**Task 6 for submission**

*Task 6 addresses* ***Unit Objective 3 – analyse*** *and* ***interpre****t financial data and information relating to accounting and end-of-month reporting for a service business;* ***Unit Objective 4*** *-* ***evaluate*** *accounting practices relating to end-of-month reporting for a service business to* ***make decisions*** *and propose* ***recommendations;*** *and* ***Unit Objective 6 - create*** *responses that communicate meaning to business owners and other stakeholders of a service business.*

Nadine Meninga owns and operates *Endurance Fitness*, a business which provides personal fitness training services. Nadine has been operating the business for two years from the converted double garage at her home. She is considering investing $200,000 to expand her business. The expansion would result in employing an extra personal trainer, purchasing new gym equipment and entering a three year lease on purpose-built gym premises.

Nadine provided the latest financial reports:

|  |  |  |  |
| --- | --- | --- | --- |
| **Endurance Fitness** | | | |
| **Statement of Financial Position** | | | |
| **as at 30 June 2018** | | | |
| **Assets** |  |  |  |
| Bank |  | 36,000.00 |  |
| Accounts receivable |  | 5,500.00 |  |
| Supplies |  | 4,400.00 |  |
| Office furniture |  | 5,500.00 |  |
| Motor vehicle |  | 25,000.00 |  |
| Equipment |  | 35,000.00 |  |
| Debentures |  | 32,000.00 | 143,400.00 |
| **Less Liabilities** |  |  |  |
| Accounts payable |  | 17,220.00 |  |
| Loan from OZ Bank |  | 25,000.00 | 42,220.00 |
| **NET ASSETS** |  |  | **$101,180.00** |
| Represented by: |  |  |  |
| **Owner's equity** |  |  |  |
| Capital | 120,000.00 |  |  |
| Add Net profit | 9,671.00 | 129,671.00 |  |
| Less Drawings |  | 28,491.00 | **$101,180.00** |

|  |  |  |
| --- | --- | --- |
| **Endurance Fitness** | | |
| **Statement of Profit or Loss** | | |
| **for the year ended 30 June 2018** | | |
| **Revenue** |  |  |
| Service revenue | 101,000.00 |  |
| Interest revenue | 95.00 | 101,095.00 |
|  |  |  |
| ***Less* Other expenses** |  |  |
| Advertising | 524.00 |  |
| Insurance | 300.00 |  |
| Electricity | 600.00 |  |  |
| Wages | 85,000.00 |  |
| Office expenses | 1,100.00 |  |
| Telephone and internet expense | 3,000.00 |  |
| Repairs and maintenance | 900.00 | 91,424.00 |
| **NET PROFIT** |  | $ 9,671.00 |

Results of the profitability ratios are:

* Net profit ratio 9.58%
* Return on owner’s equity 8.74%

A recent fitness industry journal article states that the average business in this industry has a net profit ratio of 15% and a return on owner’s equity of 10%.

You are required to prepare a 250 – 300 word **report (extract)** to Nadine that:

* **analyses** **and interprets** the financial reports and the two profitability ratios;
* **evaluates** the impact of the potential $200,000 expansion on her business’s future performance;
* **makes a decision** and **proposes a recommendation** about the viability of the expansion.

**Report (extract) to Nadine Meninga**

**ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS OF ENDURANCE FITNESS**

**Profitability/Issues identified**

The net profit ratio shows how much of each dollar of service revenue represents net profit. The net profit ratio of 9.58% is below the benchmark of 15% for other businesses in the fitness industry. Wages of $85,000 is a significant cost.

The purpose of the rate of return on owner’s equity ratio is to indicate the rate of return generated by an entity on investment of owner/s. The return on owner’s equity for Endurance Fitness is 8.74%, which is lower than the industry benchmark of 10%.

Profitability of the business is below industry benchmarks in both ratios. More information and further investigation is required to determine the reason/s for these results.

**Proposed expansion/changes**

A $200,000 business expansion is being considered. It is stated that this proposal would mean employing an extra personal trainer, purchasing new gym equipment and entering a three year lease on purpose-built gym premises. An expansion of this size requires further investigation. Some issues to consider include:

·        How will the $200,000 be financed? ie by the owner and/or financial institutions?

·        If being financed by the owner it may negatively affect the rate of return on the owner’s investment, i.e. further investment means that there would have to be a higher net profit achieved in order to get a good return. The rate of return is already lower than the industry benchmark.

·        The cost of interest on borrowings of $200,000

·        The cost of employing the personal trainer, given the already significant wages expense

·        The additional cost of renting new premises

·        Other costs in going ahead with the expansion

It is recommended that any decision on the expansion be delayed until all costs are fully investigated.