

ACCOUNTING AND FINANCE

AN INTRODUCTION

TENTH EDITION

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	2017 £m	2018 £m
EQUITY AND LIABILITIES		
Equity		
Called-up ordinary share capital	100	100
Retained earnings	<u>56</u>	<u>57</u>
	<u>156</u>	<u>157</u>
Non-current liabilities		
Borrowings – loan notes (10%)	<u>40</u>	<u>40</u>
Current liabilities		
Borrowings (all bank overdraft)	–	2
Trade payables	37	34
Taxation	<u>8</u>	<u>3</u>
	<u>45</u>	<u>39</u>
Total equity and liabilities	<u>241</u>	<u>236</u>

Included in 'cost of sales', 'distribution expenses' and 'administrative expenses', depreciation was as follows:

	2017 £m	2018 £m
Land and buildings	6	10
Plant and machinery	10	12

There were no non-current asset disposals in either year. The amount of cash paid for interest equalled the expense in each year. Dividends were paid totalling £18 million in each year.

Required:

Prepare a statement of cash flows for the business for 2018.

- 6.5** The following are the financial statements for Nailsea plc for the years ended 30 June 2018 and 2019:

Income statement for years ended 30 June

	2018 £m	2019 £m
Revenue	1,230	2,280
Operating expenses	(722)	(1,618)
Depreciation	<u>(270)</u>	<u>(320)</u>
Operating profit	238	342
Interest payable	–	(27)
Profit before taxation	238	315
Taxation	<u>(110)</u>	<u>(140)</u>
Profit for the year	<u>128</u>	<u>175</u>

Statements of financial position as at 30 June

	2018 £m	2019 £m
ASSETS		
Non-current assets		
<i>Property, plant and equipment (at carrying amount)</i>		
Land and buildings	1,500	1,900
Plant and machinery	<u>810</u>	<u>740</u>
	<u>2,310</u>	<u>2,640</u>

	2018 £m	2019 £m
Current assets		
Inventories	275	450
Trade receivables	100	250
Bank	—	118
	<u>375</u>	<u>818</u>
Total assets	<u>2,685</u>	<u>3,458</u>
EQUITY AND LIABILITIES		
Equity		
Share capital (fully paid £1 shares)	1,400	1,600
Share premium account	200	300
Retained earnings	<u>828</u>	<u>958</u>
	<u>2,428</u>	<u>2,858</u>
Non-current liabilities		
Borrowings – 9% loan notes (repayable 2025)	—	300
Current liabilities		
Borrowings (all bank overdraft)	32	—
Trade payables	170	230
Taxation	<u>55</u>	<u>70</u>
	<u>257</u>	<u>300</u>
Total equity and liabilities	<u>2,685</u>	<u>3,458</u>

There were no disposals of non-current assets in either year. Dividends were paid in 2018 and 2019 of £40 million and £45 million, respectively.

Required:

Prepare a statement of cash flows for Nailsea plc for the year ended 30 June 2019.

Advanced-level exercises

6.6

The following financial statements for Blackstone plc are a slightly simplified set of published accounts. Blackstone plc is an engineering business that developed a new range of products in 2015. These products now account for 60 per cent of its sales revenue.

Income statement for the years ended 31 March

	Note	2018 £m	2019 £m
Revenue		7,003	11,205
Cost of sales		<u>(3,748)</u>	<u>(5,809)</u>
Gross profit		3,255	5,396
Operating expenses		<u>(2,205)</u>	<u>(3,087)</u>
Operating profit		1,050	2,309
Interest payable	1	<u>(216)</u>	<u>(456)</u>
Profit before taxation		834	1,853
Taxation		<u>(210)</u>	<u>(390)</u>
Profit for the year		<u>624</u>	<u>1,463</u>

Statements of financial position as at 31 March

	Notes	2018 £m	2019 £m
ASSETS			
Non-current assets			
Property, plant and equipment	2	4,300	7,535
Intangible assets	3	–	700
		<u>4,300</u>	<u>8,235</u>
Current assets			
Inventories		1,209	2,410
Trade receivables		641	1,173
Cash at bank		123	–
		<u>1,973</u>	<u>3,583</u>
Total assets		<u>6,273</u>	<u>11,818</u>
EQUITY AND LIABILITIES			
Equity			
Share capital		1,800	1,800
Share premium		600	600
Capital reserves		352	352
Retained earnings		685	1,748
		<u>3,437</u>	<u>4,500</u>
Non-current liabilities			
Borrowings – bank loan (repayable 2024)		1,800	3,800
Current liabilities			
Trade payables		931	1,507
Taxation		105	195
Borrowings (all bank overdraft)		–	1,816
		<u>1,036</u>	<u>3,518</u>
Total equity and liabilities		<u>6,273</u>	<u>11,818</u>

Notes:

- 1 The expense and the cash outflow for interest payable are equal for each year.
- 2 The movements in property, plant and equipment during the year are:

	Land and buildings £m	Plant and machinery £m	Fixtures and fittings £m	Total £m
Cost				
At 1 April 2018	4,500	3,850	2,120	10,470
Additions	–	2,970	1,608	4,578
Disposals	–	(365)	(216)	(581)
At 31 March 2019	<u>4,500</u>	<u>6,455</u>	<u>3,512</u>	<u>14,467</u>
Depreciation				
At 1 April 2018	1,275	3,080	1,815	6,170
Charge for year	225	745	281	1,251
Disposals	–	(305)	(184)	(489)
At 31 March 2019	<u>1,500</u>	<u>3,520</u>	<u>1,912</u>	<u>6,932</u>
Carrying amount at 31 March 2019	<u>3,000</u>	<u>2,935</u>	<u>1,600</u>	<u>7,535</u>

- 3 Intangible assets represent the amounts paid for the goodwill of another engineering business acquired during the year.
- 4 Proceeds from the sale of non-current assets in the year ended 31 March 2019 amounted to £54 million.
- 5 £300 million was paid in dividends on ordinary shares in 2018, and £400 million in 2019.

Required:

Prepare a statement of cash flows for Blackstone plc for the year ended 31 March 2019. (*Hint:* A loss (deficit) on disposal of non-current assets is simply an additional amount of depreciation and should be dealt with as such in preparing the statement of cash flows.)

6.7 Simplified financial statements for York plc are:

Income statement for the year ended 30 September 2019

	£m
Revenue	290.0
Cost of sales	(215.0)
Gross profit	75.0
Operating expenses (Note 1)	(62.0)
Operating profit	13.0
Interest payable (Note 2)	(3.0)
Profit before taxation	10.0
Taxation	(2.6)
Profit for the year	<u>7.4</u>

Statement of financial position as at 30 September

	2018 £m	2019 £m
ASSETS		
Non-current assets (Note 4)	<u>80.0</u>	<u>85.0</u>
Current assets		
Inventories and trade receivables	119.8	122.1
Cash at bank	9.2	16.6
	<u>129.0</u>	<u>138.7</u>
Total assets	<u>209.0</u>	<u>223.7</u>
EQUITY AND LIABILITIES		
Equity		
Share capital	35.0	40.0
Share premium account	30.0	30.0
Reserves	<u>31.0</u>	<u>34.9</u>
	<u>96.0</u>	<u>104.9</u>
Non-current liabilities		
Borrowings	<u>32.0</u>	<u>35.0</u>
Current liabilities		
Trade payables	80.0	82.5
Taxation	<u>1.0</u>	<u>1.3</u>
	<u>81.0</u>	<u>83.8</u>
Total equity and liabilities	<u>209.0</u>	<u>223.7</u>

Notes:

- 1 Operating expenses include depreciation of £13 million and a surplus of £3.2 million on the sale of non-current assets.
- 2 The expense and the cash outflow for interest payable are equal.
- 3 A dividend of £3.5 million was paid during 2019.
- 4 Non-current asset costs and depreciation:

	<i>Cost</i> <i>£m</i>	<i>Accumulated depreciation</i> <i>£m</i>	<i>Carrying amount</i> <i>£m</i>
At 1 October 2018	120.0	40.0	80.0
Disposals	(10.0)	(8.0)	(2.0)
Additions	20.0	–	20.0
Depreciation	<u>–</u>	<u>13.0</u>	<u>(13.0)</u>
At 30 September 2019	<u>130.0</u>	<u>45.0</u>	<u>85.0</u>

Required:

Prepare a statement of cash flows for York plc for the year ended 30 September 2019.

Analysing and interpreting financial statements

Introduction

In this chapter, we consider the analysis and interpretation of the financial statements discussed in Chapters 2, 3 and 6. We shall see how the use of financial (or accounting) ratios can help to assess the financial performance and position of a business. We shall also take a look at the problems encountered when applying financial ratios.

Financial ratios can be used to examine various aspects of financial health and are widely employed by external users, such as shareholders and lenders, and by managers. They can be very helpful to managers in a wide variety of decision areas, such as profit planning, pricing, working capital management and financial structure.

Learning outcomes

When you have completed this chapter, you should be able to:

- identify the major categories of ratios that can be used for analysing financial statements;
- calculate key ratios for assessing the financial performance and position of a business and explain their significance;
- discuss the use of ratios in helping to predict financial failure; and
- discuss the limitations of ratios as a tool of financial analysis.