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# Financial Accounting Fundamentals

Relevant for 2005 Computer Based Assessment



Dak Patel

CERTIFICATE | MANAGERIAL | STRATEGIC

CIMA Exam Practice Kit

# **Financial Accounting Fundamentals**

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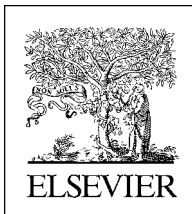
CIMA Exam Practice Kit



**Certificate Level**

# **Financial Accounting Fundamentals**

**Dak Patel**



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# About the Author

**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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# Introduction

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.

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# 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
- 3 Financial 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

<i>Learning objectives</i>	<i>Verbs used</i>	<i>Definition</i>
<b>1 Knowledge</b> <i>What you are expected to know</i>	List State Define	Make a list of Express, fully or clearly, the details of/facts of Give the exact meaning of
<b>2 Comprehension</b> <i>What you are expected to understand</i>	Describe Distinguish Explain Identify Illustrate	Communicate the key features of Highlight the differences between Make clear or intelligible/State the meaning of Recognise, establish or select after consideration Use an example to describe or explain something

**3 Application***How you are expected to apply your knowledge*

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

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

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

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

Advise	To counsel, inform or notify
Evaluate	To appraise or assess the value of
Recommend	To advise on a course of action

**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 pre-determined 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

## **xiv** Syllabus Guidance, Learning Objectives and Verbs

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](http://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](http://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.



## **xvi** Syllabus Guidance, Learning Objectives and Verbs

- 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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# Examination Techniques

## Computer-based examinations

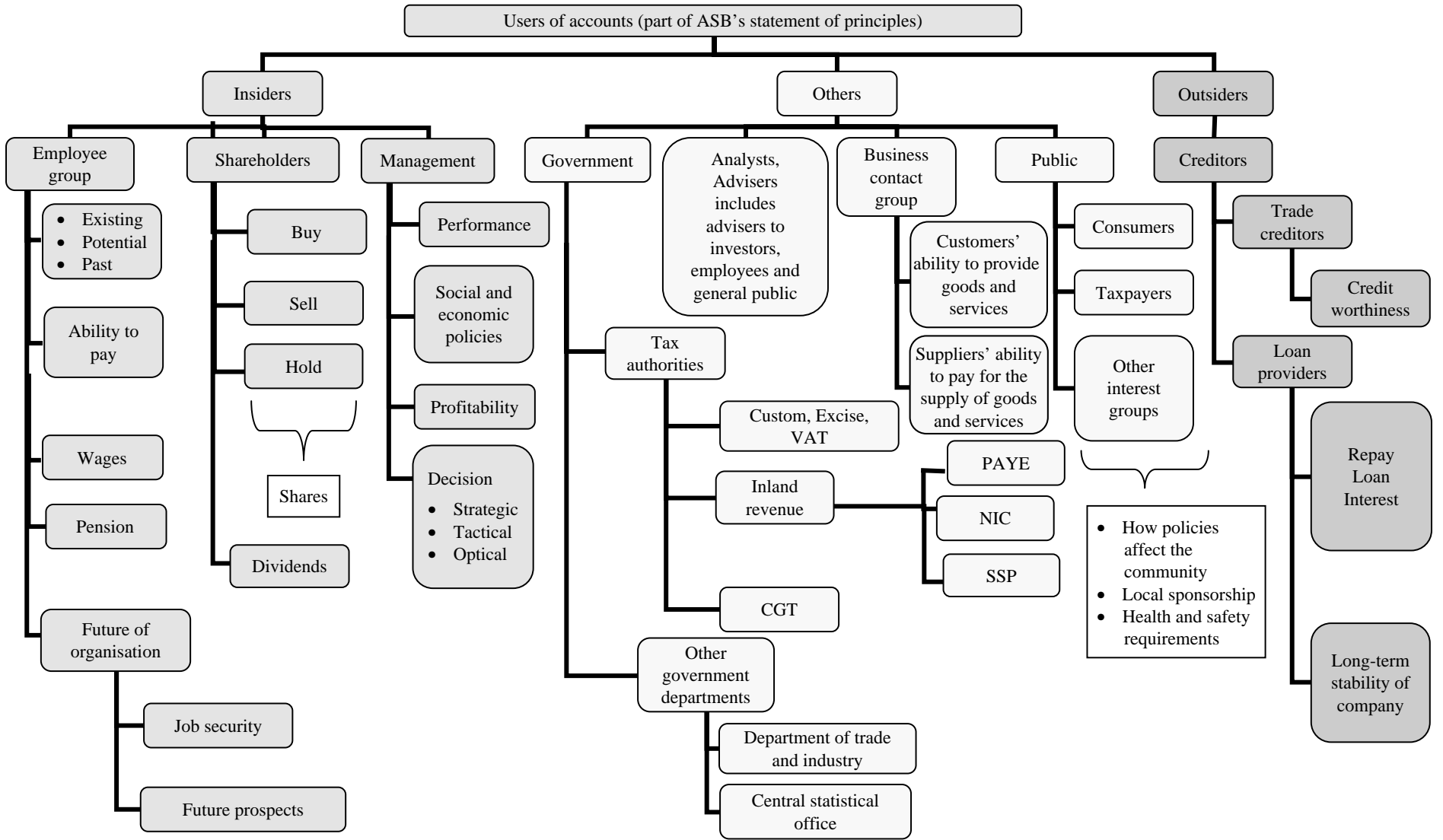
### Ten Golden rules

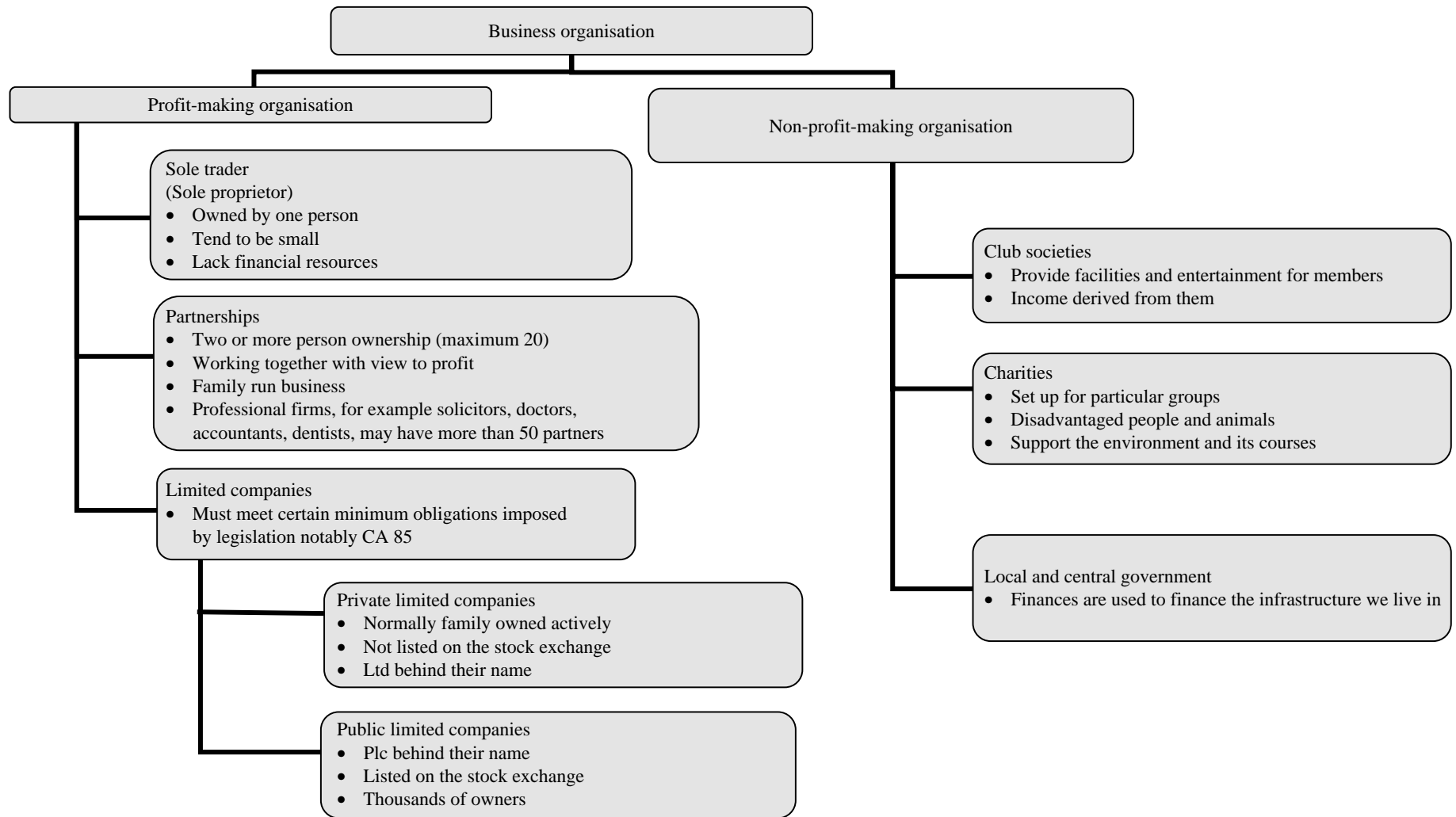
- 1 Make sure you are familiar with software before you start exam. You cannot speak to invigilator once you have started.
- 2 These exam practice kits give you plenty of exam style questions to practise.
- 3 Attempt all questions, there is no negative marking.
- 4 Double check your answer before you 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

# 1







## 4 Exam Practice Kit: Financial Accounting Fundamentals

### ? 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.

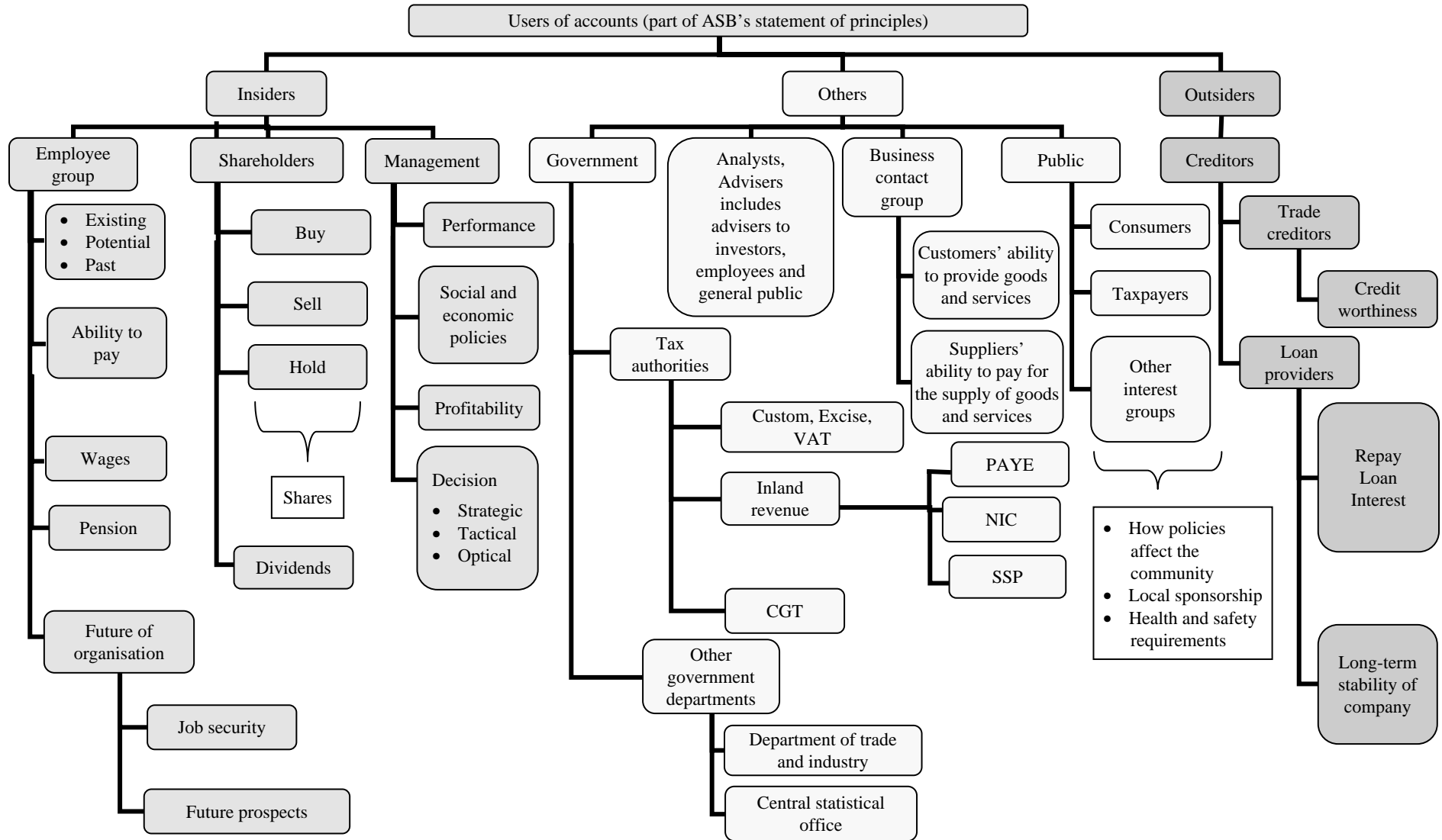
1.6 A

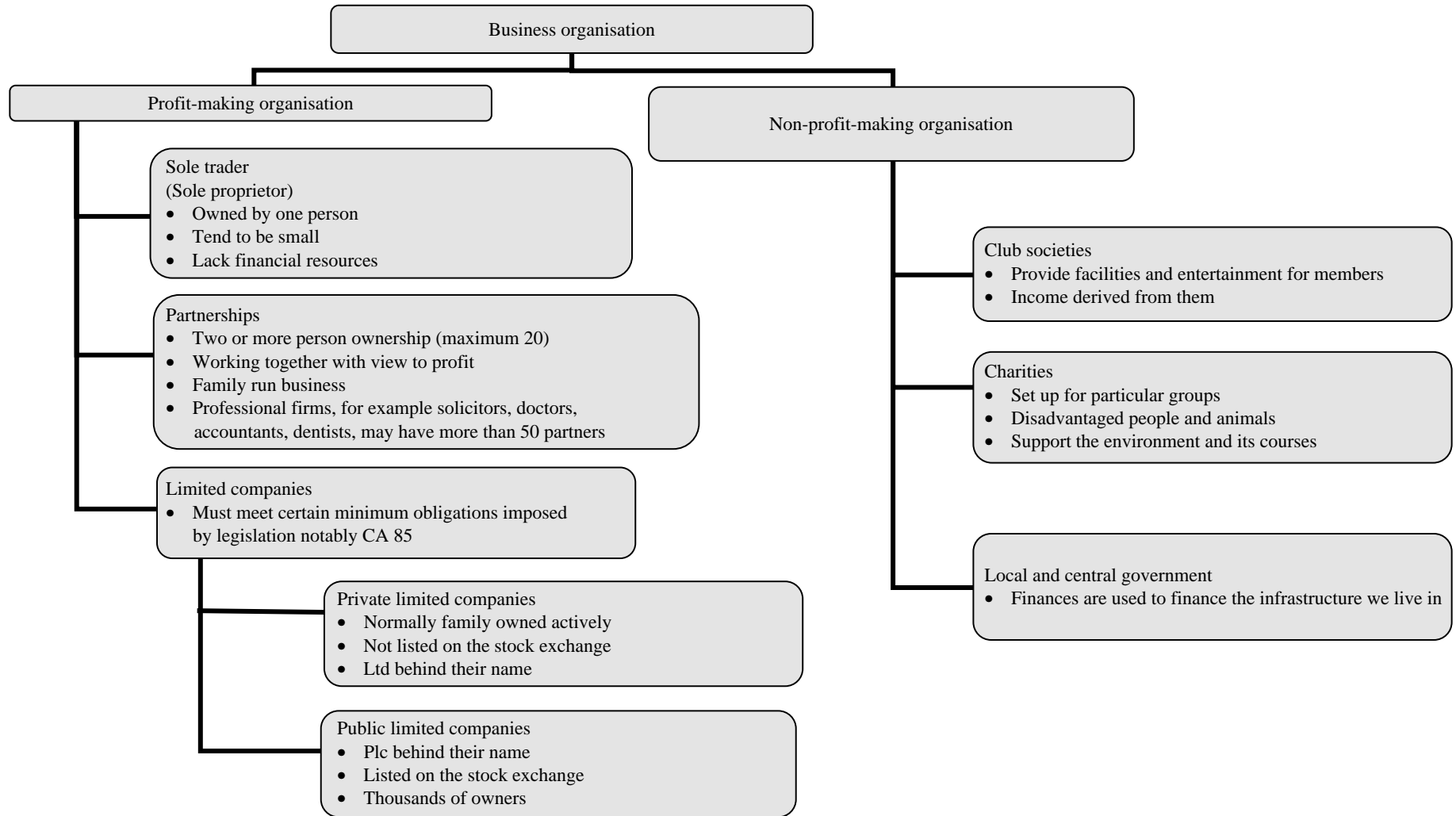
1.7 D

1.8 D

1.9 B

1.10 A





**? 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
- (2 marks)**
- 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
- (2 marks)**
- 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
- (2 marks)**
- 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.
- (2 marks)**
- 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.
- (2 marks)**

 **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.

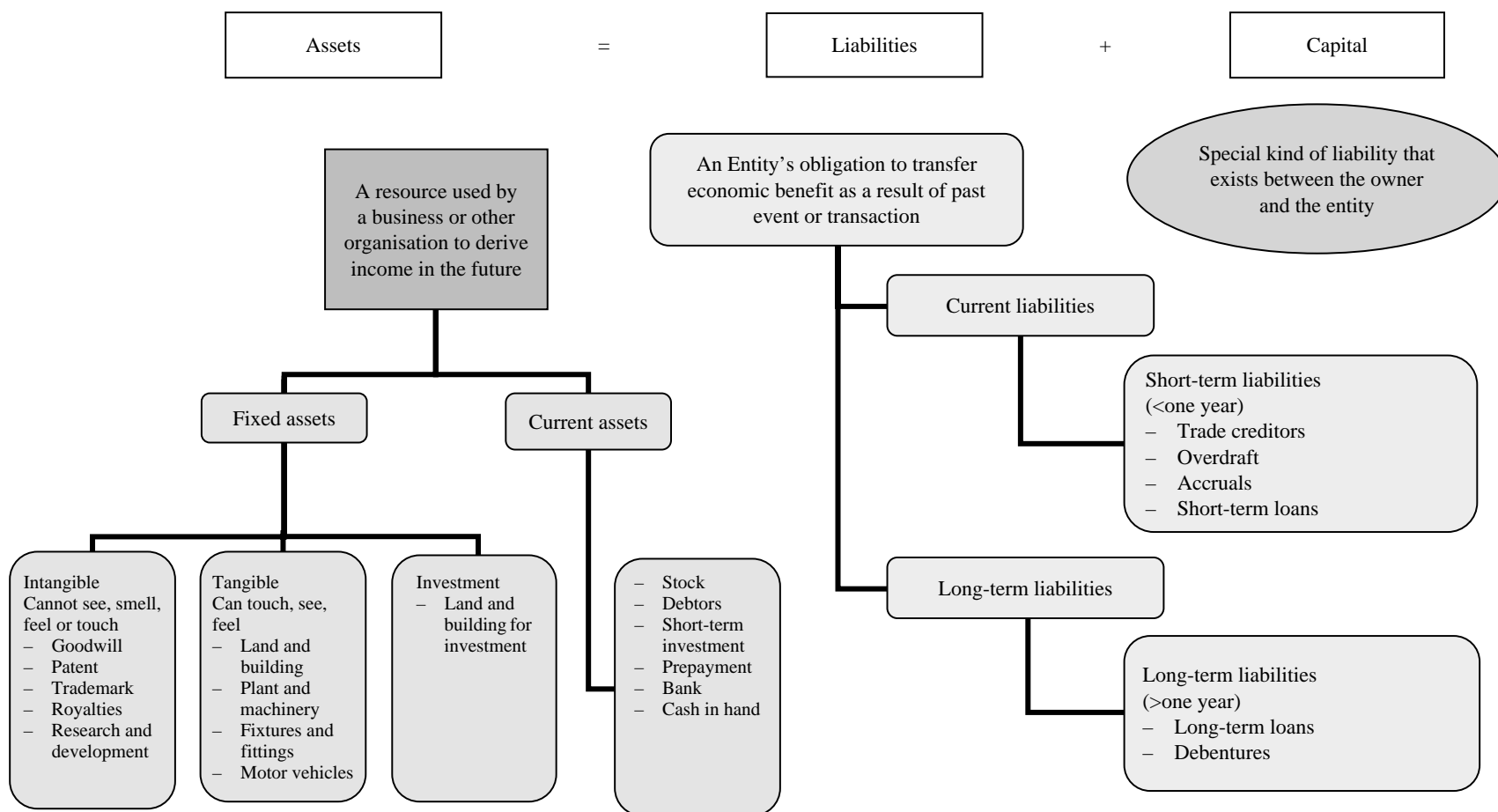
1.5 A

# The Framework of Financial Accounts

# 2



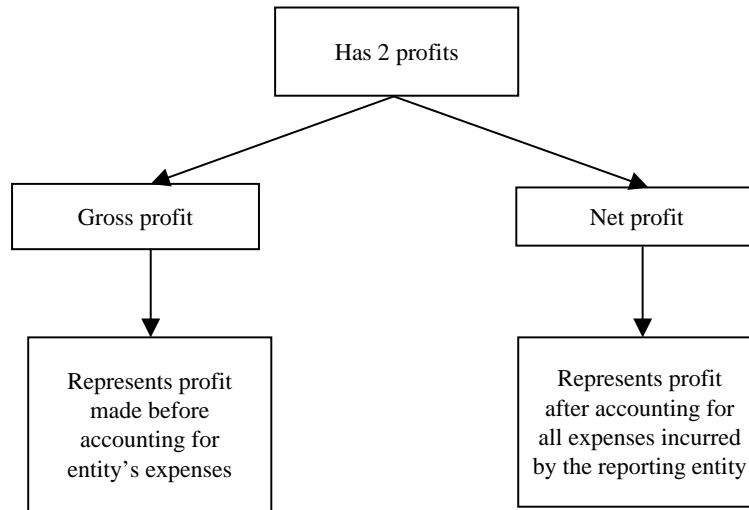
### The Accounting Equation



The balance sheet should be presented using the vertical format, this would result in the above accounting equation to be arranged.

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

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



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

**? Questions**

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

**(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.

<i>Assets</i>	<i>Liabilities</i>
Loan from A Lamb	Debtors
Motor vehicles	Money owing to bank
Premises	Stock of goods
Creditors	Loan from Riffle
Machinery	Money owing to A Little
Cash in hand	Fixtures
Capital	Creditors
Cash at bank	Buildings

**(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

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

2.2

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

2.3

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

2.4

Total Assets = Liabilities

Fixtures	12,000	Stock	8,400
Motor vehicle	30,000	Brother's loan	<u>18,000</u>
Stock of goods	21,000		26,400
Bank	16,800	+	
Cash in hand	<u>600</u>	Capital	<u>?????</u>
	<u>80,400</u>		<u>80,400</u>

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	<u>(2,400)</u>
Overall decrease in working capital	<u><u>(2,700)</u></u>

- 2.8 A

	£
Assets	14,000
Less: Liabilities	<u>(6,250)</u>
	<u><u>7,750</u></u>

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	<u>(3,000)</u>
Closing capital	<u><u>9,000</u></u>

- 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:

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

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

	£
Increase in stock = Increase in working capital	500
Decrease in bank = Decrease in working capital	(800)
Increase in creditors = Decrease in working capital	<u>(2,400)</u>
Overall decrease in working capital	<u>(2,700)</u>

2.5

	£
Opening capital	20,000
Introduced	8,000
Drawings	(16,000)
Loss – balancing figure	<u>(3,000)</u>
Closing capital	<u>9,000</u>

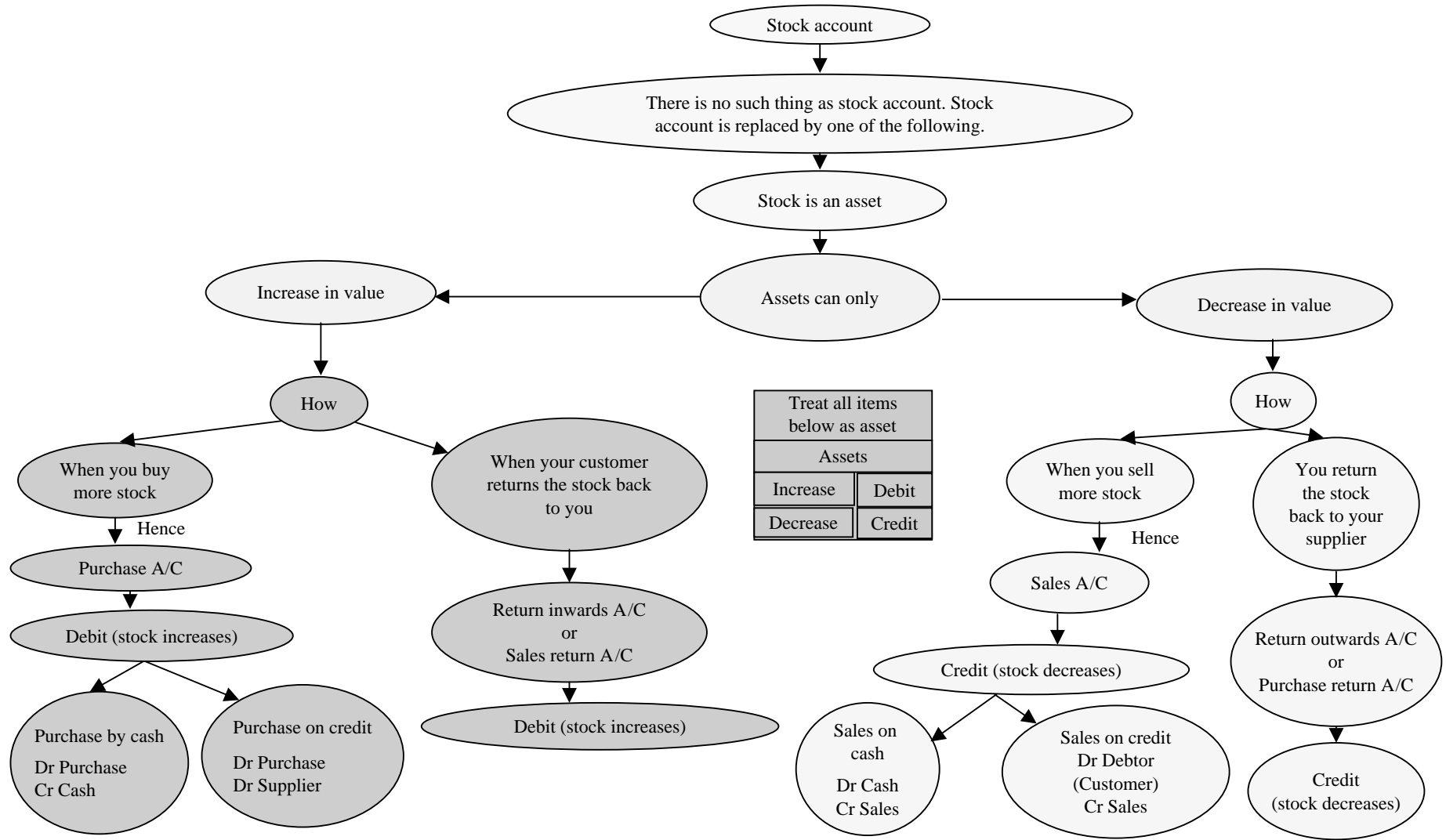
2.6 D

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.

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# The Accounting System in Action

# 3



The accounting system in action  
Ledger account

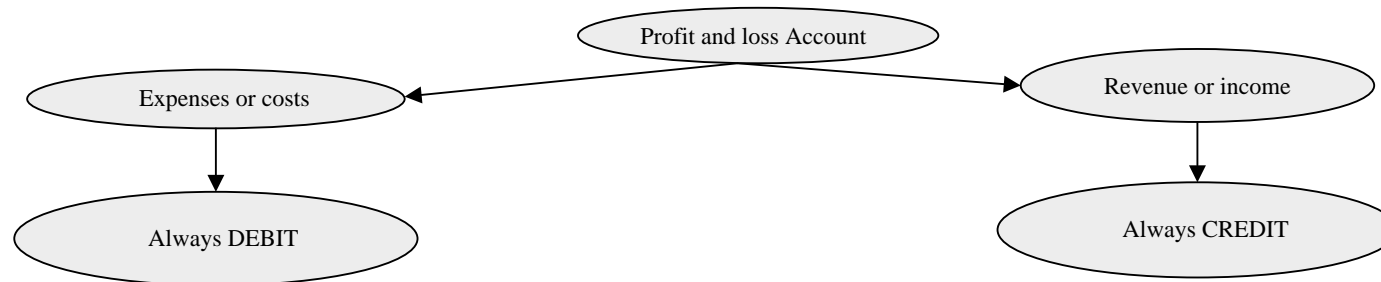
Title of account

Date	Narrative	£	Date	Narrative	£
Left hand side ↓ Debit			Right hand side ↓ Credit		

Accounting equation

Balance sheet

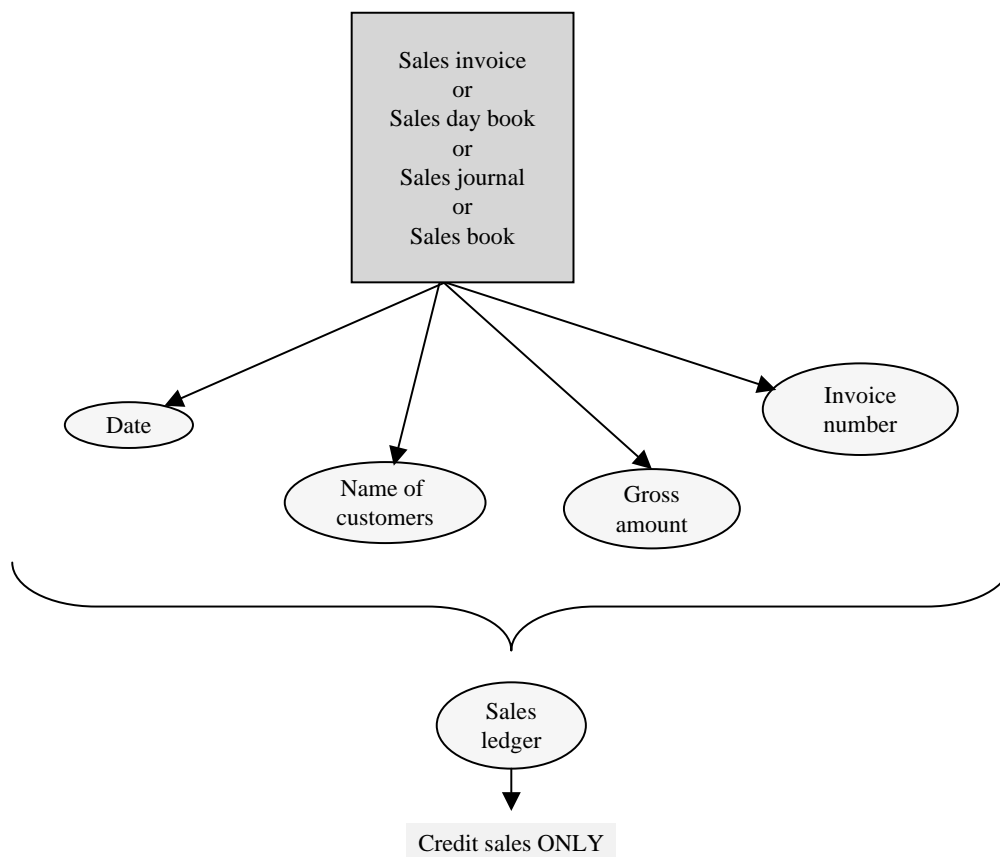
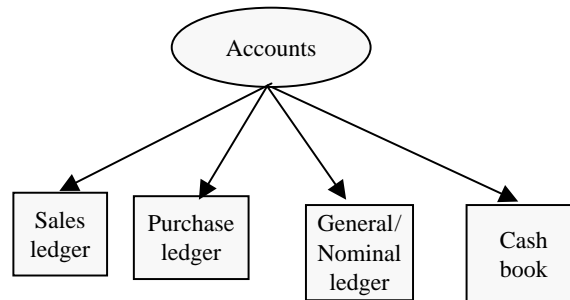
	Assets Debit side	Capital + Liabilities Credit side
Increase	Assets increase always DEBIT	Capital and Liabilities increase always CREDIT
Decrease	Assets decrease always CREDIT	Capital and Liabilities decrease always DEBIT



## 26 Exam Practice Kit: Financial Accounting Fundamentals

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.

## ? Questions

3.1 Tick the correct boxes for the following:

	<i>Debit</i>	<i>Credit</i>
(i) Increase in assets	<input type="checkbox"/>	<input type="checkbox"/>
(ii) Increase in capital	<input type="checkbox"/>	<input type="checkbox"/>
(iii) Decrease in capital	<input type="checkbox"/>	<input type="checkbox"/>
(iv) Increase in liabilities	<input type="checkbox"/>	<input type="checkbox"/>
(v) Decrease in assets	<input type="checkbox"/>	<input type="checkbox"/>
(vi) Decrease in liabilities	<input type="checkbox"/>	<input type="checkbox"/>
(vii) Increase in expenses	<input type="checkbox"/>	<input type="checkbox"/>
(viii) Decrease in income	<input type="checkbox"/>	<input type="checkbox"/>
(ix) Decrease in expenses	<input type="checkbox"/>	<input type="checkbox"/>
(x) Increase in income	<input type="checkbox"/>	<input type="checkbox"/>

**(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.

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

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

3.3 Comprehensive example (Sport stars)

Purchases		
	£	£
Sep 1 D Underwood	68	
Sep 2 M Hughes	154	
Sep 12 Cash	100	
Sep 31 M Hughes	128	

Sales		
	£	£
Sep 5 A Border		60
Sep 6 A Steward		50
Sep 21 Cash		150

Return inwards		
	£	£
Sep 19 A Steward	16	

Return outwards		
	£	£
Sep 10 D Underwood		14

## D Underwood

		£			£
Sep 10	Return outward	14	Sep 1	Purchases	68
Sep 22	Cash	54			

## A Border

		£			£
Sep 5	Sales	60	Sep 30	Cash	60

## A Steward

		£			£
Sep 6	Sales	50	Sep 19	Return inwards	16

## Cash

		£			£
Sep 21	Sales	150	Sep 12	Purchases	100
Sep 30	A Border	60	Sep 22	D Underwood	54

## M Hughes

		£			£
			Sep 2	Purchases	154
			Sep 31	Purchases	128

**? 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

<i>Debit</i>	<i>Credit</i>
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?

	<i>Debit</i>	<i>Credit</i>
A	Stock	Debtor
B	Stock	Creditor
C	Purchases	Creditor
D	Creditor	Purchases

**(2 marks)**

- 3.7 X receives goods from Y on credit and X subsequently pays by cheque. X 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?

	<i>Debit</i>	<i>Credit</i>
A	Creditors	Returns outwards
B	Creditors	Bank
C	Bank	Creditors
D	Returns outwards	Creditors

**(2 marks)**

**✓ Answers to revision questions 3**

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

	<i>Assets</i>	<i>Capital and liabilities</i>
Increase	Debit	Credit
Decrease	Credit	Debit

3.3 A

$$= 1,200 \text{ (debit)} + 2,100 \text{ (debit)} - 750 \text{ (credit)} - 960 \text{ (credit)} = 1,590 \text{ debit}$$

3.4 C

<i>When purchased</i>		<i>When returned</i>	
Dr	Office equipment	Dr	Penny
Cr	Penny	Cr	Office equipment

Hence C.

3.5 B

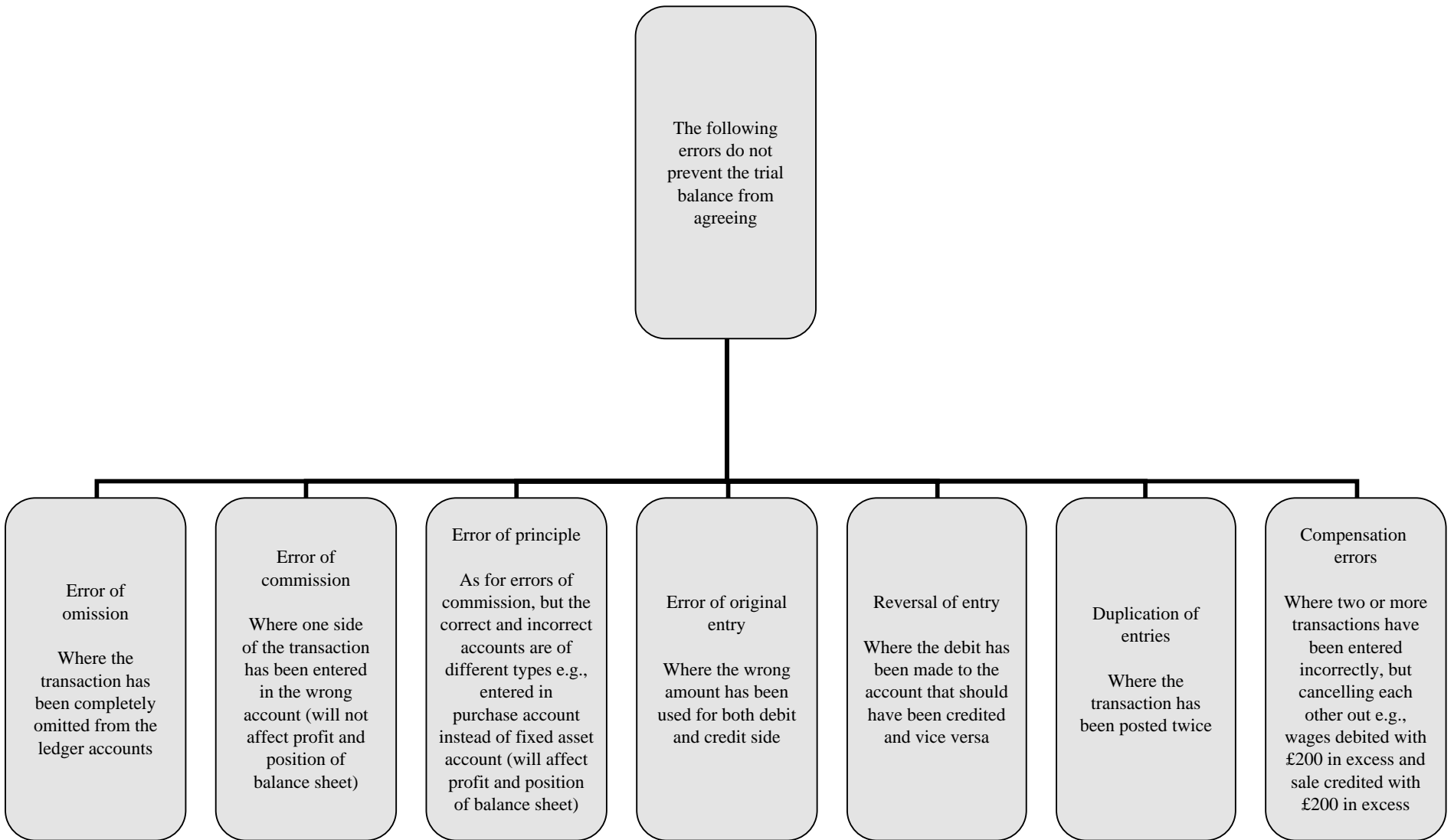
3.6 C

The stock account is never used to record purchases.

3.7 C

# Summarising the Ledger Accounts

# 4



From ledger accounts to final accounts

Bank A/C			
18 Dec 2001	SP A/C	30	
31 Dec 2001	Bal c/d	80	
		<u>110</u>	
			<u>110</u>
1 Jan 2002	Bal b/d		80

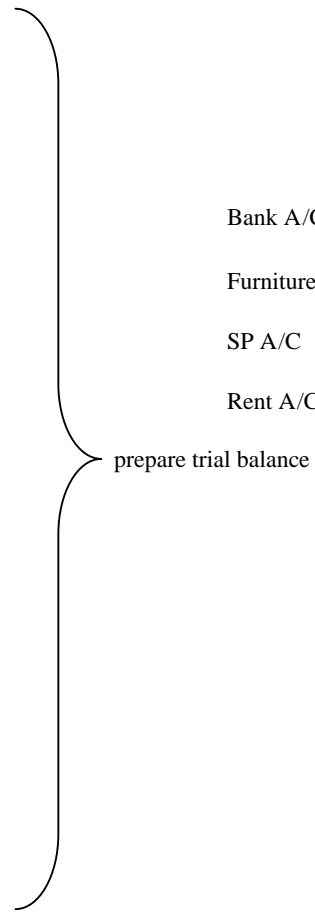
Furniture			
18 Dec 2001	Bank	70	
		<u>70</u>	
1 Jan 2002	Bal b/d		<u>70</u>
31 Dec	Bal c/d		70

SP A/C			
31 Dec 2001	Bal c/d	30	
		<u>30</u>	
			<u>30</u>
18 Dec 2001	Bank		30
			<u>30</u>
1 Jan 2002	Bal b/d		30

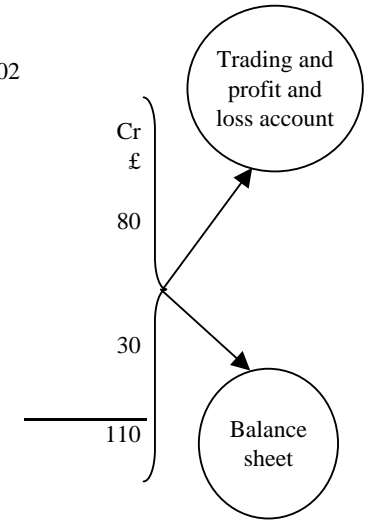
  

Rent A/C			
16 Dec 2001	Bank	40	
		<u>40</u>	
1 Jan 2002	Bal b/d		<u>40</u>
31 Dec 2001	Bal c/d		40
			<u>40</u>



Trial balance as at 31 December 2002

	Dr £		Cr £
Bank A/C			80
Furniture A/C		70	
SP A/C			30
Rent A/C		40	
		<u>110</u>	<u>110</u>





## **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. **(3 marks)**
- 4.2 What are the reasons why a trial balance may not balance? **(3 marks)**
- 4.3 Give four examples of errors that do not affect the trial balance from agreeing and explain what each one means. **(8 marks)**

 **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

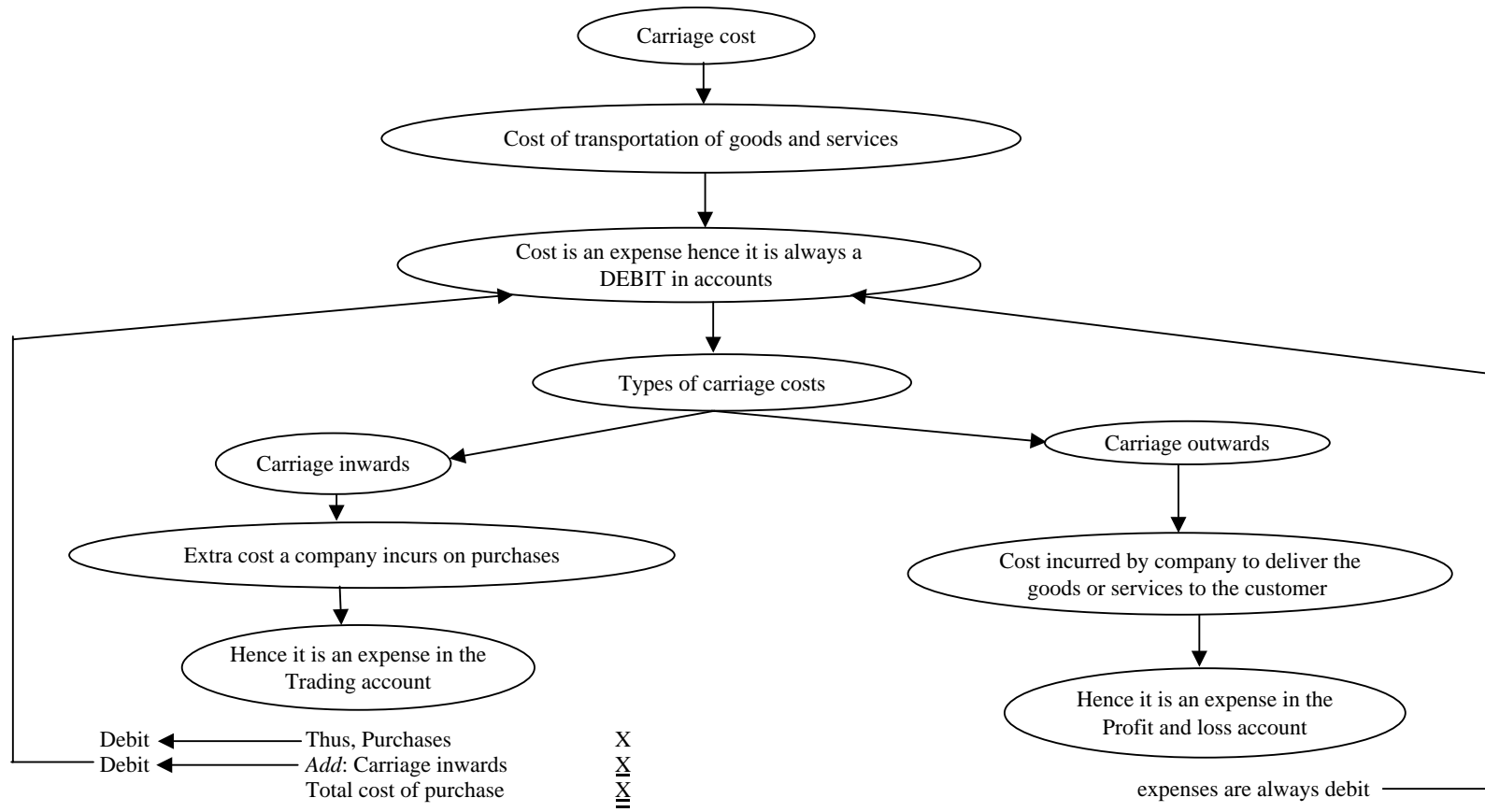
B and D are incorrect as they would give a lower debit side. C is incorrect because it would give a higher credit side.

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

# 5

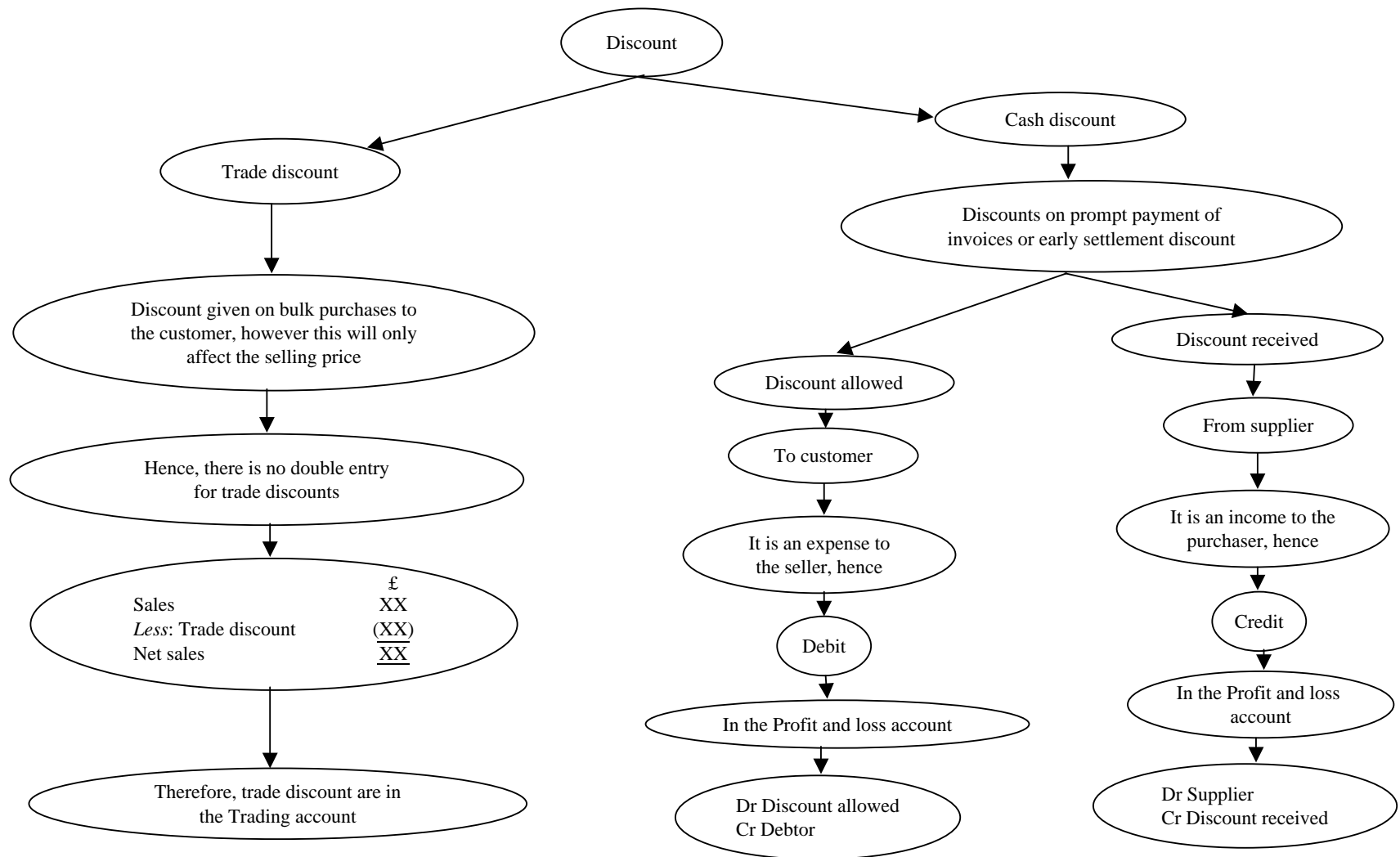


Thus which ever carriage cost they are, both are DEBITs one is in the Trading account (carriage inwards) and the other is in the Profit and loss account (carriage outwards)

Debit ← Thus, Purchases  
Debit ← Add: Carriage inwards  
Total cost of purchase

X  
X  
X

expenses are always debit





## 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%	<u>72.00</u>
Net goods value	288.00
VAT @ 17½%	<u>50.40</u>
	<u>338.40</u>

Entries:

		£	£
Dr	Purchases	288.00	
Dr	VAT	50.40	
Cr	Supplier		338.40

- 2 Sold goods costing £80:

	£		
Sales	80.00		
VAT 17½%	<u>14.00</u>		
Total Sales	<u>94.00</u>		
	£		
Dr	Debtors	94.00	
Cr	Sales		80.00
Cr	VAT		14.00

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

$$£500 \times 7/47 = £74.47$$

Hence VAT on gross amount is £74.47

or

$$£500 \times 17.5/117.5 = £74.47$$

## ? 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

(2 marks)

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

(2 marks)

5.3 Where is discount allowed disclosed?

- A Trading account
- B Profit and loss account
- C Trial balance
- D Balance sheet

(2 marks)

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

(2 marks)

5.5 Where is discount received disclosed?

- A Profit and loss account
- B Trading account
- C Balance sheet
- D Trial balance

(2 marks)

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

(2 marks)

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

(2 marks)

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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)**

5.15 As per 5.13 above, what would be the final double entry after calculation of trade discount and VAT?

		£	£
A	Dr Purchases	400	
	Dr VAT	70	
	Cr Supplier		470
B	Dr Supplier	470	
	Cr VAT		70
	Cr Purchases		400
C	Dr Purchase	587.50	
	Dr VAT	87.50	
	Cr Supplier		675.00
D	Dr Purchases	470.00	
	Dr VAT	87.50	
	Cr Supplier		557.50

**(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	<u>400</u>

5.14 B

£70

	£
List price	500.00
Less: Trade discount	<u>(100.00)</u>
Net purchases	400.00
VAT @ 17.5%	<u>70.00</u>
	<u>470.00</u>

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

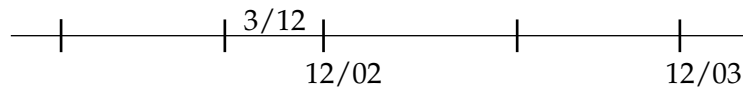
Capital employed is increased by making a profit, or by adding more capital. Writing off bad debt is clearly the opposite of making a profit; transactions such as B and C merely adjust the split of assets and liabilities but do not add anything overall.

5.2 C

The year to 31 December 2003 includes  $\frac{3}{4}$  of the rent for the year to 30 September 2003 and  $\frac{1}{4}$  of the rent for the year to 30 September 2004, that is:

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

$$(\frac{9}{12} \times 600) (\frac{3}{12} \times 800)$$



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.

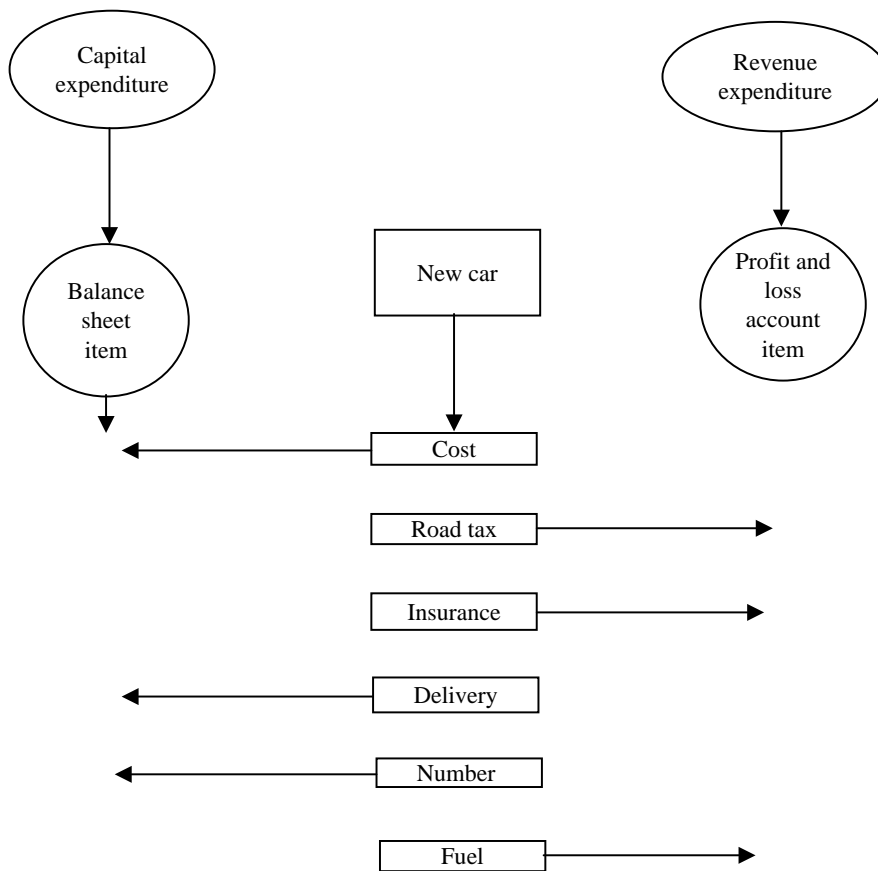


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# Accounting for Fixed Assets

# 6

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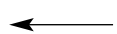
Why balance sheet?

Large amounts in pound sterling (£) (e.g. cost of car)

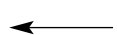
Lasts long term (>1 year e.g. cost of car)

For example, delivery cost

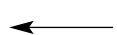
For example, install turbo engine



Value of item



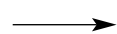
Length



One-off expense



Add value to improve capacity and performance



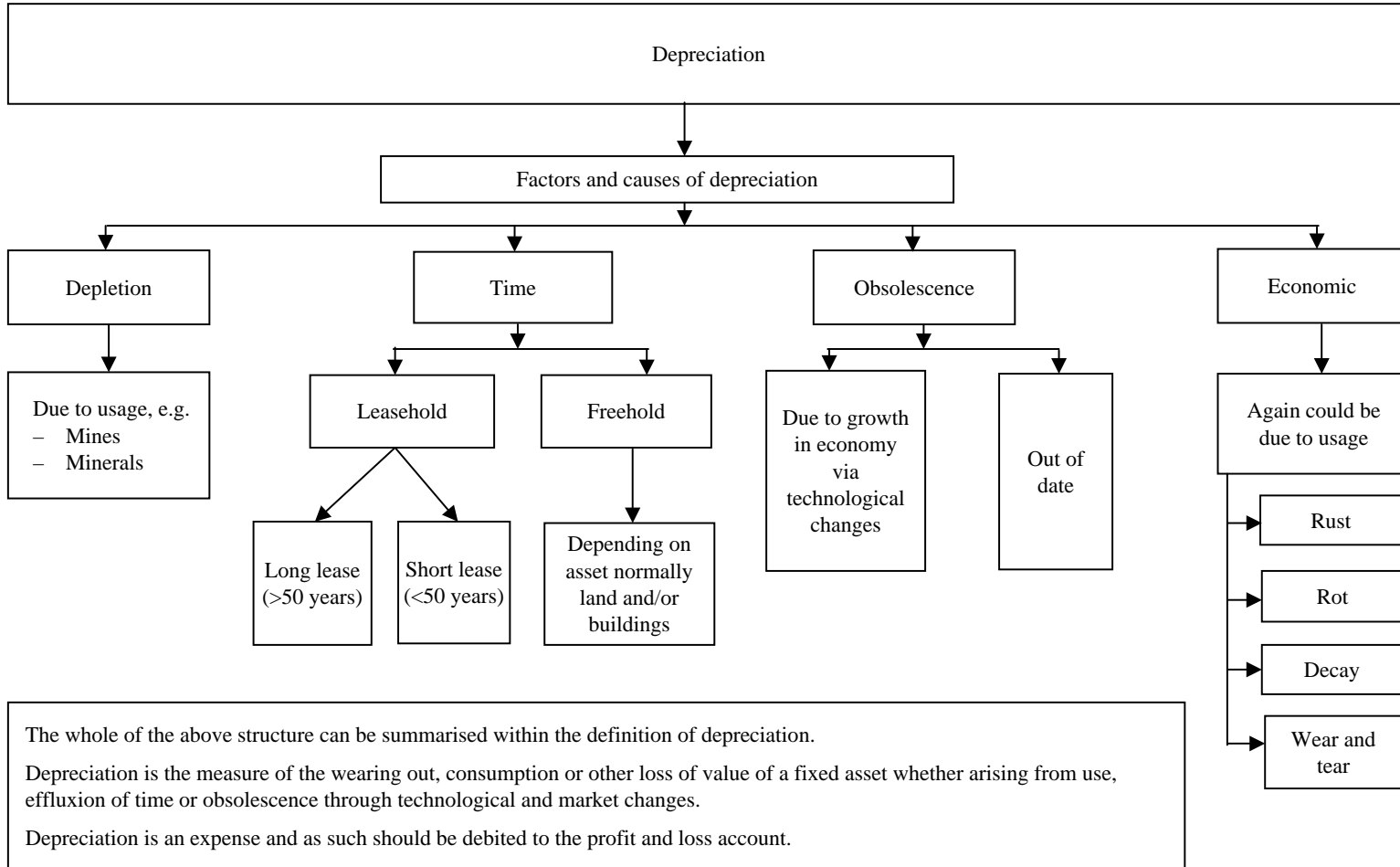
Why profit and loss?

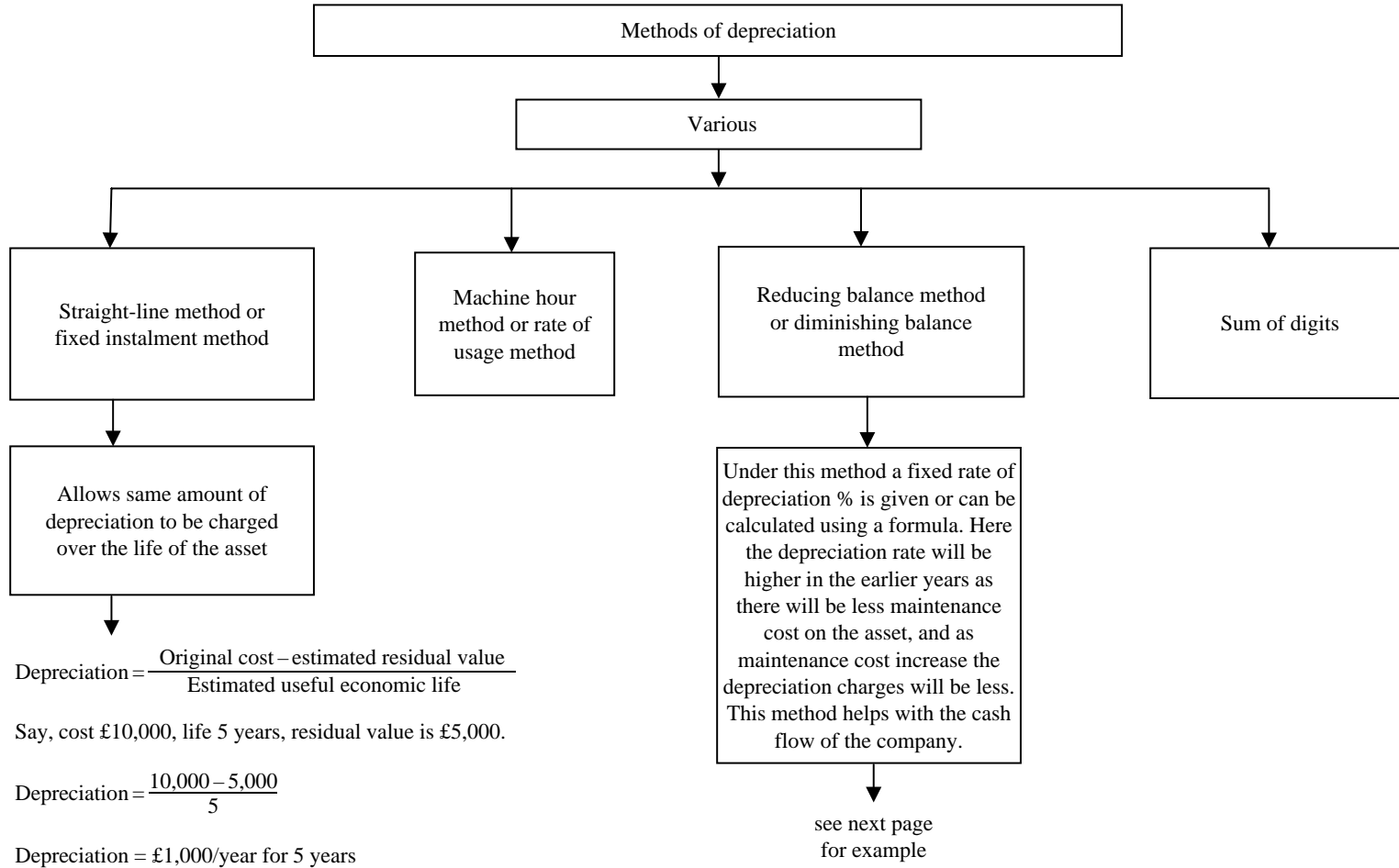
Relatively low value in £ (e.g. road tax, insurance)

Lasts short term (<1 year e.g. fuel, insurance etc.)

Recurring expense

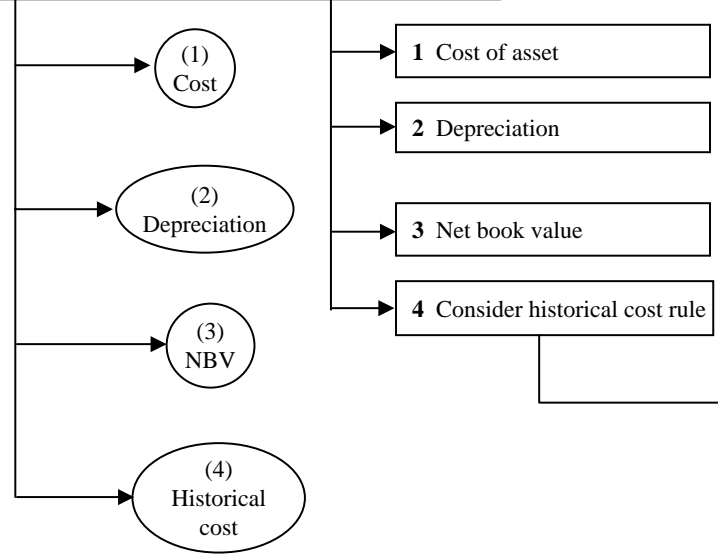
Does not add value





Purchase and sale of fixed assets: Accounting treatment

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



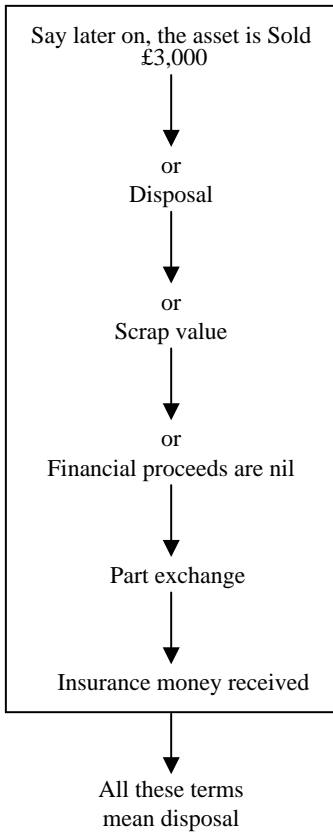
		Dr	Cr
		£	£
Dr	Fixed asset	10,000	
Cr	Bank/Cash		10,000

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

		Accumulated	
		depreciation	
		Cost	NBV
Year 1	10,000	(1,000)	9,000
Year 2	10,000	(2,000)	8,000

in the balance sheet say for 2 years

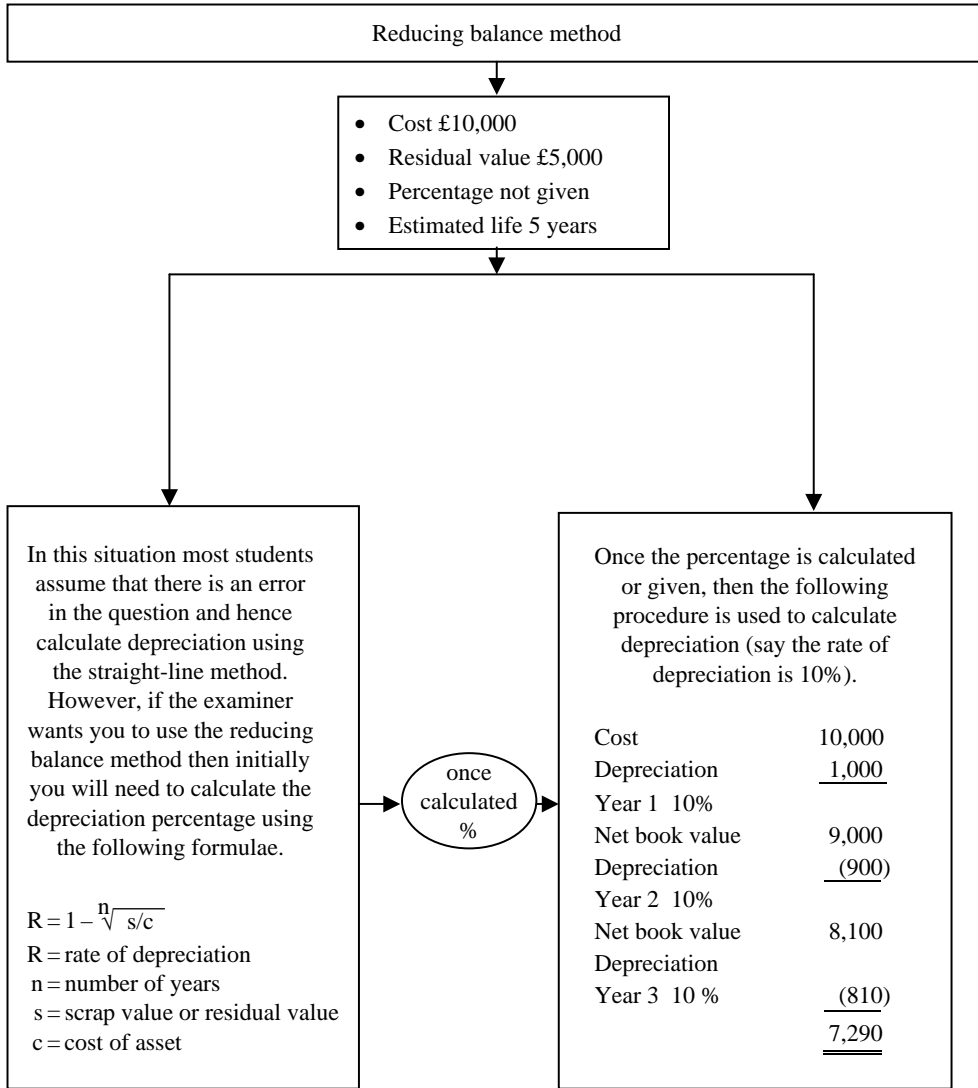
always accumulated figure to date



all mean  
the same  
thing, that is,  
disposal

(1) Close the cost of the asset (always ORIGINAL COST)	Dr Cr	Fixed asset disposal Fixed asset	Dr 10,000	Cr 10,000
(2) Close off the accumulated depreciation account (with the balance in the account)	Dr Cr	Accumulated depreciation Fixed asset disposal account	1,000	1,000
(3) Consider sales proceeds	Dr Cr	Bank/Cash Fixed asset disposal	3,000	3,000
(4) Finally consider profit or loss via the Fixed asset disposal account	Dr Cr	Profit and Loss Fixed asset disposal	6,000	6,000

Fixed asset disposal account			
	£		£
(1) Cost	10,000	(2) Accumulated depreciation	1,000
Profit and loss account (Profit)		(3) Sales proceeds	3,000
(Balancing figure)	X	(4) Profit and loss Account (Loss)	6,000
	10,000	(Balancing figure)	10,000



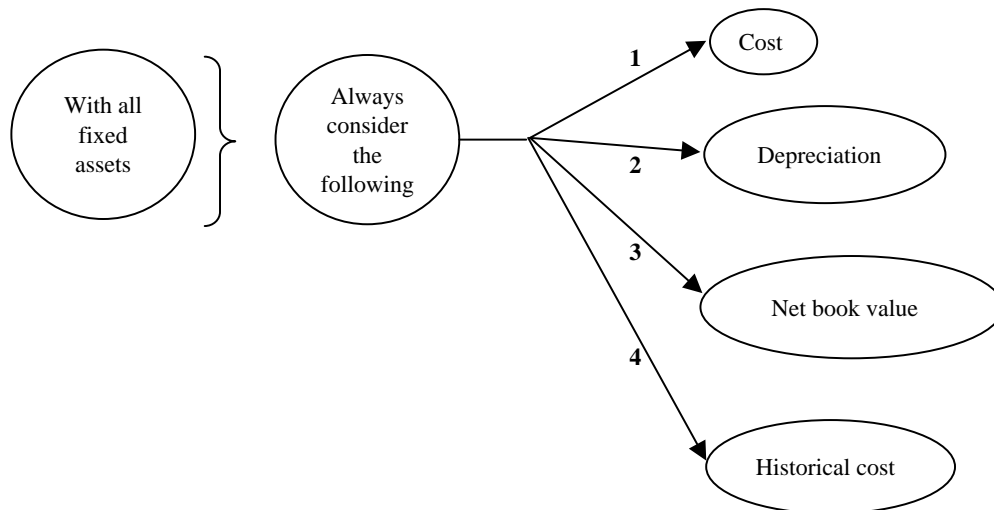
$$R = 1 - \sqrt[n]{s/c}$$

R = %



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When dealing with fixed assets and the calculation of depreciation you must always carry out the calculations in a methodological manner.  
Hence,



In the Balance sheet, depreciation is shown as follows:

	Cost £	Accumulated depreciation £	Net book value £
Say, depreciation is at 10% straight line			
Year 1	10,000	(1,000)	9,000
Year 2	9,000	(1,000)	8,000

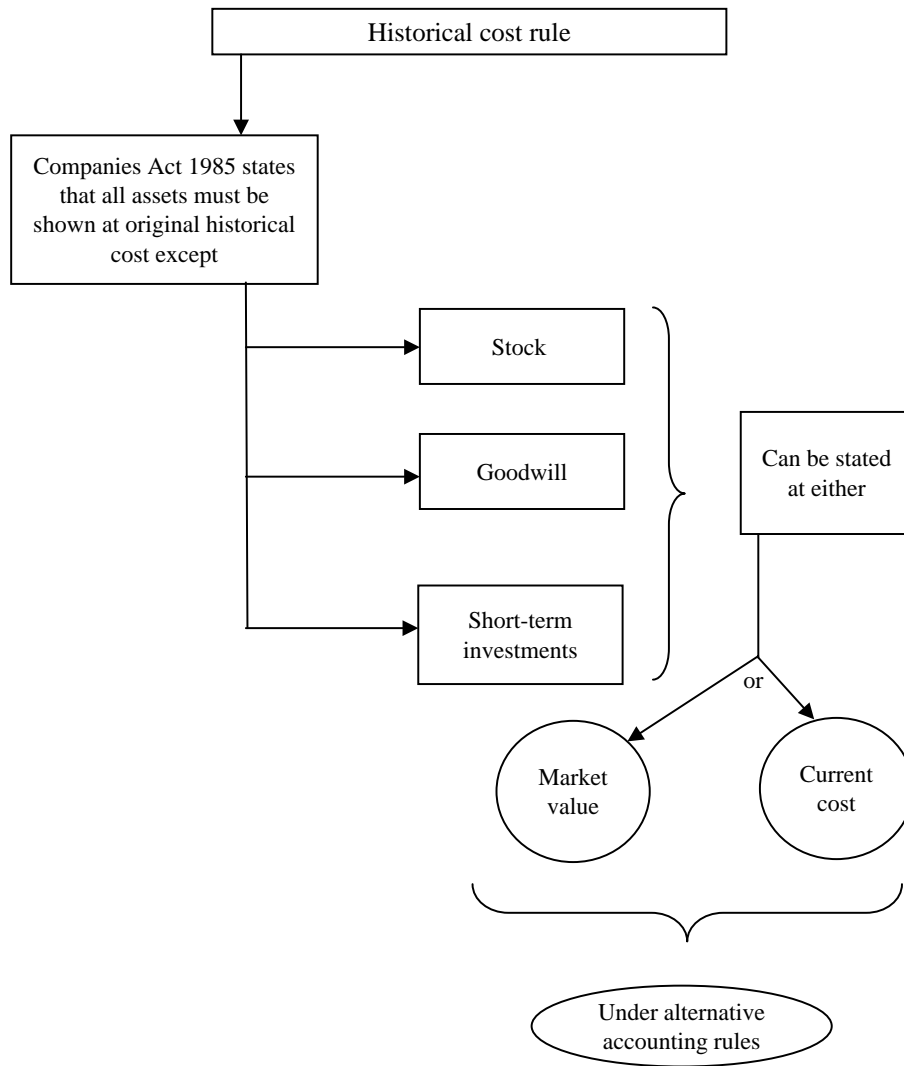
This is INCORRECT. Why?

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

	Cost	Accumulated depreciation	Net book value
Thus			
Year 2	10,000	(2,000)	8,000

1,000 last year → (points to the 1,000 in the depreciation column)  
1,000 current year → (points to the 1,000 in the depreciation column)

correct method → (points to the Year 2 row)



## 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?

		Expense account	
Prepayments b/f	X (5)	Accruals b/f	X (5)
How much have I paid (Cash/Bank) }	X (2)	How much am I suppose to pay (Profit and loss account) }	X (1)
If difference is here then Bal c/d (Accruals) }	X (4)	If difference is here then Bal c/d (Prepayments) }	X (4)
	<u>XX (3)</u>		<u>XX (3)</u>
Bal b/f (Prepayment)	XX	Bal b/f (Accrual)	XX
↓		↓	
<b>Balance sheet</b>		<b>Balance sheet</b>	
Current assets		Creditors less than 1 Year	
Stock	XX	Trade creditors	XX
Debtors	XX	Overdraft	XX
Prepayments	XX	Short-term loans	XX
		Accruals	XX

(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?

Revenue/income account			
Accrued income b/f (5)	X (5)	Prepaid income b/f	X (5)
How much am I suppose to receive (profit and loss account) }	X (1)	How much have I received (Cash/Bank) }	X (1)
If difference is here then Bal c/d (prepaid income) }	X (4)	If difference is here then Bal c/d (Accrued income) }	X (4)
	<u>XX (3)</u>		<u>XX (3)</u>
Bal b/f (Accrued income)	XX	Bal b/f (Prepaid income)	XX
<b>Balance sheet</b>		<b>Balance sheet</b>	
Current assets			
Stock	X	Overdraft	X
Debtors	X	Trade creditors	X
Prepayments	X	Accruals	X
Accrued income	X	Prepaid income	X
Accruals		Prepayments	
↓		↓	
Accrued expense		Prepaid expense	
Amount owing		Amount prepaid	
Amount outstanding		Payment in advance	
Payment in arrears		Amount overpaid	

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

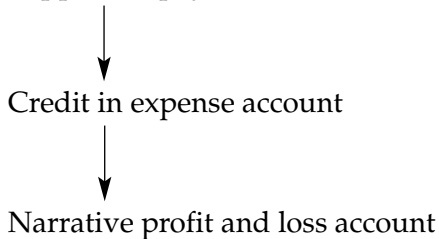
**Step 1**

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

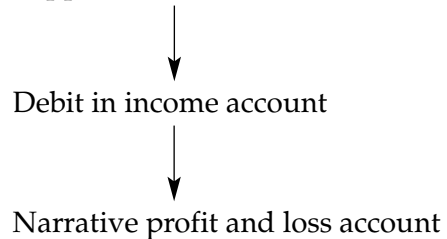
**Step 2**

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

Suppose to pay



Suppose to receive



**Step 3**

Ask yourself how much has been paid or received.

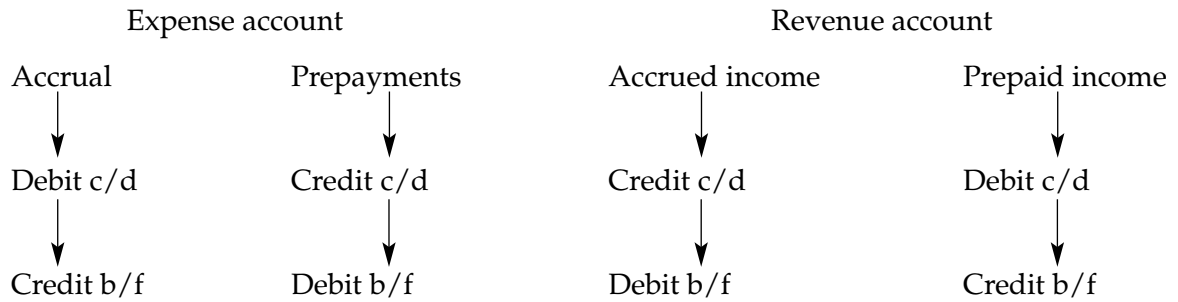
## 64 Exam Practice Kit: Financial Accounting Fundamentals

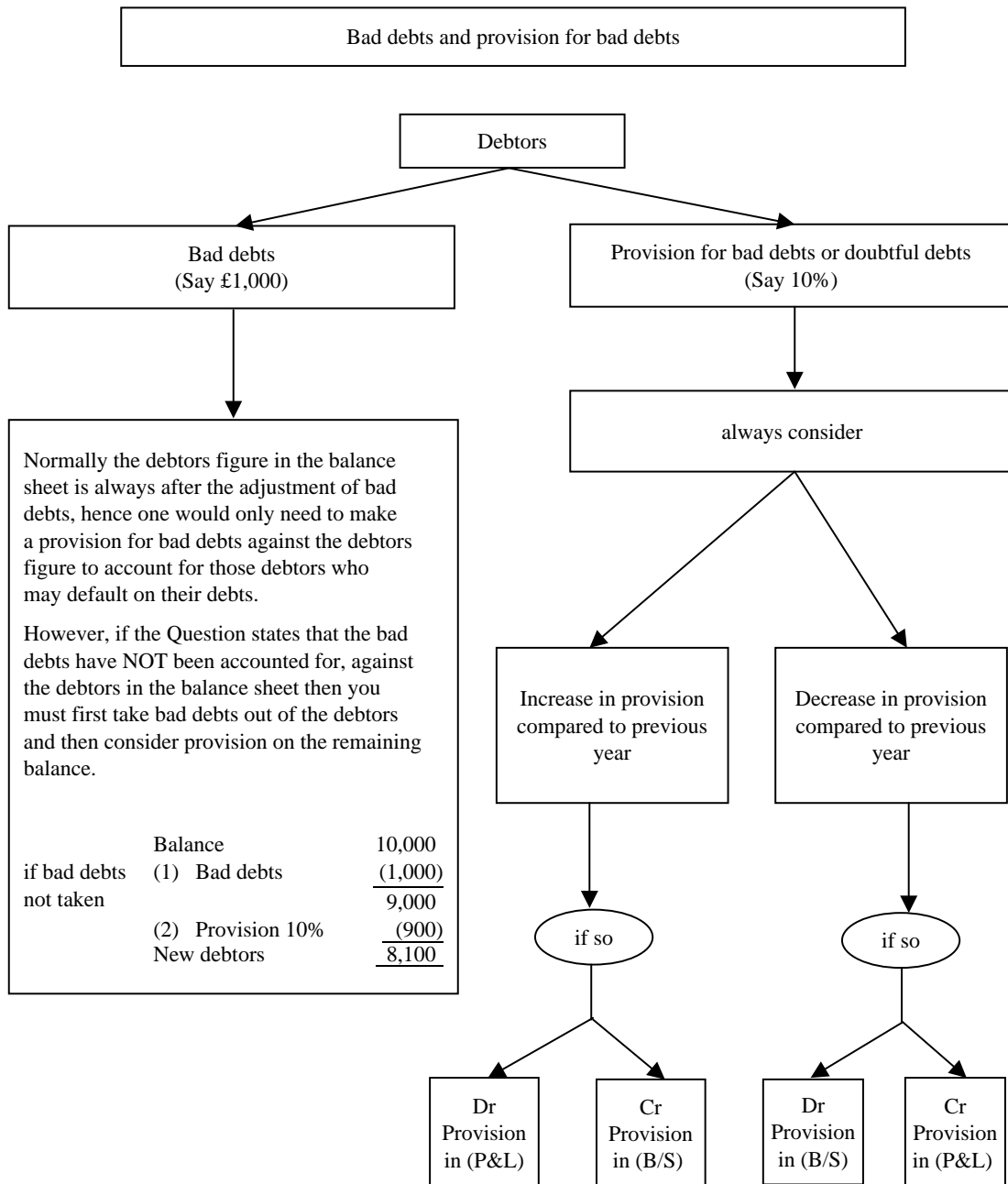
### Step 4

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.





**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.

**(7 marks)**

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 |

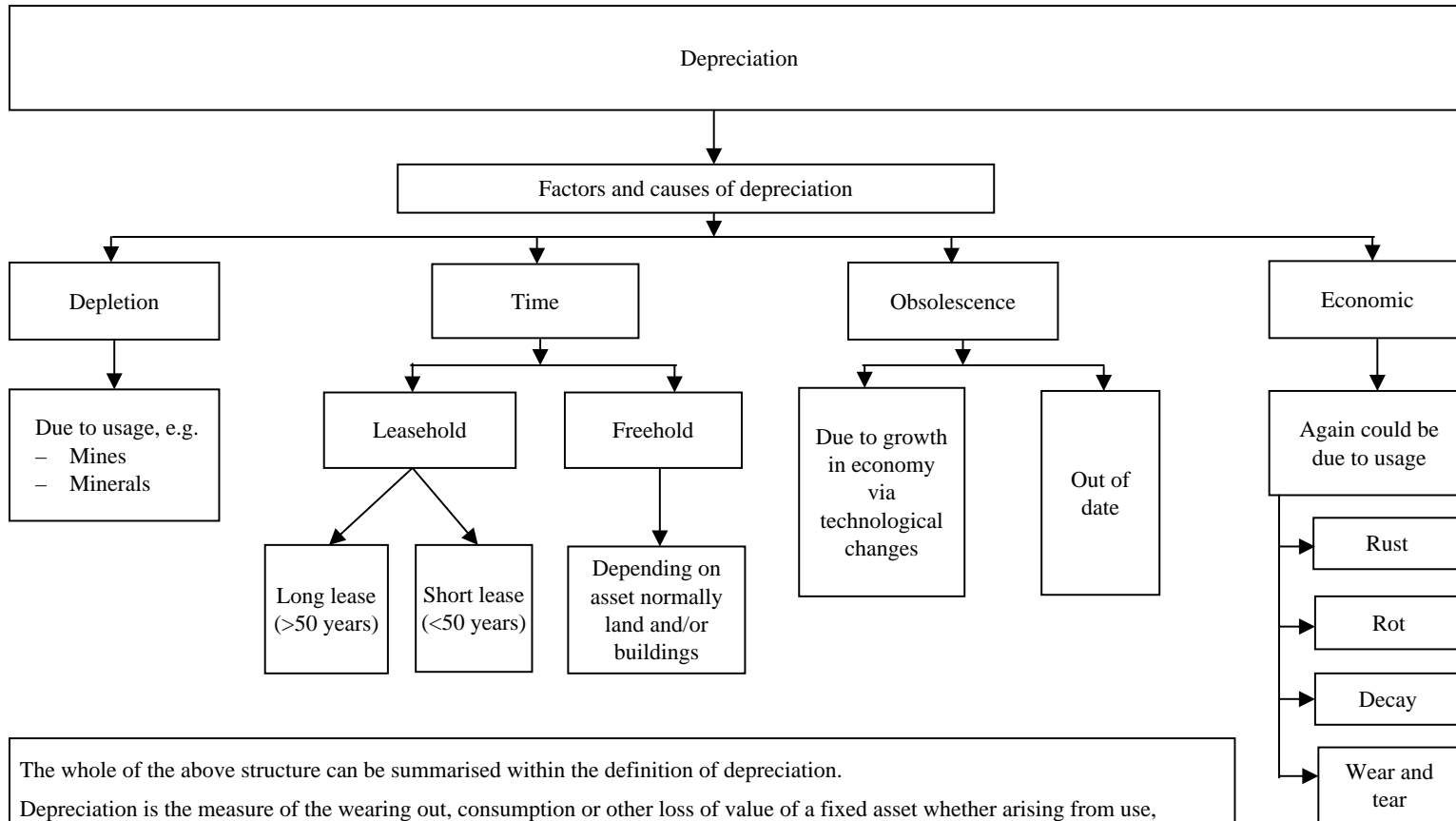
**(2 marks)**

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        |

**(2 marks)**

6.1



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.



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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  
(2 marks)
- 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  
(2 marks)
- 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  
(2 marks)
- 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  
(2 marks)
- 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.  
(2 marks)
- 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?  
(2 marks)

## ✓ Answers to revision questions 6

- 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:

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

### Fixed asset disposal account

Cost	15,000	Accumulated depreciation	9,000
		Sale proceeds	4,800
		Loss	1,200
	<u>15,000</u>		<u>15,000</u>

- 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

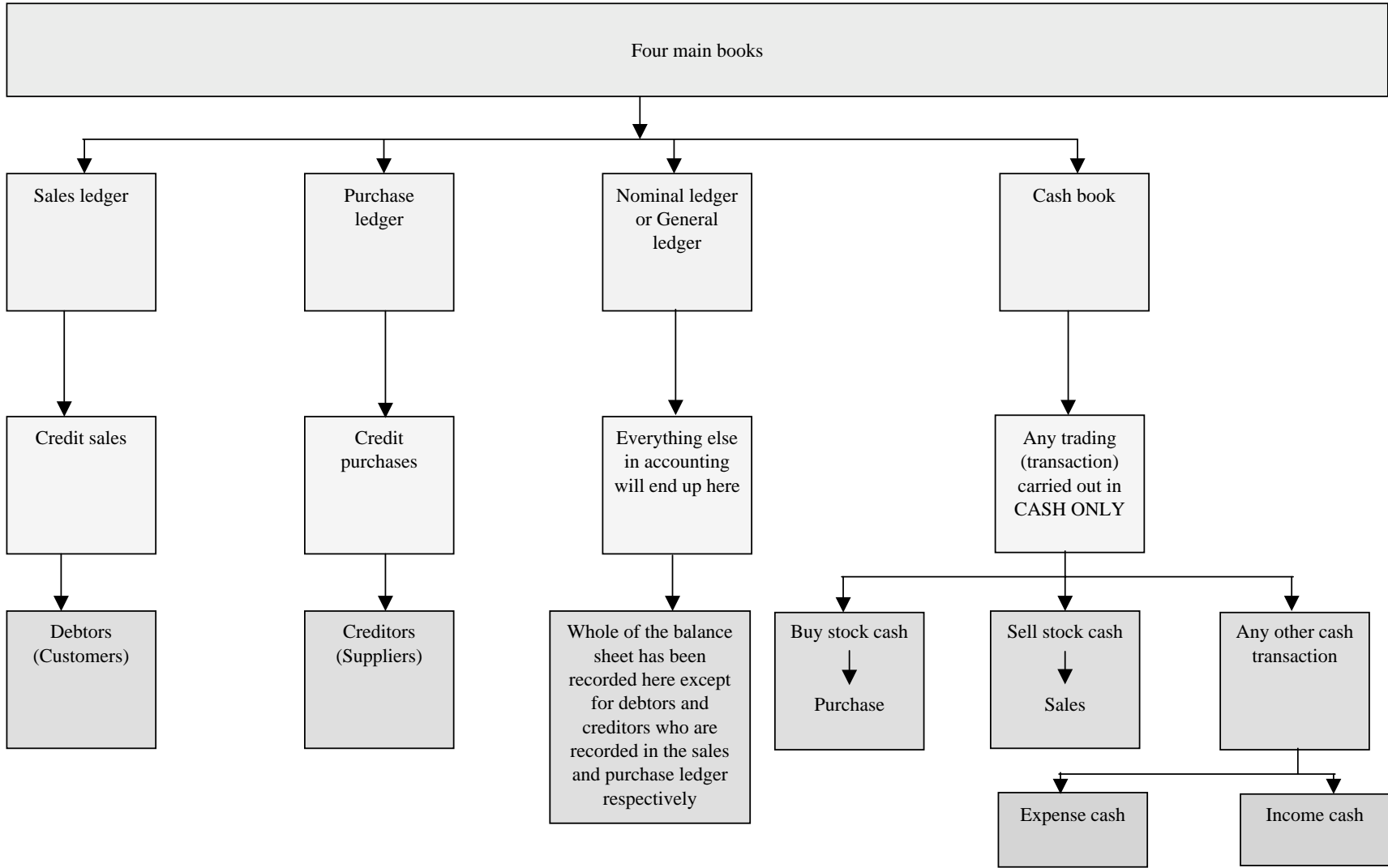
A, B and C are all correct, in most situations.

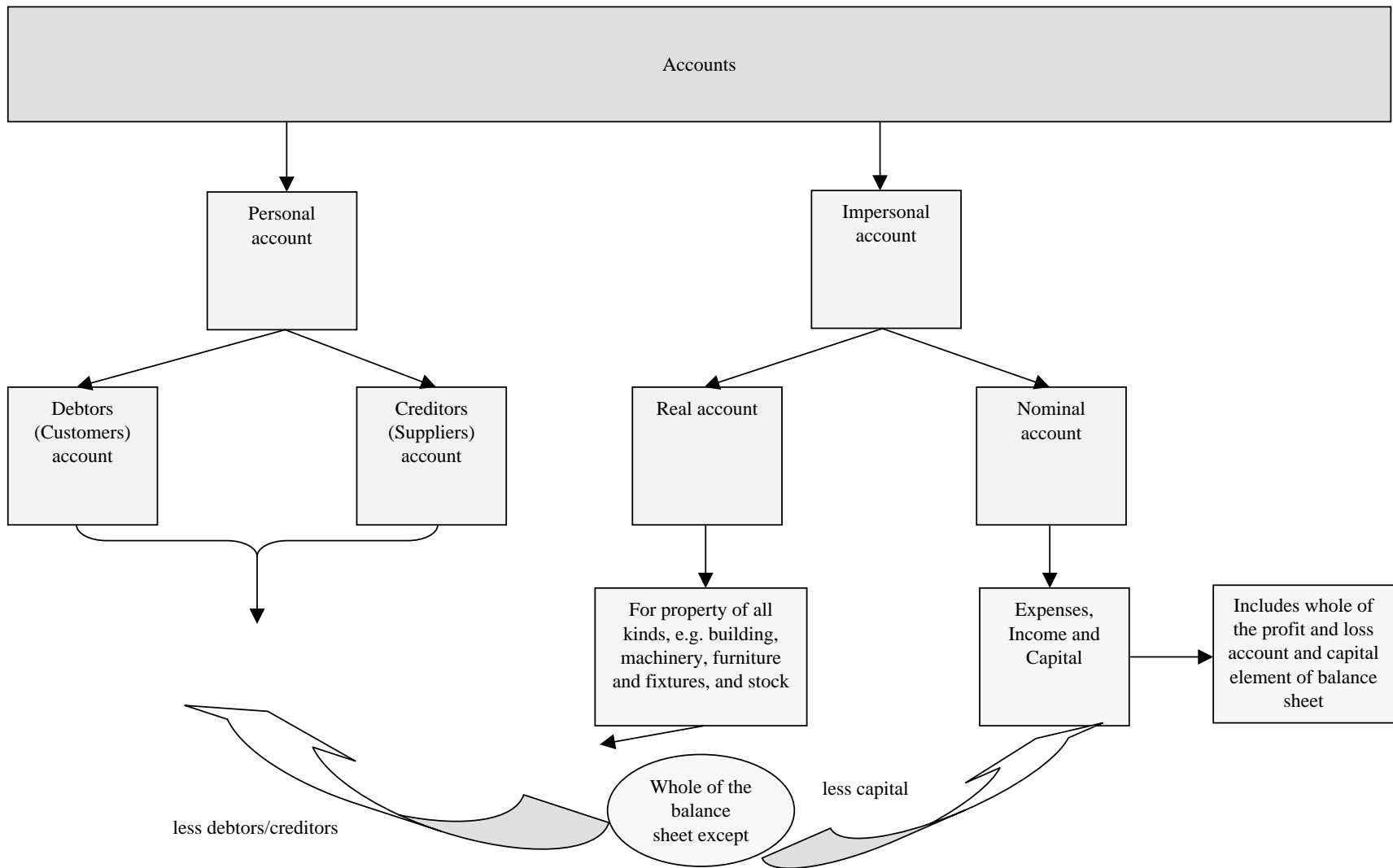
- 6.6

	£
Cost of machine	40,000
Installation	2,500
Training	1,000
Testing	500
	<u>44,000</u>

# Financial Accounting with Adjustments, Organising and Controlling the Bookkeeping System

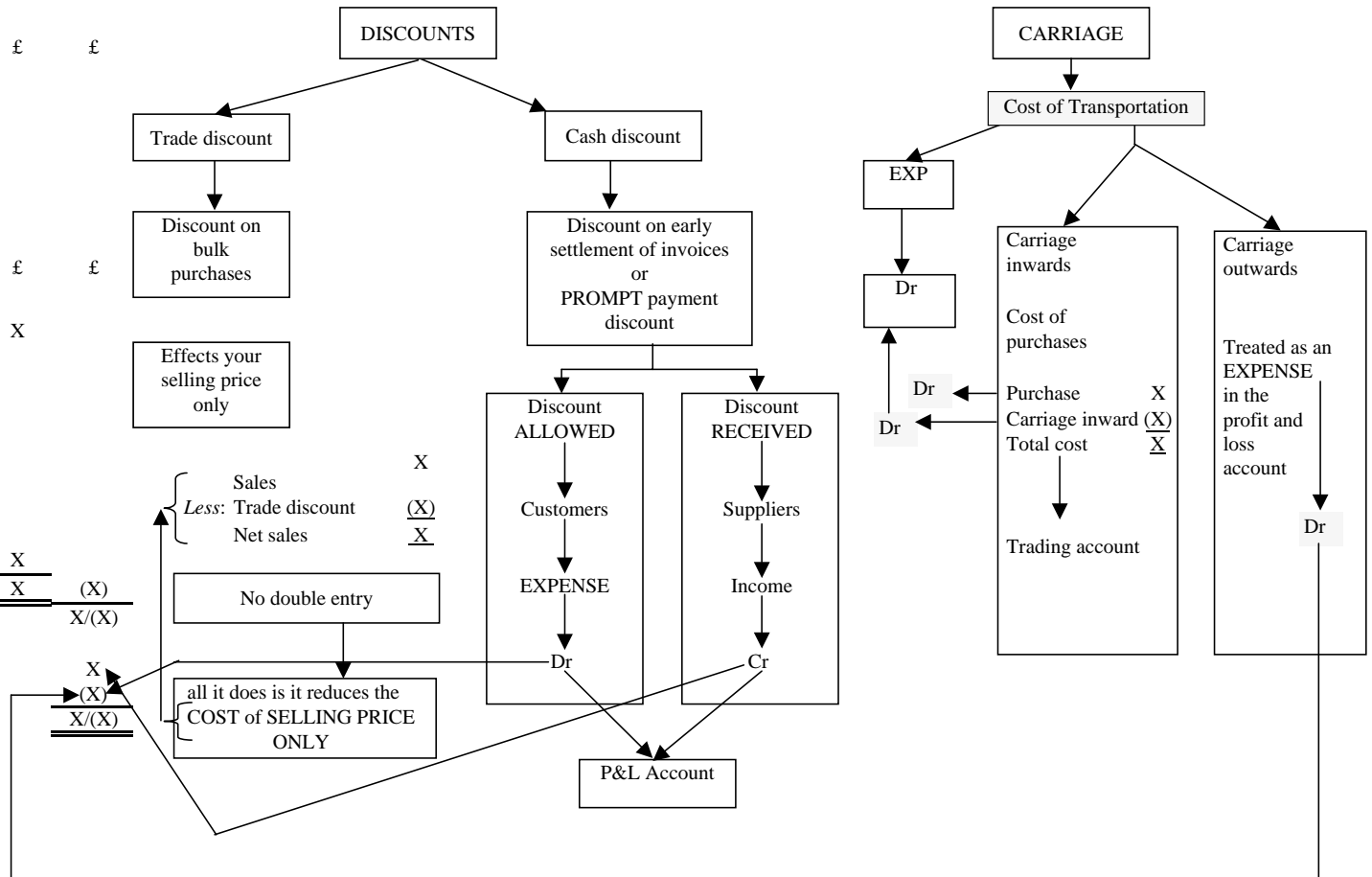
# 7

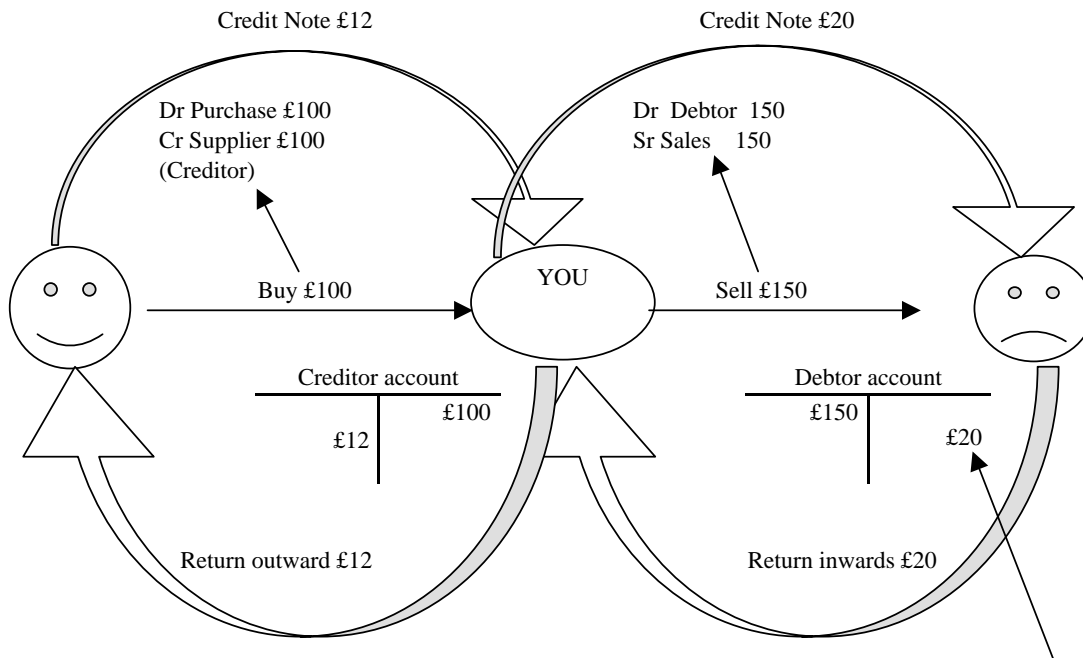




TRADING ACCOUNT  
TRADING and PROFIT and LOSS ACCOUNT

	£	£	£
Sales	X		
Less: Return inwards	(X)		
Less: Trade discount	(X)		
Less: VAT on sales	(X)		
Understated sales	X		
Less: Overstated sales	(X)		
Turnover	<u>X</u>		
	£	£	£
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		
	<u>X</u>		
Less: Closing stock	(X)		
	<u>X</u>	X	
Cost of goods sold		<u>X</u>	(X)
Gross profit/loss			<u>X/(X)</u>
Other income		X	
Other expense	(X)		
Net profit/loss		<u>X/(X)</u>	





*Debit note:* Reason it is called debit note is because we are debiting the creditor's account by the amount of returns to them.

*Debit Note £12*

*Credit note:* Reason it is called credit note is because we are crediting the debtors account by the allowance of the credit.

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.

Sales	
	Am Exp (1) 100

Bank	
Am Exp (2)	90

American Express			
Sales	(1) 100	Bank	(2) 90
			(3) 10

Commission	
Am Exp (3)	10



**? Revision question 7(A)**

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

	<i>Debit (£)</i>	<i>Credit (£)</i>
Sales		147,432
Returns	11,726	6,984
Discounts	1,742	2,534

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)**

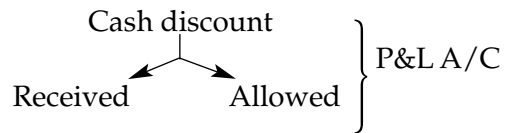
**✓ Answer to revision question 7(A)**

7.1 C

Net sales is calculated as follows:

	£
Sales	147,432
Less: Returns inwards	<u>(11,726)</u>
	<u>135,706</u>

Sales	147,432
Less: Trade discount	0
Less: Returns inwards	<u>(11,726)</u>
	<u>135,166</u>



**? 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
February	Sales	10 items at £60 each
March	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	£
Stationery	42.30
Travelling cost	76.50
Refreshments	38.70
Sundry creditors (£72.00 × 1.175)	<u>84.60</u>
	<u>242.10</u>

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

	<i>Quantity</i>	<i>Value (£)</i>	
6 × £30	6	180	
10 × £39.60	<u>10</u>	<u>396</u>	
	16	576	(£36 each)
10 × £36	(10)	(360)	
	<u>6</u>	<u>216</u>	
20 × £49	<u>20</u>	<u>980</u>	
	26	1,196	(£46 each)
5 × £46	(5)	(230)	
	<u>21</u>	<u>966</u>	

*Note:* Issues are shown in brackets

Trading account

	£	£
Sales (15 × £30)		900
Opening stock	180	
Add: Purchases	<u>1,376</u>	
	1,556	
Less: Closing stock	<u>(966)</u>	
		(590)
Profit		<u>310</u>

**? Revision questions 7(C)**

7.1 From the following information, calculate the value of purchases:

	£
Opening creditors	71,300
Cash paid	271,150
Discounts received	6,600
Goods returned	13,750
Closing debtors	68,900

**(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:

	£
Debtors at 1 January 2003	30,000
Debtors at 31 December 2003	27,000
Total receipts during 2003 (including cash sales of £15,000)	255,000

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:

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

$$\text{Purchases} = \text{£}360,400 - \text{£}71,300 = \text{£}289,100$$

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:

	£		£
Debtors at 1.1.93	30,000	Receipts less cash sales	240,000
Sales	?	Debtors at 31.12.93	27,000
	<u>267,000</u>		<u>267,000</u>

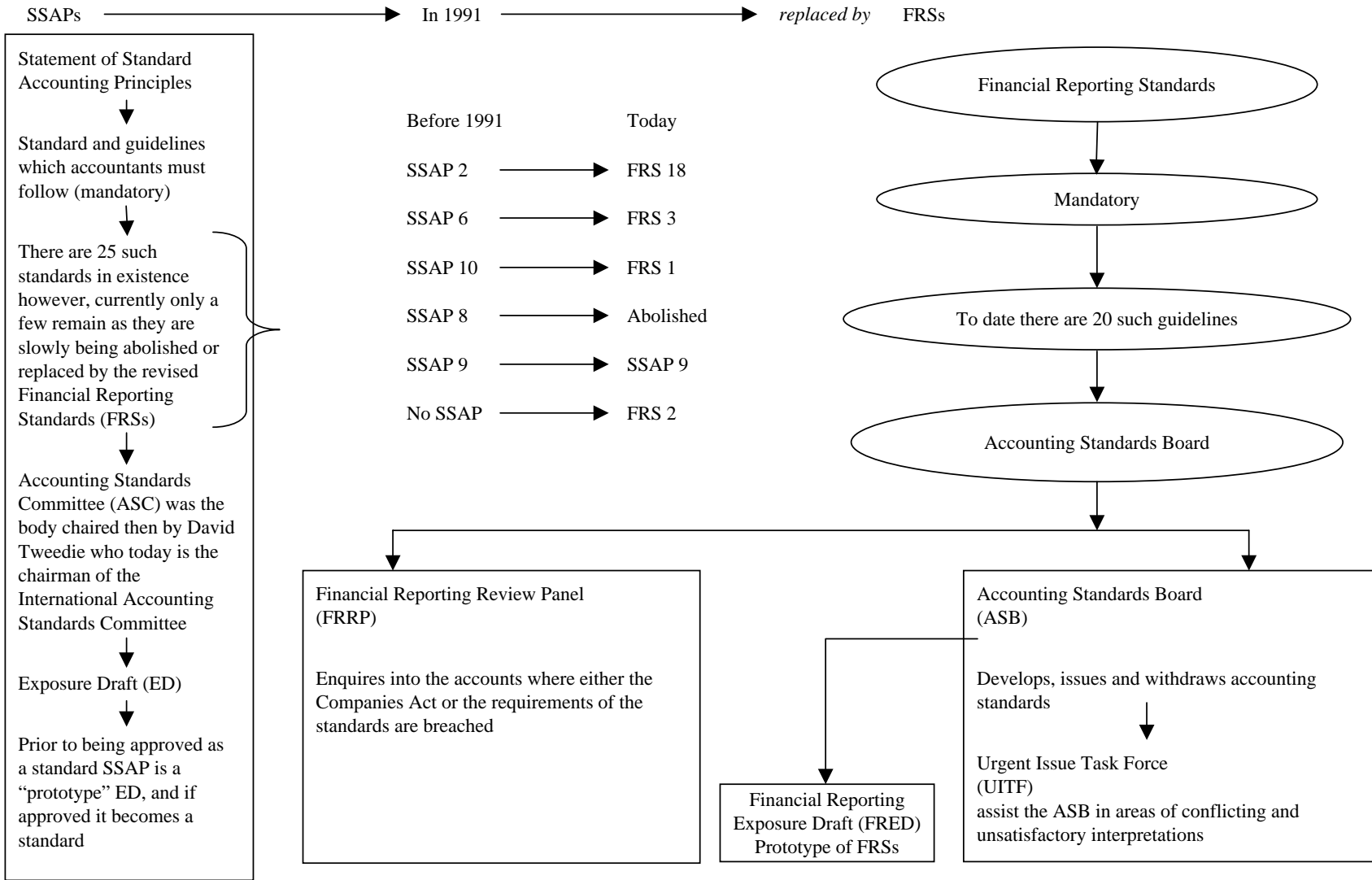
$$\text{Sales} = \text{£}267,000 - \text{£}30,000 = \text{£}237,000$$

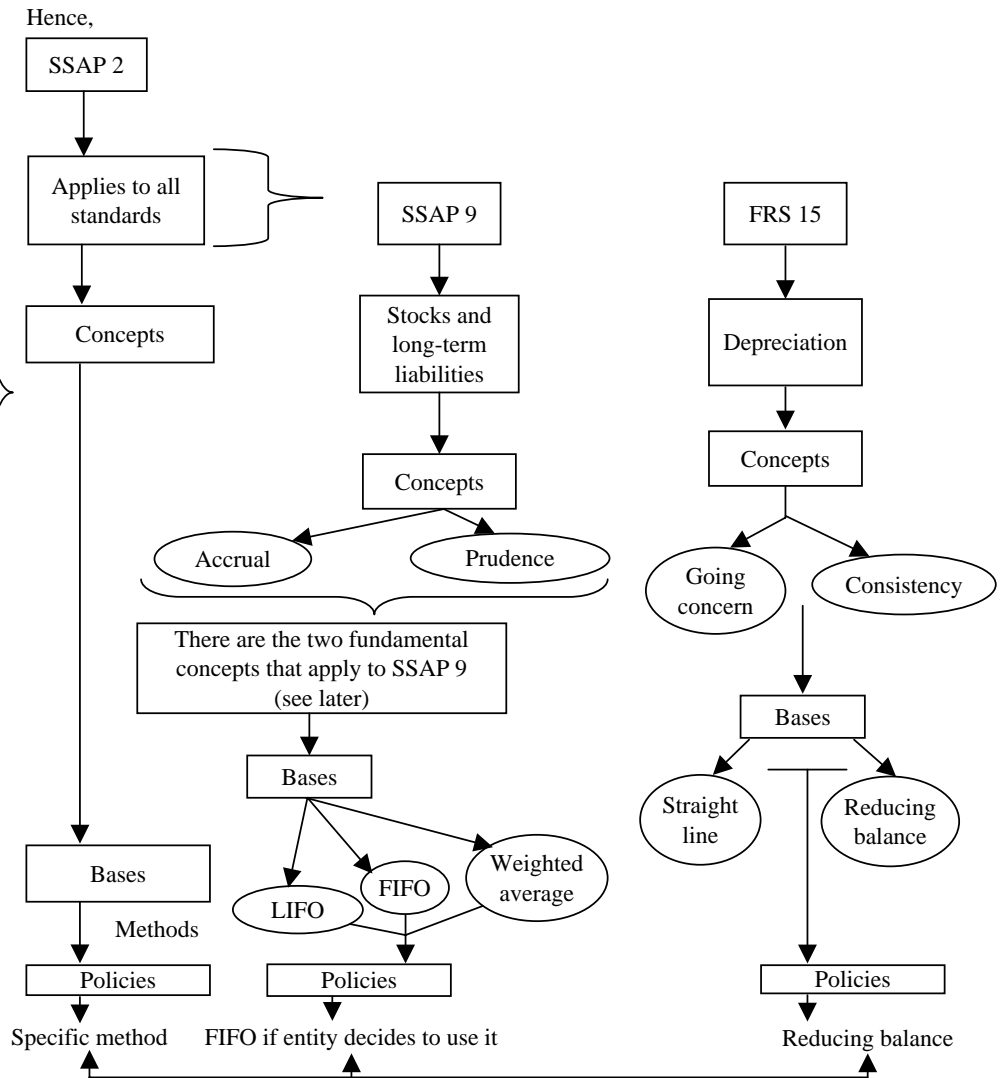
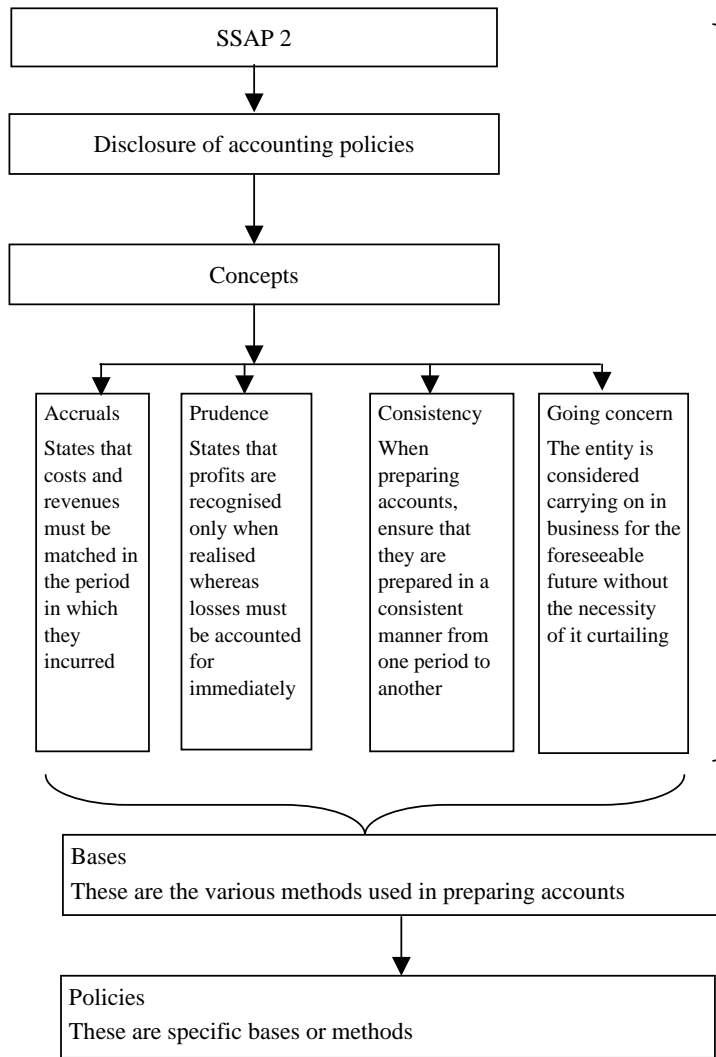
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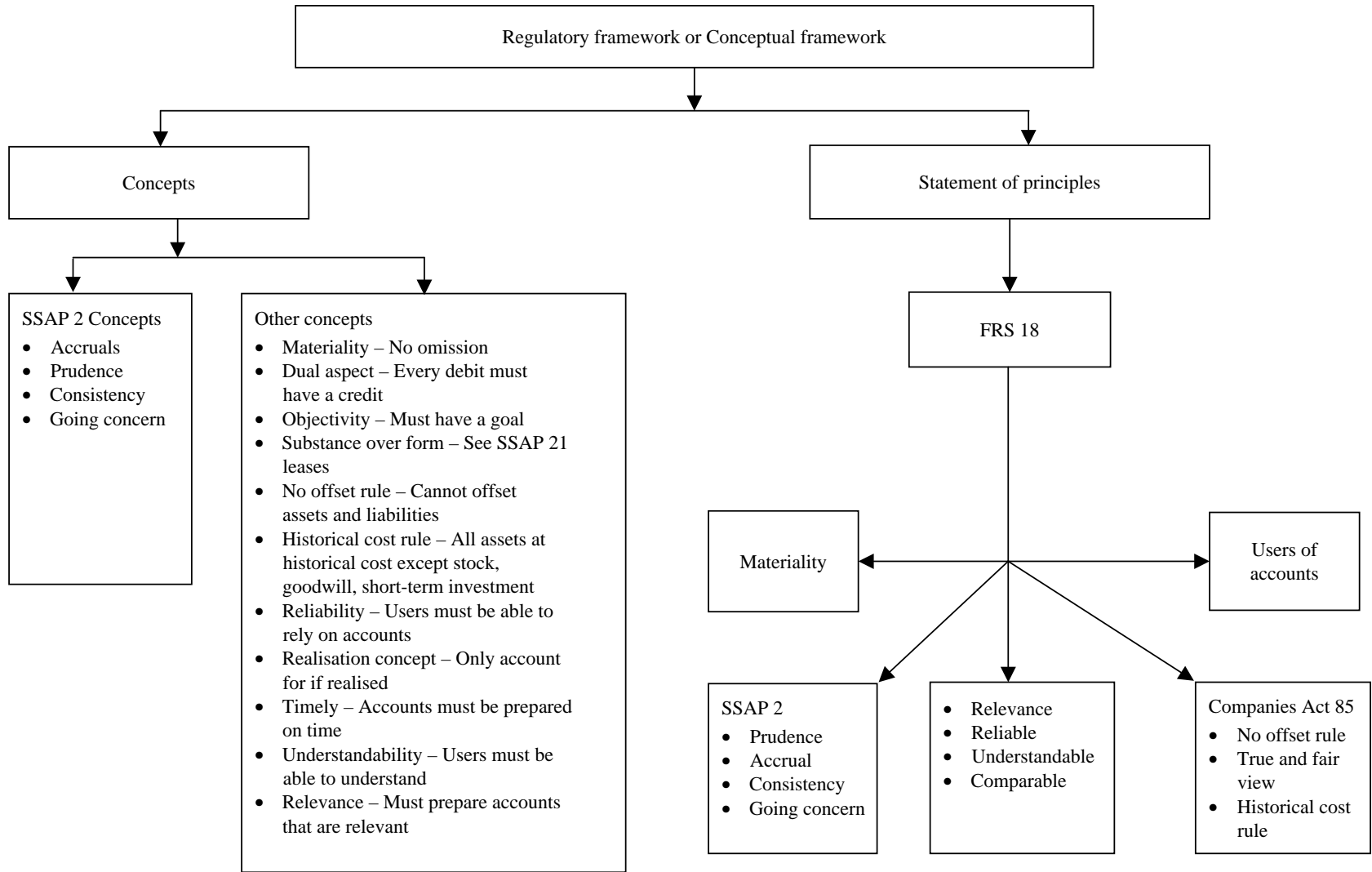
# The Regulatory Framework of Accounting

# 8









**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)**

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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 organisations'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)**

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- 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
- (2 marks)**
- 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.
- (2 marks)**
- 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
- (2 marks)**
- 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 overstating cash in the balance sheet
  - D overstating cash flow and understating cash in the balance sheet
- (2 marks)**
- 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.
- (2 marks)**
- 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
- (2 marks)**

## ✓ 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.



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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

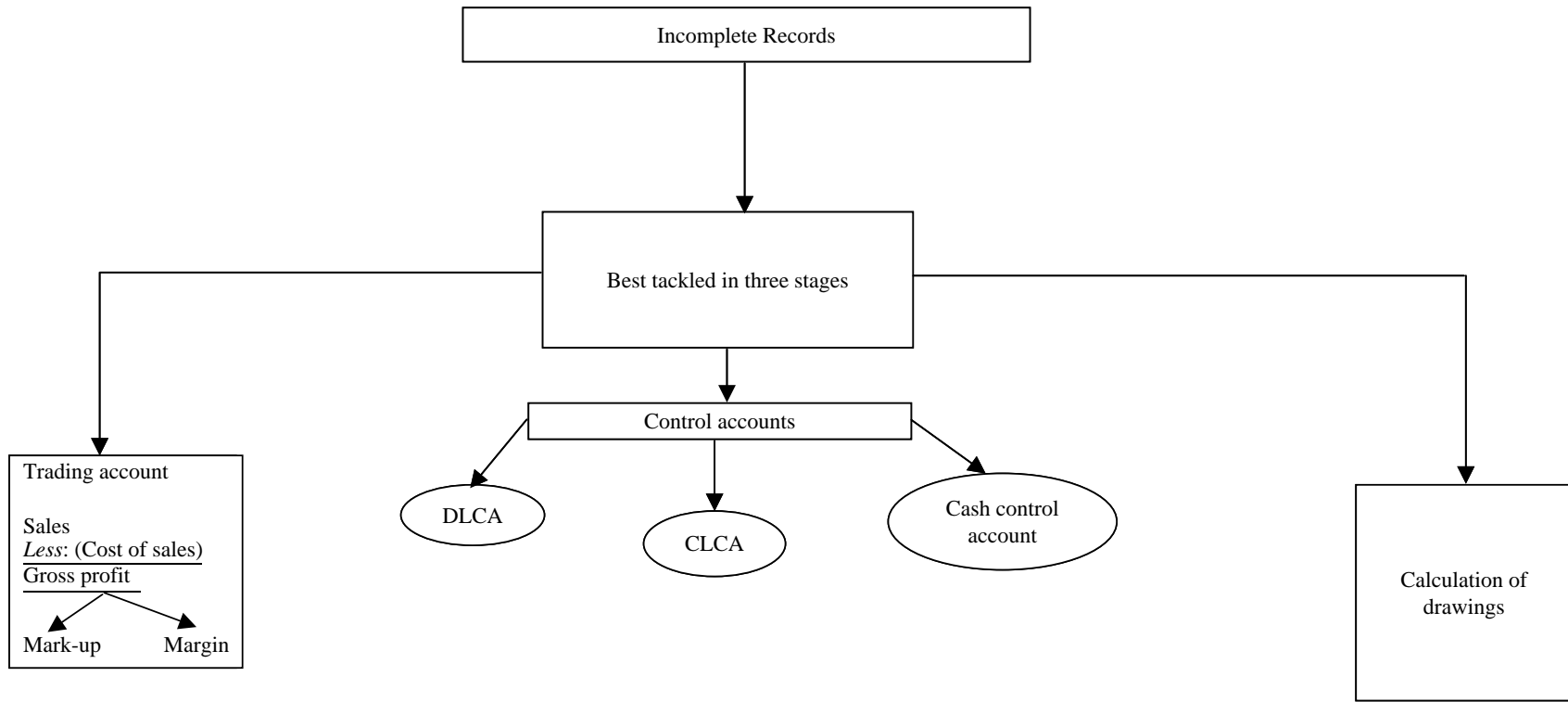
8.24 A

8.25 D

8.26 B

# Incomplete Records and Income and Expenditure Accounts

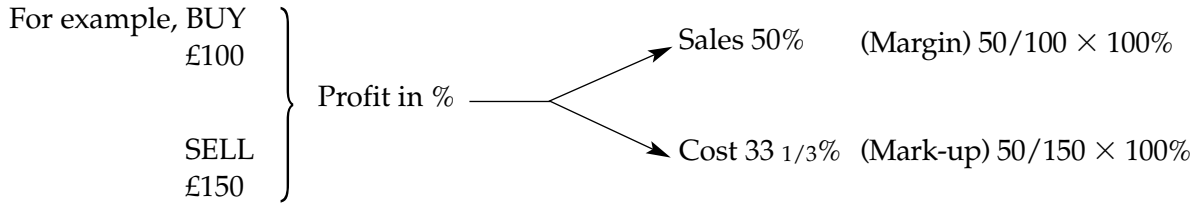
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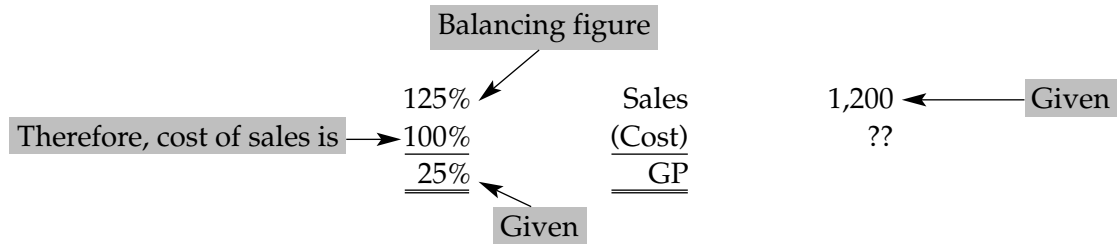
**Incomplete records**

**Reasons:**

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

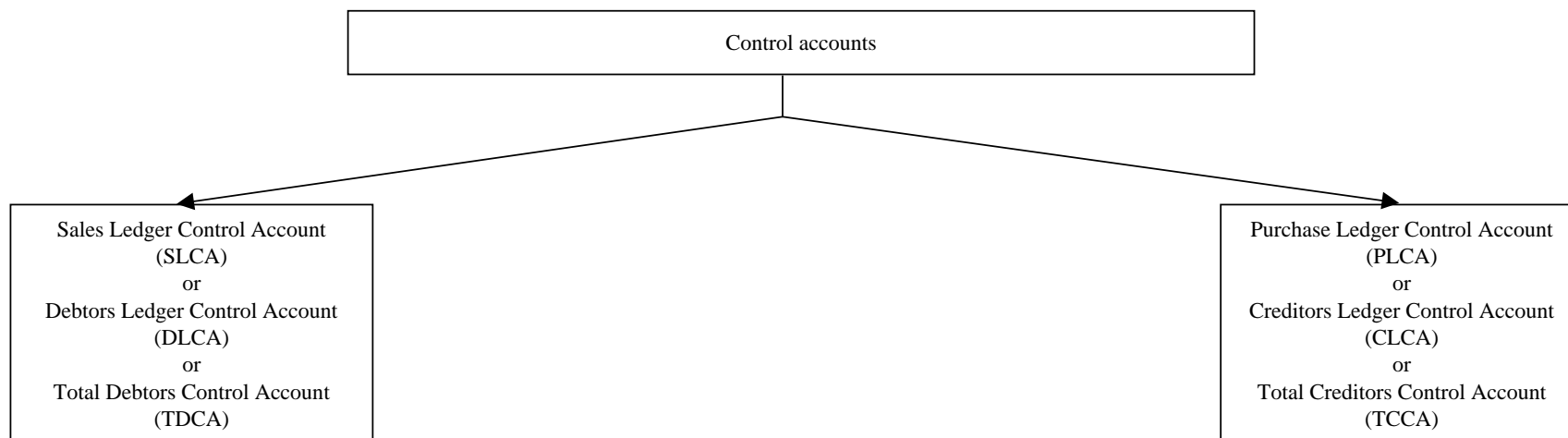


Calculate the cost of goods which have been sold for £1,200 on which a mark-up on cost of sales of 25% has been achieved.



Therefore, cost of sales =  $100/125 \times 1,200$   
 = £960





DLCA (Credit sales)

Bal b/f	X
For all other entries in this account this is the opposite entry	
XX	Creditors contra ₤      X Bal c/d                              X XX

CLCA (Credit purchases)

	Bal b/f      X
For all other entries in this account this is the opposite entry	
XX	Debtors contra ₤      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.

		DLCA				
Normal – not opposite	→	Bal b/f	X	Return inwards	X ←	These are debits as stock increases hence control accounts think opposite – credit
Sales are credit, hence debit control account	→	Sales as per sales day book	X	Bad debts	X ←	Bad debt is an expense which are debit hence control account think opposite – credit
		VAT on Sales	X	Cash from debtors	X ←	Cash received from debtors will be debit hence credit control account
		Refunds	X	Creditor’s control	X ←	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
Cheque that has been returned by the bank hence we will need to credit the original receipt of cheque therefore control account is opposite thus debit	→	Dishonoured cheques	X	Discount allowed	X ←	Expense to company hence debit, therefore opposite in control account – credit
		Bad debts written back	X	Creditors contra C	X ←	Normal – not opposite
		Bal c/d	X	Bal c/d	X ←	Normal – not opposite
			<u>XX</u>		<u>XX</u>	

### Dishonoured cheques

Reasons are as follows:

- (i) Insufficient funds
- (ii) Stale cheques (out of date) – more than 6 months old
- (iii) Words and figures (amount are different)
- (iv) Wrong signatures or not enough signatures
- (v) Stopped cheque
- (vi) “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

DLCA			
	£		£
Opening bal b/f	X	Amount received from debtors	X
Balancing figure sales	X	Closing bal c/d	X
	XX		XX

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

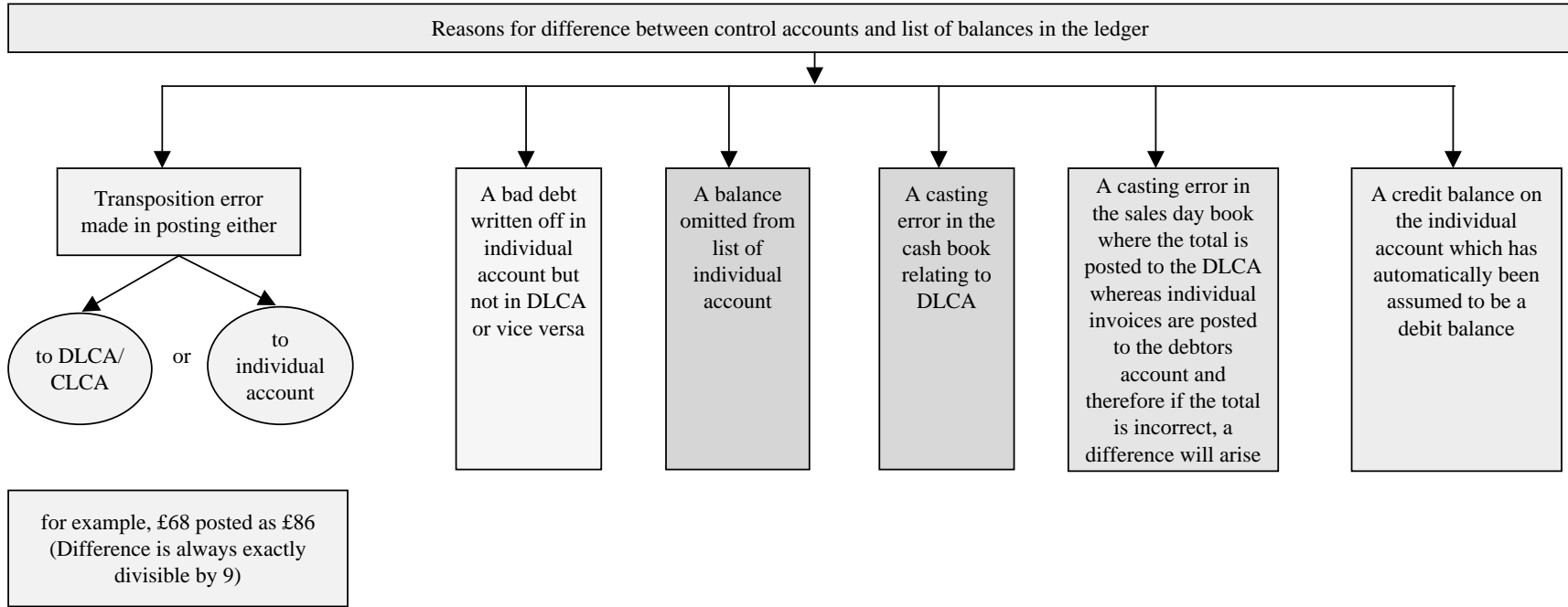
CLCA			
	£		£
Cash paid to creditor	X	Opening bal b/f	X
Closing bal c/d	X	Balancing figure purchases	X
	XX		XX

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

	£	£
Sales <i>(from DLCA if not given)</i>		X
Less: Opening stock	(X)	
Add: Purchases <i>(from CLCA if not given)</i>	X	
	X	
Less: Closing stock	(X)	
Cost of goods sold	X	(X)
Gross profit	X	X





**? Questions**

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			
	£		£
Cash sales	X	Bank	X
Capital	X	Wages	X
	<u>X</u>	Expenses	<u>X</u>
	<u>XX</u>		<u>XX</u>

**(2 marks)**

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

	£
Trade creditors at 31 December 2005	16,000
Trade debtors at 31 December 2005	12,000
Cash received from debtors	32,000
Cash paid to creditors	28,000
Mark-up on cost	30%

Calculate the closing stock at 31 December 2005.

**(8 marks)**

9.6 Devan had the following transactions relating to his business.

	£
Cash received from debtors	18,500
Due from debtors 1/1/2004	1,000
Opening stock	2,000
Closing stock	500
Due to suppliers 1/1/2004	750
Due to suppliers 31/12/2004	300
Cash paid to suppliers	1,200

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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

110%	Sales	6,160
100%	Cost of sales	(?)
	Gross profit	10%

Therefore, cost of sales =  $100/110 \times 6,160 = \text{£}5,600$

9.2 Sales

100%	Sales	??
80%	Cost of sales	(20,000)
	Gross profit	20%

Therefore, sales =  $100/80 \times 20,000 = \text{£}25,000$

9.3 Sales

133 $\frac{1}{3}$ %	Sales	??
100%	Cost of sales	(15,000)
	Mark-up	33 $\frac{1}{3}$ %

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

9.4 Gross profit on sales

	Sales	20,000
	Cost of sales	(16,000)
	Mark-up	<u>4,000</u>

Therefore, Gross profit =  $4,000/20,000 \times 100 = 20\%$

Gross profit on cost of sales

=  $4,000/16,000 \times 100 = 25\%$

9.5

CLCA			
	£		£
Paid to creditors	28,000	Bal b/f	Nil
Bal c/d	16,000	Purchases	44,000
		Balancing figure	
	<u>44,000</u>		<u>44,000</u>

since just started business

DLCA			
	£		£
Bal b/f	Nil	Received from debtors	32,000
Sales	44,000	Bal c/d	12,000
Balancing figure			
	<u>44,000</u>		<u>44,000</u>

since just started business

nil since started business current year	Sales		44,000
	Less: Opening stock	Nil	
	Add: Purchases	44,000	
		44,000	
	Less: Closing stock	?????	
		<u>?????</u>	
	Gross profit		<u>?????</u>

Balancing figure	→ 130%	Sales	44,000	← calculated in DLCA above
Q says on mark-up hence cost of sales becomes 100%	→ 100%	(Cost of sales)	??	
Given in Question	← 30%	(Gross profit)		

If 130% £44,000  
 Therefore 100% ?? Will be less  
 $100/130 \times 44,000$  £33,846

Sales		44,000
Less: Opening stock	Nil	
Add: Purchases	44,000	
	44,000	
Less: Closing stock	10,154	
Cost of sales	<u>33,846</u>	← 33,846
		<u>10,154</u>

Balancing figure

Hence closing stock will be £10,154.

9.6 (i) B

To calculate sales, prepare DCLA.

DLCA			
	£		£
Bal b/f	1,000	Received from debtors	18,500
Sales	17,500	Bal c/d	nil
Balancing figure			
	18,500		18,500

Sales = £17,500

(ii) B

To calculate purchases, prepare CLCA.

CLCA			
	£		£
Paid to creditors	1,200	Bal b/f	750
Bal c/d	300	Purchases	750
		Balancing figure	
	1,500		1,500

Purchases = £750

(iii) A

To calculate Gross profit:

	£	£
Sales		17,500
<i>Less:</i> Opening stock	2,000	
<i>Add:</i> Purchases	750	
	2,750	
<i>Less:</i> Closing stock	(500)	
Cost of goods sold	2,250	(2,250)
Gross profit		15,250

(iv) D

Gross profit as % of sales

$$\frac{\text{Gross profit}}{\text{Sales}} \times 100\% = (15,250/17,500) \times 100$$

$$= 87\%$$

(v) A

Gross profit as % of cost of sales

$$\frac{\text{Gross profit}}{\text{Cost of sales}} \times 100\% = (15,250/2,250) \times 100$$

$$= 677\%$$

Non-profit-making organisation

<u>Profit-making organisation</u>	replaced by →	<u>Non-profit-making organisation</u>
Trading and profit and loss A/C		Income and expenditure A/C Receipt and payment A/C
Balance sheet	replaced by →	Statement of affairs
Net profit	replaced by →	Surplus of income over expenditure
Net loss	replaced by →	Deficit of expenditure over income
Capital	replaced by →	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
- (2 marks)**
- 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
- (2 marks)**
- 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
- (2 marks)**
- 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
- (2 marks)**
- 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
- (2 marks)**
- 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
- (2 marks)**



- 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

Subscription paid			
Bal b/f	1,600	Received	25,000
Bal c/f	800	Arrears c/d	500
Income and expenditure account	23,100		
	25,500		25,500

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

	£
Received in year	62,250
Arrears at beginning	(250)
In advance at beginning	375
In advance at end	(600)
Total to income and expenditure	61,775

Subscriptions account (Income account)

	£		£
Arrears b/f	250	Prepayment b/f	375
Balancing figure	61,775	Received	62,250
Advance bal c/d	600		
	62,625		62,625

9.7 B

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# Manufacturing Accounts

# 10

## Introduction

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

	£	£
Sales		X
Opening stock	X	
<i>Add:</i> Purchases	<u>X</u>	
	X	
<i>Less:</i> Closing stock	<u>(X)</u>	
Cost of sales		(X)
Gross profit		<u>X</u>

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:

	£
Direct materials	X
Direct labour	X
Direct expenses	X
Prime cost	<u>X</u>
Manufacturing overheads	X
Factory cost	<u>X</u>

### Pro forma manufacturing account

	£	£
Materials consumed		
Opening stock of raw materials	X	
<i>Add:</i> Purchases of raw materials	<u>X</u>	
	X	
<i>Less:</i> Closing stock of raw materials	<u>(X)</u>	
		X
Direct wages		X
Direct expenses		<u>X</u>
Prime cost		X
Works indirect expenses		
Factory power	X	
Factory rent/rates	X	
Factory insurance	X	
Factory light and heat	X	
Plant repairs	X	
Plant depreciation	<u>X</u>	
		X
<i>Add:</i> Opening work-in-progress		X
<i>Less:</i> Closing work-in-progress		<u>(X)</u>
Factory cost of goods produced – transfers to warehouse		<u>X</u>

## 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:

### Trading and profit and loss account

	£	£
Sales		X
<i>Less: Cost of goods sold</i>		
Opening stock of finished goods	X	
<i>Add: Transfers from factory</i>	X	
	<u>X</u>	
<i>Less: Closing stock of finished goods</i>	(X)	
Gross profit		(X)
<i>Less: Distribution costs</i>	X	<u>X</u>
Administrative expenses	<u>X</u>	
Net profit		<u><u>X</u></u>

**? Revision questions 10**

10.1 The following information relates to a company at its year end:

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

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:

	£
Prime cost	112,000
Factory overheads	9,000
Opening work-in-progress	12,400
Factory cost of goods completed	114,000

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:

	£
Opening stock of raw materials	20,000
Purchases of raw materials	100,000
<i>Less:</i> Closing stock of raw materials	<u>(22,000)</u>
	98,000
Direct wages	<u>80,000</u>
Prime cost	178,000
Production overheads	<u>120,000</u>
	298,000
<i>Less:</i> Increase in work-in-progress	<u>(4,000)</u>
Cost of goods manufactured	<u><u>294,000</u></u>

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

	£
Prime cost	112,000
Factory overheads	9,000
Opening work-in-progress	12,400
Factory cost of goods completed	<u>(114,000)</u>
Closing work-in-progress	<u><u>19,400</u></u>

10.5 D

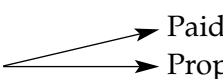


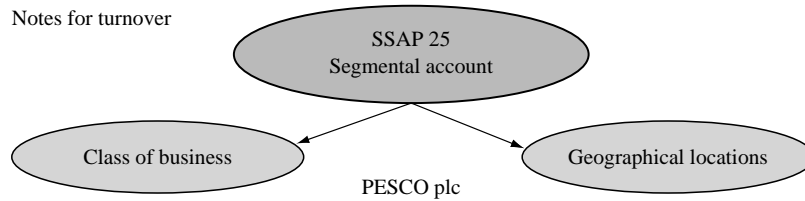
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# The Accounts of Limited Companies

# 11

## Profit and loss account

Turnover (Working 1)	A	X	
Cost of sales (Working 2)	B	<u>(X)</u>	
Gross profit/(loss)		X/(X)	
Selling and distribution expense	C	(X)	
Administration expense	D	(X)	
Interest payable and similar charges	E	(X)	
Other operating income	F	<u>X</u>	
Operating profit/PBT, profit before interest and tax (PBIT)/Profit on ordinary activities before tax (POOABT)		X	
Tax		<u>X</u>	
Profit after tax		X	
Dividends 		(X)	
Retained profit for the year		<u>(X)</u>	
Profit b/f		X/(X)	
Profit c/f		<u>X</u>	
Working 1			
Turnover	} made up of	Sales	X
		- Sales return	(X)
		- Trade discount	(X)
		- VAT on sales	(X)
		- Overstated sales	(X)
		+ Understated sales	<u>X</u>
Turnover	A	<u>X</u>	



	£m		£m
50% Retail	50	80% UK	80
10% Wholesale	10	15% Europe	15
10% Service industry	10	5% Rest of the	
30% Manufacturing	30	World (ROW)	5
	<u>100</u>		<u>100</u>

Working 2

Cost of sales } } made up of	Opening stock		X
	+ Purchases	X	
	+ Carriage inwards	X	
	– Return outwards	(X)	
	– Overstated purchases	(X)	
	+ Understated purchases	X	
	– VAT on purchases	(X)	
		<u>X</u>	
	– Closing stock	(X)	
	Cost of goods sold		<u>(X)</u>
	Cost of sales	B	<u><u>X</u></u>

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	
	<u>X</u>	C

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	X	D
	<u>X</u>	

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 → Direct debits, Standing orders and so on	X
		<u>X</u>
(iv) Commission charges		E <u><u>X</u></u>

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	<u>X</u>
	F <u><u>X</u></u>

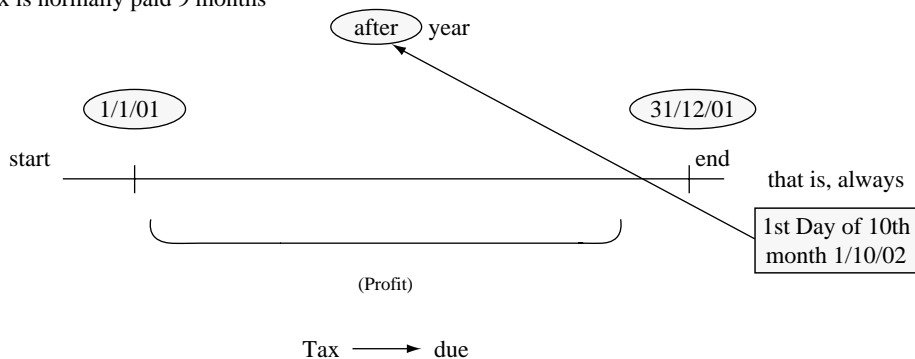
Taxation

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.

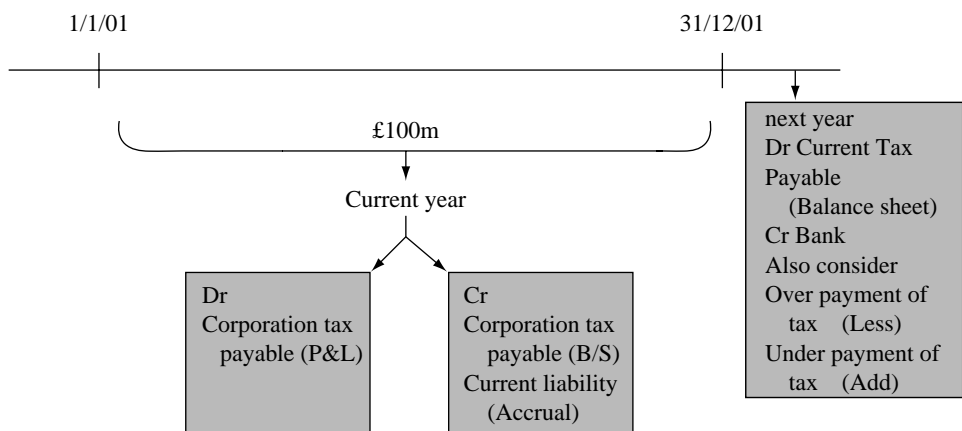
*Note:* The rate of tax, say 30%, was calculated using the UK corporation tax system.

Tax is normally paid 9 months

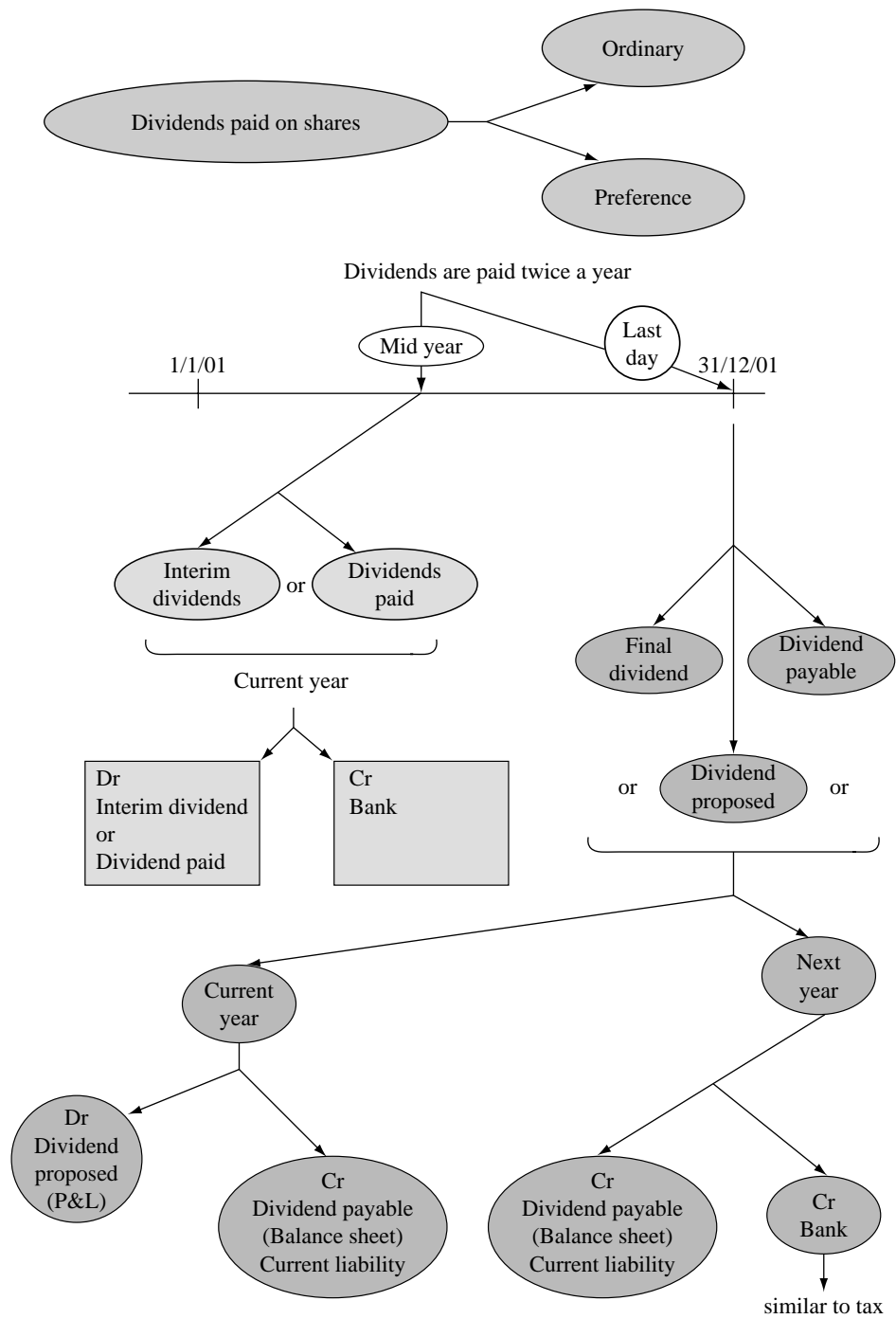


For example, Year end 1/3/02	tax due	1/12/02
Year end 30/3/02	tax due	1/1/03

Accounting Treatment



Dividends



Types of shares

*Preference shares*

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

*General differences*

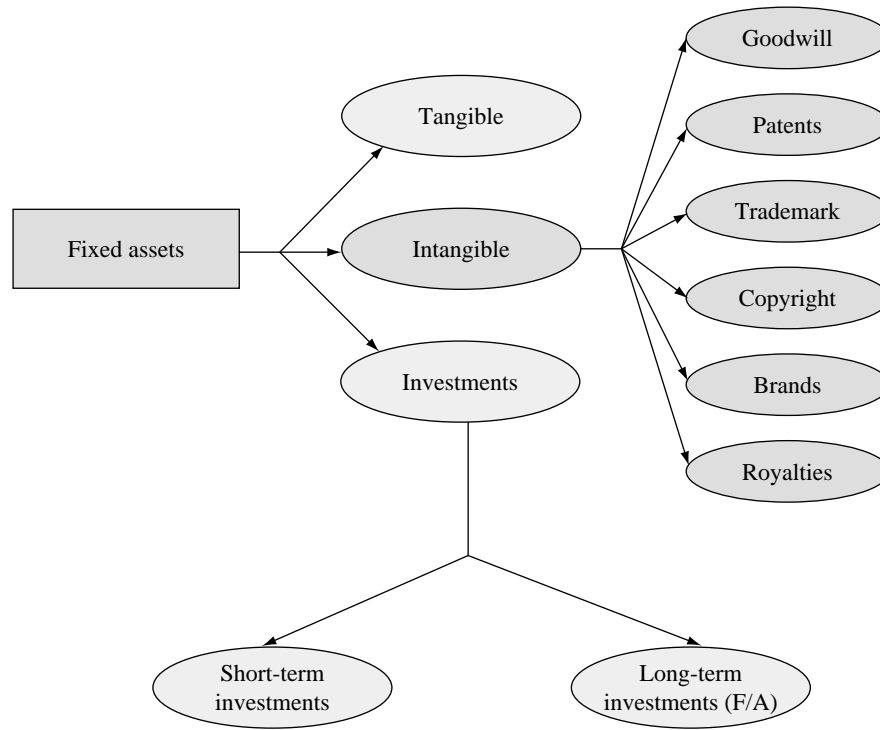
- Fixed Amount of Dividends
- Liquidation
- Profit
- Loss
- Common
- Owner
- VOTE

*Ordinary shares*

- Fluctuate
- Paid last
- Not necessary to pay dividend
- No dividends
- More common
- Owners
- Voting rights

Balance sheet

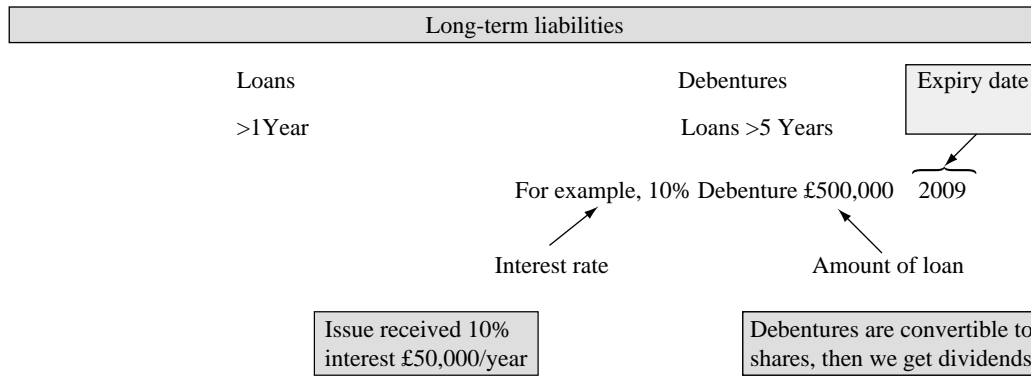
	<i>Cost</i>	<i>Accumulated depreciation</i>	<i>Net book value</i>
Fixed assets			
Land and building	X	(X)	X
Plant and machinery	X	(X)	X
Motor van	X	(X)	X
Fixtures and fittings	<u>X</u>	<u>(X)</u>	<u>X</u>
	<u>X</u>	<u>(X)</u>	<u>X</u>
Current assets			
Stock	X		
Debtors	X		
Short-term investment	X		
Prepayments	X		
Bank	X		
Cash	<u>X</u>		
		X	
Current liability < 1 Year			
Overdraft	X		
Trade creditors	X		
Accruals	X		
Taxation	X		
Dividends proposed	<u>X</u>		
		<u>(X)</u>	
Net current assets or working capital		X	
Long-term liabilities > 1 Year			
Long-term loans		(X)	
Debentures		<u>(X)</u>	
Total assets less liabilities			<u>(XX)</u>
Capital			<u>XX</u>
Share capital		X	<div style="border: 1px solid black; padding: 5px; display: inline-block;">                     Must be the same                 </div>
Share premium		X	
Profit and loss		X	
Reserves		X	
		<u>X</u>	<u>XX</u>



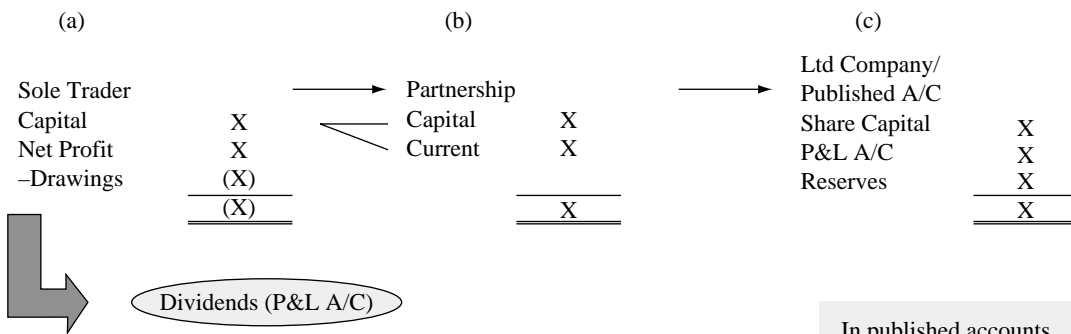
	<i>Market value</i>	<i>Book value</i>	
	£	£	
(i)	100	150	If examiner provides you with both market value and book value, always show book value
(ii)	150	100	If market value > book value then show market value in the notes to the accounts, that is disclose market value

Stock

Raw material	X
Work-in-progress	X
Finished goods	X
Consumables	<u>X</u>
	<u>X</u>



Bottom half of balance sheet for:



In published accounts, there are no drawings, these are replaced by dividends and shown in the profit and loss account

### 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



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If the share price fluctuate (increase/decrease) in the market, then the share capital is never effected. 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.

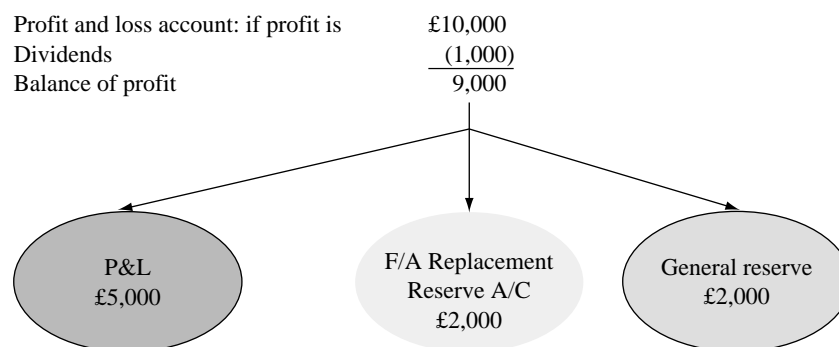
Company issues £10,000 50p ordinary shares and declares a dividend of 10p/share.

Convert the £ = shares

£10,000 = 50p shares

How many shares	20,000
	$\times 0.10$
Dividends	<u>2,000</u>

### RESERVES



## ? 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

(2 marks)

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

	<i>Debit</i>	<i>Credit</i>
	£	£
Share premium		
Share capital		
Bank		

(2 marks)

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.

(2 marks)

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

(2 marks)

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

(2 marks)

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

(2 marks)

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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	<i>Debit</i>	<i>Credit</i>
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	<u>6,000</u>
Net cash inflow	10,000
Purchase of fixed assets	(12,500)
Decrease	<u>(2,500)</u>

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

# 12

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

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

Notes to the cash-flow statement

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

Operating profit	X
Depreciation charges	X
Loss on sale of tangible fixed assets	X
Increase in stocks	(X)
Increase in debtors	(X)
Increase in creditors	X
Net cash inflow from operating activities	<u>A</u>

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

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

3 Analysis of changes in net debt

	<i>At 1 April</i> 1991	<i>Cash</i> <i>flows</i>	<i>Other</i> <i>changes</i>	<i>At 31</i> <i>March 1992</i>
	£	£	£	£
Cash in hand, at bank	X	X		X
Overdrafts	(X)	X		
		D		
Debt due within 1 year	(X)	C	(X)	(X)
Debt due after 1 year	(X)		X	(X)
Current asset investments	X	B		X
Total	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>

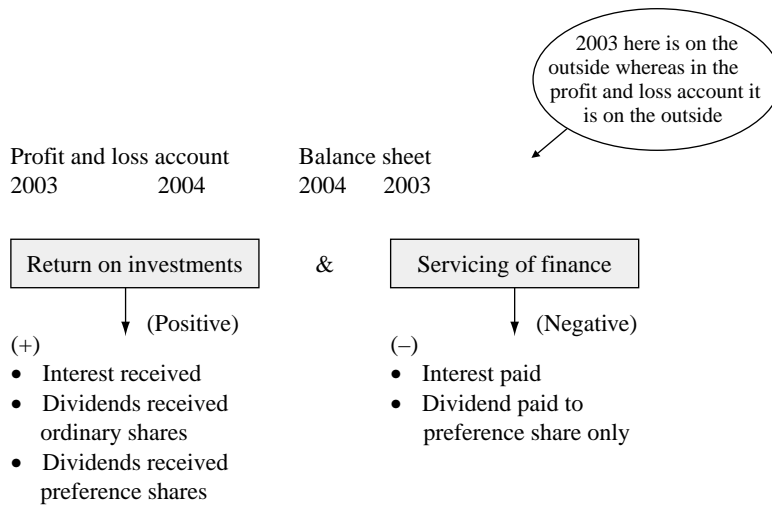
Cash-flow statement FRS 1 (R96)

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]

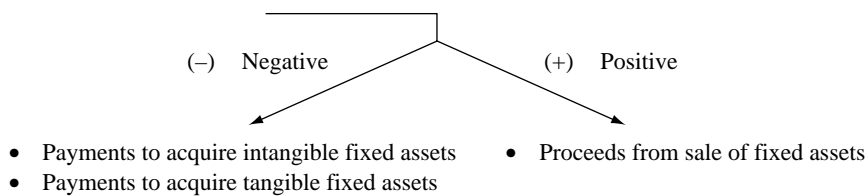
- There are no accruals effects in this topic, in other words everything is cash.
- One would normally expect a profit and loss account to be before the balance sheet, however in the exam, watch out the examiner tends to show the balance sheet before the profit and loss account.
- Always circle the years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

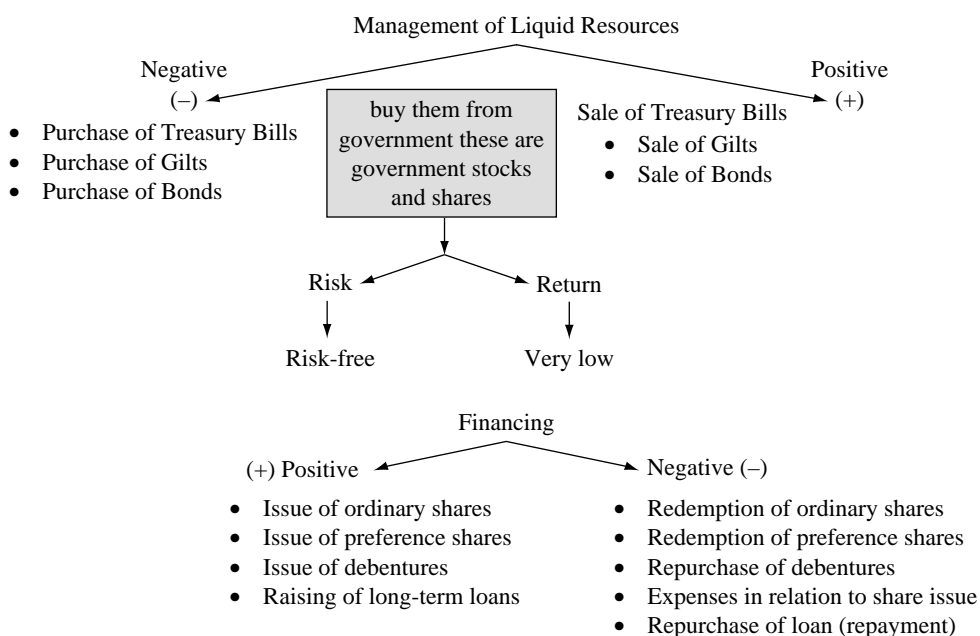
**Capital expenditure**



*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.





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:

Balance Sheet at 30 April 2005

	2005 £'000	2004 £'000
Fixed assets (Note)	<u>1,473</u>	<u>1,929</u>
Current assets		
Stocks	2,679	2,064
Trade debtors	2,379	1,818
Cash at bank and in hand	<u>21</u>	<u>30</u>
	<u>5,079</u>	<u>3,912</u>
Creditors due within one year		
Trade creditors	1,749	1,689
Dividends proposed	186	84
Taxation	<u>132</u>	<u>36</u>
	<u>(2,067)</u>	<u>(1,809)</u>
Creditors due after more than one year		
Loans and debentures	<u>(1,248)</u>	<u>(1,665)</u>
	<u>3,237</u>	<u>2,367</u>
Share capital	2,460	2,154
Profit and loss account	<u>777</u>	<u>213</u>
	<u>3,237</u>	<u>2,367</u>

*Note*

Fixed assets

1 Freehold property	£'000
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	<i>Cost</i> £'000	<i>Depreciation</i> £'000
On 30 April 2004	846	285
Additions at cost	159	
Disposals	(327)	(75)
Provision for the year		18
On 30 April 2005	<u>678</u>	<u>228</u>

## Profit and loss account for the year ended 30 April 2005

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

**(25 marks)**

## Cash-flow statement

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

## 134 Exam Practice Kit: Financial Accounting Fundamentals

### Note (1)

Reconciliation of operating profit to net cash inflow from operating activities

	£	£
Above interest 117 add		
Ignore it below interest		
→ Operating profit (PBIT) 870 + 117		987
Depreciation (non-cash item)		18
Amortisation (+)		X
Provision for bad debts		
Increase		X
Decrease		(X)
Any other provision		X/(X)
Loss on sale of fixed assets	X	
Profit on sale of fixed assets	(615)	
+ in stock	(615)	
– in stock	X	
+ in debtors	(555)	
– in debtors	X	
+ in creditors	60	
– in creditors	<u>(X)</u>	
Net cash flow		<u>(720)</u>

#### Dividend/Interest/tax

<b>Cash paid</b> (Balancing figure)	X	Bal b/f (B/S) proposed year	X
Bal c/d (B/S) current year	X	Cash received (Balancing figure)	X
		P&L (current year)	X
	<u>XX</u>		<u>XX</u>

#### Dividend account

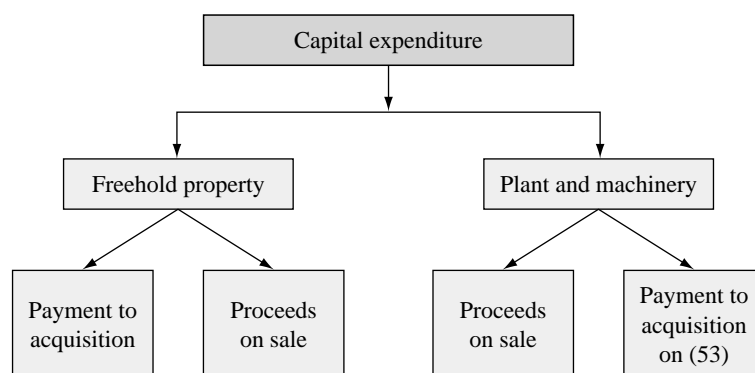
<b>Cash paid</b> (Balancing figure)	84	Bal b/f (B/S) previous year	84
Bal c/d (B/S) current year	186	P&L	186
	<u>270</u>		<u>270</u>

#### Tax

<b>Cash paid</b> (Balancing figure)	24	Bal b/f (B/S) previous year	36
Bal c/d (B/S) current year	132	P&L (current year)	120
	<u>156</u>		<u>156</u>

#### Interest

<b>Cash paid</b> (Balancing figure)	117	Bal b/f previous year	0
Bal c/d	0	P&L (current year)	117
	<u>117</u>		<u>117</u>



## F/A Disposal account

Cost	327	Accumulated depreciation	75
Profit	45	Sales proceeds	297
	<u>372</u>		<u>372</u>

START	1,315	1,315 GIVEN
D isposal	(705)	Profit on sale of fixed asset
A ddition	360	1,275 – 705 = 570
R evaluation	X/(X)	Total profit 615
T ransfer	X/(X)	
End	1,020	Therefore profit 45

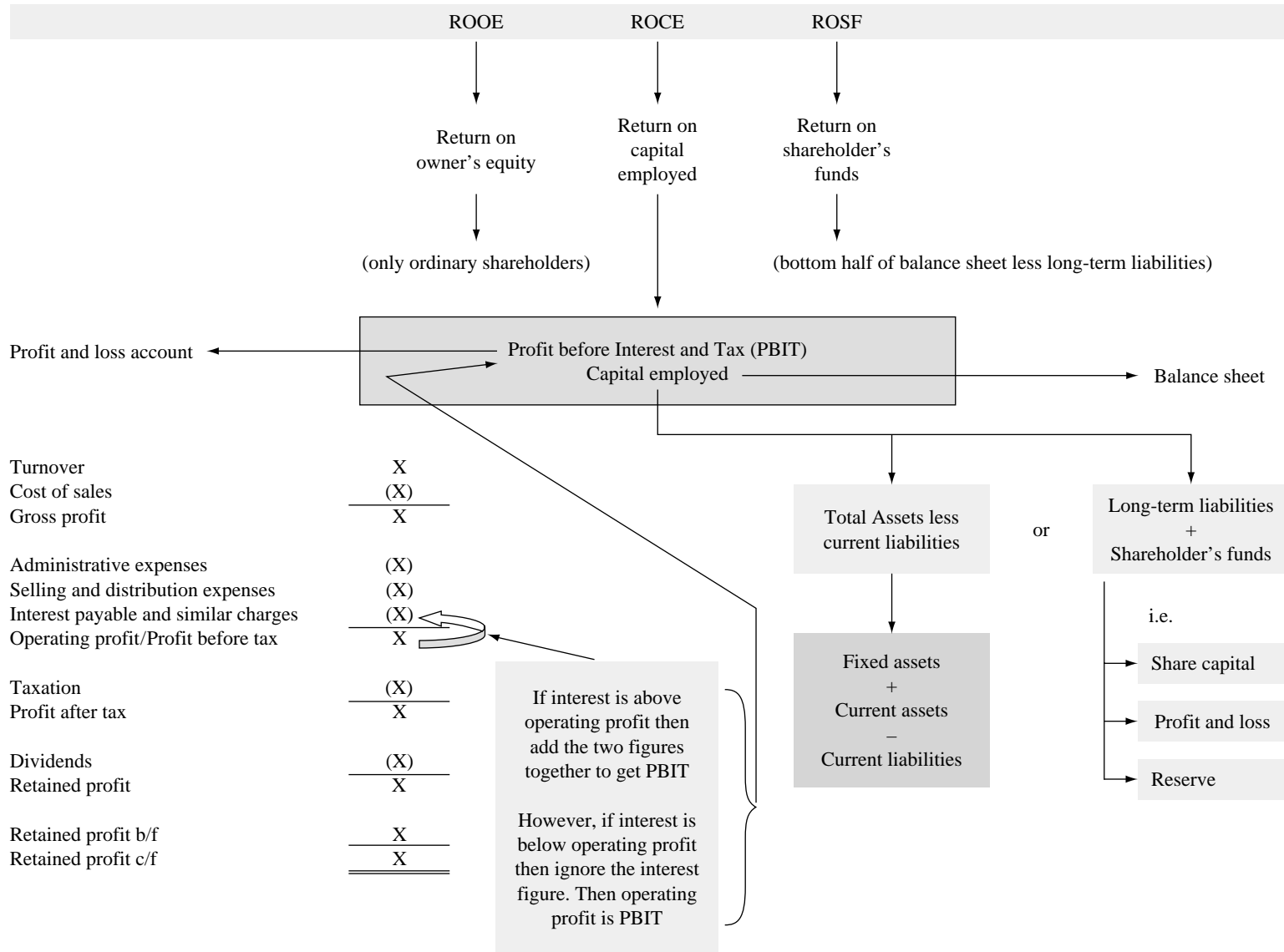
	£	£
Addition F/A	(360)	
Proceed F/A	1,275	
Proceeds plant	297	
Payment plant	<u>(159)</u>	
	1,053	

	<i>Start</i>	<i>C/f</i>	<i>End</i>
Cash	30	(9)	21
c/d	–	–	–
Debt < 1 Year	–	–	–
Debt > 1 Year	(1,665)	417	(1,248)
	(1,635)	408	(1,227)

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# Interpretation of Accounts

# 13



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.

GROSS PROFIT

$$\frac{\text{GP}}{\text{Sales}} \times 100 = a\%$$

(Turnover)

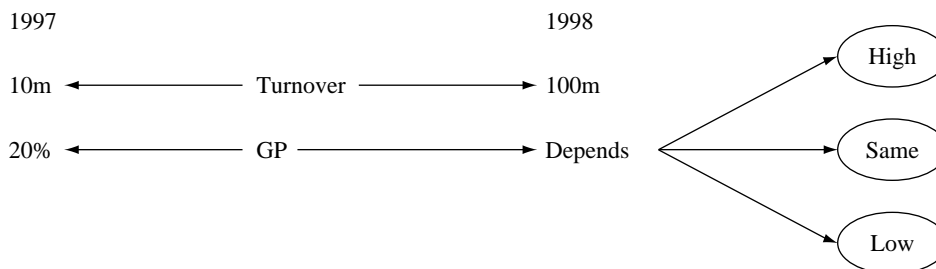
Say it is 20%

At £100 sales you made £20 profit before expenses

NET PROFIT

$$\frac{\text{Net profit}}{\text{Sales}} \times 100 = b\%$$

For example



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

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

$$\text{Average stock} = (\text{Opening stock} + \text{Closing stock})/2$$

For example,

1997	1998
6 times	10 times

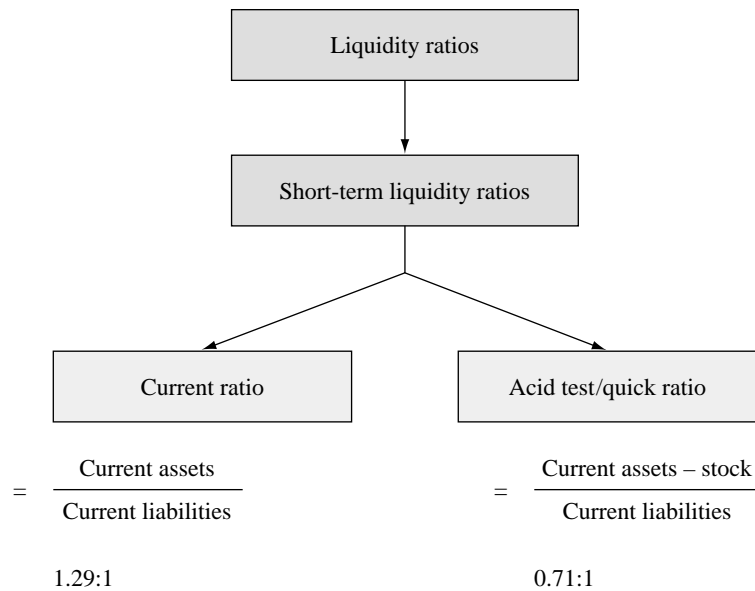


Convert the answer in no. of   
   → Days           365  
   → Weeks        52  
   → Months      12

1997           1998  
 365/6        365/10  
 61 days     37 days

**Reasons for increase in stock turnover**

- (i) Increase in demand for goods
- (ii) Good sold on special offer
- (iii) Heavy Advertising on special offer
- (iv) Monopolistic position in the market, that is you are the only one there.



**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.

**? 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:

	£	£
Sales turnover		90,000
Opening stock	8,000	
Add: Purchases	<u>53,000</u>	
	61,000	
Less: Closing stock	<u>12,000</u>	
		<u>49,000</u>
Gross profit		<u>41,000</u>

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

		£
Selling price (SP)	140	700
Cost of sales (COS)	100	<u>???</u>
Gross profit	40	<u>???</u>

$$\text{Cost of sales} \times 140/100 = 700$$

$$\text{Cost of sales} = 700/1.4 = 500$$

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

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

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

	£
Opening stock	24,000
Purchases	<u>160,000</u>
	184,000
Less: Closing stock	<u>(20,000)</u>
Cost of goods sold	<u>164,000</u>

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.

$$\text{Average stock} = (8,000 + 12,000)/2 = \text{£}10,000$$

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.

## 13.7 D

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 Examination

# 14

## ? 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?

<i>Debit</i>	<i>Credit</i>
A Purchase	Debtors
B Purchases	Creditors
C Creditors	Purchases
D Creditors	Cash

(2 marks)



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- 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?

	<i>Debit</i>	<i>Credit</i>
A	Cash	Sales
B	Cash	Debtors
C	Sales	Cash
D	Creditors	Cash

**(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?

	<i>Debit</i>	<i>Credit</i>
A	Sales	Cash
B	Sales	Debtors
C	Cash	Sales
D	Cash	Debtors

**(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:

	<i>Closing balance</i>	<i>Opening balance</i>
Rates prepayment	90	60
Rent accrual	360	300

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)**

**150** Exam Practice Kit: Financial Accounting Fundamentals

- 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.

	£
Total debtors	420,000
Bad debts written off (not previously provided for)	3,000
Provision at 1 January 1993	30,000

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:

	<i>Cost</i> £	<i>Selling price</i> £
A	3,600	4,500
B	18,600	18,300
C	2,760	2,790

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?

	<i>Debit</i>	<i>£</i>	<i>Credit</i>	<i>£</i>
A	Suspense account	1,080	Purchase returns	1,080
B	Purchase returns	1,080	Suspense account	1,080
C	Suspense account	50,640	Purchase returns	50,640
D	Purchase returns	50,640	Suspense account	50,640

**(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)	Uncleared 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?

	<i>Debit</i>	<i>£</i>	<i>Credit</i>	<i>£</i>
A	Suspense account	780	Cash	780
B	Bank charges	120	Cash	900
	Suspense	780		
C	Cash	780	Suspense account	780
D	Cash	780	Bank charges	120
			Suspense account	780

**(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)

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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

$$30,000 - 15,000 + / - \text{net profit or net loss} + 9,000 = 54,000$$

$$24,000 + / - \text{profit/loss} = 54,000$$

$$\text{Profit} = \text{£}30,000$$

2 B

$$54,000 - 18,000 + 36,000 + / - \text{profit/loss} = 63,000$$

$$72,000 + / - \text{profit/loss} = 63,000$$

$$\text{Loss} = \text{£}9,000$$

3 B

4 B

5 B

6 C

7 C

8 A ( $8/12 \times \text{£}18,000$ )

9 B

Insurance			
	£		£
Bal b/d	1,200	Profit and loss a/c	3,900
Cash	3,600	Bal c/d	900
	4,800		4,800

10 A

Rent and Rates expense			
	£		£
Bal b/d	60	Bal b/d	300
Cash	2,520	Profit and loss a/c	2,550
Bal c/d	360	Bal c/d	90
	2,940		2,940

11 B

12 C

	£
Cost	60,000
Depreciation year 1: $10\% \times \text{£}60,000$	(6,000)
	54,000
Depreciation year 2: $10\% \times (\text{£}60,000 - 6,000)$	(5,400)
	48,600



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13 B

	£
Machine 1: £120,000 × 10%	12,000
Machine 1: £144,000 × 10% × 6/12	<u>7,200</u>
	<u>19,200</u>

14 D

	£
Cost	60,000
Depreciation year 1: £60,000 × 50%	<u>(30,000)</u>
	30,000
Depreciation year 2: £30,000 × 50%	<u>(15,000)</u>
	15,000
Depreciation year 3: £7,500 × 50%	<u>(7,500)</u>
	<u>7,500</u>

Fixed asset disposal account

	£		£
Cost (original cost always)	60,000	Accumulated depreciation	52,500
P&L (balancing figure)	<u>22,500</u>	Sale proceeds	<u>30,000</u>
	<u>82,500</u>		<u>82,500</u>

15 A

Van account

	£		£
Bal b/d	18,000	Disposals account	18,000
	<u>18,000</u>		<u>18,000</u>

Accumulated depreciation account

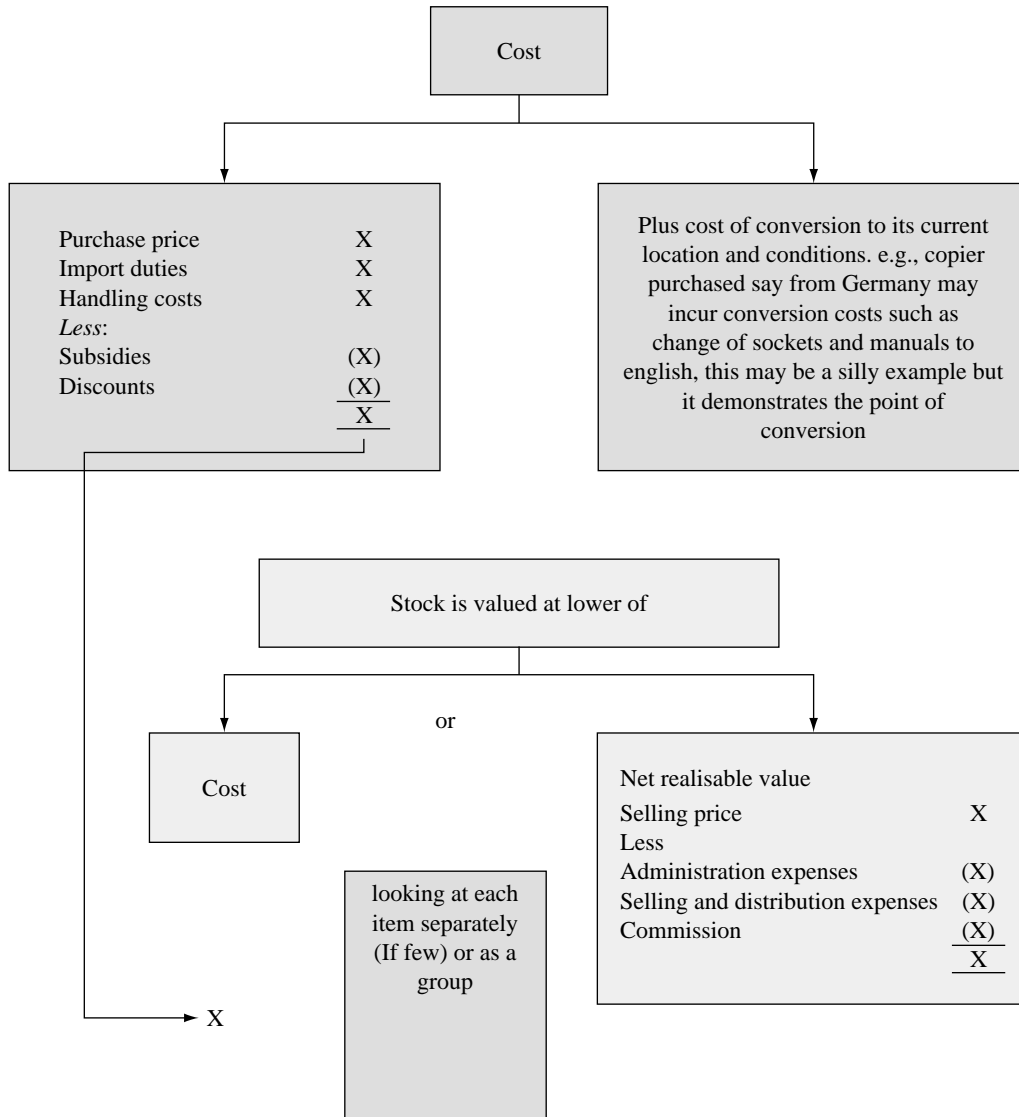
	£		£
Disposals account	13,500	Bal b/d	13,500
	<u>13,500</u>	(£18,000 × 25% × 3)	<u>13,500</u>

Disposals account

	£		£
Van (original cost)	18,000	Accumulated depreciation	13,500
Cash	27,600	New van	30,000
	<u>45,600</u>	Profit and loss A/C (balancing figure)	2,100
			<u>45,600</u>

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



16 C

Provision for doubtful debts

	£		£
Bal c/d (10% × 420,000)	42,000	Bal b/d	30,000
		Bad debts a/c	<u>12,000</u>
	<u>42,000</u>		<u>42,000</u>

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Bad debts expense			
	£		£
Provision for doubtful debts	12,000	Profit and loss a/c	15,000
Bad debts written off	3,000		
	15,000		15,000

*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)

	<i>Cost</i>	<i>Price less commission</i>	<i>Lower of cost and NRV</i>
A	3,600	4,275	3,600
B	18,600	17,385	17,385
C	2,760	2,652	2,652
			23,637

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

19 A

Debtors control			
	£		£
Bal b/d	1,950	Cash	96,750
Sales (Balancing figure)	96,000	Bal c/d	1,200
	97,950		97,950

20 A

Debtors control			
	£		£
Bal b/d	300	Cash	2,310
Sales (Balancing figure)	2,370	Bad debts written off	30
		Discount allowed	60
		Bal c/d	270
	2,670		2,670

21 B

Creditors			
	£		£
Discount received	150	Bal b/d	60
Cash	2,820	Purchases (Balancing figure)	3,000
Bal c/d	90		
	3,060		3,060

22 A

Cash book			
	£		£
Bal c/d	1,110	Bal b/d	1,080
	1,110	Standing orders	30
			1,110
			£
		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

	£
Balance as per bank statement (overdrawn)	(4,200)
Unpresented cheques	(2,400)
Uncleared lodgements	1,500
	(5,100)
Charges not entered in cash book	120
Balance as per cash book	4,980

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

		£
Opening stock		6,000
Purchases		54,000
Less: Closing stock		<u>(12,000)</u>
Cost of sales		<u>48,000</u>

		%	£
Sales	Examiner uses the term "GP margin"	100	64,000
(Cost of sales)	(Balancing figure)	<u>(75)</u>	<u>(48,000)</u>
Gross profit	Given	<u>25</u>	<u>16,000</u>

$$100/75 \times 16,000 = 21,333$$

28 D

		£
Opening stock		9,075
Add: Purchases		<u>36,325</u>
		45,400
Less: Closing stock		<u>(4,500)</u>
Cost of sales		<u>40,900</u>

		%		
Gross profit margin	100		Sales	
Balancing figure	<u>(70)</u>		(Cost of sales)	40,900
Given	<u>30</u>		<u>Gross profit</u>	
	70%	49,900		
	30%	-		

$$\text{Gross profit} = 30/70 \times 40,900 = \text{£}17,529$$

29 A

(1)	£	%
Sales	78,330	140
Mark-up	22,380	40
Cost of sales	55,950	100
Purchases (63,360 + 7,020)	70,380	
Stock (70,380 - 55,950)	14,430	

Started business hence opening stock b/f debtors and b/f creditors will be Nil

		DLCA	
Bal b/f	0	Cash received	60,450
Sales	<u>78,330</u>	Bal c/d	<u>17,880</u>
	<u>78,330</u>		<u>78,330</u>
		CLCA	
Cash paid	63,360	Bal b/f	0
Bal c/d	<u>7,020</u>	Purchases	<u>70,380</u>
	<u>70,380</u>		<u>70,380</u>

(3)	%		£
Balancing figure	140	Sales	£78,330
Mark-up thus	<u>100</u>	(Cost of sales)	????
Given	<u>40</u>	<u>Gross profit</u>	
$(100/140) \times 78,330 = 55,950$			
(4) Sales			78,330
Less: Cost of sales			
Opening stock			0
Add: Purchases			<u>70,380</u>
			70,380
Less: Closing stock			<u>(14,430)</u>
Cost of sales			<u><u>55,950</u></u>

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 businesses 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)**



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12 What is the correct double entry for the part-exchange allowance on Question 11 above?

<i>Debit</i>	<i>Credit</i>
A Fixed assets	Cash
B Cash	Fixed assets
C Fixed assets	Disposal account
D Disposal account	Fixed assets

**(2 marks)**

13 Assuming that it reconciles with the cash book, how would a balance market "Cr" on a business's bank statement appear in its balance sheet?

- A Current asset
- B Current liability
- C Fixed asset
- D Long-term liability

**(2 marks)**

14 What effect on a positive cash balance does an adjustment for unpresented paid cheques have on a bank reconciliation?

- A Increase in the cash book balance
- B Decrease in the cash book balance
- C Increase in the balance shown by the bank statement
- D Decrease in the balance shown by the bank statement

**(2 marks)**

15 A purchase day book total £7,390 had been entered in the control account £7,930.

<i>Control account</i>	<i>List of balances</i>
A Debit £540	No effect
B Debit £540	Decrease total by £540
C Credit £540	No effect
D Debit £1,080	No effect

**(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.

<i>Control account</i>	<i>List of balances</i>
A No effect	Decrease total by £2,400
B Debit £2,400	No effect
C Debit £2,400	Decrease total by £2,400
D No effect	No effect

**(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.

<i>Control account</i>	<i>List of balances</i>
A No effect	No effect
B No effect	Decrease total by £6,000
C No effect	Decrease total by £12,000
D Debit £12,000	Decrease total by £12,000

**(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.

<i>Control account</i>	<i>List of balances</i>
A No effect	Increase total by £1,912
B Credit £1,912	Increase total by £1,912
C Debit £1,912	Decrease total by £1,912
D No effect	Decrease total by £1,912

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.

<i>Debit</i>	<i>Credit</i>
A Creditors' ledger control £19,400	Suspense account £19,400
B Suspense account £19,400	Creditors' ledger control £19,400
C Creditors' ledger control £38,800	Suspense account £38,800
D Suspense account £38,800	Creditors' ledger control £38,800

**(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.)

<i>Debit</i>	<i>Credit</i>
A Stationery account £240	Suspense account £240
B Stationery account £240	Petty cash £240
C Suspense account £240	Stationery account £240
D Petty cash £240	Stationery account £240

**(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.

<i>Debit</i>	<i>Credit</i>
A Suspense account £900	Sales account £900
B Sales account £900	Suspense account £900
C Suspense account £1,800	Sales account £1,800
D Sales account £1,800	Suspense account £1,800

**(2 marks)**

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22 The purchase of office equipment for £750 had been charged to the purchases account.

<i>Debit</i>	<i>Credit</i>
A Office equipment account £750	Suspense account £750
B Purchase account £750	Office equipment account £750
C Suspense account £750	Purchase account £750
D Office equipment account £750	Purchase account £750

**(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.

<i>Debit</i>	<i>Credit</i>
A Sales returns account £36	Suspense account £36
B Suspense account £36	Sales returns account £36
C Sales returns account £110	Suspense account £110
D Suspense account £110	Sales returns account £110

**(2 marks)**

## ✓ Answers

- 1 C  
2 B  
3 C  
4 D  
5 A  
6 A

		£
100%	Sales	24,000
90%	Cost of sales	???
10%	Gross profit	

$$90/100 \times 24,000 = \text{£}21,600$$

$$21,600 - 12,000 = \text{£}9,600$$

- 7 D

Electric			
Cash paid	20,400	Bal b/f	15,000
Bal c/d	17,400	P&L	22,800
	37,800		37,800

- 8 C  
9 B

Cost	300,000
Depreciation 10% year 1	(30,000)
	270,000
Depreciation 10% year 2	(27,000)
	243,000
Depreciation 10% year 3	(24,300)

- 10 C

$$\text{Machine 1: Cost } 72,000 \times 10\% = 7,200$$

$$\text{Machine 2: Cost } 96,000 \times 10\% = 9,600 \times 6/12 = 4,800$$

$$\text{Total } 7,200 + 4,800 = \text{£}12,000$$

- 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

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$$12,000 + 6,000 + 3,000 = 21,000$$

Cost	24,000
Depreciation 50%	<u>(12,000)</u>
	12,000
Depreciation 50%	<u>(6,000)</u>
	6,000
Depreciation 50%	<u>(3,000)</u>

- 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.

	£
Opening debtors	2,000
Opening creditors	1,800
Discounts received	20
Cash sales	500
Cash from customers (including £200 from a customer whose debt was written off in 1991)	9,500
Credit purchases	6,000
Debtors to be written off	200
Discounts allowed	30
Returns inwards	40
Amounts paid to suppliers	5,400
returns outwards	50
Credit sales	13,000
Debtors to be provided for (in addition to those written off)	150

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:

	<i>Medea</i>	<i>Orestes</i>
	£	£
Rent paid 31.12.95	1,000	
Rent owed 31.12.95		1,400
Rent paid during year	4,000	5,000
Rent paid in advance at 31.12.96		500
Rent owed at 31.12.96	200	

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

	£
Balance as per bank statement	9,564
<i>Add:</i> Unpresented cheques	<u>772</u>
	10,336
<i>Less:</i> Uncleared lodgements	<u>(218)</u>
Balance as per cash book	<u><u>10,118</u></u>

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

DLCA			
	£		£
Bal b/d	2,000	Cash from credit	
Credit sales	13,000	customers (9,500 – 200)	9,300
		Bad debts expense	
		(amounts written	
		off only)	200
		Discounts allowed	30
		Return inwards	40
		Bal c/d	5,430
	<u>15,000</u>		<u>15,000</u>

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			
	£		£
Bal b/d (Orsetes)	1,400	Bal b/d (Medea)	1,000
Profit and loss a/c	8,300	Recorded in year	9,000
(balancing figure)		(4,000 + 5,000)	
Bal c/d (Orestes)	500	Bal c/d (Medea)	200
	<u>10,200</u>		<u>10,200</u>
Bal b/d (Medea)	200	Bal b/d (Orestes)	500

7 D

8 A

	£
Charge for 1997	2,700
Over provision 1996	(200)
	<u>2,500</u>

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)**

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- 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.

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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:

	£
Sales	7,500
Purchases	6,930
Returns inwards	1,650
Returns outwards	840

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:

	£
Balance b/f at 1 January 2003	166,200
Provision for doubtful debts at 1 January 1998	13,320
Increase in provision during 1998	1,440
Discount allowed in year	47,280
Sales in year	1,460,760
Purchase ledger in year	106,800
Receipts from customers in year	1,370,400

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)**

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- 23 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)**

- 24 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)**

- 25 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)**

- 26 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)**

- 27 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:

	£	£
		430,000
Sales		
Opening stock	50,000	
Purchases	312,500	
	<u>362,500</u>	
Closing stock	<u>38,000</u>	
Cost of sales		<u>324,500</u>
Gross profit		<u>105,500</u>

The following amounts have been extracted from the company's balance sheet at 30 June 2005.

	£
Trade debtors	60,000
Prepayments	4,000
Cash in hand	6,000
Bank overdraft	8,000
Trade creditors	40,000
Accruals	3,000
Proposed dividends	5,000

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%

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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

$$£14,400 \times 9/12 = £10,800 \text{ Rent expense}$$

$$£14,400 - £10,800 = £3,600 \text{ Prepayment}$$

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

$$£330,000 \times 2\% = £6,600 \text{ per year}; £6,600 \times 3 = £19,800;$$

$$£330,000 - £19,800 = £310,200; £310,200 + £138,000 = £448,200$$

13 B

$$£162,000 \times 90\% = 145,800$$

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.

$$£198,000 \times 17.5\% = £34,650$$

$$£198,000 + £34,650 = £232,650$$

$$(\text{Cost} - \text{residual value}) / \text{estimated useful life} = (232,650 - 90,000) / 3 = £47,550$$

$$£232,650 - £47,550 = £185,100$$

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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

DLCA			
Bal b/f	166,200	Discount allowed	47,280
Sales	1,460,760	Purchase ledger	106,800
		Receipts from debtors	1,370,400
		Bal c/d	102,480
	1,626,960		1,626,960

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
Opening stock	14,300	
Purchases	<u>134,800</u>	
	149,100	
Closing stock	Balancing figure	
Cost of sales	<u>130,827</u>	

CLCA			
Paid creditors	133,650	Bal b/f	3,750
Bal c/d	4,900	Purchases	134,800
		(Balancing figure)	
	138,550		138,550

	%		£
Balance	133%	Sales	174,000
Mark-up	100%	(Cost of sales)	???
Given	33%	<u>Gross profit</u>	

$$133\% = £174,000; \text{ hence } 100\% = 100/133 \times 174,000 = £130,827$$

$$\text{Therefore, } £174,000 - £130,827 = £43,173$$

24 D

Subscription account (Revenue)																		
<table style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 80%;">Accruals b/f</td><td style="text-align: right; width: 20%;">38</td></tr> <tr><td>Income and expenditure (Balancing figure)</td><td style="text-align: right;">792</td></tr> <tr><td>Prepaid income</td><td style="text-align: right;">80</td></tr> <tr><td></td><td style="text-align: right; border-top: 1px solid black;"><u>910</u></td></tr> </table>	Accruals b/f	38	Income and expenditure (Balancing figure)	792	Prepaid income	80		<u>910</u>		<table style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 80%;">Prepayment b/f</td><td style="text-align: right; width: 20%;">72</td></tr> <tr><td>Subscription received</td><td style="text-align: right;">790</td></tr> <tr><td>Accrued income c/d</td><td style="text-align: right;">48</td></tr> <tr><td></td><td style="text-align: right; border-top: 1px solid black;"><u>910</u></td></tr> </table>	Prepayment b/f	72	Subscription received	790	Accrued income c/d	48		<u>910</u>
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Accrued income c/d	48																	
	<u>910</u>																	

25 B

Subscription Account (Revenue)																		
<table style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 80%;">Arrears b/f</td><td style="text-align: right; width: 20%;">0</td></tr> <tr><td>Income and expenditure (Balancing figure)</td><td style="text-align: right;">980</td></tr> <tr><td>Prepayment c/d</td><td style="text-align: right;">58</td></tr> <tr><td></td><td style="text-align: right; border-top: 1px solid black;"><u>1,038</u></td></tr> </table>	Arrears b/f	0	Income and expenditure (Balancing figure)	980	Prepayment c/d	58		<u>1,038</u>		<table style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 80%;">Prepayment b/f</td><td style="text-align: right; width: 20%;">14</td></tr> <tr><td>Subscription received</td><td style="text-align: right;">1,024</td></tr> <tr><td>Arrears</td><td style="text-align: right;">0</td></tr> <tr><td></td><td style="text-align: right; border-top: 1px solid black;"><u>1,038</u></td></tr> </table>	Prepayment b/f	14	Subscription received	1,024	Arrears	0		<u>1,038</u>
Arrears b/f	0																	
Income and expenditure (Balancing figure)	980																	
Prepayment c/d	58																	
	<u>1,038</u>																	
Prepayment b/f	14																	
Subscription received	1,024																	
Arrears	0																	
	<u>1,038</u>																	

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

$$(\pounds 35,800 + \pounds 53,400) + \pounds 14,800 - \pounds 4,700 + \pounds 3,600 = \pounds 102,900$$

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.

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35 C

$$(\pounds 44,000 / 324,500) \times 365 \text{ days} = 49 \text{ days}$$

$$[(\text{Opening stock} + \text{Closing stock}) / 2 / \text{Cost of sales}]$$

36 A

$$(\pounds 60,000 / \pounds 430,000) \times 365 \text{ days} = 51 \text{ days}$$

$$(\text{Trade debtors} / \text{Sales}) \times 365$$

37 B

$$(\pounds 40,000 / \pounds 312,500) \times 365 \text{ days} = 47 \text{ days}$$

$$(\text{Trade creditors} / \text{Purchases}) \times 365$$

38 B

$$108,000 / 56,000 = 1.93:1$$

Current assets:Current liabilities

Current assets = Trade debtors  $\pounds 60,000$  + Prepayments  $\pounds 4,000$  + Cash in hand  $\pounds 6,000$  + Closing stock  $\pounds 38,000$

Current liabilities = Bank overdraft  $\pounds 8,000$  + Trade creditors  $\pounds 40,000$  + Accruals  $\pounds 3,000$  + Proposed dividends  $\pounds 5,000$

39 A

$$70,000 / 56,000 = 1.25:1$$

Current assets – Stock:Current liabilities

Current assets – Stock = Trade debtors  $\pounds 60,000$  + Prepayments  $\pounds 4,000$  + Cash in hand  $\pounds 6,000$  + Closing stock  $\pounds 38,000$  – Closing stock  $\pounds 38,000$

Current liabilities = Bank overdraft  $\pounds 8,000$  + Trade creditors  $40,000$  + Accruals  $\pounds 3,000$  + Proposed dividends  $\pounds 5,000$

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

$$\pounds 32,000 / 0.4 = \pounds 80,000$$

Current ratio is 1.4:1 hence

$$\text{Current assets} - \text{Current liabilities} = 32,000$$

If Current liabilities are A then Current assets are 1.4A

$$1.4A - A = 32,000; 0.4A = 32,000$$

$$\text{Hence } A = 32,000 / 0.4 = \text{Current liabilities}$$

42 C

Current liabilities = £80,000; Current assets = £80,000 × 1.4 = £112,000

Quick assets = £80,000 × 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 × 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 × 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 × 25% = £117,000

Net profit = £150,000 × 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 × £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:

<i>Users</i>	<i>Requirements</i>
1 The public	A The ability of the company to continue, and to pay pensions in the future
2 The government	B The use of information for taking operational decisions in running the company
3 Employees	C The policies of a company and how those policies affect the community, for example health and safety
4 Internal users	D The performance and financial position of a company and its ability to pay dividends
5 Shareholders	E The ability of a company to pay taxes, and administer other taxes, for example value-added tax

(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:
- | <i>Selling price per unit</i> | <i>Quantity sold</i> | <i>Cost per unit</i> |
|-------------------------------|----------------------|----------------------|
| A increased                   | no change            | increased            |
| B no change                   | increased            | no change            |
| C no change                   | no change            | decreased            |
| D decreased                   | increased            | increased            |
- (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:

	£
Purchase of raw materials	28,000
Returns inwards	2,000
Increase in stock of raw materials	850
Direct wages	10,500
Carriage inwards	1,250
Production overheads	7,000
Decrease in work-in-progress	2,500

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)

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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:

	£	£
Opening stock		24,000
Add: Purchases	244,000*	
Less: Returns	<u>(10,000)</u>	234,000
Closing stock		<u>(36,000)</u>
Cost of goods sold		<u><u>222,000</u></u>

\*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

	£
Opening balance	69,000
Credit purchases	156,800
Discounts	(2,400)
Payments	(137,800)
Purchase returns	<u>(9,400)</u>
Closing balance	<u><u>76,200</u></u>

## CLCA

	£		£
Discounts	2,400	Bal b/f	69,000
Payments	137,800	Credit purchases	156,800
Returns	9,400		
Bal c/d	<u>76,200</u>		
	<u><u>225,800</u></u>		<u><u>225,800</u></u>

1.6

	£	
Statement balance	26,800	
Add back dishonoured cheque	600	
Add back bank charges	100	
Less: Unpresented cheques	(2,800)	
Adjustment re-error	<u>(780)</u>	That is twice 390
	<u><u>23,920</u></u>	



1.7

	£
Cash book balance	(2,480)
Unpresented cheques	900
Receipt not yet processed	(280)
Bank charges	<u>(150)</u>
As per statement	<u><u>(2,010)</u></u>

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	<u>(850)</u>
Cost of material consumed	28,400
Direct wages	<u>10,500</u>
Prime cost	38,900
Production overheads	7,000
Decrease in work-in-progress	<u>2,500</u>
Production cost	<u><u>48,400</u></u>

5.4

	<i>Qty</i>	<i>Price</i> £	<i>Total</i> £
Opening stock	60	4.00	240
Purchases	<u>100</u>	4.80	<u>480</u>
Balance	160	4.50	720
Sales	<u>80</u>	4.50	<u>360</u>
Balance	80	4.50	360
Purchases	<u>120</u>	5.00	<u>600</u>
Balance	200	4.80	960
Sales	<u>50</u>	4.80	<u>240</u>
Balance	<u><u>150</u></u>		<u><u>720</u></u>

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?

Debit /Credit	\$
---------------	----

### ? 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?

	<i>Debit</i>	<i>Credit</i>
<b>A</b> Machinery	18,000	
Creditors		18,000
<b>B</b> Machinery	20,700	
Creditors		20,700
<b>C</b> Machinery	18,000	
Vat	2,700	
Creditors		20,700
<b>D</b> Machinery	20,700	
Vat		2,700
Creditors		18,000

**? 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?

Profit and loss account	Accrual or Prepayment	Balance sheet
\$		\$

**? 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 \$2000. 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?

Profit or Loss	\$
----------------	----

**? 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?

Control Account		List of Creditor Balances	
Debit or Credit	\$	Increase or Decrease	\$

**? 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

	<i>At 30th September</i>	
	2000	1999
	\$000	\$000
Stock of raw materials	70	50
Work in progress	60	70
Stock of finished goods	100	90
For the year ended 30th September 2000		
Purchases of raw materials	\$165,000	
Manufacturing wages	\$30,000	
Factory overheads	\$40,000	

The prime cost of production in the manufacturing account for the year ended 30th September 2000 is:

\$.....

**? Question 20**

When valuing stock at cost, which of the following shows the correct method of arriving at cost?

Include Inward Transport Costs	Include Production Overheads
Yes or No	Yes or No

**? 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?

\$.....

**? 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?

\$.....

### ? Question 23

The following is an extract from the balance sheets of IAS plc for the years ended 31 July 2000 and 2001.

	2001	2000
	\$000	\$000
Stock	40	90
Debtors	55	10
Creditors	45	30
Accruals	15	20

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

	\$
Subscriptions for 1999 unpaid at January 2000	400
Subscriptions for 1999 paid during the year ended 31 December 2000	550
Subscriptions for 2000 paid during the year ended 31 December 2000	7,000
Subscriptions for 2001 paid during the year ended 31 December 2000	2,000
Subscriptions for 2000 unpaid at 31 December 2000	850

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.

#### Profit & Loss Account Year Ended 31st December 2000

		\$000
Turnover		400
Cost of sales		<u>(175)</u>
Gross profit		225
Profit on sale of fixed asset		80
		<u>305</u>
Expenses	35	
Depreciation	<u>40</u>	75
Net profit		<u>230</u>
<i>31st December 1999</i>	<i>31st December 2000</i>	
	\$000	\$000
Stock, debtors, current liabilities	50	65

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:

		<i>DR</i>	<i>CR</i>
		\$	\$
<b>A</b>	Bank	240,000	
	Share capital		200,000
	Share premium		40,000
<b>B</b>	Bank	240,000	
	Share premium		240,000
<b>C</b>	Bank	240,000	
	Share capital		240,000
<b>D</b>	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.

SPA plc Profit and Loss Account for the Year Ended 30 November 2002

	<i>\$000</i>	<i>\$000</i>
Turnover		6,000
Opening stock	200	
Purchases	3,100	
Closing stock	<u>(400)</u>	
Cost of sales		<u>(2,900)</u>
Gross profit		3,100
Operating expenses		<u>(400)</u>
Operating profit		2,700
Interest		<u>(200)</u>
Retained profit for year		<u>2,500</u>

SPA plc Balance Sheet at 30 November 2002		
	<i>\$000</i>	<i>\$000</i>
Fixed assets		3,500
Current assets		
Stock	300	
Debtors	900	
Bank	50	
	<u>1,250</u>	
Current liabilities		
Trade creditors	(450)	800
		<u>4,300</u>
Share capital		2,200
Profit and loss account		<u>2,100</u>
		<u>4,300</u>

The return on capital employed in SPA is:

%

### **?** Question 39

The net asset turnover ratio in SPA is:

: 1

### **?** Question 40

The quick ratio in SPA is:

: 1



## Illustrative computer-based assessment: Solutions

 **Solution 1**

Answer: (D)

 **Solution 2**

Answer: (C)

 **Solution 3**

Answer: (B)

 **Solution 4**

Turnover \$3 million  $\times$  5% gives debtors of \$150,000  
Provision for doubtful debts is  $4\% \times \$150,000 = \$6,000$   
Existing provision is  $\$6,000 \times 3/4 = \$4,500$   
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  $7 \times \$200 = \$1,400$   
Prepaid in balance sheet  $5 \times \$200 = \$1,000$

 **Solution 9**

\$14,000

### ✓ Solution 10

Bank statement balance	overdrawn	\$(1,650)
Unpresented cheques		\$(950)
Outstanding deposits		\$1,200
Bank error		\$320
Cash book—credit balance		<u>\$(1,080)</u>

### ✓ Solution 11

Sales Ledger Control			
Opening debtors	2,000	Cheques banked credit sales	160,000
Credit sales	161,000		
(balancing figure)		Closing debtors	3,000
	<u>163,000</u>		<u>163,000</u>

Cash Account			
Opening balance	100	Cash banked	50,000
Cash sales	69,000	Cash missing	18,900
(\$230,000—\$161,000)		Closing balance	200
	<u>69,100</u>		<u>69,100</u>

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
	<u>6,000</u>
Net book value 1st August 2000	4,000
Proceeds 1st August 2000	4,900
Profit	<u>900</u>

### ✓ Solution 13

Answer: (B)

### ✓ Solution 14

Cash Account			
1st July bal b/d	250	Cash cheque	100
Photocopying	50	Cash paid out	620
Cash from bank	600	(balancing figure) 31st July bal c/d	180
	<u>900</u>		<u>900</u>

Cash paid out \$620

 **Solution 15**

Answer: (C)

 **Solution 16**

Answer: (A)

 **Solution 17**

Control Account		List of Creditor Balances	
Debit or Credit	\$	Increase or Decrease	\$
Debit	600	Increase	200

 **Solution 18**

Net salaries for April	\$16,000
Employees' national insurance and tax for April	\$8,000
Employer's national insurance	\$3,500
	<u>\$27,500</u>

 **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	<u>\$(70,000)</u>
Raw materials consumed	\$145,000
Manufacturing wages	\$30,000
	<u>\$175,000</u>

 **Solution 20**

Include Inward Transport Costs	Include Production Overheads
Yes or No	Yes or No
Yes	Yes

 **Solution 21**

Electricity Account					
		\$			\$
31 May 2001	Invoices	5,000	1 July 2000	bal b/d	400
31 May 2001	Accrual – $\$900 \times 1/3$	<u>300</u>	31 May 2001	P&L a/c	<u>4,900</u>
		<u>5,300</u>			<u>5,300</u>

Answer is \$4,900

**Solution 22**

Debtors $\$140,000 \times 5\% =$	\$7,000
Provision for doubtful debts at 31 October 2000	<u>\$11,000</u>
Change in provision	(\$4,000)
Bad debts written off	<u>\$7,000</u>
Profit and loss account	<u>\$3,000</u>

**Solution 23**

	\$000
Stock	50
Debtors	(45)
Creditors	15
Accruals	<u>(5)</u>
Cash flow from operations	<u>15</u>

**Solution 24**

Stock at valuation	\$14,000
Goods on sale or return at cost	<u>\$4,000</u>
Stock valuation	<u>\$18,000</u>

**Solution 25**

Answer: (C)

**Solution 26**

Net pay February	\$1,840
Tax January	\$500
National insurance January	\$100
	<u>\$2,440</u>

**Solution 27**

Answer: (D)

**Solution 28**

Cost of machine	\$18,000
Transportation	\$1,700
Installation	\$500
	<u>\$20,200</u>
Depreciation at 10%	<u>\$2,020</u>
Net book value	<u>\$18,180</u>

 **Solution 29**

Answer: (B)

 **Solution 30**

Answer: (D)

 **Solution 31**

Answer: (A)

 **Solution 32**

Subscriptions paid for 2000	\$ 7,000
Subscriptions owing for 2000	<u>\$850</u>
	<u>\$7,850</u>

 **Solution 33**

Net profit	230
add back: depreciation	40
less: profit on sale	<u>(80)</u>
	190
Increase working capital	<u>(15)</u>
Cash flow from operations	<u>175</u>

 **Solution 34**

Answer: (A)

 **Solution 35**

Insurance balance omitted	\$700
Wages mis-posted – not affect trial balance	Nil
Accrual omitted – not affect trial balance	Nil
Answer is \$700	

 **Solution 36**

Valuation at beginning of year	\$11,475
Purchases	\$4,360
Disposals	<u>(\$3,257)</u>
	\$12,578
Valuation at end of year	<u>(\$9,000)</u>
Depreciation	<u>\$3,578</u>

**Solution 37**

Net profit %  $\times$  asset turnover ratio = return on capital employed

$$9\% \times 3 = 27\%$$

**Solution 38**

$$\frac{\text{Operating profit}}{\text{Capital}} = \frac{\pounds 2,700,000}{\pounds 4,300,000} \times 100 = 63\%$$

**Solution 39**

$$\frac{\text{Turnover}}{\text{Net assets}} = \frac{\pounds 6,000,000}{\pounds 4,300,000} \times 100 = 1.39:1$$

**Solution 40**

$$\frac{\text{Debtors} + \text{Bank}}{\text{Current liabilities}} = \frac{\pounds 900,000 + \pounds 50,000}{\pounds 450,000} = 2.11:1$$

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:

	\$
Stock at beginning of year	
Raw materials	22,000
Work-in-progress	4,000
Finished goods	63,000
Stock at end of year	
Raw materials	25,000
Work-in-progress	1,000
Finished goods	72,000
Purchases of raw materials	220,000
Direct wages	300,000
Royalties on goods sold	45,000
Production overheads	360,000
Distribution costs	70,000
Administration expenses	290,000
Sales	1,400,000

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:

Profit or Loss	\$
----------------	----

**? 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.

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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:

	<i>\$000</i>
Net profit before interest and tax	2,300
Interest	<u>700</u>
Profit before tax	1,600
Tax	<u>400</u>
Profit after tax	1,200
Dividends	<u>200</u>
Retained profit for the year	<u>1,000</u>

Its balance sheet at 30 June 20X1 showed the following

	<i>\$000</i>
Share capital	11,000
Profit and loss account balance	<u>3,000</u>
	14,000
10% debenture	<u>4,000</u>
	<u>18,000</u>

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:

	<i>Sale Proceeds</i>	<i>Length of Ownership</i>
A	\$60,000	cannot be calculated
B	cannot be calculated	3 years
C	\$60,000	3 years
D	cannot be calculated	cannot be calculated

### ? 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

	<i>Goods excluding VAT</i>	<i>VAT</i>
	\$	\$
Sales day book	42,000	4,200
Purchases day book	26,000	2,000
Returns inwards day book	3,200	320
Returns outwards day book	700	35
Opening stock	7,000	550
Closing stock	8,300	765

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.

	<i>20X1</i>	<i>20X2</i>
	<i>\$000</i>	<i>\$000</i>
Stock	85	60
Debtors	80	95
Creditors	45	75
Accruals	20	10

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?

Increase or Decrease	\$
----------------------	----

**? 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

	<i>Cost</i>	<i>Depreciation</i>
	<i>\$000</i>	<i>\$000</i>
Opening Balance	32	18
Additions/charge	22	6
Disposals	<u>(15)</u>	<u>(10)</u>
Closing Balance	<u>39</u>	<u>14</u>

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?

Inflow/outflow	
\$	

**? 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?

\$ .....

**? 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

	<i>\$,000</i>
Stock at beginning of year – raw materials	22,000
Purchases	220,000
Stock at end of year – raw materials	(25,000)
Direct wages	300,000
Production overheads	360,000
Stock at beginning of year – work-in-progress	4,000
Stock at end of year – work-in-progress	(1,000)
	<u>880,000</u>

### ✓ Solution 4

Sales ledger control account				
		\$		\$
1 Nov 20X1	Balance b/d	30,000	Bank	60,000
	Credit sales	67,000	Cash discounts	1,400
			Sales returns	4,000
			31 Nov 20X1	Bal c/d
		<u>97,000</u>		<u>97,000</u>

### ✓ Solution 5

Answer: (A)

### ✓ Solution 6

Bank reconciliation	\$
Balance at bank 31 July 20X1	10,300
unpresented cheques	(1,700)
	<u>8,600</u>
Opening balance in cash book – balancing figure	8,450
Dishonoured cheque	(500)
Bank charges	(150)
Error \$600 × 2	800
	<u>8,600</u>

### ✓ Solution 7

	<i>units</i>	<i>unit \$</i>	<i>Total \$</i>
Opening stock	12	4	48
Purchases	60	5	300
Issue	{ (12)	{ (4)}	(48)
Issue	{ (6)	{ (5)}	(30)
Issue	(23)	(5)	(115)
Closing stock	<u>31</u>	<u>5</u>	<u>155</u>

### ✓ 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		<u>= \$3,750</u>

### ✓ Solution 14

Answer: (A)

 **Solution 15**

Telephone Expense Account			
	Debit		Credit
1 February bal b/d	250	1 February bal b/d	450
Bank	375	28 February p&l a/c	275
28 February bal c/d	<u>225</u>	28 February bal c/d	<u>125</u>
	<u>850</u>		<u>850</u>

 **Solution 16**

Capital:	30 June 20X1	\$18,000
	30 June 20X0 (\$18,000 less retained profit \$1,000)	<u>\$17,000</u>
		<u>\$35,000</u>

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	$6/12 \times \$6,200$	\$3,100
1 April 20X1 to 31 March 20X2	$6/12 \times \$6,400$	<u>\$3,200</u>
		<u>\$6,300</u>

 **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	<u>25,300</u>	
Closing stock	<u>(8,300)</u>	<u>24,000</u>
Gross profit		<u>14,800</u>

 **Solution 23**

Answer: (D)

 **Solution 24**

Gross salary 40 hours @ \$12 per hour	\$480
Employers national insurance 15% × \$480	<u>\$72</u>
	<u>\$552</u>

 **Solution 25**

	<i>\$000</i>
Stock	25
Debtors	(15)
Creditors	30
Accruals	<u>(10)</u>
Increase	<u>30</u>

 **Solution 26**

Answer: (A)

 **Solution 27**

Answer: (D)

 **Solution 28**

Answer: (D)

 **Solution 29**

Selling price	\$1,800
Cost of modification	(\$275)
Selling costs	<u>(\$140)</u>
	<u>\$1,385</u> , 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  $\$4,500 \times 3/12 = \$1,125$

 **Solution 33**

Answer: (A)

 **Solution 34**

	\$
Subscriptions in advance	1,300
Subscriptions received	12,000
Less subscriptions in advance	<u>(900)</u>
Subscriptions	<u>12,400</u>

 **Solution 35**

Net profit %  $\times$  asset turnover ratio = return on capital employed  
 $9\% \times 3 = 27\%$

 **Solution 36**

Plant and machinery purchased		(\$22,000)
Plant and machinery sold net book value (cost \$15,000 less provision for depreciation \$10,000)	= \$5,000	
profit on disposal	<u>\$3,000</u>	<u>\$8,000</u>
net cash outflow		<u>\$(14,000)</u>

 **Solution 37**

Answer: (C)

 **Solution 38**

Cash banked	\$20,000
Less cash from sale of car	\$(3,000)
Add wages	\$5,000
Add drawings (\$1,000 $\times$ 12)	\$12,000
Closing cash less opening cash (\$300 – 200)	<u>\$100</u>
	<u>\$34,100</u>

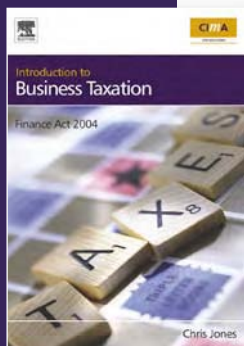
 **Solution 39**

Answer: (D)

 **Solution 40**

Answer: (D)

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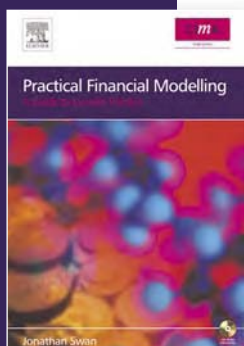
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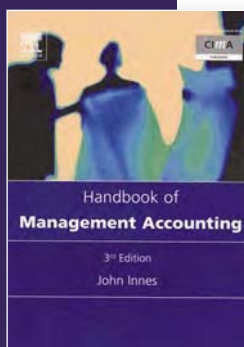
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