CIMA Exam Practice Kit

Financial Accounting
Fundamentals
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Dak Patel, FCCA FIPFM is the Principal of London School of Accountancy and Management. In 1991 he refurbished a major Accountancy college in Central London and started lecturing there on Accountancy, Taxation and Management courses. In the late 1990s he became a cofounder for an Accountancy college where he was the Managing Director. In January 2004, he founded London School of Accountancy and Management (LondonSAM). The college has enrolled over 500 students studying full time, evening and on weekends. By 2007 he plans to have set up centres overseas notably China, Mauritius, India, Pakistan and Ghana where currently he has sole agencies in place. He has also lectured at Cambridge on the MBA and DMS programmes and trained staff members of the Essex Police and Fire Brigade.
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Welcome to the new CIMA Exam Practice Kit which has been launched to coincide with a major change in the syllabus where new examinations will take place from May 2005.

This Kit has been designed with the needs of home study and distance education candidates in mind. It is also ideal for fully taught courses or for students resitting papers from the old syllabus.

These hints, questions and answers have been produced by some of the best-known freelance tutors in the United Kingdom who have specialised in their respective papers. The questions and topics selected are relevant for the May 2005 and November 2005 examinations.

The exam practice kits will complement CIMA’s existing study manuals with the Q & As from May 2005 examination published in the next edition of the CIMA study manual and the Q & As from November 2005 examination published in the 2006 edition of the CIMA Exam Practice Kit.

Good luck with your studies.
Syllabus Guidance, Learning Objectives and Verbs

A The syllabus

The syllabus for the CIMA Professional Chartered Management Accounting qualification 2005 comprises three learning pillars:

1. Management Accounting pillar
2. Business Management pillar

Within each learning pillar there are three syllabus subjects. Two of these subjects are set at the lower ‘Managerial’ level, with the third subject positioned at the higher ‘Strategic’ level. All subject examinations have a duration of three hours and the pass mark is 50%.

Note: In addition to these nine examinations, students are required to gain three years relevant practical experience and successfully sit the Test of Professional Competence in Management Accounting (TOPCIMA).

B Aims of the syllabus

The aims of the syllabus are

• to provide for the Institute, together with the practical experience requirements, an adequate basis for assuring society that those admitted to membership are competent to act as management accountants for entities, whether in manufacturing, commercial or service organisations, in the public or private sectors of the economy;
• to enable the Institute to examine whether prospective members have an adequate knowledge, understanding and mastery of the stated body of knowledge and skills;
• to complement the Institute’s practical experience and skills development requirements.
C Study weightings

A percentage weighting is shown against each topic in the syllabus. This is intended as a guide to the proportion of study time each topic requires.

All topics in the syllabus must be studied, since any single examination question may examine more than one topic, or carry a higher proportion of marks than the percentage study time suggested.

The weightings do not specify the number of marks that will be allocated to topics in the examination.

D Learning outcomes

Each topic within the syllabus contains a list of learning outcomes, which should be read in conjunction with the knowledge content for the syllabus. A learning outcome has two main purposes:

1. to define the skill or ability that a well-prepared candidate should be able to exhibit in the examination;
2. to demonstrate the approach likely to be taken by examiners in examination questions.

The learning outcomes are part of a hierarchy of learning objectives. The verbs used at the beginning of each learning outcome relate to a specific learning objective e.g. Evaluate alternative approaches to budgeting.

The verb ‘evaluate’ indicates a high-level learning objective. As learning objectives are hierarchical, it is expected that at this level students will have knowledge of different budgeting systems and methodologies and be able to apply them.

A list of the learning objectives and the verbs that appear in the syllabus learning outcomes and examinations follows:

<table>
<thead>
<tr>
<th>Learning objectives</th>
<th>Verbs used</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Knowledge</td>
<td>List</td>
<td>Make a list of</td>
</tr>
<tr>
<td></td>
<td>State</td>
<td>Express, fully or clearly, the details of/facts of</td>
</tr>
<tr>
<td></td>
<td>Define</td>
<td>Give the exact meaning of</td>
</tr>
<tr>
<td>2 Comprehension</td>
<td>Describe</td>
<td>Communicate the key features of</td>
</tr>
<tr>
<td></td>
<td>Distinguish</td>
<td>Highlight the differences between</td>
</tr>
<tr>
<td></td>
<td>Explain</td>
<td>Make clear or intelligible/State the meaning of</td>
</tr>
<tr>
<td></td>
<td>Identify</td>
<td>Recognise, establish or select after consideration</td>
</tr>
<tr>
<td></td>
<td>Illustrate</td>
<td>Use an example to describe or explain something</td>
</tr>
</tbody>
</table>
3 Application

How you are expected to apply your knowledge

<table>
<thead>
<tr>
<th>Verbs</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apply</td>
<td>To put to practical use</td>
</tr>
<tr>
<td>Calculate/compute</td>
<td>To ascertain or reckon mathematically</td>
</tr>
<tr>
<td>Demonstrate</td>
<td>To prove with certainty or to exhibit by practical means</td>
</tr>
<tr>
<td>Prepare</td>
<td>To make or get ready for use</td>
</tr>
<tr>
<td>Reconcile</td>
<td>To make or prove consistent/compatible</td>
</tr>
<tr>
<td>Solve</td>
<td>Find an answer to</td>
</tr>
<tr>
<td>Tabulate</td>
<td>Arrange in a table</td>
</tr>
</tbody>
</table>

4 Analysis

How you are expected to analyse the detail of what you have learned

<table>
<thead>
<tr>
<th>Verbs</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analyse</td>
<td>Examine in detail the structure of</td>
</tr>
<tr>
<td>Categorise</td>
<td>Place into a defined class or division</td>
</tr>
<tr>
<td>Compare and contrast</td>
<td>Show the similarities and/or differences between</td>
</tr>
<tr>
<td>Construct</td>
<td>To build up or compile</td>
</tr>
<tr>
<td>Discuss</td>
<td>To examine in detail by argument</td>
</tr>
<tr>
<td>Interpret</td>
<td>To translate into intelligible or familiar terms</td>
</tr>
<tr>
<td>Produce</td>
<td>To create or bring into existence</td>
</tr>
</tbody>
</table>

5 Evaluation

How you are expected to use your learning to evaluate, make decisions or recommendations

<table>
<thead>
<tr>
<th>Verbs</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advise</td>
<td>To counsel, inform or notify</td>
</tr>
<tr>
<td>Evaluate</td>
<td>To appraise or assess the value of</td>
</tr>
<tr>
<td>Recommend</td>
<td>To advise on a course of action</td>
</tr>
</tbody>
</table>

Computer-based assessment

CIMA has introduced computer-based assessment (CBA) for all subjects at Certificate level. The website (http://www.cimaglobal.com/students/admin/assessment/computer/questions.htm) says

Objective questions are used. The most common type is ‘multiple choice’, where you have to choose the correct answer from a list of possible answers, but there are a variety of other objective question types that can be used within the system. These include true/false questions, matching pairs of text and graphic, sequencing and ranking, labelling diagrams and single and multiple numeric entry.

Candidates answer the questions by either pointing and clicking the mouse, moving objects around the screen, typing numbers, or a combination of these responses. Try our online demo at [http://www.cimaglobal.com] to get a feel for how the technology will work.

The CBA system can ensure that a wide range of the syllabus is assessed, as a predetermined number of questions from each syllabus area (dependent upon the syllabus weighting for that particular area) are selected in each assessment.

In every chapter of this study system we have introduced these types of questions but obviously we have to label answers A, B, C, etc. rather than using click boxes. For convenience we have retained quite a lot of questions where an initial scenario leads to a number
of sub-questions. There will be questions of this type in the CBA but they will rarely have more than three sub-questions. In all such cases examiners will ensure that the answer to one part does not hinge upon a prior answer.

There are two types of questions which were previously involved in objective testing in paper-based exams and which are not at present possible in a CBA. The actual drawing of graphs and charts is not yet possible. Equally there will be no questions calling for comments to be written by students. Charts and interpretations remain on many syllabi and will be examined at Certificate level but using other methods.

For further CBA practice, CIMA Publishing has produced CIMA Inter@ctive CD-ROMs for all certificate level subjects. These products use the same software as found in the real Computer-based assessment and are available at www.cimapublishing.com.

**Financial Accounting Fundamentals and computer-based assessment**

The assessment for Financial Accounting Fundamentals is a 90-minute computer-based assessment comprising 40 compulsory questions, with one or more parts. Single part questions are generally worth 1–2 marks each, but two and three part questions may be worth 4 or 6 marks. There will be no choice and all questions should be attempted if time permits. CIMA are continuously developing the question styles within the CBA system and you are advised to try the on-line website demo at www.cimaglobal.com, to both gain familiarity with assessment software and examine the latest style of questions being used.

**The Financial Accounting Fundamentals syllabus**

**Syllabus overview**

This is an introduction to financial accounting and assumes no prior knowledge of the subject. It deals with the recording of accounting transactions and the preparation of accounting statements for single entities. The basic concepts of accounting are dealt with, and the student will be expected to understand the limitations of financial accounts in attempting to meet the needs of all users. An understanding of the different approaches to asset valuation and the resulting influence on profit measurement is required.

There is an introduction to the regulatory framework that determines published accounts requirements and a basic introduction to the role of accounting standards. An awareness of published accounts is required, but students will not be asked to prepare accounts in a published accounting format. No knowledge of any specific accounting standard is required. There will be an introduction to accounting systems and their control.

Although the emphasis is on the basic methods and techniques of the subject, students will be expected to develop a critical approach by asking why the methods and techniques are used and in what circumstances they are appropriate.

This syllabus addresses the fundamentals of the subject and recognises that some terms and definitions vary from one area of the world to another. As a result, students can use accepted alternative names to those that appear in this syllabus and be aware of alternative accounting formats. For example, International Accounting Standard 1 (IAS 1) uses
income statement instead of profit and loss account and non-current assets instead of fixed assets. Others include inventories, receivables and payables. All of these are acceptable for use in answers in this paper, but it will be expected that they are applied consistently. Similarly, IAS 1 provides illustrations of accounting formats that are used widely in published accounts and are acceptable in this paper.

**Aims**

This syllabus aims to test the student’s ability to

- explain the conceptual and regulatory framework of accounting;
- explain the nature of accounting systems and understand the control of such systems;
- prepare accounts for a single entity.

**Assessment**

This subject is assessed by computer-based assessment.

The assessment is 90 minutes and comprises 40 compulsory questions with one or more parts. A varied range of objective test questions are used.

**1(i) Conceptual and regulatory framework – 20%**

**Learning outcomes**

On completion of their studies students should be able to

- identify the various user groups which need accounting information and the characteristics of such information necessary to meet their objectives;
- explain the function of and differences between financial and management accounting systems;
- identify and explain the fundamental accounting concepts, bases and policies;
- explain the concepts of capital and revenue, cash and profit, income and expenditure and assets and liabilities;
- explain the historical cost convention;
- identify the basic methods of valuing assets on current cost, market value and economic value bases, and demonstrate their impact on profit measures and balance sheet values;
- explain the influence of legislation (e.g. Companies Acts) and accounting standards on the production of published accounting information for organisations.

**Syllabus content**

- Users of accounts and the objectives of financial statements; functions of financial and management accounts; purpose of accounting statements; stewardship; the accounting equation.
- Fundamental accounting concepts, bases and policies; capital and revenue; cash and profit; income, expenditure, assets and liabilities.
• Historical cost convention.
• Methods of asset valuation and their implications for profit measurement and the balance sheet.
• The regulatory influence of company law and accounting standards; items in formats for published accounts.

1(ii) Accounting systems – 20%

Learning outcomes

On completion of their studies students should be able to

• explain the purpose of accounting records and their role in the accounting system;
• prepare cash and bank accounts; prepare bank reconciliation statements;
• prepare petty cash statements under an imprest system;
• prepare accounts for sales and purchases, including personal accounts and control accounts;
• identify the necessity for financial accounting codes and construct a simple coding system;
• prepare nominal ledger accounts; prepare journal entries; prepare a trial balance;
• prepare accounts for indirect taxes (e.g. VAT);
• prepare accounts for payroll.

Syllabus content

• The accounting system and accounting records.
• Ledger accounts; double-entry bookkeeping.
• Preparation of accounts for cash and bank; bank reconciliations; imprest system for petty cash.
• Accounting for sales and purchases, including personal accounts and control accounts.
• Financial accounting codes and their uses.
• Nominal ledger accounting; journal entries.
• Trial balance.
• Accounting for indirect taxes (e.g. VAT).
• Accounting for payroll.

1(iii) Control of accounting systems – 15%

Learning outcomes

On completion of their studies students should be able to

• identify the requirements for external audit and the basic processes undertaken;
• explain the purpose and basic procedures of internal audit;
• explain the meaning of true and fair view;
• explain the need for financial controls;
• explain the purpose of audit checks and audit trails;
• explain the nature of errors, and be able to make accounting entries for them;
• explain the nature of fraud and basic ideas of prevention.
Syllabus content

- The purpose of external audit and the meaning of true and fair view.
- Internal audit.
- Financial controls; audit checks on financial controls; audit trails.
- Errors or fraud.

1(iv) Preparation of accounts – 45%

Learning outcomes

On completion of their studies students should be able to

- prepare accounts using accruals and prepayments;
- explain the difference between and prepare accounts for bad debts and provisions for doubtful debts;
- explain and calculate the methods of depreciation, including straight line, reducing balance and revaluation, and prepare accounts using each method;
- prepare a fixed asset register;
- explain, calculate and prepare accounts for stock;
- prepare trading accounts, profit and loss accounts, appropriations of profit and balance sheets from trial balance;
- prepare manufacturing accounts;
- prepare income and expenditure accounts;
- prepare accounts from incomplete records;
- calculate and explain basic ratios;
- prepare cash-flow statements.

Syllabus content

- Adjustments to the trial balance; accruals and prepayments.
- Bad debts and provision for doubtful debts.
- Accounting treatment for depreciation (straight line, reducing balance and revaluation methods).
- Fixed asset register.
- Accounting for stocks (excluding long-term contract work in progress); methods of stock valuation (FIFO, LIFO and average cost).
- Trading, profit and loss accounts and balance sheets from trial balance; accounting for the appropriations of profit.
- Manufacturing accounts.
- Income and expenditure accounts.
- Production of accounting statements from incomplete data.
- Ratios: return on capital employed; gross and net profit margins; asset turnover; debtors collection and creditors time to pay; current and quick ratios; stock turnover; gearing.
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Computer-based examinations

Ten Golden rules

1. Make sure you are familiar with software before you start exam. You cannot speak to invigilator once you have started.
2. These exam practice kits give you plenty of exam style questions to practise.
3. Attempt all questions, there is no negative marking.
4. Double check your answer before you put in final alternative.
5. On multiple choice questions, there is only one correct answer.
6. Not all questions will be MCQs – you may have to fill in missing words or figures.
7. Identify the easy questions first, get some points on the board to build up your confidence.
8. Try and allow five minutes at the end to check your answers and make any corrections.
9. If you don’t know the answer try process of elimination. Sadly there is no phone a friend!!
10. Take scrap paper, pen and calculator with you. Work out answer on paper first if it is easier for you.
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The Accounting Scene
Business organisation

Profit-making organisation
- Sole trader
  (Sole proprietor)
  - Owned by one person
  - Tend to be small
  - Lack financial resources

- Partnerships
  - Two or more person ownership (maximum 20)
  - Working together with view to profit
  - Family run business
  - Professional firms, for example solicitors, doctors, accountants, dentists, may have more than 50 partners

- Limited companies
  - Must meet certain minimum obligations imposed by legislation notably CA 85

  - Private limited companies
    - Normally family owned actively
    - Not listed on the stock exchange
    - Ltd behind their name

  - Public limited companies
    - Plc behind their name
    - Listed on the stock exchange
    - Thousands of owners

Non-profit-making organisation

- Club societies
  - Provide facilities and entertainment for members
  - Income derived from them

- Charities
  - Set up for particular groups
  - Disadvantaged people and animals
  - Support the environment and its courses

- Local and central government
  - Finances are used to finance the infrastructure we live in

The Accounting Scene
Questions

1.1 List five different users of financial information and briefly describe the type of information that each might require. (10 marks)

1.2 Give examples of two profit-making organisations and two non-profit-making organisations and describe each type in detail. (10 marks)

1.3 Which one of the following is not a profit-making organisation?
   A Partnership
   B Local government
   C Sole trader
   D Limited company (2 marks)

1.4 Which one of the following is not a non-profit-making organisation?
   A Public limited company
   B Charity
   C Clubs
   D Central government (2 marks)

1.5 What is the main aim of accounting?
   A To record every financial transaction individually
   B To maintain ledger accounts for every transaction
   C To prepare a trial balance
   D To provide financial information to users of such information (2 marks)

1.6 Which one of the following gives the best definition of the objective of accounting?
   A To calculate the amount of dividend to pay to shareholders
   B To record, categorise and summarise financial transactions
   C To provide useful information to users
   D To calculate the taxation due to the government (2 marks)

1.7 Which of the following are not the information requirement of equity investors?
   A Profitability
   B Performance
   C Dividends
   D Ability to repay loans (2 marks)

1.8 Which of the following are not the information requirement of government departments?
   A Firms ability to pay wages
   B Cash resources
   C Pay pensions
   D Performance of the firm (2 marks)
1.9 Which of the following is not a useful characteristic of accounting information as per ASB Statement of Principles?

A  Relevance
B  Profitability
C  Comparable
D  Complete

(2 marks)

1.10 AIS Stands for

A  Accounting Information System
B  Accounting International Standards
C  Auditing Information System
D  Auditing International Standards

(2 marks)
Answers

1.1 See diagram
1.2 See diagram
1.3 B
1.4 A
1.5 D
    All of A, B, and C are all part of the bookkeeping system. So D is correct.
1.6 A
1.7 D
1.8 D
1.9 B
1.10 A
Users of accounts (part of ASB’s statement of principles)

**Insiders**
- **Employee group**
  - Ability to pay
    - Existing
    - Potential
    - Past
  - Wages
  - Pension
  - Future of organisation
    - Job security
    - Future prospects

- **Shareholders**
  - Buy
  - Sell
  - Hold
  - Shares
  - Dividends

- **Management**
  - Performance
  - Social and economic policies
  - Profitability
  - Decision
    - Strategic
    - Tactical
    - Optical
  - Shares

- **Government**
  - Analysts, Advisers includes advisers to investors, employees and general public
  - Business contact group
  - Tax authorities
    - Custom, Excise, VAT
    - Inland revenue
    - CGT
    - Other government departments
    - Department of trade and industry
    - Central statistical office

**Others**

- **Analysts, Advisers** includes advisers to investors, employees and general public
- **Business contact group**
- **Public**
  - Customers’ ability to provide goods and services
  - Suppliers’ ability to pay for the supply of goods and services
  - Customers’ ability to provide goods and services
  - Public
  - PAYE
  - NIC
  - SSP
  - CGT

**Outsiders**

- **Creditors**
  - Trade creditors
  - Credit worthiness
  - Loan providers
  - Repay Loan Interest
  - Repay Loan Interest
  - Other interest groups
    - How policies affect the community
    - Local sponsorship
    - Health and safety requirements
  - Other interest groups
  - Other interest groups

**Business contact group**

**Outsiders**

- **Creditors**
  - Trade creditors
  - Credit worthiness
  - Loan providers
  - Repay Loan Interest
  - Other interest groups
    - How policies affect the community
    - Local sponsorship
    - Health and safety requirements
Business organisation

Profit-making organisation

- Sole trader (Sole proprietor)
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- Charities
  - Set up for particular groups
  - Disadvantaged people and animals
  - Support the environment and its courses

- Local and central government
  - Finances are used to finance the infrastructure we live in
Revision questions 1

1.1 The main aim of accounting is to
A maintain ledger accounts for every transaction  
B provide financial information to users of such information  
C prepare a trial balance  
D record every financial transaction individually  

1.2 The main aim of financial accounting is to
A record all transactions in the books of accounts  
B provide management with detailed analyses of costs  
C present the financial results of the organisation by means of recognised statements  
D calculate profit  

1.3 Financial accounts differ from management accounts in that they
A are prepared monthly for internal control purposes  
B contain details of costs incurred in manufacturing  
C are summarised and prepared mainly for external users of accounting information  
D provide information to enable the trial balance to be prepared  

1.4 Which one of the following does not apply to the preparation of financial accounts?
A They are prepared annually.  
B They provide a summary of the outcome of financial transactions.  
C They are prepared mainly for external users of accounting information.  
D They are prepared to show the detailed costs of manufacturing and trading.  

1.5 Which of the following statements gives the best definition of the objective of accounting?
A To provide useful information to users.  
B To record, categorise and summarise financial transactions.  
C To calculate the taxation due to the government.  
D To calculate the amount of dividend to pay to the shareholders.
Answers to revision questions 1

1.1 B
Maintaining ledger accounts, preparing a trial balance and recording transactions are all part of the bookkeeping system.

1.2 C

1.3 C

1.4 D
Management accounts would provide detailed costs and other information regarding manufacturing and trading.

1.5 A
The Framework of Financial Accounts
The Accounting Equation

\[ \text{Assets} = \text{Liabilities} + \text{Capital} \]

- **Assets**
  - **Fixed assets**
    - Intangible
      - Cannot see, smell, feel or touch
        - Goodwill
        - Patent
        - Trademark
        - Royalties
        - Research and development
    - Tangible
      - Can touch, see, feel
        - Land and building
        - Plant and machinery
        - Fixtures and fittings
        - Motor vehicles
    - Investment
      - Land and building for investment
  - Current assets
    - Stock
    - Debtors
    - Short-term investment
    - Prepayment
    - Bank
    - Cash in hand

- **Liabilities**
  - Current liabilities
    - Short-term liabilities (\(<\) one year)
      - Trade creditors
      - Overdraft
      - Accruals
      - Short-term loans
    - Long-term liabilities (\(>\) one year)
      - Long-term loans
      - Debentures

- **Capital**
  - Special kind of liability that exists between the owner and the entity

A resource used by a business or other organisation to derive income in the future

An Entity’s obligation to transfer economic benefit as a result of past event or transaction
The balance sheet should be presented using the vertical format, this would result in the above accounting equation to be arranged.

Assets – Liabilities = Capital

The profit and loss account (Revenue statement or Income statement)

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>X</td>
<td>Gross profit/(loss)</td>
</tr>
<tr>
<td>Less: Cost of sales</td>
<td></td>
<td>Less: Expenses</td>
</tr>
<tr>
<td>Opening stock</td>
<td>X</td>
<td>Light and heat</td>
</tr>
<tr>
<td>Add: Purchases</td>
<td>X</td>
<td>Telephone</td>
</tr>
<tr>
<td></td>
<td>X</td>
<td>Motor expenses</td>
</tr>
<tr>
<td>Less: Closing stock</td>
<td>(X)</td>
<td>Add: Other Income</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>X</td>
<td>Discount received</td>
</tr>
<tr>
<td>Gross profit/(loss)</td>
<td>X/(X)</td>
<td>Rent received</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Interest received</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Net profit/(loss)</td>
</tr>
</tbody>
</table>
Questions

2.1 | Assets | Liabilities | Capital |
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td></td>
</tr>
<tr>
<td>(i) 50,000</td>
<td>7,200</td>
<td>?</td>
<td></td>
</tr>
<tr>
<td>(ii) 112,000</td>
<td>19,600</td>
<td>?</td>
<td></td>
</tr>
<tr>
<td>(iii) 67,200</td>
<td>?</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>(iv) 96,400</td>
<td>?</td>
<td>65,800</td>
<td></td>
</tr>
<tr>
<td>(v) ?</td>
<td>25,200</td>
<td>76,800</td>
<td></td>
</tr>
<tr>
<td>(vi) ?</td>
<td>50,600</td>
<td>159,000</td>
<td></td>
</tr>
</tbody>
</table>

(6 marks)

2.2 Classify the following into Assets and Liabilities.

(i) Bank balance (vii) Premises
(ii) We owe for goods (viii) Creditor for goods
(iii) Motor vehicle (ix) Loan from D Randle
(iv) Fixture and fittings (x) Cash in hand
(v) Loan from Pringle (xi) Owing to bank
(vi) Office machinery (xii) Debtor

(6 marks)

2.3 State which of the following are shown under wrong classification for Kapil Dev’s business.

\[
\begin{array}{ll}
\text{Assets} & \text{Liabilities} \\
\text{Loan from A Lamb} & \text{Debtors} \\
\text{Motor vehicles} & \text{Money owing to bank} \\
\text{Premises} & \text{Stock of goods} \\
\text{Creditors} & \text{Loan from Riffle} \\
\text{Machinery} & \text{Money owing to A Little} \\
\text{Cash in hand} & \text{Fixtures} \\
\text{Capital} & \text{Creditors} \\
\text{Cash at bank} & \text{Buildings} \\
\end{array}
\]

(6 marks)

2.4 Mark Waugh starts business. Before any sales, he has purchased fixtures £12,000, motor vehicle £30,000 and stock of goods £21,000. Although he has paid in full for the fixtures and motor vehicle, he still owes £8,400 for some of the stock. His brother Steve has lent him £18,000. Mark, after the above, has £16,800 in the business bank account and £600 cash in hand. Calculate Mark’s capital?

(5 marks)


Answers

2.1

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>(i) 50,000</td>
<td>7,200</td>
<td>42,800</td>
</tr>
<tr>
<td>(ii) 112,000</td>
<td>19,600</td>
<td>92,400</td>
</tr>
<tr>
<td>(iii) 67,200</td>
<td>17,200</td>
<td>50,000</td>
</tr>
<tr>
<td>(iv) 96,400</td>
<td>30,600</td>
<td>65,800</td>
</tr>
<tr>
<td>(v) 102,000</td>
<td>25,200</td>
<td>76,800</td>
</tr>
<tr>
<td>(vi) 209,600</td>
<td>50,600</td>
<td>159,000</td>
</tr>
</tbody>
</table>

2.2

(i) Asset (vii) Asset
(ii) Liability (viii) Liability
(iii) Asset (ix) Liability
(iv) Asset (x) Asset
(v) Liability (xi) Liability
(vi) Asset (xii) Asset

2.3

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan from A Lamb Wrong Debtors Wrong</td>
<td></td>
</tr>
<tr>
<td>Motor Vehicles</td>
<td>Money owing to bank</td>
</tr>
<tr>
<td>Premises</td>
<td>Stock of goods Wrong</td>
</tr>
<tr>
<td>Creditors Wrong Loan from Riffle</td>
<td></td>
</tr>
<tr>
<td>Machinery</td>
<td>Money owing to A Little</td>
</tr>
<tr>
<td>Cash in hand Fixtures</td>
<td></td>
</tr>
<tr>
<td>Capital Wrong Creditors</td>
<td></td>
</tr>
<tr>
<td>Cash at bank Buildings Wrong</td>
<td></td>
</tr>
</tbody>
</table>

2.4

Total Assets = Liabilities

<table>
<thead>
<tr>
<th>Fixtures</th>
<th>12,000</th>
<th>Stock</th>
<th>8,400</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor vehicle</td>
<td>30,000</td>
<td>Brother’s loan</td>
<td>18,000</td>
</tr>
<tr>
<td>Stock of goods</td>
<td>21,000</td>
<td></td>
<td>26,400</td>
</tr>
<tr>
<td>Bank</td>
<td>16,800 +</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash in hand</td>
<td>600</td>
<td>Capital</td>
<td>?????</td>
</tr>
<tr>
<td>80,400</td>
<td>80,400</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Hence Capital = Assets – Liabilities = 80,400 – 26,400 = 54,000
Questions

2.1 Which of the following are not part of the income statement (profit and loss account)?
   A  Sales
   B  Gross profit
   C  Debtors
   D  Rent

(2 marks)

2.2 Which of the following are not part of the balance sheet?
   A  Prepayments
   B  Short-term loans
   C  Interest
   D  Creditors

(2 marks)

2.3 Which of the following is not part of the statement of movements on capital?
   A  Capital at the start of the period
   B  Net profit earned in the period
   C  Fixed assets
   D  Capital at the end of the period

(2 marks)

2.4 Which does not form part of cost of goods?
   A  Closing stock
   B  Sales
   C  Opening stock
   D  Purchases

(2 marks)

2.5 Sales £5,000, Purchases £3,000, Closing stock £2,000, Opening stock £400. Calculate
gross profit/(loss)?
   A  £3,600 Profit
   B  £400 Loss
   C  £10,400 Profit
   D  £4,400 Loss

(2 marks)

2.6 If the gross profit is £4,300, calculate net profit after the following transactions:
   Rent £1,000
   Interest £300
   Rent received £200

   A  £3,000 profit
   B  £3,200 profit
   C  £5,600 profit
   D  £5,800 profit

(2 marks)
2.7 An increase in stock of £500, a decrease in the bank balance of £800 and an increase in creditors of £2,400 results in

A a decrease in working capital of £2,700
B an increase in working capital of £2,700
C a decrease in working capital of £2,100
D an increase in working capital of £2,100

(2 marks)

2.8 The accounting equation at the start of the month was

Assets £14,000 less liabilities £6,250. During the month the following transactions took place: the business purchased a fixed asset for £3,000, paying by cheque, a profit of £3,500 was made and creditors of £2,750 were paid by cheque.

Calculate the capital at the start of the month?

A £7,750
B £11,500
C £5,500
D £8,250

(2 marks)

2.9 A sole trader has opening capital of £20,000 and closing capital of £9,000. During the period, the owner introduced capital of £8,000 and withdrew £16,000 for her own use. Calculate her profit or loss during the period?

A £21,000 loss
B £3,000 profit
C £3,000 loss
D £21,000 profit

(2 marks)

2.10 The profit of a business may be calculated by using which one of the following formula?

A Opening capital – Drawings + Capital introduced – Closing capital
B Opening capital + Drawings – Capital introduced – Opening capital
C Opening capital + Drawings – Capital introduced – Closing capital
D Closing capital – Drawings + Capital introduced – Opening capital

(2 marks)
Answers

2.1 C
2.2 C
2.3 C
2.4 B
2.5 A
2.6 B
2.7 A

£

Increase in stock = Increase in working capital 500
Decrease in bank = Decrease in working capital (800)
Increase in creditor = Decrease in working capital (2,400)
Overall decrease in working capital (2,700)

2.8 A

£

Assets 14,000
Less: Liabilities (6,250) 7,750

So a profit of £3,500 increases this to £11,250. The purchase of a fixed asset by cheque
and the payment to creditors by cheque affects assets and liabilities, but neither
affects capital.

2.9 C

£

Opening capital 20,000
Introduced 8,000
Drawings (16,000)
Loss – balancing figure (3,000)
Closing capital 9,000

2.10 B
Revision questions 2

2.1 Gross profit for 2001 can be calculated from
   A purchases for 2001 plus stock at 31 December 2001 less stock at 1 January 2001
   B purchases for 2001 less stock at 31 December 2001 plus stock at 1 January 2001
   C cost of goods sold during 2001 plus sales during 2001
   D net profit for 2001 plus expenses for 2001

(2 marks)

2.2 The capital of a sole trader would change as a result of
   A a creditor being paid his account by cheque
   B raw materials being purchased on credit
   C fixed assets being purchased on credit
   D wages being paid in cash

(2 marks)

2.3 The ‘accounting equation’ can be rewritten as
   A assets plus profit less drawings less liabilities equals closing capital
   B assets plus liabilities less drawings equals opening capital plus profit
   C assets less liabilities less opening capital plus drawings equals profit
   D opening capital plus profit less drawings less liabilities equals assets

(2 marks)

2.4 An increase in stock of £500, a decrease in the bank balance of £800 and an increase in
   creditors of £2,400 results in
   A a decrease in working capital of £2,700
   B an increase in working capital of £2,700
   C a decrease in working capital of £2,100
   D an increase in working capital of £2,100

(2 marks)

2.5 A sole trader had opening capital of £20,000 and closing capital of £9,000. During the
   period, the owner introduced capital of £8,000 and withdrew £16,000 for her own use.
   Her profit or loss during the period was

(2 marks)

2.6 The accounting equation can change as a result of certain transactions. Which one of
   the following transactions would not affect the accounting equation?
   A Selling goods more than their cost
   B Purchasing a fixed asset on credit
   C The owner withdrawing cash
   D Debtors paying their accounts in full, in cash

(2 marks)
**Answers to revision questions 2**

2.1 D

Working backwards often confuses candidates. Try drawing up a short example of a trading and profit and loss account using simple figures of your own, to prove or disprove the options given.

For example:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>20,000</td>
</tr>
<tr>
<td>Stock at 31.12.2000</td>
<td>2,000</td>
</tr>
<tr>
<td>Add: Purchases during 2001</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Less: stock at 31.12.2001</td>
<td>1,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>9,000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>11,000</td>
</tr>
<tr>
<td>Less: expenses</td>
<td>4,000</td>
</tr>
<tr>
<td>Net profit</td>
<td>7,000</td>
</tr>
</tbody>
</table>

Make all the figures different or you will make mistakes.

You can now see the options A, B and C will not give the correct answer.

2.2 D

Transactions that affect only assets and liabilities do not affect capital. Therefore, options A, B and C are irrelevant.

Profits increase capital
Losses reduce capital

2.3 C

The standard ‘accounting equation’ is

Assets = liabilities + capital

and capital equals opening capital plus profits less drawings. The only rearrangement of this equation that maintains the integrity of the accounting equation is C.

2.4 A

The effect on working capital is calculated as

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in stock = Increase in working capital</td>
<td>500</td>
</tr>
<tr>
<td>Decrease in bank = Decrease in working capital</td>
<td>(800)</td>
</tr>
<tr>
<td>Increase in creditors = Decrease in working capital</td>
<td>(2,400)</td>
</tr>
<tr>
<td>Overall decrease in working capital</td>
<td>(2,700)</td>
</tr>
</tbody>
</table>
2.5

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening capital</td>
<td>20,000</td>
</tr>
<tr>
<td>Introduced</td>
<td>8,000</td>
</tr>
<tr>
<td>Drawings</td>
<td>(16,000)</td>
</tr>
<tr>
<td>Loss – balancing figure</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Closing capital</td>
<td>9,000</td>
</tr>
</tbody>
</table>

2.6 D

The accounting equation changes when one or more of assets, liabilities or capital changes. Selling goods at a profit would change capital; purchasing a fixed asset on credit would change assets and liabilities; the owner withdrawing cash would change assets and capital; debtors paying their accounts in cash would not affect any of these.
The Accounting System in Action
There is no such thing as a stock account. A stock account is replaced by one of the following:

- **Stock is an asset**
- **Assets can only increase in value**
- **Assets can only decrease in value**

**Treat all items below as assets**

<table>
<thead>
<tr>
<th>Treat all items below as asset</th>
<th>Increase</th>
<th>Debit</th>
<th>Decrease</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**How**

**When you buy more stock**

- Debit: (stock increases)
- Purchase A/C

**When your customer returns the stock back to you**

- Return inwards A/C or Sales return A/C
- Debit: (stock increases)
- Purchase by cash
  - Dr: Purchase
  - Cr: Cash
- Purchase on credit
  - Dr: Purchase
  - Cr: Supplier

**When you sell more stock**

- Credit: (stock decreases)
- Sales A/C
- Sales on credit
  - Dr: Debtor (Customer)
  - Cr: Sales

**You return the stock back to your supplier**

- Credit: (stock decreases)
- Return outwards A/C or Purchase return A/C
- Sales on cash
  - Dr: Cash
  - Cr: Sales
### The Accounting System in Action

**Ledger account**

<table>
<thead>
<tr>
<th>Date</th>
<th>Narrative</th>
<th>£</th>
<th>Date</th>
<th>Narrative</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Left hand side</td>
<td></td>
<td></td>
<td>Right hand side</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Debit</td>
<td></td>
<td></td>
<td>Credit</td>
<td></td>
</tr>
</tbody>
</table>

#### Accounting equation

**Balance sheet**

<table>
<thead>
<tr>
<th></th>
<th>Assets side</th>
<th>Capital + Liabilities side</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase</td>
<td>Assets increase always DEBIT</td>
<td>Capital and Liabilities increase always CREDIT</td>
</tr>
<tr>
<td>Decrease</td>
<td>Assets decrease always CREDIT</td>
<td>Capital and Liabilities decrease always DEBIT</td>
</tr>
</tbody>
</table>

- **Expenses or costs**
  - Always DEBIT

- **Revenue or income**
  - Always CREDIT

- **Profit and loss Account**
Books of prime entry includes the following:

(i) Sales day book or Sales journal or Sales book
(ii) Purchases day book or Purchase journal or Purchase book
(iii) Journals
(iv) Cash book
(v) Petty cash book

Petty cash book is a book of prime entry and it is also part of the double entry system.
3.1 Tick the correct boxes for the following:

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vi)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vii)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(viii)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ix)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(x)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(i) Increase in assets
(ii) Increase in capital
(iii) Decrease in capital
(iv) Increase in liabilities
(v) Decrease in assets
(vi) Decrease in liabilities
(vii) Increase in expenses
(viii) Decrease in income
(ix) Decrease in expenses
(x) Increase in income

(10 marks)

3.2 Complete the table showing which accounts are to be credited and which are to be debited. Consider all items below as STOCK.

<table>
<thead>
<tr>
<th>Account to be debited</th>
<th>Account to be credited</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Goods bought on credit from S Davis</td>
<td></td>
</tr>
<tr>
<td>(ii) Goods returned to us by H Higgins</td>
<td></td>
</tr>
<tr>
<td>(iii) Machinery returned to A Snooker Ltd</td>
<td></td>
</tr>
<tr>
<td>(iv) Goods bought for cash</td>
<td></td>
</tr>
<tr>
<td>(v) Motor van bought on credit from I Landle</td>
<td></td>
</tr>
<tr>
<td>(vi) Goods returned by us to B Boro</td>
<td></td>
</tr>
<tr>
<td>(vii) I Mckenroe paid up his account by cheque</td>
<td></td>
</tr>
<tr>
<td>(viii) Goods bought by cheque</td>
<td></td>
</tr>
<tr>
<td>(ix) We paid creditor, S Graf, by cheque</td>
<td></td>
</tr>
<tr>
<td>(x) Goods sold on credit to J Muller</td>
<td></td>
</tr>
</tbody>
</table>

(10 marks)

3.3 Sport stars

Please prepare T accounts for the transactions below.

Comprehensive example (Sport stars)

1994

- September 1: Bought goods on credit £68 from D Underwood
- September 2: Bought goods on credit £154 from M Hughes
- September 5: Sold goods on credit to A Border for £60
- September 6: Sold goods on credit to A Steward for £50
- September 10: Returned goods £14 to D Underwood
- September 12: Goods bought for cash £100
- September 19: A Steward returned goods £16 to us
- September 21: Goods sold for cash £150
- September 22: Paid cash to D Underwood £54
- September 30: A Border paid the amount owing by him £60 in cash
- September 31: Bought goods on credit £128 from M Hughes

(15 marks)
Answers

3.1 (i) Debit
(ii) Credit
(iii) Debit
(iv) Credit
(v) Credit
(vi) Debit
(vii) Debit
(viii) Debit
(ix) Credit
(x) Credit

3.2

<table>
<thead>
<tr>
<th>Account to be debited</th>
<th>Account to be credited</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Goods bought on credit from S Davis</td>
<td>Purchase</td>
</tr>
<tr>
<td>(ii) Goods returned to us by H Higgins</td>
<td>Return inward</td>
</tr>
<tr>
<td>(iii) Machinery returned to A Snooker Ltd</td>
<td>A Snooker</td>
</tr>
<tr>
<td>(iv) Goods bought for cash</td>
<td>Purchases</td>
</tr>
<tr>
<td>(v) Motor van bought on credit from I Landle</td>
<td>Purchases</td>
</tr>
<tr>
<td>(vi) Goods returned by us to B Boro</td>
<td>B Boro</td>
</tr>
<tr>
<td>(vii) I Mckenroe paid up his account by cheque</td>
<td>Bank</td>
</tr>
<tr>
<td>(viii) We paid creditor, S Graf by cheque</td>
<td>Purchases</td>
</tr>
<tr>
<td>(ix) Goods sold on credit to J Muller</td>
<td>J Muller</td>
</tr>
</tbody>
</table>

3.3 Comprehensive example (Sport stars)

<table>
<thead>
<tr>
<th>Purchases</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 1 D Underwood</td>
<td>68</td>
</tr>
<tr>
<td>Sep 2 M Hughes</td>
<td>154</td>
</tr>
<tr>
<td>Sep 12 Cash</td>
<td>100</td>
</tr>
<tr>
<td>Sep 31 M Hughes</td>
<td>128</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sales</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 5 A Border</td>
<td>60</td>
</tr>
<tr>
<td>Sep 6 A Steward</td>
<td>50</td>
</tr>
<tr>
<td>Sep 21 Cash</td>
<td>150</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Return inwards</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 19 A Steward</td>
<td>16</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Return outwards</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 10 D Underwood</td>
<td>14</td>
</tr>
</tbody>
</table>
### The Accounting System in Action

#### D Underwood

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 10</td>
<td>Return outward</td>
<td>£14</td>
</tr>
<tr>
<td>Sep 1</td>
<td>Purchases</td>
<td>£68</td>
</tr>
<tr>
<td>Sep 22</td>
<td>Cash</td>
<td>£54</td>
</tr>
</tbody>
</table>

#### A Border

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 5</td>
<td>Sales</td>
<td>£60</td>
</tr>
<tr>
<td>Sep 30</td>
<td>Cash</td>
<td>£60</td>
</tr>
</tbody>
</table>

#### A Steward

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 6</td>
<td>Sales</td>
<td>£50</td>
</tr>
<tr>
<td>Sep 19</td>
<td>Return inwards</td>
<td>£16</td>
</tr>
</tbody>
</table>

#### M Hughes

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 21</td>
<td>Sales</td>
<td>£150</td>
</tr>
<tr>
<td>Sep 30</td>
<td>A Border</td>
<td>£60</td>
</tr>
<tr>
<td>Sep 12</td>
<td>Purchases</td>
<td>£100</td>
</tr>
<tr>
<td>Sep 22</td>
<td>D Underwood</td>
<td>£54</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Purchases</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 2</td>
<td>Purchases</td>
<td>£154</td>
</tr>
<tr>
<td>Sep 31</td>
<td>Purchases</td>
<td>£128</td>
</tr>
</tbody>
</table>
Revision questions 3

3.1 A credit balance of £1,834 brought down on B Ltd’s account in the books of A Ltd means that
   A A Ltd owes B Ltd £1,834
   B B Ltd owes A Ltd £1,834
   C A Ltd has paid B Ltd £1,834
   D A Ltd is owed £1,834 by B Ltd

(2 marks)

3.2 Which one of the following statements is correct?
   A Assets and liabilities normally have credit balances
   B Liabilities and revenues normally have debit balances
   C Assets and revenues normally have credit balances
   D Assets and expenses normally have debit balances

(2 marks)

3.3 On 1 January, a business had a customer, Junior, who owed £1,200. During January, Junior bought goods for £2,100 and returned goods valued at £750. He also paid £960 in cash towards the outstanding balance. The balance of Junior’s account on 31 January is
   A £1,590 debit
   B £1,590 credit
   C £810 debit
   D £810 credit

(2 marks)

3.4 The correct entries needed to record the return of office equipment that had been bought on credit from Penny, and not yet paid for, are

   Debit Credit
   A Office equipment Sales
   B Office equipment Penny
   C Penny Office equipment
   D Cash Office equipment

(2 marks)

3.5 Which one of the following statements regarding the balance on a ledger account is not correct?
   A A credit balance exists where the total of credit entries is more than the total of debit entries.
   B A debit balance exists where the total of debit entries is less than the total of credit entries.
   C A credit balance exists where the total of debit entries is less than the total of credit entries.
   D A debit balance exists where the total of debit entries is more than the total of credit entries.

(2 marks)
3.6 Which of the following is the correct entry to record the purchase on credit of stocks intended for resale?

\[
\begin{array}{|l|l|}
\hline
\text{Debit} & \text{Credit} \\
\hline
A \text{ Stock} & \text{Debtor} \\
B \text{ Stock} & \text{Creditor} \\
C \text{ Purchases} & \text{Creditor} \\
D \text{ Creditor} & \text{Purchases} \\
\hline
\end{array}
\]

(2 marks)

3.7 X receives goods from Y on credit and X subsequently pays by cheque. A then discovers that the goods are faulty and cancels the cheque before it is cashed by Y. How should X record the cancellation of the cheque in his books?

\[
\begin{array}{|l|l|}
\hline
\text{Debit} & \text{Credit} \\
\hline
A \text{ Creditors} & \text{Returns outwards} \\
B \text{ Creditors} & \text{Bank} \\
C \text{ Bank} & \text{Creditors} \\
D \text{ Returns outwards} & \text{Creditors} \\
\hline
\end{array}
\]

(2 marks)
3.1 A

A credit balance in the books of A Ltd indicates that it owes money; none of the distracters would result in a credit balance.

3.2 D

<table>
<thead>
<tr>
<th>Assets</th>
<th>Capital and liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase</td>
<td>Debit</td>
</tr>
<tr>
<td>Decrease</td>
<td>Credit</td>
</tr>
</tbody>
</table>

3.3 A

= 1,200 (debit) + 2,100 (debit) − 750 (credit) − 960 (credit) = 1,590 debit

3.4 C

When purchased

<table>
<thead>
<tr>
<th>Dr</th>
<th>Office equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cr</td>
<td>Penny</td>
</tr>
</tbody>
</table>

When returned

<table>
<thead>
<tr>
<th>Dr</th>
<th>Penny</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cr</td>
<td>Office equipment</td>
</tr>
</tbody>
</table>

Hence C.

3.5 B

3.6 C

The stock account is never used to record purchases.

3.7 C
Summarising the Ledger Accounts
The following errors do not prevent the trial balance from agreeing:

- **Error of omission**
  - Where the transaction has been completely omitted from the ledger accounts

- **Error of commission**
  - Where one side of the transaction has been entered in the wrong account (will not affect profit and position of balance sheet)

- **Error of principle**
  - As for errors of commission, but the correct and incorrect accounts are of different types e.g., purchased in purchase account instead of fixed asset account (will affect profit and position of balance sheet)

- **Error of original entry**
  - Where the wrong amount has been used for both debit and credit side

- **Reversal of entry**
  - Where the debit has been made to the account that should have been credited and vice versa

- **Duplication of entries**
  - Where the transaction has been posted twice

- **Compensation errors**
  - Where two or more transactions have been entered incorrectly, but cancelling each other out e.g., wages debited with £200 in excess and sale credited with £200 in excess
From ledger accounts to final accounts

<table>
<thead>
<tr>
<th>Bank A/C</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>18 Dec 2001 SP A/C</td>
<td>30</td>
</tr>
<tr>
<td>31 Dec 2001 Bal c/d</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>110</td>
</tr>
<tr>
<td>1 Jan 2002 Bal b/d</td>
<td>80</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Furniture</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>18 Dec 2001 Bank</td>
<td>70</td>
</tr>
<tr>
<td>31 Dec Bal c/d</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>70</td>
</tr>
<tr>
<td>1 Jan 2002 Bal b/d</td>
<td>70</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SP A/C</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>31 Dec 2001 Bal c/d</td>
<td>30</td>
</tr>
<tr>
<td>18 Dec 2001 Bank</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>30</td>
</tr>
<tr>
<td>1 Jan 2002 Bal b/d</td>
<td>30</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rent A/C</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>16 Dec 2001 Bank</td>
<td>40</td>
</tr>
<tr>
<td>31 Dec 2001 Bal c/d</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>40</td>
</tr>
<tr>
<td>1 Jan 2002 Bal b/d</td>
<td>40</td>
</tr>
</tbody>
</table>

Trial balance as at 31 December 2002

<table>
<thead>
<tr>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank A/C</td>
<td>80</td>
</tr>
<tr>
<td>Furniture A/C</td>
<td>70</td>
</tr>
<tr>
<td>SP A/C</td>
<td>30</td>
</tr>
<tr>
<td>Rent A/C</td>
<td>110</td>
</tr>
</tbody>
</table>

prepare trial balance

Trading and profit and loss account

Balance sheet
The trial balance

It is a list of balances in a double entry accounting system. If the records have been correctly maintained, the sum of the debit balances will equal the sum of the credit balances although certain errors, such as errors of omission of transaction or erroneous entries, will not be disclosed by the trial balance.

Trial balance is thus a list of balances on the ledger accounts. If the totals of the debit and credit balances on the trial balance are not equal, then an error or errors have been made either

(a) in the posting of the transactions to the ledger accounts or
(b) in the balancing of the accounts or
(c) in the transferring of the balances from the ledger account to the trial balance.
Questions

4.1 Discuss what is the definition of a trial balance. 

4.2 What are the reasons why a trial balance may not balance? 

4.3 Give four examples of errors that do not affect the trial balance from agreeing and explain what each one means.
**Answers**

4.1 Trial balance is a list of balances in a double entry accounting system. If the records have been correctly maintained, the sum of the debit balances will equal the sum of the credit balances although certain errors, such as errors of omission of transactions or erroneous entries, will not be disclosed by the trial balance.

4.2 Trial balance is thus a list of balances on the ledger accounts. If the totals of the debit and credit balances on the trial balance are not equal, then an error or errors have been made either:

   (a) In the posting of the transactions to the ledger accounts or
   (b) In the balancing of the accounts or
   (c) In the transferring of the balances from the ledger account to the trial balance.

4.3 Error of omission – where the transaction has been completely omitted from the ledger accounts.

   Error of commission – where one side of the transaction has been entered in wrong account (will not affect profit and position of balance sheet).

   Error of original entry – where the wrong amount has been used for both debit and credit side.

   Error of principle – as for errors of commission, but the correct and incorrect amounts are of different types for example entered in purchase account instead of fixed asset account.
Revision questions 4

4.1 Where a transaction is credited to the correct ledger account, but debited incorrectly to the repairs and renewals account instead of to plant and machinery account, the error is known as an error of

A omission
B commission
C principle
D original entry

(2 marks)

4.2 The debit side of a trial balance totals £200 more than the credit side. This could be due to

A a purchase of goods for £200 being omitted from the creditor’s account
B a sale of goods for £200 being omitted from the debtors’ account
C an invoice of £100 for electricity being credited to the electricity account
D a receipt for £200 from a debtor being omitted from the cash book

(2 marks)

4.3 An invoice from a supplier of office equipment has been debited to the stationery account. This error is known as

A an error of commission
B an error of original entry
C a compensation error
D an error of principle

(2 marks)


Answers to revision questions 4

4.1 C

This is a straightforward test of your knowledge of types of errors that can exist. If the wrong account is used, and this results in an incorrect statement of profit, then an error of principle has been made. Debiting the repairs and renewals account results in an extra charge for expenses in the profit and loss account, when the item should be included as a fixed asset on the balance sheet.

4.2 A

B and D are incorrect as they would give a lower debit side. C is incorrect because it would give a higher credit side.

4.3 D

An error of principle occurs, where an entry is made in the wrong account, and that account is of a different category from the correct account – thus affecting the view given by the final accounts. Office equipment is a fixed asset, while stationery is an expense, so both profit and fixed assets will be incorrect.
Further Aspects of Ledger Accounts
Thus which ever carriage cost they are, both are DEBITs one is in the Trading account (carriage inwards) and the other is in the Profit and loss account (carriage outwards)
Further Aspects of Ledger Accounts

Discount

Trade discount

Discount given on bulk purchases to the customer, however this will only affect the selling price

Hence, there is no double entry for trade discounts

Sales £XX
Less: Trade discount (XX)
Net sales XX

Therefore, trade discount are in the Trading account

Cash discount

Discounts on prompt payment of invoices or early settlement discount

Discount allowed

To customer

It is an expense to the seller, hence

Debit

In the Profit and loss account

Dr Discount allowed
Cr Debtor

Discount received

From supplier

It is an income to the purchaser, hence

Credit

In the Profit and loss account

Dr Supplier
Cr Discount received
**Accounting for VAT**

When an organisation within the EU States including United Kingdom reaches a certain level of turnover then they are obliged to register (in the UK) with Her Majesty’s, Customs & Excise (HMC&E).

There are three rates of VAT:
- Standard rate of 17½%
- Zero rate
- Exempt rate

VAT on sales is classified as input tax.

VAT on purchases is classified as output tax.

**Examples**

1. Purchase goods costing £360 subject to 20% trade discount:

   £  
   List price  360.00  
   Less: Trade discount 20% 72.00  
   Net goods value  288.00  
   VAT @ 17½%  50.40  
   **338.40**  

   Entries:
   £  
   Dr Purchases  288.00  
   Dr VAT  50.40  
   Cr Supplier  338.40

2. Sold goods costing £80:

   £  
   Sales  80.00  
   VAT 17½%  14.00  
   Total Sales  94.00  

   £  
   Dr Debtors  94.00  
   Cr Sales  80.00  
   Cr VAT  14.00

3. Gross amount say £500, calculate VAT on this figure:

   £500 × 7/47 = £74.47  
   Hence VAT on gross amount is £74.47  
   or  
   £500 × 17.5/117.5 = £74.47
Questions

5.1 What is cash discount?
   A When payment is made in cash
   B When payment is made by cheque
   C When payment is made before due date
   D When purchases are made in bulk

5.2 What is the double entry for discount allowed?
   A Dr Debtors Cr Discount allowed
   B Dr Debtors Cr Discount received
   C Dr Discount allowed Cr Debtors
   D Dr Discount allowed Cr Supplier

5.3 Where is discount allowed disclosed?
   A Trading account
   B Profit and loss account
   C Trial balance
   D Balance sheet

5.4 What is the double entry for discount received?
   A Dr Supplier Cr Discount received
   B Dr Discount received Cr Supplier
   C Dr Discount received Cr Customer
   D Dr Customer Cr Discount received

5.5 Where is discount received disclosed?
   A Profit and loss account
   B Trading account
   C Balance sheet
   D Trial balance

5.6 What is trade discount?
   A Discount as bulk purchases
   B Discount when paying in cash
   C Discount as early settlement of invoice
   D Discount if you trade overseas only

5.7 What is the double entry for trade discount?
   A Dr Sales Cr Trade discount
   B Dr Trade discount Cr Sales
   C Dr Purchases Cr Trade discount
   D No double entry
5.8 Where is carriage inwards disclosed?
A Profit and loss account
B Balance sheet
C Trading account
D Trial balance
(2 marks)

5.9 What does carriage inwards effect?
A Sales
B Purchases
C Drawing
D Capital
(2 marks)

5.10 Carriage outwards is disclosed in
A Balance sheet
B Profit and loss account
C Trading account
D Trial balance
(2 marks)

5.11 Calculate the VAT on £100 at standard rate.
A £17.50
B £14.89
C £117.50
D Nil
(2 marks)

5.12 How much is the VAT amount, if gross sales were £100?
A £17.50
B £14.89
C £117.50
D Nil
(2 marks)

5.13 X purchased goods costing £500 from Z Ltd (before VAT).
Z gave X a trade discount of 20%, calculate the net amount after discount.
A £470.00
B £400.00
C £587.50
D £340.43
(2 marks)

5.14 As per 5.13 above, calculate VAT on purchases after trade discount.
A £87.50
B £70.00
C £17.50
D £82.25
(2 marks)
As per 5.13 above, what would be the final double entry after calculation of trade discount and VAT?

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Dr</td>
<td>Purchases</td>
</tr>
<tr>
<td></td>
<td>Dr</td>
<td>VAT</td>
</tr>
<tr>
<td></td>
<td>Cr</td>
<td>Supplier</td>
</tr>
<tr>
<td>B</td>
<td>Dr</td>
<td>Supplier</td>
</tr>
<tr>
<td></td>
<td>Cr</td>
<td>VAT</td>
</tr>
<tr>
<td></td>
<td>Cr</td>
<td>Purchases</td>
</tr>
<tr>
<td>C</td>
<td>Dr</td>
<td>Purchase</td>
</tr>
<tr>
<td></td>
<td>Dr</td>
<td>VAT</td>
</tr>
<tr>
<td></td>
<td>Cr</td>
<td>Supplier</td>
</tr>
<tr>
<td>D</td>
<td>Dr</td>
<td>Purchases</td>
</tr>
<tr>
<td></td>
<td>Dr</td>
<td>VAT</td>
</tr>
<tr>
<td></td>
<td>Cr</td>
<td>Supplier</td>
</tr>
</tbody>
</table>

(2 marks)


**Answers**

5.1 C

Cash discount is discount on early settlement of invoice, before due day or prompt payment discount.

5.2 C

Dr Discount allowed     Cr Debtors

5.3 B

Profit and loss account

5.4 A

Dr Supplier     Cr Discount received

5.5 A

Profit and loss account

5.6 A

Discount as bulk purchase

5.7 D

No double entry

5.8 C

Trading account

5.9 B

Purchases

5.10 B

Profit and loss account

5.11 A

£17.50  \((£100 \times 17.5\% = £17.50)\)

5.12 B

£14.80  \((£100 \times 17.5/117.50 = £14.89)\)

5.13 B

£400

List price  500
Less: Trade discount  (100)
Net purchases  400
5.14 B

£70

£
List price 500.00
Less: Trade discount (100.00)
Net purchases 400.00
VAT @ 17.5% 70.00

470.00

5.15 A

£ £
Dr Purchases 400.00
Dr VAT 70.00
Cr Supplier 470.00
Revision questions 5

5.1 Which of the following transactions would result in an increase in capital employed?
   A Selling stock at profit
   B Writing off a bad debt
   C Paying a creditor in cash
   D Increasing the bank overdraft to purchase a fixed asset
   (2 marks)

5.2 Rent paid on 1 October 2002 for the year to September 2003 was £600 and rent paid on 1 October 2003 for the year to 30 September 2004 was £800. Rent payable, as shown in the profit and loss account for the year ended 31 December 2003, would be
   A £600
   B £800
   C £650
   D £750
   (2 marks)

5.3 A decrease in the provision for doubtful debts would result in
   A an increase in liabilities
   B a decrease in working capital
   C a decrease in net profit
   D an increase in net profit
   (2 marks)

5.4 The sales account is
   A credited with the total of sales made, including VAT
   B credited with the total of sales made, excluding VAT
   C debited with the total of sales made, including VAT
   D debited with the total of sales made, excluding VAT
   (2 marks)

5.5 An error of commission is one, where
   A a transaction has not been recorded
   B one side of a transaction has been recorded in the wrong account, and that account is of a different class from the correct account
   C one side of a transaction has been recorded in the wrong account, and that account is of the same class from the correct account
   D a transaction has been recorded using the wrong amount
   (2 marks)
Answers to revision questions 5

5.1 A
Capital employed is increased by making a profit, or by adding more capital. Writing off bad debt is clearly the opposite of making a profit; transactions such as B and C merely adjust the split of assets and liabilities but do not add anything overall.

5.2 C
The year to 31 December 2003 includes 3/4 of the rent for the year to 30 September 2003 and 1/4 of the rent for the year to 30 September 2004, that is:

\[ \frac{3}{4} \times \£600 + \frac{1}{4} \times \£800 = \£650 \]

(9/12 \times 600) (3/12 \times 800)

5.3 D
The change in provision for doubtful debts is taken to the profit and loss account – an increase is debited and therefore decreases net profit, while a decrease is credited and therefore increases net profit. The resultant balance on the provision for doubtful debts account is deducted from debtors (current assets), which in turn affects working capital. A decrease in the provision would increase net profit, and would increase current assets. The latter is not one of the options, therefore D is the answer.

5.4 B
VAT is excluded from sales and purchases accounts, so A and C are incorrect. Sales is revenue, and therefore the sales account is credited.

5.5 C
A is incorrect as this is an error of omission. B is incorrect as an error of principle occurs where the two accounts are of different classes. D is an example of an error of original entry.
This Page is Intentionally Left Blank
Accounting for Fixed Assets
Why balance sheet?

- Large amounts in pound sterling (£) (e.g. cost of car)
- Lasts long term (>1 year e.g. cost of car)
- For example, delivery cost

Why profit and loss?

- Relatively low value in £ (e.g. road tax, insurance)
- Lasts short term (<1 year e.g. fuel, insurance etc.)
- Recurring expense

- Add value to improve capacity and performance
- Does not add value
Accounting for Fixed Assets

Depreciation

Factors and causes of depreciation

Depletion

Due to usage, e.g.
- Mines
- Minerals

Depletion

Time

Leasehold

Long lease (>50 years)

Freehold

Depending on asset normally land and/or buildings

Obsolescence

Due to growth in economy via technological changes

Out of date

Economic

Again could be due to usage

- Rust
- Rot
- Decay
- Wear and tear

The whole of the above structure can be summarised within the definition of depreciation.

Depreciation is the measure of the wearing out, consumption or other loss of value of a fixed asset whether arising from use, effluxion of time or obsolescence through technological and market changes.

Depreciation is an expense and as such should be debited to the profit and loss account.
Exam Practice Kit: Financial Accounting Fundamentals

Methods of depreciation

Various

Straight-line method or fixed instalment method

Machine hour method or rate of usage method

Reducing balance method or diminishing balance method

Sum of digits

- Allows same amount of depreciation to be charged over the life of the asset

Depreciation = $\frac{\text{Original cost} - \text{estimated residual value}}{\text{Estimated useful economic life}}$

Say, cost £10,000, life 5 years, residual value is £5,000.

Depreciation = \( \frac{10,000 - 5,000}{5} \)

Depreciation = £1,000/year for 5 years

- Under this method a fixed rate of depreciation % is given or can be calculated using a formula. Here the depreciation rate will be higher in the earlier years as there will be less maintenance cost on the asset, and as maintenance cost increase the depreciation charges will be less. This method helps with the cash flow of the company.

see next page for example
Accounting for Fixed Assets

Buy Fixed asset
Say £10,000, depreciation 10% straight line

1 Cost of asset
2 Depreciation
3 Net book value
4 Consider historical cost rule

Dr  Cr
£  £

Dr Fixed asset 10,000 10,000
Cr Bank/Cash

Dr Depreciation expense (profit and loss) 1,000
Cr Accumulated depreciation (balance sheet) (Provision for depreciation)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
<th>Accumulated depreciation</th>
<th>NBV</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Year 1</td>
<td>10,000</td>
<td>(1,000)</td>
<td>9,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>10,000</td>
<td>(2,000)</td>
<td>8,000</td>
</tr>
</tbody>
</table>

Consider historical cost rule:
- Always accumulated figure to date
Say later on, the asset is Sold £3,000
or Disposal
or Scrap value
or Financial proceeds are nil
Part exchange
Insurance money received

All these terms mean disposal

(1) Close the cost of the asset (always ORIGINAL COST)
Dr Fixed asset disposal 10,000
Cr Fixed asset 10,000

(2) Close off the accumulated depreciation account (with the balance in the account)
Dr Accumulated depreciation 1,000
Cr Fixed asset disposal account 1,000

(3) Consider sales proceeds
Dr Bank/Cash 3,000
Cr Fixed asset disposal 3,000

(4) Finally consider profit or loss via the Fixed asset disposal account
Dr Profit and Loss 6,000
Cr Fixed asset disposal 6,000

Fixed asset disposal account

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Cost</td>
<td>10,000</td>
</tr>
<tr>
<td>Profit and loss account (Profit)</td>
<td></td>
</tr>
<tr>
<td>(Balancing figure)</td>
<td>X</td>
</tr>
<tr>
<td>(2) Accumulated depreciation</td>
<td>1,000</td>
</tr>
<tr>
<td>(3) Sales proceeds</td>
<td>3,000</td>
</tr>
<tr>
<td>(4) Profit and loss Account (Loss)</td>
<td>6,000</td>
</tr>
<tr>
<td>(Balancing figure)</td>
<td></td>
</tr>
</tbody>
</table>

10,000 10,000
Reducing balance method

- Cost £10,000
- Residual value £5,000
- Percentage not given
- Estimated life 5 years

In this situation most students assume that there is an error in the question and hence calculate depreciation using the straight-line method. However, if the examiner wants you to use the reducing balance method then initially you will need to calculate the depreciation percentage using the following formulae.

\[ R = 1 - \sqrt[\frac{n}{s/c}} \]

\[ R = \text{rate of depreciation} \]
\[ n = \text{number of years} \]
\[ s = \text{scrap value or residual value} \]
\[ c = \text{cost of asset} \]

Once the percentage is calculated or given, then the following procedure is used to calculate depreciation (say the rate of depreciation is 10%).

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
<th>Depreciation</th>
<th>Net book value</th>
<th>Depreciation</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10,000</td>
<td>1,000</td>
<td>9,000</td>
<td>900</td>
<td>8,100</td>
</tr>
<tr>
<td>2</td>
<td>9,000</td>
<td>(900)</td>
<td>8,100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>8,100</td>
<td>(810)</td>
<td>7,290</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
In the Balance sheet, depreciation is shown as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
<th>Accumulated depreciation</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>10,000</td>
<td>(1,000)</td>
<td>9,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>9,000</td>
<td>(1,000)</td>
<td>8,000</td>
</tr>
</tbody>
</table>

This is INCORRECT. Why?

As per Companies Act 1985, all assets must be shown at original historical cost with exceptions (see later).

Thus

<table>
<thead>
<tr>
<th>Year 2</th>
<th>Cost</th>
<th>Accumulated depreciation</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10,000</td>
<td>(2,000)</td>
<td>8,000</td>
</tr>
</tbody>
</table>

correct method
Companies Act 1985 states that all assets must be shown at original historical cost except:

- Stock
- Goodwill
- Short-term investments

Can be stated at either:

- Market value
- Current cost

Under alternative accounting rules
Accruals and prepayments

With any expense account, always ask the following questions to determine an accrual or a prepayment.

(a) How much am I suppose to pay? and
(b) How much have I paid?

<table>
<thead>
<tr>
<th>Expense account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepayments b/f</td>
</tr>
<tr>
<td>How much have I paid</td>
</tr>
<tr>
<td>(Cash/Bank)</td>
</tr>
<tr>
<td>If difference is here then</td>
</tr>
<tr>
<td>Bal c/d (Accruals)</td>
</tr>
<tr>
<td>If difference is here then</td>
</tr>
<tr>
<td>Bal c/d (Prepayments)</td>
</tr>
<tr>
<td>Bal b/f (Prepayment)</td>
</tr>
<tr>
<td>Balance sheet</td>
</tr>
<tr>
<td>Current assets</td>
</tr>
<tr>
<td>Stock</td>
</tr>
<tr>
<td>Debtors</td>
</tr>
<tr>
<td>Prepayments</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

(1)–(5) represents orders of transaction.

With any Income/Revenue account, always ask the following questions?

(Please note that this account is very important when dealing with the topic Non-profit-making organisations, notably clubs and societies, in which it would represent the SUBSCRIPTION ACCOUNT and the profit and loss entry would be replaced by Income and Expenditure statement.)

(a) How Much am I suppose to receive? and
(b) How much have I received?
Accounting for Fixed Assets

<table>
<thead>
<tr>
<th>Revenue/income account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued income b/f (5)</td>
</tr>
<tr>
<td>Prepaid income b/f</td>
</tr>
<tr>
<td>How much am I supposed to receive (profit and loss account)</td>
</tr>
<tr>
<td>How much have I received (Cash/Bank)</td>
</tr>
<tr>
<td>If difference is here then</td>
</tr>
<tr>
<td>Bal c/d (prepaid income)</td>
</tr>
<tr>
<td>Bal c/d (Accrued income)</td>
</tr>
<tr>
<td>X (4)</td>
</tr>
<tr>
<td>Bal b/f (Accrued income)</td>
</tr>
<tr>
<td>Bal b/f (Prepaid income)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
</tr>
<tr>
<td>Stock</td>
</tr>
<tr>
<td>Overdraft</td>
</tr>
<tr>
<td>Debtors</td>
</tr>
<tr>
<td>Trade creditors</td>
</tr>
<tr>
<td>Prepayments</td>
</tr>
<tr>
<td>Accruals</td>
</tr>
<tr>
<td>Accrued income</td>
</tr>
<tr>
<td>Prepaid income</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accruals</td>
</tr>
<tr>
<td>Accrued expense</td>
</tr>
<tr>
<td>Amount owing</td>
</tr>
<tr>
<td>Amount outstanding</td>
</tr>
<tr>
<td>Payment in arrears</td>
</tr>
<tr>
<td>Prepayments</td>
</tr>
<tr>
<td>Prepaid expense</td>
</tr>
<tr>
<td>Amount prepaid</td>
</tr>
<tr>
<td>Payment in advance</td>
</tr>
<tr>
<td>Amount overpaid</td>
</tr>
</tbody>
</table>

Step by Step guide on how to deal with accruals and prepayments.

Step 1
Ask yourself, is there any expense or income balances brought forward from previous years – hence always check the DATES carefully to determine this.

Step 2
Ask yourself, is there any amounts that I am suppose to pay or receive (Profit and loss entry).

Suppose to pay
Credit in expense account
Narrative profit and loss account

Suppose to receive
Debit in income account
Narrative profit and loss account

Step 3
Ask yourself how much has been paid or received.
Step 4
Do the totals on either the expense or income account.

Step 5
The difference will represent either accrual or prepayments in the expense account or accrued income or prepaid income in the income account. These will be the closing balances for the year.

<table>
<thead>
<tr>
<th>Expense account</th>
<th>Revenue account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrual</td>
<td>Accrued income</td>
</tr>
<tr>
<td>Debit c/d</td>
<td>Credit c/d</td>
</tr>
<tr>
<td>Credit b/f</td>
<td>Debit b/f</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepayments</td>
<td></td>
</tr>
<tr>
<td>Debit c/d</td>
<td>Credit c/d</td>
</tr>
<tr>
<td>Credit b/f</td>
<td>Debit b/f</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Prepaid income</td>
</tr>
<tr>
<td></td>
<td>Debit c/d</td>
</tr>
<tr>
<td></td>
<td>Credit b/f</td>
</tr>
</tbody>
</table>
Bad debts and provision for bad debts

Debtors

Bad debts
(Say £1,000)

Provision for bad debts or doubtful debts
(Say 10%)

always consider

Increase in provision compared to previous year

Decrease in provision compared to previous year

Normally the debtors figure in the balance sheet is always after the adjustment of bad debts, hence one would only need to make a provision for bad debts against the debtors figure to account for those debtors who may default on their debts.

However, if the Question states that the bad debts have NOT been accounted for, against the debtors in the balance sheet then you must first take bad debts out of the debtors and then consider provision on the remaining balance.

<table>
<thead>
<tr>
<th>Balance</th>
<th>10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>if bad debts not taken</td>
<td>9,000</td>
</tr>
<tr>
<td>(2) Provision 10%</td>
<td>(900)</td>
</tr>
<tr>
<td>New debtors</td>
<td>8,100</td>
</tr>
</tbody>
</table>

Bad debts recovered
It is possible that debts that have previously been written off may later be paid. If this happens, then the entries made to write-off the debt as an expense must be reversed before recording the receipt of the payment from the debtor.

(1) Dr Debtor
Cr Bad debt recovered

(2) Dr Bad debt recovered
Cr Bank/Cash

Hence net effect
Dr Debtor
Cr Bank/Cash
Questions

6.1 Discuss the factors and causes of depreciation.  

6.2 When an asset is purchased for cash what is the journal entry?

A. Dr Asset Cr Bank  
B. Dr Bank Cr Asset  
C. Dr Purchase Cr Bank  
D. Dr Bank Cr Purchase  

6.3 What is the double entry for disposal of fixed asset?

A. Dr Fixed asset Cr Bank  
B. Dr Bank Cr Fixed asset  
C. Dr Fixed asset disposal Cr Fixed asset  
D. Dr Fixed asset disposal Cr Bank  

(7 marks)  
(2 marks)  
(2 marks)
The whole of the above structure can be summarised within the definition of depreciation.

Depreciation is the measure of the wearing out, consumption or other loss of value of a fixed asset whether arising from use, effluxion of time or obsolescence through technological and market changes.

Depreciation is an expense and as such should be debited to the profit and loss account.
6.2 A

B and D are incorrect as asset is not a stock item and hence cannot be purchased unless it is purchased for resale.

6.3 C
Revision questions 6

6.1 Your firm bought a machine for £15,000 on 1 January 2001, which had an expected useful life of four years and an expected residual value of £3,000; the asset was to be depreciated on the straight-line basis. On 31 December 2003, the machine was sold for £4,800. The amount to be entered in the 2003 profit and loss account for profit or loss on disposal is

6.2 The most appropriate definition of depreciation is
   A a means of determining the decrease in market value of an asset over time
   B a means of allocating the cost of an asset over a number of accounting periods
   C a means of setting funds aside for the replacement of the asset
   D a means of estimating the current value of the asset

6.3 The purpose of charging depreciation on fixed assets is
   A to put money aside to replace the assets when required
   B to show the assets in the balance sheet at their current market value
   C to ensure that the profit is not understated
   D to spread the net cost of the assets over their estimated useful life

6.4 The phrase ‘net book value’ when applied to fixed assets means that
   A the assets are shown in the balance sheet at their original cost
   B the assets are valued at their likely selling price
   C the assets have been depreciated using the reducing balance method
   D the assets are shown in the balance sheet at their cost less accumulated depreciation

6.5 Which of the following statements regarding goodwill is not correct?
   A Goodwill is classified as an intangible fixed asset.
   B Goodwill is the excess of the value of a business as a whole over the fair value of its separable net assets.
   C Purchases goodwill may be shown on the balance sheet and amortised over a period of time.
   D Non-purchases goodwill is a liability.

6.6 We Ltd bought a new printing machine from abroad. The cost of the machine was £40,000. The installation costs were £2,500 and the employees received specific training on how to use this particular machine at a cost of £1,000. Before using the machine to print customers’ orders, a test was undertaken and the paper and ink cost was £500. What should be the cost of the machine in the company’s balance sheet?
6.1 The profit or loss on disposal is the difference between the net book value at the time of disposal and the disposal proceeds. An excess of disposal proceeds over net book value indicates a profit on disposal, while an excess of net book value over disposal proceeds indicates a loss on disposal.

The annual depreciation on the machine is calculated as:

\[
\frac{\text{Cost} - \text{residual value}}{\text{Useful economic life}} = \frac{15,000 - 3,000}{4 \text{ years}} = £3,000 \text{ per year}
\]

<table>
<thead>
<tr>
<th>Fixed asset disposal account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
</tr>
<tr>
<td>Sale proceeds</td>
</tr>
<tr>
<td>Loss</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

6.2 B

Depreciation never provides a fund for the replacement of the asset, nor does it aim to show assets at their current or market values.

6.3 D

Depreciation is not connected with the putting aside of money for the replacement of the asset, nor does it aim to show assets at their current or market values. The charging of depreciation ensures that profits are not overstated.

6.4 D

Fixed assets should, except in certain circumstances, be depreciated over their expected useful life. Answer A would almost never be appropriate. Assets are rarely valued at their expected selling price – if this is more than their cost, this would be imprudent, and if less than their cost would contravene the ‘going concern’ concept, which is discussed in a later chapter. The method of depreciation is irrelevant.

6.5 D

A, B and C are all correct, in most situations.

6.6 £

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of machine</td>
<td>40,000</td>
</tr>
<tr>
<td>Installation</td>
<td>2,500</td>
</tr>
<tr>
<td>Training</td>
<td>1,000</td>
</tr>
<tr>
<td>Testing</td>
<td>500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>44,000</strong></td>
</tr>
</tbody>
</table>
Financial Accounting with Adjustments, Organising and Controlling the Bookkeeping System
Four main books

Sales ledger
- Credit sales
  - Debtors (Customers)

Purchase ledger
- Credit purchases
  - Creditors (Suppliers)

Nominal ledger or General ledger
- Everything else in accounting will end up here
  - Whole of the balance sheet has been recorded here except for debtors and creditors who are recorded in the sales and purchase ledger respectively

Cash book
- Any trading (transaction) carried out in CASH ONLY
  - Any other cash transaction
    - Expense cash
    - Income cash

Buy stock cash
- Purchase

Sell stock cash
- Sales
Accounts

Personal account

Debtors (Customers) account

Creditors (Suppliers) account

Impersonal account

Real account

For property of all kinds, e.g. building, machinery, furniture and fixtures, and stock

Nominal account

Expenses, Income and Capital

Includes whole of the profit and loss account and capital element of balance sheet

Whole of the balance sheet except less debtors/creditors

less capital
TRADING ACCOUNT
TRADING and PROFIT and LOSS ACCOUNT

Sales £
Less: Return inwards (X)
Less: Trade discount (X)
Less: VAT on sales (X)
Understated sales X
Less: Overstated sales (X)
Turnover £ £ £

Cost of sales
Opening stock X
Add: Purchases X
Less: Return outwards (X)
Less: VAT on purchases (X)
Less: Overstated purchases (X)
Understated purchases X
Carriage inwards X

Less: Closing stock (X)
Cost of goods sold X
Add: Gross profit/loss X/(X)

Other income X
Other expense X
Net profit/loss X/(X)

DISCOUNTS
Trade discount
Cash discount
Discount on early settlement of invoices or PROMPT payment discount

Effects your selling price only

Discount on bulk purchases

Discount ALLOWED
Customers EXPENSE
Discount RECEIVED
Suppliers Income

All it does is it reduces the COST of SELLING PRICE ONLY

No double entry

Sales

Less: Trade discount (X)
Net sales £

Carriage inwards EXP
Cost of transportation EXP

Purchase X
Carriage inward (X)
Total cost £

Trading account

Carriage outwards EXP
Treated as an EXPENSE in the profit and loss account

Dr

Dr

Dr

Dr

P&L Account

Cash discount

TRADE and PROFIT and LOSS ACCOUNT
Jeremy gives to Esso petrol station and spends £100 using his American Express. American Express charge 10% commission on all such transactions. Show the entries from the initial sale to final receipt of cash from Esso’s point of view.

<table>
<thead>
<tr>
<th>Sales</th>
<th>Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Am Exp 1 100</td>
<td>Am Exp 2 90</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>American Express</th>
<th>Commission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales 1 100</td>
<td>Bank 2 90</td>
</tr>
<tr>
<td>Comm. 3 10</td>
<td>Am Exp 3 10</td>
</tr>
</tbody>
</table>
Revision question 7(A)

7.1 The following is an extract from the trial balance of Sause Ltd at 31 December 1994:

<table>
<thead>
<tr>
<th></th>
<th>Debit (£)</th>
<th>Credit (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td></td>
<td>147,432</td>
</tr>
<tr>
<td>Returns</td>
<td>11,726</td>
<td>6,984</td>
</tr>
<tr>
<td>Discounts</td>
<td>1,742</td>
<td>2,534</td>
</tr>
</tbody>
</table>

The figure to be shown in the trading account for net sales is

- A  £133,172
- B  £133,964
- C  £135,706
- D  £140,448

(2 marks)
### Answer to revision question 7(A)

7.1 C

Net sales is calculated as follows:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>147,432</td>
</tr>
<tr>
<td>Less: Returns inwards</td>
<td>(11,726)</td>
</tr>
<tr>
<td></td>
<td><strong>135,706</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>147,432</td>
</tr>
<tr>
<td>Less: Trade discount</td>
<td>0</td>
</tr>
<tr>
<td>Less: Returns inwards</td>
<td>(11,726)</td>
</tr>
<tr>
<td></td>
<td><strong>135,166</strong></td>
</tr>
</tbody>
</table>
**Revision questions 7(B)**

7.1 A book of prime entry is one in which:

A. The rules of double-entry bookkeeping do not apply.
B. Ledger accounts are maintained.
C.Transactions are entered prior to being recorded in the ledger accounts.
D. Subsidiary accounts are kept.

(2 marks)

7.2 The petty-cash imprest is restored to £300 at the end of each week. The following amounts are paid out of petty cash during week 23:

- Stationery £42.30 including VAT at 17.5%
- Travelling costs £76.50
- Office refreshments £38.70
- Sundry creditors £72.00 plus VAT at 17.5%

The amount required to restore the imprest to £300 is

(2 marks)

7.3 Stock is valued using FIFO. Opening stock was 10 units at £4 each. Purchases were 30 units at £6 each, then issues of 12 units were made, followed by issues of 8 units. Closing stock is valued at

(2 marks)

7.4 In times of rising prices, the FIFO method of stock valuation, when compared with the average cost method of stock valuation, will usually produce

A. a higher profit and lower closing stock value
B. a higher profit and a higher closing stock value
C. a lower profit and a lower closing stock value
D. a lower profit and a higher closing stock value

(2 marks)

7.5 Stock movements for product X during the last quarter were as follows:

- January
  - Purchases: 10 items at £39.60 each
  - Sales: 10 items at £60 each
- February
  - Purchases: 20 items at £49 each
  - Sales: 5 items at £60 each

Opening stock at 1 January was six items valued at £30 each.

Gross profit for the quarter, using the weighted average cost method, would be

(2 marks)
Answers to revision questions 7(B)

7.1 C

A is incorrect as the journal is one of the books of prime entry in which double-entry rules do apply. B is incorrect as ledger accounts are not maintained in books of prime entry. D is incorrect as subsidiary accounts are ledger accounts that are maintained outside the main ledgers.

7.2 £

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stationery</td>
<td>42.30</td>
</tr>
<tr>
<td>Travelling cost</td>
<td>76.50</td>
</tr>
<tr>
<td>Refreshments</td>
<td>38.70</td>
</tr>
<tr>
<td>Sundry creditors (£72.00 × 1.175)</td>
<td>84.60</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>242.10</strong></td>
</tr>
</tbody>
</table>

7.3 The first issues (twelve units) would use up the opening stock of ten units and 4 units of the purchases at £6 each, leaving 28 units at £6 each. The next issue would be of £6 units, leaving 20 units at £6 each, that is £60.

7.4 B

The closing stock figures reduces the cost of goods sold figure, which in turn increases the gross profit.

Therefore, a higher closing stock figure means a lower cost of goods sold figure, and hence a higher gross profit. In times of rising prices, the FIFO method of stock valuation will produce higher closing stock values, and therefore higher gross profit figure.

7.5 Summarised stock card

<table>
<thead>
<tr>
<th>Quantity</th>
<th>Value (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 × £30</td>
<td>180</td>
</tr>
<tr>
<td>10 × £39.60</td>
<td>396</td>
</tr>
<tr>
<td></td>
<td>576 (£36 each)</td>
</tr>
<tr>
<td>10 × £36</td>
<td>216</td>
</tr>
<tr>
<td>(10)</td>
<td>(360)</td>
</tr>
<tr>
<td>6</td>
<td></td>
</tr>
<tr>
<td>20 × £49</td>
<td>980</td>
</tr>
<tr>
<td>26</td>
<td>1,196 (£46 each)</td>
</tr>
<tr>
<td>5 × £46</td>
<td>230</td>
</tr>
<tr>
<td>(5)</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>966</td>
</tr>
</tbody>
</table>

Note: Issues are shown in brackets

Trading account

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (15 × £30)</td>
<td>900</td>
</tr>
<tr>
<td>Opening stock</td>
<td>180</td>
</tr>
<tr>
<td>Add: Purchases</td>
<td>1,376</td>
</tr>
<tr>
<td></td>
<td>1,556</td>
</tr>
<tr>
<td>Less: Closing stock</td>
<td>(966)</td>
</tr>
<tr>
<td></td>
<td>(590)</td>
</tr>
<tr>
<td>Profit</td>
<td>310</td>
</tr>
</tbody>
</table>
7.1 From the following information, calculate the value of purchases:

\[
\begin{align*}
\text{Opening creditors} & \quad 71,300 \\
\text{Cash paid} & \quad 271,150 \\
\text{Discounts received} & \quad 6,600 \\
\text{Goods returned} & \quad 13,750 \\
\text{Closing debtors} & \quad 68,900
\end{align*}
\]

(2 marks)

7.2 A suspense account shows a credit balance of £260.

This could be due to

A omitting a sale of £260 from the sales ledger
B recording a purchase of £260 twice in the purchases account
C failing to write off a bad debt of £260
D recording an electricity bill paid of £130 by debiting the bank account and crediting the electricity account

(2 marks)

7.3 You are given the following information:

\[
\begin{align*}
\text{Debtors at 1 January 2003} & \quad 30,000 \\
\text{Debtors at 31 December 2003} & \quad 27,000 \\
\text{Total receipts during 2003 (including cash sales of £15,000)} & \quad 255,000
\end{align*}
\]

Sales on credit during 2003 amount to

(2 marks)
Answers to revision questions 7(C)

7.1 Purchases can be found by constructing a control account:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid</td>
<td>271,150</td>
<td>Opening creditors</td>
<td>71,300</td>
</tr>
<tr>
<td>Discount received</td>
<td>6,600</td>
<td>Purchases</td>
<td>?</td>
</tr>
<tr>
<td>Goods returned</td>
<td>13,750</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing debtors</td>
<td>68,900</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>360,400</td>
<td></td>
<td>360,400</td>
</tr>
</tbody>
</table>

Purchases = £360,400 – £71,300 = £289,100

7.2 B

A credit balance on the suspense account indicates that the debit total of the trial balance was higher than the credit total. An error that could cause this would involve whether too great a value having been debited, too little a value have been credited, or a combination of these where an item has been recorded as a debit when it ought to have been a credit.

A would result in too little having been debited to the customer’s account
B would result in an additional debit entry, therefore this is the correct answer
C would not cause any imbalance in the trial balance as both the debit and credit entries will have been omitted
D would not cause any imbalance in the trial balance as both a debit and a credit entry have been made even though they were the wrong way round

7.3 Sales can be found by constructing a mini sales control account:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debtors at 1.1.93</td>
<td>30,000</td>
<td>Receipts less cash sales</td>
<td>240,000</td>
</tr>
<tr>
<td>Sales</td>
<td>?</td>
<td>Debtors at 31.12.93</td>
<td>27,000</td>
</tr>
<tr>
<td></td>
<td>267,000</td>
<td></td>
<td>267,000</td>
</tr>
</tbody>
</table>

Sales = £267,000 – £30,000 = £237,000
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The Regulatory Framework of Accounting
SSAPs → In 1991 replaced by FRSs

Statement of Standard Accounting Principles
- Standard and guidelines which accountants must follow (mandatory)
- There are 25 such standards in existence, however, currently only a few remain as they are slowly being abolished or replaced by the revised Financial Reporting Standards (FRSs)

Accounting Standards Committee (ASC) was the body chaired then by David Tweedie who today is the chairman of the International Accounting Standards Committee

Exposure Draft (ED)
- Prior to being approved as a standard SSAP is a “prototype” ED, and if approved it becomes a standard

Financial Reporting Standards
- Mandatory
- To date there are 20 such guidelines

Accounting Standards Board

Financial Reporting Review Panel (FRRP)
- Enquires into the accounts where either the Companies Act or the requirements of the standards are breached

Financial Reporting Exposure Draft (FRED) Prototype of FRSs

Accounting Standards Board (ASB)
- Develops, issues and withdraws accounting standards
- Urgent Issue Task Force (UITF) assist the ASB in areas of conflicting and unsatisfactory interpretations
Hence,

SSAP 2

Disclosure of accounting policies

Concepts

Accruals
States that costs and revenues must be matched in the period in which they incurred

Prudence
States that profits are recognised only when realised whereas losses must be accounted for immediately

Consistency
When preparing accounts, ensure that they are prepared in a consistent manner from one period to another

Going concern
The entity is considered carrying on in business for the foreseeable future without the necessity of it curtailing

Bases
These are the various methods used in preparing accounts

Policies
These are specific bases or methods

SSAP 9

Stocks and long-term liabilities

Concepts

Accrual

Prudence

There are the two fundamental concepts that apply to SSAP 9 (see later)

Bases

LIFO

FIFO

Weighted average

FRS 15

Depreciation

Concepts

Going concern

Consistency

Bases

Straight line

Reducing balance

Policies

Specific method
FIFO if entity decides to use it

Reducing balance
Concepts

SSAP 2 Concepts
- Accruals
- Prudence
- Consistency
- Going concern

Other concepts
- Materiality – No omission
- Dual aspect – Every debit must have a credit
- Objectivity – Must have a goal
- Substance over form – See SSAP 21 leases
- No offset rule – Cannot offset assets and liabilities
- Historical cost rule – All assets at historical cost except stock, goodwill, short-term investment
- Reliability – Users must be able to rely on accounts
- Realisation concept – Only account for if realised
- Timely – Accounts must be prepared on time
- Understandability – Users must be able to understand
- Relevance – Must prepare accounts that are relevant

Statement of principles

FRS 18

Materiality

• Relevance
• Reliable
• Understandable
• Comparable

Users of accounts

Companies Act 85
- No offset rule
- True and fair view
- Historical cost rule

Exam Practice Kit: Financial Accounting Fundamentals
Revision questions 8

8.1 If, at the end of the financial year, a company makes a charge against the profits for stationery consumed but not yet invoiced, this adjustment is in accordance with the concept:

A materiality
B accruals
C consistency
D objectivity

(2 marks)

8.2 A ‘true and fair view’ is one that

A presents the accounts in such a way as to exclude errors that would affect the actions of those reading them
B occurs when the accounts have been audited
C shows the accounts of an organisation in an understandable format
D shows the assets on the balance sheet at their current market price

(2 marks)

8.3 The historical cost convention

A fails to take account of changing price levels over time
B records only past transactions
C values all assets at their cost to the business, without any adjustment for depreciation
D has been replaced in accounting records by a system of current cost accounting

(2 marks)

8.4 In times of rising prices, the historical cost convention has the effect of

A valuing all assets at their cost to the business
B recording goods sold at their cost price, even if they are worth less than that cost
C understating profits and overstating balance sheet asset values
D overstating profits and understating balance sheet asset values

(2 marks)

8.5 If the owner of a business takes goods from stock for his own personal use, the accounting concept to be considered is the

A prudence concept
B capitalisation concept
C money measurement concept
D separate entity concept

(2 marks)

8.6 Sales revenue should be recognised when goods and services have been supplied; costs are incurred when goods and services have been received.

The accounting concept that governs the above is the

A accruals concept
B materiality concept
C realisation concept
D dual aspect concept

(2 marks)
8.7 The capital maintenance concept implies that
A the capital of a business should be kept intact by not paying our dividends
B a business should invest its profits in the purchase of capital assets
C fixed assets should be properly maintained
D profit is earned only if the value of an organisation’s net assets or its operating capability has increased during the accounting period

(2 marks)

8.8 In times of rising prices, the historical cost convention
A understates asset values and profits
B understates asset values and overstates profits
C overstates asset values and profits
D overstates asset values and understates profits

(2 marks)

8.9 The accounting concept that dictates that fixed assets should be valued at cost less accumulated depreciation, rather than their enforced saleable value, is the
A net realisable value concept
B prudence concept
C realisation concept
D going concern concept

(2 marks)

8.10 Goodwill is most appropriately classed as
A a fixed asset
B an intangible asset
C a fictitious liability
D a semi-fixed asset

(2 marks)

8.11 A major aim of the internal auditors is to
A reduce the costs of the external auditors by carrying out some of their duties
B support the work of the external auditors
C prepare the financial accounts
D report to shareholders on the accuracy of the accounts

(2 marks)

8.12 Which one of the following is not a necessary part of the stewardship function?
A To maximise profits
B To safeguard assets
C To ensure adequate controls exist to prevent or detect fraud
D To prepare the financial accounts

(2 marks)

8.13 Who issues Financial Reporting Standards?
A The Auditing Practices Board
B The Stock Exchange
C The Accounting Standards Board
D The Government

(2 marks)
8.14 Which of the following is not an accounting concept?

A Prudence
B Consistency
C Depreciation
D Accruals

(2 marks)

8.15 When preparing financial statements in periods of inflation, directors

A must reduce asset values
B must increase asset values
C must reduce dividends
D need make no adjustments

(2 marks)

8.16 Which of the following statements is correct?

A External auditors report to the directors
B External auditors are appointed by the directors
C External auditors are required to give a report to shareholders
D External auditors correct errors in financial statements

(2 marks)

8.17 What is an audit trail in a computerised accounting system?

A A list of all the transactions in a period
B A list of all the transactions in a ledger account in a period
C A list of all the items checked by the auditor
D A list of all the nominal ledger codes

(2 marks)

8.18 A concept of capital maintenance is important for

A the sources of finance
B the measurement of profit
C the relationship of debt to equity
D the purchase of fixed assets

(2 marks)

8.19 Internal controls includes ‘detect’ control and ‘prevent’ control. Which of the following is a detect control?

A Signing overtime claim forms
B Matching purchase invoices with goods received notes
C Preparing bank reconciliations
D Matching sales invoices with delivery notes

(2 marks)

8.20 Which of the following statements is not correct?

A Internal auditors review value for money
B Internal auditors should not liaise with external auditors
C Internal audit is part of internal control
D Internal audit should be independent of the activities it audits

(2 marks)
8.21 The fundamental objective of an external audit of a limited company is to
A give advice to shareholders
B detect fraud and errors
C measure the performance and financial position of a company
D provide an opinion on the financial statements

8.22 Which one of the following statements most closely express the meaning of ‘true and fair’?
A There is only one true and fair view of a company’s financial statements.
B True and fair is determined by compliance with accounting standards.
C True and fair is determined by compliance with company law.
D True and fair is largely determined by reference to generally accepted accounting practice.

8.23 A company includes in stock goods received before the year end, but for which invoices are not received until after the year end. This is in accordance with
A the historical cost convention
B the accruals concept
C the consistency concept
D the materiality concept

8.24 When there is inflation, the historical cost convention has the effect of
A overstating profits and understating balance sheet values
B understating profits and overstating balance sheet values
C understating cash flow and overstates cash in the balance sheet
D overstates cash flow and understates cash in the balance sheet

8.25 Which of the following is not a reason for providing depreciation on tangible fixed asset?
A They have a limited useful life, wearing out over time due to use or effluxion of time or by becoming obsolete.
B They are part of the cost of generating the revenue for a period, and that cost should be matched with the revenue.
C They usually decrease in value over time, hence the balance sheet should reflect this decrease in asset values.
D It is a means of valuing an asset.

8.26 Which of the following is not correct?
A Depreciation reduces the net profit of an organisation
B Providing depreciation generates cash
C If depreciation is not charged, capital will not be maintained
D By not charging depreciation, it might appear that profits have risen in line with inflation
Answers to revision questions 8

8.1 B

The accruals concept implies that the profits must be charged with expenses incurred, irrespective of whether or not an invoice has been received.

8.2 A

Part of an audit involves determining that the accounts show a true and fair view, but it does not guarantee that this is the case; in addition, many organisations who do not have an audit performed still produce accounts that show a true and fair view. Thus answer B is not wholly correct.

8.3 A

Transactions are normally included at their original cost to the business, but that does not preclude reductions in these figures for depreciation and other adjustments, therefore C is incorrect. The accounting professions have attempted to introduce systems of current cost accounting in the past, but these have never replaced the historical cost convention. Accounting transactions are always past transactions but not necessarily using the historical cost convention.

8.4 D

A is incorrect because assets can be revalued upwards or downwards from their original cost, and depreciated, even under the historical cost convention. B is incorrect as goods should be recorded at the lower of their cost and net realisable value. C is incorrect because profits are calculated without adjustment for the increased cost of replacement stocks, and asset values would be lower than their current value.

8.5 D

The separate entity concept states that the transactions of the business and those of the owner should be kept separate. Therefore, any money, goods or services taken out of the business by the owner should be treated as private transactions.

8.6 C

8.7 D

8.8 B

8.9 D

8.10 B

Goodwill arises when more is paid for the assets of a business than their fair value. Thus, an additional asset is acquired; it is intangible and should be written off over the period during which the organisation is expected to benefit from it.

8.11 B

8.12 A

Stewardship is concerned with ensuring that there is a procedure in a place to safeguard assets, provide properly for liabilities, protect against misuse of assets, and report adequately to the shareholders or stakeholders of the organisation.
8.13  C
8.14  C
8.15  D
8.16  C
8.17  A
8.18  B
8.19  C
8.20  B
8.21  D
8.22  D
8.23  B
8.24  A
8.25  D
8.26  B
Incomplete Records and Income and Expenditure Accounts
Incomplete Records

Best tackled in three stages

Control accounts

Trading account

Sales
Less: (Cost of sales)
Gross profit
Mark-up
Margin

DLCA
CLCA
Cash control account

Calculation of drawings
Incomplete Records and Income and Expenditure Accounts

Incomplete records

Reasons:
(a) Owner of the business does not keep proper accounting records.
(b) Natural disasters, earthquake, fire, flood and so on.

For example, BUY

\[
\begin{align*}
\text{BUY} & : \text{£100} \\
\text{SELL} & : \text{£150}
\end{align*}
\]

Profit in %

Sales 50% \( \text{(Margin)} \) \( \frac{50}{100} \times 100\% \)

Cost 33\,\frac{1}{3}\% \( \text{(Mark-up)} \) \( \frac{50}{150} \times 100\% \)

Calculate the cost of goods which have been sold for £1,200 on which a mark-up on cost of sales of 25% has been achieved.

\[
\text{Balancing figure}
\]

Therefore, cost of sales is \( \text{125\%} \) \( \frac{100}{100} \)

Sales \( \text{1,200} \) \( \text{Given} \)

\( \text{25\%} \) \( \text{Given} \)

\( \text{Cost} \)

Therefore, cost of sales = \( \frac{100}{125} \times 1,200 \)

= £960
For example, if I buy an item for £100 and sell it for £150 then my profit is £50. In terms of % it will be either

\[ \text{Profit/cost} \times 100\% = \frac{50}{100} \times 100 = 50\% \]

\[ \text{Profit/sales} \times 100\% = \frac{50}{150} \times 100 = 33\frac{1}{3}\% \]

As a result of this, students often get confused when it comes to dealing with profit that is based on cost and that based on selling price. Therefore, you must read the exam questions carefully and the best way to tackle this problem is to understand the following concept.

\[ \text{Sales} \]

\[ \text{(Cost of sales)} \]

\[ \text{Gross profit} \]

\[ \text{Mark-up} \]

\[ \text{Margin} \]

% will normally be given in exam question.
Incomplete Records and Income and Expenditure Accounts

Control accounts

Sales Ledger Control Account (SLCA)
orDebtors Ledger Control Account (DLCA)
orTotal Debtors Control Account (TDCA)

Creditors contra C X Debtors contra C X
Bal b/f X Bal c/d X
XX XX XX XX

DLCA (Credit sales)

For all other entries in this account this is the opposite entry

Creditors contra C X
Bal c/d X
XX

Note: Any cash sales or purchases DO NOT enter into the above accounts. However, cash from debtors and cash from creditors are not cash sales and purchases hence they will be entered in the above accounts.
**Normal – not opposite**

<table>
<thead>
<tr>
<th>DLCA</th>
<th>Bal b/f</th>
<th>Return inwards</th>
<th>X</th>
<th>X</th>
<th>These are debits as stock increases hence control accounts think opposite – credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales are credit, hence debit control account</td>
<td>Sales as per sales day book</td>
<td>X</td>
<td>Bad debts</td>
<td>X</td>
<td>Bad debt is an expense which are debit hence control account think opposite – credit</td>
</tr>
<tr>
<td>VAT on Sales</td>
<td>X</td>
<td>Cash from debtors</td>
<td>X</td>
<td>Cash received from debtors will be debit hence credit control account</td>
<td></td>
</tr>
<tr>
<td>Refunds</td>
<td>X</td>
<td>Creditor’s control</td>
<td>X</td>
<td>In debtor’s control account, the creditor’s control will be shown on the credit side normal not opposite same as balance b/f and c/d</td>
<td></td>
</tr>
<tr>
<td>Dishonoured cheques</td>
<td>X</td>
<td>Discount allowed</td>
<td>X</td>
<td>Expense to company hence debit, therefore opposite in control account – credit</td>
<td></td>
</tr>
<tr>
<td>X</td>
<td>Bad debts written back</td>
<td>X</td>
<td>Creditors contra</td>
<td>Normal – not opposite</td>
<td></td>
</tr>
<tr>
<td>X</td>
<td>Bal c/d</td>
<td>X</td>
<td>Bal c/d</td>
<td>Normal – not opposite</td>
<td></td>
</tr>
</tbody>
</table>

XX | XX

**Dishonoured cheques**

Reasons are as follows:

1. Insufficient funds
2. Stale cheques (out of date) – more than 6 months old
3. Words and figures (amount are different)
4. Wrong signatures or not enough signatures
5. Stopped cheque
6. “Postdated Cheque” – date can be made in a month time
Incomplete records and control accounts

Whenever the examiners use the following words or terminology, always consider opening a DLCA to calculate the sales figure.

(i) Opening debtors  
(ii) Closing debtors  
(iii) Amount received from debtors

\[
\begin{array}{c|c|c|c}
\text{DLCA} & \text{£} & \text{£} \\
\text{Opening bal b/f} & X & \text{Amount received from debtors} & X \\
\text{Balancing figure sales} & X & \text{Closing bal c/d} & X \\
\hline 
\text{XX} & \text{XX} \\
\end{array}
\]

Whenever the examiner uses the following words or terminology, always consider opening a CLCA to calculate the purchase figure.

(i) Opening creditors  
(ii) Closing creditors  
(iii) Cash/cheque paid to creditors

\[
\begin{array}{c|c|c|c}
\text{CLCA} & \text{£} & \text{£} \\
\text{Cash paid to creditor} & X & \text{Opening bal b/f} & X \\
\text{Closing bal c/d} & X & \text{Balancing figure purchases} & X \\
\hline 
\text{XX} & \text{XX} \\
\end{array}
\]

Wherever the examiner uses the following words, then consider trading account.

(i) Opening stock (if first year of trading, this will not be given)  
(ii) Closing stock

\[
\begin{array}{c|c|c|c}
\text{} & \text{£} & \text{£} \\
\text{Sales} & \text{from DLCA if not given} & X \\
\text{Less: Opening stock} & (X) \\
\text{Add: Purchases} & \text{from CLCA if not given} & X \\
\text{Less: Closing stock} & (X) \\
\text{Cost of goods sold} & \text{XX} & (X) \\
\text{Gross profit} & \text{XX} \\
\end{array}
\]
Reasons for difference between control accounts and list of balances in the ledger

- Transposition error made in posting either to DLCA/CLCA or to individual account
  - for example, £68 posted as £86 (Difference is always exactly divisible by 9)
- A bad debt written off in individual account but not in DLCA or vice versa
- A balance omitted from list of individual account
- A casting error in the cash book relating to DLCA
- A casting error in the sales day book where the total is posted to the DLCA whereas individual invoices are posted to the debtors account and therefore if the total is incorrect, a difference will arise
- A credit balance on the individual account which has automatically been assumed to be a debit balance
9.1 Mark-up on cost of sales = 10%
Sales £6,160
Cost of sales ????

(2 marks)

9.2 Gross profit on sales = 20%
Cost of sales £20,000
Sales ???

(2 marks)

9.3 Mark-up on cost of sales = 33 1/3%
Cost of sales £15,000
Sales ???

(2 marks)

9.4 Sales £20,000
Cost of sales £16,000
Gross profit on sales and cost of sales ???

To calculate cash sales

Cash control account

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash sales</td>
<td>Bank</td>
</tr>
<tr>
<td></td>
<td>Wages</td>
</tr>
<tr>
<td>Capital</td>
<td>Expenses</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(2 marks)

9.5 Pritesh started business on 1 January 2005. The following relates to year ended 31 December 2005.

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade creditors at 31 December 2005 16,000</td>
</tr>
<tr>
<td>Trade debtors at 31 December 2005 12,000</td>
</tr>
<tr>
<td>Cash received from debtors 32,000</td>
</tr>
<tr>
<td>Cash paid to creditors 28,000</td>
</tr>
<tr>
<td>Mark-up on cost 30%</td>
</tr>
</tbody>
</table>

Calculate the closing stock at 31 December 2005.

(8 marks)

9.6 Devan had the following transactions relating to his business.

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash received from debtors 18,500</td>
</tr>
<tr>
<td>Due from debtors 1/1/2004 1,000</td>
</tr>
<tr>
<td>Opening stock 2,000</td>
</tr>
<tr>
<td>Closing stock 500</td>
</tr>
<tr>
<td>Due to suppliers 1/1/2004 750</td>
</tr>
<tr>
<td>Due to suppliers 31/12/2004 300</td>
</tr>
<tr>
<td>Cash paid to suppliers 1,200</td>
</tr>
</tbody>
</table>
Calculate:

(i) Sales
  A £19,500  
  B £17,500  
  C £18,500  
  D None of the above

(ii) Purchases
  A £2,250  
  B £750  
  C £150  
  D None of the above

(iii) Gross profit
  A £15,250  
  B £750  
  C £16,250  
  D £18,250

(iv) Gross profit as % of sales
  A 92%  
  B 93%  
  C 82%  
  D 87%

(v) Gross profit as % of cost
  A 677%  
  B 14%  
  C 114%  
  D 87%

(10 marks)
### Answers

#### 9.1 Cost of sales

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>110%</td>
<td>Sales</td>
<td>6,160</td>
</tr>
<tr>
<td>100%</td>
<td>Cost of sales</td>
<td>(?)</td>
</tr>
<tr>
<td></td>
<td>Gross profit</td>
<td>10%</td>
</tr>
</tbody>
</table>

Therefore, cost of sales = \(\frac{100}{110} \times 6,160\) = £5,600

#### 9.2 Sales

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>Sales</td>
<td>??</td>
</tr>
<tr>
<td>80%</td>
<td>Cost of sales</td>
<td>(20,000)</td>
</tr>
<tr>
<td></td>
<td>Gross profit</td>
<td>20%</td>
</tr>
</tbody>
</table>

Therefore, sales = \(\frac{100}{80} \times 20,000\) = £25,000

#### 9.3 Sales

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>133 1/3%</td>
<td>Sales</td>
<td>??</td>
</tr>
<tr>
<td>100%</td>
<td>Cost of sales</td>
<td>(15,000)</td>
</tr>
<tr>
<td></td>
<td>Mark-up</td>
<td>33 1/3%</td>
</tr>
</tbody>
</table>

Therefore, sales = \(\frac{133 1/3}{100} \times 15,000\) = £20,000

#### 9.4 Gross profit on sales

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>20,000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(16,000)</td>
</tr>
<tr>
<td>Mark-up</td>
<td>4,000</td>
</tr>
</tbody>
</table>

Therefore, Gross profit = \(\frac{4,000}{20,000} \times 100\) = 20%

Gross profit on cost of sales

= \(\frac{4,000}{16,000} \times 100\) = 25%
### CLCA

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid to creditors</td>
<td>28,000</td>
<td>Bal b/f</td>
<td>Nil</td>
</tr>
<tr>
<td>Bal c/d</td>
<td>16,000</td>
<td>Purchases</td>
<td>44,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Balancing figure</td>
<td></td>
</tr>
<tr>
<td><strong>Balancing figure</strong></td>
<td>44,000</td>
<td><strong>Balancing figure</strong></td>
<td>44,000</td>
</tr>
</tbody>
</table>

Since just started business

### DLCA

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/f</td>
<td>Nil</td>
<td>Received from debtors</td>
<td>32,000</td>
</tr>
<tr>
<td>Sales</td>
<td>44,000</td>
<td>Bal c/d</td>
<td>12,000</td>
</tr>
<tr>
<td>Balancing figure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Balancing figure</strong></td>
<td>44,000</td>
<td><strong>Balancing figure</strong></td>
<td>44,000</td>
</tr>
</tbody>
</table>

nil since started business current year

Less: Opening stock Nil

Add: Purchases 44,000

Less: Closing stock

Gross profit

Balancing figure 130% Sales 44,000

Q says on mark-up hence cost of sales becomes 100%

Given in Question

30% (Gross profit)

If 130% £44,000

Therefore 100% ?? Will be less

\[
\frac{100}{130} \times 44,000 = 33,846
\]

Sales 44,000

Less: Opening stock Nil

Add: Purchases 44,000

Less: Closing stock 10,154

Cost of sales 33,846

Hence closing stock will be £10,154.
9.6  (i)  B

To calculate sales, prepare DCLA.

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/f</td>
<td>1,000</td>
<td>Received from debtors</td>
<td>18,500</td>
</tr>
<tr>
<td>Sales</td>
<td>17,500</td>
<td>Bal c/d</td>
<td>nil</td>
</tr>
<tr>
<td>Balancing figure</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\[
\text{Balancing figure} = 18,500 \\
\text{Sales} = £17,500
\]

(ii)  B

To calculate purchases, prepare CLCA.

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid to creditors</td>
<td>1,200</td>
<td>Bal b/f</td>
<td>750</td>
</tr>
<tr>
<td>Bal c/d</td>
<td>300</td>
<td>Purchases</td>
<td>750</td>
</tr>
<tr>
<td>Balancing figure</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\[
\text{Balancing figure} = 1,500 \\
Purchases = £750
\]

(iii)  A

To calculate Gross profit:

\[
\begin{align*}
\text{Sales} & \quad 17,500 \\
\text{Less: Opening stock} & \quad 2,000 \\
\text{Add: Purchases} & \quad 750 \\
\text{Less: Closing stock} & \quad (500) \\
\text{Cost of goods sold} & \quad 2,250 \\
\text{Gross profit} & \quad 15,250
\end{align*}
\]

(iv)  D

Gross profit as % of sales

\[
\frac{\text{Gross profit}}{\text{Sales}} \times 100\% = \frac{15,250}{17,500} \times 100 = 87\%
\]

(v)  A

Gross profit as % of cost of sales

\[
\frac{\text{Gross profit}}{\text{Cost of sales}} \times 100\% = \frac{15,250}{2,250} \times 100 = 677\%
\]
Non-profit-making organisation

\[
\frac{\text{Profit-making organisation}}{\text{Trading and profit and loss A/C}} \quad \text{replaced by} \quad \frac{\text{Non-profit-making organisation}}{\text{Income and expenditure A/C}}
\]
\[
\text{Receipt and payment A/C}
\]

\[
\frac{\text{Balance sheet}}{\text{replaced by}} \quad \frac{\text{Statement of affairs}}{\text{replaced by}}
\]
\[
\text{Surplus of income over expenditure}
\]
\[
\text{Deficit of expenditure over income}
\]
\[
\text{Accumulated funds}
\]

Non-profit-making companies

(i) Charities, Clubs, Hospitals (government department), Social clubs, School, Public sector companies.

Profit may arise from the following:

(i) Hire of hall
(ii) Sales from canteens
(iii) Sales from bar
(iv) Outings (Day trips)
(v) Fund raising

They do not have accountant, they have treasurer.
Revision questions 9

9.1 In a not-for-profit organisation, the accumulated fund is
   A long-term liabilities plus current liabilities plus current assets
   B fixed assets less current liabilities less long-term liabilities
   C the balance on the general reserve account
   D fixed assets plus net current assets less long-term liabilities

9.2 An income and expenditure account is
   A a summary of the cash and bank transactions for a period
   B another name for a receipts and payments account
   C similar to a profit and loss account in reflecting revenue earned and expenses
   D incurred during a period

9.3 A club received subscriptions during 2005 totalling £25,000. Of these, £1,600 related to 2004 and £800 related to 2006. There were subscriptions in arrears at the end of 2005 of £500. The subscriptions to be included in the income and expenditure account for 2005 amount to

9.4 Life membership fees payable to a club are usually dealt with by
   A crediting the total received to a life membership fees account and transferring a proportion each year to the income and expenditure account
   B crediting the total received to the income and expenditure account in the year in which these fees are received
   C debiting the total received to a life membership fees account and transferring a proportion each year to the income and expenditure account
   D debiting the total received to the income and expenditure account in the year in which these fees are received

9.5 A receipts and payments account is similar to
   A an income and expenditure account
   B a profit and loss account
   C a trading account
   D a cash book summary

9.6 The subscriptions receivable account of a club commenced the year with subscriptions in arrears of £250 and subscriptions in advance of £375. During the year, £62,250 was received in subscriptions, including all of the arrears and £600 for next year’s subscriptions. The amount to be taken to the income and expenditure account for the year is
9.7 The difference between a profit and loss account (which may also be referred to as an income statement) and an income and expenditure account is that

A an income and expenditure account is an international term for a profit and loss account
B a profit and loss account is prepared for a business and an income and expenditure account is prepared for a non-profit-making organisation
C a profit and loss account is prepared on an accruals basis and an income and expenditure account is prepared on a cash-flow basis
D a profit and loss account is prepared for a manufacturing business and an income and expenditure account is prepared for a non-manufacturing business

(2 marks)
**Answers to revision questions 9**

9.1  **D**

Accumulated fund is equivalent to capital.

9.2  **C**

An income and expenditure account is commonly prepared by a not-for-profit organisation as an alternative to a profit and loss account (as such organisations do not exist to make profits). A summary of cash and bank transactions, and a receipts and payments account are one and the same thing; they both include capital transactions, for example, payments for fixed assets, and neither takes account of accrued and prepaid income or expenses. Thus answers A and B are incorrect. A balance sheet is a statement of assets, liabilities and capital or accumulated fund.

9.3

<table>
<thead>
<tr>
<th>Subscription paid</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/f</td>
<td>1,600</td>
</tr>
<tr>
<td>Bal c/f</td>
<td>800</td>
</tr>
<tr>
<td>Income and expenditure account</td>
<td>23,100</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscription paid</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Received</td>
<td>25,000</td>
</tr>
<tr>
<td>Arrears c/d</td>
<td>500</td>
</tr>
</tbody>
</table>

9.4  **A**

Life membership fees represents income in advance and this is credited to a life membership fees account. A proportion of income is transferred to the income and expenditure account over the assumed life of the membership.

9.5  **D**

A receipts and payments account is a summary of the cash and bank transactions.

9.6

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Received in year: 62,250</td>
</tr>
<tr>
<td>Arrears at beginning: (250)</td>
</tr>
<tr>
<td>In advance at beginning: 375</td>
</tr>
<tr>
<td>In advance at end: (600)</td>
</tr>
<tr>
<td>Total to income and expenditure: 61,775</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriptions account (Income account)</td>
</tr>
<tr>
<td>Arrears b/f: 250</td>
</tr>
<tr>
<td>Prepayment b/f: 375</td>
</tr>
<tr>
<td>Balancing figure: 61,775</td>
</tr>
<tr>
<td>Received: 62,250</td>
</tr>
<tr>
<td>Advance bal c/d: 600</td>
</tr>
<tr>
<td>62,625</td>
</tr>
</tbody>
</table>

9.7  **B**
Introduction

So far we have worked with trading accounts of the form:

\[
\begin{array}{ll}
\text{£} & \text{£} \\
\text{Sales} & \text{X} \\
\text{Opening stock} & \text{X} \\
\textit{Add: Purchases} & \text{X} \\
\textit{Less: Closing stock} & \text{(X)} \\
\text{Cost of sales} & \text{(X)} \\
\text{Gross profit} & \text{X}
\end{array}
\]

This is perfectly satisfactory for a retail organisation that purchases and resells goods. A manufacturing company will need further details for the cost of manufacturing its products and these details can be set out in the form of manufacturing account.

Definitions

- **Direct costs** are those which can be attributed to a particular unit of production and will normally include raw materials, productive wages and other expenses capable of direct identification with production. These three are often called direct materials, direct wages and direct expenses.
- **Indirect expenses** are production expenses which cannot be attributed to a particular unit of production. They are often called manufacturing or works overheads and will include such items as factory power, plant repairs and so on.
- **Prime cost** is the total of direct expenses.
- **Factory cost or works cost** is prime cost plus a share of the factory indirect expenses.
**Stocks**

A trading firm has stocks in only one form (i.e. goods held for resale), but a manufacturing firm will have three forms of stock:

1. Direct materials – items of raw materials which have not yet been issued to production;
2. Work-in-progress – items of partly completed goods;
3. Finished goods – items which are completed but unsold.

**The pro forma**

Basic format

The manufacturing account summarises the costs of production in the factory:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct materials</td>
<td>X</td>
</tr>
<tr>
<td>Direct labour</td>
<td>X</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>X</td>
</tr>
<tr>
<td>Prime cost</td>
<td>X</td>
</tr>
<tr>
<td>Manufacturing overheads</td>
<td>X</td>
</tr>
<tr>
<td>Factory cost</td>
<td>X</td>
</tr>
</tbody>
</table>

Pro forma manufacturing account

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials consumed</td>
<td></td>
</tr>
<tr>
<td>Opening stock of raw materials</td>
<td>X</td>
</tr>
<tr>
<td><em>Add:</em> Purchases of raw materials</td>
<td>X</td>
</tr>
<tr>
<td><em>Less:</em> Closing stock of raw materials</td>
<td>(X)</td>
</tr>
<tr>
<td>Direct wages</td>
<td>X</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>X</td>
</tr>
<tr>
<td>Prime cost</td>
<td>X</td>
</tr>
<tr>
<td>Works indirect expenses</td>
<td></td>
</tr>
<tr>
<td>Factory power</td>
<td>X</td>
</tr>
<tr>
<td>Factory rent/rates</td>
<td>X</td>
</tr>
<tr>
<td>Factory insurance</td>
<td>X</td>
</tr>
<tr>
<td>Factory light and heat</td>
<td>X</td>
</tr>
<tr>
<td>Plant repairs</td>
<td>X</td>
</tr>
<tr>
<td>Plant depreciation</td>
<td>X</td>
</tr>
<tr>
<td><em>Add:</em> Opening work-in-progress</td>
<td>X</td>
</tr>
<tr>
<td><em>Less:</em> Closing work-in-progress</td>
<td>(X)</td>
</tr>
<tr>
<td>Factory cost of goods produced – transfers to warehouse</td>
<td>X</td>
</tr>
</tbody>
</table>
## Trading and profit and loss account

The trading and profit and loss account, which takes account of selling and distribution costs and administration expenses, will be in a reasonably familiar format:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trading and profit and loss account</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Sales</strong></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Less: Cost of goods sold</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening stock of finished goods</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Add: Transfers from factory</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Less: Closing stock of finished goods</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Less: Distribution costs</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Net profit</td>
<td></td>
<td>(X)</td>
</tr>
</tbody>
</table>
10.1 The following information relates to a company at its year end:

\[
\begin{array}{l}
\text{£} \\
\text{Stock at beginning of year} \\
\quad \text{Raw materials} & 20,000 \\
\quad \text{Work-in-progress} & 4,000 \\
\quad \text{Finished goods} & 68,000 \\
\text{Stock at end of year} \\
\quad \text{Raw materials} & 22,000 \\
\quad \text{Work-in-progress} & 8,000 \\
\quad \text{Finished goods} & 60,000 \\
\text{Purchase of raw materials} & 100,000 \\
\text{Direct wages} & 80,000 \\
\text{Royalties on goods sold} & 6,000 \\
\text{Production overheads} & 120,000 \\
\text{Distribution costs} & 110,000 \\
\text{Administration expenses} & 140,000 \\
\text{Sales} & 600,000 \\
\end{array}
\]

The cost of goods manufactured during the year is £.

10.2 If work-in-progress decreases during the period, then:

A prime cost will decrease
B prime cost will increase
C the factory cost of goods completed will decrease
D the factory cost of goods completed will increase

10.3 An increase in the figure for work-in-progress will

A increase in prime cost
B decrease the prime cost
C increase the cost of goods sold
D decrease the factory cost of goods completed

10.4 Your firm has the following manufacturing figures:

\[
\begin{array}{l}
\text{£} \\
\text{Prime cost} & 112,000 \\
\text{Factory overheads} & 9,000 \\
\text{Opening work-in-progress} & 12,400 \\
\text{Factory cost of goods completed} & 114,000 \\
\end{array}
\]

Closing work-in-progress is £

10.5 The prime cost of goods manufactured is the total of:

A all factory costs before adjusting for work-in-progress
B all factory costs of goods completed
C all materials and labour
D direct factory costs
Answers to revision questions 10

10.1 Cost of goods manufactured is found as follows:

\[
\begin{align*}
\text{£} & \\
\text{Opening stock of raw materials} & 20,000 \\
\text{Purchases of raw materials} & 100,000 \\
\text{Less: Closing stock of raw materials} & (22,000) \\
\text{Direct wages} & 80,000 \\
\text{Prime cost} & 178,000 \\
\text{Production overheads} & 120,000 \\
\text{Less: Increase in work-in-progress} & (4,000) \\
\text{Cost of goods manufactured} & 294,000
\end{align*}
\]

10.2 D

A decrease in work-in-progress means fewer goods are partly complete, thus the value of completed goods will be higher.

10.3 D

A and B are incorrect as work-in-progress has no effect on prime cost. The change in work-in-progress has no effect on cost of goods sold, as this depends on stock of finished goods, therefore C is incorrect. An increase in work-in-progress means that more production is in a partly finished state, and therefore less has been completed.

10.4

\[
\begin{align*}
\text{£} & \\
\text{Prime cost} & 112,000 \\
\text{Factory overheads} & 9,000 \\
\text{Opening work-in-progress} & 12,400 \\
\text{Factory cost of goods completed} & (114,000) \\
\text{Closing work-in-progress} & 19,400
\end{align*}
\]

10.5 D
This Page is Intentionally Left Blank
The Accounts of Limited Companies

Profit and loss account

<table>
<thead>
<tr>
<th>Item</th>
<th>Symbol</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover (Working 1)</td>
<td>A X</td>
</tr>
<tr>
<td>Cost of sales (Working 2)</td>
<td>B (X)</td>
</tr>
<tr>
<td>Gross profit/(loss)</td>
<td>X/(X)</td>
</tr>
<tr>
<td>Selling and distribution expense</td>
<td>C (X)</td>
</tr>
<tr>
<td>Administration expense</td>
<td>D (X)</td>
</tr>
<tr>
<td>Interest payable and similar charges</td>
<td>E (X)</td>
</tr>
<tr>
<td>Other operating income</td>
<td>F X</td>
</tr>
<tr>
<td>Operating profit/PBT, profit before interest and tax (PBIT)/Profit on ordinary activities before tax (POOABT)</td>
<td>X</td>
</tr>
<tr>
<td>Tax</td>
<td>X</td>
</tr>
<tr>
<td>Profit after tax</td>
<td>X (X)</td>
</tr>
<tr>
<td>Dividends Paid</td>
<td>(X)</td>
</tr>
<tr>
<td>Dividends Proposed</td>
<td>(X)</td>
</tr>
<tr>
<td>Retained profit for the year</td>
<td>X/(X)</td>
</tr>
<tr>
<td>Profit b/f</td>
<td>X</td>
</tr>
<tr>
<td>Profit c/f</td>
<td>X</td>
</tr>
</tbody>
</table>

Working 1

Sales                                      | X      |
Sales return                               | (X)    |
Trade discount                             | (X)    |
VAT on sales                               | (X)    |
Overstated sales                           | (X)    |
Understated sales                          | X      |
Turnover                                   | A X    |
Working 2

Cost of sales

\[
\text{Opening stock } \quad X \\
\text{+ Purchases } \quad X \\
\text{+ Carriage inwards } \quad X \\
\text{– Return outwards } \quad (X) \\
\text{– Overstated purchases } \quad (X) \\
\text{+ Understated purchases } \quad X \\
\text{– VAT on purchases } \quad (X) \\
\text{– Closing stock } \quad (X) \\
\text{Cost of closing stock } \quad \frac{\text{Cost of goods sold}}{\text{Cost of sales}} \quad B \quad \frac{X}{X}
\]

Sales and distribution expenses

- Selling and distribution \(X\)
- Warehouse rent \(X\)
- Carriage \(X\)
- Sales – Directors’ wages \(X\)
- Depreciation of car \(X\)
- Administration \(X\)
- Depreciation of van \(X\)
- Depreciation of salesman car \(X\)
- Advertising \(X\)

Administration expenses

- Light and heat \(X\)
- Rent \(X\)
- Wages staff \(X\)
- Direct wages \(X\)
- Depreciation of car \(X\)

If in doubt and not sure, treat as administration expense \(D\)

Interest payable and similar charges

This is the only expense which must be shown separately. It includes the following:

(i) Interest on loans \(X\)
(ii) Interest on overdraft \(X\)
(iii) Bank charges
   - Transferring money \(X\)
   - Direct debits, Standing orders and so on \(X\)
(iv) Commission charges \(E\)
Other operating income

Includes the following:

(i) Interest received \( X \)
(ii) Rent received \( X \)
(iii) Commission received \( X \)
(iv) Dividends received \( X \)
(v) Discount received \( X \)
(vi) Profit on disposal of fixed assets \( F \)

Taxation

NEVER NEVER calculate the tax figure in the exam question. This figure is normally given to you within the notes to the question.

If the rate of tax is provided by the examiner then you will need to disclose this in the notes to your answer stating.

*Note: The rate of tax, say 30%, was calculated using the UK corporation tax system.*

![Diagram showing tax due and payment]

For example, Year end 1/3/02 tax due 1/12/02
Year end 30/3/02 tax due 1/1/03

Accounting Treatment

![Diagram showing accounting treatment]

Dr Current Tax Payable (P&L)
Cr Corporation tax payable (B/S)
Current liability (Accrual)

next year
Dr Current Tax Payable
(Balance sheet)
Cr Bank
Also consider
Over payment of tax (Less)
Under payment of tax (Add)
Dividends

Types of shares

**Preference shares**
- Fixed %
- Paid first
- Dividend MUST
- Less common
- Investors
- No Votes

**General differences**
- Fixed Amount of Dividends
- Liquidation
- Profit
- Common
- Owner
- VOTE

**Ordinary shares**
- Fluctuate
- Paid last
- Not necessary to pay dividend
- No dividends
- More common
- Owners
- Voting rights
## Balance sheet

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Accumulated depreciation</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land and building</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
<tr>
<td>Motor van</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
</tbody>
</table>

| **Current assets**  |      |                          |                |
| Stock               | X    |                          |                |
| Debtors             | X    |                          |                |
| Short-term investment | X |                          |                |
| Prepayments         | X    |                          |                |
| Bank                | X    |                          |                |
| Cash                | X    |                          |                |

| **Current liability < 1 Year** |      |                          |                |
| Overdraft             | X    |                          |                |
| Trade creditors       | X    |                          |                |
| Accruals              | X    |                          |                |
| Taxation              | X    |                          |                |
| Dividends proposed   | X    |                          | (X)            |

| **Net current assets or working capital** | X |
| **Long-term liabilities > 1 Year**      |    |
| Long-term loans                 | (X) |
| Debentures                     | (X) | (XX) |

| **Total assets less liabilities** | XX |
| **Capital**                     |    |
| Share capital                   | X  |
| Share premium                   | X  |
| Profit and loss                 | X  |
| Reserves                        | X  | Must be the same |

| Reserves                        | X  | XX  |
Market value  Book value
£      £

(i) 100  150 If examiner provides you with both market value and book value, always show book value.
(ii) 150  100 If market value > book value then show market value in the notes to the accounts, that is disclose market value.

Stock
- Raw material  X
- Work-in-progress  X
- Finished goods  X
- Consumables  X

\[
\text{X} \quad \text{=} 
\]
Share capital – Types of shares

Authorised share capital:

These are the maximum number of shares that a company is allowed to issue by the monopolies and mergers commission (MMC).

Such type of shares will NEVER effect the calculations within the financial statements. If given in the exam question, then you will simply disclose them in the notes to the accounts.

Issued share capital:

These are the physical number of shares that a company issues. Such shares will effect the calculations within the financial statements. Every share when first issued has a nominal value (NV) or face value or par value. Normally, shares are issued at nominal value of £1. If so, then the calculations of dividends is straightforward and simple. However, if nominal value is 0.50p, 0.75p or 0.25p, then you must SLOW DOWN when calculating the dividend figure.

For example,

Company issues 10,000 £1 ordinary shares

Mr X buys 75%
Mrs Y buys 25%
Dr Bank 10,000
Cr Share capital 10,000
If the share price fluctuate (increase/decrease) in the market, then the share capital is never affected. It is the individual shareholders that will benefit or lose on such situations.

Share premium A/C:
This arises when shares are issued at greater than nominal value.
Fluctuation within the market will not effect the share premium account.

For example,
A company issues 10,000 £1 ordinary shares @ £1.60

Dr Bank 16,000
Cr Share capital 10,000
Cr Share premium 6,000

A company issues £10,000 £1 ordinary shares and declares a dividend of 10p/share.

*Note: Always convert pound into shares.*

Company issues £10,000 50p ordinary shares and declares a dividend of 10p/share.

Convert the £ = shares

£10,000 = 50p shares

How many shares 20,000

\[ \times 0.10 \]

Dividends 2,000

**RESERVES**

| Profit and loss account: if profit is | £10,000 |
| Dividends | (1,000) |
| Balance of profit | 9,000 |

- P&L £5,000
- F/A Replacement Reserve A/C £2,000
- General reserve £2,000
Revision questions 11

11.1 Revenue reserves are
A accumulated and undistributed profits of a company
B amounts that cannot be distributed as dividends
C amounts set aside out of profits to replace revenue items
D amounts set aside out of profits for a specific purpose

11.2 The correct ledger entries needed to record the issue of £400,000 £1 shares at a premium of 60p, and paid for by cheque, in full, would be

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
</tr>
</tbody>
</table>

Share premium
Share capital
Bank

11.3 Which one of the following would you expect to find in the appropriation account of a limited company, for the current year?
A Preference dividend proposed during the previous year, but paid in the current year.
B Preference dividend proposed during the current year, but paid in the following year.
C Directors’ fees.
D Auditors’ fees.

11.4 A business has made a profit of £4,000 but its bank balance has fallen by £2,500. This could be due to
A depreciation of £1,500 and an increase in stock of £5,000
B depreciation of £3,000 and the repayment of a loan of £3,500
C depreciation of £6,000 and the purchase of new fixed assets for £12,500
D the disposal of a fixed asset for £65,000 less than its book value

11.5 The record of how the profit or loss of a company has been allocated to distributions and reserves is found in the
A capital account
B profit and loss account
C reserves account
D appropriation account

11.6 Revenue reserve would decrease if a company
A sets aside profits to pay future dividends
B transfers amounts into ‘general reserves’
C issues shares at a premium
D pays dividend
11.7 Which one of the following does not form part of the equity capital of a limited company?

A  Preference share capital
B  Share premium
C  Revaluation reserve
D  Ordinary share capital

(2 marks)
Answers to revision questions 11

11.1 A

Revenue reserves can be distributed as dividends, so B is incorrect. Revenue reserves are not set aside to replace revenue items; they could be set aside for a specific purpose but this is only one use of revenue reserves.

11.2 Debit Credit

Bank 640,000
Share premium 240,000
Share capital 400,000

11.3 B

Dividends proposed are shown in the appropriation account, for payment following the annual general meeting. Directors’ and auditors’ fees are normal business expenses and appear in the profit and loss account.

11.4 C

£

Profit  4,000  
Add back depreciation  6,000
Net cash inflow  10,000
Purchase of fixed assets  (12,500)
Decrease  (2,500)

11.5 D

A company does not have a single capital account – its capital consists of several accounts. If you answered B, you are partly right, as the appropriation account is part of the profit and loss account, but is a separate section.

11.6 D

A and B are both forms of revenue reserve. Issuing shares at a premium increases reserves, but they are capital reserves anyway.

11.7 A

All the others are part of the equity capital.
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Format of the Cash-Flow Statement

Financial Reporting Standard (FRS1) (Revised 1996) deals with cash flow statements. It prescribes the following format:

**Pro forma per FRS1 (Revised)**

Pro forma cash-flow statement for the year ended 31 March 1992 for a single company with required supporting notes

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash inflow from operating activities</td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>Return on investments and servicing of finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest received</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Interest paid</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital expenditure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payments to acquire intangible fixed assets</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Payments to acquire tangible fixed assets</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Receipts from sale of tangible fixed assets</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Equity dividends paid</td>
<td></td>
<td>(X)</td>
</tr>
<tr>
<td>Management of liquid resources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase of treasury bills</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Sale of treasury bills</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Financing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issue of ordinary share capital</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Repurchase of debenture loan</td>
<td>C</td>
<td></td>
</tr>
<tr>
<td>Expenses paid in connection with share issues</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Increase in cash</td>
<td></td>
<td>D</td>
</tr>
</tbody>
</table>
Notes to the cash-flow statement

1  Reconciliation of operating profit to net cash inflow from operating activities

<table>
<thead>
<tr>
<th>Item</th>
<th>X</th>
<th>X</th>
<th>(X)</th>
<th>(X)</th>
<th>X</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation charges</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss on sale of tangible fixed assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in stocks</td>
<td>(X)</td>
<td>(X)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in debtors</td>
<td>(X)</td>
<td>(X)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in creditors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net cash inflow from operating activities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2  Reconciliation of net cash flow to movement in net debt (note 3)

<table>
<thead>
<tr>
<th>Item</th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in cash in the period</td>
<td>D</td>
<td></td>
</tr>
<tr>
<td>Cash to repurchase debenture</td>
<td>C</td>
<td></td>
</tr>
<tr>
<td>Cash used to increase liquid resources</td>
<td>B</td>
<td></td>
</tr>
<tr>
<td>Change in net debt</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Net debt at 1 April 1991</td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Net debt at 31 March 1992</td>
<td>(X)</td>
<td></td>
</tr>
</tbody>
</table>

3  Analysis of changes in net debt

<table>
<thead>
<tr>
<th>At 1 April 1991</th>
<th>Cash flows</th>
<th>Other changes</th>
<th>At 31 March 1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in hand, at bank</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Overdrafts</td>
<td>(X)</td>
<td>X</td>
<td>D</td>
</tr>
<tr>
<td>Debt due within 1 year</td>
<td>(X)</td>
<td>C</td>
<td>(X)</td>
</tr>
<tr>
<td>Debt due after 1 year</td>
<td>(X)</td>
<td>X</td>
<td>(X)</td>
</tr>
<tr>
<td>Current asset investments</td>
<td>X</td>
<td>B</td>
<td>X</td>
</tr>
<tr>
<td>Total</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Cash-flow statement FRS 1 (R96)

Points to consider

- Always think cash only when dealing with this topic.
- Always think cash inflow (+) and cash outflow (−)

[If cash outflow, do not forget brackets]

- There are no accruals effects in this topic, in other words everything is cash.
- One would normally expect a profit and loss account to be before the balance sheet, however in the exam, watch out the examiner tends to show the balance sheet before the profit and loss account.
- Always circle the years within the question.
Taxation

This will include all the taxes that the company may have paid during the year – always negative (don’t forget the brackets). Any repayments of taxes may receive – positive.

Capital expenditure

- Payments to acquire intangible fixed assets
- Payments to acquire tangible fixed assets
- Proceeds from sale of fixed assets

Note: Profit on disposal of fixed assets does not go under this heading.

Equity Dividends Paid

This will include dividends to ordinary shareholders only that is, the answer will always be negative. Do not forget brackets.

Management of Liquid Resources

- Purchase of Treasury Bills
- Purchase of Gilts
- Purchase of Bonds

Risk

Risk-free

Return

Very low

Financing

- Issue of ordinary shares
- Issue of preference shares
- Issue of debentures
- Raising of long-term loans
- Redemption of ordinary shares
- Redemption of preference shares
- Repurchase of debentures
- Expenses in relation to share issue
- Repurchase of loan (repayment)
Preparation of the cash-flow statement

The practical preparation of a cash-flow statement using the FRS1 pro forma is looked at below

Example

The draft accounts of Seafield Ltd for the year ended 30 April 2005 are set out below:

<table>
<thead>
<tr>
<th>Balance Sheet at 30 April 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

**Fixed assets (Note)**
- 1,473
- 1,929

**Current assets**

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td>2,679</td>
<td>2,064</td>
</tr>
<tr>
<td>Trade debtors</td>
<td>2,379</td>
<td>1,818</td>
</tr>
<tr>
<td>Cash at bank and in hand</td>
<td>21</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>5,079</td>
<td>3,912</td>
</tr>
</tbody>
</table>

**Creditors due within one year**

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade creditors</td>
<td>1,749</td>
<td>1,689</td>
</tr>
<tr>
<td>Dividends proposed</td>
<td>186</td>
<td>84</td>
</tr>
<tr>
<td>Taxation</td>
<td>132</td>
<td>36</td>
</tr>
<tr>
<td></td>
<td>(2,067)</td>
<td>(1,809)</td>
</tr>
</tbody>
</table>

**Creditors due after more than one year**

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and debentures</td>
<td>(1,248)</td>
<td>(1,665)</td>
</tr>
<tr>
<td></td>
<td>3,237</td>
<td>2,367</td>
</tr>
</tbody>
</table>

**Share capital**
- 2,460
- 2,154

**Profit and loss account**
- 777
- 213
- 3,237
- 2,367

**Note**

**Fixed assets**

1. **Freehold property**
   - At cost 30 April 2004: 1,365
   - At cost 30 April 2005: 1,020
   - Properties which originally cost £235,000 were sold during the year for £425,000.

2. **Plant and equipment**

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£'000</td>
<td>£'000</td>
</tr>
<tr>
<td>On 30 April 2004</td>
<td>846</td>
<td>285</td>
</tr>
<tr>
<td>Additions at cost</td>
<td>159</td>
<td></td>
</tr>
<tr>
<td>Disposals</td>
<td>(327)</td>
<td>(75)</td>
</tr>
<tr>
<td>Provision for the year</td>
<td></td>
<td>18</td>
</tr>
<tr>
<td>On 30 April 2005</td>
<td>678</td>
<td>228</td>
</tr>
</tbody>
</table>
## Profit and loss account for the year ended 30 April 2005

<table>
<thead>
<tr>
<th></th>
<th>2005 £’000</th>
<th>2004 £’000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Turnover</strong></td>
<td>8,790</td>
<td>4,689</td>
</tr>
<tr>
<td><strong>Less: Directors’ emoluments</strong></td>
<td>210</td>
<td>210</td>
</tr>
<tr>
<td><strong>Auditors’ remuneration</strong></td>
<td>18</td>
<td>15</td>
</tr>
<tr>
<td><strong>Interest on loans and debentures</strong></td>
<td>117</td>
<td>138</td>
</tr>
<tr>
<td><strong>Depreciation</strong></td>
<td>18</td>
<td>15</td>
</tr>
<tr>
<td><strong>Other operating expenses</strong></td>
<td>8,172</td>
<td>4,293</td>
</tr>
<tr>
<td></td>
<td>(8,535)</td>
<td>(4,671)</td>
</tr>
<tr>
<td><strong>Net trading profit</strong></td>
<td>255</td>
<td>18</td>
</tr>
<tr>
<td><strong>Profit on sale of fixed assets</strong></td>
<td>615</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>870</td>
<td>18</td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>(120)</td>
<td>(6)</td>
</tr>
<tr>
<td></td>
<td>750</td>
<td>12</td>
</tr>
<tr>
<td><strong>Proposed dividend</strong></td>
<td>(186)</td>
<td>(84)</td>
</tr>
<tr>
<td><strong>Retained profit for year</strong></td>
<td>564</td>
<td>(72)</td>
</tr>
<tr>
<td><strong>Bal b/f</strong></td>
<td>213</td>
<td>285</td>
</tr>
<tr>
<td><strong>Bal b/f</strong></td>
<td>777</td>
<td>213</td>
</tr>
</tbody>
</table>

(25 marks)

## Cash-flow statement

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Cash inflow/outflow from operating activities</strong></td>
<td>(720)</td>
<td></td>
</tr>
<tr>
<td><strong>Return on investment/servicing of finance:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Paid</td>
<td>(117)</td>
<td></td>
</tr>
<tr>
<td>Taxation</td>
<td>(24)</td>
<td></td>
</tr>
<tr>
<td><strong>Capital expenditure</strong></td>
<td>1,053</td>
<td></td>
</tr>
<tr>
<td><strong>Equity dividends paid</strong></td>
<td></td>
<td>(84)</td>
</tr>
<tr>
<td>Dividends paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Management of Liquid Resources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Financing:</strong></td>
<td>19X7</td>
<td>19X6</td>
</tr>
<tr>
<td>Issue of ordinary shares</td>
<td>2,460</td>
<td>2,160</td>
</tr>
<tr>
<td>Debentures</td>
<td>1,248</td>
<td>1,665</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(417)</td>
</tr>
<tr>
<td><strong>Decrease in cash</strong></td>
<td></td>
<td>(117)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(9)</td>
</tr>
</tbody>
</table>
**Note (1)**

Reconciliation of operating profit to net cash inflow from operating activities

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit (PBIT)</td>
<td>870</td>
</tr>
<tr>
<td>Add Above interest 117</td>
<td></td>
</tr>
<tr>
<td>Add Depreciation (non-cash item)</td>
<td>18</td>
</tr>
<tr>
<td>Add Amortisation (+)</td>
<td>X</td>
</tr>
<tr>
<td>Ignore it below interest</td>
<td></td>
</tr>
<tr>
<td>Ignore Provision for bad debts</td>
<td>X</td>
</tr>
<tr>
<td>Increase X</td>
<td></td>
</tr>
<tr>
<td>Decrease (X)</td>
<td></td>
</tr>
<tr>
<td>Loss on sale of fixed assets</td>
<td>(615)</td>
</tr>
<tr>
<td>Profit on sale of fixed assets</td>
<td>+ (615)</td>
</tr>
<tr>
<td>+ in stock X</td>
<td></td>
</tr>
<tr>
<td>- in stock X</td>
<td></td>
</tr>
<tr>
<td>+ in debtors (555)</td>
<td></td>
</tr>
<tr>
<td>- in debtors X</td>
<td></td>
</tr>
<tr>
<td>+ in creditors 60</td>
<td></td>
</tr>
<tr>
<td>- in creditors (X)</td>
<td></td>
</tr>
</tbody>
</table>

Net cash flow (720)

**Dividend/Interest/tax**

<table>
<thead>
<tr>
<th>Cash paid (Balancing figure)</th>
<th>Bal b/f (B/S) proposed year</th>
<th>Bal c/d (B/S) current year</th>
<th>Cash received (Balancing figure)</th>
<th>P&amp;L (current year)</th>
<th>Dividend account</th>
</tr>
</thead>
<tbody>
<tr>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>84</td>
</tr>
<tr>
<td>XX</td>
<td>XX</td>
<td></td>
<td></td>
<td></td>
<td>186</td>
</tr>
</tbody>
</table>

**Tax**

<table>
<thead>
<tr>
<th>Cash paid (Balancing figure)</th>
<th>Bal b/f (B/S) previous year</th>
<th>Bal c/d (B/S) current year</th>
<th>P&amp;L (current year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td>36</td>
<td>132</td>
<td>120</td>
</tr>
<tr>
<td>156</td>
<td>156</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Interest**

<table>
<thead>
<tr>
<th>Cash paid (Balancing figure)</th>
<th>Bal b/f previous year</th>
<th>Bal c/d</th>
<th>P&amp;L (current year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>117</td>
<td>0</td>
<td>117</td>
<td></td>
</tr>
<tr>
<td>117</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# Format of the Cash-Flow Statement

## F/A Disposal account

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Profit</th>
<th>Accumulated depreciation</th>
<th>Sales proceeds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>START</strong></td>
<td>1,315</td>
<td>45</td>
<td>327</td>
<td>297</td>
</tr>
<tr>
<td><strong>D isposal</strong></td>
<td>(705)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>A ddition</strong></td>
<td>360</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>R evaluation</strong></td>
<td>X/(X)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>T ransfer</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>End</strong></td>
<td>1,020</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1,315 GIVEN

Profit on sale of fixed asset

1,275 – 705 = 570

Total profit 615

Therefore profit 45

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Addition F/A</td>
<td>(360)</td>
<td></td>
</tr>
<tr>
<td>Proceed F/A</td>
<td>1,275</td>
<td></td>
</tr>
<tr>
<td>Proceeds plant</td>
<td>297</td>
<td></td>
</tr>
<tr>
<td>Payment plant</td>
<td>(159)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,053</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Start</th>
<th>C/f</th>
<th>End</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>30</td>
<td>(9)</td>
</tr>
<tr>
<td>c/d</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Debt &lt; 1 Year</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Debt &gt; 1 Year</td>
<td>(1,665)</td>
<td>417</td>
</tr>
<tr>
<td></td>
<td>(1,635)</td>
<td>408</td>
</tr>
</tbody>
</table>
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Interpretation of Accounts
ROOE  ROCE  ROSF

Return on owner’s equity  Return on capital employed  Return on shareholder’s funds

(only ordinary shareholders)  (bottom half of balance sheet less long-term liabilities)

Profit and loss account -> Profit before Interest and Tax (PBIT)

Capital employed -> Balance sheet

Profit and loss account

- Turnover: X
- Cost of sales: (X)
- Gross profit: X
- Administrative expenses: (X)
- Selling and distribution expenses: (X)
- Interest payable and similar charges: (X)
- Operating profit/Profit before tax: X
- Taxation: (X)
- Profit after tax: X
- Dividends: (X)
- Retained profit: X
- Retained profit b/f: X
- Retained profit c/f: X

PBIT = Turnover - Cost of sales = Gross profit - Administrative expenses - Selling and distribution expenses - Interest payable and similar charges = Operating profit/Profit before tax - Taxation

However, if interest is above operating profit, then add the two figures together to get PBIT. If interest is below operating profit, then ignore the interest figure. Then operating profit is PBIT.

Total Assets less current liabilities = Fixed assets + Current assets - Current liabilities

Or

Shareholder’s funds = Share capital + Profit and loss reserve

Share capital

Profit and loss reserve

Reserve
Factors to consider when answering question on ROCE:

1. Consider the rate of interest
2. Consider the depreciation policies of the company
3. Age of assets
4. Consider revaluation policy of the company
5. Consider intangible assets within the company, like trademark, royalties and goodwill
6. Consider position of long-term liabilities
7. Consider issue of shares: company is going to lose control.

<table>
<thead>
<tr>
<th>GROSS PROFIT</th>
<th>NET PROFIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \frac{GP}{Sales} \times 100 = a% )</td>
<td>( \frac{Net , profit}{Sales} \times 100 = b% )</td>
</tr>
</tbody>
</table>

(Turnover)

Say it is 20%

At £100 sales you made £20 profit before expenses

For example

<table>
<thead>
<tr>
<th>Year</th>
<th>1997</th>
<th>1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>10m</td>
<td>100m</td>
</tr>
<tr>
<td>GP</td>
<td>20%</td>
<td>Depends</td>
</tr>
</tbody>
</table>

When can gross profit go down even though turnover increases.

1. Selling goods on special offer
2. Cost of goods increased but selling price remained the same
3. Position of closing stock goes down therefore gross profit goes down
4. Consider pilferage/damaged goods, obsolete goods
5. Sales mix that is the company starts selling different products, with lower profit margin.

Stock turnover ratio

\[
\text{Stock turnover ratio} = \frac{\text{Cost of sales}}{\text{Stock}} = \text{No. of times}
\]

Average stock = (Opening stock + Closing stock)/2

For example,

<table>
<thead>
<tr>
<th>Year</th>
<th>1997</th>
<th>1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock turnover</td>
<td>6 times</td>
<td>10 times</td>
</tr>
</tbody>
</table>
Liquidity ratios

Short-term liquidity ratios

Current ratio

Acid test/quick ratio

\[
\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}
\]

\[
\text{Acid test/quick ratio} = \frac{\text{Current assets} - \text{stock}}{\text{Current liabilities}}
\]

1.29:1

0.71:1

Working capital

Fixed assets

Current assets

Stock 10,000

Debtors 4,000

Bank 5,000

Cash 3,000

Current liabilities

Overdraft 12,000

Trade creditors 5,000

Long-term liabilities

These ratios help to determine the short-term liquidity of the company, that is the ability for the company to pay its debts as on when they fall due. Both these ratios must be calculated together. If the answer is 1:1, the company is in a break-even situation. On the face of it, it will survive for a very short period (about 6 months).

1.4:1

In this situation, the company has got 29% assets to pay off the current liabilities. This money should be invested in order to earn interest or even used to reduce the overdraft facility.
Cash at bank £5,000

Same principle as cash above.

Debtors £5,000. It depends on the following factors:
1. Credit control position needs to be reviewed.
2. Risk of bad debts increases.
3. Money tied up necessarily.

Stock £10,000

Always consider the type of the company, for example food and vegetable.
1. Too much stock may result in perishable goods.
2. Money is tied up unnecessarily.
3. Required extra storage space, therefore handling cost will increase, that is insurance cost, storage cost, heating cost and handling cost.
4. Some companies may overstock due to (a) future price increases, (b) excess funds in the bank account.

Overdraft £12,000

This is like having cash in your hand but can be very expensive in interest payments. Interest is only paid on acceptance of the overdraft facility using the money. Overdrafts are repayable on demand. Always reconsider overdraft facility with current assets. (i.e., cancel overdraft).

Trade creditors £5,000

Too many creditors is ok, provided they are not abused (make sure they are paid on time).

Debtors day ratio

This ratio helps determine the number of days that is taken by the debtors to pay us.

On the face of it, company A has got a better credit control system. It is collecting its debts 24 days earlier than company B.

B will face bad debts problem, it is taking longer to collect its money from its debtors.

If B is a new establishment, then in order to gain customers, it may provide extra credit facilities.

Gearing or Long-Term Solvency

\[
\frac{\text{Debt}}{\text{Debt} + \text{Equity}} \times 100
\]

\[
\frac{\text{Long-term loan}}{\text{Long-term loan} + \text{Share capital} + \text{P&L} + \text{Reserve}} \times 100
\]

This ratio will determine the level of debt that is used to finance the company, for example the more you borrow, the higher is the gearing.
13  Revision questions 13

13.1 Given selling price of £700 and gross profit mark-up of 40 per cent, the cost price would be

(2 marks)

13.2 Sales are £220,000. Purchases are £160,000. Opening stock is £24,000. Closing stock is £20,000. The rate of stock turnover is

.............times

(2 marks)

13.3 The formula for calculating the rate of stock turnover is

A average stock at cost divided by cost of goods sold
B sales divided by average stock at cost
C sales divided by average stock at selling price
D cost of goods sold divided by average stock at cost

(2 marks)

13.4 A business has the following trading account for the year ending 31 May 2008:

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales turnover</td>
<td>90,000</td>
</tr>
<tr>
<td>Opening stock</td>
<td>8,000</td>
</tr>
<tr>
<td>Add: Purchases</td>
<td>53,000</td>
</tr>
<tr>
<td>Less: Closing stock</td>
<td>12,000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>49,000</td>
</tr>
</tbody>
</table>

Its rate of stock turnover for the year is

.............times

(2 marks)

13.5 A company’s gearing ratio would rise if

A a decrease in long-term loans is less than a decrease in shareholder’s funds
B a decrease in long-term loans is more than a decrease in shareholder’s funds
C interest rates rose
D dividends were paid

(2 marks)

13.6 A company has the following details extracted from its balance sheet:

£’000

| Stock    | 3,800   |
| Debtors  | 2,000   |
| Bank overdraft | 200    |
| Creditors | 2,000   |
Its liquidity position could be said to be
A very well controlled, because its current assets far outweigh its current liabilities
B poorly controlled, because its quick assets are less than its current liabilities
C poorly controlled, because its current ratio is significantly higher than the industry norm of 1.8
D poorly controlled, because it has a bank overdraft

(2 marks)

13.7 Revenue reserves would decrease if a company
A sets aside profits to pay future dividends
B transfers amounts into ‘general reserves’
C issues shares at a premium
D pays dividends

(2 marks)


✅ Answers to revision questions 13

13.1

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price (SP)</td>
<td>£140</td>
</tr>
<tr>
<td>Cost of sales (COS)</td>
<td>£100</td>
</tr>
<tr>
<td>Gross profit</td>
<td>£40</td>
</tr>
</tbody>
</table>

Cost of sales × 140/100 = 700
Cost of sales = 700/1.4 = 500

13.2 Rate of stock turnover is found by dividing cost of goods sold by average stock.

Average stock is

\[
\left( \frac{24,000 + 20,000}{2} \right) = £22,000
\]

Stock turnover = \( \frac{\text{Cost of sales}}{\text{Average stock}} \)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td>£24,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>£160,000</td>
</tr>
<tr>
<td>Less: Closing stock</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>£164,000</td>
</tr>
</tbody>
</table>

Rate of stock turnover is therefore 164,000/22,000 = 7.45 times

13.3 D

You need only know the correct formula here.

13.4 Rate of stock turnover is found by dividing cost of goods sold by average stock.

Average stock = (8,000 + 12,000)/2 = £10,000

Cost of goods sold is £49,000

Rate of stock turnover is therefore 49,000/10,000 = 4.9 times

13.5 A

The gearing ratio is the proportion of long-term loans to shareholders’ funds, thus it follows that if a decrease in long-term loans is less than a decrease in the shareholders’ funds, the gearing ratio will rise.

13.6 A

The current ratio is current assets: current liabilities, that is 5,800:2,200 = 2.6:1. The quick ratio is current assets minus stock: current liabilities, that is 2,000:2,200 = 0.9:1. The current ratio is high compared with the industry standard of 1.8:1, while the quick ratio is within acceptable limits of the ‘norm’ of 1:1. Without any evidence of the reason for the high stock levels, its current ratio would appear to be higher than what is required, and hence liquidity is poorly controlled.
Transfers between revenue reserves, as mentioned in A and B, have no effect on the overall total of revenue reserves; issuing shares at a premium increases capital reserves; the paying of dividends must be from revenue reserves, so these will decrease.
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Mock Exam 1

1 Sharon started a business on 1 January 1991 with £30,000 capital. During the year 1991 he drew £15,000 out of the business and paid in a legacy of £9,000 from his uncle. At 31 December 1991 the business’s net assets were valued at £54,000.

What was the business’s profit for the year?

A £15,000
B £24,000
C £30,000
D £39,000

(2 marks)

2 During the year ended 31 December 1992 the net assets of Sharon’s business increased from £54,000 to £63,000. He drew £18,000 out of the business and paid in a football pools win of £36,000.

What was the profit or loss for the year?

A £9,000 profit
B £9,000 loss
C £27,000 profit
D £27,000 loss

(2 marks)

3 Job makes purchases on credit from Sad Limited for £24,000. What is the correct double entry?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Purchase</td>
<td>Debtors</td>
</tr>
<tr>
<td>B Purchases</td>
<td>Creditors</td>
</tr>
<tr>
<td>C Creditors</td>
<td>Purchases</td>
</tr>
<tr>
<td>D Creditors</td>
<td>Cash</td>
</tr>
</tbody>
</table>

(2 marks)
4 Jane receives cash from Jose in part payment of an amount owed to Jade in respect of a sale to Jose. What is the correct double entry?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Cash</td>
<td>Sales</td>
</tr>
<tr>
<td>B Cash</td>
<td>Debtors</td>
</tr>
<tr>
<td>C Sales</td>
<td>Cash</td>
</tr>
<tr>
<td>D Creditors</td>
<td>Cash</td>
</tr>
</tbody>
</table>

(2 marks)

5 Sam returned goods to Dane which he had bought on credit from her. What is the double entry necessary to record this transaction?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Sales</td>
<td>Cash</td>
</tr>
<tr>
<td>B Sales</td>
<td>Debtors</td>
</tr>
<tr>
<td>C Cash</td>
<td>Sales</td>
</tr>
<tr>
<td>D Cash</td>
<td>Debtors</td>
</tr>
</tbody>
</table>

(2 marks)

6 Which of the following errors would not cause there to be a difference in the trial balance?

A incomplete double entry
B addition error
C transaction not recorded at all
D transposition error

(2 marks)

7 Which of the following errors would cause there to be a difference in the trial balance?

A amount posted to the wrong account
B transaction correctly posted but with the incorrect amount in both accounts
C transaction entered on the debit side of both accounts
D transaction not recorded at all

(2 marks)

8 Norman commenced business on 1 May 1990 and is charged rent at the rate of £18,000 per annum.

During the period to 31 December 1990 he actually paid £13,800.

What should his charge in profit and loss account be in respect of rent?

A £600
B £900
C £105
D £1,200

(2 marks)

9 Grey paid £3,600 insurance during the year to 31 March 1990.

As at 1 April 1989 he had overpaid £1,200, and the correct charge in the profit and loss account for year to 31 March 1990 is £3,900. What is the amount of the prepayment at 31 March 1990?

(2 marks)
10 The following information related to a company’s rent and rates account:

<table>
<thead>
<tr>
<th></th>
<th>Closing balance</th>
<th>Opening balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rates prepayment</td>
<td>90</td>
<td>60</td>
</tr>
<tr>
<td>Rent accrual</td>
<td>360</td>
<td>300</td>
</tr>
</tbody>
</table>

Cash payments of £2,520 were made in respect of rent and rates during the period. The charge to the profit and loss account for the year is

A £2,550  
B £2,490  
C £2,110  
D £3,030  

(2 marks)

11 Businesses charge depreciation on fixed assets in order to

A ensure that sufficient funds are available to replace the assets  
B spread the cost of the assets over their estimated useful life  
C comply with the prudence concept  
D reduce profits and dividends  

(2 marks)

12 A business buys a machine for £60,000 and depreciates it at 10% per annum by the reducing instalment method. What is the depreciation charge for the second year of the machine’s use?

A £4,800  
B £4,860  
C £5,400  
D £6,000  

(2 marks)

13 A business buys a machine for £120,000 on 1 January 1993 and another one on 1 July 1993 for £144,000. Depreciation is charged at 10% per annum on cost, and calculated on a monthly basis. What is the total depreciation charge for the two machines for the year ended 31 December 1993?

A £13,200  
B £19,200  
C £21,600  
D £26,400  

(2 marks)

14 A company buys a car for £60,000 and expects it to have a useful life of 5 years. It depreciates the car at 50% reducing balance and sells it after 3 years for £30,000. What is the profit on disposal?

A £6,000  
B £15,000  
C £18,000  
D £22,500  

(2 marks)
15  A business sells a van on 31 December 1993 which it bought on 1 January 1991 for £18,000 and has depreciated each year at 25% per annum by the straight line method. It trades this van in for a new one costing £30,000, and pays the supplier £27,600 by cheque.

A  £2,100 loss
B  £2,400 profit
C  £4,500 profit
D  £4,500 loss

(2 marks)

16  Graham has the following balances in his trial balance at 31 December 1993.

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total debtors</td>
<td>420,000</td>
</tr>
<tr>
<td>Bad debts written off (not previously provided for)</td>
<td>3,000</td>
</tr>
<tr>
<td>Provision at 1 January 1993</td>
<td>30,000</td>
</tr>
</tbody>
</table>

The company wishes to carry forward a provision equal to 10% of total debtors.

What is the total effect of the above on the profit and loss account for the year ended 31 December 1993?

A  charge of £14,700
B  credit of £14,700
C  charge of £15,000
D  credit of £15,000

(2 marks)

17  The cost of stock shown in the balance sheet at 31 March 1992 of Kelly valued on LIFO basis was 25,500. Had the stock been valued on a FIFO basis it would have been £27,600. The effect of adopting the FIFO valuation on the accounts for the year ended 31 March 1992 would be to

A  reduce profit and increase working capital £2,100
B  increase net assets and reduce losses by £2,100
C  reduce shareholders’ funds and increase current assets by £2,100
D  increase current assets and increases losses by £2,100

(2 marks)

18  Kiren sells three products A, B and C. At the company’s year end the stocks held are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Selling price</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>A</td>
<td>3,600</td>
<td>4,500</td>
</tr>
<tr>
<td>B</td>
<td>18,600</td>
<td>18,300</td>
</tr>
<tr>
<td>C</td>
<td>2,760</td>
<td>2,790</td>
</tr>
</tbody>
</table>

At sale a 5% commission is payable by the company to its agent. What is the total value of these stocks in the company’s account?

A  £23,637
B  £24,282
C  £24,960
D  £25,635

(2 marks)
19 Ali’s business had debtors of £1,950 at 1 January 1993 and £1,200 at 31 December 1993. £96,750 was received from customers on credit during the year.

Assuming that there were no bad debts and no discounts allowed, what were credit sales for the year?

A £96,000  
B £96,750  
C £97,200  
D £97,950  

(2 marks)

20 Allot’s business had debtors of £300 at 1 January 1994 and £270 at 31 December 1994. Credit sales amounted to £2,370 and cash received from debtors was £2,310; a bad debt of £30 was written off.

How much discount was allowed to customers during the year?

A £60  
B £120  
C £210  
D £270  

(2 marks)

21 Alpha’s business owed £60 to trade creditors at 1 July 1994 and £90 at 30 June 1995. Purchases on credit amounted to £3,000 during the year and suppliers allowed a total of £150 cash discount.

How much was paid to creditors during the year?

A £2,760  
B £2,820  
C £2,880  
D £2,940  

(2 marks)

22 At 30 June 1995 the balance in Barry’s cash book was £1,080 Cr. Examination of the bank statements revealed the following:

(i) Standing orders of £30 had not been recorded by Bill; and
(ii) Cheques paid to suppliers of £1,200 and receipts of £240 did not appear on the bank statement.

What was the balance on the bank statement on 30 June 1995?

A £150 Dr  
B £150 Cr  
C £2,070 Dr  
D £2,070 Cr  

(2 marks)

23 Candy returned some goods to a supplier because they were faulty. The original purchase price of these goods was £24,780.

The ledger clerk treated the return correctly on both the creditors’ ledger control account and the individual creditors’ account, but debited the purchase returns account with £25,860.
What is the correcting entry which needs to be made?

<table>
<thead>
<tr>
<th>Debit</th>
<th>£</th>
<th>Credit</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Suspense account</td>
<td>1,080</td>
<td>Purchase returns</td>
<td>1,080</td>
</tr>
<tr>
<td>B Purchase returns</td>
<td>1,080</td>
<td>Suspense account</td>
<td>1,080</td>
</tr>
<tr>
<td>C Suspense account</td>
<td>50,640</td>
<td>Purchase returns</td>
<td>50,640</td>
</tr>
<tr>
<td>D Purchase returns</td>
<td>50,640</td>
<td>Suspense account</td>
<td>50,640</td>
</tr>
</tbody>
</table>

(2 marks)

24 Cole extracted a trial balance but by mistake included the amount on the bank statement instead of the cash book balance. Review of the bank statement revealed the following:

(i) Unpresented cheques £2,400
(ii) Un cleared lodgements £1,500
(iii) Bank charges (not yet entered in cash book) £120
(iv) Balance as per bank statement £4,200 Dr

What is the journal entry required to clear the suspense account?

<table>
<thead>
<tr>
<th>Debit</th>
<th>£</th>
<th>Credit</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Suspense account</td>
<td>780</td>
<td>Cash</td>
<td>780</td>
</tr>
<tr>
<td>B Bank charges</td>
<td>120</td>
<td>Cash</td>
<td>900</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Suspense</td>
<td></td>
</tr>
<tr>
<td>C Cash</td>
<td>780</td>
<td>Suspense account</td>
<td>780</td>
</tr>
<tr>
<td>D Cash</td>
<td>780</td>
<td>Bank charges</td>
<td>120</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Suspense account</td>
<td></td>
</tr>
</tbody>
</table>

(2 marks)

25 Which of the following will reduce the net assets of a business?

A retaining a specific bad debt provision
B buying a new plant and machinery for cash
C decreasing a general bad debt provision
D creating a provision against slow-moving stock

(2 marks)

26 Which of the following will not alter the total net assets of a business?

A Drawings by the proprietor
B Receipts of interest from investments
C Payments to trade creditors
D Charging depreciation on fixed assets

(2 marks)

27 Alan’s business made purchases of £54,000 during the month of January 1996. His stock was £6,000 on 1 January and £12,000 on 31 January. His gross profit margin is 25% of sales.

What were his sales for the month?

A £60,000
B £64,000
C £75,000
D £80,000

(2 marks)
28 The accountant of Aina Limited gives you the following information for the year ended 31 December 1997:

Stock at 1 January £9,075  
Stock at 31 December £4,500  
Purchases £36,325  
Gross profit margin 30%  

What was the company’s gross profit for the year?
A £12,270  
B £13,608  
C £15,567  
D £17,529  

(2 marks)

29 Ash started a business on 1 October 1997. The following information is available for the year ended 31 September 1998:

Cash received from customers £60,450  
Cash paid to suppliers £63,360  
Trade debtors at 30 September 1998 £17,880  
Trade creditors at 30 September 1998 £7,020  
Mark-up on cost 40%  

What is the cost of stock at 30 September 1998?
A £14,430  
B £20,181  
C £23,382  
D £27,090  

(2 marks)

30 What does “Limited” mean in a company’s name?
A A company’s liability is limited to the total amount of its authorised share capital.  
B The company’s liability is limited to the total amount of its issued share.  
C The members’ liability is limited to the total amount payable on the shares held by them.  
D The members’ liability is limited to the nominal value of the shares held by them.  

(2 marks)

31 What is a reserve?
A an asset  
B a liability  
C a charge against profit  
D an appropriation of profit  

(2 marks)

32 Bill Limited shows the following items as “reserve” in its accounts. Which one of them is wrongly classified?
A plant replacement service  
B bad debt reserve  
C general reserve  
D share premium account  

(2 marks)
33 Under what heading debentures should be shown in a company’s balance sheet?

A capital
B reserves
C current liabilities
D long-term liabilities

(2 marks)
**Answers**

1  C

Old capital – drawing +/– net profit/(net loss) + legacy football wins, lottery wins = new capital

30,000 – 15,000 +/– net profit or net loss + 9,000 = 54,000
24,000 +/– profit/loss = 54,000

Profit = £30,000

2  B

54,000 – 18,000 + 36,000 +/– profit/loss = 63,000
72,000 +/– profit/loss = 63,000
Loss = £9,000

3  B

4  B

5  B

6  C

7  C

8  A (8/12 × £18,000)

9  B

<table>
<thead>
<tr>
<th>Insurance</th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bal b/d</td>
<td>1,200</td>
<td>Profit and loss a/c</td>
</tr>
<tr>
<td>Cash</td>
<td>3,600</td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td>4,800</td>
<td></td>
</tr>
</tbody>
</table>

10  A

<table>
<thead>
<tr>
<th>Rent and Rates expense</th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bal b/d</td>
<td>60</td>
<td>Bal b/d</td>
</tr>
<tr>
<td>Cash</td>
<td>2,520</td>
<td>Profit and loss a/c</td>
</tr>
<tr>
<td>Bal c/d</td>
<td>360</td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td>2,940</td>
<td></td>
</tr>
</tbody>
</table>

11  B

12  C

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
</tr>
<tr>
<td>Depreciation year 1: 10% × £60,000</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Depreciation year 2: 10% × (£60,000 – 6,000)</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
13 B

£

Machine 1: £120,000 \times 10%
12,000
Machine 1: £144,000 \times 10\% \times 6/12
7,200
19,200

14 D

£

Cost

£
Depreciation year 1: £60,000 \times 50%
(30,000)
30,000
Depreciation year 2: £30,000 \times 50%
(15,000)
15,000
Depreciation year 3: £7,500 \times 50%
(7,500)
7,500

Fixed asset disposal account

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost (original cost always)</td>
<td>60,000</td>
</tr>
<tr>
<td>P&amp;L (balancing figure)</td>
<td>22,500</td>
</tr>
<tr>
<td>82,500</td>
<td>82,500</td>
</tr>
</tbody>
</table>

15 A

Van account

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/d</td>
<td>18,000</td>
</tr>
<tr>
<td>18,000</td>
<td>18,000</td>
</tr>
</tbody>
</table>

Accumulated depreciation account

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disposals account</td>
<td>13,500</td>
</tr>
<tr>
<td>13,500</td>
<td>13,500</td>
</tr>
</tbody>
</table>

Disposals account

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Van (original cost)</td>
<td>18,000</td>
</tr>
<tr>
<td>Cash</td>
<td>27,600</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>45,600</td>
<td>45,600</td>
</tr>
</tbody>
</table>
Stock and work-in-progress
SSAP 9

Stock is cost of purchase plus other incidental costs in bringing the product to its present location and conditions plus any conversion costs that may be necessary.

Cost

Purchase price \( X \)
Import duties \( X \)
Handling costs \( X \)

Less:
Subsidies \( (X) \)
Discounts \( (X) \)
Net realisable value


Net realisable value
Selling price \( X \)
Less
Administration expenses \( (X) \)
Selling and distribution expenses \( (X) \)
Commission \( (X) \)

Provision for doubtful debts

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal c/d (10% × 420,000)</td>
<td>42,000</td>
<td></td>
</tr>
<tr>
<td>Bal b/d</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Bad debts a/c</td>
<td>12,000</td>
<td>42,000</td>
</tr>
<tr>
<td></td>
<td>42,000</td>
<td></td>
</tr>
</tbody>
</table>
Bad debts expense

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for doubtful debts</td>
<td>12,000</td>
<td>Profit and loss a/c</td>
</tr>
<tr>
<td>Bad debts written off</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>15,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

Note: Since the bad debt balance appears in the trial balance, debtors must already have been adjusted.

17 B

Closing stock is an asset in the balance sheet and is deducted from cost of sales (and hence added to profit) in the profit and loss account. An increase of stock from £25,500 to £27,600 would therefore increase assets and profit by £2,100 = (£27,600 − £25,500).

18 A

Stock is valued at lower of cost and net realisable value (costs to be incurred in selling stock are deducted from selling price in computing NRV)

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Price less commission</th>
<th>Lower of cost and NRV</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3,600</td>
<td>4,275</td>
<td>3,600</td>
</tr>
<tr>
<td>B</td>
<td>18,600</td>
<td>17,385</td>
<td>17,385</td>
</tr>
<tr>
<td>C</td>
<td>2,760</td>
<td>2,652</td>
<td>2,652</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>23,637</strong></td>
</tr>
</tbody>
</table>

Here each item A, B and C are looked at separately and not as a group.

19 A

Debtors control

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/d</td>
<td>1,950</td>
<td>Cash</td>
</tr>
<tr>
<td>Sales (Balancing figure)</td>
<td>96,000</td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td><strong>97,950</strong></td>
<td></td>
</tr>
</tbody>
</table>

20 A

Debtors control

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/d</td>
<td>300</td>
<td>Cash</td>
</tr>
<tr>
<td>Sales (Balancing figure)</td>
<td>2,370</td>
<td>Bad debts written off</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Discount allowed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td><strong>2,670</strong></td>
<td></td>
</tr>
</tbody>
</table>
21 B

<table>
<thead>
<tr>
<th>Creditors</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount received</td>
<td>150</td>
</tr>
<tr>
<td>Cash</td>
<td>2,820</td>
</tr>
<tr>
<td>Bal c/d</td>
<td>90</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,060</strong></td>
</tr>
</tbody>
</table>

22 A

<table>
<thead>
<tr>
<th>Cash book</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal c/d</td>
<td>1,110</td>
</tr>
<tr>
<td>Standing orders</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total Balance</strong></td>
<td><strong>1,110</strong></td>
</tr>
</tbody>
</table>

Balance as per bank statement (balancing figure) (150)
Unpresented cheques (1,200)
Outstanding lodgements 240
Balance as per adjusted cash book (1,110)

*Note: A debit in the bank statement indicates that the customer has overdrawn.*

23 C

Correct entry was to credit purchases returns account with £24,780. To correct, credit purchases returns with £24,780 + £25,860. Suspense account is to be debited, as the original entry will have created a suspense account balance by putting the accounts out of balance.

24 B

<table>
<thead>
<tr>
<th>£</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as per bank statement (overdrawn)</td>
<td>(4,200)</td>
</tr>
<tr>
<td>Unpresented cheques</td>
<td>(2,400)</td>
</tr>
<tr>
<td>Uncleared lodgements</td>
<td>1,500</td>
</tr>
<tr>
<td>Charges not entered in cash book</td>
<td>120</td>
</tr>
<tr>
<td>Balance as per cash book</td>
<td>4,980</td>
</tr>
</tbody>
</table>

In preparing the trial balance the following entries have been omitted:

Dr Bank charges
Cr Cash (2,400 – 1,500)

Each of these missing entries will affect the suspense account, so the net effect is:

Dr Suspense 780

25 D

26 C
27 B

\[
\begin{align*}
\text{Opening stock} & \quad 6,000 \\
\text{Purchases} & \quad 54,000 \\
\text{Less: Closing stock} & \quad (12,000) \\
\text{Cost of sales} & \quad 48,000 \\
\end{align*}
\]

S\(\frac{100}{75} \times 16,000 = 21,333\)

28 D

\[
\begin{align*}
\text{Opening stock} & \quad 9,075 \\
\text{Add: Purchases} & \quad 36,325 \\
\text{Less: Closing stock} & \quad (4,500) \\
\text{Cost of sales} & \quad 40,900 \\
\end{align*}
\]

\[
\begin{align*}
\text{Gross profit margin} & \quad 100 \\
\text{Balancing figure} & \quad (70) \\
\text{Given} & \quad 30 \\
\end{align*}
\]

Gross profit = 30/70 \times 40,900 = £17,529

29 A

<table>
<thead>
<tr>
<th>(1)</th>
<th>£</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>78,330</td>
<td>140</td>
</tr>
<tr>
<td>Mark-up</td>
<td>22,380</td>
<td>40</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>55,950</td>
<td>100</td>
</tr>
<tr>
<td>Purchases (63,360 + 7,020)</td>
<td>70,380</td>
<td></td>
</tr>
<tr>
<td>Stock (70,380 - 55,950)</td>
<td>14,430</td>
<td></td>
</tr>
</tbody>
</table>

Started business hence opening stock b/f debtors and b/f creditors will be Nil

<table>
<thead>
<tr>
<th>(2)</th>
<th>DLCA</th>
<th>CLCA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/f</td>
<td>0</td>
<td>Cash received</td>
</tr>
<tr>
<td>Sales</td>
<td>78,330</td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td>78,330</td>
<td></td>
</tr>
<tr>
<td>Cash paid</td>
<td>63,360</td>
<td>Bal b/f</td>
</tr>
<tr>
<td>Bal c/d</td>
<td>7,020</td>
<td>Purchases</td>
</tr>
<tr>
<td></td>
<td>70,380</td>
<td></td>
</tr>
</tbody>
</table>
(3) % £

Balancing figure 140 Sales £78,330
Mark-up thus 100 (Cost of sales) ???
Given 40 Gross profit

\[
\frac{100}{140} \times 78,330 = 55,950
\]

(4) Sales 78,330

\[\text{Less: Cost of sales}\]

\[
\begin{align*}
\text{Opening stock} & : 0 \\
\text{Add: Purchases} & : 70,380 \\
\text{Less: Closing stock} & : (14,430) \\
\text{Cost of sales} & : 55,950
\end{align*}
\]

30 C
31 D
32 B
33 D
Mock exam 2

1. What is meant by the term “proprietor’s funds” in the balance sheet of a sole trader’s business?
   A. Fixed assets plus current assets
   B. Fixed assets plus current assets less current liabilities
   C. Total assets less total liabilities
   D. Current assets less current liabilities
   (2 marks)

2. What is meant by the term “working capital”?
   A. Total assets less total liabilities
   B. Current assets less current liabilities
   C. Capital plus profit less drawings
   D. Capital plus profit less drawings plus long-term liabilities
   (2 marks)

3. Which of the following items should be classified as capital expenditure?
   A. Repairs to motor vans
   B. Depreciation of machinery
   C. Extension of premises
   D. Purchase of motor vans for resale
   (2 marks)

4. Which of the following items should be classified as revenue expenditure?
   A. Drawings of goods for private consumption
   B. Petrol for proprietor’s wife’s private car
   C. Purchase of a new typewriter
   D. Purchase of a new typewriter ribbon
   (2 marks)

5. Which of the following would cause a change in the proprietor’s funds of a sole trader?
   A. Depreciation of a fixed asset
   B. Purchase of a fixed asset for cash
   C. Purchase of a fixed asset on credit
   D. Sale of a fixed asset at book value
   (2 marks)

6. Beach’s business made sales of £24,000 during the month of January 1991, indirect expenses amounted to £12,000, and net profit was 10% of sales.

   What was the business’s cost of sales for the month?
   A. £9,600
   B. £12,000
   C. £14,400
   D. £21,600
   (2 marks)
7 Claim Limited paid £20,400 cash for electricity during the year ended 31 December 1993. At 1 January 1993 the company owed £15,000 and at 31 December 1993 it owed £17,400.

What charge for electricity should appear in the company’s profit and loss account for the year ended 31 December 1993?

A £17,400
B £18,000
C £20,400
D £22,800

(2 marks)

8 What is the principal purpose of charging depreciation on fixed assets?

A To ensure that sufficient funds are available to replace the assets
B To show the assets at their market value in the balance sheet
C To spread the cost of the assets over their estimated useful life
D To comply with the fundamental concept of prudence

(2 marks)

9 Ellison & Partners bought machinery for £300,000 on 1 January 1995, and have depreciated it at 10% per annum by the reducing instalment method.

What is the depreciation charge for the year ended 31 December 1997?

A £21,870
B £24,300
C £27,000
D £30,000

(2 marks)

10 Gene’s business bought a machine for £72,000 on 1 January 2000 and another one for £96,000 on 1st July 2000. Depreciation is charged at 10% per annum straight line and calculated on a monthly basis.

What is the total depreciation charge for the two machines for the year ended 31 December 2000?

A £6,000
B £8,400
C £12,000
D £16,800

(2 marks)

11 On 31 December 1998 Hello Limited sold a motor van which it had bought on 1 January 1996 for £24,000 and which it had depreciated each year at 50% by the reducing instalment method.

The company traded this van in for a new one costing £36,000, and paid the supplying garage £34,400 by cheque.

What was the profit or loss on the sale of the old van?

A £1,400 profit
B £1,600 profit
C £3,000 profit
D £3,000 loss

(2 marks)
12 What is the correct double entry for the part-exchange allowance on Question 11 above?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Fixed assets</td>
<td>Cash</td>
</tr>
<tr>
<td>B Cash</td>
<td>Fixed assets</td>
</tr>
<tr>
<td>C Fixed assets</td>
<td>Disposal account</td>
</tr>
<tr>
<td>D Disposal account</td>
<td>Fixed assets</td>
</tr>
</tbody>
</table>

(2 marks)

13 Assuming that it reconciles with the cash book, how would a balance marked “Cr” on a business’s bank statement appear in its balance sheet?

<table>
<thead>
<tr>
<th>Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Current asset</td>
</tr>
<tr>
<td>B Current liability</td>
</tr>
<tr>
<td>C Fixed asset</td>
</tr>
<tr>
<td>D Long-term liability</td>
</tr>
</tbody>
</table>

(2 marks)

14 What effect on a positive cash balance does an adjustment for unpresented paid cheques have on a bank reconciliation?

<table>
<thead>
<tr>
<th>Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Increase in the cash book balance</td>
</tr>
<tr>
<td>B Decrease in the cash book balance</td>
</tr>
<tr>
<td>C Increase in the balance shown by the bank statement</td>
</tr>
<tr>
<td>D Decrease in the balance shown by the bank statement</td>
</tr>
</tbody>
</table>

(2 marks)

15 A purchase day book total £7,390 had been entered in the control account £7,930.

<table>
<thead>
<tr>
<th>Control account</th>
<th>List of balances</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Debit £540</td>
<td>No effect</td>
</tr>
<tr>
<td>B Debit £540</td>
<td>Decrease total by £540</td>
</tr>
<tr>
<td>C Credit £540</td>
<td>No effect</td>
</tr>
<tr>
<td>D Debit £1,080</td>
<td>No effect</td>
</tr>
</tbody>
</table>

(2 marks)

16 Faulty goods, which had cost £2,400, had been returned to Roadblock Limited, but this return had not been recorded in the books.

<table>
<thead>
<tr>
<th>Control account</th>
<th>List of balances</th>
</tr>
</thead>
<tbody>
<tr>
<td>A No effect</td>
<td>Decrease total by £2,400</td>
</tr>
<tr>
<td>B Debit £2,400</td>
<td>No effect</td>
</tr>
<tr>
<td>C Debit £2,400</td>
<td>Decrease total by £2,400</td>
</tr>
<tr>
<td>D No effect</td>
<td>No effect</td>
</tr>
</tbody>
</table>

(2 marks)

17 A cash payment to Robert Conquests Limited of £6,000 had been credited to Norman Cross Limited’s account in the creditors’ ledger.

<table>
<thead>
<tr>
<th>Control account</th>
<th>List of balances</th>
</tr>
</thead>
<tbody>
<tr>
<td>A No effect</td>
<td>No effect</td>
</tr>
<tr>
<td>B No effect</td>
<td>Decrease total by £6,000</td>
</tr>
<tr>
<td>C No effect</td>
<td>Decrease total by £12,000</td>
</tr>
<tr>
<td>D Debit £12,000</td>
<td>Decrease total by £12,000</td>
</tr>
</tbody>
</table>

(2 marks)
18. A contra entry for £1,912 had been fully recorded in the books, with the creditors' ledger entry being in the account of Harry and the debtors' ledger entry being in the account of Carry. This contra, which should never have been made, is to be cancelled.

<table>
<thead>
<tr>
<th>Control account</th>
<th>List of balances</th>
</tr>
</thead>
<tbody>
<tr>
<td>A No effect</td>
<td>Increase total by £1,912</td>
</tr>
<tr>
<td>B Credit £1,912</td>
<td>Increase total by £1,912</td>
</tr>
<tr>
<td>C Debit £1,912</td>
<td>Decrease total by £1,912</td>
</tr>
<tr>
<td>D No effect</td>
<td>Decrease total by £1,912</td>
</tr>
</tbody>
</table>

The trial balance of Ovary Limited does not balance, and the bookkeeper enters the difference in a suspense account.

The following errors come to light. What correcting entries need to be made in each case? (Assuming where relevant that the control accounts are part of the double entry.)

(2 marks)

19. A total, £19,400, from the payments side of the cash book had been posted to the credit side of the creditors' ledger control account.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Creditors' ledger control</td>
<td>Suspense account £19,400</td>
</tr>
<tr>
<td>B Suspense account £19,400</td>
<td>Creditors' ledger control £19,400</td>
</tr>
<tr>
<td>C Creditors' ledger control</td>
<td>Suspense account £38,800</td>
</tr>
<tr>
<td>D Suspense account £38,800</td>
<td>Creditors' ledger control £38,800</td>
</tr>
</tbody>
</table>

(2 marks)

20. A payment of £240 from petty cash for stationery had been entered in the books twice. (The figure in the trial balance was the balance as per the petty cash book.)

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Stationery account £240</td>
<td>Suspense account £240</td>
</tr>
<tr>
<td>B Stationery account £240</td>
<td>Petty cash £240</td>
</tr>
<tr>
<td>C Suspense account £240</td>
<td>Stationery account £240</td>
</tr>
<tr>
<td>D Petty cash £240</td>
<td>Stationery account £240</td>
</tr>
</tbody>
</table>

(2 marks)

21. A sales day book total of £2,160 had been posted to the sales account as £5,040, but had been entered correctly in the debtors' ledger control account.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Suspense account £900</td>
<td>Sales account £900</td>
</tr>
<tr>
<td>B Sales account £900</td>
<td>Suspense account £900</td>
</tr>
<tr>
<td>C Suspense account £1,800</td>
<td>Sales account £1,800</td>
</tr>
<tr>
<td>D Sales account £1,800</td>
<td>Suspense account £1,800</td>
</tr>
</tbody>
</table>

(2 marks)
22. The purchase of office equipment for £750 had been charged to the purchases account.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Office equipment account £750</td>
<td>Suspense account £750</td>
</tr>
<tr>
<td>B Purchase account £750</td>
<td>Office equipment account £750</td>
</tr>
<tr>
<td>C Suspense account £750</td>
<td>Purchase account £750</td>
</tr>
<tr>
<td>D Office equipment account £750</td>
<td>Purchase account £750</td>
</tr>
</tbody>
</table>

(2 marks)

23. Faulty goods returned by a customer with a sales value of £37 had been correctly treated in his personal account and in the debtors’ ledger control account, but had been credited to the sales returns account as £73.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Sales returns account £36</td>
<td>Suspense account £36</td>
</tr>
<tr>
<td>B Suspense account £36</td>
<td>Sales returns account £36</td>
</tr>
<tr>
<td>C Sales returns account £110</td>
<td>Suspense account £110</td>
</tr>
<tr>
<td>D Suspense account £110</td>
<td>Sales returns account £110</td>
</tr>
</tbody>
</table>

(2 marks)
**Answers**

1. C
2. B
3. C
4. D
5. A
6. A

<table>
<thead>
<tr>
<th>£</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Sales</td>
<td>24,000</td>
</tr>
<tr>
<td>90% Cost of sales</td>
<td>??</td>
</tr>
<tr>
<td>10% Gross profit</td>
<td></td>
</tr>
</tbody>
</table>

$90/100 \times 24,000 = £21,600$

$21,600 - 12,000 = £9,600$

7. D

| Electric |
|---|---|---|
| Cash paid | 20,400 | Bal b/f |
| Bal c/d | 17,400 | P&L |
| | 37,800 | 37,800 |

8. C

9. B

<table>
<thead>
<tr>
<th>Cost</th>
<th>Depreciation 10% year 1</th>
<th>Depreciation 10% year 2</th>
<th>Depreciation 10% year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>300,000</td>
<td>(30,000)</td>
<td>(27,000)</td>
<td>(24,300)</td>
</tr>
</tbody>
</table>

10. C

Machine 1: Cost $72,000 \times 10\% = 7,200$

Machine 2: Cost $96,000 \times 10\% = 9,600 \times 6/12 = 4,800$

Total $7,200 + 4,800 = £12,000$

11. A

| Fixed asset disposal account |
|---|---|---|
| Cost | 24,000 | Accumulated depreciation | 21,000 |
| Paid | 34,400 | New van | 36,000 |
| | | Profit and loss | 1,400 |
| | 58,400 | 58,400 |
12,000 + 6,000 + 3,000 = 21,000

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>24,000</td>
</tr>
<tr>
<td>Depreciation 50%</td>
<td>(12,000)</td>
</tr>
<tr>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td>Depreciation 50%</td>
<td>(6,000)</td>
</tr>
<tr>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td>Depreciation 50%</td>
<td>(3,000)</td>
</tr>
</tbody>
</table>

12  C
13  A
14  D
15  A
16  C
17  C
18  B
19  C
20  D
21  A
22  D
23  C
Mock exam 3

1. Business charge depreciation on fixed assets in order to
   A. ensure that sufficient funds are available to replace the assets
   B. spread the cost of the assets over their estimated useful life
   C. comply with prudence concept
   D. reduce profits and dividends

(2 marks)

2. The following information relates to the business of Andy for the year ended 31 December 1992.

\[
\begin{array}{lc}
\text{£} & \\
\hline
\text{Opening debtors} & 2,000 \\
\text{Opening creditors} & 1,800 \\
\text{Discounts received} & 20 \\
\text{Cash sales} & 500 \\
\text{Cash from customers (including £200 from a customer whose debt was written off in 1991)} & 9,500 \\
\text{Credit purchases} & 6,000 \\
\text{Debtors to be written off} & 200 \\
\text{Discounts allowed} & 30 \\
\text{Returns inwards} & 40 \\
\text{Amounts paid to suppliers} & 5,400 \\
\text{Returns outwards} & 50 \\
\text{Credit sales} & 13,000 \\
\text{Debtors to be provided for (in addition to those written off)} & 150 \\
\end{array}
\]

What is the closing balance of the debtors ledger control account?

A. £4,930
B. £5,230
C. £5,280
D. £5,430

(2 marks)

3. Which of the following errors would cause an entry to be made in a suspense account?

A. Rent charges debited to the rates account
B. Cash paid to a creditor debited to the wrong creditor’s account
C. Cash received from a debtor debited to the wrong debtor’s account
D. Purchase of goods by the business for the proprietor’s private consumption debited to purchases

(2 marks)

4. After the draft accounts of Cats Ltd have been prepared, some stock is found in an old shed which was not included in the stocktaking. It appears that it originally costs £1,000, but it was thought that it will fetch only £100.
What is the effect on the company’s gross profit?

A Increase £100
B Decrease £900
C Increase £1,000
D Decrease £1,000

(2 marks)

5 Which of the following items is shown in a receipts and payments account but not in an income and expenditure account?

A The clubhouse electricity bill
B Subscriptions
C Affiliation fees
D The purchase of minibus

(2 marks)

6 Europes is a landlord with two tenants, Medea and Orestes. He prepare his accounts for the year ended 31 December 1996.

The following information is available:

<table>
<thead>
<tr>
<th></th>
<th>Medea</th>
<th>Orestes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent paid 31.12.95</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Rent owed 31.12.95</td>
<td></td>
<td>1,400</td>
</tr>
<tr>
<td>Rent paid during year</td>
<td>4,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Rent paid in advance at 31.12.96</td>
<td></td>
<td>500</td>
</tr>
<tr>
<td>Rent owed at 31.12.96</td>
<td>200</td>
<td></td>
</tr>
</tbody>
</table>

What figure for rental income will appear in Euripides’s profit and loss account?

A £8,300
B £8,900
C £9,100
D £9,700

(2 marks)

7 If a company pays 10% dividend, what is this a percentage of?

A profit before tax
B profit after tax
C authorised share capital
D issued share capital

(2 marks)

8 The estimated corporation tax charges of Cherry Limited for the years ended 31 December 1996 and 31 December 1997 were 2,400 and 2,700 respectively. However, the final settlements were £2,200 and £2,800 respectively.

What was the total corporation tax charge shown in the profit and loss account of Cherry Limited for the year ended 31 December 1997?

A £2,500
B £2,600
C £2,700
D £2,800

(2 marks)
9. Andrew has just completed the following reconciliation of the bank statement to his cash book.

Bank reconciliation statement as at 31 December 1995

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as per bank statement</td>
</tr>
<tr>
<td>Add: Unpresented cheques</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Less: Uncleared lodgements</td>
</tr>
<tr>
<td>Balance as per cash book</td>
</tr>
</tbody>
</table>

What figure for cash should be included in the trial balance at 31 December 1995?

A £9,564 Dr  
B £9,564 Cr  
C £10,118 Dr  
D £10,118 Cr  

(2 marks)

10. The difference between the treatment of taxation charged during the year and taxation paid during the year as far as the statement of source and application of funds is concerned is that

A. Taxation charged is an application of funds whereas tax paid would be shown as a movement in net liquid funds.
B. Taxation charged is an application of funds and tax paid would be shown in working capital as a movement on creditors.
C. Tax paid is an application of funds and taxation charged would be excluded from working capital in calculating the movement on creditors.
D. Tax paid is an application of funds and taxation charged would be shown as a movement in net liquid funds.

(2 marks)
Answers

1. C

2. D

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/d</td>
<td>2,000</td>
<td>Cash from credit</td>
</tr>
<tr>
<td>Credit sales</td>
<td>13,000</td>
<td>customers (9,500 – 200)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bad debts expense</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(amounts written</td>
</tr>
<tr>
<td></td>
<td></td>
<td>off only)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Discounts allowed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Return inwards</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td></td>
<td>200</td>
</tr>
<tr>
<td></td>
<td></td>
<td>30</td>
</tr>
<tr>
<td></td>
<td></td>
<td>40</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5,430</td>
</tr>
</tbody>
</table>

3. C

Note that there are a lot of red herrings in the Question, for example cash sales, and also entries that are to be included in CLCA have been ignored.

4. A

Omitted from closing stock, therefore its inclusion will increase profit by the lower of cost and net realisable value, that is £100.

5. D

In a receipts and payments account, capital expenditure is charged when it is incurred.

6. A

Rent receivable account

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/d (Orsetes)</td>
<td>1,400</td>
<td>Bal b/d (Medea)</td>
</tr>
<tr>
<td>Profit and loss a/c (balancing figure)</td>
<td>8,300</td>
<td>Recorded in year (4,000 + 5,000)</td>
</tr>
<tr>
<td>Bal c/d (Medea)</td>
<td>500</td>
<td>Bal c/d (Medea)</td>
</tr>
<tr>
<td></td>
<td>10,200</td>
<td>10,200</td>
</tr>
<tr>
<td>Bal b/d (Medea)</td>
<td>200</td>
<td>Bal b/d (Orsetes)</td>
</tr>
<tr>
<td></td>
<td>500</td>
<td></td>
</tr>
</tbody>
</table>

7. D

8. A

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charge for 1997</td>
<td>2,700</td>
</tr>
<tr>
<td>Over provision 1996</td>
<td>(200)</td>
</tr>
<tr>
<td></td>
<td>2,500</td>
</tr>
</tbody>
</table>

9. D

The nature of the reconciliation indicates that Andrew has an overdraft. For example, unpresented cheques have an adverse effect on the bank balance, here they are increasing therefore the bank account is overdrawn.

10. C
Mock exam 4

1. The cost of a stock item held by a company is £80 and its net realizable value is £70. When preparing balance sheet, the accountant of the company wants to know the basis of valuation of such stock. Which of the following concepts should dictate his choice?
   A. the going concern concept
   B. the money measurement concept
   C. the prudence concept
   D. the accruals concept

   (2 marks)

2. Andy introduces £150,000 into the business extending the liquidity by obtaining a loan of £100,000. The net assets of the business are worth:
   A. £50,000
   B. £100,000
   C. £150,000
   D. £250,000

   (2 marks)

3. How can we measure the net profit of a trader?
   A. Opening capital + drawings – capital introduced – closing capital
   B. Closing capital + drawings – capital introduced – opening capital
   C. Opening capital – drawings + capital introduced – closing capital
   D. Closing capital – drawings + capital introduced – opening capital

   (2 marks)

4. In a financial year, a business earned £290,000 worth of profit. A further injection of £32,000 was made during the year and stock worth £8,800 was used for private purposes by the entrepreneur.
   Considering the fact that net assets at the beginning of the year were £406,800, the closing net assets should be
   A. £350,000
   B. £357,200
   C. £633,600
   D. £720,000

   (2 marks)

5. If owner of a business withdraws cash for his personal use, the journal entries will be
   A. Dr Capital Cr Drawings
   B. Dr Cash Cr Drawings
   C. Dr Drawings Cr Capital
   D. Dr Drawings Cr Cash

   (2 marks)
6 Goods withdrawn by proprietor for his personal use are entered into the books of accounts as:

A Dr Drawings Cr Purchases
B Dr Purchases Cr Drawings
C Dr Capital Cr Drawings
D Dr Purchases Cr Sales

(2 marks)

7 Mr Malopa has paid rent of £14,400 for the period 1 January 2004 to 31 December 2004. His accounts drawn up for nine months up to 31 September 2004 should show the rent expense as:

A Only a rent expense of £7,200
B A rent expense of £10,800 and a prepayment of £3,600
C A rent expense of £10,800 and accrued income of £3,600
D A rent expense of £14,400 with an explanatory note that this is the usual charge for twelve months

(2 marks)

8 At 1 January 2004 the accounts of a trader show accrued rent payable of £1,500. During the year he pays rent bills totalling £7,650, including one bill for £2,250 in respect of the quarter ending 31 January 2005.

What is the profit and loss charge for rent payable for the year ended 31 December 2004?

A £5,400
B £6,900
C £8,400
D £9,900

(2 marks)

9 The cash book of Bright Ltd has a memorandum column recording settlement discounts allowed by suppliers. The column is totalled every week and posted to the nominal ledger.

What is the correct double entry in the nominal ledger?

A Dr Cash Cr Discounts received
B Dr Cash Cr Discounts allowed
C Dr Creditors Cr Discounts received
D Dr Discounts allowed Cr Debtors

(2 marks)

10 A company receives a settlement discount of £1,500 from a supplier. The amount is debited to the discount received account. As a result, gross profit is

A understated by £1,500
B understated by £2,800
C overstated by £2,800
D unaffected

(2 marks)
11 What action a company does need to take when coming to know that a major customer has gone bankrupt. His debt had been provided for as doubtful earlier in the year. The entries now required are

A Dr Bad and doubtful debts Cr Debtors  
B Dr Debtors Cr Bad and doubtful debts  
C Dr Debtors Cr Provision for doubtful debts  
D Dr Provision for doubtful debts Cr Debtors  

(2 marks)

12 Brain Ltd owns freehold property which cost £468,000 to acquire (being £138,000 for the land and £330,000 for the buildings). The company’s accounting policy is to depreciate buildings (but not freehold land) at the rate of 2% per annum.

After three years, what will be the net book value of the asset “freehold land and buildings” in the company’s books?

A £307,200  
B £439,920  
C £448,200  
D £459,420  

(2 marks)

13 Atomic Ltd purchases a machine for which the supplier’s list price is £162,000. Automat pays £117,000 in cash and trades in an old machine which has a net book value of £72,000. It is the company’s policy to depreciate such machines at the rate of 10% per annum on cost.

What is the net book value of the machine after one year?

A £105,300  
B £145,800  
C £170,100  
D £172,800  

(2 marks)

14 United Ltd purchases a company car for £198,000 plus VAT at 17.5%. The car is expected to have a life of three years and a residual value of £90,000. Payment is made partly in cash and partly by trading in an old car with a net book value of £70,560 and a trade-in value of £54,000. The company uses the straight-line basis to depreciate its cars. What is the net book value of the car after one year?

A £150,000  
B £156,000  
C £162,000  
D £185,100  

(2 marks)

15 Clarke’s Ltd’s stock valuation includes goods received from Maximum Ltd on a sale or return basis. The goods have been invoiced by Maximum Ltd at £72,000 and Clarke’s Ltd would expect to sell them to customers for £96,000. Charles Ltd has not recorded the purchase invoice in its books.
The effect on Charles Ltd’s profit of including these goods in the stock valuation at their cost of £72,000 is that

A profit is overstated by £72,000
B profit is understated by £24,000
C profit is understated by £72,000
D profit is stated correctly

(2 marks)

16 Cherry purchases goods with a list price of £120,000. The supplier grants a trade discount of 5% on list price, and Triangle also takes advantage of a settlement discount amounting to 2% of list price.

In Triangle’s balance sheet the value of this stock should be

A £108,000
B £114,000
C £102,600
D £120,000

(2 marks)

17 Bow Ltd’s year end is 31 December. For various reasons, stock could not be counted this year until 6 January. The stock valuation at this date was £445,800. Detailed records were kept of stock movements between the year end and the stocktaking. The following figures (all stated at cost) are available:

<table>
<thead>
<tr>
<th>(£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
</tr>
<tr>
<td>Purchases</td>
</tr>
<tr>
<td>Returns inwards</td>
</tr>
<tr>
<td>Returns outwards</td>
</tr>
</tbody>
</table>

The value of stock in Bow Ltd’s balance sheet at 31 December is

A £444,420
B £445,560
C £446,040
D £447,180

(2 marks)

18 What could be the reason of difference between the creditor’s control account and total of creditor’s balance?

A Incorrect calculation of a trade discount
B Omission of cheque payment of a supplier from ledgers
C The total of cash receipts in book was miscast
D Returns outwards were not entered in the personal account of the supplier

(2 marks)
19 The following information is available about a company’s debtors:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance b/f at 1 January 2003</td>
<td>166,200</td>
</tr>
<tr>
<td>Provision for doubtful debts at 1 January 1998</td>
<td>13,320</td>
</tr>
<tr>
<td>Increase in provision during 1998</td>
<td>1,440</td>
</tr>
<tr>
<td>Discount allowed in year</td>
<td>47,280</td>
</tr>
<tr>
<td>Sales in year</td>
<td>1,460,760</td>
</tr>
<tr>
<td>Purchase ledger in year</td>
<td>106,800</td>
</tr>
<tr>
<td>Receipts from customers in year</td>
<td>1,370,400</td>
</tr>
</tbody>
</table>

What is the balance carried forward at 31 December 2004 on the debtors control account

- A £87,720
- B £101,040
- C £102,480
- D £316,080

(2 marks)

20 A company’s cash book shows a debit balance of £8,400. The bank statement as at the same date shows an overdrawn balance of £2,520. Which one of the following timing differences could account for the discrepancy?

- A Cheques drawn but not yet presented amounted to £5,880
- B Cheques received but not yet cleared amounted to £5,880
- C Cheques drawn but not yet presented amounted to £10,920
- D Cheques drawn but not yet cleared amounted to £10,920

(2 marks)

21 A company’s cash book at 31 December 2004 shows a debit balance of £2,125. When the bank statement as at that date is received it is found that cheques drawn by the company totalling £274 had not been presented. In addition, the statement recorded bank charges of £58 which had not been entered in the cash book.

What was the balance on the bank statement as at 31 December 2004?

- A £1,909 overdrawn balance
- B £1,909 favourable balance
- C £2,341 favourable balance
- D £2,457 favourable balance

(2 marks)

22 A company’s bank statement shows an overdraft of £3,204 at 31 March 2004. The statement includes bank charges of £46 which have not yet been recorded in the company’s cash book. The statement does not include cheques for £780 paid to suppliers, nor an amount of £370 received from a debtor; both of these amounts appear in the bank statement for April 2004.

If the company prepares a balance sheet as at 31 March 2004, the figure for bank overdraft should be

- A £2,748
- B £2,794
- C £3,568
- D £3,614

(2 marks)
Ferry’s stock on 1 January 2004 cost £14,300 and his creditors were £3,750. During the year his sales amounted to £174,000, earning an average mark-up of 33% on cost. He paid £133,650 to suppliers during the year and creditors’ balances at 31 December 1995 totalled £4,900. On the same date his shop was burgled and all his stock was stolen.

What was the cost of the stolen stock?
A £16,300
B £18,273
C £30,800
D £33,100

(2 marks)

A club takes credit for subscriptions when they become due. On 1 January 2005 arrears of subscriptions amounted to £38 and subscriptions paid in advance were £72. On 31 December 2005 the amounts were £48 and £80 respectively. Subscription receipts during the year were £790.

In the income and expenditure accounts for 1995 the income from subscriptions would be shown as:
A £748
B £788
C £790
D £792

(2 marks)

A club takes no credit for subscriptions due until they are received. On 1 January 2005 arrears of subscriptions amounted to £24 and subscriptions paid in advance were £14. On 31 December 2005 the amounts were £42 and £58 respectively. Subscription receipts during the year were £1,024.

In the income and expenditure account for 1995 the income from subscriptions would be shown as:
A £956
B £980
C £998
D £1,050

(2 marks)

Which one of the following costs would not be shown as a factory overhead in a manufacturing account?
A The cost of insurance on a factory
B The cost of an extension to a factory
C The cost of depreciation on a factory
D The cost of rent on a factory

(2 marks)

Which one of the following costs would be included in the calculation of prime cost in a manufacturing account?
A Factory
B Office wages
C Direct production wages
D Depreciation on machinery

(2 marks)
28 Which one of the following costs would be included in the calculation of prime cost in a manufacturing account?

A Cost of transporting raw materials from suppliers premises  
B Wages of factory workers engaged in machine maintenance  
C Depreciation of lorries used for deliveries to customers  
D Cost of indirect production materials  

(2 marks)

29 A company’s usage of raw materials during a year was £35,800. Direct labour costs amounted to £53,400, production overheads to £14,800 and administration overheads to £10,200. Opening work-in-progress was £3,600 and closing work in progress was £4,700.

In the company’s manufacturing account, factory cost of finished goods produced is

A £102,900  
B £105,000  
C £113,100  
D £115,300  

(2 marks)

30 Many manufacturing companies transfer goods from factory to warehouse at a price which includes a mark-up on production cost. Once the mark-up has been calculated for a year’s production, what double entry is needed to bring it into the books of account?

A Dr Profit and loss account  
Cr Manufacturing account  
B Dr Manufacturing account  
Cr Profit and loss account  
C Dr Manufacturing account  
Cr Provision for unrealised profit  
D Dr Profit and loss account  
Cr Provision for unrealised profit  

(2 marks)

31 When a shareholder in a limited company sells his shares to another private investor for less than what he paid for them, the share capital of the company will

A fall by the nominal value of the shares  
B increase by the nominal value of the shares  
C increase by the amount received for the shares  
D remain unchanged  

(2 marks)

32 Which one of the following does not form part of a limited company’s equity capital?

A Ordinary share capital  
B Preference share capital  
C Revaluation reserve  
D Debenture redemption reserve  

(2 marks)
33 For which one of the following purposes is it not normally permissible to apply a share premium account?
   A Issuing fully paid bonus shares
   B Writing off preliminary expenses of formation
   C Writing off the premium payable on redemption of debentures
   D Writing off the premium payable on redemption of shares

(2 marks)

34 For which one of the following purposes is it permissible to apply a capital redemption reserve account?
   A Issuing fully paid bonus shares
   B Writing off preliminary expenses of formation
   C Writing off the premium payable on redemption of debentures
   D Writing off the premium payable on redemption of shares

(2 marks)

Data for questions 35 to 40
The trading account of Calypso Ltd for the year ended 30 June 2005 is set out below:

<table>
<thead>
<tr>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>430,000</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>50,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>312,500</td>
</tr>
<tr>
<td>Closing stock</td>
<td>38,000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>324,500</td>
</tr>
<tr>
<td>Gross profit</td>
<td>105,500</td>
</tr>
</tbody>
</table>

The following amounts have been extracted from the company's balance sheet at 30 June 2005.

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>60,000</td>
</tr>
<tr>
<td>4,000</td>
</tr>
<tr>
<td>6,000</td>
</tr>
<tr>
<td>8,000</td>
</tr>
<tr>
<td>40,000</td>
</tr>
<tr>
<td>3,000</td>
</tr>
<tr>
<td>5,000</td>
</tr>
</tbody>
</table>

In the questions that follow assume a year to be 365 days and ignore VAT.

35 Calculate the stock turnover period of Calypso Ltd in days.
   A 33 days
   B 17 days
   C 49 days
   D 51 days

(2 marks)
36 Calculate the debtors collection period of Calypso Ltd in days.

A 51 days
B 54 days
C 67 days
D 72 days

(2 marks)

37 Calculate the creditors payment period of Calypso Ltd in days.

A 45 days
B 47 days
C 50 days
D 78 days

(2 marks)

38 Calculate the current ratio of Calypso Ltd at 30 June 2005.

A 1.25:1
B 1.93:1
C 2.04:1
D 2.12:1

(2 marks)

39 Calculate the quick ratio (or acid test ratio) of Calypso Ltd at 30 June 2005.

A 1.25:1
B 1.28:1
C 1.37:1
D 1.50:1

(2 marks)

40 Calculate the length of Calypso Ltd’s cash cycle in days.

A 2 days
B 4 days
C 53 days
D 100 days

(2 marks)

Data for questions 41 to 46

The following information has been derived from the accounts of Montgomery plc for the year ended 31 December 2005.

On 31 December 2005

Current ratio 1.4:1
Quick ratio 0.9:1
Net current assets £32,000
Ordinary share capital in issue £150,000
Fixed assets as a percentage of shareholders’ funds 90%
Debtors collection period 6 weeks

For the year ended 31 December 2005

Net profit retained for the year as a percentage of ordinary share capital in issue 40%
Annual rate of stock turnover 8.775 times
Gross profit as a percentage of sales 25%
On 31 December 2005 there were no current assets other than stock, debtors and bank balances and no liabilities other than ordinary shareholders’ funds and current liabilities. Assume a 52 week year.

41 Calculate the amount of Montgomery plc current liabilities on 31 December 2005.
   A £22,857
   B £28,800
   C £44,800
   D £80,000

   (2 marks)

42 Calculate the amount of Montgomery plc’s stock at 31 December 2005.
   A £16,000
   B £32,000
   C £40,000
   D £56,000

   (2 marks)

43 Calculate Montgomery plc’s turnover for 2005.
   A £351,000
   B £437,500
   C £438,500
   D £468,000

   (2 marks)

44 Calculate Montgomery plc’s bank balance at 31 December 2005.
   A £18,000
   B £48,000
   C £54,000
   D £72,000

   (2 marks)

45 Calculate the total of the overhead expenses appearing in the profit and loss account of Montgomery plc for the year ended 31 December 2005.
   A £57,000
   B £117,000
   C £291,000
   D £408,000

   (2 marks)

46 Calculate the retained profits brought forward by Montgomery plc at 1 January 2005.
   A £78,000
   B £110,000
   C £170,000
   D £260,000

   (2 marks)
Answers

1. C
2. C
3. B
   Note: Closing capital – opening capital = increase in net assets
4. D
   £406,800 + £290,000 + £32,000 − £8,800 = £720,000
5. D
   The answer is not C because drawings will eventually be transferred to Capital Account. Initially it effects the Drawings account.

6. A

7. B
   £14,400 × 9/12 = £10,800 Rent expense
   £14,400 − £10,800 = £3,600 Prepayment

8. A (£7,650 − £2,250 = £5,400)

9. C

10. D
    Discount received is stated in the profit and loss account, hence net profit NOT gross profit by £2,800.

11. D
    A is wrong because the debit to bad and doubtful debts would already have been made when the provision was first set up.

12. C
    £330,000 × 2% = £6,600 per year; £6,600 × 3 = £19,800;
    £330,000 − £19,800 = £310,200; £310,200 + £138,000 = £448,200

13. B
    £162,000 × 90% = 145,800
    The net book value of £72,000 of the trade-in old machine is irrelevant. The trade-in value agreed is evidently £45,000, that is the difference between the supplier’s price and the cash paid.

14. D
    VAT on company cars is not recoverable and therefore must be capitalised as cost of the car.
    £198,000 × 17.5% = £34,650
    £198,000 + £34,650 = £232,650
    (Cost − residual value)/estimated useful life = (232,650 − 90,000)/3 = £47,550
    £232,650 − £47,550 = £185,100
15 A
Goods on sale or return should be excluded from the stock valuation.

16 B
Stock valuation should take account of trade discounts, but never of settlement or cash discounts.

17 B
£445,800 + (£7,500 + £840) − (£6,930 + £1,650) = £445,560

18 D
A and B would affect both the control account and the ledger in equal amounts. C does not affect the control account. The correct answer is D.

19 C

<table>
<thead>
<tr>
<th>DLCA</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal b/f</td>
<td>166,200</td>
<td>Discount allowed</td>
</tr>
<tr>
<td>Sales</td>
<td>1,460,760</td>
<td>Purchase ledger</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Receipts from debtors</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bal c/d</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

20 D
Cheques received were lodged into the bank but were not yet cleared.

21 C
£2,125 + £274 − £58 = £2,341

22 D
£3,204 + £780 − £370 = £3,614

23 B

Sales 174,000

<table>
<thead>
<tr>
<th>CLCA</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid creditors 133,650</td>
<td>Bal b/f 3,750</td>
<td></td>
</tr>
<tr>
<td>Bal c/d 4,900</td>
<td>Purchases 134,800</td>
<td></td>
</tr>
<tr>
<td>(Balancing figure)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>138,550</td>
<td>138,550</td>
<td></td>
</tr>
</tbody>
</table>

% £

Balance 133% Sales 174,000

Mark-up 100% (Cost of sales) ???

Given 33% Gross profit

133% = £174,000; hence 100% = 100/133 × 174,000 = £130,827
Therefore, £174,000 − £130,827 = £18,273
24 D

Subscription account (Revenue)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accruals b/f</td>
<td>38</td>
</tr>
<tr>
<td>Prepayment b/f</td>
<td>72</td>
</tr>
<tr>
<td>Income and expenditure (Balancing figure)</td>
<td>792</td>
</tr>
<tr>
<td>Subscription received</td>
<td>790</td>
</tr>
<tr>
<td>Prepaid income</td>
<td>80</td>
</tr>
<tr>
<td>Accrued income c/d</td>
<td>48</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>910</strong></td>
</tr>
</tbody>
</table>

25 B

Subscription Account (Revenue)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Arrears b/f</td>
<td>0</td>
</tr>
<tr>
<td>Prepayment b/f</td>
<td>14</td>
</tr>
<tr>
<td>Income and expenditure (Balancing figure)</td>
<td>980</td>
</tr>
<tr>
<td>Subscription received</td>
<td>1,024</td>
</tr>
<tr>
<td>Prepayment c/d</td>
<td>58</td>
</tr>
<tr>
<td>Arrears</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,038</strong></td>
</tr>
</tbody>
</table>

All arrears income will be credited once received hence ignore both arrears b/f and c/d.

26 B

The cost of an extension to a factory is a capital expenditure and would be shown as an asset in the balance sheet.

27 C

Prime cost includes only direct materials and direct production wages.

28 A

The cost of transporting raw materials forms part of the direct material costs.

29 A

(£35,800 + £53,400) + £14,800 − £4,700 + £3,600 = £102,900

30 B

The mark-up is debited to the manufacturing account to increase production cost to transfer price and credited to profit and loss account so that the net effect on reported profit is nil.

31 D

A transfer of shares has no effect on the company’s share capital.

32 B

Preference shares (particularly if they are irredeemable) do not form part of equity capital.

33 D

In exceptional circumstances the account can be used to finance the premium on redemption of shares.

34 A

It is permissible to convert the reserve into share capital by using it to finance a bonus.
35 C

\[(\frac{£44,000}{324,500}) \times 365 \text{ days} = 49 \text{ days}\]

\[\frac{\text{Opening stock + Closing stock}}{2} / \text{Cost of sales}\]

36 A

\[(\frac{£60,000}{£430,000}) \times 365 \text{ days} = 51 \text{ days}\]

\[\text{(Trade debtors/Sales)} \times 365\]

37 B

\[(\frac{£40,000}{£312,500}) \times 365 \text{ days} = 47 \text{ days}\]

\[\text{(Trade creditors/Purchases)} \times 365\]

38 B

\[\frac{108,000}{56,000} = 1.93:1\]

Current assets:Current liabilities

Current assets = Trade debtors £60,000 + Prepayments £4,000 + Cash in hand £6,000 + Closing stock £38,000

Current liabilities = Bank overdraft £8,000 + Trade creditors £40,000 + Accruals £3,000 + Proposed dividends £5,000

39 A

\[\frac{70,000}{56,000} = 1.25:1\]

Current assets - Stock:Current liabilities

Current assets - Stock = Trade debtors £60,000 + Prepayments £4,000 + Cash in hand £6,000 + Closing stock £38,000 - Closing stock £38,000

Current liabilities = Bank overdraft £8,000 + Trade creditors £40,000 + Accruals £3,000 + Proposed dividends £5,000

40 C

Stock turnover period + Debtors collection period - Creditors payment period = Length of cash cycle = 49 + 51 - 47 (as per Q 35, 36 and 37) = 53 days

41 D

\[\frac{£32,000}{0.4} = £80,000\]

Current ratio is 1.4:1 hence

Current assets - Current liabilities = 32,000

If Current liabilities are A then Current assets are 1.4A

\[1.4A - A = 32,000; 0.4A = 32,000\]

Hence A = 32,000/0.4 = Current liabilities
42  C

Current liabilities = £80,000; Current assets = £80,000 \times 1.4 = £112,000

Quick assets = £80,000 \times 0.9 = £72,000

Therefore, stock will be the difference between current assets and quick assets (£112,000 − 72,000) = £40,000

43  D

Cost of sales = £40,000 \times 8.775 = £351,000; Gross profit is 25% of sales

Therefore, sales equals to £351,000/0.75 = £468,000

44  A

Closing debtors = £468,000 \times 6/52 = £54,000

Current assets = £112,000 (see answer 42)

Closing stock = £40,000 (see answer 42)

Bank balance = £112,000 − £54,000 − £40,000 = £18,000

45  A

Gross profit = £468,000 \times 25\% = £117,000

Net profit = £150,000 \times 40\% = £60,000

Overhead expenses = £(117,000 − 60,000) = £57,000

46  B

Net assets = Fixed assets + Current assets

Capital employed or shareholders funds = net assets

Fixed assets equal 90\% of shareholders funds

Therefore, if net current assets equal 10\% or £32,000, net assets equal £32,000/0.1 = £320,000 and

Fixed assets equal 0.9 \times £320,000 = £288,000

Retained profits brought forward at 1 January 2005 = £320,000 − (150,000 + 60,000) = £110,000

Or a shorter cut would be

(£32,000/0.1) − (150,000 + 60,000) = £110,000
Revision questions 1

1.1 The purchases of a business for more than the aggregate of the fair value of its separable identifiable assets results in the creation of a

A share premium account
B reserve account
C suspense account
D goodwill account

(2 marks)

1.2 A business has opening stock of £24,000 and closing stock of £36,000. Purchase returns were £10,000. The cost of good sold was £222,000. Purchases were

(2 marks)

1.3 The responsibility for ensuring that all accounting transactions are properly recorded and summarised in the final accounts lies with

A the external auditors
B the internal auditors
C the shareholders
D the directors

(2 marks)

1.4 A business incurs expenditure on the following research and development activities

£240,000 on pure research
£400,000 on applied research
£700,000 on product development

The amount that could be capitalised is

(2 marks)

1.5 Your purchase ledger control account has a balance at 1 October 2008 of £69,000 credit. During October, credit purchases were £156,800, cash purchases were £4,800, and payments made to suppliers, excluding cash purchases and after deducting cash discounts of £2,400, were £137,800. Purchase returns were £9,400. The closing balance was

(2 marks)

1.6 Your firm’s bank statement at 31 October 2008 shows a balance of £26,800. You subsequently discover that the bank has dishonoured a customer’s cheque of £600 and has charged bank charges of £100, neither of which is recorded in your cash book. There are unrepresented cheques totalling £2,800. You further discover that an automatic receipt from a customer of £390 has been recorded as a credit in your cash book.

Your cash book balance, prior to correcting the errors and omissions, was

(2 marks)

1.7 Your firm’s cash book shows a credit balance of £2,480 at 30 April 2009. Upon comparison with the bank statement, you determine that there are unrepresented cheques totalling £450, and a receipt of £140 that has not yet been passed through the bank account. The bank statement shows bank charges of £75 that have not been entered on the bank statement is

(2 marks)
1.8 Ensuring that the assets of a company are properly safeguarded and utilised efficiently and effectively as part of

A the stewardship function exercised by the directors
B the external auditor’s responsibility
C the function of the financial accountant
D the internal auditor’s responsibility

(2 marks)

1.9 Match the following users with their information requirements:

<table>
<thead>
<tr>
<th>Users</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 The public</td>
<td>A The ability of the company to continue, and to pay pensions in the future</td>
</tr>
<tr>
<td>2 The government</td>
<td>B The use of information for taking operational decisions in running the company</td>
</tr>
<tr>
<td>3 Employees</td>
<td>C The policies of a company and how those policies affect the community, for example health and safety</td>
</tr>
<tr>
<td>4 Internal users</td>
<td>D The performance and financial position of a company and its ability to pay dividends</td>
</tr>
<tr>
<td>5 Shareholders</td>
<td>E The ability of a company to pay taxes, and administer other taxes, for example value-added tax</td>
</tr>
</tbody>
</table>

(2 marks)

1.10 The management accounts within a limited company are determined by

A company law
B company law and accounting standards
C the shareholders
D directors

(2 marks)
Revision questions 2

2.1 A credit balance on a ledger account indicates
   A an asset or an expense
   B a liability or an expense
   C an amount owing to the organisation
   D a liability or a revenue

   (2 marks)

2.2 An error of principle would occur if
   A plant and machinery purchased was credited to a fixed assets account
   B plant and machinery purchased was debited to the purchases account
   C plant and machinery purchased was debited to the equipment account
   D plant and machinery purchased was debited to the correct account but with the wrong amount

   (2 marks)

2.3 The accounting concept of convention that, in times of rising prices, tends to understate asset values and overstate profits, is the
   A going concern concept
   B prudence concept
   C realisation concept
   D historical cost convention

   (2 marks)

2.4 Recording the purchase of computer stationery by debiting the computer equipment account would result in
   A an overstatement of profit and an overstatement of fixed assets
   B an understatement of profit and an overstatement of fixed assets
   C an overstatement of profit and an understatement of fixed assets
   D an understatement of profit and an understatement of fixed assets

   (2 marks)

2.5 Depreciation is best described as
   A a means of spreading the payment for fixed assets over a period of year
   B a decline in the market value of the assets
   C a means of spreading the net cost of fixed assets over their estimated useful life
   D a means of estimating the amount of money needed to replace the assets

   (2 marks)

2.6 Which one of the following is a book of prime entry and part of the double-entry system?
   A The journal
   B The petty cash book
   C The sales day book
   D The purchase ledger

   (2 marks)
Revision questions 3

3.1 Your company auditor insists that it is necessary to record items of plant separately and to depreciate them over several years, but that items of office equipment, such as hand-held stapling machines, can be grouped together and written off against profits immediately.

The main reason for this difference in treatment between the two items is because

- A treatments of the two items must be consistent with treatment in previous years
- B items of plant last for several years, whereas hand-held stapling machines last only for months
- C hand-held stapling machines are not regarded as material items
- D items of plant are revalued from time to time, whereas hand-held stapling machines are recorded at historical cost

(2 marks)

3.2 Which of the following best explains what is meant by “capital expenditure”? Capital expenditure is the expenditure

- A on fixed assets, including repairs and maintenance
- B on expensive assets
- C relating to the issue of share capital
- D relating to the acquisition or improvement of fixed assets

(2 marks)

3.3 The main purpose of an audit is to

- A detect errors and fraud
- B ensure that the accounts are accurate
- C determine that the accounts show a true and fair view of the financial state of the organisation
- D ensure that all transactions have been recorded in the books of account

(2 marks)

3.4 A computerised spreadsheet package is most suitable for

- A recording the dual aspect of accounting transactions
- B maintaining an audit trail of transactions
- C performing bank reconciliations
- D preparing a cash budget

(2 marks)

3.5 When a transaction is entered into the correct ledger accounts, but the wrong amount is used, the error is known as an error of

- A omission
- B original entry
- C commission
- D principle

(2 marks)
Revision questions 4

4.1 It is important to produce a trial balance prior to preparing the final accounts because
   A it confirms the accuracy of the ledger accounts
   B it provides all the figures necessary to prepare the final accounts
   C it shows that the ledger accounts contain debit and credit entries of an equal value
   D it enables the accountant to calculate any adjustments required

   (2 marks)

4.2 A computerised accounts package would be most useful in maintaining
   A the ledger accounts
   B the books of prime entry
   C a register of fixed assets
   D the stock records

   (2 marks)

4.3 An error of original entry would occur if the purchases of goods for resale was
   A debited and credited to the correct accounts using the incorrect amount in both cases
   B credited to the purchases account and debited to the supplier’s account
   C debited to a fixed assets account
   D entered correctly in the purchases account, but entered in the supplier’s account using the wrong amount

   (2 marks)

4.4 The reducing-balance method of depreciating fixed assets is more appropriate than the straight-line method when
   A there is no expected residual value for the asset
   B the expected life of the asset is not capable of being estimated
   C the asset is expected to be replaced in a short period of time
   D the asset decreases in value less in later years than in the early years of use

   (2 marks)

4.5 A cash-flow statement can best be described as
   A a statement showing the effects of profit on cash resources
   B a statement of cash inflows and outflows from operating activities
   C a statement showing the movement in working capital
   D a statement showing the inflows and outflows of cash and cash equivalents

   (2 marks)

4.6 An increase in the gross profit margin of a business is most likely to be due to which one of the following combinations:

<table>
<thead>
<tr>
<th>Selling price per unit</th>
<th>Quantity sold</th>
<th>Cost per unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A increased</td>
<td>no change</td>
<td>increased</td>
</tr>
<tr>
<td>B no change</td>
<td>increased</td>
<td>no change</td>
</tr>
<tr>
<td>C no change</td>
<td>no change</td>
<td>decreased</td>
</tr>
<tr>
<td>D decreased</td>
<td>increased</td>
<td>increased</td>
</tr>
</tbody>
</table>

   (2 marks)
Revision questions 5

5.1 In times of rising prices, the historical cost convention results in
A stocks being valued at cost price if this is higher than their net realisable value
B fixed assets being valued at their original cost, with no adjustment for
depreciation
C profits being overstated and balance sheet values being understated
D profits being understated and balance sheet values being overstated

(2 marks)

5.2 The stewardship function is carried out by
A the internal auditors
B the external auditors
C the treasurer of a not-for-profit organisation
D the management of an organisation

(2 marks)

5.3 The following information is given for the year ended 31 October 2000:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of raw materials</td>
<td>28,000</td>
</tr>
<tr>
<td>Returns inwards</td>
<td>2,000</td>
</tr>
<tr>
<td>Increase in stock of raw materials</td>
<td>850</td>
</tr>
<tr>
<td>Direct wages</td>
<td>10,500</td>
</tr>
<tr>
<td>Carriage inwards</td>
<td>1,250</td>
</tr>
<tr>
<td>Production overheads</td>
<td>7,000</td>
</tr>
<tr>
<td>Decrease in work-in-progress</td>
<td>2,500</td>
</tr>
</tbody>
</table>

The value of factory cost of goods completed is

(2 marks)

5.4 Your organisation uses the weighted average cost method of valuing stocks. During September 2000, the following stock details were recorded.

Opening balance 60 units valued at £4 each
6 September Purchase of 100 units at £4.80 each
9 September Sale of 80 units
12 September Purchase of 120 units at £5 each
23 September Sale of 50 units

The value of the stock at 30 September 2000 was

(2 marks)

5.5 Goodwill is most appropriately classed as
A a fictitious asset
B a semi-fixed asset
C a tangible asset
D an intangible asset

(2 marks)
5.6 The reducing-balance method of depreciating fixed asset is more appropriate than the straight-line method when

A the expected life of the asset is short
B the asset is expected to decrease in value by a fixed percentage of cost each year
C the expected life of the asset cannot be estimated accurately
D the asset is expected to decrease in value less in later years than in the earlier years of its life

(2 marks)

5.7 An increase in the provision for doubtful debts would result in

A a decrease in working capital
B an increase in working capital
C an increase in liabilities
D an increase in net profit

(2 marks)

5.8 The gross profit mark-up is 60 per cent where sales are £120,000 and

A cost of sales is £48,000
B gross profit is £72,000
C gross profit is £75,000
D cost of sales is £75,000

(2 marks)

5.9 Revenue reserves would increase if a company

A issue shares at a premium
B makes a transfer from retained profit reserve to general reserves
C retained profits
D increases its current bank balances

(2 marks)
**Answers to revision questions 1**

1.1 D

Share premium arises where shares are issued for more than their par value. Reserves are created from profits retained in the business or from the upward revaluation of fixed assets. The suspense account is created when there is an imbalance in the ledger accounts. Goodwill arises when the value of the assets purchases is less than the purchase price.

1.2 Reconstruction of cost of goods sold to establish the purchases figure:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td>24,000</td>
</tr>
<tr>
<td>Add: Purchases</td>
<td>244,000</td>
</tr>
<tr>
<td>Less: Returns</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Closing stock</td>
<td>(36,000)</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>222,000</td>
</tr>
</tbody>
</table>

*Found by difference

1.3 D

1.4 £700,000

Only development expenditure is capitalised if they satisfy criteria, all other are written off to profit and loss account as per SSAP13.

1.5

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance</td>
<td>69,000</td>
</tr>
<tr>
<td>Credit purchases</td>
<td>156,800</td>
</tr>
<tr>
<td>Discounts</td>
<td>(2,400)</td>
</tr>
<tr>
<td>Payments</td>
<td>(137,800)</td>
</tr>
<tr>
<td>Purchase returns</td>
<td>(9,400)</td>
</tr>
<tr>
<td>Closing balance</td>
<td>76,200</td>
</tr>
</tbody>
</table>

**CLCA**

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discounts</td>
<td>2,400</td>
<td>Bal b/f</td>
</tr>
<tr>
<td>Payments</td>
<td>137,800</td>
<td>Credit purchases</td>
</tr>
<tr>
<td>Returns</td>
<td>9,400</td>
<td></td>
</tr>
<tr>
<td>Bal c/d</td>
<td>76,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>225,800</td>
<td></td>
</tr>
</tbody>
</table>

1.6

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement balance</td>
<td>26,800</td>
</tr>
<tr>
<td>Add back dishonoured cheque</td>
<td>600</td>
</tr>
<tr>
<td>Add back bank charges</td>
<td>100</td>
</tr>
<tr>
<td>Less: Unpresented cheques</td>
<td>(2,800)</td>
</tr>
<tr>
<td>Adjustment re-error</td>
<td>(780)</td>
</tr>
<tr>
<td></td>
<td>23,920</td>
</tr>
<tr>
<td>Description</td>
<td>£</td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>-------</td>
</tr>
<tr>
<td>Cash book balance</td>
<td>(2,480)</td>
</tr>
<tr>
<td>Unpresented cheques</td>
<td>900</td>
</tr>
<tr>
<td>Receipt not yet processed</td>
<td>(280)</td>
</tr>
<tr>
<td>Bank charges</td>
<td>(150)</td>
</tr>
<tr>
<td>As per statement</td>
<td>(2,010)</td>
</tr>
</tbody>
</table>

1.8 A

1.9 1C, 2E, 3A, 4B, 5D

1.10 D
Answers to revision questions 2

2.1 D
2.2 B
2.3 D
2.4 A
2.5 C
2.6 B
Answers to revision questions 3

3.1  C
3.2  D
3.3  C
3.4  D
3.5  B
Answers to revision questions 4

4.1 C
4.2 A
4.3 A
4.4 D
4.5 D
4.6 C
Answers to revision questions 5

5.1 C
5.2 D
5.3

£

- Purchase of raw material 28,000
- Carriage inwards 1,250
- Increase in stock (850)
- Cost of material consumed 28,400
- Direct wages 10,500
- Prime cost 38,900
- Production overheads 7,000
- Decrease in work-in-progress 2,500
- Production cost 48,400

5.4

<table>
<thead>
<tr>
<th></th>
<th>Qty</th>
<th>Price</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td>60</td>
<td>4.00</td>
<td>240</td>
</tr>
<tr>
<td>Purchases</td>
<td>100</td>
<td>4.80</td>
<td>480</td>
</tr>
<tr>
<td>Balance</td>
<td>160</td>
<td>4.50</td>
<td>720</td>
</tr>
<tr>
<td>Sales</td>
<td>80</td>
<td>4.50</td>
<td>360</td>
</tr>
<tr>
<td>Balance</td>
<td>80</td>
<td>4.50</td>
<td>360</td>
</tr>
<tr>
<td>Purchases</td>
<td>120</td>
<td>5.00</td>
<td>600</td>
</tr>
<tr>
<td>Balance</td>
<td>200</td>
<td>4.80</td>
<td>960</td>
</tr>
<tr>
<td>Sales</td>
<td>50</td>
<td>4.80</td>
<td>240</td>
</tr>
<tr>
<td>Balance</td>
<td>150</td>
<td></td>
<td>720</td>
</tr>
</tbody>
</table>

5.5 D
5.6 D
5.7 A
5.8 D

Sales 120,000 160%
Cost of sales ??? 100%
Gross profit ??? 60%

\[(100/160) \times 120,000\]

5.9 C
Mock assessment 1

Illustrative Computer-based Assessment

Instructions: attempt all 40 questions

Time allowed 1½ hours

Do not look at or attempt this illustrative computer-based assessment until you have fully completed your revision and are about to sit your computer-based assessment.
Illustrative computer-based assessment: Questions

Question 1
The fundamental objective of an external audit of a limited company is to:
(A) give advice to shareholders.
(B) detect fraud and errors.
(C) measure the performance and financial position of a company.
(D) provide an opinion on the financial statements.

Question 2
A receives goods from B on credit terms and A subsequently pays by cheque. A then
discovers that the goods are faulty and cancels the cheque before it is cashed by B.
How should A record the cancellation of the cheque in his books?
(A) Debit creditors, credit returns outwards.
(B) Credit bank, debit creditors.
(C) Debit bank, credit creditors.
(D) Credit creditors, debit returns outwards.

Question 3
The profit of a business may be calculated by using which of the following formulae?
(A) Opening capital – drawings + capital introduced – closing capital.
(B) Closing capital + drawings – capital introduced – opening capital.
(C) Opening capital + drawings – capital introduced – closing capital.
(D) Closing capital – drawings + capital introduced – opening capital.

Question 4
The turnover in a company was $3 million and its debtors were 5% of turnover. The
company wishes to have a provision for doubtful debts of 4% of debtors, which would
make the provision 33% higher than the current provision. What figure would appear in
the profit and loss account?

<table>
<thead>
<tr>
<th>Debit /Credit</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Question 5
Which of the following should be accounted for as capital expenditure?
(A) the cost of painting a building.
(B) the replacement of windows in a building.
(C) the purchase of a car by a garage for re-sale.
(D) legal fees on the purchase of a building.
**Question 6**

A business purchases a machine on credit terms for $18,000 plus vat at 15%. The business is registered for VAT. How should this transaction be recorded in the books?

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Machinery</td>
<td>18,000</td>
</tr>
<tr>
<td></td>
<td>Creditors</td>
<td>18,000</td>
</tr>
<tr>
<td>B</td>
<td>Machinery</td>
<td>20,700</td>
</tr>
<tr>
<td></td>
<td>Creditors</td>
<td>20,700</td>
</tr>
<tr>
<td>C</td>
<td>Machinery</td>
<td>18,000</td>
</tr>
<tr>
<td></td>
<td>Vat</td>
<td>2,700</td>
</tr>
<tr>
<td></td>
<td>Creditors</td>
<td>20,700</td>
</tr>
<tr>
<td>D</td>
<td>Machinery</td>
<td>20,700</td>
</tr>
<tr>
<td></td>
<td>Vat</td>
<td>2,700</td>
</tr>
<tr>
<td></td>
<td>Creditors</td>
<td>18,000</td>
</tr>
</tbody>
</table>

**Question 7**

Which of the following statements most closely expresses the meaning of ‘true and fair’?

(A) There is only one true and fair view of a company’s financial statements
(B) True and fair is determined by compliance with accounting standards
(C) True and fair is determined by compliance with company law
(D) True and fair is largely determined by reference to generally accepted accounting practice.

**Question 8**

On 1st May 2000 A Ltd pays a rent bill of $2,400 for the period to 30th April 2001. What is the charge to the profit and loss account and the entry in the balance sheet for the year ended 30th November 2000?

<table>
<thead>
<tr>
<th>Profit and loss account</th>
<th>Accrual or Prepayment</th>
<th>Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td></td>
<td>$</td>
</tr>
</tbody>
</table>

**Question 9**

S Ltd exchanged stock for a delivery vehicle with T Ltd. The stock had cost S Ltd $12,000 and the normal selling price was $14,000; the delivery vehicle had cost T Ltd $11,000 and the normal selling price was $15,000.

How should S Ltd value the vehicle in its balance sheet?

$..............

**Question 10**

Z’s bank statement shows a balance of $1,650 overdrawn. The bank statement includes bank charges of $100 which have not been entered in the cash book. There are
unpresented cheques totalling $950 and deposits not yet credited of $1,200. The bank statement incorrectly shows a direct debit payment of $320 which belongs to another customer.

The figure in the balance sheet should be:

Overdrawn $

? Question 11

There is $200 in the till at the year end at F Ltd but the accountant suspects that some cash has been stolen. At the beginning of the year there was $100 in the till and debtors were $2,000. Total sales in the year were $230,000. Debtors at the end of the year were $3,000. Cheques banked from credit sales were $160,000 and cash sales of $50,000 have been banked.

How much cash was stolen during the year?

$.................

? Question 12

A car was purchased for $10,000 on 1st April 1997 and has been depreciated at 20% per annum straight line. The company policy is to charge depreciation, once a year at the end of the year, on the cost of an asset in use at the year end. Assume there is no residual value. The car was traded in for a replacement vehicle on 1st August 2000 for an agreed figure of $4,900. What was the profit or loss on the disposal of the vehicle for the year ended 31st December 2000?

<table>
<thead>
<tr>
<th>Profit or Loss</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

? Question 13

A company includes in stock goods received before the year end but for which invoices are not received until after the year end. Is this in accordance with:

(A) the historical cost convention?
(B) the accruals concept?
(C) the consistency concept?
(D) the materiality concept?

? Question 14

I Ltd operates the imprest system for petty cash. At 1st July there was a float of $250. During July the petty cashier received $50 from staff for using the photocopier and a cheque for $100 was cashed for an employee. In July cheques were drawn for $600 for petty cash. It was decided to increase the cash float to $180 from the 1st August. How much cash was paid out by the petty cashier in July?

$.................
**Question 15**
Which of the following sentences does NOT explain the distinction between financial and management accounts?

(A) Financial accounts are primarily for external users and management accounts are primarily for internal users.
(B) Financial accounts are normally produced annually and management accounts are normally produced monthly.
(C) Financial accounts are more accurate than management accounts.
(D) Financial accounts are audited by an external audit and management accounts do not normally have an external audit.

**Question 16**
When there is inflation, the historical cost convention has the effect of:

(A) overstating profits and understating balance sheet values.
(B) understating profit and overstating balance sheet values.
(C) understating cash flow and overstating cash in the balance sheet.
(D) overstating cash flow and understating cash in the balance sheet.

**Question 17**
When reconciling the creditors ledger control account with the list of creditors ledger balances of M, the following errors were found: the purchase day book had been overstated by $600 and the personal ledger of a supplier had been understated by $200. What adjustment must be made to correct these errors?

<table>
<thead>
<tr>
<th>Control Account</th>
<th>List of Creditor Balances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit or Credit</td>
<td>$</td>
</tr>
<tr>
<td>$</td>
<td>Increase or Decrease $</td>
</tr>
</tbody>
</table>

**Question 18**
B is a builder with a staff of ten employees. In April 2000 he paid the following amounts:

- Net salaries after tax and national insurance: $16,000
- Tax and employees' national insurance for March 2000: $7,000
- Employer’s national insurance for March 2000: $3,000

He owes $8,000 for April’s tax and employees’ national insurance and $3,500 for April’s employer’s national insurance. What is the correct expense to be included in April’s profit and loss account?

$.................
### Question 19

The following information relates to M Ltd

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>Stock of raw materials</td>
<td>70</td>
<td>50</td>
</tr>
<tr>
<td>Work in progress</td>
<td>60</td>
<td>70</td>
</tr>
<tr>
<td>Stock of finished goods</td>
<td>100</td>
<td>90</td>
</tr>
<tr>
<td>For the year ended 30th September 2000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases of raw materials</td>
<td>$165,000</td>
<td></td>
</tr>
<tr>
<td>Manufacturing wages</td>
<td>$30,000</td>
<td></td>
</tr>
<tr>
<td>Factory overheads</td>
<td>$40,000</td>
<td></td>
</tr>
</tbody>
</table>

The prime cost of production in the manufacturing account for the year ended 30th September 2000 is:

$\ldots\ldots\ldots$

### Question 20

When valuing stock at cost, which of the following shows the correct method of arriving at cost?

<table>
<thead>
<tr>
<th>Include Inward Transport Costs</th>
<th>Include Production Overheads</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes or No</td>
<td>Yes or No</td>
</tr>
</tbody>
</table>

### Question 21

At 30 June 2000 an electricity ledger account had an accrual of $400 and a credit balance was brought down at 1 July 2000. During the financial year electricity invoices totalling $5,000 were paid, including an invoice for $900 for the quarter ended 31 May 2001.

What is the profit and loss account charge for electricity payable for the year ended 30 June 2001?

$\ldots\ldots\ldots$

### Question 22

The provision for doubtful debts in the ledger of B Ltd at 31 October 2000 was $11,000. During the year ended 31 October 2001 bad debts of $7,000 were written off. Debtor balances at 31 October 2001 were $140,000 and the company policy is to have a general provision of 5%.

What is the charge for bad and doubtful debts in the profit and loss account for the year ended 31 October 2001?

$\ldots\ldots\ldots$
Question 23
The following is an extract from the balance sheets of IAS plc for the years ended 31 July 2000 and 2001.

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>Stock</td>
<td>40</td>
<td>90</td>
</tr>
<tr>
<td>Debtors</td>
<td>55</td>
<td>10</td>
</tr>
<tr>
<td>Creditors</td>
<td>45</td>
<td>30</td>
</tr>
<tr>
<td>Accruals</td>
<td>15</td>
<td>20</td>
</tr>
</tbody>
</table>

What figure would appear in the cash flow statement of IAS plc for the year ended 31 July 2001 as part of the cash flow from operations?

Question 24
The stock at SOR Ltd was valued at $14,000 and excludes goods supplied to a customer on a sale or return basis. The customer still has 30 days within which to return the stock. The goods on sale or return were purchased by SOR Ltd for $4,000 and were invoiced at a mark-up of 25%.

The value stock at SOR Ltd should be:

$.............

Question 25
A trial balance does not balance. Which of the following errors may be the cause of this failure to balance?

(A) The purchase of a machine had been debited to the machine repairs account.
(B) A cheque from a customer had been credited to the purchase ledger account of the customer.
(C) Goods returned inwards had been debited to the sales ledger account of the customer.
(D) The depreciation charge on machinery had been credited to the cost of machinery account.

Question 26
S is employed by T Ltd. His pay details for January and February are as follows:

January: Gross Salary $2,200; Tax $500; National insurance $100; Net pay $1,600
February: Gross Salary $2,500; Tax $550; National insurance $110; Net pay $1,840.

Tax and national insurance are payable to the government one month after they are deducted from employees' salaries.

How much cash did T Ltd pay out in February in connection with S's wages?

$.............
Question 27
Which of the following provides the best definition of an ‘audit trail’?

(A) the marks left by an auditor when a document has been inspected.
(B) the working papers of an auditor.
(C) the pursuit of a fraud by an auditor.
(D) the trail of a transaction from source document to financial statement.

Question 28
N plc purchased a machine for $18,000. The transportation costs were $1,700 and installation costs were $500. The machine broke down at the end of the first month in use and cost $400 to repair. N plc depreciates machinery at 10% per annum on cost, assuming no residual value.

What is the net book value of the machine after one year, to the nearest pound?

$.................

Question 29
Which of the following might explain the debit balance on a purchase ledger account?

(A) the company took a cash discount to which they were not entitled and paid less than the amount due.
(B) the company mistakenly paid too much.
(C) the book-keeper failed to enter a contra with the sales ledger.
(D) the book-keeper failed to post a cheque paid to the account.

Question 30
In a period of inflation, which of the following methods of charging stock issues to production will give the lowest profit figure?

(A) Average cost.
(B) LIFO.
(C) FIFO.
(D) Replacement cost.

Question 31
Which of the following provides the best explanation of the objective of an internal audit?

(A) The objective is to assist the directors of a company in the effective discharge of their financial responsibilities towards the members.
(B) The objective is to provide support to the external auditor.
(C) The objective is to detect fraud and error.
(D) The objective is to audit the financial statements.
**Question 32**

The following information at 5 January 2001 relates to a club which has a year end of 31 December 2000

<table>
<thead>
<tr>
<th>Subscription for 1999 unpaid at January 2000</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriptions for 1999 paid during the year ended 31 December 2000</td>
<td>550</td>
</tr>
<tr>
<td>Subscriptions for 2000 paid during the year ended 31 December 2000</td>
<td>7,000</td>
</tr>
<tr>
<td>Subscriptions for 2001 paid during the year ended 31 December 2000</td>
<td>2,000</td>
</tr>
<tr>
<td>Subscriptions for 2000 unpaid at 31 December 2000</td>
<td>850</td>
</tr>
</tbody>
</table>

It is the club’s policy to write off overdue subscriptions after 1 year.

What amount should be credited to the income and expenditure account for the year ended 31 December 2000?

$..............

**Question 33**

Extracts from the financial statements of ASB Ltd are set out below.

<table>
<thead>
<tr>
<th>Profit &amp; Loss Account Year Ended 31st December 2000</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>400</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(175)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>225</td>
</tr>
<tr>
<td>Profit on sale of fixed asset</td>
<td>80</td>
</tr>
<tr>
<td>Net profit</td>
<td>230</td>
</tr>
<tr>
<td>31st December 1999</td>
<td>$000</td>
</tr>
<tr>
<td>Stock, debtors, current liabilities</td>
<td>50</td>
</tr>
<tr>
<td>31st December 2000</td>
<td>$000</td>
</tr>
<tr>
<td></td>
<td>65</td>
</tr>
</tbody>
</table>

What figure would appear in the cash flow statement of ASB Ltd for the year ended 31st December 2000 for cash from operations?

**Question 34**

The correct ledger entries to record the issue of 200,000 $1 Ordinary Shares at a premium of 20% and paid by cheque is:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>$240,000</td>
</tr>
<tr>
<td>Share capital</td>
<td>$200,000</td>
</tr>
<tr>
<td>Share premium</td>
<td>$40,000</td>
</tr>
</tbody>
</table>

| Bank  | $240,000 |
| Share premium  | $240,000  |

| Bank  | $240,000 |
| Share capital  | $240,000  |

| Bank  | $200,000 |
| Share premium  | $40,000  |
| Share capital  | $160,000  |
Question 35

M plc's trial balance did not balance at 31 May 2001. The following errors were discovered: insurance of $700 prepaid at 31 May 2000 had not been brought down as an opening balance on the insurance account; wages of $6,000 had been incorrectly debited to the purchases account; the book-keeper had failed to accrue for the telephone invoice owing at 31 May 2001 of $400.

What was the difference on the trial balance?

$............................

Question 36

S is a builder who has numerous small items of equipment. He calculates his depreciation using the revaluation method. At the beginning of his financial year he valued his equipment at $11,475; he bought equipment costing $4,360 and he sold equipment for $3,257. At the end of his financial year he valued his equipment at $9,000.

What is his depreciation charge on equipment for the year?

$............................

Question 37

The net profit percentage in a company is 9% and the turnover to asset ratio is 3.

What is the return on capital employed?

%............................

Question 38

The accounts for SPA plc are set out below.

<table>
<thead>
<tr>
<th>SPA plc Profit and Loss Account for the Year Ended 30 November 2002</th>
<th>$000</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>3,100</td>
<td></td>
</tr>
<tr>
<td>Closing stock</td>
<td>(400)</td>
<td></td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(2,900)</td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td>3,100</td>
<td></td>
</tr>
<tr>
<td>Operating expenses</td>
<td>(400)</td>
<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td>2,700</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>(200)</td>
<td></td>
</tr>
<tr>
<td>Retained profit for year</td>
<td>2,500</td>
<td></td>
</tr>
</tbody>
</table>
SPA plc Balance Sheet at 30 November 2002

<table>
<thead>
<tr>
<th></th>
<th>$000</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets</td>
<td></td>
<td>3,500</td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>Debtors</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,250</td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade creditors</td>
<td>(450)</td>
<td>800</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4,300</td>
</tr>
<tr>
<td>Share capital</td>
<td>2,200</td>
<td></td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>2,100</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>4,300</td>
</tr>
</tbody>
</table>

The return on capital employed in SPA is:

\[ \% \]

**Question 39**

The net asset turnover ratio in SPA is:

\[ \text{______ : 1} \]

**Question 40**

The quick ratio in SPA is:

\[ \text{______ : 1} \]
Illustrative computer-based assessment: Solutions

Solution 1
Answer: (D)

Solution 2
Answer: (C)

Solution 3
Answer: (B)

Solution 4
Turnover $3 million × 5% gives debtors of $150,000
Provision for doubtful debts is 4% × $150,000 = $6,000
Existing provision is $6,000 × 3/4 = $4,500
Change in provision to profit and loss account = debit $1,500

Solution 5
Answer: (D)

Solution 6
Answer: (C)

Solution 7
Answer: (D)

Solution 8
$2,400 for one year is $200 per month
Charge to profit and loss account 7 × $200 = $1,400
Prepaid in balance sheet 5 × $200 = $1,000

Solution 9
$14,000
Solution 10

Bank statement balance overdraft $1,650
Unpresented cheques $950
Outstanding deposits $1,200
Bank error $320
Cash book-credit balance $(1,080)

Solution 11

Sales Ledger Control

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening debtors</td>
<td>2,000</td>
<td>Cheques banked credit sales 160,000</td>
</tr>
<tr>
<td>Credit sales</td>
<td>161,000</td>
<td></td>
</tr>
<tr>
<td>(balancing figure)</td>
<td></td>
<td>Closing debtors 3,000</td>
</tr>
<tr>
<td></td>
<td>163,000</td>
<td></td>
</tr>
</tbody>
</table>

Cash Account

| Opening balance      | 100              | Cash banked 50,000 |
| Cash sales           | 69,000           | Cash missing 18,900 |
| ($230,000–$161,000)  |                  | Closing balance 200 |

Cash missing is $18,900

Solution 12

1st April 1997 Cost 10,000
Depreciation charge at 20%
1997 2,000
1998 2,000
1999 2,000
     6,000
Net book value 1st August 2000 4,000
Proceeds 1st August 2000 4,900
Profit 900

Solution 13

Answer: (B)

Solution 14

Cash Account

| 1st July bal b/d  | 250              | Cash cheque 100 |
| Photo copying     | 30               | Cash paid out 620 |
| Cash from bank    | 600 (balancing figure) 31st July bal c/d 180 |
|                  | 900              |                  |

Cash paid out $620
Solution 15
Answer: (C)

Solution 16
Answer: (A)

Solution 17

<table>
<thead>
<tr>
<th>Control Account</th>
<th>List of Creditor Balances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit or Credit</td>
<td>$</td>
</tr>
<tr>
<td>Debit</td>
<td>600</td>
</tr>
<tr>
<td>Increase or Decrease</td>
<td>$</td>
</tr>
<tr>
<td>Increase</td>
<td>200</td>
</tr>
</tbody>
</table>

Solution 18
Net salaries for April $16,000
Employees’ national insurance and tax for April $8,000
Employer’s national insurance $3,500
$27,500

Solution 19
Prime cost is direct materials and direct labour
Opening stock of raw materials $50,000
Purchases $165,000
Closing stock of raw materials $(70,000)
Raw materials consumed $145,000
Manufacturing wages $30,000
$175,000

Solution 20

<table>
<thead>
<tr>
<th>Include Inward Transport Costs</th>
<th>Include Production Overheads</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes or No</td>
<td>Yes or No</td>
</tr>
<tr>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Solution 21

<table>
<thead>
<tr>
<th>Electricity Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>31 May 2001</td>
</tr>
<tr>
<td>Invoices</td>
</tr>
<tr>
<td>31 May 2001</td>
</tr>
<tr>
<td>Accrual – $900 × 1/3</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Answer is $4,900
Solution 22

Debtors $140,000 \times 5\% = 7,000
Provision for doubtful debts at 31 October 2000 $11,000
Change in provision $(4,000)
Bad debts written off 7,000
Profit and loss account 3,000

Solution 23

$960

Stock 50
Debtors (45)
Creditors 15
Accruals (5)
Cash flow from operations 15

Solution 24

Stock at valuation 14,000
Goods on sale or return at cost 4,000
Stock valuation 18,000

Solution 25

Answer: (C)

Solution 26

Net pay February 1,840
Tax January 50
National insurance January 100
2,440

Solution 27

Answer: (D)

Solution 28

Cost of machine 18,000
Transportation 1,700
Installation 500
Depreciation at 10% 2,020
Net book value 18,180
Solution 29
Answer: (B)

Solution 30
Answer: (D)

Solution 31
Answer: (A)

Solution 32
Subscriptions paid for 2000 $7,000
Subscriptions owing for 2000 $850
$7,850

Solution 33
Net profit 230
add back: depreciation 40
less: profit on sale (80) 190
Increase working capital (15)
Cash flow from operations 175

Solution 34
Answer: (A)

Solution 35
Insurance balance omitted $700
Wages mis-posted – not affect trial balance Nil
Accrual omitted – not affect trial balanceNil
Answer is $700

Solution 36
Valuation at beginning of year $11,475
Purchases $4,360
Disposals (3,257)
$12,578
Valuation at end of year ($9,000)
Depreciation $3,578
Solution 37
Net profit % × asset turnover ratio = return on capital employed
9% × 3 = 27%

Solution 38
\[
\frac{\text{Operating profit}}{\text{Capital}} = \frac{\mathbf{\mathsterlings}2,700,000}{\mathbf{\mathsterlings}4,300,000} \times 100 = 63\%
\]

Solution 39
\[
\frac{\text{Turnover}}{\text{Net assets}} = \frac{\mathbf{\mathsterlings}6,000,000}{\mathbf{\mathsterlings}4,300,000} \times 100 = 1.39:1
\]

Solution 40
\[
\frac{\text{Debtors + Bank}}{\text{Current liabilities}} = \frac{\mathbf{\mathsterlings}900,000 + \mathbf{\mathsterlings}50,000}{\mathbf{\mathsterlings}450,000} = 2.11:1
\]
Mock assessment 2

Illustrative Computer-based Assessment

Instructions: attempt all 40 questions

Time allowed 1½ hours

Do not look at or attempt this illustrative computer-based assessment until you have fully completed your revision and are about to sit your computer-based assessment.
Illustrative computer-based assessment: Questions

Question 1
A credit balance of $800 brought down on X Limited’s account in the books of Y Limited means that
(A) X Limited owes Y Limited $800.
(B) Y Limited owes X Limited $800.
(C) Y Limited has paid X Limited $800.
(D) Y Limited has overpaid X by $800.

Question 2
The responsibility for ensuring that all accounting transactions are properly recorded and summarised in the accounts lies with
(A) the government.
(B) the shareholders.
(C) the internal auditors.
(D) the directors.

Question 3
The following information relates to a company at its year end:

<table>
<thead>
<tr>
<th>Category</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock at beginning of year</td>
<td></td>
</tr>
<tr>
<td>Raw materials</td>
<td>22,000</td>
</tr>
<tr>
<td>Work-in-progress</td>
<td>4,000</td>
</tr>
<tr>
<td>Finished goods</td>
<td>63,000</td>
</tr>
<tr>
<td>Stock at end of year</td>
<td></td>
</tr>
<tr>
<td>Raw materials</td>
<td>25,000</td>
</tr>
<tr>
<td>Work-in-progress</td>
<td>1,000</td>
</tr>
<tr>
<td>Finished goods</td>
<td>72,000</td>
</tr>
<tr>
<td>Purchases of raw materials</td>
<td>220,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>300,000</td>
</tr>
<tr>
<td>Royalties on goods sold</td>
<td>45,000</td>
</tr>
<tr>
<td>Production overheads</td>
<td>360,000</td>
</tr>
<tr>
<td>Distribution costs</td>
<td>70,000</td>
</tr>
<tr>
<td>Administration expenses</td>
<td>290,000</td>
</tr>
<tr>
<td>Sales</td>
<td>1,400,000</td>
</tr>
</tbody>
</table>

The cost of goods manufactured during the year is
$.............

Question 4
Your sales ledger control account has a balance at 1 November 20X1 of $30,000 debit. During November, credit sales were $67,000, cash sales were $15,000 and receipts from customers, excluding cash receipts, and after deducting cash discounts of $1,400 were $60,000. Sales returns were $4,000.
The closing balance on the sales ledger control account was

$ .............

Question 5

In a not-for-profit organisation, the accumulated fund is:

(A) fixed assets plus net current assets less long-term liabilities.
(B) the balance on the general reserve.
(C) fixed assets plus working capital.
(D) long-term liabilities plus current liabilities minus current assets.

Question 6

Your company’s bank statement at 31 July 20X1 shows a favourable balance of $10,300. You subsequently discover that the bank has dishonoured a customer’s cheque for $500 and has charged bank charges of $150, neither of which is recorded in your cash book. There are unpresented cheques totalling $1,700. You further discover that a receipt from a customer of $400 has been recorded as a credit in your cash book.

Your cash book balance, prior to correcting the errors and omissions, was

$ .............

Question 7

Stock is valued using FIFO. Opening stock was 12 units at $4 each. Purchases were 60 units at $5 each, then issues of 18 units were made, followed by issues of 23 units.

Closing stock is valued at

$ .............

Question 8

A book of prime entry is one in which:

(A) transactions are entered prior to being recorded in ledger accounts.
(B) ledger accounts are maintained.
(C) the rules of double-entry book-keeping do not apply.
(D) memorandum accounts are kept.

Question 9

Sales are $310,000. Purchases are $165,000. Opening stock is $21,000. Closing stock is $18,000.

The rate of stock turnover is

$ .............
Question 10
Which ONE of the following statements is true?
(A) Sales less factory cost of goods completed equals gross profit.
(B) Prime cost is recorded in the trading account.
(C) Factory cost of goods completed is recorded in the trading account.
(D) Closing work in progress is not included in the balance sheet.

Question 11
A Receipts and Payments account is similar to:
(A) an income and expenditure account
(B) a trading account
(C) a profit and loss account
(D) a cash book summary

Question 12
Revenue reserves would decrease if a company:
(A) paid dividends
(B) issued shares at a premium
(C) set aside profits to pay future dividends
(D) transferred amounts into ‘general reserves’

Question 13
A machine cost $16,000. It had an expected useful life of 4 years and an expected residual value of $4,000. It was depreciated at 25% per annum on the reducing balance basis. A full year’s depreciation was charged in the year of purchase, with none in the year of sale. During year 4, it was sold for $3,000.

The profit or loss on disposal was:

<table>
<thead>
<tr>
<th>Profit or Loss</th>
<th>$</th>
</tr>
</thead>
</table>

Question 14
The major aim of the internal auditors is to
(A) report to the directors.
(B) prepare draft financial statements.
(C) report to shareholders on the accounts.
(D) reduce the costs of the external auditors by carrying out some of their duties.

Question 15
At 1 February, the telephone expenses account showed 2 months’ rental prepaid of $250 and 2 months’ telephone calls accrued of $450. During February, a fixed standing order payment of $375 was paid.
What is the balance on the telephone ledger account at 28 February?

$ ..............

**Question 16**

Your company’s profit and loss account for the year ended 30 June 20X1 showed the following:

<table>
<thead>
<tr>
<th></th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit before interest and tax</td>
<td>2,500</td>
</tr>
<tr>
<td>Interest</td>
<td>700</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>1,600</td>
</tr>
<tr>
<td>Tax</td>
<td>400</td>
</tr>
<tr>
<td>Profit after tax</td>
<td>1,200</td>
</tr>
<tr>
<td>Dividends</td>
<td>200</td>
</tr>
<tr>
<td>Retained profit for the year</td>
<td>1,000</td>
</tr>
</tbody>
</table>

Its balance sheet at 30 June 20X1 showed the following

<table>
<thead>
<tr>
<th></th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>11,000</td>
</tr>
<tr>
<td>Profit and loss account balance</td>
<td>3,000</td>
</tr>
<tr>
<td>10% debenture</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>18,000</td>
</tr>
</tbody>
</table>

No new loans or shares were raised, repaid or issued during the year.

Return on average capital employed for the year ended 30 June 20X1 is

$ ..............

**Question 17**

Insurance paid on 1 April 20X0 for the year to 31 March 20X1 was $6,200, and insurance paid on 1 April 20X1 to 31 March 20X2 was $6,400.

Insurance in the profit and loss account for the year ended 30 September 20X1 would be

$ ..............

**Question 18**

A business has made a profit of $45,000 but its bank balance has fallen by $8,000. This could be due to:

(A) depreciation of $32,000 and the purchase of new fixed assets of $85,000.
(B) depreciation of $32,000 and the repayment of a loan of $21,000.
(C) the disposal of a fixed asset for $53,000 less than its book value.
(D) depreciation of $40,000 and an increase in stocks of $13,000.
**Question 19**

A company's fixed asset register shows a net book value of $250,000. The fixed asset account in the nominal ledger shows a net book value of $190,000. The difference could be due to a disposed asset not having been deducted from the fixed asset register:

(A) with disposal proceeds of $75,000 and a net book value of $15,000.
(B) with disposal proceeds of $75,000 and a loss on disposal of $15,000.
(C) with disposal proceeds of $40,000 and a net book value of $20,000.
(D) with disposal proceeds of $75,000 and a profit on disposal of $15,000.

**Question 20**

A fixed asset costing $80,000 was sold at a book loss of $20,000. Depreciation had been provided using the reducing balance method, at 25% per annum since its purchase.

Which of the following correctly describes the sale proceeds and length of time for which the asset had been owned:

<table>
<thead>
<tr>
<th>Sale Proceeds</th>
<th>Length of Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>A $60,000</td>
<td>cannot be calculated</td>
</tr>
<tr>
<td>B cannot be calculated</td>
<td>3 years</td>
</tr>
<tr>
<td>C $60,000</td>
<td>3 years</td>
</tr>
<tr>
<td>D cannot be calculated</td>
<td>cannot be calculated</td>
</tr>
</tbody>
</table>

**Question 21**

A company’s gearing ratio would rise if

(A) profits increased.
(B) interest rates on loans increased.
(C) a decrease in long-term loans is proportionately LESS than a decrease in shareholders’ funds.
(D) a decrease in long-term loans is proportionately MORE than a decrease in shareholders’ funds.

**Question 22**

The following totals appear in a company's day books and nominal ledger in February 20X2

<table>
<thead>
<tr>
<th>Goods excluding VAT</th>
<th>VAT $</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>42,000</td>
<td>4,200</td>
</tr>
<tr>
<td>26,000</td>
<td>2,000</td>
</tr>
<tr>
<td>3,200</td>
<td>320</td>
</tr>
<tr>
<td>700</td>
<td>35</td>
</tr>
<tr>
<td>7,000</td>
<td>550</td>
</tr>
<tr>
<td>8,300</td>
<td>765</td>
</tr>
</tbody>
</table>

The gross profit for February 20X2 is

$............
Question 23
In times of rising prices, the FIFO method of stock valuation, when compared to the Average Cost method of stock valuation, will usually produce:

(A) a lower profit and a lower closing stock value.
(B) a higher profit and a lower closing stock value.
(C) a lower profit and a higher closing stock value.
(D) a higher profit and a higher closing stock value.

Question 24
An employee is paid at the rate of $12 per hour. The earnings in excess of $150 a week are taxed at 25 per cent. Employee’s national insurance is 10 per cent and employer’s national insurance is 15 per cent of gross salary. During week 15, the employee worked 40 hours.

The amount to be charged to the profit and loss account is $ ..............

Question 25
The following is an extract from the balance sheets of EZ Ltd for the years ended 31 March 20X1 and 20X2.

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>Stock</td>
<td>85</td>
<td>60</td>
</tr>
<tr>
<td>Debtors</td>
<td>80</td>
<td>95</td>
</tr>
<tr>
<td>Creditors</td>
<td>45</td>
<td>75</td>
</tr>
<tr>
<td>Accruals</td>
<td>20</td>
<td>10</td>
</tr>
</tbody>
</table>

What figure would appear in the cash flow statement of EZ Ltd for the year ended 31 March 20X2 as part of the cash flow from operations?

<table>
<thead>
<tr>
<th>Increase or Decrease</th>
<th>$</th>
</tr>
</thead>
</table>

Question 26
An imprest system is:

(A) a method of controlling petty cash.
(B) an audit process.
(C) accounting computer software.
(D) automatic agreement of the cash book and bank statement.

Question 27
Which of the following is correct?

(A) only public limited companies are required by law to have an external audit.
(B) all limited companies are required by law to have an external audit.
(C) an external audit for a limited company is voluntary.
(D) only companies above a certain size are required by law to have an external audit.
Question 28
Which of the following expenses should be included in prime cost in a manufacturing account?

(A) Office salaries.
(B) Factory insurance.
(C) Repairs to factory machinery.
(D) Direct production wages.

Question 29
A Ltd has an item in stock which cost $1,500 and can be sold for $1,800. However, before it can be sold it will require to be modified at a cost of $275. The expected selling costs of the unit are an additional $140. How should this item be valued in stock?

$.............

Question 30
A 'value for money audit' is:

(A) a review of expenditure to ensure effectiveness, efficiency and economy.
(B) an external audit with limited scope.
(C) a voluntary audit by an unregistered auditor.
(D) none of these.

Question 31
Which of the following statements regarding a fixed assets register is NOT correct?

(A) A fixed assets register records the physical location of an asset.
(B) A fixed assets register agrees with the fixed asset nominal ledger account.
(C) A fixed assets register enables depreciation charges to be posted to the nominal ledger.
(D) A fixed assets register enables reconciliations to be made with the nominal ledger.

Question 32
S Ltd purchased a car for $24,000 on 1 January 20X1. The estimated useful life is 4 years with a residual value of $6,000. B Ltd uses the straight line method for depreciation and charges depreciation on a monthly basis. What is the charge for depreciation for the year ended 31 March 20X1?

$.............


Question 33
Which of the following statements concerning a ‘true and fair’ view is correct?
(A) True and fair is mainly determined by compliance with generally accepted accounting practice.
(B) True and fair means the financial statements are accurate.
(C) There can only be one true and fair view of a company’s financial statements.
(D) True and fair has a precise definition which is universally accepted.

Question 34
The H Club discloses the following note to its Income and Expenditure Account.
‘Subscriptions in arrears are accounted for when received; subscriptions in advance are accounted for on a matching basis.’
At 31 May 20X3 there were subscriptions owing of $750 and subscriptions in advance of $1,300. During the year ended 31 May 20X4 subscriptions of $12,000 were received, including subscriptions relating to the previous year of $650 and subscriptions in advance of $900.
What amount should be included for subscriptions in the year ended 31 May 20X4?
$ ...............

Question 35
The net profit percentage in a company is 9% and the asset turnover ratio is 3.
What is the return on capital employed?

Question 36
GAAP Ltd provides the following note to fixed assets in its balance sheet.
Plant and Machinery

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>Opening Balance</td>
<td>32</td>
<td>18</td>
</tr>
<tr>
<td>Additions/charge</td>
<td>22</td>
<td>6</td>
</tr>
<tr>
<td>Disposals</td>
<td>(15)</td>
<td>(10)</td>
</tr>
<tr>
<td>Closing Balance</td>
<td>39</td>
<td>14</td>
</tr>
</tbody>
</table>

The additional machinery was purchased for cash. A machine was sold for cash at a profit of $3,000.
What is the net cash flow for plant and machinery?

<table>
<thead>
<tr>
<th>Inflow/outflow</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Question 37
Which of the following errors will cause the trial balance totals to be unequal?

(A) errors of omission.
(B) errors of principle.
(C) errors of transposition.
(D) all the above.

Question 38
P is a sole proprietor whose accounting records are incomplete. All the sales are cash sales and during the year $20,000 was banked, including $3,000 from the sale of a business car. He paid $5,000 wages in cash from the till and withdrew $1,000 per month as drawings. The cash in the till at the beginning and end of the year was $200 and $300, respectively.

What were the sales for the year?

\[ \text{Sales for the year} \]

Question 39
Which of the following is an appropriation by a limited company?

(A) donation to a charity.
(B) loan interest.
(C) directors’ salaries.
(D) dividends.

Question 40
Which of the following is a record of prime entry?

(A) the nominal ledger.
(B) the sales ledger.
(C) the trial balance.
(D) the sales day book.
Illustrative computer-based assessment: Solutions

Solution 1
Answer: (B)

Solution 2
Answer: (D)

Solution 3

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock at beginning of year – raw materials</td>
<td>$22,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>$220,000</td>
</tr>
<tr>
<td>Stock at end of year – raw materials</td>
<td>($25,000)</td>
</tr>
<tr>
<td>Direct wages</td>
<td>$300,000</td>
</tr>
<tr>
<td>Production overheads</td>
<td>$360,000</td>
</tr>
<tr>
<td>Stock at beginning of year – work-in-progress</td>
<td>$4,000</td>
</tr>
<tr>
<td>Stock at end of year – work-in-progress</td>
<td>($1,000)</td>
</tr>
<tr>
<td>Total</td>
<td>$880,000</td>
</tr>
</tbody>
</table>

Solution 4

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Nov 20X1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance b/d</td>
<td>$30,000</td>
<td>Bank</td>
<td>$60,000</td>
</tr>
<tr>
<td>Credit sales</td>
<td>$67,000</td>
<td>Cash discounts</td>
<td>$1,400</td>
</tr>
<tr>
<td>Sales returns</td>
<td></td>
<td>Sales returns</td>
<td>$4,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31 Nov 20X1</td>
<td></td>
<td>Bal c/d</td>
<td>$31,600</td>
</tr>
<tr>
<td></td>
<td>$97,000</td>
<td></td>
<td>$97,000</td>
</tr>
</tbody>
</table>

Solution 5
Answer: (A)

Solution 6

<table>
<thead>
<tr>
<th>Description</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank reconciliation</td>
<td></td>
</tr>
<tr>
<td>Balance at bank 31 July 20X1</td>
<td>$10,300</td>
</tr>
<tr>
<td>Unpresented cheques</td>
<td>($1,700)</td>
</tr>
<tr>
<td>Openning balance in cash book – balancing figure</td>
<td>$8,450</td>
</tr>
<tr>
<td>Dishonoured cheque</td>
<td>($500)</td>
</tr>
<tr>
<td>Bank charges</td>
<td>($150)</td>
</tr>
<tr>
<td>Error $600 × 2</td>
<td>$800</td>
</tr>
<tr>
<td></td>
<td>$8,600</td>
</tr>
</tbody>
</table>
Solution 7

<table>
<thead>
<tr>
<th></th>
<th>units</th>
<th>unit $</th>
<th>Total $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td>12</td>
<td>4</td>
<td>48</td>
</tr>
<tr>
<td>Purchases</td>
<td>60</td>
<td>5</td>
<td>300</td>
</tr>
<tr>
<td>Issue 1</td>
<td>(12)</td>
<td>(4)</td>
<td>(48)</td>
</tr>
<tr>
<td>Issue 2</td>
<td>(6)</td>
<td>(5)</td>
<td>(30)</td>
</tr>
<tr>
<td>Issue 3</td>
<td>(23)</td>
<td>(5)</td>
<td>(115)</td>
</tr>
<tr>
<td>Closing stock</td>
<td>31</td>
<td>5</td>
<td>155</td>
</tr>
</tbody>
</table>

Solution 8

Answer: (A)

Solution 9

Average stock is opening stock $21,000 + closing stock $18,000 = $39,000/2 = $19,500

Cost of goods sold is opening stock $21,000 + purchases $165,000 – closing stock $18,000 = $168,000

Stock turnover is cost of goods sold/average stock $168,000/$19,500 = 8.6

Solution 10

Answer: (C)

Solution 11

Answer: (D)

Solution 12

Answer: (A)

Solution 13

Cost $16,000 \times 75\% \times 75\% \times 75\% = $6,750
Proceeds on disposal = $3,000
Loss on disposal = $3,750

Solution 14

Answer: (A)
Solution 15

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th></th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 February bal b/d</td>
<td>250</td>
<td>450</td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td>375</td>
<td>275</td>
<td></td>
</tr>
<tr>
<td>28 February bal c/d</td>
<td>225</td>
<td>125</td>
<td></td>
</tr>
<tr>
<td></td>
<td>850</td>
<td>850</td>
<td></td>
</tr>
</tbody>
</table>

Solution 16

Capital: 30 June 20X1 $18,000
30 June 20X0 ($18,000 less retained profit $1,000) $17,000
$35,000

Average capital $35,000/2 = $17,500
Profit before interest and taxes = $2,300
Return on average capital employed = $2,300/$17,500 = 13.1%

Solution 17

1 April 20X0 to 31 March 20X1 6/12 x $6,200 $3,100
1 April 20X1 to 31 March 20X2 6/12 x $6,400 $3,200
$6,300

Solution 18
Answer: (A)

Solution 19
Answer: (D)

Solution 20
Answer: (D)

Solution 21
Answer: (C)

Solution 22

Sales less returns $38,800
Opening stock 7,000
Purchases less returns 25,300
Closing stock (8,300) 24,000
Gross profit 14,800
Solution 23
Answer: (D)

Solution 24
Gross salary 40 hours @ $12 per hour $480
Employers national insurance 15% × $480 $72
$552

Solution 25
Stock $9000
(25)
Debtors (15)
Creditors (30)
Accruals (10)
Increase 30

Solution 26
Answer: (A)

Solution 27
Answer: (D)

Solution 28
Answer: (D)

Solution 29
Selling price $1,800
Cost of modification ($275)
Selling costs ($140)
$1,385, which is less than cost

Solution 30
Answer: (A)

Solution 31
Answer: (B)

Solution 32
Cost less residual value is $24,000 less $6,000 = $18,000
Depreciation charge is $18,000/4 years = $4,500
Depreciation charge for year ended 31 March 20X1 $4,500 × 3/12 = $1,125
Solution 33
Answer: (A)

Solution 34

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriptions in advance</td>
<td>1,500</td>
</tr>
<tr>
<td>Subscriptions received</td>
<td>12,000</td>
</tr>
<tr>
<td>Less subscriptions in advance</td>
<td>(900)</td>
</tr>
<tr>
<td>Subscriptions</td>
<td>12,400</td>
</tr>
</tbody>
</table>

Solution 35
Net profit % x asset turnover ratio = return on capital employed
9% x 3 = 27%

Solution 36

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and machinery purchased</td>
<td>($22,000)</td>
</tr>
<tr>
<td>Plant and machinery sold</td>
<td></td>
</tr>
<tr>
<td>net book value</td>
<td></td>
</tr>
<tr>
<td>(cost $15,000 less provision for depreciation $10,000)</td>
<td></td>
</tr>
<tr>
<td>profit on disposal</td>
<td>$3,000</td>
</tr>
<tr>
<td>net cash outflow</td>
<td>$8,000</td>
</tr>
<tr>
<td></td>
<td>$(14,000)</td>
</tr>
</tbody>
</table>

Solution 37
Answer: (C)

Solution 38

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash banked</td>
<td>$20,000</td>
</tr>
<tr>
<td>Less cash from sale of car</td>
<td>$(3,000)</td>
</tr>
<tr>
<td>Add wages</td>
<td>$5,000</td>
</tr>
<tr>
<td>Add drawings ($1,000 x 12)</td>
<td>$12,000</td>
</tr>
<tr>
<td>Closing cash less opening cash ($300 - 200)</td>
<td>$100</td>
</tr>
<tr>
<td></td>
<td>$34,100</td>
</tr>
</tbody>
</table>

Solution 39
Answer: (D)

Solution 40
Answer: (D)
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