

# The kenaston convenience store essay sample



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Considering how successful the Kenaston Convenience Store has been for the last three years and considering the density of population which the subdivision in Regina has at the moment, a preliminary evaluation of the profitability of CML's buying out the convenience store signals a positive outcome. According to a preliminary examination of the income statements, net income of the company in 2009 rose by 14% from 2008. Net income as a percentage of gross income also shows an upward trend. For example, in 2008 it was 39% while in 2009 it was 41%. However a closer scrutiny of the income statements reveals that not enough information has been provided. Therefore ratios such as net income as a percentage of gross income may not show accurate trends. The categories of information which need to be investigated further are particularly related to operating expenses. Unless these categories of information are made available, it would not be feasible to proceed with the buy-out. Below are some of the adjustments that should be made to the income statements before they can be considered as being fully reflective of the store's activities.

According to the information available, the convenience store is located in a two storied building in which the first floor is occupied by the store and the second floor is occupied by the current owners. The owners own the building as well. However the building has outstanding mortgage payments which are lumped together with other expenses. That makes it difficult to separate personal expenses incurred by the owners from the operating expenses of the convenience store.

Therefore, in this case, the expenses are being overstated. According to the information available, three categories of expenses are being shown for the

entire building and currently no distinction is made between those expenses which are related to the owners' apartment and those which are related to store operations. This is a lack of information that has to be eliminated before the income statements can be considered as fully reflective of the store's activities. In implementing the buy-out, CML will have to buy the building as well and the mortgage payments along with it. However, given the current information, there is no way to assess how much the mortgage will be for the first floor and the utility expenses along with it. Obviously CML is not going to buy the entire building because store operations are confined to the first floor. Therefore the need here is to assess what the recurring costs are going to for the first floor without being associated with any of the costs from the owners' apartment. So the income statements need to be adjusted in this regard.

The level of petty cash that is spent periodically is not captured in the income statements. The practice currently is that the owners withdraw cash from the register when they need it. This is not recorded in the income statements and therefore this is another cost category that needs to be clearly identified. A related cost category is salaries and wages. The income statements do show this cost category but it is not clear how the expenses are being incurred as the staff consists entirely of the owner's family who do not get paid. However when CML buys out the company, it will have to hire employees to man the counters and in that scenario, salaries and wages expenses will be a major category in the income statements. This is an important adjustment inasmuch as wages and salaries are big expenses for any business. However, given the current information, there is no way to

determine how much CML would incur in terms of salaries and wages if it were to operate the Kenaston Convenience Store. Therefore information pertaining to how much a hired staff would have to be paid in Regina should be collected and this information should be used to recalculate wages and salaries. This would rectify the shortcoming of the store currently not having any paid staff internally.

It is advisable to reassess the rate of amortization which the company is currently applying. The income statements that have been provided have been prepared for the bank. Therefore the rates of amortization are determined on the basis of the Income Tax act. However more information should be made available regarding the composition of the capital assets so that it is possible for the evaluators at CML to determine the actual rates according to which the capital assets should be amortized. Once the amortization rates have been re-determined, the expenses would be changed and the net profit would be changed as well.

Advertising and promotion expenses are also not reflected accurately. The Kenaston Convenience Store had printed a large volume of flyers 30% of which were found to be unusable at the end of 2009. However the full expenses have been shown at the end of 2009 without including the expenses related to waste. It's not as if the remaining flyers could be recycled for later promotional programs. They have been damaged and rendered unusable. Therefore, the remaining 30% of the flyers should be classified as waste and the cost of carrying this waste and its disposal should be shown in the income statements.

The figures in cost of sales are not accurate because data on inventory management are not fully available. The current owners are using inventory items for their personal use with recording such purposes in the financial statements. Therefore, cost of sales is not being calculated accurately. Two separate accounts need to be maintained, one showing the cost of items that are withdrawn for personal use and one that shows the cost of items that are generating revenue for the store. Three separate accounts are made use of in calculating cost of sales. The first account is related to the opening inventory at the beginning of the year, the second one to the purchases made during the year and the third one to the ending inventory at the end of the year. Both opening and ending inventories should be stripped of items withdrawn for personal use and cost of sales should be calculated again accordingly.

The above adjustments are required to make the income statements fully reflective of the store's activities.

## References

Higgins, Robert C. *Analysis of Financial Management*. McGraw-Hill/Irwin. 2007.