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Level 2 Book-keeping & Accounts
Solutions Booklet

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Level 2 Book-keeping & Accounts
Solutions Booklet

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Advanced Aspects of Depreciation

Answers to 'Think about it' Questions

Page 2 – Specific causes of depreciation**:**
- Wear and tear
- Depletion (of natural resources)
- Technical obsolescence
- Inadequacy
- Passage of time

Page 5 – Three types of assets and methods to match:
- Hand tools – revaluation method
- Motor vehicle – reducing balance method
- Machinery – machine hours

Page 6 – Effects of the different methods of depreciation:
- The reducing balance method had the highest depreciation charge resulting in the lowest net book value at the end of the first year.
- The straight-line method has the lowest depreciation charge resulting in the highest net book value at the end of the first year.

Solutions to Target Practice Questions

Question 1

(a) Depreciation is an accounting adjustment, which **measures** the fall in **value** of a **fixed asset**.

(b) The charge for deprecation is posted to the **debit** side of the Depreciation Expense Account and the **credit** side of the Provision for Depreciation Account.

Question 2

Machinery Cost

		£			£
01/01/X5	Bank	120 000	31/12/X5	Balance c/d	120 000
		120 000			120 000
01/01/X6	Balance b/d	120 000	31/12/X6	Balance c/d	120 000
		120 000			120 000
01/01/X7	Balance b/d	120 000			

Provision for Depreciation of Machinery

		£			£
31/12/X5	Balance c/d	12 000	31/12/X5	Depreciation Expense	12 000
		12 000			12 000
			01/01/X6	Balance b/d	12 000
31/12/X6	Balance c/d	24 000	31/12/X6	Depreciation Expense	12 000
		24 000			24 000
			01/01/X7	Balance b/d	24 000

Motor Vehicles Cost

		£			£
01/01/X5	Bank	28 000	31/12/X5	Balance c/d	28 000
		28 000			28 000
01/01/X6	Balance b/d	28 000	31/12/X6	Balance c/d	28 000
		28 000			28 000
01/01/X7	Balance b/d	28 000			

Provision for Depreciation of Motor Vehicles

		£			£
31/12/X5	Balance c/d	7 000	31/12/X5	Depreciation Expense	7 000
		7 000			7 000
			01/01/X6	Balance b/d	7 000
31/12/X6	Balance c/d	12 250	31/12/X6	Depreciation Expense	5 250
		12 250			12 250
			01/01/X7	Balance b/d	12 250

Depreciation Expense

		£			£
31/12/X5	PFD Machinery	12 000			
31/12/X5	PFD Motor vehicles	7 000	31/12/X5	Profit and Loss	19 000
		19 000			19 000
31/12/X6	PFD Machinery	12 000			
31/12/X6	PFD Motor vehicles	5 250	31/12/X6	Profit and Loss	17 250
		17 250			17 250

Workings

	Machinery		Motor vehicles	
		£		£
Purchase cost		120 000		28 000
Depreciation 31 December 20X5	**£120 000 x 10%**	**12 000**	**£28 000 x 25%**	**7 000**
		108 000		21 000
Depreciation 31 December 20X6	**£120 000 x 10%**	**12 000**	**£21 000 x 25%**	**5 250**
		96 000		15 750

N.B. PFD = Provision for Depreciation

Question 3

Machines:	**A**	**B**	**C**	**D**
	£	**£**	**£**	**£**
Cost 01/01/X7	35 000	42 000	22 500	50 000
Depreciation charge:				
(£35 000 x 12%) x 10/12	3 500			
£42 000 x 12%		5 040		
(£22 500 x 12%) x 4/12			900	
£50 000 x 12%				6 000
NBV	31 500	36 960	21 600	44 000
Sales proceeds	28 600		15 360	
Profit/(Loss)	(2 900)		(6 240)	

Machinery Cost

		£			£
01/01/X7	Bank	149 500	30/04/X7	Disposal Machine C	22 500
			31/10/X7	Disposal Machine A	35 000
			31/12/X7	Balance c/d	92 000
		149 500			149 500
01/01/X8	Balance b/d	92 000			

Provision for Depreciation of Machinery

		£			£
30/04/X7	Disposals - C	900	30/04/X7	Depreciation expense - C	900
31/10/X7	Disposals - A	3 500	31/10/X7	Depreciation expense - A	3 500
			31/12/X7	Depreciation expense - B	5 040
31/12/X7	Balance c/d	11 040	31/12/X7	Depreciation expense - D	6 000
		15 440			15 440
			01/01/X8	Balance b/d	11 040

Depreciation Expense

		£			£
30/04/X7	PFD of Machinery - C	900			
31/10/X7	PFD of Machinery - A	3 500			
31/12/X7	PFD of Machinery - B	5 040			
31/12/X7	PFD of Machinery - D	6 000	31/12/X7	Profit and Loss	15 440
		15 440			15 440

Asset Disposal

		£			£
30/04/X7	Machine C Cost	22 500	30/04/X7	PFD Machine C	900
31/10/X7	Machine A Cost	35 000	30/04/X7	Bank	15 360
			30/04/X7	Loss on Disposal Machine C	6 240
			31/10/X7	PFD Machine A	3 500
			31/10/X7	Bank	28 600
			31/10/X7	Loss on Disposal Machine C	2 900
		57 500			57 500

Question 4

	Truck 1 £	Truck 2 £	Truck 3 £	Truck 4 £
Depreciation for year ended 31 March 20X7	6 250	3 750	6 750	10 000

Trucks Cost					
		£			£
01/04/X6	Balance b/d	131 000	30/09/X6	Disposal Truck 2	30 000
			31/12/X6	Disposal Truck 3	36 000
			31/12/X6	Balance c/d	65 000
		131 000			131 000
01/01/X7	Balance b/d	65 000			

Provision for Depreciation of Trucks					
		£			£
			01/04/X6	Balance b/d	33 750
30/09/X6	Disposals – Truck 2	11 250	30/09/X6	Depreciation – Truck 2	3 750
31/12/X6	Disposals – Truck 3	15 500	31/12/X6	Depreciation – Truck 3	6 750
			31/03/X7	Depreciation – Truck 1	6 250
31/03/X7	Balance c/d	33 750	31/03/X7	Depreciation – Truck 4	10 000
		60 500			60 500
			01/04/X7	Balance b/d	33 750

Depreciation Expense					
		£			£
30/09/X6	PFD –- Truck 2	3 750			
31/12/X6	PFD –- Truck 3	6 750			
31/03/X7	PFD –- Truck 1	6 250			
31/03/X7	PFD –- Truck 4	10 000	31/03/X7	Profit and Loss	26 750
		26 750			26 750

Asset Disposal					
		£			£
30/09/X6	Truck 2 Cost	30 000	30/09/X6	PFD Truck 2	11 250
30/09/X6	Profit on disposal – Truck 2	8 750	30/09/X6	Bank	27 500
31/12/X6	Truck 3 Cost	36 000	31/12/X6	PFD Truck 3	15 500
31/12/X6	Profit on disposal – Truck 3	2 300	31/12/X6	Bank	22 800
		77 050			77 050

Question 5

Asset Disposal					
		£			£
01/07/X6	Machine 1 Cost	30 000	01/07/X6	Machine 1 Provision for Depreciation	10 500
01/10/X6	Machine 2 Cost	30 000	01/07/X6	Cost of truck (trade-in)	18 000
31/10/X6	Profit on Disposal – Machine 2	5 500	01/07/X6	Loss on disposal	1 500
			31/10/X6	Machine 2 Provision for Depreciation	10 500
			31/10/X6	Machine 2 Cost (exchange)	25 000
		65 500			65 500

Chapter 2
Adjusting for Accruals and Prepayments

Answers to 'Think about it' Questions

Page 16 – Why is an expense prepayment an asset on the balance sheet?

- As the expense is paid for before it is used, the supplier owes the business the amount until such time when the expense prepayment is used up. Since the expense supplier owes the business, he is similar to a debtor, which is a current asset.

Page 17 – Why is an expense accrual a liability on the on the balance sheet?

- As the expense as been used up but unpaid at the end of the period the business owes the supplier; the supplier is similar to a creditor, therefore a current liability on the balance sheet.

Solutions to Target Practice Questions

Question 1

(a) A prepayment for Heat and Light of £330.

		£	£
Dr	Prepayments	330	
Cr	Heat and Light		330

(b) Accrued Motor Expenses of £927.

		£	£
Dr	Motor expenses	927	
Cr	Accruals		927

(c) Sales of £2500 invoiced in advance.

		£	£
Dr	Sales	2 500	
Cr	Accruals and deferred income		2 500

(d) Rent receivable but not yet collected of £700.

		£	£
Dr	Prepayments and accrued income	700	
Cr	Rent receivable		700

Question 2

(a) Telephone accrual: 1/3 x £900 = £300

(b) Insurance prepayment: 7/12 x £420 = £245

(c) Electricity accrual: 2/3 x £840 = £560

(d) Rent prepayment: 1/2 x £8000 = £4000

Question 3

Telephone

		£			£
30/06/X1	Accrual	300	30/06/X1	Profit and Loss Account	300
		300			300

Motor Insurance

		£			£
01/02/X1	Bank	420	30/06/X1	Prepayment	245
			30/06/X1	Profit and Loss Account	175
		420			420

Electricity

		£			£
30/06/X1	Accrual	560	30/06/X1	Profit and Loss Account	560
		560			560

Rent

		£			£
01/04/X1	Bank	8 000	30/06/X1	Prepayment	4 000
			30/06/X1	Profit and Loss Account	4 000
		8 000			8 000

Accruals

		£			£
			30/06/X1	Telephone	300
30/06/X1	Balance c/d	860	30/06/X1	Electricity	560
		860			860
			01/07/X1	Balance b/d	860

Prepayments

		£			£
30/06/X1	Motor insurance	245			
30/06/X1	Rent	4 000	30/06/X1	Balance c/d	4 245
		4 245			4 245
01/07/X1	Balance b/d	4 245			

Question 4

Rent, Rates, Electricity and Gas					
		£			£
01/10/X6	Balance b/d - Rent	780	01/10/X6	Balance b/d - Electricity	275
01/10/X6	Balance b/d - Rates	1 500	01/10/X6	Balance b/d - Gas	130
01/04/X7	Bank - Rates	1 700			
30/09/X7	Bank - Rent (12 x £800)	9 600			
30/09/X7	Bank - Electricity	3 000	30/09/X7	Profit and Loss Account	16 778
30/09/X7	Bank - Gas	1 900			
30/09/X7	Balance c/d - Electricity	245	30/09/X7	Balance c/d – Rent	800
30/09/X7	Balance c/d - Rent	108	30/09/X7	Balance c/d – Rates	850
		18 833			18 833
01/10/X7	Balance b/d – Rent	800	01/10/X7	Balance b/d - Electricity	245
01/10/X7	Balance b/d – Rates	850	01/10/X7	Balance b/d - Rent	108

Workings:

Rent prepayment: 1 x £800 = £800
Rates prepayment: 6/12 x £1700 = £850
Electricity accrual: £245
Gas accrual: 1/3 x £324 = £108

Question 5

Birch
Trading, Profit and Loss Account for the year ended 31 December 20X3

	£	£
Sales		113 750
Cost of Sales		
Opening stock	4 025	
Purchases (£50 925 + £665)	51 590	
	55 615	
Less: Closing stock	3 765	
		51 850
Gross profit		61 900
Less: Expenses		
Wages	23 500	
Rent, rates and insurance (£6125 + £350 - £1312)	5 163	
Heat and light (£5525 – £210)	5 315	
Motor expenses (£3489 + £300 - £442)	3 347	
Telephone and stationery (£1672 + £136 - £95)	1 713	
Depreciation	3 938	
		42 976
Net profit		18 924

Birch
Balance Sheet at 31 December 20X3

	£	£
Fixed assets		
Motor vehicles: cost		15 750
Less: Accumulated depreciation		5 907
		9 843
Current assets		
Stock	3 765	
Debtors	3 553	
Prepayments (£442 + £1312 + £210 + £95)	2 059	
Bank	195	
	9 572	
Current liabilities		
Creditors	3 290	
Accruals (£300 + £350 + £665 + £136)	1 451	
	4 741	
Net Current Assets		4 831
		14 674
Capital account		
Opening Capital		13 250
Add: Net profit		18 924
		32 174
Less: Drawings		17 500
		14 674

Chapter 3
Bad Debts and Provision for Doubtful Debts

Answers to 'Think about it' Questions

Page 28 – Why would a business decide to increase or decrease its provision for doubtful debts?

- If the business financial records over a period of time show a trend in an increasing number of bad debts, or if the economy is not doing well, then it is likely that the business would increase the provision to ensure that profits and current assets are not overstated. If trends shows that the level of bad debts is decreasing then the business may decrease the provision.

Solutions to Target Practice Questions

Question 1

Dr	Provision for Doubtful Debts
Cr	Profit and Loss Account

Question 2

An increase in the provision for doubtful debts will **decrease** the net profit for the year and a decrease in the provision for doubtful debts will **increase** the net profit for the year.

Question 3

Bad debt provision: (£55 400 - £2650) x 4% = 2110

Balance Sheet Extract at 31 December 20X4

Current Assets

	£
Debtors (£55 400 - £2650)	52 750
Less: Provision for Doubtful Debts	2 110
	50 640

Question 4

Year ended 30 September:	20X5	20X6	20X7
	£	£	£
Debtors	34 150	39 275	44 498
Bad debts written off	(500)	(1 800)	(1 926)
Revised debtors	33 650	37 475	42 572
Less: specific provision	(850)	(1 475)	(1 772)
Balance of debtors	32 800	36 000	40 800
	1%	2%	3%
General provision	328	720	1 224
Add: specific provision	850	1 475	1 772
Total provision	1 178	2 195	2 996
Increase in provision		£1 017	£801

Question 5

Bad Debts

		£			£
30/09/X5	Bad debts written off	500			
30/09/X5	Provision for doubtful debts	1 178	30/09/X5	Profit and Loss Account	1 678
		1 678			1 678
30/09/X6	Bad debts written off	1 800			
30/09/X6	Provision for doubtful debts	1 017	30/09/X6	Profit and Loss Account	2 817
		2 817			2 817
30/09/X7	Bad debts written off	1 926			
30/09/X7	Provision for doubtful debts	801	30/09/X7	Profit and Loss Account	2 727
		2 727			2 727

Bad Debts Recovered

		£			£
30/09/X6	Profit and Loss Account	245	30/09/X6	Bank	245
		245			245
30/09/X7	Profit and Loss Account	423	30/09/X7	Bank	423
		423			423

Provision for Doubtful Debts

		£			£
30/09/X5	Balance c/d	1 178	30/09/X5	Bad debts	1 178
		1 178			1 178
			01/10/X5	Balance b/d	1 178
30/09/X6	Balance c/d	2 195	30/09/X6	Bad debts	1 017
		2 195			2 195
			01/10/X6	Balance b/d	2 195
30/09/X7	Balance c/d	2 996	30/09/X7	Bad debts	801
		2 996			2 996
			01/10/X7	Balance b/d	2 996

Alice Jones - Profit and Loss Account Extract for the year ended 30 September 20X7

		£
Gross Profit		
Add: Bad debts recovered		423
Expenses	**£**	
Increase in provision for doubtful debts	801	
Bad debts	1 926	

Alice Jones – Balance Sheet Extract at 30 September 20X7

Current Assets

	£
Debtors	42 572
Less: Provision for doubtful debts	2 996
	39 576

Chapter 4
Introduction to Partnership Accounts

Answers to 'Think about it' Questions

Page 33 – What are some of the benefits of a partnership in comparison to a sole trader?

- More capital available to invest in the business; greater opportunity to expand the business
- Sharing of work load
- Access to a wider range of skills and knowledge which contributes to the success of the business
- Each partner won't have bear the loss on their own; losses are shared among partners

Page 38 – What do these partner balances on their current account tells you?

- Both George and Fred have credit balances on their current accounts; this means that the business owes them money. If the balances were debit then this would mean that the partners' owe the business/partnership.

Solutions to Target Practice questions

Question 1

Term	Definition
Partnership	A partnership is formed when two or more people set up in business together.
Partnership agreement	A written document that sets out the terms of trade with each partner.
Capital Account	Capital is the amount invested by a partner in the business and this is held in the capital account.
Current Account	This is the account that records the balance owed to or from the partnership by the partners. The balance on this account will fluctuate as profits are earned and drawings are taken.
Interest on capital	This is an annual amount awarded to the partners based on a percentage of the capital they have invested. It represents a return on their investment.
Drawings	These are the amounts withdrawn from the partnership by the partners.
Interest on drawings	This is interest charged at an agreed percentage to take account of the timing of drawings and to discourage partners from drawing from the business.
Salary	This is a specified amount due to a partner before the profits are shared.
Profit share ratio	The share or split of the remaining profits or losses between the partners. This could be expressed as a percentage or as a ratio e.g. 2:1

Question 2

	Debit	Credit
Share of profit	Appropriation Account	Partners' Current Account
Share of loss	Partners' Current account	Appropriation Account
Salary	Appropriation Account	Partners' Current Account
Interest on capital	Appropriation Account	Partners' Current Account
Interest on drawings	Partners' Current Account	Appropriation Account
Interest on loan from partner	Profit and Loss Account	Partners' Current Account or Bank account

Question 3

Using the accounting equation (Assets = Capital + Liabilities), the capital introduced by each partner can be calculated:

	Exe	Why	Zed	Total
	£	£	£	£
Plant and equipment	28 000	37 500	15 000	80 500
Motor vehicles	18 700		10 900	29 600
Stock	2 500	1 750	3 250	7 500
Debtors	8 208	6 023	1 615	15 846
Bank	1 115	864	1 234	3 213
Creditors	(5 850)	(3 600)	(885)	(10 335)
	52 673	42 537	31 114	126 324

Exe, Why and Zed
Balance Sheet at 1 July 20X6

		£	£
Fixed assets			
Plant and equipment			80 500
Motor vehicles			29 600
			110 100
Current assets			
Stock		7 500	
Debtors		15 846	
Bank		3 213	
		26 559	
Current liabilities			
Creditors		(10 335)	
Net Current Assets			16 224
			126 324
Represented by:			
Capital Accounts	Exe	52 673	
	Why	42 537	
	Zed	31 114	
			126 324

Note:
As the assets and liabilities contributed by each partner now become the partnership assets and liabilities, they are shown as a total figure on the partnership balance sheet.

Question 4

The profit needs to be adjusted to account for the loan interest of
5% x £20 000 = £1000.
The revised profit for appropriation is £39 661 - £1000 = £38 661.

Jake and Misty
Appropriation Account
for the year ended 31 December 20X2

		£	£
Revised profit			38 661
Add: Interest on drawings	Jake (£16 620 x 5%)	831	
	Misty (£23 760 x 5%)	1 188	
			2 019
			40 680
Less: Interest on capital	Jake (£26 000 x 8%)	2 080	
	George (£19 500 x 8%)	1 560	
			(3 640)
Less: Salary	Misty		(7 800)
			29 240
Profit share	Jake (75%)	21 930	
	Misty (25%)	7 310	
			29 240

Partners' Current Accounts

		Jake	Misty			Jake	Misty
		£	£			£	£
01/01/X2	Balance b/d	-	4 420	01/01/X2	Balance b/d	2 340	-
31/12/X2	Interest on drawings	831	1 188	31/12/X2	Interest on capital	2 080	1 560
31/12/X2	Drawings	16 620	23 760	31/12/X2	Salary	-	7 800
				31/12/X2	Profit share	21 930	7 310
31/12/X2	Balance c/d	8 899	-	31/12/X2	Balance c/d	-	12 698
		26 350	29 368			26 350	29 368
01/01/X3	Balance b/d	-	12 698	01/01/X3	Balance b/d	8 899	-

Question 5

Tiger and Snake
Trading, Profit and Loss Account for the year ended 31 December 20X8

	£	£
Sales		120 000
Cost of Sales		
Opening stock	2 750	
Purchases	45 000	
	47 750	
Less: Closing stock	3 000	
		44 750
Gross profit		75 250
Less: Expenses		
Wages (£24 000 + £800)	24 800	
Insurance (£2800 - £400)	2 400	
Depreciation: equipment (£40 000 x 10%)	4 000	
Depreciation: motor vehicles ((£18 500 - £3700) x 25%)	3 700	
Bad debts ((£33 400 x 5%) - £1002)	668	
		35 568
Net profit		39 682

Tiger and Snake
Appropriation Account
for the year ended 31 December 20X8

		£	**£**
Net profit			39 682
Add: Interest on drawings	Tiger (£2000 x 5%)	100	
	Snake (£4000 x 5%)	200	
			300
			39 982
Less: Interest on capital	Tiger (£40 000 x 7%)	2 800	
	Snake (£20 000 x 7%)	1 400	
			(4 200)
Less: Salary	Snake		(4 000)
			31 782
Profit share	Tiger (2/3)	21 188	
	Snake (1/3)	10 594	
			31 782

Partners' Current Accounts

		Tiger £	Snake £			Tiger £	Snake £
31/12/X8	Interest on drawings	100	200	01/01/X8	Balance b/d	11 300	9 088
31/12/X8	Drawings	2 000	4 000	31/12/X8	Interest on capital	2 800	1 400
				31/12/X8	Salary	-	4 000
31/12/X8	Balance c/d	33 188	20 882	31/12/X8	Profit share	21 188	10 594
		35 288	25 082			35 288	25 082
				01/01/X9	Balance b/d	33 188	20 882

Tiger and Snake
Balance Sheet at 31 December 20X8

		£	£
Fixed assets			
Buildings at cost			65 000
Plant and equipment (NBV) (£40 000 - £4000 - £4000)			32 000
Motor vehicles (NBV) (£18 500 - £3700 - £3700)			11 100
			108 100
Current assets			
Stock		3 000	
Debtors (£33 400 - £1670)		31 730	
Prepayments		400	
		35 130	
Current liabilities			
Bank overdraft		6 400	
Creditors		21 960	
Accruals		800	
		29 160	
Net Current Assets			5 970
			114 070
Represented by:			
Capital Accounts	Tiger	40 000	
	Snake	20 000	
			60 000
Current Accounts	Tiger	33 188	
	Snake	20 882	
			54 070
			114 070

Chapter 5
Admission and Retirement of Partners

Answers to 'Think about it' Questions

Page 44 – What are some of the specific reasons why someone would be willing to pay for goodwill?

- Goodwill in a business may be based on the industry-specific knowledge, know-how and good reputation for customer service that the business has. Additionally, if it is in a good location for business then this could add to goodwill.

Solutions to Target Practice Questions

Question 1

	£	£
Consideration (amount paid)		45 000
Assets and liabilities acquired:		
Fixtures and fittings	22 400	
Stock	3 700	
Debtors	16 750	
Creditors	(2 895)	
		39 955
Goodwill		5 045

Question 2

The goodwill introduced by the new partner needs to be shared between the existing partners. The share that each of the existing partners receives is based on the difference between their old profit share and the new profit share now that a new partner has been admitted. The double entry will be to debit the bank with the £25 000 and credit the capital accounts of the existing partners with the appropriate share of the goodwill.

Question 3

	Dr £	CR £
Bank	18 000	
Helen Capital Account		18 000

Being the payment of Helen's capital contribution into the partnership bank account

Goodwill	30 000	
Dan Capital Account (1/2 x £30 000)		15 000
Collette Capital Account (1/2 x £30 000)		15 000

Being the creation of goodwill written into the partners' capital accounts in the old profit sharing ratio

Dan Capital Account (3/6 x £30 000)	15 000	
Collette Capital Account (2/6 x £30 000)	10 000	
Helen Capital Account (1/6 x £30 000)	5 000	
Goodwill		30 000

Being the goodwill written out of the partners' capital accounts in the new profit sharing ratio

Partners' Capital Accounts									
		Dan	Collette	Helen			Dan	Collette	Helen
		£	£	£			£	£	£
01/01/X7	Goodwill	15 000	10 000	5 000	01/01/X7	Balance b/d	35 000	35 000	
					01/01/X7	Bank			18 000
01/01/X7	Balance c/d	35 000	40 000	13 000	01/01/X7	Goodwill	15 000	15 000	
		50 000	50 000	18 000			50 000	50 000	18 000
					01/01/X7	Balance b/d	35 000	40 000	13 000

Question 4

Revaluation Account – Knot and Berry					
		£			£
31/12/X2	Plant and machinery (£99 000 - £92 000)	7 000	31/12/X2	Goodwill	34 500
31/12/X2	Debtors	458			
31/12/X2	Capital account : Knot (2/3)	18 028			
31/12/X2	Capital account : Berry (1/3)	9 014			
		34 500			34 500

Bank Account					
		£			£
31/12/X2	Balance b/d	12 120	31/12/X2	Knot	28 705
31/12/X2	Capital account: Rasp	25 000	31/12/X2	Balance c/d	8 415
		37 120			37 120
01/01/X3	Balance b/d	8 415			

Goodwill					
		£			£
31/12/X2	Revaluation	34 500	31/12/X2	Capital account: Berry (3/4)	27 375
31/12/X2	Capital accounts: Rasp	2 000	31/12/X2	Capital account: Rasp (1/4)	9 125
		36 500			36 500

Partners' Capital Accounts									
		Knot	Berry	Rasp			Knot	Berry	Rasp
		£	£	£			£	£	£
31/12/X2	Goodwill		27 375	9 125	31/12/X2	Balance b/d	90 000	74 000	
31/12/X2	Bank	28 705			31/12/X2	Revaluation	18 028	9 014	
31/12/X2	Loan	86 115			31/12/X2	Goodwill			2 000
					31/12/X2	Plant and machinery			15 000
					31/12/X2	Cash			25 000
31/12/X2	Balance c/d		55 639	32 875	31/12/X2	Current account	6 792		
		114 820	83 014	42 000			114 820	83 014	42 000
					01/01/X3	Balance b/d		55 639	32 875

Berry and Rasp
Balance Sheet at 1 January 20X3

		£	£
Fixed assets			
Plant and machinery (£92 000 + £15 000)			107 000
Motor vehicles			32 700
			139 700
Current assets			
Stock		19 125	
Debtors (£22 950 - £458)		22 492	
Bank		8 415	
		50 032	
Current liabilities			
Creditors		(11 100)	
Net Current Assets			38 932
			178 632
Long term liabilities			
Loan from Knot			86 115
			92 517
Represented by:			
Capital Account	Berry	55 639	
	Rasp	32 875	
			88 514
Current account	Berry		4 003
			92 517

Question 5

Revaluation Account – Freeman and Hardy					
		£			£
01/07/X1	Fixtures and Fittings (£37 500 - £35 000)	2 500	01/07/X1	Land and Buildings (£105 000 - £93 750)	11 250
01/07/X1	Capital Account: Freeman (3/5)	22 875	01/07/X1	Stock (£29 500 - £28 125)	1 375
01/07/X1	Capital Account: Hardy (2/5)	15 250	01/07/X1	Goodwill	28 000
		40 625			40 625
01/07/X1	Land and Buildings	11 250	01/07/X1	Fixtures and fittings	2 500
01/07/X1	Stock	1 375	01/07/X1	Capital Account: Freeman (2/5)	15 250
01/07/X1	Goodwill	28 000	01/07/X1	Capital Account: Hardy (2/5)	15 250
			01/07/X1	Capital Account: Willis (1/5)	7 625
		40 625			40 625

Partners' Capital Accounts									
		Freeman	Hardy	Willis			Freeman	Hardy	Willis
		£	£	£			£	£	£
01/07/X1	Revaluation	15 250	15 250	7 625	01/07/X1	Balance b/d	75 000	50 000	
					01/07/X1	Revaluation	22 875	15 250	
01/07/X1	Balance c/d	82 625	50 000	25 375	01/07/X1	Bank			33 000
		97 875	65 250	33 000			97 875	65 250	33 000
					01/07/X1	Balance b/d	82 625	50 000	25 375

Freeman, Hardy and Willis
Balance Sheet at 1 July 20X1

		£	£
Fixed assets			
Land and buildings			93 750
Fixtures and fittings			37 500
			131 250
Current assets			
Stock		28 125	
Debtors		18 750	
Bank (£4600 + £33 000)		37 600	
		84 475	
Current liabilities			
Creditors		(23 450)	
Net Current Assets			61 025
			192 275
Represented by:			
Capital accounts	Freeman	82 625	
	Hardy	50 000	
	Willis	25 375	
			158 000
Current accounts	Freeman	24 060	
	Hardy	10 215	
			34 275
			192 275

Chapter 6
Dissolution of a Partnership

Answers to 'Think about it' Questions

Page 69 – How can you tell that the accounting entries for the sale of the partnership are correct?

- They are correct because the balances on the partners' capital account (£8506 and £8038 for Yum and Zip respectively) are equal exactly to the balance on the bank account.

Solutions to Target Practice Questions

Question 1

	Debit	Credit
Transfer of asset balances into the dissolution account	Dissolution account	Asset account
Transfer of liability balances into the dissolution account	Liability account	Dissolution account
Banking the proceeds from the sale of assets	Bank	Dissolution account
Paying the costs of dissolution	Dissolution account	Bank
Repaying any partners' loans to the partnership	Partners' loans	Bank

Question 2

Fixtures and Fittings

		£			£
31/12/X7	Balance b/d	24 000	31/12/X7	Dissolution account	24 000
		24 000			24 000

Delivery Van

		£			£
31/12/X7	Balance b/d	4 000	31/12/X7	Dissolution account	4 000
		4 000			4 000

Stock

		£			£
31/12/X7	Balance b/d	8 400	31/12/X7	Dissolution account	8 400
		8 400			8 400

Debtors

		£			£
31/12/X7	Balance b/d	12 200	31/12/X7	Dissolution account	12 200
		12 200			12 200

Bank

		£			£
31/12/X7	Balance b/d	355	31/12/X7	Creditors paid	9 050
31/12/X7	Sale of fixtures and fittings and stock	29 500	31/12/X7	Costs of dissolution	600
31/12/X7	Debtors collected	12 200	31/12/X7	Repay loan to Jake	12 000
			31/12/X7	Capital account: Ham	9 284
			31/12/X7	Capital account: Shem	3 668
			31/12/X7	Capital account: Jake	7 453
		42 055			42 055

Creditors

		£			£
31/12/X7	Dissolution account	9 349	31/12/X7	Balance b/d	9 349
		9 349			9 349

Loan From Jake

		£			£
31/12/X7	Bank	12 000	31/12/X7	Balance b/d	12 000
		12 000			12 000

Dissolution Account

		£			£
31/12/X7	Fixtures and fittings	24 000	31/12/X7	Creditors	9 349
31/12/X7	Delivery van	4 000	31/12/X7	Fixtures and fittings and stock sale proceeds	29 500
31/12/X7	Stock	8 400	31/12/X7	Delivery van taken by Shem	2 500
31/12/X7	Debtors	12 200	31/12/X7	Debtors	12 200
31/12/X7	Dissolution costs	600	31/12/X7	Capital account: Ham	1 567
31/12/X7	Creditors paid	9 050	31/12/X7	Capital account: Shem	1 567
			31/12/X7	Capital account: Jake	1 567
		58 250			58 250

Partners' Current Accounts

		Ham	Shem	Jake			Ham	Shem	Jake
		£	£	£			£	£	£
31/12/X7	Balance b/d		2 265	980	31/12/X7	Balance b/d	851		
31/12/X7	Capital accounts	851			31/12/X7	Capital accounts		2 265	980
		851	2 265	980			851	2 265	980

		Ham £	Shem £	Jake £			Ham £	Shem £	Jake £
Partners' Capital Accounts									
31/12/X7	Current account		2 265	980	31/12/X7	Balance b/d	10 000	10 000	10 000
31/12/X7	Delivery van		2 500		31/12/X7	Current account	851		
31/12/X7	Dissolution account	1 567	1 567	1 567					
31/12/X7	Bank	9 284	3 668	7 453					
		10 851	10 000	10 000			10 851	10 000	10 000

Question 3

The deficit of £27 000 needs to be shared between Cave and Round in the ratio of their capital balances at the last agreed Balance Sheet.

Cave $\frac{30\ 000}{50\ 000}$ x £27 000 = £16 200 **Round** $\frac{20\ 000}{50\ 000}$ x £27 000 = £10 800

		Con £	Cave £	Round £			Con £	Cave £	Round £
Partners' Capital Accounts									
30/06/X6	Balance b/d	27 000			30/06/X6	Balance b/d		18 900	14 750
30/06/X6	Share of Con's debit balance		16 200	10 800	30/06/X6	Transfer to other partners	27 000		
30/06/X6	Bank		2 700	3 950					
		27 000	18 900	14 750			27 000	18 900	14 750

Question 4

		£			£
Realisation Account					
30/06/X2	Land and buildings	564 000	30/06/X2	Creditors	109 680
30/06/X2	Plant and machinery	174 150	30/06/X2	Debtors collected	135 470
30/06/X2	Stock	83 250	30/06/X2	Lincoln Ltd	965 000
30/06/X2	Debtors	142 600			
30/06/X2	Creditors paid	109 680			
30/06/X2	Capital account: Ely	68 235			
30/06/X2	Capital account: Bath	68 235			
		1 210 150			1 210 150

		£			£
Account with Lincoln Ltd					
30/06/X2	Realisation account	965 000	30/06/X2	Bank	400 000
			30/06/X2	Shares	565 000
		965 000			965 000

Bank					
		£			£
30/06/X2	Balance b/d	6 520	30/06/X2	Creditors paid	109 680
30/06/X2	Lincoln Ltd	400 000	30/06/X2	Repay loan to Ely	8 000
30/06/X2	Debtors collected	135 470	30/06/X2	Capital account: Ely	221 357
			30/06/X2	Capital account: Bath	202 953
		541 990			541 990

Partners' Capital Accounts							
		Ely	Bath			Ely	Bath
		£	£			£	£
30/06/X2	Shares	282 500	282 500	30/06/X2	Balance b/d	400 000	400 000
30/06/X2	Bank	221 357	202 953	30/06/X2	Current account	35 622	17 218
				30/06/X2	Dissolution account	68 235	68 235
		503 857	485 453			503 857	485 453

Question 5

	DR	CR
	£	£
Dissolution account	4 500	
Goodwill		4 500
Dissolution account	41 000	
Tangible assets		41 000

Transferring the net assets of the partnership to the dissolution account.

Creditors	11 900	
Dissolution account		11 900

Transferring the liabilities of the partnership to the dissolution account.

Dissolution account	11 900	
Bank		11 900

Pay the creditors from the bank account.

Bank	35 000	
Dissolution account		35 000

Money received from debtors.

Capital account: Hales	7 000	
Capital account: Owen	3 500	
Dissolution account		10 500

Transferring the balance on the dissolution account to the partners' capital accounts in their profit sharing ratio.

	DR £	CR £
Current account: Hales	3 000	
Capital account: Hales		3 000
Current account: Owen	1 925	
Current account: Owen		1 925

Transferring the balances on the partners' current accounts to their capital accounts.

Capital account: Hales	11 000	
Capital account: Owen	8 425	
Bank		19 425

Paying the final capital account balances from the bank.

Chapter 7
Formation of a Company – Meaning, Purpose and Effect

Answers to 'Think about it' Questions

Page 75 – What are some of the advantages a limited company may have in comparison to a partnership?

- Liability of owners is limited; this means that owners' (shareholders') personal assets cannot be used to pay company debts. Most partnerships have unlimited partnerships
- A company has access to different ways of borrowing (e.g. debentures) that is not available to partnerships
- A company is not affected by death, retirement or bankruptcy of a shareholder; in contrast a partnership comes to an end if these events happen
- Shares are easily transferable without the consent of the shareholders
- Unlimited capital through the issue of shares.

Page 77 – Why can a company issue shares for more than its par or nominal value?

The price of shares on the market is generally influenced by factors such as the potential earning power of the shares, financial conditions in the country and the general business and economic conditions. If a company has been trading successfully and the economic conditions in the country is favourable, this could build a potential shareholder's confidence in the earning power of the shares and so he/she may be willing to pay more than the par value of the shares to own part of the company. If a prospective shareholder is willing to pay more than the par value, then the company will sell the shares for more. .

Solutions to Target Practice Questions

Question 1

	Dr	Cr
	£	**£**
Bank (500 000 x £1.95)	975 000	
Ordinary Shares (500 000 x £1)		500 000
Share Premium (500 000 x £0.95)		475 000

Being the issue of 500 000 Ordinary shares of £1 at a value of £1.95

Question 2

The ordinary shareholders are the owners of the company. Ordinary shareholders will usually have the right to vote at the Annual General Meeting and are entitled to the profits of the company after all expenses have been charged against income (including any preference dividends). Once the Preference Shareholders have been paid their dividend, all remaining profits (reserves) form part of the Ordinary Shareholders' funds.

When the company has earned a profit, preference shareholders are guaranteed a fixed percentage dividend per share, which must be paid out before the ordinary shareholders receive a dividend. Cumulative preference shares entitle the holder to payments of previous years dividends, if these have not been paid when due because of insufficient profit and/or funds.

If the company is wound up, preference shareholders have their capital repaid before the ordinary shareholders. Because they take preference over the ordinary shares, preference shares are a less risky investment. However, preference shareholders are not normally entitled to vote at general shareholder meetings and therefore cannot influence the running of the company. So preference shareholders are more like lenders than shareholders.

Question 3

Johnson Limited
Balance Sheet Extract at 31 December 20X5

	£
Creditors falling due within one year	
Bank loan	6000
Creditors falling due in more than one year	
Bank loan	9000

<u>Note:</u>
Remember that six months of repayments will have been made between 1 July 20X5 and 31 December 20X5, totalling £3000. The total outstanding balance at 31 December will be £15 000.

Question 4

- **Authorised share capital** is the maximum number of shares that a company can issue.
- **Issued share capital** is the number of shares that have been issued or sold to shareholders.

Question 5

The annual charge for debenture interest is £9000 therefore the company needs to accrue the remaining £4000. It also needs to accrue an additional £3000 unsecured loan stock interest. The journal entries are:

	Dr £	**Cr £**
Debenture Interest	4500	
Accruals		4500
Loan Interest	3000	
Accruals		3000

<u>Note to students</u>:
Where questions state the value of shares in pence (e.g. 5p), always remember to express the value as a proportion of a whole pound when making calculations using the share price; for example, 5p stated in a question should be expressed as £0.05 for the purpose of your calculations.

Chapter 8
Limited Companies – The Profit and Loss Account

Solutions to Target Practice Questions

Question 1

First calculate the number of ordinary shares and then use it to calculate the dividends for ordinary shareholders:

- Ordinary dividend: £600 000 ÷ £0.75 = 800 000 shares
  Therefore: 800 000 shares x £0.08p = £64 000

Preference dividend: 9% x £350 000 = £31 500

Question 2

Cranmer Ltd
Appropriation Account for the Year Ended
31 December 20X2

	£	£
Net profit for the year		105 000
6% Preference dividend (6% x £80 000)	4 800	
Interim ordinary dividend paid	12 000	
Proposed final ordinary dividend – £0.05 per share	10 000	
		26 800
		78 200
Transfer to replacement machinery reserve		30 000
Retained profit for the year		48 200
Retained profit at 1 January 20X2		140 000
Retained profit c/fwd		188 200

Question 3

Wolsey plc
Appropriation Account for the Year Ended
31 May 20X5

	£	£
Net profit for the year		159 456
10% Preference dividend (10% x £40 000)	4 000	
Proposed final ordinary dividend – £0.07 per share	14 000	
		18 000
		141 456
Transfer to General Reserve		45 000
Retained profit for the year		96 456
Retained profit at 31 May 20X4		87 000
Retained profit c/fwd		183 456

Question 4

Thomas Ltd
Profit & Loss and Appropriation Account for the year ended 30 April 20X7

	£	£
Gross profit		192 953
Less: Expenses		
Other administrative expenses	32 471	
Depreciation charge	4 600	
Auditors' remuneration	10 200	
Directors' remuneration (£36 200 + £8 000)	44 200	
Debenture interest (£4 200 + £1 400))	5 600	
Loan interest (£3 950 + £650)	4 600	
		101 671
Net profit for the year		91 282
4% Preference dividend	6 000	
Interim ordinary dividend paid	6 000	
Proposed final ordinary dividend – £0.06	18 000	
		30 000
		61 282
Transfer to General Reserve		15 000
Retained profit for the year		46 282
Retained profit at 1 May 20X6		104 228
Retained profit c/fwd		150 510

Chapter 9
Limited Companies – The Balance Sheet

Solutions to Target Practice Questions

Question 1

Largo Ltd
Trading, Profit & Loss and Appropriation Account for the year ended 30 September 20X1

	£000	£000
Sales		4 800
Cost of sales		
Opening stock	500	
Purchases	2 120	
	2 620	
Less: Closing stock	568	
		2 052
Gross profit		2 748
Less: Expenses		
Directors remuneration	160	
Wages and salaries	30	
Rent, rates and insurance (£244 + £28 - £20)	252	
Administrative expenses	540	
Depreciation:		
Motor vehicles (£600 x 10%)	60	
Plant and machinery ((£1800 - £320) x 20%)	296	
Debenture interest (£48 + £48)	96	
		1 434
Net profit for the year		1 314
Interim ordinary dividend paid	25	
Proposed final ordinary dividend (240 000 x £0.10)	24	49
Retained profit for the year		1 265
Retained profit b/fwd		111
Retained profit c/fwd		1 376

Largo Ltd
Balance Sheet at 30 September 20X1

	Cost £000	Acc. Dep. £000	NBV £000
Fixed assets			
Motor vehicles	600	120	480
Plant and machinery	1 800	616	1 184
	2 400	736	1 664
Current assets			
Stock		568	
Debtors		590	
Prepayments		20	
Cash in hand		150	
		1 328	
Creditors due within one year			
Creditors		476	
Accruals		28	
Debenture interest		48	
Proposed final dividend		24	
		576	
Net current assets			752
Total assets less current liabilities			2 416
Creditors falling due in more than one year			
12% Debentures (20X8)			800
Net assets			1 616
Shareholders' funds			
Capital and Reserves:			
Ordinary Shares of £1 each			240
Profit and loss account			1 376
Total shareholders' funds			1 616

Question 2

Legato plc
Trading, Profit & Loss and Appropriation Account for the year ended 31 December 20X8

	£	£
Sales		224 000
Cost of sales		
Opening stock	20 000	
Purchases	100 000	
	120 000	
Less: Closing stock	39 200	
		80 800
Gross profit		143 200
Less: Expenses		
Directors fees	23 200	
Wages and salaries	32 000	
Rent, rates and insurance	8 800	
General expenses	4 800	
Printing, telephone and stationery	5 600	
Depreciation:		
Plant (£144 000 x 10%)	14 400	
Motor vehicles ((£64 000 - £24 000) x 25%)	10 000	
Debenture interest	3 200	
		102 000
Net profit for the year		41 200
Preference dividend (£24 000 x 10%)	2 400	
Proposed final ordinary dividend (64000 x 4 = 256000 shares @ £0.02 per share)	5 120	7 520
Retained profit for the year		33 680
Retained profit b/fwd		12 000
Retained profit c/fwd		45 680

Legato plc
Balance Sheet at 31 December 20X8

	Cost £	Acc. Dep. £	NBV £
Fixed assets			
Plant	144 000	38 400	105 600
Motor vehicles	64 000	34 000	30 000
	208 000	72 400	135 600
Current assets			
Stock		39 200	
Debtors		20 800	
Cash at bank		4 800	
		64 800	
Creditors due within one year			
Creditors		11 200	
Debenture interest		3 200	
Preference dividend		2 400	
Proposed final dividend		5 120	
		21 920	
Net current assets			42 880
Total assets less current liabilities			178 480
Creditors falling due in more than one year			
8% Debentures			40 000
Net assets			138 480
Shareholders' funds			
Capital and Reserves:			
256000 ordinary shares of £0.25 each			64 000
Share premium			4 800
Profit and loss account			45 680
Ordinary shareholders' (equity) funds			114 480
10% Preference shares			24 000
Total shareholders' funds			138 480

Question 3

Molto plc
Appropriation Account for the year ended 31 December 20X3

	£	£
Net profit for the year		166 100
Preference dividend	6 600	
Proposed final ordinary dividend	9 900	
		16 500
		149 600
Transfer to general reserves		22 000
Retained profit for the year		127 600
Retained profit b/fwd		52 800
Retained profit c/fwd		180 400

Molto plc
Balance Sheet at 31 December 20X3

	Cost £	Acc. Dep. £	NBV £
Fixed assets			
Fixtures	159 500	33 550	125 950
Vehicles	22 000	5 500	16 500
	181 500	39 050	142 450
Current assets			
Stock		396 000	
Debtors		111 100	
Prepayments		4 950	
Cash in hand		31 900	
		543 950	
Creditors due within one year			
Creditors		103 400	
Preference dividend		6 600	
Ordinary dividend		9 900	
		119 900	
Net current assets			424 050
Total assets less current liabilities			566 500
Creditors falling due in more than one year			
5% Debentures			22 000
Net assets			544 500
Shareholders' funds			
Capital and Reserves:			
Ordinary shares of £1 each			198 000
Profit and loss account			180 400
General reserves			56 100
Ordinary shareholders' (equity) funds			434 500
6% Preference shares			110 000
Total shareholders' funds			544 500

Question 4

Rall Ltd
Trading, Profit & Loss and Appropriation Account for the year ended 31 March 20X6

	£	£
Sales		1 071 900
Cost of sales		
Opening stock	80 400	
Purchases	567 000	
	647 400	
Less: Closing stock	84 420	
		562 980
Gross profit		508 920
Less: Expenses		
Wages and salaries	151 786	
Directors' remuneration (£88 000 + £3000)	91 000	
Administrative expenses	114 374	
Distribution expenses	18 264	
Depreciation: Buildings (£201 600 x 4%)	8 064	
Motor vehicles (£90 000 – £28 480) x 25%	15 380	
Plant and machinery (£160 800 x 15%)	24 120	
Debenture interest (£6 750 + £2 250)	9 000	
		431 988
Net profit for year		76 932
Interim ordinary dividend paid	30 000	
Final ordinary dividend proposed	8 400	
Dividends paid		38 400
Retained profit for the year		38 532
Retained profit b/fwd		119 010
Retained profit c/fwd		157 542

Rall Ltd
Balance Sheet at 31 March 20X6

	Cost	Acc. Dep.	NBV
	£	£	£
Fixed assets			
Freehold property	201 600	48 384	153 216
Motor vehicles	90 000	43 860	46 140
Plant and machinery	160 800	96 480	64 320
	452 400	188 724	263 676
Current assets			
Stock		84 420	
Debtors	124 968		
Less: Provision for doubtful debts	5 918	119 050	
Cash at bank		2 924	
		206 394	
Creditors due within one year			
Trade creditors		70 878	
Accruals		3 000	
Debenture interest		2 250	
Ordinary dividend		8 400	
		84 528	
Net current assets			121 866
Total assets less current liabilities			385 542
Creditors falling due in more than one year			
10% Debenture 20X9			90 000
Net assets			295 542
Shareholders' funds			
Capital and Reserves:			
Ordinary shares of £1 each			120 000
Share premium			18 000
Retained profits			157 542
Total shareholders' funds			295 542

Question 5

Poco plc
Trading, Profit & Loss and Appropriation Account for the year ended 31 May 20X8

	£	£
Sales		609 141
Cost of sales		
Opening stock	26 364	
Purchases	349 003	
	375 367	
Less: Closing stock	48 230	
		327 137
Gross profit		282 004
Less: Expenses		
Delivery expenses	19 634	
Wages and salaries (£41 177 + £5 460)	46 637	
Directors' remuneration	43 680	
Rent and rates (£15 015 - £260)	14 755	
Advertising	13 650	
Sundry expenses	10 748	
Insurance	2 470	
Bad debts	763	
Increase in provision for doubtful debts	650	
Depreciation: Buildings (£364 000 x 4%)	14 560	
Motor vehicles (£73 060 x 20%)	14 612	
Plant and machinery (£23 270 x 40%)	9 308	
Bank interest	2 639	
Debenture interest	3 380	
		197 486
Net profit for year		84 518
Final ordinary dividend proposed		10 400
Retained profit for the year		74 118
Retained profit b/fwd		45 362
Retained profit c/fwd		119 480

Poco plc
Balance sheet at 31 May 20X8

	Cost £	Acc. Dep. £	NBV £
Fixed assets			
Leasehold premises	364 000	60 060	303 940
Motor vehicles	73 060	18 057	55 003
Fixtures and fittings	45 500	31 538	13 962
	482 560	109 655	372 905
Current assets			
Stock		48 230	
Debtors	140 153		
Less: provision for bad debts	3 770	136 383	
Prepayments		260	
Cash in hand		481	
		185 354	
Creditors due within one year			
Bank overdraft		23 075	
Trade creditors		40 654	
Accruals		5 460	
Debenture interest		1 690	
Ordinary dividend		10 400	
		81 279	
Net current assets			104 075
Total assets less current liabilities			476 980
Creditors falling due in more than one year			
10% Debenture			33 800
Net assets			443 180
Shareholders' funds			
Capital and Reserves:			
Ordinary shares of £1 each			130 000
Share premium			45 825
Profit and loss account			119 480
General reserve			91 000
Ordinary shareholders' (equity) funds			386 305
8% Preference shares			56 875
Total shareholders' funds			443 180

Chapter 10
Control Accounts

Answers to 'Think about it' Questions

Page 101 – Other control/checking measure or process introduced at Level 1:

- Trial balance
- Bank Reconciliation statement

Page 103 – What does the balance on the Sales Ledger Control Account represent?

- As the balance is on the debit side this indicates that this is the amount owed to the business by its debtors. If the balance was on the other side, this would indicate that the business owes this amount to debtors; probably for a refund, or for a credit note, or an overpayment by the debtor.

Page 106 – What does the balance on the Purchases Ledger Control Account represent?

- As the balance is on the credit side, this indicates that this is the amount owed to creditors by the business. If the balance was on the debit side, this would indicate that a creditor(s) owes the business a refund or for a credit note for goods returned after settlement made, or for an overpayment.

Solutions to Target Practice Questions

Question 1

Sales Ledger Control Account

		£			£
01/01/20X3	Balance b/d	37 170	01/01/20X3	Balance b/d	196
31/12/20X3	Credit sales	100 819	31/12/20X3	Bank: (payments received)	96 371
31/12/20X3	Bank: (payments to debtors)	42	31/12/20X3	Discounts allowed	597
			31/12/20X3	Bad debts written off	1 002
			31/12/20X3	Contra	364
31/12/20X3	Balance c/d	154	31/12/20X3	Balance c/d	39 655
		138 185			138 185
01/01/20X4	Balance b/d	39 665	01/01/20X4	Balance b/d	154

Purchases Ledger Control Account

		£			£
01/01/20X3	Balance b/d	1 178	01/01/20X3	Balance b/d	20 372
31/12/20X3	Purchase returns (returns outwards)	1 723	31/12/20X3	Credit purchases	61 179
31/12/20X3	Bank: (payments to creditors)	56 381			
31/12/20X3	Discounts received	1 554			
31/12/20X3	Contra	364			
31/12/20X3	Balance c/d	21 529	31/12/20X3	Balance c/d	1 178
		82 729			82 729
01/01/20X4	Balance b/d	1 178	01/01/20X4	Balance b/d	21 529

Question 2

Sales Ledger Control Account					
		£			£
01/01/20X4	Balance b/d	15 030	01/01/20X4	Balance b/d	42
30/06/20X4	Credit sales	93 450	30/06/20X4	Bank: (payments received)	89 948
			30/06/20X4	Discounts allowed	2 610
			30/06/20X4	Sales returns (returns inwards)	797
			30/06/20X4	Bad debts written off	153
			30/06/20X4	Contra	329
30/06/20X4	Balance c/d	28	30/06/20X4	Balance c/d	14 629
		108 508			108 508
01/07/20X4	Balance b/d	14 629	01/07/20X4	Balance b/d	28

Purchases Ledger Control Account					
		£			£
01/01/20X4	Balance b/d	9	01/01/20X4	Balance b/d	11 145
30/06/20X4	Purchase returns (returns outwards)	180	30/06/20X4	Credit purchases	71 685
30/06/20X4	Bank: (payments to creditors)	70 264			
30/06/20X4	Discount received	2 138			
30/06/20X4	Contra	329			
30/06/20X4	Balance c/d	9 930	30/06/20X4	Balance c/d	20
		82 850			82 850
01/07/20X4	Balance b/d	20	01/07/20X4	Balance b/d	9 930

Question 3

Sales Ledger Control Account					
		£			£
01/03/20X7	Balance b/d	11 278	01/03/20X7	Balance b/d	206
31/03/20X7	Credit sales	67 660	31/03/20X7	Bank: (payments received)	61 472
31/03/20X7	Interest charged to customers	112	31/03/20X7	Discounts allowed	2 180
31/03/20X7	Bank:(dishonoured cheques)	470	31/03/20X7	Sales returns (returns inwards)	2 756
			31/03/20X7	Bad debts written off	240
			31/03/20X7	Contra	431
31/03/20X7	Balance c/d	268	31/03/20X7	Balance c/d	12 503
		79 788			79 788
01/04/20X7	Balance b/d	12 503	01/04/20X7	Balance b/d	268

Purchase Ledger Control Account					
		£			£
01/03/20X7	Balance b/d	121	01/03/20X7	Balance b/d	6 845
31/03/20X7	Purchase returns (returns outwards)	1 335	31/03/20X7	Credit purchases	51 494
31/03/20X7	Bank: (payments to creditors)	46 771			
31/03/20X7	Discounts received	1 512			
31/03/20X7	Contra	431			
31/03/20X7	Balance c/d	8 335	31/03/20X7	Balance c/d	166
		58 505			58 505
01/04/20X7	Balance b/d	166	01/04/20X7	Balance b/d	8 335

Foley Fixings
Balance Sheet Extract at 31 March 20X7

Current Assets	**£**
Debtors (£12 503 + £166)	12 669
	12 669

Current Liabilities	**£**
Creditors (£8 335 + £268)	8 603
	8 603

Chapter 11
Incomplete Records

Answers to 'Think about it' Questions

Page 119 – How could we tell that the cash balances were debit ones?

- Because it is not possible for the cash account to have a credit balance

Page 121 – Why is the comparison of capital method of calculating profit not recommended?

- This method does not provide enough information for management purposes; for example, no information about gross profit or expenses and revenues is shown which are important for business planning

Solutions to Target Practice Questions

Question 1

Sales / Debtors			
	£		£
Debts taken over	1 134	Payments received	33 870
Sales for the year	36 583	Discounts allowed	1 023
		Bad debts written off	460
		Contra	609
		Balance c/d	1 755
	37 717		37 717

Workings:
Debtors at 31 August 20X7: £1820 - £65 = £1755
Bad debts written off: £395 + £65 = £460

Question 2

Purchases / Creditors			
	£		£
Paid to creditors	21 096	Creditors taken over	994
Discounts received	190	Purchases for the year	22 397
Contra	609		
Cash purchases	207		
Balance c/d	1 289		
	23 391		23 391

Question 3

(a) Calculation of opening and closing capital

Assets and Liabilities at	1 January 20X3 £	31 December 20X3 £
Shop fittings	13 200	11 200
Stock	42 240	49 170
Debtors	48 180	33 660
Bank	23 100	30 060
Cash	1 650	2 640
Creditors	(34 320)	(26 400)
Capital	94 050	100 330

(b) Net profit calculation

	£
Capital at 31 December 20X3	100 330
Capital at 1 January 20X3	94 050
Increase in capital : Apparent profit	6 280
Add: Drawings	16 500
Estimated net profit	22 780

(c)

Phil Fordham
Trading, Profit and Loss Account for the year ended 31 December 20X3

	£	£
Sales		
Cost of sales		198 250
Opening stock	42 240	
Purchases	129 000	
	171 240	
Less: Closing stock	49 170	
		122 070
Gross profit		76 180
Less: Expenses		
Business expenses (£50 490 + £910)	51 400	
Depreciation (£13 200 - £11 200)	2 000	
		53 400
Net profit		22 780

Phil Fordham
Balance Sheet at 31 December 20X3

	£	£
Fixed assets		
Shop fittings		11 200
Current assets		
Stock	49 170	
Debtors	33 660	
Bank	30 060	
Cash in hand	2 640	
	115 530	
Current liabilities		
Creditors	26 400	
	26 400	
Net current assets		89 130
Net assets		100 330
Capital		
Capital at 1 January 20X3		94 050
Profit for the year		22 780
		116 830
Less: Drawings		16 500
Capital at 31 December 20X3		100 330

Workings:

Sales / Debtors

	£		£
Balance b/d	48 180	Payments received	210 870
Sales for the year	198 250	Cash sales	1 900
		Balance c/d	33 660
	246 430		246 430

Purchases / Creditors

	£		£
Paid to creditors	136 920	Balance b/d	34 320
Balance c/d	26 400	Purchases for the year	129 000
	163 320		163 320

Question 4

(a)

Fran Fosset
Statement of Affairs at 1 July 20X7

	£	£
Fixed assets		
Motor vehicle (NBV)		5 225
Current assets		
Stock	4 400	
Debtors	4 290	
Bank	963	
	9 653	
Current liabilities		
Creditors	3 718	
	3 718	
		5 935
Capital at 1 July 20X7		11 160

(b)

Sales / Debtors

	£		£
Balance b/d	4 290	Payments received	98 450
Sales for the year	99 385	Balance c/d	5 225
	103 675		103 675

(c)

Purchases / Creditors

	£		£
Paid to creditors	53 020	Balance b/d	3 718
Balance c/d	4 532	Purchases for the year	53 834
	57 552		57 552

(d)

Fran Fosset
Trading, Profit and Loss Account for the year ended 30 June 20X8

	£	£
Sales		
Cost of sales		99 385
Opening stock	4 400	
Purchases	53 834	
	58 234	
Less: Closing stock	4 950	
		53 284
Gross profit		46 101
Bank interest received		138
		46 239
Less: Expenses		
Wages for staff	11 770	
Rent (£1045 + £550)	1 595	
Vehicle running expenses	1 815	
Other general expenses (£4202 - £935)	3 267	
Depreciation (£5225 - £3850)	1 375	
		19 822
Net profit		26 417

Fran Fosset
Balance Sheet at 30 June 20X8

	£	£
Fixed assets		
Motor vehicle (NBV)		3 850
Current assets		
Stock	4 950	
Debtors	5 225	
Prepayments	935	
Bank	21 979	
	33 089	
Current liabilities		
Creditors	4 532	
Accruals	550	
	5 082	
Net current assets		28 007
Net assets		31 857
Capital		
Capital at 1 July 20X7		11 160
Profit for the year		26 417
		37 577
Less: Drawings		5 720
Capital at 30 June 20X8		31 857

Question 5

Workings:

The following accounts need to be prepared to calculate the sales and purchases figures for the trading account and the business and depreciation expense for the profit and loss account.

Sales / Debtors

	£		£
Balance b/d	50 400	Bank	141 400
Sales for the year	140 000	Balance c/d	49 000
	190 400		190 400

Purchases / Creditors

	£		£
Bank	57 806	Balance b/d	45 500
Balance c/d	42 000	Purchases for the year	54 306
	99 806		99 806

Business Expenses

	£		£
Balance b/d	420	Balance b/d	870
Bank	42 000	Profit and Loss Account	41 769
Balance c/d	762	Balance c/d	543
	43 182		43 182

Plant and Equipment

	£		£
Introduced by Far	70 000	Profit and Loss Account	5 250
		Balance c/d	64 750
	70 000		70 000

Sand and Iego
Trading, Profit and Loss Account for the year ended 31 March 20X2

	£	£
Sales		140 000
Cost of sales		
Opening stock	35 000	
Purchases	54 306	
	89 306	
Less: Closing stock	38 500	
		50 806
Gross profit		89 194
Less: Expenses		
Business expenses	41 769	
Depreciation	5 250	
		47 019
Net profit		42 175

Sand and Iego
Appropriation Account for the year ended
31 March 20X2

	£	£
Net profit		42 175
Interest on capital:		
Sand (£60 000 x 5%)	3 000	
Iego (£30 000 x 5%)	1 500	
		4 500
		37 675
Iego - Salary		5 000
		32 675
Profit share		
Sand (3/5)	19 605	
Iego (2/5)	13 070	
		32 675

Sand and Iego
Balance Sheet at 31 March 20X2

	£	£
Fixed assets		
Plant and equipment		64 750
Current assets		
Stock	38 500	
Debtors	49 000	
Bank	1 694	
Prepayments	543	
	89 737	
Liabilities		
Creditors	42 000	
Accruals	762	
	42 762	
Net current assets		46 975
Net assets		111 725
Capital accounts		
Sand	60 000	
Iego	30 000	
		90 000
Current accounts		
Sand (£15 290 + £3000 + £19 605 - £24 000)	13 895	
Iego (£6260 + £1500 + £5000 + £13 070 - £18 000)	7 830	
		21 725
		111 725

Chapter 12
Stock Valuation

Answers to 'Think about it' Questions

Page 134 – Which accounting concept is the principle of valuing stock at NRV based on?

- It is based on the accounting concept of 'prudence'. If stock is not valued at NRV where it is less than cost, then closing stock will be overvalued and gross profit overstated. Additionally, using this valuation principle will ensure that the loss on stock is matched to the period of purchase, where the loss occurred, rather than in the period where the goods are sold.

Solutions to Target Practice Questions

Question 1

Type of bird house	Purchases (A)	Sales (B)	Stock quantity (A – B)	£ per bird house	Total stock value
Small hanging bird house	5 000	3 500	1 500	15	22 500
Large hanging bird house	8 000	6 200	1 800	19	34 200
Small thatched bird house	9 000	6 500	2 500	35	87 500
Large thatched bird house	12 000	9 700	2 300	45	103 500
	Total stock value				247 700

Geoffrey Wollowmead
Trading Account for the year ended
30 June 20X7

	£	£
Sales *[1]		1 155 000
Less: Cost of sales		
Purchases *[2]	1 082 000	
Less: Closing stock	247 700	
		834 300
Gross profit		320 700

Workings:

*[1] (3500 x £22 + (6200 x £25) + (6500 x £45) + (9700 x £65)

*[2] (5000 x £15) + (8000 x £19) + (9000 x £35) + (12 000 x £45)

Question 2

Classy Feet: Stock valuation at 31 March 20X4			
	Cost £	**NRV £**	**Total £**
Original stock value			15 692
(a) Trainers	15 x £35 = £525	15 x (80% x £35) = £420	(105)
(b) Boots	£1200	£2000 x 30% = £600	(600)
(c) Ladies shoes	20 x £26 = £520	20 x (£28 - £4) = £480	(40)
(d) Men's formal footwear	£500	NIL	(500)
Revised stock valuation			14 447

If the NRV is lower than the cost then the difference between the two figures must be deducted from the original stock value.

Question 3

Carol Carlton
Trading Account for the year ended
31 December 20X7

	£	£
Sales		18 000
Less: Cost of sales		
Opening stock	38 720	
Purchases	12 000	
	50 720	
Less: Closing stock (missing figure)	39 020	
Cost of goods sold		11 700
Gross profit (35% of sales)		6 300

Working from the known figures to the unknown figures: Use sales less gross profit to calculate the cost of goods sold (£11 700); then subtract the cost of goods sold from the cost of goods available for resale (£50 720) to find closing stock.

Therefore closing stock is:
£50 720 - £11 700 =
£39 020

The cost of stock stolen was £39 020 - £9360 = £29 660

Chapter 13
Manufacturing Account

Solutions to Target Practice Questions

Question 1

	Direct materials	Indirect materials	Direct labour	Direct expenses	Production overheads
Raw materials	✓				
Business rates					✓
Wages of factory foreman					✓
Crane hire for one order				✓	
Royalties				✓	
Depreciation of machinery					✓
Machine operators wages			✓		
Grease for machines		✓			

Question 2

Resin Ltd
Manufacturing Account for the year ended
30 September 20X7

	£	£
Raw materials		
Opening stock - raw materials	89 900	
Purchases – raw materials	756 900	
Carriage on raw materials purchased	39 150	
	885 950	
Less: Returns to raw materials suppliers	(26 100)	
Less: Closing stock - raw materials	(146 450)	
Cost of raw materials consumed		713 400
Direct wages (£861 300 + £17 400)		878 700
Direct expenses		47 850
Prime cost		1 639 950
Add: Production overheads		609 000
		2 248 950
Add: Opening work in progress	188 500	
Less: Closing work in progress	(220 400)	
		(31 900)
Production (manufacturing) cost		2 217 050

Question 3

Resin Ltd
Manufacturing Account for the year ended
30 September 20X7

	£	£
Raw materials		
Opening stock - raw materials	89 900	
Purchases – raw materials	756 900	
Carriage on raw materials purchased	39 150	
	885 950	
Less: Returns to raw materials suppliers	(26 100)	
Less: Closing stock - raw materials	(146 450)	
Cost of raw materials consumed		713 400
Direct wages (£861 300 + £17 400)		878 700
Direct expenses		47 850
Prime cost		1 639 950
Add: Opening work in progress	139 200	
Less: Closing work in progress	(162 400)	(23 200)
		1 616 750
Add: Production overheads		609 000
Production (manufacturing) cost		2 225 750
Manufacturing Profit		445 150
Transfer to Trading Account		2 670 900

Question 4

Kevin Coyle
Manufacturing Account for the year ended
31 March 20X6

	£	£
Raw materials		
Opening stock - raw materials	4 250	
Purchases – raw materials	22 500	
Carriage inwards	1 000	
	27 750	
Less: Closing stock - raw materials	(3 625)	
Cost of raw materials consumed		24 125
Direct wages		23 125
Prime cost		47 250
Add: Production overheads		
Rent	3 516	
Insurance	891	
General expenses	1 500	
Lighting	2 343	
Depreciation: Plant and machinery	1 875	
		10 125
		57 375
Add: Opening work in progress	3 000	
Less: Closing work in progress	(4 500)	
		(1 500)
Production (manufacturing) cost		55 875

Kevin Coyle
Trading & Profit and Loss Account for the year ended 31 March 20X6

	£	£
Sales		112 500
Opening stock –finished goods	7 625	
Production cost	55 875	
Closing stock – finished goods	(10 250)	
		53 250
Gross profit		59 250
Add: Discount received		2 000
		61 250
Less: expenses		
Office salaries	21 125	
Rent	1 172	
General expenses	938	
Insurance	297	
Advertising	1 750	
Lighting	781	
Bad debts	812	
Carriage outwards	469	
Depreciation: Motor vehicle	625	
		27 969
Net profit		33 281

Kevin Coyle
Balance Sheet at 31 March 20X6

	£	£	£
Fixed assets			
Plant and machinery (NBV)			9 500
Motor vehicles (NBV)			4 625
			14 125
Current assets			
Stock: Raw materials	3 625		
Work in progress	4 500		
Finished goods	10 250		
		18 375	
Trade debtors		9 625	
Bank		4 500	
		32 500	
Creditors falling due within one year			
Trade Creditors		7 500	
Net current assets			25 000
Net assets			39 125
Capital			
Opening capital			21 344
Net profit			33 281
			54 625
Less: Drawings			15 500
			39 125

Question 5

(a)

Edwin Crump Ltd
Manufacturing Account for the year ended
31 December 20X8

	£	£
Raw materials		
Opening stock - raw materials	29 900	
Purchases – raw materials	651 300	
Carriage inwards	35 640	
	716 840	
Less: Purchase returns – raw materials	(19 500)	
Less: Closing stock - raw materials	(50 700)	
Cost of raw materials consumed		646 640
Direct wages		302 250
Prime cost		948 890
Add: Production overheads		
Indirect wages	60 450	
Production salaries	54 600	
Production overheads	241 800	
Depreciation	68 640	
		425 490
		1 374 380
Add: Opening work in progress	20 800	
Less: Closing work in progress	(28 600)	
		(7 800)
Production (manufacturing) cost		1 366 580

(b)

Edwin Crump Ltd
Trading Account for the year ended
31 December 20X8

	Manufactured £	**Bought** £		**Manufactured** £	**Bought** £
Opening stock	32 500	31 200	Sales	1 665 300	713 700
Production (manufacturing) cost	1 366 580				
Purchases		509 600			
Carriage		18 960			
	1 399 080	559 760			
Less: Closing stock	(44 295)	(36 750)			
Cost of sales	1 354 785	523 010			
Gross profit	310 515	190 690			
	1 665 300	713 700		1 665 300	713 700

Chapter 14
Non-trading Organisations

Answers to 'Think about it' Questions

Page 164 – Why is it important for any organisation to prepare a bank reconciliation statement?

- A bank reconciliation statement is necessary to explain any differences between the cash book and the bank statement and to identify any errors that may have been made in the cash book or the bank statement. It is important that the bank balance is correct as it is shown on the balance sheet; an incorrect figure may be misleading.

Solutions to Target Practice Questions

Question 1

Business	Non-trading organisation
Profit and Loss Account	Income and Expenditure Account
Profit	Surplus or Excess of income over expenditure
Loss	Deficit or Excess of expenditure over income
Capital	Accumulated Fund

Question 2

Skitter Bowls Club
Receipts and Payments Account
for the year ended 31 December 20X2

RECEIPTS	£	PAYMENTS	£
Balance b/d – Cash in hand	145	Rent paid	1 200
Balance b/d – Cash at bank	2 366	Competition prizes	465
Subscriptions	4 950	Stationery	115
Competition entry fees	600	Advertising	300
Sale of refreshments	845	Purchases of refreshments	532
Donations	200	Purchase of lawn mower	1 575
		Balance c/d – Cash in hand	75
		Balance c/d – Cash at bank	4 844
	9 106		9 106

Question 3

Skitter Bowls Club
Receipts and Payments Account for the year ended 31 December 20X2

	£	£
Cash in hand	145	
Cash at bank	2 366	
		2 511
Receipts		
Subscriptions	4 950	
Competition entry fees	600	
Sales of refreshments	845	
Donations	200	
		6 595
		9 106
Payments		
Rent paid	1 200	
Competition prizes	465	
Stationery	115	
Advertising	300	
Purchase of refreshments	532	
Purchase of lawn mower	1 575	
		4 187
Cash in hand	75	
Cash at bank	4 844	
		4 919

Question 4

Dixie Railway Enthusiasts Club
Catering Trading Account
for the year ended 30 April 20X7

	£	£
Sales (£25 694 - £1720 + £1496)[1]		25 470
Opening stock	2 500	
Purchases (£15 250 - £1164 + £1838)[2]	15 924	
	18 424	
Less: Closing stock	(2 850)	
		15 574
		9 896
Less: Expenses		
Wages for catering staff (£6725 - £244 + £269)	6 750	
Insurance (£350 + £125 - £145)	330	
Premises' expenses (£1472 + £216 - £246)	1 442	
		8 522
Catering profit		1 374

Notes:

1. To calculate the catering sales receipts relating to the current year, the amount of £1720, which was received for last year's sale, is subtracted and the amount owing at the end of the current year is added.
2. Purchases is also adjusted to account for the amounts owing for last year and the current year

Question 5

Seadley Boys Football Club
Income and Expenditure Account for the year ended 31 August 20X9

	£	£
Income		
Gate fees		6 960
Profit from sale of refreshments		9 108
Donations		460
Sponsorship		1 280
Advertising revenue		586
		18 394
Less: Expenditure		
Rent for pitch (£2640 - £200)	2 440	
Repairs to equipment (£347 + £280)	627	
Pitch maintenance expenses	450	
Groundsman's wages	5 110	
Printing and stationery	602	
Sundry expenses	7 414	
Depreciation of equipment ((£3300 + £630) x 20%)[1]	786	
		17 429
Surplus / Excess of income over expenditure		965

Notes:

1. Equipment of £630 is added to the net book value of equipment currently on the books (£3300). The total of £3930 is then used in calculating the depreciation for the year, i.e. £3930 x 20% = £786

Chapter 15
Non-trading Organisations: Subscriptions Account and Balance Sheet

Solutions to Target Practice Questions

Question 1

Chuggle Bowls Club
Subscriptions Account

	£		£
Balance b/d – Subscriptions owing	540	Balance b/d – Subscriptions prepaid	180
Income and Expenditure Account	9 660	Subscriptions received – re 20X1	360
		Subscriptions received – re 20X2	8 760
		Subscriptions received – re 20X3	240
Balance c/d – Subscriptions prepaid	240	Balance c/d – Subscriptions owing	900
	10 440		10 440
Balance b/d – Subscriptions owing	900	Balance b/d – Subscriptions prepaid	240

Question 2

Coldridge Canary Club
Accumulated Fund at 31 December 20X3

	£	£
Club house		18 500
Motor van		1 400
		19 900
Stock of competition prizes		435
Bank		885
Cash in hand		220
		21 440
Loan	6 700	
Competition entry fees paid in advance	280	
Accrued expenses for club secretary	600	
Owing to suppliers of competition prizes	350	
		(7 930)
Accumulated fund		13 510

Question 3

Totem Kick-boxing Club
Accumulated Fund at 30 April 20X7

	£	£
Club house		45 000
Sports equipment		2 300
Stock of merchandise		1 105
Prepaid club expenses		325
Subscriptions in arrears		108
High interest bank account		5 000
Cash in hand		140
		53 978
Loan	33 750	
Accrued staff wages	89	
Subscriptions in advance	216	
Bank overdraft	727	
Owing to suppliers of merchandise	776	
		(35 558)
Accumulated fund		18 420
Life fund		2 000
		16 420

Question 4

Workings

Kidling Gardeners Association
Accumulated Fund at 30 June 20X5

	£	£
Gardening tools and equipment		2 725
Stock of seeds		130
Subscriptions in arrears		115
Bank		345
Prepaid insurance		55
		3 370
Creditor for seeds	175	
Subscriptions in advance	85	
		(260)
Accumulated fund at 30 June 20X5		3 110

Subscriptions Account

	£		£
Balance b/d – Subscriptions owing	115	Balance b/d – Subscriptions prepaid	85
Income and Expenditure Account	2 105	Subscriptions received	2 175
Balance c/d – Subscriptions prepaid	145	Balance c/d – Subscriptions owing	105
	2 365		2 365

Kidling Gardeners Association
Seed Trading Account
for the year ended 30 June 20X6

	£	£
Sales		1 812
Opening stock	130	
Purchase of seeds (£1090 - £175 + £126) [1]	1 041	
	1 171	
Less: Closing stock	(145)	
		1 026
Seeds Profit		786

Kidling Gardeners Association
Income and Expenditure Account for the year ended 30 June 20X6

	£	£
Income		
Subscriptions		2 105
Profit on sale of seeds		786
Flower show entry fees	210	
Flower show prizes	195	
Profit on flower show		15
Annual trip to Chelsea Flower Show	650	
Annual trip expenses	530	
Profit on annual trip		120
Equipment hire		490
		3 516
Expenditure		
Costs of visiting speakers	900	
Hire of hall for meetings	1 200	
Advertising	95	
Insurance (£120 + £55 - £60) [2]	115	
Secretary's expenses	375	
Depreciation Gardening tools and equipment (£2725 - £2044) [3]	681	
		3 366
Surplus / Excess of income over expenditure		150

Notes:

1. Adjusted to account for the amount owing at the end of the current year as well as for the previous year.
2. Figure adjusted for prepayment at start and close of the year
3. As there were no purchases of gardening tools and equipment during the year, the difference between the net book value at start and the net book value at end is the depreciation figure.

Kidling Gardeners Association
Balance Sheet at 30 June 20X6

	£	£
Fixed assets		
Gardening tools and equipment		2 044
Current assets		
Stock of seeds	145	
Subscriptions in arrears	105	
Prepaid insurance	60	
Bank	1 177	
	1 487	
Current liabilities		
Subscriptions in advance	145	
Owed to suppliers seeds	126	
	271	
Net current assets		1 216
Net assets		3 260
Represented by:		
Accumulated fund		
At 1 July 20X5		3 110
Surplus / Excess of income over expenditure		150
At 30 June 20X6		3 260

Question 5

Workings:

Covington Handbell Ringers Society
Accumulated Fund at 31 December 20X6

	£	£
Handbells - valuation		12 000
Bank		1 312
Subscriptions in arrears		600
		13 912
Subscriptions in advance	300	
Owed to suppliers of music	65	
		(365)
		13 547

Subscriptions Account

	£		£
Balance b/d – Subscriptions owing	600	Balance b/d – Subscriptions prepaid	300
Income and Expenditure Account	7 500	Subscriptions received	7 050
Balance c/d – Subscriptions prepaid	450	Balance c/d – Subscriptions owing	1 200
	8 550		8 550

Covington Handbell Ringers Society
Income and Expenditure Account for the year ended 31 December 20X7

	£	£
Income		
Subscriptions		7 500
Concert ticket sales	3 000	
Hire of concert venue	2025	
Profit on concert		975
		8 475
Expenditure		
Hire of practice hall	2 600	
Maintenance of handbells	1 200	
Purchase of music (£2450 - £65 + £112) [1]	2 497	
Club secretary expenses	275	
Depreciation: Handbells (£12 000 - £10 000)	2 000	
		8 572
Deficit / Excess of expenditure over income		(97)

Covington Handbell Ringers Society
Balance Sheet at 31 December 20X7

	£	£
Fixed assets		
Handbells (£10 000 + £4000) [2]		14 000
Current assets		
Subscriptions in arrears	1 200	
Bank	2 812	
	4 012	
Current liabilities		
Subscriptions in advance	450	
Owed to suppliers of music	112	
	562	
		3 450
		17 450
Represented by:		
Accumulated fund		
At 1 January 20X7		13 547
Legacy donation		4 000
Deficit / Excess of expenditure over income		(97)
At 31 December 20X7		17 450

Notes:

1. Figure adjusted to account for the amount owing to music suppliers and the start and end of the year..
2. The handbells donated (£4000) is added to show the total value of fixed assets (handbells) at the end of the year.

Chapter 16
Errors and the Use of a Suspense Account

Answers to 'Think about it' Questions

Page 196 – Now that there is no longer a balance on the suspense account (shown on the page), what does this tell you?

- If the balance on the suspense is cleared this indicates that all the errors, which caused the difference on the trial balance, have been found and corrected.

Solutions to Target Practice Questions

Question 1

Error	Type of Error
(a) A purchases invoice for £452 had been entered into the books of account as £425.	Error of Original Entry
(b) A sales invoice for £200 was debited to the account of S. Smith instead of S. Smyth.	Error of Commission
(c) A purchases invoice for stationery, totalling £375 had not been entered into the books of account.	Error of Omission
(d) The purchase of a computer costing £1200 had been posted to the Stationery Account.	Error of Principle
(e) A sales receipt from Co-Com Ltd was entered in the books of account as a debit to Co-Com Ltd and a credit to the Bank.	Reversal of Entries
(f) The additions on the Sales Account were overcast by £200 and the additions on the Rent Account were overcast by £200.	Compensating Error

Question 2

		Dr	Cr
		£	£
(a)			
	Britsom Ltd – Purchases Ledger	1 500	
	Bryson Ltd – Purchases Ledger		1 500
(b)			
	Sales	259	
	Sales Ledger Control		259
	Walters Ltd – Sales Ledger (memo)		259
	Sales Ledger Control	295	
	Walters Ltd – Sales Ledger (memo)	295	
	Sales		295
(c)			
	Carriage inwards	62	
	Carriage outwards		62

(d)		Dr £	Cr £
	Purchases Ledger Control	678	
	Slipshod Ltd – Purchases Ledger (memo**)**	678	
	Bank		678
	Purchases Ledger Control	678	
	Slipshod Ltd – Purchases Ledger (memo)	678	
	Bank		678
OR			
	Purchases Ledger Control	1 356	
	Slipshod Ltd – Purchases Ledger (memo)	**1 356**	
	Bank		1 356
(e)			
	Petrol	38	
	Bank		38

Question 3

	Dr £	Cr £
Fixed Assets	1 875	
Suspense Account		1 875
Suspense Account	5 250	
Trade Debtors		5 250
Business Expenses	2 250	
Accruals		2 250
Electricity	862	
Stationery		862
Suspense Account	750	
Rent receivable		750

Suspense Account

	£		£
Trade debtors	5 250	Balance b/d	4 125
Rent receivable	750	Fixed assets	1 875
	6 000		6 000

Question 4

Suspense Account

	£		£
Balance b/d	442	Sales day Book under-cast	750
Bad debt	245		
Understated sales receipt	63		
	750		750

Sales Ledger Control

	£		£
Balance b/d	21 942	Correct sales invoice	500
Sales Day Book under-cast	750	Bad debt	245
Unrecorded sale	2 750	Understated sales receipt	63
		Balance c/d	24 634
	25 442		25 442
Balance b/d	24 634		

Sales Ledger	**£**
Balance b/d	22 058
Incorrect sales invoice	(500)
Unrecorded sale	2 750
Omitted account – T Tallis	326
	24 634

Question 5

	Dr £	**Cr** £
Sales Ledger Control Account	27	
Suspense Account		27
Suspense Account	170	
Discounts allowed		85
Discounts received		85
Bank charges	280	
Suspense Account		280
Suspense Account	63	
Purchases Ledger Control Account		63
Book-binding machines	9 820	
Purchases		9 820

Suspense Account

	£		£
Balance b/d	74	Sales Ledger Control Account	27
Discounts allowed	85	Bank charges	280
Discounts received	85		
Purchases Ledger Control Account	63		
	307		307

Amended profit calculation for
Kandoo Books Ltd at 30 June 20X7

	£
Draft profit	25 947
Decrease in discounts allowed	85
Increase in discounts received	85
Increase in bank charges	(280)
Decrease in purchases	9 820
Amended profit	35 657

Chapter 17
Calculation and Interpretation of Ratios

Answers to 'Think about it' Questions

Page 205 – Why would each of these parties be interested in the information provided by ratio analysis?

- The owners and managers would want to find out how profitable the business is and whether the business is providing a competitive return on the capital invested. They would also want to see if the forecasted growth has been achieved and where and how they are making their profit or loss.
- Present and potential investors would also be interested in profitability information from ratio analysis to decide whether or not the business is a good investment.
- Lenders and suppliers would be interested in the liquidity and the profitability of the firm; they would want to find out if the business is able to repay any loans, debts etc.
- The government would be interested mainly for taxation purposes and for information for national accounting

Solutions to Target Practice Questions

Question 1

Profitability ratios look at the relationship between profit and sales. This can be either gross profit or net profit.

Profitability also looks at the relationship between profit and capital employed.

Liquidity ratios measure the financial stability of the business. They consider whether the business can meets its current liabilities with its current assets.

Asset utilisation ratios examine how effectively management is using the assets of the business.

Question 2

(a) Gross profit margin percentage $\frac{86\ 400}{345\ 600}$ x 100 = 25.0%

For every £1 of sales the business makes £0.25 of gross profit.

(b) Net profit percentage $\frac{34\ 320}{345\ 600}$ x 100 = 9.9%

The business makes £0.09 profit for every £1 of sales after all expenses have been accounted for.

(c) Debtor' collection period $\frac{28\ 800}{345\ 600}$ x 365 = 30.4 days

This is the average number of days the company has to wait before receiving payment from debtors.

(d) Creditors' settlement period $\frac{20\ 160}{255\ 000}$ x 365 = 28.9 days

This is the average number of days the company takes to pay its creditors.

(e) Working capital / Current ratio

$$\frac{49\,560}{21\,780} = 2.3 : 1$$

This is the number of times that current liabilities are covered by current assets. The ratio indicates that Danrow has £2.30 of current assets for every £1 of current liabilities; Danrow could pay its current liabilities 2.30 times.

(f) Liquidity / Acid test ratio

$$\frac{31\,560}{21\,780} = 1.4 : 1$$

This is the number of times that current liabilities are covered by current assets without including stock. Danrow could still cover it current liabilities reasonably well without the need to convert stock to cash.

Question 3

1. Gross profit margin percentage

$$\frac{146\,250}{270\,000} \times 100 = 54.2\%$$

2. Net profit percentage

$$\frac{67\,500}{270\,000} \times 100 = 25.0\%$$

3. Debtors' collection period

$$\frac{27\,000}{270\,000} \times 365 = 36.5 \text{ days}$$

4. Creditors' settlement period

$$\frac{21\,750}{114\,750} \times 365 = 69.2 \text{ days}$$

5. Working capital / Current ratio

$$\frac{114\,750}{25\,350} = 4.5 : 1$$

6. Liquidity / Acid test ratio

$$\frac{81\,750}{25\,350} = 3.2 : 1$$

Question 4

	Rond Ltd			Trub Ltd		
Return on capital employed	1125 / 4320	x 100	= 26.04%	935 / 7160	x 100	=13.06%
Gross profit margin percentage	2115 / 3825	x 100	= 55.29%	2375 / 4950	x 100	= 47.98%
Net profit percentage	1125 / 3825	x 100	= 29.41%	935 / 4950	x 100	= 18.89%
Sales to capital employed	3825 / 4320		0.89 times	4950 / 7160		0.69 times
Stock turnover	1710 / 1125		1.52 times	2575 / 900		2.86 times
Debtors' collection period	450 / 3825	x 365	= 42.94 days	1125 / 4950	x 365	= 82.95 days
Creditors' settlement period	405 / 1710	x 365	= 86.45 days	675 / 2575	x 365	= 95.68 days
Working capital / Current ratio	1800 / 630		= 2.86 : 1	2030 / 1170		= 1.74:1
Liquidity / Acid test ratio	675 / 630		= 1.07 : 1	1130 / 1170		0.97:1

The recommendation would be that Rond Ltd appears to offer the most attractive investment opportunity because it is more profitable, has no long term loan commitments and is more liquid. However, Steer plc would need to consider whether both companies use similar accounting policies.

Question 5

	30 June 20X7			30 June 20X6		
1. Current ratio	2557 / 1273		= 2.01: 1	1946 / 1145		= 1.70:1
2. Acid test (Quick ratio)	1486 / 1273		= 1.17: 1	1257 / 1145		= 1.10 : 1
3. Stock turnover	3570 / 1071		= 3.33 times	3444 / 689		= 5.00 times
4. Debtors collection period	1486 / 5950	x 365	= 91 days	837 / 5740	x 365	= 53 days
5. Creditors settlement period	547 / 3570	x 365	= 56 days	1145 / 3444	x 365	= 121 days

Current ratio
This ratio gives an overall view of the financial stability of a company by considering whether its current liabilities are adequately covered by its current assets. The results of Hymid Ltd for each of the years ended 30 June 20X6 and 30 June 20X7 indicate that it can comfortably meet its current liabilities from its current assets. In fact the current ratio has risen in 20X7.

Acid test ratio
This ratio gives a better indication of a company's liquidity because it excludes stock, which may not be easily or quickly converted into cash. The acid test ratio has remained fairly stable over the two years.

Stock turnover
This ratio measures how many times the company has replaced its stock during the year. This has fallen in 20X7 from 5.00 times to 3.33 times. This indicates that the company is either not selling its stock as quickly or it is holding higher levels of stock. Either of these will have the effect of decreasing the bank balance.

Debtors' collection period
This is the average time it takes a company to collect its debts, expressed in days. In 20X7 Hymid Ltd took 38 days longer to collect its debts than in 20X6. This will mean that there is less cash being paid into the bank.

Creditors' settlement period

This is the average time it takes a company to pay its debts, expressed in days. This is not a very accurate ratio since trade creditors may include overheads, and if we are not given the purchases figure and have to use the cost of sales figure, this may be subject to fluctuations in stock levels.

A company will maximise its cash flow by collecting its debts before paying its creditors. In 20X6 Hymid Ltd collected its debts 68 days before paying its creditors, but in 20X7 this situation reversed, with creditors being paid 35 days earlier than debts are being collected. This will have an adverse effect on the cash flow of the company.

Overall, an increase in stock holding, debtors being allowed to pay one month later than previously and a reduction in the creditors' settlement period have contributed to the reduction in the bank balance.

Chapter 18
Preparing Simple Financial Statements Using Ratios

Solutions to Target Practice Questions

Question 1

The first step is to calculate gross profit:

Cost price	+	Gross profit	=	Selling price
£9 600		?		£13 440

Therefore gross profit is £3840.

Mark up

$$\frac{3\ 840}{9\ 600} \times 100 = 40.0\%$$

Margin

$$\frac{3\ 840}{13\ 440} \times 100 = 28.6\%$$

Question 2

Gross profit can be calculated as £234 500 x 65% = £152 425.

Cost of sales + gross profit = sales,

Therefore sales = £386 925.

Question 3

Gross profit can be calculated as 25% x £300 000 = £75 000.

Cost of sales is calculated as £300 000 - £75 000 = £225 000

Cost of sales comprises:

Opening stock	+ Purchases	– Closing stock	= Cost of sales
£32 000	+ **?**	£36 000	= £225 000

Therefore, the figure for purchases is £229 000.

Question 4

Workings:

(a) Average stocks (£8540 + £14 500) ÷ 2 = £11 520

(b) Calculate cost of sales using stock turnover

$$\frac{\text{Cost of Sales}}{\text{Stock}} \longrightarrow \frac{\textbf{?}}{11\ 520} = 5$$

Therefore cost of sales is 5 x £11 520 = £57 600

(c) Calculate purchases using cost of sales:

Opening stock	+	Purchases	–	Closing stock	=	Cost of sales		
£8540	+	**?**	-	£14 500	=	£57 600		

Therefore, the figure for purchases is £63 560.

(d) If gross profit is 40% of sales, then cost of sales is 60% of sales. Therefore, sales: £57 600 x (100 ÷ 60) = £96 000

(e) Fixed assets: £2500 x (100 ÷ 25) = £10 000 value of fixed assets at beginning of year. Fixed Assets at 31 March 20X5 are £10 000 - £2 500 = £7 500 NBV at 31 March 20X5

Carmen Foulkes
Trading and Profit & Loss Account for the year ended 31 March 20X5

	£	£
Sales		96 000
Cost of sales		
Opening stock	8 540	
Purchases	63 560	
	72 100	
Less: Closing stock	(14 500)	
		57 600
Gross profit		38 400
Less: Expenses		22 300
Net profit		16 100

Carmen Foulkes
Balance Sheet at 31 March 20X5

	£	£
Fixed assets		
Fixtures and fittings (NBV)		7 500
Current assets		
Stock	14 500	
Debtors	950	
Bank	1 692	
	17 142	
Current liabilities		
Creditors (balancing figure)	4 342	
	4 342	
Net current assets		12 800
Net assets		20 300
Capital		
Capital at 1 April 20X4		12 000
Net profit		16 100
		28 100
Less: Drawings (£150 x 52)		7 800
Capital at 31 March 20X5		20 300

Question 5

<u>Workings:</u>

(a) Average stock (£7392 + £11 088) ÷ 2 = £9 240

(b) Calculate cost of sales using stock turnover:

$$\frac{\text{Cost of Sales}}{\text{Stock}} \longrightarrow \frac{\textbf{?}}{9\ 240} = 15$$

Therefore, cost of sales is 15 x £9240 = £138 600

(c) Calculate purchases using cost of sales:

Opening stock + Purchases – Closing stock = Cost of sales
£7 392 + **?** – £11 088 = £138 600

Therefore, the figure for purchases is £142 296.

(d) Gross profit = £262 500 - £138 600 = £123 900

(e) Net profit = £262 500 x 15% = £39 375

(f) Calculate debtors using debtors' collection period

$$\frac{\text{Debtors}}{\text{Sales}} \text{ x 365 days} \longrightarrow \frac{\textbf{?}}{262\ 500} \text{ x 365 days} = 28$$

Therefore debtors is 28 ÷ 365 x £262 500 = £20 136 (rounded to the nearest £)

(g) Calculate creditors using creditors settlement period

$$\frac{\text{Creditors}}{\text{Purchases}} \text{ x 365 days} \longrightarrow \frac{\textbf{?}}{142\ 296} \text{ x 365 days} = 35$$

Therefore creditors is 35 ÷ 365 x £142 296 = £13 645 (rounded to the nearest £)

(h) Calculate the bank overdraft using current ratio:

Stock plus debtors is twice as large as creditors plus bank overdraft:

£11 088 + £20 136 = £31 224 ÷ 2 = £15 612 - £13 645 = £1967 bank overdraft

John Duffy
Trading and Profit & Loss Account for the year ended 31 December 20X8

	£	£
Sales		262 500
Cost of sales		
Opening stock	7 392	
Purchases	142 296	
	149 688	
Less: Closing stock	(11 088)	
		138 600
Gross profit		123 900
Less: Expenses (balancing figure)		84 525
Net profit		39 375

John Duffy
Balance Sheet at 31 December 20X8

	£	£
Fixed assets		
Fixtures and fittings (NBV)		52 500
Current assets		
Stock	11 088	
Debtors	20 136	
	31 224	
Current liabilities		
Creditors	13 645	
Bank overdraft	1 967	
	15 612	
Net current assets		15 612
Net assets		68 112
Capital		
Capital at 1 January 20X8		33 937
Net profit		39 375
		73 312
Less: Drawings (£100 x 52)		5 200
Capital at 31 December 20X8		68 112

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