

CHAPTER 1.8 FINANCIAL STATEMENTS OF SOLE TRADERS

QUESTION 1

State two benefits and two drawbacks of operating as a sole trader.

[4]

M/J 19/P22 Q1(c)

SOLUTION

Mark Scheme

Benefits:

- Entitled to all profits
- No need to publish financial statements

Drawbacks:

- Unlimited liability
- All the risk
- No separate legal entity
- Sole trader provides internal capital
- Sole trader provides ideas

Suggested Solution

Advantages could include:

- Sole traders are entitled to all the profits earned by their respective businesses.
- Sole traders are in the total control of all decisions in their respective businesses.
- Sole traders work independently so they do not have to gain the approval of anyone else.
- There is no legal obligation to publish sole trader accounts.

Drawbacks

- Limited ability to raise capital
- Unlimited liability for all the business' debts.
- Limited ideas
- Lack of continuity as it may dissolve due to various reasons.
- No sharing of managerial responsibilities for a sole trader resulting in increased workload and more stress
- Higher risks

QUESTION 2

Explain the accounting treatment at the year-end in the income statement and statement of financial position of Prepayments and Accruals

[4]

O/N 18/P21/Q1(b)

SOLUTION

Mark Scheme

Prepayments:

Deducted from expenses
Increases profit
Shown as a current asset

Accruals:

Added to expenses
Decreases profit
Shown as a current liability

1 mark for each valid point. [4]

Suggested Solution**Prepayments:**

- Deducted from expenses
- Increases profit for the year
- Shown as a current asset

Accruals:

- Added to expenses
- Decreases profit for the year
- Shown as a current liability