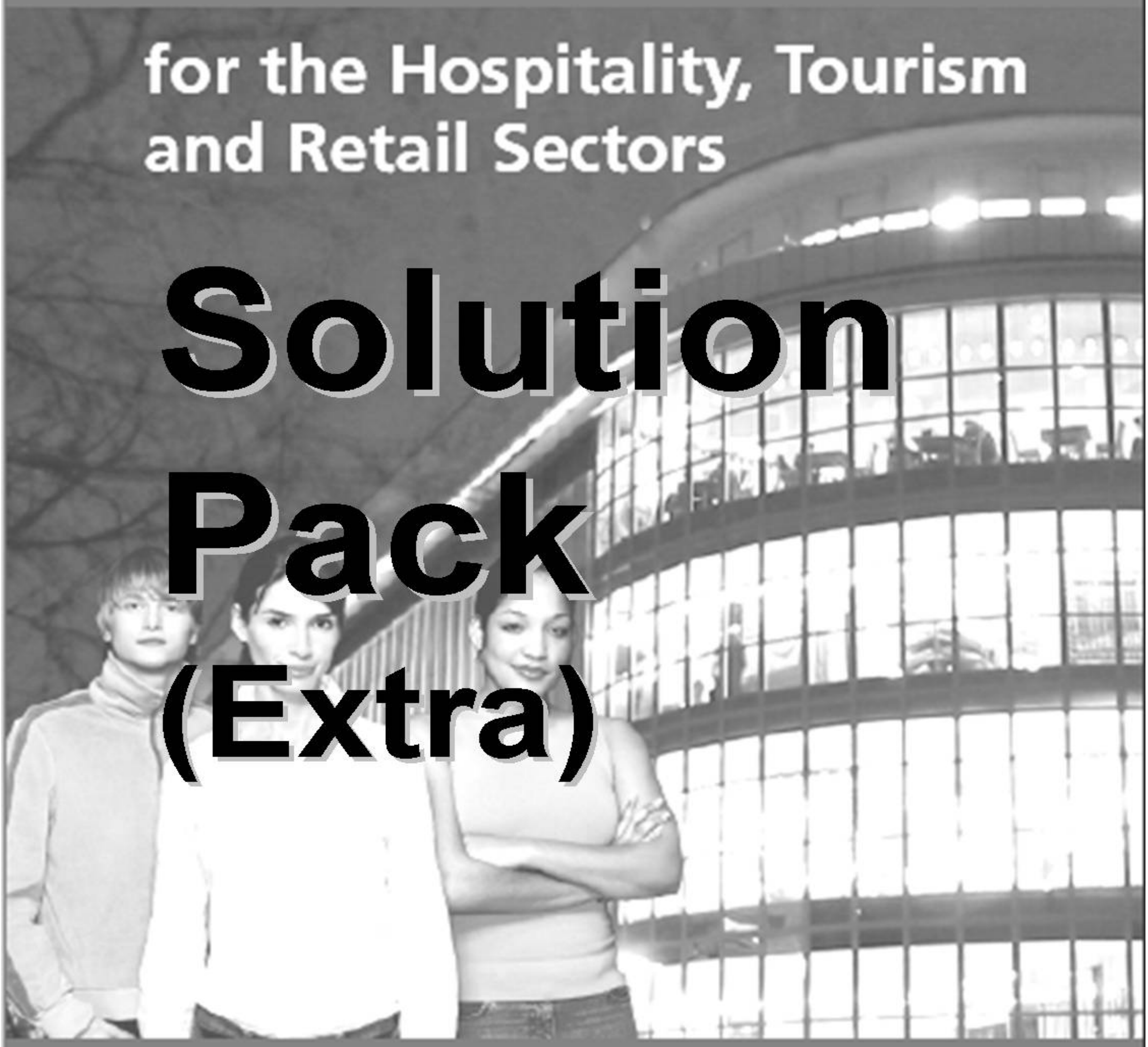
Financial Accounting

for the Hospitality, Tourism and Retail Sectors



Solution Pack (Extra)

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Financial Accounting for the Hospitality, Tourism and Retail Sectors

Solution Pack

This pack contains the solutions to the additional questions only available through the password protected Lecture Resources site.

These questions and solutions should only be used on courses where the text book has been adopted as the main text. The questions and solutions should not be used or modified for any other purpose.

Chapter 1 Solution

		True	False
a)	The recording of data or transactions is known as bookkeeping	☑	
b)	A sole-trader must publish accounts for the general public		☑
c)	All Partnerships are protected by limited liability		☑
d)	ASB stands for Accounting Standards Board	☑	
e)	Financial accounting involves planning, forecasting and control		☑
f)	Management accounting is not governed by legislation or accounting standards	☑	
g)	Accounting regulations is through the government, EU, stock exchange and accounting standards	☑	
h)	The objective of an accounting regulatory framework is to ensure adequate relevant disclosure, objectivity and comparability of accounting information to external users of financial reports.	☑	

Chapter 2 Solution

	Assets	Liabilities	Capital
1) Owner puts €200,000 into the business opening a bank account	Increase	-	Increase
2) Bought Premises paying in cash	-	-	-
3) Bought fixtures and fittings on credit from Fine Interiors Ltd	Increase	Increase	-
4) Purchased stock paying by cheque	-	-	-
5) Obtained a loan which was immediately lodged in the bank	Increase	Increase	-
6) Purchases stock on credit from a supplier	Increase	Increase	-
7) Gave personal equipment to the business	Increase	-	Increase
8) Paid the amount outstanding relating to fixtures and fittings by cheque	Decrease	Decrease	-

Transaction	Account to be debited	Account to be credited
1) The owner invested €15,000 into the business	Bank	Capital
2) Purchased office equipment on credit from ABC Ltd	Equipment	ABC Ltd
3) Returned some of the office equipment as it was unsuitable	ABC Ltd	Equipment
4) Bought a used van paying by cheque	Vehicles	Bank
5) Paid ABC Ltd the amount outstanding by cheque	ABC Ltd	Bank
6) Received a loan from Allied Financing which was lodged in the bank account	Bank	Allied Fin
7) Paid a creditor by cheque	Creditor	Bank
8) Withdrew money out of the bank and put it into the cash till	Cash	Bank
9) Repaid part of the loan to Allied Financing by cheque	Allied Fin	Bank

BANK ACCOUNT TRANSACTIONS

1 May Invested €20,000 in business
2 May Paid for Machinery worth €6,000
3 May Took out a €5,000 loan
4 May Sold stock receiving €3,000 payment
5 May Paid €12,000 for a vehicle
6 May Received €1,500 for debtor re credit sales
7 May Paid €4,000 to a creditor
8 May Withdrew €500 for cash till / petty cash

Chapter 3 Solution

COMPLETE THE FOLLOWING TABLE WITH THE ACCOUNT TO BE DEBITED AND CREDITED FOR EACH TRANSACTION.

Transaction	Account to be debited	Account to be credited
1) Paid telephone by cheque	Telephone	Bank
2) Paid for computer consumables by cheque	Consumables	Bank
3) Paid utility bill by cheque	Utilities	Bank
4) Paid wages by cheque	Wages	Bank
5) Received a cheque from a tenant for rent	Bank	Rent received
6) Bought postage stamps paying with cash	Postage	Cash
7) Paid advertising costs by cheque	Advertising	Bank
8) Returned some computer consumables for a cash refund	Cash	Consumables
9) Purchased stock of goods paying by cheque	Purchases	Bank
10) Purchased stock of goods on credit from C&C Suppliers Ltd.	Purchases	C&C Suppliers
11) Sold goods on credit to Duffy & Sons	Duffy & Sons	Sales
12) Sold goods for cash	Cash	Sales
13) Returned some of the goods purchased from C&C Suppliers for an allowance	C&C Suppliers	Purch. Returns
14) Some goods were returned for a cash refund	Cash	Purch. Returns
15) Received cheque payment from Duffy & Sons Ltd	Bank	Duffy & Sons
16) Paid amount due to C&C Suppliers Ltd by cheque	C&C Suppliers	Bank

Chapter 4 Solution

CAPITAL A/C

			1	Bank a/c	20000
10	Bal c/d	20500	5	Equip a/c	500
		20500			20500
			11	Bal b/d	20500

Drawings A/C

7	Cash a/c	50	10	Bal c/d	50
11	Bal b/d	50			

PURCHASES A/C

1	Bank a/c	600			
2	Glynn a/c	350			
8	Bank a/c	800			
9	Bank a/c	500	10	Bal c/d	2250
		2250			2250
11	Bal b/d	2250			

PURCHASES RETURNS A/C

10	Bal c/d	50	3	Glynn a/c	50
			11	Bal b/d	50

SALES A/C

			4	Cash a/c	400
			5	Carroll a/c	200
			5	Cash a/c	300
			6	Carroll a/c	120
10	Bal c/d	1220	8	Cash a/c	200
		1220			1220
			11	Bal b/d	1220

SALES RETURNS A/C

9	Cash a/c	40	10	Bal c/d	40
11	Bal b/d	40			

BANK A/C

1	Capital a/c	20000	1	Rent Payable a/c	450
8	Carroll a/c	200	2	Cash a/c	500
10	Rent Rec a/c	80	6	Insurance a/c	175
			1	Purchases a/c	600
			7	Glynn a/c	300
			8	Purchases a/c	800
			9	Purchases a/c	500
			10	Stationery a/c	25
			10	Bal c/d	16930
		20280			20280
11	Bal b/d	16930			

CASH A/C

2	Bank a/c	500	5	Stationery a/c	50
4	Sales a/c	400	7	Wages a/c	200
5	Sales a/c	300	8	Drawings	50
7	Stationery a/c	5	9	Sales Returns a/c	40
8	Sales a/c	200	9	Postage a/c	30
			10	Bal c/d	1035
		1405			1405
11	Bal b/d	1035			

EQUIPMENT A/C

3	Equip. Suppliers a/c	1000	10	Bal c/d	1500
5	Capital a/c	500			
		1500			1500
11	Bal b/d	1500			

Furniture A/C

9	Style Furn. a/c	560	10	Style Furn. a/c	60
			10	Bal c/d	500
		560			560
11	Bal b/d	500			

Rent A/C

1	Bank a/c	450	10	Bal c/d	450
11	Bal b/d	450			

Stationery A/C

5	Cash a/c	50	7	Cash a/c	5

Glynn & Co. A/C

3	Pur. Returns a/c	50	2	Purchases a/c	350
7	Bank a/c	300			
		350			350

10	Bank a/c	25	10	Bal c/d	70
		75			75
11	Bal b/d	70			

Insurance A/C

6	Bank a/c	175	10	Bal c/d	175
11	Bal b/d	175			

Wages A/C

7	Cash a/c	200	10	Bal c/d	200
11	Bal b/d	200			

Postage A/C

8	Cash a/c	30	10	Bal c/d	30
11	Bal b/d	30			

Rent Received A/C

10	Bal c/d	80	10	Bank a/c	80
			11	Bal b/d	80

Equipment Supplies A/C

10	Bal c/d	1000	3	Equipment a/c	1000
			11	Bal b/d	1000

Fine Style Furniture A/C

10	Furniture a/c	60	9	Furniture a/c	560
10	Bal c/d	500			
		560			560
			11	Bal b/d	500

Carroll & Co. A/C

5	Sales a/c	200	8	Bank a/c	200
6	Sales a/c	120	10	Bal c/d	120
		320			320
11	Bal b/d	120			

Trial Balance as at 10th July

	Debit	**Credit**
Capital		20500
Drawings	50	
Purchases	2250	
Purchases returns		50
Sales		1220
Sales returns	40	
Bank	16930	
Cash	1035	
Equipment	1500	
Furniture	500	
Rent	450	
Stationery	70	
Insurance	175	
Wages	200	
Postage	30	
Rent received		80
Creditor - equipment suppliers		1000
Creditor - fine style		500
Debtor - Carroll	120	
	23350	**23350**

The trial balance from this question can be used to prepare a Trading, Profit and Loss account for Jimmy Ward's first ten days trading. A physical stock check on the 10th July shows goods to the value of €1,600. A balance sheet as at July 10th can also be prepared.

Trading and Profit and Loss Account for period ended 10 July

Sales		1220	
less returns inwards		(40)	1180
Cost of sales:			
Opening stock		0	
Purchases	2250		
add carriage inwards	0		
less returns outwards	(50)	2200	
Less closing stock		(1600)	(600)
Gross profit			580
Add Rent received			80
Less Expenses			
Rent		450	
Stationery		70	
Insurance		175	
Wages		200	
Postage		30	
			925
Net Loss			(265)

Balance sheet as at 10 July

Fixed Assets:			
Equipment			1,500
Furniture			500
			2,000
Current Assets:			
Stock		1,600	
Debtors		120	
Cash in hand		1,035	
Bank		16,930	
		19,685	
Current Liabilities:			
Creditors	1,500	(1,500)	18,185
			20,185
Financed by:			
Capital			20,500
Profit & Loss			(265)
Drawings			(50)
			20,185

Chapter 5 Solution

a) Lakeside Holiday Village Accounting System

Business transactions classified according to the following					
Credit sales	No sales returns (no refunds)	No purchases of stock	No purchase returns	**Cash receipts/ payments**	**Other**

Transactions are recorded in the books of original entry					
Sales journal	Sales returns journal	Purchases journal	Purchases returns journal	**Cash book**	**General journal**

At the end of a period the transactions are summarised and recorded in the ledger accounts		
Sales ledger **Contains all the individual debtor/customers accounts**	Purchases ledger	**General ledger**

From the ledger accounts a trial balance is extracted

Preparation of the final accounts (P&L Account and Balance Sheet)

b) THE USE OF COMPUTERS IN LAKESIDE HOLIDAY VILLAGE

The advantages of using a computerised accounting system in the Lakeside Holiday Village include:

1. Ultimately they reduce the cost of providing the required financial information for the organisation.
2. The saving of time as the owners/managers can devote themselves to the proper running of their businesses.
3. Computers have greater accuracy of calculation than manual systems subject to human error.
4. Speed in the preparation of financial reports to provide more timely information for managers.
5. Greater information at the fingertips of management.
6. A greater variety of financial reports for management. Thus management can tailor their financial reporting more closely.

Chapter 6 Solution

James Clarkson

Trading and Profit and Loss Account for year ended 30 June 2005

	€	€	€
Sales		380,000	
- Returns in		(22,000)	358,000
Less cost of sales			
Opening stock		13,000	
Purchases	150,000		
+ Carriage in	10,000		
- Returns out	(7,000)	153,000	
Less closing stock		(35,000)	
Cost of sales			(131,000)
Gross profit			227,000
Add Gains			
Discount received		19,000	
Rent received		20,000	39,000
Less Expenses			
Carriage out		4,500	
Discount allowed		1,500	
Insurance		9,500	
Light and heat		5,500	
Marketing expenses		8,000	
Office expenses		15,000	
Sundry expenses		3,000	
Wages and salaries		120,000	(167,000)
Net profit			99,000

Balance sheet as at 30 June 2005

Fixed Assets	€	€	€
Premises			436,000
Shop equipment			52,000
Shop fittings			88,000
			576,000
Current Assets			
Stock	35,000		
Debtors	5,000		
Cash	2,000		
Bank	19,000	61,000	
Current Liabilities			
Creditors	38,000		
Loan	15,000	(53,000)	8,000
			584,000
Financed by			
Capital			500,000
Profit & loss			99,000
Drawings			(15,000)
			584,000

Chapter 7 Solution

VAT IMPLICATIONS FOR RETAIL OUTLET AND COFFEE SHOP

Value added tax (vat) is a tax on consumer spending. Businesses (whether sole traders, partnerships or companies) charge VAT on the supply of goods and services and they act as a collector of these monies for the Revenue Commissioners. The business planned by Mick Roche involves both a retail operation and the provision of food. If the business has turnover in excess of €51,000 in relation to the supply of goods then VAT will need to be accounted for. Mick needs to be aware of the rates of VAT for each type of stock and each activity. The table below summarises the relevant taxable activities

Taxable – higher rate 21%	Taxable – lower rate 13.5%	Exempt	Zero rated
Stationery	Provision of Food	Not applicable	Printed books
Adult clothing			Children's clothes
General souvenirs			Human food/drink

As can be seen from examining the table above, the retail activities involve two different VAT activities (taxable and zero rated). Stationery, adult clothing and probably most of the general souvenirs will have VAT chargeable at the higher rate of 21% while the books, children's clothes and food items are zero rated.

If the coffee shop option is taken then VAT is chargeable at the lower rate of 13.5%.

Chapter 8 Solution

Cash Book

01/4	Balance b/d	€14,496	03/4	A Brady Ltd Cheque 17808	~~€4,500~~
03/4	Debtors a/c	~~€24,642~~	03/4	ESB Cheque 17809	~~€1,584~~
10/4	Debtors a/c	~~€20,244~~	06/4	K Lynch Cheque 17810	~~€21,375~~
17/4	Debtors a/c	€23,331	06/4	CBT Ltd Cheque 17811	~~€17,610~~
24/4	Debtors a/c	~~€25,977~~	10/4	J Moore Cheque 17812	~~€2,295~~
30/4	**Debtors a/c**	**€4,500**	15/4	Sunway Ltd Cheque 17813	€14,826
30/4	**Debtors a/c**	**€22,596**	22/4	AC Advert Cheque 17814	~~€14,421~~
			25/4	**Holiway Cheque 17815**	**€14,025**
			25/4	C&C Cheque 17816	~~€10,200~~
			25/4	Rent Cheque 17817	~~€3,600~~
			25/4	**PM Ltd Cheque 17818**	**€624**
			25/4	Eircom Cheque 17819	~~€2,250~~
			29/4	**ABC Ltd Cheque 17820**	**€1,326**
			29/4	**P Flynn Cheque 17821**	**€3,207**
			29/4	**H Willis Cheque 17822**	**€2,502**
			30/4	**Balance c/d**	**€21,441**
		€135,786			€135,786

Bank Statement -April

01/4	Balance				€10,302 Cr
02/4	**Lodgement**			**€24,000**	€34,302 Cr
02/4	**Cheque**	**17805**	**€7,326**		€26,976 Cr
02/4	Cheque	17808	~~€4,500~~		€22,476 Cr
02/4	**Cheque**	**17806**	**€12,480**		€9,996 Cr
05/4	Lodgement			~~€24,642~~	€34,638 Cr
05/4	Cheque	17809	~~€1,584~~		€33,054 Cr
08/4	Cheque	17811	~~€17,610~~		€15,444 Cr
11/4	Lodgement			~~€20,244~~	€35,688 Cr
11/4	Cheque	17810	~~€21,375~~		€14,313 Cr
12/4	Cheque	17812	~~€2,295~~		€12,018 Cr
17/4	Lodgement			€23,661	€35,679 Cr
19/4	Cheque	17813	€14,862		€20,817 Cr
24/4	Lodgement			~~€25,977~~	€46,794 Cr
24/4	Cheque	17814	~~€14,421~~		€32,373 Cr
26/4	**Dividend**			**€246**	€32,619 Cr
26/4	**Bank charges**		**€62**		€32,557 Cr
26/4	Cheque	17817	~~€3,600~~		€28,957 Cr
28/4	Cheque	17816	~~€10,200~~		€18,757 Cr
30/4	**Direct debit**		**€1,320**		€17,437 Cr
30/4	Cheque	17819	~~€2,250~~		€15,187 Cr
30/4	**Standing order**		**€789**		€14,398 Cr

The first lodgement and cheques 17805 and 17806 are outstanding items from last month. €10,302 + €24,000 - €7,326 - €12,480 = €14,496 the opening cash book balance.

(a) <u>Corrected Cash Book</u>

Balance b/d	€21,441	Error cheque 17813	€36
Error lodgement	€330	Bank charges	€62
Dividend	€246	Direct debit	€1,320
		Standing order	€789
		Balance c/d	**€19,810**
	€22,017		€22,017
Balance b/d	**€19,810**		

(b) <u>Bank Reconciliation Statement</u>

Balance per bank statement		€ 14,398
Add outstanding lodgements		
30th April	€ 4,500	
30th April	<u>€ 22,596</u>	€ 27,096
Less unpresented cheques		
17,815	€ 14,025	
17,818	€ 624	
17,820	€ 1,326	
17,821	€ 3,207	
17,822	<u>€ 2,502</u>	<u>€ 21,684</u>
Balance per corrected cash book		**€ 19,810**

Chapter 9 Solution

Fixed Asset Account

		€			€
01/01/2002	Bal b/d	336,000	30/09/2002	Disposal a/c	120,000
01/07/2002	Bank a/c	178,000			
01/09/2002	Bank a/c	7,000	31/12/2002	Bal c/d	401,000
		521,000			521,000
01/01/2003	Bal b/d	401,000			

Provision For Depreciation Account

		€			€
30/09/2002	Disposal a/c	112,500	01/01/2002	Bal b/d	225,000
31/12/2002	Bal c/d	256,750	31/12/2002	P & L a/c	144,250
		369,250			369,250
			01/01/2003	Bal b/d	256,750

Disposal Account

		€			€
30/09/2002	Asset a/c	120,000	30/09/2002	Deprec. A/c	112,500
31/12/2002	P&L a/c	2,500	30/09/2002	Bank a/c	10,000
		122,500			122,500

P&L Account

31/12/2002	Prov. Dep. A/c	€144,250	31/12/2002	Disposal a/c	€2,500

Balance Sheet (Fixed Assets)

	Cost	**Acc. Dep**	**NBV**
Machinery	€401,000	(€256,750)	€144,250

Depreciation workings for disposal:

		€
1998	Cost	120,000
	Depreciation	**60,000**
	NBV	60,000
1999	Depreciation	**30,000**
	NBV	30,000
2000	Depreciation	**15,000**
	NBV	15,000
2001	Depreciation	**7,500**
	NBV	7,500

Total deprecation 112,500

Depreciation calculation for 2002:

	€	
Cost	401,000	*i.e. balance on machinery account*
Accumulated Depreciation	112,500	*(225000–112500)*
NBV before 2002 deprec.	288,500	
Depreciation 2002	**144,250**	*(288,500 x 50%)*

Chapter 10 Solution

Profit and Loss Extract

	2001	2002	2003	2004	2005
	€	€	€	€	€
Gross profit					
Add gains					
Bad debt recovered					1,000
Reduction bad debt provision			500	200	
Less expenses					
Bad debts		(28,000)	(39,000)	(22,000)	(40,000)
Specific provision bad debts					(3,500)
Increase bad debt provision	(4,000)	(750)			(75)
Increase discount provision				(1,539)	(29)

Balance Sheet Extract

	2001	2002	2003	2004	2005
	€	€	€	€	€
Debtors	80,000	95,000	85,000	81,000	86,000
Less bad debt provision	(4,000)	(4,750)	(4,250)	(4,050)	(7,625)
Less discount provision	0	0	0	(1,539)	(1,568)
	76,000	90,250	80,750	75,411	76,808

Workings	€	€	€	€	€
Provision bad debts					
New provision (5% of debtors)	4,000	4,750	4,250	4,050	4,125
Old provision	0	4,000	4,750	4,250	4,050
Adjustment	4,000	750	-500	-200	75
Provision discount					
New provision (2% of debtors – provision bad debts)				1,539	1,568
Old provision				0	1,539
Adjustment				1,539	29

Chapter 11 Solution

Sean Leahy

Trading and Profit and Loss Account for year ended 31 December 2005

	€	€	€
Sales		1,128,000	
- Returns in		(55,000)	1,073,000
Less cost of sales			
Opening stock		58,000	
Purchases	820,000		
+ Carriage in	15,000		
- Returns out	(78,000)	757,000	
Less closing stock		(72,000)	
Cost of sales			(743,000)
Gross profit			330,000
Add Gains			
Bad debts recovered		500	
Discount received		40000	
Rent received		20000	
Provision bad debts (reduction)		1,000	61,500
Less Expenses			
Bad debts		5,000	
Carriage out		10,000	
Discount allowed		12,000	
Insurance	9,000		
- Drawings	(800)		
- Prepayment	(3,200)	5,000	
Light and heat	13,000		
+ Accrual	700	13,700	
Marketing expenses			
Office expenses		60,000	
Postage & courier		1,500	
Repairs		12,000	
Telephone	8,000		
+ Accrual	200	8,200	
Wages & salaries		169,000	
Loan interest accrual		3,000	
Provision bad debts			
Provision discount		12,000	
Depreciation - buildings		7,000	
Depreciation - equipment		8,000	
Depreciation - fixtures		14,700	341,100
Net profit			50,400

Sean Leahy
Balance sheet as at 31December 2005

	€	€	€
Fixed Assets	*cost*	*depreciation*	*NBV*
Premises	350,000	(28,000)	322,000
Equipment	70,000	(38,000)	32,000
Fittings	98,000	(59,700)	38,300
	518,000	(125,700)	392,300
Current Assets			
Stock		72,000	
Debtors	250,000		
Less provision bad debts	(10,000)		
Less provision discount	(12,000)	228,000	
Bank		20,000	
Cash		5,000	
Prepaid expenses		3,200	
		328,200	
Current Liabilities			
Creditors	152,000		
Accrued expenses	900		
Loan interest accrued	3,000	(155,900)	172,300
Long Term Liabilities			
Loan			(50,000)
			514,600
Financed by			
Capital			480,000
Profit & loss			50,400
Drawings			(15,800)
			514,600

Chapter 12 Solution

The two options the Molloy brothers can evaluate are partnership and private company. Sole-trader is not an option because there will be more than one owner while a public company must have a minimum of 7 shareholders.

The choice therefore is partnership versus private company status.

Partnership	**Limited company**
Advantages 1. Simplicity and ease of set-up 2. The general lack of legal controls and restrictions 3. Privacy, as the accounts of partnerships are not required to be published	Advantages 1. The owner's liability is limited 2. Companies tend to have greater access to capital 3. The business continues despite the death or incapacity of an owner 4. Profits are taxed at the corporation tax rate of 12.5%
Disadvantages 1. Not protected by limited liability 2. The life of the partnership can be limited by agreement or by the life of the partners 3. Profits are taxed at income tax rates	Disadvantages 1. Are more regulated 2. It is more difficult to withdraw money from a company 3. Must file accounts with the companies registrar (lack of privacy)

If it is important to the brothers to have limited liability then the limited private company is the best option. They will also have profits taxed at corporate rates which are more favourable then been taxed at income tax rates. The main advantage of the partnership option is privacy and lack of regulation.

Chapter 13 Solution

Remember you were asked to CHOOSE FOUR concepts to describe

The Business entity concept

This concept states that the business is separate from the owner. Thus the items recorded in a firm's accounting records and books are limited to the transactions that affect the firm and will not concern themselves with the private transactions of the owner. The only transactions between the business and the owner that is recorded in the business records are

1. The owner investing resources (usually cash) in the business.
2. The owner taking out resources (usually cash or stock) from the business for his own use (termed drawings).

The Dual aspect concept

This concept states that there are two aspects of accounting. One represented by the assets of the business and the other by the claims against them (capital and liabilities). This concept states that these two aspects will always be equal.

The Money Measurement Concept

The assets of the business must be measured in some uniform way. Obviously this has to be in some monetary form. It follows that some assets of the business cannot appear on the balance sheet of a company because to put a monetary value on them would be too subjective. The most obvious example is the Human asset of a good work force or excellent management team. These assets cannot appear on the balance sheet, as it is very difficult if not impossible to put an objective monetary value on them. An example of an exception to this rule is football clubs.

The Realisation Concept

The concept clarifies when a business accounts for a transaction and thus the related profit or loss on the transaction. For example when is a sale a sale, or when is a purchase a purchase? When do we account for expenses? There are three clear stages in the life of a transaction.

1. The order stage
2. The transfer of goods and acceptance of liability by the purchaser
3. The payment or cash stage

Obviously if some businesses account for sales based on orders received (and some still try to do this to boost sales) and, other businesses account for sales based only on cash received, then there is no point in comparing the businesses performances as they recognise sales and profits at different time periods. The realisation concept holds to the view that a transaction should be accounted for at the transfer of goods and acceptance of liability stage not at the order stage. Effectively the realization concept tells us when to recognise the profits or loss on a transaction. It states that profits or losses on transactions can only be accounted for when realization has occurred. A number of criteria have to be observed before realisation can occur. The most critical of these is that goods or services have been provided to a buyer who accepts liability for them and the monetary value of the goods or services have been established. Ultimately it is essential that all businesses account for transactions on the same basis.

The Cost /Current Value Concept

In presenting financial statements a measurement basis must be chosen for each category of asset and liability. The choice is

- Historical cost: This is where the asset is valued at its initial transaction cost. This may be subsequently re-measured if the recoverable amount of the asset is lower than cost.
- Current value: This is where the asset is valued based on its current value at the time it was acquired. Assets and liabilities measured on the current value basis are carried at up to date current values and thus will be re-measured frequently. Re-measurement however will only be recognised if there is sufficient evidence that the monetary values of the asset /liability has changed and the new amount can be measured with sufficient reliability. For example once a business has decided to apply current values to its property assets then they will be constantly re-measured on the basis of an independent valuer assessment.

The Going Concern Concept

The going concern concept requires that in preparing the accounts we assume the business will continue into the foreseeable future. This ensures the basis of measuring and valuing assets and liabilities will remain at either cost or current value. If the accounts were to be prepared on the basis that the business was to be sold or about to go into liquidation then an alternative basis for valuing the assets would have to be considered including the break-up values for assets. Thus unless the business entity is in liquidation or the directors have no alternative but to cease trading or liquidate then the going concern basis will apply and all assets and liabilities will be valued at historic cost or current value whichever is appropriate.

The Accruals Concept

The calculation of profit is based on the accruals concept, which requires that the effects of transactions should be accounted for when they occur and are included in the statements for the periods they relate to. Knowledge of this concept is essential in understanding the net profit figure and the differences between cash and profit.

The accruals concept requires two things

1. When calculating net profit expenses should be matched against related revenues. Thus in the trading account if 100 units are sold in January then only the cost of 100 units is deducted in calculating gross (trading) profit. In the profit and loss section only the expenses of January is deducted when calculating net profit for January. In the trading account of a product-based company purchases are matched to sales on a unit basis, and in the profit and loss account expenses are matched on a time basis. For a service company all expenses are matched on a time basis.
2. Net profit is the difference between revenues earned (not necessarily received) and expenses charged (not necessarily paid). Thus net profit is worked on a transactions basis. That is, if a transaction occurs it should be accounted for irrespective of whether cash has passed hands. Thus revenues and expenses are accounted for as soon as an invoice has been issued and liability has been accepted. For businesses that buy and sell on credit, sales and purchases in the trading account will be a mixture of cash and credit transactions. Also, expenses that relate to a period will be deducted from sales in the calculation of net profit for that period whether those expenses are paid or not. Any unpaid expenses will also be shown in the balance sheet under liabilities.

The Prudence Concept

The intention of the prudence concept is to see that all asset values and profit figures are realistic rather than optimistic or pessimistic. The essence of the concept is to insist that revenue or profit should not be accounted for until the business is virtually certain to get it, but that a loss in an assets value is accounted for as soon as it is probable or likely. The ability to reasonably measure the asset or liability is also necessary to ensure the reliability of the accounts. Ultimately the prudence concept requires that in preparing financial statements, gains or losses, assets and liabilities should not be overstated or understated.

This concept requires.

1. That one should never anticipate profits. This can be explained by asking when does a company account for a sales transaction? A sales transaction should only be accounted for when ownership of the goods passes from the company to the buyer and not when the goods were originally ordered. To account for the transaction at the order stage would be imprudent. This is related to the realization concept outlined in chapter 3.
2. One must provide for all possible losses. If a company knows that next year it will incur losses on a part / section of the business then it should provide for those losses <u>now</u>. To provide for something is to treat it as a loss <u>now</u>. In other words show it as a loss/expense in the profit and loss account. However a provision should only be recognised and accounted for when the following criteria apply
    - It is probable that a transfer of economic benefits will have to occur.
    - A reasonable estimate of the amount involved can be made.

A good example of the prudence concept is with regard to bad debts. If a company becomes aware just prior to the year end that a debtor is likely to go into 'liquidation' and cease trading, then prudence requires a provision in the accounts for this future loss.

The Consistency Concept

The consistency concept requires that when a business has decided on an accounting treatment for an item it will account for all similar items in the same way. The objective of the consistency concept is to ensure accounts are more comparable. Consistency arose due to the belief that if accounts are not prepared on a consistent basis using similar accounting policies and assumptions then any comparison will not just be meaningless but also misleading. However the consistency concept is not rigid and should the directors feel that the "truth and fairness" of the accounts are impaired by rigidly sticking to the particular accounting policy they can change it but the reason for the change and the effect of the change must be explained.

Materiality Concept

The materiality concept recognises that some transactions are not sufficiently important to waste time and effort in ensuring the correct accounting treatment. For example a hotel company purchases a cleaning machine which has an estimated life of 5 years for €60. Should a company treat this as a fixed asset and depreciate accordingly or write it off as an expense in the period purchased. In this case the €60 cost implies this is not a material item and thus should be written off as an expense in the period purchased.

Information is considered material if its omission or misstatement could influence the economic decisions of the various user of account. What represents a material value will differ from business to business as some businesses can fix their materiality level at €1,000 while another fixes at €200. The bottom line is if the cost of accounting for a transaction in the correct manner is greater than the value of the transaction then the amount in question would not be considered material.

Chapter 14 Solution

Night Life Limited
Trading and Profit and Loss Account for year ended 31/1/2006

	€	€
Sales		876,000
Opening stock	68,000	
Purchases	368,000	
Less closing stock	(84,000)	
Cost of sales		(352,000)
Gross profit		524,000
Administration	251,500	
Distribution	121,400	
Annual depreciation - equipment	10,000	
Annual depreciation - fixtures	22,400	(405,300)
Net operating profit		118,700
Interest paid	11,500	
Interest due	12,500	(24,000)
Net profit before tax		94,700
Corporation tax		(14,000)
Net profit after interest and tax		80,700
Transfer to reserves		(18,000)
Dividend policy		
Interim ordinary dividend	20,000	
Provision preference dividend	9,000	
Proposed final dividend	21,600	(50,600)
Retained profit current year		12,100
Retained profit b/f		78,000
Retained profit c/f		90,100

Night Life Limited
Balance sheet as at 31/1/2006

	€	€	€
	Cost	*Accumulated Depreciation*	*N.B.V*
Fixed Assets			
Buildings			1,000,000
Equipment	100,000	72,000	28,000
Fixtures	200,000	110,400	89,600
	300,000	182,400	1,117,600
Current Assets			
Stock	84,000		
Debtors	6,000		
Bank	71,600		
VAT refund due	4,000	165,600	
Current Liabilities			
Creditors	88,000		
Debenture interest	12,500		
Corporation tax	14,000		
Preference share dividend	9,000		
Ordinary share dividend	21,600	145,100	20,500
Long Term Liabilities			
10% Debentures			240,000
			898,100
Capital and Reserves			
Share capital			
Ordinary share capital			360,000
Preference share capital			100,000
Reserves			
Share premium			80,000
Revaluation reserve			180,000
Retained profit			90,100
General reserve			88,000
			898,100

Chapter 15 Solution

a) Cash flow statement

	€'000	€'000
Net cash flow operating activities		
net profit before interest and tax		2,420
Adjust for non cash items		
Depreciation	970	
Loss on sale of fixed assets	250	1,220
Adjust for increases/ decreases in working capital		
Stock	23	
Debtors	(6)	
Creditors	(60)	
Prepayments	(2)	
Accruals	3	(42)
		3,598
net cash flow return on investment /servicing of debt		
Interest paid		(416)
Net Cash flow taxation		
Tax paid		(470)
Net cash flow capital expenditure		
Sale of fixed assets	170	
Purchase of fixed assets	(2508)	(2,338)
Dividends		(500)
management of Liquid resources		
Short-term investments		(13)
Financing		
Issue of debentures	119	
Redemption of bank loans	(200)	(81)
		(220)

Overall cash flow	2003	2004	NCF
	€'000	€'000	€'000
Bank	120	0	(120)
Bank loans and overdrafts	0	100	(100)
			(220)

b) Movement in net debt

Calculation of net debt	**2003**	**2004**	
	€'000	€'000	€'000
Cash	120	(100)	(220)
Debt	(5,281)	(5,200)	81
	(5,161)	(5,300)	(139)

Reconciliation of movements in net cash flow to movements in net debt

	€'000
Movement in cash	(220)
Movements in debt	81
	(139)
Net debt 1/1/04	5,161
Net debt 31/12/04	5,300

Chapter 16 Solution

Ratio Analysis – Debenhams plc

			2002		2001
PROFITABILITY					
Gross profit margin	Gross profit x 100 / Sales	£240 / £1,689	**14.2%**	£231 / £1,607	**14.4%**
Net profit margin	Net profit (PBIT) x 100 / sales	£162 / £1,689	**9.6%**	£157 / £1,607	**9.8%**
Expenses to sales	Expenses x 100 / sales	£79 / £1,689	**4.7%**	£74 / £1,607	**4.6%**
ROCE	Net profit (PBIT) x 100 / Capital Employed	£162 / £785	**20.6%**	£157 / £728	**21.5%**
ROOE	Net profit after int. & tax x 100 / Shareholders funds	£109 / £725	**15.0%**	£102 / £669	**15.3%**
EFFICIENCY					
Fixed asset turnover	Sales / Fixed assets	£1,689 / £939	**1.8 : 1**	£1,607 / £876	**1.84 : 1**
Total asset turnover	Sales / Total assets	£1,689 / £785	**2.15 : 1**	£1,607 / £728	**2.21 : 1**
Stock Turnover	Cost of Sales / Average stock	£1,448 / 207.3	**7 times**	£1,376 / 211.1	**6.5 times**
Stock days	Average stock x 365 / Cost of sales	207.3 / £1,448	**52.3 days**	211.1 / £1,376	**56 days**
Debtors days	Trade debtors x 365 / Credit sales	£20 / £1,689	**4.3 days**	£17 / £1,607	**3.8 days**
Creditors days	Trade creditors x 365 / Credit purchases	£70 / £1,441	**17.7 days**	£60 / £1,376	**16 days**
LIQUIDITY					
Current ratio	Current Assets / Current Liabilities	£291 / £384	**0.76 : 1**	£270 / £365	**0.74 : 1**
Quick-acid test ratio	Current Assets - Stock / Current Liabilities	£88 / £384	**0.23 : 1**	£59 / £365	**0.16 : 1**

RISK					
Gearing	Fixed interest debt / Shareholders funds	£59 / £785	**0.08 : 1**	£59 / £728	**0.08 : 1**
Interest cover	Net profit (PBIT) / Interest	£162 / £6	**25.3 : 1**	£157 / £8.2	**19.1 : 1**
INVESTMENT					
Earnings per share	Net profit after Int & tax / Number of shares	£109 / 365.9	**29.8 pence**	£102 / 367	**27.9 pence**
Price earnings ratio (P/E)	Market price of share / EPS	n/a / 29.8	**n/a**	n/a / 27.9	**n/a**
Dividend cover	Profit available to pay dividend / Dividends paid and proposed	£109 / £46	**2.4 times**	£102 / £43	**2.4 times**
Dividend yield	Dividend per share x 100 / Market price per share	0.126 / n/a	**n/a**	0.117 / n/a	**n/a**

Chapter 17 Solution

Profit Statement using Departmental approach

	Outdoor Sports	Indoor Sports	Swimming Pool	All Weather Surfaces	Total
	€	€	€	€	€
Sales	60,000	75,000	75,000	90,000	300,000
Less specific department costs	(10,000)	(38,000)	(52,000)	(44,000)	(144,000)
Departmental profit	**50,000**	**37,000**	**23,000**	**46,000**	**156,000**
Expenses					
Light & Heat					(10,000)
Rent & Rates					(30,000)
Administration					(52,000)
Advertising & marketing					(12,000)
Total expenses					(104,000)
Net Profit					**52,000**

Profit Statement using Net Profit approach

	Outdoor Sports	Indoor Sports	Swimming Pool	All Weather Surfaces	Total
	€	€	€	€	€
Sales	60,000	75,000	75,000	90,000	300,000
Less specific department costs	(10,000)	(38,000)	(52,000)	(44,000)	(144,000)
Departmental profit	**50,000**	**37,000**	**23,000**	**46,000**	**156,000**
Expenses					
Light & Heat	(4,000)	(1,500)	(1,500)	(3,000)	(10,000)
Rent & Rates	(12,000)	(4,500)	(4,500)	(9,000)	(30,000)
Administration	(10,400)	(18,200)	(15,600)	(7,800)	(52,000)
Advertising & marketing	(2,400)	(3,000)	(3,000)	(3,600)	(12,000)
Total expenses	(28,800)	27,200	(24,600)	(23,400)	(104,000)
Net Profit	**21,200**	**9,800**	**(1,600)**	**22,600**	**52,000**