Incomplete Records (A)

2007, Question 7

SALES.

Credit sales = Payments from debtors + Debtors 31/12 – Debtors 1/1

Cash sales = Total of cash payments + Cash 31/12 – Cash 1/1 + Cash drawings

PURCHASES.

Credit purchases = Payments to creditors + creditors 31/12 – creditors 1/1

Cash purchases: Given in the question as €105,200

So total purchases = Credit purchases €51,000 + Cash purchases €105,200 = €156,200

Just before we record that as our purchases figure though, we need to minus from it any drawings of stock which in this case is €7,800 (€150 x 52wks). The reason for this is that when we take goods from stock we're essentially stopping them from being sold. Since 'purchases' officially refers to things we buy with the intention of re-selling to our customers, we can't count as purchases anything that we don't get to sell.

So our final figure for purchases is: €156,200 - €7,800 = **€148,400**

BANK.

The last big thing to work out before we can start for real is the bank figure. To do this we add up all of the money which has gone into the bank (all of the lodgements + the money received from the loan) and minus all of the payments (all of the bank payments + the money spent from the loan + any money taken out for investments). So it's:

Receipts: €61,000 + €116,000 + €3,000 + €180,000 = €360,000

Payments: €14,000 + €38,800 + €5,400 + €2,250 + €6,800 + €28,400 + €155,000 + €4,800 = €255,450

The last figure in that list of payments (€4,800) is the money taken out of our bank account to go into an investment fund. We were told that €1,200 came out at the end of each month starting at the end of September. i.e. 4 months x €1,200 = €4,800

The bank figure is therefore the receipts €360,000 minus the payments €255,450 = **€104,550**

GOODWILL.

Goodwill is a fixed asset and is the difference between what we paid for a business and what it seems to be worth (which we find out by subtracting all of the liabilities from all of the assets on the 1/1). In this case the company seems to be worth as follows at the start of the year:

Assets: Premises €560,000 + Stock €19,000 + Debtors €12,000 + 3 Months Insurance Prepaid €1,600 + Cash €200 = €592,800

Liabilities: Creditors €18,200 + Wages Due €2,600 = €20,800

Therefore the business seems to be worth €592,800 - €20,800 = €572,000

But we are told that we paid €590,000 for it. Goodwill is therefore the difference between €590,000 and €572,000. i.e. €18,000

So now we're ready to actually do the answer!

In completing our trading and profit and loss account, the first part will be easy. We've already worked out sales and purchases and the two stock figures are clearly shown at the top and bottom of the question.

Trading Account for P.Lynch 31/12/06

	€	€	€
Sales			374800
Opening Stock		19000	
Purchases		148400	
Closing Stock		-16400	
Cost of Sales		151000	151000
Gross Profit			223800

Next we need to do the profit and loss account which involves finding any gains or expenses that P.Lynch had during the year. The only gain involved in this question (and in fact in every leaving cert question on this topic so far) is the very last item in the question - €25 interest earned by Lynch's investments.

The expenses he paid during the year are scattered throughout the question:

In the 'Cash Payments' heading we can see General Expenses.

In the 'Bank Payments' heading we can see Light and Heat, Interest, and Insurance. (Obviously we're looking for *expenses* here so that's why I'm ignoring the fixed assets that we spent money on and also the creditors (because they were for *purchases* and we already dealt with them.

What you might be familiar with from other topics though, is that knowing what the expenses are is only half the battle. We also need to be sure how much we should put into the account for each of these expenses. This means looking at the opening and closing balances and also at any other information in the question, to see if we need to make any changes.

Remember the normal accounting rules:

If something is due on the 1/1 we subtract.
If something is due on the 31/12 we add.
If something is prepaid on the 1/1 we add.
If something is prepaid on the 31/12 we subtract.

So in this case, our four expenses will be as follows:

General Expenses: €73,800 - €2,600 (Wages due 1/1) = €71,200

Light and Heat: €5,400 + €480 (Electricity due 31/12) – 25% (we're told that 25% of light and heat wasn't for the business) = €4,410

Interest: €2,250 + €750 (if we borrowed €180,000 at 5% on the 1/9, we should owe €3,000 for the year. So if we've already paid €2,250 then €750 must be still due at the end of the year) – 20% (we're told that 20% of the interest wasn't for the business) = €2,400

Insurance: €6,800 + €1,600 (insurance prepaid on the 1/1) - €1,700 (this is 3 months' worth of the €6,800 we paid. If we started the year with 3 months insurance already paid and then we're told that we paid for a full year, then there must still be 3 months prepaid at the end of the year) = €6,700

So now we have the full answer to (a):

Trading and Profit and Loss Account 31/12

	€	€	€
Sales			374800
Opening Stock		19000	
Purchases		148400	
Closing Stock		-16400	151000
Gross Profit			223800
Gains			
Investment Income			25
			223825
Expenses			
General Expenses		71200	
Light and Heat		4410	
Interest		2400	
Insurance		6700	84710
NET PROFIT			139115

(b) Thankfully almost all of the hard work is done by now. All we have to do is not leave anything out! The four sections of the balance sheet will be as follows:

Fixed Assets.
The fixed assets are our goodwill of €18,000 (worked out at the very start), Buildings of €715,000 (the €560,000 we started with plus the €155,000 we bought after taking out the loan), Delivery vans of €28,400 (bought during the year as we can see in the 'bank payments'), Furniture of €10,500 (that's €14,000 worth of furniture bought during the year as mentioned in the 'bank payments' minus the 25% that we are told was not for the business), and Investment Fund of €4,825 (which is four months of €1,200 that we've put into the fund from our bank account, along with the €25 interest earned so far).

Current Assets.
The current assets are our stock €16,400, Debtors €20,200 and Cash €400 (all given in the closing balances of the question), as well as the bank figure we worked out at the very beginning of our answer (€104,550) and the insurance prepaid of €1,700 that we worked out when we were doing our expenses.

Current Liabilities.
There are only three current liabilities: Creditors of €30,400 and Electricity due of €480 are both mentioned in the closing balances at the end of the question. The

interest we owe on the loan of €750 we worked out earlier when we were doing the expenses.

Financed By.
The final step is to complete the 'financed by' section. In it we need to put the loan of €180,000, the Net profit of €139,115, the Capital of €590,000 (that's the money put into the business at the very start by the owner), and two slightly sneaky figures: There's €3,000 in here that comes from the 'Dividends' heading in the bank lodgements. Since these are 'lodgements' they can't be dividends that we've *paid.* Instead what they mean is that the owner *earned* dividends from some other shares he has and decided to put the money into this business - i.e. that's why it goes into the 'financed by' section. Finally you'll see a minus figure of €23,770 for drawings. This is just the total of all of the drawings from the business during the year Stock (€7,800), Cash (€10,400), Furniture (€3,500), Interest (€600), and Light and Heat (€1,470).

So the answer looks like this:
Balance Sheet as at 31/12.

Fixed Assets.	€	€	€
Goodwill			18000
Buildings			715000
Delivery Vans			28400
Furniture			10500
Investment Fund			4825
			776725
Current Assets.			
Stock		16400	
Debtors		20200	
Bank		104550	
Cash		400	
Insurance Prepaid		1700	
		143250	
Current Liabilities.			
Creditors	30400		
Interest Due	750		
Electricity Due	480		
	31630	31630	
		111620	111620
			888345

Financed By.

Loan	180000
Capital	590000
Dividends Introduced	3000
Net Profit	139115
Drawings	-23770
	888345

Part (C) asks us three quick questions:

(i) An accounting concept is a general rule that governs how accounts are prepared.

(ii) Consistency and Prudence.

(iii) Prudence is applied in calculating the value of closing stock. Lynch records stock at the lower of cost and net realisable value, in order to give a pessimistic view. It is possible that stock might ultimately be sold for more than the amount shown in the accounts but the prudence concept ensures that we remain on the side of caution.