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LCBB4001 Accounting Fundamentals, Assessment 1

QUESTION 1

Question 1(a)

Wales PLC			
Profit and Loss Statement for the year ended 31st December 2021			
PARTICULARS	Amount(£)	PARTICULARS	Amount(£)
Cost of Sales	578,650	Sales (800,000 + 980)	£800,980
Interest paid	2,000		
Distribution Cost	28,000		
Administrative Expenses	30,000		
Sales commission	3,000		
Directors remuneration	5,000		
Preference dividend paid	30,000		
Ordinary dividend	30,000		
	20,000		
	100,000		

Retained profits at 1st January 2021	£132,000	
<u>Add:</u> Net profit	£ 4,330	£ 136,330
Long Term Liability		
4% Debentures		£ 100,000
Current Liabilities		
Trade payable		
Outstanding sales commission		£ 188,625
Provision for corporate tax		£ 3,000
Total		<u>£ 100,000</u>
Assets		£ 1,227,955
Non- Current assets		
Fixed Assets		
Plant and equipment		
Current assets		£ 650,000
Debtors (170,125 + 980)		
Stock		£ 171,105
Cash and bank		£ 330, 600
Total		<u>£ 76,250</u> £ 1,227,955

Question 1 (b)

The statement of financial position or the balance sheet balances since the total asset, that is, the current and non-current assets, equals the total liabilities plus the total shareholders' equity. The balance sheet, therefore, balances because of the principle of double entry. This principle ensures that all the transactions are recorded in at least two accounts, making the entries consistent and balanced. The balancing shows that there are double entries of all the transactions, no computing

or typing errors, placing all the entries in the right sections, recording data from the correct sources of the company financial statement, and imputing the correct figures.

QUESTION 2

Question 2 (a) calculation of ratios, showing working and formulas

1. ROCE

FORMULA: $\frac{\text{Earnings before interest and tax}}{\text{Capital employed}}$

Capital employed

Capital employed = total asset – current liabilities

2021

EBIT = 805 + 19 + 22 = 846

$846 / (9736 - 2511) = 846 / 7225 = 0.1170$

2020

EBIT = 699 + 26 + (5) = 720

$720 / (10,087 - 3,046) = 720 / 7041 = 0.1022$

2. ROE

FORMULA= $\frac{\text{net income}}{\text{Shareholders' equity}}$

Shareholders' equity

Shareholders' equity = total assets – total liabilities

2021

431

9,736 - 6648

$$431/3088=0.1396$$

2020

$$\underline{366}$$

$$10,087 - 7,175$$

$$366/2912 = 0.1257$$

3. Earnings per share

FORMULA= Net income of the company

Average outstanding shares of the company

EPS = net income of the company- dividend to preferred to shareholders

Average outstanding shares of the company

2021

Net income = 431

Dividend to preferred shares = 255

Average outstanding shares= 1371

$$(431-255)/ 1371 = 0.128$$

2020

Net income =366

Dividend to preferred shareholders =242

Average outstanding shares =1371

$$(366- 242) / 1371 = 0.09$$

4. Net profit margin

$$\text{FORMULA} = \frac{\text{Net profit}}{\text{Revenue}} \times 100$$

2021

$$(431 / 6,738) \times 100 = 6.397$$

2020

$$(366) / (6441) \times 100 = \\ = 5.682$$

5. Asset Turnover

$$\text{FORMULA} = \frac{\text{Net sales}}{\text{Average total asset}}$$

2021

$$\frac{6,738}{(10,087 + 9736 / 2)}$$

$$= 0.67$$

$$= 0.67$$

2020

$$\frac{6,441}{10,087}$$

$$= 0.63$$

$$= 0.63$$

6. Stock holding days

$$\text{FORMULA: cost of goods sold (COGS) / average value of inventory}$$

2021

COGS= 3,235

Average Value of Inventory= 708

Stock holding days = $3,235/708 = 4.6\text{days}$

2020

COGS = 3096

Average Value of Inventory = 659

Stock holding days = $3096/659 = 4.7\text{days}$

7. Debtors collection period

FORMULA: $\{\text{Account receivable} / \text{total net sales}\} \times 365$

2021

Receivables = 1249

Total net sales = 6,738

$\{(1249/6738) \times 365\} = 67.66 \text{ days}$

2020

Receivables = 1287

Net sales = 6441

$\{(1287/6441) \times 365\} = 72.93 \text{ days}$

8. Current ratio

FORMULA= current asset / current liabilities

2021

Current assets = 2303

Current liabilities 2,511

$(2,303/2,511) = 0.917$

2020

Current asset = 2355

Current liabilities = 3046

$(2,355/3,046) = 0.773$

9. Gearing ratio

FORMULA: Total Debts

Total Assets

2021

Total debts = 4137

Total assets = 9,736

4137

9736

$=0.4249$

2020

Total debts = 4129

Total asset = 10,087

4129

10087

$$=0.4093$$

10. Interest cover

$$\text{FORMULA} = \frac{\text{EBIT}}{\text{Interest expenses}}$$

Interest expenses

2021

$$\text{EBIT} = 846$$

$$\text{Interest expenses} = 226$$

$$\frac{846}{226}$$

$$= 3.743$$

2020

$$\text{EBIT} = 720$$

$$\text{Interest expenses} = 181$$

$$\frac{720}{181}$$

$$= 3.978$$

Question 2 (b)

Comments on Sweet PLC's financial performance and position based on these ratios

ROCE

The return on capital employed assesses the company's profitability and capital efficiency (Zeller, *et al.*, 2019). There is improved performance in the capital employed by the company, recording higher ROCE in 2021(0.1170) compared to 0.1022 in 2020. This also indicates that in 2021, Sweet plc's profit increased.

ROE

The return on equity ratios measures the company's profitability and how efficiently sweets plc generates the profits. From the ratios, Sweet plc recorded higher profits in 2021as compared to 2020; there was higher efficiency in 2021 in generating the profits compared to 2020

EPS

This measures how much money sweet plc can earn from each share of its stock. It, therefore, indicates the company's value in the exchange market.in 2021 the company had a higher value as compared to 2020. It had a greater EPS of 0.1396 compared to 2020, which was at 0.1257. More investors were, therefore, able to pay more for the company's shares in 2021 compared to 2020.

Net profit margin

This shows how the company profits or the income is generated as percentage revenue (Ainsworth and Deines, 2019). The company has poor profits, recording below 10 % in its profit margins. The company performed better in 2021, recording a profit margin of 6.397% compared to 2020 when it had 5.682%.

Asset turnover

This indicates how efficiently the company deploys assets to generate revenues (Felber *et al.*, 2019). The company's efficiency in deploying the assets to generate revenues is poor, as the asset

turnover ratio in the retail sector should be 2.5 or greater to be considered good. The company has recorded less than 2.5 asset turnover ratio in both years.

Stock holding days

This depicts the number of days that the sweet plc. Holds the inventory or the stock before making sales (Scott, 2018). The company has perfect stock holding days and makes sales very fast to the consumers. In both years, the company has 4.6 and 4.7 stock holding days in 2021 and 2020, respectively

Debtor's collection period

This indicates the average time that the company takes to collect debts (Gabric, 2018). In 2021 the company recorded 67.66 days which shows reducing the number of debtors collection period compared to 2020, which was 72.93; this indicates increased efficiency by Sweet plc. However, the company has a bad collection period to be most efficient; the company needs to collect the debts on average 45 days.

Current ratio

This assesses and measures how efficiently the company can pay the short-term obligation, usually due within one year (Morales-Díaz and Zamora-Ramírez, 2018). This includes short-term loans. Current ratios of 1.50 are good, showing ample liquidity for the company. In both years, sweet plc has a current ratio below 1.50 showing the company is struggling to meet its short-term obligation. The company has few assets to pay the company's current liabilities.

Gearing ratio

This shows the financial leverage of sweet plc. It shows the proportion of debts versus equity (Scott, 2018). The company, therefore, has an average proportion of debts versus equity. In 2021 the company recorded 0.4249, which is 42.49 %, while in 2020, its gearing ratio is 0.4093, which is 40.93. While a gearing ratio lower than 25 is considered low risk, a gearing ratio between 25% and 50 % is normal. This company's gearing ratio falls between 25%- 50%, which is normal. It also indicates the company has a higher degree of financial leverage

Interest cover ratio

This assesses how easy the company can pay interest on outstanding debts (Zeller, *et al.*, 2019). Two is least considered acceptable for any company. From the ratios, the company has 3.743 and 3.978 in 2021 and 2020, respectively. In 2020 the company had higher operating profits to meet the interest compared to 2021.

References

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