

Users of accounting information finance essay



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Accounting is the process of systematically recording, measuring, and communicating information about financial transactions. The heart of accounting is the double-entry bookkeeping. This involves at least two entries for every transaction: a debit and credit account in another account. This method helps to prevent chargeback error occurred because the sum is equal to the sum of the credits. The three main financial statements is accounting income statement, balance sheet and cash flow statement.

The accounting can be done on cash basis or on an accrual basis. Cash accounting records, cash inflows and outflows in the period they occur. Accrual accounting records of income and expenditure during this period, their reasons, rather than a cash payment, to come and to go. For example, a check written in June for May's utilities would appear as a May expense under the accrual method and as an June expense under the cash method.

There are two kinds of users of accounting information: internal users and external users. Internal users are usually company managers who use accounting information to decide how to plan and control operations on a daily and long-term basis. External users are existing or potential investors, creditors, analysts, financial advisers, regulatory authorities, unions, and the general public. They use accounting information to make a few of decisions about whether to buy, hold, sell, lend, continue a relationship, or make an agreement. Accounting rules and methods are sometimes subject to clarification or can appear to change a company's true performance.

Accounting is very important because it is the language of business, and it is at the root of making informed business decisions. Without accounting, managers would not know which products were successful, which business

decisions were the right ones, and whether the company was earning money.

Task 1

Describe FIVE (5) different users and their needs for Continental Limited financial statements. Explain five regulatory characteristic of these financial statements that will provide useful information to the users.

Five different of accounting users for Continental Limited financial statements is manager, tax inspector, bank, investor and perspective buyers. There are two broad categories of accounting information users, that is, external users and internal users. External users is banks, tax inspector, owner of the company and etc. Bank is also called as creditor in principle of accounting, they are utilize accounting information to make lending decision. The creditors invest resources in the business by extending credit. Therefore, the creditors of a business have an interest in how well the business performs. In order for the creditor to recover their investment, the business must generate enough cash to pay them. In addition, the business is the creditor's customer, and thus creditors have an interest in the continued success of the business. For an example, bank A are willing to lending one million ringgit Malaysia to Continental Limited company, and bank A was charge an interest to this company in how well the business performs.

Tax inspector is also governments. Various governments have an interest in the economic performance of businesses. City, county, state and federal governments collect taxes from businesses within their jurisdictions. The better a business does, the more taxes the government can collect. In

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In addition, workers are taxed on their wages. In contrast, workers who are laid off unemployed can file claims for unemployment compensation, which results in a financial burden for the government. City and state governments often provide incentives for businesses to locate in their jurisdiction. An example such as, Continental Limited was earned two point five million from their businesses, government would send a tax inspector to calculate how much taxes Continental Limited need to pay to government on that years.

One more external users is the owner of the company. The owner who have invested resources in the business clearly have an interest in how well the business performs. Most owners want to get the most economic value for their investments. To the extent that the business is profitable, owners will expect to share in the business profits. Since owners may eventually decide to sell their business, they also have an interest in the total economic worth of the business. This economic worth may reflect results of past profits as well as prospects for future profits. Example, owner of Continental Limited was planning to extend their company business with the all interest in how well business performed.

The other board of the accounting users is internal users. Internal users are parties inside the reporting entity or company who are interested in accounting information. Types of internal users include the managers and the employees. The managers are those individuals who the owners have authorized to operate the business. Managers are primarily evaluated on the economic performance of the business. The managers of businesses that perform a poorly are often fired by the owners. Thus, managers have an incentive to maximize the economic value of the business. Owners may

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offers managers salary contracts that are tied directly to how well business performs. For example, a manager might receive a percent of the profits or a percent of the increase in profits.

In addition, the employees provide services to the business in exchange for their pay. The employees have an interest in the economic performance of the business because their jobs depend upon it. During business downturns, it's not unusual for a business to lay off workers for extended period of time. In the extreme, a business may fail and the employees lose their jobs permanently. Employees labor unions often use the good economic performance of a business to argue for wage increase. In contrast, business often use poor economic performance to argue for employees concessions such as wages decrease.

The users of financial statements use financial statements for a large variety of business purposes and their ability to understand and analyze financial statements helps them to succeed in the business world.

The internal users of financial statements are individuals who have direct bearing with the organization. There are include, managers and owners. For the smooth operation of the organization, the managers and owners need the financial reports essential to make business decisions. So as to provide a more comprehensive view of the financial position of an organization, financial analysis is performed with the information supplied in the financial statements. The financial statement is used to formulate contractual terms between the company and other organizations.

A variable of the financial statement like the current debt to equity ratio is important in deciding the amount of long term capital that would be required to be raised. The financial statements of other companies can also provide investment solutions to different companies. Sometimes it becomes difficult to decide the right field in which financial resources may be channelized. In such situations the financial statements of other companies provide the appropriate guideline.

The financial reports or the financial statements are of immense use to the employees of the company for making collective bargaining agreements. Such statements are used for discussing matters of promotion, rankings and salary hike.

The external users comprise of institutional investors, financial institutions, government, vendors and general mass and media. Institutional investors is the external users of financial statements are basically the investors who use the financial statements to assess the financial strength of a company. This would help them to make logical investment decisions. Financial Institutions is the users of financial statements are also the different financial institutions like banks and other lending institutions who decide whether to help the company with working capital or to issue debt security to it. Government is the financial statements of different companies are also used by the government to analyze whether the tax paid by them is accurate and is in line with their financial strength. Vendor is the vendors who extend credit to a business require financial statements to assess the creditworthiness of the business. General Mass and Media is the common people as well as media also make part of the users of financial statements.

The characteristic of financial statements is understandability, relevance, reliability and comparability. Understandability is means, workers or employees will only do work when they are really understand the information that given by customer or company. In addition, relevance is means capable of confirming or correcting the existing though process and information. Reliability is means free from bias, free from errors, especially materials errors. And the last is, comparability, it means prepare financial statements by following a uniform pattern of presentation which is usually as instructed by the international or Local Accounting Standard.

Task 2

Prepare the income statement and balance sheet of Continental Limited for year ending 31 Dec 2010 for the internal use by company directors and management. Show the necessary workings.

Task 4

Based on the income statement and balance sheet made in task 2 and 3, calculate the appropriate accounting ratios for year ending 31 Dec 2010 and compare them with the industry averages provided to assess the profitability and liquidity of Continental Limited.

1).

Percentage of Gross Profit on Sales =

Gross Profit

x 100

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Sales

=

175,000

x 100

360,000

49%

2).

Percentage of Net Profit on Sales =

Net Profit

x 100

Sales

=

103,500

x 100

360,000

29%

3).

ROCE

(Return On Capital Employed) =

Net Profit

x 100

Capital Employed

=

103, 500

x 100

500, 000 + 603, 500

=

103, 500

x 100

1, 103, 500

9%

4).

Current Ratio =

Current Asset

Current Liability

=

174, 000

25, 000

6. 96 : 1

5).

Stock Turnover =

Sales - Gross Profit

x 30 Days

(Opening Stock + Closing Stock) / 2

=

360, 000 - 175, 000

x 30 Days

(50, 000 + 65, 000) / 2

=

185, 000

x 30 Days

115, 000 / 2

=

185, 000

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x 30 Days

57, 500

3. 21 x 30 Days

96 Days

6).

Debtors Collection Period =

Debtor

x 365 Days

Sales

=

70, 000

x 365 Days

360, 000

0. 19 x 365 Days

69 Days

7).

Creditors Collection Period =

Creditors

x 365 Days

Purchases

=

25, 000

x 365 Days

200, 000

0. 125 x 365 Days

47 Days

According to the calculation, show that the percentage of net profit on the sales of Continental Limited is higher than the one in Industry Averages which are 30% and 18% : 49% and 29% respectively. That's means Continental Limited gained beyond profit than Industry Averages. ROCE (return on capital employed) for Continental Limited and Industry Average both amount of 9%. So, as we can see that the decision making on investment for Industry Average and Continental Limited are slightly the same and reachable the accuracy.

Therefore, the existing ratios for it are 2: 1 (Industry Average) and 6. 96: 1 (Continental Limited) respectively. In additional, the higher of the ratio reach, the more capable the companies obtain to pay its obligation. As a result, this has proven that Continental Limited has the more ability to pay back its short-term liabilities in a short time period than Industry Averages. However, as for the stock turnover period of Industry Averages wins

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Continental Limited about six days which stands 90 days and 96.3 days respectively which means Continental Limited needs to use longer time to sell out their stocks.

In conclusion, the debtors' collection and creditor's payment for both companies have huge differences compared to other accounting ratio which has been explained above. Debtors' collection and creditor's payment for Industry Averages are 45 days and 60 days while Continental Limited obtain 69 days (debtors') and 25 days (creditors).

Conclusion

Overall of this assignment, we had learnt about the calculation of gross profit on sales, net profit on sales, return on capital employed, current ratio, stock turnover, debtors collection periods, creditors collection periods, balance sheet and also income statement. All of these calculation is been useful in our future working and this accounting subject was provides us a wide variety of different users and also purposes. Therefore, it is practically use in economic purposes and social environment. The use of accounts is to understand the financial statement of a company to decide the investment from profitable of investor or to close up a company if it continuously loss profit. Accounting is very important because it is the language of business, and it is at the root of making informed business decisions.