

Final Accounts of a Sole Trader

Introduction

The sole trader is both the oldest and the most common form of business enterprise. There is one person legally and personally responsible for the business and that is the owner. The sole trader accounts for a very high percentage of Irish businesses despite the limited liability offered by other forms of enterprise. A sole trader is a person who has set up a business with the intention of making a profit. Examples of sole traders include butchers, newsagents, solicitors, mechanics and publicans. There are both advantages and disadvantages to being a sole trader let's take a look at some.

Advantages:

The sole trader

- Keeps all profits earned in the business
- Has the ability to make all the business decisions
- Is relatively easy to set up, it avoids a lot of legal procedures for setting up a business

Disadvantages

The sole trader

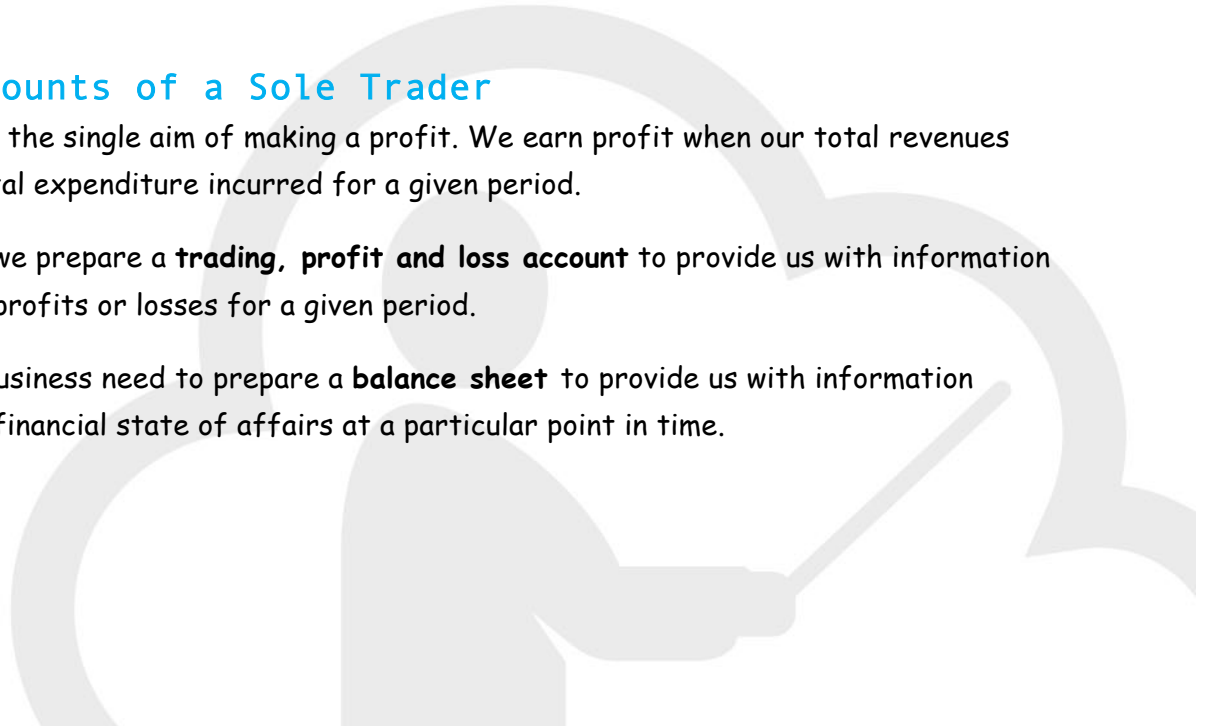
- Takes on all of the responsibility of the business
- Is liable for all the debts of a business even to the extent of having to sell personal property to cover debts owed
- Is limited in its capacity to extract extra capital for expansion

Final Accounts of a Sole Trader

A business has the single aim of making a profit. We earn profit when our total revenues exceed our total expenditure incurred for a given period.

As a business we prepare a **trading, profit and loss account** to provide us with information regarding our profits or losses for a given period.

We also as a business need to prepare a **balance sheet** to provide us with information regarding our financial state of affairs at a particular point in time.



Trading Account

We use the trading account to establish how much the revenue received from sales exceeds the cost of these same goods.

The difference between these two figures is called **gross profit**. If the sales figure is less than the cost of goods sold the resulting difference is referred to as a **gross loss**.

Sales refer to all cash and credit sales (net of returns inwards) of goods in which the trader normally deals.

Cost of goods **sold** is arrived at as follows:

Opening stock of goods for resale

Add Purchases (cash and credit) of goods for resale
+ Carriage on purchases
+ Duties on purchases
= Cost of goods available for sale
Less Closing stock of goods for resale
= Cost of goods sold for the period
GP = Sales less cost of goods sold
NP = Gross Profit less net expenses for the period

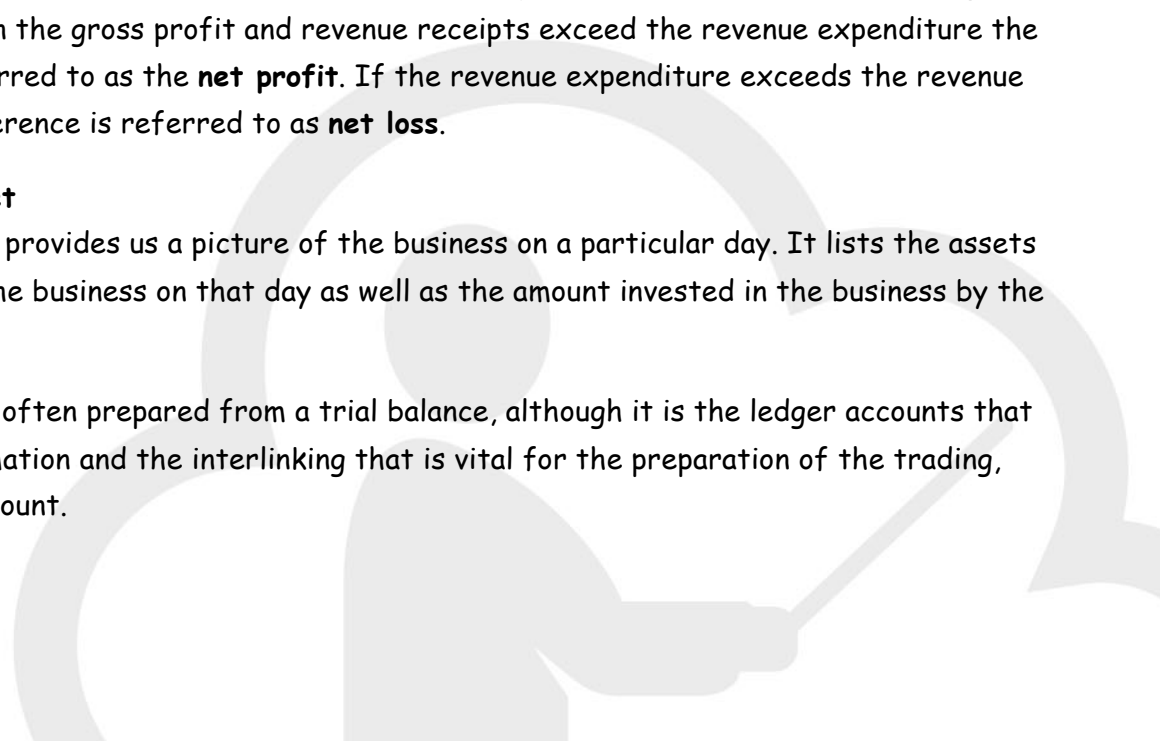
Profit & Loss Account

We use the profit and loss account to ascertain the net profit or loss of a business during a given period. When the gross profit and revenue receipts exceed the revenue expenditure the difference is referred to as the **net profit**. If the revenue expenditure exceeds the revenue receipts, the difference is referred to as **net loss**.

The Balance Sheet

The balance sheet provides us a picture of the business on a particular day. It lists the assets and liabilities of the business on that day as well as the amount invested in the business by the owner (capital).

Final accounts are often prepared from a trial balance, although it is the ledger accounts that provide the information and the interlinking that is vital for the preparation of the trading, profit and loss account.



Bookkeeping

Things we need to keep in mind:

Assets and expenses are on the debit side of the trial balance.

Liabilities and gains are on the credit side of the trial balance.

Add expenses due.

Add gains due.

Less expenses prepaid.

Less gains prepaid.

Expenses due are a current liability.

Gains due are a current asset.

Expenses prepaid are a current asset.

Gains prepaid are a current liability.

Expenses are usually classified into two columns:

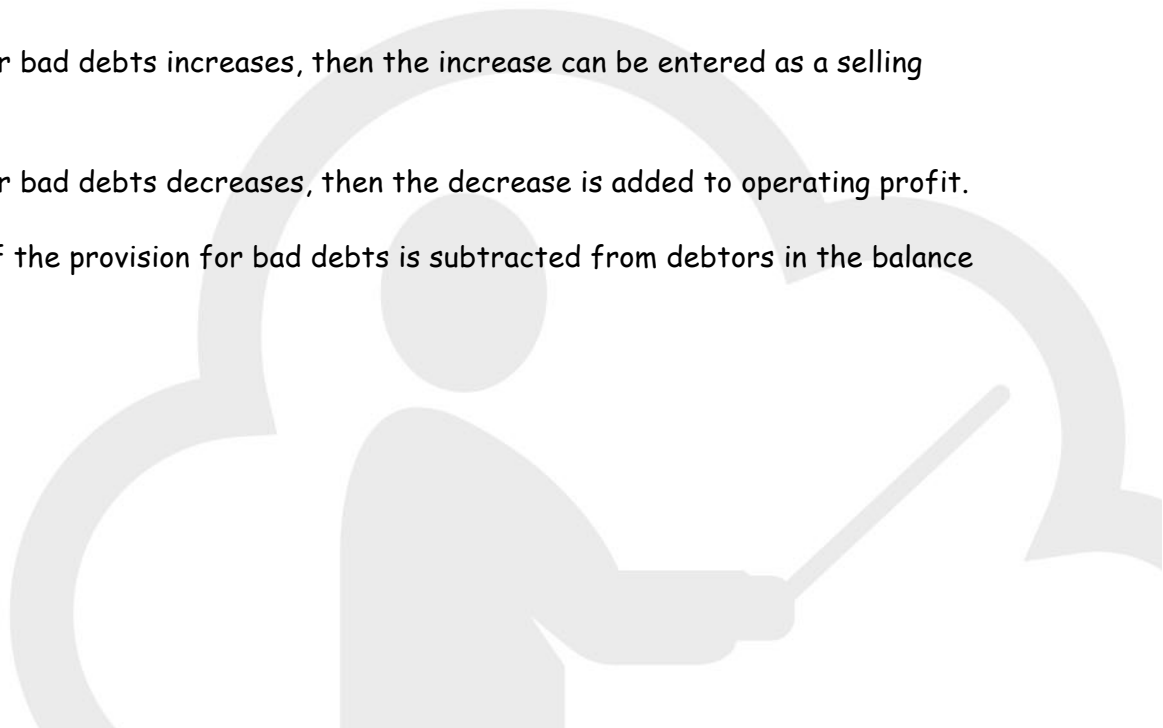
Administration (indirect running expenses)

Selling & Distribution (expenses incurred in trying to create sales).

If the provision for bad debts increases, then the increase can be entered as a selling expense.

If the provision for bad debts decreases, then the decrease is added to operating profit.

The new balance of the provision for bad debts is subtracted from debtors in the balance sheet.



Classifications

Fixed Assets

These are assets that are held in a business and are not for resale, such as buildings, vehicles and equipment.

Current Assets

These assets values are constantly changing in line with the activity of the business. They are usually held for a short duration in a business and include stock, debtors, cash and prepayments.

Current Liabilities

These are debts that are payable within one year e.g. creditors and bank overdraft. These can be referred to as creditor's amounts falling due within 1 year.

Long-term Liabilities

These are debts owed that do not have to be paid back for more than a year from the date of the balance sheet i.e. bank loans and mortgages.

Working Capital

This is the amount by which the current assets exceed the current liabilities. It illustrates a business's capability to repay its debts.

Capital

This is the total of the owner's investment in the firm. It is the amount owed by the firm to the owner. It is the capital invested plus the profit less the drawings.

These items are set out in the form of a balance sheet on the last day of the period in question. A balance sheet shows how the finance invested in the business is being used and who has provided the finance.

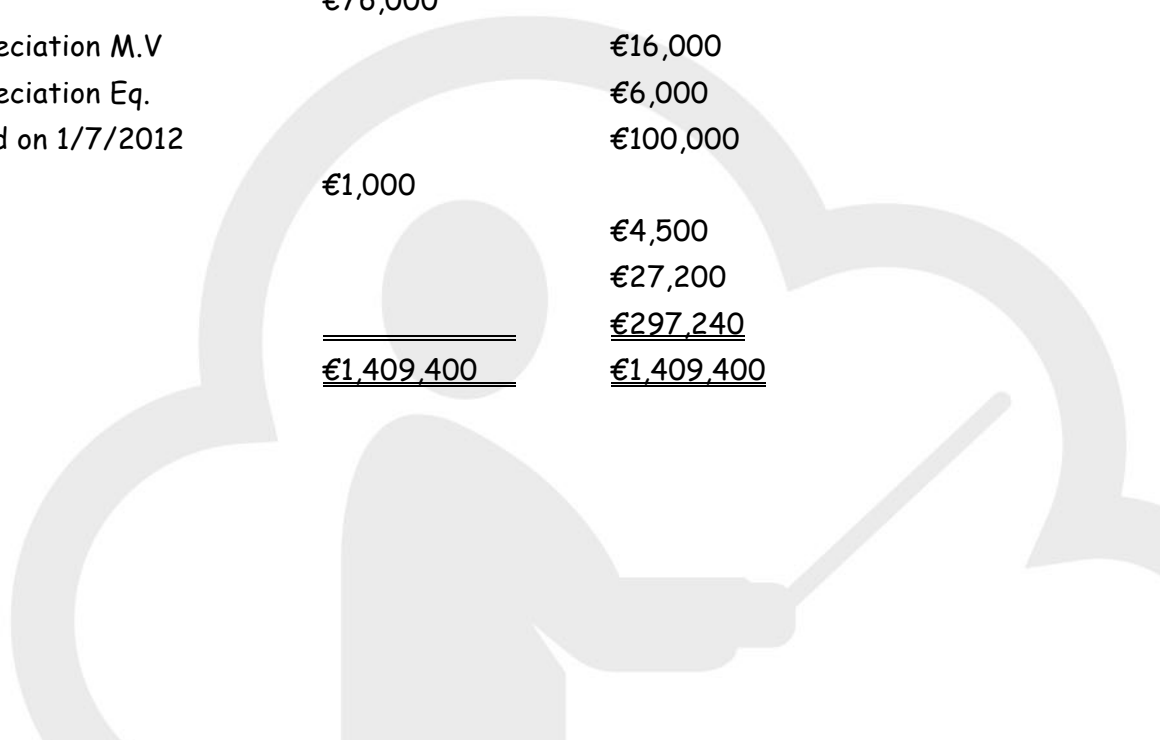


Let's take a look at an example question

Q 8.1

The following balances were extracted from the books of J. Watson, a sole trader on 31/12/2012:

Purchases and sales	€340,000	€890,000
General expenses	€24,000	
Wages and salaries	€102,000	
Carriage inwards	€1,000	
Returns out		€7,860
Stocks, 1/1/2012	€46,000	
Rent received		€28,000
Showroom expenses	€28,800	
Returns in	€16,000	
Carriage out	€10,000	
Goodwill	€40,000	
Discount	€2,000	
Advertising	€15,000	
Stationery	€9,600	
Provision for bad debts		€1,600
Debtors and creditors	€45,000	€31,000
Drawings	€25,000	
Buildings	€600,000	
Equipment	€28,000	
Motor vehicles	€76,000	
Accumulated depreciation M.V		€16,000
Accumulated depreciation Eq.		€6,000
Term loan received on 1/7/2012		€100,000
VAT	€1,000	
PRSI		€4,500
Bank		€27,200
Capital		€297,240
	<u>€1,409,400</u>	<u>€1,409,400</u>



You are given the following additional information:

- a) Stock at 31/12/2012 was €49,000
- b) Advertising is for the year ended 31/4/2013
- c) Stock of stationery on hand at 31/12/2012, €600
- d) Rent received due, €300
- e) The provision for bad debts is to be adjusted to 5% of the debtors
- f) Provision should be made for interest due on loan at the rate of 5% per annum
- g) Depreciation is to be provided as follows:
 - Buildings 2% of cost
 - Equipment 10% of cost
 - Motor vehicles 20% of book value
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You are asked to show:

- a) A trading, profit and loss account for the year ended 31/12/2012
- b) A balance sheet as at 31/12/2012

Trading and Profit and Loss Account of J. Watson for the year ended 31/12/2012			
Sales			€ 890,000.00
Less returns in			€ 16,000.00
			€ 874,000.00
Less Cost of Sales			
Opening stock		€ 46,000.00	
Purchases	€ 340,000.00		
Less purchases returns (returns out)	€ 7,860.00	€ 332,140.00	
Carriage in		€ 1,000.00	
		€ 379,140.00	
Less Closing stock		€ 49,000.00	
Cost of Sales			€ 330,140.00
Gross Profit			€ 543,860.00
Selling and less expenses	Administration	Sell/ Distribution	
General expenses	€ 24,000.00		
Wages and salaries	€ 102,000.00		
Carriage out		€ 10,000.00	
Stationery (9,000 - 600)	€ 9,000.00		
Advertising (15,000 - 5,000)		€ 10,000.00	
Showroom expenses		€ 28,800.00	
Increase in provision for B.D (2,250 -1,600)		€ 650.00	
Discount allowed		€ 2,000.00	
Dep. On buildings	€ 12,000.00		
Dep. On equipment	€ 2,800.00		
Dep. On motor vehicles		€ 12,000.00	
	€ 149,800.00	€ 63,450.00	€ 213,250.00
			€ 330,610.00
Add Operating income			
Rent received (28,000 + 300)			€ 28,300.00
Operating Profit			€ 358,910.00
Less Interest			€ 5,000.00
Net Profit			€ 353,910.00

Balance Sheet of J. Watson as at 31/12/2012				
Intangible Assets				
Goodwill				€ 40,000.00
Fixed Assets	Cost	Depreciation	Book Value	
Buildings	€ 600,000.00	€ 12,000.00	€ 588,000.00	
Equipment	€ 28,000.00	€ 8,800.00	€ 19,200.00	
Motor vehicles	€ 76,000.00	€ 28,000.00	€ 48,000.00	
	€ 704,000.00	€ 48,800.00	€ 655,200.00	€ 655,200.00
				€ 695,200.00
Current Assets				
Closing stock			€ 49,000.00	
Debtors		€ 45,000.00		
Less provision for bad debts		€ 2,250.00	€ 42,750.00	
VAT			€ 1,000.00	
Stationery prepaid			€ 600.00	
Advertising prepaid			€ 5,000.00	
Rent received due			€ 300.00	
			€ 98,650.00	
Less Current Liabilities				
Creditors		€ 31,000.00		
PRSI		€ 4,500.00		
Bank		€ 27,200.00		
Interest on loan due		€ 5,000.00	€ 67,700.00	
Working Capital				€ 30,950.00
Total Net Assets				€ 726,150.00
Financed By				
Capital				€ 297,240.00
Add Net Profit				€ 353,910.00
				€ 651,150.00
Less Drawings				€ 25,000.00
				€ 626,150.00
Long Term Liability				
Term Loan				€ 100,000.00
Capital Employed				€ 726,150.00

Homework

Q 8.2

The following was extracted from the books of M. Morty on the 31/12/2012.

Purchases	€272,460	
Sales		€447,250
Sales returns	€7,250	
Purchases returns		€12,660
Carriage in	€1,800	
Stock at 1/1/2012	€46,500	
Rent	€7,000	
Rates	€7,200	
Insurance	€1,480	
Light and Heat	€16,300	
Discount allowed	€3,500	
Discount received		€860
Commission paid	€10,950	
Salaries	€58,540	
Debtors	€27,600	
Creditors		€34,690
Land and buildings	€107,500	
Fixtures and fittings	€12,500	
Motor vehicles	€14,800	
Drawings	€8,250	
Cash in hand	€1,380	
Bank	€8,000	
PRSI		€1,010
VAT		€6,090
Loan		€50,000
Capital		<u>€60,450</u>
	<u>€613,010</u>	<u>€613,010</u>

You are given the following information:

- Stock at 31/12/2012 was valued at €54,500.
- Rates prepaid amounted to €200
- Rent due amounted to €700
- Depreciate fixtures and fittings by 10%, motor vehicles by 20% and buildings by 2%.

Trading & Profit & Loss Account M. Morty for year ended 31/12/12			
Sales			€ 447,250.00
Less sales returns			€ 7,250.00
			€ 440,000.00
Less Cost of Sales			
Opening stock		€ 46,500.00	
Purchases	€ 272,460.00		
Less Purchases returns	€ 12,660.00	€ 259,800.00	
Carriage In.		€ 1,800.00	
		€ 308,100.00	
Less Closing stock		€ 54,500.00	
Cost of Sales			€ 253,600.00
Gross Profit			€ 186,400.00
Add Discount received			€ 860.00
			€ 187,260.00
Less Expenses			
Rent		€ 7,700.00	
Rates		€ 7,000.00	
Insurance		€ 1,480.00	
Light and Heat		€ 16,300.00	
Discount allowed		€ 3,500.00	
Commission paid		€ 10,950.00	
Salaries		€ 58,540.00	
Depreciation			
Fixtures and fittings		€ 1,250.00	
Motor vehicles		€ 2,960.00	
Buildings		€ 2,150.00	
Total expenses			€ 111,830.00
Net Profit			€ 75,430.00

Balance Sheet as at 31/12/2012				
Fixed Assets	Cost	Depreciation	Book Value	
Land and buildings	€ 107,500.00	€ 2,150.00	€ 105,350.00	
Fixtures and fittings	€ 12,500.00	€ 1,250.00	€ 11,250.00	
Motor vehicles	€ 14,800.00	€ 2,960.00	€ 11,840.00	
	€ 134,800.00	€ 6,360.00	€ 128,440.00	€ 128,440.00
Current Assets				
Closing stock			€ 54,500.00	
Trade debtors			€ 27,600.00	
Bank			€ 8,000.00	
Cash			€ 1,380.00	
Prepayments			€ 200.00	
			€ 91,680.00	
Less Current Liabilities				
Trade creditors		€ 34,690.00		
VAT		€ 6,090.00		
PRSI		€ 1,010.00		
Accruals		€ 700.00	€ 42,490.00	
Working Capital				€ 49,190.00
Total Net Assets				€ 177,630.00
Financed By				
Capital				€ 60,450.00
Add Net Profit				€ 75,430.00
				€ 135,880.00
Less Drawings				€ 8,250.00
				€ 127,630.00
Long Term Liability				
Loan				€ 50,000.00
Capital Employed				€ 177,630.00