

## CHAPTER 1

# Accounting and reporting on a cash flow basis

### Question 1 – Jane Parker

#### (i) Cash budget (£000)

	Jan	Feb	Mar	Apr	May	June	Total
Initial capital	150.00			82.50			232.50
Customers					60.00	75.00	135.00
<b>Total receipts</b>	<b>150.00</b>			<b>82.50</b>	<b>60.00</b>	<b>75.00</b>	<b>367.50</b>
Machinery	30.00						30.00
Motor vehicles	24.00						24.00
Premises	75.00						75.00
Drawings	1.20	1.20	1.20	1.20	1.20	1.20	7.20
Suppliers		30.00	48.00	60.00	60.00	60.00	258.00
Rates		1.20					1.20
Wages	2.25	2.25	2.25	2.25	2.25	2.25	13.50
General expenses		0.75	0.75	0.75	0.75	0.75	3.75
Insurance	–	–	–	–	–	2.10	2.10
<b>Total payments</b>	<b>132.45</b>	<b>35.40</b>	<b>52.20</b>	<b>64.20</b>	<b>64.20</b>	<b>66.30</b>	<b>414.75</b>
Net cash flow	17.55	(35.40)	(52.20)	18.30	(4.20)	8.70	
Balance b/f	–	17.55	(17.85)	(70.05)	(51.75)	(55.95)	
<b>Balance c/f</b>	<b>17.55</b>	<b>(17.85)</b>	<b>(70.05)</b>	<b>(51.75)</b>	<b>(55.95)</b>	<b>(47.25)</b>	<b>(47.25)</b>

#### (ii) Statement of cash flows (£000)

##### *Realised operating cash flows for the period ended 30 June 20X1*

Receipts from customers	<b>135.00</b>
Payments:	
Suppliers	258.00
Rates	1.20
Wages	13.50
General expenses	3.75
Insurance	2.10
	<b><u>278.55</u></b>
	<b><u>(143.55)</u></b>

***For information only***

***Statement of financial position as at 30 June 20X1***

	<b>£000</b>
Capital – introduced	232.50
– withdrawn	(7.20)
Net operating cash flows:      Realised	(143.55)
Unrealised	<u>(7.80)</u>
	<u>73.95</u>
Premises (NRV)	75.00
Vehicles (NRV)	19.20
Machinery (NRV)	27.00
Net cash balance	<u>(47.25)</u>
	<u>73.95</u>

***(iii) Further information regarding Jane Parker***

- Nature of business linked to Parker's business background, technical ability, special skills, know-how, existing/terminated business involvement, contacts, associates and related parties.
- Type of business unit to be used, and rationale for its selection.
- Sources of long- and short-term capital.
- Products' life cycle and cash flow projections over product life cycle.
- Initial investment in fixed assets and their terminal value at the end of the life cycle.
- Parker's attitude to risk, and how this affects the choice of discount rate and payback period.

## Question 2 – Mr Norman

### (a) *Purchases budget (£000)*

p	Jan	Feb	Mar	Apr	May	June
Sales	15.00	20.00	35.00	40.00	40.00	45.00
Gross profit	3.00	4.00	7.00	8.00	8.00	9.00
Purchases	12.00	16.00	28.00	32.00	32.00	36.00
<b>Payments</b>		<b>12.00</b>	<b>16.00</b>	<b>28.00</b>	<b>32.00</b>	<b>32.00</b>

#### Notes:

- This is a start-up situation.
- Purchases equal projected sales less a gross margin on sales at 20%.
- Goods are bought in the month of sale; assume stocks remain constant.

### (b) *Statement of cash flows (£000)*

	Jan	Feb	Mar	Apr	May	June	Total
Initial capital	50.00						50.00
Cash sales	7.50	10.00	17.50	20.00	20.00	22.50	97.50
Credit sales	–	7.50	10.00	17.50	20.00	20.00	75.00
	<b>57.50</b>	<b>17.50</b>	<b>27.50</b>	<b>37.50</b>	<b>40.00</b>	<b>42.50</b>	<b>222.50</b>
Premises	80.00						80.00
Rent and rates	2.20	2.20	2.20	2.20	2.20	2.20	13.20
Suppliers		12.00	16.00	28.00	32.00	32.00	120.00
Commission		0.30	0.40	0.70	0.80	0.80	3.00
Wages	0.60	0.60	0.60	0.60	0.60	0.60	3.60
Insurance	3.50	–	–	–	–	–	3.50
	<b>86.30</b>	<b>15.10</b>	<b>19.20</b>	<b>31.50</b>	<b>35.60</b>	<b>35.60</b>	<b>223.30</b>
Net cash flow	(28.80)	2.40	8.30	6.00	4.40	6.90	
Balance b/f	–	(28.80)	(26.40)	(18.10)	(12.10)	(7.70)	
<b>Balance c/f</b>	<b>(28.80)</b>	<b>(26.40)</b>	<b>(18.10)</b>	<b>(12.10)</b>	<b>(7.70)</b>	<b>(0.80)</b>	<b>(0.80)</b>

**(c) Statements of operating cash flows and financial position**

***Realised operating cash flows for the period ended 30 June 20X8***

	<b>£000</b>
Receipts from customers	172.50
Payments:	
Suppliers	120.00
Rates	13.20
Wages	3.60
Commission	3.00
Insurance	3.50
	<b><u>143.30</u></b>
	<b><u>29.20</u></b>

**Notes:**

- The cash flow statement with summary attached is effectively a 6-month cash budget showing the cash received, cash paid each month and the resulting month-end balances.
- It is necessary to separate sales and purchase transactions into cash and on-credit, and to identify clearly the month of receipt and payment.
- Commission is paid in the month after the sale is made, and all other cash flows are clearly indicated and allocated to specific months.
- Note that the format of the cash flow statement brings out key figures – for management decision and control. For example:
  - month-end balances – assist in the control of liquidity;
  - cash deficiencies – identify how much must be financed;
  - early warning – allows management to approach appropriate sources;
  - cash surpluses – identify amounts to be invested on the best terms.

***Statement of financial position as at 30 June 20X8***

	<b>£000</b>
Capital – introduction	50.00
Net operating cash flows: <b>Realised</b>	29.20
<b>: Unrealised</b>	<u>(4.00)</u>
	<b><u>75.20</u></b>
Premises ( <b>NRV</b> )	76.00
Net cash balance	(0.80)
	<b><u>75.20</u></b>

**Notes:**

- This statement shows net assets of £75,200.
  - Make up: premises £76,000 less the negative cash balance £800.
- The negative cash balance indicates the need for overdraft arrangements.
- The statement is based on cash flow concept:
  - It ignores accrual-based figures (£36,900 less £25,250).
  - Accruals are not regarded as real assets and liabilities.
  - Critics of the cash flow concept would maintain that its utility has therefore been seriously diminished.

**(d) Letter to the bank requesting an overdraft facility**

- The maximum overdraft facility of £28,800:
  - will be required at the end of January;
  - will be eliminated by July.
- Overdraft will fall progressively as per the cash budget.
- It might be practical to request a limit of £30,000:
  - for the full 6-month period;
  - reducing it to £15,000 thereafter to allow for contingencies. The facility is only to be called on as required.
- Refer to the cash budget to support the request
  - confirm that it is based on the most likely scenario;
  - agree to a repayment schedule.
- Specify that collateral security is available in the form of premises if it should be required.
- If not an existing customer:
  - give outline details of business background;
  - explain future plans;
  - market.

## CHAPTER 2

# Accounting and reporting on an accrual accounting basis

### Question 1 – Jane Parker

#### (a) Cash budget (£000)

	Jan	Feb	Mar	Apr	May	June	Total
Initial capital	150.00					75.00	225.00
Customers				60.00	75.00	75.00	210.00
<b>Total receipts</b>	<b>150.00</b>			<b>60.00</b>	<b>75.00</b>	<b>150.00</b>	<b>435.00</b>
Machinery	30.00						30.00
Motor vehicles	24.00						24.00
Premises	75.00						75.00
Drawings	1.50	1.50	1.50	1.50	1.50	1.50	9.00
Suppliers		30.00	48.00	60.00	60.00	60.00	258.00
Rates							
Wages	2.25	2.25	2.25	2.25	2.25	2.25	13.50
General expenses		0.75	0.75	0.75	0.75	0.75	3.75
	132.75	34.50	52.50	64.50	64.50	64.50	413.25
Net cash flow	17.25	(34.50)	(52.50)	(4.50)	10.50	85.50	
Balance b/f	–	17.25	(17.25)	(69.75)	(74.25)	(63.75)	
<b>Balance c/f</b>	<b>17.25</b>	<b>(17.25)</b>	<b>(69.75)</b>	<b>(74.25)</b>	<b>(63.75)</b>	<b>(21.75)</b>	<b>(21.75)</b>

All balances are overdrawn except for January 20X1

	Feb	Mar	Apr	May	June
<b>o/d</b>	<b>17.25</b>	<b>69.75</b>	<b>74.25</b>	<b>63.75</b>	<b>4.65</b>

#### Note:

No entries will be made for the 20X0/X1 local taxes that are paid in Feb 20X2 – this situation arose because Jane Parker had assumed that the business would only pay the taxes from the start of the tax year, e.g. 1.4.20X1.

However, there will be an entry in the profit and loss account and the statement of financial position.

**(b) Jane Parker – profit and loss account for 6 months ended 30.6.20X1**

	€000	€000
Sales [60.00 + (5 × 75.00)]		435.00
Purchases	378.00	
Closing inventory	<u>(30.00)</u>	
Cost of sales		<u>348.00</u>
Gross profit		87.00
Wages	13.50	
General expenses	4.50	
Local taxes (1.1.X1 – 30.6.X1)	4.00	
Insurance	13.20	
Depreciation:		
– Vehicles	2.40	
– Machinery	<u>1.50</u>	<u>39.10</u>
<b>Net profit</b>		<b><u>47.90</u></b>

***Budgeted statement of financial position as at 30 June 20X1***

Capital		225.00
Net profit		47.90
Less: drawings		<u>(9.00)</u>
		<b><u>263.90</u></b>
<b>Non-current assets</b>		
Premises		75.00
Vehicles	24.00	
Less: depreciation	<u>2.40</u>	21.60
Machinery	30.00	
Less: depreciation	<u>1.50</u>	28.50
<b>Current assets</b>		
Inventory	30.00	
Trade receivables (3 × 75.00)	225.00	
Insurance	13.20	268.20
<b>Current liabilities</b>		
Trade payables	120.00	
Local taxes (1.1.X1 – 30.6.X1)	4.00	
Bank overdraft	4.65	
General expenses	<u>0.75</u>	<u>(129.40)</u>
Net current assets		<u>138.80</u>
		<b><u>263.90</u></b>

**(c) Possible action to deal with exceeding agreed overdraft limit**

- Approach the bank to re-negotiate the overdraft or arrange a loan facility for an agreed term.
- The amount and the period for which additional facilities are required depend on preparing a projected cash flow statement for a longer period taking into account future plans, e.g. owner's drawings requirement, any additional capital expenditure, etc.
- In particular, consider alternatives such as the following:
  - Leasing vehicles and/or machinery
  - Mortgaging the property
  - Getting debts in quicker manner
  - Introducing more capital
  - Obtaining or providing loan capital.

**Question 2 – Mr Norman**

**(a) Purchases budget (\$000)**

	Jan	Feb	Mar	Apr	May	Jun
Sales units	1.65	2.20	3.85	4.40	4.40	4.95
– Closing inventory		0.55	0.96	1.10	1.10	1.24
+ Closing inventory	0.55	0.96	1.10	1.10	1.24	1.38
<b>Purchases units</b>	<b>2.20</b>	<b>2.61</b>	<b>3.99</b>	<b>4.40</b>	<b>4.54</b>	<b>5.09</b>

		<b>Purchases \$000</b>	<b>Sales \$000</b>	
Jan	(2,200 × 40)	88.00	82.50	(1,650 × 50)
Feb	(2,610 × 40)	104.40	110.00	(2,200 × 50)
Mar	(3,990 × 40)	159.60	192.50	(3,850 × 50)
Apr	(4,400 × 40)	176.00	220.00	(4,400 × 50)
May	(4,540 × 40)	181.60	220.00	(4,400 × 50)
Jun	(5,090 × 40)	203.60	247.50	(4,950 × 50)
		<b>913.20</b>	<b>1,072.50</b>	



**(b) Cash flow forecast (£000)**

	Jan	Feb	Mar	Apr	May	June	Total
Initial capital	150.00						150.00
Cash sales	41.25	55.00	96.25	110.00	110.00	123.75	536.25
Credit sales		41.25	55.00	96.25	110.00	110.00	412.50
	<b>191.25</b>	<b>96.25</b>	<b>151.25</b>	<b>206.25</b>	<b>220.00</b>	<b>233.75</b>	<b>1098.75</b>
Premises	80.00						80.00
Commission		1.65	2.20	3.85	4.40	4.40	16.50
Suppliers		88.00	104.40	159.60	176.00	181.60	709.60
Administration	8.00	8.00	8.00	8.00	8.00	8.00	48.00
Wages	17.00	17.00	17.00	17.00	17.00	17.00	102.00
Insurance	0.35						0.35
<b>Total payments</b>	<b>105.35</b>	<b>114.65</b>	<b>131.60</b>	<b>188.45</b>	<b>205.40</b>	<b>211.00</b>	<b>956.45</b>
Net cash flow	85.90	(18.40)	19.65	17.80	14.60	22.75	
Balance b/f	—	85.90	67.50	87.15	104.95	119.55	
<b>Balance c/f</b>	<b>85.90</b>	<b>67.50</b>	<b>87.15</b>	<b>104.95</b>	<b>119.55</b>	<b>142.30</b>	

**(c) Budgeted statement of income for 6 months ended 30 June 20X8**

	\$000	\$000
Sales		1,072.50
Purchases	913.20	
Closing inventory (1,380 units × £40)	<u>(55.20)</u>	
Cost of sales	<u>858.00</u>	
Gross profit		214.50
Wages	102.00	
Administration	48.00	
Commission (2% of 1,072.50)	21.45	
Insurance	0.18	
Amortisation of lease	<u>8.00</u>	
		<u>179.63</u>
Net profit		<u>34.87</u>

***Budgeted statement of financial position as at 30 June 20X8***

	<b>\$000</b>	<b>\$000</b>
Capital		150.00
Net profit		<u>34.87</u>
		<b><u>184.87</u></b>
<b>Non-current assets</b>		
Leasehold premises	80.00	
Less amortisation	<u>(8.00)</u>	
		72.00
<b>Current assets</b>		
Inventory	55.20	
Trade receivables	123.75	
Pre-payments – insurance	0.17	
Cash	<u>142.30</u>	
	<u>321.42</u>	
<b>Current liabilities</b>		
Trade payables	203.60	
Commission	<u>4.95</u>	
	<u>208.55</u>	
Net current assets		<u>112.87</u>
		<b><u>184.87</u></b>

***(d) Investment of surplus funds***

- **Acid test ratio**

- At the end of the first 6 months trading, Norman's statement of financial position shows that the acid test ratio is 1.28:1 (266.22/208.55) – this is higher than the basic 1:1 ratio but it should be compared with the ratio of similar businesses in the same industry in order to establish a norm. It would appear, however, that the business has surplus funds to invest.

- **Amount to invest**

- A projected cash flow statement is required, taking into account future plans regarding the owner's drawing requirements, future capital commitments and working capital criteria, e.g. debtor collection and creditor payment terms.

- **Period to invest**

- The projected cash flow will give an indication of the period of the investment, e.g. it could range from overnight on the money market to term investments.

The important aspect is that the owner should be aware of the projected cash flows, so that return on surplus funds can be maximised.