AS Level Accounts: Financial Accounting

Preparation of Financial Statements

Lesson 1.28

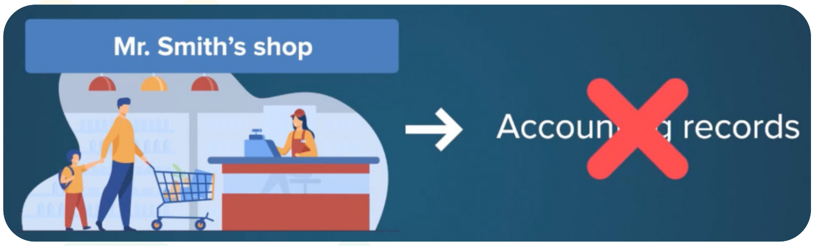
Sole Traders II

Revision Notes

Candidates should have an understanding of:

- How to prepare a statement of profit or loss and a statement of financial position for a sole trader from incomplete accounting records. The business may be a trading or a service business

- **Small cash-based** organisations, such as **grocers** and **vendors** keep **incomplete records** of their **transactions.** It's because there is **no statutory requirement** for such businesses to **maintain** a **full set** of accounting records.



  - However, they have to **determine** the **profit or loss for the year** and the **financial position** of the business at the **end of the year.**

- The **profit or loss for the year** of small **cash-based** businesses is **derived** from the **capital section** of the **statement of financial position.** It is calculated by comparing the **net assets (capital)** at the **beginning** of the year with the **net assets** at the **end** of the year.

Particulars	Amount ($)
Closing capital	xxx
Less: Opening capital	(xxx)
Retained profit	**xxx**
Add: Drawings	xxx
	xxx
Less: Capital introduced	(xxx)
Profit (loss) for the year	**xxx**

  - Sometimes, the **proprietor** may **take out** the **cash** or **goods** for **private use** from the business, these **withdrawals** of the **owner** are considered as **drawings** and **added** to the **retained profits.**

- A **statement of affairs** is a **list** of **assets, capital,** and **liabilities** prepared without using **double-entry records.** It looks **similar** to the **statement of financial position** but the only difference is that the **capital** is a **balancing figure** in the **statement of affairs.**

Statement of affairs, for the year ended, 31 Dec, xxxx		
	$	**$**
Assets		
Non-current assets:		
Land	xxx	
Building	xxx	
Equipment	xxx	xxx
Current assets:		
Inventory	xxx	
Trade receivables / Debtors	xxx	
Other receivables:		
Prepaid expenses	xxx	
Accrued income	xxx	
Bank / Cash	xxx	xxx
Total assets		xxx
Capital and liabilities		
Opening capital	xxx	
Add: Profit for the year	xxx	
Add: Capital introduced	xxx	
Less: Drawings	(xxx)	xxx
Non-current liabilities		
Long-term loans	xxx	xxx
Current liabilities		
Trade payables / Creditors	xxx	
Bank overdraft	xxx	
Other payables:		
Outstanding / Accrued expenses	xxx	
Advance income	xxx	xxx
Total capital and liabilities		xxx

  - An **opening statement of affairs** lists all the **assets, capital** and **liabilities** at the **beginning** of the **relevant** accounting period. The **difference** between the **two sides** or the **balancing figure** is **opening capital.**
  - A **closing statement of affairs** lists all the **assets, capital** and **liabilities** at the **end** of the **relevant accounting period**. The **difference** between the **two sides** or the **balancing figure** is **closing capital.**

- Generally, there are **five stages** in the preparation of the **statement of profit or loss** and the **statement of financial position** of a sole proprietorship from **incomplete accounting records.**

Step 1 : Prepare opening statement of affairs

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Step 2 : Compile the summary of bank transactions

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Step 3 : Compile the summary of cash transactions

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Step 4 : Calculate the total sales for the year and total purchases for the year

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Step 5 : Preparation of financial statements

- All the **debit items** and **credit items** are **listed** in the **format** of the **sales ledger control account** and the **balancing figure** would be the amount of **total credit sales.** After calculating the **total credit sales,** we add the **total cash sales** and **credit sales** to calculate the **total sales.**

Total debtors account or Sales ledger control account

Dr.	$		Cr. $
Balance b/d (Opening balance)	XXX	Bank/Cash (payment received)	XXX
Credit sales (Balancing figure)	XXX	Discount allowed	XXX
Dishonoured cheques (bank)	XXX	Return inward/ Sales return	XXX
Interest charged to debtors	XXX	Control-PLCA	XXX
		Bad debts	XXX
		Balance c/d	XXX
	XXX		XXX
Balance b/d	XXX		

Total sales = Cash sales + Credit sales

- The **purchases ledger control account** is constructed by **listing** all the **debit items** and **credit items** to calculate the amount of **total credit purchases**. After calculating the **total credit purchases**, we add the **total cash purchases** and **credit purchases** to calculate the **total purchases**.

Total creditors account or Purchases ledger control account

Dr.	$		Cr. $
Bank (payment made)	XXX	Balance b/d (Opening balance)	XXX
Discount received	XXX	Credit purchases (balancing figure)	XXX
Return outward	XXX	Interest charged to debtors	XXX
Contra-SLCA	XXX		
Balance c/d	XXX		
	XXX		XXX
		Balance b/d	XXX

Total purchases = Cash purchases + Credit purchases

- **Markup** is the **profit percentage** applied to the cost of **sales**. It is **calculated** by **dividing gross profit** by the **cost of sales** and then multiplying it by **100.**

$$\text{Markup} = \frac{\text{Gross profit}}{\text{Cost of sales}} \times 100$$

- **Margin** is the **profit percentage** applied to **sales**. It is calculated by dividing **gross profit** by **sales** and then multiplying it by **100.**

$$\text{Margin} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

Here's an example of an examination question on this topic:

Rikesh had an opening capital of $40 000. He withdrew $12 000 as drawings during the year, and his net assets were $80 000 at the end of the year, which resulted in a bank overdraft of $28 000.

What was the profit during the first year?

a. $68 000
b. $62 000
c. $40 000
d. $52 000

Answer: D

The profit or loss for the year is derived by considering the change in net assets and the drawings during the year. The change in net assets is 40 000 dollars, and the drawings are 12 000 dollars, which totals the profit for the year of 52 000 dollars. Therefore, the answer is D.