Exercise walk-through

2.4
Financial statements

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**

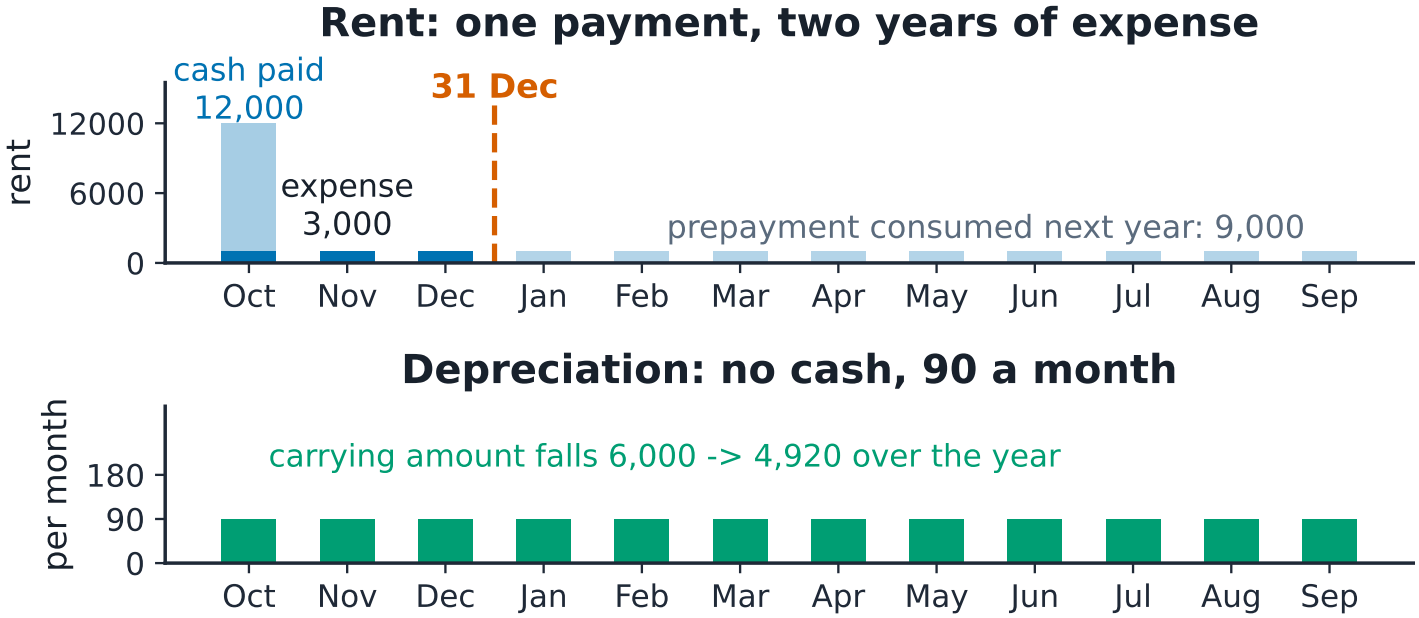
Revenue

	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.

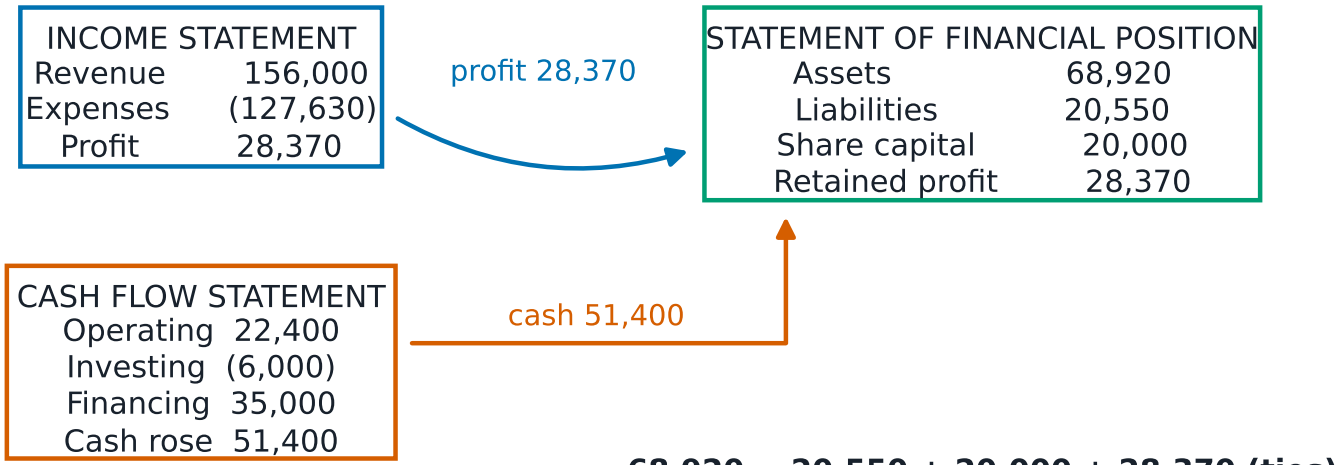
Accruals and adjustments: two timetables



Rent: cash in October, **expense** spread; **depreciation**: expense, no cash.

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.

Exercises 2.1·2.2

2.1 From Nimbus's figures, restate the income statement in the "non-accountant" order: what came in, what the bread cost, what running the business cost, what was left – and give each subtotal. [4]

2.2 Nimbus pays a £5,000 dividend from year-1 profit. State the effect on the income statement and on the balance-sheet equity. [3]

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2.1

- What came in: revenue 156,000.
- What the bread cost: 62,400, leaving gross 93,600 (60.0%).
- Running the business: 52,000 + 3,000 + 8,000 + 1,080 + 250 + 900 = 65,230.
- What was left: 93,600 − 65,230 = 28,370 ✓.

2.2 Nimbus pays a £5,000 dividend from year-1 profit. State the effect on the income statement and on the balance-sheet equity. [3]

2.2

- No income-statement effect: dividends distribute profit, they are not an expense.
- Equity falls to 20,000 + 28,370 − 5,000 = 43,370.
- Cash falls 5,000; the balance sheet re-ties at both totals 63,920.

Exercise 2.3

2.3 A junior drops the depreciation line from the balance sheet's equipment entry. Quantify both effects of that single omission. [3]

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- Assets overstated by 1,080 (equipment at 6,000 not 4,920).
- Equity overstated by 1,080 (profit overstated, depreciation missed).
- The balance sheet still ties – the omission is symmetric, which is why it is caught by review, not by the tie.

Exercise 3.1

3.1 The café of sheet 2.3, fully assembled: owner contributed £20,000 and took a £25,000 loan (5%, interest unpaid) on 1 January; equipment £9,000 bought for cash; purchases £39,000 paid (closing inventory £2,600); revenue £98,000 of which £6,000 is receivables; wages £34,000 with £800 accrued; rent £9,600 paid (£1,600 expensed); other costs £7,300 paid; electricity £180 unpaid. Assemble the statement of financial position and verify the tie. [7]

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3.1

- Cash: $20{,}000 + 25{,}000 + 92{,}000 - 9{,}000 - 39{,}000 - 33{,}200 - 9{,}600 - 7{,}300 = 38{,}900$.
- Assets: $38{,}900 +$ receivables $6{,}000 +$ prepayment $8{,}000 +$ inventory $2{,}600 +$ equipment $6{,}875 = 62{,}375$.
- Liabilities: wages $800 +$ electricity $180 +$ interest $1{,}250 +$ loan $25{,}000 = 27{,}230$.
- Equity: $20{,}000 +$ profit $15{,}145 = 35{,}145$.
- Tie: $27{,}230 + 35{,}145 = 62{,}375$ ✓ (machine-verified).

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3.2

- Every transaction is recorded as a double effect that preserves the equation, so the totals cannot drift apart.
- Profit flows into equity by definition; cash lands in assets by definition.
- The balance is an identity of the definitions – errors hide INSIDE the sides, which is why review is needed.