

## BA291 – Introduction to Business

### Financial Information & Accounting Concepts

#### In-Class Exercise Solution

1. Financial accounting is concerned with providing relevant financial information of an organization to different types of external users. The primary focus of financial accounting is on the financial information provided by profit-oriented companies to their present and potential investors and creditors, whereas, managerial accounting's primary focus is concerned with preparing financial information for use by users within the organization.

2. There are five elements of financial statement: Asset Liability, Equity, Revenue and Expense

3. Accounting is a process of:

- Recording - business transactions in the books of accounts. It involves searching for the correct information that is material and has monetary value.
- Classifying - after recording, the transaction is further bifurcated into different accounts depending on the nature of the transaction.
- Summarizing – formation of financial statements and generation of understandable information that shall show overall position and performance of the company during a given period of time.
- Communication - refers to deriving conclusions on the company's position and performance from the financial statements and broadcasting the financial statements to users of financial information.

4.

- a. liability
- b. revenue
- c. asset
- d. asset, liability, equity
- e. revenue
- f. equity
- g. equity
- h. expense
- i. liability
- j. equity
- k. equity

5.

- account receivable – asset (current)
- sales – pasta's sauce – revenue
- inventory – asset (current)
- cash – asset (current)
- owner's drawings – equity
- salary payable – liability (current)
- service revenue – revenue
- cost of goods sold – expense
- equipment – asset (non-current)
- prepaid rent – asset (current)
- notes payable [due in 5 years] – liability (non-current)

unearned sales revenue – liability  
 equipment [factory machine] – asset (non-current)  
 employee’s salary – expense  
 share capital – equity  
 prepaid insurance – asset (asset)  
 depreciation – expense  
 interest receivable – asset  
 rent expense – expense  
 building – asset (non-current)  
 notes payable [due in 6 months] – liability (current)  
 taxes payable – liability (current)  
 owner’s capital – equity

6.

<b>Jackson Corporation</b>			
<b>Statement of Financial Position</b>			
<b>For the year ended December 31, 2018</b>			
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash			40,000.00
Marketable securities			10,000.00
Accounts receivable			34,000.00
Inventories			75,000.00
Prepaid rent			16,000.00
<b>Total Current Asset</b>			<b>175,000.00</b>
<b>Non-current assets:</b>			
<b>Property, plant &amp; equipment:</b>			
Machinery			145,000.00
Less: Accumulated depreciation			[11,000.00]
Net property, plant & equipment			134,000.00
Patent			83,000.00
<b>Total Non-current assets</b>			<b>217,000.00</b>
<b>TOTAL ASSETS</b>			<b>392,000.00</b>
<b>LIABILITIES &amp; EQUITY</b>			
<b>Current liabilities:</b>			
Accounts payable			8,000.00
Wages payable			4,000.00
Taxes payable			32,000.00
<b>Total current liabilities</b>			<b>44,000.00</b>
<b>Non-current liabilities:</b>			
Bonds payable			200,000.00
<b>Total Non-current liabilities</b>			<b>200,000.00</b>
<b>TOTAL LIABILITIES</b>			<b>244,000.00</b>
<b>Equity:</b>			
Ordinary share capital			100,000.00
Retained earnings			48,000.00
<b>TOTAL EQUITY</b>			<b>148,000.00</b>
<b>TOTAL LIABILITIES &amp; EQUITY</b>			<b>392,000.00</b>

7.

**Inventories:**

Current assets – Cash – Short-term investments – Account receivable – Prepaid expense =  
Inventories

$$1,594,927 - 239,186 - 353,700 - 504,944 - 83,259 = \$413,838$$

**Total assets:**

Total liabilities + Equity = Total assets

$$956,140 + 1,370,627 = \$2,326,767$$

**Property and Equipment (net):**

Total assets – Current assets – Long-term receivables = Property and equipment

$$2,326,767 - 1,594,927 - 110,800 = \$621,040$$

**Accounts payable:**

Total current liabilities – Notes payable and short-term debt – Accrued liabilities – Other  
current liabilities = Accounts payable

$$693,564 - 31,116 - 421,772 - 181,604 = \$59,072$$

**Long-term debt**

Total liabilities – Current liabilities = Long-term debt

$$956,140 - 693,564 = \$262,576$$

Trident Corporation			
Statement of Financial Position			
For year ended xxxx			
<b>ASSETS</b>			
<i>Current assets:</i>			
Cash			239,186.00
Short-term investments			353,700.00
Accounts receivable			504,944.00
Inventories			413,838.00
Prepaid expenses			83,259.00
<b>Total Current Assets</b>			<b>1,594,927.00</b>
<i>Non-current assets:</i>			
Long-term receivable			110,800.00
Property and equipment (net)			621,040.00
<b>Total Non-Current Assets</b>			<b>731,840.00</b>
<b>TOTAL ASSETS</b>			<b>2,326,767.00</b>
<b>LIABILITIES &amp; EQUITY</b>			
<i>Current liabilities:</i>			
Notes payable			31,116.00
Short-term debt			421,772.00
Accounts payable			59,072.00
Other current liabilities			181,604.00
<b>Total current liabilities:</b>			<b>693,564.00</b>
<i>Non-current liability:</i>			
Long-term debt			262,576.00
<b>Total Non-current liability</b>			<b>262,576.00</b>
<b>TOTAL LIABILITIES</b>			<b>956,140.00</b>
<i>Equity:</i>			
Shareholders' Equity			1,370,627.00
<b>TOTAL EQUITY</b>			<b>1,370,627.00</b>
<b>TOTAL LIABILITIES &amp; EQUITY</b>			<b>2,326,767.00</b>

8.  
a.)

Willow Company			
Income Statement			
For years ended December 2017 & 2018			
	2017	2018	
Luggages sold (units)	800		1,200
Price per unit (THB)	2,500		2,500
<b>Net Sales</b>	<b>2,000,000</b>		<b>3,000,000</b>
Luggages sold (units)	800		1,200
COGS per unit (THB)	350		400
<b>COGS</b>	<b>280,000</b>		<b>480,000</b>
<b>Gross profit</b>	<b>1,720,000</b>		<b>2,520,000</b>
<b>Selling, General &amp; Admin Expenses</b>	<b>90,000</b>		<b>900,000</b>
<b>Operating Income</b>	<b>1,630,000</b>		<b>1,620,000</b>
Interest expense	30,000		30,000
Tax expense (30% of OI)	489,000		486,000
<b>Net Income</b>	<b>1,111,000</b>		<b>1,104,000</b>

b.)

**Gross profit ratio: Year 2017 0.86; Year 2018 0.84** – for every dollar of sale in years 2017 and 2018, \$0.86 and \$0.84 returned as gross profit respectively.

**Net profit ratio: Year 2017 0.55; Year 2018 0.37** – for every dollar of sale in years 2017 and 2018, \$0.55 and \$0.37 returned as net profit respectively.

9.) The purpose and importance of profitability and financial risks analysis are to evaluate the financial performance and position of the company in terms of profitability and risks. The ratios help users to review the financial statements to make informed decisions about the business.

10.)

***Profitability Ratios:***

**Gross profit ratio** establishes a relationship between gross profit earned and net revenue generated from operations.

**Net profit ratio** represents how much of sales revenue has translated into income. This ratio shows how much of each \$1 of sales is returned as profit. The larger the ratio figure (the closer it gets to 1), the more of each sales dollar is returned as profit.

**Return on assets** the return on total assets measures the company's ability to use its assets successfully to generate a profit. The higher the return (ratio outcome), the more profit is created from asset use.

**Return on equity** return on equity measures the company's ability to use its invested capital to generate income. The invested capital comes from stockholders investments in the company's stock and its retained earnings and is leveraged to create profit. The higher the return, the better the company is doing at using its investments to yield a profit.

***Financial Risks Ratios:***

***Liquidity***

**Current ratio** the current ratio considers the amount of current assets available to cover current liabilities. The higher the current ratio, the more likely the company can cover its short-term debt.

**Quick ratio** The quick ratio, also known as the acid-test ratio, is similar to the current ratio except current assets are more narrowly defined as the most liquid assets, which exclude inventory and prepaid expenses. The conversion of inventory and prepaid expenses to cash can sometimes take more time than the liquidation of other current assets. A company will want to know what they have on hand and can use quickly if an immediate obligation is due.

***Leverage***

**Debt ratio** debt ratio measures the proportion of assets paid for with debt. A high ratio implies that the bulk of company financing is coming from debt; this is a risky financial structure, since the borrower is at risk of not being able to pay for the associated interest expense or paying back the principal. A low debt ratio reflects a conservative financing strategy of using only equity to pay for assets.

**Debt to equity ratio** The debt-to-equity ratio shows the relationship between debt and equity as it relates to business financing. A company can take out loans, issue stock, and retain earnings to be used in future periods to keep operations running. It is less risky and less costly to use equity sources for financing as compared to debt resources. This is mainly due to interest expense repayment that a loan carries as opposed to equity, which does not have this requirement. Therefore, a company wants to know how much debt and equity contribute to its financing. Ideally, a company would prefer more equity than debt financing

11.

**Gross profit ratio: 0.5**

**Net profit ratio: 0.29**

It means every dollar of sales, \$0.5 returned as gross profit and \$0.29 returned as net profit. If Barry's Superstore thinks it is still low, they should consider reducing expenses and increase sales.

**Return on assets: 0.16**

**Return on equity: 0.37**

The higher the result, the better the company is using their assets (ROA) and investments (ROE) to generate profit. The company should compare the current result with the previous years and evaluate how effectively they have been utilizing their assets and equity to generate profit.

**Current ratio: 2 or 2:1**

The company has twice as many current assets as current liabilities. The company has enough current assets to cover its obligation. But if the company has too many current assets, they should consider investing their assets in different ways to grow the company.

**Quick ratio: 1.6 or 1.6:1**

The company has enough quick assets to cover their immediate obligation.

**Debt ratio: 0.6**

60 per cents of the company's assets are financed through debt. This is a concern because it is more than half of the company assets (50%) which are being financed through debt.

**Debt to equity ratio: 1.5**

\$1.50 of the company's equity is contributed from lenders. This is a concern because it is trending towards insolvency. The company wants to get below 1 to improve their long-term business viability.

- end -