

A LEVEL ACCOUNTING

**Summer Independent Learning Task
Year 11 to Year 12**



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The Summer Independent Learning is made up of three parts:

Part 1: Sources of Finance – Task 1 and Task 2.

Part 2: Preparation of Income statements for sole-traders – Task 3 and Task 4 Task 5 and Tasks 6.

Part 3: Profitability Ratios -Task 7 – measuring the performance of a sole trader business using profitability ratios.

Part 1 – Sources of finance

As part of your studies in this subject, you need to learn about **sources of finance**.

A 'source of finance' is a place from where a business obtains the money (also known as 'capital') to operate.

You are expected to know about the following sources of finance:

- owner's capital (owner's savings)
- partners' capital
- bank overdraft
- bank loan
- mortgage
- ordinary shares or share capital
- debentures (loan capital)

For each source of finance listed above, you'll need to know the definition, the features of each source of finance, the advantages (benefits), disadvantages (drawbacks) and the purpose for which each source might be used by the business. For example:- expansion, paying suppliers etc.

TASK 1

1. Open up a word document and create a table like the one on page 3.
2. If you do not have access to a computer, use a ruler or straight edge and a pen to draw a table in a similar format.
3. Conduct a research of each type of source listed above.
4. Useful links are provided below to help you with your research.
5. Complete the table for **each** source of finance.
6. Print a copy of your table and take along with you to your first lesson in September. If you did it on paper ensure to take it along with you to your first lesson.

Type of finance: Owner's Capital		
Definition/ general description/ purpose or use		
	Advantages	Disadvantages

Useful links and sources of information

A general introduction to sources of finance

<https://www.bbc.co.uk/bitesize/guides/zdy2scw/revision/3>

Owner's capital & partners' capital

<https://www.tutor2u.net/business/reference/finance-personal-sources-of-finance-for-a-startup>

<https://www.tutor2u.net/business/reference/organisation-partnerships>

Bank Overdraft & Bank Loan <https://www.tutor2u.net/business/reference/sources-of-finance-bank-overdraft>

<https://www.tutor2u.net/business/reference/sources-of-finance-bank-loans>

Ordinary shares / share capital

<https://www.bbc.co.uk/bitesize/guides/zhwtmfr/revision/2>

<https://www.tutor2u.net/business/reference/finance-introduction-to-share-capital>

Debentures

<https://www.tutor2u.net/business/reference/debentures>

TASK 2

Once you have completed **Task 1** of each source of finance, the key skill you need is the ability to **compare** and **contrast** different sources of finance, in order to decide whether that particular source will benefit the business or not. A popular comparison is between money from ordinary shares (share capital) and money from loans or debentures (loan capital).

1. Using the information from task 1, analyse (explain) the differences and similarities between a **bank loan** and **share capital**. Make a judgement as to which you think is best for a business that decides to expand and open a new shop.
2. Write 3 paragraphs - one showing similarities, the other showing the differences and the final, making a judgement as to which one is best for the expansion and why?
3. Bring this to your lesson in September.

Part 2 – Preparing Income Statements

Businesses have to complete an income statement. An income statement is a financial statement which must be produced every year to show if the business is making a profit or a loss. It shows the total revenue (sales) made from selling goods and services and the expenses (bills) the business has to pay out. The profit or loss is calculated by finding the difference between the total revenue made and the expenses to be paid.

TASK 3

Follow the next few steps to see how an income statement is prepared.

Step 1: Introduction to Income statements

- The main activity of a trading business is to buy goods at one price and sell the same goods at a higher price. The difference between the two prices represents a profit known as **gross profit**. The gross profit for each item is totalled to show one figure.
- At the end of the financial year, the business needs to produce an income statement, showing the trading of the business and showing the gross profit for the year.
- The main income the business makes is from sales of goods or services. This is called **revenue, sales revenue, sales or turnover**.

Step 2: What do I need to know?

- As a student, you need to know the layout of the income statement.
- The top half of the income statement is called the **Trading Section or Trading Account**
- The bottom half is called the **Profit and Loss section or Profit and Loss Account**
- Combined, they are called the **Income statement**

Step 3: The layout of the Income Statement (Trading Section)

Income Statement for Wyvern Wholesalers for year ended December 31, 2024

	£	£	£
Sales (Revenue)			250,000
Less Sales Returns			<u>(5,400)</u>
Net Revenue (A)			244,600
Opening Inventory (1 January 2024)		12,350	
Purchases	156,000		
Add: Carriage Inwards	-		
Less: Purchase Returns	<u>(7,200)</u>		
Net Purchases (B)		<u>148,800</u>	
		161,150	
Less: Closing Inventory (31 December 2024)		<u>(16,300)</u>	
Cost of Sales (C)			<u>(144,850)</u>
Gross Profit (D)			<u><u>99,750</u></u>

Step 4: Key Terms to know from the Trading Section

- **Revenue** – money coming into the business from selling goods or services.
- **Purchases** – This is the amount spent to buy goods or inventory that the business will sell on or trades with.
- **Inventory** – these are the goods that the business has in stock or available to sell.
- **Cost of Sales** – cost to the business of the goods or inventory which have been sold in the financial year.
- **Carriage inwards** – the expense or cost to the business of having purchases or inventory delivered or transported to the business. It is also called transportation inwards.

Step 5: Learn how to find the figures labelled A B C and D

- The trading section of the Income Statement shown at **Step 3**, illustrates figures labelled **A, B, C** and **D**.
- The table below demonstrates how these figures have been calculated.
- Take your time to go through these, by calculating the figures individually and make notes to be used in your lessons.

Cost of Sales (C) Opening inventory Add: Purchases Add: Carriage inwards Less: Purchase Returns Less: Closing inventory = Cost of Sales	Gross Profit (D) Revenue Less: Sales Returns = Net Revenue Less: Cost of Sales = Gross Profit or Gross Loss
Net Revenue or Turnover (A) Revenue (Sales) Less: Sales Returns = Net Revenue	Net Purchases (B) Purchases Add: Carriage Inwards Less: Purchase Returns = Net Purchases

Step 6: Calculate the profit for the year

- Businesses have many other **costs** or **expenses** they will have to pay. They need to pay rent, electricity, salaries and insurance, etc.
- We now need to include these **costs** or **expenses** on the income statement by subtracting them from the **gross profit** or **total income** (gross profit + other income)

Step 7: The layout of the Income Statement (Profit and Loss Section)

Income Statement for Wyvern Wholesalers for year ended December 31, 2024

	£	£	£
Gross Profit			99,750
Add discount Received (other income)			<u>2,500</u>
			102,250
Less Expenses			
Discount allowed		3,700	
Salaries		46,000	
Electricity and Gas		3,000	
Business Rent and Rates		2,000	
Sundry Items		<u>4,700</u>	
(E)			<u>59,400</u>
Profit for the Year (F)			<u>42,850</u>

Step 8: Learn how to find the figures labelled E and F

Total Expenses (E)	Profit for the year (F)
$3,700 + 46,000 + 3,000 + 2,000 + 4,700 = \text{£}59,400$	Total income $\text{£}102,250$ – total expenses $\text{£}59,400$ = profit for the year $\text{£}42,850$

Step 9: Full layout of an Income Statement

Name of owner or business

INCOME STATEMENT FOR YEAR ENDED (date)

	£	£	£
Revenue			
Opening Inventory			
Purchases			
Less Closing Inventory			
Less: Cost of Sales			
Gross Profit			
Less Expenses:			
Office Rent			
Heating and Lighting			
Wages and Salaries			
Profit for the Year			

Step 10: Prepare an Income Statement from a list of balances

QUESTION:

The following information has been extracted from the business accounts of **Matthew Lloyd** from his first year of trading which ended on 31st December 2022.

	£
Purchases	94 350
Revenue (Sales)	125 890
Inventory at 31 st December 2018 (Closing Inventory)	5 950
Office Rent	4 850
Heating and Lighting	2 120
Wages and Salaries	10 350
Office Equipment	8 500

Use information above to prepare the **Income Statement** of **Matthew Lloyd** for the year ended 31st December 2022

(** there is no opening inventory! **)

How to prepare the Income Statement of Matthew Lloyd

1. Get a blank sheet of lined paper and draw up the layout of an income statement using the example at step 9 to guide you
2. Include the title showing the business name, statement name and date the financial year ends (see steps 3 and 9 for example)
3. Layout the income statement (see step 9)
4. Use the figures listed in the question above and insert them next to the description of the figures in your layout.
5. Calculate net revenue, net purchase and cost of sales (See steps 3 and 5 how to do it)

6. Calculate gross profit (See steps 3 and 5 how to do it)
7. Add up total expenses (See steps 7 and 8 how to do it)
8. Calculate profit for the year (See steps 7 and 8 how to do it)

Step 11: Check your answer

MATTHEW LLOYD INCOME STATEMENT FOR YEAR ENDED 31 DECEMBER 2018

	£	£	£
Revenue			125,890
Opening Inventory		-	
Purchases		94,350	
Less Closing Inventory		<u>5,950</u>	
Cost of Sales			<u>88,400</u>
Gross Profit			37,490
Less Expenses:			
Office Rent		4,850	
Heating and Lighting		2,120	
Wages and Salaries		<u>10,350</u>	
			<u>17,320</u>
Profit for the Year			<u>20,170</u>

This is a simple version as carriage inward, sales returns and purchases returns were not included in this example.

TASK 4

You are to fill in the missing figures for the following businesses: **Use the steps 3 to 8 above to guide you.**

	Revenue	Opening Inventory	Purchases	Closing Inventory	Cost of Sales	Gross Profit	Expenses	Profit/ (Loss) for the year
	£	£	£	£	£	£	£	£
Business A	20 000	5 000	10 000	3 000			4 000	
Business B	35 000	8 000	15 000	5 000				10 000
Business C		6 500	18 750	7 250		18 500	11 750	
Business D	45 250	9 500		10 500		20 750		10 950
Business E	71 250		49 250	9 100		22 750	24 450	
Business F	25 650	4 950	13 750			11 550		(3 450)

TASK 5

The following balances have been recorded by the bookkeeper of Jon Adam at 31st December 2017.

	£	£
Inventory at 1 st January 2017 (opening inventory)	14 350	
Purchases	114 472	
Revenue (Sales)		259 688
Office rent	13 718	
Heating and Lighting	12 540	
Wages and Salaries	42 614	
Vehicle Expenses	5 817	
Advertising	6 341	

Inventory at 31st December 2017 is valued at £16 280 (closing inventory)

Required: You are to prepare the Income Statement of Jon Adam for the year ended 31st December 2017. **Use Step 10 to guide you.**

TASK 6

The following balances have been recorded by the bookkeeper of Sara Lewis as at 31st December 2018.

	£	£
Revenue (Sales)		144 810
Purchases	96 318	
Inventory at 1 st January 2018 (Opening inventory)	16 010	
Salaries	18 465	
Heating and Lighting	1 820	
Rent and Business rates	5 647	
Sundry Expenses	845	
Vehicle Expenses	1 684	

Inventory at 31st December 2018 (Closing inventory) is valued at £13 735.

REQUIRED: You are to prepare the Income Statement of Sara Lewis for the year ended 31st December 2018. **Use step 10 to guide you.**

Part 3 – Profitability Ratios

Preparing an Income Statement on its own has very little use or meaning to a business. Therefore, to check how profitable the business is, they use what is known as **profitability ratios**. These are calculations that are used to check to see:-

- if the business is performing better or worse than last year by comparing this year's results with previous year's results.
- if the business is performing better or worse than their competitors by comparing their results with similar businesses in the same business sector.
- If the business is performing better or worse than their budgets and forecasts.

They will then use the results of their findings to make decisions on how to improve or what to change.

Profitability Ratios

Gross Profit Margin

$$\frac{\text{Gross Profit}}{\text{Revenue}} \times 100$$

The higher the percentage the better

Gross Profit Mark Up

$$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100$$

A margin of 25% means for every £100 of purchases made, the business makes £25 gross profit

Expenses in relation to Revenue

$$\frac{\text{Expenses}}{\text{Revenue}} \times 100$$

Should show a fall as revenue increases

Profit in relation to Revenue

$$\frac{\text{Profit for the Year}}{\text{Revenue}} \times 100$$

The higher the better

Example using Mathew Lloyd answer. **See step 11**

Gross Profit Margin

$$\frac{\text{Gross Profit}}{\text{Revenue}} \times 100 = \frac{37,490}{125,890} \times 100 = \mathbf{29.78\%}$$

A gross profit margin of 29.78% means that for every £100 of revenue or sales the business makes £29.78 is made in gross profit

Gross Profit Mark Up

$$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100 = \frac{37,490}{88,400} \times 100 = \mathbf{42\%}$$

A mark-up of 42% means that for every £100 of purchases or goods bought (cost of sales) the business made £42 in gross profit

Expenses in relation to Revenue

$$\frac{\text{Expenses}}{\text{Revenue}} \times 100 = \frac{17,320}{125,890} \times 100 = \mathbf{14\%}$$

Expense in relation to revenue of 14% means that for every £100 of revenue, the business spends £14 on expenses.

Profit in relation to Revenue

$$\frac{\text{Profit for the Year}}{\text{Revenue}} \times 100 = \frac{20,170}{125,890} \times 100 = \mathbf{16\%}$$

Profit in relation to revenue of 16% means that for every £100 of revenue or sales, the business made profit of £16 after all expenses have been considered.

TASK 7

REQUIRED: Using the income statement created for Sara Lewis, calculate the following profitability ratios:

- I. Gross profit margin
- II. Gross profit mark up
- III. Expenses in relation to revenue
- IV. Profit in relation to revenue

END OF TASKS

INSTRUCTIONS FOR HANDING IN

Bring your completed tasks to your first accounting lesson in September 2025.

Good luck and see you soon,

The Accounting Team at New College Learning Trust