

Sole traders

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Read first: [The accounting equation](#), [Other payables and other receivables](#), [Depreciation and disposal of non-current assets](#), [Irrecoverable debts and provision for doubtful debts](#)

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What you need to know

By the end of this topic you should be able to:

1. **Explain the advantages and disadvantages of being a sole trader**, a business owned and run by one person.
2. **Explain why a sole trader prepares an income statement and a statement of financial position**, and what each one tells the owner and other users.
3. **Tell a trading business from a service business**: a trading business buys goods and sells them on; a service business sells work or skill and has no goods to sell.
4. **Prepare an income statement** for a trading business (with a trading section, gross profit and profit for the year) and for a service business (income less expenses, with no gross profit).
5. **Understand that a statement of financial position shows assets and liabilities on one particular date**, not over a period.
6. **Recognise and define each part of a statement of financial position**: non-current assets, intangible assets, current assets, current liabilities, non-current liabilities and capital.
7. **Understand how the items in a statement of financial position fit together**: assets always equal capital plus liabilities, and profit and drawings change capital.
8. **Prepare a statement of financial position** for a trading business and for a service business.
9. **Adjust for depreciation** using the straight-line, reducing balance and revaluation methods.
10. **Adjust for accrued and prepaid expenses**, and for **accrued and prepaid income**.
11. **Adjust for irrecoverable debts and the provision for doubtful debts**.
12. **Adjust for goods taken by the owner for their own use**.

The ledger entries for each adjustment are in their own topics (accruals and prepayments, depreciation, irrecoverable and doubtful debts). This topic puts them all into the two financial statements.

Understand it

What a sole trader is

A **sole trader** is a business owned by one person. The owner may employ staff, but they alone put in the capital, make the decisions and take the profit or loss. Most small shops, trades people and one-person practices are sole traders.

Advantages

- The owner **keeps all the profit**.
- The owner has **full control** and can **make decisions quickly**, without asking anyone.
- It is **easy and cheap to set up**, with few legal formalities.
- The owner can **take drawings whenever they want**, and the accounts are **private** (they don't have to be published).
- The owner is close to the customers and staff, so the service can be personal.

Disadvantages

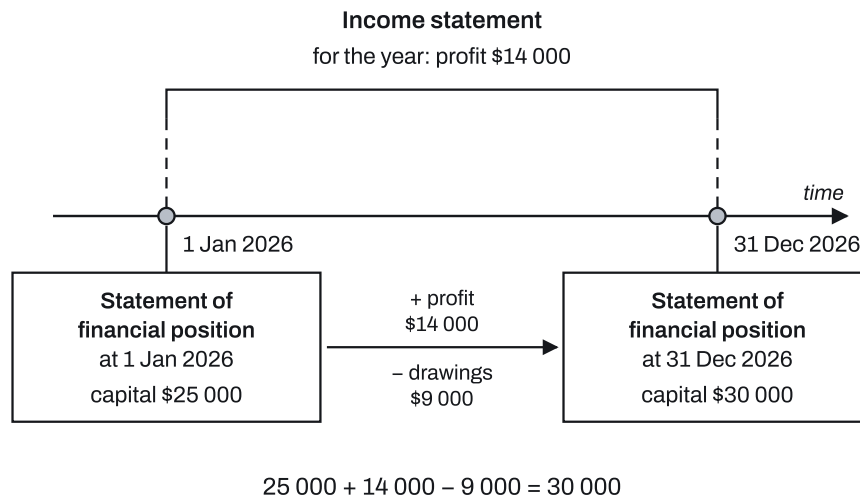
- **Unlimited liability**: the owner and the business are not separate in law, so if the business cannot pay its debts, the owner's **personal possessions** (house, car, savings) can be taken to pay them.
- **Capital is limited** to the owner's own savings, the profits kept in the business and what a bank will lend. A sole trader cannot issue shares or debentures.
- The owner **bears all the losses and all the risk**.
- There is **no one to share the work**, the responsibility or the ideas, and the owner often works long hours.
- If the owner is ill or dies, the business may stop.

A limited company has the opposite features: its owners have **limited liability** and it can raise capital by selling shares. So a question that asks why someone chose to be a sole trader rather than a company is looking for **control, keeping all profit and freedom to take drawings**, never "limited liability" or "easier to borrow".

Two statements, a period and a date

At the end of each financial year the owner prepares two statements from the trial balance.

- The **income statement** covers a **period**, usually a year: "Income statement for the year ended 31 December 2026". It compares the income earned with the expenses of earning it and shows the **profit or loss for the year**. It measures **performance**. The income and expense accounts are closed off by transferring them to it, so the income statement is **part of the double-entry system**.
- The **statement of financial position** (SFP) is a picture on **one date**: "Statement of financial position at 31 December 2026". It lists what the business owns (assets), what it owes (liabilities) and what it owes the owner (capital). It shows the **financial position**. It is a list of the balances left after the income statement is prepared, so it is **not** part of double entry.



The two statements are linked through **capital**. The profit from the income statement belongs to the owner, so it is added to capital in the SFP; drawings are taken off.

Why prepare them? The owner, and anyone lending to the business, can:

- see whether the business made a **profit or a loss**, and whether profit is rising or falling compared with earlier years;
- see which **expenses** are high and could be controlled (operating costs are in the income statement, not in the bank statement or the SFP);
- decide how much can safely be taken as **drawings**, and plan for the future;
- see what the business **owns and owes** on a date, whether it can pay its debts as they fall due, and the owner's stake (the **net worth**, capital);
- give a bank the information it asks for before it lends, and work out the tax due on the profit.

Trading businesses and service businesses

A **trading business** buys goods and sells them at a higher price: a shop, a car dealer, a builders' merchant. Its income statement has a **trading section** that works out **gross profit**:

$$\text{Gross profit} = \text{net revenue} - \text{cost of sales}$$

A **service business** sells a skill or work, not goods: an accountant, a hairdresser, a plumber, a driving school, a taxi firm, an estate agent, a travel agent, a mechanic, an insurance company. It has **no goods for resale**, so it has no revenue from sales, no cost of sales, **no trading section and no gross profit**. Its income statement starts with its fees and other income and takes off its expenses:

$$\text{Profit for the year} = \text{fees} + \text{other income} - \text{expenses}$$

A service business may still own inventory of materials it uses (shampoo, spare parts), but it doesn't sell them as goods. A shop that sells flowers, books or food is a **trading** business, even if it is small. "Surplus" is a word for clubs and societies, not businesses: a business earns a profit.

The income statement of a trading business

Here is the layout, top to bottom, with each item's place.

Income statement for the year ended ...	\$	\$
Revenue		✓
Less Sales returns		✓
		Net revenue
Less Cost of sales		
Opening inventory	✓	
Purchases (less purchases returns and goods for own use)	✓	
Carriage inwards	✓	
	✓	
Less Closing inventory	✓	✓
Gross profit		✓
Add Other income (discount received, rent receivable, commission receivable, decrease in provision for doubtful debts)		✓
		✓
Less Expenses (wages, rent, insurance, carriage outwards, discount allowed, depreciation, irrecoverable debts, increase in provision for doubtful debts, loan interest, ...)	✓	total each
Profit for the year (or loss)		✓

Two things never go in: **capital expenditure** (buying non-current assets) and **drawings**. Assets, liabilities and capital belong in the SFP.

A service business uses only the bottom half: fees, add other income, less expenses, profit for the year.

The statement of financial position

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

Every SFP is this equation laid out in full. The two halves always have the same total.

Assets, what the business owns or is owed:

- **Non-current assets** are kept for more than a year to run the business, not to sell: premises, machinery, fixtures and fittings, motor vehicles, equipment. Each is shown at **cost**, less **accumulated depreciation**, giving its **net book value**, in three labelled columns.

- **Intangible assets** are non-current assets with **no physical form**: goodwill, trademarks and brand names. They are listed with the non-current assets.
- **Current assets** are cash, or will turn into cash within a year: inventory, trade receivables (less the provision for doubtful debts), other receivables (expenses paid in advance and income still due), bank and cash. They are listed starting with the **least liquid** (inventory), so in **decreasing order of liquidity** they are cash, bank, trade receivables, inventory. Work in progress (part-made goods) is also inventory, a current asset.

Capital and liabilities, where the resources came from:

- **Capital** is what the business owes the owner:

$$\text{Closing capital} = \text{opening capital} + \text{capital introduced} + \text{profit for the year} - \text{drawings}$$

A loss is subtracted instead. A sole trader has **no** share capital, reserves or retained earnings: those are for limited companies.

- **Non-current liabilities** are debts due **more than 12 months** after the SFP date: a long-term bank loan, a mortgage.
- **Current liabilities** are debts due **within 12 months**: trade payables, other payables (expenses owing), income received in advance, a bank overdraft (repayable on demand), and any loan due within a year.

The two halves answer different questions: the assets side shows **how the resources are being used**; the capital and liabilities side shows **where they came from**.

How the items fit together. Because the equation always balances, a change in one place is matched somewhere else:

- a profit increases capital, and the extra assets (more cash, more inventory) match it;
- drawings reduce both capital and assets;
- buying equipment partly for cash and partly on a loan repayable in 18 months raises non-current assets, lowers current assets (the cash) and raises non-current liabilities;
- if you know every figure but one, the missing figure makes the two sides equal.

The year-end adjustments

The trial balance shows what was **paid and received**. The income statement must show what **belongs to the year** (the matching, or accruals, principle). So each adjustment changes **one figure in the income statement and one in the SFP**.

Adjustment	Income statement	Statement of financial position
Expense accrued (owing)	Add to the expense	Current liability: other payables
Expense prepaid (paid in advance)	Subtract from the expense	Current asset: other receivables
Income accrued (due, not yet received)	Add to the income	Current asset: other receivables

Adjustment	Income statement	Statement of financial position
Income prepaid (received in advance)	Subtract from the income	Current liability
Depreciation for the year	Expense	Add to accumulated depreciation
Irrecoverable debt written off	Expense	Subtract from trade receivables
Increase in provision for doubtful debts	Expense	Trade receivables less the new provision
Decrease in provision for doubtful debts	Other income	Trade receivables less the new provision
Goods taken for own use	Subtract from purchases	Add to drawings
Owner's private expense paid by the business	Take out of the expense	Add to drawings
Capital expenditure wrongly in an expense (such as repairs)	Take out of the expense	Add to the non-current asset's cost
Extra bank charges found on the bank statement	Add to bank charges	Take off the bank balance (or add to the overdraft)

Time-apportioning. If a payment covers more than 12 months, find the cost of one month and multiply by the months inside the year. Insurance of \$1 950 paid for the 15 months from 1 January 2026 to 31 March 2027: $1\,950 \div 15 = 130$ a month, so the expense for 2026 is $130 \times 12 = 1\,560$ and \$390 is prepaid.

Depreciation, three methods.

- **Straight line:** the same amount each year, $(\text{cost} - \text{residual value}) \div \text{years of use}$, or a percentage of **cost**. A van costing \$20 000, kept 4 years and sold for \$2 000: $(20\,000 - 2\,000) \div 4 = 4\,500$ a year.
- **Reducing balance:** a percentage of the **net book value** (cost less accumulated depreciation at the start of the year). Machinery at cost \$16 000 with accumulated depreciation \$4 000, at 25%: $(16\,000 - 4\,000) \times 25\% = 3\,000$.
- **Revaluation,** for many small items such as loose tools: $\text{opening valuation} + \text{purchases} - \text{closing valuation}$. Tools valued at \$1 800, \$450 of new tools bought, valued at \$1 700 at the year end: $1\,800 + 450 - 1\,700 = 550$.

Goods taken for own use. When the owner takes goods from the shop for themselves, the goods were bought for the business but will never be sold. They are **not** an expense and **not** a sale at selling price: take their **cost** off purchases, and add it to drawings. If this is forgotten, purchases are too high, so profit is **understated**; drawings are understated by the same amount, so closing capital is **unaffected**.

Key facts and formulas

There is no formula list in the IGCSE Accounting exam, so everything here must be learnt.

Formula	Status
Net revenue = revenue – sales returns	Learn it
Cost of sales = opening inventory + purchases – purchases returns – goods for own use + carriage inwards – closing inventory	Learn it
Gross profit = net revenue – cost of sales (trading businesses only)	Learn it
Profit for the year = gross profit + other income – expenses	Learn it
Service business: profit for the year = fees + other income – expenses	Learn it
Assets = capital + liabilities	Learn it
Closing capital = opening capital + capital introduced + profit – drawings	Learn it
Net book value = cost – accumulated depreciation	Learn it
Straight line: $(\text{cost} - \text{residual value}) \div \text{years}$, or % of cost	Learn it
Reducing balance: $\% \times \text{net book value at the start of the year}$	Learn it
Revaluation: opening valuation + purchases – closing valuation	Learn it
Expense for the year = amount paid + amount owing at the end – amount prepaid at the end	Learn it
Time-apportion: $(\text{payment} \div \text{months covered}) \times \text{months in the year}$	Learn it
Working capital = current assets – current liabilities	Learn it
Current: within 12 months of the SFP date; non-current: more than 12 months	Learn it

How to do it

We have 70 tagged questions for this topic from 2021 to 2025 (52 different, as many appear on two or three paper variants): 57 one-mark multiple-choice questions from Paper 1 and 13 twenty-mark Paper 2 questions where this topic is one or more parts. 10 of the Paper 2 questions mix two or three types, so the counts add up to 88.

Question type	Questions
Explain the purpose of the income statement and SFP	13
Advantages and disadvantages of being a sole trader	12
Prepare an income statement with year-end adjustments	11
Classify items in a statement of financial position	10
Service business or trading business	10
Advise the owner on a business decision	10
Calculate an SFP total or a missing figure	7
Prepare the capital account (and inventory account)	5
Prepare a statement of financial position or one section of it	4
Calculate profit or net purchases from a list	4
Effect of a transaction or an omission	2

1. Explain the purpose of the income statement and SFP (13 questions)

All multiple choice. Sort each option into **period** or **date**, then check the double-entry claim.

- **Income statement:** a **period**; income and expenses; profit or loss; **performance**; part of double entry; shows operating costs.
- **SFP:** one **date**; assets, liabilities and capital; **financial position** and net worth; not part of double entry.
- "Why prepare an SFP?" To **summarise what the business owns and owes** (its net worth) at a date. Not to calculate profit, not to list transactions, not to "check that assets equal capital plus liabilities" (that is always true, it isn't the purpose).
- "What does the capital and liabilities section show?" **Where the resources came from**.
- Neither statement shows the bank balance's day-to-day movements (that is the cash book) or proves arithmetical accuracy (that is the trial balance).

2. Advantages and disadvantages of being a sole trader (12 questions)

All multiple choice. Learn the two lists in "Understand it", then:

1. Cross out anything that belongs to a company: **limited liability, issuing shares or debentures**.

2. "Being responsible for all losses" and "unlimited liability" are **disadvantages**, even though they are true of a sole trader.
3. "Unlimited liability" means the owner can lose **personal possessions** as well as the business, not that they can't borrow or must work alone.
4. "Provides all the capital" is a disadvantage (capital is limited), and "controls the decision-making" is an advantage.

3. Prepare an income statement with year-end adjustments (11 questions)

Paper 2, usually 8–12 marks, from a trial balance or list of balances plus 4–7 notes.

1. **Decide: trading or service?** Is there revenue from sales, purchases and inventory? If not, it is a service business: no trading section.
2. **Go through the notes first** and write the adjusted figure next to each balance, with the working: $7\,200 + 350, 2\,340 \div 13 \times 12$, and so on.
3. **Head it** with the owner's name and "Income statement for the year ended [date]".
4. **Trading section:** revenue less sales returns; cost of sales in the order opening inventory, purchases (less returns and goods for own use), carriage inwards, less closing inventory; gross profit.
5. **Other income:** discount received, rent, commission, a decrease in the provision.
6. **Expenses:** list each one with its adjusted figure, total them in the outer column.
7. **Profit for the year** = gross profit + other income – total expenses. This is an own-figure mark, so always finish it.

Variations you will meet:

- **Income received for part of the year.** A tenant who started renting partway through the year at a fixed monthly rent: find the rent per month from what was paid, count the months due, and add what is still owing (accrued income) or take off anything paid for next year (prepaid income).
- **Payments covering more than 12 months**, such as 13 or 15 months of insurance or property tax: time-apportion.
- **Private items:** part of a motor or insurance bill that is for the owner is drawings; take it out.
- **Capital expenditure hidden in repairs:** take it out of repairs and add it to the asset's cost **before** working out depreciation.
- **A bank statement shows extra bank charges:** add them to the expense (and to the overdraft in the SFP).
- **Incomplete records** (some questions): work out purchases from payments to suppliers plus what is still owed, or revenue from cost of sales and a mark-up, then prepare the statement as usual.

4. Classify items in a statement of financial position (10 questions)

All multiple choice. Ask of each item: **owned or owed? More or less than 12 months?**

It is...	Examples
Non-current asset	premises, machinery, vehicles, fixtures, equipment
Intangible asset	goodwill, trademarks, brand names
Current asset	inventory, work in progress, trade receivables, prepaid expenses, income due, bank, cash
Current liability	trade payables, expenses owing, income received in advance, bank overdraft, loan due within 12 months
Non-current liability	loan or mortgage due after more than 12 months
Not in the SFP of a sole trader	revenue and expenses (income statement), retained earnings (companies)

Traps: the **provision for doubtful debts** is not a liability (it is taken off trade receivables); **prepaid income** is a liability, not an asset; a **bank balance** and **trade receivables** are current assets, never intangible.

5. Service business or trading business (10 questions)

1. **Does it sell goods it has bought?** Shop, store, factory, dealer, newsagent: trading. **Does it sell a skill or work?** Repairer, salon, school, agent, taxi, cleaner, insurance, accountant, lawyer: service.
2. A service business has **no trading section**, **no gross profit** and no cost of sales; its income statement shows **profit for the year** only.
3. Its profit = fees + other income – expenses (never "less cost of sales").

A "repair shop" or "mechanic" is service even though it uses parts; a "furniture factory" or "flower shop" is not.

6. Advise the owner on a business decision (10 questions)

Paper 2, usually 5 marks: "Advise ... Justify your answer by providing two advantages and two disadvantages".

1. Give **two points for** and **two points against**, one mark each. Each must fit **this** business: use the figures you have just prepared (a bank overdraft or loan already held, the profit, the drawings, competitors, customers).
2. End with a clear **recommendation**, one mark: "Kwame should..." or "should not...". A recommendation with no reasons, or reasons with no recommendation, loses marks.

Useful points, turned to fit the scenario:

- **For** a new asset, credit sales, card payments or a refurbishment: more customers or sales, higher profit, keep up with competitors, customer convenience, more efficient.
- **Against**: the cost and how to finance it (an overdraft already held makes a loan harder), extra running costs (interest, depreciation, fuel, fees), lower liquidity, irrecoverable debts on credit sales, staff training, the sales may not rise.

Variations you will meet:

- **Protect profit when a cost rises** ("suggest two courses of action and the impact of each"): one mark for the action, one for its impact on the business. Choose actions that fit the scenario, for example:
 - switch to a cheaper supplier: it takes time to find one, and a cheaper one may not exist;
 - charge a tenant more rent for any space the business lets out: the tenant may be unhappy or move out, and that income is lost;
 - open for fewer hours or employ fewer staff: less work can be done, so income falls, and staff or customers may be unhappy;
 - cut staff pay: staff may be unhappy and leave, and the service may suffer;
 - use less of the resource (switch off equipment, fit energy-saving lighting): it may cost money to set up and saves only a little.
- "Suggest two reasons for a bank overdraft" (to pay suppliers or expenses before customers pay, to buy assets, seasonal trade).

7. Calculate an SFP total or a missing figure (7 questions)

- **Total current liabilities:** add trade payables, bank overdraft, expenses owing, income received in advance and any loan due within 12 months. Leave out prepaid expenses and trade receivables (assets) and long-term loans.
- **Non-current or current loan?** Count 12 months from the SFP date. At 31 March 2026, a loan due on 15 November 2026 is current; loans due on 30 April 2027 and in 2030 are non-current.
- **Missing capital:** assets – liabilities. Current assets \$18 400, non-current assets \$42 000, current liabilities \$7 900, non-current liabilities \$15 000: capital = 60 400 – 22 900 = 37 500.
- **Missing bank balance:** put everything into assets = capital + liabilities. If the bank figure comes out negative it is an **overdraft** (a credit balance). Non-current assets \$21 500, trade receivables \$640, capital \$19 800, trade payables \$1 150: bank = 20 950 – 22 140 = –1 190, an overdraft of \$1 190.
- **Working capital** = current assets – current liabilities. A bank overdraft is a current **liability**.

8. Prepare the capital account (and inventory account) (5 questions)

Paper 2, 3–4 marks.

1. **Credit:** "Balance b/d" (opening capital) on the first day, any capital introduced, and "Income statement" (profit for the year) on the last day.
2. **Debit:** "Drawings" (the drawings account's total, **including goods for own use** and private expenses), and a loss if there was one.
3. "Balance c/d" on the debit side makes the totals equal; bring it down as "Balance b/d" on the first day of the next year on the credit side.

Every line needs a date and a detail. Worked Example 4 shows the layout. An **inventory account** is also used at the year end: opening inventory debited as "Balance b/d" and credited to "Income statement"; closing inventory debited from "Income statement" and carried down.

9. Prepare a statement of financial position or one section of it (4 questions)

1. Head it "Statement of financial position at [date]".
2. **Non-current assets** in three labelled columns, **Cost**, **Accumulated depreciation**, **Net book value**, with this year's depreciation added to the accumulated figure.
3. **Current assets**: inventory (closing), trade receivables less irrecoverable debts less the new provision, other receivables (prepaid expenses and income due), bank, cash.
4. **Capital**: opening + profit – drawings (adjusted for goods and private expenses).
5. **Non-current liabilities**, then **current liabilities**: trade payables, other payables, income prepaid, bank overdraft (adjusted for any late bank charges).
6. Total both halves. If they don't match, check that every adjustment appears **twice** (once in the income statement, once here).

When only a section is asked for (current assets, current liabilities, assets), give just that section with its total.

10. Calculate profit or net purchases from a list (4 questions)

- **Service profit**: fees + other income – expenses. **Drawings are not an expense**, so ignore them.
- **Net purchases**: purchases – purchases returns + carriage inwards – goods taken for own use.
Purchases \$31 600, returns \$1 240, carriage inwards \$520, goods taken \$880: $31\,600 - 1\,240 + 520 - 880 = 30\,000$.

11. Effect of a transaction or an omission (2 questions)

1. Write the double entry (or the missing one).
 2. Follow each side to the statements.
- **Goods for own use not recorded**: purchases too high, so profit **understated**; drawings understated by the same amount, so capital **no effect**.
 - **Buying a non-current asset partly for cash, the rest due in more than 12 months**: non-current assets up, current assets down, non-current liabilities up (current liabilities unchanged).

Worked examples

Example 1

Nadia is a private music tutor. She provided the following information for her financial year.

	\$
Fees from students	64 500
Commission receivable	2 300

	\$
Studio rent	9 600
Travel expenses	3 150
Stationery	850
Drawings	12 000

What was her profit for the year? [1]

A \$41 200 B \$50 900 C \$53 200 D \$54 900

Income = $64\,500 + 2\,300 = 66\,800$. Expenses = $9\,600 + 3\,150 + 850 = 13\,600$. Profit = $66\,800 - 13\,600 = 53\,200$. **C (1)**

Drawings are not an expense: taking them off gives A. B leaves out the commission; D adds the stationery instead of taking it off.

Example 2

Olumide is a garden designer. His year ended on 31 December 2025. His books showed:

	\$
Design fees	96 400
Rent received from a tenant	3 200
Salaries	41 250
Office rent	10 400
Motor expenses	6 880
Advertising	2 140

Additional information:

1. A tenant has rented Olumide's storeroom since 1 April 2025 at \$400 a month.
2. The office rent paid covered the 13 months from 1 January 2025 to 31 January 2026.
3. One quarter of the motor expenses were for Olumide's private car.
4. \$300 was owing for advertising at 31 December 2025.
5. Loose tools were valued at \$2 600 on 1 January 2025. Tools costing \$900 were bought and paid for during the year. The tools were valued at \$2 750 on 31 December 2025. Depreciation uses the revaluation method.

(a) Prepare Olumide's income statement for the year ended 31 December 2025. [7]

(b) State how the private motor expenses are treated in the financial statements. [1]

(c) Explain why Olumide's income statement does not show a gross profit. **[1]**

(a)

Olumide: Income statement for the year ended 31 December 2025

	\$	\$
Design fees		96 400
Rent receivable (400×9)		3 600 (1)
		100 000
Less Expenses		
Salaries	41 250	
Office rent ($10\,400 \div 13 \times 12$)	9 600 (1)	
Motor expenses ($6\,880 - 1\,720$)	5 160 (1)	
Advertising ($2\,140 + 300$)	2 440 (1)	
Depreciation of loose tools ($2\,600 + 900 - 2\,750$)	750 (1)	59 200 (1)
Profit for the year		40 800 (1)OF

The tenant owes for 9 months (April to December), \$3 600, but has paid \$3 200: \$400 is accrued income, a current asset (other receivables) in the SFP. \$800 of office rent is prepaid, also an other receivable. The \$300 of advertising owing is an other payable.

(b) The private part, $6\,880 \div 4 = 1\,720$, is added to **drawings**, not charged as an expense. **(1)**

(c) Olumide sells a service, not goods, so there is no revenue from sales and no cost of sales to work out a gross profit from. **(1)**

Example 3

Kwame owns a sports shop. His trial balance at 30 June 2026 was as follows.

	Debit \$	Credit \$
Revenue		142 800
Sales returns	1 950	
Purchases	86 400	
Purchases returns		1 120
Carriage inwards	740	
Inventory at 1 July 2025	9 350	
Wages	18 600	

	Debit \$	Credit \$
Rent	7 800	
Insurance	1 680	
Electricity	2 215	
Discount received		460
Commission receivable		1 400
Fixtures and fittings at cost	24 000	
Provision for depreciation of fixtures and fittings		6 000
Trade receivables	5 440	
Provision for doubtful debts		150
Trade payables		7 260
Bank	9 915	
Cash	285	
Loan from bank (repayable 2029)		6 000
Capital at 1 July 2025		18 785
Drawings	15 600	
	183 975	183 975

Additional information:

1. Inventory at 30 June 2026 was valued at \$10 180.
2. During the year Kwame took sports goods costing \$620 for his own use. No entry has been made.
3. Wages of \$450 were owing at 30 June 2026.
4. The insurance paid covers the 15 months from 1 July 2025 to 30 September 2026.
5. Commission of \$200 was due to Kwame but had not been received.
6. Fixtures and fittings are depreciated at 15% per annum by the reducing balance method.
7. A debt of \$240 is to be written off as irrecoverable. The provision for doubtful debts is to be 5% of the remaining trade receivables.

Prepare Kwame's income statement for the year ended 30 June 2026. **[11]**

Workings first: insurance $1\,680 \div 15 \times 12 = 1\,344$ (\$336 prepaid); depreciation $(24\,000 - 6\,000) \times 15\% = 2\,700$; receivables $5\,440 - 240 = 5\,200$, new provision $5\,200 \times 5\% = 260$, an increase of $260 - 150 = 110$.

Kwame: Income statement for the year ended 30 June 2026

	\$	\$
Revenue		142 800

	\$	\$
Less Sales returns		1 950
		140 850 (1)
Less Cost of sales		
Opening inventory	9 350	
Purchases (86 400 – 1 120 – 620)	84 660 (1)(1)	
Carriage inwards	740 (1)	
	94 750	
Less Closing inventory	10 180	84 570
Gross profit		56 280 (1)OF
Add Discount received		460
Commission receivable (1 400 + 200)		1 600 (1)
		58 340
Less Expenses		
Wages (18 600 + 450)	19 050 (1)	
Rent	7 800	
Insurance	1 344 (1)	
Electricity	2 215	
Depreciation of fixtures and fittings	2 700 (1)	
Irrecoverable debts	240	
Increase in provision for doubtful debts	110 (1)	33 459
Profit for the year		24 881 (1)OF

The two marks on purchases are for taking off the returns and the goods for own use. Carriage inwards goes **before** closing inventory is subtracted.

Example 4

This continues Example 3.

(a) Prepare Kwame's capital account for the year ended 30 June 2026. Balance the account and bring down the balance on 1 July 2026. [4]

(b) Prepare Kwame's statement of financial position at 30 June 2026. [9]

Several local schools have asked Kwame to supply their sports kit on 60 days' credit. At present he sells only for cash.

(c) Advise Kwame whether or not he should sell to the schools on credit. Justify your answer by giving two advantages and two disadvantages. [5]

(a) Drawings = $15\,600 + 620 = 16\,220$.

Capital account

Date	Details	\$	Date	Details	\$
2026			2025		
Jun 30	Drawings (1)	16 220	Jul 1	Balance b/d	18 785
	Balance c/d	27 446	2026		
			Jun 30	Income statement (1)	24 881
		43 666			43 666
			2026		
			Jul 1	Balance b/d (1)OF	27 446

(1) for the dates.

(b)

Kwame: Statement of financial position at 30 June 2026

	\$	\$	\$
Non-current assets	Cost	Accumulated depreciation	Net book value
Fixtures and fittings	24 000	8 700	15 300 (1)
Current assets			
Inventory		10 180 (1)	
Trade receivables (5 440 – 240)	5 200		
Less Provision for doubtful debts	260	4 940 (1)	
Other receivables (336 + 200)		536 (1)	
Bank		9 915	
Cash		285	25 856
Total assets			41 156
Capital and liabilities			
Capital: opening balance		18 785	
Add Profit for the year		24 881	
		43 666	

	\$	\$	\$
Less Drawings		16 220	27 446 (1)OF
Non-current liabilities			
Loan from bank			6 000 (1)
Current liabilities			
Trade payables		7 260	
Other payables		450 (1)	7 710
Total capital and liabilities			41 156 (1)(1)OF

Accumulated depreciation = 6 000 + 2 700 = 8 700. Both totals are \$41 156, so the statement balances.
Kwame's working capital is 25 856 – 7 710 = 18 146.

(c)

Advantages:

- The schools buy kit in bulk, so Kwame's revenue and gross profit should rise. (1)
- Other sports shops may already offer credit; offering it too helps Kwame keep these customers from going to competitors. (1)

Disadvantages:

- He would wait 60 days for the money but must still pay his trade payables of \$7 260, which could strain his bank balance. (1)
- Some schools may pay late or not at all, causing irrecoverable debts (he has just written off \$240), and he would need to keep sales ledger accounts and chase debts. (1)

Recommendation: Kwame should sell to the schools on credit, because his bank balance of \$9 915 can cover 60 days' wait and schools are reliable customers, but he should set a credit limit for each school. (1)

Common mistakes

- **Putting SFP items in the income statement.** Examiners report assets, liabilities, capital, drawings, and cost or accumulated depreciation of non-current assets appearing in income statements. Only income and expenses go in.
- **Treating a service business like a shop.** Candidates invent sales, cost of sales or a gross profit for a service business. It has fees and expenses only.
- **Getting the trading section wrong.** Sales returns are added to revenue or left out (they are subtracted); carriage inwards is missed, put after closing inventory, or subtracted (it is added before closing inventory is taken off); items appear in the wrong order.
- **Mishandling goods for own use.** They come off **purchases** at cost and go into **drawings**. Examiners also see them left out of the capital account.

- **Leaving the profit out of the capital account.** Most candidates enter the opening balance and drawings, but forget the profit (or use a figure other than the one from the income statement).
- **Using trial balance figures unchanged in the SFP.** Accumulated depreciation must include this year's charge, receivables must be net of irrecoverable debts and the new provision, and the overdraft must include late bank charges.
- **Missing column headings.** Non-current assets need "Cost", "Accumulated depreciation" and "Net book value" above the three columns, or the figures earn nothing.
- **Leaving out other receivables and other payables.** Every prepayment and accrual in the income statement must also appear in the SFP. Income received in advance is a current liability, and is often left out or mislabelled.
- **Treating a bank overdraft as an asset.** A credit bank balance is a current liability. In a working capital calculation it is subtracted.
- **Depreciating the wrong amount.** When capital expenditure is hidden in repairs, add it to the asset's cost **before** calculating depreciation.
- **Using abbreviations or wrong words:** "COGS", "GP", "NP", "Inv." and "surplus" lose marks. Write "cost of sales", "gross profit", "profit for the year".
- **Advice that is one-sided or has no recommendation.** Many answers discuss only the advantages, or only one option, and never say what the owner should do.

How to get the marks

- **Headings.** Name the business or owner, the statement and the date: "Income statement **for the year ended** 30 June 2026" (a period) but "Statement of financial position **at** 30 June 2026" (a date).
- **Show workings in brackets** beside each adjusted figure, such as "Insurance (1 680 ÷ 15 × 12)". Each adjusted line usually earns its own mark, and a working can earn the mark even if a slip spoils the total.
- **Own-figure marks.** Gross profit, profit for the year and the SFP totals are marked on your own figures. Always finish the statement, even if an earlier line is wrong.
- **Labels matter.** Use the full names: "Other payables", "Other receivables", "Provision for doubtful debts", "Balance b/d". An amount with a wrong or missing label may earn nothing.
- **SFP layout:** three labelled columns for non-current assets; current assets and current liabilities each with a subtotal; capital shown as opening balance, plus profit, less drawings.
- **Ledger accounts** (capital, inventory): date, detail and amount on the right side of every line; balance and bring down.
- **"Advise ... Justify your answer":** two points for and two against, each tied to the business's figures or situation, then a clear recommendation that doesn't contradict the points. One mark each, usually 5 in all.
- **"State"** needs a short answer (a principle's name, one advantage). **"Explain"** needs the reason too: not just "unlimited liability" but "so the owner's personal possessions could be taken to pay the business's debts".
- **Multiple choice:** decide first whether the item belongs to a **period** or a **date**, to a **sole trader** or a **company**, to a **service** or a **trading** business. Most wrong options mix these up.

Quick check

1. Classify each item as a non-current asset, an intangible asset, a current asset, a current liability or a non-current liability: (i) goodwill, (ii) delivery van, (iii) rent received in advance, (iv) loan repayable in five years, (v) wages owing, (vi) insurance paid in advance.
2. At the year end a business had: trade payables \$4 380, bank overdraft \$1 250, loan repayable in 8 months \$2 000, loan repayable in 4 years \$9 000, electricity owing \$190, commission received in advance \$240 and rent paid in advance \$600. Calculate the total of the current liabilities.
3. Ravi's capital at the start of the year was \$30 500. During the year he paid in a further \$4 000, took \$9 800 in cash and goods costing \$700 for his own use. His profit for the year was \$12 750. Calculate his capital at the end of the year.
4. A shopkeeper paid \$1 200 for new display shelving and recorded it in the repairs account. Ignoring depreciation, state the effect on (i) profit for the year, (ii) non-current assets and (iii) closing capital.
5. Which of these businesses prepare a trading section in their income statement: a pharmacy, a driving school, a plumber, a bookshop?

Answers

1. (i) Intangible asset. (ii) Non-current asset. (iii) Current liability. (iv) Non-current liability. (v) Current liability. (vi) Current asset.
2. $4\,380 + 1\,250 + 2\,000 + 190 + 240 = 8\,060$: **\$8 060**. The 4-year loan is non-current and the rent paid in advance is an asset.
3. $30\,500 + 4\,000 + 12\,750 - (9\,800 + 700) = 36\,750$: **\$36 750**.
4. The shelving is capital expenditure but was charged as an expense. (i) Expenses are \$1 200 too high, so profit is **understated by \$1 200**. (ii) Non-current assets are **understated by \$1 200**. (iii) Profit is added to capital, so closing capital is **understated by \$1 200**; the SFP still balances because both sides are \$1 200 too low.
5. The **pharmacy and the bookshop**, which buy and sell goods. The driving school and the plumber sell a service.

Past questions to try

- **0452/21/M/J/22 Q2**: a full income statement with seven adjustments, goods for own use and the capital account, then advice on a bank loan.
- **0452/23/O/N/22 Q1**: parts (a) to (c), an income statement for a service business, its capital account and advice on how to finance expansion.
- **0452/12/O/N/24 Q21**: picking the current liabilities out of a mixed list.
- **0452/12/F/M/24 Q23**: the effect of unrecorded goods for own use on profit and capital.