

LEVEL/ LEFEL 4

MODULE CODE/ COD Y MODIWL: LCBB4001

ACCOUNTING FUNDAMENTALS

ASSESSMENT TYPE/ MATH O ASESU: ASSIGNMENT

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Name: Erika Massa

Student Number: 2011291

Module Title: Accounting Fundamentals (LCBB4001)

Assignment Title: Accounting Fundamentals Assessment 1

Module: (LCBB4001)

Lecturer's Name: Rexon Nting

a) Prepare an income statement for the year ended 31st December 2019 for Eccles plc and a statement of financial position as at that date.

Eccles plc

Income Statement for the year ended 31st December 2018

	£	£
Revenue (826650+980)	827,630	
Cost of Sales (578650+3000)	(581,650)	
Gross Profit		245,980
Director Remuneration	(5,000)	
Distribution Cost	(28,000)	
Admin Cost	(3,000)	
Operating Profit		182,980
Interest Paid	(2,000)	
Profit Before Tax		180,980
Tax	68,000	
Net Profit		112,980
Retained Earnings (1-jan-18)	132,000	
Ordinary Dividend	(20,000)	
Performa Dividend	(30,000)	
Retired Earning (31-dec-18)		194,980

Eccles PLC

Statement of Financial Position As at 31st December 2019

	£	£
ASSET		
Non-Current Asset		
Plant and equipment	<u>632,730</u>	
		632,730
Current Asset		
Stocks at 31/12/18	330,600	
Debtors	170,125	
Cash	12,900	
Accrued Asset	<u>980</u>	
		<u>514,605</u>
TOTAL ASSET		<u>1147,335</u>
LIABILITIES		
CURRENT LIABILITIES		
Trade and Creditor	(171,355)	
ACCRUED LIABILITIES		
Tax payable	(68,000)	
Commission	<u>(3,000)</u>	
		(242,355)
NON-CURRENT LIABILITIES		
4% Debentures	<u>(100,000)</u>	
		(100,000)
TOTAL LIABILITIES		<u>(342,355)</u>
NET ASSET EQUITY		804,980
Retained Earnings		194,980
£1 Ordinary Shares		310,000
10% £1 Preferences Shares		300,000
TOTAL LIABILITIES AND EQUITY		1147,335
TOTAL EQUITY		804,980

b) Explain why the statement of financial position balances.

The statement of financial position balances because of the accounting equation $ASSET = LIABILITIES + EQUITY$. Using the double-entry bookkeeping, for every transaction in one account, there is another equivalent in another one. For example, if I have to record a transaction of £100 purchase paid in cash:

-I would credit the cash account of £100

-I would debit the purchase account of 100£

Using this system, at the end, Debit and Credit always must balance.

(McLaney and Atrill, 2016)

a. Prepare a schedule of ratios for Chocco plc for 2019 and 2018.

b. Using the information in the financial statements and the ratios you have calculated, comment on the financial performance and position of Chocco plc

(McLaney and Atrill, 2016)

INVESTMENT RATIOS:

-Return on Capital Employed:

= (Profit before interest / Asset Employed) x 100%

Year 2019:

$[805 / (9,736 - 2,511)] \times 100\% = (805 / 7,225) \times 100\% = \mathbf{11.14\%}$

Year 2018:

$[699 / (10,087 - 3.046)] \times 100\% = (699 / 7,041) \times 100\% = \mathbf{9.92\%}$

The profitability of the Asset invested increased of 1.22% from 2018 to 2019.

In 2019 for every £100 invested, there is a return of £11.14. There is a more efficient use of the capital invested that would definitely help the Company to find more potential investors. This Ratio is used by the investors as a benchmark performance with competitors to decide where is best to invest their money.

-Return on Equity:

= (Earnings / Ordinary share capital and reserves) x 100%

Year 2019:

$(431 / 3,088) \times 100\% = \mathbf{13.95\%}$

Year 2018:

$(366 / 2,912) \times 100\% = \mathbf{12.56\%}$

The Company Chocco plc increased the generating of returns of the investments it received from 2018 to 2019 of 1.39%. In 2019 for every £100 it received it generated £13.95 in return. It means that the Company improved the efficiency in generating a return from new investment and simultaneously the profit for its shareholders. As much, the Return on Equity Ratio is high as much Company is capable of generating profit for its Stockholders. Comparing two companies with the same profit, a higher Return on Equity Ratio would entice potential investors. In this case, it means that Company with higher ROE is capable of making the same profit of the other Company, using fewer resources.

-Earnings per Share:

= Earnings / Number of ordinary shares

Year 2019:

$431 / 300 = \mathbf{1.43 \text{ per share}}$

Year 2018:

$366 / 300 = \mathbf{1.22 \text{ per share}}$

In 2019 for every ordinary share held in the Company, it earns £1.43 of net profit. Earning Per Share is the sign of higher earnings, strong financial position and therefore reliable Company to invest, and it increased from 2018 to 2019 of 0.21%. It measures the Shareholder's profit individually, for any single share. The increase shows that the Company is growing and is capable of generating more money for every share.

-Price Earnings Ratio:

= market price / Earnings per share

Year 2019:

$$5.12 / 1.43 = \mathbf{3.58}$$

Year 2018

$$4.00 / 1.22 = \mathbf{3.27}$$

The market value of a stock related to its earning had an increase of 0.31 from 2018 to 2019. This Ratio is needed from the investors to know how much they are willing to pay to buy a share. High Price Earning Ratio could be a good investment as not, as could have been overvalued. Likewise, Low Price Earning Ratio could be a bad investment as not, as could have been undervalued.

PROFITABILITY RATIOS:

-Gross Profit Margin:

$$= (\text{Gross profit} / \text{Sales}) \times 100\%$$

Year 2019:

$$(3,503 / 6,738) \times 100\% = \mathbf{51.98\%}$$

Year 2018:

$$(3,345 / 6,441) \times 100\% = \mathbf{51.93\%}$$

In year 2019 Chocco plc will earn £51.98 on every £100 sale. It shows the gross profit Chocco plc makes after deducting the cost of sales. The gross profit is slightly increased by 0.5% from 2018 to 2019. It also means that Company barely decreases its direct expenses.

-Net Profit Margin:

$$= (\text{Net profit} / \text{Sales}) \times 100\%$$

Year 2019:

$$(805 / 6,738) \times 100\% = \mathbf{11.94\%}$$

Year 2018:

$$(699 / 6,441) \times 100\% = \mathbf{10.85\%}$$

In year 2019 Chocco plc will earn a net profit of £11.94 on every £100 sales. The company it improved at turning sales into profit from 2018 to 2019 of 1.09%.

It appears that the different of Net Profit Margin during the years (1.09%) is barely double the difference of the Gross Profit Margin during the years (0.5%). It means that the Company improved to reduce its indirect expenses, increasing its Net Profit.

EFFICIENCY RATIOS:

-Asset Turnover

$$= \text{Turnover} / \text{Assets employed}$$

Year 2019:

$$6,738 / (9,736 - 2,511) = 6,738 / 7,225 = \mathbf{0.93}$$

Year 2018:

$$6,441 / (10,087 - 3,046) = 6,441 / 7,041 = \mathbf{0.91}$$

The Asset turnover from 2018 to 2019 slightly increased by 0.02. It measures the efficiency, the productivity of the Company and ability to use its assets to generate revenue. The same value of the Ratio can be valued differently from Company operating in a different field; however, it is relevant to measure the Company's performance

Stock Holding Period:

$$= (\text{Inventory} / \text{Cost of Sales}) \times 365$$

Year 2019:

$$(708 / 3,235) \times 365 = \mathbf{79.88 \text{ Days}}$$

Year 2018:

$$(659 / 3,096) \times 365 = \mathbf{77.69 \text{ Days}}$$

Stock holding's average time increase of 2.19 days from 2018 to 2019. This means slightly inefficiently management order. Stock is tied up unnecessarily longer before turning into sales. It is mean less liquidity and less activity on the Cash Flow Statement.

-Debtors Collection Period:

$$= (\text{Trade receivables} / \text{Credit Sales}) \times 365$$

Year 2019

$$(1,249 / 6,738) \times 365 = \mathbf{67.65 \text{ Days}}$$

Year 2018

$$(1,287 / 6,441) \times 365 = \mathbf{72.93 \text{ Days}}$$

The average number of days a business takes to collect its trade receivables after sales have been created decreased of 5.28 days from 2018 to 2019. A lower value is usually better, as long customers have reasonable credit facilities, for the Company because it means it can collect the money early and have more liquidity and pay early the suppliers.

-Creditors Payment Period:

$$= (\text{Trade payable} / \text{Credit Purchases}) \times 365$$

Year 2019:

$$(583 / 3,235) \times 365 = \mathbf{65.37 \text{ Days}}$$

Year 2018:

$$(655 / 3,096) \times 365 = \mathbf{77.22 \text{ Days}}$$

This Ratio is the average number of days in which a company pays its suppliers. In general, a low creditors payment period highlights good working capital management because the Company is availing early payment discounts. However, in this case, even if Chocco plc improved the shortage period to pay its suppliers from 2018 to 2019 of 11.85 days, it seems a bad result because:

In 2019 the Debtors Collection Period Ratio is < Creditors Payment Period in 2019

Consequently, the Company is paying its suppliers before collecting money from its creditors. The Company may face liquidity's problem.

LIQUIDITY RATIOS:

-Current Ratio:

= Current assets / Current liabilities

Year 2019:

$$2,303 / 2,511 = \mathbf{0.91}$$

Year 2018

$$2,355 / 3,046 = \mathbf{0.77}$$

The Current Ratio in 2018 was 0.77, which means that the Company was able to repay 0.77% of the same amount of current liabilities with current assets as current liabilities. In 2019, the current Ratio increased by 0.14%, but it did not increase enough to reach a positive value. In 2019 The Current Ratio is $0.91 < 1$, indicating that the Company had problems making timely payments to suppliers and creditors (Hawkins., 2017).

-Quick Asset Ratio:

= Current assets - inventory / Current liabilities

Year 2019:

$$(2,303 - 708) / 2,511 = 1,595 / 2,511 = \mathbf{0.63}$$

Year 2018:

$$(2,355 - 659) / 3,046 = 1,696 / 3,046 = \mathbf{0.55}$$

The quick liquidity ratio for 2018 was 0.55, meaning that for every pound of current liabilities, there is £0.55 of most liquid assets. With a ratio of 0.63 in the second year, the Company's short-term liquidity was minimal and improved compared with the previous year. However, the Company will continue to face difficulties in meeting its current obligations. When The Quick Asset Ratio is < 1 it means Company do not have the ability to pay his short-term obligation (Schroeder et al., 2019).

FINANCING RATIOS:

-Gearing Ratio:

= (Debt / Debt + Equity) x 100%

Year 2019:

$$[4,137 / (4,137 + 3,088)] \times 100\% = (4,137 / 7,225) \times 100\% = \mathbf{57.25\%}$$

Year 2018:

$$[4,129 / (4,129 + 2,912)] \times 100\% = (4,129 / 7,041) \times 100\% = \mathbf{58.65\%}$$

Good results would be a percentual that do not cross the threshold of 50%. Chocco plc has a low risk to downturns its economy. Although there is an improvement of 1.4% from 2018 to 2019. It shows that in 2019 57.25% of its funds is from external resources.

-Interest Cover:

= profit before interest / Interest charges

Year 2019:

$$805 / 226 = \mathbf{3.56 \text{ Times}}$$

Year 2018:

$$699 / 181 = \mathbf{3.86 \text{ Times}}$$

As the interest Cover Ratio is > 1 , it means Chocco plc is able to meet its interest obligation, even if it has a slight decrease of 0.3 times from 2018 to 2019 in the Interest Cover Ratio. Chocco plc in 2019 can meet its

interest payment more than 3.56 times over. If a company has an interest coverage ratio of 1, which means that it is very dangerous, it can simply pay a fascinating amount to a loan officer, and there are no regulations. The interest coverage ratio should be considerably higher than 1.5; in this scenario, the monetary institution will lend without difficulty.

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