

## QUESTIONS

### Question 1 Byron

Byron is a wholesaler of DIY kitchen fittings. In the year to 28 February 20X1 his business transactions include the following:

Purchase on credit of goods for resale at a cost of £12 800

Drawings by Byron of £15 000

Payment of interest on a business bank overdraft of £750

Sale of a non-current asset for £7000. The asset had cost £23 000 and accumulated depreciation at the date of sale was £18 660.

For each transaction show the impact on cash, other assets and liabilities and the impact on profit.

### Question 2 Ciaran

Ciaran's trading business has the following income statement for the year ended 31 May 20X2:

	£	£
Revenue		365 210
Cost of sales		
Opening inventory	28 470	
Purchases	289 462	
	<hr/>	
	317 932	
Less: closing inventory	(29 950)	
	<hr/>	
		287 982
Gross profit		<hr/>
		77 228
Interest received		1 802
Expenses		(51 550)
Profit for the year		<hr/>
		27 480
		<hr/>

Expenses include £4850 depreciation.

Trade receivables at 31 May 20X2 were £39 447; the corresponding figure at 31 May 20X1 was £38 402.

Trade payables at 31 May 20X2 were £29 572; the corresponding figure at 31 May 20X1 was £32 224.

Prepare the first section of Ciaran's statement of cash flows concluding with the figure for net cash inflow or outflow from operating activities.

### Question 3 Decca

Decca runs a designer fashion store. Her income statement for the year ending 31 December 20X7 was as follows:

	£	£
Revenue		686 004
Cost of sales		
Opening inventory	75 550	
Purchases	461 473	
	<hr/>	
	537 023	
Closing inventory	(78 772)	
	<hr/>	
		458 251
Gross profit		<hr/>
		227 753
Expenses excluding depreciation		(143 270)
Depreciation		(21 420)
		<hr/>
Operating profit		63 063
Interest paid		(1 857)
		<hr/>
Profit for the year		61 206
		<hr/>

Decca's statements of financial position at 31 December 20X7 and 20X6 were as follows:

	20X7	20X7	20X6	20X6
	£	£	£	£
<b>ASSETS</b>				
<b>Non-current assets</b>		118 180		139 600
<b>Current assets</b>				
Inventory	78 772		75 550	
Trade receivables and prepayments	7 255		5 250	

Cash at bank	2 806	-
	<u>88 833</u>	<u>80 800</u>
	<u>207 013</u>	<u>220 400</u>

#### CAPITAL AND LIABILITIES

##### Capital

Capital brought forward	80 179	88 639
Profit for the year	61 206	28 740
Drawings	(36 800)	(37 200)
	<u>104 585</u>	<u>80 179</u>

##### Non-current liabilities

Long-term loan	20 000	40 000
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##### Current liabilities

Bank overdraft	-	7 481
Traded payables and accruals	82 428	92 740
	<u>82 428</u>	<u>100 221</u>
	<u>207 013</u>	<u>220 400</u>

During the year ending 31 December 20X7 Decca has not bought or sold any non-current assets.

- Prepare a statement of cash flows for Decca for the year ending 31 December 20X7.
- Briefly comment on the state of the business as revealed by the income statement, statements of financial position and statement of cash flows.

#### Question 4 Demetrios

Demetrios runs a car spares business. During his 20X5 financial year he moved the business from its rented premises to a freehold retail warehouse. This has given the business much more selling space and Demetrios hopes to be able to increase revenue by a significant amount in the new location. The new warehouse cost £140 000 and Demetrios had to take out a long-term loan of £100 000. £40 000 of the cost of the warehouse relates to land value. The remainder (£100 000) is to be depreciated over 50 years on the straight line basis. By 31 March 20X5 Demetrios has owned the warehouse for six months and the charge to depreciation included in his income statement is £1000.

Other movements in non-current assets are as follows:

### Fittings and storage

	£
Cost at 1 April 20X4	18 250
Additions	16 600
Disposals	(9 870)
Cost at 31 March 20X5	<u>24 980</u>

	£
Depreciation at 1 April 20X4	15 200
Accumulated depreciation on disposals	(8 462)
Depreciation for the year	2 498
Depreciation at 31 March 20X5	<u>9 236</u>

The fittings and storage equipment that was disposed of at the time of the move to the new premises was mostly very old. Demetrios received £1000 for it.

Demetrios's income statement for the year ending 31 March 20X5 was as follows:

	£	£
Revenue		276 774
Cost of sales		
Opening inventory	77 870	
Purchases	195 376	
	<u>273 246</u>	
Closing inventory	(78 120)	
		<u>195 126</u>
Gross profit		81 648
Expenses excluding depreciation		(61 995)
Depreciation (£1000 + 2498)		(3 498)
Loss on sale of non-current assets		(408)
Operating profit		<u>15 747</u>
Interest paid		(3 662)
Profit for the year		<u>12 085</u>

Demetrios's statements of financial position at 31 March 20X5 and 20X4 were as follows:

	20X5	20X5	20X4	20X4
	£	£	£	£
<b>ASSETS</b>				
<b>Non-current assets</b>				
Warehouse		139 000		-
Fittings and storage		15 744		3 050
		<u>154 744</u>		<u>3 050</u>
<b>Current assets</b>				
Inventory	78 120		77 870	
Trade receivables and prepayments	2 006		1 980	
Cash at bank	-		38 431	
		<u>80 126</u>		<u>118 281</u>
		<u>234 870</u>		<u>121 331</u>
<b>CAPITAL AND LIABILITIES</b>				
<b>Capital</b>				
Capital brought forward		89 889		81 384
Profit for the year		12 085		29 975
Drawings		(22 651)		(21 470)
		<u>79 323</u>		<u>89 889</u>
<b>Non-current liabilities</b>				
Long-term loan		100 000		-
<b>Current liabilities</b>				
Bank overdraft	12 270		-	
Payables and accruals	43 277		31 442	
		<u>55 547</u>		<u>31 442</u>
		<u>234 870</u>		<u>121 331</u>

Prepare a statement of cash flows for Demetrios for the year ending 31 March 20X5.

## ANSWERS

### Answer 1 Byron

	Effect on cash etc.	Effect on profit
Purchase on credit of goods for resale at a cost of £12 800	No immediate effect on cash. Trade payables and inventory both increase by £12 800. Cash will decrease in the future when the liability of £12 800 is paid.	No immediate effect on profit. A sale of these goods will probably take place at which point their value is set off against revenue in the form of cost of sales
Drawings of £15 000	Cash and capital are both reduced by £15 000	There is no impact on profit. Effectively, Byron is taking £15 000 of his own capital out of the business.
Payment of interest on bank overdraft of £750	Cash is decreased (or, more likely, the liability of bank overdraft is increased).	The interest paid reduces profits
Sale of non-current asset for £7000	Cash is increased by £7000. The total carrying amount of non-current assets is reduced by the carrying amount of the asset which has been disposed of (£23 000 - £18 660 = £4340)	There is a profit on sale of £2660 (£7000 – carrying amount of £4340). This increases the overall profits from Byron's business.

### Answer 2 Ciaran

Extract from statement of cash flows for the year ending 31 May 20X2

	£
Operating profit (working 1)	25 678
Add back: depreciation	4 850

	30 528
Inventory – increase (29 950 – 28 470) (cash outflow)	(1 480)
Trade receivables – increase (39 447 – 38 402) (cash outflow)	(1 045)
Payables – decrease (29 572 – 32 224) (cash outflow)	(2 652)
Net cash inflow from operating activities	25 351

### *Working 1*

#### Operating profit

Gross profit	77 228
Less: expenses	<u>(51 550)</u>
	<u>25 678</u>

### **Answer 3 Decca**

a)

#### Statement of cash flows for the year ending 31 December 20X7

	£	£
Operating profit		63 063
Add back: depreciation		21 420
		<u>84 483</u>
Less: increase in inventory (78 772 – 75 550)	(3 222)	
Less: increase in trade receivables and prepayments (7 255 – 5 250)	(2 005)	
Less: decrease in trade payables (82 428 – 92 740)	(10 312)	
		<u>(15 539)</u>
<i>Cash generated from operations</i>		68 944
Interest paid		(1 857)
<i>Net cash inflow from operating activities</i>		<u>67 087</u>
<b>Cash flows from financing activities</b>		
Capital returned to owner (drawings)	(36 800)	
Long-term loan repayment (40 000 – 20 000)	(20 000)	

<i>Net cash outflow from financing activities</i>	(56 800)
Net increase in cash	10 287
Overdraft at beginning of period	(7 481)
Cash at end of period	2 806

b) Decca's business appears to have improved its performance in 20X7, compared to 20X6. Profit for 20X6 was £28 740, compared to £61 206 in 20X7; this is a very substantial increase. The cash position has improved: Decca has paid off the overdraft and half (£20 000) of the long-term loan. Inventory and trade receivables are not greatly different at the two year ends but trade payables have been reduced from £92 740 to £82 428 between 31 December 20X6 and 31 December 20X7. Although it can be helpful to have a reasonably high level of payables (providing what is effectively a source of interest-free credit) there are limits. If amounts due are not paid within a reasonable time limit suppliers may become reluctant to make further supplies of goods available.

Only a fairly limited comparison is possible from the figures available. It would be helpful to have the 20X6 income statement in order to analyse the business performance in more detail.

#### **Answer 4 Demetrios**

##### Statement of cash flows for the year ending 31 March 20X5

	£	£
Operating profit		15 747
Add back: depreciation		3 498
Add back: loss on sale of non-current assets		408
		19 653
Less: increase in inventory (78 120 – 77 870)	(250)	
Less: increase in trade receivables and prepayments (2006 - 1980)	(26)	
Add: increase in payables (43 277 – 31 442)	11 835	
		11 559
<i>Cash generated from operations</i>		31 212
Interest paid		(3 662)
<i>Net cash inflow from operating activities</i>		27 550
<b>Cash flows from investing activities</b>		
Purchase of non-current assets:		



Purchase of building	(140 000)	
Purchase of fixtures and storage	(16 600)	
Proceeds of sale of non-current assets (cash inflow)	1 000	
<i>Net cash outflow from investing activities</i>	<hr/>	(155 600)
<b>Cash flows from financing activities</b>		
Capital returned to owner (drawings)	(22 651)	
Long-term loan	100 000	
Net cash inflow from financing activities	<hr/>	77 349
Net cash outflow		<hr/> (50 701)
Cash at beginning of period		38 431
Overdraft at end of period		<hr/> (12 270)