CHAPTER 2

Accounting and reporting on an accrual   
 accounting basis

Question 1 - Sasha Parker

(a) *Cash budget (€000)*

*Jan Feb Mar Apr May June Total*

Initial capital 150.00 75.00 225.00

Customers 60.00 75.00 75.00 210.00

Total receipts 150.00 60.00 75.00 150.00 435.00

Machinery 30.00 30.00

Motor vehicles 24.00 24.00

Premises 75.00 75.00

Drawings 1.50 1.50 1.50 1.50 1.50 1.50 9.00

Suppliers 30.00 48.00 60.00 60.00 60.00 258.00

Rates

Wages 2.25 2.25 2.25 2.25 2.25 2.25 13.50

General expenses 0.75 0.75 0.75 0.75 0.75 3.75

132.75 34.50 52.50 64.50 64.50 64.50 413.25

Net cash flow 17.25 (34.50) (52.50) (4.50) 10.50 85.50

Balance b/f - 17.25 (17.25) (69.75) (74.25) (63.75)

Balance c/f 17.25 (17.25) (69.75) (74.25) (63.75) (21.75) (21.75)

All balances are overdrawn except for January 20X1

*Feb Mar Apr May June*

o/d 17.25 69.75 74.25 63.75 4.65

Note:

No entries will be made for the 20X0/X1 local taxes that are paid in Feb 20X2 - this situation arose because Sasha Parker had assumed that the business would only pay the taxes from the start of the tax year, e.g. 1.4.20X1.

However, there will be an entry in the profit and loss account and the statement of financial   
position.

11

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(b) *Sasha Parker - profit and loss account for six months ended 30 June   
 20X1*

*€000 €000*

Sales [60.00 + (5 × 75.00)] 435.00

Purchases 378.00

Closing inventory (30.00)

Cost of sales 348.00

Gross profit 87.00

Wages 13.50

General expenses 4.50

Local taxes (1.1.X1-30.6.X1) 4.00

Insurance 13.20

Depreciation:

- Vehicles 2.40

– Machinery 1.50 39.10

Net profit 47.90

*Budgeted statement of financial position as at 30 June 20X1*

Capital 225.00

Net profit 47.90

*Less*: drawings ( 9.00)

263.90

Non-current assets

Premises 75.00

Vehicles 24.00

*Less*: depreciation 2.40 21.60

Machinery 30.00

*Less*: depreciation 1.50 28.50

Current assets

Inventory 30.00

Trade receivables (3 × 75.00) 225.00

Insurance 13.20 268.20

Current liabilities

Trade payables 120.00

Local taxes (1.1.X1-30.6.X1) 4.00

Bank overdraft 4.65

General expenses 0.75 (129.40)

Net current assets 138.80

263.90

12

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(c) *Possible action to deal with exceeding agreed overdraft limit*

Approach the bank to re-negotiate the overdraft or arrange a loan facility for an agreed term.

The amount and the period for which additional facilities are required depend on preparing a projected cash flow statement for a longer period taking into account future plans, e.g. owner’s drawings requirement and any additional capital expenditure.

In particular, consider alternatives such as the following: Leasing vehicles and/or machinery

Mortgaging the property

Getting debts in quicker manner Introducing more capital

Obtaining or providing loan capital.

Question 2 - Mr Norman

(a) *Purchases budget ($000)*

*Jan Feb Mar Apr May Jun*

Sales units 1.65 2.20 3.85 4.40 4.40 4.95

− Closing inventory 0.55 0.96 1.10 1.10 1.24

+ Closing inventory 0.55 0.96 1.10 1.10 1.24 1.38

Purchases units 2.20 2.61 3.99 4.40 4.54 5.09

*Purchases Sales*

*$000 $000*

Jan (2,200 × 40) 88.00 82.50 (1,650 × 50)

Feb (2,610 × 40) 104.40 110.00 (2,200 × 50)

Mar (3,990 × 40) 159.60 192.50 (3,850 × 50)

Apr (4,400 × 40) 176.00 220.00 (4,400 × 50)

May (4,540 × 40) 181.60 220.00 (4,400 × 50)

Jun (5,090 × 40) 203.60 247.50 (4,950 × 50)

913.20 1,072.50

13

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(b) *Cash flow forecast ($000)*

*Jan Feb Mar Apr May June Total*

Initial capital 150.00 150.00

Cash sales 41.25 55.00 96.25 110.00 110.00 123.75 536.25

Credit sales 41.25 55.00 96.25 110.00 110.00 412.50

191.25 96.25 151.25 206.25 220.00 233.75 1,098.75

Premises 80.00 80.00

Commission 1.65 2.20 3.85 4.40 4.40 16.50

Suppliers 88.00 104.40 159.60 176.00 181.60 709.60

Administration 8.00 8.00 8.00 8.00 8.00 8.00 48.00

Wages 17.00 17.00 17.00 17.00 17.00 17.00 102.00

Insurance 0.35 0.35

Total payments 105.35 114.65 131.60 188.45 205.40 211.00 956.45

Net cash flow 85.90 (18.40) 19.65 17.80 14.60 22.75

Balance b/f - 85.90 67.50 87.15 104.95 119.55

Balance c/f 85.90 67.50 87.15 104.95 119.55 142.30

(c) *Budgeted statement of income for six months ended 30 June 20X8*

*$000 $000*

Sales 1,072.50

Purchases 913.20

Closing inventory (1,380 units × £40) (55.20)

Cost of sales 858.00

Gross profit 214.50

Wages 102.00

Administration 48.00

Commission (2% of 1,072.50) 21.45

Insurance 0.18

Amortisation of lease 8.00

179.63

Net profit 34.87

14

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*Budgeted statement of financial position as at 30 June 20X8*

*$000 $000*

Capital 150.00

Net profit 34.87

184.87

Non-current assets

Leasehold premises 80.00

Less amortisation (8.00)

72.00

Current assets

Inventory 55.20

Trade receivables 123.75

Pre-payments − insurance 0.17

Cash 142.30

321.42

Current liabilities

Trade payables 203.60

Commission 4.95

208.55

Net current assets 112.87

184.87

(d) *Investment of surplus funds* Acid test ratio

At the end of the first six-month trading, Norman’s statement of financial position shows that the acid test ratio is 1.28:1 (266.22/208.55) - this is higher than the basic 1:1 ratio but it should be compared with the ratio of similar businesses in the same industry in order to establish a norm. It would appear, however, that the business has surplus funds to invest.

Amount to invest

A projected cash flow statement is required, taking into account future plans regarding the owner’s drawing requirements, future capital commitments and working capital criteria, e.g. debtor collection and creditor payment terms.

Period to invest

The projected cash flow will give an indication of the period of the investment, e.g. it could range from overnight on the money market to term investments.

The important aspect is that the owner should be aware of the projected cash flows, so that return on surplus funds can be maximised.