

44.1 A drill to practise using provisions to match future expenditure against current revenue

REQUIRED: for each set of data below, show the necessary entries on a provision account, with an extract from the P&L Account for each relevant year, plus an account for money and promises.

Business 1

YEAR 1: a firm runs a small lottery, selling 100 tickets for £1 each, and offering a prize of £90. At the end of Year 1, all 100 tickets have been sold, but the winner has not yet been selected.

P&L 1	
	Sales 100
provision for prize 90	

Money & Promises	
	cash received Year 1 100

Provision	
	P&L 1 new provision = balance at end of YR1 90

YEAR 2: the winner of the lottery is selected and given the prize of £90.

P&L 2	
prize paid 90	release of provision 90

Money & Promises	
cash received Year 1 100	
	prize paid Year 2 90

Provision	
	P&L 1 new provision = balance at end of YR1 90
P&L 2 release of provision 90	
<u>90</u>	<u>90</u>

Business 2

YEAR 1: a farmer rents a field to a motor-cycling club for the whole of Year 1, for a rent of £1 000. The farmer expects that he will have to pay costs of £300 to restore the land to agricultural use in Year 2.

P&L 1	
	rental income 1 000
provision for restoration	300

Money & Promises	
	cash received Year 1 1 000

Provision	
	P&L 1 new provision = balance at end of YR1 300

YEAR 2: the actual cost to restore the land is £310.

P&L 2	
restoration costs	310
	release of provision 300

Money & Promises	
cash received Year 1	1 000
	costs paid Year 2 310

Provision	
	P&L 1 new provision = balance at end of YR1 300
P&L 2 release of provision	300
	<u>300</u>
	<u>300</u>

Business 3

YEAR 1: a business takes a three-year lease on a property, with an undertaking to fully redecorate the property before leaving at the end of the third year. It is estimated that the cost of redecoration will be £1 500.

P&L 1		Provision for Redecoration	
Year 1 provision for redecoration	500		
		P&L 1 new provision = balance at end of YR1	500

YEAR 2: the business continues to occupy the property.

P&L 2		Provision for Redecoration	
Year 2 provision for redecoration	500		
			P&L 1 new provision = balance at end of YR1 500
		c/f 1 000	P&L 2 further provision 500
		<u>1 000</u>	<u>1 000</u>
			balance at end of YR 2 1 000

YEAR 3: the business occupies the property until the end of the year, and redecorates at a cost of £1 400 before leaving.

P&L 3		Provision for Redecoration	
actual cost of redecoration 1 400	release of provision 1 000		
			P&L 1 new provision = balance at end of YR1 500
		c/f 1 000	P&L 2 further provision 500
		<u>1 000</u>	<u>1 000</u>
			balance at end of YR 2 1 000
Money & Promises			
	costs paid Year 3 1 400	P&L 3 release of provision 1 000	
		<u>1 000</u>	<u>1 000</u>

YEAR 1: a mining business develops a new site which it believes will have a three-year useful life. Environmental legislation demands that the business must clean up the site after its operations, and it is estimated that after three years of operations, the cost of cleaning up (to be paid in Year 4) will be £600 000.

YEAR 2: as a result of stricter environmental legislation, it is now estimated that the cost of cleaning up will be £800 000.

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Business 4 cont'd

YEAR 3: the business continues to operate the site until the end of the year.

However, technological improvements indicate that the cost of cleaning up will probably be only £700 000.

P&L 3		Provision for Redecoration	
<i>Year 3 provision for clean up</i> 200 000			<i>P&L 1 new provision</i> 200 000 <i>= balance at end of YR1</i>
		<i>c/f</i> 500 000	<i>P&L 2 further provision</i> 300 000 500 000 500 000
			<i>balance at end of YR 2</i> 500 000 <i>P&L 3 further provision</i> 200 000 700 000 700 000
			<i>balance at end of YR 3</i> 700 000

YEAR 4: the site is cleaned up at an actual cost of £670 000.

P&L 4		Provision for Redecoration	
<i>actual cost for clean up</i> 670 000	<i>release of provision</i> 700 000		<i>P&L 1 new provision</i> 200 000 <i>= balance at end of YR1</i>
		<i>c/f</i> 500 000	<i>P&L 2 further provision</i> 300 000 500 000 500 000
			<i>balance at end of YR 2</i> 500 000 <i>P&L 3 further provision</i> 200 000 700 000 700 000
		<i>P&L 4 release of provision</i> 700 000	<i>balance at end of YR 3</i> 700 000

Money & Promises	
	<i>costs paid Year 4</i> 670 000