FINANCIAL ACCOUNTING – 2023-2024

by (Name)
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Section A: Unilever ratio analysis

Unilever is a large British multinational specializing in the manufacture of fast-moving consumer goods. Its headquarters is in London. Among the goods it produces and sells include baby food, bottled water, beauty products, cleaning agents, healthcare and hygiene products, and soap among others. Unilever products are available on shelves in over 190 countries. Key brands associated with the company include Axe, Dove, Knorr, Omo, Magnum, and others. With this product portfolio and multinational presence, there is good reason to evaluate the company's performance. This part of the report evaluates key financial ratios to critically evaluate the firm's performance over the past 3 years.

Profitability ratios

In this instance, key profitability ratios considered include return on assets, profit margin, gross margin, return on shareholder's funds and return on capital employed. Return on shareholder's funds (or equity) remained high between 2020 and 2022 at 45% in the initial year, 43% in 2021 and 47% in 2022. This meant that for every 1GBP of equity invested, between 0.43 and 0.47 was realized. Return on capital invested continually rose throughout the period from 16.99 in 2020 to 19.73 in 2022 also reflecting a higher return for every pound in capital invested into the firm. Return on total assets reflected a similar trajectory rising from 11.82 to 13.28 within the period as profit margin increased marginally from 15% in 2020 to 17% in 2022. Gross margin, however, declined from 43% in 2020 to 40% in 2022.

The profitability ratios demonstrate that Unilever performed relatively well despite the macroeconomic shocks introduced by the COVID-19 pandemic. The result on profitability was minimal, only being evident from increasing operational costs resulting in lower gross margin. Nevertheless, there was better revenue performance since the net margin remained unaffected. Moreover, the COVID-19 pandemic was only felt for return on equity, which stabilized in 2022. Thus, the company has robust profitability performance.

Operational ratios

Operational ratios are applied to demonstrate the efficiency of company operations. In this evaluation, they include asset turnover, fixed asset turnover, interest cover, stock turnover, debt collection, and creditor payments. Asset turnover rose from 1.08 in 2020 to 1.15 in 2022 but registered a decline in 2021. This implies that for every £1 invested in assets, Unilever managed between £1.04 and £1.15 in revenue demonstrating strong asset performance. Similarly, fixed assets also reported increasing turnover from 0.98 in 2020 to 1.02 in 2022; no fluctuation was recorded. Fixed assets had achieved at least £1.02 in revenue for every £1 invested. Interest coverage remained high at between 11.84 in 2020 and 13.64 in 2022. This demonstrated the company's strong debt performance since it could cover interest payments on debt sufficiently. There was also evidence of strong sales as the company reported an inventory turnover of 11.37 in 2020 and 10.13 in 2022. The decline shows that there was a marginal decline in sales but they remained strong throughout the period. Debt collection ranged between 24 days in 2020 and 27 days in 2022 showing a marginal decline in receivables performance. Creditor payment days also increased from 60 days in 2020 to 67 days in 2022. This implied that payables were also slightly delayed. The implication of payables and receivables is a favourable cash position for Unilever to support short-term transactions. The increase in these metrics may also be attributed to the effects of COVID-19, which strained cash availability.

Structure ratios

Structure ratios were also considered in the evaluation. They included the current ratio, liquidity ratio, asset cover, and gearing. The current ratio demonstrates how well the firm can pay off its current liabilities using its current assets. In 2020, the ratio was 0.75 which declined to 0.70 in 2022. This indicates that the firm can pay £0.75 using current assets for every £1 of current liabilities. This indicates relatively good health. Meanwhile, the liquidity ratio demonstrates how well the company can pay off its liabilities using its assets. In 2020, the ratio was 0.57 which declined to 0.52 in 2022. This decline is consistent with the decline in the current ratio and indicates a lower relative capability to repay the company's long-term liabilities in 2022. For every £1 of long-term debt, the company can pay off £0.52 in 2022. This also indicates good health for companies in the industry although the desired threshold is usually a 1.0 ratio. There is room for structural improvement in its asset-liability composition.

Despite declining current and liquidity ratios, the firm's asset coverage increased from 2.98 in 2020 to 3.4 in 2022. This indicates that the firm's ability to repay liabilities after liquidating assets increased between the 2 years. This may allay any concerns raised by the declining current and liquidity ratios as mere fluctuations common in the course of business. Finally, gearing became more favourable as it declined from 191% in 2020 to 167% in 2022. Gearing describes the relationship between debt and equity. This decline demonstrates a greater balance between debt and equity but remains with much more debt. As a cheaper source of capital, it is expected that gearing remains over 100% as companies favour debt over equity as a source of cheaper capital. Thus, high gearing is characteristic of a well-performing company as lenders issuing debt demonstrate confidence.

Per employee ratios

Finally, per-employee ratios were considered as a final aspect of performance. They include profit per employee, turnover per employee, and sales/turnover. Profit per employee increased from 47,707 in 2020 to 66,236 in 2022 demonstrating greater performance per employee despite the COVID-19 pandemic. Employee performance remained resilient despite significant macroeconomic disruptions. Turnover per employee experienced a decline in 2021 but overall increased from 302,633 in 2020 to 385,471 in 2022. Again, this shows improved employee performance but demonstrates the effect of the pandemic in the penultimate observation year. Finally, salaries/turnover remained fairly constant at 12.02 in 2020 and 11.68 in 2022. This demonstrates that Unilever retains acceptable labour costs of almost 10 percent of its revenue.

Conclusion

Overall, Unilever demonstrates strong performance in all its financial ratios. Profitability ratios demonstrate strong resilience against the COVID-19 pandemic on most fronts. Indeed, this is expected given that the firm largely deals in fast-moving consumer goods. Unlike other firms that anticipated sales decline since they dealt with luxury goods, Unilever maintained strong performance and even grew in some aspects. Operationally, the organization also remained sound with high levels of efficiency in the various aspects evaluated. Even though its receivables days increased, payables days increased further meaning that the company's cash position also remained favourable. Structurally, the company remained sound with an adequate asset base to offset liabilities in case of any adverse outcomes. Even with less-

Accountancy rules

1. Going concern – the company will continue operations in the foreseeable future.
2. Accrual – revenues and expenses are recognized when they are earned.
3. Consistency – the same principles are applied in all accounting periods
4. Prudence – caution is exercised in recognizing revenues and assets whereas liabilities and expenses are recognized as soon as they become probable.
5. Historical cost – assets will be recorded at their original cost.

Question 2

Statement of cashflows:

Operating Activities:

Net Profit: £25,000

Adjustments for non-cash items:

Depreciation: £30,000 - (-£22,500) = £52,500

Changes in working capital:

Increase in Inventory: £40,000 - £24,000 = £16,000

Increase in Trade Receivables: £27,000 - £18,000 = £9,000

Increase in Trade Payables: £22,000 - £18,000 = £4,000

Net cash provided by operating activities: £25,000 (Net Profit) + £52,500 (Depreciation) + £16,000 (Increase in Inventory) + £9,000 (Increase in Trade Receivables) - £4,000 (Increase in Trade Payables) = £98,500

Investing Activities:

Purchase of Investments: £11,000

Net cash used in investing activities: -£11,000

Financing Activities:

Repayment of Loans: -£29,500

Dividends paid (if any, not provided in the information): assume £0

Net cash used in financing activities: -£29,500

Net Increase in Cash: £98,500 (Operating Activities) - £11,000 (Investing Activities) - £29,500 (Financing Activities) = £57,000

Cash at the Beginning of the Year: £12,000

Cash at the End of the Year: £12,000 + £57,000 = £69,000

Memo

To: Mr. Boris

From: Accounting Department

Date: 13th December, 2023

Re: Cashflow statement

This memo summarizes the cashflow statement. At the end of 2022, the net cash provided by operating activities was £98,500. The company invested £11,000 leading to an outflow of the same amount in investing activities. There were loan repayments of £29,500 which also led to outflows in financing activities. Therefore, the net increase in cash for the year was £57,000, resulting in a closing cash balance of £69,000. The cashflow statement is attached for your perusal.

Sincerely,

Accounting department.

than-ideal current and liquidity ratios, there was boosted confidence in its asset coverage. A comparison with other industry players would also be effective in putting these structural ratios within context. Finally, per-employee ratios demonstrate low labour costs and high labour productivity within the firm.

Even with the insights provided by ratio analysis, these ratios only capture a snapshot that should be interpreted within the company's operating environment. This is the reason behind industry comparisons that help place such ratios within context. For instance, the ideal current and liquidity ratios are at least 1.0. However, many companies may never achieve this. To ensure that one's interpretation is accurate, therefore, an industry outlook is beneficial to understand the performance of similar companies. This promotes the holistic understanding of such a ratio against other qualitative information. Therefore, all financial ratios must be interpreted contextually to promote the accurate presentation of opinions and supplement the weakness that arises by focusing solely on their outcomes.

Section B

Question 1

Income statement

Sales	£550,000
Cost of Goods Sold	
Opening Stock	£22,500
Purchases	£286,000
Less: Closing Stock	(£22,500)
Cost of Goods Sold	£286,000 - £22,500 = £263,500
Gross Profit	£550,000 - £263,500 = £286,500
Operating Expenses:	
Directors Remuneration	£52,000
Audit and Accountancy	£2,000
Advertising	£1,000
Electricity	£4,000
Insurance	(£1,950 - £500) = £1,450
Office Expenses	£6,300
Rent and Rates	£15,000
Wages and Salaries	£30,000

Total Operating Expenses	£111,750
Net Profit Before Interest and Tax	£286,500 - £111,750 = £174,750
Bank Interest	£625
Net Profit Before Tax	£174,750 - £625 = £174,125

Balance sheet

Assets	
Current Assets	
Debtors	£43,250
Inventory	£22,500
Total current assets	£65,750
Fixed assets	
Fixtures and Fittings (Cost – Depreciation	£150,000 - £45,000 = £105,000
Motor Vehicle (Cost - Depreciation)	£60,000 - £15,600 = £44,400
Total fixed assets	£149,400
Total assets	£215,150
Liabilities	
Current liabilities	
Creditors	£9,200
Payables (audit, advertising & bank)	£3,000
Wages and salaries payable	£30,000
Insurance, office expenses & electricity payables	£12,250
Bank interest	£625
Rents and rates provision	£15,000
Total current liabilities	£70,075
Non-current liabilities	
Bank	£1,750
Director's remuneration	£52,000
Long-term bank loan	£5,000
Total non-current liabilities	£58,750
Equity	
Shares outstanding	£25,000
Profit and loss account	£26,575

References

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