

Service Firms Theory | Accounting

Why do firms prepare accounts?

- To calculate profit.
- To assess the effectiveness of different parts of the organisation.
- To use as a business plan when trying to attract investment.
- To calculate tax liability.

Factors a lender should consider before granting a loan. (2018):

- Gearing – The firm has no long-term loans at the moment which would encourage a lender to grant a loan.
- Ability to pay interest – The net profit is (€44,745) with no interest charges at present. The acid test ratio is (1.92:1) meaning the firm is liquid and could easily meet future interest charges.
- What is the purpose of the loan? The purpose of the loan is to update the IT system making the company more efficient going into the future.
- What security can she offer? Security is adequate with fixed assets of (€174,800) and investments of (€100,000) to cover a loan of (€150,000).

Arguments against increasing clients' fees to help clear a bank overdraft. (2014):

- The Centre is profitable and is generating enough cash to clear the overdraft without taking any remedial action that could have negative effects on profitability.
- The proposed increase of (15%) in clients' fees would raise only (€49,620) based on this year's figures. This is only (one third) of the overdraft of (€135,000) and so would not be adequate. This increase in fees could however cause a drop in membership with loss of income.
- Based on this year's figures the overdraft will have been cleared by the end of next year without taking any remedial action now. The Centre this year has repaid a loan of (€50,000) plus interest (€6,000) and had capital expenditure of (€295,000) (Equipment (€15,000), Extension (€230,000), Vehicles (€50,000)). This is all non-recurring expenditure.
- The Centre had a surplus of (€157,040) this year and is clearly being run profitably and will continue to be profitable. Its return on capital employed is (17.1%).