DEMO COMPANY

TRIAL BUSINESS

ACCOUNTS FOR THE PERIOD

1 APRIL 2005 TO 31 MARCH 2006

EXPLANATORY NOTES

BASIS OF PREPARATION

Your accounts have been prepared on the basis of the books, records, information and explanations supplied by you. The accounts have not been audited. We have used the information that you have supplied to prepare accounts in accordance with your instructions and in accordance with our best understanding of generally accepted accounting principles for a business of your type and size and of the requirements of the Inland Revenue.

VAT

You are VAT registered. As such all figures shown in the accounts are net of VAT because VAT charged by you and to you are mere movements of cash to and from HM Customs & Excise.

VAT

You are not VAT registered. As such VAT is not charged upon your sales. VAT charged to you is included in the expenses in the accounts.

SALES

Your sales income includes all invoices raised by you during the course of the year whether or not they had been paid by the year end. Those persons who had not paid you at the year end and who you do not expect to pay are included in the accounts as a bad debt. Otherwise such persons have been treated as trade debtors at the year end date.

COST OF SALES

These expenses represent the direct costs that you have to incur to make sales to your clients. In general terms these expenses include the cost of all materials, sub-contract costs, and disbursements that you have incurred during the course of the year as a direct consequence of the work you have undertaken. These costs have been analysed between headings appropriate to your business.

OPENING AND CLOSING STOCK AND WORK IN PROGRESS

Stock represents those physical items that you had in your possession either at the beginning or end of the year and which were items of a type which you might either sell directly to your clients or which you might incorporate into the work that you sell to them. This stock is valued at the lower of its cost, which is the price you paid for it, or its net realisable value, which is the amount you might obtain from selling it having allowed for other costs that you have to incur to make that sale.

Work in progress represents the value of work that you have undertaken at the balance sheet date on projects on behalf of your clients but which has yet to be billed to them. The value presents the costs that you have incurred but excludes any value of your own time. If you are unlikely to be paid for the costs you have incurred then those costs have not been included in the accounts. Where sums that might be considered work in progress are of insignificant amount they are not included in the accounts.

OVERHEADS

Overhead expenses represent those costs which you have to incur to enable you to undertake your business and which do not usually vary substantially with the level of business that you undertake. Such costs have been analysed in the accounts into headings appropriate for your business.

DEPRECIATION

Depreciation is a measure of the wearing out of the fixed assets that you have bought for use in your business over their useful lives. Most of the estimates involve the writing off of the cost in equal instalments over the life of the asset.

SCHEDULE OF BUSINESS ASSETS

Because of the size and nature of your business we have not prepared a balance sheet for inclusion with these accounts.   We have instead include a schedule of business assets. This schedule of business assets shows all those items of equipment that you have acquired for use in your business and where appropriate indicates what proportion of that cost is incurred for business purposes. The schedule does in particular show the assets that you acquired in the current year and the assets that you have disposed of in the current year. Tax relief is claimed on the costs of these assets by making what is called a "capital allowance claim". This cost is not reflected in your profit and loss account included in these accounts.

FIXED ASSETS

Fixed assets are those items of equipment that you have purchased to use in your business which can be reasonably expected to remain in use for longer than one year. They include furniture, electrical equipment, computers, improvements to your property (if any), cars, vans, bicycles, and the like. They are shown at their cost in the notes to the accounts and this cost is written off over their useful life by way of making a depreciation charge (see above). The original cost less the depreciation to date is called the "net book value" of fixed assets and is shown on the balance sheet. It is not necessarily the sum that you would sell the asset for. It is an approximate measure of the remaining worth of the assets to the business, not their worth to someone else. It does, however, provide a useful measure and reminder that assets do not last forever.

TRADE DEBTORS

Trade debtors are those persons to whom you have sent invoices before the year end and who had not paid you by that date. This figure does, therefore, represent the amount that you were owed by clients at the year end.

PREPAYMENTS

A prepayment occurs when you pay for something before the balance sheet date but do not get the benefit of what you have paid until after the balance sheet date. The obvious example is with regard to insurance. If you pay for twelve months insurance in advance two months before your balance sheet date the benefit of 10/12 of the sum paid will be obtained next year. If, therefore, the insurance cost is £600 the prepayment would be £600 x 10/12 = £500. Other prepayments occur most commonly with regard to rent, rates and maintenance contracts on equipment, all of which are charged for fixed periods of time and are often paid in advance.

TRADE CREDITORS

This sum represents the amount that you owed at the balance sheet date to those persons who had billed you for goods and services that had been supplied before the balance sheet date but where you paid them after the balance sheet date. This is therefore the people to whom you owed money at that time.

ACCRUALS

Accruals represent sums that you owe for goods and services that you have consumed before the balance sheet date but where the invoice is received later. An obvious example is telephone costs. If a telephone bill for a three month period is received one month after the balance sheet date then two months of the cost relates to the period before the balance sheet date. So, to calculate the accrual, and assuming the bill was for £450, we multiply £450 x 2/3 = £300. This sum is shown as a creditor in the balance sheet under the accruals heading, and is treated as an expense in the profit and loss account. Accruals can arise with regard to a large range of accounts headings. Accountancy costs are a very common one.

CAPITAL ACCOUNT

Balance sheet accounts have, by definition, to balance. The balance sheet is split into two parts. The top half shows what you have invested your money in. Your money is tied up in fixed assets, stock, debtors, prepayments and cash. Your trade creditors and accruals (including your tax creditor) help finance these investments, but the bit that they do not pay for has been provided by you. The bottom half of the balance sheet, which is your capital account, shows how you have provided this money. At the start of the year you had a balance of investment in the business, representing the net value of the top half of the balance sheet at that time. In the year you have made money, which profit has been added on to the balance brought forward, but you have taken some of that money out, and put some of it aside to pay tax. These sums represent your drawings in the year. The net balance left over is still in the business. However, do not expect to see it in cash. It is made up of a whole mix of bits and pieces which together make up the top half of the balance sheet. You have invested in all those assets, and will need to continue to do so for the business to carry on. So taking out all you have earned is sometimes very difficult, but that is why a positive balance on your capital account is also a good thing, because it shows that you have committed resources to the future success of your business activity.