

## **Chapter 9 Adjustments to the Profit and Loss Account and Balance Sheet: 2**

### **Questions**

1. Oriana is a chiropodist who works from a small converted house which she bought freehold on 1 January 20X1 for £145 000. She lets out the upstairs offices to a firms of financial advisers. Downstairs, Oriana and her assistant, Jackie, provide a range of chiropody and aromatherapy footbath services.

Of the £145 000 paid for the house, £35 000 is estimated to relate to the value of the land on which the house stands, and the remainder is the value of the building itself. Oriana depreciates the freehold building over 100 years (i.e. at 1% per year) on the assumption that it will have no value at the end of the 100 year period.

Oriana's chiropody equipment, which originally cost £36 906, is depreciated on the reducing balance basis at 20% per year. It was included in her balance sheet at 31 December 20X4 at a net book value of £23 620.

During the accounting year to 31 December 20X5 Oriana has not bought or disposed of any fixed assets.

- a) Show the amounts for depreciation to be shown in Oriana's profit and loss account for the year ending 31 December 20X5
  - b) Show the tangible fixed assets section of Oriana's balance sheet at 31 December 20X5.
2. Odile is the sole UK distributor of a French quick-drying cement product. She paid £100 000 on 21 January 20X4 for a licence which grants her the sole distribution rights for a five year period. Odile's amortisation policy is to calculate amortisation for inclusion in the profit and loss account for each complete month of ownership of an intangible asset.
- What amount of amortisation in respect of this licence will be included in Odile's profit and loss account for the year ending 31 May 20X4?
3. Padma runs a specialist textile and soft furnishings business in shop premises rented from the local authority. At the back of the shop is a small workshop where Padma's two part-time employees produce made-to-measure curtains and covers, and carry out repairs and alterations.

At Padma's 31 August 20X7 year end, her balance sheet showed  
the following fixed asset details:

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Fixed assets

Shop fittings at cost

Less: depreciation

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Workshop equipment at  
cost

Less: depreciation

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Delivery vehicle at cost

Less: depreciation

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Fixed assets at net book  
value

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In the year ending 31 August 20X8, the following events take place:

1. Padma's made-to-measure service is doing very well. She takes on another part-time employee and buys a new sewing machine and a new cutting table for a total cost of £4 200.
2. Padma sells the delivery vehicle for £5 200 and buys a new one for £19 275.

Padma's depreciation policy is as follows:

1. Shop fittings are depreciated at 10% of cost each year. (NB: of the £16 660 of shop fittings at cost, £8 200 is fully depreciated).
  2. Workshop equipment is depreciated at 25% per year on the reducing balance basis.
  3. The delivery vehicle is depreciated at 30% per year on the reducing balance basis.
  4. A full year's depreciation is included in the accounts in the year of purchase of an asset. There is no depreciation in the year of disposal.
- 
- a) Show the amounts for depreciation and the profit or loss on sale to be included in Padma's profit and loss account for the year ending 31 August 20X8.
  - b) Show the fixed assets section of Padma's balance sheet at 31 August 20X8.

Work to the nearest £.

4. Quincey is a marketing consultant working from rented offices in a city centre. The principal fixed assets of his business are his luxurious car (for impressing clients), the business computer system and some high quality office furniture.

The accounting records show the following totals at Quincey's year end date of 30 June 20X6:

	£
Car at cost	4
	2
	4
	4
	6
Depreciation on car at 1	1
July 20X5	8
	5
	7
	0
Business computer	7
system at cost	8

	0
	0
Depreciation on	
business computer	4
system at 1 July 20X5	6
	8
	0
Office furniture at cost	1
	2
	6
	9
	0
Depreciation on office	
furniture at 1 July 20X5	3
	8
	0
	7
Entertaining expenses	6
	4
	6
	0
Electricity	1
	6



	2
	4
Consultancy fee income	1
	3
	8
	7
	8
	0
Secretary's salary	1
	5
	5
	2
	0
Sundry expenses	3
	8
	6
	9
Debtors	1
	0
	5
	6
	5
Capital at 1 July 20X5	5

	4
	3
	4
	2
Travelling expenses	4
	4
	2
	0
Office rental	1
	8
	8
	8
	4
Telephone	1
	2
	0
	0
Interest received	9
	6
	0
Drawings	5
	8
	5

	0
	0
Creditors	1
	2
	0
	0
Insurance	8
	7
	0
Assistant's salary	2
	4
	8
	0
	0
Cash at bank	1
	2
	6
	9
	1

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Notes:

1. It is necessary to take account of the depreciation expense for the year ending 30 June 20X6. The following rates apply:

Car	25% on the reducing balance basis
Business computer system	20% on the straight line basis
Office furniture	10% on the straight line basis

None of the fixed assets are fully depreciated, and there have been no additions or disposals of fixed assets during the accounting year.

2. An accrual of £384 is necessary in respect of telephone charges at 30 June 20X6.

Prepare a profit and loss account for Quincey's business for the year ending 30 June 20X6 and a balance sheet at that date.

5. Qasim is a wholesaler of specialist cable products for telecommunications businesses. He runs the business from a rented warehouse with office attached. The business owns a range of specialised warehouse fittings, two fork lift trucks and various delivery vehicles. Also, there is a computer system to deal with on-line orders and despatch and invoicing documentation.

- a) At 31 December 20X8, Qasim's balance sheet contained the following information relating to fixed assets:

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Fixed assets

Warehouse fittings at cost

Less: depreciation

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Fork lift trucks

Less: depreciation

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Delivery vehicles

Less: depreciation

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Fixed assets at net book  
value

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During the year ending 31 December 20X9 the following events take  
place:

One of the fork lift trucks, which cost £13 100, was sold for £5 200. Half of the depreciation at 31 December 20X8 of £17 910 related to this truck. A new fork lift, with computerised controls, was bought during the year for £18 250. There were no other additions or disposals of fixed assets.

Qasim's depreciation policy includes the following:

1. Warehouse fittings are depreciated at 10% per year on the straight line basis. None of the fittings was fully depreciated at 31 December 20X8.
2. Fork lift trucks are depreciated at 25% per year on the reducing balance basis.
3. Delivery vehicles are depreciated at 30% on the reducing balance basis.
4. A full year's depreciation is charged in the year of acquisition of an asset, but none in the year of disposal.

i) Show the amounts for depreciation and the profit or loss on sale to be included in Qasim's profit and loss account for the year ending 31 December 20X9.

ii) Show the fixed assets section of Qasim's balance sheet at 31 December 20X9.



- b) The remainder of Qasim's accounting totals at 31 December 20X9  
 are as follows:

	£
Interest charges	1
	4
	0
	2
Purchases returns	1
	5
	0
	0
Drawings	2
	1
	0
	0
	0
Stock at 31 December	5
20X9	4
	3
	5
	2
Administrative expenses	2

	4
	4
	4
	8
Long-term loan	2
	5
	0
	0
	0
Capital at 1 January	6
20X9	1
	8
	3
	3
Overdraft	1
	5
	4
	9
	1
Debtors	6
	8
	1
	5

	0
Sales	5
	1
	8
	2
	7
	6
Stock at 1 January 20X9	4
	5
	0
	9
	8
Purchases	3
	8
	7
	8
	7
	8
Secretarial salaries	1
	8
	2
	7
	6

Warehouse operatives	3
salaries	6
	3
	7
	0
Warehouse heating,	1
lighting etc.	0
	2
	2
	8
Warehouse rental	2
	5
	0
	0
	0
Trade creditors	6
	2
	5
	9
	4

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Building on the information calculated in part a) of the question,  
 complete Qasim's profit and loss account for the year ending 31  
 December 20X9 and his balance sheet at that date.



## Chapter 9 Students' questions

### ANSWERS

#### 1. Oriana

##### Working 1

Value of building = £145 000 – 35 000 = £110 000

Annual depreciation charge on building = £110 000 x 1% = £1100

##### Working 2

Depreciation of machinery = 20% of net book value

Net book value at start of year = £23 620; there are no additions or disposals of fixed assets.

So, charge for depreciation of equipment = 20% x £23 620 =  
£4724

##### Working 3

Depreciation of the building from 20X1 to 20X5 (for inclusion in the balance sheet): £1100 (annual depreciation charge) x 5 years =  
£5500.

#### Working 4

Depreciation of equipment:

At 31 December 20X4 cost of equipment = £36 906 and net book value = £23 620. Depreciation in the balance sheet at that date was: £36 906 – 23 620 = £13 286.

Depreciation in the balance sheet at 31 December 20X5 = amount accumulated up to the end of 20X4 (£13 286) + the charge for the year (£4724) = £18 010.

- a) Depreciation to be included in Oriana's profit and loss account for the year ending 31 December 20X5:

Depreciation of building	£1100 (working 1)
Depreciation of equipment	£4724 (working 2)

- b) Extract from Oriana's balance sheet at 31 December 20X5

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Fixed assets
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Land at cost

Building at cost

Less: depreciation

(working 3)

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Equipment at cost

Less: depreciation

(working 4)

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Fixed assets at net book  
value

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2. Odile

The number of full months of ownership in the accounting year = 4  
(February, March, April and May).

Annual amortisation charge:  $\frac{\pounds 100\,000}{5 \text{ years}} = \pounds 20\,000$  per year

4 months amortisation, therefore, is:  $\pounds 20\,000 \times \frac{4}{12} = \pounds 6\,667$  (to  
the nearest £)

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3. Padma

Working 1: depreciation of shop fittings

£8200 of the cost of shop fittings is fully depreciated; this means that only £8460 (£16 660 – 8200) is subject to depreciation at 10% on cost:

$$£8460 \times 10\% = £864$$

Working 2: depreciation of workshop equipment

	£
Net book value at 1 September 20X6	5317
Additions in the year	<u>4200</u>
Total	
	<u>9517</u>

Depreciation for the year = £9517 x 25% = £2379 (to the nearest £)

Working 3: disposal of delivery vehicle

There is no depreciation in the year of disposal so the profit or loss is calculated by comparing sale proceeds with the net book value at the start of the year, as follows:

£

Proceeds of sale	5200
Net book value	<u>3307</u>
Profit on sale	<u>1893</u>

Working 4: depreciation of new delivery vehicle

There is a full year's depreciation in the year of acquisition, so  
 depreciation is calculated as follows:

$$£19\,275 \times 30\% = £5782$$

- a) Depreciation and profit on sale to be included in Padma's profit and  
 loss account for the year ending 31 August 20X8:

Depreciation of shop fittings	£864
(working 1)	
Depreciation of workshop equipment	£2379
(working 2)	
Depreciation of delivery vehicle	£5782 (working 4)
Profit on disposal of delivery vehicle	£1893
(working 3)	

- b) Extract from Padma's balance sheet at 31 August 20X8

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Fixed assets

Shop fittings at cost

Less: depreciation (£12 420 + 864)

Workshop equipment at cost (£12 604  
+ 4200)

Less: depreciation (£7287 + 2379)

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Delivery vehicle at cost

Less: depreciation

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Fixed assets at net book value

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#### 4. Quincey

Working 1: depreciation of car

Net book value at 1 July 20X5 = £42 446 – 18 570 = £23 876

Depreciation for the year = £23 876 x 25% = £5969

Working 2: depreciation of business computer system

Depreciation = 20% of cost (i.e. the straight line basis) = £7800 x  
 20% = £1560

Working 3: depreciation of office furniture

Depreciation = 10% of cost = £12 690 x 10% = £1269

Quincey: profit and loss account for the year ending 30 June 20X6

	:
Consultancy fees	:
	:
	:
	:
	:
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	:
Interest received	:
	:
	:



Expenses

Depreciation of car (working  
1)

Depreciation of business  
computer system (working 2)

Depreciation of office  
furniture (working 3)

Secretary's salary

Assistant's salary

Office rental

Telephone (£1200 + accrual  
of £384)

Insurance

Electricity

Travelling expenses

Entertaining expenses

Sundry expenses

	2019	2020
Fixed assets	100	100
Car at cost	100	100



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Office furniture at cost

Less: depreciation (£3 807 +  
1 269)

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Debtors

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Current liabilities

Creditors

Accrual

Net current assets



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Capital at 1 July 20X5		
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Profit for the year		
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Drawings		

## Working 1

## Working 2

Disposal of fork lift truck: compare disposal proceeds with net book value at the date of sale. Net book value is calculated as follows:

Cost	£13 100
Less: depreciation ( $1/2 \times £17\ 910$ )	<u>(8 955)</u>
Net book value	4 145
Proceeds of sale	<u>5 200</u>
Profit on sale	<u>£1 055</u>

### Working 3

Depreciation of fork lift trucks:

Net book value at 1 January 20X9	8 290
Less: disposed of (see working 2)	
<u>(4 145)</u>	
	4 145
Addition of new fork lift truck during the year	<u>18 250</u>
	<u>22 395</u>
Depreciation at 25% per year (reducing balance) = $25\% \times £22\ 395 =$	
£5599	

### Working 4

Depreciation of delivery vehicles = 30% x net book value = 30% x  
 £20 384 = £6115.

- a) i) The amounts to be shown for depreciation and profit or loss on  
 sale in Qasim's profit and loss account for the year ending 31  
 December 20X9 are:

Depreciation of warehouse fittings	£1 280
(working 1)	
Depreciation of fork lift trucks	£5 599
(working 3)	
Depreciation of delivery vehicles	£6 115
(working 4)	
Profit on disposal of fork lift truck	£1
055 (working 2)	

- ii) Fixed assets section of Qasim's balance sheet at 31 December  
 20X9

Fixed assets

Warehouse fittings at cost

Less: depreciation (£7 680 +  
 1 280)

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Fork lift trucks at cost (£26  
 200 + 18 250 – 13 100)

Less: depreciation (£17 910  
 – 8 955 + 5 599)

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Delivery vehicles at cost

Less: depreciation (£28 420

+ 6 115)

Sales

Cost of sales

Opening stock

Purchases

Less: purchases

returns



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Closing stock

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Gross profit

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Expenses

Administrative  
expenses

Secretarial salaries

Warehouse

operatives salaries

Interest charges

Warehouse lighting,  
heating etc

Warehouse rental

Depreciation of  
warehouse fittings

Depreciation of fork  
lift trucks

Depreciation of  
delivery vehicles

Profit on sale of fork  
lift truck

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Net profit

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Qasim: balance sheet at 31 December 20X9

Fixed assets

Warehouse fittings at cost

Less: depreciation (£7 680 +  
 1 280)

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Fork lift trucks at cost (£26

200 + 18 250 – 13 100)

Less: depreciation (£17 910

– 8 955 + 5 599)

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	:
	:

Delivery vehicles at cost

Less: depreciation (£28 420

+ 6 115)

Current assets

Stock



Debtors

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Current liabilities

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Creditors

Bank overdraft

Net current assets

Long-term liabilities: long-	(
term loan	:
	:
	(
	(
	(
	,
	,
	_____
	:
	,
	:
	:
	:
	_____
Capital at 1 January 20X9	(
	:
	:
	(
	:
	:
	:
Profit for the year	:
	:

## Drawings