Chapter 11

The financial statements of sole traders

Financial statements of Sole traders

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Income Statement for the year ended 31 December

	€	€	€
Revenue/Sales			860,000
Less cost of sales			
Opening stock		76,000	
Add Purchases		428,000	
Add carriage inwards		34,000	
Less closing stock		(82,000)	
Cost of sales			(456,000)
Gross profit	**Note 1**		**404,000**
Add other income/revenue	**Note 2**		
Discount received		35,000	
Rental income		380	35,380
			439,380
Less Operating Expenses	**Note 3**		
Wages and salaries		225,000	
Rent	72,000		
Less rent prepaid	(24,000)	48,000	
Carriage outwards		18,000	
Insurance		9,500	
Provision for bad debts		500	
Office expenses	3,500		
Add accrued expenses	750	4250	
Travel expenses		950	
Energy costs		3,400	
Depreciation of fixtures		24,000	
Depreciation of equipment		70,000	
Loan Interest		500	(404,100)
Net profit			35,280

Statement of Financial Position at 31 December

	€	€	€
Non-Current Assets	Cost	Deprec.	NBV
Fixtures **Note 3**	120,000	48,000	72,000
Equipment **Note 3**	350,000	140,000	210,000
	470,000	188,000	282,000
Current Assets			
Closing stock		82,000	
Accounts Rec **Note 3**	90,000		
- Provision bad debts	(10,620)	79,380	
Bank		4,000	
Prepaid expenses **Note 3**		24,000	189,380
Total Assets			471,380
Capital and Liabilities			
Opening Capital			337380
Net profit			35,280
Less drawings			(7,280)
Closing capital			365,380
Non Current Liabilities			
Loans			20,000
Current Liabilities			
Accounts payable		85,250	
Accrued expenses		750	86,000
Total Capital and Liabilities			***471,380***

Steps in preparing the Income statement

Revenue less expenses = profit

1. **Start with revenue and deduct cost of sales to get gross profit**
2. **Cost of sales is opening stock + purchases + carriage inward – closing stock.**

3. **Add additional income (Cr column) to gross profit**
4. **Deduct expenses (Dr column). Watch for prepayments, accruals, loan interest, depreciation and provision for bad debts.**
5. **Gross profit + add income – expenses = net profit**

Steps in preparing the Balance sheet

Assets = Capital + Liabilities

1. **Start with non-current assets. Show these at cost less accum depreciation = net book value**
2. **List the current assets such as closing stock, Accounts rec less provisions, prepayments and cash or bank balances**
3. **Calculate total assets**
4. **Calculate capital – opening capital + the profit made less drawings**
5. **List non-current liabilities – Loans (on cr side)**
6. **List current liabilities – accounts payable, accruals (expenses owing) bank overdraft.**

Comprehensive example

	Debit €	Credit €
Purchases	**154,000**	
Sales		**350,000**
Creditors		**30,000**
Debtors	**25,000**	
Bad debt	**1,200**	
Marketing and sales	**10,420**	
Office expenses	**5,600**	
Insurance	**6,700**	
Discounts	**900**	**1,000**
Carriage inwards	**5,000**	
Stock as at 1/7/03	**5,000**	
Wages and salaries	**90,000**	
Motor expenses	**5,600**	
Rates	**4,600**	
Light and heat	**4,678**	
Provision bad debts (1/7/03)		**300**
Premises	**154,000**	
Furniture & equipment	**60,500**	
Depreciation furniture(1/7/03)		**3,200**
Motor vehicles	**40,000**	
Depreciation vehicles (1/7/03)		**4,000**
Bank	**4,200**	
Loan (to be repaid 2009)		**120,000**
Drawings	**22,500**	
Capital		**91,398**
	599,898	**599,898**

The following additional information is available:

1. Stock was counted and valued at 30 June at €6,000.
2. Insurance includes €1,000 of cover that relates to the year to 30 June of next year.
3. Bad debts of €1,000 included in debtors in the trial balance is to be written off.
4. Wages owing at the 30 June amounted to €5,000.
5. Provision for bad debts is to be maintained at a level of 3 percent of debtors after all bad debts are written off.
6. It is the policy of the business to depreciate furniture and equipment at 10 per cent per annum straight line method and motor vehicles at 20 per cent per annum straight line method. There is no depreciation on premises.
7. Interest on the loan is charged at €6,000 for the year. This has not been paid by 30 June.

Required:

a) Prepare a trading and profit and loss account for the year to 30 June

b) Prepare a balance sheet at that date

Income Statement for the year ended 30 June

		€	€
Sales			350,000
Less Cost of Goods Sold			
	Opening inventory	5,000	
	Purchases	154,000	
	Carriage Inwards	5,000	
		164,000	
	Closing inventory	6,000	158,000
Gross Profit			192,000
Other Income			
Discount Received			1,000
			193,000
Less Expenses			
	Bad debts **(Note 1 1,200 + 1000)**	2,200	
	Insurance **(Note 2 6,700-1,000)**	5,700	
	Marketing and Sales	10,420	
	Discount allowed	1,000	
	Office expenses	5,600	
	Wages/Salaries **(Note 3 90,000 + 5,000)**	95,000	
	Motor expenses	5,600	
	Rates	4,500	
	Light and heat	4,678	
	Increase in Provision for bad debts **(Note 4)**	420	
	Provision for depreciation **(Note 5)**		
	Motor vehicles	8,000	
	Office furniture and equipment	6,050	
	Loan Interest	6,000	155,168
Net Profit			37,832

Statement of Financial Position as at 30th June

		€ Cost	€ Acc Dep	€ N.B.V.
Non - current Assets (Note 5)				
Premises		154,000		154,000
Office furniture and Equipment		60,500	9,250	51,250
Motor vehicles		40,000	12,000	28,000
		254,500	21,250	233,250
Current Assets:				
Inventory			6,000	
Accounts Receivable	**(Note 1)**	24,000		
Less provision for bad debts		720	23,280	
Prepayments	**(Note 2)**		1,000	
Bank			4,200	34,480
Total Assets				**267,730**
Capital and Liabilities				
Opening capital				91,398
Net profit				37832
				129,230
Drawings				22,500
Closing capital				106,730
Long-term liabilities				
Loan				120,000
Current Liabilities				
Accounts payable			30,000	
Accruals	**(Note 3/6)**	**(5,000 + 6,000)**	11,000	41,000
Capital + Liabilities				**267,730**

Profit as an estimate

The calculation of profit requires management to estimate certain figures and thus an element of profit is based on management's subjective opinion.

- Management ignoring the need to provide for bad debts to ensure profit and assets (debtors) are recorded at higher levels
- Management estimating long lives on assets ensures a lower depreciation charge in the profit and loss account. The result is higher profits and higher asset levels.
- The adjustment for accruals need to be estimated. A lower estimate ensures a higher profit
- Classification decisions relating to capital and revenue expenditure can result in profit being created.

It is important to appreciate that profit is, in many respects, an opinion and one should judge a profit figure based on the assumptions that underlie the calculation of that profit.