

University of Wales Trinity Saint David

BA (Hons) Business Management Level 4 - Weekend

Accounting Fundamentals LCBB4001– Lecturer: Dr Emad Elhashen

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In submitting this work, I affirm that my work adheres to the scholarly and intellectual standards of honesty and integrity. I affirm that this work is my work only and that in the preparation of this work I have not consulted any person. I affirm that I have not plagiarised or misrepresented the ideas or language of someone else as my own and that I have fully and accurately attributed any ideas or text of others to the sources and documented each source.

QUESTION 1

INCOME STATEMENT WALES PLC FOR THE YEAR ENDING 31st DECEMBER 2019

	£'000	£'000
SALES		30,300
LESS: Cost of Sales	16,220	
Add: Inventory	3,120	
Add: Plant depreciation (W2)	2,560	
		(21,900)
Gross profit		8,400
LESS: Distribution exp	2,160	
Administration exp (W4)	4,140	
		(6,300)
Operating Profit		2,100
Less: Finance cost (12% x 4000)	480	
Operating profit before tax		1,620
Less: Taxation (note 5)		(1,600)
Profit for the year		20
Other comprehensive income:		
Land revaluation (20,000(Note 2) – 15,000)		5,000
Total Comprehensive income		5,020

Workings

(W1) Building depreciation: $2\% \times 16,000 = 320$

(W2) Plant depreciation: $10\% \times 25,600 = 2,560$

(W3) Allowance for Trade receivable: $8,240 - 240 = 8,000 \times 2\% = 160$

(W4) Administration expenses : $2,920 + 320(w3) + 240(\text{note}3) + 160(W3) + 500 \text{ Insurance (Note)4} = 4,140$

WALES PLC's - STATEMENT OF FINANCIAL POSITION as of 31st December 2019

<u>ASSETS</u>	£	
Non-current assets		
Building at cost	16,000	
Less Accum depr	<u>(4,260+320)</u>	11,420
Land at cost	20,000	
Less Accum depr	<u>(0)</u>	20,000
Plant at cost	25,600	
Less Acum depr	<u>(4,960+2,560)</u>	<u>18,080</u>
		49,500
<u>CURRENT ASSETS</u>		
Trade receivable (8,240-240(note3) – 160(w3))	7,840	<u>7,840</u>
<u>Total assets</u>		<u>57,340</u>
 <u>EQUITY</u>		
Ordinary shares £1	29,000	
Shares premium	5,000	
Retained profit for the year (8,380 + 5,020-560(dividend paid))	<u>12,840</u>	46,840
<u>LIABILITIES</u>		
Current Liabilities		
Trade payable	4,480	
Interest Paid	240	
Taxation	1,600	
Bank overdraft ((note4) 500 -320)	<u>180</u>	6,500
Long-term liabilities		
12% Debentures		<u>4,000</u>
<u>Total Equity and Liabilities</u>		<u>57,340</u>

QUESTION 2

a) Ratio calculations for Jerry plc for 2019 and 2018:

No	NOTES	2019	2018
1	RETURN ON CAPITAL EMPLOYED	$22.8 / 135.1(W1) * 100\% = 16.87\%$	$26.2/145.4(W2) * 100\% = 18.02\%$
2	RETURN ON EQUITY	$12.9 / (17.8 + 18.2) * 100\% = 35.83\%$	$18.3 / (17.8 + 5.3) * 100\% = 79.22\%$
3	EPS	$12.9 / 17.8 = 0.72p$	$18.3 / 17.8 = 1.03p$
4	GROSS PROFIT MARGIN	$191.8 / 501.3 * 100\% = 38.26\%$	$186.9 / 486.8 * 100\% = 38.39\%$
5	ASSET TURNOVER	$501.3/286.1 = 1.75$	$486.8/ 293.8 = 1.65$
6	STOCK HOLDING PERIOD	$38.8 / 309.5 * 365 = 46 \text{ days}$	$41.1 / 299.9 * 365 = 50 \text{ days}$
7	DEBTORS COLLECTION PERIOD	$114.9/501.3 * 365 = 84 \text{ days}$	$114.7/486.8 * 365 = 86 \text{ days}$
8	CURRENT RATIO	$153.9(W3)/151 = 1.01\% : 1$	$156.5(W4)/148.4 = 1.05\% : 1$
9	GEARING	$(41.9/41.9 + 93.2) * 100\% = 31.01\%$	$(65.1/65.1 + 80.3) * 100\% = 44.78\%$
10	INTEREST COVER	$22.8 / 0.2 = 114$	$26.2 / 3.5 = 7.48$

Workings:

(W1) Assets employed 2019: $93.2 + 41.9 = 135.1$

(W2) Assets employed 2018: $80.3 + 65.1 = 145.4$

(W3) Total of current assets 2019: $38.8 + 114.9 + 0.2 = 153.9$

(W4) Total of current assets 2018: $41.1 + 114.7 + 0.7 = 156.5$

b) Looking at the ratios calculated at point (a) for Jerry plc, we can identify the following situations:

Return on capital employed ratio shows Jerry plc was more efficient generating profit from its capital in 2018 than in 2019. In 2019 ROCE is 17 pence per capital pound or 16.8% vs. 18 pence per capital pound or 18% in 2018. However, we also need to consider that in 2018 the revenue was slightly lower than the one obtained in 2019 but the loan was higher so the company's profitability and capital efficiency should be analyzed over a longer period to establish if the company is profitable and stable to attract investors. As with return on capital, a ROE is a measure of generally management's ability to generate income from the equity available to it. Both ROEs for 2019 and 2018 are above 20% which shows a good profitability for both financial years.

The **Earnings Per Share (EPS)** value in 2018 was higher than in 2019 with 0.31p difference showing that company was more profitable in 2018. EPS is one of the most important variables in determining a company's stock's value and also indicates if a company is profitable enough to pay out more money

to its shareholders. The **Gross Profit Margin** fluctuates slightly in 2019 comparing to 2018 which shows that Jerry plc has good management practices and good products.

The **Asset Turnover Ratio** is used as an indicator of the efficiency with which a company is using its assets to generate revenue. Considering that Jerry plc has in both 2019 and 2018 ATR above one, meaning for every pound in assets they generate 1.75 respectively 1.65 in sales, means that the company is efficient in generating revenue from its assets. The **Stock Holding Period** indicates the number of days the products are on stock before they turn into sales. It is a good indicator of management's performance as Jerry plc trades their own label products having an average stock holding period of approximate 46 days in 2019 respectively 50 days in 2018.

Debtor Collection Period indicates the average time taken to collect trade debts. So, a reduced period is an indicator of increased efficiency as we can see for this company the DCP is 84 days in 2019 and 86 days in 2018. This period also helps the company to compare the real collection period with the granted credit period and make the necessary adjustments. The **current ratio** for Jerry plc cannot be considered a good one as it has to be between 1.2 to 2 but is not a bad ratio either as it is not below 1. This means that the company have enough liquid assets to cover its short-term liabilities.

The Gearing Ratio measures how much a company is funded by debt versus how much is financed by equity. A high gearing ratio means the company has a larger proportion of debt versus equity. Jerry plc has a moderately low risk gearing ratio registered at 31.01% in 2019 and higher in 2018 at 44.78%. A company's **interest coverage** determines whether it can pay off its debts, the higher the interest coverage ratio, the more changes for the company to pay its debts.

QUESTION 3

Financial information about the activities and resources of a company is typically of interest to many people. The people potentially interested in a company's financial statements need information about the company for various reasons.

(a) Three user groups interested in a company's financial statements include:

- Employees
- Suppliers
- Customers

Employees

Employees and their representatives need to have access to information on business performance for two principal reasons:

- 1) wage and salary negotiation and
- 2) assessment of current and forward opportunity in terms of employment

They can be interested in the current financial stability and the longer-term financial viability of the business. They need information to be presented in a clear, simple, and accessible form.

Suppliers

This group consists of trade creditors that represent an important element in the supply of a business's working capital. They can be interested in the financial stability of the business in terms of cash flow and the firm's ability to meet its short-term liabilities. They would also consider current and future cash flow together with current and future profitability.

Customers

This group will be interested in the business's short and long term financial stability but also in its potential to supply high quality goods and services. They can also have interest in the environmental policy of the business.

(b) Discuss the advantages and disadvantages of a highly regulated financial reporting regime. You should consider the perspective of both user and the preparer of the financial statements.

The rapid changes of global market-imposed transformations in terms of financial reports and their use as well. Currently, the financial market is regulated by European and international bodies. Companies in the United States and European Union complain that forcing them to publish audited financial statements is difficult and hurts economic activity. Regulators and others in favor of such reporting argue that capital providers, customers, and suppliers can use accurately reported financials to better evaluate disclosing and related companies, benefiting everyone. (Daks, 2018)

It is argued that more and better regulation is necessary to raise the quality of financial reporting in order to protect the public from fraud and failures. Another argument in favor of regulation is that accounting information is a public good, and public goods are under-produced in a free market. (Atril, 2016)

There may be reasons for governments to impose reporting and auditing mandates, perhaps to improve tax collection or fight money laundering. But when it comes to the efficiency of market-wide resource allocation, there should be taken into consideration the need for smaller companies' reporting requirements.

(c) The primary limitation of financial statements is the reliance on historical costs, inadaptation to inflation, prone to frauds, easily manipulated. Financial statement limitations are relatable with current markets looking at the accounting and financial fraud in the news every day.

References

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

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