

LCBB4001 ACCOUNTING FUNDAMENTALS

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Accounting Fundamentals Assessment 1

Solution1

Income Statement for the year ended 31st December 2019

Particulars	Amount £m
Sales	30,300
Cost of sales	18780
Gross Profit	11520
Distribution Cost	-2160
Administration expense	-4140
Operating Profit	
Finance Cost	-800
Profit before taxation	4420
Taxation	-1600

Profit for the Year	2820
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**Statement of Financial Position as on 30st
December 2019**

Particulars	Amount £m	Amount £m
Property, plant & equipment	49500	
Current Assets		
Inventory	3120	
Trade Receivables	7840	
Bank	320	
Total Assets		60780
Current Liabilities		
Trade Payables	4480	

Other creditors(accumulated depreciation and provision for receivables, outstanding insurance)	9920	
Long Term Loans		
12% debentures 2024	4000	
Total liability		18400
Equity		
£1 ordinary shares	29000	
Share premium	5000	
Retained earning	8380	42380
Total Liability		60780

Working Notes:

1. Depreciation on Building=Cost *rate of depreciation/100

So $16000 \times 2/100 = 320$

2. Depreciation on Plant

$25600 \times 10/100 = 2560$

3. Receivables= $8240 - 240(\text{bad debts}) = 8000 \times 2/100 = 160$ (Deduction as commission)

4. Land revalued at £20,000,000

5. Cost of Goods sold= $16220 + 2560 = 18780$

6. Administration cost= $2920 + 320 + 240 + 160 + 500 = 4140$

320 depreciation on building

160 Receivables deduction

240 Bad debts

500 Insurance

7. Equipment , plant and machinery= $20000 + 11420 + 18080 = 49500$

Solution 2:

1. Return on capital employed: EBIT/ total assets – current liabilities

- year 2018:

$$\text{EBIT} = 26.2$$

Capital employed = total assets – current liabilities

$$293.8 - 148.4 = 145.4$$

$$\text{ROCE} = 0.18$$

- year 2019

$$\text{EBIT} = 22.8$$

Capital employed = total assets – current liabilities

$$286.1 - 151.0 = 131.1$$

$$\text{ROCE} = 0.17$$

2) Return on equity = net income / equity

Year 2018:

$$\text{Net income} = 18.3$$

$$\text{Equity} = 80.3$$

$$\text{ROE} = 18.3 / 80.3 = .23$$

Year 2019:

Net income = 12.9

Equity = 93.2

Roe = .14

3) $\text{EPS} = \text{profit after tax} - \text{dividend} / \text{number of equity shares}$

Year 2018:

Profit after tax = 18.3

Number of equity shares = 17.8

EPS = 1.03

Year 2019

Profit after tax = 12.9

Number of equity shares = 17.8

EPS = .72

4) $\text{Gross profit margin} : \text{net sales} - \text{COGS} / \text{net sales}$

Year 2018:

Net sales = 486.8

COGS = 299.9

Gross profit margin = $486.8 - 299.9 / 486.8 = .38$

Year 2019

Net sales = 501.3

COGS = 309.5

Gross profit margin = $501.3 - 309.5 / 50.3 = .38$

5) Assets turnover = net sales / total assets

Year 2018 =

Total assets = 293.8

Net sales = 486.8

Assets turnover = 1.66

Year 2019 =

Total assets = 286.1

Net sales = 508.3

Assets turnover = 1.78

6) Year 2019 =

Stock holding period =

Inventory/Cost of sales*365=

$38.8/309.5*365=45.76$

Year 2018

$41.1/299.9*365$

=50.02

7) Debtors collection period = (average debtors / credit sales) 365 days

Year 2018 =

= $114.7 / 486.8 * 365 = 86$ days

Credit sales = Revenue (Assume)

Year 2019 =

= $114.9 / 501.3 * 365 = 83.66$

Credit sales = Revenue (Assume)

8) Current ratio = current assets / current liabilities

Year 2018 =

Current assets = 156.5

Current liabilities = 148.4

Current ratio = 1.05

Year 2019 =

Current assets = 153.9

Current liabilities = 151

Current ratio = 1.02

9) Gearing ratio = long term debt + short term debt / shareholders equity

Year 2018 =

Long term debt = 65.1

Short term debt = 148.4

Equity = 80.3

Gearing ratio = $148.4 + 65.1 / 80.3 = 2.66$

Year 2019 =

Short term debt = 151

Long term debt = 41.9

Equity = 93.2

Gearing ratio = $151 + 41.9 / 93.2 = 2.07$

10) Interest cover = earnings before interest and tax (EBIT) / INTEREST EXPENSE

Year 2018 =

EBIT = 26.2

Interest expense =

Interest cover ratio =

Year 2019 =

EBIT = 22.8

Interest expense =

Interest coverage ratio =

b) The situation revealed by each ratio is:

- Return in capital employed = not very much difference found between the return on capital employed of both the years for 2019 is .17 and for 2018 is .18 so we can say that 2018 was more efficient than 2019 (Konchitchki, et. al., 2016).
- Return on equity: IN general the ratio from 15 to 20 % is considered good the ROE of 2018 is 23% and of 2019 is 14% so it is considered that in year 2018 the return on equity was good than in year 2019.
- EPS: in 2018 EPS shown good, this is 1.03 in comparison to the year 2019 which is .72.
- Gross profit margin: the gross profit margin defines the company's financial position and it is shown that in year 2018 was as same as that in the year 2019 which is 38%.
- Assets turnover: It is calculated to find the earning of the company as per the invested assets in the company so the value of assets that is a higher ratio is much better and it is seen that in year 2019 i.e. 1.78 is higher than in year 2018 i.e.1.66 that is better then (Bushman, 2016).
- Debtors' holding period: Stock holding period is 45.76 in FY 2018 and in FY 19 it was 50.02 that means in 20178 stock hold for less days in comparison to FY 2019.
- Debtor's collection period: IN FY 18 it is recovered in 86days and in FY 19 it is recovered in 83.66 days that indicated that in FY 19 debtors paying fast, this ratio indicated the payment received from the debtors.
- Current ratio: A adequate current ratio must have to be between 1to 2 and it is seen that in yaer2018 it is 1.5 and in year 2019 it is 1.2 both are sound ratios but in year 2018 was something better than of 2019.
- Gearing ratio: It is calculated to find the value of transaction on which the loan amount is used, as their funding the gearing ratio of year 2018 is 2.66 and that of the year 2019 is 2.07 the ratio of year 2018 is much better than the ratio of 2019 (Dunn, 2018).

Solution 3:

a) The three user groups interested in financial statements are:

- **Management:** Management is the main user of the financial statement. The accounting department prepared it as per the performance of the business and then they discuss it with the management and management used it for the better management of funds of the business. With the help of this they check the growth by compare the two years data. They mainly looks on the cash flows, liquidity, cash balances etc. with this they knows about the growth and progress of the company and also helps in making good decisions for making huge profit efficiently. And they used it to earn more and more profit with existing recourses.
- **Investors:** In case of Company they are the owners of the company. So it the right of the shareholders to know the financial position of the business and take the decision of further investment in the company (Konchitchki, et. al., 2016). They keep them self updated by checking the financial statements and other statements of the company. So it is demanded by them to provides financial statement as per required and mandatorily at the end of year.
- **Customers:** Customers are also the user of the financial data as it is the habit of the customer that they purchases goods from the company who is transparent in all aspects , for this they check the financial performance and make faith against the company.

b) The advantages of the financial reporting regime are:

- **Comparability:** For comparison in two relative years and from the competitors it is required, with the help of this one can take the decision of investment in the company.
- **Flexibility:** The provided data in this can be used as required as it is not required to use the data as it is, it can be used by making some modification in this, so it is more popular in the industry of finance (Dunn, 2018).
- **Provides high quality of standards:** The provided data are prepared by the qualified team so it is high in standard and many authorities believe on this so business can easily use this.

Disadvantages of financial reporting regime are:

- Not universally acceptable: The principal of making financial statement are not depends on generally acceptable principal so it is not widely accepted by the all legal authority, some people not making faith on this as they think business make it to manipulate the accounts for showing high growth.

- Manipulation of the standards: As different methods shown different results so it is the matter of doubt that in actual it is shown the actual performance of the business to only the matter of manipulation (Bushman, 2016).

Costs are increased: It increases the cost for the business, and the valuable times of the management are also spending on this so it is cost effective.

c) The limitations of financial statements are as follows:

- **Based on historical cost:** This is based on the historical cost of the item effective but in actual the cost of the related item is different so it is not present the actual valuation.

- **Intangible assets:** intangible assets are not recorded in this but the expenses made on those assets are recorded. By this the value of the business could affected badly.

- **Inflation Rate:** In case of inflation the valued assets are at book value not at inflated rate so it is not actual value of the assets (Mensah, et. al., 2016).

- **Time:** Financial statements are prepared for specific time period only.

- **Non financial Matters:** It is included only the financial matters the matter related to non-finance they are not considered in this so it is not realistic.

- **Personal prejudice:** As it is finalize by the manager so it may they manipulate it because of some personal issues so it is not always that it present fair value.

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