

**45.1 A drill to practise the use of rolling provisions**

REQUIRED: for each set of data below, show an extract from the P&L Account for each relevant year, plus an account for the relevant provision.

## Business 1

The business guarantees to repair, free of charge, any of its sales that prove defective within one year of sale.

YEAR 1: sales for the year are £600 000. The business estimates that repair costs on these goods will be 5% of their sales value.

P&L 1		Provision for Repairs	
	Sales 600 000		P&L 1 new provision 30 000 = balance at end of YR1
Year 1 provision for repairs	30 000		

YEAR 2: actual repair costs are £31 000. Sales for the year are £800 000, and the business continues to estimate that repair costs will be 5% of the value of goods sold.

P&L 2		Provision for Repairs	
	Sales 800 000		P&L 1 new provision 30 000 = balance at end of YR1
actual repair cost	31 000	c/f 40 000	P&L 2 increase in provision 10 000
increase in provision	10 000	<u>40 000</u>	<u>40 000</u>
			balance at end of YR 2 40 000

YEAR 3: actual repair costs are £38 000. Sales for the year are £900 000. The business has made improvements to the quality of its goods and now believes that repair costs will be only 4% of the value of goods sold.

P&L 3		Provision for Repairs	
	Sales 900 000		P&L 1 new provision 30 000 = balance at end of YR1
actual repair cost	38 000	c/f 40 000	P&L 2 increase in provision 10 000
decrease in provision	4 000	<u>40 000</u>	<u>40 000</u>
		P&L 3 decrease in provision 4 000	balance at end of YR 2 40 000
		c/f 36 000	
		<u>40 000</u>	<u>40 000</u>
			balance at end of YR 3 36 000

## Business 2

A school offers courses which last one year. Students pay for the whole course in advance, but are guaranteed a full refund of their fees if they do not pass the public examination at the end of their course. Unfortunately, the accounting year-end of the school falls between the end of the course and the announcement of the examination results.

YEAR 1: sales for the year are £250 000. The school estimates that 10% of the students awaiting results at the end of the year will fail the examination and require a refund.

P&L 1		Provision for Refunds	
	Sales 250 000		
Year 1 provision for refunds	25 000		
		P&L 1 new provision = balance at end of YR1	25 000

YEAR 2: actual refunds to the previous year's students are £23 000. Sales for the year are £300 000. Higher standards are now expected in the examination, and the school estimates that 15% of the students will fail the examination and require a refund.

P&L 2		Provision for Refunds	
	Sales 300 000		
actual refund cost	23 000		
increase in provision	20 000		
		c/f	45 000
			<u>45 000</u>
			P&L 1 new provision = balance at end of YR1
			25 000
			P&L 2 increase in provision
			20 000
			<u>45 000</u>
			balance at end of YR 2
			45 000

YEAR 3: actual refunds to the previous year's students are £45 000. Sales for the year are £280 000. Once again, the school estimates that 15% of the students will fail the examination and require a refund.

P&L 3		Provision for Refunds	
	Sales 280 000		
actual refund cost	45 000		
	decrease in provision		
	3 000		
		c/f	45 000
			<u>45 000</u>
		P&L 3 decrease in provision	3 000
		c/f	42 000
			<u>45 000</u>
			P&L 1 new provision = balance at end of YR1
			25 000
			P&L 2 increase in provision
			20 000
			<u>45 000</u>
			balance at end of YR 2
			45 000
			<u>45 000</u>
			balance at end of YR 3
			42 000