

QUESTIONS

Question 1 Joey

1. Joey's recent business phone bills are as follows:

Period covered	£
1.11.X4 – 31.1.X5	661
1.2.X5 – 30.4.X5	776
1.5.X5 – 31.7.X5	524
1.8.X5 – 31.10.X5	840

Joey's year end is 31 December. At 31 December 20X5 he estimates that the November and December phone charges (which will not be billed until the end of January 20X6) will amount to 2/12 of the previous 12 months' charges.

How much is the telephone expense in Joey's income statement for the year ending 31 December 20X5? (work to the nearest £).

Question 2 Jacinta

2. Jacinta's accrued expenses for the year ending 31 March 20X8 total £4820. In her statement of financial position this amount:

1. Decreases capital
2. Increases assets
3. Is included under current liabilities
4. Is deducted from capital.

Which of these statements are correct?

- a) 2 & 3
- b) 1 & 4
- c) 1 & 3
- d) 2 & 4

Question 3 Per

3. Per prepares his accounts to 31 January each year. At 31 January 20X4 he has the following balances on electricity and telephone accounts:

Electricity	6 464
Telephone	3 118

Per is due to receive an electricity bill in respect of the three month period to 31 January 20X4, but it has not yet arrived. By 15 February it has still not arrived and he rings up the electricity company. The customer services representative tells Per that they are having trouble with their computerised billing system, but that the amount of the bill to 31 January 20X4 will be £2350.

The most recent telephone bill received by Per covered the three month period to 30 November 20X3. Usually Per would expect to spend about £300 per month on phone charges and that seems a reasonable estimate for January 20X4. However, he knows that an unusually large number of calls were made just before Christmas, and he estimates that call charges for December were probably in the region of £420.

- a) What amount should be included in Per's income statement for electricity and telephone expenses up to 31 January 20X4?
- b) What is the total accrual for electricity and telephone at 31 January 20X4?
- c) Where is this amount shown in the statement of financial position?

Question 4 Khalil

3. Khalil runs a decorative tile shop. He imports an exclusive range of tiles from South America upon which import duties have to be paid. Most of Khalil's sales are for cash, but he supplies some trade customers on credit. In order to encourage his customers to pay within 30 days he offers a discount of 1.5% for early payment.

Khalil is concerned because his volume of trade has declined and he thinks it's probable that his margins have worsened over the year. In the year to 31 December 20X3 his gross profit margin was 23.7% and net profit margin was 8.2%.

At Khalil's year end, 31 December 20X4, he has the following balances in his account books relating to sales and expenses items:

	£
Sales returns	1 897
Opening inventory at 1 January 20X4	98 761
Premises rent and rates	32 900
Bank charges	976
Sundry expenses	4 992
Revenue	618 772
Service charges on property	5 252
Telephone	1 772
Purchases	473 405
Administration and accountancy	3 700
Staff wages	47 550
Purchases returns	2 950
Discounts allowed	477
Electricity	4 906
Import duties	5 547
Closing inventory at 31 December 20X4	103 471

Prepare Khalil's income statement for the year ending 31 December 20X4. Calculate his gross and net profit margins. Have they worsened, as Khalil suspects, or have they improved?

Question 5 Ling

5. Ling imports household furnishings and ornaments which she sells on at a profit to retailers. She runs her business from a small warehouse, with an office attached, and she employs a full-time manager to take care of the day to day running of the business while she is away on buying trips.

At Ling's year end, 30 April 20X6, the balances in her accounting records relating to sales and expenses items are as follows:

	£
Manager's salary	22 650

Other staffing costs	18 917
Revenue	293 750
Discounts received	720
Travelling expenses	10 766
Sales returns	1 222
Import duties on purchases	7 721
Opening inventory at 1 May 20X5	24 297
Telephone	2 892
Interest received	1 652
Warehouse rental	20 470
Other premises costs	10 200
Purchases	120 887
Delivery charges (for delivery to customers)	5 521
Administrative expenses	6 247
Bank charges	360
Closing inventory at 30 April 20X6	13 127
Sundry expenses	2 424

Notes:

1. Of the warehouse rental, £2173 should be accounted for as a prepayment
2. Telephone charges have been invoiced up to the end of March 20X6. Ling estimates that an accrual of £385 will be required for April's charges.

Prepare Ling's income statement for the year ending 30 April 20X6.

Question 6 Linley

6. Linley has a retail business selling bedroom furniture. Two years ago he opened a branch of his business in a nearby town. The day to day management of the branch is delegated to Linley's trusted colleague, Olwen.

All the records for the business are kept at the head office. Linley keeps a record of sales made by the branch so that he can pay Olwen a sales-based commission. In the year ending 31 March 20X5 sales at the branch total £159 500. Linley has agreed to pay Olwen 1% of branch sales as commission, and this must be accrued for in the year end accounts.

At the year end, 31 March 20X5, the following amounts are recorded in Linley's books:

	£
Purchases	447 331
Closing inventory at 31 March 20X5	75 210
Premises rental	39 421
Electricity	7 662
Insurance	6 420
Other staff costs	41 448
Trade receivables	1 620
Cash at bank	12 471
Drawings	52 000
Administrative costs	12 246
Sundry expenses	5 521
Non-current assets	26 250
Sales returns	2 588
Purchases returns	3 667
Haulage and carriage costs (for delivery of purchases to Linley)	10 261
Opening inventory at 1 April 20X4	70 462
Trade payables	40 211
Capital at 1 April 20X4	48 014
Trade payables: HMRC	5 227
Telephone	3 860
Revenue	642 442

Notes:

1. The insurance total of £6420 comprises:

Charges to 31 December 20X4	2 700
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Paid on 1 January 20X5	3 720
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The amount paid at the beginning of January covers the year to 31 December 20X5. An adjustment is required for a prepayment.

2. Commission for Olwen must be accrued in accordance with the arrangements explained earlier.

3. The telephone charges of £3860 are for the ten months to 31 January 20X5. An accrual is required for February and March 20X5. Linley's estimate of the total charges for the two months is £772.

Question 7 Miles

7. Miles is the sole UK distributor for an extensive range of glassware imported from Ireland. The business was started by Miles' father, and is well-established and profitable. Its principal customers are retailers, although Miles sells a small proportion of 'seconds' inventory direct to the public from a shop attached to the warehouse. Miles' relationships with his customers are generally good and most of them pay within 30 days. Miles offers a fairly generous settlement discount of 1.5% to those customers who settle promptly.

Recently, however, Miles has had some trouble extracting payment from Welbrand Furnishers plc, a listed company which has experienced some well-publicised trading difficulties. By 31 December 20X4, Miles' year end, the Welbrand receivable amount has built up to £35 270. Three months ago, Miles refused to make any further supplies to the company. Some of outstanding invoices are now over 9 months old. These days, when Miles rings the accounts department of the company, he gets an answering machine. His calls are never returned.

Miles' accountant suggests that 100% allowance should be made against the amount owed by Welbrand. She does not think it should be completely written off at present because there is some talk in the financial press of a takeover bid for Welbrand. This could put the company on a secure footing and may mean that Miles' receivable will eventually be settled.

Miles' accounting records at 31 December 20X4 show the following balances:

	£
Opening inventory at 1 January 20X4	71 445
Closing inventory at 31 December 20X4	73 622
Business rates	10 791
Trade payables	84 420
Capital at 1 January 20X4	447 729
Water rates & plumbing repairs	8 800
Secretarial and administrative salaries	32 869

Discounts allowed	8 640
Bank interest received	1 202
Revenue	898 720
Telephone	8 370
Electricity	11 621
Warehouse supervisor's salary	20 408
Other warehouse salaries	38 696
Accountancy charges	2 400
Trade receivables (including £35 270 owed by Welbrand)	109 172
Sundry expenses	2 590
Legal costs	1 800
Purchase returns	1 850
Cash at bank	26 259
Selling costs	22 440
Drawings	45 000
Non-current assets: warehouse & equipment	282 460
Delivery expenses (for deliveries to customers)	16 260
Non-current assets: delivery vans	32 600
Sales returns	8 620
Purchases	672 680

Notes:

1. An adjustment must be made to the business rates total: £2178 relates to the 20X5 accounting year and should be treated as a prepayment.
2. An accrual of £1497 for electricity charges is required.

Prepare Miles' income statement and statement of financial position at 31 December 20X4.

Question 8 Sharon

8 Sharon runs a business selling cards and novelty items from a busy shop in a large shopping centre.

She has the following list of account balances at 31 August 20X1:

	£
Administration expenses	8 219
Purchases	224 069
Non-current assets	27 662
Sundry expenses	1 007
Bank charges	1 830
Premises rental (included business and water rates)	
	68 000
Opening inventory at 1 September 20X0	45 517
Revenue	464 714
Subscriptions to trade association	818
Electricity	5 337
Property services charge	17 004
Cash at bank	18 712
Interest received	460
Assistants' wages	38 830
Mobile phone	766
Travelling expenses	3 600
Phone –shop	3 234
Drawings	61 300
Insurance	5 237
Trade payables	24 165
Opening capital at 1 September 20X0	42 065
Accountant's and solicitor's fees	2 070
Discounts received	1 808
Closing inventory at 31 August 20X1	46 522

Notes

1. In a normal year Sharon expects to make a gross profit on sales of 50% and a net profit of 16.3%.
2. An accrual of £1307 for property services charges is required at 31 August 20X1.
3. Not all of the £5237 for insurance relates to the year to 31 August 20X1. Sharon estimates that £465 of the charges relate to the next accounting period.

4. Sharon is still waiting for an electricity bill up to the 31 August 20X1. She reads the electricity meter at 31 August and on the basis of the reading estimates that further charges of £1107 will have to be accrued for the year.
5. Some phone charges have not been billed by the year end. An accrual of £200 should be made.

Prepare an income statement for Sharon for the year ending 31 August 20X1 and a statement of financial position at that date. Calculate gross and net profit margins and compare them with the expected performance of the business.

ANSWERS

Answer 1 Joey

Telephone expense for the year ending 31 December 20X5 is calculated as follows:

	£
January 20X5 – $1/3 \times £661$	220
February – April 20X5	776
May – July 20X5	524
August – October 20X5	840
November & December 20X5:	
$(661 + 776 + 524 + 840) \times 2/12$	467
Total	2 827

Answer 2 Jacinta

Accruals decrease capital (statement 1) and are included under current liabilities (statement 3).

The correct answer is c).

Answer 3 Per

8.7

a)

Electricity: $£6464 + 2\,350 = £8814$

Telephone: $£3118 + 420 + 300 = £3838$

b)

Total accrual = $£2350 + 420 + 300 = £3070$

c)

The accrual will be shown as part of current liabilities, generally immediately following trade payables.

Answer 4 Khalil

Income statement for the year ending 31 December 20X4

	£	£	£
Revenue			618 772

Less: returns		(1 897)
		<hr/> 616 875

Cost of sales

Opening inventory		98 761	
Purchases	473 405		
Add: import duties	5 547		
Less: Purchases returns	(2 950)		
	<hr/>	476 002	
		<hr/> 574 763	
Closing inventory		(103 471)	
		<hr/>	471 292
Gross profit			<hr/> 145 583

Expenses

Premises rent and rates		32 900	
Service charges on property		5 252	
Staff wages		47 550	
Electricity		4 906	
Telephone		1 772	
Discounts allowed		477	
Bank charges		976	
Administration and accountancy		3 700	
Sundry expenses		4 992	
			102 525
Net profit			<hr/> 43 058

Gross profit margin

$$\frac{145\,583}{616\,875} \times 100 = 23.6\%$$

616 875

Net profit margin

$$\frac{43\,058}{616\,875} \times 100 = 7.0\%$$

616 875

Both gross and net profit margins are lower than in the previous year.

Answer 5 Ling

Income statement for the year ending 30 April 20X6

	£	£	£
Revenue			293 750
Less: returns			(1 222)
			<hr/> 292 528
Cost of sales			
Opening inventory		24 297	
Purchases	120 887		
Add: import duties	7 721		
	<hr/>	128 608	
		<hr/> 152 905	
Closing inventory		(13 127)	
		<hr/>	139 778
Gross profit			<hr/> 152 750
Interest received			1 652
Discounts received			720
			<hr/> 155 122
Expenses			
Warehouse rental	20 470		
Less: prepayment	(2 173)		
	<hr/>	18 297	
Other premises costs		10 200	
Manager's salary		22 650	
Other staff costs		18 917	
Travelling expenses		10 766	
Telephone	2 892		
Add: accrual for telephone charges	385		
	<hr/>	3 277	
Delivery charges		5 521	
Administrative expenses		6 247	

Bank charges	360	
Sundry expenses	2 424	
		98 659
Net profit		56 463

Answer 6 Linley

Working 1: insurance

Insurance to 31 December 20X4	2 700
Paid on 1 January 20X5 (for one year)	3 720
Less: prepaid – 9/12 x £3 720	(2 790)
Insurance charge for year to 31 March 20X5	3 630

Income statement for the year ending 31 March 20X5

	£	£	£
Revenue			642 442
Less: returns			(2 588)
			639 854
Cost of sales			
Opening inventory		70 462	
Purchases	447 331		
Add: haulage and carriage costs	10 261		
Less: Purchases returns	(3 667)		
		453 925	
		524 387	
Closing inventory		(75 210)	
			449 177
Gross profit			190 677
Expenses			
Premises rental		39 421	
Electricity		7 662	
Telephone charges	3 860		
Add: accrual	772		

	4 632	
Insurance (working 1)	3 630	
Staff costs	41 448	
Administrative costs	12 246	
Sundry expenses	5 521	
Accrued commission – Olwen		
£159 500 x 1%	1 595	
		116 155
Net profit		<u>74 522</u>

Statement of financial position at 31 March 20X5

	£	£
ASSETS		
Non-current assets		26 250
Current assets		
Inventory	75 210	
Trade receivables	1 620	
Prepayment	2 790	
Cash at bank	12 471	
		<u>92 091</u>
		<u>118 341</u>
CAPITAL AND LIABILITIES		
Capital		
Capital at 1 April 20X4		48 014
Add: profit for the year		74 522
Less: drawings		(52 000)
		<u>70 536</u>
Current liabilities		
Trade payables	40 211	
Trade payables: HMRC	5 227	
Accruals (£772 + £1595)	2 367	
		<u>47 805</u>

118 341

Answer 7 Miles

Income statement for the year ending 31 December 20X4

	£	£	£
Revenue			898 720
Less: returns			(8 620)
			<hr/> 890 100
Cost of sales			
Opening inventory		71 445	
Purchases	672 680		
Less: Purchases returns	(1 850)		
	<hr/>	670 830	
		<hr/> 742 275	
Closing inventory		(73 622)	
		<hr/>	668 653
Gross profit			<hr/> 221 447
Bank interest received			1 202
			<hr/> 222 649
Expenses			
Business rates	10 791		
Less: prepayment	(2 178)		
	<hr/>	8 613	
Telephone		8 370	
Electricity	11 621		
Add: accrual	1 497		
	<hr/>	13 118	
Delivery expenses		16 260	
Water rates & plumbing repairs		8 800	
Secretarial and administrative salaries		32 869	
Warehouse supervisor's salary		20 408	
Other warehouse salaries		38 696	
Accountancy charges		2 400	

Legal costs	1 800	
Discounts allowed	8 640	
Selling costs	22 440	
Sundry expenses	2 590	
Allowance for doubtful trade receivable	35 270	
		<hr/>
		220 274
Net profit		<hr/>
		2 375
		<hr/>

Statement of financial position at 31 December 20X4

	£	£
ASSETS		
Non-current assets		
Warehouse & equipment		282 460
Delivery vans		32 600
		<hr/>
		315 060
Current assets		
Inventory	73 622	
Trade receivables	109 172	
Less: allowance for doubtful receivable	(35 270)	
	<hr/>	
	73 902	
Prepayment	2 178	
Cash at bank	26 259	
	<hr/>	
		175 961
		<hr/>
		491 021
		<hr/>
CAPITAL AND LIABILITIES		
Capital		
Capital at 1 January 20X4		447 729
Add: profit for the year		2 375
Less: drawings		(45 000)
		<hr/>
		405 104
Current liabilities		
Trade payables	84 420	
Accrual	1 497	
	<hr/>	

85 917

491 021

Answer 8 SharonSharon: Income statement for the year ending 31 August 20X1

	£	£	£
Revenue			464 714
Cost of sales			
Opening inventory		45 517	
Add: purchases		224 069	
		<hr/> 269 586	
Less: closing inventory		(46 522)	
		<hr/>	(223 064)
Gross profit			<hr/> 241 650
Discounts received			1 808
Interest received			460
			<hr/> 243 918
Expenses			
Premises rental (including business and water rates)		68 000	
Property services charge	17 004		
Add: accrual	<hr/> 1 307		
		18 311	
Electricity	5 337		
Add: accrual	<hr/> 1 107		
		6 444	
Assistants' wages		38 830	
Phone – shop	3 234		
Add: accrual	<hr/> 200		
		3 434	
Mobile phone		766	
Insurance	5 237		

Less: prepayment	(465)	
		4 772
Administration expenses		8 219
Sundry expenses		1 007
Subscriptions to trade association		818
Bank charges		1 830
Accountant's and solicitor's fees		2 070
Travelling expenses		3 600
		(158 101)
Net profit		85 817

Sharon: Statement of financial position at 31 August 20X1

	£	£
ASSETS		
Non-current assets		27 662
Current assets		
Inventory	46 522	
Prepayment	465	
Cash at bank	18 712	
		65 699
		93 361
CAPITAL AND LIABILITIES		
Capital		
Opening capital balance 1 September 20X0	42 065	
Add: net profit for the year	85 817	
	127 882	
Less: drawings	(61 300)	
Closing capital balance 31 August 20X1		66 582
Current liabilities		
Trade payables	24 165	
Accruals (£1307 + 1107 + 200)	2 614	

	26 779
	<hr/>
	93 961
	<hr/>

Sharon's gross profit margin = $\frac{241\,650}{464\,714} \times 100 = 52\%$

Her net profit margin = $\frac{85\,817}{464\,714} \times 100 = 18.5\%$

Business performance has been better than usual in the year to 31 August 20X1. Gross profit margin is generally expected to be 50% but this year it has improved to 52%. Net profit margin is expected to be 16.3% but this year has improved to 18.5%.