

Free accounting case study analysis for sportswear kit case study example

[Finance](#), [Investment](#)



Question 1

The Purpose and Usefulness of the Income Statement in Assessing Business Performance

Income statement is a financial document that attempts to measure financial performance of an organization over a specified accounting period. The major purpose and usefulness of an income statement is to summarize the business revenue stream and expenses by categorizing activities into operating and non-operating accounts. Income statement is useful in business performance assessment by showing any net loss or profit earned over a specified accounting year or a quarter .

The operating section of income statement is important to assess business performance of Sportswear-Kit since it discloses information about regular operational activities that result in generation of revenues and incurrence of expenses. For instance, the income statement of Sportswear-Kit Company lists sources of revenue and expenses directly and indirectly involved with the manufacturing of sports equipment. Similarly, the non-operating items section of income statement for Sportswear-Kit may include irregular business activities such as sale of old plant equipment and a factory.

Overall, the purpose and usefulness of income statement is to provide an insight to the management and investor base whether the business has earned or lost money during the reporting period, about the historical financial performance and examines the capability to generate revenue stream to cover operating expenses and control costs.

Identification of Particular Concerns from Income Statements for 2013 and 2014

It has come to light that from 2013 to 2014, the unsold stock in form of closing inventories for Sportswear-Kit has been increasing. This points out to the fact that the business may be finding it difficult to sell its inventories due to which the ending stock since 2012 has been rising which is certainly detrimental to smooth operational efficiency of Sportswear-Kit and its expansion.

The fixed interest obligation on long-term loan is under control but the interest expense on bank overdraft facility has increased substantially in 2014 by £5, 200. Because of this, the short-term liquidity strength of Sportswear-Kit may have been compromised and there is a little safety margin to investments by short-term creditors and lenders. Due to this, the interest rate risk exposure of Sportswear-Kit has also increased.

Question 2

The Purpose and Usefulness of the Balance Sheet in Assessing the Business Performance

Balance sheet discloses information about the assets, liabilities and owners' equity in the business. The main purpose of designing a balance sheet is to provide its users an idea about the financial position of the company at end of a specific accounting period. Balance sheet is useful to all investors and creditors in assessing the financial performance of any company, including Sportswear-Kit, by determining its net financial standing by specifying what the business owes to others as liabilities/debt and what it actually owns as assets.

Identification of Particular Concerns from Balance Sheets for 2013 and 2014

Sportswear-Kit is extending major portion of its sales on credit due to which its receivables increased from 2013 to 2014. If the cash is not collected from customers in timely manner, the liquidity position of Sportswear-Kit suffers heavily. Same is the case for rising stock of ending or unsold inventories which also points out that Sportswear-Kit may be selling either outdated sportswear materials or their demand in the market is on decline.

Though the bank loan has declined by a small portion from 2013 to 2014, yet the interest payment obligation remained the same since Sportswear-Kit is obliged to repay the interest and principal amount at fixed regular intervals.

This confirms that the interest rate risk exposure has been increasing .

Because of decline in liquidity strength and weak management of cash, receivables, inventories and bank funding etc, the profit generation capability of Sportswear-Kit has declined dramatically over a one year period from 2013 to 2014. This could also be confirmed from income statement which reveals that much of the net profit for 2014 was eaten up by increased purchases of materials for production and rising operating expenses which show that Sportswear-Kit is not good at controlling its costs and expenses.

Question 3

The Purpose and Usefulness of Cash Flow Statement in Assessing the Business Performance

A statement which specifies the gross receipts as well as payments of the business by highlighting their sources and uses of cash over a certain time period is known as cash flow statement. The main purpose of cash flow

statement is to reveal if the business is running out-of-money or not despite it may be profitable at the same time. This statement is useful in assessing the financial performance of Sportswear-Kit in a manner that it specifies whether owners are investing more money into the business or not, its liquidity condition and the amount of fixed asset investments.

Particular Concerns from Cash Flow Statement of 2013 and 2014

This statement points out exactly to the same trends or concerns identified in previous questions of this paper. Over a one year period, the cash flow statement clarifies that cash to be collected from customers has increased, there is a slight cash inflow from creditors in the form of financial support and there was a sharp decline in cash balances. Despite the fact that Sportswear-Kit has no cash balance in its wallet to cover short-term obligations, the cash balance for 2015 would be negative meaning that the business is now forced to borrow further from banking institutions to finance working capital operations for smooth running.

Question 4 – Investment Decision

After a careful analysis of the financial performance assessment of Sportswear-Kit for 2013 and 2014, it has been decided that the additional funds should not be extended to Sportswear-Kit. All these problems have already been prominently discussed in last three questions in this paper. Sportswear-Kit is at the verge of falling into liquidity trap since no cash is left with it, collects cash from customer in a late manner and faces difficulties in selling inventories. Though using more debt has provided Sportswear-Kit

with tax advantage since interest payments are considered as costs and so are tax-deductible , yet the profitability of this organization has declined heavily.

Works Cited

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