



Prifysgol Cymru
Y Drindod Dewi Sant
University of Wales
Trinity Saint David

Component 1:
Coursework: Essay

Name: Kristian Nash

Student ID: 2130196

Module: Accounting Fundamentals

Module Code: LCBB4001

Lecturer: Dr Winifred Soribe

Contents

Question 1).....	3
Question 2	5
Question 3a).....	7
Question 3b).....	10
References	12

QUESTION 1

You have been talking to someone who had read a few chapters of an accounting text some years ago. During your conversation the person made the following statements:

1. The statement of financial position shows how much cash has come into and left the business during the accounting period and the resulting balance at the end of the period.
2. Non-current assets are things that cannot be moved.
3. Managers should only supply financial information to the "current" shareholders of companies.
4. No need to include prepayments and accruals on the statement of financial position.
5. No need for regulation over financial accounts.
6. It is important to balance ledger (T) accounts and trial balance before preparing financial statements.

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

[30 marks]

Question 1)

1. The statement of financial position, often called the balance sheet, is a snapshot of a company's financial status at a specific moment, not a record of cash flows over time. It doesn't show how much cash has come into or left the business during the accounting period. Instead, it shows what the business owns (assets) and what it owes (liabilities) at a date, usually the end of the accounting period. The balance sheet helps stakeholders understand the company's financial situation by showing its assets, liabilities and equity. It's like taking a picture of the company's financial situation, capturing what it owns, owes and the difference between the two at that moment. Understanding the balance sheet is important for investors, creditors and managers to assess the company's ability to meet its obligations and its overall financial stability.
2. Non-current assets are things a company owns that aren't supposed to become cash quickly. They include stuff like buildings or equipment. But they can also still be moved around if needed. The term non-current just means they're not meant to change into cash right away. It's like saying they're not the type of assets you can easily sell for quick cash. Even though they're not as flexible as cash, they're still very important for keeping the business running smoothly. So, they're not stuck in one place, but they're not as quick to turn into cash as other things the company owns. (www.bench.co. (n.d.).)
3. Managers shouldn't only supply financial information to the "current" shareholders of companies as this is not the correct way of doing business. Instead, they have a duty to provide financial information to all shareholders, regardless of when they bought their shares. All shareholders, whether current or not, have invested in the company and deserve access to accurate financial data. This transparency helps build trust and ensures fair treatment of all shareholders. Also providing financial information to all shareholders promotes accountability and helps prevent potential conflicts of interest. Therefore, it's important for managers to share financial information with all shareholders, not just those who currently hold shares. (Raponi, M. A. (2015).)
4. It is important to include prepayments and accruals on the statement of financial position. Prepayments are payments made in advance for goods or services that the company will receive in the future, while accruals are expenses incurred but not yet paid for. Both prepayments and accruals represent financial obligations of the company and should be reflected accurately on the statement of financial position to provide a true picture of the company's financial position. Ignoring these items would make the financial statements not

accurate and mislead stakeholders about the company's liabilities and assets. So, including prepayments and accruals on the statement of financial position is essential for ensuring the financial statements are accurate and reliable for decision-making purposes. (AAT Comment. (2020).)

5. Regulation over financial accounts is important to ensure honesty and accuracy in reporting. Financial regulations provide guidelines and standards that companies must follow when preparing their financial statements. These regulations help prevent fraud, manipulation and misinformation which could harm investors and stakeholders. By enforcing rules and standards, regulators ensure that financial information is consistent, transparent and trustworthy. This promotes confidence in the financial markets and encourages investment. Without regulation, there would be no safeguards against unethical behaviour or misleading financial reporting, leading to potential financial instability and loss of trust in the system. So having regulation over financial accounts is important for having integrity and value in the financial sector. (commission.europa.eu. (n.d.))
6. Balancing ledger accounts and the trial balance before preparing financial statements is essential for accuracy. Ledger accounts are where transactions are recorded, and balancing them making sure that debits equal credits, maintaining accuracy in the company's records. The trial balance summarizes all ledger account balances to check for mathematical correctness. If ledger accounts and the trial balance aren't balanced, it could indicate errors in recording transactions, leading to not accurate financial statements. Balancing these accounts and the trial balance helps identify and correct mistakes before preparing financial statements ensuring that the statements accurately reflect the company's financial position and performance. This process is important for providing reliable financial information to stakeholders, such as investors, creditors and management, helping in decision-making and maintaining trust in the company's financial reporting. So, it's important to balance ledger accounts and the trial balance as part of the financial statement preparation process.

QUESTION 2

The following balances relate to Wales plc for the year ended 31st December 2022:

	£
Sales (revenue)	900,000
Equipment at cost	650,000
Equipment accumulated depreciation	130,000
4% Debentures	100,000
Cost of sales	578,650
Administrative expenses	160,000
Interest paid	2,000
Directors' remuneration	5,000
Distribution costs	28,000

The following information is relevant:

1. The equipment useful life is 10 years, and it is depreciated using the straight-line method (10% annually). Depreciation on equipment is charged to cost of sales. Depreciation of 2022 has not been recorded yet.
2. Salaries of December 2022 (£10,000) had not been paid until the end of the month. The company paid it on 3rd January 2023. Salaries are charged to the administrative expenses.
3. Corporation tax for the year is estimated at £15,000.
4. Salesmen are owed commission of £2,000 in respect of December sales. It will be paid on 31st January 2023 and has not been recorded in the ledger accounts yet.
5. Goods valued at £1000 were sent to customers on 31st December 2022. Payment is due on 28 February 2023. This has not been recorded in the ledger accounts yet.

Required: Prepare an income statement for the year ended 31st December 2022 for Wales plc.

[20 marks]

Income Statement for Wales plc

For the Year Ended 31st December 2022

Question 2

£

Sales (revenue): 901,000

Cost of sales: (643,650)

Gross profit: 257,350

Distribution costs: (30,000)

Administrative expenses : (170,000)

Director's remuneration: (5,000)

PBIT (operating profit): 62,350

Interest paid: (2,000)

Profit before tax: 60,350

Corporation tax: (15,000)

Profit after tax: 45,350

QUESTION 3

Sweets plc is a long-established sweets and confectionery manufacturer. All products are manufactured in the UK, but sales are made worldwide. It is a growing but competitive market. Given below are extracts from their financial statements,

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).

Required:

a. Calculate the following ratios for Sweets plc for 2022 and 2021, showing the formulas and workings:

- 1- ROCE
- 2- ROE
- 3- Earnings per share
- 4- Net profit margin
- 5- Asset turnover
- 6- Stock holding days
- 7- Debtors collection period
- 8- Current ratio
- 9- Gearing ratio
- 10- Interest cover

[30 marks]

b. Using the information in the financial statements and the ratios you have calculated, critically discuss the financial performance and position of Sweets plc.

[20 marks]

Question 3a)

Return on Capital Employed (ROCE)

2022:

$$\text{ROCE} = (\text{Profit before interest} / \text{Assets employed}) \times 100$$

$$\text{Profit before interest (2022)} = 846$$

$$\text{Assets employed (2022)} = 7225$$

$$\text{ROCE (2022)} = (846 \div 7225) \times 100 = 11.70\%$$

2021:

$$\text{Profit before interest (2021)} = 720$$

$$\text{Assets employed (2021)} = 7041$$

$$\text{ROCE (2021)} = (720 \div 7041) \times 100 = 10.22\%$$

Return on Equity (ROE)

2022:

$$\text{ROE (2022)} = (\text{Earnings} / \text{Equity}) \times 100$$

$$\text{ROE (2022)} = (431 \div 3088) \times 100 = 13.95\%$$

2021:

$$\text{ROE (2021)} = (366 \div 2912) \times 100 = 12.56\%$$

Earnings per Share (EPS)

2022:

EPS (2022) = Earnings ÷ Number of ordinary shares

EPS (2022) = $431 \div 300 = 1.43$

2021:

EPS (2021) = $366 \div 300 = 1.22$

Net Profit Margin

2022:

Net profit margin (2022) = (Net profit ÷ Revenue) × 100

Net profit margin (2022) = $(431 \div 6738) \times 100 = 6.39\%$

2021:

Net profit margin (2021) = $(366 \div 6441) \times 100 = 5.68\%$

Asset Turnover

2022:

Asset turnover (2022) = Revenue ÷ Assets employed

Asset turnover (2022) = $6738 \div 7225 = 0.93$

2021:

Asset turnover (2021) = $6441 \div 7041 = 0.91$

Stockholding Day

2022:

Stockholding days (2022) = (Inventory ÷ Cost of sales) × 365

Stockholding days (2022) = $(708 \div 3235) \times 365 = 79.88 \text{ days} = 80 \text{ days}$

2021:

Stockholding days (2021) = $(659 \div 3096) \times 365 = 77.69 \text{ days} = 78 \text{ days}$

Debtors Collection Period

2022:

Debtors collection period (2022) = $(\text{Trade receivable} \div \text{Revenue}) \times 365$

Debtors collection period (2022) = $(1249 \div 6738) \times 365 = 67.65 \text{ days} = 68 \text{ days}$

2021:

Debtors collection period (2021) = $(1287 \div 6441) \times 365 = 72.93 \text{ days} = 73 \text{ days}$

Current Ratio

2022:

Current ratio (2022) = $\text{Current assets} \div \text{Current liabilities}$

Current ratio (2022) = $2303 \div 2511 = 0.91$

2021:

Current ratio (2021) = $2355 \div 3046 = 0.77$

Gearing Ratio

2022:

Gearing ratio (2022) = $(\text{Debt} \div \text{Debt} + \text{Equity}) \times 100$

Gearing ratio (2022) = $(4137 \div (4137 + 3088)) \times 100 = (4137 \div 7225) \times 100 = 57.25\%$

2021:

Gearing ratio (2021) = $(4129 \div (4129 + 2912)) \times 100 = (4129 \div 7041) \times 100 = 58.64\%$

Interest Cover

2022:

Interest cover (2022) = $\text{Profit before interest} \div \text{Interest}$

Interest cover (2022) = $846 \div 226 = 3.74$

2021:

Interest cover (2021) = $720 \div 181 = 3.97$

Question 3b)

In 2022, Sweets plc showed an overall improvement in most financial ratios compared to 2021. This indicates a better performance and position for the company.

Firstly, the Return on Capital Employed (ROCE) increased from 10.22% in 2021 to 11.70% in 2022. This suggests that the company generated more profit relative to the assets it employed, showing better efficiency in its operations.

Similarly, the Return on Equity (ROE) increased from 12.56% in 2021 to 13.95% in 2022. This means that the company provided a greater return to its shareholders in 2022 compared to the previous year.

Earnings per Share (EPS) also rose from £1.22 in 2021 to £1.43 in 2022. This indicates an increase in profitability on a per-share basis.

The Net Profit Margin increased from 5.68% in 2021 to 6.39% in 2022, showing that the company was able to retain a higher proportion of its revenue as profit.

Moreover, the Asset Turnover improved slightly from 0.91 in 2021 to 0.93 in 2022, indicating that the company generated more revenue relative to its assets.

The Stockholding Days increased from 78 days in 2021 to 80 days in 2022, suggesting that the company held onto its stock for a slightly longer period, possibly to manage inventory levels more effectively.

On the other hand, the Debtors Collection Period decreased from 73 days in 2021 to 68 days in 2022, indicating that the company was able to collect money from its customers at a faster rate.

The Current Ratio improved from 0.77 in 2021 to 0.91 in 2022, indicating that the company was in a stronger position to meet its short-term liabilities in 2022.

Furthermore, the Gearing Ratio decreased from 58.64% in 2021 to 57.25% in 2022, suggesting that the company relied slightly less on debt financing in 2022 compared to the previous year.

However, the Interest Cover decreased from 3.97 in 2021 to 3.74 in 2022, indicating a lower capacity to service existing debt as well as any future debt.

While Sweets plc showed an overall improvement in its financial performance from 2021 to 2022, it's important to look at the decrease in its Interest Cover ratio. This shows a potential challenge in servicing the company's interest needs, showing a worse ability to manage debt effectively. Therefore, Sweets plc must adopt a better approach to debt management, making sure that it has a balance between leveraging opportunities for growth and looking after its financial stability.

It's also important to note the positive path ahead shown in lots of the financial results. Sweets plc had great profitability, having better returns for shareholders and an improved ability to handle day-to-day expenses and obligations.

In the future, Sweets plc needs to watch its finances closely, keep an eye on how much it owes, and find ways to lower risks. By paying attention to what's happening in the market and making smart money moves, the company can keep growing and stay strong in its industry. Good money management and planning ahead will be key to keeping Sweets plc successful and its investors happy.

References

- www.bench.co. (n.d.). Understanding a Balance Sheet (With Examples and Video). [online] Available at: <https://www.bench.co/blog/accounting/balance-sheet>.
- Raponi, M. A. (2015). FY 2014 Independent Auditor's Report. Washington, DC: U.S. Government Publishing Office.
- AAT Comment. (2020). Accruals and prepayments - Level 3 study tips. [online] Available at: <https://www.aatcomment.org.uk/audience/students/accruals-and-prepayments-level-3-study-tips/>.
- commission.europa.eu. (n.d.). EU Financial Regulation. [online] Available at: https://commission.europa.eu/publications/eu-financial-regulation_en.