

Module: Accounting Fundamentals

ALEXANDRU ANDREI DAHORE

STUDENT NUMBER:2130564

MODULE CODE :LCBB4001

LECTURER:Winfred Soribe

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Introduction

A variety of accounting principles and their applications to organizations will be covered in this assessment. There are three questions given, and the answers to them are required. A few statements that need to be assessed are related to question 1. Appropriate illustrations will also be included in the conversation. In response to question 2, the data from the trial balance will be used to create Wales plc's income statement for the year that concluded on December 31, 2022. In question 3, accounting ratios will be assessed using Sweets plc's financial statements to examine the performance and financial health of the business throughout the various recorded periods.

When it comes to recording, analyzing, and reporting a business's financial transactions for the reported accounting period, accounting fundamentals are thought of as a collection of technical protocols. To create financial statements, such as statements of income, balance sheets, cash flow statements, etc., certain accounting rules are applied. Financial reporting is more transparent and accurate when the right standards and procedures are used (Warfield *et al.* 2007).

Main Body

Question 1

1. This assertion is unjustified because a company's statement of cash flows primarily displays the company's cash inflows and outflows. Together with the income statement and the balance sheet, or statement of financial position, it is also a financial statement. The net cash flow for the period is calculated from the difference between the cash inflows and outflows, and it is added to the initial balance of cash to get the closing cash balances for each period. The business's assets, liabilities, and equity are displayed in the statement of financial position. The balance sheet's two sides should always balance since the accounting formula is as follows: $\text{assets} = \text{liabilities} + \text{equity}$ (Nilsson and Stockenstrand, 2015).

2. It is not possible to regard the foregoing statement to be totally accurate. A business's resources that yield financial gains are its assets. Both current and non-current assets are referred to as

belonging to a corporation. Since non-current assets have been there for more than a year and bring value to the business, they are also considered fixed assets. Fixed assets lose value over time, in contrast to current assets. Some examples of fixed or not-current assets include plant and buildings, machinery, and equipment. On the other hand, intangible fixed assets lack physical substance and include things like copyright, goodwill, and patents. Nevertheless, unlike intangible assets, tangible fixed assets can be physically transported. Accordingly, the statement deviates from the accounting meaning of non-current assets (Peterdy, 2022).

3. It is not customary to present financial reports to the company's current shareholders because regulatory frameworks and jurisdictions suggest that all parties involved—including creditors, employees, suppliers, customers, and potential and actual shareholders—should receive access to the company's financial information. This is done in an effort to promote financial information accountability and transparency so that wise company decisions can be made. Complete financial disclosure to the public is required in order for a company to list on a stock exchange as a public limited company. Additionally, the management finds it simpler to make choices. Additionally, there are less opportunities for financial mismanagement and information manipulation. Additionally, the complete disclosure of financial records will enhance the company's reputation (Andon *et al.* 2015).

4. The inclusion of accruals and prepayments in the accounting records is significant, hence this assertion is not justified. The cash paid up front for the purchase of products or services that the business will receive shortly is known as prepayment. All of the costs that have happened but have not been noted in the financial records are called accruals. A company's balance sheet shows these two items under the respective sections for current assets and current liabilities. In order to ensure that the statements meet accounting requirements, these transactions must be taken into account in order to correct the expense account and make the statements more precise (Berry and Jarvis, 1991). Prepayments and accruals are documented in the statement of financial position to ensure uniformity and comparability of the financial statements.

5. Since there are several advantages to financial account regulation, the aforementioned argument is not supported. Regulation is needed to preserve the accuracy and transparency of financial data. Financial regulation also safeguards shareholders or investors since it ensures that the financial statements appropriately reflect the company's status and performance throughout the reported

period. Investors can therefore feel secure and decide on the best course of action for the company. The market will see a decrease in information asymmetry. Moreover, regulations stop unethical accounting activities including data manipulation and company secret information theft. This leads to increased stability in the financial system. Furthermore, the business can seek outside funding sources to raise funds after implementing regulatory compliances (IFRS, 2023).

6. The provided statement is accurate. Prior to a company's financial statements being prepared, the trial balance and ledger accounts need to be balanced. Businesses record their financial transactions in ledger accounts. A business's credit and debit transactions are displayed on a trial balance. Trial balance is generated in order to assess the mathematical faults of the double entry accounting system and verify the accuracy of ledger accounts. Correct recording of ledger accounts is shown by an equal trial balance on the credit and debit sides. Thus, it is possible to provide reliable financial statements, which the company's stakeholders will use to inform their decisions (Taxmann, 2022).

Question 2

One of the financial statements used to assess the company's financial performance is the income statement. The business's income statement for the reported year projects the amount of money received, the business's direct and indirect expenses, taxes, interest, and gross, operating, and net profits (Atrill *et al.* 2018). To help them make wise investment decisions in the company, this statement is especially helpful to external stakeholders and investors.

In the books of Wales plc	
For the year ended 31st December 2022	
Income Statement	
<i>Particulars</i>	<i>£</i>
Sales revenue	9,01,000
Cost of sales or purchases	5,78,650
Gross profit	3,22,350

Administrative expenses	1,70,000
Directors' remuneration	5,000
Distribution costs	28,000
Cost of debentures	4,000
Depreciation of equipment	65,000
Outstanding commission	2,000
Total operating expenses	2,74,000
Earnings before tax and interests (EBIT)	48,350
Interests paid	2,000
Earnings before Tax (EBT)	46,350
Corporation Tax	15,000
Earnings after Tax or profit for the year	31,350

Workings:

- i. Revenue raised from sales = Sales + credit sales = £900,000 + £1,000 = £901,000.
- ii. Gross income/ profit = Total sales revenue – cost of sales = £901,000 - £578,650.
- iii. Administrative costs = £160,000 + salaries payable for December = £160,000 + £10,000 = £170,000.
- iv. Debentures = 4% of £100,000 = £4,000.
- v. Costs of depreciation = 10% straight-line basis on £650,000 = £650,000*10% = £65,000.
- vi. Earnings before interests and tax (EBIT) = Gross profit – operating expenses = £322,350 - £274,000 = £48,350.
- vii. Earnings before Tax (EBT) = Operating profit – interest expenses = £48,350 - £2,000 = £46,350.

viii. Earnings after Tax or Net profit for the year = EBT – corporation tax = £46,350 - £15,000 = £31,350.

Question 3

a. Calculation of financial ratios

1- ROCE:

Since it assesses how successfully the company uses the capital raised for operating profit, the ROCE ratio is another helpful indicator of the profitability of the company. Return on Capital Employed (ROCE) is defined as the divisional value of the company's operating earnings and capital employed (total assets less current liabilities) (McLaney, 2005). Any company that can successfully employ capital investments to generate greater operational profit would have a higher ROCE ratio, which is always desirable.

Calculation of Return on Capital Employed		
Particulars	2022	2021
Earnings before interest and tax (EBIT)	805	699
Total Asset	9,736	10,087
Current liabilities	2,511	3,046
Capital employed	7,225	7,041
ROCE= EBIT/ Capital employed	11.14	9.93

2- ROE:

The ratio known as return on equity evaluates how well a business uses shareholder equity to generate net profit. A higher ratio indicates that the business has made better use of its equity to produce net profit; conversely, a lower ratio indicates the reverse and is not in the best interests of the organization (Tulsian, 2002).

Calculation of Return on equity (ROE)		
Particulars	2022	2021
Net income	431	366
Shareholders' equity	3,088	2,912

ROE= Net income/ Shareholders' equity

13.96%

12.57%

3- Earnings per Share (EPS):

EBITDA (earnings per share) ratio is also important to evaluate a company's success. To calculate the earnings per share (EPS), which indicates how many shares the company must sell to make a profit, the net profit of the business is divided by the average number of ordinary shares. Greater EPS indicates that the business sells enough common shares to achieve a sufficient net profit.

Calculation of Earnings per share		
Particulars	2022	2021
Net profit	431	366
Outstanding shares	300	300
Average outstanding shares	300	300
EPS= Net profit/ Average outstanding shares	1.44	1.22

4- Net profit margin:

An organization's ability to turn a profit from sales revenue is shown by its net profit margin. According to McLaney (2005), the net profit margin of a business is determined by dividing its net profit by its total sales revenue. Better firm profitability is correlated with a bigger net profit margin.

Net profit margin		
Particulars	2022	2021
Net profit	431	366
Total revenue	6738	6441
Net profit margin= (net profit /revenue)*100	6.40%	5.68%

5- Assets turnover:

The ability of a company to generate sales revenue in proportion to its assets is gauged by the asset's turnover ratio. A greater ratio indicates that the business makes effective use of its resources to increase sales. A low assets turnover ratio, however, highlights the misuse or underutilization of assets (Atrill *et al.* 2018).

Asset turnover		
Particulars	2022	2021
Total revenue	6738	6441
Total Asset	9,736	10,087
Asset turnover= Revenue/average total asset	0.69	0.64

6- Stock holding days:

Days of stock holding are a gauge of the company's financial health. The inventory days ratio indicates the average number of days needed by a company to sell off its inventory (Tulsian, 2002). A company's inventory days for the given period are calculated by dividing its average inventories by the cost of sales, and then multiplying the result by 365.

Stock holding days		
Particulars	2022	2021
Inventory	708	659
Cost of goods sold	3235	3096
Stock holding days= (Inventory/cost of goods sold) x 365	79.88 days	77.69 days

7- Debtors collection period:

One efficiency ratio that is also used to gauge credit clients' payment terms is trade receivable days, which is based on how long it takes them to pay the company (McLaney, 2005). A company's financial efficiency is indicated by a lower trade receivable day, which indicate that customers are paying for the products produced by the company more quickly.

Calculation of debtor's collection period		
Particulars	2022	2021
Trade receivables	1,249	1,287
credit sales	6,738	6,441
Debtors collection period= (Trade receivables/annual credit sales)*365	67.66 days	72.93 days

8- Current ratio:

According to McLaney (2005), the current ratio represents the proportion of a company's available current assets to its available current liabilities for the given period. This ratio illustrates how well the company can use its liquid assets to settle its short-term debt. Better corporate liquidity is indicated by a current ratio greater than 1.

Calculation of current ratio		
Particulars	2022	2021
Current asset	2,303	2,355
Current liabilities	2511	3046
Current ratio= current asset/ current liabilities	0.92	0.77

9- Gearing ratio:

The gearing ratio indicates the percentage of the company's equity that is financed by its long-term borrowing. A higher ratio suggests that the company has more financial leverage because debt financing accounts for the bulk of the equity raised by the business (Bull, 2007).

Calculation or gearing ratio		
Particulars	2022	2021
Loans and borrowings	4137	4129
Shareholder's equity	3,088	2,912
Gearing ratio= loans and borrowings/shareholder equity	1.420673077	1.41792582

10- Interest cover:

With the assessed earnings, the interest cover ratio calculates how many times the business can pay for current interests. Better corporate financial health is indicated by a higher interest cover ratio (Bull, 2007).

Calculation of interest cover		
Particulars	2022	2021
Earnings before interest and taxes (EBIT)	805	699

Interest expenses	226	181
Interest cover= EBIT/Interest expenses	3.56	3.86

b. Assessment of the company's financial performance and position

Through profitability ratios, the financial performance of the company can be compared over the two periods. The ROCE has increased from 2021 to 2022, which is an indicator that the capital employed of the company has been well used to raise more operating profit in 2022 compared to 2021. Also, the return on equity has increased in 2022, so shareholders can rest assured that more income has been raised by using the equity of shareholders effectively. Higher net profit margin opines that in 2022 the company has managed to contain its operating expenses to a lower level. EPS is higher in 2022, which indicates that the company has earned more net profit by issuing more shares. The liquidity position of the company has also improved in 2022 as the current ratio has gone higher. The company is more obliged to meet the financial obligations using its short-term resources. Also, using the most liquid resources, the short-term obligations are met. Sweet Plc's inventory days have increased in 2022, which means that the company has taken more time to sell the inventory in 2022, leading to a fall in financial efficiency. However, the debtor's collection period has fallen in 2022, which indicates that the company in 2022 recovers credit payments from customers more quickly compared to 2021. This indicates an improvement in cash flow position of the company. Gearing ratio in 2021 and 2022 are quite similar, meaning that the capital structure of the business has not changed much. However, the ratio is more than 1, which means that the equity of the company is financed more through long-term debts. However, the interest cover ratio has fallen, which means that in 2022, the company cannot be obliged to pay the interests using the operating income as effectively in 2022 as in 2021.

Conclusion

The applications of accounting principles by firms for a range of objectives have been covered in this examination. Accounting basics are important for financial reporting, financial statement

interpretation, and performance and health assessment. Complete financial information disclosure and regulatory compliance are necessary to preserve the accuracy and transparency of the business's financial statements. Decisions are also made by the business's stakeholders using the information that is connected to financial reports. The present analysis has taken into account the situations of Wales Plc and Sweets Plc.

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