12 FINAL ACCOUNTS

For most businesses, the final accounts, which are produced at the end of each financial year, comprise:

- trading account
- profit and loss account
- balance sheet

Final accounts can be presented in a vertical format, or a horizontal format. In this chapter we shall look at both. The vertical format, however, is more common nowadays and is used as the standard format in this book.

When preparing final accounts it is important to distinguish between capital expenditure and revenue expenditure.

FINAL ACCOUNTS AND THE TRIAL BALANCE

So far we have looked at the format of business accounts and the recording of different types of transactions. All that we have covered is usually carried out by the book-keeper. We will now see how the financial accountant takes to a further stage the information prepared by the book-keeper. The financial accountant will use the information from the accounting system, which is summarised in the trial balance (see Chapter 5), in order to produce the final accounts of a business.

The final accounts can be produced more often than once a year in order to give information to the owner(s) on how the business is progressing. However, it is customary to produce annual or final accounts for the benefit of the Inland Revenue, bank manager and other interested parties. Limited companies (see Chapter 25) have a legal responsibility to report to their shareholders each year, while non-trading organisations (such as clubs and societies – see Chapter 22) report financial results to the members annually.

The starting point for preparing final accounts is the trial balance prepared by the book-keeper. All the figures recorded on the trial balance are used in the final accounts. The trading account and the profit and loss account are both 'accounts' in terms of double-entry book-keeping. This means that amounts recorded in these accounts must also be recorded elsewhere in the book-keeping system. By contrast, the balance sheet is not an account, but is simply a statement of account balances remaining after the trading and profit and loss accounts have been prepared.

To help us with the preparation of final accounts we will use the trial balance, shown on the next page, which has been produced by the book-keeper at the end of the firm's financial year.

TRIAL BALANCE OF WYVERN WHOLESALERS AS AT 31 DECEMBER 20-1

	Dr	Cr
	£	£
Sales		250,000
Purchases	156,000	
Sales returns	5,400	
Purchases returns		7,200
Discount received		2,500
Discount allowed	3,700	
Stock at 1 January 20-1	12,350	
Salaries	46,000	
Electricity and gas	3,000	
Rent and rates	2,000	
Sundry expenses	4,700	
Premises	100,000	
Equipment	30,000	
Vehicles	21,500	
Debtors	23,850	
Bank overdraft		851
Cash	125	
Creditors		12,041
Value Added Tax		3,475
Capital		110,000
Drawings	10,442	
Long-term loan		33,000
	419,067	419,067

Note: stock at 31 December 20-1 was valued at £16,300

You will see that the trial balance includes the stock value at the start of the year, while the end-of-year valuation is noted after the trial balance. For the purposes of financial accounting, the stock of goods for resale is valued by the business (and often verified by the auditor) at the end of each financial year, and the valuation is entered into the book-keeping system (see page 171). We will present the final accounts

- before adjustments for items such as accruals, prepayments, depreciation of fixed assets, bad debts written off, and provision for bad debts (each of which will be dealt with in Chapters 13 -15)
- in vertical format, ie in columnar form (the alternative layout – horizontal format – is looked at on page 174)

On page 171 we will look at the double-entry book-keeping for amounts entered in the trading and profit and loss accounts.

Trading Account

The main activity of a trading business is to buy goods at one price and then to sell the same goods at a higher price. The difference between the two prices represents a profit known as *gross profit*. Instead of calculating the gross profit on each item bought and sold, we have seen how the book-keeping system stores up the totals of transactions for the year in either purchases account or sales account. Further, any goods returned are recorded in either purchases returns account or sales returns account.

At the end of the financial year (which can end at any date – it doesn't have to be the calendar year) the total of purchases and sales accounts, together with purchases returns and sales returns, are used to form the trading account. It is also necessary to take note of the value of stock of goods for resale held at the beginning and end of the financial year.

The trading account is set out as follows:

TRADING ACCOUNT OF WYVERN WHOLESALERS
FOR THE YEAR ENDED 31 DECEMBER 20-1

	£	£	£
Sales			250,000
Less Sales returns			5,400
Net sales (or turnover)			244,600
Opening stock (1 January 20-1)		12,350	
Purchases	156,000		
Carriage in	–		
Less Purchases returns	7,200		
Net purchases		148,800	
		161,150	
Less Closing stock (31 December 20-1)		16,300	
Cost of Goods Sold			144,850
Gross profit			99,750

notes on trading account

- **Sales and purchases** only include items in which the business trades – items to be kept for use in the business, such as machinery, are not included in sales and purchases but are classified as fixed assets.
- **Adjustments** are made for the value of stock in the store or warehouse at the beginning and end of the financial year. The opening stock is added to the purchases because it has been sold during the year. The closing stock is deducted from purchases because it has not been sold; it will form the opening stock for the next financial year, when it will be added to next year's figure for purchases.

- The figure for **cost of goods sold** (often written as 'cost of sales') represents the cost to the business of the goods which have been sold in this financial year. Cost of goods sold is:

  opening stock
  \+ purchases
  \+ carriage in (see below)
  – purchases returns
  – closing stock
  = cost of goods sold

- **Gross profit** is calculated as:

  sales
  – sales returns
  = net sales
  – cost of goods sold
  = gross profit

  If cost of goods sold is greater than net sales, the business has made a *gross loss*.

- **Carriage in** is the expense to the business of having purchases delivered (eg if you buy from a mail order company, you often have to pay the post and packing – this is the 'carriage in' cost). The cost of carriage in is added to purchases.

- **Net sales** (often described as turnover) is:

  sales
  – sales returns
  = net sales

- **Net purchases** is:

  purchases
  \+ carriage in
  – purchases returns
  = net purchases

Profit and Loss Account

In the profit and loss account are listed the various running expenses (or revenue expenditure) of the business. The total of running expenses is deducted from gross profit to give net profit for the year. Net profit is an important figure: it shows the profitability of the business after all expenses, and how much has been earned by the business for the owner(s). It is on this profit, after certain adjustments, that the tax liability will be based.

The profit and loss account follows on from the trading account and is set out as follows:

PROFIT AND LOSS ACCOUNT OF WYVERN WHOLESALERS FOR THE YEAR ENDED 31 DECEMBER 20-1			
	£	£	£
Gross profit			99,750
Add Discount received			2,500
			102,250
Less expenses:			
Discount allowed		3,700	
Salaries		46,000	
Electricity and gas		3,000	
Rent and rates		2,000	
Sundry expenses		4,700	
			59,400
Net profit			42,850

Notes:

- The various running expenses shown in the profit and loss account can be listed to suit the needs of a particular business: the headings used here are for illustrative purposes only.
- Amounts of income are also included in profit and loss account, eg discount received in the example; these are added to gross profit.
- The net profit is the amount the business earned for the owner(s) during the year; it is important to note that this is not the amount by which the cash/bank balance has increased during the year.
- If the total of expenses exceeds gross profit (and other income), the business has made a net loss.
- Drawings by the owner(s) are not listed as an expense in profit and loss account – instead, they are deducted from capital (see balance sheet below).
- If the owner of the business has taken goods for his or her own use, the amount should be deducted from purchases and added to drawings (see also page 207).

The trading account and the profit and loss account are usually combined together, rather than being shown as separate accounts, as shown in the 'vertical format' at the top of the next page.

The trading and profit and loss account forms part of the double-entry book-keeping system and can also be set out in 'horizontal' format (see page 174).

service sector businesses

You should note that when preparing the final accounts of a service sector business – such as a secretarial agency, solicitors, estate agents, doctor – a trading account will not be prepared because, instead of trading in goods, the business supplies services. Thus the final accounts will consist of a profit and loss account and balance sheet. The profit and loss account, instead of starting with gross profit, will commence with the income from the business activity, such as 'fees', 'income from clients', 'charges', 'work done'. Other items of income, such as discount received, are added, and the expenses are then listed and deducted to give the net profit, or net loss, for the accounting period. An example is shown at the bottom of the next page.

TRADING AND PROFIT AND LOSS ACCOUNT OF WYVERN WHOLESALERS
FOR THE YEAR ENDED 31 DECEMBER 20-1

	£	£	£
Sales			250,000
Less Sales returns			5,400
Net sales			244,600
Opening stock (1 January 20-1)		12,350	
Purchases	156,000		
Carriage in	–		
Less Purchases returns	7,200		
Net purchases		148,800	
		161,150	
Less Closing stock (31 December 20-1)		16,300	
Cost of Goods Sold			144,850
Gross profit			99,750
Add Discount received			2,500
			102,250
Less expenses:			
Discount allowed		3,700	
Salaries		46,000	
Electricity and gas		3,000	
Rent and rates		2,000	
Sundry expenses		4,700	
			59,400
Net profit			42,850

PROFIT AND LOSS ACCOUNT OF WYVERN SECRETARIAL AGENCY
FOR THE YEAR ENDED 31 DECEMBER 20-1

	£	£
Income from clients		110,000
Less expenses:		
Salaries	64,000	
Heating and Lighting	2.000	
Telephone	2.000	
Rent and Rates	6,000	
Sundry Expenses	3,000	
		77,000
Net profit		33,000

BALANCE SHEET

The trading and profit and loss account shows two types of profit – gross profit and net profit, respectively – for the financial year (or such other time period as may be chosen by the business). A balance sheet, by contrast, shows the state of the business at one moment in time. It lists the assets and the liabilities at a particular date, but is not part of the double-entry book-keeping system.

The balance sheet of Wyvern Wholesalers, using the figures from the trial balance on page 163, is as follows:

BALANCE SHEET OF WYVERN WHOLESALERS
AS AT 31 DECEMBER 20-1

	£	£	£
Fixed Assets			
Premises			100,000
Equipment			30,000
Vehicles			21,500
			151,500
Current Assets			
Stock		16,300	
Debtors		23,850	
Cash		125	
		40,275	
Less Current Liabilities			
Creditors	12,041		
Value Added Tax	3.475		
Bank overdraft	851		
		16,367	
Working Capital			23,908
			175,408
Less Long-term Liabilities			
Loan			33,000
NET ASSETS			142,408
FINANCED BY:			
Capital			
Opening capital			110,000
Add net profit			42,850
			152,850
Less drawings			10,442
			142,408

notes on the balance sheet

- **assets**

  Assets are items or amounts owned or owed to the business, and are normally listed in increasing order of liquidity, ie the most permanent assets are listed first.

  Fixed assets are long-term assets, and are divided between tangible fixed assets, which have material substance such as premises, equipment, vehicles, and intangible fixed assets, such as goodwill (see below).

  Current assets are short-term assets which continually change from day-to-day, such as stock, debtors, bank (if not overdrawn) and cash.

- **intangible fixed assets**

  Intangible fixed assets (not shown in the balance sheet above) will appear on some balance sheets, and are listed before the tangible fixed assets. An intangible asset does not have material substance, but belongs to the business and has value. A common example of an intangible fixed asset is goodwill, which is where a business has bought another business and paid an agreed amount for the existing reputation and customer connections (the goodwill).

- **liabilities**

  Liabilities are items or amounts owed by the business.

  Current liabilities are amounts owing at the balance sheet date and due for repayment within 12 months or less (eg creditors, Value Added Tax, bank overdraft).

  Long-term liabilities are borrowings where repayment is due in more than 12 months (eg loans, bank loans).

- **capital and working capital**

  Capital is money owed by the business to the owner. It is usual practice to show on the balance sheet the owner's investment at the start of the year plus net profit for the year less drawings for the year; this equals the owner's investment at the end of the year, ie at the balance sheet date.

  Working capital is the excess of current assets over current liabilities. Without working capital, a business cannot continue to operate.

significance of the balance sheet

The balance sheet shows the assets used by the business and how they have been financed. The concept may be expressed as a formula:

	Fixed assets
plus	Working capital
minus	Long-term liabilities
equals	Net assets
equals	Capital

The vertical presentation balance sheet agrees the figure for net assets (£142,408), with capital.

Preparation of Final Accounts from a Trial Balance

The trial balance contains the basic figures necessary to prepare the final accounts but, as we shall see in the next section, the figures are transferred from the double-entry accounts of the business. Nevertheless, the trial balance is a suitable summary from which to prepare the final accounts. The information needed for the preparation of each of the final accounts needs to be picked out from the trial balance in the following way:

- go through the trial balance and write against the items the final account in which each appears
- 'tick' each figure as it is used – each item from the trial balance appears in the final accounts once only
- the year-end (closing) stock figure is not listed in the trial balance, but is shown as a note; the closing stock appears twice in the final accounts – firstly in the trading account, and secondly in the balance sheet (as a current asset).

If this routine is followed with the trial balance of Wyvern Wholesalers, it then appears as follows.

TRIAL BALANCE OF WYVERN WHOLESALERS AS AT 31 DECEMBER 20-1

	Dr	Cr		
	£	£		
Sales		250,000	T	✔
Purchases	156,000		T	✔
Sales returns	5,400		T	✔
Purchases returns		7,200	T	✔
Discount received		2,500	P & L *(income)*	✔
Discount allowed	3,700		P & L *(expense)*	✔
Stock 1 January 20-1	12,350		T	✔
Salaries	46,000		P & L *(expense)*	✔
Electricity and gas	3,000		P & L *(expense)*	✔
Rent and rates	2,000		P & L *(expense)*	✔
Sundry expenses	4,700		P & L *(expense)*	✔
Premises	100,000		BS *(fixed asset)*	✔
Equipment	30,000		BS *(fixed asset)*	✔
Vehicles	21,500		BS *(fixed asset)*	✔
Debtors	23,850		BS *(current asset)*	✔
Bank overdraft		851	BS *(current liability)*	✔
Cash	125		BS *(current asset)*	✔
Creditors		12,041	BS *(current liability)*	✔
Value Added Tax		3,475	BS *(current liability)*	✔
Capital		110,000	BS *(capital)*	✔
Drawings	10,442		BS *(capital)*	✔
Long-term loan		33,000	BS *(long-term liability)*	✔
	419,067	419,067		
Stock at 31 December 20-1 was valued at £16,300			T	✔
			BS *(current asset)*	✔

Note: T = trading account; P & L = profit and loss account; BS = balance sheet

DOUBLE-ENTRY BOOK-KEEPING AND THE FINAL ACCOUNTS

We have already noted earlier in this chapter that the trading and profit and loss account forms part of the double-entry book-keeping system. Therefore, each amount recorded in this account must have an opposite entry elsewhere in the accounting system. In preparing the trading and profit and loss account we are, in effect, emptying each account that has been storing up a record of the transactions of the business during the course of the financial year and transferring it to the trading and profit and loss account.

trading account

In the trading account of Wyvern Wholesalers the balance of purchases account is transferred as follows (debit trading account; credit purchases account):

Purchases Account

Dr					Cr
20-1		£	20-1		£
31 Dec	Balance b/d (ie total for year)	156,000	31 Dec	Trading account	156,000

The account now has a nil balance and is ready to receive the transactions for next year.

The balances of sales, sales returns, and purchases returns accounts are cleared to nil in a similar way and the amounts transferred to trading account, as debits or credits as appropriate.

Stock account, however, is dealt with differently. Stock is valued for financial accounting purposes at the end of each year (it is also likely to be valued more regularly in order to provide management information). Only the annual stock valuation is recorded in stock account, and the account is not used at any other time. After the book-keeper has extracted the trial balance, but before preparation of the trading account, the stock account appears as follows:

Stock Account

Dr					Cr
20-1		£	20-1		£
31 Dec	Balance b/d	12,350			

This balance, which is the opening stock valuation for the year, is transferred to the trading account to leave a nil balance, as follows (debit trading account; credit stock account):

Stock Account

Dr					Cr
20-1		£	20-1		£
31 Dec	Balance b/d	12,350	31 Dec	Trading account	12,350

The closing stock valuation for the year is now recorded on the account as an asset (debit stock account; credit trading account):

Stock Account

Dr					Cr
20-1		£	20-1		£
31 Dec	Balance b/d	12,350	31 Dec	Trading account	12,350
31 Dec	Trading account	16,300	31 Dec	Balance c/d	16,300
20-2					
1 Jan	Balance b/d	16,300			

The closing stock figure is shown on the balance sheet as a current asset, and will be the opening stock in next year's trading account.

profit and loss account

Expenses and income items are transferred from the double-entry accounts to the profit and loss account. For example, the salaries account of Wyvern Wholesalers has been storing up information during the year and, at the end of the year, the total is transferred to profit and loss account (debit profit and loss account; credit salaries account):

Salaries Account

Dr					Cr
20-1		£	20-1		£
31 Dec	Balance b/d (ie total for year)	46,000	31 Dec	Profit and loss account	46,000

The salaries account now has a nil balance and is ready to receive transactions for 20-2, the next financial year.

net profit

After the profit and loss account has been completed, the amount of net profit (or net loss) is transferred to the owner's capital account. The book-keeping entries are:

- **net profit**
  - debit profit and loss account
  - credit capital account

- **net loss**
  - debit capital account
  - credit profit and loss account

A net profit increases the owner's stake in the business by adding to capital account, while a net loss decreases the owner's stake.

drawings

At the same time the account for drawings, which has been storing up the amount of drawings during the year is also transferred to capital account:

- debit capital account
- credit drawings account

Thus the total of drawings for the year is debited to capital account.

capital account

When these transactions are completed, the capital account for Wyvern Wholesalers appears as:

Dr		Capital Account			Cr
20-1		£	20-1		£
31 Dec	Drawings for year	10,442	31 Dec	Balance b/d	110,000
31 Dec	Balance c/d	142,408	31 Dec	Profit and loss account (net profit for year)	42,850
		152,850			152,850
20-2			20-2		
			1 Jan	Balance b/d	142,408

Note: It is the balance of capital account at the end of the year, ie £142,408, which forms the total for the capital section of the balance sheet. Whilst this figure could be shown on the balance sheet by itself, it is usual to show capital at the start of the year, with net profit for the year added, and drawings for the year deducted. In this way, the capital account is summarised on the balance sheet.

balance sheet

Unlike the trading and profit and loss account, the balance sheet is not part of the double-entry accounts. The balance sheet is made up of those accounts which remain with balances after the trading and profit and loss account transfers have been made. Thus it consists of asset and liability accounts, including capital.

Horizontal Presentation of Final Accounts

So far in this chapter we have used the vertical presentation for setting out the final accounts of a business, ie we have started at the top of the page and worked downwards in columnar or narrative style. An alternative method is the horizontal presentation, where each of the financial statements is presented in the format of a two-sided account. The set of final accounts presented earlier would appear, in horizontal style, as follows:

TRADING ACCOUNT OF WYVERN WHOLESALERS
FOR THE YEAR ENDED 31 DECEMBER 20-1

	£	£		£
Opening stock		12,350	Sales	250,000
Purchases	156,000		Less Sales returns	5,400
Carriage in	-		Net sales	244,600
Less Purchases returns	7,200			
Net purchases		148,800		
		161,150		
Less Closing stock		16,300		
Cost of Goods Sold		144,850		
Gross profit c/d		99,750		
		244,600		244,600

PROFIT AND LOSS ACCOUNT OF WYVERN WHOLESALERS
FOR THE YEAR ENDED 31 DECEMBER 20-1

	£		£
Discount allowed	3,700	Gross profit b/d	99,750
Salaries	46,000	Discount received	2,500
Electricity and gas	3,000		
Rent and rates	2,000		
Sundry expenses	4,700		
Net profit	42,850		
	102,250		102,250

BALANCE SHEET OF WYVERN WHOLESALERS
AS AT 31 DECEMBER 20-1

	£	£		£	£
Fixed Assets			**Capital**		
Premises		100,000	Opening capital		110,000
Equipment		30,000	Add net profit		42,850
Vehicles		21,500			152,850
		151,500	Less drawings		10,442
Current Assets					142,408
Stock	16,300		**Long-term Liabilities**		
Debtors	23,850		Loan		33,000
Cash	125				175,408
		40,275	**Current Liabilities**		
			Creditors	12,041	
			Value Added Tax	3,475	
			Bank overdraft	851	
					16,367
		191,775			191,775

a choice of formats

In your study of Business Accounts you will see both forms of presentation from time-to-time in the accounts of different businesses and organisations. The vertical format is more common nowadays and is used as the standard format in this book. As you will appreciate, both forms of presentation use the same information and, after a while, you will soon be able to 'read' either version.

a 'pro-forma' vertical presentation of final accounts

Many students studying final accounts for the first time find it helpful to be able to follow a set layout, or pro-forma – certainly in the early stages. A sample layout for final accounts is included in Appendix 1 (page 559). There are some items included that will be covered in later chapters, and the layout will need to be amended to fit the needs of partnership (Chapter 23) and limited company final accounts (Chapter 25).

Capital Expenditure and Revenue Expenditure

When preparing final accounts it is important to distinguish between capital expenditure and revenue expenditure.

capital expenditure

Capital expenditure can be defined as expenditure incurred on the purchase, alteration or improvement of fixed assets. For example, the purchase of a car for use in the business is capital expenditure. Included in capital expenditure are such costs as:

- delivery of fixed assets
- installation of fixed assets
- improvement (but not repair) of fixed assets
- legal costs of buying property

revenue expenditure

Revenue expenditure is expenditure incurred on running expenses. For example, the cost of petrol or diesel for the car (above) is revenue expenditure. Included in revenue expenditure are the costs of:

- maintenance and repair of fixed assets
- administration of the business
- selling and distributing the goods or products in which the business trades

capital expenditure and revenue expenditure – the differences

Capital expenditure is shown on the balance sheet, while revenue expenditure is an expense in the profit and loss account. It is important to classify these types of expenditure correctly in the accounting system. For example, if the cost of the car was shown as an expense in profit and loss account, then net profit would be reduced considerably, or a net loss recorded; meanwhile, the balance sheet would not show the car as a fixed asset – clearly this is incorrect as the business owns the asset.

Study the following examples and the table on the next page; they both show the differences between capital expenditure and revenue expenditure.

- **cost of building an extension to the factory £30,000, which includes £1,000 for repairs to the existing factory**
  - capital expenditure, £29,000
  - revenue expenditure, £1,000 (because it is for repairs to an existing fixed asset)
- **a plot of land has been bought for £20,000, the legal costs are £750**
  - capital expenditure £20,750 (the legal costs are included in the capital expenditure, because they are the cost of acquiring the fixed asset, ie the legal costs are capitalised)

- **the business' own employees are used to install a new air conditioning system: wages £1,000, materials £1,500**
  – capital expenditure £2,500 (an addition to the property); note that, in cases such as this, revenue expenditure, ie wages and materials purchases, will need to be reduced to allow for the transfer to capital expenditure
- **own employees used to repair and redecorate the premises: wages £500, materials £750**
  – revenue expenditure £1,250 (repairs and redecoration are running expenses)
- **purchase of a new machine £10,000, payment for installation and setting up £250**
  – capital expenditure £10,250 (costs of installation of a fixed asset are capitalised)

Only by allocating capital expenditure and revenue expenditure correctly between the balance sheet and the profit and loss account can the final accounts reflect accurately the financial state of the business. The chart below shows the main items of capital expenditure and revenue expenditure associated with three major fixed assets – buildings, vehicles and computers.

	capital expenditure	revenue expenditure
BUILDINGS	• cost of building • cost of extension • carriage on raw materials used • legal fees • labour cost of own employees used supervising the building • installation of utilities, eg gas, water, electricity	• general maintenance • repairs • redecoration
VEHICLES	• net cost, including any optional extras • delivery costs • number plates • changes to the vehicle	• fuel • road fund licence • extended warranty • painting company logo • insurance • servicing and repairs
COMPUTERS	• net cost • installation and testing • modifications, including memory upgrades, to meet specific needs of business • installation of special wiring • cost of air conditioning to computer room • staff training (where directly related to new equipment) • computer programs (but can be classified as revenue expenditure if cost is low and will have little impact on final accounts)	• data storage discs • printer paper and other consumables • insurance • computer programs (or can be classified as capital expenditure if cost is high and will have a large impact on final accounts)

CHAPTER SUMMARY

- The final accounts of a business comprise:
  - trading account, which shows gross profit
  - profit and loss account, which shows net profit
  - balance sheet, which shows the assets and liabilities of the business at the year-end

  Appendix 1 (page 559) gives a specimen layout for final accounts.

- The starting point for the preparation of final accounts is the summary of the information from the accounting records contained in the book-keeper's trial balance.

- Each item from the trial balance is entered into the final accounts once only.

- Any notes to the trial balance, such as the closing stock, affect the final accounts in two places.

- The trading account and profit and loss account form part of the double-entry book-keeping system – amounts entered must be recorded elsewhere in the accounts.

- The balance sheet is not part of the double-entry system; it lists the assets and liabilities at a particular date.

- Final accounts can be presented in either a vertical or a horizontal format.

- Capital expenditure is expenditure incurred on the purchase, alteration or improvement of fixed assets.

- Revenue expenditure is expenditure incurred on running expenses.

There is more material to cover in connection with final accounts, and the next few chapters deal with accruals and prepayments, depreciation of fixed assets, bad debts and provision for bad debts, and accounting concepts and stock valuation. In addition the more specialist final accounts of partnerships (Chapter 23), limited companies (Chapter 25), and manufacturing businesses (Chapter 26), will be studied. Final accounts can also be analysed and interpreted (Chapter 28) to give the user of the accounts information about the financial state of the business.

Case Study 1 follows after the questions at the end of this chapter; it looks at a fully worked example of a handwritten book-keeping system.

QUESTIONS

NOTE: an asterisk (*) after the question number means that an answer to the question is given in Appendix 2.

12.1* The following information has been extracted from the business accounts of Matthew Lloyd for his first year of trading which ended on 31 December 20-8:

	£
Purchases	94,350
Sales	125,890
Stock at 31 December 20-8	5,950
Rates	4,850
Heating and lighting	2,120
Wages and salaries	10,350
Office equipment	8,500
Vehicles	10,750
Debtors	3,950
Bank balance	4,225
Cash	95
Creditors	1,750
Value Added Tax	450
Capital at start of year	20,000
Drawings for year	8,900

You are to prepare the trading and profit and loss account of Matthew Lloyd for the year ended 31 December 20-8, together with his balance sheet at that date.

12.2 Complete the table below for each item (a) to (g) indicating with a tick:

- whether the item would normally appear in the debit or credit column of the trial balance
- in which final account the item would appear at the end of the accounting period and whether as a debit or credit

	TRIAL BALANCE		FINAL ACCOUNTS			
			TRADING & P& L		BALANCE SHEET	
	Debit	Credit	Debit	Credit	Debit	Credit
(a) Salaries						
(b) Purchases						
(c) Debtors						
(d) Sales returns						
(e) Discount received						
(f) Vehicle						
(g) Capital						

12.3* You are to fill in the missing figures for the following businesses:

	Sales	Opening Stock	Purchases	Closing Stock	Gross Profit	Expenses	Net Profit/ (Loss)*
	£	£	£	£	£	£	£
Business A	20 000	5 000	10 000	3 000	....	4 000	....
Business B	35 000	8 000	15 000	5 000	....	....	10 000
Business C	....	6 500	18 750	7 250	18 500	11 750	....
Business D	45 250	9 500	....	10 500	20 750	....	10 950
Business E	71 250	....	49 250	9 100	22 750	24 450	....
Business F	25 650	4 950	13 750	....	11 550	....	(3 450)

* Note: a net loss is indicated in brackets

12.4* The following trial balance has been extracted by the book-keeper of John Adams at 31 December 20-7:

	Dr £	Cr £
Stock at 1 January 20-7	14,350	
Purchases	114,472	
Sales		259,688
Rates	13,718	
Heating and lighting	12,540	
Wages and salaries	42,614	
Vehicle expenses	5,817	
Advertising	6,341	
Premises	75,000	
Office equipment	33,000	
Vehicles	21,500	
Debtors	23,854	
Bank	1,235	
Cash	125	
Capital at 1 January 20-7		62,500
Drawings	12,358	
Loan from bank		35,000
Creditors		17,281
Value Added Tax		2,455
	376,924	376,924

Stock at 31 December 20-7 was valued at £16,280.

You are to prepare the trading and profit and loss account of John Adams for the year ended 31 December 20-7, together with his balance sheet at that date.

12.5 The following trial balance has been extracted by the book-keeper of Clare Lewis at 31 December 20-4:

	Dr £	Cr £
Debtors	18,600	
Creditors		12,140
Valus Added Tax		1,210
Bank overdraft		4,610
Capital at 1 January 20-4		25,250
Sales		144,810
Purchases	96,318	
Stock at 1 January 20-4	16,010	
Salaries	18,465	
Heating and lighting	1,820	
Rent and rates	5,647	
Vehicles	9,820	
Office equipment	5,500	
Sundry expenses	845	
Vehicle expenses	1,684	
Drawings	13,311	
	188,020	188,020

Stock at 31 December 20-4 was valued at £13,735.

You are to prepare the trading and profit and loss account of Clare Lewis for the year ended 31 December 20-4, together with her balance sheet at that date.

12.6 Classify the following costs as either capital expenditure or as revenue expenditure

(a) purchase of vehicles

(b) rent paid on premises

(c) wages and salaries

(d) legal fees relating to the purchase of property

(e) redecoration of the office

(f) installation of air-conditioning in the office

(g) wages of own employees used to build extension to the stockroom

(h) installation and setting up of a new machine

12.7 The following transactions relate to AB Stores, a small retail business which separates direct selling expenses from other overhead expenses:

Purchase of new weighing equipment for use within the business.

Rent received from sub-letting office space over the business.

Payment of business rate to the local authority.

Cost of extension to the rear of the business.

Wages of sales assistants.

Legal fees paid in connection with the extension.

You are required to:

(a) Enter each item under one of the three headings:

(i) Capital expenditure

(ii) Revenue expenditure

(iii) Revenue receipt

(b) State which items would appear in:

(i) The trading account

(ii) The profit and loss account

(iii) The balance sheet

Note: your answer should be in table form.

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