

SCHOOL OF BUSINESS
LONDON CAMPUS

Assignment 1 - Essay

Valentina Petkova 2232604

Accounting Fundamentals

CODE / LCBB4001

TO / Nadeem Mirza

DATE / 21 December 2023

WORD COUNT / 2400

Contents

PART 1 – Accounting fundamentals.	3
Statement of financial position (Balance Sheet).....	3
Non-current assets are things that cannot be moved.	3
Managers supplying financial information.....	4
Prepayments and accruals on the statement of financial position.....	5
Regulation over financial accounts.	5
Balancing ledger (T) accounts and trial balance before preparing financial statements.....	6
PART 2 – Generating a statement of income.	7
PART 3 - Analysis of Sweet Plc based on a given statement.	9
References.....	14

PART 1 – Accounting fundamentals.

Statement of financial position (Balance Sheet)

The Statement of financial position, also known as the Balance Sheet, is an important document that provides condensed information about the condition of a company in the specific moment looking at it through a financial perspective. It offers a summary of the involvement of the company highlighting key aspects such as liabilities, shareholders equity and assets and it offers insights into the general financial health of the company. The balance sheet refers equations that involve assets equal liabilities and equity (Wood, 2011).

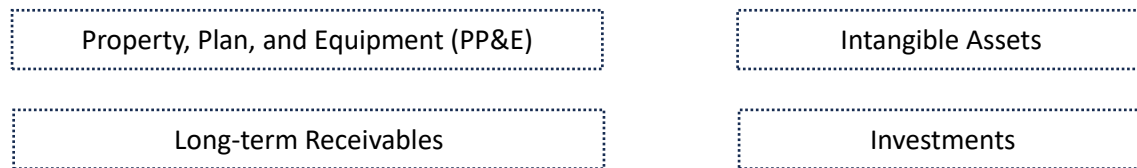
On the asset side, it enumerates current assets like cash, accounts receivable and inventory along with non-current assets such as property, plant and equipment. Liabilities on the other hand encompass current obligations like accounts payable and long-term commitments like loan and deferred tax liabilities. The equity section outlines the shareholders' stake in the company, including common and preferred stock, additional paid-in capital, retained earnings, and if applicable, treasury stock (Wood, 2011).

Analysts and investors use the Balance Sheet to assess a company's liquidity, solvency, and overall financial stability. By comparing assets against liabilities and equity, stakeholders gain valuable insights into the firm's ability to meet short-term obligations and its overall financial structure (Wood, 2011). The Balance Sheet when analysed alongside other financial statements aids in comprehensive evaluations of a company's financial performance and strategic decision-making.

Non-current assets are things that cannot be moved.

Non-Current Assets, also known as long-term assets or fixed assets, are resources that a company owns or controls with the expectation of deriving future benefits over an extended period, typically beyond one year. These assets play a crucial role in the company's operations and are not intended for immediate conversion into cash. Non-current assets are vital components of a company's balance

sheet, contributing to its overall value and providing a foundation for long term business operations (Atrill, 2019).



Non-current assets are essential for a company’s growth and sustainability, representing investments that contribute to its ongoing operations, competitive advantage, and overall value. Proper management and strategic utilization of non-current assets are critical for long-term success and financial stability.

Managers supplying financial information.

The notion that managers should exclusively provide financial information to “current” shareholders of companies raises important considerations within the broader context of corporate transparent, accountability and ethical disclosure practices. Shareholders whether current or potential, have a vested interest in understanding the financial health and performance of the companies in which they invest (Atrill, 2019).

Open and transparent communication benefit not only shareholders but also contribute to market efficient and investor confidence. While current shareholders certainly have a direct ownership stake, potential shareholders, including prospective investor and analysis, play a pivotal role in shaping marker dynamics. Providing financial information exclusively to current shareholders could be perceived as limiting access to critical data that influences investment decisions and marker perceptions (Atrill, 2019).

Financial markets thrive on the availability of accurate and timely information. Companies that prioritize transparency foster trust and credibility among all stakeholder, attracting a broader investor base. Excluding potential shareholders from financial disclosures might hinder the company’s ability to attract new investments and limit its marker exposure.

In the contemporary business landscape where information is a valuable commodity, responsible corporate governance encourages companies to provide comprehensive financial disclosures accessible to both current and potential shareholders (Atrill, 2019). This approach not only aligns with principles of fairness and equality but also supports the broader goals of market efficiency, investor protection and sustainable corporate success.

Prepayments and accruals on the statement of financial position.

Prepayments (deferred expenses) and accruals (unrecorded expenses) are essential components of the statement of financial position. Prepayments represent future economic benefits paid in advance, while accruals account for expenses incurred but not yet paid. Both are crucial for presenting a comprehensive and accurate financial position (Lucey, 2009).

Regulation over financial accounts.

Regulation over financial accounts is a critical aspect of maintaining transparency, accountability and the integrity of financial markets. Governments and regulatory bodies worldwide implement a robust framework of rules and standards to govern the preparation, presentation and auditing of financial accounts by companies. These regulations serve to protect investors, ensure fair market practices, and promote financial stability (Lucey, 2009).

Key regulatory elements include compliance with generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS) depending on the jurisdiction. These standards dictate how financial transactions are recorded, summarized and disclosed in financial statements. Regulatory bodies such as the Financial Accounting Standards Board (FASB) in the United States or the International Accounting Standards Board (IASB) globally, regularly update and refine these standards to adapt to evolving business practices and economic landscape (Lucey, 2009).

Furthermore, regulation mandates the external audit of financial statements by independent auditing firms to verify their accuracy and adherence to accounting standards. This oversight enhances the credibility of financial reporting, instilling trust among investors and stakeholders.

Regulation over financial accounts is not only a safeguard against fraudulent activities and mismanagement but also a cornerstone for informed decision-making (Lucey, 2009). It ensures that financial information is reliable, comparable, and relevant thereby contributing to the overall efficiency and integrity of financial markets. The continuous evolution of regulatory frameworks reflects the dynamic nature of global economies and the imperative to maintain a fair and transparent financial landscape.

Balancing ledger (T) accounts and trial balance before preparing financial statements.

Before preparing financial statements, it is essential to ensure that ledger accounts are balance and that the trial balance is accurate. Balancing ensures that debits equal credits in each ledger account, and the trail balance verifies that total debits equal total credits across all accounts. A balanced trial balance is a critical step in producing accurate financial statements, serving as a preliminary check for errors and ensuring the integrity of the accounting records (Atrill, 2019)

PART 2 – Generating a statement of income.

Wates Plc Income Statement For the Year Ended 31 st December 2022				
Revenue				900,000
Cost of Sales:				
Cost of Sales			578,650	
Depreciation on Equipment			(65,000)	[1]
Gross Profit			386,350	
Operating Expenses				
Administrative Expenses			160,000	[2]
Directors' Remuneration			5,000	
Distribution Costs			28,000	
Salaries (adjusted for accrual)			10,000	[2]
Operating Profit			183,350	
Other Expense:				
Interest Paid			2,000	
Commission Payable (Accrual)			2,000	[4]
Profit Before Tax			179,350	
Tax Expense (Estimated)			15,000	[3]
Net Profit			164,350	

Notes:

1. Depreciation on equipment is calculated as £650,000* 10% = £65,000.
2. Salaries for December 2022 were unpaid at the end of the year but have been adjusted for accrual.
3. Corporation tax is estimated at £15,000.
4. Commission payable is an accrual for December salesmen commission that will be paid in January 2023.

This income statement reflects the adjustments based on the additional information provided, ensuring a more accurate representation of Wates pls's financial performance for the year ended 31st December 2022.

PART 3- Analysis of Sweet Plc based on a given statement.

Profit and Loss statement for the year ended 31st December

	2022	2021
	£m	£m
Revenue	6,738	6,441
Cost of sales	<u>(3,235)</u>	<u>(3,096)</u>
Gross profit	3,503	3,345
Distribution costs	(437)	(422)
Marketing and selling costs	(1,324)	(1,274)
Administrative expenses	<u>(937)</u>	<u>(950)</u>
Operating profit	805	699
Profit/loss on sale of fixed assets	19	(5)
Investment income	22	26
Interest payable	<u>(226)</u>	<u>(181)</u>
Profit/(loss) before taxation	620	539
Taxation	<u>(189)</u>	<u>(173)</u>
Profit for the year	<u>431</u>	<u>366</u>

Statement of Financial Position as at 31st December

	2022	2021
	£m	£m
Non- Current assets		
Intangible assets	5,485	5,809
Property, plant and equipment	1,613	1,605
Investments	<u>335</u>	<u>318</u>
	<u>7,433</u>	<u>7,732</u>
Current assets		
Inventory	708	659
Trade receivables	1,249	1,287
Investments	145	232
Cash	<u>201</u>	<u>177</u>
	<u>2,303</u>	<u>2,355</u>
Total assets	<u>9,736</u>	<u>10,087</u>
Current liabilities		
Trade payables	(583)	(655)
Other creditors	<u>(1,928)</u>	<u>(2,391)</u>
	<u>(2,511)</u>	<u>(3,046)</u>
Non current liabilities		
Loans and other borrowings	<u>(4,137)</u>	<u>(4,129)</u>
Net assets	<u>3,088</u>	<u>2,912</u>
Equity		
Ordinary share capital (50p shares)	300	300
Share premium	1,071	1,071
Retained profits	<u>1,717</u>	<u>1,541</u>
	<u>3,088</u>	<u>2,912</u>

Additional information:

- i. During 2022 a total dividend of £255m was paid (2021: £242m)
- ii. The average share price during 2022 was £5.12 (2021: £4.00).

2022**2021****ROCE**

Profit before interest	620	539
----- x 100%	----- x 100 =	----- x 100 =
Capital Employed	9,736 – 2,511	10,087 – 3,046
	8,58	7,65
<i>(Total Assets – Total Liabilities)</i>		

ROE

Earnings	431	366
----- x 100%	----- x 100% =	----- x 100% =
Equity	3,088	2,912
	13.9	12.5

EPS (Earnings per share)

Earnings	431	366
-----	----- =	----- =
Number of ordinary shares	£ 300	300
	1,43	1,22

Net profit margin

Operating profit	805	699
----- x100	----- x 100 =	----- x 100 =
Sales	3,235	3,096
	24,88	22,57

Asset turnover

Revenue	6,738	6,441
----- (times)	----- =	----- =
Capital employed	9,736 – 2,511	10,087 – 3,046
	-487	- 600
<i>(Total Assets – Total Liabilities)</i>		

2022**2021**

Stock holding days

Inventory		708		659
-----		-----		-----
	x 365 days		x 365 =	x 365 =
Cost of sales		3,235	79	77
				3096

Debtors collection period

Trade Receivables		1,249m		1,287
-----		-----		-----
	x 365 days		x 365 =	x 365 =
Credit Sales (or Revenue)		6,738m	67	72
				6,441

Current ratio

Current Assets		2,303		2,355
-----		-----		-----
	x:1		=	=
Current liabilities		2,511	0,197	0,773
				3,046

Gearing ratio

Long term debt		4,137		4,129
-----		-----		-----
	x 100%		x 100 =	x 100 =
Long term debt + equity		4,137 + 3,088	57,25	58,64
				4,129 + 2,912
D/E		100 - 57,25 = 42,75%		100 - 58,64 = 41,36%

Interest cover

Profit Before Interest		620		539
-----		-----		-----
	(times)		=	=
Interest charges		226	2,743	2,977
				181

Return of Capital Employed (ROCE)

ROCE increased from 7,65% in 2021 to 8.58% in 2022.

A higher ROCE indicates improved efficiency in capital utilization.

This suggests that the company is generating more profit per unit of capital employed, which is positive for stakeholders.

Return on Equity (ROE)

ROE increased from 12,5% in 2021 to 13,9% in 2022.

The rise in ROE suggests enhanced profitability relative to shareholders' equity.

Investors may find the increase in ROE favourable as it reflects improved returns on their investment.

Earnings Per Share (EPS)

EPS increased from 1.22 in 2021 to 1.43 in 2022.

Higher EPS indicates increased profitability per share.

This could be attractive to investors and may contribute to a positive market perception.

Net Profit Margin

Net Profit margin increased from 22.57% in 2021 to 24.88% in 2022.

The improvement suggests that a higher percentage of revenue is translating into profit.

Efficient cost management and pricing strategies may have contributed to this positive trend.

Asset Turnover

Asset turnover decreased from -600 in 2021 to -487 in 2022.

A negative asset turnover may indicate issues with asset management or a need for closer scrutiny.

Further investigation is needed to understand the reasons behind the decrease and its impact on overall performance.

Stock Holding days

Stock Holding days increased from 77 in 2021 to 79 in 2022.

The increase may suggest a longer period for which stocks are held before being sold.

This could tie up working capital and impact cash flow necessitating a review of inventory management practices.

Debtors Collection Period

Debtor collection period decreased from 72 in 2021 to 67 in 2022.

A shorter collection period is generally positive indication faster receipt of cash from customers.

This could enhance liquidity and cash flow management.

Current Ratio

The current ratio decreased from 0.773 in 2021 to 0.0197 in 2022.

A current ratio below 1 may raise concerns about the company's short term liquidity.

There may be a need to assess working capital management and the ability to meet short term obligations.

Gearing Ratio

The gearing ratio decreased from 58.64% in 2021 to 57.25% in 2022.

A lower gearing ratio indicates a relatively lower reliance on debt financing.

While this may suggest reduced financial risk it is essential to consider the overall capital structure and debt servicing capabilities.

Interest Cover

Interest cover decreased from 2,977 in 2021 to 2,743 in 2022.

A lower interest cover ratio may signal increased financial risk and reduced ability to cover interest expenses.

Close monitoring of the company's debt management and interest obligation is crucial.

Conclusion

The financial performance and position of the company have exhibited both positive and concerning trends. While improved ROCE, ROE, EPS, and net profit margin reflect enhanced profitability and capital efficiency, the decline in asset turnover and current ratio, along with increased stock holding days, warrant attention.

Key areas for further investigation include inventory management, working capital practices, and the impact of changes in liquidity ratios on the company's ability to meet short-term obligations.

Additionally, the reduction in the debtor's collection period is a positive sign, contributing to improved cash flow.

To strengthen the overall financial position, a holistic approach that addresses liquidity, efficiency, and debt management is recommended. Regular monitoring and a proactive strategy to mitigate risks will be essential for sustaining positive financial performance.

References

Atrill, P. (2019) Accounting and finance for non-specialists . Eleventh edition. Harlow, England :, Pearson.

Atrill, P. (2016) Accounting and finance for non-specialists . Tenth edition. Harlow, England :, Pearson.

Drury, C. (2021) Management and cost accounting . 11th edition. Andover :, Cengage Learning.

Lucey, T. (2009) Costing . 7th ed. London ;; Australia ;; South-Western Cengage Learning.

Sangster, Alan. (2018) Frank Wood's business accounting 1 [electronic resource] . 14th ed. Harlow :, Pearson.

Wood, F. (2011) Frank Wood's Business accounting 1 . 12th ed. Harlow, Essex ;; New York :, Financial Times Prentice Hall/Pearson.