

## Finance and Accounting for Business

### Questions for students

#### Financial Accounting

1. You start a business at the beginning of the year contributing \$10 000 and borrowing \$20 000. You buy some kit for \$25 000, paying the amount in full upon the suppliers invoice, and inventory for \$2000. Orders flood in and you sell \$70 000 of goods during the year receiving cash for all but \$4000. Your cost of sales is 30% of revenues and you incur other operating costs of \$20 000 of which \$2000 is a quarter's prepaid rent for the following year. You decide to write off the value of your equipment purchases over 5 years to a residual value of \$5000. Your interest charges are 8% (which are all paid in the year) and you decide to provide for profit tax at a rate of 25%. At the end of the year you have \$5000 of inventory in hand and you owe your suppliers \$4500.

Required:

Show the above on an extended trial balance for the first year of trading identifying clearly the profit retained in the business at the year end.

#### Indicative answer

	NCA	Inv	Rec	Cash	=	CL	NCL	OE	R	-E
Capital introduced				10000				10000		
Loan				20000			20000			
Purchase of equipment	25000					25000				
Payment for equipment				-25000		-25000				
Inventory purchase		2000				2000				
Revenues			70000						70000	
Cash from customers			-66000	66000						
Cost of sales		-21000								21000
Other operating costs			2000			20000				18000
Depreciation	-4000									4000
Interest				-1600						1600
Purchases		24000				24000				
Payments to suppliers				-41500		-41500				
Tax provision						6350				6350
Profit retained								19050		19050
	21000	5000	6000	27900		10850	20000	29050	70000	70000

2. Using the information in question 1 produce an income statement, cash flow statement and balance sheet.

#### Indicative answer:

Income statement	\$	Cash flow statement	\$
Sales revenue	70000	Cash flow from operating activities	
less cost of sales	<u>21000</u>	Cash flow from operations	24500
Gross profit	49000	Less tax payable	<u>0</u>
less other operating costs	<u>22000</u>		<u>24500</u>
Operating profit	27000	Cash flow from investing activities	

less interest paid	<u>1600</u>	Purchase of equipment	<u>-25000</u>
Profit before tax	25400		<u>-25000</u>
tax	<u>6350</u>	Cash flow from financing activities	
Profit for the year	<u>19050</u>	Less interest paid	-1600
		Add equity introduced	10000
<b>Balance Sheet</b>	\$	Add borrowing	<u>20000</u>
Non current assets	21000		<u>28400</u>
Current Assets			
Inventories	5000	Cash flow for the year	27900
Receivables	6000		
Cash	<u>27900</u>		
	<u>38900</u>		
Less:			
Current liabilities	-10850		
Non current liabilities	<u>-20000</u>		
Net assets	<u>29050</u>		
Owner equity			
Capital introduced	10000		
Profit retained	<u>19050</u>		
Total equity	<u>29050</u>		

3. On the basis of the accounting information for the first year of operation show the effects of the following:

You pay yourself a dividend of \$5000 halfway through the year and provide for a further \$5000 at the year end.

You discover that half of the receivables outstanding are a bad debt and you will not receive any cash from the customer's bankruptcy.

**Required:**

Show the corrections as changes to the extended trial balance and their impact upon the income statement, cash flow statement and balance sheet.

Indicative answer

	NCA	Inv	Rec	Cash	=	CL	NCL	OE	R	-E
	21000	5000	6000	27900		10850	20000	29050	70000	70000

Bad debt written off				-2000					2000
Dividend paid				-5000			-5000		
Dividend payable					5000		-5000		
Reduction in profit							-2000		-2000
	21000	5000	4000	22900	15850	20000	17050	70000	70000

#### Income statement

Sales revenue	70000
less cost of sales	21000
Gross profit	<u>49000</u>
less other operating costs	24000
Operating profit	<u>25000</u>
less interest paid	1600
Profit before tax	<u>23400</u>
tax	6350
Profit for the year	<u><u>17050</u></u>

#### Balance Sheet

Non current assets	21000
Current Assets	
Inventories	5000
Receivables	4000
Cash	22900
	<u>31900</u>
Less:	
Current liabilities	-15850
Noncurrent liabilities	-20000
Net assets	<u>17050</u>
Owner equity	
Capital introduced	10000

#### Cash flow statement

Cash flow from operating activities	
Cash flow from operations	24500
Less tax payable	0
	<u>24500</u>
Cash flow from investing activities	
Purchase of equipment	-25000
	<u>-25000</u>
Cash flow from financing activities	
Less interest paid	-1600
Less dividends paid	-5000
Add equity introduced	10000
Add borrowing	20000
	<u>23400</u>
Cash flow for the year	22900

Profit retained	17050
less dividends	-10000
	<u>7050</u>
Total equity	<u><u>17050</u></u>