Exercise walk-through

2.3
Accruals and adjustments

University Business

Double entry and ledgers: debits left, credits right

The week posted: debits left, credits right

Cash

20,000	6,000
15,000	
3,000	
38,000	**6,000**

Equipment

6,000	
6,000	**0**

Inventory

4,000	1,200
4,000	**1,200**

Cost of sales

1,200	
1,200	**0**

Loan

	15,000
0	**15,000**

Payables

	4,000
0	**4,000**

Share capital

	20,000
0	**20,000**

Revenue

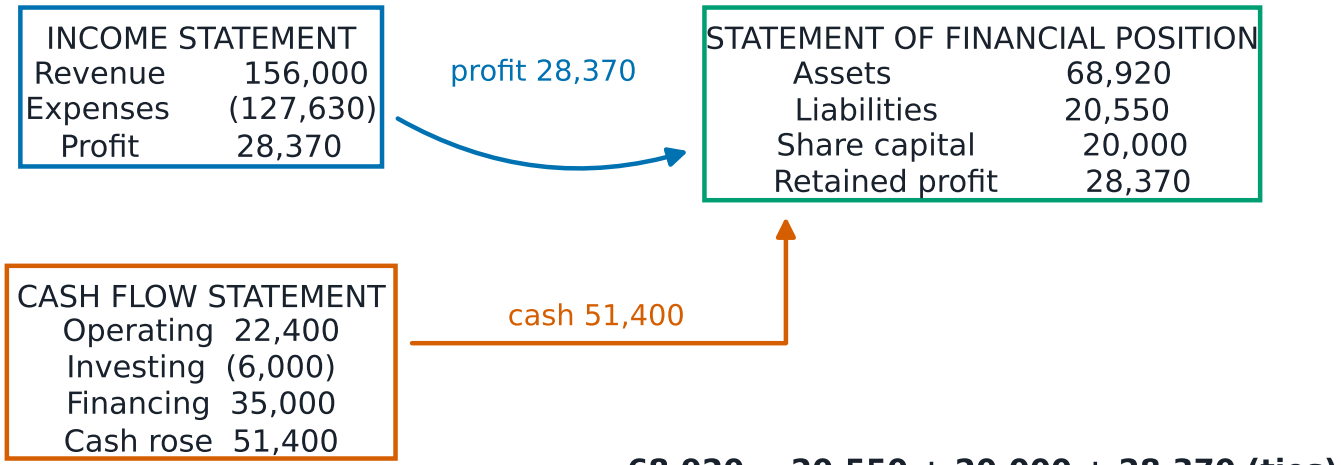
	3,000
0	**3,000**

Trial balance: Dr 32,000 + 6,000 + 2,800 + 1,200 = 42,000
= Cr 15,000 + 4,000 + 20,000 + 3,000 = 42,000

The week posted to six T-accounts; the **trial balance** ties at 42,000.

Financial statements: one profit, one cash

One profit, one cash: the statements close against each other

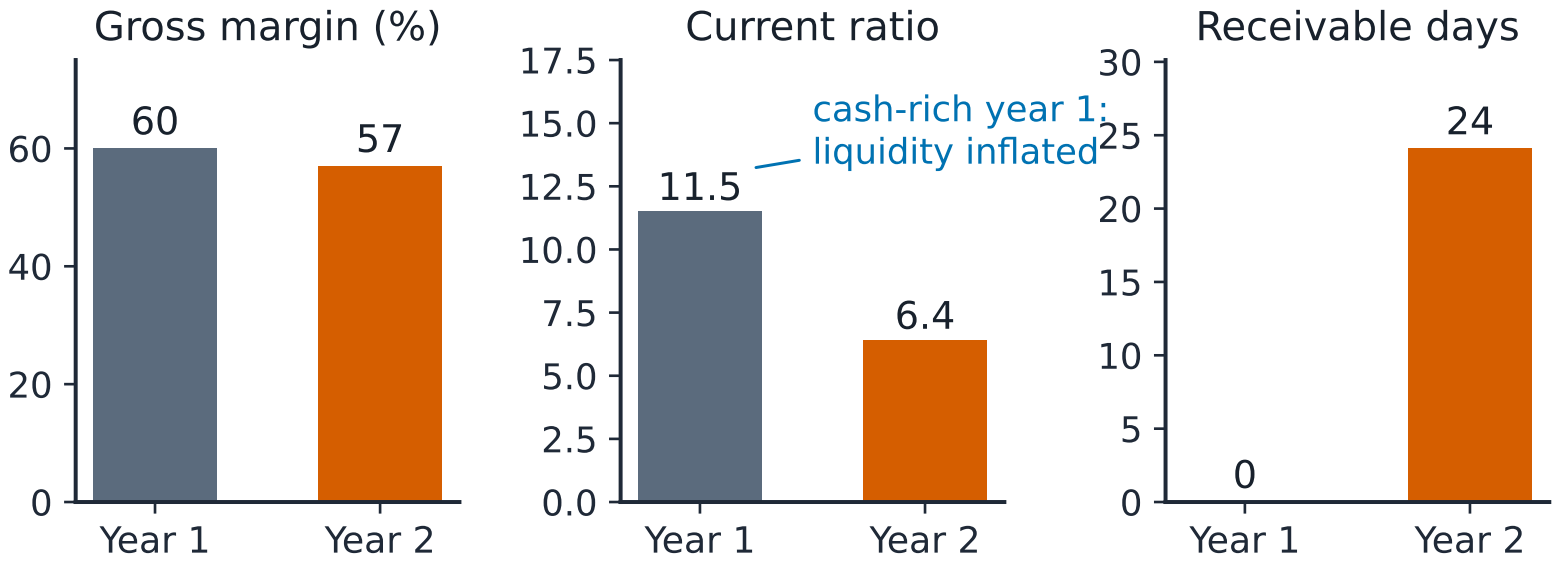


68,920 = 20,550 + 20,000 + 28,370 (ties)

Profit flows to equity; closing cash lands on the balance sheet.

Ratios and their limits: windows that frame

Every ratio is a window - and windows frame what they show



Margin 60% to 57%, **current ratio** 11.5 to 6.4: year 1 is distorted.

Exercises 2.1·2.2

2.1 Rent of £9,600 a year is paid on 1 November; the year ends 31 December. Compute the year's expense and the prepayment asset, and check they sum to the cash paid. [3]

2.2 Equipment costs £9,000 with a £500 residual over four years. Compute the annual depreciation and the carrying amount after one year. [3]

Exercises 2.1·2.2

2.1 Rent of £9,600 a year is paid on 1 November; the year ends 31 December. Compute the year's expense and the prepayment asset, and check they sum to the cash paid. [3]

2.1

- Expense $= 9{,}600 \times 2/12 = 1{,}600$.
- Prepayment $= 9{,}600 \times 10/12 = 8{,}000$.
- Check: $1{,}600 + 8{,}000 = 9{,}600$ ✓.

2.2 Equipment costs £9,000 with a £500 residual over four years. Compute the annual depreciation and the carrying amount after one year. [3]

2.2

- Depreciation $= (9{,}000 - 500)/4 = 2{,}125$ a year.
- Carrying amount after one year $= 9{,}000 - 2{,}125 = 6{,}875$.

Exercise 2.3

2.3 Wages expense is stated as £34,000, of which £1,100 relates to next year's January rota... state what belongs in this year's profit and what stands on the balance sheet. [3]

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2.3

- If £1,100 of the 34,000 is NEXT year's cost, the year's wage expense is 32,900.
- The 1,100 stands as... it was PAID this year but belongs to next year, so it is a prepayment asset of 1,100.
- Profit takes 32,900; the balance sheet carries a 1,100 prepayment.

Exercise 3.1

3.1 A café's year to 31 December: revenue £98,000 (cash 92,000, receivables 6,000); cost of sales £36,400; wages £34,000 (of which £800 accrued); rent as practice 2.1; other costs £7,300 paid; electricity £180 received unpaid; equipment depreciation £2,125; a £25,000 loan at 5% with the year's interest unpaid. Compute the year's profit. [7]

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3.1

- Gross profit = 98,000 − 36,400 = 61,600.
- Rent expense = 1,600 (practice 2.1).
- Wages 34,000 (the accrued 800 is inside it).
- Interest = 25,000 × 5% = 1,250, accrued.
- Profit = 98,000 − 36,400 − 34,000 − 1,600 − 7,300 − 180 − 2,125 − 1,250 = 15,145.
- Gross margin check: 61,600/98,000 = 62.9%.

Exercise 3.2

3.2 The owner says: ”We paid £9,600 rent and £1,250 loan interest, so profit should fall by £10,850.” Correct the reasoning with the two accrual ideas it misses. [3]

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3.2

- The rent’s cash year and expense year differ: only 1,600 of the 9,600 belongs to this year; 8,000 is next year’s, held as a prepayment.
- The interest: $25{,}000 \times 5\% = 1{,}250$ matches the cash – here cash and expense coincide only because the loan ran the full year and interest is unpaid-but-accrued; had it been paid in advance it would mirror the rent.
- The correction: profit falls by the MATCHED costs (1,600 rent + 1,250 interest = 2,850 of the owner’s 10,850), the rest is timing, not expense.