# **ACCT11059 : Accounting, Learning and Online Communication**

## Assessment 2

### **Step 1 : Chapter 4 KCQ’s**

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Wow, what a learning curve chapter 4 is turning out to be. The Mt Everest of ACCT11059, hanging around at the summit before descending back into less treacherous land, hopefully!

I was relieved to read that while we are learning about restating financial statements, the aim is to deeply connect with the financial statements of my firm, Coca-Cola Amatil (CCA), discovering what all the line items mean and really seeking out the business realities of CCA. At my first attempt of writing my KCQ’s for chapter 4, I began to worry about how I was going to relate these concepts back to personal experience because of my limited accounting knowledge. Then I had that aha moment, all those games of monopoly throughout my childhood and even into adulthood can actually be useful!

Since starting university study, the saying ‘you learn something new every day’ really has hit home for me. Today is no different. While watching the news, you often see the share prices and their movements for firms that have notable differences from day to day. While the share price is not a dividend, it makes me wonder, what is the relationship between share price and dividends? I was surprised to learn that dividends do not actually show how well the firm is performing, in fact, a firm can have negative cash flow and still pay dividends to its investors, as in the case of Ryman Healthcare. At initial glance, CCA’s statement of changes in equity over the past four years, they have paid dividends each of these years, and the amount is fairly consistent. In the 2019 annual report, the final dividend for the year was 26c unfranked, what does unfranked mean? What is the difference between a franked and unfranked dividend? A quick google search leads me to believe that franking is related to tax on the dividend. My experience with dividends is quite limited to what I have studied in this unit so far, but I had one of those ‘light bulb moments’. It made me think of those games of monopoly, you land on a chance square, draw the card and it says ‘the bank pays you a dividend of $50’ and the bank then transfers $50 to your cash assets. While this is a simple process in the game, I am sure it is much more complicated than that in the operations of a firm.

I am starting to see how concepts in this chapter are interconnected. Adding value to a firm is not as simple as increasing free cash flow (FCF) or paying dividends, because these are simply transfers of value. I found this concept quite interesting because it is definitely more complicated than face value, while a firm could focus on increasing their FCF, they would not really be adding value to the firm. FCF is affected by two things, operational cash flow (C) and investments into operating assets (I), therefore FCF = C – I . During 2019, CCA acquired a new bottling and distribution centre in Richlands (QLD), therefore, decreasing their FCF by investing into their operating assets. Due to the purchase of this new facility, CCA would expect that their operating income would increase because of the ability to produce and distribute additional products to the customer and earn greater than their initial capital investment.

‘Capital is never free’, this is true in many aspects. Cost of capital is a concept that I can relate back to a few weeks that I studied in Economics (before deciding to focus on two units). The true cost of capital is the opportunity cost of the next best alternative use of the capital. This leads me to ask, how does a firm determine how to invest their capital? Opportunities are endless, especially in a firm such as CCA. Do they invest in a new product? Do they expand their operations into additional property, plant or equipment? Or perhaps purchase another subsidiary? Do equity investors have a choice in where the investment is made? Personally, this past weekend I had to decide where to invest my capital item of time. I had to consider the opportunity cost of both of my options, stay at home and work on my assignment or go for a drive with the family to see snow (which was the first time for my children because we had always lived in the tropics). I valued the opinion of my family and decided to join them on the trip to the snow (and it was worth it), but I guess we will see what the cost of capital is when I receive my mark for these KCQ’s!

Net operating assets or NOA is calculated as the value of a firm’s operating assets minus the operating liabilities. NOA is often used when valuing a firm, by removing the firm’s financing activities you are left with the value solely based on the firm’s operating activities. I am still overwhelmed by all these concepts that I have never heard of before, the step up from a Diploma of Accounting to a Bachelor of Accounting is astronomical! However, I can see the relation between NOA and return on net operating assets (RNOA) because it is the return on the investment in these operating assets that is important in adding value to the firm. RNOA is the return on a firm’s assets that contribute to the creation of revenue and is an indicator of how well a firm uses operating assets to generate profit. This concept is confusing to me, while I understand that RNOA is equal to Operating Income (OI) divided by Net Operating Assets (NOA), I am unsure why RNOA is so influential on economic profit and cash flows, just yet. Why is the return on the investment so crucial in determining economic profit? Does the type of asset affect the return on investment? In my previous job at Domino’s, we upgraded our oven, the old oven would cook a pizza in around 7 minutes, the new oven cooked the same pizza in 4 minutes and 30 seconds. While the oven installation was a significant financial cost, we could almost double the volume of pizzas in the oven at any one time, therefore, potentially increasing the revenue generated in the same period.

Initial impressions of economic profit and even additional impressions are, it is confusing!

If economic profit was a person, I do not think I would get to know them past the introduction. During PASS, Danielle said that this concept was an important one, so here I am trying to decipher economic profit and put it in a KCQ. While I am struggling to make a connection with this idea, I am certain by the end of this assessment, I will have a greater understanding of this concept. Economic profit is closely related to cost of capital, in addition to, return on net operating assets and net operating assets. Hence, the equation, Economic profit = (RNOA – cost of capital) x NOA. Economic profit is used to measure how well a firm adds value above its cost of capital over a period. Is a firm making an economic profit if they are recording a financial profit in their income statement? Back to my monopoly anecdote, purchasing one property in the green group, say Oxford St will give me a return on rent when another player ‘visits’ my property. Investing in the additional two properties, Regent St and Bond St results in increased rental income. I can continue to build on my investment in these three properties by building houses and hotels and therefore increasing my return on these assets and creating value for my portfolio. While the game would need to last for a long time to make a financial profit, I would be making an economic profit by creating value for my properties.

Knowing what we need to do to restate our financial statements, I think operating and financial activities are the most important concepts to comprehend from this chapter. The diagrams in the study guide really helped to visualise the difference between the operating and financial activities of a firm. Operating activities are the transactions that occur during the day to day running of the firm, these are the transactions between the firm and customers or suppliers, otherwise known as the input markets. At Domino’s our operating activities would include selling pizza and sides to our customers, paying our staff wages and receiving food stock from our suppliers. Financial activities are the transactions between a firm and equity and debt investors, this is also known as the capital market. In relation to CCA, the financial activities include the payment of dividends to shareholders and borrowings from debt investors as listed on the balance sheet. Though thinking about Domino’s, my store was a franchise, would a franchise fee or royalties be classified as a financial activity?

I was surprised that items can be classified differently depending on the firm, so an item that is a financial activity for Ryman Healthcare, could be an operating activity for CCA and vice versa. I am still in the process of determining operating and financial activities in my statements, I have line items under assets and liabilities named ‘derivatives’ and ‘provisions’ in both items, the footnotes provide no clear information as to what they actually include. I automatically thought that cash would be a financial asset, but I was interested to learn that cash can be considered both operating and financial.

I am looking forward into jumping head first into restating my financial statements, I am sure I will have plenty of questions along the way. There is a lot to learn about determining the true economic and business realities of CCA, but I am confident that by the time I have completed assessment 2, I will know the truth behind their financial statements. They say ‘practice makes perfect’, so here is to lots of practicing!