3.86$$

Year 2022

$$805 / 226 = 3.56$$

Question 3B)

-Return on Capital Employed (ROCE): The rise from 9.93% in 2021 to 11.1% in 2022 shows that Sweets plc is making more running profit compared to the amount of capital it has used. This means that the invested cash is being used more efficiently to make money.

-The Return on Equity (ROE) Going from 12.2% to 14.4% shows that the business is making more money in terms of owners' equity. This is a good sign for buyers because it shows that the company can make money from their investments.

-Earnings per Share (EPS): The rise from 61p to 72p shows that each share is making the company more money. This is good news for owners because it means the company is making more money overall per share.

-The fact that the net profit margin went up from 5.6% to 6.4% shows that Sweets plc is keeping a bigger chunk of its sales as net profit. This means better control of costs and a better ability to turn sales into profits.

- The small rise from 0.65 to 0.68 in asset turnover means that Sweets plc is making more money per unit of total assets. This shows how well assets are being used to make sales.
- 81 days to 77 days, The drop in stock holding days shows that the business is better handling its inventory, which shortens the time it takes to sell its stock.
- Collection Period for Debtors: The reduction in the collection period for debtors from 72 to 69 days shows that the company is receiving debts faster, which improves its cash flow cycle.
- Current Ratio: The current ratio went up from 0.77 to 0.92, which means that the company has more short-term cash on hand and can better meet its short-term commitments.
- Gearing ratio: As the gearing ratio goes up from 2.46 to 2.15, it means that more money is being borrowed. This can boost profits, but it also increases financial danger because it means borrowing more money.
- The slight drop from 3.86 to 3.56 says that the company may not be able to cover its interest costs as well as it used to. This could be a problem, and the business needs to make sure it can easily meet its interest responsibilities.

In conclusion, Sweets plc is showing signs of improving its profitability, efficiency, and cash. However, the company needs to pay close attention to the fact that it is taking on more debt and having a little less interest cover to lower the risks that come with these changes.

References

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