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.

(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

(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 *$000*	*Sales* *$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**	

(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

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.