LC Accounting (Interpretation of Accounts) – Key Definitions

Formula - Return on Capital Employed (ROCE)

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Net Profit after Taxes X 100
Gross Capital Employed
(%)

Return on Shareholders' Funds

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Profit after Tax and
Preference Dividends
Ordinary Shares +
Reserves
(%)

Gross Profit Margin

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Gross Profit x 100
Sales

Net Profit Margin

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Net Profit x 100
Sales
(%)

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Dividend per Share	$\dfrac{\text{Total Ordinary Dividend}}{\text{No. of Issued Ordinary Shares}}$
Dividend Yield	$\dfrac{\text{Dividend per Share x 100}}{\text{Market Value}}$ (%)
Real Rate of Return on Shares	Dividend Cover x Dividend Yield (%)
Earnings per Share	$\dfrac{\text{Net Profit after Preference Dividend}}{\text{No. of Issued Ordinary Shares}}$ (cent)

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Price Earnings Ratio	<u>Market Price</u> Earnings Per Share (cent)
Time to recoup share value	<u>Market Price</u> Dividend per Share (years)
Dividend Cover	Net Profit after <u>Preference Dividend</u> Ordinary Dividend (times)
Current Ratio	Current Assets ÷ Current Liabilities : 1

Quick Ratio / Acid test

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$$\frac{\text{Current Assets - Closing Stock}}{\text{Current Liabilities}} : 1$$

Gearing Ratio

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$$\frac{\text{Debt Capital x 100}}{\text{Total Capital}}$$

(%)

Average Stock

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$$\frac{\text{Opening Stock + Closing Stock}}{2}$$

Rate of Stock Turnover

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$$\frac{\text{Cost of Sales}}{\text{Average Stock}}$$

(times)

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Period of Credit given to Debtors	Debtors x (365 / 12) / Credit Sales (days / months)
Period of Credit received from Creditors	Creditors x (365 / 12) / Credit Purchases (days / months)
Interest Cover	Net Profit before Interest / Interest paid (times)
Predicted Market Value	P/E ratio x Earnings per Share

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Real Value of Shares	Last year's P/E ratio x by this year's Earnings per Share
Solvency	A company's ability to pay all of its' debts as they fall due in the long term.
Limitations of Ratio Analysis	- Often not comparable between firms. - Do not account for seasonal fluctuations. - Relies on historical data.
How to increase liquidity	-Paying out lower dividends. -Selling investments. -Issuing more shares. -Collect debts faster.

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LC Accounting (Incomplete Records) – Key Definitions

Advice for better record keeping	-Keep a detailed cash book and ledger. -Accurate accounts. -Avoid reliance on estimates.
Four fundamental concepts of accounting	- Accruals - Going Concern - Prudency - Consistency
Accruals	All expenses incurred and revenue income in a particular period must be included in the accounts of that period, regardless of when they were paid or received.
Going Concern	When an accountant is preparing company accounts, they must be able to assume that the company will continue indefinitely.

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Causes of a decrease in gross profit percentage

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- Cash losses.
- Stock losses.
- Mark downs during sales.
- Incorrect stock valuation.
- Higher cost of sales.

How to lower gearing

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- Issue more ordinary shares.
- Repay debentures.

Liquidity

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The ability of a company to pay its short-term debts as they fall due.

Gearing

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Represents debt as a percentage of total capital employed.

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Consistency

A firm should use the same methods of accounting for an accounting issue each and every time.

Prudency

When preparing accounts revenue should not be overestimated and expenses should not be underestimated.

Extra information 'double-entry' provides

- Trial Balance
- Total Sales & Purchases figures
- Bank balance
- Capital and Drawings

Characteristics of good accounting

- Relevant
- Reliable
- Easily understood
- Comparable

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Term	Definition
Advantages of budgeting	- Provides advance warning of potential difficulties. - Helpful when attracting investment. - Can be used for decision-making.
Flexible budgeting	Flexible budgets are used to show how costs, and as a result profits, are likely to change at different levels of production.
Adverse Variance	When the difference between an actual cost or revenue and the previously budgeted amount is worse than expected e.g. budgeted expenses turn out to be higher.
Controllable Costs	Costs over which the firm has power or control, such as wages.

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Uncontrollable Costs	Costs which the firm has no power or control over, such as raw materials.
Factors to consider when budgeting	- Last year's sales - The state of the economy - Sales of competing firms - Results of market research - Trends in the market
Principle Budgeting Factor	This is the element that restricts the firm from expanding indefinitely, such as capital availability or production capacity.
Capital Budget	Consists of the large-scale or long-term revenue and expenditure that a firm expects to incur, e.g. the construction of a premises.

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Cash Budget	A cash budget is an estimate of the future income and expenditure of the firm, in order to identify periods of excess expenditure or a surplus of cash.
Mixed cost	A cost with both fixed and variable elements.
Step Cost	This is a cost that is fixed between certain levels of production before changing, e.g. factory rent might change as a larger factory is required.
Direct Cost	A cost that can be completely attributed to the production of specific goods or services.

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Financial accounting characteristics

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Financial accounting records transactions of the past, usually for external stakeholders and is also legally required.

Management accounting characteristics

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Management accounting deals with predictions for the future, is used for internal decisions, and is optional.

Apportionment of Costs

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Apportionment occurs where indirect costs are divided out using a suitable basis.

Allocation of Costs

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Allocation occurs where direct costs are linked specifically to the item being produced.

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LC Accounting (Cashflow Statements) – Key Definitions

Cashflow Statement	Measures the cash inflow and outflow for the year. Shows the difference between cash-flow and profit. Aids in financial planning and to attract possible investment.
Non-Cash Item	A non-cash item is an expense or gain that effects profit but doesn't involve cash inflow or outflow.
Income vs. Profit	Profit does not always mean an increase in cash because there are many items that influence the profit of a firm but that do not involve an inflow of cash.
Solvency	A firm is solvent if total assets exceed all outside liabilities.

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Obligations of a PLC	- Provide a full set of accounts, balance sheet and a cashflow statement to shareholders. - Register a full set of accounts with the registrar of companies.
Responsibilities of a PLC Director	- To comply with the Companies Act. - To keep proper accounting records. - Publish Final Accounts annually.
Financial Reporting Standard 1	Requires large companies to prepare a Cash Flow Statement for each activity period, which should be entered under standard headings according to their purpose.
Financial Reporting Standards	Accounting standards issued by the Accounting Standards Board which dictate accounting expectations for firms.

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Five types of errors that are not revealed by the trial balance	1. Error of Omission. 2. Error of Commission. 3. Error of Principle. 4. Reversal of Entries. 5. Error of Original Entry.
Error of Omission	When the accountant completely omits a transaction from the books.
Error of Commission	When a transaction is attributed to the wrong account (e.g. two debtors are confused).
Error of Principle	When the incorrect type of account is used (e.g. a fixed asset is bought and debited as stock)

LC Accounting (Correction of Errors) – Key Definitions

Reversal of entries

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When a transaction is recorded in the correct accounts but on the incorrect sides.

Errors that do affect the trial balance

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1. Mathematical Errors
2. Entering only one entry of a transaction
3. Entering two different amounts for a debit and corresponding credit entry.

Compensating errors

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This is when errors of equal value cancel each other out.

Suspense Account

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An account in which discrepancies are entered temporarily before allocation to the correct or final account.

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Methods of financing an extension

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- Increase subscription fee
- Find sponsorship.
- Sell investments.

Points a treasurer makes if members proposed to reduce the subscriptions

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- Income could fall if no new members join.
- If members will pay the current subscription rate, new development could be financed.

Special purpose profit and loss account

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This is an account for transactions outside the normal day-to-day running of the club.

Advice to give the treasurer

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- If there is a surplus of income, new services could be offered to members.
- Consider the introduction of a levy.
- Try to attract sponsorship.

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Term	Definition
Audit	Independent examination of a firm's accounts, aiming to clarify whether the accounts represent a 'true and fair' picture of the financial state of the organisation.
Items which auditors must express an opinion in their reports	- Accounts representing a fair view of the financial records. - Director's report is consistent with the accounts. - Profit and Loss Account and Balance Sheet have been prepared correctly.
Items to be included in a director's report	1. Description of the previous year's performance. 2. Statement of future plans, such as a merger. 3. Recommended dividends for this year.
Qualified auditor's report	This is when an auditor is not satisfied that the accounts have all of the necessary requirements and that they must 'qualify' their report with this concern.