RUNNING HEAD: FINANCIAL ACCOUNTING

Financial statements of Quartz Furniture

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***Answer 1***

A business is started with the viewpoint of earning a profit through its operations. A detailed analysis of all operational activities is shown in the income statement of a business. It shows revenues and expenses so that profit can be ascertained. The expenses are shown as either direct or indirect. Direct expenses are shown as a part of the cost of goods sold. A direct expense is the one which is identifiable in the final product or one without which a product cannot be completed (Bragg, 2019). An indirect expense is the one which is not identifiable in the final product. The example can be given as depreciation expense or utility expense. The statement is important because it will communicate the efficiency of operations of a business.

The balance sheet measures the value of a business at a given point in time. It shows the sources of finance and resources purchased with the help of these sources. Liabilities and owner equity are considered sources of finance for the business, whereas assets are the resources of the company. This statement shows whether the company has taken more loans or is financed by the shareholder's money. Company will be able to compare from the past, whether it has increased or decreased its resources. Stakeholders like creditors see the items in a balance sheet to predict whether the loan can be returned or not. Since income statement figure change with the changes in operations, companies use the balance sheet to compare performance from one year to other. For a business like Quartz, the balance sheet will be the most important financial statement. Items sold are manufactured by the business, and the impact of operations will be shown on the balance sheet. For a retail business which does not manufacture anything, the income statement will also be important.

Statement of Cash flows shows inflows and outflows of cash from various activities. The statement is divided into three main activities, namely operating, investing and financing activities. These activities show the results of different actions on cash balances. The business must be able to get positive cash flow from almost all activities. Operations must be run in a way that results in positive net cash flow. Investing activities may have a negative net cash flow because of some investments made by the company. Financing activities are concerned with business financing in the form of shares issued and dividends paid. For Quartz Company, this statement will show whether it can generate positive net cash flow over a while. As the company will grow over time, investing and financing sections of the cash flow statement will also become more important.

***Answer 2***

While looking at the income statement, there is a decrease in the gross profit earned by the company. There is an increase in the amount of closing inventory which shows that the company may not have been able to sell the inventory in time. There have been more purchases from the wholesalers, which means that the company intended to increase its sales but could not achieve its targets. There is a slight increase in sales, but it is not enough to consume the whole inventory. There are some percentages and ratios which can be calculated from the first part of the income statement.

*Gross Profit margin*

It shows gross profit as a percentage of net sales. For the year 2018, this figure was 27.22%, and in 2019, this figure was 23.54. The decrease in gross margin can be attributed to the increase in the cost of sales. Company has to make sure that it makes just enough products which can be sold in a short time. For both years, the company has been able to convert its inventory to sales 12 times in a year which means that products are sold over one month's time. An improvement can be brought in this regard by decreasing the amount of inventory at hand. There is an increase in all indirect expenses from the year 2018 to 2019, including interest payments made on loans. The company generated less profit in 2019 as compared to 2018. Now it should be able to use the amount of loan taken in a manner that will allow it to improve its financial performance. It is debatable as a separate discussion about whether the company should have taken a loan or raised funds from equity (J.Wild et al., 2017).

The balance sheet gives a better picture of business because there is an improvement in working capital or company. If we calculate the current ratio, it was 2.28 in 2018 and 2.83 in 2019 showing that the company is in a better position to pay off its short term debts if they all become due at the same time. The ratio of long term loan and equity shows that there is a slight increase in the ratio from the year 2018 to 2019. Company has taken more debt which is also evident from the increase in interest expenses in the income statement of the company. Receivables turnover ratio shows the number of times company has been able to recover cash from its debtors. The company had receivables turnover of 19 times in 2018 and 13 times in 2019 which means that there was a considerable decrease in receipts from debtors. This will ultimately affect the ability of a firm to have enough cash for operations.

In the statement of cash flow, there is a big decline in the net cash flow from operating activity. There is an increase in receivables for the company, which may show that the company is not able to recover amounts from debtors on time. There is a positive cash flow from financing activity, which is due to the loan taken by the company from a bank. This increase or positive inflow cannot be considered long term because there will be cash outflows associated with it in future.

# ***Bibliography***

Bragg, S., 2019. *https://www.accountingtools.com.* [Online]   
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J.Wild, K.Shaw & B.Chiapetta, 2017. *Fundamental Accounting Principles.* New York: McGraw Hill.