Welcome to the July issue of "Developing Competence"

Here we focus on the interesting concept of Incomplete Records.
It is often the case that this forms the basis of an examination question at level 3.
It will also be of interest, I am sure, to practicing members who use some of the techniques covered here in their day to day business activity.

You will note that the topic relies heavily upon the Accounting Equation a concept that underpins much of accounting theory and practice.

By now I am sure that those of you that took the June diet of examinations will have received your results. For those of you that were successful I offer my warm congratulations, for those of you that did not achieve, don't be too down hearted you will I am sure bounce back with success next time.

If there are any topics that are troubling in your studies I am to start a Q and A zone in the next newsletter, please send in you questions to me at the Institute.

Enjoy your reading.
Philip

Incomplete Records

The trainee Certified Book-keeper needs to develop competence in the preparation of accounts from incomplete records and the concept often features as an examination question at Level 3.

Many small businesses do not keep complete double entry records. For them a simple cash book to record receipts and payments may be enough.

A system complete with day books and ledgers would provide better information and be less susceptible to undetected error; but there is no law which says books must be double entry.

The trouble with incomplete records, when it comes to preparing period end financial statements, is that they do not tell the whole story. There is no record of outstanding debtors or creditors, nor stock and in some cases little analysis of income and expenditure or the identification of capital and revenue.

In a double entry system these would all be represented by ledger balances. In an incomplete system the figures must be calculated or extracted.

Arriving at the year end profit and loss account and balance sheet will rely heavily on application of the concept of the 'accounting equation'. This is defined as: Assets equal proprietors' Capital plus Liabilities or Assets – Liabilities = Capital. Thus the value of capital can be determined at any point in time.

Examination questions on incomplete records – a frequent feature in Level 3 tend to focus on either sole trader or partnership accounts. In such instances any change in capital structure will be influenced by any one or a combination of the following transactions, events or results:

- introduction of capital;
- drawings: and or
- trading profits or losses

Using the accounting equation, and given the values of opening and closing capital together with drawings and the amounts of any capital introductions, the value of profit or loss can be determined – as is illustrated below.

Example 1

Tony Cook is a self employed plumber(working on a part-time basis) His financial details for the years ended 2004 and 2005 showed:

	2004	**2005**
Assets:		
Motor Vehicle	6,500	5,500
Equipment	2,500	2,000
Stock	750	1,650
Cash at Bank	900	1,300
	10,650	10,450
Less Creditors	750	650
	£9,900	£9,800

Tony Cook's drawings for the year were £10,650. He had sold some shares for £1,050, the proceeds of which he had paid into his business bank account.

Thus profit for the year can be calculated as:

	£
Capital at start of the period	9,900
Add capital introduced (sale of shares)	1,050
	10,950
Drawings for period	10,650
	300
Capital at the end of the period	9,800
Net profit	£9,500

		£
so:	Capital at start of year	9,900
	Add capital introduced	1,050
		10,950
	Add profit for year	9,500
		20,450
	Less drawings	10,650
	Capital at end of year	£9,800

The balance sheet figures should be supported by reconciled bank statements, unpaid sales invoices totalling the sum included as debtors, unpaid purchase invoices totalling creditors, and receipts for payments for fixed assets along with depreciation calculations.

Example 2

A similar approach can be used to determine sales and purchases totals, when given a cash book showing receipts and payments, together with opening and closing debtors and creditors. The following illustrates the use of such techniques.

John Risdon is a self employed motor engineer. He maintains a cash book to record his business receipts and payments. The following is a summary of the cash book for year ended 31 December 2005

Cash Book

Balance b/d	1,500	Drawings	14,100
Work done	39,300	Materials	17,300
Sale of own car	4,000	Van running expenses	4,100
		Wages, trainee	5,100
		Admin	250
		Tools and consumables	600
		General expenses	350
		Balance c/d	3,000
	£44,800		£44,800

Assets and liabilities at 31 December 2004 and 2005 were:

	2004	**2005**
Motor van	7,500	5,000
Stock materials	1,350	1,450
Debtors for work done	3,400	3,750
Creditors for supplies	1,250	1,450
Van insurance pre-paid	160	170

The motor vehicle had been purchased second hand on 1 January 2004 for £10,000 and is subject to depreciation at 25% per annum, straight line, (that is, it is being written off over four years, its expected useful economic life).

This information can be used to produce statements for the year ended 31 December 2005

Opening capital can be arrived at by using the "accounting equation".

	£	
Assets:		
Motor van	7,500	
Stock	1,350	
Debtors	3,400	
Cash at bank	1,500	(see cash book summary)
Pre-payments	160	
	13,910	
Less creditors	1,250	
Capital	£12,660	

Work done during the year:

	£
Cash received during the year	39,300
Less owed at start of the year	3,400
	35,900
Add owed at end of the year	3,750
	£39,650

This can be shown in the form of a control account:

Sales Ledger Control

	Balance b/d	3,400	2005	Receipts from debtors (cash book)	39,300
2005	Work done	39,650	2005	Balance c/d	3,750
		£43,050			£43,050
2006	Balance b/d	3,750			

Likewise the purchases and motor van running costs (where because opening and closing creditors and debtors – the insurance pre-payment – and the actual amounts paid are all known, the charge for the year can be calculated).

Purchase Ledger Control

2005	Payments to creditors for materials	17,300	2005	Balance b/d	1,250
	Balance c/d	1,450	2005	Purchases	17,500
		£18,750			£18,750
			2006	Balance b/d	1,450

Motor Van Running Costs

2005	Balance b/d (pre-payment)	160	2005	Charge for year	4,090
2005	Payments	4,100		Balance c/d	170
		£4,260			£4,260
2006	Balance b/d	170			

Notes for Preparation of the Final Accounts

NB: The difference between the opening and closing motor van valuation (£7,500 - £5,000 = £2,500, is the depreciation charge for the year, ie: (£10,000 x 25% per annum).

The proceeds from the sale of the personal motor vehicle, which were paid into the business bank account, represents capital introduced. Other costs are shown in the summary cash book extract.

We can now draft the final accounts for the year ended 31 December 2005

Trading and Profit and Loss Account of J Risdon
for Year Ended 31 December 2005

		£
Work done		39,650
Opening stock of materials	1,350	
Add purchases	17,500	
	18,850	
Less closing stock of materials	1,450	
Cost of materials used		17,400
Wages		5,100
Motor vehicle running costs		4,090
Administration		250
Tools and consumables		600
General expenses		350
Depreciation motor van		2,500
		30,290
Net profit for year		£9,360

Balance Sheet as at 31 December 2005

	£	£	£
Fixed assets:	**Cost**	**Depreciation**	**Net Book Value**
Motor van	10,000	5,000	5,000
Current assets:			
Stock		1,450	
Debtors		3,750	
Cash at bank		3,000	
Pre-payment		170	
		8,370	
Less:			
Current liabilities:			
Creditors		1,450	
Net current assets			6,920
Total assets less current liabilities			11,920
Financed by:			
Opening capital			12,660
Add capital introduced			4,000
			16,660
Add profit for year			9,360
			26,020
Less drawings			14,100
			11,920

I hope that this overview helps you to develop further your competence in this fascinating of topic areas.

