Using Financial Information

1. Imagine you have your own small business. What information does each of the following financial statements provide about your business?

a) The Revenue Statement

b) The Balance Sheet

c) The Statement of Cash Flows

The revenue statement would reveal the performance of the business for the duration of the financial period measured. This includes that of sales/revenue, costs of inventory, and expenses which gives the figure for both gross and net profit. That is, for a small business, it would identify if the business was providing a good or service that customers wish to buy (through a healthy gross profit) and how well the owner/manager was managing expenses (through the net profit outcome).

The balance sheet measures the state of the business at a particular point in time, i.e. at the measurement date. This includes that of current outstanding obligations such as debtors and creditors, cash balance, leftover inventory and long term assets and commitments such as buildings, fixtures, mortgage and many others. It also reveals contributions by the owner/s of the business which is reflected in owner's equity. Hence it identifies to the small business owner the ability to pay debts as they fall due and the need to develop stock control and debt collection strategies.

The statement of cash flows reveals the cash flow activities of the business which is categorised into operating, investing, and financing cash flows. It is useful to assess the ability of the business to collect money from credit sales as well as the ability to fulfill its current obligations such as payments of its suppliers/creditors. The cash flow statement will help the small business owner identify the times when the business is receiving and paying out money and therefore help schedule such things as paying accounts.

Copyright © Pearson Education Australia (a division of Pearson Australia Group Pty Ltd)

2. Calculate the value of net profit (or loss) for the following three companies, using the information below (show all working).

Sales $350,000 COGS $170,000 Expenses $95,000

Sales $170,000 COGS $123,000 Expenses $56,250

Revenue $563,000 Opening stock $74,000 Closing stock $92,500 Purchases $216,000 Expenses $305,000

The three following formulas would be useful:

Gross Profit/Loss = Sales – Costs of Goods Sold (COGS)

COGS = Opening stock + Purchases – Closing Stock

Net Profit/Loss = Gross Profit/Loss – Expenses

Gross Profit = $350,000 – $170,000
= $180,000

Net Profit = $180,000 – $95,000
= $85,000

Gross Profit = $170,000 – $123,000
= $47,000

Net Profit = $47,000 – $56,250
= -$9,250 (a net loss of $9,250)

COGS = $74,000 + $216,000 – $92,500
= $ 197,500

Gross Profit = $563,000 – $197,500
= $365,500

Net Profit = $365,500 – $305,000
= $60,500

3. Calculate the value of owner's equity for the following three companies, using the information below (show all working).

Assets $300,000 Liabilities $170,000

Assets: current $300,000 non-current $179,500 Liabilities $170,250

Current assets $112,300 Non-current assets $207,600 Current liabilities $46,000 Non-current liabilities $143,600

The accounting equation:

Total Assets = Total Liabilities + Owner's Equity

Owner's Equity = $300,000 – $170,000
= $130,000

Owner's Equity = ($300,000 + $179,500) – $170,250
= $309,250

Owner's Equity = ($112,300 + $207,600) – ($46,000 + $143,600)
= $130,300

Copyright © Pearson Education Australia (a division of Pearson Australia Group Pty Ltd)

4. A business has a ROE ratio of 2%. Briefly evaluate the performance of this business based on this figure.

ROE (Return on Owner's Equity) is a profitability ratio which measures the net return for the capital invested by the owners or shareholders of the business. ROE of 2% indicates that the return to the owners is only 2% from their contribution. By looking at the figure itself, it seems very small and the business is possibly unprofitable. However, comparisons across time, competitors and industry benchmarks should be taken into account for a meaningful interpretation.

5. If a business has credit sales of $140,000 and average accounts receivable of $9,500, calculate the accounts receivable turnover ratio. How often do customers pay their accounts to this business (on average)?

Accounts receivable turnover ratio = credit sales/average accounts receivable
= $140,000/$9,500
= 14.74 times per year (correct to 2 decimal places)

Therefore, on average, customers pay their accounts to this business 14.74 times per year, that is every 24.77 days (365/14.74).

Copyright © Pearson Education Australia (a division of Pearson Australia Group Pty Ltd)