

CHAPTER 1
FINANCIAL REPORTING AND ACCOUNTING

Quick test**Question 1**

| | <i>Transaction</i> | <i>Accounts affected</i> | <i>Type of account</i> | <i>Increase / Decrease</i> |
|-----|---|---------------------------------|-------------------------------|-----------------------------------|
| (a) | Owner started business by paying into a business bank account | Bank | Asset | Increase |
| | | Capital | Capital | Increase |
| (b) | Loan received | Bank | Asset | Increase |
| | | Loan | Liability | Increase |
| (c) | Motor car purchased for cheque | Motor vehicles | Asset | Increase |
| | | Bank | Asset | Decrease |
| (d) | Goods purchased on credit from supplier Hall | Purchases | Expense | Increase |
| | | Payables | Liability | Increase |
| (e) | Goods sold on credit to customer White | Sales | Income | Increase |
| | | Receivables | Asset | Increase |
| (f) | Cheque paid for office expenses | Bank | Asset | Decrease |
| | | Office expenses | Expense | Increase |
| (g) | Goods sold for cash to customer Black | Sales | Income | Increase |
| | | Bank | Asset | Increase |
| (h) | Goods purchased on credit from supplier Marks | Purchases | Expense | Increase |
| | | Payables | Liability | Increase |
| (i) | Credit note issued for goods returned by White | Sales | Income | Decrease |
| | | Receivables | Asset | Decrease |
| (j) | Credit note received from Hall for return of faulty goods | Purchases | Expense | Decrease |
| | | Payables | Liability | Decrease |
| (k) | Cheque paid for car insurance | Insurance | Expense | Increase |
| | | Bank | Asset | Decrease |

| | | | | |
|-----|--|--------------------|-----------|----------|
| (l) | Cheque paid to Hall | Bank | Asset | Decrease |
| | | Payables | Liability | Decrease |
| (m) | Wages paid in cash | Wages | Expense | Increase |
| | | Cash | Asset | Decrease |
| (n) | Owner withdrawals to cover personal expenses | Bank | Asset | Decrease |
| | | Drawings | Capital | Decrease |
| (o) | Cheque received from White | Bank | Asset | Increase |
| | | Receivables | Asset | Decrease |
| (p) | Cheque paid to Marks after deducting a £50 cash discount | Bank | Asset | Decrease |
| | | Payables | Liability | Decrease |
| | | Discounts received | Income | Increase |
| (q) | Payment made on loan £1,500 (NB - loan of £5,000 has interest @ 10% p.a. and is being repaid in £1,000 instalments) | Bank | Asset | Decrease |
| | | Loan | Liability | Decrease |
| | | Interest | Expense | Increase |

Question 2

Follow the rules of double-entry given in the text:

Statement of financial position accounts

| ASSET | | LIABILITY | | CAPITAL | |
|-------|---|-----------|---|---------|---|
| + | - | - | + | - | + |

Statement of profit or loss accounts

| INCOME | | EXPENSE | |
|--------|---|---------|---|
| - | + | + | - |

| | | | | |
|-----|--|--------------------|-------|-------|
| | Dr | Payables | 300 | |
| | Cr | Purchases | | 300 |
| (k) | Cheque paid for car insurance | | | |
| | Dr | Insurance | 195 | |
| | Cr | Bank | | 195 |
| (l) | Cheque paid to Hall | | | |
| | Dr | Payables | 1,125 | |
| | Cr | Bank | | 1,125 |
| (m) | Wages paid in cash | | | |
| | Dr | Wages | 250 | |
| | Cr | Cash | | 250 |
| (n) | Owner withdrawals to cover personal expenses | | | |
| | Dr | Drawings | 500 | |
| | Cr | Bank | | 500 |
| (o) | Cheque received from White | | | |
| | Dr | Bank | 900 | |
| | Cr | Receivables | | 900 |
| (p) | Cheque paid to Marks after deducting a £50 cash discount | | | |
| | Dr | Payables | 1,200 | |
| | Cr | Bank | | 1,150 |
| | Cr | Discounts received | | 50 |
| (q) | Payment made on loan (NB loan of £5,000 has interest @ 10% p.a. and is being repaid in £1,000 instalments) | | | |
| | Dr | Loan | 1,000 | |
| | Dr | Loan interest | 500 | |
| | Cr | Bank | | 1,500 |

| Bank | | Motor Vehicles | |
|-------------|---------------|------------------|---------------|
| Capital | 15,000 | Motor Vehicles | 8,000 |
| Loan | 5,000 | Office expenses | 340 |
| Sales | 1,300 | Insurance | 195 |
| Receivables | 900 | Payables | 1,125 |
| | | Drawings | 500 |
| | | Payables & disc. | 1,150 |
| | | Loan & interest | 1,500 |
| | | Balance c/d | <u>9,390</u> |
| | <u>22,200</u> | | <u>22,200</u> |
| Balance b/d | 9,390 | | |
| | | Bank | <u>8,000</u> |
| | | | <u>8,000</u> |
| | | Balance b/d | 8,000 |
| | | Balance c/d | <u>8,000</u> |

| Purchases | |
|-------------|--------------|
| Payables | 2,250 |
| Payables | <u>1,200</u> |
| | <u>3,450</u> |
| Balance b/d | 3,150 |

| Payables | |
|-------------|--------------|
| Payables | 300 |
| Bank | 1,125 |
| Bank | 1,200 |
| Balance c/d | <u>825</u> |
| | <u>3,450</u> |
| Balance b/d | 825 |

| Office expenses | |
|-----------------|------------|
| Bank | <u>340</u> |
| | <u>340</u> |
| Balance b/d | 340 |

| Receivables | |
|-------------|--------------|
| Sales | 1,645 |
| Sales | 245 |
| Bank | 900 |
| Balance c/d | <u>500</u> |
| | <u>1,645</u> |
| Balance b/d | 500 |

| Sales | |
|-------------|--------------|
| Receivables | 245 |
| Balance c/d | <u>2,700</u> |
| | <u>2,945</u> |
| Balance b/d | 2,700 |

| Insurance | |
|-------------|------------|
| Bank | <u>195</u> |
| | <u>195</u> |
| Balance b/d | 195 |

| Wages | |
|-------------|------------|
| Cash | <u>250</u> |
| | <u>250</u> |
| Balance b/d | 250 |

| Cash | |
|-------------|------------|
| Balance c/d | <u>250</u> |
| | <u>250</u> |
| Balance b/d | 250 |

| Drawings | |
|-------------|------------|
| Bank | <u>500</u> |
| | <u>500</u> |
| Balance b/d | 500 |

| Loan | |
|-------------|--------------|
| Bank | 1,000 |
| Balance c/d | <u>4,000</u> |
| | <u>5,000</u> |
| Balance b/d | 4,000 |

| Loan interest | |
|---------------|------------|
| Bank | <u>500</u> |
| | <u>500</u> |
| Balance b/d | 500 |

| Discounts received | |
|--------------------|-----------|
| Balance c/d | <u>50</u> |
| | <u>50</u> |
| Balance b/d | 50 |

| Capital | |
|-------------|---------------|
| Balance c/d | <u>15,000</u> |
| | <u>15,000</u> |
| Balance b/d | 15,000 |

Trial balance

Debit Credit

| | | |
|--------------------|---------------|---------------|
| | £ | £ |
| Bank | 9,390 | |
| Motor vehicles | 8,000 | |
| Purchases | 3,150 | |
| Payables | | 825 |
| Office expenses | 340 | |
| Receivables | 500 | |
| Sales | | 2,700 |
| Insurance | 195 | |
| Wages | 250 | |
| Cash | | 250 |
| Drawings | 500 | |
| Loan | | 4,000 |
| Loan interest | 500 | |
| Discounts received | | 50 |
| Capital | | 15,000 |
| | <u>22,825</u> | <u>22,825</u> |

Question 3

P. Glass

Statement of profit or loss for the year ended 30 June 20X4

| | | | |
|------------------------|--------------|----------------|-----------------|
| | £ | £ | £ |
| Revenue | | | 19,647 |
| Less: Returns inwards | | | <u>(205)</u> |
| | | | 19,442 |
| Cost of sales | | | |
| Opening inventories | | 2,368 | |
| Purchases | 13,874 | | |
| Less: Returns outwards | <u>(322)</u> | | |
| | | 13,552 | |
| Carriage inwards | | <u>250</u> | |
| | | 16,170 | |
| Closing inventories | | <u>(2,946)</u> | |
| | | | <u>(13,224)</u> |
| Gross profit | | | 6,218 |
| Expenses | | | |
| Salaries and wages | | 4,206 | |
| Rent | | 300 | |
| Insurance | | 76 | |
| Motor expenses | | 554 | |
| Office expenses | | 328 | |
| Heat and light | | 160 | |
| General expenses | | 325 | |
| Discounts allowed | | <u>68</u> | |
| | | | <u>(6,017)</u> |
| Net profit for year | | | <u>201</u> |

P. Glass

Statement of financial position at 30 June 20X4

| | £ | £ |
|-------------------------------|--------------|----------------|
| Non-current assets | | |
| Premises | | 5,000 |
| Motor vehicles | | 1,800 |
| Fixtures and fittings | | <u>450</u> |
| | | 7,250 |
| Current assets | | |
| Inventories | 2,946 | |
| Trade receivables | <u>3,704</u> | |
| | | <u>6,650</u> |
| Total assets | | <u>13,900</u> |
| Capital | | |
| Capital at 1 July 20X3 | | 10,458 |
| Net profit for year | | <u>201</u> |
| | | 10,659 |
| Less: Drawings | | <u>(1,200)</u> |
| | | 9,459 |
| Current liabilities | | |
| Bank overdraft | 1,710 | |
| Trade payables | <u>2,731</u> | |
| | | <u>4,441</u> |
| Total capital and liabilities | | <u>13,900</u> |

Develop your understanding

Question 4

Lytax

Statement of profit or loss for the year ended 31 December 20X2

| | £ | £ |
|---------------------|----------------|----------------|
| Revenue | | 159,000 |
| Cost of sales | | |
| Opening inventories | 7,800 | |
| Purchases | 79,500 – 1,500 | <u>78,000</u> |
| | | 85,800 |
| Closing inventories | | <u>(8,000)</u> |
| | | <u>77,800</u> |
| Gross profit | | 81,200 |
| Expenses | | |
| Discounts allowed | 700 | |
| Heat and light | 1,300 | |

| | | | |
|---------------------------------------|------------------------|------------|-----------------|
| Insurance | 1,400 – (6/12 x 1,000) | 900 | |
| Wages and salaries | 24,200 + 400 | 24,600 | |
| General expenses | | 1,200 | |
| Irrecoverable debts | | 700 | |
| Increase in allowance for receivables | 450 – 300 | 150 | |
| Loan interest | 8% x 15,000 | 1,200 | |
| Depreciation: Buildings | 40,000/50 | 800 | |
| Plant and machinery | 15% x 38,000 | 5,700 | |
| Fixtures and fittings | 5% x (21,300 – 5,300) | <u>800</u> | |
| | | | <u>38,050</u> |
| Net profit for year | | | <u>£ 43,150</u> |

Lytax

Statement of financial position at 31 December 20X2

| | £ | £ | £ |
|---------------------------------|----------------|--------------------------|-----------------|
| | Cost | Accumulated depreciation | NBV |
| Non-current assets | | | |
| Land and buildings | 67,000 | 12,800 | 54,200 |
| Plant and machinery | 38,000 | 13,800 | 24,200 |
| Fixtures and fittings | <u>21,300</u> | <u>6,100</u> | <u>15,200</u> |
| | <u>126,300</u> | <u>32,700</u> | <u>93,600</u> |
| Current assets | | | |
| Inventories | | 8,000 | |
| Receivables | 9,000 | | |
| Less: Allowance for receivables | <u>(450)</u> | | |
| | | 8,550 | |
| Prepayments | | <u>500</u> | |
| | | | <u>17,050</u> |
| Total assets | | | <u>£110,650</u> |
| Capital | | | |
| Balance at 1 January 20X2 | | | 68,000 |
| Net profit for the year | | | <u>43,150</u> |
| | | | 111,150 |
| Drawings | 25,000 + 1,500 | | <u>(26,500)</u> |
| Balance at 31 December 20X2 | | | 84,650 |
| Non-current liabilities | | | |
| 5-year loan | | | 15,000 |
| Current liabilities | | | |
| Bank overdraft | | 1,000 | |
| Payables | | 8,400 | |
| Accruals | 1,200 + 400 | <u>1,600</u> | |
| | | | <u>11,000</u> |
| Total capital and liabilities | | | <u>£110,650</u> |

Question 5

Porter Ltd.

Statement of profit or loss for the year ended 31 May 20X6

| | | |
|--|--------------|----------------|
| | £000 | £000 |
| Revenue | | 4,377 |
| Cost of sales | | |
| Opening inventories | 1,071 | |
| Purchases | <u>2,225</u> | |
| | 3,296 | |
| Closing inventories | <u>1,123</u> | <u>(2,173)</u> |
| Gross profit | | 2,204 |
| Royalties receivable | | <u>42</u> |
| | | 2,246 |
| Expenses | | |
| Wages and salaries | 808 | |
| Motor expenses | 164 | |
| Rent | 210 | |
| General distribution costs | 81 | |
| General administration expenses (79 - $\frac{7}{12} \times 24 + \frac{2}{3} \times 6$) | 69 | |
| Directors' remuneration | 185 | |
| Irrecoverable debts | 31 | |
| Increase in allowance for receivables 34 - 29 | 5 | |
| Directors' bonuses | 36 | |
| Auditors' fees | 12 | |
| Depreciation: | | |
| Plant and machinery 10% x 1,750 | 175 | |
| Motor vehicles 35% x (320 - 145) | <u>61</u> | |
| | | <u>(1,837)</u> |
| Profit from operations | | 409 |
| Debenture interest 7% x 800 | | <u>(56)</u> |
| Profit before tax | | 353 |
| Income tax | | <u>(102)</u> |
| Profit for the year | | <u>£ 251</u> |

Porter Ltd.

Statement of changes in equity for the year ended 31 May 20X6

| | <i>Equity share capital</i> | <i>Preference share capital</i> | <i>Retained earnings</i> | <i>Total</i> |
|------------------------|-------------------------------------|---|------------------------------|--------------|
| | £000 | £000 | £000 | £000 |
| Balance at 1 June 20X5 | 600 | 500 | 336 | 1,436 |
| Profit for the year | | | 251 | 251 |
| Dividends paid | | | <u>(119)</u> | <u>(119)</u> |
| Balance at 31 May 20X6 | <u>600</u> | <u>500</u> | <u>468</u> | <u>1,568</u> |

Porter Ltd.
Statement of financial position at 31 May 20X6

| | £000 | £000 | £000 |
|---------------------------------|------------------|-----------------------------|--------------|
| | Cost | Accumulated depreciation | NBV |
| Non-current assets | | | |
| Plant and machinery | 1,750 | 679 | 1,071 |
| Motor vehicles | <u>320</u> | <u>206</u> | <u>114</u> |
| | <u>2,070</u> | <u>885</u> | 1,185 |
| Current assets | | | |
| Inventories | | 1,123 | |
| Trade receivables | 781 | | |
| Less: Allowance for receivables | <u>(34)</u> | 747 | |
| Prepayments | | <u>14</u> | |
| | | | <u>1,884</u> |
| Total assets | | | <u>3,069</u> |
| Equity | | | |
| Equity share capital | | | 600 |
| Preference share capital | | | <u>500</u> |
| | | | 1,100 |
| Retained earnings | | | <u>468</u> |
| | | | 1,568 |
| Non-current liabilities | | | |
| 7% debentures | | | 800 |
| Current liabilities | | | |
| Bank overdraft | | 43 | |
| Trade payables | | 498 | |
| Accruals | 4 + 28 + 12 + 36 | 80 | |
| VAT | | 54 | |
| Income tax | 102 - 76 | <u>26</u> | |
| | | | <u>701</u> |
| Total equity and liabilities | | | <u>3,069</u> |

Take it further

Question 6

Falmouth plc

Statement of profit or loss for the year ended 30 June 20X1

| | | |
|---|--------------------------|---------------------|
| | £000 | £000 |
| Revenue | | 6,590 |
| Cost of sales | | |
| Opening inventories | 380 | |
| Purchases | 4,304 | |
| | <u>4,684</u> | |
| Closing inventories | (440) | |
| | | <u>(4,244)</u> |
| Gross profit | | 2,346 |
| Expenses | | |
| Wages and salaries | 508 | |
| Light and heat | 62 + 12 | 74 |
| Irrecoverable debts expense | 30 – 8 | 22 |
| Increase in allowance for receivables | 24 - 20 | 4 |
| Other administration expenses | 196 - 5/12 x 18 | 188.5 |
| Directors' bonuses | | 24 |
| Depreciation: Freehold buildings | 400 / 50 | 8 |
| Plant and machinery | (1,460 - 320 + 40) x 10% | 118 |
| Motor vehicles | 33% x (440 - 230) | 69.3 |
| Loss on sale | | <u>88</u> |
| | | <u>(1,103.8)</u> |
| Profit from operations | | 1,242.2 |
| Interest payable on debentures | 8% x 400 | 32 |
| Dividends on redeemable preference shares | 12% x 200 | <u>24</u> |
| | | <u>(56)</u> |
| Profit before tax | | 1,186.2 |
| Income tax | | (256) |
| Profit for the year | | <u><u>930.2</u></u> |

Falmouth plc

Statement of changes in equity for the year ended 30 June 20X1

| | <i>Equity share capital</i> £000 | <i>Retained earnings</i> £000 | <i>Total</i> £000 |
|-------------------------|---|--------------------------------------|----------------------|
| Balance at 1 July 20X0 | 500 | 368 | 868 |
| Profit for the year | | 930.2 | 930.2 |
| Dividends paid | | (56) | (56) |
| Balance at 30 June 20X1 | <u>500</u> | <u>1,242.2</u> | <u>1,742.2</u> |

Falmouth plc
Statement of financial position at 30 June 20X1

| | £000 | £000 | £000 |
|-------------------------------------|--------------|---------------------------------|-----------------------|
| | <i>Cost</i> | <i>Accumulated depreciation</i> | <i>NBV</i> |
| Non-current assets | | | |
| Freehold land and buildings | 860 | 48 | 812 |
| Plant and machinery | 1,180 | 370 | 810 |
| Motor vehicles | 440 | 299.3 | 140.7 |
| | <u>2,480</u> | <u>717.3</u> | <u>1,762.7</u> |
| Current assets | | | |
| Inventories | | 440 | |
| Receivables | 578 + 8 | 586 | |
| Less: allowance for receivables | | <u>(24)</u> | |
| | | 562 | |
| Prepayments | | 7.5 | |
| Bank | | <u>168</u> | |
| | | | <u>1,177.5</u> |
| Total assets | | | <u><u>2,940.2</u></u> |
| Equity | | | |
| Equity share capital | | 500 | |
| Retained earnings | | <u>1,242.2</u> | |
| | | | 1,742.2 |
| Long-term liabilities | | | |
| Redeemable preference share capital | | 200 | |
| 8% debentures | | <u>400</u> | |
| | | | 600 |
| Current liabilities | | | |
| Payables | | 390 | |
| Accruals | 12 + 24 | 36 | |
| Debenture interest payable | 32 – 16 | 16 | |
| Redeemable preference dividend | 24 – 12 | 12 | |
| Income tax payable | 256 – 112 | <u>144</u> | |
| | | | <u>598</u> |
| Total equity and liabilities | | | <u><u>2,940.2</u></u> |

Workings

| <u>Sale of plant and machinery</u> | | £000 |
|------------------------------------|-----------|--------------|
| Original cost | | 320 |
| Accumulated depreciation | 60% x 320 | <u>(192)</u> |
| Net book value at time of disposal | | 128 |
| Proceeds | | <u>40</u> |
| Loss on sale | | <u>88</u> |

Cost of plant and machinery

| | |
|---------------------------------|--------------|
| Per trial balance | 1,460 |
| + Proceeds incorrectly credited | 40 |
| - Plant sold | (320) |
| | <u>1,180</u> |

Previous irrecoverable debt received

This amount had been written off as an irrecoverable debt in previous years. The correct accounting treatment is to credit the amount received to irrecoverable debts, i.e. to reduce this year's irrecoverable debts expense. The adjustment required is therefore:

Dr Receivables
Cr Irrecoverable debts