

ACCOUNTING FUNDAMENTALS

ASSESSMENT 1

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THE ANSWER FOR THE QUESTION 1:

Following the balances relate to Wales plc for the year ended 31st December 2022 and the relevant information from question 1, I prepared an Income Statement and a Statement of financial position as at that date.

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBRE 2022

£'000

		sales	800,000
		goods	980
Revenue/Sales	800,980		
Cost of sales	<u>-578650</u>		
Gross profit	222,330		
Distribution cost	-28,000		
Administration expenses	<u>-30,000</u>		
Operating profit	164,330		
Interest paid	-2,000		
Director remuneration	-5,000		
Ordinary divided paid	-20,000		
Preferance divided paid	-30,000		
Outstanding comision	<u>-3,000</u>		
Profit before tax	104,330		
Taxation	<u>-100,000</u>		
Net profit of the year	4,330		

Wales plc
STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2022

	£'000	£'000
Non Current Assets		
Property, plant & equipment	1,250,000	
Intangible assets		
		1,250,000
Current Assets		
Inventories	510,850	
Trade receivable (170,125+980)	171,105	
Cash and bank	96,000	
		777,955
Total Assets		2,027,955
Current Liabilities		
Trade payable	188,625	
Short term borrowings	3,000	
Current tax payable	100,000	
		291,625
Non-Current Liabilities		
Long term borrowings	200,000	
Long term provisions		
		200,000
Total Liabilities		491,625
NET ASSETS (TA-TL)		1,536,330
Equity		
£1 ordinary shares	900,000	
£1 preference shares	500,000	
Retained profit	132,000	
Earnings/ Profit of the year	4,330	
Total Equity		1,536,330
Total Equity and Liabilities		2,027,955

For the second point of Question 1, it is required to answer to the question “why does the statement of financial position balance”?

A Statement of Financial Position or Balance Sheet displays the total amount of wealth during a specific period. The Statement of Financial Position is always balanced as it is produced by following the Income Statement and all the accounts have been finalised and balanced-off in the accounting books at that time (Double entry) (*Atrill and McLaney, 2018*).

With the Balance Sheet, all we do is copy the carried forward amounts from the accounts and arrange them where they should go on the statement (*accountingsimplified, 2020*).

A Statement of Financial Position is a list of balances that show the financial condition as of a certain date and are categorised according to whether they are assets, equity, or liabilities.

The so-called "accounting equation" is often followed by the statement of financial situation:

$$\text{ASSETS} = \text{CAPITAL} + \text{LIABILITIES}$$

(*Atrill, P., 2016*)

It must be balanced, in order, for the statement of financial status to be taken seriously/correct. Furthermore, the assets of the business must be equal to the sum of its liabilities and equity (*Atrill and McLaney, 2018*). Therefore, demonstrating the balance and the fact that the equation holds up its primary objective just like in the first exercise from the assessment where we have:

ASSETS of £2 027 955 and the sum of equity and liabilities as £2 027 955, so our Statement of Financial Position as at 31st December 2022 for Wales plc is balanced.

Analysts can frequently use the statement of financial position to assess the overall health of a firm in addition to using it for required reporting.

The business can evaluate an entity's financial health using the Statement of Financial Position. The underlying patterns in the financial situation, liquidity risk, financial risk, credit risk, and company risk may all be detected using this method. It may also be used to forecast future profits' volume, timing, and volatility. (*accountingsimplified.com, 2020*)

THE ANSWERS FOR THE QUESTION 2

To answer at this question, based on the extracts from their financial statements given in the assessment brief, I have calculated the following ratios for Sweets plc for 2021 and 2020:

RATIOS	FORMULAS	2021	2020
ROCE (Return on Capital Employed)	$\frac{\text{Profit Before Interest}}{\text{Capital Employed}} \times 100\%$	11.14%	9.92%
ROE (Return on Equity)	$\frac{\text{Earnings}}{\text{Equity}} \times 100\%$	13.95%	12.56%
EPS (Earnings per Share)	$\frac{\text{Earnings}}{\text{Number of ordinary shares}}$	£ 0.71	£ 0.61
NPM (Net Profit Margin)	$\frac{\text{Operating Profit}}{\text{Sales}} \times 100\%$	11.94%	10.85%
AT (Assets Turnover)	$\frac{\text{Revenue}}{\text{Capital Employed}}$	1 day	1 day

SHP (Stock Holding Days)	$\frac{\text{Inventory}}{\text{Cost of Sales}} \times 365 \text{ days}$	80 days	78 days
DCP (Debtors Collection Period)	$\frac{\text{Trade Receivables}}{\text{Credit Sales(or Revenue)}} \times 365 \text{ days}$	68 days	73 days
CR (Current Ratio)	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	(1:1)	(1:1)
GR (Gearing Ratio)	$\frac{\text{Long Term Debt}}{\text{Long Term Debt} + \text{Equity}} \times 100\%$	57.25%	58.64%
IC (Interest Cover)	$\frac{\text{Profit Before Interest}}{\text{Interest Charges}}$	3.56 (time)	3.86 (time)

2021

ROCE= (805/7225) × 100%=11.14%

Capital Employed=Total Assets-Current Liabilities=9736-2511=7225

ROE= (431/3088) ×100%=13.95%

EPS=431/600=£0.718

£1 ordinary share capital=300/0.50=600 (number of ordinary shares)

NPM= (805/6738) ×100%=11.94%

AT=6738/7225=0.93~ 1 day

SHD= (708/3235) ×365=79.88~ 80 days

DCP= (1249/6738) ×365=67.65~ 68 days

CR=2303/2511=0.91 (1:1)

GR= (4137/7225) ×100%=57.25%

IC=805/226 =3.56 (time)

2020

ROCE= [699/ (10087-3046)] ×100% =9.92%

ROE= (366/2912) ×100% =12.56%

EPS=366/ (300/0.5) =£ 0.61

NPM= (699/6441) ×100%=10.85%

AT= 6441/7041 =0.91~ 1 day

SHP= (659/3096) ×365 =77.69~ 78 days

DCP= (1287/6441) ×365 =72.93~ 73 days

CR=2355/3046 =0.77 (1:1)

GR=4129/ (4129+2912) ×100% =58.64%

IC=699/181 =3.86~ 4 days

Financial ratios are tools used to evaluate a company's financial performance by comparing different financial data points. By analysing financial ratios, a company can identify areas of strength and weakness and make adjustments to improve its financial performance, such as if the company is spending too much on operating expenses relative to its revenue. Additionally, ratios can be used by investors to evaluate a company's financial health and to make investment decisions (*Atrill, P. 2016*).

There are several types of financial ratios, including liquidity ratios, profitability ratios, solvency ratios, and efficiency ratios. (*Atrill, P. 2016*)

Based on the calculations provided, the company Sweets plc seems to be performing well but there are some areas that could use improvement.

ROCE and ROE are important metrics for evaluating a company's financial performance, considering capital structure and return generated for shareholder's equity. (*Watson, S. 2023*) The ROCE and ROE of Sweets plc have increased from the first year to the second year, which suggests that the company is becoming more efficient at generating profits from its capital.

The NPM ratio is used for comparing the profitability of companies in the same industry, as well as for evaluating the financial performance of a company over time. Based on the NPM ratio's calculated has also increased, indicating that the company is generating more profit from its sales (*CFI, 2023*).

A higher AT ratio indicates that the company is more efficient in using its assets to generate revenue. The AT of Sweets plc has remained stable at 1 day, which is a good sign that the company is managing its inventory efficiently (*Finance Train, 2022*).

The SHP ratio is useful for comparing the returns on different real estate investments with varying holding periods. Based on the calculation of Sweets plc for 2020 and 2021, SHP has increased slightly, but it is still within a reasonable range, suggesting that the company is managing its inventory well (*Atrill, P. 2016*). The DCP has decreased, which is a positive sign that the company is collecting its receivables more quickly.

The CR remains stable at (1:1) in both years (the minimum acceptable level for a company's liquidity), indicating that the company has a good balance between its current assets and liabilities and Sweets plc may be in a better position to meet its short-term obligations (*Girardin, M. 2023*).

The GR and IC ratios are used in investment analysis. In the Sweets plc situation, the GR and IC has decreased slightly from the first year to the second year, but it is still at a healthy level, which suggests that the company is experiencing strong growth and managing its debt well (*Atrill and McLaney 2018*).

Overall, after analysing the financial performance and position of the company Sweets plc, it seems to be strong, generating profits, but the GR and IC could be improved.

However, regarding the additional information, the average share price during 2020 was £4.00 while in 2021 it was £5.12. This clearly portrays the increase in the share prices from 2020-2021, suggesting that the market has a positive outlook on the company's future.

REFERENCES LIST

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