

ACCOUNTING O.L

General Revision

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Explain The difference between Each of the following pairs of words or phrases.

1- Assets & Liabilities

- Assets : is an item of value owned by a company
- Liabilities : are creditors' claims on assets that reflect obligations to provide assets, products or services to others

2- Carriage inwards & Carriage outwards.

- Carriage inwards: is the shipping and handling costs incurred by a company that is receiving goods from suppliers (appear in income statement as a cost of Purchases)
- Carriage outwards: is the shipping and handling costs incurred by a company that is shipping goods to a customer. (appear in income statement as a other expenses)

3- Accounting & Bookkeeping

- Accounting : is an information system – includes the process of recording, classifying, summarizing, reporting, analyzing and interpreting the financial condition and performance of a business – in order to communicate it to stakeholders for business decision making.
- Bookkeeping: is the process of recording, in chronological order, the daily transactions of a business entity. It forms part of the accounting information system.

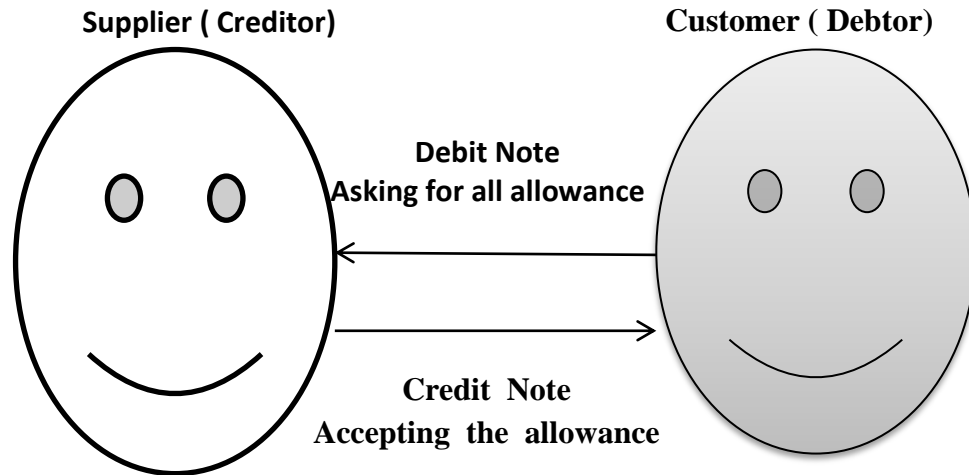
4- Error of principle & Error of Commission.

- Error of principle : when a transaction is entered using the correct amount and on the correct side but in the wrong account of the same class.
- Error of Commission: when a transaction is entered using the correct amount and on the correct side but in the wrong class

5- Debit Note& Credit note

- Debit Note: A document sent to a supplier asking for allowance for unsatisfactory good (reduction of the amount due)

- Credit Note: A document sent to a customer showing allowance given by supplier in respect of unsatisfactory good (reduction of the amount due)



6- Gross Profit & Net Profit.

- Gross Profit : It's that profit achieved by the business without taking in consideration the operating expenses as electricity and rent (the difference between the selling price and the cost price)

$$\text{Gross profit} = \text{Net Sales} - \text{Cost of Sales}$$
- Net Profit : It's the final profit that is awarded to the owner of the business at the end of each financial year after deducting all the expenses from all the revenue.

$$\text{Net profit} = \text{Gross profit} + \text{other revenue} - \text{other expenses.}$$

7- Service business & trading business

- Service business : do not have these inventories. Service firms derive their revenue from services which they provide to customers.
- Trading business : are businesses that buy goods which will be resold to its buyers. Trading firms usually have inventories of goods to be resold

8- Current Liabilities & non- Current Liabilities

- Current Liabilities : represents amounts payable within a period of 12 months from the balance sheet date as (Bank overdraft – trade payables – owing expenses)

- Non- Current Liabilities: : There are the amounts payable more than 12 months after the balance sheet date as (Loans)

9- Trade payable & Trade Receivables.

- Trade payable: (Creditors) Is the amount due to the suppliers who provide the company with its needs of inventory , goods , raw materials..... on credit
- Trade Receivables: (Debtors) amount owed by customers buying the company's goods on credit.

10- Capital expenditure & Revenue expenditure.

- Capital expenditure : Money paid to buy /install Non -Current assets and legal fees paid to register Non –Current assets . It's recorded at the balance sheet
- Revenue expenditure: Money paid to run a business . It's recorded as expenses at income statement

11- Bad debts & Provision for doubtful debts.

- Bad debts : Amount of money which the trade receivable won't be able to pay (Considered as expense)
- Provision for doubtful debts: It's an estimate to the amount of money the business won't be to collect from its trade receivables. (Varies from each year)

12- Bank Statement & bank Reconciliation Statement.

- Bank Statement : Is a copy of the business as it appears in the books of the bank.
- Bank Reconciliation Statement: shows the balance on the bank statement adjusted for amounts not yet credited , Cheques not yet presented and any Bank error . the final figure should agree with the balance in the bank account in the Cash book.

13- Margin & Mark – up

- Margin : Is the gross profit measured as a percentage of selling price
 $(\text{Gross profit} \div \text{Sales}) \times 100$
- Mark – up: Is the gross profit measured as a percentage of cost price
 $(\text{Gross profit} \div \text{cost of sales}) \times 100$

14- Partner's capital account & Partner's Current account.

- Partner's capital account : These accounts are kept to record the beginning contribution of partners in financing the business and any change occur to.
- Partner's Current account: These accounts are kept to record either the amount owed by or owed to partner for each year.

15- Prime Cost & Cost of production.

- Prime Cost : The Total of direct labor , direct material and direct expenses
- Cost of production : Is founding by adding the factory overhead to the prime cost.

16- Called up share Capital & paid up share capital.

- Called up share Capital : Total amount of shares the company had requested from shareholders
- paid up share capital.: part of called up capital where company had actually received from shareholders

17- Preference shares & Ordinary shares.

- Preference shares & Ordinary Shares are a Shares in a company (equity shares) but the Preference shares give their holders an entitlement to a fixed dividend but which do not usually carry voting rights. The important difference between preference and ordinary shares are:
1. The dividend on ordinary shares is uncertain and variable (high when the company does well, poor or non-existent when it does badly). Preference shareholders get a fixed dividend which, if not paid, usually accrues until it can be.
 2. Each ordinary share usually carries a vote. Preference shares do not usually carry a vote unless dividends fall into arrears.

3. In the event of a winding up, preference shares are usually repayable at par value, and rank above the claims of ordinary shareholders (but behind bank and trade creditors).
- Preference shares may be issued with the right of conversion into ordinary shares. These are called convertibles.

18- Capital owned & Capital employed.

- Capital owned : The amount and other resources employed in the business which belong to the owner of the business .(Total assets)
- Capital employed: Total assets less current liabilities. (capital + non- current liabilities)

19- Current Ratio & quick Ratio

- Current Ratio : How many times our Current assets cover our Current liabilities
- quick Ratio : : How many times our Current assets cover our Current liabilities without stock

20- Liquidity ratios & profitability ratios & Efficiency ratios

- Liquidity ratios : Ability of the business to pay its short-term debts whenever due and to continue its day-to-day operations.
- Profitability ratios : Ability of the firm to generate profits using its available resources.
- Efficiency ratios : Ability to maximize output from a given input.

21- Balance Sheet & Income Statement

- Balance Sheet : final account prepared to measure the final position of the business at the end of each financial year at the specific date
- Income Statement : Final account prepared to show either “ Net Profit “ or “ Net Loss” made by the business at the end of each financial year during the period.

22- Trade discount & cash discount

- Trade discount : A reduction given by the supplier to the customer for bulk purchases. Are not shown in the double entry account only appear in the

invoice And are deducted from the list price of the goods when recording in the day book.

- cash discount : A reduction given by the supplier to the customer to encourage quick payments. It's consists:
 - a) Discount allowed : A reduction given by the firm to the customer who pay their account within the time allowed
 - b) Cash discount : A reduction given to the firm by the supplier when we pay his account within the time allowed

Cash discount are shown in the double entry accounts and in the statement of account but not shown in the invoice or the day book

Provide a definition of each of the following words or phrases.

1. Capital	It's the owner investment in the business
2. Bank overdraft	A credit balance brought down in the bank column of the cash book
3. Contra entry	The transaction of Money withdraw from bank to place in cash vice versa
4. Imprest system of Petty cash	Each month to the petty cashier got certain float of money to spend from and pay day to day expenses at the end of the period the imprest amount is restored so that the petty cashier can start the new period
5. Net Current assets	The net deference between the current assets and the current liabilities
6. Prudence	Never anticipate a profit but estimate all losses .
7. Going concern	It's assumed that the business will continue to operate for an indefinite period of the time and that there is no intention to close down the business.
8. Accrued expense	Expenses incurred but not yet paid (current Liabilities)
9. Prepaid income	Revenues received in advance .(current Liabilities)
10. Depreciation	It's an estimate of loss in the Non-Current assets
11. Bad debt recovered	When the Trade receivable is able to pay the amount after writing it off as a bad debt. (considered as revenue)
12. Narrative in connection with Journal entry	A brief explanation of why the entry is being made , this is necessary because of the great variety transactions which are recorded in the journal
13. Control Account	Is an account which check the arithmetical accuracy of a ledger is to assist in locating errors in the sales ledger and purchase ledger
14. Accumulated fund	All surplus less deficit made by the club since it had arisen

15. Goodwill	It is an intangible fixed assets representing the good reputation of the firm which equal the difference between the net assets and selling price of the firm.
16. Direct expense of manufacturing	There are any expenses which a manufacturer can directly link with the product begin manufactured
17. Appropriation account	That account which shows how the profit for the year has been used
18. Collection period for trade receivables	How long it takes us to collect our money from trade receivables ((debtor) – shorter is better- (debtors ÷ credit sales) × 365
19. Rate of turnover	How many times the inventory is sold and replaced during a period of the time – higher is better-
20. Dividends	Proposed by the directors at the year end will not be paid by the balance sheet date and must therefore be shown in the balance sheet as a liability.
21. Authorized – share capital	Maximum amount of the shared capital the business is allowed to issue.
22. Issued share - capital	Amount of share capital issued for sale.

- **Explain why some transactions are recorded in the Journal before being entered in the ledger accounts.**

Journal provides the only prime entry for certain types of transaction e.g. purchases / sales of fixed assets , error correction

Gives explanation also reduces risk of omission , error, fraud

- **Explain why it would be more meaningful to compare the percentage of gross profit to sales of each department.**

Cannot compare Gross Profit in \$ as each department had different amount of sales. Gross Profit must be related to the sales

- **Explain two non-financial factors which The manger should consider before closing the department**

Effect on staff morale

Effect on Customers.

Effect on reputation of the business.

Effect on Suppliers.

- **State three ways could reduce the risk of bad debts.**

Obtain references from new credit Customers.

Issue invoices and statements promptly

Supply goods on a cash only basis

Refuse further supplies until outstanding account paid

- **State the effect on gross & net profit with opening stock and Closing stock.**

If Opening stock is overstated the net profit is understated vice versa

If Closing stock is overstated the net profit is overstated vice versa

- **Give two reasons why it is important for Owner to know his net profit as a percentage of the capital employed.**

N.P. as percentage of capital employed:

- Measures overall profitability of the business in relation to resources used
- Indicates adequacy of return on owner's investment
- Enables comparisons to be made, e.g. against other investments, earlier years, similar firms

- Assists decision-making, e.g. in production, cost of borrowing
- **State and explain one advantage of dividing the ledger into these three sections.**

Work can be shared between several people.

Easier for reference as same type of accounts are kept together .

Easier to introduce checking procedures.

- **Explain what is meant by the going concern principle.**

Accounts are prepared on the basis that the business will continue to operate for an indefinite period of time.

- **On what basis should stock be valued when the going concern principle is applied**

Lower of cost and net realizable value

- **State and explain two disadvantages to a business of having insufficient working capital**

May have problems paying debts as they fall due

May not be able to take advantage of cash discounts

Cannot make the most of opportunities as they occur

Difficulties in obtaining further supplies

- **State two ways in which a business could increase its working capital.**

Injection of more capital

Long-term loans

Sale of surplus fixed assets

Reduce drawings

- **State one reason why a supplier of goods on credit sends a statement of account to the customer**

To show all transaction for period

To show amount owing

To agree records, settle difference

To act as reminder to pay

- **State what is meant by the accounting concept of matching.**

Matching concept states that costs incurred in an accounting period should be matched against the revenue / income of that period

- **Explain Cost of materials consumed**

Is the cost of raw material actually used in production. It consists of net purchases of material, adjusted for opening and closing stock, plus carriage on raw material.

- **State two possible disadvantages to Owner of not paying her creditors promptly**

Creditors may refuse further supplies of goods.

Good relationship between company and supplier is damage.

- **Explain the term ‘Accumulated Fund’ in connection with the accounts of a non-trading organization such as a club.**

Accumulated Fund is the equivalent to the capital of the trading organization, the difference between the assets and liabilities.

The annual surpluses (less any deficits) accumulate within a non – trading organization to form the accumulated

- **State one reason why a supplier would give trade discount to a customer**

Customer is in same type of trade; for bulk purchases

- **State and explain two reasons why charging interest on drawings could be an advantage to the partnership.**

Interest on drawings discourages large or early cash withdrawals

Thus could improve cash/working capital position

Also produces additional residual income/profits for division between

Partners

- **State one reason why a business uses a purchases journal**

Reason for using a purchases journal:

- Fewer transactions recorded in the purchases account
- Bookkeeping can be spread between several people
- Can be analyzed into products/areas etc.
- To identify credit purchases (can be useful for comparison purposes)
- Provides information for the purchases ledger control account.

- **State two advantages to preparing control accounts**

- Provides instant totals of debtors and creditors
- Prove the arithmetical accuracy of the ledgers they control
- Enable the Balance Sheet to be prepared quickly
- May be used to identify ledgers in which there are errors when a trial balance does not agree
- Provides a summary of the transactions relating to debtors/creditors for the period
- Provides an internal check on the appropriate ledgers – may reduce fraud

- **Explain what is meant by an accrued expense.**

An expense incurred in the accounting period but unpaid at the end of the period.

- **Explain why we should record the financial transactions of her**

To ensure no transactions are forgotten/overlooked (not relying on human memory)

To enable profit to be calculated

To enable the financial position of the business to be ascertained business.

- **State one possible advantage to company of paying his creditors before the due date.**

May be able to take advantage of cash discounts

Improves the relationship with suppliers

- **One condition which must be present for information to be regarded as reliable is shown below. State two other conditions.**

1- The information must be capable of being depended on as being a true statement of the transactions and events which are being recorded.

2- Information must be -

- capable of being independently verified
- free from bias
- free from significant errors
- prepared with suitable caution being applied to any judgments and estimates which are necessary

- **State one possible disadvantage to company of paying his creditors**

The business is deprived of the use of the money earlier than necessary before the due date

- **Explain why it is necessary to open a suspense account when the totals of a trial balance fail to agree**

To make the totals of the trial balance agree and so that draft final accounts may be prepared.

- **Jones has a similar business and his gross profit percentage is higher than Smith's. Suggest two reasons for this difference.**

Jones may charge higher prices for his goods, possibly because they are in high demand

Jones can buy his goods more cheaply, take advantage of trade discount.

- **What is the reason for charging depreciation on capital expenditure (Fixed assets) in the Profit and Loss Account?**

To charge the cost of the capital expenditure to profits earned over the useful life of the asset

- **Write one that should not be included in the sales ledger control account and explain why it does not appear.**

Item : Cash sales

Explanation: The double entry is sales account and cash book. They do not appear in a debtor's account and so do not appear in the sales ledger control account.

Item : Provision for bad debts

Explanation: This is the balance on the provision account at the start of the month to cover any future bad debts. It does not appear in a debtor's account and so does not appear in the sales ledger control account.

- **Explain what is meant by an error of omission.**

A transaction completely omitted from the books e.g. cash sales not recorded

- **Suggest one reason for the difference in the petty cash balance.**

Missing voucher or lost money by difference amount
Pilfered from cash box

- **Explain why quick ratio is a useful accounting ratio.**

Shows whether the business has sufficient liquid assets to meet its current liabilities

- **State two reasons why it is possible to have a debit balance on a purchases ledger control account**

Overpayment of amount due
Cash discount not deducted before payment made
Returned goods after payment of amount due
Payment made to creditor in advance

- **Explain why the information used to write up any purchases ledger control account is obtained from books of prime (original) entry and not from the purchases ledger**

A purchases ledger control account acts as a check on the purchases ledger. If there is an error in the purchases ledger it will not be revealed by a control account prepared from the individual accounts in that ledger.

- **Explain why the accounting principle (matching/ prudence) is applied when maintaining a provision for doubtful debts**

Matching : to ensure that the amount of sales for the year which are unlikely to be paid are treated as an expense of that particular year.

Prudence : to ensure that the profit is not overstated and that the asset of debtors in the Balance Sheet shows a more realistic amount

- **Explain two advantages of joining the partnership.**

Will have a share in the profits
Can take part in decision-making
Prospects for the future

- **Explain two disadvantages of joining the partnership.**

Will be personally liable for the debts of the firm
Will have greater responsibility
Will probably have to invest capital

- **Jannah's business has a bank overdraft at 31 August 2015. Suggest one way in which he could reduce or eliminate the overdraft.**

Overdraft may be reduced by collecting debtors, reducing stock, delaying payment of creditors, delaying drawings, increasing capital , Sell fixed assets, Long Term Loan

- **Explain what is meant by a contra entry in connection with control accounts.**

A contra entry is where a transfer is made from an account of a person/business in the sales ledger to an account of the same person/business in the purchases ledger.

This may occur when a person/business is both a customer and a supplier

- **Explain why the accounting principle Matching / Prudence is applied when providing for depreciation of fixed assets.**

Matching : To ensure that the loss in value of fixed assets is spread over the period in which they are earning revenue.

Prudence: To ensure that the profit is not overstated and the value of the fixed assets is not overstated.

- **Give two examples of adjustments made in a bank reconciliation statement.**

Uncredited or unpresented cheques

Items found in updating cash book, e.g. direct debits, bank interest, charges,

Dishonoured cheques

bank or cash book errors

- **Give one example of a business with:**

A high rate of stock turnover: Newsagent, petrol station, food store etc.
hairdressing salon, clothing shop, but not bank

A low rate of stock turnover: Furniture, carpets, cars, machines, etc

- **Give one reason for preparing a trial balance.**

To prepare final account / To check arithmetical accuracy of books

To check accounts balance / To locate errors

- **State one advantage of dividing the ledger into these three areas.**

Work can be shared between several people

Easier for reference as same type of accounts are kept together

Easier to introduce checking procedures

- **List and Explain four objectives which must consider when selecting accounting policies.**

Relevance : Financial information is only relevant if it can be used –

To confirm or correct prior expectations about past events

To assist in forming, revising or confirming expectations about the future

As the basis for financial decisions

Reliability : information must be capable of being:

Independently verified.

Free from bias

Free from significant errors.

Prepared with suitable caution applied to any judgments which are necessary.

Comparability : information must be compared with other similar information about the same business for another period or at another point in time.

Understandability : Financial statement can be understood by users of these statements.

- **Explain why the quick ratio is more reliable than the current ratio as an indicator of liquidity.**

Stock is not regarded as a liquid asset – a buyer has to be found and then the money collected. Some stock may prove to be unsaleable

Or / The quick ratio shows whether the business would have any surplus liquid funds if all the current liabilities were paid immediately from the liquid assets.

- **Suggest one possible reason which could account for the change in the current ratio**

Increase in current liabilities greater than the increase in current assets

Increase in creditors and no significant change in current assets

Decrease in debtors and no significant change in current liabilities

Decrease in bank and no significant change in current liabilities

Decrease in stock and no significant change in current liabilities

- **Explain how the change in the debtors' collection period may have affected the payment period for creditors.**

Debtors are taking longer to pay so this may have a knock-on effect and mean that the creditors may have to wait longer for their accounts to be paid

- **List four things should consider when comparing our results with those of a similar business.**

- 1- There may be differences that affect profitability e.g. one business may rent premises and the other business may own premises.
- 2- The accounts may be for 1 year only and not show trends
- 3- The accounts may not be for a typical year
- 4- The financial year may end at a different point in the trading cycle
- 5- The businesses may operate different accounting policies e.g. depreciation
- 6- The accounts do not show non-monetary items but these are important in the success of a business
- 7- It is not always possible to obtain all the information about a business in order to make a true comparison

- **Suggest two reasons for this difference between two organization's return on capital employed**

Different type of business / Different products

Capital/labour intensive business / Business with higher net profit

Business with lower capital

- **Give four items of information you would expect to find on a statement of account.**

Customer's name, address, date, total sales, sales returns, invoice numbers, amount due, discount, net total, cash/cheques received, terms of business, due date.

- **Explain what is meant by the imprest system in relation to petty cash books**

The petty cashier starts each period with the same amount of money (the imprest). At the end of the period the chief cashier will make up the cash remaining so that it is equal to the imprest amount

- **Explain how the double entry is completed for the items recorded in the analysis columns of the petty cash book.**

At the end of each period (1) the totals of the analysis columns for expenses (1) are debited to the appropriate expense account (1) The individual items in the ledger accounts column are debited to the appropriate creditors' accounts (1)

- **Explain why it is important that the stocks are valued at the lower of cost and net realisable value**

If stock is not valued at the lower figure then both the net profit and the current assets may be overstated. Or/ It is the application of the principle of prudence.

- **State two ways in which the rate of stock turnover of finished goods may be improved**

- 1- Reduce stock levels
- 2- Generate more sales activity

- **State two ways in which the percentage of gross profit to sales could be improved.**

Look for cheaper supplies

Increase selling prices

Change proportions of different types of goods sold

- **State two ways in which the percentage of net profit to sales could be improved**

Increase gross profit e.g. increase profit margin, increase selling prices etc.

Increase sales

Reduce expenses e.g. reduce staffing levels, reduce advertising etc.

Increase other income e.g. rent out part of premises, earn more discount

- **List three business people (excluding the owner) who would be interested in final accounts. In each case state one reason why the person would be interested in the accounts.**

1- **Bank manager** :

Assessment of prospects of any requested loan/overdraft repaid when due
 Assessment of prospects of any interest on loan/overdraft being paid when due
 Assessment of the security available to cover any loan/overdraft

2- **Lenders:**

Assessment of prospects of any requested loan when due
 Assessment of prospects of any interest on loan being paid when due
 Assessment of the security available to cover any loan

3- **Creditor for goods :**

Assessment of the liquidity position
 Identifying how long the business takes to pay creditors
 Identifying future prospects of the business
 Identifying what credit limit is reasonable

4- **Managers :**

Assessment of past performance
 Basis of future planning
 Control the activities of the business
 Identifying areas where corrective action is required

- **Give two reasons why it is important for a business to prepare final accounts or financial statements each year.**

To calculate profit or loss
 To know what assets and liabilities the business has
 To compare with previous year
 To compare with other businesses
 To calculate accounting ratios
 For use by other parties e.g. bank

- **State one reason why should maintain a provision for doubtful debts.**

Ensures that profits are not overstated (prudence)

Ensures that debtors are shown in balance sheet at more realistic amount (prudence)

Application of matching principle as the amount of sales unlikely to be paid for are treated as an expense of that particular year

- **State the purpose of providing for depreciation of a fixed asset**

To measure the use of a fixed asset over the period of its useful life.

- **Explain the difference between capital receipts and revenue receipts.**

Capital receipts are amounts received from the sale of fixed assets

Revenue receipts are sales and other items of income which are recorded in the trading and profit and loss account.

- **State one reason why it is necessary to open a suspense account when the totals of a trial balance fail to agree.**

To balance the trial balance / To allow draft final accounts to be prepared

- **State and explain one advantage of maintaining both a capital and a current account for each partner.**

Advantage of maintaining separate current accounts

Easier to see profit retained by each partner

Easier to calculate interest on capital (if allowed)

- **State one reason why it is possible to have a credit balance brought down on a sales ledger control account**

Overpayment of amount due by debtor

Cash discount not deducted by debtor before payment made

Goods returned by debtor after payment of amount due

Payment made in advance by debtor

- **Explain two ways could improve the collection period for debtors.**

Offer cash discount for prompt payment

Charge interest on overdue accounts

Improve credit control

Refuse further supplies on credit until outstanding balance paid

Invoice discount and debt factoring.

- **Suggest two ways in which Khalid might reduce or eliminate the deficit on his capital account.**

Contribute further capital – but not by taking (bank) loan

Obtain capital by taking partner / Reduce drawings

Increase net profit (reduce loss if shown Loss) (e.g. by increasing fees/commissions, reducing expenses (or any one specific expense))

- **Explain two ways in which reduce the risk of bad debts.**

Obtain reference from new credit customers

Fix a credit limit for each customer

Issue invoices and statements promptly

Follow up overdue accounts promptly

Supply goods on a cash basis only

Refuse further supplies until outstanding account is paid

- **For each ratio suggest two possible reasons which could account for the increase in the ratio between opening of the year and end of the year.**

- **Gross profit as a percentage of sales.**

Purchasing goods more cheaply

Reducing trade discounts to customers

Increasing selling prices

- **Net profit as a percentage of sales.**

Increase in gross profit percentage

Reduction in expenses

Differences in types of expenses (fixed/variable)

- **Collection period for debtors.**

Less efficient credit control

Allowing longer credit to maintain sales

Not allowing cash discounts to debtors

- **Payment period for creditors.**

Shortage of liquid funds

Knock-on effect of debtors taking longer to pay

Suppliers not allowing cash discounts

- **Suggest one reason why the straight line (equal instalment) method might be more suitable for to use when depreciating machinery.**

Machinery's value may not fall heavily in

Maintenance costs may not rise disproportionately

Straight line easier to calculate, same amount each suitable year development

Difficulty in choosing reducing balance rate or acceptable alternative

- **In the balance sheet, non-current (fixed) assets are shown at their net book value. Explain how net book value is different from cost.**

Net book value = Cost less accumulated depreciation

- **Suggest two ways in which Owner might be able to encourage his customers to pay their invoices.**

Send statement

Offer cash discount (not trade discount)

Limit credit (no more credit sales)

Charge interest on overdue amounts

Use debt collection methods

- **It is not usual to charge depreciation on land. Suggest two reasons why depreciation should not be charged on land.**

Land has an indefinite expected life.

Land does not wear out.

Land is not consumed by use.

Land increases in value over time

- **State two reasons why Company maintains a petty cash book.**

To remove small cash payments from the main cash book.

To reduce the number of entries in the main cash book and the expenses in the ledger.

To allow the chief cashier to delegate some of the work.

- **State one advantage of the imprest system**

The chief cashier is aware of exactly how much is spent in each period.

The cash remaining and the total of the vouchers received should always be equal to the imprest amount.

- **State two reasons why Company should depreciate their non-current (fixed) assets**

To spread the cost of fixed assets over their useful lives.

To apply the accruals principle – recognising the time difference between payment for the fixed asset and its loss in value.

To provide a more realistic view of the fixed assets.

To record the loss in value of fixed assets – the part of the cost of the fixed asset consumed during the period of use.

The annual depreciation charge represents the cost of using the fixed asset to earn revenue.

- **Explain why it is necessary for company to prepare a manufacturing account at the end of his financial year.**

To calculate how much it has cost the business to manufacture the goods produced in the financial year.

- **Suggest two reasons why decision- maker purchased the goods rather than manufacturing them himself.**

Production did not meet demand.

It was cheaper to buy the goods rather than make them.

Those particular items could not be made by the business.

- **Explain the meaning of each of the following terms.**

Mark-up: is the gross profit measured as a percentage of the cost price.

Margin: Margin is the gross profit measured as a percentage of the selling price

- **Suggest two ways for improve the profit margin.**

Increase selling prices.

Obtain cheaper supplies.

Change mix of sales.

- **Explain why an agreement should be drawn up when a partnership is formed.**

To avoid misunderstandings/disagreements later.

- **Explain why the partnership agreement included clauses on each of the following:**

Interest on drawings : To discourage the partners from making excessive drawings.

Partner’s salary: To compensate for an unequal work-load. OR In recognition of work done in the business.

- **Explain the meaning of the term ‘limited liability’.**

The liability of the members (shareholders) of a company for the debts of the company is limited to the amount they agree to pay the company for their shares. (shareholder’s assets are not available to pay company debts/losses)

- **Explain why items are recorded on the opposite side of the cash book to that on which they appear on the bank statement.**

The bank statement is a copy of the account of the business as it appears in the books of the bank. This is from the viewpoint of the bank – the business depositing money is a creditor of the bank. (2)

The bank account in the cash book is prepared from the viewpoint of the business – the bank is a debtor of the business which has deposited the money (2)

- **Explain the meaning of each of the following terms.**

Authorised capital: is the maximum amount of share capital a company is allowed to issue

Called-up capital: is the total amount of capital a company has requested from its shareholders

Paid-up capital: is that part of the called up capital for which a company has actually received the money from its shareholders.

- **State why a narrative should be shown as part of a journal entry**

A narrative explains the reasons for the entries which are to be made in the ledger.

- **Explain two disadvantages to having insufficient working capital**

Cannot meet liabilities when they are due.
 May experience difficulties in obtaining further supplies on credit.
 Cannot take advantage of cash discounts.
 Cannot take advantage of business opportunities as they arise.

- **Give two reasons why the balance shown in a cash book might not agree with the balance shown on a bank statement at the same date**

Items on bank statement not shown in cash book (accept individual items, bank charges, bank interest, etc.)

Items in cash book not on bank statement (accept individual items, cheques not yet presented, etc.)

Errors in cash book or made by bank (accept only one type of error)

Dishonoured cheques

- **Give one purpose of sending a statement of account to a customer.**

To inform or remind the customer of the amount due

To confirm the settlement terms

To ensure that no errors have been made by customer or supplier

- **State one reason for charging depreciation on non-current (fixed) assets in an income statement (profit and loss account).**

To spread the cost of the asset over its useful life

(not to calculate profit or loss on sale etc.)

(not causes of depreciation, but accept depletion, wear and tear, obsolescence and usage over time as reasons for need to depreciate.)

- **Suggest one reason why there was a difference in the petty cash between the amount actually in the box and the expected amount.**

Lost or missing voucher

Lost or stolen cash

Error brought forward or in counting cash

Amount not recorded

- **Explain the meaning of a contra entry in connection with control accounts and explain why such an entry may be made.**

A contra entry is when an account in the sales ledger is set against an account in the purchases ledger. Such an entry is made when a supplier is also a customer of the business and has an account in both ledgers

- **Explain why the information used to write up Company's sales ledger control account is obtained from books of prime (original) entry and not from the sales ledger.**

The sales ledger control account acts as a check on the sales ledger. If there is an error in the sales ledger it will not be revealed by a control account prepared from the individual accounts in that ledger.

- **Explain why the directors of Searle Ltd will be pleased that the return on capital employed (ROCE) is higher than at the end of the previous financial year.**

If the return on capital employed increases it indicates that the company is employing its resources more efficiently

- **Suggest two reasons why the percentage of gross profit to sales is greater than it was at the end of the previous financial year.**

Increase in selling prices

Obtaining cheaper supplies

Reduction the rate of trade discount allowed to customers

Increase in the rate of trade discount received from suppliers

Passing on increased costs to customers

Different product mix

- **Explain the meaning of each of the following terms.**

Bank reconciliation statement : A statement prepared by the trader to explain why the balance on the bank column in the cash book differs from the balance on the bank statement

Cheques not yet credited : Cheques received by the trader and recorded in the cash book but which have not yet been recorded as being received by the bank

Cheques not yet presented: Cheques paid by the trader and recorded in the cash book but which have not yet been recorded as being paid by the bank

- **A person studying the financial statements (final accounts) of a business must be aware that these statements do have limitations and will not provide a complete picture of the performance and position of a business. State how each of the following may be regarded as a limitation of financial statements (final accounts).**

Non-financial aspects :Accounts only record information which can be expressed in monetary terms. (1) This means that there are many important factors which influence the performance of a business which will not appear in the financial statements (final accounts) e.g. quality of management, goodwill, skill of workforce etc. (1)

Historical cost: Transactions are always recorded at the actual cost. (1) This means that it can be difficult to compare transactions which have taken place at different times because of the effect of inflation. (1)

- **Explain how payment period for trade payables (creditors) may be affected by the collection period for trade receivables (debtors).**

- 1- The business may not have enough liquid funds with which to pay the creditors until money is received from the debtors.
- 2- If the debtors pay within the set time the business may be able to pay its creditors within the set time without any significant impact on the bank balance.
- 3- If the debtors fail to pay within the set time it may be necessary to obtain short-term funds in order to pay the creditors

- **A member of the Club is worried because the surplus or deficit in the income and expenditure account does not agree with the bank balance on end of the year. Explain one reason why the surplus or deficit does not equal the bank balance.**

R & P A/c shows total money paid and received

I & E A/c adjusts figures for accruals and prepayments

I & E A/c includes non-monetary items such as depreciation

I & E A/c includes only revenue items

- **State two causes of depreciation.**

Physical deterioration

Economic reasons

Passage of time

Depletion

- **State three reasons why this ratios is important.**

Percentage of gross profit to sales:

This measures the success in selling goods

The ratio shows the gross profit earned per \$100 of sales The ratio can be compared with previous years

The ratio can be compared against other businesses

Percentage of profit for the year (net profit) to sales:

Percentage of profit for the year (net profit) to sales

This measures the overall success of the business

The ratio shows the net profit earned per \$100 of sales

The ratio can be compared with previous years

The ratio can be compared against other businesses

The ratio indicates how well the business controls its expenses

Return on capital employed (ROCE)

The ratio shows the profit earned per \$100 employed in the business

The ratio can be compared with previous years

The ratio can be compared against other businesses

The ratio measures the profitability of the investment in the business

The ratio shows how efficiently the capital is being employed

- State the difference between cost and net realisable value.

Cost is the actual purchase price plus any additional costs incurred in bringing the inventory (stock) to its present condition and position.

Net realisable value is the estimated receipts from the sale of the inventory (stock), less any costs of completing or selling the goods.

- Explain two ways could improve the rate of inventory (stock) turnover.

Reduce (inventory) stock levels

Generate more sales activity

Only replace inventory (stock) when needed

- If the expenditure has exceeded its income. State the reason why this should not be allowed to continue?

Because the club has to pay a day to day basis expenditure and if the club does not have a sufficient funds to pay this kind of expenditure the activity will stop.

- “ The club which does not make a good profit every year should be closed” discuss the statement ?

The main aim of non – profit organization is provision of satisfactory and service to the society and survival by making enough income to cover the expenditure without looking a good profit . So the club which does not make a

good profit . So the club which does not make a good profit every year should not be close.

- **Explain how we will be able to decide in the future if the provision for doubtful debts is adequate**

By comparing (1) the amount of actual bad debts (1) with the provision made.

- **Explain what is meant by a non-current asset.**

A non-current asset is an asset held for the long term for use by a business (1) and is not for resale.(1)

- **Explain why we should include the depreciation charge in his income statement.**

Depreciation should be included as a charge to the income statement so that the cost of the non-current asset is spread over the life of the asset or he is following the matching principle and the profit is not overstated (accept accurate or realistic) or he is following the prudence principle.

- **Explain what is meant by a service business**

A service business provides services, not goods e.g. travel agent, professionals, insurance

- **Explain the purpose of a partnership appropriation account.**

To show how the profit for the year is shared between the partners

- **Explain two advantages of maintaining accounting records using the double entry method**

Less risk of errors

Less risk of fraud

Easier to refer to previous transactions

Financial position can be ascertained

Easier to prepare financial statements

Easier to make business decisions

Easier to calculate accounting ratios

- **State one way in which the issue of preference shares may affect the existing ordinary shareholders**

Reduction in profit available for ordinary shareholders Prior claim on the assets of the company in the event of a winding up

- **State one reason why it is possible to have a credit balance brought down on a sales ledger control account**

Overpayment of amount due by a debtor

Cash discount not deducted by debtor before payment made

Goods returned by debtor after payment of amount due

Payment made in advance by debtor

- **Explain how the change in the percentage of expenses to sales has affected the efficiency of the business.**

Percentage of expenses has increased (1) The efficiency of the business in controlling expenses has decreased (2)

- **Explain why it is important to have an adequate amount of working capital.**

To be able to meet debts when they fall due

To be able to take advantage of cash discounts

To be able to take advantage of business opportunities as they arise

To ensure that there is not difficulty in obtaining further supplies

- **State one reason why we maintain a petty cash book in addition to her main cash book.**

To avoid recording small cash payments in the main cash book

To reduce the number of entries in the main cash book

- **State two advantages of trading in partnership.**

Additional finance

Additional knowledge and skills

Sharing of responsibilities

Sharing of risks

Discussions can take place before taking decisions

- **State two disadvantages of trading in partnership.**

Profits have to be shared

Decisions have to be recognised by all partners/disagreements may arise

Decisions may take longer to put into effect

One partner's actions are binding on all partners

All partners are responsible for the debts of the business

- **Explain what is meant by a compensating error. Give an example of this type of error.**

Compensating errors occur when two or more errors cancel each other out
Example – sales account undercast and wages account undercast

- **Explain what is meant by an error of principle. Give an example of this type of error.**

When a transaction is entered using the correct amount and on the correct side, but in the wrong class of account. Example – Motor Vehicles debited to the account of Motor Expenses

- **Explain the effect on income statement of recording capital expenditure as revenue expenditure.**

Expenses are overstated
Profit for the year is understated

- **Explain the effect on balance sheet of recording capital expenditure as revenue expenditure.**

Non-current assets are understated
Owner's capital (Profit) is understated

- **State two reasons why the bank would want to see financial statements before agreeing to the loan.**

To assess whether the interest can be paid when due
To assess whether the loan can be repaid when due
To assess whether there is security for the loan

- **If The bank decided to refuse the application for a loan. Suggest two reasons for the bank's decision**

There are not enough non-current assets for security of the loan
There is not enough profit to cover the loan interest
The business would not be able to re-pay the loan on time
Drawings for the year exceed the profit for the year

- **Suggest two other possible sources of finance**

Introduce additional capital
Admit a partner/form a limited company
Mortgage
Loans from other sources
Sell surplus non-current assets

- **Suggest two items which may appear in the cash book but not on the bank statement**

Cheques not presented / Amounts not credited / Cash book errors

- **Suggest two items which may appear on the bank statement but not in the cash book**

Standing orders / Direct debits/ Credit transfers/ Dishonoured cheques/ Bank charges interest/ Bank errors

- **Suggest two reasons why it was necessary for Company to purchase finished goods**

Production did not meet demand

It was cheaper to buy rather than make

Could not make those particular items

Not economical to make such a small amount

- **Give one example of an account which may appear in each section of the ledger.**

General ledger : Any non-current asset, inventory, capital, drawings, loan, sales, purchases, returns, expenses, incomes, etc

Sales ledger : Credit customers/debtors/trade receivables

Purchases ledger : Credit suppliers/creditors/trade payables

- **Explain why it is important for Owner to keep his personal expenses separate to those of the business.**

Applying the business (accounting entity principle the business is treated as being completely separate from the owner. (1) Only the transactions of the business are recorded in the business' books

- **State one reason why the partners receive interest on capital.**

To reward the partner investing more capital To encourage partners to invest in the business

- **State one reason why the partners are charged interest on drawings**

To discourage the partners from making drawings

To discourage drawings early in the financial year

To help the cash flow of the business

- **State two ways in which a manager can use her/his accounting information.**

To monitor progress (1) using accounting ratios (1) For decision-making (1) for future planning (1) For comparison purposes (1) with previous years or other businesses (1)

- **Suggest two reasons for the change in the company's bank balance**

Purchase of non-current assets

Purchase of inventory

Dividends paid/tax paid

Increase in debtors/non payment by debtors

- **Explain why company Limited created a general reserve.**

To set aside profit for re-investment

To indicate that part of the profit is not available for distribution

To set aside profit for payment of future dividends

- **Explain the difference between a dishonoured cheque and an unpresented cheque**

Dishonoured cheque – a cheque which the bank refuses to pay (1) Cheque not presented – cheque paid by the business but which has not yet been presented to the bank for payment/not yet paid by the bank (1)

- **Explain the difference between a standing order and a direct debit**

Standing order – an instruction by a customer to the bank to pay fixed amounts at stated dates to a named person or firm (1)

Direct debit – authority given to the bank to make payments (at irregular dates and amounts) on request by a named person or firm (1)

- **State the purpose of calculating the collection period for trade receivables.**

To see the average time the trade receivables take to pay their accounts

- **Suggest two reasons why a trader wants to know his profit for the year**

To see the return on his investment

To see if he is generating funds for re-investment

To decide whether to continue in business or close the business

To compare the profit with previous years

To compare the profit with that of other businesses

To ensure that drawings do not exceed profit

To plan for the future/assist decision-making

To know if expenses can be controlled better/if improvements can be made
 To calculate ratios/calculate profitability/measure performance
 To compare profit with the salary if he worked elsewhere

- **Explain why not all the corrections require an entry in the suspense account.**

Only errors that affect the balancing of the trial balance are corrected using a suspense account.

- **Explain what is meant by the term relevance.**

Financial information is only relevant if it can be used :

To confirm or correct prior expectations about past events

To assist in forming, revising or confirming expectations about the future

As the basis for financial decisions

In time to be able to influence decisions

- **Explain the importance of the return on capital employed (ROCE).**

This shows the profit earned for each \$100 used in the business. (1) The higher the percentage the more efficiently the capital is being employed. (1)

- **Explain two factors our company should consider when comparing our results with those of a similar business.**

Should compare with a business of approximately the same size

Should compare with a business of the same type (sole trader)

The financial statements may be for one year which will not show trends

The financial statements may be for one year which is not a typical year

The financial year may end on different dates (when inventories are high/low)

The businesses may operate different accounting policies

The statements do not show non-monetary factors

It may not be possible to obtain all the information needed to make comparisons

- **State why the updated cash book balance rather than the balance on the bank statement would appear in the balance sheet.**

The balance sheet would not balance if the bank statement balance was included because only balances on the books of the business can be included in the balance sheet of the business

- **State what is meant by the term ‘subscription’ in a club’s accounts.**

An amount paid by a member for the right to use the facilities of a club

- **Speedy Runner Sports Club maintains a subscriptions account. Explain why this account can have two opening balances.**

Some members of the club may be in arrears with their subscriptions and other members may have prepaid their subscriptions.

- **Explain why there are no drawings in a club or society.**

Members have not invested any capital so there can be no drawings which represent amounts taken from the return on an investment

- **Explain what is meant by the accounting policy of comparability**

Financial statements are only useful if the information they contain can be compared with previous periods or other businesses

- **Explain how the accruals (matching) principle has been applied in the preparation of the rent and rates account.**

The accruals principle has been applied when only the expense for the year was transferred to the income statement

- **Describe the straight line method of depreciation & State the circumstances when this method of depreciation may be used.**

The straight line method of depreciation uses the same amount of depreciation each year. This method is used where each year is expected to benefit equally from the use of the asset. Ex. Buildings

- **Describe the reducing (diminishing) balance method of depreciation & when this method of depreciation may be used.**

The reducing balance method of depreciation uses the same percentage rate of depreciation each year, but it is calculated on the book value at the end of each year. This method is used where the greater benefits from the use of the asset will be gained in the early years of its life. Ex. Computer equipment, Motor vehicle.

- **Describe the revaluation method of depreciation & State the circumstances when this method of depreciation may be used.**

The asset is valued at the end of each year and the difference between the opening and closing value is the depreciation for the year. This method is used

where it is impractical or difficult to maintain detailed records of the asset. Ex. Loose tools, packing cases, small items of equipment

- Explain how a bank overdraft can arise.

A business has paid out more from the bank than it has paid in

- Explain why dividing the ledger into sections makes it easier to use.

Work can be shared between several people

Easier for reference

Same type of accounts are kept together

- Explain why a limited company might decide not to distribute all of its profit for the year in the form of a dividend.

For reinvestment in the business

To plough back profits

For allocating dividends in the future

If there is not enough actual cash available to pay a dividend

- State two differences between debentures , preference shares and ordinary shares

debentures	preference shares	ordinary shares
- Fixed rate of interest	- Fixed rate of dividend	- Variable rate of dividend
- Holders receive interest	- Do not carry voting rights	- Holders receive dividend
- Holders are creditors	- Rank before ordinary shares for payment of dividend	- Holders are members of the company
- Are long term loans	- Are equity	- Are equity
- Do not carry voting rights	- Rank before ordinary shares in a winding up	- Carry voting rights
- Rank before ordinary shares in a winding up		- Rank after debentures in a winding up

- Explain why the capital account balance in the trial balance is that of opening Capital.

The trial balance was drawn up before the preparation of the income statement/before profit for the year has been calculated

- **Suggest two items which might be included in the total of administration and selling costs.**

Office rent/rates

Office salaries

Office general expenses

Office insurance

Salaries/commission of sales staff

Advertising expenses

- **Maria Rahman has asked A1 Traders to supply her with goods on credit.**

State one reason, other than checking the payment period for trade payables, why A1Traders would want to see Maria's financial statements.

To consider liquidity position

To see total amount owing to other credit suppliers

To determine the credit limit

To determine the period of credit to be allowed

- **Suggest one reason for the debit balance on Ian McMillan's current account on 1 February 2013.**

Drawings and interest on drawings exceeded the interest on capital, interest on loan and share of profit

Or

Share of loss, drawings and interest on drawings exceeded the interest on capital and interest on loan

- **State one advantage of maintaining both a capital account and a current account for each partner**

Easier to see the profit retained by each partner

Easier to calculate interest on capital.

- **Explain to a member of the club why the accumulated fund cannot be distributed among the club members in the form of dividend.**

The members have not invested any capital so there can be no dividend which represents a return on the amount invested

- **Explain why there could be a credit balance on a bank account but not on the cash account**

Can withdraw more from bank than put in/can have overdraft
Cannot take more cash than is physically present

- **State one advantage of using a book of prime entry**

Reduces the number of entries in the ledger
Acts as an aid for posting to the ledger
Helps to gather and summaries accounting information/facilitate preparation of control accounts
Groups together similar types of transactions
Allows work to be divided between several people

- **Explain why the company decided to make the set-off**

Save on administration costs
The debt can be settled by using one cheque only

- **Explain how the ordinary shareholders may be affected if Watson Limited issues additional debentures.**

Reduction in profit available for ordinary shareholders
Prior claim on the assets of the company in the event of a winding up

- **State what is meant by the term ‘rate of inventory turnover’.**

The number of times a business sells and replaces its inventory in a given period of time.

- **Explain the difference between a prepayment and an accrual.**

A prepayment is an amount paid in advance for a service which has not yet been received

An accrual is an amount owed for a service which has been received but not yet paid for

- **State two reasons, other than finding errors, why we should reconcile cash book with the statement received from the bank.**

Ascertain the true bank balance at a certain date
Assist in detecting fraud and embezzlement
Identify any “stale” cheques

Demonstrate that any differences between the cash book balance and that on the statement are due to genuine reasons

- **Explain how accountant is applying the matching principle when he depreciates the motor vehicles.**

Ensures that the loss in value of motor vehicles is spread over the period in which they are earning revenue