Exercise walk-through

3.2
Final accounts

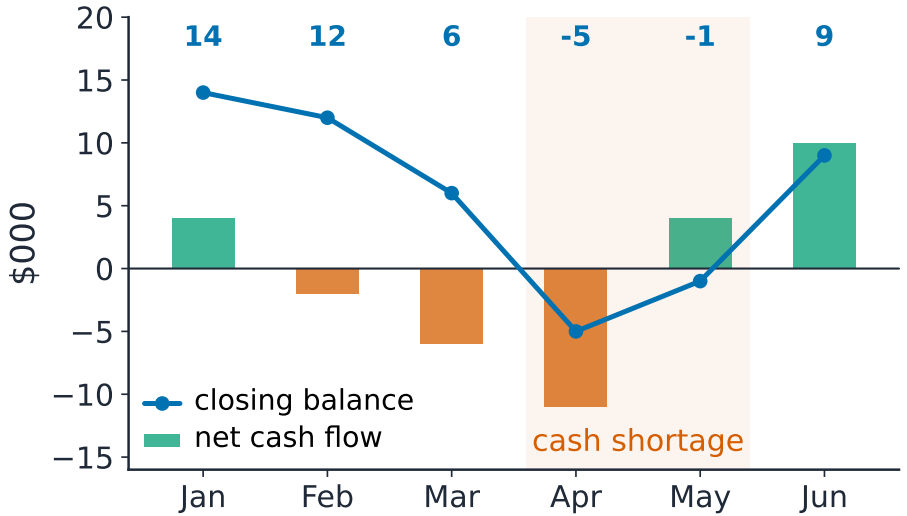
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Profitability and liquidity ratios

- **Ratio analysis** compares numbers from the **final accounts** so that a business can be compared with last year and with its rivals.
- **Profitability ratios** measure profit against sales or against the money invested.
- **Capital employed** is non-current **liabilities** plus **equity**: $160{,}000 + 200{,}000 = 360{,}000$.
- The **return on capital employed** (ROCE) of 25% is far above the roughly 6% interest on the bank loan, so borrowing to invest has paid off.

$$\text{gross profit margin} = \frac{\text{gross profit}}{\text{sales revenue}} \times 100 = \frac{240{,}000}{600{,}000} \times 100 = 40\%$$

Figure: Cash flow



- A six-month cash-flow forecast: bars of net **cash flow** and a line of closing balance that falls below zero in April and May before recovering in June
- Match each part of the diagram to the text.

Sources for this lesson

- International Baccalaureate, *Business Management guide* (first assessment 2024).
- Reports on ofo's growth and collapse in *Caixin* and the *Financial Times* (2017–2019).
- International Accounting Standards Board, IAS 1 *Presentation of Financial Statements* (the names of the **final accounts**).
- P. Atrill and E. McLaney, *Accounting and Finance for Non-Specialists* (12th edition, 2023).

Exercises 2.1·2.2

2.1 Define **current assets**, giving **one** example. [2]



2.2 Distinguish between gross profit and profit for the period. [2]

- sales revenue
- gross profit
- profit before interest and tax
- profit for the period

Exercises 2.1·2.2

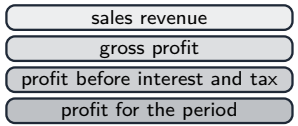
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2.1

assets that will be turned into cash or used within one year; e.g. cash, inventories, trade receivables

2.2 Distinguish between gross profit and profit for the period. [2]



2.2

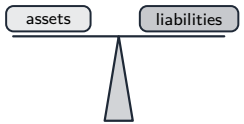
gross profit: sales revenue minus cost of sales; profit for the period: what remains after all expenses, interest and tax are also taken away

Exercises 2.3·2.4

2.3 A firm's data for last year ($000): sales revenue 500, cost of sales 300, expenses 120, interest 10, tax 14. Construct its statement of profit or loss. [4]

line	$000
sales revenue	500
cost of sales	300
gross profit	
…	

2.4 A firm has non-current assets of $400,000, current assets of $150,000, current liabilities of $90,000 and non-current liabilities of $160,000. Calculate its net assets. [2]



Exercises 2.3·2.4

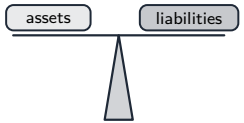
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gross profit	
…	

2.3

gross profit = 500 − 300 = **200**; profit before interest and tax = 200 − 120 = **80**; profit before tax = 80 − 10 = **70**; profit for the period = 70 − 14 = **56** ($000), with correct labels and layout

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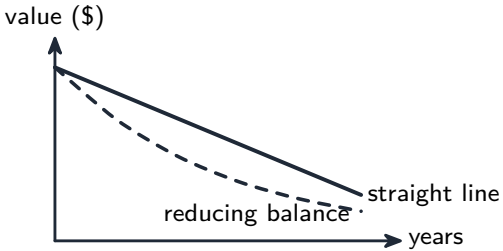


2.4

400 000 + 150 000 − 90 000 − 160 000 = $**300 000**

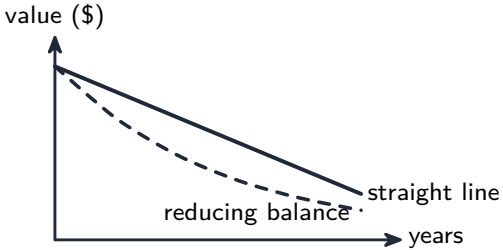
Exercise 2.5

2.5 A machine costs \$50,000, has a residual value of \$5,000 and a useful life of 5 years. (a) Using the straight-line method, calculate the annual depreciation and the net book value after 2 years. (b) Using the reducing-balance method at 30%, calculate the net book value after 2 years. [4]



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2.5

(a) $(50\,000 - 5\,000) \div 5 = \$\mathbf{9\,000}$ per year; NBV after 2 years $= 50\,000 - 18\,000 = \$\mathbf{32\,000}$; (b) year 1: $50\,000 \times 0.3 = 15\,000$, NBV $35\,000$; year 2: $35\,000 \times 0.3 = 10\,500$, NBV $= \$\mathbf{24\,500}$

Exercise 3.1

3.1 Rivera Furniture makes tables and chairs. Extracts from its accounts are shown ($000).

Using the data, discuss what Rivera's final accounts tell its shareholders, its employees and its bank. [10]

$000	year 1	year 2
sales revenue	800	950
cost of sales	480	620
gross profit	320	330
expenses	200	230
profit before interest and tax	120	100
cash	60	15
long-term loans	100	220

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3.1

award up to [10]: revenue rose from 800 to 950 (about 19%); but gross profit rose only from 320 to 330, so cost of sales grew faster than revenue; gross profit margin fell from 40% to about 35%; profit before interest and tax fell from 120 to 100 as expenses rose; shareholders: lower profit may mean lower dividends and share value; employees: growing sales support jobs, but falling profit may lead to cost cuts; bank: cash fell from 60 to 15 and loans more than doubled to 220: higher risk of not repaying; limits: only two years, no data on competitors or the economy; balanced judgement

Exercise 3.2 (a)

3.2 Rivera Furniture paid $500,000 to buy a rival firm whose net assets were valued at $350,000.

(a) Calculate the goodwill paid. [2]

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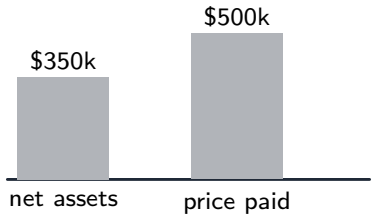
(a) Calculate the goodwill paid. [2]

(a) $500\,000 - 350\,000 = \$\mathbf{150\,000}$

Exercise 3.2 (b)

3.2 Rivera Furniture paid $500,000 to buy a rival firm whose net assets were valued at $350,000.

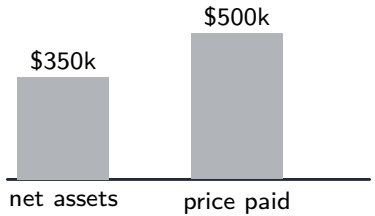
(b) Explain **two** difficulties of valuing intangible assets such as goodwill and brand names. [4]



Exercise 3.2 (b)

3.2 Rivera Furniture paid \$500,000 to buy a rival firm whose net assets were valued at \$350,000.

(b) Explain **two** difficulties of valuing intangible assets such as goodwill and brand names. [4]



(b) any two, explained: no physical form and no market price, so the value is an estimate; value can change quickly, e.g. a brand damaged by a scandal; different valuers or methods give different figures, allowing window dressing