

## CHAPTER 1 BANK RECONCILIATION STATEMENTS

- 1 At 31 December 1997, a customer's bank statement shows that his bank account is overdrawn by \$10 136. At that date, cheques drawn on his account, but not yet presented to the bank, totalled \$4 998 and cheques paid into his account, but not yet credited by the bank, totalled \$5 896. His bank statement shows that interest of \$181 has been charged, but this has not yet been entered in the cash book. What is the correct bank balance to be shown in the balance sheet at 31 December 1997?
- A** \$9 057 overdrawn                      **B** \$9 238 overdrawn  
**C** \$10 853 overdrawn                      **D** \$11 034 overdrawn
- May 98 P1 Q6 / May 03 P1 Q9/Specimen 16 P1 Q5

- 2 The table shows extracts from business bank reconciliation.
- |   |       |
|---|-------|
|   | \$    |
| Cash book balance in hand at 31 December                            | 2 075 |
| Balance as per bank statement at 31 December                        | 2 250 |
| Bank charges per bank statement not entered in cash book            | 150   |
| Outstanding cheques not presented at the year-end                   | 325   |
| What is the bank balance to be shown in the financial statements?   |       |
| <b>A</b> \$1 600 <b>B</b> \$1 925 <b>C</b> \$2 075 <b>D</b> \$2 225 |       |
- Nov 01 P1 Q8

- 3 In the cash book of a company the bank account showed a credit balance of \$5 000. There were unpresented cheques amounting to \$1 500. The bank statement showed bank charges of \$700 not in the cash book. What is the balance on the bank statement?
- A** \$3 300 debit                      **B** \$4 200 debit                      **C** \$4 200 credit                      **D** \$5 800 credit
- May 02 P1 Q4/May 14 P12 Q8/Nov 14 P12 Q6

- 4 The balance at bank in X's cash book at 30 April is \$12 460 debit. However, a cheque for \$14 470 received from Y and a cheque for \$1 740 paid to Z appears in the cash book but not on the bank statement. Bank charges of \$4 500 have not been entered in the cash book. What is the balance shown on the bank statement at 30 April?
- A** \$4 770 credit                      **B** \$4 770 debit                      **C** \$20 690 credit                      **D** \$20 690 debit
- Nov 02 P1 Q11/ Nov 08 P1 Q10

- 5 A bank reconciliation statement shows a credit balance of \$400 in the Cash Book and a balance in hand of \$100 in the bank statement. The bank reconciliation statement includes unpresented cheques of \$700 in addition to cheques banked and not yet credited in the bank statement. What is the total of cheques banked and not yet credited?
- A** \$200                      **B** \$400                      **C** \$1 000                      **D** \$1 200
- Nov 03 P1 Q12

- 6 When preparing a bank reconciliation statement the following information is available.

	\$
Bank balance shown by the cash book	20 000 debit
Unpresented cheques	2 500
Uncleared bankings	1 400
Standing order shown on the bank statement (not in the cash book)	300

- What is the balance on the bank statement?
- A** \$18 600                      **B** \$19 200  
**C** \$20 800                      **D** \$21 400

May 04 P1 Q10

- 7 The table shows details relating to a company's banking transactions at 31 December.

	\$
Balance at bank per bank statement	22 650
Un-cleared lodgments	3 110
Un-presented cheques	6 290
Bank credit recorded twice by bank in error	650

Which balance for cash at bank should appear in the Balance Sheet at 31 December?

- A** \$18 820                      **B** \$20 120  
**C** \$25 180                      **D** \$26 480

Nov 04 P1 Q8/May 12 P12 Q7

- 8 A draft Balance Sheet shows a bank balance of \$1 400. The following information is now available.

	\$
cheques issued but not yet cleared by the bank	150
bank charges not in the cash book	45
lodgments in the cash book but not on the bank statement	220

What is the figure shown on the Bank Statement?

- A** \$1 285                      **B** \$1 355  
**C** \$1 425                      **D** \$1 515

May 06 P1 Q12

- 9 A bank statement shows a credit balance of \$8 360. Comparison with the cash book reveals:

- Cheques totalling \$18 725, sent to suppliers, have not been presented.
- Cheques totalling \$16 223, received from customers, have not been credited by the bank.
- Bank charges of \$124 have not been entered in the cash book.

What is the correct cash book balance?

- A** \$5 734 credit                      **B** \$5 734 debit  
**C** \$5 858 debit                      **D** \$10 986 credit

Nov 06 P1 Q11

- 10 The bank statement of a business shows an overdraft of \$250 at the year end. There are cheques written but not yet cleared by the bank amounting to \$140. Lodgments not yet credited by the bank amount to \$220.

How would the balance in the cash book be shown in the balance sheet?

		\$
<b>A</b>	current asset	170
<b>B</b>	current asset	330
<b>C</b>	current liability	170
<b>D</b>	current liability	330

Nov 07 P1 Q9

- 11 At the year-end a cash book shows a credit balance of \$4800.

The bank statement included bank charges of \$25 which had not been included in the cash book.

Cheque payments entered in the cash book before the year end to the value of \$250 had not yet cleared the bank.

How would the bank balance be shown in the balance sheet?

		\$
<b>A</b>	current asset	4 775
<b>B</b>	current liability	4 825
<b>C</b>	current asset	5 025
<b>D</b>	current liability	5 075

May 08 P1 Q8

- 12 The cash book of a business shows a credit balance of \$12 500 at 30 June. Bank charges of \$2 000 have not yet been entered in the cash book.

A cheque for \$20 000 received from a debtor, and a cheque for \$3000 paid to a creditor have been entered in the cash book, but have not yet been shown on the bank statement.

What is the balance shown on the bank statement at 30 June?

- A** \$2 500 credit **B** \$2 500 debit  
**C** \$31 500 credit **D** \$31 500 debit

May 11 P1 Q3

- 13 The following items are recorded in the cash book of a business but not yet recorded in its bank statement:

	\$
Cheques drawn	3000
Amounts banked	250

The cash book shows a bank overdraft of \$2600. What is the balance on the bank statement?

- A** \$150 in hand **B** \$150 overdraft  
**C** \$400 in hand **D** \$400 overdraft

Nov11 P1 Q7/ May 17 P12 Q8

- 14 At the financial year end of a business the following information is available.

	\$
debit balance on the bank statement	1 000
Unpresented cheques	300
lodgements not yet credited by the bank	600
bank charges and interest charged not yet entered in the cash book	150

What is the current balance in the cash book?

- A** \$400 credit **B** \$400 debit **C** \$550 credit **D**\$550 debit

May 13 P12 Q7

- 15 A business is preparing a bank reconciliation and finds the following.

	\$
Unpresented cheques	3 190
Uncredited bankings	1 949

The cash book has a debit balance of \$5 000.

Which adjustments should be made to the cash book balance to reconcile it to the bank statement?

- A** minus \$3 190, minus \$1 949 **B** minus \$3 190, plus \$1 949  
**C** plus \$3 190, minus \$1 949 **D** plus \$3 190, plus \$1 949

Nov 13 P12 Q9

- 16 A trader made the following transactions

	\$
cash withdrawn from bank for business use	200
cash banked	120

What was the total effect on ledger accounts?

	increase	\$	decrease	\$
<b>A</b>	bank account	80	cash account	80
<b>B</b>	bank account	320	cash account	320
<b>C</b>	cash account	80	bank account	80
<b>D</b>	cash account	320	bank account	320

May 15 P12 Q2

- 17 A bank reconciliation statement has been prepared by an inexperienced book-keeper.

	\$
bank statement balance (overdrawn)	(68 100)
cheques received not paid in	<u>141 200</u>
	209 300
cheques paid to suppliers, not yet presented	<u>(41 800)</u>
cash book balance (overdrawn)	<u>167 500</u>

What is the correct bank balance according to the cash book?

- A** \$31 300 overdrawn                      **B** \$31 300  
**C** \$167 500 overdrawn                    **D** \$167 500

Nov 15 P12 Q15

- 18 The year-end balance in the cash book was \$23 780. This was different from the balance on the bank statement. The difference was due to the following items.

	\$
bank charges	216
a customer's cheque which was dishonoured	1 375
a bank error meant a cheque was incorrectly debited to the bank account	560

What should be the value of bank in the statement of financial position?

- A** \$21 629                      **B** \$22 189                      **C** \$25 371                      **D** \$25 931

Nov 16 P12 Q5

**ANSWER KEY**

1	B	6	C	11	B	16	C
2	B	7	A	12	D	17	B
3	B	8	A	13	A	18	B
4	B	9	C	14	C		
5	A	10	C	15	C		

**DETAILED ANSWERS**

- 1 As closing balance of adjusted cash book is shown as cash at bank in the balance sheet. This figure can be calculated through bank reconciliation statement as follows

**Bank Reconciliation Statement**

	\$
<b>Overdraft balance as per adjusted cash book (balancing figure)</b>	<b>9 238</b>
Add Uncredited cheques	<u>5 896</u>
	15 124
Less Unpresented cheques	<u>(4 998)</u>
Overdraft balance as per bank statement	<u>10 136</u>

\* Interest is not accounted for, as this has already been recorded in the bank statement.

- 2 As closing balance of adjusted cash book is shown as cash at bank in the balance sheet. This figure can be calculated through bank reconciliation statement as follows

**Bank Reconciliation Statement**

	\$
<b>Balance as per adjusted cash book (balancing figure)</b>	<b>1 925</b>
Add Unpresented cheques	<u>325</u>
Balance as per bank statement	<u>2 250</u>

**Alternatively**

	\$
Balance as per original cashbook	2 075
Less Bank charges accounted for	<u>(150)</u>
Balance as per adjusted cash book	<u>1 925</u>

- 3 **Bank Reconciliation Statement**

	\$
Bank overdraft as per cash book (\$5 000 + \$700)	5 700
Less Unpresented cheques	<u>(1 500)</u>
Bank balance as per bank statement (Dr)	<u>4 200</u>

- 4 **Bank Reconciliation Statement**

	\$
Balance as per adjusted cash book (Dr) (\$12 460 – \$4 500)	7 960
Add Unpresented cheques	1 740
Less Uncredited cheques	<u>(14 470)</u>
Balance as per bank statement (Dr)	<u>4 770</u>

- 5 **Bank Reconciliation Statement**

	\$
Balance as per cash book (Cr)	400
<b>Add Uncredited cheques (balancing figure)</b>	<b>200</b>
Less Unpresented cheques	<u>(700)</u>
Balance as per bank statement (Cr)	<u>100</u>

6

**Adjusted Cash Book**

	\$		\$
Balance b/f	20 000	Standing order payment	300
	<u>20 000</u>	Balance c/d	<u>19 700</u>
			<u>20 000</u>

**Bank Reconciliation Statement**

	\$
Balance as per adjusted Cash book (Dr)	19 700
Add Unpresented cheques	<u>2 500</u>
	22 200
Less Uncleared deposits	<u>(1 400)</u>
Balance as per bank statement	<u>20 800</u>

7

**Bank Reconciliation Statement**

	\$	\$
Balance as per bank statement		22 650
Add Uncleared lodgments		<u>3 110</u>
		25 760
Less Unpresented cheques	6 290	
Bank credit recorded twice by bank	<u>650</u>	<u>(6 940)</u>
Balance as per adjusted cash book		<u>18 820</u>

8

**Bank Reconciliation Statement**

	\$
Balance as per adjusted cash book (\$1 400 – \$45)	1 355
Add Un-presented cheques	150
Less Un-credited cheques	<u>(220)</u>
Balance as per bank statement	<u>1 285</u>

9

**Bank Reconciliation Statement**

	\$
Balance as per bank statement (cr)	8 360
Add Uncreditedcheques	16 223
Less Unpresented cheques	<u>(18 725)</u>
Balance as per adjusted cash book (dr)	<u>5 858</u>

10

**Bank Reconciliation Statement**

	\$
Balance as per bank statement (Dr)	250
Add Unpresented cheques	140
Less Uncreditedcheques	<u>(220)</u>
Balance as per adjusted cash book to be shown in balance sheet (Cr)	<u>170</u>

11

**Adjusted Cash Book**

	\$		\$
Balance c/d	4 825	Balance b/f	4 800
	<u>4 825</u>	Bank charges	<u>25</u>
			<u>4 825</u>

So "B" option is correct.

12

**Adjusted Cash Book**

	\$		\$
Balance c/d	14 500	Balance b/f	12 500
	<u>14 500</u>	Bank charges	<u>2 000</u>
			<u>14 500</u>

<b>Bank Reconciliation Statement</b>		<b>\$</b>
Balance as per adjusted Cash book (Cr)		14 500
Add   Uncleared deposits		<u>20 000</u>
		34 500
Less   Unpresented cheques		<u>(3 000)</u>
Balance as per bank statement (Dr)		<u><u>31 500</u></u>

<b>Bank Reconciliation Statement</b>		<b>\$</b>
Overdraft balance as per cash book (Cr)		2 600
Add   Amounts banked but not credited		250
Less   Cheques drawn but not presented		<u>(3 000)</u>
Balance as per bank statement (Cr)		<u>150</u>

<b>Bank Reconciliation Statement</b>		<b>\$</b>
Balance as per bank statement		1 000
Add   Unpresented cheques		<u>300</u>
		1 300
Less   lodgements not yet credited by the bank		<u>(600)</u>
Balance as per adjusted cash book (Credit)		<u><u>550</u></u>

**Adjusted Cash Book**

Balance c/d (Bank reconciliation)	\$ 700	<b>Balance b/f (balancing figure)</b>	\$ 550
	<u>700</u>	Bank charges and interest	<u>150</u>
			<u>700</u>

	Cash	Bank
cash withdrawn from bank for business use	200↑	200↓
cash banked	<u>120↓</u>	<u>120↑</u>
Net change	<u><u>80↑</u></u>	<u><u>80↓</u></u>

<b>Bank Reconciliation Statement</b>		<b>\$</b>
Overdraft balance as per bank statement (Dr)		68 100
Add   cheques paid to suppliers, not yet presented (Un-presented Cheques)		41 800
Less   cheques received not paid in (Un-credited cheques)		<u>(141 200)</u>
Balance as per adjusted cash book (Dr)		<u><u>31 300</u></u>

<b>Adjusted Cash Book</b>			
	\$		\$
Balance b/f	23 780	Bank charges	216
		Customer A/c (dishonoured cheque)	1 375
	<u>23 780</u>	<b>Balance c/d</b>	<u><b>22 189</b></u>
			<u><u>23 780</u></u>

So "B" option is correct.

## CHAPTER 2 ACCOUNTING FOR DEPRECIATION

- 1 A vehicle cost \$30 000. The vehicle was later sold for \$9 000 and the profit on disposal was \$1500  
What was the accumulated depreciation of the vehicle on disposal?  
A \$7 500 B \$19 500 C \$21 000 D \$22 500  
May 98 P1 Q3 / Nov 02 P1 Q3/ May 09 P1 Q1
- 2 Which item may be included in a Balance Sheet at more than historical cost?  
A goodwill B land and buildings  
C research expenditures D work in progress  
May 98 P1 Q5 / May 01 P1 Q7
- 3 What is ignored in the calculation of depreciation of non-current assets?  
A original cost B maintenance cost  
C estimated residual value D expected economic life  
May 98 P1 Q13 / Nov 99 P1 Q9
- 4 A business buys a machine for \$40 000 and depreciates it at the rate of 10% per year using the reducing balance method  
What is the depreciation charge for the second year of the machine's use?  
A \$ 3 200 B \$ 3 240  
C \$ 3 600 D \$ 4 000  
Nov 98 P1 Q9
- 5 Why are non-current assets depreciated?  
A to allow for the increase in repairs with use  
B to provide cash for replacement  
C to show their current value in the balance sheet  
D so that the income statement includes a charge for their use  
May 99 P1 Q2 / Nov 99 P1 Q11/ Nov 05 P1 Q15/Nov 11 P1 Q17
- 6 A business purchases a computer for \$3 200. It is estimated that it will have a useful life of 5 years and a residual value of \$700. Straight line depreciation is charged each year.  
What is the net book value at the end of year 2?  
A \$ 1 920 B \$ 2 200 C \$ 2 560 D \$ 2 700  
May 99 P1 Q3
- 7 A company uses the straight line method of depreciation for all its non-current assets. On 1 January, the company bought machinery on hire purchase. The cash price was \$115 000 and the interest for the year is \$19 550. The estimated useful life of the machinery is five years with no residual value.  
What is the charge for depreciation for the year ended 31 December?  
A \$19 000 B \$23 000 C \$26 910 D \$42 550  
Nov 99 P1 Q14 / May 03 P1 Q11/Nov 12 P12 Q18
- 8 A vehicle was part exchanged for a new vehicle. The value placed on the old vehicle was \$12 000.  
Which entries record the \$12 000 part exchange?  
A Dr Cash account  
Cr Motor Vehicles account  
B Dr Motor Vehicles account  
Cr Cash account  
C Dr Disposals account  
Cr Motor Vehicles account  
D Dr Motor Vehicles account  
Cr Disposals account  
Nov 00 P1 Q1/May 04 P1 Q4/Specimen 16 P1 Q4

- 9 A business buys a computer for \$2 200 on 1 January 1998. The computer will be used for four years, after which time it will be sold for \$280. The business uses the straight-line method of depreciation. What is the depreciation charge for the year ended 31 December 1999?

A \$480                      B \$550                      C \$960                      D \$1 100  
Nov 00 P1 Q4/May 04 P1 Q3/ May 09 P1 Q3

- 10 Why do businesses charge depreciation on their non-current assets?

A to ensure that sufficient cash is available to replace the assets  
B to show the realisable value of the assets in the balance sheet  
C to show when the assets must be replaced  
D to spread the cost of the assets over their estimated useful lives

Nov 00 P1 Q7 / May 01 P1Q6 / Nov 01 P1 Q6/ Nov 08 P1 Q6

- 11 An asset cost \$120 000 and has accumulated depreciation of \$72 400. The asset is sold for \$46 500. What is the loss or profit on disposal?

A loss of \$1 100    B loss of \$73 500  
C profit of \$1 100    D profit of \$73 500

Nov 00 P1Q13/ May 13 P12 Q18

- 12 A business sold a non-current asset. The following information is known.

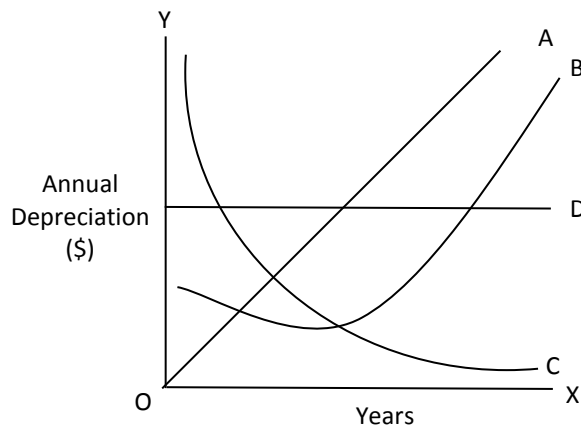
	\$
Original Cost	500
Accumulated depreciation on date of sale	240
Profit on sale	70

What is the proceed from the sale of non-current asset?

A \$170                      B \$ 190                      C \$ 310                      D \$ 330

May 01 P1 Q18

- 13 There are various methods of calculating the annual charge for depreciation. Which curve best represents the reducing balance method?



Specimen 02 P1 Q3

- 14 An asset, which would **not** normally be depreciated, is

A building                      B land                      C patents                      D plant and machinery  
Specimen 02 P1 Q6

- 15 Which asset does **not** need to be depreciated?

A land    B an oil well  
C a quarry    D a revalued property

May 02 P1Q12

- 16 The table shows information relating to a company's non-current assets.

	\$
Cost at 1 January 2002	10 500
Accumulated depreciation at 1 January 2002	4 900
Purchases for the year ended 31 December 2002	2 500
Disposals for the year ended 31 December 2002	700

Depreciation is 25% per annum on the reducing balance basis.

What is the depreciation charge for the year?

- A** \$1 850                      **B** \$2 025                      **C** \$2 200                      **D** \$3 250

May 03 P1 Q4

- 17 On 1 October 2001 a company purchased machinery for \$26 000. It was decided to depreciate the asset using the reducing balance method at a rate of 20% per annum. On 30 September 2003 the asset was sold for \$12 000. What is the profit or loss on disposal?

- A** \$3 600 loss                      **B** \$3 600 profit  
**C** \$4 640 loss                      **D** \$4 640 profit

Nov 03 P1 Q4/ May 07 P1 Q3/May 14 P12 Q6

- 18 A business has chosen to use the straight line method of providing for depreciation of equipment. Why should it continue to use this method in subsequent years?

- A** accounting principles never allow accounting methods to be changed  
**B** other methods of depreciation are unsuitable for depreciating equipment  
**C** to ensure that profits are stated on a consistent basis over time  
**D** to ensure that the Balance Sheet always shows the market value for equipment

Nov 03 P1 Q8/ May 06 P1 Q5

- 19 A non-current asset is purchased on 1 April 2000 at a cost of \$240 000. It has an estimated residual value of \$40 000 at the end of its 5 years life and is to be depreciated on the reducing balance basis at the rate of 30% each year.

What is the depreciation charge for the year ending 31 March 2002 (to the nearest \$)?

- A** \$42 000                      **B** \$50 400                      **C** \$98 000                      **D** \$117 600

May 04 P1 Q6

- 20 Why is a provision for depreciation made in accounts?

- A** to charge the cost of non-current assets against profit  
**B** to make a provision for repairs  
**C** to make cash available to replace non-current assets when necessary  
**D** to show the current market values of non-current assets

Nov 05 P1 Q15

- 21 Non-current assets of a company were:

	start of year 10 \$	end of year 10 \$
at cost	460 000	505 000
cumulative depreciation	<u>215 000</u>	<u>237 000</u>
net book value	<u>245 000</u>	<u>268 000</u>

During the year non-current assets costing \$92 000 were purchased and non-current assets with a net book value of \$16 000 were sold.

What was the depreciation charge for the year?

- A** \$22 000                      **B** \$23 000                      **C** \$53 000                      **D** \$69 000

Nov 07 P1 Q4/Nov 10 P1 Q3/May 11 P1 Q11/ Nov 14 P12 Q2

- 22 What is the purpose of providing for depreciation?
- A To apply the matching principle.
  - B To ascertain the true value of non-current assets.
  - C To ensure that money is available for repair of non-current assets.
  - D To provide cash in the business for replacement.

Nov 07 P1 Q5/Nov 14 P12 Q10

- 23 The table gives information relating to the non-current assets of a business.

	\$
net book value at the end of the year	25 000
net book value at the beginning of the year	16 000
depreciation charge for the year	5 000
additions at cost during the year	22 000

What is the net book value of disposals during the year?

- A \$8 000
- B \$11 000
- C \$18 000
- D \$22 000

May 08 P1 Q3

- 24 A company has two non-current assets. Details are given in the table.

Asset	date bought	Cost (\$)	depreciation method		residual value
X	1 Jan, Year 1	10 000	straight line	life 5 years	\$2 000
Y	1 Jan, Year 1	20 000	reducing balance	rate 20%	Nil

What is the depreciation charge for the year ended 31 December, Year 2?

- A \$4 800
- B \$5 200
- C \$5 600
- D \$6 000

May 08 P1 Q5

- 25 An item of machinery cost \$60 000. The machinery was later sold for \$8 000 and the loss on disposal was \$3 000.

What was the accumulated depreciation on the machinery on disposal?

- A \$46 000
- B \$49 000
- C \$52 000
- D \$55 000

Nov 08 P1 Q3

- 26 A company's policy is to depreciate its equipment by 30 % annually using the reducing balance method. A piece of equipment which was two years old was sold for \$6000 and the profit on sale was \$1590. What was the cost price of the equipment?

- A \$7 590
- B \$9 000
- C \$9 600
- D \$11 025

May 09 P1 Q12

- 27 A business purchases a vehicle for \$10 000. The business depreciates its non-current assets at 20 % using the diminishing value method.

What is the depreciation charge for year 2?

- A \$1 600
- B \$2 000
- C \$6 400
- D \$8 000

May 10 P1 Q30



33 A business depreciates its non-current assets at 20% using the straight-line method. Depreciation is calculated on a time basis in the year of acquisition and disposal.

	\$
non-current assets, at cost, 31 December 2013	200 000
purchase of machinery 1 January 2014	50 000
disposal of machinery 30 September 2014	40 000
non-current assets, at cost, 31 December 2014	210 000

What is the depreciation charge for non-current assets for the year ended 31 December 2014?

- A \$42 000    B \$48 000  
C \$50 000    D \$52 000

May 15 P12 Q6

34 A trader prepares a disposal account. On which sides do the cost of the asset and sale proceeds appear?

	cost of the asset	sale proceeds
A	credit	credit
B	credit	debit
C	debit	credit
D	debit	debit

Nov 15 P12 Q5

35 A business depreciates its motor vehicles over four years using the straight-line method. A full year's depreciation is charged in the year of purchase, but none in the year of sale.

A vehicle purchased on 1 July 2011 for \$18 000 had an estimated residual value of \$4000. The vehicle was sold for \$5000 on 31 December 2014.

Which entry appeared in the income statement for the year ended 31 December 2014?

- A \$1 000 loss    B \$2500 loss  
C \$2500 profit    D \$5000 profit

Nov 15 P12 Q13

36 A non-current asset costs \$250 000 and has a useful economic life of 25 years. The estimated residual value is \$10 000.

Depreciation is provided on a straight line basis.

After 10 years the asset is sold for \$120 000. Disposal costs of \$20 000 are incurred.

What is the loss on disposal?

- A \$30 000    B \$34 000  
C \$50 000    D \$54 000

Specimen 16 P1 Q3

37 A company's financial year ends on 31 December.

On 1 April 2015, the following payments relating to a new machine were made.

	\$
Purchase cost	50 000
Installation	10 000

Machinery is depreciated at 20% on cost per annum, calculated from the date of purchase.

What was the depreciation of the new machine for the year ended 31 December 2015?

- A \$7 500    B \$9 000  
C \$10 000    D \$12 000

May 16 P12 Q2

**38** A business purchased a motor vehicle on 1 January 2012 for \$24 000. The estimated useful life of the motor vehicle was four years and the estimated residual value at the end of four years was \$8 000. The business depreciates motor vehicles at 25% per annum using the reducing balance method. No depreciation is charged in the year of disposal. The motor vehicle was sold on 31 July 2015 for \$12 000.

What was the profit on the sale of the motor vehicle?

- A**     \$1 875     **B**     \$4 000
- C**     \$5 250     **D**     \$8 000

May 16 P12 Q3

**39** A disposal account is used to record the sale of a non-current asset. Which transactions are recorded on the credit side of the disposal account?

- A**     cost, loss on disposal and sale proceeds
- B**     cost, profit on disposal and sale proceeds
- C**     depreciation, loss on disposal and sale proceeds
- D**     depreciation, profit on disposal and sale proceeds

Nov 16 P12 Q2

**40** The following information was available for the disposal of a machine.

	\$
accumulated depreciation	45 000
profit on disposal	8 100
sale proceeds	75 600

What was the original cost of the machine?

- A**     \$22 500     **B**     \$38 700
- C**     \$112 500     **D**     \$128 700

Nov 16 P12 Q3

**41** Amitav purchased a van costing \$20 000. He provided an old van with a net book value of \$8 000 in part exchange. There was a profit on disposal of \$1 500.

What was the cash outflow arising from the purchase?

- A**     \$9 500     **B**     \$10 500     **C**     \$12 000     **D**     \$13 500

May 17 P12 Q3

**42** The net book value of a company's non-current assets was as follows.

	\$
at 1 January 2016	100 000
at 31 December 2016	80 000

During 2016 assets were sold for \$20 000, realizing a profit on disposal of \$5 000.

Depreciation charged for 2016 was \$8 000.

What was the expenditure on new assets in 2016?

- A**     \$3 000     **B**     \$5 000     **C**     \$8 000     **D**     \$15 000

May 17 P12 Q4

**ANSWER KEY**

1	D	12	D	23	A	34	C
2	B	13	C	24	A	35	B
3	B	14	B	25	B	36	D
4	C	15	A	26	B	37	B
5	D	16	A	27	A	38	A
6	B	17	C	28	A	39	C
7	B	18	C	29	A	40	C
8	D	19	B	30	A	41	B
9	A	20	A	31	C	42	A
10	D	21	C	32	B		
11	A	22	A	33	B		

**DETAILED ANSWERS**

- 2** As we know
- |                                 |   |                    |
|---------------------------------|---|--------------------|
| Cost – Accumulated depreciation | = | Book value         |
| \$30 000 – X                    | = | \$7 500 *          |
| X                               | = | \$30 000 – \$7 500 |
| X                               | = | \$22 500           |
| * Book value + Profit on sale   | = | Selling price      |
| X + \$1 500                     | = | \$9 000            |
| X                               | = | \$9 000 – \$1 500  |
| X                               | = | \$7 500            |
- 3** Formula for calculating straight line depreciation is  $\left(\frac{\text{Cost}-\text{Scrap value}}{\text{Remaining useful life}}\right)$ . As repair cost is not part of formula so “B” is the right option.
- 4**
- |   |    |                |
|---|----|----------------|
| Cost  | \$ | 40 000         |
| Depreciation for first year (\$40 000 × 10%)              |    | <u>(4 000)</u> |
| Depreciation for second year [(\$40 000 – \$4 000 × 10%)] |    | <u>(3 600)</u> |
- 6**
- |                                 |   |   |
|---------------------------------|---|---|
| Annual depreciation of computer | = | $\frac{\text{Cost}-\text{Scrap value}}{\text{Remaining useful life}}$ |
|                                 | = | $\frac{\$3\,200-\$700}{5\text{ years}}$                               |
|                                 | = | \$500   |
| Depreciation for two years      | = | \$500 × 2   |
|                                 | = | \$1 000   |
| Book value at the end of year 2 | = | \$3 200 – \$1 000   |
|                                 | = | \$2 200   |
- 7** Non-current assets are recorded at the cost of acquisition which is \$115 000, whereas interest paid is recorded as an expense so depreciation charge will be  $\left(\frac{\$115\,000-\text{zero}}{5\text{ years}}\right) = \$23\,000$
- 8** Motor Vehicle will be debited as it is being purchased whereas disposal account will be credited as the asset within the disposal account has been sold.

$$\begin{aligned}
 9 \quad \text{Annual depreciation of computers*} &= \frac{\text{Cost} - \text{Scrap value}}{\text{Remaining useful life}} \\
 &= \frac{\$2\,200 - \$280}{4 \text{ years}} \\
 &= \$480
 \end{aligned}$$

\* This is done so, as annual depreciation for each year remains constant under straight line unless an asset is purchased or sold during the year

$$\begin{aligned}
 11 \quad \text{Selling price} &- \text{Book value} &= &\text{Profit (loss) on sales} \\
 \$46\,500 &- (\$120\,000 - \$72\,400) &= &\$1\,100 \\
 &\text{Loss on sale} &= &\$1\,100
 \end{aligned}$$

$$\begin{aligned}
 12 \quad \text{Cost} &- \text{Accumulated depreciation} &= &\text{Book value} \\
 \$500 &- \$240 &= &\$260 \\
 &\text{Sales proceed} &= &\text{Book value} + \text{Profit on sale} \\
 & &= &\$260 + \$70 \\
 & &= &\$330
 \end{aligned}$$

16			\$	\$
	Cost at 1 January 2002		10 500	
	Add Purchases		<u>2 500</u>	13 000
	Less Disposals		700	
	Accumulated depreciation		<u>4 900</u>	<u>(5 600)</u>
	Written down (reduced) value of non-current assets			<u>7 400</u>

$$\text{Depreciation for the year } (\$7\,400 \times 25\%) = \$1\,850$$

17		\$
	Cost of machine sold	26 000
	Depreciation for first year ( $\$26\,000 \times 20\%$ )	<u>(5 200)</u>
		20 800
	Depreciation for second year ( $\$20\,800 \times 20\%$ )	<u>(4 160)</u>
	Book value of machine sold	16 640
	Sales price of machine sold	<u>12 000</u>
	Loss on machine disposal	<u>4 640</u>

19		\$
	Cost of non-current asset on 1 April 2000	240 000
	Depreciation for the year ending 31 March 2001 ( $\$240\,000 \times 30\%$ )	<u>(72 000)</u>
		168 000
	Depreciation for the year ending 31 March 2002 ( $\$168\,000 \times 30\%$ )	<u>(50 400)</u>

21 **Non-current asset Account (at book value)**

	\$		\$
Balance b/f	245 000	Asset disposal	16 000
Cash	92 000	<b>Depreciation (balancing figure)</b>	<b>53 000</b>
	<u>337 000</u>	Balance c/d	<u>268 000</u>
			<u>337 000</u>

22 This was a knowledge based question on depreciation. Of the options given only option **A** contained reference to an accounting concept, that of matching and is the correct key. Depreciation is a non-cash expense so it is wrong to assume that depreciation is aimed at retaining cash in the business.

23 **Non-current asset Account (at book value)**

	\$		\$
Balance b/f	16 000	<b>Asset disposal (balancing figure)</b>	<b>8 000</b>
Cash (additions)	22 000	Depreciation	5 000
	<u>          </u>	Balance c/d	<u>25 000</u>
	<u>38 000</u>		<u>38 000</u>

24		\$
	Depreciation under straight line $\left(\frac{\$10\,000 - \$2\,000}{5\text{ years}}\right)$	1 600
	Depreciation under reducing balance [ $\{\$20\,000 - (\$20\,000 \times 20\%)\} \times 20\%$ ]	<u>3 200</u>
	Total depreciation charge for the year ended 31 December, Year 2.	<u>4 800</u>

25	Selling price	–	Book value	=	Profit (loss) on sales
	\$8 000	–	(\$60 000 – accumulated depreciation)	=	(\$3 000)
			Accumulated depreciation	=	\$49 000

26	Original Cost $\times 70\% \times 70\%$	=	Book value after two years
	Original Cost $\times 70\% \times 70\%$	=	\$6 000 – \$1 590
	Original Cost	=	<u>\$4 410</u>
			49%
	Original Cost	=	\$9 000

27		\$
	Cost of non-current asset	10 000
	Depreciation for the first year ( $\$10\,000 \times 20\%$ )	<u>(2 000)</u>
		8 000
	Depreciation for the second year ( $\$8\,000 \times 20\%$ )	<u>(1 600)</u>

28 “A” option is correct as initial cost of machine should include purchase price, installation cost and cost of testing the machine before use. Manufacturer list price should be ignored as it was purchased for \$7 000. In addition advertising cost is a revenue expense and cannot be treated as part of initial capital cost.

29	Vehicle transferred to the business	–	Vehicle sold by the business	=	Increase in value of vehicles
	\$4000	–	\$2 500	=	\$1 500

30 **Non-current asset Account (at book value)**

	\$		\$
Balance b/f	115 000	<b>Asset disposal (balancing figure)</b>	<b>25 000</b>
Cash	105 000	Depreciation	40 000
	<u>          </u>	Balance c/d	<u>155 000</u>
	<u>220 000</u>		<u>220 000</u>

**Asset disposal Account**

	\$		\$
Non-current asset	25 000	<b>Bank – Sales proceeds (Bal. figure)</b>	<b>15 000</b>
	<u>          </u>	Loss on disposal	<u>10 000</u>
	<u>25 000</u>		<u>25 000</u>

33	Depreciation [ $(\$200\,000 - \$40\,000) \times 20\%$ ] + [ $\$50\,000 \times 20\%$ ] + [ $\$40\,000 \times 20\% \times \frac{9}{12}$ ]	\$48 000
----	---	----------

35		\$
	Cost of motor vehicles sold	18 000
	Depreciation for three years under SLM $\left(\frac{\$18\,000 - \$4\,000}{4\text{ years}}\right) \times 3\text{ years}$	<u>(10 500)</u>

Book value of motor vehicles sold	7 500
Sales price of motor vehicles sold	<u>(5 000)</u>
Loss on motor vehicles disposal	<u>2 500</u>

<b>36</b>		<b>\$</b>
Cost of non-current asset sold	250 000	
Depreciation for ten years under SLM $\left(\frac{\$250\,000 - \$10\,000}{25\text{ years}}\right) \times 10\text{ years}$	<u>(96 000)</u>	
Book value of non-current asset sold	154 000	
Net sales price of non-current asset sold (\$120 000 – \$20 000)	<u>(100 000)</u>	
Loss on non-current asset disposal	<u>54 000</u>	

<b>37</b>	Depreciation for the year ended 31 December 2015	=	$[(\$50\,000 + \$10\,000) \times 20\% \times \frac{9}{12}]$
		=	\$9 000

<b>38</b>		<b>\$</b>
Cost of machine sold	24 000	
Depreciation for 2012 (\$24 000 × 25%)	<u>(6 000)</u>	
	18 000	
Depreciation for 2013 (\$18 000 × 25%)	<u>(4 500)</u>	
	13 500	
Depreciation for 2014 (\$13 500 × 25%)	<u>(3 375)</u>	
Book value of motor vehicle sold	10 125	
Sales price of motor vehicle sold	<u>12 000</u>	
Profit on the sale of the motor vehicle	<u>1 875</u>	

**40 Machine disposal Account**

	\$		\$
<b>Machine - cost (Balancing figure)</b>	<b>112 500</b>	Bank – Sales proceeds	75 600
Profit on disposal	<u>8 100</u>	Accumulated depreciation	<u>45 000</u>
	<u>120 600</u>		<u>120 600</u>

<b>41</b>	Purchase price	–	Trade in value	=	Cash outflow on purchase
	\$20 000	–	(\$8 000 + \$1 500)	=	\$10 500

**42 Non-current asset Account (at book value)**

	\$		\$
Balance b/f	100 000	Asset disposal (\$20 000 – \$5 000)	15 000
<b>Cash (purchase/expenditure on asset)</b>	<b>3 000</b>	Depreciation	8 000
	<u>103 000</u>	Balance c/d	<u>80 000</u>
			<u>103 000</u>

## CHAPTER 3 BAD DEBTS AND PROVISION FOR DOUBTFUL DEBTS

- 1 The figures show a calculation of the provision for doubtful debts.

	1 July 1997	30 June 1998
	\$	\$
Trade receivable X	750	nil
Trade receivable Y	1 000	2 000
Trade receivable Z	<u>nil</u>	<u>1 500</u>
	1 750	3 500
General provision	<u>4 150</u>	<u>7 200</u>
Total provision	<u>5 900</u>	<u>10 700</u>

During the period, X was made bankrupt and a final payment of \$50 was received. What is the charge for the year to 30 June 1998 for bad and doubtful debts?

- |          |         |          |         |
|----------|---------|----------|---------|
| <b>A</b> | \$3 050 | <b>B</b> | \$4 750 |
| <b>C</b> | \$4 800 | <b>D</b> | \$5 500 |

May 98 P1 Q10

- 2 A company increases its provision for bad debts by \$ 1 600 from \$3 000. What will be the effect of this adjustment on the year-end balance sheet?

	Net profit	Net trade receivables
<b>A</b>	decrease by \$1 600	decrease by \$1 600
<b>B</b>	decrease by \$1 600	decrease by \$4 600
<b>C</b>	increase by \$1 600	decrease by \$1 600
<b>D</b>	increase by \$1 600	decrease by \$4 600

Nov 98 P1 Q5 / May 02 P1 Q5/Nov 13 P12 Q2

- 3 A Company's year-end Sales Ledger balances are shown below.

Debit	\$14 240
credit	\$960

When preparing the annual accounts, it was decided to write off bad debts of \$200 and to maintain the provision for doubtful debts at 2½%.

What will be the provision for doubtful debts at the year-end?

- |          |       |          |       |
|----------|-------|----------|-------|
| <b>A</b> | \$151 | <b>B</b> | \$327 |
| <b>C</b> | \$332 | <b>D</b> | \$351 |

Nov 99 P1 Q2

- 4 At the beginning of the year a company has a provision for doubtful debts of \$1 000. At the end of the year required provision is \$2 500. During the year debts of \$1 500 are written off and \$100 is received in respect of a debt written off many years ago.

What is the **net** amount charged to the Income statement for bad and doubtful debts?

- |          |         |
|----------|---------|
| <b>A</b> | \$1 500 |
| <b>B</b> | \$2 500 |
| <b>C</b> | \$2 900 |
| <b>D</b> | \$3 000 |

May 00 P1 Q14

- 5 The writing off of a bad debt is an example of the

- |          |                             |
|----------|-----------------------------|
| <b>A</b> | going concern concept       |
| <b>B</b> | matching concept            |
| <b>C</b> | prudence concept            |
| <b>D</b> | substance over form concept |

Nov 00 P1 Q6/Nov 04 P1 Q6

- 6 The table shows information about a business.

	\$
Provision for Doubtful Debts at 1 January 2000	700
Trade receivables at 31 December 2000 (after writing off bad debt of \$30	15 000
Charge to Income statement for bad and doubtful debts for the year ended 31 December 2000 (including bad debts written off \$30	200

What is the percentage provision that has been made for doubtful debts at 31 December 2000?

- A** 3.3%                                      **B** 4.7%  
**C** 5.8%                                      **D** 6.0%

Nov 01 P1 Q2

- 7 A trial balance at 30 April 2003, before making end of year adjustments, showed:

	Debit (\$)	Credit (\$)
Trade receivables	17 800	-
Provision for doubtful debts	-	580

At 30 April 2003 it was decided to write off a bad debt of \$800 and to make a provision for doubtful debts of 2% of trade receivables. During the year an amount of \$200 was received from a customer relating to a debt that was written off in the year ended 30 April 2002.

What was the total bad and doubtful debt expense for the year ended 30 April 2003?

- A** \$360                                      **B** \$560  
**C** \$940                                      **D** \$1 140

May 03 P1 Q3

- 8 At the beginning of the year a business has a provision for doubtful debts of \$2 600. At the year end the provision is to be 5% of trade receivables.

The balance on the Trade receivables Control account at the year-end is \$69 200, before writing off a bad debt of \$480. The business operates a separate Bad Debts accounts.

What is the entry in the Income statement for the provision for doubtful debts?

- A** \$836 debit              **B** \$860 debit              **C** \$836 credit              **D** \$860 credit

Nov 03 P1 Q3/Nov 06 P1 Q4

- 9 At the end of a financial period, a business has the following balances.

	\$
Total trade receivables balances	10 620
Bad debt not yet written off	260
Provision for doubtful debts brought forward	460

What should the business do if it wishes to maintain the bad debt provision at 5% of trade receivables?

- A** decrease the existing provision by \$58  
**B** increase the existing provision by \$58  
**C** decrease the existing provision by \$71  
**D** increase the existing provision by \$71

May 04 P1 Q5

- 10 A company has the following balances.

	\$
Trade receivables at 31 December 2003	125 400
Provision for doubtful debts at 1 January 2003	1 800

During the year ended 31 December 2003 bad debts of \$20 500 were written off. The company provides for 5% of trade receivables at each year-end.

What is the doubtful debts expense for the year ended 31 December 2003?

- A** \$3 445                      **B** \$4 470                      **C** \$5 245                      **D** \$6 270

Nov 04 P1 Q5

- 11** A business makes a provision for doubtful debts equal to 5% of its trade receivables. At 31 March 2003 net trade receivables were shown in the Balance Sheet as \$17 100. At 31 March 2004 the balance on its Sales Ledger Control account was \$19 000. In the year ended 31 March 2004 a bad debt of \$800 had been written off. How much should be debited in the Income statement for the year ended 31 March 2004 for the provision for doubtful debts?
- A** \$10                      **B** \$50                      **C** \$55                      **D** \$95
- May 05 P1 Q4
- 12** On 30 September 2005 a manufacturer's current assets totalled \$28 000. The next day only two transactions took place.
- 1** Inventory bought for cash. The list price of \$2 000 was subject to a trade discount of 20% and a cash discount of 5%. Payment was made immediately.
  - 2** A bad debt of \$400 was written off.
- What was the total of current assets on 2 October 2005?
- A** \$27 680                      **B** \$28 080                      **C** \$29 520                      **D** \$29 600
- May 06 P1 Q4
- 13** A trial balance shows:
- |                              | Dr (\$) | Cr (\$) |
|------------------------------|---------|---------|
| provision for doubtful debts |         | 1 200   |
| trade receivables            | 28 000  |         |
- \$2 100 of the trade receivables are irrecoverable and are to be written off. The owner of the business wishes to make the provision for doubtful debts equal to 5 % of his outstanding trade receivables. What is the amount debited to the income statement for the provision for doubtful debts?
- A** \$95                      **B** \$1 295                      **C** \$1 400                      **D** \$2 600
- May 07 P1 Q4
- 14** A trial balance at 30 June, before making end of year adjustments, showed:
- |                              | debit (\$) | credit (\$) |
|------------------------------|------------|-------------|
| trade receivables            | 35 600     | -           |
| provision for doubtful debts | -          | 1 160       |
- At 30 June, it was decided to write off a bad debt of \$1 600 and to make a provision for doubtful debts equal to 2% of trade receivables. What was the total expense in the income statement for bad and doubtful debts for the year ended 30 June?
- A** \$680                      **B** \$1 120                      **C** \$2 080                      **D** \$2 280
- May 08 P1 Q4/Nov 15 P12 Q6
- 15** A business makes a provision for doubtful debts equal to 5 % of its trade receivables. At 31 March 2008 the provision for doubtful debts was \$850. At 31 March 2009 the trade receivables after the provision for doubtful debts were \$17 100. How much is the increase in the provision for doubtful debts for the year ended 31 March 2009?
- A** \$45                      **B** \$50                      **C** \$850                      **D** \$900
- Nov 09 P1 Q3
- 16** What is the main use of a computerised age analysis of trade receivables?
- A** aid debt collection procedures                      **B** match sales invoices against orders  
**C** reconcile sales ledger balances                      **D** show credit notes issued
- May 11 P1 Q14
- 17** Who is most likely to use an age analysis of debtors?
- A** cashier                      **B** credit controller  
**C** sales ledger supervisor                      **D** sales manager
- May 13 P12 Q9

- 18** A business is reviewing credit limits for its customers. What would result in a customer's credit limit being reduced?
- A** Cash discounts are always taken by the customer.
  - B** Sales have increased to that customer.
  - C** The customer always pays their debt on time.
  - D** The customer has lost a major contract.

Nov 13 P12 Q21

- 19** Which statement is correct?
- A** The balance on the bad debts recovered account is carried down to the next accounting period.
  - B** The balance on the bad debts recovered account is credited to the income statement.
  - C** The balance on the provision for doubtful debts account is calculated before the deduction of bad debts.
  - D** The balance on the provision for doubtful debts account is not included in a trial balance.

May 14 P12 Q3

- 20** At the end of its financial year a business had trade receivables of \$16 000 and had provision for doubtful debts of \$640. The provision is to be maintained at 5%. Which amount is shown in the income statement?
- A** \$160 credit
  - B** \$160 debit
  - C** \$800 credit
  - D** \$800 debit

Nov 14 P12 Q1

- 21** A business started on 1 January 2013. At 31 December 2014 the following information is available.

	<b>31 December 2013 (\$)</b>	<b>31 December 2014 (\$)</b>
trade receivables	80 000	100 000
increase in provision for doubtful debts in income statement	4 000	2 000

What is the rate for provision for doubtful debts in 2014?

- A** 2%
- B** 3.33%
- C** 5%
- D** 6%

May 15 P12 Q4

**ANSWER KEY**

1	D	7	A	13	A	19	B
2	B	8	A	14	B	20	B
3	D	9	B	15	B	21	D
4	C	10	B	16	A		
5	C	11	B	17	B		
6	C	12	A	18	D		

**DETAILED ANSWERS**

- 1** In Income statement changes in provision for doubtful debts & bad debts written off are recorded.  
So
- |  |              |
|--|--------------|
|  | \$           |
| Increase in provision (\$10 700 – \$5 900) | 4 800        |
| Bad debts written off (\$750 – \$50)       | <u>700</u>   |
| Amount to be charged in Income statement   | <u>5 500</u> |
- 3** Credit balance of trade receivables is shown as liability so only debit balances will be considered to calculate provision that is  
Provision for doubtful debts = (\$14 240 – \$200 × 2½ %) = \$351
- 4**
- |  |              |
|--|--------------|
|  | \$           |
| Total bad debts written off                                  | 1 500        |
| Increase in provision for doubtful debts (\$2 500 – \$1 000) | 1 500        |
| Less Bad debts recovered                                     | <u>(100)</u> |
| Net amount to be charged to Income statement                 | <u>2 900</u> |
- 6**
- |                             |   |  |
|-----------------------------|---|--|
| Increase in provision       | = | \$200 – \$30                                   |
|                             | = | \$170  |
| So provision at 31 December | = | Provision on 1 January + Current year increase |
|                             | = | \$700 + \$170                                  |
|                             | = | \$870  |
- As we know
- |                                   |   |                        |
|-----------------------------------|---|------------------------|
| Trade receivables × Provision (%) | = | Provision (\$)         |
| \$15 000 × X                      | = | \$870                  |
| X                                 | = | \$870 ÷ \$15 000 × 100 |
| X                                 | = | 5.8%                   |
- 7**
- |   |            |              |
|---|------------|--------------|
|   | \$         | \$           |
| Bad debts   |            | 800          |
| Bad debts recovery  |            | (200)        |
| Provision for doubtful debts required [(\$17 800 – \$800) × 2%] | 340        |              |
| Provision for doubtful debts available                          | <u>580</u> |              |
| Decrease in provision   |            | <u>(240)</u> |
| Total bad and doubtful debts                                    |            | <u>360</u>   |
- 8**
- |   |              |
|---|--------------|
|   | \$           |
| Provision for doubtful debts required [(\$69 200 – \$480) × 5%] | 3 436        |
| Existing provision for doubtful debts                           | <u>2 600</u> |
| Increase in provision   | <u>836</u>   |
- Increase in provision for a doubtful debt involves the following entry.
- |    |                              |       |       |
|----|------------------------------|-------|-------|
| Dr | Income statement             | \$836 |       |
| Cr | Provision for doubtful debts |       | \$836 |

<b>9</b>		\$
	Provision for doubtful debts required $[(\$10\,620 - \$260) \times 5\%]$	518
	Provision for doubtful debts brought forward	<u>460</u>
	Increase in existing provision	<u>58</u>
<b>10</b>		\$
	Provision for doubtful debts required $(\$125\,400 \times 5\%)$	6 270
	Provision for doubtful debts at 1 January 2003	<u>(1 800)</u>
	Doubtful expense for the year	<u>4 470</u>
<b>11</b>		\$
	Provision for doubtful debts required on 31 March 2004 $(\$19\,000 \times 5\%)$	950
	Provision for doubtful debts brought forward (31 March 2003 $\frac{\$17\,100}{95\%} \times 5\%$ )	<u>(900)</u>
	Increase in provision to be debited to Income statement	<u>50</u>
<b>12</b>		\$
	Total of current assets on 30 September	28 000
	Increase in inventories $(\$2\,000 \times 80\%)$	1 600
	Decrease in cash $(\$2\,000 \times 80\% \times 95\%)$	(1 520)
	Decrease in trade receivables due to bad debts	<u>(400)</u>
	Total of current assets on 2 October	<u>27 680</u>
<b>13</b>		\$
	Provision for doubtful debts required $[(\$28\,000 - \$2\,100) \times 5\%]$	1 295
	Existing provision for doubtful debts	<u>(1 200)</u>
	Increase in provision to be debited to income statement	<u>95</u>
<b>14</b>		\$
	Bad debts	1 600
	Increase in provision for doubtful debts required $[\$1\,600 - \{(\$35\,600 - \$1\,600) \times 2\%\}]$	<u>(460)</u>
	Total expense in the income statement for bad and doubtful debts	<u>1 120</u>
<b>15</b>		\$
	Provision for doubtful debts required on 31 March 2009 $(\frac{\$17\,100}{95\%} \times 5\%)$	900
	Provision for doubtful debts brought forward 31 March 2008	<u>(850)</u>
	Increase in provision to be debited to Income statement	<u>50</u>
<b>18</b>	The question requires identifying a situation where the credit limit of customers should have been reduced. The implication here is that the customer will be less likely to pay their account on time or at all. This, therefore, should be something negative, which was the customer losing a major contract.	
<b>20</b>		\$
	Provision for doubtful debts required $(\$16\,000 \times 5\%)$	800
	Existing provision for doubtful debts	<u>640</u>
	Increase in provision	<u>160</u>

Increase in provision for a doubtful debt involves the following entry.

<b>Dr</b>	Income statement	\$160
<b>Cr</b>	Provision for doubtful debts	\$160

<b>21</b>	Provision at 31 December 2014	=	Provision on 31 Dec 2013 + Current year increase
		=	\$4 000 + \$2 000
		=	\$6 000
	As we know		
	Trade receivables × Provision (%)	=	Provision (\$)
	\$100 000 × X	=	\$6 000
		=	$\frac{\$6\,000}{\$100\,000} \times 100$
		=	6%

### CHAPTER 4

### INVENTORY VALUATION

- 1** The normal selling price of an inventory item is \$22 per unit. The item originally costs \$15 per unit, but can only be sold at the normal selling price after modification cost of \$14 per unit. The scrap value of the item is \$7 per unit. At how much price should the item be valued in the balance sheet?
- |          |               |          |              |
|----------|---------------|----------|--------------|
| <b>A</b> | \$7 per unit  | <b>B</b> | \$8 per unit |
| <b>C</b> | \$14 per unit | <b>D</b> | \$15per unit |

Nov 98 P1 Q8/ Nov 07 P1 Q14

- 2** Inventory should be valued at the lower of cost and net realisable value. The table shows data about four products.

Product	W	X	Y	Z
Cost (\$)	18	19	17	23
Realisable value (\$)	15	28	17	26
Selling cost (\$)		3	2	3

At how much should the total inventories is valued?

- |          |      |          |      |
|----------|------|----------|------|
| <b>A</b> | \$72 | <b>B</b> | \$77 |
| <b>C</b> | \$78 | <b>D</b> | \$87 |

May 99 P1 Q24/May 06 P1 Q14

- 3** A company’s year-end is 30 June, but because of staff shortage the inventory could not be counted until 6 July. The inventory valuation at this date was \$86 500. However detailed records were kept of inventory movement between 30 June & 6 July. The table shows the data available

	\$
Sales (at cost)	1 750
Purchases	1 550
Returns inwards (at cost)	310
Returns outwards	190

What is the value of inventory on the company’s balance sheet at 30 June?

- |          |          |          |          |          |          |          |          |
|----------|----------|----------|----------|----------|----------|----------|----------|
| <b>A</b> | \$86 180 | <b>B</b> | \$86 420 | <b>C</b> | \$86 580 | <b>D</b> | \$86 820 |
|----------|----------|----------|----------|----------|----------|----------|----------|

Nov 99 P1 Q10

- 4** How should inventories be valued in published accounts?
- |          |                  |          |  |
|----------|------------------|----------|--|
| <b>A</b> | cost             | <b>B</b> | net realisable value                     |
| <b>C</b> | replacement cost | <b>D</b> | the lower of cost & net realisable value |

Nov 99 P1 Q21/May 08 P1 Q14

- 5** Which of the following is always acceptable as a means of inventory valuation under SSAP9 “Accounting for inventories and long term contracts”?
- |          |                |          |                  |
|----------|----------------|----------|------------------|
| <b>A</b> | base inventory | <b>B</b> | FIFO             |
| <b>C</b> | LIFO           | <b>D</b> | replacement cost |

May 00 P1 Q23

- 6** When valuing inventory, which costs should be included?
- |          |  |
|----------|--|
| <b>A</b> | production   |
| <b>B</b> | production and administration                          |
| <b>C</b> | production, marketing and distribution                 |
| <b>D</b> | production, marketing, administration and distribution |

May 00 P1 Q32/May 08 P1 Q11

- 7 The table shows information relating to the end of year inventory

	\$
Cost	50 000
Realisable value	45 000
Realisable costs	5 000
Replacement cost	35 000

What is the value of inventory at the balance sheet date?

- A**     \$35 000                                      **B**     \$40 000  
**C**     \$45 000                                      **D**     \$50 000

Nov 00 P1 Q22/Nov 12 P12 17

- 8 One of the characteristics of the LIFO basis of inventory valuation is that LIFO
- A**     determines the exact profit in historic cost terms in respect of completed jobs  
**B**     gives balance sheet values reflecting up-to-date costs  
**C**     matches revenues with up-to-date costs  
**D**     smoothes the effect of seasonal cost fluctuations

Specimen 02 P1 Q11

- 9 A company operates in a country where the price level is rising. The use of FIFO rather than LIFO inventory valuation will
- A**     raise reported profits  
**B**     lower reported profits  
**C**     lower the value of net assets shown in the Balance Sheet  
**D**     leave the value of reported profits unchanged

Specimen 02 P1 Q17

- 10 A company has listed its year-end inventories.

Inventory Item	Purchase price \$000	Production costs \$000	Selling costs \$000	Sales value \$000
Metal	60	10	11	65
Plastic	25	5	6	40
Wood	<u>50</u>	<u>12</u>	<u>15</u>	<u>60</u>
	<u>135</u>	<u>27</u>	<u>32</u>	<u>165</u>

At what valuation should the company include its inventory in the Balance Sheet?

- A**     \$129 000                      **B**     \$162 000                      **C**     \$143 000                      **D**     \$194 000

Specimen 02 P1 Q18

- 11 On 6 January 2002 a firm lost its entire inventory in a fire. Inventory had a Balance Sheet valuation of \$650000 on 31 December 2001.  
 In the period 1-5 January 2002 purchases were \$75 000 and sales were \$96 000.  
 The average gross profit the firm makes is 25% of selling price.  
 What was the value of the inventory on 5 January?

- A**     \$629 000                      **B**     \$647 000                      **C**     \$653 000                      **D**     \$671 000

May 02 P1 Q11

- 12 Inventory which cost \$1 200 has been damaged. It would have sold for \$1 800 when perfect. It can be sold for \$1 700 if repairs are undertaken at a cost of \$600. To replace the inventory would cost \$1 000. At what value should the damaged inventory be shown in the final accounts?

- A**     \$1 000                                      **B**     \$1 100  
**C**     \$1 200                                      **D**     \$1 800

Nov 02 P1 Q8/May 06 P1 Q6/ Nov 09 P1 Q6





- 23 A company has the following costs for an item of inventory.

	\$
purchase cost	12 000
carriage in	2 000
conversion costs	18 000
storage costs	8 000

What should the inventory be valued at?

- A** \$12 000      **B** \$14 000      **C** \$32 000      **D** \$40 000

Nov 10 P3 Q10

- 24 At the year-end a company discovers that some inventory is damaged.

This inventory originally cost \$2 000 and to replace it would now cost \$1 900.

It would normally sell for \$2 400 but can now only be sold for \$2 200 if repairs costing \$400 are undertaken.

At what value should the damaged inventory be shown in the financial statements?

- A** \$1 800      **B** \$1 900      **C** \$2 000      **D** \$2 200

May 11 P1 Q5

- 25 A trader buys and sells garden fertiliser in 50 kilo units. Inventory at 1 July was 250 units valued at \$16 per unit. Purchases and sales during the month were as follows.

Date		purchases (units)	sales (units)
3 July	sales		100
11 July	purchases (\$13 per unit)	200	
14 July	sales		200
25 July	purchases (\$14 per unit)	200	
29 July	sales		200

The FIFO method is used to value inventory.

What is the value of the closing inventory at 31 July?

- A** \$1 950      **B** \$2 100      **C** \$2 400      **D** \$4 000

Nov 11 P1 Q16

- 26 Draft financial statements show revenue of \$106 000 and closing inventory of \$2100.

There were 100 items which had cost \$10 an item but which were for sale at \$6 an item. At the year-end these were with a customer on a sale or return basis. These items were treated as having been sold although no sale had been agreed.

What are the values of revenue and inventory when the principle of prudence is applied?

	Revenue (\$)	Inventory (\$)
<b>A</b>	105 000	2 700
<b>B</b>	105 000	3 100
<b>C</b>	105 400	2 700
<b>D</b>	105 400	3 100

Nov 12 P12 Q6

- 27 Hedley has 100 items of inventory in his warehouse and five more with a customer on a sale or return basis. He provides the following information.

	\$ per unit
historic cost paid	60
selling price	85
current replacement cost	65

Which value should appear in the statement of financial position for inventory?

- A** \$6 000      **B** \$6 300      **C** \$6 825      **D** \$8 500

May 14 P12 Q1

- 28 A business bought and sold the following items of inventory.

Month	details	units	cost per unit (\$)
January	purchased	30	2.00
February	purchased	20	2.50
March	sold	10	–

It uses the AVCO method of inventory valuation.

What was the value of inventory at the end of March?

- A \$20                      B \$22                      C \$88                      D \$90  
May 15 P12 Q16

- 29 Inventory is valued at the lower of cost and net realisable value.

What is net realisable value?

- A selling price  
B selling price less cash discount  
C selling price less further cost to completion  
D selling price less trade discount

Nov 15 P12 Q18

- 30 A company commences business on 1 April. It buys the following units of inventory.

date	quantity	unit cost
1 April	200	\$250
1 September	400	\$200
1 December	200	\$300

During the year, it sells 500 units at \$550 each.

What is the gross profit for the year using the FIFO method of inventory valuation?

- A \$85 000                      B \$155 000                      C \$156 250                      D \$165 000  
Specimen 16 P1 Q23

- 31 A business uses the AVCO method of inventory valuation.

The following transactions took place.

1 March	purchase 1 000 units at \$65 per unit
2 March	purchased 1 200 units at \$66 per unit
4 March	sold 1 850 units at \$68 per unit

What was the value of closing inventory?

- A \$22 750                      B \$22 941                      C \$23 100                      D \$23 800  
Nov 16 P12 Q22

- 32 Sam was unable to conduct a physical count of inventory at 31 December 2016.

On 3 January 2017 inventory had been sold to Abdul for \$11 950. The cost price of this inventory had been \$9 560.

On 4 January 2017 inventory had been returned by Sita. It had been sold for \$2 390. The cost price of this inventory was \$1 912.

Sam valued his inventory at 5 January 2017 at cost, \$59 750.

What was the value of inventory at 31 December 2016?

- A \$50 190                      B \$52 012                      C \$67 398                      D \$69 310  
May 17 P12 Q11

- 33 Jamal uses the AVCO system to value his inventory. He provides the following information:

March 1	no opening inventory
6	60 units were purchased at \$120 per unit
17	100 units were purchased at \$116 per unit
23	110 units were sold for \$150 per unit

What was the cost of sales for March?

- A \$5 875                      B \$12 925                      C \$13 000                      D \$18 800  
May 17 P12 Q22

**ANSWER KEY**

1	B	10	A	19	A	28	C
2	A	11	C	20	B	29	C
3	C	12	B	21	B	30	D
4	D	13	C	22	A	31	B
5	B	14	A	23	C	32	C
6	A	15	B	24	A	33	B
7	B	16	D	25	B		
8	C	17	B	26	C		
9	A	18	C	27	B		

**DETAILED ANSWERS**

- 1 Net realisable value (NRV) = (\$22-\$14) = \$8  
 Original cost = \$15  
 Inventory should be valued at lower of cost or NRV i.e. \$8.

2

Product	1 Cost (\$)	2 Realisable Value (\$)	3 Selling Cost (\$)	2-3 Net Realisable Value (\$)	Lower of Cost & NRV (\$)
W	18	15	-	15	15
X	19	28	3	25	19
Y	17	17	2	15	15
Z	23	26	3	23	<u>23</u>
					<u>72</u>

- 3
- |                          |  |               |
|--------------------------|--|---------------|
|                          |  | \$            |
| Inventory at 6 July      |  | 86 500        |
| Add Sales at cost        |  | 1 750         |
| Return outwards          |  | 190           |
| Less Purchases           |  | (1 550)       |
| Return inwards (at cost) |  | <u>(310)</u>  |
| Inventory at 30 June     |  | <u>86 580</u> |

- 7 Net realisable value (\$45 000 – \$5 000) = \$40 000  
 Cost = \$50 000  
 So inventory should be valued at \$40 000.

\* Replacement cost is ignored as law does not permit this method.

10

	1	2	3(1+2)	4	5	6(4-5)	7
Inventory Item	Purchase price \$000	Production cost \$000	Total cost \$000	Sale value \$000	Selling cost \$000	Net realisable value \$ 000	Lower of cost and NRV \$000
Metal	60	10	70	65	11	54	54
Plastic	25	5	30	40	6	34	30
Wood	<u>50</u>	<u>12</u>	<u>62</u>	<u>60</u>	<u>15</u>	<u>45</u>	<u>45</u>
	<u>135</u>	<u>27</u>	<u>162</u>	<u>165</u>	<u>32</u>	<u>133</u>	<u>129</u>

<b>11</b>		\$
	Opening inventory (on 31 December 2001)	650 000
	Add Purchases	<u>75 000</u>
		725 000
	Less Cost of sales (96 000 × 75%)	<u>(72 000)</u>
	Inventory on 5 January 2002	<u>653 000</u>

**12** Inventory should be valued at lower of cost or net realisable value so it would be \$1 100 (\$1 700 – \$600).

<b>13</b>		\$	\$
	Sales (2 units @ \$400) + (2 units @ \$400)		1 600
	Cost of sales		
	Purchases (3 @ \$200) + (3 @ \$250)	1 350	
	Closing inventory [(3+3) – (2+2)] @ \$250	<u>(500)</u>	<u>(850)</u>
	Gross profit		<u>750</u>

**14** **Inventory Sheet**

Date	Receipts			Issues			Balance			
	Jan	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount
01								100	2.00	200
12		150	2.10	315				250	2.06	515
15					100	2.06	206	150	2.06	309
27		50	2.20	110				200	2.095	419

<b>15</b>		\$
	Value of inventory at 10 January	104 000
	Inventory purchased	(16 000)
	Inventory sold ( $\$15\,000 \times \frac{100}{125}$ )	<u>12 000</u>
	Inventory value at 31 December	<u>100 000</u>

**17** If a business has more than one item of inventory then each inventory item is valued separately at lower or cost and net realisable value i.e.

	Selling price	–	Repairs cost	=	Net realisable value
Item1	\$7 600	–	\$880	=	\$6 720
Item2	\$2 450	–	\$190	=	\$2 260

If we compare NRV with individual costs of inventory items we can see that cost of item 1 is lower whereas net realisable value of item 2 is lower.

On the basis of above calculation total value of inventory will be \$7 520 (\$5 260 + \$2 260).

**19** As inventory is valued at lower of cost or net realisable value of each separate item so value of inventory will be determined as

	Cost (\$)	Net realisable value (\$)	Lower value (\$)
Item 1	2 160	2 450 – 190 = 2 260	2 160
Item 2	3 190	3 060 – 320 = 2 740	<u>2 740</u>
		Total	<u>4 900</u>

**20** Inventory on 31 March is \$380 [(100 units × \$3 + (20 units × \$4)].

**21** **Inventory Sheet**

Date	Receipts			Issues			Balance			
	Jan	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount
01								200	6.00	1 200
12		300	6.50	315				500	6.30	3 150
15					250	6.30	1 575	250	6.30	1 575
27		100	6.70	670				350		2 245

22 Inventory held at 31 January (100 units @ \$5) = \$500

23 Inventory should be valued at total cost of production and will include material cost \$14 000 (\$12000 + \$2 000) and conversion cost i.e. all production costs excluding material (\$18 000) so it should be valued at \$32 000 (\$14 000 + \$18 000).

24 Net realisable value (NRV) = (\$2200 – \$400) = \$1 800  
 Original cost = \$2 000  
 Inventory should be valued at lower of cost or NRV i.e. \$1 800.

25 **Inventory Sheet**

Date	Purchases			Sales			Balance			
	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount	
1 July							250	16	4 000	
3 July				100	16	1 600	150	16	2 400	
11 July	200	13	2 600				150 200	16 13	5 000	
14 July				200	150 50	16 13	3 050	150	13	1 950
25 July	200	14	2 800				150 200	13 14	4 750	
29 July				200	150 50	13 14	2 650	<b>150</b>	<b>14</b>	<b>2 100</b>

26 As inventory is recorded at net realisable value or cost whichever is lower so it will be valued at \$2 700 [ $200 + (100 \times 6)$ ]. On the other hand, the revenue will be \$105 400 [ $\$106 000 - (100 \times \$6)$ ].

27 Closing Inventory = 105 units @ \$60 = \$6 300

28 **Inventory Sheet**

Date	Receipts			Issues			Balance		
	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount
January	30	2.00					30	2.00	60
February	20	2.50					50	2.20	110
March				10	2.20	22	<b>40</b>	<b>2.20</b>	<b>88</b>

	<b>\$</b>	<b>\$</b>
Sales (500 units @ \$550)		275 000
Cost of sales		
Purchases [(200 @ \$250) + (400 @ \$200) + (200 @ \$300)]	190 000	
Closing inventory [(200 @ \$300) + (100 @ \$200)]	<u>(80 000)</u>	<u>(110 000)</u>
Gross profit		<u>165 000</u>

\* Closing inventory units = [(200+400 +200) – 500 units] = 300 units

31 **Inventory Sheet**

Date	Purchases			Sales			Balance		
	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount
01	1 000	65	65 000				1 000	65.000	65 000
02	1 200	66	79 200				2 200	65.545	144 200
04				1 850	65.545	121 259	<b>350</b>	<b>65.545</b>	<b>22 941</b>

<b>32</b>		\$
	Inventory at 5 January	59 750
	Add Sales at cost	9 560
	Less Return inwards (at cost)	<u>(1 912)</u>
	Inventory at 31 December	<u>67 398</u>

**33** Inventory Sheet

Date	Purchases			Sales at cost			Balance		
March	Qty	Rate	Amount	Qty	Rate	Amount	Qty	Rate	Amount
01	60	120	7 200				60	120.00	7 200
02	100	116	11 600				160	117.50	18 800
04				<b>110</b>	<b>117.50</b>	<b>12 925</b>	50	117.50	5 875

## CHAPTER 5

## Basic Financial Statements

- 1 A business has a bank balance of \$4 800. It pays for material invoiced at \$3 000 less trade discount of 30% and settlement discount of 10%. A cheque for \$450 is received from a trade receivable. What is the bank balance after these transactions?

A \$2 250                      B \$3 360                      C \$3 450                      D \$3 500

May 99 P1 Q4

- 2 The table shows extract from a trial balance.

	Debit (\$)	Credit (\$)
Prepayments	4 620	
accruals		8 125
bank balances	14 920	3 612
trade payables		18 148
loan (10 years)		15 000

Which total for current liabilities should be disclosed in the balance sheet?

A \$26 273                      B \$26 380  
C \$29 885                      D \$44 885

May 99 P1 Q5

- 3 Draft accounts included a loan due for payment in 20 months' time, as part of the trade payables. Which effect will the necessary adjustment have?

A increase net assets  
B increase net current assets  
C no effect on net current assets  
D reduce net current assets

May 00 P1 Q1/ Nov 05 P1 Q4/ Nov 08 P1 Q2

- 4 The following debit balance appears on a trial balance at 31 December 1999, after the preparation of the company's annual accounts.

Stationery                      \$8 000

What is the stationery item?

A an amount due to the company's stationery supplier  
B the annual stationery charge for 1999  
C an accrual for stationery at 31 December 1999  
D stationery inventory in hand at 31 December 1999

Nov 00 P1 Q2

- 5 A business starts trading on 1 May 2000. The table shows rent paid on the premises.

Date	Period	Amount
2 May 2000	1 May – 30 Jun	\$1 000
3 Jul 2000	1 Jul – 30 Sep	\$1 500
2 Oct 2000	1 Oct – 31 Dec	\$1 500
4 Jan 2001	1 Jan – 31 Mar	\$1 560
1 Apr 2001	1 Apr – 30 Jun	\$1 560

Which amount should be shown in the accounts for the year ended 30 April 2001 for rent prepayment?

A \$520                      B \$1 000                      C \$1 040                      D \$1 560

May 01 P1 Q1

- 6 Which statement is correct?

A carriage inward is a credit                      B carriage outward is a debit  
C purchases return is a debit                      D sales return is a credit

May 01 P1 Q2/May 12 P12 Q1

- 7 The sales included in the trial balance of a company amounting to \$880 000. This balance is made up as follows:

	\$
Cash sales	215 000
Credit Sales	536 000
Goods sent on sale or return awaiting acceptance by the consignees	45 000
Goods sent on sale or return for which customers have accepted invoices	<u>84 000</u>
Total	<u>880 000</u>

The sales to be recorded in the Trading section of income statement are

- A      \$751 000                  B      \$796 000                  C      \$835 000                  D      \$880 000  
 Specimen 02 P1 Q2

- 8 When preparing a sole trader's annual accounts, no adjustments were made for closing amounts prepaid. What is the effect of these omissions?

<b>A</b>	net profit overstated	trade payables understated
<b>B</b>	net profit understated	trade payables understated
<b>C</b>	current assets overstated	owner's capital overstated
<b>D</b>	current assets understated	owner's capital understated

May 02 P1 Q2/ Nov 07 P1 Q2/ May 14 P12 Q2

- 9 The table shows information from the books of a business at 30 April 2002.

Invoiced	\$
Credit sales invoiced during financial year	79 000
Goods sent to customers on 28 April 2002 and invoiced 4 May 2002	6 100
Goods sent to customers during April 2002 on sale or return basis but not sold by 30 April 2002	8 300

What is the amount to be credited to the Trading section of income statement as sales for the year ended 30 April 2002?

- A      \$76 800                                  B      \$85 100  
 C      \$85 300                                  D      \$93 400

May 02 P1 Q8/ May 10 P1 Q6

- 10 Which of the following is a tangible non-current asset?

- A      patents  
 B      purchased Goodwill  
 C      short leasehold  
 D      trade marks

Nov 02 P1 Q5

- 11 A customer paid a deposit in advance for goods to be supplied at a later date. How should this be recorded in the seller's books?

	Debit	Credit
<b>A</b>	cash	customer
<b>B</b>	cash	sales
<b>C</b>	customer	prepayment
<b>D</b>	customer	sales

May 03 P1 Q2/ May 07 P1 Q2/Nov 10 P1 Q2

- 12 A business sells some of its inventory for \$80 on credit to a customer. The inventory originally cost \$50. Which statement actually reflects the effect of this transaction on the Balance Sheet?

	Current assets	Owner's capital
A	decrease by \$30	decrease by \$30
B	decrease by \$30	increase by \$30
C	increase by \$30	increase by \$30
D	increase by \$30	decrease by \$30

May 03 P1 Q12/ Nov 08 P1 Q13/ May 09 P1 Q11/May 13 P12 Q17/ Nov 14 P12 Q8

- 13 The accounting year end for a company is 31 October. The table shows the company's telephone bill received on 2 December for the three months ended 30 November.

	\$
telephone calls to 30 November	1 041
rental of equipment for the period from 1 September to 30 November	<u>156</u>
total telephone bill	<u>1 197</u>

Which accrual should the company make in the accounts for the year ended 31 October?

- A \$503                      B \$798                      C \$1 093                      D \$1 197

Nov 05 P1 Q2

- 14 In the books of Y how could a credit entry of \$500 in X's account have arisen?

- A X bought goods from Y                      B X returned goods to Y  
C Y made a payment to X                      D Y returned goods to X

Nov 06 P1 Q2/May 13 P12 Q1

- 15 The following debit balance appears on a trial balance after preparing the manufacturing account for the year.

loose tools                      \$18 000

What is this item?

- A liability for loose tools                      B the annual charge for loose tools  
C a prepayment for loose tools                      D inventory of loose tools

May 08 P1 Q7

- 16 Interest receivable account shows interest of \$17 500 received during the year. Interest of \$1600 is due at the year-end. How will this be shown in the final accounts?

	income statement	\$	balance sheet	\$
A	credit	17 500	trade receivables	1 600
B	credit	19 100	trade receivables	1 600
C	debit	17 500	trade payables	1 600
D	debit	19 100	trade payables	1 600

Nov 08 P1 Q4

- 17 A business has the following assets and liabilities.

	\$
short-term investment	6 000
loan interest owing	1 500
loan repayable within one year	12 000
deposits from customers for orders	4 500
trade payables	27 000
trade receivables	39 000
pre-payments	3 500

What is the amount of net current assets?

- A \$3 500                      B \$4 500                      C \$8 000                      D \$15 500

Nov 08 P1 Q17

- 18 The table shows information from a business at 30 November 2008.

	\$
Credit sales invoiced during financial year	80 000
Goods dispatched to customers in November 2008 and invoiced in December 2008	5 000
Goods included in sales for November 2008 on a sale or return basis, but only sold in December 2008	
- at invoice price	10 000
- at cost price	8 000

Which amount will appear in the trading section of income statement as sales for the year ended 30 November 2008?

- A**     \$75 000                      **B**     \$77 000                      **C**     \$83 000                      **D**     \$85 000

May 09 P1 Q6

- 19 The directors of a company provide the following information.

	\$
bank overdraft	1 200
equipment	12 000
non-current loan	8 000
petty cash	900
inventories	2 500
trade payables	3 000
trade receivables	2 000

What is the amount of the net current assets?

- A**     \$1 200                      **B**     \$2 400                      **C**     \$3 600                      **D**     \$5 200

May 09 P1 Q18

- 20 A business has a bank overdraft of \$4 800. It pays for materials invoiced at \$3 000 less a trade discount of 20% and a settlement discount of 5%.

A cheque for \$500 is received from a trade receivable.

What is the bank balance after these transactions?

- A**     \$2 020 overdraft                      **B**     \$6 580 overdraft  
**C**     \$7 150 overdraft                      **D**     \$7 580 overdraft

May 10 P1 Q2

- 21 Which transaction would increase the current assets of a business?

- A**     paying invoices \$950, after receiving \$50 cash discount  
**B**     purchasing a machine on credit for \$1200  
**C**     purchasing inventory for \$1100 cash and selling it on credit for \$1500  
**D**     selling inventory with an original cost of \$800 at below cost price

May 11 P1 Q12

- 22 The following summarised information has been taken from the balance sheet of a partnership.

	\$
non-current assets	42 000
capital accounts	36 000
current accounts (debit)	5 000
current liabilities	7 000
non-current liabilities	15 000

What is the amount of current assets?

- A**     \$6 000                      **B**     \$11 000  
**C**     \$17 000                      **D**     \$21 000

May 11 P1 Q13

- 23 A business paid \$5 750 during its trading year for advertising. Part of this amount included \$500 in respect of the next financial year.

Which effects would the correct treatment of the \$500 have on the financial statements?

	profit for the year	net current assets
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

May 12 P11 Q2

- 24 An item can be converted easily into cash.  
In which section of the statement of financial position would this item appear?

A capital  
B current assets  
C current liabilities  
D non-current assets

Nov 13 P12 Q6/Specimen 16 P1 Q8

- 25 A trader took out a 6% bank loan of \$30 000 on 1 November 2013, to be repaid in full in 10 years' time. Interest is to be paid annually. No interest had been paid by 30 April 2014.

How should this be recorded in the statement of financial position at 30 April 2014?

	current liabilities	non-current liabilities
	\$	\$
A	0	30000
B	900	30 000
C	1 800	30000
D	30 900	0

May 14 P12 Q4

- 26 Which statement contains the correct accounting treatment for accrued income?

A added to income and shown as a current asset  
B added to income and shown as a current liability  
C deducted from income and shown as a current asset  
D deducted from income and shown as a current liability

May 15 P12 Q1

- 27 A business has extracted the following information from its books of account at 31 December 2014, its first year of trading.

	\$000
carriage inwards	12
carriage outwards	15
closing inventory	86
purchases	286
returns inwards	10
returns outwards	2
revenue	524

What is the gross profit for the year ended 31 December 2014?

A \$301 000  
B \$304 000  
C \$320 000  
D \$328 000

May 15 P12 Q9

28 How are closing inventory and loss for the year treated?

	closing inventory	loss for the year
A	debit in statement of financial position credit in income statement	debit in capital account credit in income statement
B	debit in statement of financial position credit in income statement	debit in income statement credit in capital account
C	debit in income statement credit in statement of financial position	debit in capital account credit in income statement
D	debit in income statement credit in statement of financial position	debit in income statement credit in capital account

May 15 P12 Q11

29 Why does a trader account for accrued income?

- A so that current liabilities are not overstated
- B so that current liabilities are not understated
- C so that profit is not overstated
- D so that profit is not understated

Nov 15 P12 Q1

30 A trader sends his staff on a training course costing \$100 per person. 10 staff attended in April and 4 in May. Half the total cost had to be paid at the start of April and the balance at the end of May. Which entry for training was made in the statement of financial position on 30 April?

- A \$300 accrual
- B \$400 accrual
- C \$600 prepayment
- D \$700 prepayment

Nov 15 P12 Q2

31 Katrina commenced business on 1 January 2015. For the year ended 31 December 2015, the following information is available.

	\$
Drawings	53 500
profit for the year	62 700
Revenue	1 500 000
Expenses	875 000

What was the cost of sales for the year?

- A \$562 300
- B \$571 500
- C \$678 000
- D \$687 000

May 16 P12 Q10

32 A company pays or receives the following amounts on the last day of its financial year.

	\$
deposit paid to a supplier	6 500
rental income received in advance	8 000
loan repayment	3 000
payment for last month's sales commission	900

Which of these amounts will be included as other receivables in the statement of financial position?

- A \$6 500
- B \$14 500
- C \$17 500
- D \$18 400

Nov 16 P12 Q9

**33** Which are examples of the accounting equation?

- 1** capital + assets = liabilities  
**2** capital = assets + liabilities  
**3** capital = assets – liabilities

**A** 1 and 3      **B** 1 only      **C** 2 and 3      **D** 3 only  
 May 17 P12 Q2

**34** The following information is extracted from the statement of financial position of a business at 31 December 2016.

	\$
bank loan (repayable 2025)	16 200
other payables	1 880
bank overdraft	11 600
capital	20 710
drawings	19 100
inventory	14 610
other receivables	1 420
trade payables	14 110
trade receivables	9 050

What is the value of the net current liabilities?

**A** \$1 590      **B** \$2 510      **C** \$18 710      **D** \$20 320  
 May 17 P12 Q7

**ANSWER KEY**

1	B	10	C	19	A	28	A
2	C	11	A	20	B	29	D
3	B	12	C	21	C	30	A
4	D	13	B	22	B	31	A
5	C	14	B	23	D	32	A
6	B	15	D	24	B	33	D
7	C	16	B	25	B	34	B
8	D	17	A	26	A		
9	B	18	A	27	B		

**DETAILED ANSWERS**

- 1**
- |  |   |              |
|--|---|--------------|
|  |   | \$           |
|  | Bank balance at start                         | 4 800        |
|  | Less Material cost paid                       | * (1 890)    |
|  | Add Cheque received from trade receivables    | <u>450</u>   |
|  | Bank balance at end                           | <u>3 360</u> |
|  |   |              |
|  | *List price of material                       | 3 000        |
|  | Less Trade discount (\$3 000 × 30%)           | <u>(900)</u> |
|  |   | 2 100        |
|  | Less Settlement (cash) discount (\$2 100×10%) | <u>(210)</u> |
|  | Amount actually paid for material             | <u>1 890</u> |
- 2** As liabilities have credit nature, so only the credit side of trial balance should be considered where a non-current loan (of 10 years) is also shown, which is obviously not part of current liabilities so we have added accruals, bank on credit side & trade payables to calculate current liabilities.
- 3** The adjustment will have the following effects
- |                         |  |                  |  |
|-------------------------|--|------------------|--|
| Non-current liabilities |  | ↑                |  |
| Current liabilities     |  | ↓                |  |
| Total liabilities       |  | <u>No change</u> |  |
- As we know Net assets = Total assets – Total liabilities  
& Net current assets = Current assets – Current liabilities  
Net assets will not change as there is no change in total liabilities. Whereas decrease in current liabilities will result in increase net current assets.
- 4** As trial balance is prepared after the preparation of company's annual accounts (income statement) so it means that trial balance includes only balance sheet items. As amount is given on the debit side so it cannot be an accrual or liability, so it will be stationery inventory.
- 5** Payment on 1 April covers period of three months i.e. from April to June so payment per month =  $\frac{\$1\,560}{3} = \$520$ . Moreover as year ends on 30 April, it means that rent for May & June has been paid in advance i.e.  $\$520 \times 2 = \$1\,040$
- 7** Total sales = \$215 000 + \$536 000 + \$84 000 = \$835 000

8 Effects of prepaid expenses are

Prepaid expenses	↑	(Current assets ↑)
Expenses	↓	(Net profit / owner's capital ↑)

The omission of prepaid expenses will carry the reverse effects i.e.

Current assets	↓
Owner's capital	↓

9 Sales is recognised as income when the goods are delivered so sales for the year will be (\$79 000 + \$6 100 = \$85 100

12 Effects of this transaction are

Trade receivables	↑	\$80 (with sale price)
Sales	↑	\$80 (with sale price)
Cost of sales	↑	\$50 (with cost price)
Inventory	↓	\$50 (with cost price)

Net increase in current assets = \$80 (receivables ↑) – \$50 (inventory ↓) = \$30

Net increase in owner's capital = \$80 (sales ↑) – \$50 (cost of sales ↑) = \$30

14		\$
	Total telephone calls due on 31 October (\$1 041 × <sup>2</sup> / <sub>3</sub> )	694
	Equipment rental expense from 1 September to 31 October (\$156 × <sup>2</sup> / <sub>3</sub> )	<u>104</u>
	Total amount accrued for telephone on 31 October	<u>798</u>

15 As trial balance is prepared after the preparation of company's manufacturing account so it means that trial balance includes only balance sheet items. As amount is given on the debit side so it cannot be a trade payable. Moreover payment for loose tools is usually not made in advance so it will be loose tools inventory.

17	<b>Current Assets</b>	\$	\$
	Short-term investment	6 000	
	Trade receivables	39 000	
	Pre-payments	<u>3 500</u>	48 500
	<b>Current Liabilities</b>		
	Loan interest owing	1 500	
	Loan repayable within one year	12 000	
	Deposits from customers for orders	4 500	
	Trade payables	<u>27 000</u>	<u>(45 000)</u>
	<b>Net Current Assets</b>		<u><u>3 500</u></u>

18 Sales is recognised as income when the goods are delivered to the customers whereas goods sent on sale or return basis are not treated as sales unless they are sold so sales for the year will be (\$80 000 + \$5 000 – \$10 000 = \$75 000

19		\$
	Current Assets (\$2 500 + \$2 000 + \$900)	5 400
	Current Liabilities (\$1 200 + \$3 000)	<u>(4 200)</u>
	Net Current Assets	<u>1 200</u>

20		\$
	Bank overdraft at start	4 800
	Add Material cost paid	* 2 280
	Less Cheque received from trade receivables	<u>(500)</u>
	Bank overdraft at end	<u>6 580</u>

*List price of material	3 000
Less Trade discount (\$3 000 × 20%)	<u>(600)</u>
	2 400
Less Settlement (cash) discount (\$2 400×5%)	<u>(120)</u>
Amount actually paid for material	<u>2 280</u>

- 21 "C" option is correct as sale of inventory will increase receivables by \$1 500 and decrease in inventory by \$1 100. Items in "A" and "B" options will reduce current assets as they involve payment of cash. "D" option is also incorrect as inventory is sold at a price below cost price

22		\$	\$
	Non-Current Assets		42 000
	<b>Current Assets (balancing figure)</b>	<b>11 000</b>	
	Current liabilities	<u>(7 000)</u>	
	Net Current Assets		4 000
			46 000
	Non-current liabilities		<u>15 000</u>
			<u>31 000</u>
	Capital accounts	36 000	
	Current accounts (debit)	<u>(5 000)</u>	<u>31 000</u>

- 25 As bank loan is repayable after 10 years so its amount of \$30 000 should be recorded as non-current liability. On the other hand, as loan was taken 6 months before the end of the year so its unpaid amount of \$900 ( $\$30\,000 \times 6\% \times \frac{6}{12}$ ) for 6 months will be shown as current liability.

27		\$000	\$000
	Revenue	524	
	Returns inwards	<u>10</u>	514
	Cost of sales		
	Purchases	286	
	Add Carriage inwards	12	
	Less Returns outwards	(2)	
	Less Closing inventory	<u>(86)</u>	<u>(210)</u>
	Gross profit for the year		<u>304</u>

28	Effects of Closing Inventory	Current Assets ↑	Debit	Statement of financial position
		Cost of Sales ↓	Credit	Income statement
	Effects of loss for the year	Capital ↓	Debit	Statement of financial position
		Income statement	Credit	Income statement

- 29 "D" option is correct as if we omit to add accrued income in the respective income account in the income statement then it would understate both total incomes and profit for the year.

30	<b>Month</b>	<b>Amount paid</b>	<b>Income statement expense</b>	<b>difference</b>
	April	\$700 (14 × 100)	\$1 000 (10 × 100)	\$300 Accrued

31		\$
	Sales	1 500 000
	<b>Cost of Sales (\$1 500 000 – \$937 700)</b>	<b><u>(562 300)</u></b>
	Gross profit (\$62 700 + \$875 000)	937 700
	Expenses	<u>(875 000)</u>
	Profit for the year	<u>62 700</u>

<b>33</b>	<b>Current Liabilities</b>	\$	\$
	Other payables	1 880	
	Bank overdraft	11 600	
	Trade payables	<u>14 110</u>	27 590
	<b>Current Assets</b>		
	Inventory	14 610	
	Other receivables	1 420	
	Trade receivables	<u>9 050</u>	<u>(25 080)</u>
	<b>Net current liabilities</b>		<u><u>2 510</u></u>

## CHAPTER 6 ACCOUNTING CONCEPTS AND CONVENTIONS

- 1 A Company decides to change from the straight-line method of depreciation to the reducing balance method.  
Which accounting concept does this proposal contravene?
- |   |               |   |               |
|---|---------------|---|---------------|
| A | consistency   | B | going concern |
| C | historic cost | D | materiality   |
- May 98 P1 Q4 / Specimen 02 P1 Q7/ May 07 P1 Q6
- 2 The capitalisation of development costs is an example of the convention of
- |   |                 |   |                     |
|---|-----------------|---|---------------------|
| A | business entity | B | matching            |
| C | prudence        | D | substance over form |
- Nov 98 P1 Q4/ May 09 P1 Q5
- 3 Which of the following is an example of the accounting principle of substance over form?
- |   |   |
|---|---|
| A | accruing expenses in order to match items with the related revenues |
| B | capitalising a motor vehicle bought on hire purchase                |
| C | capitalising goodwill on acquisition of a business entity           |
| D | not depreciating freehold land                                      |
- May 99 P1 Q6
- 4 Which of the following is an example of the application of the accounting principle of substance over form?
- |   |  |
|---|--|
| A | capitalising assets held under finance leases        |
| B | charging operating leases rental to Income statement |
| C | providing for expenses not yet paid                  |
| D | recognising a contingent liability                   |
- Nov 99 P1 Q5
- 5 Which accounting convention is observed when leased assets are shown in the Balance Sheet?
- |   |          |   |                     |
|---|----------|---|---------------------|
| A | accruals | B | materiality         |
| C | prudence | D | substance over form |
- May 00 P1 Q6
- 6 A machine acquired on hire purchase legally belongs to the seller until the final hire purchase instalment has been paid. However it is treated for accounting purposes as a non-current asset in the books of the hire purchaser. This is an example of
- |   |          |   |                     |
|---|----------|---|---------------------|
| A | matching | B | materiality         |
| C | prudence | D | substance over form |
- Specimen 02 P1 Q8
- 7 There is great uncertainty about the continuance of a business. This has caused the proprietor to make a large reduction in the valuation of the year-end inventory.  
Which accounting concept does this illustrate?
- |   |               |   |                     |
|---|---------------|---|---------------------|
| A | going concern | B | matching            |
| C | materiality   | D | substance over form |
- May 02 P1 Q7/May 11 P1 Q2
- 8 The treasurer of a club has decided **not** to include subscriptions owing by members in the Balance Sheet at the year-end. Which accounting concept is being applied?
- |   |                   |   |               |
|---|-------------------|---|---------------|
| A | accruals          | B | going concern |
| C | money measurement | D | prudence      |
- Nov 02 P1 Q7

- 9** Accountants prefer the commercial reality of a transaction to a strictly legal approach. This is an example of  
**A** consistency **B** materiality  
**C** prudence **D** substance over form  
 Nov 02 P1 Q9/May 11 P1 Q1
- 10** Which of the following is the definition of a business as a going concern?  
**A** the assets owned by the business exceed its liabilities.  
**B** the business has accumulated revenue reserves.  
**C** the business is currently liquid and able to pay its trade payables.  
**D** the business will continue in operational existence for the foreseeable future.  
 May 03 P1 Q6
- 11** A sole trader pays private expenses from the business bank account and records them as drawings. Which accounting principle is applied?  
**A** business entity **B** going concern  
**C** matching **D** prudence  
 May 03 P1 Q7
- 12** A business values obsolete inventory at net realisable value. Which accounting principle has been applied?  
**A** consistency **B** going concern  
**C** materiality **D** prudence  
 Nov 03 P1 Q7/Nov 12 P12 Q7
- 13** A pocket calculator costs \$9.50 and has a useful life of 5 years. The bookkeeper has decided to treat the purchase of the calculator as revenue expenditure. Which accounting concept has been applied?  
**A** accruals **B** materiality  
**C** prudence **D** substance over form  
 Nov 03 P1 Q9/ Nov 07 P1 Q6
- 14** What does the 'going concern' principle mean?  
**A** a business is profitable  
**B** a business will continue to operate for the foreseeable future  
**C** the assets of a business exceed its liabilities  
**D** the assets of a business should be valued at disposal value  
 May 04 P1 Q7
- 15** When a businessman introduces capital into his business, the transaction is debited in the Cash Book and credited to his Capital account. Of which accounting principle is this an example?  
**A** entity **B** going concern  
**C** matching **D** prudence  
 May 04 P1 Q8/ Nov 08 P1 Q7
- 16** A company does not include the value of skills gained by its employees from training programmes in its financial statements. Which accounting principle is being applied?  
**A** consistency **B** materiality  
**C** money measurement **D** substance over form  
 May 04 P1 Q9
- 17** Of which concept is the writing off of a bad debt an example?  
**A** going concern **B** matching  
**C** prudence **D** substance over form  
 Nov 04 P1 Q6

- 18** A company purchases machinery on hire purchase over four years but does not own the machinery until the final payment has been made.  
At the end of year 1 the company shows the machinery in its Balance Sheet as a non-current asset and also records the liability for the amount still owed.  
Which accounting principle is being applied?  
**A** consistency **B** materiality  
**C** prudence **D** substance over form  
 Nov 04 P1 Q7
- 19** Businesses anticipate losses but not profits in preparing their annual accounts.  
Which accounting concept is being applied here?  
**A** accruals **B** consistency  
**C** going concern **D** prudence  
 May 05 P1 Q6
- 20** What is an example of the application of the concept of accounting for substance over form?  
**A** accounting for inventory losses  
**B** recording an asset acquired under a hire purchase agreement as a non-current asset  
**C** recording the premium on the issue of ordinary shares in a share premium account  
**D** writing off a debt from a customer in liquidation  
 May 05 P1 Q7
- 21** A business sells its freehold premises to a bank and agrees to repurchase them in five years' time. The business continues to use the premises on lease from the bank. The premises remain in the balance sheet of the business.  
What is the reason for this accounting treatment?  
**A** the asset must be treated in the same way from year to year  
**B** the commercial reality of the transaction is that the business still owns the asset  
**C** the cost of the asset must be matched with the periods expected to benefit from its use  
**D** the income from the sales proceeds must not be anticipated.  
 Nov 05 P1 Q7
- 22** A company excludes from its Balance Sheet machinery for which spare parts are no longer obtainable. Which concept is being applied by the company?  
**A** going concern **B** materiality  
**C** prudence **D** substance over form  
 Nov 05 P1 Q8
- 23** Which accounting policies illustrate the matching principle?  
**1** charging depreciation on non-current assets  
**2** revaluing non-current assets on a regular basis  
**3** using the reducing balance method of depreciation  
**A** 1, 2 and 3 **B** 1 and 2 only **C** 1 and 3 only **D** 2 and 3 only  
 May 06 P1 Q7/Nov 11 P1 Q4
- 24** The following information relates to a company's non-current assets at 31 December.
- |                       | cost price (\$) | disposal value (\$) |
|-----------------------|-----------------|---------------------|
| motor vehicles        | 25 000          | 18 000              |
| equipment             | 48 000          | 36 000              |
| fixtures and fittings | 12 000          | 5 000               |
- The company has a serious cash shortage and will cease to trade within the next two months.  
What is the total value for non-current assets in the company's Balance Sheet at 31 December?  
**A** \$26 000 **B** \$59 000 **C** \$85 000 **D** \$144 000  
 Nov 06 P1 Q6

- 25 An item of inventory originally cost \$5 000, but has deteriorated badly and is written down to its estimated net realisable value of \$2 000.  
Which accounting principle has been applied?  
A consistency B materiality  
C prudence D substance over form  
May 07 P1 Q5
- 26 Which accounting treatments illustrate the use of the matching principle?  
1 valuation of inventory at net realisable value rather than cost  
2 using the First In First Out method of valuation each year  
3 charging depreciation on non-current assets  
A 1, 2 and 3 B 1 and 3 only  
C 2 only D 3 only  
Nov 07 P1 Q7
- 27 Which transaction applies the matching concept?  
A a machine acquired on long-term rental is included in non-current assets  
B computer equipment is depreciated over two years  
C a building is revalued following a fall in property prices  
D a waste-paper basket is treated as revenue expenditure  
May 08 P1 Q6/ Nov 16 P12 Q1
- 28 In preparing the income statement, only realised profits and not anticipated profits must be brought into account. In addition, all possible losses must also be taken into account.  
Which accounting principle does this describe?  
A accruals B consistency  
C going concern D prudence  
May 09 P1 Q7
- 29 A business is separate from its owner. This results in only business transactions being recorded in the accounts. Which accounting principle applies?  
A business entity B materiality  
C money measurement D prudence  
Nov 09 P1 Q4
- 30 The personal spending of the owner of a business is **not** recognised as a business expense.  
Which accounting principle is being applied?  
A business entity B consistency  
C money measurement D prudence  
May 10 P1 Q4
- 31 A business obtained a machine by means of a hire purchase agreement. It showed the machine in its balance sheet at the cash price of \$30000 although only \$10 000 has been repaid.  
Which accounting principle is involved?  
A accruals B materiality  
C prudence D substance over form  
May 10 P1 Q5
- 32 What does the application of the accounting principle of consistency ensure?  
A that all losses are provided for  
B that assets are recorded at their actual cost  
C that financial statements are produced annually  
D that profits are calculated the same way each year  
Nov 10 P1 Q4/ May 13 P12 Q5

- 33** A company values its loose tools for inclusion in its balance sheet. The tools are not very valuable and the company uses estimating when valuing them. Which accounting principle is being applied?  
**A** accruals **B** consistency  
**C** going concern **D** materiality  
 Nov 11 P1 Q6
- 34** A business buys a machine on hire purchase for \$50 000. Although it will not own the machine until it has paid the final installment, it has made the following entries:
- | debit             |          | credit                  |          |
|-------------------|----------|-------------------------|----------|
| Machinery account | \$50 000 | Bank account            | \$5 000  |
|                   |          | Finance company account | \$45 000 |
- Which accounting principle has been applied?  
**A** going concern **B** matching  
**C** prudence **D** substance over form  
 May 12 P12 Q4
- 35** Which accounting principle means that a company's financial statements are comparable from one period to the next?  
**A** accruals **B** consistency  
**C** going concern **D** materiality  
 May 12 P12 Q6
- 36** Which accounting principle attempts to deal with off-balance-sheet transactions?  
**A** consistency **B** going concern  
**C** prudence **D** substance over form  
 Nov 12 P12 Q5
- 37** A trader recently purchased a non-current asset for his business at a cost of \$6 500. A friend told him he could buy a similar asset on-line for \$5 000. The trader is now unsure how to value the asset in the books of account. Which principle should the trader apply?  
**A** accruals **B** business entity  
**C** historical cost **D** materiality  
 May 13 P12 Q6
- 38** The creation of a provision for doubtful debts is an example of which accounting concept?  
**A** business entity **B** consistency  
**C** prudence **D** realisation  
 Nov 15 P12 Q11
- 39** A business has a good reputation. The owner wishes to include goodwill in the financial statements. An accountant advises against it. Which accounting principle is the accountant applying?  
**A** business entity **B** going concern  
**C** matching **D** prudence  
 Specimen 16 P1 Q1
- 40** When a businessman introduces capital into his business, the transaction is debited in the cash book and credited to his capital account. Of which accounting concept is this an example?  
**A** business entity **B** going concern  
**C** matching **D** prudence  
 May 17 P12 Q1

**ANSWER KEY**

1	A	12	D	23	C	34	D
2	B	13	B	24	B	35	B
3	B	14	B	25	C	36	D
4	A	15	A	26	D	37	C
5	D	16	C	27	B	38	C
6	D	17	C	28	D	39	D
7	A	18	D	29	A	40	A
8	D	19	D	30	A		
9	D	20	B	31	D		
10	D	21	B	32	D		
11	A	22	C	33	D		

**CHAPTER 7****CAPITAL AND REVENUE**

1 It is necessary to distinguish between revenue and capital expenditures.

When must this distinction be made?

- A when preparing cash budgets
- B when preparing investment appraisal calculations
- C when preparing income statements
- D when preparing purchase ledger control accounts

May 98 P1 Q1/ May 08 P1 Q1

2 Which of the following is a revenue expense?

- A acquisition of another business
- B auditor's fees
- C legal expenses on purchase of property
- D purchase of premises

Nov 98 P1 Q1

3 Which payment should be treated as revenue expenditure in the accounts of a hotel?

- A installation cost of a new alarm
- B legal fees for debt collection
- C legal fees incurred in the purchase of the hotel
- D purchase of a computer

May 99 P1 Q1

4 On 1 January 2001 a second-hand truck was bought for \$15 000.

It was discovered on the date of purchase that the truck's engine did not work. The table shows work subsequently carried out on the truck.

Date	Work	Cost(\$)
3 January 2001	engine replaced	8 500
15 January 2001	shelving fitted	2 100
10 October 2001	gear box replaced	1 800

How much should be debited to the truck account?

- A \$15 000
- B \$17 100
- C \$25 600
- D \$27 400

May 00 P1 Q4

5 What is an example of capital expenditure?

- A payment of an electricity bill
- B payment of employee's wages
- C purchase of a brand name
- D purchase of inventories

May 01 P1 Q3

6 Which item is revenue expenditure?

- A cost of painting new office premises during construction
- B cost of repairs to factory plant and machinery
- C legal fees for the purchase of new factory premises
- D wages of a company's own workmen for building an office extension

May 02 P1 Q3/ May 07 P1 Q1/Nov 12 P12 Q2

- 7 A business that purchases a shop incurs the following costs.

	\$
Purchase price of the shop	680 000
Legal fees incurred in the purchase of the shop	7 200
Cost of initial inventory	12 500
Cost of installing air conditioning	47 300

Which amount will be capitalised as the cost of the shop?

- A** \$680 000      **B** \$687 200      **C** \$734 500      **D** \$747 000

May 03 P1 Q5

- 8 Which item should be treated as capital expenditure?

- A** the addition of a back-up system on an existing computer at a cost of \$900  
**B** costs incurred in repairing a car when the costs cannot be recovered from the insurance company  
**C** rent paid on a factory, whilst the company negotiated the purchase of that same factory  
**D** the replacement of a wooden fence with a new fence

Nov 03 P1 Q30/ May 06 P1 Q1

- 9 Expenditure on a machine during a year has included the following:

	\$
Insurance costs	2 400
New engine – machine will now produce more products per hour	22 300
Cleaning costs	7 200

How much of this expenditure should be treated as capital expenditure?

- A** none      **B** \$22 300  
**C** \$24 700      **D** \$31 900

May 04 P1 Q1/Nov 11 P1 Q2

- 10 An item of capital expenditure has been incorrectly treated as revenue expenditure in the accounts of a business. What is the effect of this error on the accounts of the business?

	Assets	Profit
<b>A</b>	overstated	overstated
<b>B</b>	overstated	understated
<b>C</b>	understated	overstated
<b>D</b>	understated	understated

May 04 P1 Q2/ May 10 P1 Q1/ Nov 15 P12 Q4/ Nov 16 P12 Q8

- 11 An item of revenue expenditure has been incorrectly treated as capital expenditure in the accounts of a business. What effect will the correction of this error have on the accounts?

	Net profit	Net assets
<b>A</b>	decrease	decrease
<b>B</b>	decrease	increase
<b>C</b>	increase	decrease
<b>D</b>	increase	increase

May 04 P1 Q12

- 12 A Spender owns a road haulage business.  
Which would be classified as capital expenditure?

- A** purchase of number plates for new lorries  
**B** purchase of replacement fuel pump for lorries  
**C** purchase of replacement tyres for lorries  
**D** purchase of road tax licence

Nov 04 P1 Q4

- 13** A business purchases a new van.  
The table shows the purchase invoice details:

	\$
Purchase price	13 000
Delivery charge	500
Sign writing	200
Road tax	200
Tank of fuel	50

How much should be debited to the motor van account?

- A** \$13 500      **B** \$13 700      **C** \$13 900      **D** \$13 950  
May 05 P1 Q1

- 14** Which item should be treated as capital expenditure?

- A** cost of carriage on the purchase of a non-current asset  
**B** cost of replacement of part of a non-current asset  
**C** depreciation of a non-current asset  
**D** repairs to a non-current asset

Nov 05 P1 Q3/ Nov 08 P1 Q1

- 15** The following items of expenditure take place during the first month of a transport business.

	\$
Rent	1 000
insurance of building	1 300
insurance of vehicle	350
road tax	500
purchase of vehicle	15 000
number plate for vehicle	150
painting of vehicle in company colours	750
wages for lorry driver	100
wages for painting vehicle	150

What is the total capital expenditure?

- A** \$15 000      **B** \$15 500      **C** \$16 050      **D** \$16 550  
Nov 05 P1 Q5

- 16** What would be treated as part of the capital cost of the purchase of a building?

- 1** legal costs of the purchase  
**2** redecoration of the building  
**3** installation of air conditioning needed for the machinery in the building

- A** 1 only      **B** 1 and 3 only      **C** 2 and 3 only      **D** 1, 2, & 3

Nov 06 P1 Q1

- 17** A company's net profit is \$20 000. Capital receipts of \$5 000 have been treated as revenue receipts. Capital expenditure of \$4 000 has been treated as revenue expenditure.

What is the correct net profit figure?

- A** \$11 000      **B** \$19 000      **C** \$21 000      **D** \$29 000

Nov 06 P1 Q3

- 18** Anna owns a plumbing business. Costs for the year were \$49 500 for wages and \$95 000 for materials. These included \$2 200 labour and \$540 materials used by Anna in the extension of the business premises. Additional planning and legal costs of the extension were \$450.

What was Anna's total revenue expenditure for the year?

- A** \$141 310      **B** \$141 760      **C** \$142 300      **D** \$144 500

Nov 13 P12 Q3

19 Which cost should be treated as revenue expenditure?

- A installing a new sound system in a car
- B purchase of a trailer for a car
- C replacing a damaged engine of a car
- D replacing an old car with a new one

Nov 15 P12 Q9

20 A trader made four transactions.

- 1 paid for repairs to manufacturing equipment
- 2 purchased an item to be used by the business for more than 12 months
- 3 took goods for resale for his own use
- 4 transferred his own vehicle to the business

Which items are capital expenditure?

- A 1 and 2
- B 2 and 3
- C 2 only
- D 3 and 4

Specimen 16 P1 Q2

21 A building was purchased for \$500 000. The following costs were also incurred.

	\$
adapting the new building	50 000
legal fees for the building purchase	5 000
cleaning the building	4 000
salary of building manager	20 000

What was the capital cost of the building?

- A \$550 000
- B \$555 000
- C \$559 000
- D \$579 000

May 16 P12 Q4

22 A printing company installed a large printing press. Which costs are capital expenditure in the first year of its operation?

- 1 installation of the press
  - 2 depreciation of the press
  - 3 repairs to the press
  - 4 upgrades to the press
- A 1 and 2      B 1 and 4      C 2 and 3      D 3 and 4

Nov 16 P12 Q4

**ANSWER KEY**

1	C	7	C	13	B	19	C
2	B	8	A	14	A	20	C
3	B	9	B	15	C	21	B
4	C	10	D	16	B	22	B
5	C	11	A	17	B		
6	B	12	A	18	B		

**NOTE FOR STUDENTS**

Capital expenditures are shown in balance sheet as non-current assets whereas revenue expenditures are recorded in income statement as expenses.

An expense is said to be a capital expense, if it fulfills **any** of the following conditions.

- (i) The amount spent is incurred on acquiring the non-current assets, i.e. it includes purchase price of assets plus costs incurred in connection with the acquisition of non-current assets e.g. installation costs on machine, import duty on imported cars, registration charges for transfer of property rights etc.
- (ii) If the expenditure is expected to benefit the business for a period more than one year.
- (iii) The expenditure is incurred at the initiation of business e.g. preliminary expenses, discount on issue of debentures etc.
- (iv) The expenditure is incurred on extension of business e.g. construction or extension of building, purchase of patents or copyrights etc.
- (v) The expenditure increases the earning capacity of the business whereas revenue expenditure just maintains the earning capacity.

**DETAILED ANSWERS**

4 See note (i)

5 See note (iv) and (v)

7		\$
	Purchase price of the shop	680 000
	Legal fees incurred in the purchase of the shop	7 200
	Costs of installing air conditioning	<u>47 300</u>
	Capital cost of the shop	<u>734 500</u>

10 Effects of treating a capital expenditure as revenue expenditure will be:

Capital expenditure (Non-current assets)	↓
Revenue expenditure (Income statement expenses)	↑
Or Profit of the business	↓

So, in the light of the above "D" option is correct.

11 Revenue expenditure has been incorrectly treated as a capital expenditure, so its correction will have the following effects.

Capital expenditure (non-current assets)	↓
Revenue (Income statement) expenditures	↑
Or Profit	↓

So "A" option is correct.

12 All the expenses incurred in connection with the purchase of the any non-current asset like vehicle will become part of its cost which is \$13 700 calculated as (\$13 000 + \$500 + \$200).

13		\$
	Purchase of vehicle	15 000
	Number plate for vehicle	150
	Painting of vehicle in company colours	750
	Wages for painting vehicle	<u>150</u>
	Total capital expenditure	<u>16 050</u>

<b>17</b>			\$
	Net Profit before correction		20 000
	Wrong inclusion of capital receipts in revenue receipts corrected		(5 000)
	Wrong treatment of capital expenditure as revenue expenditure corrected		<u>4 000</u>
	Correct Net Profit		<u>19 000</u>
<b>18</b>			\$
	Materials (\$95 000 – \$540)		94 460
	Wages (\$49 500 – \$2 200)		<u>47 300</u>
	Total revenue expenditure for the year		<u>141 760</u>
<b>21</b>	Capital cost of the building	=	\$500 000 + \$50 000 + \$5 000
		=	\$555 000

Cleaning the building and salary of building manager are not included in the capital cost due to their recurring nature and having a useful life less than one year.

## CHAPTER 8

## SUSPENSE ACCOUNT

1 Which adjustment will result in an increase in a company's stated profit?

- A the amortisation of goodwill
- B the application of reserves for the issue of bonus shares
- C the capitalisation of development costs
- D the upward revaluation of non-current assets

May 98 P1 Q27

2 A trial balance fails to agree. The debits exceed the credits.

Which single error in the nominal ledger would cause the difference?

- A a contra between the trade receivables and trade payables ledgers has been entered on the credit side of both control accounts
- B a rental receipt has been entered twice in the rent receivable account
- C the closing inventory for the previous period has not been entered in the inventory account
- D the opening electricity accrual has been brought forward on the wrong side of the ledger account

Nov 98 P1 Q6/ Nov 06 P1 Q9

3 Sales returns of \$400 have been credited to the trade receivable's account as \$40. A Suspense Account is created to complete the trial balance. What is the balance on the Suspense Account?

- A \$40 DR                      B \$40 CR                      C \$360 DR                      D \$360CR

Nov 98 P1 Q7 / Nov 01 P1 Q7/ Nov 15 P12 Q10

4 The directors of a company are finishing the accounts for the year ended 30 June 1997. They discover that the inventory at 1 July 1996 was over-valued by \$50 000.

What is the effect of correcting this error in the accounts?

	Net profit For year-end 30 June 1997	Reserves b/f At 1 July 1996
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

Nov 98 P1 Q10/ May 04 P1 Q15/ Nov 07 P1 Q16

5 A company discovers that its opening inventory was over-valued by \$30 000.

This amount is considered to be significant.

Which effects will the correction of this error have on the financial statements for the year?

	Net profit	Retained profit brought forward	Closing inventory
A	– \$30 000	– \$30 000	nil
B	nil	– \$30 000	– \$30 000
C	+ \$30 000	– \$30 000	nil
D	+ \$30 000	– \$30 000	– \$30 000

Nov 98 P1 Q11/May 16 P12 Q12

6 A company's trial balance shows debit balances in excess of credit balances by \$1 000.

What could explain this?

- A cash overstated by \$540  
omission of the telephone account totalling \$460
- B trade payables control account overstated by \$450  
trade receivables control account understated by \$550
- C omission of accumulated depreciation of \$500  
sales understated by \$500
- D purchases understated by \$500 in the nominal ledger  
omission of sales invoices totalling \$500

May 99 P1 Q9

7 When preparing the final accounts for the year; the following errors are discovered.

- 1 Sales day book was understated by \$300.
- 2 No provision had been made for accrued overtime costs, \$200.
- 3 No account had been taken of prepaid rent, \$400.

The draft net profit figure is \$8 050.

What will be the net profit when the errors are corrected?

- A \$8 150                      B \$8 550                      C \$8 750                      D \$8 950

May 99 P1 Q14

8 An electricity accrual of \$375 was treated as a prepayment in preparing a trader's Income statement. What was the effect on profit?

- A overstated by \$375                                      B overstated by \$750  
C understated by \$375                                      D understated by \$750

May 99 P1 Q16/Nov 10 P1 Q9

9 Motor vehicles purchased for \$530 000 at the start of the year have been incorrectly depreciated for the whole year using the straight line method at 10% instead of 25%

Ledger balances **after** the entries have been posted:

Motor vehicles	\$530 000
Provision for depreciation	\$53 000

Which entries will correct the error?

- A debit Income statement \$79 500; credit provision for depreciation of vehicles \$79 500  
B debit Income statement \$132 500; credit provision for depreciation of vehicles \$132500  
C debit provision for depreciation of vehicles \$79 500; credit Income statement \$79 500  
D debit provision for depreciation of vehicles \$132 500; credit Income statement \$132500

Nov 99 P1 Q3/ May 05 P1 Q10

10 A trial balance failed to agree and the difference was entered in a Suspense Account. A credit balance of \$1 530 in the Sales Ledger had been wrongly extracted as a debit balance.

Which journal entry will correct this error?

	Debit		Credit	
A	suspense	\$3 060	-	
B	suspense	\$1 530	sales	\$1 530
C	suspense	\$3 060	sales	\$3 060
D	sales	\$3 060	suspense	\$3 060

Nov 99 P1 Q7

11 An extract from a trial balance is shown.

	Debit (\$)	Credit (\$)
Trade receivables	2 700 000	
provision for doubtful debts		135 000
finished goods inventory	3 500 000	

The following adjustments are needed:

The provision for doubtful debts is to be 4% of book value of trade receivables;

Finished goods inventory costing \$50 000 is found to be un-saleable.

What is the effect of these changes on the net profit?

- A decrease by \$23 000  
B increase by \$23 000  
C decrease by \$77 000  
D increase by \$77 000

Nov 99 P1 Q13

- 12 The difference on a trial balance is entered in a suspense account. It is discovered that a discount received has been debited to the discount allowed account.

Which journal entry corrects the error?

- A** Dr Discount received account  
Cr Suspense account
- B** Dr Suspense account  
Cr Discount allowed account
- C** Dr Discount allowed account  
Dr Discount received account  
Cr Suspense account
- D** Dr Suspense account  
Cr Discount allowed account  
Cr Discount received account

May 00 P1 Q7

- 13 A company's accounts showed a gross profit of \$84 200. It was found that the opening inventory had been overstated by \$4 200 and that the closing inventory had been understated by \$3 700.

What is the corrected gross profit?

- A** \$78 300      **B** \$83 800      **C** \$84 700      **D** \$92 100

May 00 P1 Q11/Nov 14 P12 Q4

- 14 The difference on a trial balance has been entered in a suspense account. A receipt of \$5 000 from a trade receivable has been debited to the bank account and credited to the sales account.

Which journal entry is necessary to correct the error?

	Debit		Credit	
<b>A</b>	sales account	\$5 000	suspense account	\$5 000
<b>B</b>	sales account	\$5 000	trade receivables account	\$5 000
<b>C</b>	suspense account	\$10 000	bank account	\$10 000
<b>D</b>	suspense account	\$5 000	bank account	\$5 000

May 00 P1 Q12

- 15 After draft accounts had been prepared, the following errors were discovered.

Opening inventory was overvalued by \$2 000.

Closing inventory was undervalued by \$3 000.

If the original gross profit was \$90 000, what was the gross profit after the errors were corrected?

- A** \$85 000      **B** \$89 000      **C** \$91 000      **D** \$95 000

May 01 P1 Q13

- 16 The draft accounts of a business show a net profit of \$64 000 before taking account of the following.

1. The reduction of the Provision for Doubtful Debts by \$300.

2. The purchase of office stationery costing \$2 400 which has not been entered in the records; only one sixth of this stationery was used by the year-end.

What is the corrected net profit?

- A** \$64 300      **B** \$64 100      **C** \$63 900      **D** \$61 900

Nov 01 P1 Q3/May 13 P12 Q4

- 17 The final accounts of John Gates contain two errors. The closing inventory in trade has been overvalued by \$6 000 and an uninsured theft of inventory costing \$9 000 has not been taken into account. What effects will correction of these errors have on John Gates accounts?

	Gross profit	Net Profit
<b>A</b>	reduced by \$6 000	increased by \$3 000
<b>B</b>	reduced by \$3 000	reduced by \$3 000
<b>C</b>	increased by \$3 000	reduced by \$6 000
<b>D</b>	increased by \$6 000	increased by \$6 000

Specimen 02 P1 Q9

- 18** A trial balance has been prepared. It does not balance so a suspense account is opened. Later several errors are found. One involves the Rent Payable Account when \$234 paid in advance from the previous year has been brought forward at the start of the current year on the wrong side of the account and as \$324.

Which journal entry will correct the situation?

	Debit		Credit	
<b>A</b>	rent payable	\$90	suspense	\$90
<b>B</b>	suspense	\$90	rent payable	\$90
<b>C</b>	suspense	\$558	rent payable	\$558
<b>D</b>	rent payable	\$558	suspense	\$558

Specimen 02 P1 Q10

- 19** The trial balance of a business does not agree. The difference has been entered in a Suspense account. The error was caused by a cheque for \$400 from Omar being debited to Omar's account.

What is the journal entry to correct this?

	debit	Credit	with
<b>A</b>	Bank account	Suspense account	\$400
<b>B</b>	Suspense account	Omar's account	\$400
<b>C</b>	Suspense account	Omar's account	\$800
<b>D</b>	Suspense account	Bank account	\$800

May 02 P1 Q10

- 20** A transport business owned by a sole proprietor purchases a motor vehicle. This is charged to the Motor Vehicles Running Costs account.

What are the effects of this on the end-of-year Balance Sheet?

<b>A</b>	non-current assets understated	current assets understated
<b>B</b>	non-current assets overstated	current assets overstated
<b>C</b>	non-current assets overstated	capital account overstated
<b>D</b>	non-current assets understated	capital account understated

Nov 02 P1 Q1/ May 09 P1 Q2

- 21** A company's accounts showed a gross profit for the year of \$32 500. After the accounts were prepared it was found that the opening inventory had been overstated by \$2 400 and the closing inventory had been understated by \$3 400.

What is the corrected gross profit for the year?

<b>A</b>	\$26 700	<b>B</b>	\$31 500	<b>C</b>	\$33 500	<b>D</b>	\$38 300
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Nov 02 P1 Q6/May 12 P12 Q8

- 22** A trial balance does not balance and a Suspense account is opened. Subsequently the following errors are found and the Suspense account is cleared.

- 1 A sales invoice for \$1 240 had been omitted from the books.
- 2 Rent paid of \$2 600 was entered correctly in the cash book but incorrectly as \$6 200 in the Rent account.
- 3 The purchases journal was under cast by \$1 980.

What was the original balance on the Suspense account?

<b>A</b>	\$1 620 credit	<b>B</b>	\$4 340 debit	<b>C</b>	\$5 580 credit	<b>D</b>	\$5 580 debit
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Nov 02 P1 Q10

- 23** Which of the following would prevent a trial balance from balancing?

- A a credit note from a supplier entered in the sales journal
- B a discount allowed posted to the discount received account
- C an invoice entered twice in the sales journal.
- D a refund to a customer wrongly posted to discounts allowed account.

May 03 P1 Q8

- 24** A business omitted discounts allowed of \$700 from its trial balance. During the year a machine had been sold for cash of \$500 but the only accounting entry made was a debit in the Bank account. What is the balance on the Suspense account?

<b>A</b>	\$200 debit	<b>B</b>	\$1 200 debit
<b>C</b>	\$200 credit	<b>D</b>	\$1 200 credit

Nov 03 P1 Q10/May 16 P12 Q7

- 25** A business has a draft net profit of \$84 000. It is discovered that the closing inventory was overvalued by \$4 000 and that discounts received of \$1 500 were treated as an expense. What is the corrected net profit?

<b>A</b>	\$81 500	<b>B</b>	\$83 000
<b>C</b>	\$89 500	<b>D</b>	\$91 000

Nov 03 P1 Q11

- 26** Which of the following will increase profit?

<b>A</b>	increasing depreciation rates
<b>B</b>	increasing distributable reserves
<b>C</b>	increasing the provision for doubtful debts
<b>D</b>	increasing the value of closing work-in-progress

Nov 03 P1 Q15

- 27** A trial balance does not balance. The difference has been entered in a Suspense account. The following errors are found.

<b>1</b>	The Purchase Ledger Control account balance of \$48 300 has been included as a debit balance.
<b>2</b>	Provision for depreciation has been overcast by \$960.
<b>3</b>	A cash payment of \$630 for rent has been credited in the Cash book and debited to the Bad Debts account.

What is the correcting debit entry to the Suspense account?

<b>A</b>	\$47 340	<b>B</b>	\$95 010
<b>C</b>	\$95 640	<b>D</b>	\$97 560

May 04 P1 Q11

- 28** A company's trial balance includes a suspense account. It was found that the only errors were discounts received of \$240 and discounts allowed of \$312, which had both been entered on the incorrect sides of the respective ledger accounts.

Which is the double entry required to clear the Suspense account balance?

	Account	Dr (\$)	CR (\$)
<b>A</b>	Discounts Allowed	312	
	Discounts Received		240
	Suspense		72
<b>B</b>	Discounts Received	240	
	Suspense	72	
	Discounts Allowed		312
<b>C</b>	Discounts Allowed	624	
	Discounts Received		480
	Suspense		144
<b>D</b>	Discounts Received	480	
	Suspense	144	
	Discounts Allowed		624

Nov 04 P1 Q9/Nov 13 P12 Q10

- 29** A suspense account has a balance of \$450 debit.  
What has caused this balance in the Suspense account?
- A** motor expenses of \$225, correctly entered in the cash book, and posted to motor expenses as a credit
  - B** motor expenses of \$225, entered in the cash book as a receipt and posted to motor expenses as a credit
  - C** motor expenses of \$450, correctly entered in the cash book, and posted to motor vehicles as a debit
  - D** motor expenses of \$675, entered in the cash book as a credit of \$225 and posted to motor expenses as \$225 debit

May 05 P1 Q9/ Nov 16 P12 Q7

- 30** The wages of staff employed in getting goods into a saleable condition have been debited in the Income statement.  
What is the effect of this error?

	<b>Gross profit</b>	<b>Net profit</b>
<b>A</b>	overstated	no effect
<b>B</b>	overstated	overstated
<b>C</b>	understated	no effect
<b>D</b>	understated	understated

May 05 P1 Q14/ May 08 P1 Q17/May 13 P12 Q13

- 31** The following errors in the accounting records have been found and corrected:
- 1.** a purchase invoice for \$250 was omitted from the books of account
  - 2.** a sale for \$120 to X was debited to the account of Y
  - 3.** the sales days book was over-added by \$100

The gross profit for the year before correcting the errors was \$60 200.

What is the correct gross profit for the year?

- A** \$59 850
- B** \$59 970
- C** \$60 350
- D** \$60 550

Nov 05 P1 Q10

- 32** A sole trader has calculated a draft net profit of \$56 750.  
He then discovers the following mistakes: Discounts Received of \$580 and Discounts Allowed of \$665 have been recorded on the wrong sides of the Discounts Received and Allowed accounts.

What is the corrected draft net profit?

- A** \$56 580
- B** \$56 665
- C** \$56 835
- D** \$56 920

May 06 P1 Q10/Nov 14 P12 Q3

- 33** A cheque for payment of wages of \$214 has been debited to the purchases account as \$241. A suspense account is created.

What are the correcting entries?

	<b>account to be debited</b>	<b>\$</b>	<b>account to be credited</b>	<b>\$</b>
<b>A</b>	purchases suspense	214 27	wages	241
<b>B</b>	wages	214	suspense	214
<b>C</b>	wages suspense	214 27	purchases	241
<b>D</b>	purchases	241	wages suspense	214 27

Nov 06 P1 Q10



- 40 Entries of \$700 in the discount received account had not been entered in the trade payables' ledger. During the year a machine was sold for \$1 000. There was only one entry made and it was a credit in the bank account. What is the balance on the suspense account?
- A \$1 700 credit    B \$1 700 debit  
 C \$2 700 credit    D \$2 700 debits

May 09 P1 Q8

- 41 A business has discovered several errors in its sales ledger. All the accounts in the other ledgers have been entered correctly. Which error will not affect the agreement of the trial balance?
- A A sale to Clark of \$2 000 was debited to Clarkson's account.  
 B A sale to Garcia of \$100 was entered in Garcia's account as \$1 000.  
 C A sale to Wong of \$4 700 was omitted from Wong's account.  
 D A sales return of \$1 200 was debited to Khan's account.

Nov 09 P1 Q7

- 42 A trial balance fails to agree and the bookkeeper finds the following errors.
- 1 A bank overdraft of \$100 was shown as a debit in the trial balance.
  - 2 A telephone bill for \$400 was debited to the insurance account.
  - 3 A cash purchase of \$160 was entered in the purchases account as \$150; the purchase was entered correctly in the cash account.
- The bookkeeper opens a suspense account in order to correct the errors. What is the opening entry in the suspense account?

- A credit \$190    B credit \$210  
 C debit \$60    D debit \$550

Nov 09 P1 Q8

- 43 Which error will cause an entry in the suspense account?
- A a transposition error when transferring a ledger account balance to the trial balance  
 B an error of commission where the wrong account is used for a transaction but it is the correct type of account  
 C an error of omission  
 D an error of principle

May 10 P1 Q9

- 44 Which error will **not** affect the trial balance?
- A posting of \$3000 purchases to the debit of the motor vehicle account  
 B posting of \$3000 purchases to the credit of the motor vehicle account  
 C posting of \$3000 road tax refund to the debit of the motor vehicle account  
 D posting of \$3000 sales to the debit of the motor vehicle account

Nov 10 P1 Q6

- 45 Closing inventory has been overvalued. What is the effect on the financial statements?

	<b>net current assets</b>	<b>profit from operations</b>
<b>A</b>	overstated	overstated
<b>B</b>	overstated	understated
<b>C</b>	understated	overstated
<b>D</b>	Understated	understated

May 11 P1 Q4

- 46 Which error will cause a trial balance **not** to balance?
- A an invoice entered as a credit note on original input.  
 B a journal entry that does not balance.  
 C a transaction entered as the wrong amount on original input.  
 D a transaction not entered.

Nov 11 P1 Q9

- 47** A trial balance includes a suspense account. The bank balance of \$28 412 has mistakenly been entered as an overdraft and placed on the credit side as \$28 142. There has also been an addition error and the debit side of the trial balance has been undercast by \$450. Which entry in the suspense account would correct these errors?

<b>A</b>	credit \$56 104	<b>B</b>	debit \$56 104
<b>C</b>	credit \$57 004	<b>D</b>	debit \$57 004

Nov 12 P12 Q8

- 48** A draft income statement shows a profit for the year of \$360 000. Interest received for the year of \$1200 has been treated as interest paid. What is the correct profit?

<b>A</b>	\$357 600	<b>B</b>	\$358 800
<b>C</b>	\$361 200	<b>D</b>	\$362 400

Nov 12 P12 Q10

- 49** Which error would result in the creation of a suspense account?

<b>A</b>	crediting the commission received account with rent received
<b>B</b>	crediting the discounts allowed account with the discounts received
<b>C</b>	debiting the bank interest paid account with bank interest received
<b>D</b>	debiting the petrol account with a purchase of a new car

May 13 P12 Q8

- 50** An error of reversal is made when recording the payment of a telephone bill for \$500. Which journal entries are required to record the correction of this error?

	debit	\$	credit	\$
<b>A</b>	bank	500	telephone	500
<b>B</b>	bank	1 000	telephone	1 000
<b>C</b>	telephone	500	bank	500
<b>D</b>	telephone	1 000	bank	1 000

May 13 P12 Q10

- 51** A business had a profit for the year of \$450 000 before correcting the following errors.

- Closing inventory was undervalued by \$15 000.
- Sales returns of \$5 000 had been recorded as purchases returns.
- The charge for depreciation was overstated by \$20 000.

What was the corrected profit?

<b>A</b>	\$435 000	<b>B</b>	\$445 000	<b>C</b>	\$475 000	<b>D</b>	\$495 000
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Nov 13 P12 Q13

- 52** A trial balance failed to agree. A suspense account was opened. The following errors were then discovered.

- The sales returns journal had been undercast by \$850.
- The purchases journal had been overcast by \$975.

What was the opening balance on the suspense account before the correction of the errors?

<b>A</b>	\$125 credit	<b>B</b>	\$125 debit
<b>C</b>	\$1 825 credit	<b>D</b>	\$1 825 debit

May 14 P12 Q7

- 53** What would cause a trial balance **not** to balance?

<b>A</b>	a casting error in the cash account
<b>B</b>	a transposition error in extracting the trial balance
<b>C</b>	discounts allowed posted to discounts received account
<b>D</b>	misposting of an invoice to a creditor's account

May 14 P12 Q9

- 54 A suspense account shows a debit balance of \$350. What could have caused this?
- A** A purchase of \$350 was debited to the rent account.  
**B** A purchase of \$350 was omitted from the purchases journal.  
**C** A sale of \$350 was debited to the sales account and credited to the debtors' control account.  
**D** A sale of \$350 was posted twice to the sales account.

Nov 14 P12 Q5

- 55 Rachel's trial balance did not agree and she placed the difference in a suspense account. The following shows how four errors have been corrected using the suspense account.

suspense account			
	\$		\$
difference in trial balance	200	discount received	310
discount allowed	160	sundry expenses	390
cash	<u>340</u>		
	<u>700</u>		<u>700</u>

The profit for the year before the errors were corrected was \$35 400.

What is the correct profit for the year?

- A** \$34 520  
**B** \$34 540  
**C** \$34 860  
**D** \$35 480
- 56 An invoice for purchases was credited to the purchases account. How is the balance on the purchases account corrected?
- A** decrease by the value of the invoice  
**B** decrease by twice the value of the invoice  
**C** increase by the value of the invoice  
**D** increase by twice the value of the invoice

Nov 15 P12 Q14

Nov 15 P12 Q16

- 57 On 1 January 2012 a business had prepaid rent of \$50. During 2012, it made three rent payments of \$250 each. On 31 December 2012, the business owed \$200 rent for 2012. The business owner only charged the rent payments made during 2012 in the income statement. What is the effect on profit for the year?
- A** \$200 overstated  
**B** \$200 understated  
**C** \$250 overstated  
**D** \$250 understated

Specimen 16 P1 Q6

- 58 In an income statement carriage outwards of \$5 000 has been treated as carriage inwards. Carriage inwards of \$3 000 has been treated as carriage outwards. What are the effect(s) of these errors on the profit?

	gross profit	profit for the year
<b>A</b>	overstated by \$2 000	understated by \$2 000
<b>B</b>	overstated by \$8 000	no effect
<b>C</b>	understated by \$2 000	no effect
<b>D</b>	understated by \$8 000	overstated by \$8 000

May 16 P12 Q8

- 59 The following errors were found after a suspense account was opened.
- 1 Motor repairs of \$400 were credited to the motor vehicle at cost account.
  - 2 A payment for electricity was debited in the electricity account as \$2 500 instead of \$5 200.
  - 3 A \$450 cash purchase of goods for resale had been completely omitted from the books.
  - 4 Discount allowed of \$50 had been debited to the discounts received account.
- Which items would be entered in the suspense account?
- A** 1 and 2      **B** 2 and 3      **C** 2 and 4      **D** 3 and 4
- May 17 P12 Q5

- 60 A business provides the following information.

	year 1 \$	year 2 \$
profit for the year	30 000	40 000
cost of goods sold	240 000	320 000

The owner then discovers that at the end of year 1 the value of inventory was overstated by \$2000. What are the correct profits for the year and cost of goods sold figures?

	Year 1		year 2	
	profit for the year \$	cost of goods sold \$	profit for the year \$	cost of goods sold \$
<b>A</b>	28 000	238 000	42 000	322 000
<b>B</b>	28 000	242 000	40 000	320 000
<b>C</b>	28 000	242 000	42 000	318 000
<b>D</b>	32 000	238 000	38 000	318 000

May 17 P12 Q10

**ANSWER KEY**

1	C	16	C	31	A	46	B
2	D	17	C	32	A	47	C
3	D	18	D	33	C	48	D
4	C	19	C	34	C	49	C
5	C	20	D	35	B	50	D
6	C	21	D	36	A	51	C
7	B	22	A	37	D	52	A
8	B	23	B	38	D	53	C
9	A	24	A	39	A	54	D
10	A	25	B	40	B	55	C
11	A	26	D	41	A	56	D
12	D	27	C	42	A	57	C
13	D	28	C	43	A	58	C
14	B	29	A	44	A	59	A
15	D	30	A	45	A	60	C

**DETAILED ANSWERS**

1 "C" option is correct as when development cost is treated as a capital item (Asset), costs charged to Income statement will be reduced and profits would increase.

2 First two errors will result in overstatement of credit side. Whereas "C" will result in under cast of debit side as closing inventory of last year is the opening inventory of current year, so its understatement will also reduce opening inventory which is shown on the debit side of the trial balance. So "D" is the right option as liability is shown on the wrong (debit) side resulting in overstatement of debit side.

<b>Actual entry</b>	<b>Wrong entry</b>	<b>Rectifying entry</b>
Sales Return \$400	Sales Return \$400	Suspense \$360
Trade receivable \$400	Trade receivable \$40	Trade receivable \$360

Suspense account	
\$	\$
Trade receivables <u>360</u>	Difference in trial balance <u>360</u> → So "D" is the right option
<u>360</u>	<u>360</u>

4 See explanation of Question 15

5 Correction of this error will have the following effects

Opening inventory of current year	↓30 000
Closing inventory of last year	↓30 000

Decrease in closing inventory of last year will reduce the retained profit brought forward from the last year and decrease in current year opening inventory will increase current year net profit. However closing inventory of current year will not be affected.

	\$
Draft net profit	8 050
Add Correction of understatement of sale	300
Prepaid rent recorded	400
Less Accrued overtime expense recorded	<u>(200)</u>
Corrected net profit	<u>8 550</u>

8 As accrued expense has been treated as prepayment i.e. deducted from expense instead of being added resulting in increase in profit by double amount ( $\$375 + \$375$ ) =  $\$750$

9		\$
	Correct depreciation ( $\$530\,000 \times 25\%$ )	132 500
	Less Wrong depreciation ( $\$530\,000 \times 10\%$ )	<u>(53 000)</u>
	Depreciation to be recorded to correct the mistake	<u>79 500</u>

**Journal entry** to rectify the mistake will be

Income statement	\$79 500
Provision for depreciation	\$79 500

10 "A" option is correct, as there is no mistake in sales ledger's account, so it is not corrected. As mistake lies only in trial balance, so it is corrected by entering the amount only in suspense account.

11		(Effect on profit)
		\$
	Decrease in provision for bad debts	27 000 ↑
	$\$135\,000 - (\$2\,700\,000 \times 4\%)$	<u>50 000 ↓</u>
	Decrease in finished goods inventory	<u>23 000 ↓</u>
	Decrease in net profit	<u>23 000 ↓</u>

13		\$
	Original gross profit before correction	84 200
	Add Correction of overvaluation of opening inventory	4 200
	Correction of under valuation of closing inventory	<u>3 700</u>
	Revised gross profit	<u>92 100</u>

14	<b>Actual entry</b>	<b>Wrong entry</b>	<b>Rectifying entry</b>
	Bank 5 000	Bank 5 000	Sales 5 000
	Trade receivables 5 000	Sales 5 000	Trade receivables 5 000

15		\$
	Original gross profit before correction	90 000
	Add Correction of overvaluation of opening inventory	2 000
	Correction of under valuation of closing inventory	<u>3 000</u>
	Revised gross profit	<u>95 000</u>

16		\$
	Net Profit as per draft accounts	64 000
	Add Reduction in provision for doubtful debts	300
	Less Stationery expense ( $\$2\,400 \times \frac{1}{6}$ )	<u>(400)</u>
	Corrected net profit	<u>63 900</u>

17		\$
	Gross profit before correction	xx xxx
	Less Decrease in closing inventory	(6 000)
	Add Decrease in purchases	<u>9 000</u>
	Net increase in Gross Profit	<u>3 000</u>
	Net Profit	xx xxx
	Add Increase due to gross profit adjustments	3 000
	Less Loss by theft	<u>(9 000)</u>
	Net decrease in Net profit	<u>(6 000)</u>

<b>18</b>	<b>Actual entry</b> Rent payable 234 <hr/>	<b>Wrong entry</b> <hr/> Rent payable 324	<b>Rectifying entry</b> Rent payable 558 Suspense 558
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**20** Effects of this error will be  
     Motor vehicles (non-current assets)      ↓  
     Motor vehicles cost ↑ (profit ↓) capital      ↓

<b>21</b>		<b>\$</b>
	Gross Profit before correction	32 500
	Add Correction of overstatement of opening inventory	2 400
	Correction of understatement of closing inventory	<u>3 400</u>
	Corrected gross profit	<u><u>38 300</u></u>

<b>Suspense account</b>			
	<b>\$</b>		<b>\$</b>
Rent (\$6 200–\$2 600)	3 600	Difference in trial balance (*)	1 620
	<hr/>	Purchases	<u>1 980</u>
	<u>3 600</u>		<u>3 600</u>

**24** As a result of mistakes \$200 (\$700 – \$500) was overstated on the credit side of trial balance. As we know suspense account is shown on the smaller side of trial balance to equalise the debit and credit sides so in this case suspense account will appear on debit side with \$200.

<b>25</b>		<b>\$</b>
	Draft net profit	84 000
	Add Treatment of discount received as expense corrected (\$1500+\$1500)	3 000
	Less Overvaluation of closing inventory corrected	<u>(4 000)</u>
	Corrected net profit	<u><u>83 000</u></u>

**26** “A” option will increase depreciation expense and reduce profits. “B” option will increase reserves but decrease profits. “C” option also reduces profits as you are providing for an expense. “D” option is correct as closing work in process is deducted from costs and increases profits.

<b>Suspense Account</b>			
	<b>\$</b>		<b>\$</b>
Purchase ledger control a/c	96 600	Difference in trial balance (*)	95 640
	<hr/>	Provision for depreciation	<u>960</u>
	<u>96 600</u>		<u>96 600</u>

<b>28</b>	<b>Actual Treatment</b>		<b>Wrong Treatment</b>		<b>Rectifying Treatment</b>	
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	
	Dis. Allowed	312	Dis. Received	240	Dis. Allowed	624
	Dis. Received	240	Dis. Allowed	312	Dis. Received	480
					Suspense	144

**29** “A” option is correct as both effects are shown on the credit side resulting in a debit balance of \$450.

**30** Effects of this error are  
     Trading section expense      ↓  
     Gross profit and Net profit      ↑  
     Profit and loss section expense      ↑  
     Net profit      ↓

So error will overstate gross profit but will not affect net profit, as understatement of trading section expense will be counterbalanced by overstatement of profit and loss section expenses.

<b>31</b>		<b>\$</b>
	Gross profit before correction	60 200
	Omission of purchase invoice accounted for	(250)
	Sales overcast corrected	<u>(100)</u>
	Correct gross profit	<u>59 850</u>

<b>32</b>		<b>\$</b>
	Draft net profit	56 750
	Less Correction in discounts accounts *	<u>(170)</u>
	Correct net profit	<u>56 580</u>

<b>*</b>	<b>Actual Entry</b>	<b>Wrong Entry</b>	<b>Correcting Entry</b>
	Discount allowed \$665	Discount allowed \$580	Discount allowed \$85
	Discount received \$580	Discount received \$665	Discount received \$85
			Suspense\$170

<b>33</b>	<b>Actual Entry</b>	<b>Wrong Entry</b>	<b>Correcting Entry</b>
	Wages \$214	Purchases \$241	Wages \$214
	Cash \$214	Cash \$214	Suspense \$27
			Purchases \$241

<b>36</b>	<b>Actual Entry</b>	<b>Wrong Entry</b>	<b>Correcting Entry</b>
	Trade payables \$1 400	Trade payables \$1 400	Suspense \$2 800
	Dis. received \$1 400	Dis. allowed \$1 400	Dis. allowed \$1 400
		—	Dis. received \$1 400

**37** The trial balance totals suggest that debit side total is more than the total of credit side so is represented by “D” option. “B” option does not affect agreement of trial balance, whereas “A” and “C” options result in overstatement of credit side.

<b>39</b>		<b>\$</b>
	Capital expense recorded as purchases	↓ 200 000
	Depreciation omitted on non-current asset treated as purchases (\$200 000 × 15%)	↑ (30 000)
	Net effect of errors on net profit	<u>170 000</u>

**40** The debit side of trial balance was understated by \$700 due to omission of discounts received in the trade payables’ ledger whereas credit side of trial balance was overstated by \$1 000 on account of only credit entry in bank account. As a result suspense account balance appeared on the debit (smaller) side of trial balance as it was understated by \$1 700 due to errors.

<b>Suspense Account</b>			
	<b>\$</b>		<b>\$</b>
O/D mistake in trial balance corrected	200	Difference in trial balance (*)	190
	<u>200</u>	Purchases	<u>10</u>
			<u>200</u>

**44** “A” option is correct because a debit item (expense) is recorded as another debit item (asset) (error of principle). In “B” option a debit item is recorded as a credit item whereas in “C” and “D” options credit items are recorded as debit items.

**45** This error will have the increase closing inventory (net current assets) of current year, This will also reduce Cost of sales and will overstate the current year Operating profit. However increase in opening inventory of next year will not affect current year results.

**46** “B” option is correct. Item in “A” option represents complete reversal of entries. Item in “C” option is an example of original entry whereas item in “D” option is a case of error of omission.

47 **Suspense Account**

	\$		\$
Difference in trial balance (*)	57 004	Bank a/c (\$28 412 + \$28142)	56 554
	<u>57 004</u>	Trial balance error corrected	<u>450</u>
			<u>57 004</u>

In order to clear the opening debit balance in the suspense account a credit entry is needed in the suspense account with \$57 004.

48	Net profit before correction	\$360 000
	Interest received treated as interest paid now corrected	<u>\$2 400</u>
	Correct net profit	<u>\$362 400</u>

49 The only transaction resulting in the creation of a suspense account would be C. Bank interest received must have been a credit entry and was wrongly debited, thus resulting in two debits and no credit resulting in the creation of a suspense account.

50	<b>Actual entry</b>		<b>Wrong entry</b>		<b>Rectifying entry</b>	
	\$	\$	\$	\$	\$	\$
	Telephone	500	Bank	500	Telephone	1 000
	Bank	500	Telephone	500	Bank	1 000

51		\$
	Draft net profit	450 000
	Add Undervaluation of closing inventory corrected	15 000
	Sales returns recorded as purchases returns corrected (\$5 000+\$5 000)	(10 000)
	Overstatement of depreciation corrected	<u>20 000</u>
	Corrected net profit	<u>475 000</u>

52 **Suspense account**

	\$		\$
Purchases	975	<b>Difference in trial balance (*)</b>	<b>125</b>
	<u>975</u>	Sales returns	<u>850</u>
			<u>975</u>

55		\$
	Original profit for the year before correction	35 400
	Add Discount allowed	160
	Less Discount received	(310)
	Sundry expenses	<u>(390)</u>
	Correct profit for the year	<u>34 860</u>

56 As this is case of reversal of entry so requires correction by twice the value of the invoice on the debit side of Purchases account.

57		\$
	Rent expense paid during the year and charged to income statement (\$250 × 3)	750
	Actual rent expense to be charged to income statement (\$750 + \$200 + \$50)	<u>1 000</u>
	Overstatement of Profit (due to understatement of rent expense in income statement)	<u>250</u>

58		<b>Error 1</b>	<b>Error 2</b>	<b>Net effect</b>	<b>Effect on gross profit</b>	<b>Effect on net profit</b>
	Carriage inwards	\$5 000↑	\$3 000↓	\$2 000↑	\$2 000↓	\$2 000↓
	Carriage outwards	\$5 000↓	\$3 000↑	\$2 000↓	<u>          </u>	<u>\$2 000↑</u>
	Net effect on profit				<u>\$2 000↓</u>	<u>No effect</u>

- 59 'A' option is correct. Item 3 is an example of error of omission and item 4 is an example of error of commission so will not be entered in suspense account.
- 60 Overstatement of closing inventory of year 1 by \$2 000 will result in ↓ in cost of goods sold and ↑ in profit by \$2 000.  
Overstatement of opening inventory of year 2 by \$2 000 will result in ↑ in cost of goods sold and ↓ in profit by \$2 000.

## CHAPTER 9

## CONTROL ACCOUNTS

- 1 The sales day book of a business has been overcast by \$800. The business maintains control accounts as part of the double entry bookkeeping system.  
The effect of correcting this error will be to make adjustments to the

- A** control account, with a decrease in profit of \$800  
**B** control account, with no effect on profit  
**C** ledger balances of the individual trade receivables, with a decrease in profit of \$800  
**D** ledger balances of the individual trade receivables, with no effect on profit

May 98 P1 Q7

- 2 The table shows the summarised sales ledger control account at the year-end.

	\$
Amounts owed to the company	712 500
Amounts owed by the company for deposits received	27 700
Bad debt, previously written off, now collected from the liquidator	7 500
Payment to a debt collector for a customer's dishonoured cheque	1 500

How will the trade receivables be shown in the balance sheet at the year-end?

- A** \$677 300      **B** \$678 800      **C** \$712 500      **D** \$714 000

May 98 P1 Q11

- 3 The Purchase Ledger Control Account for the year showed the following transactions.

	\$
Opening balance: credit	20 000
debit	4 000
Transactions for the year	
Suppliers' invoices	45 000
Discounts received	500
Credit notes received	1 500
Sales ledger contra	5 000
Closing balances: credit	23 000
Debit	nil

How much cash did the company pay its trade payables during the year?

- A** \$31 000      **B** \$34 000      **C** \$35 000      **D** \$54 000

May 99 P1 Q8

- 4 An extract from a company's trial balance is shown.

	Debit(\$)	Credit(\$)
Trade receivables Control Account – debit balances	225 000	
Trade receivables Control Account – credit balances		2 800
Trade payables Control Account – debit balances	3 200	
Trade payables Control Account – credit balances		261 000
Directors Loan Account	12 000	

How much should be disclosed as trade receivables in the company's financial statements?

- A** \$222 200      **B** \$228 200      **C** \$237 400      **D** \$240 200

Nov 99 P1 Q6/ May 09 P1 Q16

- 5 The table shows transactions for a month.

	\$
Credit sales	16 810
Sales returns	1 150
Discount allowed	276
Bad debts written off	100
Increase in provision for doubtful debts	600
Increase in trade receivables	5 406

How much cash was received from trade receivables during the month?

- A** \$9 278      **B** \$9 878      **C** \$10 154      **D** \$20 690  
Nov 99 P1 Q8
- 6 A purchase ledger control account has a closing balance of \$92 460. A trade receivable for \$720 transferred from the sales ledger has been recorded on the wrong side of the purchase ledger control account.  
What is the correct balance on the purchase ledger control account?  
**A** \$91 020      **B** \$91 740      **C** \$93 180      **D** \$93 900  
May 00 P1 Q2/ Nov 08 P1 Q8
- 7 What would not appear in a sales ledger control account?  
**A** cash received from trade receivables  
**B** discounts allowed  
**C** provision for doubtful debts  
**D** returns inwards  
May 00 P1 Q8/ May 06 P1 Q9
- 8 X buys from and sells goods to Y. At the end of the month, X owes Y \$3 200 and Y owes X \$1 941. An agreement is in force for the Sales Ledger account and Purchase Ledger account balances to be offset, so that only one payment is made.  
Which double entry records the offset in X's books?

		Dr (\$)	Cr (\$)
<b>A</b>	purchase ledger control account	3 200	
	sales ledger control account		3 200
<b>B</b>	Y's (purchase ledger) account	1 941	
	sales ledger control account		1 941
<b>C</b>	purchases ledger control account	1 259	
	sales ledger control account		1 259
<b>D</b>	purchases ledger control account	1 941	
	sales ledger control account		1 941

Nov 00 P1 Q8/May 14 P12 Q10

- 9 X Ltd maintains control accounts. The total of the Sales Day book for a month has been overstated.  
Which adjustments are required as a result of this error?

	Sales Ledger Control account	list of Sales Ledger balances
<b>A</b>	Dr	reduce
<b>B</b>	Dr	no change
<b>C</b>	Cr	reduce
<b>D</b>	Cr	no change

Nov 00 P1 Q9





- 20 The following information is taken from the books of a business at 30 April.

	\$
total of sales ledger balances	84 000
balance on sales ledger control account	83 100

What could have caused the difference between the sales ledger balances and the sales ledger control account balance?

- A an invoice for \$900 not entered in the sales journal
- B an invoice in the sales journal for \$2 100 entered in the sales ledger account as \$1 200
- C the sales journal total for March overstated by \$900
- D the sales journal total for April, \$9800, entered in the sales ledger control account as \$8900

May 08 P1 Q10

- 21 A trade payable for \$720 transferred from the purchases ledger has been entered on the wrong side of the sales ledger control account.

The sales ledger control account has a closing balance of \$92 460, before correcting the transfer. A provision for doubtful debts of \$1000 is to be made.

What is the correct balance on the sales ledger control account?

- A \$90 020
- B \$91 020
- C \$91 740
- D \$92 180

Nov 08 P1 Q8

- 22 The correct balance on the purchases ledger control account is \$63 000 but has been entered in the trial balance as \$36 000. The difference on the trial balance has been entered in a suspense account. Which journal entry corrects this error?

	account to be debited	\$	account to be credited	\$
A	purchases ledger control account	27 000	suspense account	27 000
B	-		suspense account	27 000
C	suspense account	27 000	-	
D	suspense account	27 000	purchases ledger control account	27 000

May 09 P1 Q9

- 23 Who is most likely to use the trade payables' ledger?

- A cashier
- B credit controller
- C trade payables
- D purchases controller

May 09 P1 Q10

- 24 At 31 March the balance sheet of a company included the following.

	\$
trade receivables	23 000
provision for doubtful debts	1 200

During April credit sales were \$64 000 and cash sales were \$256 000.

Credit customers paid \$56 840 net of a 2 % cash discount.

What will be the trade receivables at 30 April?

- A \$27 800
- B \$28 960
- C \$29 000
- D \$30 160

Nov 09 P1 Q5/Nov 10 P1 Q5

- 25 The following balances appear in the internal accounts of a company.

	\$
trade receivables' ledger debit balances	261 000
credit balances	3 000
trade payables' ledger credit balances	156 000
debit balances	2 000

How will the trade receivables and trade payables be shown in the published accounts?

	Trade receivables (\$)	Trade payables (\$)
<b>A</b>	258 000	154 000
<b>B</b>	261 000	156 000
<b>C</b>	263 000	159 000
<b>D</b>	264 000	158 000

Nov 09 P3 Q13

- 26 Which of the following items will be debited to accounts in the purchases ledger?

- 1 discount allowed
- 2 payments to suppliers
- 3 purchases
- 4 purchases returns

- A** 1 and 2      **B** 2 and 3      **C** 2 and 4      **D** 3 and 4

May 10 P1 Q3

- 27 Which item will be entered in a purchase ledger control account?

- A** discount allowed
- B** discount received
- C** prepaid rent
- D** returns inwards

May 10 P1 Q7

- 28 The total of the list of individual balances in the purchase ledger does not agree with the balance on the purchase ledger control account.

When listing the individual suppliers' accounts a credit balance had been shown as a debit balance. What is needed to correct the mistake on the total of the purchase ledger balances?

- A** decrease by the amount of the credit balance
- B** decrease by twice the amount of the credit balance
- C** increase by the amount of the credit balance
- D** increase by twice the amount of the credit balance

May 10 P1 Q8

- 29 A trial balance at 31 December shows:

	Debit (\$)	credit (\$)
trade receivables control account	48 500	2 900
trade payables control account	3 600	34 800

It is then found that an invoice, \$900, issued to a trade receivable on 27 December, has not been entered in the accounting records.

What is the correct figure for trade receivables in the balance sheet at 31 December?

- A** \$46 500      **B** \$49 400
- C** \$51 200      **D** \$53 000

May 10 P1 Q10



- 36** A business provided the following information.

	\$
1 April purchases ledger credit balance	16 725
30 April credit purchases for the month	42 653
30 April payments made to trade payables	37 324
30 April purchases returns	723

What is the balance on the purchases ledger control account at 30 April?

- A** \$12 119                      **B** \$21 331  
**C** \$59 378                      **D** \$62 529

Nov 15 P12 Q12

- 37** The purchases ledger control account has a closing balance of \$15 300. Discounts received of \$600 have been entered on the wrong side of the control account.

What is the corrected balance?

- A** \$14 100                      **B** \$14 700  
**C** \$15 900                      **D** \$16 500

Specimen 16 P1 Q9

- 38** Which statement about the sales ledger control account is correct?

- A** It is to verify the total of the customers' account balances in the sales ledger.  
**B** It is used to calculate the gross profit on sales.  
**C** It is used to calculate the total sales for the year.  
**D** It is used to reconcile the cash received from customers with the bank statement.

May 16 P12 Q5

- 39** In which book of prime entry is the contra between the sales ledger control account and the purchase ledger control account recorded?

- A** cash book  
**B** general journal  
**C** purchases journal  
**D** sales journal

May 16 P12 Q6

- 41** At the end of the year, the balance on a firm's sales ledger control account was \$12 900. The total of the customers' accounts in sales ledger was \$11 900.

The following errors were then discovered.

- 1** A customer's account had been undercast by \$700.
- 2** A contra with a supplier in the purchases ledger of \$200 had only been entered in the sales ledger control account.
- 3** The discount allowed column in the cash book totalled \$500. This had not been posted to the nominal ledger.

What was the correct balance on the sales ledger control account?

- A** \$11 200                      **B** \$11 400                      **C** \$12 000                      **D** \$12 400

Nov 16 P12 Q6

- 41** Which items appear in a sales ledger control account?

- 1** cash discount allowed
- 2** credit sales
- 3** payments to trade payables
- 4** returns inwards

- A** 1, 2 and 3                      **B** 1, 2 and 4                      **C** 1, 3 and 4                      **D** 2, 3 and 4

May 17 P12 Q6

**ANSWER KEY**

1	A	12	A	23	D	34	B
2	C	13	C	24	C	35	B
3	A	14	B	25	C	36	B
4	B	15	B	26	C	37	A
5	B	16	A	27	B	38	A
6	A	17	C	28	D	39	B
7	C	18	D	29	D	40	D
8	D	19	B	30	B	41	B
9	D	20	D	31	B		
10	D	21	B	32	A		
11	D	22	C	33	B		

**DETAILED ANSWERS**

- 2 Trade receivables will simply be shown in the balance sheet as \$712 500. \$27 700 represents amount owed by the company, \$1 500 represents a collection expense whereas bad debts recovery of \$7 500 will not change the trade receivables' figure as the entries will be:

		Debit (\$)	Credit (\$)
<b>A</b>	Trade receivables	7 500	
	Bad Debts Recovery		7 500
<b>B</b>	Cash	7 500	
	Trade receivables		7 500
<b>Or</b>	Cash	7 500	
	Bad Debts Recovery		7 500

3

**Purchase Ledger Control Account**

	\$		\$
Balance b/f (Dr)	4 000	Balance b/f (Cr)	20 000
Discount received	500	Purchases (invoices)	45 000
Credit notes received (returns out)	1 500		
Sale ledger contra	5 000		
<b>Cash to suppliers (balancing figure)</b>	<b>31 000</b>		
Balance c/d (Cr)	<u>23 000</u>		
	<u>65 000</u>		<u>65 000</u>

- 4 Debit balances of both trade receivables' and trade payables' control accounts will be disclosed as trade receivables in the balance sheet i.e. (\$225 000 + \$3 200 = \$228 200). Although director's loan is an asset but is not a trade receivable as trade receivables arise purely from trading activities of the business.

5

**Sales Ledger Control Account**

	\$		\$
Credit sales	16 810	Sales Returns	1 150
		Discount allowed	276
		Bad debts	100
		Increase in trade receivables	#5 406
		Cash from receivables (bal. figure)	<u>9 878</u>
	<u>16 810</u>		<u>16 810</u>

#Due to increase in the amount of trade receivables the closing figure of trade receivables will be more than its opening figure. So this increase is recorded in place of closing trade receivables.

6 **Adjusted Purchase Ledger Control Account**

	\$		\$
Sale ledger contra (720+720)	1 440	Balance b/f (Cr)	92 460
Balance c/d (Cr)	<u>91 020</u>		
	<u>92 460</u>		<u>92 460</u>

\* As amount was recorded on the wrong side so account is debited by \$720 to correct the error and debited by \$720 to record \$720 on the debit sale.

7 If you pass a journal entry for provision for bad debts, you will find that it is created out of profits and trade receivables are neither debited nor credited, so it is not shown in sales ledger control account.

	Balances before adjustments	Balances after adjustments	Change
Trade receivables	1 941	-	1 941(↓)Cr
Trade payables	<u>3 200</u>	1 259	1 941(↓)Dr
Net trade payables	<u>1 259</u>		

So the entry will be:

	Debit	Credit
Purchase ledger control account	\$1 941	
Sale ledger control account		\$1 941

\*It will be wrong to choose B option because on the one hand an individual account is debited and total or control account is credited on the other.

9 The correcting entry will be

	Debit (\$)	Credit (\$)
Sales	αα	
Suspense		αα

Decrease in sales will be credited in the sales ledger control account. While as there is no mistake in trade receivables account so total of sales ledger balances will not be affected.

	\$
Trade payables Control account (Cr)	26 800
Trade receivables Control account (Cr)	800
Add Omission of purchase invoice now recorded	<u>1 000</u>
Trade payables figure to be shown in the balance sheet	<u>28 600</u>

11 \$67 521 + \$4 500 = \$72 021

\*\$5 210 and \$7 000 will not be shown as current assets as these amounts are given on the credit side.

12 **Sales Ledger Control Account**

	\$		\$
Balance b/f (Dr)	10 000	Cash from trade receivables	45 000
Credit sales	50 000	Sales Returns	400
Bank (dishonoured cheques)	100	Discount allowed	350
	<u>60 100</u>	Balance c/d (balancing figure)	<u>14 350</u>
			<u>60 100</u>

13 **Adjusted Sales Ledger Control Account**

	\$		\$
Balance b/f (Dr)	40 000	Discount allowed	1 200
Sales book corrected	500	Bad debts	400
	<u>40 500</u>	Balance c/d (balancing figure)	<u>38 900</u>
			<u>40 500</u>

16 **Trade payables' account**

	\$		\$
Cash	110 000	Balance b/f	20 000
Contra (set-off)	2 000	Purchases	120 000
Discount received	3 000		
Balance c/d (Balancing figure)	<u>25 000</u>		
	<u>140 000</u>		<u>140 000</u>

17 **Trade payables' account**

	\$		\$
Balance c/d (Balancing figure)	164 762	Balance b/f	163 762
		Purchases	<u>1 000</u>
	<u>164 762</u>		<u>164 762</u>

	Balances before adjustments (\$)	Balances after adjustments (\$)	Change (\$)
Trade receivables	750	250	500(↓)Cr
Trade payables	<u>500</u>	-	500(↓)Dr
Net trade receivables	<u>250</u>		

So the entry will be to debit Purchase ledger control account and credit Sales ledger control account with \$500.

21 **Adjusted Sales Ledger Control Account**

	\$		\$
Balance b/f (Dr)	92 460	Sale ledger contra (720+720)	1 440
		Balance c/d (Dr)	<u>91 020</u>
	<u>92 460</u>		<u>92 460</u>

\* As amount was recorded on the wrong side so account is credited by \$720 to correct the error and credited by \$720 to record \$720 on the debit sale.

24 **Trade receivables Account**

	\$		\$
Balance b/f (Dr)	23 000	Cash from trade receivables	46 840
Credit sales	64 000	Discount allowed $\left(\frac{\$56\,840}{98\%} \times 2\%\right)$	1 160
		<b>Balance c/d (balancing figure)</b>	<b><u>29 000</u></b>
	<u>87 000</u>		<u>87 000</u>

28 Its correction requires increase in the purchase ledger credit balances with double amount; one to eliminate effects of its wrong addition on the debit side and the other is in effort to show it correctly as a credit balance.

	\$
Trade receivables control account (Dr)	48 500
Trade payables control account (Dr)	3 600
Add Omission of sales invoice now recorded	<u>900</u>
Trade receivables figure to be shown in the balance sheet	<u>53 000</u>

30 **Trade Receivables Account**

	\$		\$
Balance b/f (Dr)	46 000	Cash from receivables	303 800
Credit sales (\$350 000 × 80%)	280 000	Discount allowed $\left(\frac{\$303\,800}{98\%} \times 2\%\right)$	6 200
		<b>Balance c/d (balancing figure)</b>	<b><u>16 000</u></b>
	<u>326 000</u>		<u>326 000</u>

## 31 Trade Receivables Control Account

	\$		\$
Balance b/f (Dr)	14 320	Contra	400
	<u>14 320</u>	<b>Balance c/d (balancing figure)</b>	<b><u>13 920</u></b>
			<u>14 320</u>

## 32 Sales Ledger Control Account

	\$		\$
Balance b/f	31 000	Discount allowed	2 300
Credit sales	125 400	<b>Cash from customers (bal. figure)</b>	<b>119 100</b>
	<u>156 400</u>	Balance c/d	<u>35 000</u>
			<u>156 400</u>

## 33 Purchase Ledger Control Account

	\$		\$
Cash (payment)	17 800	Balance b/f	1 200
<b>Contra (set-off) - Balancing figure</b>	<b>200</b>	Purchases	18 400
Discount received	300		
Balance c/d	<u>1 300</u>		
	<u>19 600</u>		<u>19 600</u>

34 "B" option is correct whereas items in all other options are recorded in sales ledger control accounts so do not affect suppliers' outstanding balances.

## 36 Purchase Ledger Control Account

	\$		\$
Cash to suppliers	37 324	Balance b/f (Cr)	16 725
Purchase returns	723	Purchases (invoices)	42 653
<b>Balance c/d (Cr) (balancing figure)</b>	<b><u>21 331</u></b>		
	<u>59 378</u>		<u>59 378</u>

## 37 Adjusted Purchase Ledger Control Account

	\$		\$
Discount received (\$600 + \$600)	1 200	Balance b/f (Cr)	15 300
<b>Balance c/d (Cr)</b>	<b><u>14 100</u></b>		
	<u>15 300</u>		<u>15 300</u>

## 40 Adjusted Sales Ledger Control Account

	\$		\$
Balance b/f (Dr)	12 900	Discount allowed	500
	<u>12 900</u>	<b>Balance c/d (balancing figure)</b>	<b><u>12 400</u></b>
			<u>12 900</u>

41 Option 'B' is correct as item 3 is recorded in 'purchase ledger control account'.

## CHAPTER 10 ACCOUNTS FROM INCOMPLETE RECORDS

- 1 Rent is paid by a business monthly in advance on the first day of each month. The payments during this financial year have been as follows:

- Up to and including 1 June \$500 per month
- From 1 July thereafter \$600 per month

Which amount(s) will appear in the accounts for the year ended 31 October?

	income statement expense	Balance sheet
A	\$6 400	\$600 prepayment
B	\$6 400	\$600 accrual
C	\$6 400	—
D	\$7 000	—

May 98 P1 Q2/ May 08 P1 Q2/Nov 12 P12 Q1/ May 15 P12 Q3

- 2 A business makes sales with a gross profit margin of 30%. At 1<sup>st</sup> April 1997, the inventory was valued at \$2 600 and at 31 March 1998 at \$3 800. During the year the sales totalled \$80 800.

What was the value of purchases during the year?

- A \$56 560      B \$57 760      C \$60 360      D \$63 354

May 98 P1 Q9

- 3 A sole trader's year-end is 31 December. Rent is paid in arrears. Until 30 April 1998, the rent was \$240 per month. This was increased to \$270 per month from 1 May 1998.

What is the sole trader's rent payable for the year ending 31 December 1998?

- A \$2 880      B \$3 120      C \$3 150      D \$3 240

Nov 98 P1 Q2

- 4 A new business was established with opening capital of \$15 000. At the end of the year net assets were \$20 000. During the year the proprietor's drawings were \$3 000 and this resulted in an overdraft at the end of the year of \$3 000.

What was the profit during the year?

- A \$2 000      B \$3 000      C \$5 000      D \$8 000

May 99 P1 Q7/ Nov 09 P1 Q9

- 5 The table shows transactions relating to a commodity during a period.

	Units	Value \$
purchased	50	\$4
sold	30	\$10

Of the remaining units, 8 are damaged and therefore worthless.

What is the profit for the period?

- A \$68      B \$100      C \$148      D \$180

May 99 P1 Q15

- 6 The table shows opening and closing Rent Receivable Account balances.

	Start of year	End of year
	\$	\$
rent received in advance	4 200	1 600
rent due in arrears	2 000	2 400

During the year, \$111 000 rental income was received.

What is the total rent receivable for the year?

- A \$110 600      B \$111 000      C \$112 800      D \$114 000

Nov 99 P1 Q4 / May 03 P1 Q30/May 12 P12 Q2

- 7 A business paid \$15 000 for electricity in the year. The closing accrual was \$2 000 and the opening prepayment was \$1 000.

What is the charge for electricity for that year?

- A \$15 000      B \$16 000      C \$17 000      D \$18 000  
May 00 P1 Q3/Nov 09 P1 Q2

- 8 A company purchases a product that costs \$240. The company expects to make a gross profit margin of  $33\frac{1}{3}\%$ . What is the company's mark-up?

- A \$60      B \$80      C \$100      D \$120  
May 00 P1 Q10

- 9 A company sells goods on sale or return at a mark-up of 25%.  
At the Balance Sheet date the following information is available.

Goods in warehouse	\$300 000 (cost)
Goods sent on sale or return	\$200 000 (at invoice price)

What will be the value of closing inventory in the company accounts?

- A \$300 000      B \$450 000      C \$460 000      D \$500 000  
May 00 P1 Q13/ Nov 04 P1 Q14

- 10 X Ltd rents its building to Y Ltd.

At 31 December 1998, Y Ltd owed \$4 500 for rent, but at 31 December 1999 he paid \$3 200 in advance. During the year X Ltd had received \$17 100 in rental from Y Ltd.

What is the rental income to be shown in X LTD's Income statement for the year ended 31 December 1999?

- A \$9 400      B \$15 800      C \$18 400      D \$24 800  
Nov 00 P1 Q3/ Nov 04 P1 Q2/May 13 P12 Q3

- 11 The table shows the following balances for a business.

	Start of year	End of year
	\$	\$
Inventory	6 000	9 000
Trade payables	8 000	10 000

Total payments to trade payables were \$20 000.

What is the cost of sales for the year?

- A \$15 000      B \$19 000      C \$21 000      D \$25 000  
Nov 00 P1 Q10

- 12 The bookkeeper of a company has disappeared. There is no cash in till and theft is suspected. The following information is known

	\$
Cash balance at beginning of period	750
Total sales during the period	150 000
Decrease in trade receivables during the period	5 500
Receipts from trade receivables paid into bank	96 000
Expenses paid from cash received	5 000

How much cash has the bookkeeper stolen during the period?

- A \$44 250      B \$49 750      C \$55 250      D \$60 250  
May 01 P1 Q4 / Nov 02 P1 Q4

- 13 A tenant pays annual rent of \$6 000. Payment is made quarterly in advance on 1 January, 1 April, 1 July and 1 October.

Which of the following should be included in his accounts for the year ended 31 October 2001?

- A \$500 accrual      B \$500 prepayment  
C \$1 000 accrual      D \$1 000 prepayment

Nov 01 P1 Q1

- 14** A Company's accounting year-end is 31 December. It always pays its insurance premiums annually, in advance, on the due date 1 September.  
During the last few years the following premiums have been paid:

1. \$2 400
2. \$2 760
3. \$3 840

What will be the charge for insurance in the company's Income statement for Year 3?

- A** \$2 760      **B** \$3 120      **C** \$3 480      **D** \$3 840

Nov 01 P1 Q4

- 15** On 6 January 2002 a firm lost its entire inventory in a fire. Inventory had a Balance Sheet valuation of \$650 000 on 31 December 2001.

In the period 1-5 January 2002 purchases were \$75 000 and sales were \$96 000.

The average gross profit the firm makes is 25% of selling price.

What was the value of the inventory on 5 January?

- A** \$629 000      **B** \$647 000      **C** \$653 000      **D** \$671 000

May 02 P1 Q11

- 16** The table gives data about rental income for the year ended 31 March 2003.

	\$
Rents owing 31 March 2002	1 400
Rents received in advance 31 March 2002	1 300
Cash received	13 700
Rents written off	560
Rents owing at 31 March 2003	1 750
Rents paid in advance at 31 March 2003	1 600

Which figure for rental income will appear in the Income statement for the year ended 31 March 2003?

- A** \$14 010      **B** \$14 210      **C** \$14 310      **D** \$14 510

Nov 03 P1 Q2/Nov 11 P1 Q1/May 15 P12 Q14

- 17** The table shows information relating to the non-current assets of a business.

	\$
Net book value at the beginning of year	28 000
Net book value at end of year	25 000
Depreciation charge for the year	4 000
Disposals at net book value	9 000

What is the figure for non-current asset additions?

- A** \$2 000      **B** \$6 000  
**C** \$10 000      **D** \$16 000

Nov 03 P1 Q5

- 18** A business owner suspects a loss of cash has occurred. He provides the data shown.

	\$
Cash balance at the start of the month	150
Cash balance at the end of the month	100
Cash banked	10 200
Cash sales per till rolls	10 500

How much cash has been lost?

- A** \$200      **B** \$250  
**C** \$300      **D** \$350

Nov 03 P1 Q13/ Nov 06 P1 Q14/May 14 P12 Q14

- 19 You are given the following information on 31 December 2003 by X, a sole trader.

	\$
Total purchases for year	95 000
Returns inwards	3 000
Returns outwards	2 000
Inventory withdrawn by X for personal use	5 000

Unsold inventory on 31 December 2003 was valued at \$1 000 more than on 1 January 2003.

What is the cost of sales?

- A \$86 000      B \$87 000      C \$89 000      D \$97 000

Nov 04 P1 Q16

- 20 At the end of year 1 a company had a debit balance of \$760 on its Rent Payable account. Payments for rent in year 2 totalled \$10 600 and at the end of the year rent prepaid was \$1 290. How much rent was charged against profit in year 2?

- A \$8 550      B \$10 070      C \$10 600      D \$11 130

May 05 P1 Q5

- 21 How may net profit be calculated?

- A Closing Capital + Drawings – Additional Capital – Opening Capital  
 B Closing Capital – Drawings + Additional Capital – Opening Capital  
 C Opening Capital + Drawings – Additional Capital – Closing Capital  
 D Opening Capital – Drawings – Additional Capital – Closing Capital

May 05 P1 Q11/ Nov 08 P1 Q11

- 22 A business does not keep proper accounting records. The following information is available at the start of the year.

- 1 A motor car valued at \$2 500
- 2 Inventories which cost \$4 000 with a sale value of \$6 000
- 3 Bank overdraft of \$500
- 4 A loan to a friend from the business bank account \$1 000

What is the Capital account balance at the start of the year?

- A \$5 000      B \$7 000      C \$8 000      D \$9 000

May 05 P1 Q16

- 23 A company's financial year ends on 31 December. At 31 December year 1 the company carried forward a debit balance of \$36 200 on the Rent account. During Year 2 payments made for 12 months' rent, to 31 March Year 3, were \$157 200.

What is the amount of rent to be charged against profit in the year ended 31 December Year 2?

- A \$121 000      B \$154 100      C \$160 200      D \$193 400

Nov 05 P1 Q9/Nov 13 P12 Q7

- 24 The accounting year end of a business is 31 October. On 1 April the business rents out part of its warehouse for an annual rent of \$6 000 receivable in equal instalments on 1 April, 1 July, 1 October and 1 January. At 31 October what would the final accounts show?

	Income statement		Balance Sheet	
		\$		\$
A	rental income	3 500	current asset	1 000
B	rental income	3 500	current liability	1 000
C	rental income	4 500	current liability	1 000
D	rental income	6 000	current asset	1 500

May 06 P1 Q2/ Nov 09 P1 Q1

- 25 The following information is taken from the stationery account of a business.

	\$
Inventory of stationery at beginning of the year	600
Cash paid for stationery during the year	7 000
Invoice not yet received for stationery	480
Inventory of stationery at end of year	800

How much should be debited to the Income statement for stationery?

- A**     \$6 680                      **B**     \$6 800                      **C**     \$7 280                      **D**     \$8 080  
 May 06 P1 Q3/ May 09 P1 Q4

- 26 The following information is extracted from the records of a business.

	\$
At 31 December 2004:	
Rent paid in advance	4 000
During the year ended 31 December 2005:	
Rent paid	41 000
At 31 December 2005:	
Rent paid in advance	7 000

How much will be debited for rent in the Income statement for the year ended 31 December 2005?

- A**     \$34 000                      **B**     \$38 000                      **C**     \$41 000                      **D**     \$44 000  
 May 06 P1 Q8

- 27 At the end of a financial year the following information is available.

	\$
Sales	200 000
Opening inventory	15 000
Closing inventory	18 000

If the business makes a standard mark-up of 25%, what were the purchases?

- A**     \$147 000                      **B**     \$153 000                      **C**     \$157 000                      **D**     \$163 000  
 May 06 P1 Q16/Nov 07 P1 Q12/ Nov 09 P3 Q24/ Nov 10 P1 Q10/May 12 P12 Q13

- 28 A trader does not keep double-entry records.

At the beginning of a period, suppliers are owed \$43 600.

Payments of \$197 320 were made in the period.

Suppliers are owed \$35 390 at the end of the period.

What are the total purchases for the period?

- A**     \$118 330                      **B**     \$189 110                      **C**     \$205 530                      **D**     \$276 310  
 May 06 P1 Q17

- 29 X has not kept proper records for his business.

Between 31 December 2004 and 31 December 2005 his net assets had increased by \$30 000.

On 1 January 2005, X brought into the business his private car which had cost \$12 000 but now has a re-sale value of \$8 000.

Drawings for the year ended 31 December 2005 were \$16 000.

What was X's profit for the year ended 31 December 2005?

- A**     \$22 000                      **B**     \$26 000                      **C**     \$34 000                      **D**     \$38 000  
 Nov 06 P1 Q16

- 30 The following information relates to a business:

	\$
opening trade receivables	280 000
cash received during the year	520 000
discounts allowed during the year	30 000
bad debts written off during the year	15 000
closing trade receivables	265 000

What were the sales during the year?

- A** \$490 000      **B** \$535 000      **C** \$550 000      **D** \$580 000

May 07 P1 Q8

- 31 A trader, whose purchases are all on credit, does not keep double entry records. The following information is available:

	\$
opening trade payables	51 660
payments to suppliers during the year	212 760
closing trade payables	56 340

The discount received for the year amounted to \$1000.

What were the purchases for the period?

- A** \$209 080      **B** \$214 940      **C** \$217 440      **D** \$218 440

May 07 P1 Q11

- 32 A business does not keep complete accounting records. The following information is known:

	\$
capital at start of year	52 000
capital at end of year	55 000
owner's drawings in year	13 000
capital introduced during the year	25 000

What is the net profit/loss for the year?

- A** net loss \$9 000      **B** net profit \$9 000  
**C** net loss \$15 000      **D** net profit \$15 000

May 07 P1 Q13/ Nov 12 P12 Q16

- 33 At the beginning of the financial year inventory was valued at \$15 000. During the year, sales of \$21000 and purchases of \$18 000 were made. Unfortunately, the entire inventory was stolen on the last day of the financial year.

Goods are marked up by 50 % to calculate selling price. What is the cost of the stolen inventory?

- A** \$7 500      **B** \$11 000      **C** \$19 000      **D** \$22 500

May 07 P1 Q15

- 34 A company receives payment for 20 % of its sales in the month of sale, 50 % in the following month and 30 % two months after the month of sale.

The table shows sales for four months.

	\$
January	180 000
February	240 000
March	270 000
April	220 000

How much were total cash receipts in April?

- A** \$220 000      **B** \$228 000      **C** \$249 000      **D** \$251 000

May 07 P1 Q17

- 35 A business prepares its accounts to 31 December. Insurance premiums paid were:

date paid		\$
January 2006	paid for 6 months to 31 December 2005	940
July 2006	paid for 6 months to 30 June 2006	1 120
January 2007	paid for 6 months to 31 December 2006	1 245
March 2007	paid for 6 months to 30 June 2007	1 880

Which amount should be shown in the income statement for the year ended 31 December 2006?

- A \$1 120      B \$2 060      C \$2 365      D \$3 305

Nov 07 P1 Q3

- 36 A company income statement includes:

	\$000
dividend	300
increase in inventory	200
overheads	400
purchases	800

If the net profit percentage is 20 %, what is the figure for sales?

- A \$1 120 000      B \$1 250 000  
C \$1 625 000      D \$1 750 000

May 09 P1 Q19

- 37 The table shows information provided by a company.

	\$000
sales for the year	500
purchases for the year, at cost	450
closing inventory, at selling price	50

There was no opening inventory.

What was the gross profit for the year?

- A \$80 000      B \$90 000      C \$90 909      D \$110 000

May 09 P3 Q12

- 38 The summarised balance sheets for a business for two years are as follows.

	year 1 (\$)	year 2 (\$)
non-current assets	9 000	12 000
current assets	6 000	8 000
less current liabilities	(5 000)	(6 000)
net assets	10 000	14 000

The drawings in year 1 were \$5 000 and in year 2 \$3 000.

What is the net profit for year 2?

- A \$1 000      B \$4 000      C \$5 000      D \$7 000

Nov 09 P1 Q12/ May 13 P12 Q12

- 39 A firm has incomplete accounting records. The following figures are known.

	\$
capital at start of year	20 000
owner's drawings	7 000
capital at end of year	30 000

How much profit has the firm made during the year?

- A \$7 000      B \$17 000  
C \$27 000      D \$30 000

May 10 P1 Q12

- 40 The table shows transactions relating to an inventory item during a period.

	number of units	per unit
bought	100	cost \$16
sold	60	selling price \$25

Of the remaining units, 20 are damaged and can only be sold for \$10 each.

What is the profit for the period?

- A \$220                      B \$300                      C \$420                      D \$540

May 10 P1 Q14

- 41 On 1 January 2009 a business had prepaid rent of \$50. During 2009, three rent payments were made of \$250 each. On 31 December 2009, the business still owes \$200 rent on account for 2009.

The business owner has charged the rent payments made during 2009 in his income statement. What is the effect on net profit?

- A \$200 too high                      B \$200 too low  
C \$250 too high                      D \$250 too low

Nov 10 P1 Q1

- 42 X started a business 3 years ago and now has a capital of \$175 000. Over that period his profits have been \$73 000 and his drawings \$52 000. In year 2 he introduced cash of \$35 000 and in year 3 he took out of the business, for his own use, a non-current asset with a net book value of \$4000. How much capital did he start the business with?

- A \$67 000                      B \$115 000                      C \$123 000                      D \$158 000

Nov 10 P1 Q16

- 43 A business paid \$10 000 for waste disposal in the year.

The opening prepayment was \$1500 and the closing accrual was \$2000. What was the charge for waste disposal for the year?

- A \$6 500  
B \$9 500  
C \$10 500  
D \$13 500

May 11 P1 Q10/Nov 15 P12 Q3

- 44 A new business was established with opening capital of \$20 000.

At the end of the first year, assets less liabilities were \$26 000. The owner withdrew \$7 000 as drawings during the year and this resulted in a bank overdraft of \$5 000 at the end of the year.

What was the profit during the first year?

- A \$8 000                      B \$12 000  
C \$13 000                      D \$18 000

May 11 P1 Q17/May 15 P12 Q19

- 45 A business sells goods at a mark-up of 33.3%. Information for a year is given.

	\$000
revenue	600 000
opening inventory	53 000
closing inventory	68 000

What are the total purchases for the year?

- A \$415 000  
B \$435 000  
C \$450 000  
D \$465 000

May 11 P1 Q30

- 46 The table shows information for a business at 31 March in Year 1.

	\$
inventory	16100
trade payables	5200
other payables	2000

The information excludes the purchase of \$3700 of goods. These goods were delivered on 31 March Year 1, but the invoice states that legal title to the goods does not pass until payment is received.

Which values should appear in the balance sheet on 31 March Year 1?

	inventory (\$)	trade payables (\$)	other payables (\$)
<b>A</b>	16100	5200	2000
<b>B</b>	16100	5200	5700
<b>C</b>	19800	5200	5700
<b>D</b>	19800	8900	2000

Nov 11 P1 Q5/May 15 P12 Q7

- 47 A business provides the following information.

	\$
cash received from customers	200 000
opening trade receivables	40 000
closing trade receivables	30 000
discounts allowed	5 000
provision for doubtful debts	4 000

How much are the credit sales?

- A** \$190 000      **B** \$195 000      **C** \$199 000      **D** \$215 000

Nov 11 P1 Q8/Nov 13 P12 Q12

- 48 The following information is taken from a trader's statement of financial position.

	\$
non-current assets	80 000
capital at start of year	75 000
drawings	16 000
profit for the year	13 000
non-current liability	6 000
current assets	12 700

What is the amount of trade payables?

- A** \$8 700      **B** \$11 700      **C** \$14 700      **D** \$26 700

Nov 13 P12 Q1

- 49 During the month a company lost a quantity of inventory in a burglary. The table shows the company's results for the month.

	\$
opening trading inventory, at cost	30 000
Purchases	210 000
Revenue	330 000
closing trading inventory, at cost	4 000

A gross profit on all sales of 30% has been achieved.

What was the cost of the inventory lost in the burglary?

- A** \$4 000      **B** \$5 000      **C** \$9 000      **D** \$13 000

Nov 13 P12 Q11

- 50 A business provides the following information.

	\$
revenue	140 000
opening inventory	22 000
closing inventory	24 500
Purchases	120 000

Goods are sold at cost plus 25%.

The owner has taken goods for own use but has not recorded these as drawings.

What is the value of the goods taken for own use?

- A** \$5 500                      **B** \$10 500                      **C** \$12 500                      **D** \$17 500

May 14 P12 Q11

- 51 At 1 January 2014 a business had prepaid rent of \$700. In July it paid an invoice for \$9300 and on 31 December it transferred an expense of \$9000 to the income statement.

Which value appeared in the statement of financial position at 31 December 2014?

- A** \$400 other payables                      **B** \$400 other receivables  
**C** \$1000 other payables                      **D** \$1000 other receivables

Nov 15 P12 Q8

- 52 A business sells goods at a uniform gross profit margin of 30%. The following information is available.

	\$
revenue	62 000
opening inventory	10 000
purchases	45 000

What is the value of closing inventory?

- A** \$10 000                      **B** \$11 600  
**C** \$16 500                      **D** \$18 600

Specimen 16 P1 Q14

- 53 A company received interest of \$8 800 during the financial year. Interest of \$700 was due at the beginning of the year and \$850 at the end of the year.

Which entry appeared in the interest received account to make the transfer to the income statement?

- A** \$8 650 credit  
**B** \$8 650 debit  
**C** \$8 950 credit  
**D** \$8 950 debit

May 16 P12 Q9

- 54 The following information is available for rent and rates.

	\$
prepaid rent at the start of the year	1 250
accrued rates at the start of the year	1 380
Rent and rates income statement amount	8 750
Prepaid rent at the end of the year	1 104
accrued rates at the end of the year	1 000

What is the amount paid for rent and rates during the year?

- A** \$8 516                      **B** \$8 854  
**C** \$8 880                      **D** \$8 984

May 16 P12 Q11

- 55 A sole trader provides the following information.

	start of year \$	end of year \$
total assets	100 000	135 000
total liabilities excluding owner's capital	(35 000)	(40 000)

During the year the owner took drawings of \$18 000.

What was the profit for the year?

- A \$12 000      B \$30 000      C \$35 000      D \$48 000

Nov 16 P12 Q10

- 56 A trader did not keep full accounting records. The following information was available for 2015.

	\$
trade payables on 1 January	32 785
trade payables on 31 December	43 630
payments to suppliers during the year	72 830
discounts received during the year	3 450

What was the value of purchases?

- A \$58 535      B \$65 435      C \$80 225      D \$87 125

Nov 16 P12 Q11

- 57 Finn provides the following information.

	\$
capital at the start of the year	19 800
profit for the year	24 000
drawings (cash)	19 500
drawings (goods for own use)	1 100
private vehicle transferred to business use	6 000

What was Finn's capital at the end of the year?

- A \$23 200      B \$24 300      C \$29 200      D \$31 400

May 17 P12 Q9

## ANSWER KEY

1	C	16	C	31	D	46	D
2	B	17	C	32	A	47	B
3	B	18	D	33	C	48	C
4	D	19	B	34	D	49	B
5	C	20	B	35	C	50	A
6	D	21	A	36	B	51	D
7	D	22	B	37	C	52	B
8	D	23	B	38	D	53	D
9	C	24	B	39	B	54	D
10	A	25	C	40	C	55	D
11	B	26	B	41	C	56	D
12	C	27	D	42	C	57	C
13	D	28	B	43	D		
14	B	29	D	44	C		
15	C	30	C	45	D		

## DETAILED ANSWERS

$$\begin{array}{rclcl}
 1 & \text{Rent expense} & = & (\$500 \times 8 \text{ months}) & + & (\$600 \times 4 \text{ months}) \\
 & & = & \$4\,000 & + & \$2\,400 \\
 & & = & \$6\,400 & & 
 \end{array}$$

No amount will be shown in the balance sheet as monthly rent is paid on the first day of each month and payment expires as the month ends.

2				\$	\$
	Sales				80 800
	Cost of sales				
	Opening inventory		2 600		
	Add Purchases (balancing figure)		<u>57 760</u>		
			60 360		
	Less Closing inventory		<u>(3 800)</u>		<u>(56 560)</u>
	Gross profit (80 800 × 30%)				<u>24 240</u>

$$\begin{array}{rclcl}
 3 & \text{Rent payable} & = & (\$240 \times 4 \text{ months}) & + & (\$270 \times 8 \text{ months}) \\
 & & = & \$960 & + & \$2\,160 \\
 & & = & \$3\,120 & & 
 \end{array}$$

4				\$	
	Capital (net assets) at year end				20 000
	Add Drawings				<u>3 000</u>
					23 000
	Less Opening capital				<u>(15 000)</u>
	Net Profit for the year				<u>8 000</u>

\* Overdraft at end is not considered because it has already been subtracted from year-end assets resulting in net assets of \$20 000 at the year-end.

5				\$	
	Sales (30 × 10)				300
	Cost of sales (30 × 4)				<u>(120)</u>
	Gross profit				180
	Loss by damage (8 × 4)				<u>(32)</u>
	Net profit				<u>148</u>

6

Rent income	=	Rent received	-	Pre-receipts at end	+	Pre-receipts at start	+	Accrued at end	-	Accrued at start
	=	\$111 000	-	\$1 600	+	\$4 200	+	\$2 400	-	\$2 000
	=	\$114 000								

7

Electricity Paid	+	Closing Accrual	+	Opening Prepayment	=	Electricity Expense
\$15 000	+	\$2 000	+	\$1 000	=	\$18 000

8

Sales	=	Cost	+	Profit
X	=	\$240	+	1/3 X
X - 1/3 X	=	\$240		
2/3 X	=	\$240		
X	=	\$240 x 3/2		
	=	\$360		
Profit	=	\$360 x 1/3		
	=	\$120		

**Alternatively** Margin = 33 1/3% = 1/3

To convert margin into mark-up, the value in numerator will be subtracted from denominator, So it will be

Mark-up	=	1/3 - 1	=	1/2
Profit	=	\$240 x 1/2	=	\$120

9

Cost of goods in warehouse	\$
	300 000
Cost of goods sent on "sale or return". (\$200 000 x 100/125)	<u>160 000</u>
Value of closing inventory	<u>460 000</u>

10

Rent account			
	\$		\$
Arrears b/f	4 500	Cash	17 100
Income statement(bal. figure)	9 400		
Pre-received c/d	<u>3 200</u>		
	<u>17 100</u>		<u>17 100</u>

11

Opening inventory	\$
	6 000
Add Purchases (\$20 000+\$10 000-\$8 000)	22 000
Less Closing inventory	<u>(9 000)</u>
Cost of sale	<u>19 000</u>

12

Cash account			
	\$		\$
Balance b/f	750	Expenses	5 000
Trade receivables	96 000	Bank	96 000
Sales *	<u>59 500</u>	Loss by theft(balancing figure)	<u>55 250</u>
	<u>156 250</u>		<u>156 250</u>

\*

Trade receivables' account			
	\$		\$
Decrease in trade receivables	5 500	Cash	96 000
Credit sales (balancing figure)	<u>90 500</u>		
	<u>96 000</u>		<u>96 000</u>

Cash sales = \$150 000 - \$90 500 = \$59 500

- 13 As last quarterly rental payment was made on 1 October, and year ends on 31 October, so it means that rent of two months (November and December) has been paid in advance which is \$1 000\*

$$\begin{aligned} \text{*Per month rent} \times 2 \text{ months} &= \$6\,000 \times \frac{2}{12} \\ &= \$1\,000 \end{aligned}$$

- 14 Rent paid in year 2 covers rent expense from September of year 2 to August of year 3; whereas rent paid in year 3 represents rent expense from September of year 3 to August of year 4.

$$\begin{aligned} \text{So rent expense of year 3} &= \left[ \begin{array}{l} 8 \text{ months of} \\ \text{rent payment} \\ \text{in year 2} \end{array} \right] + \left[ \begin{array}{l} 4 \text{ months of} \\ \text{rent payment} \\ \text{in year 3} \end{array} \right] \\ &= (\$2\,760 \times \frac{8}{12}) + (\$3\,840 \times \frac{4}{12}) \\ &= \$1\,840 + \$1\,280 \\ &= \$3\,120 \end{aligned}$$

15		\$
	Opening inventory (on 31 December 2001)	650 000
	Add Purchases	75 000
	Less Cost of sales (96 000 × 75%)	<u>(72 000)</u>
	Inventory on 5 January 2002	<u>653 000</u>

16 **Rent account**

	\$		\$
Owing b/f	1 400	Pre-received b/f	1 300
<b>Income statement (balancing figure)</b>	<b>14 310</b>	Cash	13 700
Pre-received c/d	1 600	Rent written off	560
	<u>17 310</u>	Owing c/d	<u>1 750</u>
			<u>17 310</u>

17 **Non-current assets account (at book value)**

	\$		\$
Book value b/f	28 000	Depreciation	4 000
Cash (additions) (*)	10 000	Disposals (at book value)	9 000
	<u>38 000</u>	Book value c/d	<u>25 000</u>
			<u>38 000</u>

18 **Cash account**

	\$		\$
Balance b/f	150	Cash banked	10 200
Cash sales	10 500	Income statement a/c (loss)	350
	<u>10 650</u>	Balance c/d	<u>100</u>
			<u>10 650</u>

19		\$
	Total purchases for the year	95 000
	Return outwards	(2 000)
	Inventory withdrawn by X for personal use	<u>(5 000)</u>
	Net purchases for the year	88 000
	Increase in inventories *	<u>(1 000)</u>
	Cost of sale	<u>87 000</u>

\* Increase in inventories means that closing inventory is more than opening inventory by \$1 000, and as closing inventory is subtracted to calculate cost of sale so \$1 000 is subtracted from purchases to calculate cost of sales.

20

**Rent Account**

Prepaidb/f	\$ 760	Income statement(bal. figure)	\$ 10 070
Cash	<u>10 600</u>	Balance c/d (prepaid)	<u>1 290</u>
	<u>11 360</u>		<u>11 360</u>

22

Assets at year start (\$2 500 + \$4 000+ \$1 000)	\$ 7 500
Liabilities at year start	<u>(500)</u>
Capital at year start	<u>7 000</u>

23

**Rent account (Year 2)**

Balance b/f	\$ 36 200	Income statement (*)	\$ 154 100
Bank	<u>157 200</u>	Balance c/d (\$157 200 ÷ 4)	<u>39 300</u>
	<u>193 400</u>		<u>193 400</u>

24

Rental income for the year = \$6 000 ×  $\frac{7}{12}$  (April to October)  
= \$ 3 500

As rental income received on 1 October (\$6 000 ×  $\frac{1}{4}$ ) covers a period of 3 months, of which 2 months (November and December) relate to next financial year so \$1 000 will be recorded as a current liability.

25

**Stationery account**

Balance b/f (opening inventory)	\$ 600	Income statement(Balancing figure)	\$ 7 280
Cash	7 000	Balance c/d (closing inventory)	800
Balance c/d (accruals)	<u>480</u>		
	<u>8 080</u>		<u>8 080</u>

26

**Rent account**

Balance b/f	\$ 4 000	Income statement(bal. figure)	\$ 38 000
Cash	<u>41 000</u>	Balance c/d	<u>7 000</u>
	<u>45 000</u>		<u>45 000</u>

27

As we know

Sales	–	Cost of sales	=	Gross profit
\$200 000	–	x	=	0.25 x
		1.25 x	=	\$200 000
		x (Cost of sales)	=	\$160 000

Where

Opening inventory	+	Purchases	–	Closing inventory	=	Cost of sales
\$15 000	+	Purchases	–	\$18 000	=	\$160 000
		Purchases	=	\$163 000		

28

**Trade payables' account**

Cash paid to suppliers	\$ 197 320	Balance b/f	\$ 43 600
Balance c/d	<u>35 390</u>	Purchases (balancing figure)	<u>189 110</u>
	<u>232 710</u>		<u>232 710</u>

29

Increase in net assets	\$ 30 000
Add Drawings	<u>16 000</u>

Less Additional investment by the owner	(8 000)
Net profit for the year	<u>38 000</u>

**30 Trade receivables' account**

	\$		\$
Balance b/f	280 000	Cash	520 000
Sales (balancing figure)	550 000	Discounts allowed	30 000
		Bad debts	15 000
	<u>830 000</u>	Balance c/d	<u>265 000</u>
			<u>830 000</u>

**31 Trade payables' account**

	\$		\$
Bank	212 760	Balance b/f	51 660
Discounts received	1 000	Purchases (Balancing figure)	218 440
Balance c/d	<u>56 340</u>		
	<u>270 100</u>		<u>270 100</u>

**32** Capital at year end + Drawings – Opening capital – Additional capital = Net profit (Loss)  
 \$55 000 + \$13 000 – \$52 000 – \$25 000 = (\$9 000)  
 So net loss is \$9 000.

**33 Income Statement (Trading Section)**

	\$	\$
Sales		21 000
Cost of sales		
Opening inventory	15 000	
Purchases	<u>18 000</u>	
	33 000	
Less inventory lost by theft (balancing figure)	<u>(19 000)</u>	<u>14 000</u>
Gross profit (*)		<u>7 000</u>

\* Gross profit = Sales  $\times \frac{1}{2+1}$   
 = \$21 000  $\times \frac{1}{3}$   
 = \$7 000

**34 Calculation of cash receipts in April**

Cash receipts from sale of April (\$220 000 $\times$ 20%)	44 000
Cash receipts from sale of March (\$270 000 $\times$ 50%)	135 000
Cash receipts from sale of February (\$240 000 $\times$ 30%)	<u>72 000</u>
	<u>251 000</u>

**35** Income statement will include insurance paid for 12 months to December 2006; so it should be \$2 365 (\$1 120 + \$1 245).

**36** Sales – Cost of Sales – overheads = Net profit  
 x – (\$800 000 – \$200 000) – \$400 000 = 0.20x  
 0.80x = \$1 000 000  
 x (cost of sales) = \$1 250 000

**37** Gross profit ratio =  $\frac{\text{Gross Profit}}{\text{Sales revenue}} \times 100$

Option A	=	$\frac{\$80\,000}{\$500\,000} \times 100$	=	16.00%
Option B	=	$\frac{\$90\,000}{\$500\,000} \times 100$	=	18.00%
Option C	=	$\frac{\$90\,909}{\$500\,000} \times 100$	=	18.18%
Option D	=	$\frac{\$110\,000}{\$500\,000} \times 100$	=	22.00%

Now we will use "trial and error" method to find out the answer

	Sales	–	Cost of sales	=	Gross profit
Option A	\$500 000	–	[\$450 000 – (\$50 000 × 84.00%)]	≠	(\$500 000 × 16.00%)
Option B	\$500 000	–	[\$450 000 – (\$50 000 × 82.00%)]	≠	(\$500 000 × 18.00%)
Option C	<b>\$500 000</b>	–	<b>[\$450 000 – (\$500 000 × 81.82%)]</b>	=	<b>(\$500 000 × 18.18%) verified</b>
Option D	\$500 000	–	[\$450 000 – (\$500 000 × 78.00%)]	≠	(\$500 000 × 22.00%)

**38**

Net Profit	=	Net assets at year end	+	Drawings	–	Net assets at year start
	=	\$14 000	+	\$3 000	–	\$10 000
	=	\$7 000				

**39**

Net Profit	=	Closing Capital	+	Drawings	–	Opening Capital
	=	\$30 000	+	\$7 000	–	\$20 000
	=	\$17 000				

**40** **Income Statement (Trading Section)**

	\$	\$
Sales (60 units @ \$25)		1 500
Cost of sales		
Purchases (100 units @ \$16)	1 600	
Closing inventory [(20 units @ \$16 + (20 units @ \$10)]	<u>(520)</u>	<u>(1 080)</u>
Gross profit ( $\$240\,000 \times \frac{25}{125}$ )		<u>420</u>

**41** **Rent Account**

	\$		\$
Balance b/f	50	Income Statement (balancing figure)	1 000
Cash (\$250 × 3)	750		
Balance c/d	<u>200</u>		
	<u>1 000</u>		<u>1 000</u>

As rental expense is understated by \$250 (\$1 000 – \$750 so profit would have been overstated by \$250.

**42**

Opening Capital	+	Additional capital	+	Net Profit	–	Drawings	=	Closing Capital
Opening Capital	+	\$35 000	+	\$73 000	–	(\$52 000 + \$4 000)	=	\$175 000
Opening Capital	=	\$175 000	–	\$35 000	+	(\$52 000 + \$4 000)	–	\$73 000
Opening Capital	=	\$123 000						

**43** **Waste Disposals Account**

	\$		\$
Balance b/f	1 500	Income Statement charge (bal. figure)	13 500
Cash	10 000		
Balance c/d	<u>2 000</u>		
	<u>13 500</u>		<u>13 500</u>

**44**

Net Profit	=	Closing Capital	+	Drawings	–	Opening Capital
	=	\$26 000	+	\$7 000	–	\$20 000
	=	\$13 000				

45	Sales	–	Cost of sales	=	Gross profit	
	\$600 000	–	X	=	$\frac{1}{3}X$	
			$\frac{4}{3}X$	=	\$600 000	
			x (Cost of sales)	=	\$450 000	
	Opening inventory	+	Purchases	–	Closing inventory	=
	\$53 000	+	Purchases	–	\$68 000	=
			Purchases	=	\$465 000	

46		inventory (\$)	trade payables (\$)	other payables (\$)
	Balances before adjustment	16100	5200	2000
	Adjustment for goods purchases	<u>3 700</u>	<u>3 700</u>	–
	Balances after adjustment	<u>19 800</u>	<u>8 900</u>	<u>2 000</u>

## 47 Trade Receivables Account

	\$		\$
Balance b/f	40 000	Cash received from customers	200 000
<b>Credit Sales (balancing figure)</b>	<b>195 000</b>	Discounts allowed	5 000
	<u>235 000</u>	Balance c/d	<u>30 000</u>
			<u>235 000</u>

48		\$	\$
	Total Assets (\$80 000 + \$12 700)		92 700
	Equity (\$75 000 + \$13 000 – \$16 000)	72 000	
	Non-Current Liabilities	<u>6 000</u>	<u>(78 000)</u>
	Trade payables		<u>14 700</u>

## 49 Income Statement (Trading Section)

		\$	\$	\$
Revenue				330 000
Cost of sales				
Opening inventory			30 000	
Purchases	210 000			
<b>Less inventory lost by theft (balancing figure)</b>	<b><u>(5 000)</u></b>	<u>205 000</u>		
			235 000	
Closing Inventory		<u>(4 000)</u>		<u>(231 000)</u>
Gross profit (\$330 000 × 30%)				<u>99 000</u>

## 50 Income Statement (Trading Section)

		\$	\$	\$
Revenue				140 000
Cost of sales				
Opening inventory			22 000	
Purchases	120 000			
<b>Less Drawings of goods (balancing figure)</b>	<b><u>(5 500)</u></b>	114 500		
Closing Inventory		<u>(24500)</u>		<u>(112 000)</u>
Gross profit (\$140 000 × $\frac{25}{125}$ )				<u>28 000</u>

## 51 Rent account

	\$		\$
Balance (receivable) b/f	700	Income statement (transfer)	9 000
Cash (invoice payment)	<u>9 300</u>	<b>Balance (receivable) c/d (bal. figure)</b>	<b><u>1 000</u></b>
	<u>17 100</u>		<u>17 100</u>

52	Sales	-	Cost of sales	=	Gross profit
	\$62 000	-	(10 000 + 45 000 - Closing inventory)	=	(\$62 000 × 30%)
	\$62 000	-	(10 000 + 45 000 - Closing inventory)	=	\$18 600
			Closing inventory	=	\$11 600

53 **Interest received account**

	\$		\$
Owing b/f	700	Cash	8 800
<b>Income statement (balancing figure)</b>	<b>8 950</b>	Owing c/d	<u>850</u>
	<u>9 650</u>		<u>9 650</u>

54 **Rent and rates Account**

	\$		\$
Balance (prepaid) b/f	1 250	Balance (accrued) b/f	1 380
<b>Cash (balancing figure)</b>	<b>8 984</b>	Income Statement	8 750
Balance (accrued) c/d	<u>1 000</u>	Balance (prepaid) c/d	<u>1 104</u>
	<u>11 234</u>		<u>11 234</u>

55	Profit for the year	=	Closing Capital	+	Drawings	-	Opening Capital
		=	(\$135 000 - \$40 000)	+	\$18 000	-	(\$100 000 - \$35 000)
		=	\$95 000	+	\$18 000	-	\$65 000
		=	\$48 000				

56 **Trade payables' account**

	\$		\$
Cash paid to suppliers	72 830	Balance b/f	32 785
Discounts received	3 450	<b>Purchases (balancing figure)</b>	<b>87 125</b>
Balance c/d	<u>43 630</u>		<u>119 910</u>
	<u>119 910</u>		<u>119 910</u>

57	capital at start	+	Additional capital	+	Net profit	-	Drawings	=	Capital at end
	\$19 800	+	\$6 000	+	\$24 000	-	(\$19 500 + \$1 100)	=	\$29 200

## CHAPTER 11 FINANCIAL STATEMENTS OF PARTNERSHIP

- 1 The following appropriation account for a partnership contains one error.

	\$	\$
Profit as per Profit and Loss section of income statement		18 861
Interest on capital: Able	1 000	
Baker	<u>500</u>	<u>1 500</u>
		17 361
Salary: Able		<u>900</u>
Balance of profit:		18 261
Share of balance of profit: Able	12 174	
Baker	<u>6 087</u>	<u>18 261</u>
		<u>Nil</u>

What should be Abel's share of the balance of profit, when the error is corrected?

- A** \$10 974      **B** \$11 574      **C** \$12 974      **D** \$14 074  
 Nov 98 P1 Q15

- 2 Information from a partnership's accounts is shown

	\$
Net profit before interest	15 000
Interest on a partner's loan to the firm	1 000
Interest on capital accounts	2 000
Drawings	10 000

Which profit figure is to be appropriated between the partners?

- A** \$3 000      **B** \$13 000      **C** \$14 000      **D** \$15 000  
 May 99 P1 Q13

- 3 Interest charged on a partner's drawings account should be

- A** debited to the profit and loss section of income statement  
**B** credited to the profit and loss section of income statement  
**C** debited to the appropriation account  
**D** credited to the appropriation account

May 00 P1 Q9/ Nov 04 P1 Q12/May15 P12 Q12

- 4 Which is not an appropriation of profit?

- A** partner's interest on capital      **B** partner's interest on drawings  
**C** partner's interest on loan      **D** partner's share of profit

May 01 P1 Q11

- 5 A partnership maintains both capital and current accounts for its partners.

Which is the correct accounting entry for recording interest on capital for partner X?

	Debit	Credit
<b>A</b>	Appropriation A/c	X's Capital account
<b>B</b>	Appropriation A/c	X's Current account
<b>C</b>	X's Capital account	Appropriation A/c
<b>D</b>	X's Current account	Appropriation A/c

Nov 02 P1 Q12/ May 06 P1 Q15/ May 17 P12 Q14

- 6 X, Y and Z are in partnership, sharing profits in the ratio 2:2:1. X is allowed an annual salary of \$10000. Y has made a loan to the partnership on which the partnership pays interest of \$5 000 each year. Profit for the year before appropriations is \$150 000.

What is Z's total appropriation of profit for the year?

- A** \$27 000      **B** \$28 000      **C** \$29 000      **D** \$30 000

Nov 04 P1 Q10

7 In the absence of a partnership agreement the partners claim that they are:

1	entitled to interest on the capitals at the rate of 5% per annum
2	entitled to interest on loans to the firm at 5% per annum
3	entitled to interest on loans to the firm at 10% per annum
4	not entitled to interest on capitals
5	not entitled to interest on loans to the firm

Which claims are correct?

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

Nov 04 P1 Q11

8 What appears as a credit in the Appropriation Account of a partnership?

- A Goodwill      B interest on capital  
C net trading profit      D partnership salaries

Nov 05 P1 Q13/May 08 P1 Q16

9 Dele and Iyabo are partners in a business and share profits in the ratio of 3:1.

Their net profit is \$80 000.

The following information is available:

	Dele (\$)	Iyabo (\$)
interest on capitals	3 000	2 500
interest on drawings	500	1 000

How will the residual net profit be shared?

	Dele (\$000)	Iyabo (\$000)
A	57 000	19 000
B	58 875	21 125
C	59 500	20 500
D	60 500	19 500

May 06 P1 Q18

10 Hilary and Lee commenced in partnership on 1 January 2005. There was no partnership agreement concerning the division of interest on the loan or of profits.

	Hilary (\$)	Lee (\$)
capital contribution	5 000	600
loan to partnership	-	1 000

At the year-end, 31 December 2005, net profit before the loan interest was \$8 850.

What would be Hilary's share of the profit?

- A \$4 400      B \$4 425      C \$4 800      D \$4 827

Nov 06 P1 Q17

11 The following information is available for the partnership of Atul and Mansoor at 31 December:

	\$
net profit before appropriations	60 000
salary of Atul	9 000
drawings: Atul	12 000
Mansoor	13 000
interest on capital: Atul	400
Mansoor	500

Residual profits are shared between Atul and Mansoor in the ratio 2: 1.

What is Mansoor's share of total profit for the year?

- A \$16 200      B \$17 000  
C \$17 100      D \$17 200

May 07 P1 Q14

- 12 Partnership capitals are \$60 000 for X and \$90 000 for Y. The partnership agreement provides for interest on capitals at 10 % per annum, but makes no other financial provisions. Profits for the current year total \$75 000.

How will the total profits be divided between the partners?

	X (\$)	Y (\$)
A	30 000	45 000
B	36 000	39 000
C	37 500	37 500
D	39 000	36 000

Nov 07 P1 Q11

- 13 Information about the final accounts of a partnership is given.

	\$
net profit before interest	160 000
interest on bank loan	14 000
interest credited to capital accounts	15 000
drawings	70 000
partnership salaries	24 000

What is the remaining balance of profits to be appropriated amongst the partners?

- A \$66 000      B \$107 000      C \$121 000      D \$137 000

Nov 08 P1 Q18

- 14 X and Y are partners in a business. X receives an annual salary of \$5000 from the partnership and the balance of profits and losses is shared between X and Y in the ratio of 3: 2 respectively. In the last financial year, the net profit was \$30 000.

How much was credited to each partner for the year?

	X (\$)	Y (\$)
A	10 000	15 000
B	12 000	18 000
C	20 000	10 000
D	21 000	14 000

May 09 P1 Q15

- 15 X and Y are in partnership. Their profit and loss appropriation account shows the following.

	X (\$)	Y (\$)	Total (\$)
interest on capital	1 600	1 800	3 400
interest charged on drawings	500	400	900
partners' salaries	2 000	3 000	5 000
share of profit	8 000	12 000	20 000

What is the net profit before appropriations?

- A \$17 500      B \$22 500      C \$27 500      D \$29 300

Nov 09 P1 Q12

- 16 X, Y and Z are in partnership sharing profits and losses in the ratio 5: 2: 3. Y is entitled to a salary of \$18000 per annum. Partners receive interest at 6 % per annum on their capital account balances at the start of the year.

At the beginning of the year, capital account balances were:

X	\$30 000
Y	\$22 000
Z	\$20 000

The net profit before salary and interest for the year is \$140 000.

What is Y's share of the total profits?

- A \$23 536      B \$28 000      C \$42 856      D \$46 000

May 10 P1 Q15

- 17 Land M are in partnership.  
Which item should appear in the partnership appropriation account?

A additional capital contributed by M  
 B cash drawings of Land M during the year  
 C salary due to L  
 D salary paid to M's wife

May 10 P1 Q16

- 18 X and Y are in partnership, sharing residual profits and losses equally after the payments below are made.

1 2 % interest is charged on partners' drawings  
 2 salary to Y of \$10 000

The partners' drawings for the year were: X \$12 000  
 Y \$8000

The net profit for the current year is \$52 000.

How much will each partner receive in share of residual profits?

A \$10 800 B \$11 200  
 C \$20 800 D \$21 200

Nov 10 P1 Q13

- 19 X, Y and Z are in partnership sharing profits and losses equally. The data shown is extracted from their books.

	\$
Net assets at end of year	600 000
Capital account balances at start of year	320 000
Current account balances at start of year (credit)	100 000
Partnership salary – Y	30 000
Total drawings during year	60 000

What was X's share of net profit for the year?

A \$40 000 B \$60 000  
 C \$70 000 D \$80 000

Nov 10 P3 Q4

- 20 A partnership provides the following financial information for the year ended 30 June 2011.

	\$000
profit from operations	240
bank interest payable	21
interest credited to current accounts	15
Drawings	100
partnership salaries	95

What is the residual balance of profits to be appropriated between the partners?

A \$9 000 B \$104 000 C \$109 000 D \$204 000

May 11 P1 Q16

- 21 If partners do not draw up a partnership agreement, the provisions of the Partnership Act apply.  
Which statement is true as a provision of the Partnership Act?

A Interest on drawings is charged at 5 % a year.  
 B Interest on loans from partners is to be at 8 % a year.  
 C Partners are not entitled to salaries.  
 D Profits are to be shared in the ratio of fixed capitals.

Nov 11 P1 Q12

- 22** X and Y have been business partners for several years, sharing profits in the ratio of 2:1. Y now wishes to retire and leave X to continue with a new business partner. Y's capital account amounts to \$15 800 and his current account shows a debit balance of \$3500. Goodwill is valued at \$6600. The book values of certain tangible assets are to be valued upwards by \$3000.

What is the amount due to Y on his retirement from the business?

- A** \$13 500      **B** \$15 500      **C** \$20 500      **D** \$22 500

Nov 11 P1 Q13

- 23** The table shows information about four partners in a partnership.  
Which partner has the greatest net reward from interest on capital and interest on drawings?

	fixed capital (\$)	annual drawings (\$)
<b>A</b>	20 000	30 000
<b>B</b>	20 000	50 000
<b>C</b>	60 000	30 000
<b>D</b>	60 000	50 000

May 12 P12 Q10

- 24** Which items would appear in a partnership's appropriation account?

- 1** partners' interest on capital      **2** partners' introduction of new capital  
**3** salaries of employees      **4** salaries of partners

- A** 1 and 2      **B** 1 and 4      **C** 2 and 3      **D** 3 and 4

Nov 12 P12 Q14

- 25** Which items would appear in a partnership's appropriation account, in the absence of a partnership agreement?

- 1** profit for the year      **2** partners' interest on drawings  
**3** partners' salaries      **4** partners' share of profits

- A** 1 and 2      **B** 1 and 4      **C** 2 and 3      **D** 3 and 4

May 14 P12 Q15

- 26** A partnership makes a profit for the year of \$108000 before taking account of appropriations. Other financial information is as follows

	X	Y	Z
salary	–	–	\$10 000
capital balance	\$50 000	\$40 000	\$10 000
profit sharing ratio	5	3	2

Interest on capital is allowed at 8% per annum.

What is Z's share of the profit for the year?

- A** \$18 000      **B** \$18 800      **C** \$28 000      **D** \$28 800

May 14 P12 Q16

- 27** The following information is available for a partnership at 31 December 2013.

	\$
residual loss	3 000
total salaries to partners	5 000
total interest on capital	27 000
total drawings	14 000
total interest on drawings	700

How much is the profit for the year?

- A** \$14 300      **B** \$20 300      **C** \$28 300      **D** \$34 300

Nov 14 P12 Q13

- 28 In which account should a partner's drawings appear in the partnership's end-of-year financial statements?
- |          |                           |          |                           |
|----------|---------------------------|----------|---------------------------|
| <b>A</b> | appropriation account     | <b>B</b> | income statement          |
| <b>C</b> | partner's capital account | <b>D</b> | partner's current account |

Specimen 16 P1 Q11

- 29 X and Y are in partnership. Their income statement and appropriation account shows the following.

	\$
depreciation of non-current assets	5 000
interest on loan from Y	600
interest on capital	2 400
interest charged on drawings	900
partners' salaries	5 000
remaining profit	12 000

What is the profit for the year before any appropriations?

- |          |          |          |          |
|----------|----------|----------|----------|
| <b>A</b> | \$18 500 | <b>B</b> | \$19 100 |
| <b>C</b> | \$20 300 | <b>D</b> | \$25 900 |

Specimen 16 P1 Q12

- 30 The following information relates to a partnership.

	\$
profit from operation	90 000
loan interest	3 200
interest on drawings	6 000
drawings	40 000
interest on capital	11 000

What is the residual profit to be appropriated amongst the partners?

- |          |          |          |          |          |          |          |          |
|----------|----------|----------|----------|----------|----------|----------|----------|
| <b>A</b> | \$41 800 | <b>B</b> | \$69 800 | <b>C</b> | \$81 800 | <b>D</b> | \$91 800 |
|----------|----------|----------|----------|----------|----------|----------|----------|

Nov 16 P12 Q14

**ANSWER KEY**

1	A	9	A	17	C	25	B
2	C	10	A	18	D	26	D
3	D	11	D	19	C	27	C
4	C	12	B	20	C	28	D
5	B	13	B	21	C	29	A
6	B	14	C	22	B	30	C
7	B	15	C	23	C		
8	C	16	C	24	B		

**DETAILED ANSWERS**

1 Salary of Able has been added to profit instead of being deducted. So if this mistake is corrected then the balance of profit will be \$16 461 so Abel's share will be \$10 974 calculated as  $\frac{\$12\,174}{\$18\,261} \times \$16\,461$ .

2 As profit can be appropriated between the partners only after paying all income statement expenses so it will be \$14 000 (\$15 000 – \$1 000).

4 "Interest on loan is correct option" as it is recorded in income statement.

6		\$	\$
	Profit before appropriation		150 000
	Less X's salary		<u>(10 000)</u>
			<u>140 000</u>
	Profit share: X ( $\$140\,000 \times \frac{2}{5}$ )	56 000	
	Y ( $\$140\,000 \times \frac{2}{5}$ )	56 000	
	Z ( $\$140\,000 \times \frac{1}{5}$ )	<u>28 000</u>	<u>140 000</u>
	So "B" option is correct		

9		\$	\$
	Net profit		80 000
	Add Interest on drawings (\$500 + \$1 000)		1 500
	Less Interest on capitals (\$3 000 + \$2 500)		<u>(5 500)</u>
			<u>76 000</u>
	Profit share: Dele ( $\$76\,000 \times \frac{3}{4}$ )	57 000	
	: Iyabo ( $\$76\,000 \times \frac{1}{4}$ )	<u>19 000</u>	<u>76 000</u>

10		\$	\$
	Net profit before loan interest		8 850
	Loan interest ( $\$1\,000 \times 5\%$ )		<u>(50)</u>
			<u>8 800</u>
	Profit share : Hilary ( $\$8\,800 \times \frac{1}{2}$ )	4 400	
	Lee ( $\$8\,800 \times \frac{1}{2}$ )	<u>4 400</u>	<u>8 800</u>

\* In the absence of a partnership agreement profits and losses are shared equally between the partners and interest on partner's loans is paid at the rate of 5%.

11		\$	\$
	Net profit before appropriations		60 000
	Less Salary : Atul	(9 000)	
	Interest on capital (\$400 + \$500)	<u>(900)</u>	<u>(9 900)</u>
			<u>50 100</u>

Profit share	: Atul ( $\frac{2}{3}$ )	33 400	
	: Mansoor ( $\frac{1}{3}$ )	<u>16 700</u>	<u>50 100</u>
Mansoor share in total profit \$16 700 + \$500 = \$17 200			
<b>12</b>		\$	\$
Profits for the current year			75 000
Less Interest on capitals	: X (\$60 000 × 10%)	6 000	
	: Y (\$90 000 × 10%)	<u>9 000</u>	<u>(15 000)</u>
Profit share	: X (\$60 000 × $\frac{1}{2}$ )	30 000	
	: Y (\$60 000 × $\frac{1}{2}$ )	<u>30 000</u>	<u>60 000</u>
So total profit share	= X (\$30 000 + \$6 000) = \$36 000		
	Y (\$30 000 + \$9 000) = \$39 000		
<b>13</b>			\$
Net profit before interest			160 000
Interest on bank loan			(14 000)
Interest credited to capital accounts			(15 000)
Partnership salaries			<u>(24 000)</u>
			<u>107 000</u>
<b>14</b>		\$	\$
Profits for the current year			30 000
Less X's salary			<u>(5 000)</u>
Profit share	: X (\$25 000 × $\frac{3}{5}$ )	15 000	
	: Y (\$25 000 × $\frac{2}{5}$ )	<u>10 000</u>	<u>25 000</u>
So total amount to be credited to partners' accounts			
	X (\$5 000 + \$15 000) = \$20 000		
	Y = \$10 000		
<b>15</b>		\$	\$
<b>Net Profit (balancing figure)</b>			<b>27 500</b>
Add Interest on drawings			<u>900</u>
			28 400
Less Interest on capitals		3 400	
Partners' salaries		<u>5 000</u>	<u>(8 400)</u>
Profit share : X		8 000	
: Y		<u>12 000</u>	<u>20 000</u>
<b>16</b>		\$	\$
Profit before salaries and interest			140 000
Less Y's salary		18 000	
Interest on capital X (\$30 000 × 6%)		1 800	
Y (\$22 000 × 6%)		1 320	
Z (\$20 000 × 6%)		<u>1 200</u>	<u>(22 320)</u>
Profit share	X (\$117 680 × $\frac{5}{10}$ )	58 840	
	Y (\$117 680 × $\frac{2}{10}$ )	23 536	
	Z (\$117 680 × $\frac{3}{10}$ )	<u>35 304</u>	<u>117 680</u>

So Y will receive \$42 856 (\$18 000 on account of salary, \$1 320 On account of interest and \$25 536 on account of profit share).

<b>18</b>			\$	\$
	Net profit			52 000
	Add Interest on Drawings	X (\$12 000 × 2%)	240	
		Y (\$8 000 × 2%)	<u>160</u>	400
	Less Y's salary			<u>(10 000)</u>
				<u>42 400</u>
	<b>Profit share</b>	<b>X (\$42 400 × 1/2)</b>		<b>21 200</b>
		<b>Y (\$42 400 × 1/2)</b>		<b><u>21 200</u></b>
				<b><u>\$42 400</u></b>

<b>19</b>			\$	\$
	Capitals at start			320 000
	Current accounts at start		100 000	
	Salary Y		30 000	
	Drawings		<u>(60 000)</u>	
			70 000	
	Profit share (balancing figure)		<u>210 000</u>	<u>280 000</u>
	Net assets at year end			<u>600 000</u>

X's s share in net profit will be \$70 000 ( $\$210\,000 \times \frac{1}{3}$ ).

<b>20</b>			\$000	\$000
	Net profit after interest (\$240 000 – \$21 000)			219
	Less Partnership salaries		95	
	Interest on capital credited to current accounts		<u>15</u>	<u>(110)</u>
	Residual balance of profits to be appropriated between the partners			<u>109</u>

<b>22</b>	<b>Y's Account</b>			
		\$		\$
	Current Account	3 500	Balance b/f	15 800
	<b>Total amount due (balancing figure)</b>	<b>15 500</b>	Goodwill ( $\$6\,600 \times \frac{1}{3}$ )	2 200
		<u>19 000</u>	Revaluation Profit ( $\$3\,000 \times \frac{1}{3}$ )	<u>1 000</u>
				<u>19 000</u>

**23** 'C' partner has the greatest net reward from interest on capital and interest on drawings as his net capital (fixed capital – drawings) is more than the other partners.

**26** The correct answer was **D**, which combined a salary of \$10 000 plus interest on capital of \$800 ( $\$10\,000 \times 8\%$ ) and a 20% share of the residual profit of \$90 000 [ $\$108\,000 - \$10\,000 - \{(\$50\,000 + \$40\,000 + \$10\,000) \times 8\%\}$ ], amounting to \$18 000.

<b>27</b>			\$	\$
	<b>Net profit for the year (Balancing figure)</b>			<b>28 300</b>
	Add Interest on Drawings			<u>700</u>
				29 000
	Less Salaries to partners		5 000	
	Interest on capital		<u>27 000</u>	<u>(32 000)</u>
	Residual Loss			<u>(3 000)</u>

<b>29</b>		\$	\$
	<b>Profit before any appropriation (\$12 000 + \$7 400 – \$900)</b>		<b>18 500</b>
	Add Interest charged on drawings		900
	Less Interest on capital	2 400	
	Partners' salaries	<u>5 000</u>	<u>(7 400)</u>
	Remaining profit available for distribution		<u>12 000</u>
<b>30</b>			\$
	Profit from operations		90 000
	Loan interest		(3 200)
	Interest on drawings		6 000
	Interest on capital		<u>(11 000)</u>
	Residual profit to be appropriated		<u>81 800</u>

## CHAPTER 12 PARTNERSHIP CHANGES & DISSOLUTION

- 1 Two partners X and Y, each with a Capital Account of \$10 000 and sharing profits and losses equally, agree to admit Z to the partnership, with profits and losses continuing to be shared equally. Goodwill is valued at \$15 000 but is not to be retained in the books.

What will be the balance on X's Capital account after admission of Z?

- A \$10 000      B \$12 500      C \$15 000      D \$17 500

Nov 99 P1 Q12

- 2 X, Y and Z are in business sharing profits in the ratio 3:2:1. At the end of the year, the balance on Y's Capital Account is \$39 400.

Y retires at the end of the year and, to determine his settlement, the assets are revalued upwards by \$57 000. The partnership does not account for goodwill.

If Y takes a car valued at \$4 800 as part of his settlement, what is the balance remaining on his capital account to be settled in cash?

- A \$39 400      B \$44 400      C \$53 600      D \$59 000

Nov 99 P1 Q18

- 3 A and B are partners in a business and share profits and losses equally. They decide to admit Z as a partner when the goodwill was standing at \$6 000. The new profit-sharing ratio between A, B and Z is to be 3:2:1. Goodwill is now valued at \$24 000 and is not to be retained in the firms books. What will be the goodwill adjustments in the partners' capital accounts?

	Debits			Credits		
	A (\$)	B (\$)	Z (\$)	A (\$)	B (\$)	Z (\$)
A	9 000	6 000	3 000	9 000	9 000	Nil
B	9 000	9 000	Nil	9 000	6 000	3 000
C	12 000	8 000	4 000	9 000	9 000	Nil
D	12 000	12 000	Nil	12 000	8 000	4 000

May 00 P1 Q17

- 4 X and Y are partners sharing profits equally. On the admission of Z as a partner, goodwill is agreed at \$18 000 and they agree to share profits equally.

What is the effect of this change on the capital account balance of X?

- A decrease \$3 000      B decrease \$6 000  
C increase \$3 000      D increase \$6 000

Nov 00 P1 Q14

- 5 The table shows a Balance Sheet for a partnership.

	\$		\$
Goodwill	5 000	Capital account:	
Net assets	12 000	Partner X	10 000
		Partner Y	7 000
	<u>17 000</u>		<u>17 000</u>

X and Y share profits in the ratio 3:2. They now wish to change the profit share ratio to 2:1. Goodwill is revalued to \$10 000 and remains in the Balance Sheet at this value.

What is the new capital account balance of partner X?

- A \$9 000      B \$10 000      C \$13 000      D \$13 333

Nov 01 P1 Q11

- 6 A partnership does not maintain a goodwill account. No adjustments were made for Goodwill in the partners' Capital accounts. What is the effect of this omission?

	Continuing partners' Capital accounts total balances	New partner's Capital account balance
A	overstated	understated
B	understated	overstated
C	understated	understated
D	overstated	overstated

Nov 02 P1 Q13

- 7 A and B are in partnership, sharing profits and losses equally. A's capital account is \$6 000 and B's capital account is \$5 000. Goodwill is valued at \$12 000, but is not shown in the accounts. They agree to admit Z as a new partner and to share profits and losses equally.

What is A's new capital account balance?

- A \$4 000      B \$8 000      C \$10 000      D \$12 000

Nov 04 P1 Q15

- 8 X and Y are in partnership, sharing profits equally. They agree to admit Z as an equal partner. Z is to introduce capital of \$100 000. The partnership goodwill is \$60 000 and all adjustments are to be made in the capital accounts.

Which shows the correct situation after the admission of Z?

	Capital Accounts					
	X (\$)		Y (\$)		Z (\$)	
A	credit	10 000	credit	10 000	credit	80 000
B	credit	10 000	credit	10 000	debit	20 000
C	credit	30 000	credit	30 000	debit	60 000
D	debit	30 000	debit	30 000	credit	160 000

Nov 07 P3 Q3/ May 11 P3 Q5

- 9 When partners change, what is the main reason for taking goodwill into account?

- A to benefit the existing partners  
 B to ensure fairness between the existing and incoming partners  
 C to record the value of goodwill  
 D to safeguard the rights of incoming partners

May 09 P3 Q1

- 10 X and Y are in partnership sharing profits equally. They each have capital accounts with credit balances of \$40 000. They admit Z into the partnership and profits are still shared equally and goodwill is valued at \$48 000. No goodwill account is to appear in the books. Z introduces \$30 000 cash.

At the same date X takes a business car valued at \$10 000, for personal use.

What are the balances on the capital accounts after the above transactions have taken place?

	X \$000	Y \$000	Z \$000
A	24	24	(16)
B	38	48	14
C	48	48	14
D	64	64	30

May 09 P3 Q2

- 11 X, Y and Z are in partnership sharing profits 40%; 40%; and 20%.

Y wishes to retire.

Capital account balances are X \$120 000, Y \$130 000 and Z \$150 000.

Goodwill is recorded in the books as \$50 000 but the partners agree it is worth \$90 000.

How much will Y be entitled to withdraw?

- A \$136 000      B \$146 000      C \$150 000      D \$168 000

Nov 09 P1 Q18

- 12 A partnership has been dissolved and \$15 000 is left in the bank. How should this be distributed between the partners?

A according to the last agreed balances on their capital accounts  
 B according to the last agreed profit sharing ratio  
 C according to the last agreed total balances on their capital and current accounts  
 D equally

May 10 P3 Q3

- 13 X and Y are equal partners. They agree to admit Z as an equal partner. Z agrees to pay \$33 000 for his share of the goodwill. Goodwill is not to appear in the accounts. The partnership offices are to be revalued at \$60 000 more than their present book value. What changes are needed in the partners' capital accounts to record these events?

	X (\$)	Y (\$)	Z (\$)
A	+ 16500	+ 16500	-33 000
B	+30 000	+30 000	+33 000
C	+33 000	+33 000	+33 000
D	+46500	+46500	nil

May 10 P3 Q4

- 14 Why is goodwill adjusted in the accounts when a new partner is admitted?

A a more accurate value of non-current assets is shown in the balance sheet  
 B original partners can be credited for their efforts in building up the partnership business  
 C partners can take higher drawings as a result of their share of the goodwill  
 D the new partner knows how much they have to introduce as capital

Nov 10 P3 Q2

- 15 X, Y & Z are in partnership sharing the profits and losses equally. The balances on their capital accounts are \$40 000, \$35 000 and \$32 000 respectively. Z retires and as part of his settlement takes a car at an agreed value of \$4 000. The car has a book value of \$4 600. Goodwill is valued at \$15 000. How much cash will Z receive when he leaves the partnership?

A \$32 400  
 B \$32 800  
 C \$33 000  
 D \$37 000

May 12 P32 Q1

- 16 When goodwill is **not** adjusted in the books which of the following statements are correct?

1 A new partner does not have to introduce an amount as capital.  
 2 Non-current assets are undervalued.  
 3 Partners do not receive credit for their efforts in building up the business.  
 4 Retiring partners will receive a lower amount of money when leaving the business.

A 1 and 2  
 B 1 and 4  
 C 2 and 3  
 D 3 and 4

May 12 P32 Q2

- 17 X becomes a partner in a business receiving a 25% share in the profits. He pays in \$60 000 as his capital. The goodwill of the business is valued at \$40 000.

What is the balance on X's capital account, if goodwill is not included in the books?

A \$20 000  
 B \$50 000  
 C \$60 000  
 D \$70 000

Nov 13 P12 Q17

- 18 Goodwill is adjusted in partners' accounts when there is a change in the profit sharing ratio. How is this recorded?

	debit	credit
<b>A</b>	capital accounts in new profit sharing ratio	capital accounts in old profit sharing ratio
<b>B</b>	capital accounts in old profit sharing ratio	capital accounts in new profit sharing ratio
<b>C</b>	current accounts in new profit sharing ratio	current accounts in old profit sharing ratio
<b>D</b>	current accounts in old profit sharing ratio	current accounts in new profit sharing ratio

Nov 14 P12 Q9

- 19 Kay and Lay share profits and losses in the ratio of 3 : 1. Capital account balances are Kay \$100 000 and Lay \$84 000. There was no goodwill account in the books. The partners change the profit sharing ratio to 4 : 1. Goodwill is valued at \$54 000 and is not to be retained in the books of account.

What is the balance on Lay's capital account after the adjustment for goodwill?

- A** \$70 500      **B** \$81 300      **C** \$86 700      **D** \$97 500

May 15 P12 Q13

- 20 X and Y are in partnership with combined capital and current account balances of \$125 000. Z is admitted as a partner, introducing capital of \$40 000. At that time, the assets of the partnership are revalued upwards by \$50 000 and goodwill was valued at \$18 000. Goodwill was not to remain in the books of account.

What was the total capital employed of the partnership immediately after the admission of Z?

- A** \$183 000      **B** \$197 000      **C** \$215 000      **D** \$233 000

Specimen 16 P1 Q13

- 21 X, Y and Z are in partnership and they have the following assets and liabilities.

	\$
property	400 000
fixtures and fittings	350 000
closing inventory	25 000
trade receivables	45 000
bank overdraft	22 000

The partnership was dissolved on the following terms.

X took the property and half the fixtures and fittings at a valuation of \$560 000.

The remaining fixtures and fittings and the entire inventory were sold for \$140 000.

The trade receivables paid in full with the exception of one debt of \$4700.

The total cost of dissolution was \$2500.

What was the loss on dissolution of the partnership?

- A** \$57 700      **B** \$60 200      **C** \$77 500      **D** \$82 200

Specimen 16 P1 Q15

- 22 X and Y were in partnership sharing profit and losses equally. They then admitted Z into the partnership and profits and losses were still shared equally.

The following transactions took place.

1 Z introduced capital of \$50 000.

2 Goodwill was valued at \$30 000. No goodwill account is kept in the books of account.

3 X took a computer from the business at a value of \$3 000.

After these transactions had taken place, the balance on X's capital account was \$60 000.

What was the opening balance on X's capital account?

- A** \$55 000      **B** \$58 000      **C** \$65 000      **D** \$75 000

May 16 P12 Q13

- 23 A and B were in partnership sharing profits and losses equally when they decided to retire. Details of the realisation are shown in the table.

	book value \$000	realized value \$000
non – current assets	50	65
current assets excluding cash and bank	25	23
cash and bank balances	4	-
current liabilities	18	14
costs of realization	1	-

How much profit **each** partner entitled to on realization?

- A**    \$8 000                                  **B**    \$10 000  
**C**    \$12 000                                 **D**    \$75 000

May 16 P12 Q14

- 24 A partnership admits a new partner.  
Which statement is correct?

- A**    Profits will always be shared equally following the new partner's admission.  
**B**    The new partner will always benefit if assets are later revalued upwards.  
**C**    The new partner must always contribute capital to the partnership.  
**D**    The new partner will always pay for a share of partnership goodwill.

Nov 16 P12 Q12

- 25 X, Y and Z are in partnership sharing the profits and losses in the ratio of 2 : 2 : 1.  
At 31 December the following information is available.

	<b>X</b> \$	<b>Y</b> \$	<b>Z</b> \$
capital account balances	100 000	100 000	50 000
current account balances	20 000	15 000	(5 000)

On 31 December Z retires from the partnership. Total assets are revalued upwards by \$45 000. There is no goodwill.

How much will Z be paid on his retirement?

- A**    \$54 000                  **B**    \$59 000                  **C**    \$60 000                  **D**    \$65 000

Nov 16 P12 Q13

- 26 A partnership earned an average profit during the year of \$15 000 per month. Halfway through the year D and E were joined by a new partner F and profits were shared equally before and after the change. In the first half of the year D transferred his private vehicle to the partnership at a valuation of \$12 000. D's drawings amounted to \$60 000 during the year. What was the increase in D's current account balance during the year?

- A**    \$15 000                  **B**    \$30 000                  **C**    \$75 000                  **D**    \$87 000

Nov 16 P12 Q15

- 27 Which item is **not** taken into account when a partner joins a partnership?

- A**    balances on the partners' current accounts    **B**    capital introduced by the new partner  
**C**    changes in the profit sharing ratio            **D**    goodwill

May 17 P12 Q12

- 28** Ali, Bharti and Chan were in partnership sharing profit and losses in the ratio 3:2:1. Bharti retired from the partnership on 30 June 2016.

The following were the balances available at 30 June 2016.

	Ali (\$)	Bharti (\$)	Chan (\$)
capital accounts	60 000 Cr	40 000 Cr	20 000 Cr
current accounts	18 650 Cr	6 100 Dr	8 950 Cr

On her retirement, Bharti retained a partnership motor vehicle at an agreed valuation of \$4 000.

Goodwill was valued at \$39 000.

How much was payable to Bharti on her retirement?

- A**      \$33 900                      **B**      \$42 900                      **C**      \$46 900                      **D**      \$50 900

May 17 P12 Q13

## ANSWER KEY

1	B	8	A	15	B	22	B
2	C	9	B	16	D	23	A
3	C	10	B	17	B	24	B
4	C	11	B	18	A	25	A
5	C	12	C	19	C	26	A
6	B	13	D	20	C	27	A
7	B	14	B	21	D	28	B

## DETAILED ANSWERS

1

	Effects on capital		
	X (\$)	Y (\$)	Z (\$)
Goodwill \$15 000↑	( <sup>1</sup> / <sub>2</sub> ) ↑7 500	( <sup>1</sup> / <sub>2</sub> ) ↑7 500	Nil
Goodwill \$15 000↓	( <sup>1</sup> / <sub>3</sub> ) ↓5 000	( <sup>1</sup> / <sub>3</sub> ) ↓5 000	( <sup>1</sup> / <sub>3</sub> ) ↓5 000
Net effect on capital	<u>↑2 500</u>	<u>↑2 500</u>	<u>↓5 000</u>
X's capital account balance before goodwill adjustment			\$10 000
Increase in capital due to goodwill adjustment			<u>2 500</u>
X's capital account balance after goodwill adjustment			<u>\$12 500</u>

2

## Y's Capital account

	\$		\$
Car	4 800	Balance b/f	39 400
Cash(balancing figure)	<u>53 600</u>	Revaluation profit ( $\$57\ 000 \times \frac{2}{6}$ )	<u>19 000</u>
	<u>58 400</u>		<u>58 400</u>

3

	Effects on capital		
	A (\$)	B (\$)	C (\$)
Goodwill \$18 000↑*	( <sup>1</sup> / <sub>2</sub> ) ↑9 000	( <sup>1</sup> / <sub>2</sub> ) ↑9 000	Nil
Goodwill \$24 000↓**	( <sup>3</sup> / <sub>6</sub> ) ↓12 000	( <sup>2</sup> / <sub>6</sub> ) ↓8 000	( <sup>1</sup> / <sub>6</sub> ) ↓4 000
* Goodwill required – Existing goodwill	= Goodwill required to be raised		
\$24 000 – \$6 000	= \$18 000		
**Total goodwill	= Old + Newly raised		
	= \$6 000 + \$18 000		
	= \$24 000		

4

	Effects on capital		
	X (\$)	Y (\$)	Z (\$)
Goodwill \$18 000↑	( <sup>1</sup> / <sub>2</sub> ) ↑9 000	( <sup>1</sup> / <sub>2</sub> ) ↑9 000	Nil
Goodwill \$18 000↓	( <sup>1</sup> / <sub>3</sub> ) ↓6 000	( <sup>1</sup> / <sub>3</sub> ) ↓6 000	( <sup>1</sup> / <sub>3</sub> ) ↓6 000
Net effect on capital	<u>↑3 000</u>	<u>↑3 000</u>	<u>↓6 000</u>
So X's capital will increase by \$3 000			

5

	\$	\$
Journal entry to raise goodwill		
Goodwill (\$10 000 – \$5 000)	5 000	
X Capital ( <sup>3</sup> / <sub>5</sub> )		3 000
Y Capital ( <sup>2</sup> / <sub>5</sub> )		2 000
So after this adjustment X capital will become \$13 000 (\$10 000 + \$3 000).		

7

	\$
Original capital account balance of A	6 000
Goodwill raised ( $\$12\ 000 \times \frac{1}{2}$ )	6 000
Goodwill written off ( $\$12\ 000 \times \frac{1}{3}$ )	<u>(4 000)</u>
New capital account balance of A	<u>8 000</u>

8

	Effects on capital		
	X (\$)	Y (\$)	Z (\$)
Goodwill \$60 000↑	( <sup>1</sup> / <sub>2</sub> ) ↑30 000	( <sup>1</sup> / <sub>2</sub> ) ↑30 000	Nil
Goodwill \$60 000↓	( <sup>1</sup> / <sub>3</sub> ) ↓20 000	( <sup>1</sup> / <sub>3</sub> ) ↓20 000	( <sup>1</sup> / <sub>3</sub> ) ↓20 000
Net effect on capital	Cr. ↑10 000	Cr. ↑10 000	Dr. ↓20 000

Z's capital will have a net credit change of \$80 000 i.e. [\$100 000 (Capital investment) – \$20 000 (goodwill adjustment)].

10

	Effects on capital		
	X (\$)	Y (\$)	Z (\$)
Opening balances of partners' capital	40 000	40 000	
New capital investment			30 000
Withdrawal of personal vehicle	(10 000)		
Goodwill raised \$48 000↑	( <sup>1</sup> / <sub>2</sub> ) ↑24 000	( <sup>1</sup> / <sub>2</sub> ) ↑24 000	Nil
Goodwill \$48 000↓	( <sup>1</sup> / <sub>3</sub> ) ↓16 000	( <sup>1</sup> / <sub>3</sub> ) ↓16 000	( <sup>1</sup> / <sub>3</sub> ) ↓16 000
Net effect on capital	<u>38 000</u>	<u>48 000</u>	<u>14 000</u>

11

	\$
Original capital account balance of Y	130 000
Goodwill raised (\$40 000 × 40%)	<u>16 000</u>
New capital account balance of Y	<u>146 000</u>

13

	Effects on capital	
	X (\$)	Y (\$)
Revaluation profit (\$60 000 × <sup>1</sup> / <sub>2</sub> )	↑30 000	↑30 000
Goodwill share (\$33 000 × <sup>1</sup> / <sub>2</sub> )	( <sup>1</sup> / <sub>2</sub> ) ↑16 500	( <sup>1</sup> / <sub>2</sub> ) ↑16 500
Net effect on capital	<u>46 500</u>	<u>46 500</u>

15

Z Capital			
	\$		\$
Car	4 000	Balance b/f	32 000
Loss on car disposal [(4600–4000) × <sup>1</sup> / <sub>3</sub> ]	200	Goodwill (\$15 000 × <sup>1</sup> / <sub>3</sub> )	5 000
<b>Bank (balancing figure)</b>	<b><u>32 800</u></b>		
	<u>37 000</u>		<u>37 000</u>

17

X's capital Account			
	\$		\$
Goodwill (\$40 000 × 25%)	10 000	Bank	60 000
<b>Balance c/d</b>	<b><u>50 000</u></b>		
	<u>60 000</u>		<u>60 000</u>

19

Lay's Capital			
	\$		\$
Goodwill (\$54 000 × <sup>1</sup> / <sub>5</sub> )	10 800	Balance b/f	84 000
<b>Balance c/d(balancing figure)</b>	<b><u>86 700</u></b>	Goodwill (\$54 000 × <sup>1</sup> / <sub>4</sub> )	<u>13 500</u>
	<u>97 500</u>		<u>97 500</u>

20

	\$
Capital employed before admission of X	125 000
New capital investment by Z	40 000
Upward revaluation of assets	<u>50 000</u>
Capital employed after admission of X	<u>215 000</u>

21		<b>\$</b>
	Disposal value of net assets sold [ $\$560\,000 + \$140\,000 + (\$45\,000 - \$4\,700)$ ]	740 300
	Less Book values of net assets sold ( $\$400\,000 + \$350\,000 + \$25\,000 + \$45\,000$ )	(820 000)
	Cost of dissolution	<u>(2 500)</u>
	Loss on dissolution	<u><u>82 200</u></u>

22	<b>X's Capital</b>			
		<b>\$</b>		<b>\$</b>
	Goodwill ( $\$30\,000 \times \frac{1}{3}$ )	10 000	<b>Balance b/f (balancing figure)</b>	<b>58 000</b>
	Drawings (Computer)	3 000	Goodwill ( $\$30\,000 \times \frac{1}{2}$ )	15 000
	Balance c/d	<u>60 000</u>		
		<u>73 000</u>		<u>73 000</u>

23	<b>Realisation Account</b>			
		<b>\$</b>		<b>\$</b>
	Non – current assets	50 000	Bank: Non – current assets	65 000
	Current assets excluding cash and bank	25 000	Bank: Current assets excl. cash/bank	23 000
	Bank (costs of realisation)	1 000	Discount received ( $18\,000 - 14\,000$ )	4 000
	<b>Profit share : A (<math>\\$1\,600 \times \frac{1}{2}</math>)</b>	<b>8 000</b>		
	<b>B (<math>\\$1\,600 \times \frac{1}{2}</math>)</b>	<b>8 000</b>		
		<u>16 000</u>		
		<u>92 000</u>		<u>92 000</u>

25	<b>Z Capital</b>			
		<b>\$</b>		<b>\$</b>
	Current account	5 000	Balance b/f	50 000
	<b>Bank (balancing figure)</b>	<b><u>54 000</u></b>	Revaluation profit ( $\$45\,000 \times \frac{1}{5}$ )	<u>9 000</u>
		<u>59 000</u>		<u>59 000</u>

26		<b>\$</b>
	Profit share – first 6 months ( $\$15\,000 \times 6 \times \frac{1}{2}$ )	45 000
	last 6 months ( $\$15\,000 \times 6 \times \frac{1}{3}$ )	30 000
	Drawings	<u>(60 000)</u>
	Increase in D's current account balance during the year	<u>15 000</u>

28	<b>Bharti's Capital</b>			
		<b>\$</b>		<b>\$</b>
	Current account	6 100	Balance b/f (balancing figure)	40 000
	Drawings (vehicle)	4 000	Goodwill ( $\$39\,000 \times \frac{2}{6}$ )	13 000
	<b>Balance c/d</b>	<b><u>42 900</u></b>		
		<u>53 000</u>		<u>53 000</u>

## CHAPTER 13

## COMPANY BASICS

- 1 For which purpose can a share premium account legally be used?
- A** to make a rights issue                      **B** to pay an ordinary dividend  
**C** to repay debentures                      **D** to write off preliminary expenses
- May 98 P1 Q14 / May 02 P1 Q17

- 2 A company has just been wound up and the only assets that remain have realised \$45 000.  
 A summary of the company's capital structure shows:

- ordinary shares	\$20 000
- preference shares	\$40 000
- loan stock	\$30 000

How will \$45 000 be distributed?

	Ordinary shares (\$)	Preference shares (\$)	Loan stock (\$)
<b>A</b>	10 000	20 000	15 000
<b>B</b>	-	15 000	30 000
<b>C</b>	20 000	25 000	-
<b>D</b>	-	40 000	5 000

May 98 P1 Q15 / Specimen 02 P3 Q2 / May 03 P3 Q3/Nov 10 P3 Q5

- 3 The data shows the income statement of a company for the year ended 31 August 1999.

	\$
Operating profit	40 000
Less Debenture interest	<u>(6 000)</u>
	34 000
Profit on sale of investment shares	<u>68 000</u>
	102 000
Transfer to general reserve	<u>(30 000)</u>
Unappropriated profit for year	<u>72 000</u>

What was the distributable profit for the accounting year ended 31 August 1999?

- A** \$34 000                      **B** \$40 000                      **C** \$72 000                      **D** \$102 000
- May 98 P1 Q28 / Nov 01 P1 Q29 / Specimen 02 P3 Q9

- 4 What is the meaning of a company's authorised share capital?
- A** the maximum amount that it is permitted to borrow  
**B** the maximum nominal value of shares it is permitted to issue  
**C** the nominal value of ordinary and preference share capital in issue  
**D** the total of shareholders' funds

Nov 98 P1 Q27 / Nov 01 P1 Q28

- 5 From which of the following do revenue reserves arise?
- A** the issue of new shares by a company  
**B** the revaluation of non-current assets  
**C** the share premium received on shares issued by the company  
**D** the trading activities of a company

May 99 P1 Q29/ Nov 04 P1 Q3

- 6 A cash budget shows that a company will exceed its overdraft limit.  
 Which item of expenditure should the directors consider delaying?

- A** debenture interest                      **B** dividends                      **C** rent and rates                      **D** taxation
- May 99 P1 Q35

- 7 A company is set up with an authorised share capital of \$3 million. It plans to purchase immediately a factory with \$1 million. Preliminary expenses will be \$100 000 and the immediate requirement for working capital will be \$800 000. It will also require new equipment costing \$600 000 in 12 months' time.

What is the minimum amount the company needs to raise now?

- A \$1 000 000      B \$1 900 000      C \$2 500 000      D \$3 000 000

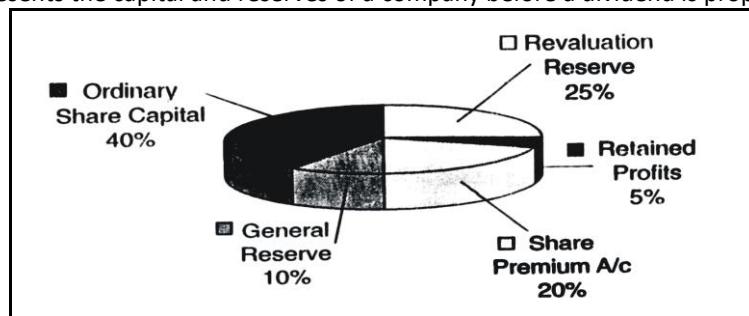
May 00 P1 Q29/May 10 P1 Q17

- 8 A Company has issued non-cumulative preference shares and ordinary shares. Which statement is true?

- A if no preference dividend is paid, it is carried forward to a future year  
 B preference shareholders always get a dividend  
 C preference shareholders and ordinary shareholders always get a dividend  
 D preference shareholders may get a dividend

May 01 P1 Q14/Nov 06 P1 Q5/Nov 12 P12 Q19

- 9 The diagram represents the capital and reserves of a company before a dividend is proposed.



The total of the capital and reserves is \$1 100 000.

What is the maximum amount that can be distributed to shareholders as dividend?

- A \$55 000      B \$110 000      C \$165 000      D \$440 000

May 01 P1 Q27

- 10 Which of the following is a revenue reserve?

- A a capital redemption reserve  
 B a general reserve  
 C a revaluation reserve  
 D a share premium account

Specimen 02 P1 Q1

- 11 Which of the following statement is not true?

- A a share must have a face value  
 B authorised share capital is higher or the same as issued share capital  
 C shares can be issued at premium  
 D there are only two classes of share capital

Specimen 02 P1 Q22

- 12 What type of capital must all limited companies have?

- A convertible loan stock      B debentures  
 C ordinary shares      D preference shares

Nov 02 P3 Q1

- 13 Which is not a source of long-term finance?

- A bank overdraft      B debentures  
 C ordinary shares      D preference shares

May 03 P3 Q14/ May 08 P3 Q18

- 14 Which of the following is a realised gain?  
**A** a surplus on revaluation of trade investments to current market value  
**B** a surplus arising from professional revaluation of the company office block  
**C** a surplus arising on the sale of patents  
**D** goodwill arising on the purchase of another business  
 Nov 03 P1 Q14
- 15 A company has an authorised capital of \$1 000 000.  
 Which statement must be true?  
**A** The company must issue \$1 000 000 in shares  
**B** The company must not issue more than 1 000 000 shares  
**C** The shares issued must not exceed \$1 000 000  
**D** The shares and debentures must not exceed \$1 000 000  
 Nov 03 P1 Q20
- 16 When a company is short of liquid funds, for what purpose may the reserves be used?  
**A** to finance the take-over of another business the company is anxious to acquire  
**B** to maintain dividends during periods of low profitability  
**C** to pay trade payables promptly so as to obtain discounts  
**D** to write down assets whose value to the business has fallen  
 May 04 P1 Q18
- 17 Which transaction will cause an increase in shareholders' capital?  
**A** disposal of a non-current asset for more than its book value  
**B** increasing the provision for bad debts  
**C** receipt of a loan  
**D** receipt of payment from trade receivable in cash  
 May 04 P3 Q18
- 18 A company has completed arrangements for the closure of part of its business next year.  
 What should the company create in this year's accounts for the closure costs?  
**A** a contingency  
**B** a liability  
**C** a provision  
**D** a reserve  
 May 05 P1 Q2
- 19 Which statements are true about debentures and ordinary shares?
- |          | Debentures                          | Ordinary shares                               |
|----------|-------------------------------------|---|
| <b>A</b> | can be issued at a premium          | are never issued at a premium                 |
| <b>B</b> | holders are owners of a company     | holders are lenders of a company              |
| <b>C</b> | interest is a charge against profit | dividends are an appropriation of profit      |
| <b>D</b> | interest varies from year to year   | dividends are paid at the same rate each year |
- May 05 P1 Q17/ May 17 P12 Q17
- 20 A company has revalued its non-current assets upwards during the most recent accounting period.  
 What will be the effect of this?  
**A** to increase capital employed and increase profits  
**B** to increase capital employed and reduce profits  
**C** to reduce capital employed and reduce profits  
**D** to reduce capital employed and no effect on profits  
 May 05 P1 Q21

- 21** A company has issued shares at a premium.  
For what purpose may the balance on the share premium account be used?
- A** to provide for the premium on the redemption of shares which were issued at par  
**B** to provide for the discount on a new issue of shares  
**C** to write off the preliminary expenses incurred in forming the company  
**D** to write off a loss on the revaluation of non-current assets
- Nov 05 P1 Q1
- 22** Which of the following may be used to smooth distributable profits from one year to another?
- A** asset revaluation reserve                      **B** capital redemption reserve  
**C** general reserve                                      **D** provisions for depreciation
- Nov 05 P3 Q19
- 23** A director-owned company needs additional funds.  
Which method of finance might lead to a reduction of the director's control of the business?
- A** bank loan    **B** debenture  
**C** ordinary share issue                              **D** preference share issue
- Nov 06 P1 Q19
- 24** How should goodwill be treated by a limited company?
- A** Goodwill should always be written off immediately.  
**B** Non-purchased goodwill is shown in the balance sheet.  
**C** Purchased goodwill is shown in the balance sheet and written off over its useful life.  
**D** Purchased goodwill remains on the balance sheet as a permanent item.
- May 11 P1 Q8
- 25** A company has an issued share capital of 200 000 6 % cumulative preference shares of \$1 each fully paid and 800 000 ordinary shares of \$1 each fully paid.  
Assuming that the company earns no profit in the year, which statement is correct?
- A** Both preference and ordinary shares are paid a dividend in the year.  
**B** The unpaid dividends for both preference and ordinary shares are carried forward to a future year.  
**C** The unpaid preference dividend is carried forward to a future year.  
**D** The preference shares are paid a total dividend of \$12 000 in the year.
- May 12 P12 Q15
- 26** The following items appear in a statement of financial position.
- an estimate of a liability in a court case, the outcome of which is uncertain
  - an unrealised surplus from the revaluation of a non-current asset
  - accumulated depreciation on non-current assets
  - an estimate of future loss arising from bad debts
- How many of these are provisions and how many are reserves?
- |          | provisions | reserves |
|----------|------------|----------|
| <b>A</b> | 1          | 3        |
| <b>B</b> | 2          | 2        |
| <b>C</b> | 3          | 1        |
| <b>D</b> | 4          | 0        |
- Nov 12 P12 Q3
- 27** Which shares are entitled to have arrears of dividend carried forward to future years?
- A** cumulative preference shares                      **B** non-cumulative preference shares  
**C** ordinary shares    **D** redeemable shares
- May 14 P12 Q20

**28** The profits of Bronte Limited are as follows.

year ended 31 December 2013 nil

year ended 31 December 2014 \$60 000

Bronte Limited has in issue 200 000 5% preference shares of \$1 each.

What is the profit available for distribution to ordinary shareholders for the year ended 31 December 2014, if the preference shares are (i) cumulative or (ii) non-cumulative?

	<b>cumulative</b> \$	<b>non-cumulative</b> \$
<b>A</b>	40 000	40 000
<b>B</b>	40 000	50 000
<b>C</b>	50 000	40 000
<b>D</b>	50 000	50 000

May 15 P12 Q17

**29** Which statement describes the treatment of purchased goodwill for a limited company?

- A** a tangible non-current asset that can be amortised
- B** a tangible non-current asset that can be depreciated
- C** an intangible non-current asset that can be amortised
- D** an intangible non-current asset that can be depreciated

May 17 P12 Q15

**ANSWER KEY**

1	D	9	C	17	A	25	C
2	B	10	B	18	C	26	C
3	D	11	D	19	C	27	A
4	B	12	C	20	B	28	B
5	D	13	A	21	C	29	C
6	B	14	C	22	C		
7	B	15	C	23	C		
8	D	16	D	24	C		

**DETAILED ANSWERS**

- 2** As loan stockholders are the lenders of the business, so they are entitled to get their investment of \$30 000 back before the shareholders.  
Moreover after payment to loan stockholders, preference shareholders will be paid off as they have preference over the ordinary shareholders to receive repayment of their capital in case of winding up of a company. So remaining \$15 000 (\$45 000 – \$30 000) will be distributed among them.
- 3** Distributable profit is the profit available for distribution to the ordinary shareholders i.e.  

$$\text{Distributable profit} = \text{Profit after tax and preference dividend} = \text{Profit before ordinary dividends and transfer to reserves}$$
and the answer would obviously be \$102 000 which is profit after all the expenses but before transfer of profits to reserves i.e. profits are distributed as dividends only when they are left after meeting all business expenses, tax and preference dividends.
- 7** As immediate requirement of the company on its formation is only \$1 900 000 (\$1 000 000 + \$100 000 + \$800 000) so that is the minimum amount to be raised by the company.
- 8** “D” option is correct as if profits are available they will receive dividend, but in the absence of profit no dividend can be distributed to them nor carried forward to the next year being of non-cumulative in nature.
- 9** Revenue Reserves i.e. Retained profits and General Reserves can be distributed as dividends among the shareholders so they will be  $(\$1\ 100\ 000 \times 15\%*) = \$165\ 000$   
\* 5% + 10% = 15%
- 14** “C” is the right option. The remaining three options do not involve any inflow of cash.
- 17** Statement of this Question seems to be incorrect as share capital only increases when new share capital is issued. So this Question should state that which transaction would cause an increase in shareholders’ fund (equity). The equity increases either due to issuance of new share capital or due to the profits made by the company so “A” option is correct as it involves profit on sale of a non-current asset.
- 19** “C” option is correct as interest is shown as an expense in the Income statement whereas ordinary dividend is shown as an appropriation in the Profit and Loss appropriation account.
- 20** Due to upward revaluation of non-current assets, non-current assets and capital employed will increase. This will increase depreciation charge and as a result profits will reduce.
- 26** “C” option is correct as an estimate of a liability in a court case will be a provision under IAS 37 whereas we know that provisions are made for accumulated depreciation on non-current assets (item 3 and to provide for an estimate future loss arising from bad debts (item 4. However, an unrealised surplus from the revaluation of a non-current asset (item 2 will be recorded as revaluation reserve.

## CHAPTER 14

## COMPANY FINAL ACCOUNTS

1 What will be classified in a balance sheet at 31 December 1998 as a current liability?

- A debentures
- B preference shares
- C prepaid expenses
- D proposed dividend

Nov 98 P1 Q3 / May 02 P1 Q6

2 Which item will be included in a balance sheet as a liability?

- A loan stock issued by the company
- B preference shares issued by the company
- C revaluation reserves
- D share premium account

May 99 P1 Q11/ May 04 P1 Q14

3 What do the reserves of limited companies include?

- A debentures
- B ordinary shares
- C preference shares
- D share premium

May 99 P1 Q12

4 The table shows details of freehold property.

	\$
Historical cost	80 000
Depreciation	25 000

The property is to be shown in the balance sheet at its current valuation of \$100 000. Which entries are to be made in the ledger accounts?

	Dr.	\$	Cr.	\$
<b>A</b>	Non-current assets account	20 000	Income statement	20 000
<b>B</b>	Non-current assets account	20 000	Revaluation reserves	45 000
	Provision for depreciation	25 000		
<b>C</b>	Non-current assets account	45 000	Income statement	20 000
			Provision for depreciation	25 000
<b>D</b>	Non-current assets account	20 000	Revaluation reserves	20 000

May 00 P1 Q5

5 Which should company **not** show as non-current asset in its Balance Sheet?

- A plant bought on hire purchase
- B plant fully depreciated
- C plant held on finance lease
- D plant held on operating lease

May 00 P1 Q21/Nov 11 P1 Q3

- 6 The table shows how a non-current asset appears in the Balance Sheet.

	<b>\$</b>
non-current asset at cost	120 000
accumulated depreciation	<u>(18 000)</u>
net book value	<u>102 000</u>

The asset is revalued at \$ 136 000.

What is the journal entry to record the revaluation?

		Dr.(\$)	Cr. (\$)
<b>A</b>	Non-current asset at cost	16 000	
	Income statement		16 000
<b>B</b>	Non-current asset at cost	16 000	
	Accumulated Depreciation	18 000	
	Revaluation Reserve		34 000
<b>C</b>	Non-current asset at cost	34 000	
	Revaluation Reserve		34 000
<b>D</b>	Non-current asset at cost	16 000	
	Revaluation Reserve		16 000

Nov 00 P1 Q5/ Nov 08 P1 Q5

- 7 The table shows the share capital of a company.

	ordinary shares of \$1	5% preference shares of \$0.50
Number of shares authorised	100 000	60 000
Number of shares issued as fully paid	60 000	40 000

The directors declare an ordinary dividend of 7.5%.

What will be the total dividend for the year?

- A** \$5 500      **B** \$6 500      **C** \$9 000      **D** \$10 500

Nov 00 P1 Q12 / Nov 01 P1 Q18

- 8 A company issues a 5-year bond of \$1 000 000. Interest for year 1 and 2 will be at the rate of 10% per annum, and for year 3, 4 and 5 it will be 12% per annum. What will be the charge for interest shown in its Income statement each year?

- A** \$100 000 in each year  
**B** \$100 000 in year 1 and 2 and \$120 000 in year 3, 4 and 5  
**C** \$112 000 in each year  
**D** \$120 000 in each year

Nov 00 P1 29/ Nov 06 P3 Q18/ May 09 P3 Q14

- 9 The table shows extract from a company's trial balance at 31 March 2001.

	Debit (\$)	Credit (\$)
Bank overdraft		7 000
Debentures (2005)		18 000
Preference shares		9 000
Proposed preference dividend		900
Bad debts provision		800
Balance on trade payables ledger	1 500	
Trade payables		30 000

Which total for current liabilities should be disclosed in the financial statements?

- A** \$30 900      **B** \$36 400  
**C** \$37 900      **D** \$38 700

May 01 P1 Q5

- 10 The table shows an extract from the draft Balance Sheet of a company.

Non-current assets	Cost \$	Depreciation \$	Net book value \$
Freehold buildings	700 000	200 000	500 000
Plant and machinery	450 000	100 000	350 000

Freehold buildings are to be revalued to \$950 000. Plant and machinery is to be written down to \$250 000. How much will be credited to the Assets Revaluation Reserves?

- A \$50 000  
 B \$150 000  
 C \$250 000  
 D \$450 000

Nov 01 P1 Q12

- 11 What adjustment will result in an increase in a company's stated profit?

- A the amortisation of goodwill  
 B the application of reserves for the issue of bonus shares  
 C the capitalisation of development costs  
 D the upward revaluation of non-current assets

Specimen 02 P3 Q8/Nov 03 P1 Q21

- 12 A Company has an authorised ordinary share capital of \$1 million (50% issued), \$200 000 10% fully paid-up preference shares and \$200 000 8% debentures. Operating profits for the most recent year are \$100 000. If the profits were fully distributed, they would be sufficient to pay an ordinary share dividend of

- A 8%                      B 12.8%                      C 16%                      D 16.8%

Specimen 02 P3 Q11

- 13 A company made the following payments:

		\$
1 June 2001	Final dividend for the year ended 31 March 2001	40 000
1 December 2001	Interim dividend for the year ended 31 March 2002	15 000
1 June 2002	Final dividend for the year ended 31 March 2002	50 000

What are the entries for dividends in the Profit and Loss Appropriation Account for the year ended 31 March 2002 and the Balance Sheet at that date?

	Profit and Loss Appropriation Account (\$)	Balance Sheet (\$)
A	55 000	50 000
B	55 000	65 000
C	65 000	50 000
D	65 000	65 000

May 02 P1 Q15

- 14 What does the Profit and Loss Appropriation Account of a limited company show?

- A capital and revenue reserves                      B how net profit is applied  
 C how net profit is earned                              D the directors' salaries

Nov 02 P1 Q16

- 15 A Company has an authorised share capital of 2 million of \$0.25 ordinary shares of which 1.6 million are in issue. It is proposed to pay a dividend totalling \$40 000.

Which correctly describes the amount of dividend?

- A 8%    B 10%  
 C \$0.08 per share                              D \$0.10 per share

May 03 P1 Q16

16 A Company is financed by

10 000 \$1 ordinary shares
\$5 000 10% loan

Net profit before interest and taxation is \$2 500. Tax payable is \$400.  
 What is the maximum dividend per share payable from this year’s profits?

- A** \$0.16   **B** \$0.20  
**C** \$0.21   **D** \$0.25

May 03 P1 Q18

17 Freehold land and buildings are shown in the accounts at a cost price of \$200 000 and accumulated depreciation of \$40 000. The property is to be revalued in the books at \$340 000.  
 What is the double entry to record this transaction?

	Account	DR (\$)	CR (\$)
<b>A</b>	Freehold land and buildings	140 000	
	Income statement		140 000
<b>B</b>	Freehold land and buildings	140 000	
	Accumulated depreciation	40 000	
	Income statement		180 000
<b>C</b>	Freehold land and buildings	140 000	
	Revaluation reserve		140 000
<b>D</b>	Freehold land and buildings	140 000	
	Accumulated depreciation	40 000	
	Revaluation reserve		180 000

Nov 03 P1 Q6//Nov 15 P12 Q7

18 An extract from a company’s Balance Sheet is given.

	\$
Ordinary share capital	50 000
General reserves	10 000
Income statement	4 000
10% debentures	20 000

What are the ordinary shareholders’ funds?

- A** \$50 000   **B** \$54 000  
**C** \$64 000   **D** \$80 000

Nov 03 P1 Q19/ May 13 P12 Q20

19 The following information is extracted from the books of a company.

	\$ 000
Freehold premises at cost	125
Provision for depreciation of freehold premises	50

The premises are revalued at \$180 000.

Which entries are required in the company’s books to record the revaluation?

	Profit and Loss	Freehold Premises at Cost account	Provision for Depreciation	Revaluation Reserve
<b>A</b>	none	debit \$55 000	debit \$50 000	credit \$105 000
<b>B</b>	debit \$50 000	debit \$55 000	none	credit \$105 000
<b>C</b>	debit \$55 000	debit \$75 000	debit \$50 000	credit \$180 000
<b>D</b>	debit \$75 000	debit \$55 000	debit \$50 000	credit \$180 000

May 05 P1 Q8

- 20 A company has the following figures at the financial year end:

	\$
5% debentures repayable 2010	5 000
Trade payables	1 500
Accruals	1 200
Share capital	20 000
Income statement balance	1 800
Prepayments	1 000
Bank overdraft	6 500

What is the figure, which should appear in the Balance Sheet under the heading "current liabilities"?

- A \$8 000      B \$9 000      C \$9 200      D \$11 000

May 05 P3 Q15

- 21 A building cost \$340 000 several years ago. At 30 June 2004 the accumulated depreciation on the building was \$47 600 and it was decided to revalue the building to its market value of \$560 000.

What will be the balance on the Revaluation Reserve?

- A \$172 400      B \$220 000      C \$267 600      D \$512 400

Nov 05 P1 Q16/Nov 13 P12 Q4

- 22 A newly formed company issues  
1 000 000 ordinary shares of \$1 at \$2.50 each  
\$300 000 5% debentures.

Operating profit for the year was \$465 000

The directors recommend an 8% ordinary dividend for the year

What is the retained profit for the year?

- A \$250 000      B \$370 000      C \$385 000      D \$400 000

May 06 P1 Q21/May 16 P12 Q16

- 23 A published Balance Sheet for a company at 1 January 2005 included:

	\$ million
Ordinary share capital	500
Income statement	200

The company results for the year to 31 December 2005 included:

	\$ million
profit before taxation	50
Taxation	15
dividends proposed	10
revaluation surplus on land	15

What was the Income statement balance at 31 December 2005?

- A \$225 million      B \$240 million      C \$250 million      D \$265 million

Nov 06 P3 Q11

- 24 The capital structure of a company is shown.

	\$
700 000 ordinary shares of \$0.25 each	175 000
8 % loan stocks	160 000

During the year the company made profits before interest of \$105 000. The directors wish to distribute as much of the profits as possible by way of dividend.

What is the dividend per share?

- A \$0.1317      B \$0.15      C \$0.5268      D \$0.60

May 07 P1 Q19

- 25 Which will show the lowest figure in the balance sheet of a company?
- A** authorised share capital                      **B** called-up share capital  
**C** issued share capital                                **D** paid up share capital

May 07 P3 Q10

- 26 A company shows the following balance sheet extracts at 31 March 2007.

	\$000
general reserve	125
provision for re-organisation	90
trade payables	50
accruals	12
estimated tax refund	25
bills payable	32
bank overdraft	74
cash at bank	44

What amount is shown as current liabilities in the accounts?

- A** \$136 000                      **B** \$168 000                      **C** \$193 000                      **D** \$258 000

Nov 07 P3 Q11

- 27 The table shows extracts from the trial balance of a business at 31 December 2007.

	\$
ordinary share capital	20 000
share premium	40 000
long term loan (repayable 2017)	30 000
bank overdraft	60 000
4 % preference share capital	50 000
7 % debentures 2012	70 000

What is total of 'non-current liabilities' in the balance sheet?

- A** \$100 000    **B** \$150 000  
**C** \$160 000    **D** \$210 000

May 08 P1 Q18/ Nov 13 P12 Q22

- 28 Plant and machinery is included as part of a company's non-current assets. It decides to revalue its plant and machinery and finds that some is worth more and some worth less than the values on the balance sheet.

As a result of the decision, which statement is true?

- A** It only needs to revalue plant and machinery which has lost value.  
**B** It only needs to revalue plant and machinery which has gained value.  
**C** It must revalue all plant and machinery.  
**D** It must revalue all its non-current assets in the balance sheet.

May 09 P3 Q8

- 29 The table shows balances at the end of a year.

	\$
expenses prepaid	6 000
expenses accrued	4 000
bank overdraft	11 500
trade payables	13 400
trade receivables	10 500
loan (2015)	20 000

What is the total of current liabilities?

- A** \$16 500                      **B** \$17 400                      **C** \$28 900                      **D** \$48 900

Nov 09 P1 Q30

- 30 A company shows the following figures in its balance sheet.

	\$ 000
Goodwill	35
equipment, at cost, less depreciation	70
bank overdraft	17
loan repayable over 5 years(current liability portion \$20 000)	100
inventories for resale	95
trade payables	54
6 month deposit account	125

What is the figure for capital and reserves?

- A      \$29 000                      B      \$84 000                      C      \$99 000                      D      \$154000  
 Nov 09 P3 Q9

- 31 A company has the following current assets and current liabilities.

	\$
bank deposit account	6 000
bank overdraft	4 500
loan interest payable	2 500
deposits from customers (for orders)	1 500
loans to employees	4 000
trade payables	9 000
trade receivables	12 000

What is the amount of the net current assets?

- A      \$(3500                                      B      \$4500  
 C      \$7500                                      D      \$13 500

Nov 10 P1 Q15

- 32 The table shows extracts from the trial balance of a company at 31 December 2009.

	\$
ordinary share capital	750 000
8 % preference shares	250 000
6 % debentures (2015	150 000
bank loan repayable (2012	75 000
bank overdraft	110 000
mortgage on buildings (repayable 2010	120 000

What is the total of non-current liabilities in the balance sheet at 31 December 2009?

- A      \$195 000                                      B      \$225 000  
 C      \$345 000                                      D      \$595 000

Nov 10 P1 Q19

- 33 What would **not** appear in the income statement of a limited company?

- 1 finance costs
- 2 revenue
- 3 ordinary dividends paid
- 4 ordinary dividends payable

- A      1 and 2                                      B      1 and 4  
 C      2 and 3                                      D      3 and 4

Nov 11 P3 Q10

- 34** A non-current asset costing \$206 000, with a net book value of \$131 000, is revalued to \$275 000. How should the revaluation be recorded?

- A** Dr Asset at cost \$69 000  
Cr Revaluation reserve \$69 000
- B** Dr Provision for depreciation \$75 000  
Dr Asset at cost \$69 000  
Cr Revaluation reserve \$144 000
- C** Dr Provision for depreciation \$144 000  
Cr Revaluation reserve \$144 000
- D** Dr Revaluation reserve \$144 000  
Cr Asset at cost \$69 000  
Cr Provision for depreciation \$75 000

May 12 P12 Q3

- 35** A company's year-end is 30 April. It purchases a factory in May 2009 at a cost of \$200 000. The factory will be depreciated over 20 years. A full year's depreciation is charged in the year of purchase. In May 2012 the factory is re-valued at \$300 000.

How much should be included in the revaluation reserve account?

- A** \$100 000   **B** \$120 000
- C** \$130 000   **D** \$140 000

May 12 P32 Q3

- 36** The following information is taken from the financial statements of a limited company.

	<b>\$000</b>
retained earnings at the start of the year	50
profit attributable to equity holders	30
dividends paid during the year	15
dividends proposed payable in the next financial year	10
surplus on revaluation of land during the year	20

What are the retained earnings at the end of the year?

- A** \$55 000   **B** \$65 000
- C** \$80 000   **D** \$100 000

May 12 P32 Q15

- 37** A trial balance shows the following information.

	<b>\$</b>
premises at cost	150 000
accumulated depreciation on premises	25 000

On 1 January the premises are revalued at \$270 000. At the same time 200 000 shares of \$1 each are issued for \$300 000.

What is the value of the reserves created on 1 January?

- A** \$120 000   **B** \$145 000
- C** \$220 000   **D** \$245 000

Nov 12 P12 Q4

- 38** Which item appears in the financial statements of a limited company but not in those of a sole trader or partnership?

- A** dividends paid                                   **B** other payables
- C** other receivables                               **D** trade payables

Nov 12 P12 Q13

- 39** A company has an authorised share capital of 1 000 000 \$0.50 ordinary shares. Its issued share capital is 800 000 shares. An ordinary dividend of 7½ % is declared. How much is payable to the shareholders?

**A** \$30 000      **B** \$37 500      **C** \$60 000      **D** \$75 000

Nov 12 P12 Q20

- 40** During the year ended 31 December 2012 a business made a profit of \$31 000. A dividend of 8% was paid on the 200 000 ordinary shares of \$0.50 each, and \$12 000 was transferred to general reserve.

The retained earnings of the business on 31 December 2012 amounted to \$68 000.

What was the balance of retained earnings on 1 January 2012?

**A** \$41 000      **B** \$57 000      **C** \$65 000      **D** \$79 000

May 13 P12 Q14

- 41** A company has the following expenses for the year.

	\$
directors' salaries	140 000
depreciation of delivery vehicles	87 000
office salaries	90 000
loan interest	33 000
discounts allowed	12 000

What is the total of the administration overheads?

**A** \$242 000      **B** \$263 000      **C** \$329 000      **D** \$362 000

Nov 13 P12 Q15

- 42** A business has settled a legal dispute with a customer and expects to pay him \$10 000 before the end of the next financial year.

Which heading is this amount included under in the company's statement of financial position for this financial year?

**A** capital and reserves      **B** current liabilities  
**C** non-current assets      **D** non-current liabilities

May 14 P12 Q17

- 43** Which statement is correct?

**A** All reserves are created by a transfer from retained earnings.  
**B** Revaluation reserves appear in the non-current assets section of the statement of financial position.  
**C** Some reserves are treated as current liabilities at the financial year end.  
**D** Total reserves form part of shareholders' equity.

Specimen 16 P1 Q7

- 44** Which item appears in a company's income statement?

**A** dividends      **B** inventory  
**C** trade payables      **D** transfer to reserves

Specimen 16 P1 Q10

- 45** Which items will be shown in the statement of changes in equity?

**1** dividends proposed  
**2** interest paid on debentures  
**3** issues of share capital  
**4** transfers to reserves

**A** 1 and 2      **B** 1 and 4      **C** 2 and 3      **D** 3 and 4

Specimen 16 P1 Q18

46 What might stop financial statements showing a true and fair view?

- A changes in depreciation methods from year to year
- B changes in dividend policy
- C creation of a general reserve
- D inclusion of purchased goodwill in a statement of financial position

May 16 P12 Q1

47 A company is formed with the issue of 100 000 6% non-cumulative preference shares of \$1 each and 300 000 ordinary shares of \$1 each issued at a premium of \$0.20. It earned profits of \$3 000, \$16 000 and \$31 000 in the first three years of trading. The directors wish to pay an ordinary dividend of 5% each year when possible. What value of ordinary dividends does the company actually pay in years 2 and 3?

	year 2 \$	year 3 \$
A	7 000	15 000
B	7 000	18 000
C	10 000	15 000
D	10 000	18 000

Nov 16 P12 Q17

**ANSWER KEY**

1	D	13	C	25	D	37	D
2	A	14	B	26	B	38	A
3	D	15	B	27	A	39	A
4	B	16	A	28	C	40	B
5	D	17	D	29	C	41	A
6	B	18	C	30	D	42	B
7	A	19	A	31	B	43	D
8	C	20	C	32	B	44	B
9	C	21	C	33	D	45	D
10	D	22	B	34	B	46	A
11	C	23	A	35	C	47	C
12	B	24	A	36	B		

**DETAILED ANSWERS**

**7** Capital amount (\$) × Dividend(%) = Dividend in (\$)

Ordinary dividend	=	(60 000 × 7.5%)	=	4 500
Preference dividend	=	(40 000 × 5%)	=	<u>1 000</u>
Total dividend				<u>5 500</u>

**8** Interest for year 1 and 2 (\$1 000 000 × 10%) = \$100 000  
Interest for year 3, 4 and 5 (\$1 000 000 × 12%) = \$120 000

$$\text{Average interest} = \frac{\$100\,000 + \$100\,000 + \$120\,000 + \$120\,000 + \$120\,000}{5 \text{ years}}$$

$$= \$112\,000$$

Interest on bonds which are issued with interest rates which may vary with external factors (e.g. the rates charged by the national banks) should be shown in the Income statement at the actual cost incurred each year then "B" option would have been correct. In this item, the total cost of interest is known at the time of issue and should therefore be charged in the income statement in equal amounts.

**9** \$7 000 + \$900 + \$30 000 = \$37 900

\* Debit balances on trade payables ledger will be shown as asset.

**10** Journal entries to record revaluation will be

		\$	\$
<b>(i)</b>	Freehold buildings	250 000	
	Provision for depreciation	200 000	
	Revaluation Reserves		450 000
<b>(ii)</b>	Provision for depreciation	100 000	
	Revaluation Reserves / Income statement	100 000	
	Plant and Machinery		200 000

So "D" option is correct

<b>12</b>		\$
	Profits before interest	100 000
	Less Debenture interest (\$200 000 × 8%)	<u>(16 000)</u>
		84 000
	Less Preference dividend (\$200 000 × 10%)	<u>(20 000)</u>

	Profits available to pay ordinary dividend								<u>64 000</u>
	As we know								
	Share capital × Dividend (%) =	Dividend (in \$)							
	(1 million × 1/2) \$500 000 × X =	\$64 000							
		$\frac{\$64\,000}{\$500\,000} \times 100$							
		12.8 %							
<b>15</b>	Dividend (%) =	$\frac{\text{Total ordinary dividend}}{\text{Issued ordinary share capital}} \times 100$							
		$\frac{\$40\,000}{1\,600\,000 \text{ shares} \times \$0.25} \times 100$							
		10%							
<b>16</b>	Dividend per share =	$\frac{\text{Total ordinary dividend}}{\text{Number of ordinary shares}}$							
		$\frac{\$1\,600}{10\,000 \text{ shares}}$							
		\$0.16 per ordinary share							
	* Maximum profits available for payment of ord. dividend =	Net profit before interest and tax	–	Interest	–	Tax			
		\$2 500	–	(\$5 000 × 10%)	–	\$400			
		\$1 600							
<b>18</b>	Shareholders' fund =	Ordinary capital + All Reserves + Profits							
		\$50 000 + \$10 000 + \$4 000							
		\$64 000							
<b>20</b>	Current liabilities will be \$9 200 i.e. \$1 500 + \$1 200 + \$6 500								
<b>21</b>	Building (\$560 000 – \$340 000)								↑ \$220 000 Dr
	Provision for depreciation								↓ \$47 600 Dr
	Revaluation reserves								↑ \$267 600 Cr
<b>22</b>	Operating profit								\$465 000
	Less Interest on debentures (\$300 000 × 5%)								(15 000)
	Ordinary dividends (1 000 000 × \$1 × 8%)								<u>(80 000)</u>
	Retained profits for the year								<u>\$370 000</u>
<b>23</b>									<b>\$million</b>
	Profit before tax								50
	Tax								(15)
	Proposed dividends								<u>(10)</u>
	Current year profit								25
	Retained profits balance b/f								<u>200</u>
	Retained profits balance c/f								<u>225</u>
<b>24</b>									<b>\$</b>
	Profit before interest								105 000
	Less Loan interest (\$160 000 × 8%)								<u>(9 600)</u>
	Profits available to pay ordinary dividend								<u>95 400</u>
	Dividend per share =	$\frac{\text{Total ordinary dividend}}{\text{Total number of ordinary shares}}$							
		$\frac{\$95\,400}{700\,000 \text{ shares}}$							
		\$0.1317							

25 Current liabilities = \$50 000 + \$12 000 + \$32 000 + \$74 000 = \$168 000

27 'Non-current liabilities' imply non-current liabilities and include long term loan of \$30 000 (repayable in 2017 and 7 % debentures \$70 000 (repayable in 2012); so total trade payables would become \$100 000 (\$30 000 + \$70 000).

29		\$	
	Expenses accrued		4 000
	Bank overdraft		11 500
	Trade payables		<u>13 400</u>
			<u>28 900</u>

30		\$ 000
	Total assets (\$35 000 + \$70 000 + \$95 000 + \$125 000)	325
	Total liabilities (\$17 000 + \$100 000 + \$54 000)	<u>(171)</u>
	Capital and reserves	<u>154</u>

31	<b>Current Assets</b>	\$	\$
	Bank deposit account	6 000	
	Loans to employees	4 000	
	Trade receivables	<u>12 000</u>	22 000
	<b>Current Liabilities</b>		
	Bank overdraft	4 500	
	Loan interest payable	2 500	
	Deposits from customers (for orders)	1 500	
	Trade payables	<u>9 000</u>	<u>(17 500)</u>
	<b>Net Current Assets</b>		<u>4 500</u>

32	Total non-current liabilities	=	6% Debentures (2015)	+	Bank Loan Repayable (2012)
		=	\$150 000	+	\$75 000
		=	\$225 000		

Bank overdraft and mortgage on buildings (repayable in 2010 are current liabilities as payable in the following year.

33 "D" option is correct as 3<sup>rd</sup> item is shown in the Statement of changes in equity whereas ordinary dividends payable (4<sup>th</sup> item) is not accounted for in the financial statements unless approved by the ordinary shareholders in the annual general meeting.

34	Non-current asset (\$275 000 – \$206 000)	↑ \$69 000 Dr
	Provision for depreciation	↓ <u>\$75 000 Dr</u>
	Revaluation reserves	↑ <u>\$144 000 Cr</u>

35	Non-current asset (\$300 000 – \$200 000)	↑ \$100 000 Dr
	Provision for depreciation ( $\frac{\$200\ 000 \times 3}{20}$ )	↓ <u>\$30 000 Dr</u>
	Revaluation reserves	↑ <u>\$130 000 Cr</u>

36		\$000
	Retained earnings at the start of the year	50
	Profit attributable to equity holders	30
	Dividends paid during the year	<u>(15)</u>
	Retained earnings at the end of the year	<u>65</u>

<b>37</b>	Increase in Revaluation reserves [ $\$270\,000 - (\$150\,000 - \$25\,000)$ ]		\$145 000
	Increase in Share premium [ $\$300\,000 - (200\,000 \text{ shares @ } \$1 \text{ each})$ ]		<u>\$100 000</u>
	Value of the reserves created on 1 January		<u>\$245 000</u>
<b>39</b>	Dividend payable (\$)	= Issued share capital × Dividend (%)	
		= (800 000 shares @ \$0.5) × 7.5%	
		= \$30 000	
<b>40</b>			<b>\$000</b>
	<b>Retained earnings on 1 January 2012 (balancing figure)</b>		<b>57</b>
	Profit attributable to equity holders		31
	Dividends paid during the year ( $\$200\,000 \times \$0.50 \times 8\%$ )		(8)
	Transfer to general reserves		<u>(12)</u>
	Retained earnings on 31 December 2012		<u>68</u>
<b>41</b>	Administration Overheads	= \$140 000 + \$90 000 + \$12 000	
		= \$242 000	
<b>44</b>	'B' option is correct as inventory is part of 'cost of sales' section. Items in 'A' and 'D' options are shown in statement of changes in equity whereas trade payables ('C' option) is a balance sheet item.		
<b>47</b>			
		\$	\$
	Profit for the year	16 000	31 000
	Preference dividend ( $\$100\,000 \times 6\%$ )	<u>(6 000)</u>	<u>(6 000)</u>
	Profit available to pay ordinary dividend	10 000	25 000
	Ordinary dividend ( $\$300\,000 \times 5\%$ ) limited to the profit available	<u>(10 000)</u>	<u>(15 000)</u>

## CHAPTER 15 ISSUE OF SHARES AND DEBENTURES

- 1 A company's balance sheet includes

	\$
Capital and Reserves:	
Ordinary shares of \$0.50 each fully paid	84 000
Retained profit	<u>50 000</u>
	<u>134 000</u>

The company makes a one-for-two rights issue of ordinary shares of \$0.50 each, at \$1.30 each. The issue was fully subscribed. A bonus issue of two-for-three ordinary shares of \$0.50 followed the rights issue. What is now the maximum possible balance of the retained profit?

- A** \$50 000  
**B** \$41 600  
**C** \$33 200  
**D** nil

May 98 P1 Q29 / Specimen 02 P3 Q10

- 2 A Company's balance sheet includes the following extract.

	\$
Authorised share capital	
10 million ordinary shares of \$1 each	10 000 000
Issued share capital:	
2 million ordinary shares of \$1 each	2 000 000
Reserves:	
Share premium	2 000 000
General reserves	400 000
Retained profit	1 000 000

What is the maximum number of bonus shares that could legally be issued?

- A** 1 400 000                      **B** 2 400 000  
**C** 3 000 000                      **D** 3 400 000

May 99 P1 Q17/ Nov 04 P1 Q17

- 3 A shareholder in a company sells his shares to another person. What is the effect on the Share Capital account of the company?

- A** it is increased by any premium paid for the shares  
**B** it is increased by the selling price of the shares  
**C** it is reduced by the value of shares sold  
**D** it remains unaltered

Nov 99 P1 Q15 / Nov 01 P1 Q14 / May 03 P1 Q19/ May 14 P12 Q19

- 4 A Company raises cash by issuing 8% debentures. What is the effect on the company's profit and net current assets in the year of issue?

	Profits	net current assets
<b>A</b>	decrease	decrease
<b>B</b>	decrease	increase
<b>C</b>	increase	decrease
<b>D</b>	increase	increase

Nov 99 P1 Q16/ May 12 P12 Q16

- 5 An extract of a company balance sheet is shown.

Capital and Reserves	<b>\$000</b>
Issued Share Capital:	
4 million ordinary shares of \$0.50 each	2 000
Share Premium Account	800

The company decides to make a rights issue to existing shareholders. The issue was made on the basis of 1 new share for every 4 held, at a price of \$3.00 a share.

What was the impact on the Share Premium Account of this rights issue?

- A** no change                                        **B** increase by \$2.5 million  
**C** increase by \$3 million                       **D** increase by \$12 million

Nov 99 P1 Q29

- 6 A company currently has the following capital and reserves:

	<b>\$</b>
\$1 ordinary share capital	400 000
Share premium account	60 000
Revaluation reserve	120 000
General reserve	310 000
Retained profit	<u>90 000</u>
	<u><b>980 000</b></u>

The company is about to make a 1 for 4 bonus issue. What is the maximum amount of distributable reserves after the bonus issue?

- A** \$300 000            **B** \$360 000            **C** \$400 000            **D** \$420 000

Nov 99 P1 Q32

- 7 The table shows extracts from a company's Balance Sheets at 31 December 1998 and 1999.

	<b>31 December 1998</b>	<b>31 December 1999</b>
	<b>(\$m)</b>	<b>(\$m)</b>
Ordinary shares of \$1 each	100	130
Share premium account	50	80

**Notes:**

- (i)** On 1 July 1999 there was a bonus issue of 1 for 10.  
**(ii)** On 1 October 1999 there was a rights issue  
**(iii)** There are no other reserves balances.

How much cash was received from the issue of shares in the year ended 31 December 1999?

- A** \$20m                **B** \$30m                **C** \$50m                **D** \$60m

May 00 P1 Q15 / Nov 06 P1 Q22

- 8 What will be the effect of a bonus issue on the share capital and net assets?

	<b>Share capital</b>	<b>Net assets</b>
<b>A</b>	increase	no effect
<b>B</b>	increase	reduce
<b>C</b>	no effect	no effect
<b>D</b>	increase	increase

May 00 P1 Q16

- 9 Which event does not require entries in a company's ledger accounts?

- A** A bonus issue of shares  
**B** an issue of the company's shares at a price above nominal value  
**C** a rights issue of shares  
**D** a sale by a shareholder of shares at a price above nominal value.

May 00 P1 Q28

- 10** A Company, with an existing issued share capital of \$400 000 \$1 ordinary shares, made a 1-for-5 Bonus Issue. This was later followed by a 1-for-3 Rights Issue.  
What will be the balance on the Share Capital account after these transactions?

- A** \$400 000  
**B** \$480 000  
**C** \$613 333  
**D** \$640 000

Nov 00 P1 Q15/ Nov 16 P12 Q18

- 11** A Company decides to make a rights issue to those holding ordinary shares. The issue, which was fully subscribed, was on a 1 for 4 bases, at a price of \$2.00 per share. The company's Balance Sheet extract immediately before the rights Issue is shown.

Capital and Reserves	\$'000
Issued share capital	
2 million Ordinary shares of \$0.50 each	1 000
1 million Preference shares of \$1 each	1 000
Share Premium account	<u>400</u>
	<u>2 400</u>

The listed share price was \$3.00

What was the impact on the Share Premium Account (SPA) of the rights issue?

- A** SPA did not change  
**B** SPA increased by \$375 000  
**C** SPA increased by \$750 000  
**D** SPA increased by \$1 million

Nov 00 P1 Q28

- 12** A company's share capital consists of 80 000 \$0.50 shares which are all issued at a premium of 20%. The market value of each share is now \$0.80.  
What amount will appear in the company's Balance Sheet for ordinary share capital?

- A** \$40 000      **B** \$48 000      **C** \$51 200      **D** \$64 000

May 01 P1 Q10

- 13** A limited company with an authorised share capital of \$500 000 and an issued share capital of \$300 000 in \$1 ordinary shares makes a 1 for 4 bonus issue followed by a 1 for 5 rights issue.  
What will be the balance on the share capital following these transactions?

- A** \$375 000      **B** \$450 000      **C** \$500 000      **D** \$750 000

Nov 01 P1 Q13

- 14** A company has authorised capital of 500 000 \$0.25 ordinary shares. By 31 December, it had issued 400 000 \$0.25 ordinary shares at \$0.60 per share. The market price of the shares on 31 December 2000 was \$0.75 each.  
What figure is carried in the balance sheet on 31 December 2000 in respect of share capital?

- A** \$100 000  
**B** \$125 000  
**C** \$240 000  
**D** \$300 000

Specimen 02 P1 Q23/Nov 14 P12 Q16

- 15 A Company's Balance Sheet as at 31 December 2001 included:

	\$
Ordinary shares of \$0.50 each, fully paid	320 000
Cash at bank	100 000

The following then took place:

February 2002	A one-for-two rights issue of ordinary shares of \$0.50 each at \$1.10. The issue was fully subscribed.
April 2002	A bonus issue of one for four ordinary shares of \$0.50 each.

Assume no other transactions took place between 31 December 2001 and 30 April 2002. What were the balances of the Ordinary Share Capital and Bank accounts on 30 April 2002?

	Ordinary Share Capital (\$)	Bank (\$)
<b>A</b>	600 000	452 000
<b>B</b>	600 000	572 000
<b>C</b>	840 000	452 000
<b>D</b>	840 000	620 000

May 02 P1 Q18

- 16 A Company makes a bonus issue of shares. What is the effect on the net assets and the reserves in the Balance Sheet?

	Net assets	Reserves
<b>A</b>	increase	decrease
<b>B</b>	increase	unchanged
<b>C</b>	unchanged	decrease
<b>D</b>	unchanged	increase

Nov 02 P1 Q18/ May 07 P1 Q18/Nov 10 P1 Q18

- 17 At the beginning of the year a company has authorised share capital of 200 000 \$0.50 ordinary shares and issued share capital of 100 000 \$0.50 ordinary shares. During the year the company makes a further issue of 50 000 \$0.50 ordinary shares at a price of \$1.20 each.

What is the balance on the Share Capital account at the end of the year?

<b>A</b>	\$75 000	<b>B</b>	\$110 000	<b>C</b>	\$125 000	<b>D</b>	\$160 000
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Nov 02 P1 Q19/ May 09 P1 Q21

- 18 A Company's share capital consists of 150 000 ordinary shares of \$0.50 each. It makes a rights issue of 1 ordinary share for every 3 already held at \$1.20 per share. It then makes a bonus issue of 1 share for every 5 held.

Which amount will be shown in the Balance Sheet for share capital?

<b>A</b>	\$120 000	<b>B</b>	\$145 000	<b>C</b>	\$155 000	<b>D</b>	\$165 000
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May 04 P1 Q19

- 19 Which statement about bonus shares is true?

- A** They may be issued as repayment of debentures  
**B** They may be issued at a premium  
**C** They may be issued to the holders of preference share  
**D** They may be issued using the premium received from an issue of preference share

May 04 P1 Q20

- 20 Which is a reason for a company issuing bonus shares to its existing shareholders?

- A** to capitalise reserves  
**B** to increase profits available for dividend  
**C** to raise the market value of shares  
**D** to raise additional cash

May 04 P3 Q20

- 21 What will result in an increase in cash funds to a business?  
**A** bonus issue of shares **B** increase in authorised share capital  
**C** revaluation of non-current assets **D** rights issue of shares
- Nov 04 P1 Q18

- 22 A company's Balance Sheet shows the following balances

	\$
Ordinary shares of \$1 each	100 000
Share premium	10 000
Retained profits	48 000
Bank balance	50 000

A 1 for 4 bonus issue takes place, leaving the reserves in the most useful form.  
 What are the new account balances?

	Share Premium (\$)	Retained Profits (\$)	Bank (\$)
<b>A</b>		33 000	50 000
<b>B</b>		33 000	75 000
<b>C</b>	10 000	23 000	50 000
<b>D</b>	10 000	23 000	75 000

Nov 04 P1 Q19

- 23 Which of the following is a reason for a company issuing bonus shares?  
**A** to increase liquidity **B** to increase profitability  
**C** to reduce gearing **D** to reduce revenue reserves
- Nov 04 P3 Q18

- 24 A company makes a 1 for 4 bonus issue of ordinary shares.  
 What will happen to share capital and shareholders' funds?

	Share capital	Shareholders' funds
<b>A</b>	increased by 25%	decreased by 25%
<b>B</b>	increased by 25%	increased by 25%
<b>C</b>	increased by 25%	no change
<b>D</b>	no change	increased by 25%

May 05 P1 Q18

- 25 A company made a bonus issue of shares on the basis of 1 for every 3 held. The directors wish to keep the reserves in the most flexible form.

Balance Sheet extract (before bonus issue)	\$000
Capital and reserves	
ordinary shares \$0.20 each	900
share premium	100
revaluation reserve	170
retained profits	<u>130</u>
	<u>1 300</u>

What will be the position after the bonus issue?

	Share capital \$000	Share premium \$000	Revaluation reserve \$000	Retained profits \$000
<b>A</b>	1 200	nil	nil	100
<b>B</b>	1 200	nil	70	30
<b>C</b>	1 200	nil	100	Nil
<b>D</b>	1 200	100	nil	nil

Nov 05 P1 Q18

- 26** A limited company has an authorised share capital of \$750 000 and an issued share capital of \$450 000 in \$1.00 ordinary shares.

It makes a 1 for 3 rights issue of shares at \$2.00 per share which is fully taken up.

What is the balance on the share capital account following this transaction?

- A** \$600 000      **B** \$700 000      **C** \$750 000      **D** \$900 000

Nov 05 P1 Q19

- 27** A company with an issued share capital of \$200 000 of \$1.00 ordinary shares makes a bonus issue of one \$1.00 ordinary share for every five already held. It also issues \$80 000 debentures at a discount of 5%. The company has a bank balance of \$40 000 before the issues.

What is the bank balance after the issues?

- A** \$76 000      **B** \$116 000      **C** \$120 000      **D** \$166 000

Nov 05 P1 Q20

- 28** What will increase the working capital and net assets and reserves of a company?

- A** a bonus issue of shares  
**B** a debenture issue  
**C** an issue of shares at a premium  
**D** an issue of shares at nominal value

May 06 P1 Q19

- 29** At January 2005 the capital structure of S Limited was as follows.

	\$
issued share capital 100 000 ordinary shares of \$1 each	100 000
share premium account	30 000

On 1 April 2005 the company made an issue of 20 000 shares for \$36 000.

On 1 June 2005 a bonus issue of one share for every six in issue was made. The share premium account was used for the purpose.

What is the balance on the share premium account at 31 December 2005?

- A** \$26 000      **B** \$34 000      **C** \$46 000      **D** \$56 000

May 06 P1 Q20/ May 10 P1 Q18

- 30** A company has issued 80 000 shares of \$0.50 each. These are quoted on the stock exchange at \$1.60 each. The company makes a rights issue on a 1 for 4 basis at a price of \$1.20 each.

What is the balance on the Share Capital account after the rights issue?

- A** \$50 000      **B** \$100 000      **C** \$120 000      **D** \$160 000

May 06 P1 Q22

- 31** A director-owned company needs additional funds.

Which method of finance might lead to a reduction of the director's control of the business?

- A** bank loan  
**B** debenture  
**C** ordinary share issue  
**D** preference share issue

Nov 06 P1 Q19

- 32** Which statement is correct?

- A** A bonus issue of shares will increase the amount of cash available to the company.  
**B** A rights issue of shares is always made at the nominal value of the shares.  
**C** A rights issue of shares will increase the amount of cash available to the company.  
**D** If shares are issued at an amount that is more than the nominal value of the shares, the excess must be debited to the share premium account

Nov 06 P1 Q20

- 33 A company balance sheet shows the following:

	<b>\$000</b>
\$1 ordinary shares	500
retained earnings	400
10% debentures	<u>300</u>
	<u>1 200</u>
net assets	<u>1 200</u>

A fully subscribed 1 for 4 rights issue at \$2 per share is made and 50% of the debentures are repaid at par. What are the net assets following these changes?

- A** \$1 100 000  
**B** \$1 175 000  
**C** \$1 225 000  
**D** \$1 300 000

Nov 06 P1 Q21

- 34 A company issues 500 000 ordinary shares of \$1 each for \$3 each and 250 000 6 % debentures. By what amount will net assets of the company increase as a result of these transactions?

- A** no increase  
**B** \$750 000  
**C** \$1 500 000  
**D** \$1 750 000

Nov 07 P1 Q17

- 35 A company's balance sheet shows:

	<b>\$</b>
share capital ordinary shares of \$10 each	100 000
general reserve	60 000
retained profit	210 000

The company pays a dividend of \$70 000, makes a bonus issue of 5 000 ordinary shares and raises a debenture loan of \$120 000.

What will be the total of share capital and reserves after these transactions are completed?

- A** \$250 000  
**B** \$300 000  
**C** \$350 000  
**D** \$420 000

Nov 07 P1 Q18

- 36 A limited company has the following capital structure:

	<b>\$</b>
\$1 ordinary shares	500
general reserve	300
retained profit	<u>200</u>
	<u>1 000</u>

The following transactions will take place:

- a bonus issue of 1 share for every 5 held;
- an issue of 500 000 shares of \$1 each at a premium of \$0.50;
- an issue of debentures of \$250 000.

What will be the total of the share capital and reserves after the completion of these transactions?

- A** \$1 500 000      **B** \$1 750 000      **C** \$1 850 000      **D** \$2 000 000

Nov 07 P3 Q17

37 A company's capital is

	\$
ordinary shares of \$1.00 each	200 000
share premium account	80 000
revenue reserves	160 000

Changes now to be made (in the order given)

- A one for one bonus issue
- A rights issue of 100 000 ordinary shares of \$1.00 each at \$1.40 per share

The company wishes to maximize the amounts available to pay dividends.

What will be the ordinary capital and reserves of the company?

	ordinary share capital (\$)	share premium (\$)	revenue reserves (\$)
<b>A</b>	500 000	40 000	40 000
<b>B</b>	500 000	80 000	nil
<b>C</b>	540 000	nil	40 000
<b>D</b>	540 000	40 000	40 000

May 08 P1 Q19

38 What is the effect on a company's balance sheet of issuing bonus shares?

- A** the bank balance will be increased
- B** the non-current liabilities will be increased
- C** the reserves will be reduced
- D** the share capital will be reduced

Nov 08 P1 Q19

39 A company, with an existing issued share capital of 200 000 ordinary shares of \$0.50 each, made a one for four bonus issue. This was later followed by a one for two rights issue at \$1.20 per share. What will be the balance on the share capital account after these transactions?

- A** \$125 000      **B** \$187 500      **C** \$270 000      **D** \$375 000

Nov 08 P1 Q20

40 A shareholder sells some ordinary shares for more than he paid for them. What is the effect on the company balance sheet?

	ordinary share capital	share premium account
<b>A</b>	decrease	decrease
<b>B</b>	decrease	increase
<b>C</b>	no effect	decrease
<b>D</b>	no effect	no effect

May 09 P1 Q20

41 An extract from a company's balance sheet is given.

	\$000
issued ordinary share capital	250
issued preference shares	180
retained profit	320
share premium account	125
8 % debentures	100

What are the ordinary shareholders' funds?

- A** \$695 000      **B** \$775 000      **C** \$875 000      **D** \$975 000

Nov 09 P1 Q15

- 42 An extract from a company's balance sheet shows the following.

	\$000
issued ordinary shares of \$0.25 each	600
share premium account	150
retained profits	300

The company makes a rights issue of one new ordinary share for each three held, at a price of \$0.30 per share. All shares were taken up.

What does the new balance sheet show?

	issued ordinary share capital \$000	share premium \$000
<b>A</b>	600	120
<b>B</b>	800	150
<b>C</b>	800	190
<b>D</b>	800	600

Nov 09 P1 Q16

- 43 A company's Balance Sheet at 31 December 2008 includes:

	\$
Ordinary shares of \$1.00	12 000
Retained profit	4000

In January 2009, the company made a bonus issue of one share for every four held.

In June 2009, the company made a rights issue at \$1.60 of one share for every two held.

By how much did these transactions increase the company's bank balance?

- A** \$9 600      **B** \$12 000      **C** \$12 800      **D** \$19 200

Nov 09 P1 Q17

- 44 When is a share premium account opened?

- A** when shares are issued at a price above nominal value  
**B** when shares are redeemed by the company at a premium  
**C** when shares are sold by a shareholder at a price above their nominal value  
**D** when the company issues bonus shares

May 10 P1 Q19

- 45 A company makes a 1-for-3 bonus issue of shares. The book value of its shareholders' funds immediately before the issue is as follows.

	\$
ordinary share capital	300 000
share premium account	120 000
retained profit	100 000

The costs of the bonus issue are \$10 000.

What will be the book value of shareholders funds after the bonus issue?

- A** \$510 000      **B** \$520 000  
**C** \$610 000      **D** \$620 000

May 10 P3 Q6

- 46 Which statement about the issue by a company of bonus shares is correct?

- A** They can be issued at a premium.  
**B** They can be issued by using both capital and revenue reserves.  
**C** They can only be issued from capital reserves.  
**D** They can only be issued from revenue reserves.

May 10 P3 Q15

- 47 A company's share capital and reserves are:

	\$
Non-current (fixed) assets	250 000
net current assets	<u>125 000</u>
share capital and reserves	<u>375 000</u>
150 000 shares \$1 each	150 000
share premium	75 000
general reserve	125 000
retained profits	<u>25 000</u>
	<u>375 000</u>

The directors propose to issue bonus shares on the basis of one \$1 share for every three already held. Following this the directors intend to make a rights issue on the basis of one new \$1 share for every four shares held, at a premium of \$0.20 per share.

What will the total net assets of the company be after the share issues?

- A** \$425 000  
**B** \$435 000  
**C** \$475 000  
**D** \$485 000

Nov 10 P1 Q20

- 48 The equity section of a company's balance sheet is as follows.

	\$
ordinary shares of \$0.50 each	200 000
preference shares of \$1 each	100 000
share premium	50 000
retained earnings	120 000

The following items have not yet been adjusted.

- 1 purchase returns of \$10 000 have been credited to the sales returns account
- 2 a long term loan of \$40 000 has not been recorded
- 3 a rights issue during the year of 200 000 ordinary shares at a premium of \$0.10each

What will the total of equity be after the above adjustments have been made?

- A** \$590 000  
**B** \$600 000  
**C** \$630 000  
**D** \$640 000

Nov 10 P3 Q18

- 49 A company issues for cash 50 000 shares of \$5 each at a premium of \$15 each and \$300 000 4% debentures.

By what amount will the net assets of the company increase?

- A** \$250 000  
**B** \$550 000  
**C** \$1 000 000  
**D** \$1 300 000

May 11 P1 Q8

- 50 An extract from Bumble Ltd's balance sheet shows the following.

	\$000
ordinary shares of \$0.25 each	500
share premium	100
retained earnings	300

The company makes a rights issue of 1 share for each 4 held at a price of \$0.30 per share. All shares are taken up.

What will the new balance sheet show?

	A	B	C	D
	\$000	\$000	\$000	\$000
ordinary shares of \$0.25 each	625	500	625	625
rights issue	–	125	–	–
share premium	100	125	125	100
retained earnings	300	275	300	325

May 11 P1 Q9

- 51 Why would convertible loan stock be issued by a company?

- A to increase the equity of the company at the issue date
- B to increase gearing on conversion
- C to increase the market value of the company's equity at the issue date
- D to obtain low-cost finance when equity market conditions are unfavourable

May 11 P3 Q3

- 52 Zachary plc has the following summary balance sheet at 31 Dec 2009.

	\$ million
ordinary shares of \$1 each	50
retained earnings	70
net assets	120

Zachary plc made a bonus issue (1 for 2 of ordinary shares on 1 January 2010 and a rights issue (1 for 5 of ordinary shares on 31 December 2010 at \$2 per share.

The share issue was fully subscribed. Retained earnings were \$12 million for 2010. What were the net assets at 31 December 2010?

- A \$112 million
- B \$150 million
- C \$162 million
- D \$187 million

May 11 P3 Q18

- 53 What occurs in a rights issue of shares?

- A Any premium on the issue is added to a capital reserve.
- B Any premium on the issue is added to a revenue reserve.
- C Any premium on the issue is written off to the income statement.
- D The nominal value of the issue is written off to the income statement.

Nov 11 P1 Q19

- 54 A company has the following items in its statement of financial position.

	\$
ordinary share capital, shares of \$0.50 each	900000
retained earnings	450000
long-term bank loan	30000

The company issues 100 000 bonus shares of \$0.50 each to its shareholders.  
What is the total amount of shareholders' funds after the issue of the bonus shares?

- A     \$1 300000                      B     \$1 350000  
C     \$1 380000                      D     \$1 40000

Nov 11 P3 Q3

- 55 An extract from a company's statement of financial position is shown below.

	\$
ordinary shares at \$0.50 share	500 000
premium account	100 000
retained earnings	300 000
	<u>900 000</u>

The day after this statement was prepared the company made a 1 for 4 rights issue at a price that was at 20 % below the current market price of \$1 per share.

What was the balance on the share premium account after the rights issue?

- A     \$100 000                        B     \$137 500  
C     \$175 000                        D     \$200 000

May 12 P32 Q5

- 56 A company makes a 1 for 2 bonus issue.

What effect will this have?

- A     improve cash flow  
B     increase shareholders' funds  
C     reduce an ordinary shareholder's percentage holding  
D     reduce the value of an ordinary share

May 12 P32 Q6

- 57 A company has ordinary shares of \$1 each. Each year it pays a dividend of 10% of the nominal value of the shares.

It now wishes to raise a further \$120 000 by an issue of shares. This would bring in additional profit of \$10 000 and dividends paid would increase by \$2 500 a year.

At which price should the company issue the new shares to maintain the percentage of dividend?

- A     \$1.00                      B     \$1.20                      C     \$1.60                      D     \$4.80

May 13 P12 Q19

- 58 A company issues shares at a premium.  
Which effect does the issue have on the company's statement of financial position?

	net assets	share capital
A	decrease	decrease
B	decrease	no effect
C	increase	increase
D	increase	no effect

May 14 P12 Q21/Nov 14 P12 Q17/Nov 15 P12 Q21

- 59 The following balances are extracted from the books of Juno Limited.

	30 April 2014	30 April 2013
	\$	\$
ordinary shares of \$0.50 each	700 000	500 000
share premium	90 000	50 000

How many ordinary shares have been issued during the year ended 30 April 2014?

- A 200 000      B 240 000      C 400 000      D 480 000  
Nov 14 P12 Q16
- 60 A limited company issues 5000 ordinary shares of \$2 each at a premium of \$0.50. What is the effect on share capital and liquidity?

	share capital \$	liquidity
A	increase 10 000	improve
B	increase 10 000	no effect
C	increase 12 500	improve
D	increase 12 500	no effect

May 15 P12 Q18

- 61 A company made a rights issue of shares. Where is this recorded?

- A Income statement and Statement of financial position  
B Income statement only  
C Statement of changes in equity and Statement of financial position  
D Statement of financial position only

Specimen 16 P1 Q16

- 62 A company's statement of financial position shows the following.

	\$
share capital ordinary shares of \$10 each	100 000
general reserve	60 000
retained earnings	210 000

The following transactions then take place.

- The company pays a dividend of \$70 000.
- The company makes a bonus issue of 5000 ordinary shares.
- The company issues a debenture of \$120 000.

What will be the total of share capital and reserves after these transactions are completed?

- A \$250 000      B \$300 000  
C \$350 000      D \$420 000

Specimen 16 P1 Q17

- 63 A company made a bonus issue of ordinary shares. How was this recorded in its books of account?

	account debited	account debited
A	bank	share capital
B	retained earnings	share capital
C	share capital	bank
D	share capital	retained earnings

Specimen 16 P1 Q19



**ANSWER KEY**

1	C	18	A	35	B	52	C
2	D	19	D	36	B	53	A
3	D	20	A	37	A	54	B
4	B	21	D	38	C	55	C
5	B	22	A	39	B	56	D
6	C	23	D	40	D	57	D
7	D	24	C	41	A	58	C
8	A	25	A	42	C	59	C
9	D	26	A	43	B	60	A
10	D	27	B	44	A	61	C
11	C	28	C	45	A	62	B
12	A	29	A	46	B	63	B
13	B	30	A	47	B	64	C
14	A	31	C	48	A	65	A
15	A	32	C	49	C	66	D
16	C	33	D	50	C	67	D
17	A	34	C	51	D	68	D

**DETAILED ANSWERS**

- 1** Right shares will have the following effects
- |  |                                  |   |   |
|--|----------------------------------|---|---|
| Bank   | $\uparrow 1.30 \times 84\,000^*$ | = | \$109 200 (Issue price)                       |
| Ordinary share capital                       | $\uparrow 0.50 \times 84\,000$   | = | \$42 000 (Face value)                         |
| Share Premium                                | $\uparrow 0.80 \times 84\,000$   | = | \$67 200 (Premium)                            |
| * Original number of shares                  |                                  | = | $\frac{\$84\,000}{\$0.50}$                    |
|  |                                  | = | 168 000                                       |
| Number of right shares                       |                                  | = | 168 000 shares $\times \frac{1}{2} = 84\,000$ |
| Bonus shares will have the following effects |                                  |   |   |
| Ordinary capital                             | $\uparrow 168\,000^* \times 0.5$ | = | \$84 000                                      |
| Reserves                                     | $\downarrow 168\,000 \times 0.5$ | = | \$84 000                                      |
| * Number of bonus shares                     |                                  | = | $(\$168\,000 + \$84\,000 \times \frac{2}{3})$ |
|  |                                  | = | 168 000 shares                                |

In order to have maximum amount of retained profit, share premium balance is used to issue bonus shares before using retained profits. This means that out of \$84 000, \$67 200 should be taken from share premium and remaining \$16 800 (\$84 000 – \$67 200) will be taken from retained profits which will then become \$33 200 (\$50 000 – \$16 800).

- 2** As bonus shares are issued out of reserves i.e. Reserves  $\square$  share capital  $\square$ . As further 8 000 000 shares (10 000 000 – 2 000 000) can legally be issued whereas, total reserves of \$3 400 000 (\$2 000 000 + \$400 000 + \$1 000 000) are available. So bonus shares can only be issued to the extent of \$3 400 000, however if authorised share capital would have been \$5 000 000 then company can only be able to issue 3 000 000 shares (5 000 000 – 2 000 000).
- 3** As Company is not a party in this transaction, as the shares are now subject to trade have already been issued, so this will not alter share capital.
- 4** Issue of Debentures has the following effects
- |                                    |            |
|------------------------------------|------------|
| Cash                               | $\uparrow$ |
| Debentures (non-current liability) | $\uparrow$ |

Moreover interest on debentures will also be paid so interest expense will also increase. As a result profits will decrease and net current assets will increase because of increase in cash.

5 Effects of rights issue will be

Cash/bank	↑ 3.00 × 1 million	= \$3.0million
Share capital	↑ 0.50 × 1 million	= \$0.5million
Share premium	↑ 2.50 × 1 million	= \$2.5million

6 As distributable reserves here are general reserves and retained profits so to issue bonus shares capital reserves i.e. share premium account, revaluation reserves should be firstly used.

As amount of bonus issue is \$100 000  $\left(\frac{\$400\ 000}{4}\right)$  and capital reserves are sufficient to issue bonus shares, the whole amount of general reserves and retained profits will be available after bonus issue.

	\$(m)
Ordinary shares before bonus and rights issue	100
Bonus issue (\$100m $\times \frac{1}{10}$ )	<u>10</u>
Ordinary share before rights issue	110
Ordinary shares after rights issue	<u>130</u>
Net increase in capital A (rights issue)	<u>20</u>
Share premium original amount	50
Premium used for bonus issue	<u>10</u>
Premium before rights issue	40
Premium after rights issue	<u>80</u>
Net increase in premium B	<u>40</u>
Total increase in cash = \$20m A + \$40m B = \$60m	

8 Issue of bonus shares has the following effects:

Share capital	↑
Reserves	↓

As there is no change in any of asset or liability so net assets remains constant whereas share capital increases due to bonus issue.

	\$
Share capital at present	400 000
Bonus shares (\$400 000 $\times \frac{1}{5}$ )	<u>80 000</u>
Share capital after bonus issue	480 000
Right shares (\$480 000 $\times \frac{1}{3}$ )	<u>160 000</u>
Share capital after rights and bonus issue	<u>640 000</u>

11	Number of rights shares	=	2 million $\times \frac{1}{4}$	
		=	500 000	
	Share premium per share	=	Issue price -- Face price	
		=	\$2.00 - \$0.50	= \$1.50
	Increase in share premium	=	500 000 shares $\times$ \$1.50	= \$750 000

12 As share capital is recorded at its face value so it will be 80 000  $\times$  \$0.50 = \$40 000

	\$	
13	Issued share capital before rights and bonus issue	300 000
	Bonus issue (\$300 000 $\times \frac{1}{4}$ )	<u>75 000</u>
		375 000
	Rights issue (\$375 000 $\times \frac{1}{5}$ )	<u>75 000</u>
	Share capital after rights and bonus issue	<u>450 000</u>

14 As share capital is recorded at its face value so it will be 400 000 shares × \$0.25 = \$100 000

15 Effects of the transactions took place in February and April 2002

February 2002 : Bank (320 000 shares * × \$1.10)	=	\$352 000 ↑
Ordinary capital (320 000 shares × \$0.50)	=	\$160 000 ↑
Share premium (320 000 shares × \$0.60)	=	\$192 000 ↑

$$\begin{aligned} * \text{ Number of rights shares} &= \frac{\$320\,000}{\$0.50} \times \frac{1}{2} \\ &= 320\,000 \text{ shares} \end{aligned}$$

$$\begin{aligned} \text{April 2002 : Number of bonus shares} &= \text{Existing shares} \times \frac{1}{4} \\ &= \frac{\$320\,000 + \$160\,000}{\$0.50} \times \frac{1}{4} \\ &= 960\,000 \times \frac{1}{4} \\ &= 240\,000 \text{ shares} \end{aligned}$$

$$\begin{aligned} \text{Effects : Ordinary share capital} &= 240\,000 \text{ shares} \times \$0.50 = \$120\,000 \uparrow \\ \text{Reserves} &= \$120\,000 \downarrow \end{aligned}$$

So balance of share capital and bank after these transactions will be

	Ordinary capital	Bank
Balances on 31 December 2001	320 000	100 000
Issue of right shares in February 2002	160 000	352 000
Bonus issue in April 2002	<u>120 000</u>	<u>-</u>
Balances on 30 April 2002	<u>600 000</u>	<u>452 000</u>

16 The effects of bonus issue of shares are

Reserves	↓
Ordinary share capital	↑

As there is no change in assets and liabilities so net assets will not change.

	\$
Issued ordinary capital at start (100 000 shares × \$0.50)	50 000
New issue (50 000 shares × \$0.50)	<u>25 000</u>
Balance on the share capital at end	<u>75 000</u>

$$\begin{aligned} 18 \text{ Number of right shares (150 000 shares} \times \frac{1}{3}) &= 50\,000 \text{ shares} \\ \text{Number of bonus shares } [(150\,000 + 50\,000) \times \frac{1}{5}] &= 40\,000 \text{ shares} \\ \text{Total number of ordinary shares} &= (150\,000 + 50\,000 + 40\,000) \text{ shares} \\ &= 240\,000 \text{ shares} \\ \text{Value of ordinary share capital} &= 240\,000 \text{ shares @ } \$0.50 \\ &= \$120\,000 \end{aligned}$$

20 Because of bonus issue reserves decrease and share capital increases. In other words reserves are converted into share capital i.e. the reserves are capitalised, so "A" option is correct.

21 Effects of the four options are:

A.	Reserves	↓	Share capital	↑
B.	No effect in accounting records			
C.	Non-current assets	↑	Revaluation Reserves (Capital)	↑
D.	Bank	↑	Share Capital	↑

As "D" option involves receipts of cash so this is the correct option.

<b>22</b>	Number of bonus shares ( $100\ 000 \text{ shares} \times \frac{1}{4}$ )	=	25 000 shares	
	Effects of bonus issue = $25\ 000 \times \$1$	=	\$25 000 ordinary capital	↑
		=	\$10 000 share premium	↓
		=	\$15 000 retained profits	↓

So in the light of above "A" option is correct.

**23** "A" option is incorrect as cash is not generated on bonus issue. "B" option is also incorrect as bonus shares are issued to replace cash dividends, "C" option is also wrong as bonus issue involves the conversion of reserves into ordinary share capital and so there will be no effect on gearing level. "D" option is correct as due to bonus issue reserves are reduced.

**24** "C" option is correct as issue of bonus shares has the following effects

Ordinary share capital	↑
Reserves	↓

As both share capital and reserves are part of shareholders' funds so shareholders' fund will not change.

<b>25</b>	Effects of bonus shares will be	<b>Original</b>	<b>Change</b>	<b>New</b>
		<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
	Ordinary Capital ( $900 \times \frac{1}{3}$ )	900	300	1 200
	Share premium	100	(100)	Nil
	Revaluation reserves	170	(170)	Nil
	Retained profits ( $\$300 - \$100 - \$170$ )	130	30	100

<b>26</b>			<b>\$</b>
	Ordinary share capital ( $450\ 000 \times \frac{1}{3} \times \$1$ )	↑	150 000 Cr
	Share premium ( $450\ 000 \times \frac{1}{3} \times \$1$ )	↑	150 000 Cr
	Bank ( $450\ 000 \times \frac{1}{3} \times \$2$ )	↑	300 000 Dr
	New Ordinary Capital = $\$450\ 000 + \$150\ 000 = \$600\ 000$		

<b>27</b>		<b>\$</b>
	Bank balance before the issues	40 000
	Issue of debentures ( $\$80\ 000 \times 95\%$ )	<u>76 000</u>
	Bank balance after the issues	<u>116 000</u>

\* Bonus shares are not accounted for as they do not involve inflow of cash

<b>28</b>	Effects of the four options are	
(A)	Ordinary share capital	↑
	Reserves	↓
(B)	Bank (working capital)	↑
	Debentures (long term loans)	↑
(C)	<b>Bank (working capital / net assets)</b>	↑
	<b>Ordinary share capital</b>	↑
	<b>Share premium (reserves)</b>	↑
(D)	Bank (working Capital/ net assets)	↑
	Ordinary share capital	↑

**Correct**

**29** **Share premium account**

	<b>\$</b>		<b>\$</b>
Equity capital-bonus issue ( $\$120\ 000 \div 6$ )	20 000	Balance b/f	30 000
Balance c/d	<u>26 000</u>	Bank (new issue)	<u>16 000</u>
	<u>46 000</u>		<u>46 000</u>

<b>30</b>	Number of ordinary shares before rights issue	80 000
	Number of rights shares ( $80\,000 \times \frac{1}{4}$ )	<u>20 000</u>
	Total number of ordinary shares after rights issue	<u>100 000</u>

Face value of shares to be shown in balance sheet = 100 000 shares @ \$0.50 = \$50 000

<b>33</b>	Effects of rights issue are			
	(500 000 $\times \frac{1}{4}$ shares $\times$ \$1) =	\$125 000	↑	Ordinary Share Capital
	(500 000 $\times \frac{1}{4}$ shares $\times$ \$2) =	\$250 000	↑	Bank
	(500 000 $\times \frac{1}{4}$ shares $\times$ \$1) =	\$125 000	↑	Share Premium

Effects of repayment of debentures are

Debentures	↓	\$150 000 ( $300\,000 \times \frac{1}{4}$ )
Bank	↓	\$150 000

Net assets after these changes will be \$1 300 000 ( $\$1\,200\,000 + \$125\,000 + \$125\,000 - \$150\,000$ ) or ( $1\,200\,000 + \$250\,000 - \$150\,000$ ).

<b>34</b>	Issue of ordinary shares will have the following effects			
	Face	$1.00 \times 500\,000 =$	\$500 000	↑ Ordinary capital
	Issue	$\underline{3.00} \times 500\,000 =$	\$1 500 000	↑ Bank
	Premium	$\underline{2.00} \times 500\,000 =$	\$1 000 000	↑ Share premium
	Issue of debenture will have the following effects			
	Face	\$250 000	↑	Debentures
	Issue	\$250 000	↑	Bank

As a result of the above transactions asset of bank will increase by \$1 750 000 ( $\$1\,500\,000 + \$250\,000$ ) whereas a liability of debentures will increase by \$250 000 so net asset will increase by \$1500 000.

<b>35</b>	Effects of payments of dividends will be	
	Dividends ↑ or Retained profits	↓ \$70 000
	Bank	↓ \$70 000

	Effects of bonus issue will be	
	General Reserves ( $5\,000 \times \$10$ )	↓ \$50 000
	Ordinary share capital	↑ \$50 000

	and effects of raising a debenture loan will be	
	Bank	↑ \$120 000
	Debentures	↑ \$120 000

So total of share capital and reserves will be calculated as

		\$
	Share capital and reserves as per balance sheet ( $\$100\,000 + \$60\,000 + \$210\,000$ )	370 000
	Payment of dividends (reduction in profit)	(70 000)
	Increase in ordinary share capital (bonus issue)	50 000
	Reduction in general reserves (bonus issue)	<u>(50 000)</u>
	Share capital and reserves after completion of above transactions	<u>300 000</u>

<b>36</b>	Effects of bonus shares issued	
	Ordinary share capital ( $\$500\,000 \times \frac{1}{5}$ )	↑ \$100 000
	General Reserves	↓ \$100 000

Effects of issue of shares for cash	
Ordinary Capital (500 000 × \$1)	↑ \$500 000
Premium (500 000 × \$0.5)	↑ \$250 000
Bank	↑ <u>\$750 000</u>

Effects of debentures issue are	
Bank	↑ \$250 000
Debentures	↑ \$250 000

	\$
Share capital and reserves before issue of share and debentures	1 000 000
Increase in ordinary capital due to bonus issue	100 000
Decrease in general reserves due to bonus issue	(100 000)
Increase in ordinary capital on issue of new shares	500 000
Increase in share premium on issue of new shares	<u>250 000</u>
Share capital and reserves after issue of shares and debentures	<u>1 750 000</u>

37

	ordinary capital \$	share premium \$	revenue reserves \$
Share capital and reserves as per balance sheet	200 000	80 000	160 000
Effects of bonus issue	200 000	(80 000)	(120 000)
Effects of rights issue(100 000 shares×\$1);(100 000 shares× 0.40)	<u>100 000</u>	<u>40 000</u>	<u>        </u>
Share capital & reserves after completion of above transactions	<u>500 000</u>	<u>40 000</u>	<u>40 000</u>

39

	\$
Share capital before right and bonus issue	100 000
Bonus shares [(200 000 × 1/4) shares × \$0.05]	<u>25 000</u>
Share capital after bonus issue	125 000
Right shares [{"(200 000 + 50 000) × 1/2} shares × \$0.05]	<u>62 500</u>
Share capital after rights and bonus issue	<u>187 500</u>

41

Ordinary shareholders' funds	=	Ordinary share capital	+	All reserves	+	Retained profits
	=	\$250 000	+	\$125 000	+	\$320 000
	=	\$695 000				

The examiner report however shows "C" as correct option. According to examiner report issued preference shares are included in ordinary shareholders' funds which is incorrect, however they could be included if calculation total shareholders' funds was asked for.

42

issued ordinary share capital			share premium		
Original balance	New issue	New balance after issue	Original balance	New issue	New balance after issue
\$000	\$000	\$000	\$000	\$000	\$000
600	200*	800	150	40*	190

\*Effects of rights issue will be

Bank	↑0.30 × 800 000 shares**	= \$240 000
Share capital	↑0.25× 800 000 shares	= \$200 000
Share premium	↑0.05 × 800 000 shares	= \$40 000

** Number of right shares	=	$\frac{600\ 000\ \text{shares}}{\$0.25} \times \frac{1}{3}$
	=	800 000 shares

43 Effects of rights issue will be

<b>Bank</b>	$\uparrow 1.60 \times 7\,500 \text{ shares}^*$	<b>= \$12 000</b>
Share capital	$\uparrow 1.00 \times 7\,500 \text{ shares}$	= \$7 500
Share premium	$\uparrow 2.50 \times 7\,500 \text{ shares}$	= \$4 500

$$* \text{ Number of right shares} = \frac{[12\,000 + (12\,000 \times \frac{1}{4})] \times \frac{1}{2}}{7\,500 \text{ shares}}$$

As bonus issue does not affect cash flows so it is irrelevant in this Question.

45	Ord. share capital	share premium	retained profits	Total
	\$	\$	\$	\$
Balances before Bonus Issue	300 000	120 000	100 000	520 000
Effects of Bonus Issue	100 000	(100 000)	(10 000)	<u>(10 000)</u>
				<u>510 000</u>

48 The effects of correction of errors will be

<b>1</b>	Sales returns	\$10 000	
	Purchases returns		\$10 000
<b>2</b>	Bank	\$40 000	
	Long term loans		\$40 000
<b>3</b>	Bank [200 000 × (\$0.5 + \$0.1)]	\$120 000	
	Ordinary capital (200 000 × \$0.5)		\$100 000
	Share premium (200 000 × \$0.1)		\$20 000

First two transactions have no effect on total equity however rights issue will increase equity by \$120 000 and it will become \$590 000 (\$200 000 + \$100 000 + \$50 000 + \$120 000 + \$120 000) (rights issue)] so "A" option is correct.

49 Effects of debentures issue

Bank	$\uparrow$ \$300 000
4% Debentures	$\downarrow$ \$300 000

Effects of issue of shares for cash

Ordinary Capital (50 000 × \$5)	$\uparrow$ \$250 000
Premium (50 000 × \$15)	$\uparrow$ <u>\$750 000</u>
Bank (50 000 × \$20)	$\uparrow$ <u>\$1 000 000</u>

Net assets will increase with \$1 000 000 (issue price of shares); however issue of debentures will not affect net assets as increase in bank (asset) is set-off by an increase in debentures (non-current liability).

50 Effects of rights issue are

Ordinary Capital (500 000 ÷ \$0.25 shares) × $\frac{1}{4}$ @ \$0.25	$\uparrow$ \$125 000
Premium (500 000 ÷ \$0.25 shares) × $\frac{1}{4}$ @ \$0.05	$\uparrow$ \$25 000

	Ordinary shares	Share premium	Retained earnings
	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Balances as per balance sheet	500	100	300
Issue of right shares	<u>125</u>	<u>25</u>	<u>Nil</u>
Balances after rights issue	<u>625</u>	<u>125</u>	<u>300</u>

52 Effects of bonus issue

Ordinary share capital (50 million × $\frac{1}{2}$ )	$\uparrow$ \$25 million
Retained Earnings	$\downarrow$ \$25 million

Effects of rights issue

Bank [((50 million + (50 million × $\frac{1}{2}$ )) × $\frac{1}{5}$ ) shares @ \$2]	$\uparrow$ \$30 million
---	-------------------------

Ordinary Capital  $[(50 \text{ million} + (50 \text{ million} \times \frac{1}{2}) \times \frac{1}{5}]$  shares @\$1 Premium  $\uparrow$  \$15 million  
 $\uparrow$  \$15 million

Net assets will become \$162 million after an increase of \$42 million i.e. \$30 million on account of rights issue and \$12 million on account of retained earnings for the current year. However bonus issue will not affect net assets as increase in share capital is set-off by decrease in another equity item of retained earnings.

<b>54</b>	Effects of bonus shares issued		
	Ordinary share capital (100 000 × \$0.50)		$\uparrow$ \$50 000
	Retained earnings		$\downarrow$ \$50 000
			<b>\$</b>
	Shareholders' funds before bonus issue		1 350 000
	Increase in ordinary capital due to bonus issue		50 000
	Decrease in retained earnings due to bonus issue		<u>(50 000)</u>
	Shareholders' funds after bonus issue		<u>1 350 000</u>

**55** Number of rights shares =  $\frac{\$500\,000}{\$0.50} \times \frac{1}{4}$   
 = 250 000 shares

Bank (250 000 shares × \$0.80) = \$200 000  $\uparrow$   
 Ordinary capital (250 000 shares × \$0.50) = \$125 000  $\uparrow$   
 Share premium (250 000 shares × \$0.30) = \$75 000  $\uparrow$

New Premium amount = \$100 000 + \$75 000  
 = \$175 000

**56** Bonus issue reduces the value of an ordinary share due to increase in number of ordinary shares in issue.

**57** Dividend rate (%) =  $\frac{\text{Additional Ordinary Dividend}}{\text{Additional Nominal value of share capital}} \times 100$   
 10% =  $\frac{\$2\,500}{\text{Additional Nominal value of share capital}} \times 100$   
 Nominal value of new shares = \$25 000  
 Issue price per new share =  $\frac{\text{Issue Price of New Shares}}{\text{Number of new shares issued}} \times 100$   
 =  $\frac{\$120\,000}{25\,000 \text{ shares}} \times 100$   
 = \$4.80 per share

**58** 'C' option is correct as issue of bonus shares has the following effects:

Bank (net assets)  $\uparrow$   
 Share capital  $\uparrow$   
 Reserves  $\uparrow$

**59** Number of shares issued =  $\frac{\$700\,000 - \$500\,000}{\$0.50}$   
 = 400 000 shares

**60** Effects of issue of ordinary shares will be

Share capital	$\uparrow 2.00 \times 5\,000$	= \$10 000
Share premium	$\uparrow 0.50 \times 5\,000$	= \$2 500
Cash/bank	$\uparrow 2.50 \times 5\,000$	= \$12 500

62	ordinary capital	General Reserves	Retained Earnings	Total
	\$	\$	\$	\$
Share capital and reserves as per balance sheet	100 000	60 000	210 000	370 000
Effects of dividend paid			(70 000)	(70 000)
Effects of bonus issue (5 000 shares × \$10)	<u>50 000</u>	<u>(50 000)</u>	<u>          </u>	<u>          </u>
Capital & reserves after dividends & bonus issue	<u>150 000</u>	<u>10 000</u>	<u>140 000</u>	<u>300 000</u>

64 Both Equity and Net assets increase with the issue price of the shares (nominal value of the shares plus the value of the premium) so "C" option is correct.

65 Total reserves will increase by \$100 000 ("A" Option) representing premium on issue of shares (\$300 000 – \$200 000). Creation of reserves will not have any effect on total reserves as it results in decrease in retained profits and increase in General reserves with the same amount.

68	Ord. share capital	share premium	retained profits	Total
	\$	\$	\$	\$
Effects of Bonus Issue	5 000	(3 000)	(2 000)	-
Effects of Rights Issue	7 500	1 500		<u>9 000</u>
Total increase in equity				<u>9 000</u>

## CHAPTER 16

## RATIO ANALYSIS - CALCULATION

- 1 The following items appeared in a balance sheet at year-end.

	\$
Non-current assets	100 000
Inventory	50 000
Trade receivables	40 000
Cash at bank	20 000
Trade payables	10 000

What is the quick (acid test) ratio?

- A** 21:1                      **B** 11:1                      **C** 6:1                      **D** 2:1

May 98 P1 Q22 / Specimen 02 P1 Q24

- 2 The draft accounts of a company for the year ended 31 December 1997 include the following:

- Turnover	\$280 000
- Gross profit	\$60 000

It was subsequently discovered that the closing inventory was understated by \$10 000.

What will be the gross profit percentage after correcting this error?

- A** 17.9%                      **B** 20.7%                      **C** 21.4%                      **D** 25.0%

May 98 P1 Q24 / Nov 02 P1 Q25 / Nov 14 P12 Q19

- 3 The opening inventory of a business is \$10 000 and the cost of goods sold is \$200 000. Using the average figure for opening and closing inventories, what value of closing inventory is needed to give an inventory turnover ratio of 10 times?

- A** \$10 000                      **B** \$20 000                      **C** \$30 000                      **D** \$40 000

Nov 98 P1 Q22 / May 03 P1 Q23

- 4 The current liabilities of a business total \$84 000. The current ratio was 1.2: 1 and the quick ratio (or acid test ratio) was 0.7:1

What is the figure for inventory?

- A** \$16 800                      **B** \$42 000                      **C** \$58 800                      **D** \$100 800

May 99 P1 Q25

- 5 The table shows extracts from the balance sheet of a company.

	\$
Inventory	25 000
Trade receivables	125 000
Dividends payable	10 000
Trade payables	90 000
Short-term investment	25 000
Prepayments	5 000
Tax owing	15 000
Bank overdraft	20 000

What is the quick ratio?

- A** 0.96:1                      **B** 1.15:1                      **C** 1.24:1                      **D** 1.33:1

Nov 99 P1 Q24

- 6 The table shows amounts included in a trial balance.

	\$
Cash sales	125 000
Credit sales	250 000
Returns: cash sales	6 000
Returns: credit sales	8 000
Trade receivables	38 000
Other trade receivables	12 000

What is the trade receivables' collection period?

- A** 38 days      **B** 51 days      **C** 55 days      **D** 57 days  
Nov 99 P1 Q25
- 7 The table shows an extract from some accounts

	Year ended 31 December 1999 (\$)
Sales	13 000
Cost of sales	9 000
Trade receivables	1 888
Prepayments	100

What is the trade receivable turnover period for 1999?

- A** 50 days      **B** 53 days      **C** 56 days      **D** 77 days  
May 00 P1 Q25 / Nov 01 P1 Q26
- 8 The profit before interest extracted from a company's Income statement is \$128 000 (interest is \$8 000). The table shows amounts included in the company's Balance Sheet.

	\$
Non-current assets	485 000
Net current assets	27 000
Amounts falling due after one year :debentures	80 000

How much is the return on the total capital employed?

- A** 20.3 %      **B** 21.6 %      **C** 23.4 %      **D** 25.0 %  
May 00 P1 Q27/Nov 06 P1 Q26/May 11 P1 Q19
- 9 Opening inventory is valued at \$13 500 and closing inventory is valued at \$14 500. What will be the resulting inventory turn from a mark-up of 25% and sales for the period of \$175000?
- A** 10 times      **B** 12 times      **C** 12.5 times      **D** 15 times  
Nov 00 P1 Q24 / Specimen 02 P1 Q25

- 10 The table shows an extract from a business Balance Sheet.

	\$
Trade receivables	200 000
Trade payables	100 000
Inventories	250 000
Bank overdraft	50 000

What is the current ratio?

- A** 1.3: 1      **B** 2.5: 1      **C** 3.0: 1      **D** 4.5: 1  
Nov 00 P1 Q25

- 11 The following figures and ratios were extracted from a company's final accounts.

Closing inventory	\$22 500
Trade payables	\$15 000
Current ratio	3.0 : 1
Acid test ratio	1.5 : 1

Which figures appeared on the Balance Sheet at the end of the year for Trade receivables and Bank?

	Trade receivables (\$)	Bank (\$)
<b>A</b>	10 000	5 000
<b>B</b>	17 500	5 000
<b>C</b>	25 000	12 500
<b>D</b>	25 000	20 000

Nov 00 P1 Q27

- 12 \$100 000 is available for investment.

The table shows details of three businesses available for purchase.

Business	Purchase price (\$)	Estimated future maintainable profits (\$)
1	50 000	8 500
2	70 000	10 500
3	90 000	12 600

Money not used in the purchase of a business is lent at an interest rate of 13% per annum.

Which course of action will give the highest return on capital employed?

- A** lending \$100 000  
**B** purchasing business 1  
**C** purchasing business 2  
**D** purchasing business 3

May 01 P1 Q17

- 13 A company's inventory turnover ratio is calculated using the cost of goods sold and the average of opening and closing inventories. In each of the last two financial years, closing inventory was valued at \$5000 more than the corresponding opening inventory.

In both years, the inventory turnover was ten times and in the earlier year the cost of goods sold was \$125000.

What was the cost of goods sold in the second year?

- A** \$200 000  
**B** \$175 000  
**C** \$150 000  
**D** \$125 000

May 02 P1 Q22

- 14 A business has the following current assets and current liabilities:

	\$
Trade receivables	6 000
Bank overdraft	1 500
Cash in hand	50
Trade payables	5 050

The only other item in the working capital is inventory. The current ratio is 2:1.

What is the value of the inventory?

- A** \$2 550                      **B** \$4 050                      **C** \$5 550                      **D** \$7 050

May 02 P1 Q23

- 15 The table shows the capital structure of a company.

	<b>\$000</b>
ordinary shares of \$1 each	100
share premium account	200
retained profits	<u>300</u>
	600
15 % loan stock (issued 5 years ago)	<u>400</u>
	<u>1 000</u>

Operating profits average \$260 000 per annum.

What is the return on shareholders' funds?

- A** 26.0 %      **B** 33.3 %      **C** 43.3 %      **D** 66.7 %

May 02 P3 Q13/ Nov 07 P1 Q23

- 16 The table shows an extract from a company's accounts for the year ended 31 December 2001.

	<b>\$</b>
Credit sales	100 000
Cost of sales	80 000
Trade receivables	16 438
Trade payables	12 329

What is the trade receivables' collection period?

- A** 30 days      **B** 45 days      **C** 60 days      **D** 75 days

Nov 02 P1 Q21

- 17 Given a working capital ratio of 2.5:1 and the data below what is the figure for inventory?

	<b>\$</b>
Trade payables	10 000
Bank overdraft	4 400
Trade receivables	20 000
Prepayments	600
Accruals	1 600
Long-term loan	5 000
Inventory	?

- A** \$15 900      **B** \$16 900      **C** \$19 400      **D** \$31 900

Nov 02 P1 Q23/Nov 14 P12 Q20

- 18 The table shows year-end information for three companies.

Company	Sales \$	Operating profit as % of sales	Capital employed \$
<b>X</b>	200 000	10	50 000
<b>Y</b>	500 000	15	100 000
<b>Z</b>	600 000	20	200 000

How should the companies be placed to show their relative orders of returns on capital employed?

	Returns on capital employed Highest $\longrightarrow$ Lowest		
<b>A</b>	X	Y	Z
<b>B</b>	Z	Y	X
<b>C</b>	Y	Z	X
<b>D</b>	X	Z	Y

Nov02 P1 Q24/ Nov10 P1 Q24

- 19 A company's trade receivables total \$27 000. There is a collection period of 30 days. The budget for the coming year provides for an increased turnover of 50% with the relevant collection period being increased to 60 days. What will the year-end trade receivables be?

A \$13 500      B \$27 000      C \$40 500      D \$81 000  
Nov 02 P3 Q22/ May 03 P3 Q24

- 20 The following items are included in the Balance Sheet of a business.

	\$ 000
Inventory	64
Trade receivables	126
Trade payables	87
Bank (debit balance)	21
Bank loan (repayable in 2 years)	50

What is the quick (acid test) ratio?

A 1.1: 1      B 1.2: 1      C 1.7: 1      D 2.4: 1  
May 03 P1 Q21

- 21 The following information is available for a business.

	\$
Opening inventory	29 000
Credit purchases	186 000
Closing inventory	8 000
Trade payables at year end	24 000

What is the trade payables' payment period?

A 40 days      B 43 days      C 48 days      D 54 days  
May 03 P1 Q22

- 22 The following information is taken from a Balance Sheet.

	\$
Inventories	4 950
Trade receivables	7 400
Cash at bank and in hand	2 500
Bank overdraft	1 000
Other short-term trade payables	4 500

What is the quick (acid test) ratio?

A 1.8: 1      B 2.2: 1      C 2.7: 1      D 3.5: 1  
Nov 03 P1 Q22

- 23 The following items appear on a Balance Sheet.

	\$
Inventory	10 000
Provision for doubtful debts	2 000
Cash and bank	4 000
Trade payables	10 000

The current ratio is 2: 1. How much are the trade receivables?

A \$4 000      B \$6 000  
C \$8 000      D \$10 000

Nov 03 P1 Q23

- 24 A company's trade receivables total \$42 000 when the trade receivables' days are 40. The company budgets in the coming year for a 30% increase in turnover and trade receivables' days reduced to 30. What will the budgeted trade receivables be at the year-end?

A \$24 231  
 B \$31 500  
 C \$40 950  
 D \$43 077

Nov 03 P3 Q24

- 25 Which gives the return on capital employed?

A  $\frac{\text{net profit}}{\text{sales}} \times \frac{\text{capital employed}}{\text{sales}} \times 100$   
 B  $\frac{\text{net profit}}{\text{sales}} \times \frac{\text{sales}}{\text{capital employed}} \times 100$   
 C  $\frac{\text{sales}}{\text{net profit}} \times \frac{\text{capital employed}}{\text{sales}} \times 100$   
 D  $\frac{\text{sales}}{\text{net profit}} \times \frac{\text{sales}}{\text{capital employed}} \times 100$

Nov 04 P1 Q22

- 26 The table shows information from a company's accounts.

	\$ 000
Turnover	135
Gross profit	34
Profit before interest and tax	11
Profit after tax	8
Non-current assets	59
Current assets	50
Debentures	12
Current liabilities	40

What is the return on total capital employed?

A 8.1%  
 B 11.3%  
 C 14.0%  
 D 15.9%

May 05 P1 Q19

- 27 The following information is given for a business at 31 December 2004.

Current ratio	3.6:1
Average inventory	\$12 000
Trade receivables	4 000
Trade payables	5 000

What was the value of inventory at 1 January 2004?

A \$9 400  
 B \$10 000  
 C \$12 000  
 D \$14 000

May 05 P1 Q24

- 28 Given below are extracts from a company's Income statement and Balance Sheet for last year.

Income statement	\$000
net profit before interest and tax	200
Interest paid	(20)
net profit before taxation	180
taxation	(60)
Dividends	(10)
retained profit for year	<u>110</u>

Balance Sheet	\$000
net assets	1 000
long term loan	(100)
share capital and reserves	<u>900</u>

What is the return on total capital employed?

- A 18%                      B 20%                      C 22.2%                      D 25.7%

Nov 05 P1 Q24

- 29 The table shows an extract from a company's final accounts:

	\$
purchases	28 000
cost of sales	24 000
trade payables	4 200
accruals	1 100

What is the trade payables' collection period for the year?

- A 55 days                      B 64 days  
C 69 days                      D 81 days

May 06 P1 Q23

- 30 During the year ended 31 March 2006 a business made sales of \$560 000 of which 25% were for cash. The trade receivables at 31 March 2005 were \$52 000 and at 31 March 2006 they were \$56 000.

What is the trade receivables' collection period based on average trade receivables?

- A 34 days                      B 35 days                      C 47 days                      D 49 days

Nov 06 P1 Q24

- 31 A business turns over its inventory 5 times a year. Average inventory is \$54 000 and sales are made at a mark-up of one third.

How much are the sales?

- A \$240 000                      B \$270 000                      C \$320 000                      D \$360 000

May 07 P1 Q21/May 12 P12 Q20

- 32 A company has the following information in its balance sheet:

	\$000
taxation due	40
trade receivables	150
bank overdraft	90
inventory	110
proposed dividend	70
trade payables	80

What is the liquidity (acid test or quick) ratio?

- A 0.54: 1                      B 0.88: 1                      C 0.93: 1                      D 1.85: 1

May 07 P1 Q22

- 33** A business has cash sales of \$69 030 and credit sales of \$1 406 070 in a year (360 days). The trade receivables' collection period is 40 days.

What is the closing trade receivables' balance?

- A** \$35 152      **B** \$36 878      **C** \$156 230      **D** \$163 900

May 07 P1 Q23

- 34** A company produces the following information concerning inventory turnover (rate of inventory turn).

year 1	average inventory	\$60 000
	Inventory turnover	10 times
year 2	average inventory	double last year
	cost of goods sold	increased to \$960 000

What will be the inventory turnover in year 2?

- A** 8 times      **B** 10 times      **C** 16 times      **D** 20 times

Nov 07 P1 Q20

- 35** The table shows information for a business at the year end.

	\$000
average inventory	25
credit sales	150
credit purchases	112
total purchases	140
trade payables	28
trade receivables	39

What is the payment period for trade payables (to the nearest day)?

- A** 68 days      **B** 73 days      **C** 91 days      **D** 95 days

Nov 07 P1 Q21

- 36** The table shows the capital structure of a company.

	\$000
share capital \$5 shares	300
share premium account	200
retained profits	500
10 % debenture stock (issued 3 years ago)	<u>600</u>
	<u>1 600</u>

Operating profits average \$150 000 a year. What is the return on shareholders' funds?

- A** 9 %      **B** 9.4 %      **C** 15 %      **D** 18.75 %

Nov 07 P3 Q13

- 37** A company's sales are made evenly over a year (360 days). 10% of the sales are for cash. The trade receivable balance is \$26 700 and the trade receivable collection period is 30 days.

What are the total sales (cash and credit) for the year?

- A** \$320 400      **B** \$356 000      **C** \$801 000      **D** \$890 000

May 08 P1 Q20/May 11 P1 Q29

- 38** The following information has been taken from a recent balance sheet of a business.

	\$000
non-current assets	150
capital	170
current liabilities	5

What is the current ratio?

- A** 3: 1      **B** 4: 1      **C** 5: 1      **D** 6: 1

May 08 P1 Q24/May 13 P12 Q23

- 39** During a financial year, a business made cash sales of \$63 875 and credit sales of \$146 000. Trade receivables pay every 40 days.

What is the total trade receivables at the end of the year?

- A** \$7 000                      **B** \$12 167                      **C** \$16 000                      **D** \$23 000

May 08 P3 Q13

- 40** The following information has been taken from a recent balance sheet.

non-current assets	\$30 000
working capital ratio	5: 1
capital	\$34 000
current liabilities	\$1 000

What is the amount of the current assets?

- A** \$1 000    **B** \$5 000  
**C** \$6 000    **D** \$20 000

Nov 08 P1 Q22

- 41** The following data is available at the end of a financial year.

opening inventory	\$500 000
Purchases	\$2 250 000
closing inventory	\$750 000
gross profit margin	50%
trade receivables collection period	60 days

Sales are all on credit and accrue evenly over a 360-day accounting period.

What is the value of trade receivables at the year-end?

- A** \$333 333    **B** \$375 000  
**C** \$500 000    **D** \$666 667

Nov 08 P1 Q23

- 42** In a year a business purchases inventory in cash for \$11 680, and also on credit for \$32485. Trade payables are paid every 30 days.

What is the closing trade payables balance?

- A** \$960    **B** \$1 710    **C** \$2 670    **D** \$3 630

Nov 08 P3 Q15

- 43** Assets and liabilities of a business at its year end include the following information.

	\$
accruals	5 000
bank overdraft	6 800
cash	600
prepayments	4 500
proposed dividend	12 000
inventory	51 800
trade payables	20 100
trade receivables	24 200

What is the current ratio?

- A** 0.67:1    **B** 1.85: 1    **C** 2.19: 1    **D** 2.54: 1

May 09 P1 Q22

- 44** A business has a trade receivable turnover period of 40 days based on year end trade receivables. Annual sales are \$180 000 of which 13 % are cash sales.

What is the year end trade receivables figure based on a year of 360 days?

- A** \$2 600    **B** \$17 400    **C** \$20 000    **D** \$45 200

May 09 P1 Q24



- 51 A business has the following assets and liabilities.

	\$000	\$000
Non-current (fixed) assets		420
inventory	120	
trade receivables	<u>310</u>	
	430	
trade payables	<u>(220)</u>	
net current assets		<u>210</u>
total assets less current liabilities		630
long term loan		<u>(130)</u>
net assets		<u>500</u>

What is the business's quick (acid test) ratio?

- A 1.41 : 1      B 1.95 : 1      C 2.43 : 1      D 3.86 : 1  
Nov 10 P1 Q23

- 52 A business has a trade receivables turnover period of 40 days and annual sales of \$479 970. What is the year end trade receivables figure?

- A \$11 999      B \$15 780  
C \$39 997      D \$52 599

Nov 10 P3 Q13

- 53 The annual accounts of a business include the following.

	\$
revenue	160 000
opening inventory	10 000
closing inventory	14 000

Inventory turnover is 10 times. What is the gross profit?

- A \$20 000      B \$40 000      C \$60 000      D \$120 000  
May 11 P1 Q18

- 54 The following data is available at the end of a financial year.

opening inventory	\$60 000
purchases	\$420 000
closing inventory	\$80 000
mark up	25 %
trade receivables turnover	50 days

Sales are all on credit and accrue evenly over the year.

What is the amount of trade receivables at the end of the year (to the nearest \$500)?

- A \$55 000      B \$57 500      C \$68 500      D \$72 000  
May 11 P1 Q21

- 55 A company has a return on capital employed of 20% and an asset turnover of 2.5 times. What was the company's net profit ratio?

- A 8 %      B 16 %      C 20 %      D 50 %  
May 11 P3 Q14

- 56 A company has the following information.

	\$
profit before tax	300 000
profit from operations	400 000
equity	1 200 000
non-current liabilities	800 000

What is the company's return on total capital employed?

- A** 15 %      **B** 20 %      **C** 25 %      **D** 33.3 %  
May 11 P3 Q15

- 57 The following data is available for the first year of trading for a business to 31 December 2010.

	\$
inventory at 31 December 2010	\$200 000
inventory turnover during 2010	6 times
average inventory during 2010	\$180 000

What was the value of inventory purchased during 2010?

- A** \$880 000      **B** \$1 080 000      **C** \$1 280 000      **D** \$1 380 000  
May 11 P3 Q16

- 58 The following items appear on a balance sheet.

	\$
inventory	20 000
balance at bank	2 000
cash in hand	1 500
trade payables	11 000
provision for doubtful debts	500

The current ratio is 3 :1.

How much do the trade receivables owe?

- A** \$9500      **B** \$10 000      **C** \$12 000      **D** \$12 500  
Nov 11 P1 Q21

- 59 The table gives information about a company.

	year 1 \$	year 2 \$
Revenue	150 000	200 000
cost of sales	<u>105 000</u>	<u>130 000</u>
	45 000	70 000
administration and distribution expenses	<u>27 000</u>	<u>47 500</u>
profit from operations	<u>18 000</u>	<u>22 500</u>
non-current assets	120 000	110 000
net current assets	30 000	40 000
non-current liabilities	(50 000)	(10 000)

What happened to gross profit margin and return on capital employed in year 2?

	gross profit margin	return on capital employed
<b>A</b>	decreased	decreased
<b>B</b>	increased	decreased
<b>C</b>	decreased	increased
<b>D</b>	increased	increased

May 12 P12 Q19



- 64 A company has the following year end information.

	\$000
credit purchases	320
credit sales	800
total purchases	440
total sales	900
trade payables	40
trade receivables	160

How long does the company take to pay its trade suppliers (rounded to the nearest day)?

- A 34 days      B 46 days      C 65 days      D 73 days  
Specimen 16 P1 Q21

- 65 A business has prepared the following information for the year ended 30 April 2015.

	\$	\$
Revenue		220 000
opening inventory	25 000	
Purchases	120 000	
closing inventory	(31 000)	
cost of goods sold		<u>114 000</u>
gross profit		<u>106 000</u>

What was the inventory turnover?

- A 86 days      B 90 days  
C 95 days      D 100 days

May 16 P12 Q21

- 66 A company provides the following information.

	\$
profit from operations	16 000
finance costs	4 000
ordinary share capital (\$1 shares)	50 000
non-current liabilities	4 000
retained earnings	20 000

What is the return on capital employed?

- A 16.22%      B 17.14%      C 21.62%      D 22.86%  
May 17 P12 Q19

- 67 The following financial information is available for a business. All purchases and sales are made on credit.

	\$
purchase	121 980
revenue	209 980
trade payable	45 448
trade receivables	28 765

What is the average collection period?

- A 50 days      B 79 days      C 86 days      D 136 days  
May 17 P12 Q20

**ANSWER KEY**

1	C	18	C	35	C	52	D
2	D	19	D	36	A	53	B
3	C	20	C	37	B	54	C
4	B	21	C	38	C	55	A
5	B	22	A	39	C	56	B
6	D	23	C	40	B	57	C
7	B	24	C	41	D	58	B
8	D	25	B	42	C	59	D
9	A	26	D	43	B	60	C
10	C	27	B	44	B	61	A
11	B	28	B	45	A	62	B
12	B	29	A	46	A	63	A
13	B	30	C	47	B	64	B
14	D	31	D	48	C	65	B
15	B	32	A	49	D	66	C
16	C	33	C	50	A	67	A
17	C	34	A	51	A		

**DETAILED ANSWERS**

$$\begin{aligned}
 1 \quad \text{Quick ratio} &= \frac{\text{Trade receivables} + \text{Bank}}{\text{Current Liabilities}} \\
 &= \frac{\$40\,000 + \$20\,000}{\$10\,000} \\
 &= 6 : 1
 \end{aligned}$$

- 2 To rectify the mistake, closing inventory will be increased by \$10 000, which will reduce cost and increase profit, so gross profit ratio after correcting the error will be

$$\begin{aligned}
 \text{Gross profit ratio} &= \frac{\text{Gross Profit}}{\text{Sales revenue}} \times 100 \\
 &= \frac{\$60\,000 + \$10\,000}{\$280\,000} \times 100 \\
 &= 25\%
 \end{aligned}$$

$$\begin{aligned}
 3 \quad \text{Inventory turnover ratio} &= \frac{\text{Cost of Sales}}{\text{Average inventory}} \\
 10 &= \frac{\$200\,000}{\frac{X}{2}} \\
 X &= \frac{\$200\,000}{10} \\
 &= \$20\,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Where average inventory} &= \frac{\text{Opening inventory} + \text{Closing inventory}}{2} \\
 \$20\,000 &= \frac{\$10\,000 + \text{Closing inventory}}{2} \\
 \$40\,000 &= \$10\,000 + \text{Closing inventory} \\
 \text{Closing inventory} &= \$40\,000 - \$10\,000 \\
 &= \$30\,000
 \end{aligned}$$

**Alternatively**

$$\begin{aligned}
 \text{Inventory turnover} &= \frac{\text{Cost of Sales}}{\text{Average inventories}} \\
 10 &= \frac{\$200\,000}{(\$10\,000 + X)/2}
 \end{aligned}$$

$$\begin{aligned}
 10 &= \frac{\$200\,000 \times 2}{\$10\,000 + X} \\
 (\$10\,000 + X) \times 10 &= \$400\,000 \\
 \$100\,000 + 10X &= \$400\,000 \\
 10X &= \$400\,000 - \$100\,000 \\
 10X &= \$300\,000 \\
 X &= \$30\,000
 \end{aligned}$$

- 4 As we know that to calculate quick assets inventory is subtracted from current assets. So if we subtract quick ratio from current ratio then we will arrive at inventory as a ratio or proportion of current liabilities i.e. 0.5: 1 (1.2 – 0.7).

It means inventory is  $\frac{1}{2}$  of current liabilities i.e.  $\$84\,000 \times \frac{1}{2} = \$42\,000$  is the figure for inventory.

5 Quick ratio =  $\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$

$$\begin{aligned}
 &= \frac{\$125\,000 + \$25\,000 + \$5\,000}{\$90\,000 + \$10\,000 + \$15\,000 + \$20\,000} \\
 &= 1.15:1
 \end{aligned}$$

6 Trade receivables collection period =  $\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$

$$\begin{aligned}
 &= \frac{\$38\,000}{\$250\,000 - \$8\,000} \times 365 \\
 &= 57 \text{ days approximately}
 \end{aligned}$$

Liquidity position in simplest words means cash position, and out of four options only “B” option will result in increase in cash.

7 Trade receivables turnover period =  $\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$

$$\begin{aligned}
 &= \frac{\$1\,888}{\$13\,000} \times 365 \\
 &= 53 \text{ days}
 \end{aligned}$$

8 Return on Capital employed (%) =  $\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$

$$\begin{aligned}
 &= \frac{\$128\,000}{\$485\,000 + \$27\,000} \times 100 \\
 &= 25\%
 \end{aligned}$$

9 Inventory turnover =  $\frac{\text{Cost of Sales}^*}{\text{Average inventories}}$

$$\begin{aligned}
 &= \frac{\$140\,000}{(\$13\,500 + \$14\,500)/2} \\
 &= \frac{\$140\,000}{\$14\,000} \\
 &= 10 \text{ times}
 \end{aligned}$$

\* Cost of sales is not given but we know that

$$\begin{aligned}
 \text{Sales} &= \text{Cost} + \text{Profit} \\
 \$175\,000 &= X + 0.25X \\
 \$175\,000 &= 1.25X \\
 X &= \frac{\$175\,000}{1.25} \\
 &= \$140\,000
 \end{aligned}$$

10 Current ratio =  $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

$$\begin{aligned}
 &= \frac{\$200\,000 + \$250\,000}{\$100\,000 + \$50\,000} \\
 &= 3.0:1
 \end{aligned}$$

- 11 As we know that the only difference between current and acid test ratio is of inventory so we can say that

Current ratio	3.00: 1.00
Acid-test ratio	<u>(1.50: 1.00)</u>
Inventory as a ratio to current liabilities	<u>1.50: 1.00</u>

So if inventory is 1.5 then current liabilities	=	1
So if inventory is 1 then current liabilities	=	$1/1.50$
So if inventory is \$22 500 then current liabilities	=	$\$22\,500 \times 1/1.50$
	=	\$15 000 *

This means current assets other than inventory will be  $\$15\,000 \times 1.5 = \$22\,500$  and no option other than "B" has a total of \$22 500 for trade receivables and Bank

#### Alternatively

\* This problem can also be solved by assuming that trade payables is the only current liability so quick assets will be \$22 500 ( $\$15\,000 \times 1.50$  so "B" option will be the correct.

Option	Prospective Returns	\$
A	$\$100\,000 \times 13\%$	= 13 000
B	$\$8\,500 + [(\$100\,000 - \$50\,000) \times 13\%]$	= 15 000
C	$\$10\,500 + [(\$100\,000 - \$70\,000) \times 13\%]$	= 14 400
D	$\$12\,600 + [(\$100\,000 - \$90\,000) \times 13\%]$	= 13 900

As "B" option has the highest return so it would be the right choice.

13	Inventory turnover (first year)	=	$\frac{\text{Cost of Sales}}{\text{Average inventories}}$
	10	=	$\frac{\$125\,000}{\text{Average inventories}}$
	Average inventory	=	$\frac{\$125\,000}{10}$
		=	\$12 500

As we knew that closing inventory was valued at \$5 000 more than the corresponding opening inventory so.

Average inventory	=	$\frac{\text{Opening inventory} + \text{Closing inventory}}{2}$
\$12 500	=	$\frac{X + (X + \$5\,000)}{2}$
$2X + \$5\,000$	=	$\$12\,500 \times 2$
$2X$	=	$\$25\,000 - \$5\,000$
$X$	=	$\frac{\$20\,000}{2}$
	=	\$10 000

So closing inventory at the end of year 1 and opening inventory at the start of year 2 will be \$15 000 ( $\$10\,000 + \$5\,000$ ).

Inventory turnover (in 2 year)	=	$\frac{\text{Cost of Sales}}{\text{Average inventories}}$
10	=	$\frac{\text{Cost of Sales}}{\$15\,000 + (\$15\,000 + \$5\,000)/2}$
10	=	$\frac{\text{Cost of Sales}}{\$17\,500}$
Cost of sales	=	\$175 000

$$\begin{aligned}
 14 \quad \text{Current ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\
 2 &= \frac{\$6\,000 + \$50 + \text{Inventory}}{\$1\,500 + \$5\,050} \\
 2 &= \frac{\$6\,050 + \text{Inventory}}{\$6\,550} \\
 \$13\,100 &= \$6\,050 + X \\
 X &= \$13\,100 - \$6\,050 \\
 \text{Closing Inventory} &= \$7\,050
 \end{aligned}$$

$$\begin{aligned}
 15 \quad \text{Return on shareholders' fund} &= \frac{\text{Profit after tax and preference dividends}}{\text{Total shareholders' funds}} \times 100 \\
 &= \frac{\$260\,000 - (\$400\,000 \times 15\%)}{\$600\,000} \times 100 \\
 &= \frac{\$200\,000}{\$600\,000} \times 100 \\
 &= 33.3\%
 \end{aligned}$$

$$\begin{aligned}
 16 \quad \text{Trade receivables collection period} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365 \text{ days} \\
 &= \frac{\$16\,438}{\$100\,000} \times 365 \text{ days} \\
 &= 60 \text{ days}
 \end{aligned}$$

$$\begin{aligned}
 17 \quad \text{As Current ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\
 \text{Liquid ratio} &= \frac{\text{Current Assets excluding Inventory}}{\text{Current Liabilities}} \\
 &= \frac{\$20\,600}{\$16\,000} \\
 &= 1.2875:1
 \end{aligned}$$

So if we subtract liquid ratio from current (working capital) ratio then we will have inventory value. Thus inventory as a ratio of Current liabilities will be 1.2125:1 (2.5 – 1.2875) i.e.

$$\begin{aligned}
 \text{Current liabilities} \times 1.2125 &= \text{Inventory} \\
 \$ (10\,000 + 4\,400 + 1\,600) \times 1.2125 &= \text{Inventory} \\
 \text{Closing Inventory} &= \$16\,000 \times 1.2125 \\
 \text{Closing Inventory} &= \$19\,400
 \end{aligned}$$

$$\begin{aligned}
 18 \quad \text{Return on capital employed} &= \frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100 \\
 X &= \frac{\$200\,000 \times 10\%}{\$50\,000} \times 100 = 40\% \\
 Y &= \frac{\$500\,000 \times 15\%}{\$100\,000} \times 100 = 75\% \\
 Z &= \frac{\$600\,000 \times 20\%}{\$200\,000} \times 100 = 60\%
 \end{aligned}$$

So "C" will be the correct option.

$$\begin{aligned}
 19 \quad \text{Current year} & \\
 \text{Trade receivable collection period} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365 \\
 30 &= \frac{\$27\,000}{\text{Credit Sales}} \times 365 \\
 \text{Credit sales} &= \$328\,500
 \end{aligned}$$

	<b>Coming year</b>		
	Trade receivable collection period	=	$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$
	60	=	$\frac{\text{Trade receivables}}{\$328\,500 \times 150\%} \times 365$
	Trade receivables	=	$\frac{\$492\,750}{365} \times 60$
		=	\$81 000
<b>20</b>	Quick ratio	=	$\frac{\text{Current Assets}-\text{Inventory}}{\text{Current Liabilities}}$
		=	$\frac{\$126\,000+\$21\,000}{\$87\,000}$
		=	$\frac{\$147\,000}{\$87\,000}$
		=	1.7:1
<b>21</b>	Trade payables payment period	=	$\frac{\text{Trade payables}}{\text{Credit Purchases}} \times 365$
		=	$\frac{\$24\,000}{\$186\,000} \times 365$
		=	47.1 Or 48 days
<b>22</b>	Quick ratio	=	$\frac{\text{Current Assets}-\text{Inventory}}{\text{Current Liabilities}}$
		=	$\frac{\$7\,400+\$2\,500}{\$1\,000+\$4\,500}$
		=	1.8: 1
<b>23</b>	Current ratio	=	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
	2	=	$\frac{\$10000+\text{Trade receivables}-\$2000+\$4000}{\$10000}$
	\$20 000	=	\$12 000 + Trade receivables
	Trade receivables	=	\$8 000
<b>24</b>	Trade receivables days (current)	=	$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$
	40	=	$\frac{\$42\,000}{\text{Credit Sales}} \times 365$
	Credit sales	=	\$383 250
	Trade receivables days (budgeted)	=	$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$
	30	=	$\frac{\text{Trade receivables}}{\$383\,250 \times 130\%} \times 365$
	Trade receivables	=	\$40 950
<b>26</b>	Return on Capital employed	=	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
		=	$\frac{\$11\,000}{\$59\,000+\$50\,000-\$40\,000} \times 100$
		=	15.9%
<b>27</b>	Current ratio	=	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
	3.6	=	$\frac{\text{Closing inventory}+\$4\,000}{\$5\,000}$
	\$18 000	=	Inventory + \$4 000
	Closing Inventory	=	\$ 18 000 – \$4 000

	=	\$14 000
Average Inventory	=	$\frac{\text{Opening inventory} + \text{Closing inventory}}{2}$
\$12 000	=	$\frac{\text{Opening inventory} + \$14\ 000}{2}$
Opening Inventory	=	\$24 000 – \$ 14 000
	=	\$10 000
<b>28</b> Return on capital employed	=	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
	=	$\frac{\$200\ 000}{\$1\ 000\ 000} \times 100$
	=	20%
<b>29</b> Trade payables' collection period	=	$\frac{\text{Trade payables}}{\text{Credit Purchases}} \times 365$
	=	$\frac{\$4\ 200}{\$28\ 000} \times 365$
	=	55 days
<b>30</b> Trade receivables' collection period =	=	$\frac{\text{Average Trade receivables}}{\text{Credit Sales}} \times 365$
	=	$\frac{(\$52\ 000 + \$56\ 000) / 2}{\$560\ 000 \times 75\%} \times 365$
	=	47 days approximately
<b>31</b> Inventory turnover	=	$\frac{\text{Cost of Sales}}{\text{Average inventories}}$
5	=	$\frac{\text{Cost of Sales}}{\$54\ 000}$
Cost of sales	=	\$270 000
Sales	=	Cost of sales + profit
	=	\$270 000 + (\$270 000 × $\frac{1}{3}$ )
	=	\$360 000
<b>32</b> Liquidity (acid test) ratio	=	$\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$
	=	$\frac{\$40\ 000 + \$90\ 000 + \$70\ 000 + \$80\ 000}{\$150\ 000}$
	=	0.54
<b>33</b> Trade receivables' collection period =	=	$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 360$
40	=	$\frac{\text{Trade receivables}}{\$1\ 406\ 070} \times 360$
Trade receivables	=	\$156 230
<b>34</b> Inventory turnover rate	=	$\frac{\text{Cost of Sales}}{\text{Average inventories}}$
	=	$\frac{\$960\ 000}{\$60\ 000 \times 2}$
	=	8 times
<b>35</b> Trade payables' payment period	=	$\frac{\text{Trade payables}}{\text{Credit Purchases}} \times 365$
	=	$\frac{\$28\ 000}{\$112\ 000} \times 365$
	=	91 days approximately

$$\begin{aligned}
 36 \quad \text{Return on shareholders' Equity} &= \frac{\text{Profit after tax and preference dividends}}{\text{Total shareholders' funds}} \times 100 \\
 &= \frac{\$150\,000 - (\$600\,000 \times 10\%)}{\$300\,000 + \$200\,000 + \$500\,000} \times 100 \\
 &= 9\%
 \end{aligned}$$

$$\begin{aligned}
 37 \quad \text{Trade receivables' collection period} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 360 \\
 30 &= \frac{\$26\,700}{\text{Credit sales}} \times 360 \\
 \text{Credit sales} &= \$320\,400
 \end{aligned}$$

As credit sales are 90% (100% – 10%) of total sales so total sales would become  $\$35600 \left( \frac{\$320\,400}{90\%} \right)$ ; so “B” option is correct.

$$\begin{aligned}
 38 \quad \text{Current ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\
 &= \frac{\$170\,000 + \$5\,000 - \$150\,000}{\$5\,000} \\
 &= 5:1
 \end{aligned}$$

$$\begin{aligned}
 39 \quad \text{Trade receivables' collection period} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365 \\
 40 &= \frac{\text{Trade receivables}}{\$146\,000} \times 365 \\
 \text{Trade receivables} &= \$16\,000
 \end{aligned}$$

$$\begin{aligned}
 40 \quad \text{Working Capital ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\
 5 &= \frac{\text{Current Assets}}{\$1\,000} \\
 &= \$5\,000
 \end{aligned}$$

$$\begin{aligned}
 41 \quad \text{Trade receivables' collection period} &= \frac{\text{Trade receivables}}{(\$500\,000 + \$2\,250\,000 - \$750\,000) / 0.50} \times 360 \\
 60 &= \frac{\text{Trade receivables}}{\$4\,000\,000} \times 360 \\
 \text{Trade receivables} &= \$666\,667
 \end{aligned}$$

$$\begin{aligned}
 42 \quad \text{Trade payables' payment period} &= \frac{\text{Trade payables}}{\text{Credit Purchases}} \times 365 \\
 30 &= \frac{\text{Trade payables}}{\$32\,485} \times 365 \\
 \text{Trade payables} &= \$2\,670
 \end{aligned}$$

$$\begin{aligned}
 43 \quad \text{Current ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\
 &= \frac{\$600 + \$4\,500 + \$51\,800 + \$24\,200}{\$5\,000 + \$6\,800 + \$12\,000 + \$20\,100} \\
 &= \frac{\$81\,100}{\$43\,900} \\
 &= 1.85:1
 \end{aligned}$$

$$\begin{aligned}
 44 \quad \text{Trade receivables' collection period} &= \frac{\text{Trade receivables}}{\text{Net Credit Sales}} \times 360 \\
 40 &= \frac{\text{Trade receivables}}{\$180\,000 \times 87\%} \times 360 \\
 \text{Trade receivables} &= \$17\,400
 \end{aligned}$$

$$\begin{aligned}
 45 \quad \text{Trade payables at year end} &= \$80\,000 \times 150\% \\
 &= \$120\,000
 \end{aligned}$$

Mark scheme suggests "C" option as correct option which could have only been correct if there were increase of 50% in credit purchases as last year purchases were \$960 000 [30 = \$80 000 / (credit purchases) × 360] case and next year trade payables in that case would have been \$240 000 [60 = Trade payables / (\$960 000 × 150%) × 360].

$$\begin{aligned}
 46 \quad \text{Inventory turnover rate (days)} &= \frac{\text{Average inventories}}{\text{Cost of Sales}} \times 365 \\
 &= \frac{(\$2\,470 + \$2\,156) / 2}{\$12\,500} \times 365 \\
 &= 68 \text{ days approximately}
 \end{aligned}$$

47 As we know that to calculate quick assets inventory is subtracted from current assets so if we subtract quick ratio from current ratio then we will arrive at inventory as a ratio or proportion of current liabilities i.e. 0.5: 1 (2.0 – 1.5).

It means inventory is  $\frac{1}{2}$  of current liabilities i.e. \$10 000 ×  $\frac{1}{2}$  = \$5 000 is the figure for inventory.

$$\begin{aligned}
 48 \quad \text{Trade receivables' turnover (days)} &= \frac{\text{Trade receivables}}{\text{Net Credit Sales}} \times 365 \\
 42 &= \frac{\text{Trade receivables}}{\$927\,100} \times 365 \\
 \text{Trade receivables} &= \$106\,680
 \end{aligned}$$

49	Gross Profit	=	Cost of Sales	×	Mark-up rate	=	
	A	=	(1 000 × 8)	×	15%	=	\$1 200
	B	=	(1 000 × 6)	×	30%	=	\$1 800
	C	=	(1 000 × 7)	×	25%	=	\$1 750
	D	=	(1 000 × 10)	×	20%	=	\$2 000

50 As we know that the only difference between current and acid test ratio is of inventory so we can say that

Current ratio (current assets as a ratio to current liabilities)	2.25: 1.00
Acid-test ratio (liquid assets as a ratio to current liabilities)	<u>(1.50: 1.00)</u>
Inventory as a ratio to current liabilities	<u>0.75: 1.00</u>

So if current liabilities are 1 then inventory is = 0.75

So if current liabilities are \$4 000 then inventory is = \$4 000 × 0.75

= \$3 000

$$\begin{aligned}
 51 \quad \text{Quick (acid-test) ratio} &= \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}} \\
 &= \frac{\$310\,000}{\$220\,000} \\
 &= 1.41:1
 \end{aligned}$$

$$\begin{aligned}
 52 \quad \text{Trade receivables turnover period} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365 \\
 40 &= \frac{\text{Trade receivables}}{\$479\,970} \times 365 \\
 \text{Trade receivables} &= \frac{40}{365} \times \$479\,970 = \$52\,599
 \end{aligned}$$

$$\begin{aligned}
 53 \quad \text{Inventory turnover} &= \frac{\text{Cost of Sales*}}{\text{Average inventories}} \\
 10 &= \frac{\text{Cost of Sales}}{(\$10\,000 + \$14\,000)/2} \\
 \text{Cost of Sales} &= \$120\,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Gross Profit} &= \text{Sales} - \text{Cost of Sales} \\
 &= \$160\,000 - \$120\,000 \\
 &= \$40\,000
 \end{aligned}$$

$$\begin{aligned}
 54 \quad \text{Trade receivables' collection period} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365 \\
 &= \frac{\text{Trade receivables}}{(\$60\,000 + \$420\,000 - \$80\,000) \times 1.25} \times 365 \\
 50 &= \frac{\text{Trade receivables}}{\$5\,000\,000} \times 365 \\
 \text{Trade receivables} &= \$68\,500
 \end{aligned}$$

55 In order to solve the question we assume that the word 'net' is missing in "assets turnover ratio". If we divide return on capital employed by net assets turnover then we have net profit ratio as shown below.

$$\begin{aligned}
 \frac{\text{Return on capital employed}}{\frac{\text{net profit}}{\text{capital employed}}} &\div \frac{\text{Net assets turnover}}{\frac{\text{net assets (capital employed)}}{\text{sales}}} = \frac{\text{Net profit ratio}}{\frac{\text{net profit}}{\text{sales}}} \\
 20\% &\div 2.5 = 8\%
 \end{aligned}$$

$$\begin{aligned}
 56 \quad \text{Return on capital employed} &= \frac{\text{Operating profit}}{\text{Capital employed}} \times 100 \\
 &= \frac{\$400\,000}{\$1\,200\,000 + \$800\,000} \times 100 \\
 &= 20\%
 \end{aligned}$$

$$\begin{aligned}
 57 \quad \text{Inventory turnover ratio} &= \frac{\text{Cost of Sales}}{\text{Average inventory}} \\
 6 &= \frac{\text{Cost of Sales}}{\$180\,000} \\
 \text{Cost of sales} &= \$180\,000 \times 6 \\
 \text{Cost of sales} &= \$1\,080\,000 \\
 \text{Cost of Sales} &= \text{Opening inventory} + \text{Purchases} - \text{Closing inventory} \\
 \$1\,080\,000 &= \text{Nil} + \text{Purchases} - \$200\,000 \\
 \text{Purchases} &= \$1\,280\,000
 \end{aligned}$$

$$\begin{aligned}
 58 \quad \text{Current ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\
 3 &= \frac{\$20\,000 + \$2\,000 + \$1\,500 + \text{Trade receivables} - \$500}{\$11\,000} \\
 &= \frac{\$23\,000 + \text{Trade Receivables}}{\$11\,000} \\
 \text{Trade receivables} &= (\$11\,000 \times 3) - \$23\,000 \\
 &= \$10\,000
 \end{aligned}$$

		year 1	year 2
59	Gross profit margin	$\frac{\text{Gross Profit}}{\text{Sales Revenue}} \times 100$	$\frac{\text{Gross Profit}}{\text{Sales Revenue}} \times 100$
		$\frac{\$45\,000}{\$150\,000} \times 100$	$\frac{\$70\,000}{\$200\,000} \times 100$
		30%	35%
	Return on capital employed	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
		$\frac{\$18\,000}{\$150\,000} \times 100$	$\frac{\$22\,500}{\$150\,000} \times 100$
		12%	15%

As both ratios are increasing so "D" option is correct.

60	Credit customers' collection period =	$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$
	=	$\frac{\$80\,000}{\$630\,000} \times 365$
	=	47 days approximately
61	Return on Capital employed =	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
	=	$\frac{\$160\,000}{\$500\,000 + \$250\,000 + \$300\,000} \times 100$
	=	15.23%
62	Trade payables turnover =	$\frac{\text{Trade payables}}{\text{Credit Purchases}} \times 365$
	=	$\frac{\$49\,000}{\$210\,000 + \$49\,000 - \$38\,000} \times 365$
	=	80.93 or 81 days
63	Return on Capital employed =	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
	=	$\frac{\$200\,000}{\$500\,000 + \$160\,000 + \$380\,000} \times 100$
	=	19.23%
64	Trade payables' payment period =	$\frac{\text{Trade payables}}{\text{Credit Purchases}} \times 365$
	=	$\frac{\$40\,000}{\$320\,000} \times 365$
	=	46 days approximately
65	Inventory turnover =	$\frac{\text{Average inventories}}{\text{Cost of Sales*}} \times 360$
	=	$\frac{(\$25\,000 + \$31\,000)/2}{\$114\,000} \times 360$
	=	$\frac{\$28\,000}{\$114\,000} \times 360$
	=	90 days
66	Return on Capital employed =	$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
	=	$\frac{\$16\,000}{\$50\,000 + \$4\,000 + \$20\,000} \times 100$
	=	21.62%
67	Trade receivables collection period =	$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$
	=	$\frac{\$28\,765}{\$209\,980} \times 365$
	=	50 days approximately

## CHAPTER 17 RATIO ANALYSIS - INTERPRETATION

- 1 A company wishes to improve its current ratio and its acid test ratio.  
How can this be done?

A by granting increased discounts to trade receivables  
 B by increasing the provision for doubtful debts  
 C by purchasing additional inventory on credit  
 D by the sale of non-current assets

Nov 98 P1 Q40 / May 03 P1 Q24/Specimen 16 P1 Q22

- 2 From the following balance sheet extract, how can the business best improve its quick ratio?

Current Assets	\$000	\$000
Inventory	45	
Trade receivables	45	
Cash at bank	<u>35</u>	
	125	
<b>Current liabilities</b>		
Trade payables	<u>(75)</u>	50
<b>Non-current liabilities: Debentures</b>		<u>(30)</u>
<b>Net current assets less non-current liabilities</b>		<u>20</u>

A by collecting all outstanding trade receivables  
 B by redeeming the debentures  
 C by selling the inventory  
 D by using all the cash at bank to pay trade payables

May 99 P1 Q26

- 3 A company is operating in a very competitive market.  
Which ratios represent the reaction to the competition?

	Gross profit Percentage	Period of credit allowed to trade receivables
A	20%	30 days
B	20%	45 days
C	25%	30 days
D	25%	45 days

May 99 P1 Q27

- 4 What is the accounting equation for capital employed?

A current assets – current liabilities  
 B non-current assets + current assets – current liabilities  
 C non-current assets + current assets + current liabilities  
 D net current assets – current liabilities

Nov 99 P1 Q1 / May 02 P1 Q1/Nov 06 P1 Q7

- 5 How is a company best able to reduce its working capital in the short term?

A by decreasing the rate of inventory turnover  
 B by disposing of some surplus non-current assets  
 C by reducing the trade receivable collection period by offering discounts  
 D by reducing the time taken to pay its suppliers

Nov 99 P1 Q23/Nov 09 P1 Q19

- 6 How will a company's liquidity be improved?

A by a bonus issue of shares  
 B by a rights issue of shares  
 C by reducing the provision for doubtful debts  
 D by reducing the rate of depreciation on non-current assets

Nov 99 P1 Q28 / Specimen 02 P1 Q21

- 7 How can a business increase its current ratio?  
**A** increase trade payables **B** increase trade receivables  
**C** reduce bank balance **D** reduce inventory  
 May 00 P1 Q24

- 8 Which statement correctly expresses the relationship between return on capital employed, net assets turnover and profit margin?  
**A** net assets turnover = return on capital employed  $\times$  profit margin  
**B**  $\frac{\text{Profit margin}}{\text{Net assets turnover}} = \text{return on capital employed}$   
**C** profit margin + net assets turnover = return on capital employed  
**D** return on capital employed = net assets turnover  $\times$  profit margin  
 Nov 00 P1 Q23/ May 05 P1 Q22

- 9 Which transaction will cause an increase in capital employed?  
**A** disposal of a non-current asset for more than its book value  
**B** increasing the provision for bad debts  
**C** receipt of a loan  
**D** receipt of payment from a trade receivable in cash  
 Nov 00 P1 Q26

- 10 Which is a correct definition of return on net capital employed?  
**A** net profit for the year as a percentage of non-current assets  
**B** net profit for the year as a percentage of non-current assets plus current liabilities  
**C** net profit for the year as a percentage of non-current assets plus current assets  
**D** net profit for the year as a percentage of non-current assets plus working capital  
 May 01 P1 Q8

- 11 A company has a current ratio of 2:1 and a quick ratio of 0.5:1.  
 What is the effect on the two ratios, if the company uses cash to buy inventory?

	Current ratio	Quick ratio
<b>A</b>	decrease	decrease
<b>B</b>	decrease	increase
<b>C</b>	no change	decrease
<b>D</b>	no change	increase

May 98 P1 Q23 / May 01 P1 Q24 / Specimen 02 P1 Q26/May 06 P1 Q25

- 12 The acid test (quick) ratio of a business has fallen while turnover has remained constant.  
 What is the reason for the fall?  
**A** a decrease in the bank overdraft **B** a decrease in inventory  
**C** an increase in cash **D** an increase in trade payables  
 Nov 01 P1 Q24/Nov 09 P1 Q20

- 13 The table shows extracts from a company's Income statements for 2000 and 2001.

	2000 \$	2001 \$
Sales	50 000	100 000
Cost of sales	15 000	34 000

What might explain the change in the profit margin?

- A** a cut in sales price  
**B** an increase in sale price  
**C** cheaper suppliers  
**D** the loss of a major customer

Nov 01 P1 Q25

- 14 Excel Products Limited sells two products X and Y. The summarised results for the last financial year include the following

	X	Y
	\$	\$
Sales	50 000	100 000
Less Cost of Sales	<u>30 000</u>	<u>67 500</u>
Gross profit	<u>20 000</u>	<u>32 500</u>

The company wants to improve its gross profit to sales ratio.  
Which is the best way to achieve this?

- A a reduction in inventory levels.  
B an increase in sales of product X  
C a 10% increase in sales of X and Y.  
D a reduction in the amount of variable overheads charged to the Income statement.
- Specimen 02 P1 Q27
- 15 A business purchases inventory on credit.  
Which of the following is now true?

	Current ratio	Acid test ratio
A	decreases	decreases
B	increases	increases
C	unchanged	decreases
D	unchanged	increases

May 02 P1 Q19

- 16 A business has a gross profit to sales ratio of 40%, and a net profit to sales ratio of 10%.  
If the sales volume increases by 8% which of the following will generally be true?

	Gross profit to sales ratio	Net profit to sales ratio
A	increases	decreases
B	increases	increases
C	unchanged	decreases
D	unchanged	increases

May 02 P1 Q20/ May 08 P1 Q21

- 17 The current ratio of a company increases from 1.4 to 1.9.  
Which of the following could explain this movement?

- A an issue of more share capital for cash  
B the giving of more generous credit terms to customers  
C the granting of cash discounts to customers  
D the purchase of some short-term investments

May 02 P1 Q21

- 18 Which business is likely to have the lowest Gross Profit/ Sales margin?

- A a car manufacturer  
B a computer software company  
C a jewellery shop  
D a supermarket

Nov 02 P1 Q20



- 25 What would increase the working capital (current) ratio of a business?  
**A** buying inventory on credit for \$2 000 and selling it immediately for \$3 000 cash  
**B** paying trade payables \$1 000 cash  
**C** purchasing a non-current asset of \$10 000 on credit  
**D** selling inventory of \$1 000 at cost price on credit  
 May 04 P1 Q23/ Nov 09 P1 Q18
- 26 A business calculated that its quick (acid test) ratio is lower this year than last year. What caused the reduction in the ratio?  
**A** an increase in trade payables **B** an increase in inventory  
**C** an increase in trade receivables **D** an increase in bank  
 Nov 04 P1 Q20
- 27 The gross profit ratio of a business has increased. Which statement is correct?  
**A** purchases have been obtained at reduced cost  
**B** sales have increased  
**C** sales returns have decreased  
**D** inventories have decreased  
 Nov 04 P1 Q21
- 28 The trade receivables' collection period of a business has increased from 55 to 90 days. Which reason could **not** account for this?  
**A** a large bad debt written off  
**B** a large credit sale made just before the year-end  
**C** a major customer in financial difficulty  
**D** poor credit control  
 Nov 04 P1 Q23/Nov 10P3 Q16
- 29 A company has a high liquidity ratio. Which of the following will reduce liquidity?  
**A** doubling the annual rates of depreciation?  
**B** making a bonus issue to existing shareholders  
**C** converting loan stock into shares  
**D** replacing machinery earlier than planned  
 May 05 P1 Q20
- 30 A business increases its provision for doubtful debts. What is the effect on the current and acid test ratios?
- |          | current ratio | acid test ratio |
|----------|---------------|-----------------|
| <b>A</b> | decrease      | decrease        |
| <b>B</b> | decrease      | no change       |
| <b>C</b> | no change     | decrease        |
| <b>D</b> | no change     | no change       |
- Nov 05 P1 Q21
- 31 Which accounting ratio is used to assess working capital management?  
**A** gross profit ratio  
**B** net profit ratio  
**C** return on capital employed  
**D** inventory turnover ratio  
 Nov 05 P1 Q22

- 32 A company's gross profit ratio for the year ended 31 December 2003 was 25%. This increases to 28% for the year ended 31 December 2004.

What could have been responsible for the increase?

- A an increase in the cost of purchases during 2004
- B an increase in the volume of sales during 2004
- C an over-valuation of inventory at 31 December 2004
- D an under-valuation of inventory at 31 December 2004

Nov 05 P1 Q23 /Nov 10 P1 Q22/May 15 P12 Q20

- 33 A company has the following gross profit and net profit ratios for two years.

	Year 1	Year 2
gross profit %	26%	29%
net profit %	13%	10%

The company's turnover has remained unchanged for both years.

What is a correct interpretation of these ratios?

	cost of sales		Overheads	
	increased	decreased	increased	Decreased
A	√	×	√	×
B	√	×	×	√
C	×	√	×	√
D	×	√	√	×

May 06 P1 Q24

- 34 A business has a current ratio of 1.75:1 and a quick (acid test) ratio of 1:1. The business sells inventory on credit at its usual mark-up.

What is the effect of this on the current ratio and quick (acid test) ratio?

	current ratio	Quick (acid test) ratio
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

Nov 06 P1 Q23

- 35 The following data is available:

	This year (\$)	Last year (\$)
credit sales	60 000	50 000
credit purchases	40 000	28 000
trade payables (average)	10 000	16 000
trade receivables (average)	12 000	8 000

Which statement is correct?

- A Trade receivables' and trade payables' turnover ratios have improved.
- B Trade receivables' and trade payables' turnover ratios have worsened.
- C Trade receivables are paying faster, but trade payables are being paid more slowly.
- D Trade receivables are paying more slowly, but trade payables are being paid faster.

Nov 06 P1 Q25

- 36 What does the ratio of current assets / current liabilities show?

- A asset usage
- B liquidity
- C profitability
- D return on capital employed

May 07 P1 Q20

- 37 A firm has calculated the following accounting ratios for the year ended 30 June:

	year ended	
	30 June 2005	30 June 2006
gross profit on sales	30 %	33 %
net profit on sales	15 %	14 %

What could explain the changes in the percentages?

- A A fall in interest payments was equal to an increase in administration costs.
- B An increase in raw material costs was covered by an increase in selling price.
- C An increase in the advertising budget has allowed the firm to increase the selling price.
- D An increase in the advertising budget has led to a rise in sales volume.

May 07 P1 Q24/Nov 11 P1 Q23

- 38 The accounts of a business show that it has increased its sales revenue by 50 % in one year whilst its cost of sales has increased by 60 % over the same period.

What is the explanation for the change in profit margin?

- A an increase in marketing expenses
- B an increase in sales price
- C an increase in sales volume
- D an increase in supplier price

Nov 07 P1 Q22

- 39 What might cause working capital to fall?

- A an amount owing by a customer has turned out to be a bad debt
- B an old delivery van has been given in full exchange for a new computer
- C a payment of cash has been made to a trade payable
- D new inventory has been purchased on credit

May 08 P1 Q23

- 40 Which ratio indicates how efficiently a company controls its overheads?

- A current assets / current liabilities
- B gross profit / Sales
- C net profit / sales
- D sales / capital employed

Nov 08 P1 Q21

- 41 Which actions would improve the liquidity (acid test) ratio of a business in the short term?

- 1 trade receivables paying their debts
- 2 delaying paying trade payables
- 3 selling a number of surplus non-current assets
- 4 selling inventory

- A 1 and 2
- B 2 and 3
- C 1 and 4
- D 3 and 4

May 09 P1 Q23

- 42 A company buys and re-sells goods. It has a higher gross profit margin than its rivals. Which reason could explain this?

- A Rival companies pay less for goods than the company.
- B Rival companies spend less on advertising than the company.
- C The company charges a higher selling price than its rivals.
- D The company charges a lower price than its rivals.

May 10 P1 Q20

- 43 A business has \$10 000 in the bank and buys inventory for \$6 000 paying by cheque. What is the effect of this on its current ratio and quick (acid test) ratio?

	current ratio	quick (acid test) ratio
A	decreases	increases
B	decreases	no effect
C	no effect	decreases
D	no effect	no effect

May 11 P1 Q20

- 44 When is working capital most likely to increase?
- A when the business increases its selling prices  
 B when the credit period allowed to customers is reduced  
 C when the credit period taken from suppliers is increased  
 D when the value of inventory decreases

Nov 11 P1 Q18/Nov 15 P12 Q22

- 45 A business has a rate of inventory turnover of 17 times a year. What is the numerator in the calculation?
- A average inventory  
 B closing inventory  
 C cost of sales  
 D credit sales

Nov 11 P1 Q20

- 46 Which ratio measures a business' average payment period?
- A current ratio  
 B liquid ratio  
 C trade payables turnover  
 D trade receivables turnover

Nov 11 P1 Q22

- 47 What is a limitation of the use of accounting information that is totally outside the entity's control?
- A changes in legal reporting requirements  
 B changes in inventory valuation method  
 C changes in total assets employed  
 D changes in working capital

Nov 11 P1 Q24

- 48 Which action will improve a company's quick ratio?
- A collecting all outstanding debtors  
 B using cash at the bank to buy equipment  
 C using cash at bank to pay creditors  
 D using cash at the bank to repay a loan

Nov 11 P3 Q15

- 49 A business finds that it is unable to pay its trade payables because of a poor cash flow. What should it do to improve its cash flow?
- A factor its trade receivables  
 B increase its trade receivables  
 C increase its inventory  
 D repay its overdraft

May 12 P12 Q17



- 57** A business sells a single product.  
This year the gross profit margin and net profit margin were both lower than last year.  
What is the reason for this change?
- |          |                          |          |                               |
|----------|--------------------------|----------|-------------------------------|
| <b>A</b> | decrease in carriage out | <b>B</b> | decrease in sales returns     |
| <b>C</b> | increase in carriage in  | <b>D</b> | increase in purchases returns |
- May 14 P12 Q23
- 58** A company's non-current asset turnover figure rises from 3.4 times in Year 1 to 4 times in Year 2.  
Sales revenue has been constant.  
What explains the change?
- |          |  |
|----------|--|
| <b>A</b> | The cost of repairs to non-current assets had decreased.                                       |
| <b>B</b> | The cost of repairs to non-current assets had increased.                                       |
| <b>C</b> | The depreciation charge for the year was higher than the cost of non-current assets purchased. |
| <b>D</b> | The depreciation charge for the year was lower than the cost of non-current assets purchased.  |
- May 14 P12 Q25
- 59** Gordon sells goods on credit to Sybil.  
Which information from Sybil's financial statements is of greatest interest to him?
- |          |               |          |                            |
|----------|---------------|----------|----------------------------|
| <b>A</b> | current ratio | <b>B</b> | gross profit margin        |
| <b>C</b> | mark-up       | <b>D</b> | return on capital employed |
- May 14 P12 Q26
- 60** Which ratio will give the best indication of short term liquidity?
- |          |                                   |
|----------|-----------------------------------|
| <b>A</b> | current ratio                     |
| <b>B</b> | liquid (acid test) ratio          |
| <b>C</b> | trade payables turnover (days)    |
| <b>D</b> | trade receivables turnover (days) |
- May 15 P12 Q21
- 61** An investor is looking at the financial statements of a company in which he may decide to invest.  
Which item helps him to rely on the financial statements?
- |          |  |
|----------|--|
| <b>A</b> | consistency of accounting policies from one period to the next           |
| <b>B</b> | estimation of accounting provisions relying on the opinion of managers   |
| <b>C</b> | inflation in the currency in which the financial statements are prepared |
| <b>D</b> | lapse of time since the date of the statement of financial position      |
- May 15 P12 Q22
- 62** John failed to write off a bad debt of \$8000.  
What was the effect of this omission?
- |          |   |
|----------|---|
| <b>A</b> | His trade payables turnover (in days) was overstated.     |
| <b>B</b> | His trade payables turnover (in days) was understated.    |
| <b>C</b> | His trade receivables turnover (in days) was overstated.  |
| <b>D</b> | His trade receivables turnover (in days) was understated. |
- Nov 15 P12 Q23
- 63** Which ratio measures a business's average credit period?
- |          |                            |
|----------|----------------------------|
| <b>A</b> | current ratio              |
| <b>B</b> | inventory turnover         |
| <b>C</b> | liquid (acid test) ratio   |
| <b>D</b> | trade receivables turnover |
- Specimen 16 P1 Q20

- 64** A company's profit from operations has increased by 10% in a year, whilst its gross profit has only increased by 5%.

Which factors could explain this?

- 1** a decrease in finance costs
- 2** a decrease in distribution costs
- 3** an increase in rent received
- 4** an increase in selling prices

- A** 1 and 2                      **B** 1 and 4                      **C** 2 and 3                      **D** 3 and 4

May 16 P12 Q15

- 65** Which action leaves the value of working capital unchanged?

- A** disposal of a non-current asset                      **B** issuing shares for cash  
**C** purchasing goods for resale on credit                      **D** writing off an irrecoverable debt

Nov 16 P12 Q20

- 66** Owusu Limited has a constant level of annual sales and a constant gross margin. Each year the inventory increases.

Which effects does this have on the inventory holding period and on inventory turnover?

	inventory holding (in days)	inventory turnover (times)
<b>A</b>	decrease	decrease
<b>B</b>	decrease	Increase
<b>C</b>	increase	decrease
<b>D</b>	increase	increase

Nov 16 P12 Q21

- 67** Who are internal users of accounting information?

- A** customers                      **B** directors  
**C** lenders                      **D** shareholders

May 17 P12 Q18

**ANSWER KEY**

1	D	18	D	35	C	52	B
2	C	19	C	36	B	53	D
3	B	20	B	37	C	54	A
4	B	21	D	38	D	55	C
5	C	22	D	39	A	56	A
6	B	23	C	40	C	57	C
7	B	24	C	41	D	58	C
8	D	25	A	42	C	59	A
9	C	26	A	43	C	60	B
10	D	27	A	44	A	61	A
11	C	28	A	45	C	62	C
12	D	29	D	46	C	63	D
13	A	30	A	47	A	64	C
14	B	31	D	48	C	65	C
15	A	32	C	49	A	66	C
16	D	33	D	50	D	67	B
17	A	34	D	51	C		

**DETAILED ANSWERS**

- 1** "A" option will decrease trade receivables and increase cash (with relatively low amount because of discounts). So it will not improve the ratio.  
 "B" option will reduce trade receivables and consequently there will be no improvement.  
 "C" option will increase inventory and trade payables. In the absence of existing current ratio its behaviour cannot be determined; however acid-test ratio will decrease, because of increase in denominator and no change in numerator.  
 "D" option will decrease non-current assets and increase cash, as cash is current as well as quick asset, so its increase will improve both ratios.
- 2** "A" option will increase cash and decrease trade receivables, as both are quick assets, so there will be no change in quick ratio  
 "B" option will decrease both cash and debentures, as cash is quick asset so its reduction will also decrease quick assets and quick ratio.  
 "C" option will decrease inventory and increase cash, as cash is quick asset so its increase will also increase quick ratio so it is the right option.
- 3** In a competitive market company may earn low profits and has to offer more incentives to customers. As in "B" option, company is earning lowest profit and allowing extended period to trade receivables for payment. So it will be the right choice.
- 5** "C" option is correct as it decreases trade receivables and increases another current asset i.e. cash but with relatively low amount.
- 8** Formulas for these three ratios are as under
- $$\text{Net assets turnover} = \frac{\text{Net Sales}}{\text{Net Assets}}$$
- $$\text{Return on capital employed} = \frac{\text{Operating Profit}}{\text{Capital Employed or Net Assets}} \times 100$$
- $$\text{Profit margin} = \frac{\text{Operating Profit}}{\text{Net Sales}} \times 100$$

If we put these formulas in equation one by one we will find that "D" is the right choice as

$$\begin{array}{lcl} \text{Return on capital employed} & = & \text{Net assets turnover} \times \text{Profit margin} \\ \frac{\text{Operating Profit}}{\text{Net Assets}} & = & \frac{\text{Net Sales}}{\text{Net Assets}} \times \frac{\text{Operating Profit}}{\text{Net Sales}} \end{array}$$

You can see that equation gets verification, which shows "D", is the right option

- 9 Increase in provision for bad debts will reduce trade receivables and capital employed whereas receipt of cash from trade receivables will not change capital employed as one asset will increase with the decrease in the other. However both "A" and "C" options will increase capital employed but the effect of receipt of a loan ("C" option) is significant than that of "A". However examiners' report suggests "A" as a correct option.

- 11 Effects of this transaction will be

Cash	↓
Inventory	↑

As both are included in current assets, so there will be no change in current assets and current ratio, whereas cash is a quick asset but inventory is not; so decrease in cash will decrease quick assets and quick ratio. So there will be no change in current ratio but quick ratio will decrease.

- 12 Quick ratio =  $\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$

"A" option will decrease denominator and "C" option will increase numerator both of which will ultimately improve the ratio whereas "B" option will not affect the ratio as inventory is not used in the formula. "D" option will result in increase in denominator and hence ratio will fall.

- 13 "D" option is incorrect as sales have increased; "C" option is wrong as proportional increase in cost of sales is more than sales. "B" option is also incorrect, as increase in sales price normally results in decrease in quantity sold and increase in profit margin whereas "A" option seems to be correct as the cut in sales price is without corresponding decrease in costs.

- 14 Products "X" and "Y" have gross profit ratios of 40% and 32.5% respectively, so to increase gross profit, effort should be made to increase sale of product having higher gross profit margin i.e. product "X" so "B" option is correct, "D" option is irrelevant as it may improve net profit but will not change gross profit.

- 15 If inventory is purchased on credit then it will have the following effects.

Inventory (current assets)	↑
Trade payables (current liabilities)	↑

Now assume current assets including inventory	500
Inventory	100
Current liabilities	200

So if inventory of \$100 is purchased then current and acid test ratios will be

	Ratios before transaction	Ratios after transaction
Current ratio	$\frac{\$500}{\$200} = 2.5:1$	$\frac{\$500 + \$100}{\$300} = 2.0:1$
Acid test ratio	$\frac{\$500 - \$100}{\$200} = 2.0:1$	$\frac{\$500 - \$100}{\$200 + \$100} = 1.33:1$

- 16 Gross profit ratio normally remains constant regardless of the amount of sales revenue. Whereas increase in sales volume will not affect fixed cost element in Income statement expenses resulting in increase in Net profit ratio.

17 The effects of the options is given below

<b>A</b>	Share capital	↑
	Bank (current assets)	↑
<b>C</b>	Bank (with relatively lower amount than trade receivables)	↑
	Trade receivables	↓
	Discount allowed	↑
<b>D</b>	Short-term investment (current asset)	↑
	Bank (current asset)	↓

So only "A" option will increase current assets and current ratio as a consequence.

18 Normally those businesses have lower gross profit ratio, whose sales volume is high, deal in competitive market and in perishable goods (having nominal monetary value) like super market in this case.

19	Current ratio		Year 1	Year 2	Year 3
	<u>Current Assets</u>	=	<u>\$124 000</u>	<u>\$120 000</u>	<u>\$108 000</u>
	Current Liabilities	=	\$80 000	\$99 000	\$97 000
			1.55:1	1.21:1	1.11:1

From the above calculation it can be determined that company's liquidity position has continually declined cover the 3 years.

20 Effects of this transaction will be

Sales and trade receivables	↑ (at sales price)
Inventory	↓ (at cost price)

As both trade receivables and inventories are current assets, so increase in trade receivables with higher value will increase current assets and current ratio as well. Whereas inventory is not included for calculating quick ratio but due to increase in trade receivables, quick assets and quick ratio will increase so "B" option will be correct.

21 Fixed asset turnover is measured by dividing the net book value of fixed assets into turnover. Capital-intensive industries will tend to have low non-current asset turnover. Retail department stores are, by comparison, not capital-intensive.

22 Item 1 will increase cash and decrease trade receivables; as both assets are quick assets so will not affect acid-test ratio. Items 3 and 4 will increase cash and Quick ratio as a consequence.

23 In the year 2004 gross profit ratio has increased whereas net profit ratio has decreased, this means that operating expenses have increased in the second year. So, "C" option is correct as high sales prices result in high gross profit margins whereas expenses on advertising campaign will increase income statement expenses and net profit margin will decrease as a consequence.

24 Return on capital employed is calculated by using the formula  $\left(\frac{\text{Operating Profit}}{\text{Capital Employed}}\right)$ . A rate of return will increase if the numerator increases at a higher rate than the denominator, or denominator decreases at a higher rate than the numerator. So the "C" option is correct, as reduction in overhead expenses will raise operating profits and the rate of return as a result.

25 Working capital (current) ratio increases either due to increase in current assets at a higher rate than current liabilities, or due to decrease in current liabilities at a higher rate than those of current assets. The effects of the four options on current assets and current liabilities will be:

			\$
<b>A</b>	(i)	Inventory (current asset)	↑ 2 000
		Trade payables (current liability)	↑ 2 000

(ii)	Cash (current asset)	↑	3 000
	Inventory (current asset)	↓	2 000
	Profit	↑	1 000

As current assets are increased by \$1 000 so the ratio will increase

<b>B</b>	Trade payable (current Liability)	↓	1 000
	Cash (current asset)	↓	1 000
<b>C</b>	Non-current assets	↑	10 000
	Trade payables (current liability)	↑	10 000
<b>D</b>	Inventory (current asset)	↓	1 000
	Trade receivables (current asset)	↑	1 000

26 Quick ratio is calculated as  $\left(\frac{\text{Current Assets}-\text{Inventory}}{\text{Current Liabilities}}\right)$ . Ratio will decrease either due to decrease in numerator or increase in denominator, so as in "A" option trade payables have increased resulting in reduction in the quick ratio.

27 Although "B" and "C" options will increase gross profit figure but not the gross profit ratio, whereas if purchases are obtained at reduced costs ("A" option), this will reduce per unit cost and increase gross profit ratio as a consequence.

28 Let us assume

$$\begin{aligned} \text{Trade receivables turnover in days (existing)} &= \frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365 \\ &= \frac{\$20}{\$100} \times 365 \\ &= 73 \text{ days} \end{aligned}$$

Now consider option "A" and assume that a trade receivable of \$10 is written off as bad and would result in reduction of collection period

$$\begin{aligned} \text{Trade receivables turnover days (option "A")} &= \frac{\$20-\$10}{\$100} \times 365 \\ &= 36.5 \text{ days} \end{aligned}$$

So "A" option is correct, whereas all other options will increase trade receivables' collection period.

29 "D" option is correct as all other options do not involve any outlay of cash (the most liquid asset)

32 "C" option is correct. "A" and "D" options will reduce both gross profit and gross profit ratio. "B" option will only increase gross profit figure but gross profit ratio will not change.

33

	Year 1	Year 2	Change
Gross profit %	26%	29%	3% ↑
Net profit %	<u>13%</u>	<u>10%</u>	<u>3%</u> ↓
Overheads	<u>13%</u>	<u>19%</u>	<u>6%</u> ↑

Moreover increase in "Gross Profit ratio" indicates decrease in cost of sales so "D" option is correct.

34 Sale of inventory will have the following effects

Sales (cost + profit)	↑
Trade receivables (cost + profit)	↑
Closing Inventory (cost)	↓

As both trade receivables and inventory are part of numerator of current ratio and increase in trade receivables value is more than inventory so current ratio will increase whereas increase in trade receivables will also increase quick ratio so "D" option is correct

<b>35</b>		<b>This year</b>	<b>Last Year</b>
Receivables' turnover ratio (times) =	$\frac{\text{Credit Sales}}{\text{Trade receivables}}$	$\frac{\$60\,000}{\$12\,000}$ 5 times	$\frac{\$50\,000}{\$8\,000}$ 6.25 times
Trade receivables' collection period		$365 \div 5 = 73$ days	$365 \div 6.25 = 58$ days
Payables' turnover ratio (times) =	$\frac{\text{Credit Purchases}}{\text{Trade payables}}$	$\frac{\$40\,000}{\$10\,000}$ 4 times	$\frac{\$28\,000}{\$16\,000}$ 1.75 times
Trade payables' payment period		$365 \div 4 = 91$ days	$365 \div 1.75 = 209$ days
So in view of above "D" option is correct.			

<b>37</b>		<b>Year ended</b>	
		<b>30 June 2005</b>	<b>30 June 2006</b>
Gross profit on sales		30%	33%
Net profit on sales		<u>15%</u>	<u>14%</u>
Expenses on sales		<u>15%</u>	<u>19%</u>

The above analysis show increase in both gross profit (mainly due to increase in selling price) and income statement expenses (probably advertising).

- 38** "D" option is correct as it indicates that cost of sales has increased proportionately at a higher rate than sales revenue. "A" option will have no effect on profit margin whereas increase in sales price ("B" option) would increase profit margin.
- 42** "A" option is wrong as if rival companies pay less for goods then the company will have lower gross profit margin than its rivals. "B" option is incorrect as advertising expense does not affect gross profit margin. "C" option is correct as if sales price is higher and cost of sales remains constant then gross profit margin would be higher.
- 43** Effects of this transaction will be
- |           |   |
|-----------|---|
| Inventory | ↑ |
| Bank      | ↓ |
- As both are included in current assets, so there will be no change in current assets and current ratio, whereas bank is a quick asset but inventory is not; so decrease in bank will decrease quick assets and quick ratio. So there will be no change in current ratio but quick ratio will decrease.
- 44** Statements in B, C and D options would all reduce the working capital. This left the only answer as A.
- 50** Increase in rate of cash discount from 3% to 5% will not affect gross profit to sales ratio as it is not used in the calculation of gross profit. Introduction of new inventory control system to stop pilferage will, however, increase inventory levels and gross profit to sales ratio.
- 53** Transaction 2 will increase cash and decrease trade receivables, as both are current assets, so there will be no change in current ratio.  
Transaction 3 will increase long-term loan and overdraft (denominator) will decrease so reduction in overdraft will increase the ratio.  
Transaction 4 will increase cash and decrease non-current assets, so due to increase in cash (numerator) the current ratio will increase.
- 55** "C" option is correct as this is the only one which could result in delayed collections from trade receivables.

- 58** This required candidates to consider the components in calculating non-current asset turnover. The formula is turnover (sales) ÷ net book value of non-current assets. The result over the two years was an increase.  
The numerator was constant so the denominator must have reduced. This could only have been as a result of **C**.
- 60** "B" option is correct as "liquid ratio" considers liquid assets only by excluding the least liquid current asset of inventory from the calculation.
- 62** As bad debts are related to trade receivables so there would be no effect of omitting bad debts on trade payables. Therefore option 'A' and option 'B' cannot be correct. Omission to write off bad debts overstated trade receivables resulting in overstatement of trade receivables turnover (in days).
- 64** As profit from operations is profit before interest so change in finance costs (statement 1) will not affect it whereas increase in selling price (statement 4) has already affected gross profit. Increase in operating income (rent) and decrease in operating expense (distribution) will increase profit for the year without affecting gross profit.
- 65** 'C' option is correct as it will increase inventory and trade payables with the same amount.