Mock Exam One

AAT L3 Financial Accounting: Preparing Financial Statements

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This practice assessment is one of a set of five AAT mock practice assessments which have been published for this subject. They are produced by our expert AAT tutors, giving real AAT exam style and standard tasks, that ensure the very best for exam success. All practice assessments are relevant for the current syllabus.

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Mock Exam One

AAT L3 Financial Accounting: Preparing Financial Statements

Assessment information:

You have **2 hours and 30 minutes** to complete this practice assessment.

- This assessment contains **6 tasks** and you should attempt to complete every task.
- Each task is independent. You will not need to refer to your answers to previous tasks.
- The total number of marks for this assessment is 120.
- Read every task carefully to make sure you understand what is required.
- Where the date is relevant, it is given in the task data.
- Both minus signs and brackets can be used to indicate negative numbers unless task instructions state otherwise.
- You must use a full stop to indicate a decimal point. For example, write 100.57 not 100,57 or 10057.
- You may use a comma to indicate a number in the thousands, but you don't have to. For example, 10000 and 10,000 are both acceptable.

Task 1 (28 marks)

This task is about using daybooks, and accounting for and monitoring non-current assets.

(a) Complete the following sentences about using daybooks.

(3 marks)

A sales invoice for £3,600 issued to a customer for the sale of goods on credit would be recorded in the ▼

A small transaction of £3.40 paid in cash for postage stamps would be recorded in the ▼

A credit note received from a supplier for a prompt payment discount would be recorded in the ▼

Picklist: Sales Day Book, Sales Returns Day Book, Discounts Allowed Day Book, Purchase Day Book, Purchase Returns Day Book, Discounts Received Day Book, Petty Cash Book.

You are working on the accounting records of A. Business. A. Business is a VAT registered business.

The business part-exchanged an old item of machinery for a new machine in its factory. The following is the relevant purchase invoice for the new machine.

To: A. Business	**From: ZAR Traders Invoice number: 1123**	**Date: 1 Sept 20X6**
Item	**Details**	**£**
Machine AZ50	AZ50	19,000.00
Software	for AZ50	1,290.00
2 x PC Monitors (screens)	@ £150 each for AZ50	300.00
Delivery and installation	for AZ50	800.00
Net total		21,390.00
VAT 20%		4,278.00
Total		25,668.00

All VAT can be reclaimed on the purchase cost for the items above.

The following details relate to the old item of machinery replaced by the business.

Item description	**Machine AX56**
Date of purchase	01/09/X4
Date of sale	24/07/X7
Part-exchange value	£2,000.00 plus VAT

- The business has a policy of capitalising expenditure over £200.
- Plant and machinery is depreciated at 25% per annum on a diminishing balance basis.
- Motor vehicles are depreciated at 35% per annum on a diminishing balance basis.
- A full year's depreciation is charged in the year of acquisition and none in the year of disposal.

(b)(i) For the year ended 31 August 20X7, record the following in the extract from a non-current asset register shown below.

- Any acquisitions of non-current assets
- Any disposals of non-current assets
- Depreciation

(12 marks)

Enter answers where a grey picklist is required and insert numerical answers in the highlighted grey cells only. Show all numerical answers to TWO decimal places.

Description/ Serial number	Acquisition date	Cost £	Depreciation charges £	Carrying amount £	Funding method	Disposal proceeds £	Disposal date
Plant and machinery							
Machine AX56	01/09/X4	13000.00			Loan		
Year ended 31/08/X5			3250.00	9750.00			
Year ended 31/08/X6			2437.50	7312.50			
Year ended 31/08/X7			Picklist 1	Picklist 2		2000.00	24/07/X7
Picklist 3	01/09/X6				Part Exchange		
Year ended 31/08/X7							
Motor vehicles							
Car EN65 RBV	23/01/X6	6700.00			Loan		
Year ended 31/08/X6			2345.00	4355.00			
Year ended 31/08/X7							
Car BN60 DFV	26/08/X5	7800.00			Finance lease		
Year ended 31/08/X5			2730.00	5070.00			
Year ended 31/08/X6			1774.50	3295.50			
Year ended 31/08/X7			1153.43	2142.07			

Picklist 1	Picklist 2	Picklist 3
0.00	**9750.00**	**Machine AX56**
2031.25	**7312.50**	**Car BN60 DFV**
1828.13	**0.00**	**Car EN65 RBV**
1523.44	**13000.00**	**Machine AZ50**

(b)(ii) Complete the following calculation (3 marks)

Calculate the gain or loss on disposal of Machine AX56 for the year ended 31 August 20X7. **Show your answer rounded to TWO decimal places. Use a minus sign or brackets to indicate a loss on disposal.**

£ [ ]

A business is registered for VAT.

(c) Drag and drop two items that are included as capital expenditure and two items that are excluded from capital expenditure.

(2 marks)

VAT		
Site preparation costs	**Costs included**	**Costs excluded**
Delivery cost		
Revenue expenditure		

You are working on the accounting records of a business for the year ended 31 August 20X7. VAT can be ignored. A new machine has been acquired, the cost was £18,930 and the amount was paid from the business bank account. The business plans to sell the new machine after 5 years when its residual value is expected to be £2,000.

Machines are depreciated using the straight-line method. A full year's depreciation is charged in the year of acquisition. Depreciation has already been entered in the accounting records of the business for existing machines and the amounts are shown in the ledger accounts below.

(d)(i) Calculate the depreciation charge of the new machine for the year ended 31 August 20X7

(2 marks)

£ ☐

Make entries in the ledger accounts below for the acquisition and depreciation charges for the new machine for the year ended 31 August 20X7. For each ledger account show clearly the balance to be carried down or transferred to the statement of profit or loss, as appropriate.

(d)(ii) Make entries in the accounts below for:

- **The acquisition of the new machine**
- **The depreciation charges for the new machine**

(6 marks)

Picklist: Bank, Depreciation charges, Disposals, Machinery accumulated depreciation, Machinery at cost, Profit or loss account, Balance c/d.

Machinery at cost

	£		£
Balance b/d	84900		
	84900		0

Machinery accumulated depreciation

	£		£
		Balance b/d	49200
	0		49200

Depreciation charges

	£		£
Balance b/d	22600		
	22600		0

End of Task

Task 2 (14 marks)

This task is about recording period end adjustments.

You are working on the accounting records of a business for the year ended 31 December 20X7. In this task you are to ignore VAT.

Business policy: accounting for accruals and prepayments
An entry is made to the income or expense account and an opposite entry to the relevant asset or liability account. In the following period, asset or liability entries are reversed.

You are looking at motor vehicle expenses for the year.

- The cash book for the year shows payments for motor vehicle expenses of £8,042. This amount includes £1,467 for the following payments relating to motor vehicle insurance.

Insurance Car EN15 RBV	**Insurance Car SG67 EEF**
Insurance for the period 1 May 20X7 to 30 April 20X8. **£900 for the period.**	Insurance for the period 1 January 20X7 to 31 December 20X7. **£567 for the period.**

(a)(i) Complete the following statement. Do NOT use a minus sign or brackets.

(4 marks)

The motor vehicle expense account needs an adjustment for

[▼] of £ [ ] dated [▼]

Picklist	**Picklist**
Accrued expenses	31/12/X8
Accrued income	31/12/X7
Prepaid expenses	30/04/X8
Prepaid income	01/01/X7

(a)(ii) Update the motor vehicle expenses account

Show clearly:

- **the cash book figure**
- **the year-end adjustment**
- **the transfer to the statement of profit or loss for the year.** (6 marks)

Motor vehicle expenses

	£		£
	0		0

Picklist: Motor vehicle expenses, Bank, Accrued expenses, Accrued expenses (reversal), Accrued income, Accrued income (reversal), Prepaid income, Prepaid income (reversal), Prepaid expenses, Prepaid expenses (reversal), Statement of financial position, Profit or loss account, Balance b/d, Balance c/d.

(b) Show the journal entries that will be required to adjust for closing inventory of £13,422 for the year ended 31 December 20X7.

(4 marks)

Account	Dr £	Cr £

Picklist: Bank, Purchases, Closing inventory (statement of profit or loss account), Balance b/d, Balance c/d, Closing inventory (statement of financial position).

End of Task

Task 3 (24 marks)

This task is about producing, adjusting, checking and extending the trial balance.

(a) Enter the figures in the table shown below to the appropriate trial balance debit or credit columns. Do not enter zeros in unused column cells. Do NOT use minus signs or brackets.

(2 marks)

Extract from the trial balance

	Ledger balance	Trial balance	
Account	**£**	**£ DR**	**£CR**
Prepaid income	1000		
Drawings	8900		
Carriage inwards	1029		
Accrued income	1504		

A trial balance shown below has been drawn up and balanced using a suspense account. You now need to make some corrections and adjustments for the year ended 31 December 20X7. You may ignore VAT in this task.

The general allowance for doubtful debts needs to be adjusted to 2% of outstanding trade receivables.

(b)(i) Refer to the extract from the extended trial balance below. Calculate the value of the adjustment required (to the nearest £).

(2 marks)

£ [ ]

(b)(ii) Record the adjustment in (b)(i) and the following adjustments in the extract from the extended trial balance below.

(8 marks)

- Office expenses of £90 have been correctly posted to the cashbook but no corresponding debit entry was made to office expenses.
- The payables ledger control account in the general ledger has been extracted and included in the trial balance incorrectly as £5,999. The correct balance should be £6,739.
- Staff wages of £1,080 were posted in error to office expenses.

Ledger account	Ledger balances		Adjustments	
	Dr £	Cr £	Dr £	Cr £
Bank	21932			
Opening inventory	6781			
Irrecoverable debts	750			
Capital		24976		
Office expenses	4200			
Staff wages	16339			
Allowance for doubtful receivables		400		
Allowance for doubtful receivables adjustment				
Depreciation charges	2952			
Van at cost	17400			
Van accumulated depreciation		6090		
Purchases	45688			
Payables ledger control		5999		
Sales		79991		
Receivables ledger control	24090			
Suspense		650		

You are preparing a payables ledger control account reconciliation for the year ended 31 December 20X7. The current balance showing in the payables ledger control account is a credit balance of £27,042 and the total amount outstanding in the payables ledger is a credit balance of £22,044.

The payables ledger has been compared to the payables ledger control account and the following errors or omissions have been identified:

1.	The total column in the purchases daybook was undercast by £1,000. The amount posted to the payables ledger control account was £131,673 but the correct amount should have been £132,673.
2.	Purchases returns of £5,640 have been credited to the payables ledger control account in error. The correct entries have been made in the payables ledger accounts for suppliers.
3.	A purchase invoice of £240 from Streets Ltd was omitted from purchases daybook. The correct entry was made in the payables ledger account of the supplier.
4.	A set-off entry of £5,042 was omitted from the payables ledger account of M. Smith. The correct entry was made in payables ledger control account.
5.	Purchase returns of £120 were debited in error to the payables ledger account of Winkle Traders Ltd instead of the payables ledger account of Traders RUS Ltd.
6.	A purchase invoice was sent by a supplier for £360 in error, the correct amount should have been £3,600. The incorrect amount of £360 was posted to both the payables ledger and payables ledger control account.

(c) Using the table below show THREE adjustments that should appear in the payables ledger control account. Enter only ONE figure for each line. Do not enter zeros in unused cells. Do NOT use minus signs or brackets.

(6 marks)

Account	Dr £	Cr £

Picklist: Adjustment 1, Adjustment 2, Adjustment 3, Adjustment 4, Adjustment 5, Adjustment 6

(d) You are to compete the extended trial balance shown below. Ensure you calculate the profit or loss and complete in the appropriate space in the first column whether it is a profit or a loss.

(6 marks)

Extended Trial Balance

Ledger account	Ledger balances		Adjustments		Statement of profit or loss		Statement of financial position	
	Dr £	Cr £	Dr £	Cr £	Dr £	Cr £	Dr £	Cr £
Bank	18,533			800			17,733	
Opening inventory	4,500				4,500			
Capital		22,622						22,622
Drawings	8,000						8,000	
Office expenses	4,589				4,589			
Van expenses	12,320		360					
Staff wages	13,239				13,239			
Discounts allowed	471				471			
Discounts received		579				579		
Carriage outwards	540				540			
Loan		20,000						20,000
Closing inventory			3,300	3,300		3,300	3,300	
Advertising expenses	8,000		800					
Depreciation charges			6,234		6,234			
Vans at cost	27,400						27,400	
Vans - accumulated depreciation		9,590		6,234				15,824
Purchases	19,680				19,680			
Payables ledger control		1,009	550					
Accrued expenses				360				360
Irrecoverable debts			240		240			
Sales		68,612				68,612		
Receivables ledger control	3,090			240			2,850	
Loan interest paid	1,500				1,500			
Suspense	550			550				
Pick list								
Total	122,412	122,412	11,484	11,484	**Autosum**	**Autosum**	**Autosum**	**Autosum**

Pick list: Profit for the year, Loss for the year, Suspense, Balance b/d, Balance c/d.

End of Task

Task 4 (24 marks)

This task is about producing financial statements for sole traders and partnerships.

You have been given the following information about a partnership business.

- The partners are Albert and Brenda.
- The financial year end is the 31 March.
- There is no interest on capital or interest on drawings for the partners.

Figures relating to the year ended 31 March 20X7 were as follows:

	Albert	**Brenda**
Profit share	70%	30%
Drawings for the year	£25,000	£60,000
Salary (per month)	£1,500	£2,000
Sales commission earned for the year	£7,560	£3,450

Profits earned by the partnership for the year ended 31 March 20X7 were £97,000.

(a)(i) Prepare a partnership appropriation account for the year ended 31 March 20X7. Use a minus sign for deductions or where there is a loss to be distributed.

(10 marks)

Picklist: Share of residual profit – A, Share of residual profit – B, Share of residual loss – A, Share of residual loss – B, Drawings – A, Drawings – B, Salary – A, Salary – B, Sales commission – A, Sales commission – B.

Partnership appropriation account for the year ended 31 March 20X7

	£
Profit for appropriation	
Residual profit available for distribution	
Share of residual profit or loss:	
Total residual profit or loss distributed	

Brenda had a current account balance of £340 in debit on the 1 April 20X6. Brenda has taken drawings of £60,000 from the partnership business during the year ended 31 March 20X7.

(a)(ii) Complete the following sentences about Brenda's current account:

(5 marks)

Brenda's current account will be shown in the [ ]

Picklist: Statement of financial position, Statement of profit or loss.

Brenda's current account as at 31 March 20X7 would be a [ ] balance of £ [ ]

Picklist : Debit, Credit.

You have the following information about a sole trader:

- The sole trader had taken business goods valued at £1,300 during the year for personal use.
- Profit for the year ended 31 March 20X7 was £13,228.

(b) Complete the capital account for the year ended 31 March 20X7. Show clearly the balance carried down to the next financial year.

(6 marks)

Picklist: Balance b/d, Balance c/d, Bank, Capital, Drawings, Expenses, Profit for the year, Loss for the year, Statement of financial position, Suspense.

Capital

	£		£
		Balance b/d	19228
	0		19228

(c) Show whether the following statements are TRUE or FALSE

(3 marks)

	TRUE	FALSE
The calculation of cost of sales in a statement of profit or loss account is equal to opening inventory plus net purchases less closing inventory.	☐	☐
Capital injections and profits earned during a period are both credit entries in the capital account of a partner.	☐	☐
A bank overdraft and the payables ledger control account are presented as non-current liabilities in the statement of financial position.	☐	☐

End of Task

Task 5 (18 marks)

This task is about accounting principles, qualities of useful financial information and interpreting financial statements using profitability ratios.

(a) Reconciliation of a cash book balance to the bank statements, or a payables ledger account balance to a supplier statement received, is more likely to support which one of the following qualitative characteristics of useful financial information. Choose ONE answer only.

(2 marks)

Verifiability	☐
Timeliness	☐
Comparability	☐
Relevance	☐

(b) Show whether the following is TRUE or FALSE.

(2 marks)

Mark-up precentage maybe calculated as: $\dfrac{\text{Gross profit}}{\text{Sales}}$ x 100%

True	☐
False	☐

You are working as a finance assistant to a management accountant. The management accountant has asked you to post a journal of £5,900 from motor vehicle expenses to motor vehicles (a non-current asset). You have checked the details of the invoice paid and feel there is no justification to make such a posting.

(c) Which ONE of the following is NOT a likely response given to the management accountants request.

(2 marks)

Seek guidance from your practice manager regarding the posting of this journal.	☐
Discuss the matter with the management accountant to see if there is a valid case for posting this journal.	☐
Post the journal without question as the management accountant is your client.	☐

The following information exists for a business.

Statement of profit or loss extract	£
Sales	53,508
Cost of sales	31,802
Gross profit	21,706
Expenses	12,900
Net profit	8,806

Statement of financial position extract	£
Non-current assets	30,500
Current assets	3,080
Current liabilities	550
Non-current liabilities	14,000
Capital	19,030

(d) Calculate the following ratios based on the information above. Answers should be rounded to two decimal places.

(6 marks)

Return on capital employed (%) ☐

Sales margin (%) ☐

Expenses as a percentage of sales (%) ☐

(e) Show whether the following statements are TRUE or FALSE

(3 marks)

	TRUE	FALSE
The return on capital employed ratio could be improved if a business repays a 5 year bank loan.	☐	☐
Whether a ratio is better or worse requires a comparison to be made with another organisation, or to a different time period.	☐	☐
The sales margin ratio could be improved if a business repays its 5 year bank loan.	☐	☐

(f) Complete the following sentences about accounting principles.

(3 marks)

The [ ] concept is an accounting rule that exercises conservatism and caution when making judgements about accounting transactions under conditions of uncertainty.

The [ ] concept means to recognise the business can continue to operate and remain in business for the foreseeable future.

The [ ] concept states that business transactions and the personal transactions of its owner are different for accounting purposes.

Picklist: Materiality, Going concern, Consistency, Separate entity, Money measurement, Prudence.

End of Task

Task 6 (12 marks)

This task is about preparing accounting records from incomplete information.

You are working on the accounting records of a sole trader to the year ended 31 August 20X8.

You have the following information:

Day book summaries	Goods £	VAT £	Total £
Sales	299,751	59,950	359,701
Sales returns	None		
Purchases	68,900	13,780	82,680
Purchase returns	not available		

VAT on discounts have been correctly adjusted in the sales and purchase daybooks.

- Cash sales of £32,600 were recorded plus 20% VAT.
- The owner of the business took drawings from cash sales for personal use and any amount remaining was banked.
- All purchases were on credit terms.
- A contra entry of £1,200 was made between the receivables ledger and payables ledger during the year.

Balances as at	31 August 20X7 £	31 August 20X8 £
Trade receivables	55,769	424,537
Trade payables	29,522	35,672
Closing inventory	11,000	22,000
Bank	4,549 debit	not available
Cash	2,300	5,430
VAT	3,344 credit	not available

Receipts and payments recorded in the bank account include:

Amounts to suppliers	69,627
Amounts from credit customers	334,990
Amounts banked from cash sales	15,000
HMRC - VAT paid	24,990
Premises expenses	18,990
Wages	15,000
Loan repayment	12,336
Motor vehicle expenses	10,680
Bank charges and interest	2562

(a)(i) Find the total purchase returns figure including VAT by completing the payables ledger control account for the year ended 31 August 20X8.

(5 marks)

Payables ledger control

Details	Amount £	Details	Amount £
		Balance b/d	29522
Total	**Autosum**	**Total**	**Autosum**

Picklist: Receivables ledger control, Balance c/d, Bank, Cash purchases, Purchase daybook, Purchase returns daybook, Discounts received.

(a)(ii) Find the missing drawings figure the owner has taken for personal use by completing the cash account for the year ended 31 August 20X8.

(4 marks)

Cash account

Details	Amount £	Details	Amount £
Balance b/d	2300		
Total	**Autosum**	**Total**	**Autosum**

Picklist: Balance c/d, Bank, Cash sales, Drawings.

A trader is allowed by its suppliers to settle its accounts 60 days after purchases are made. Purchases were £60,000 during the accounting year.

(b) Which of the following is most likely to be the total balance in the payables ledger control account at the year end.

(2 marks)

£15,000	☐
£10,000	☐
£5,000	☐

The following details exist for a business.

- Costs of sales for the year were £170,000
- Mark up is 30%

(c) Using the information above calculate sale income earned for the year ended.

(1 mark)

£ ☐

End of Task

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Revision Notes

The day books (also called books of ‘original’ or ‘prime entry’)

Day books keep a record of a business's past transactions. In a manual bookkeeping system the day books will complete the first entries in the accounting system for transactions such as invoices, credit notes, bank receipts and payments.

At the end of each accounting period the total amounts are added up from the day books and these summary amounts are posted to general ledger accounts using a double entry system. Transactions recorded in the day books are also used to update the receivables ledger (customer account balances owing for the sale of goods on credit) and the payables ledger (supplier account balances owed for the purchase of goods on credit).

The day books (also called books of ‘original’ or ‘prime entry’)

- Sales Day Book (SDB records sales invoices issued to credit customers).
- Sales Returns Day Book (SRDB records credit notes to reverse sales invoices issued to credit customers, due to goods returned or disputes with customers).
- Discounts Allowed Day Book (DADB records credit notes to reverse sales invoices, due to prompt payment discounts allowed for customers, if settling sales invoices early).
- Purchase Day Book (PDB records purchase invoices issued from credit suppliers).
- Purchase Returns Day Book (PRDB records credit notes received from suppliers to reverse purchase invoices issued from credit suppliers, due to goods returned or disputes with suppliers).
- Discounts Received Day Book (DRDB records credit notes received from suppliers to reverse purchase invoices, due to prompt payment discounts received from suppliers, if settling purchase invoices early).
- Cash Book (CB records all cash and bank transactions for the business).
- Petty Cash Book (PCB records very small cash transactions for the business).
- Journal Book (JN records any postings made to the general ledger for accounting adjustments that are not recorded in any other day book, such as to correct errors and omissions).

The general ledger

The general ledger is a double-entry accounting system, whereby ledger accounts are kept to record all the financial balances required to produce a statement of profit or loss (reporting general ledger account balances for ‘income’ and ‘expenses’) and a statement of financial position (reporting general ledger account balances for ‘assets’, ‘liabilities’ and ‘capital’).

The receivables ledger

When a significant amount of detailed information is needed for credit sales transactions made to customers of a business, then a subsidiary ledger is commonly used. Subsidiary ledgers are kept when there is a large amount of transaction information that needs to be recorded, a subsidiary ledger avoids large volumes of transactions that would otherwise be recorded in the general ledger.

The ‘receivables ledger' is also called the ‘sales ledger’ and also called ‘trade receivables’, it represents ledgers kept for each customer account, including the total balance owed by each customer to be ‘received’ by the business. The accounts receivables subsidiary ledger is a breakdown of the total amount of receivables that would be included in the general ledger.

The receivables ledger is not part of the double entry general ledger system, it is maintained separately and independently. The receivables ledger records the detailed transaction history for all credit customers of the business, which would include sales invoices, credit notes and money received from each credit customer.

The payables ledger

When a significant amount of detailed information is needed for credit purchases made from suppliers to a business, then a subsidiary ledger is commonly used. Subsidiary ledgers are kept when there is a large amount of transaction information that needs to be recorded, a subsidiary ledger avoids large volumes of transactions that would otherwise be recorded in the general ledger.

The ‘payables ledger' is also called the ‘purchases ledger’ and also called ‘trade payables’, it represents ledgers kept for each supplier account, including the total balance owed to each supplier to be ‘payable’ by the business. The accounts payables subsidiary ledger is a breakdown of the total amount of payables that would be included in the general ledger.

The payables ledger is not part of the double entry general ledger system, it is maintained separately and independently. The payables ledger records the detailed transaction history for all credit suppliers to a business, which would include purchase invoices, credit notes and money paid to each credit supplier.

Total amounts posted from the day books to the general ledger

Sale of goods on credit

Credit Customers	Total Amount	VAT Amount	Net Amount
Sales Day Book (SDB)	**DR** Receivables Ledger Control	**CR** VAT	**CR** Sales
Sales Returns Day Book (SRDB)	**CR** Receivables Ledger Control	**DR** VAT	**DR** Sales Returns
Discounts Allowed Day Book (DADB)	**CR** Receivables Ledger Control	**DR** VAT	**DR** Discounts Allowed

The sale of goods on credit to customers are recorded in the sales day book and receivables ledger. Cash sales are sales earned from customers that were not on credit and are recorded in the cash book.

Purchase of goods on credit

Credit Suppliers	Total Amount	VAT Amount	Net Amount
Purchases Day Book (PDB)	**CR** Payables Ledger Control	**DR** VAT	**DR** Purchases
Purchases Returns Day Book (PRDB)	**DR** Payables Ledger Control	**CR** VAT	**CR** Purchases Returns
Discounts Received Day Book (DRDB)	**DR** Payables Ledger Control	**CR** VAT	**CR** Discounts Received

The purchase of goods on credit from suppliers are recorded in the purchases day book and payables ledger. Cash purchases are purchases made from suppliers that were not on credit and are recorded in the cash book.

Money received and paid

Transaction	Total Amount in the cash and bank columns of a cash book	VAT and Net Amounts in the analysis columns of a cash book
Money received	DR Bank or DR Cash	CR VAT and Net amounts
Money paid	CR Bank or CR Cash	DR VAT and Net amounts

DEAD CLIC

Don't get clouded in the double entry logic, ledgers are just balances kept for the five financial elements and you are either increasing or decreasing these balances according to the rules of double entry.

Important double entry terminology

DEAD CLIC defines what is the 'normal balance' or the natural state for a T account. DEAD CLIC is an acronym that defines elements of the financial statements and indicates whether each element would be overall a debit or credit balance. It can be used for determining the correct debit or credit balance that would exist in a ledger account, but the element must be determined first. It can also be used to determine the correct double entry to increase or decrease a ledger account balance.

DEAD CLIC

Debit	**Credit**
Expenses	**L**iabilities
Assets	**I**ncome
Drawings	**C**apital

The elements	Natural state	Increase balance (as per the natural state)	Decrease balance (opposite to natural state)
Income	Credit	Credit	Debit
Expenses	Debit	Debit	Credit
Assets	Debit	Debit	Credit
Liabilities	Credit	Credit	Debit
Capital	Credit	Credit	Debit

The elements of final accounts

Five elements make up the final accounts for a business and these are assets, liabilities, capital (equity), income and expenses.

- Assets, liabilities and capital are presented in the statement of financial position (SFP) which reports about the wealth and liquidity (cash) position of the business.
- Income and expenses are presented in the statement of profit or loss (SPL) which reports the profit earned (or loss incurred) by the business.

Assets

Resources controlled by the business as a result of past events and from which future benefits (money) are expected to flow to the business.

Non-current assets are assets consumed or used by a business beyond a period of one year, they are long-term investments and used to generate products, services or cash for a business.

Examples of non-current assets

- Land and buildings.
- Manufacturing plant and equipment.
- Equipment and tools.
- Computer equipment.
- Office equipment.
- Furniture, fixtures and fittings.
- Motor vehicles.

An accumulated depreciation account in the general ledger is a credit balance and represents an amount provided as depreciation charges in previous accounting periods for non-current assets. This contra account (a credit balance) is normally netted against the original cost of the non-current asset (a debit balance) to show ‘the carrying value’ in the statement of financial position.

Current assets are assets expected to be converted quickly into cash within a period of one year or less.

Examples of current assets

- Closing inventory the business currently holds for resale.
- Trade receivables (money to be ‘received’ and owed from credit customers). Also called the receivables ledger control account.
- Prepaid expenses (expenses paid but not yet consumed).
- Accrued income (income earned but not yet received).
- VAT owed from HMRC.
- Money in the bank account.
- Cash in hand (physical notes and coins).

The allowance for doubtful receivables account in the general ledger is a credit balance and represents an amount provided for doubtful debts in the receivables ledger control account. This contra account (a credit balance) is normally netted against the amount in the receivables ledger control account (a debit balance) to show 'net trade receivables' in the statement of financial position.

Liabilities

Present obligations of the business arising from past events and in future money will be paid out by the business to settle outstanding balances.

Non-current liabilities are obligations expected to be settled (paid) by the business beyond a period of one year

Examples of non-current liabilities

- Bank loans.
- Hire purchase agreements.
- Lease agreements.

Current liabilities are obligations expected to be settled (paid) by the business within a period of one year or less.

Examples of current liabilities

- VAT owed to HMRC.
- Wages owed to staff.
- Accrued expenses (expenses consumed but not yet paid).
- Prepaid income (income received but not yet earned).
- Bank overdraft (money owed to the bank).
- Trade payables (money to be 'paid' and owed to credit suppliers). Also called the payables ledger control account.

Capital

Capital (equity) simply means the value of ownership. Capital is the residual interest (whatever is left) from the assets of the business after deducting all liabilities. The balance of assets less liabilities ('net assets') represent what is owed by the business to the owner of the business. A drawings account also records any money taken from the business by the owner. A drawings account is kept separate to the capital account because it provides more information.

Any profit shown in a statement of profit or loss is owed to the owner of the business (increasing their capital balance) and any losses shown in a statement of profit or loss reduce what is owed to the owner of the business (decreasing their capital balance).

Assets, liabilities and capital are presented in the statement of financial position for a business, which reports about the wealth and liquidity (cash) position of the business.

Income

Money earned or received by the business from the sale of goods or services, or from other investments and income sources.

- Cash sales (sales that were for cash, not on credit).
- Credit sales (sales that were on credit).
- Rent received from rental of business premises.
- Bank interest received.
- Discounts received (prompt payment discounts) from suppliers.
- Gain on disposal of non-current assets.

The sales returns account in the general ledger is a debit balance and represents sales returns by customers. This contra account (a debit balance) is normally netted against sales (a credit balance) to show ‘net sales’ in a statement of profit or loss.

Expenses

Costs incurred or paid for by the business in the normal course of trade, such as the cost of goods purchased for resale and other expenses consumed.

- Cash purchases (purchases that were for cash, not on credit).
- Credit purchases (purchases that were on credit).
- Rent payments for business premises.
- Premises insurance, light and heat.
- Staff wages.
- Motor vehicle running costs.
- Advertising and marketing.
- Depreciation charges (an expense for the wear and tear, fall in value or obsolescence of non-current assets).
- Loss on disposal of non-current assets.
- Bank interest and bank charges.
- Irrecoverable debts (bad debts written off in the receivables ledger control).
- Allowance for doubtful receivables adjustment.
- Discounts allowed (prompt payment discounts) to credit customers.
- Accountancy and legal services.
- Carriage inwards.
- Carriage outwards.

The purchase returns account in the general ledger is a credit balance and represents purchase returns to suppliers. This account is normally netted against purchases (a debit balance) to show ‘net purchases’ in a statement of profit or loss. Carriage inwards represent an expense for delivery charges made by suppliers and normally treated as part of cost of goods sold. Exam tasks may expect you to include purchases as one single figure within the trading account section (see later) of a statement of profit or loss, after adding carriage inwards and deducting purchase returns. Exam task instructions would be given wherever relevant. Carriage outwards represents delivery charges incurred by the business to transport goods sold to customers, these expenses are included below the trading account in a statement of profit or loss (see later).

The initial trial balance

An initial ‘trial balance’ (a ‘trial of balances’) as the name suggests is an accounting statement where all debit and credit balances from the general ledger (a double-entry system) are shown together to test their equality. The receivables and payables ledgers are independent from the general ledger and are not included in a trial balance.

The purpose of a trial balance is to ensure that all entries made in the general ledger have been properly balanced and to check the accuracy of entries made before a final set of financial statements are constructed for a business.

The accounting equation

The accounting equation states that the sum of the business’s total assets less its total liabilities (net assets) would be equal to the capital (equity) owed to the owner of the business. Capital is the residual interest (whatever is left for the owner).

Total **A**ssets (debits) - Total **L**iabilities (credits) = **C**apital (a ‘credit’ balance remaining).

Types of errors not disclosed by the trial balance

Errors and omissions occur in the general ledger that do **not** cause an imbalance between the total of all debit and credit balances in a trial balance. This makes these types of error more difficult to detect. These types of error can be remembered using the acronym ‘TOPCROC’. You do not need to memorise the different types of error but exam tasks can require you to prepare adjustments to an extended trial balance or produce journal entries required to correct errors.

- **T Transposition**
  A digit (number) for an amount posted is reversed incorrectly for both a debit and credit entry made.
- **O Original entry**
  Documents such as invoices or credit notes are prepared incorrectly or the wrong amounts are posted incorrectly to the day books.
- **P Principle**
  An amount incorrectly posted to the wrong general ledger account and the wrong financial element.
- **C Commission**
  An amount incorrectly posted to the wrong general ledger account but the right financial element.
- **R Reversal of entries**
  Debit and credit entries are incorrectly posted the wrong way round.
- **O Omission**
  No entry has been made in the general ledger (a transaction is not recorded).
- **C Compensating**
  Very rare but can happen, two independent errors create an imbalance between debit and credit amounts, but each error compensates and cancels out the other (so no imbalance would exist in the trial balance).

Types of errors disclosed by the trial balance

Errors and omissions occur in the general ledger that do cause an imbalance between the total of all debit and credit balances in a trial balance. This makes these types of error easier to detect because the trial balance will not balance.

These types of error can be remembered using the acronym 'TESCOS'. You do not need to memorise the different types of error but exam tasks can require you to prepare adjustments to an extended trial balance or produce journal entries required to correct errors.

- **T Transposition**
  A digit (number) for an amount posted is reversed incorrectly for a debit amount posted but the credit amount is correctly posted, or vice versa.
- **E Extraction**
  A general ledger balance in error is balanced incorrectly. The incorrect balance is 'extracted' and shown incorrectly in a trial balance.
- **S Single entry**
  A debit entry is posted without any corresponding credit entry, or vice versa.
- **C Casting**
  A column in a day book is added up ('casted') incorrectly and the incorrect amount posted from a day book to the general ledger.
- **O Omission**
  A general ledger balance in error is missed out altogether from a trial balance.
- **S Same sided**
  Two debit entries are posted in error without any corresponding credit entry, or vice versa.

Suspense accounts

A suspense account balance is opened each time an imbalance exists between the total of all debits and credits in a trial balance. A balance is opened in a suspense account to ensure equality between the total of all debits and credits in a trial balance, it is a temporary account and will be closed whenever the errors can be found and corrected. A suspense account can also temporarily store financial transactions until they can be verified and the correct general ledger accounts for the posting is determined.

Practice example 1

Trial Balance (totals before the suspense account opened)	154,896	155,279
Suspense account opened (debit balance)	383	
Trial balance totals agree but errors need to be found	155,279	155,279

In the example above the total debit amounts and total credit amounts in a trial balance do not agree and a suspense account is temporarily opened to hold the amount of any imbalance. An amount of £383 is missing on the debit side (£155,279 - £154,896) which becomes a suspense account balance to ensure the trial balance debit and credit totals do agree.

The extended trial balance (ETB)

An ETB is a workings paper in a manual book-keeping system used to prepare the final debit and credit balances for the statement of profit and loss account (SPL) and the statement of financial position (SFP). You must be able to transfer balances from ledger accounts, a list of balances or written data into the correct debit or credit columns of an initial trial balance. You must be able to place the following period adjustments correctly into the adjustment columns of an adjusted trial balance so that it balances:

- Closing inventory
- Accruals of income or expenses
- Prepayments of income or expenses
- Depreciation
- Irrecoverable debts
- Allowances for doubtful receivables
- Disposals of non-current assets (NCA) including part-exchange.

You must be able to correct errors that are not shown by an initial trial balance and correct errors that are shown by an initial trial balance by the use and clearing of a suspense account.

You must be able to complete the SPL and SFP columns of an ETB by extending figures from the ledger balances and adjustment columns to the relevant statement of profit or loss (SPL) and statement of financial position (SFP) columns. You must be able to balance off the ETB by calculating the profit or loss amount and enter the relevant figure in the SPL and SFP columns. The completion of an ETB for partnerships is excluded from your syllabus. An example of a fully completed ETB is shown below.

Extended Trial Balance

Ledger account	Ledger balances		Adjustments		Statement of profit or loss		Statement of financial position	
	Dr £	Cr £	Dr £	Cr £	Dr £	Cr £	Dr £	Cr £
Bank		1,299						1,299
Opening inventory	4,200				4,200			
Capital		7,928						7,928
Drawings	22,000						22,000	
Premises expenses	16,931				16,931			
Bank charges and interest	320				320			
Staff wages	12,480				12,480			
Sales returns	2,400				2,400			
Purchases returns		480				480		
Carriage inwards	940				940			
Bank loan		15,900						15,900
Closing inventory			3,200	3,200		3,200	3,200	
Administration expenses	6,600				6,600			
Depreciation charges			2,740		2,740			
Office equipment at cost	27,400						27,400	
Office equipment - accumulated depreciation		5,480		2,740				8,220
Purchases	25,420				25,420			
Payables ledger control account		5,725						5,725
Allowance for doubtful receivables		300		39				339
Allowance for doubtful receivables - adjustment			39		39			
Sales		86,400				86,400		
Receivables ledger control account	3,390						3,390	
Loan interest paid	1,431				1,431			
Profit for the year					16,579			16,579
Totals	123,512	123,512	5,979	5,979	90,080	90,080	55,990	55,990

The purpose of a bank reconciliation

A bank reconciliation is the process of agreeing a closing cash book balance recorded by the business to the closing balance shown on the bank statements. A bank reconciliation is an important internal control to help a business identify any errors or omissions from its cash receipts or payments recorded. It also helps to discover any cash fraud in a more timely manner.

Reasons for performing a bank reconciliation

- Detecting errors
- Identifying fraudulent transactions and theft
- Keeping track of trade receivables and trade payables

The process for a bank reconciliation

1. Compare and match receipts recorded in the cash book (receipts are 'debits' in the cash book) to receipts recorded on the bank statements (receipts are 'credits' on a bank statement) **AND** Compare and match payments recorded in the cash book (payments are 'credits' in the cash book) to payments recorded on the bank statements (payments are 'debits' on a bank statement).

The end result of step 1 is to discover unmatched receipts and payments from comparing both sets of records.

2. Revise the cash book by making entries in the cash book for items that appear on the bank statements but are not recorded in the cash book. Examples of such items include bank interest received, bank charges and interest paid, automated payments or receipts (such as BACS and faster payments) that have been omitted (missed) from the cash book.

An exam task may provide a cash book and expect you to enter missing items not in the cash book, as well as total and balance the cash book. An exam task alternatively could ask for the debit or credit entries to revise a cash book. The end result of step 2 is to have an accurate and up-to-date closing balance for the cash book.

3. Complete a bank reconciliation statement that will agree the closing balance in the revised cash book to the closing balance shown on the bank statements. A bank reconciliation statement adjusts the closing balance shown on the bank statement for 'timing differences' to agree this closing balance to the cash book.

Earlier timing differences are items recorded in the cash book in the previous month and are now clearing 'early' on the bank statements in the following month. Earlier timing differences are not reconciling items for the current month and these items should be ignored when completing step 2 above.

The receivables ledger control account (RLCA)

The general ledger account that represents the total amount owed by credit customers is the receivables ledger control account (RLCA). An example of a receivables ledger control account (RLCA) is shown below. Using the principle of DEAD CLIC, the balance brought down (b/d) is on the debit side because the receivables ledger control account is an asset (customers owe money to the business). All entries within this account would include VAT.

- Debit entries are made for sales invoices which increase the balance owed by credit customers.
- Credit entries are made for customer payments, discounts allowed, sales returns, and irrecoverable debts, which decrease the balance owed by credit customers.

Example of a receivables ledger control account

Receivables ledger control account

Date	Details	Amount £	Date	Details	Amount £
1 Apr	Balance b/d	12,900	30 Apr	Bank	24,060
30 Apr	Sales	31,200	30 Apr	Sales returns	500
			30 Apr	Discounts allowed	624
			30 Apr	Set off entries to PLCA	1,200
			30 Apr	Irrecoverable debts	680
			30 Apr	Balance c/d	17,036
	Total	44,100		**Total**	44,100
1 May	Balance b/d	17,036			

All amounts entered in the RLCA would be inclusive of VAT. Cash sales are not recorded in the receivables ledger or receivables ledger control account. A set-off (contra) entry occurs in a situation when you have a customer who orders goods on credit but also supplies goods on credit to the same business. In such cases agreements can be made to set-off balances between the receivables and payables ledger without any payment.

Purpose of the receivables ledger control account

- Checks the accuracy of the total customer balances in the receivables ledger.
- Provides a quick total for customer balances in the receivables ledger.
- Helps to identify any errors or missing figures.

Types of error that are common in the receivables ledger control and receivables ledger include sales invoices, credit notes or bank receipts that have been duplicated or omitted. In a manual book keeping system mistakes may happen in one ledger system but not the other and the balances from each ledger may not agree at the end of a period.

Summary for the effect of duplications and omissions

Type of error	Transaction	Error made in the receivables ledger control account (RLCA)	Error made in the receivables ledger
Duplication e.g. same transaction entered twice	Sales invoice (debit entry)	RLCA balance higher than the receivables ledger balance	Receivables ledger balance higher than the RLCA balance
	Credit notes, payments, set off entries and irrecoverable debts (credit entry)	RLCA balance lower than the receivables ledger balance	Receivables ledger balance lower than the RLCA balance
Omission e.g. transaction not recorded	Sales invoice (debit entry)	RLCA balance lower than the receivables ledger balance	Receivables ledger balance lower than the RLCA balance
	Credit notes, payments, set off entries and irrecoverable debts (credit entry)	RLCA balance higher than the receivables ledger balance	Receivables ledger balance higher than the RLCA balance

The payables ledger control account (PLCA)

The general ledger account that represents the total amount owed to credit suppliers is the payables ledger control account (PLCA), the entries in this account are the summarised total amounts entered from the day books. An example of a payables ledger control account (PLCA) is shown below. Using the principle of DEAD CLIC, the balance brought down (b/d) is on the credit side because the payables ledger control account is a liability (the business owes money to suppliers). All entries within this account would include VAT.

- Credit entries are made for purchase invoices which increase the balance owed to credit suppliers.
- Debit entries are made for supplier payments, discounts received and purchase returns which decrease the balance owed to credit suppliers.

Example of a payables ledger control account

Payables ledger control account

Date	Details	Amount £	Date	Details	Amount £
30 Apr	Discounts received	249	1 Apr	Balance b/d	6,590
30 Apr	Purchase returns	360	30 Apr	Purchases	24,895
30 Apr	Bank	15,296			
30 Apr	Set off entries to RLCA	1,200			
30 Apr	Balance c/d	14,380			
	Total	31,485		**Total**	31,485
			1 May	Balance b/d	14,380

All amounts entered in the PLCA would be inclusive of VAT. Cash purchases are not recorded in the payables ledger or payables ledger control account. A set-off (contra) entry occurs in a situation when you have a customer who orders goods on credit but also supplies goods on credit to the same business. In such cases agreements can be made to set-off balances between the receivables and payables ledger without any payment.

Purpose of the payables ledger control account

- Checks the accuracy of the total supplier balances in the payables ledger.
- Provides a quick total for supplier balances in the payables ledger.
- Helps to identify any errors or missing figures.

Types of error that are common in the payables ledger control and payables ledger include purchase invoices, credit notes or bank payments that have been duplicated or omitted. In a manual book keeping system mistakes may happen in one ledger system but not the other and the balances from each ledger may not agree at the end of a period.

Summary for the effect of duplications and omissions

Type of error	**Transaction**	**Error made in the Payables ledger control account (PLCA)**	**Error made in the Payables ledger**
Duplication e.g. same transaction entered twice	Purchase invoice (credit entry)	PLCA balance higher than the payables ledger balance	Payables ledger balance higher than the PLCA balance
	Credit note or payment (debit entry)	PLCA balance lower than the payables ledger balance	Payables ledger balance lower than the PLCA balance
Omission e.g. transaction not recorded	Purchase invoice (credit entry)	PLCA balance lower than the payables ledger balance	Payables ledger balance lower than the PLCA balance
	Credit note or payment (debit entry)	PLCA balance higher than the payables ledger balance	Payables ledger balance higher than the PLCA balance

Incomplete records

Incomplete records is an accounting situation, where a business does not maintain a double-entry bookkeeping system and does not produce a trial balance. The accountant has minimal records to prepare final accounts, such as a cash book only, or no actual accounting records exist at all.

The receivables and payables ledger control accounts are useful accounting tools for incomplete records, they can be used to estimate and calculate missing figures and help prepare the final accounts. General ledger accounts such as bank and cash can also help identify missing items such as money or goods taken or stolen, or the drawings a sole trader has taken from the business but did not record.

The VAT control account

The purpose of a VAT control account is to accurately record VAT collected from sales (outputs of the business) and VAT to be reclaimed from purchases and expenses (inputs to the business). It provides the necessary details for a VAT return to be prepared and submitted to HMRC.

An example of a VAT control account is shown below. Using the principle of DEAD CLIC, the balance brought down (b/d) is on the credit side because the VAT control account is normally a liability (VAT is owed to HMRC).

In some cases VAT is owed from HMRC (a refund of VAT is due to the business). This can happen when a business reclaims more input VAT on its purchases and expenses compared to output VAT it owes on its sales. The balance brought down (b/d) in this case would be on the debit side and indicates an 'asset' as VAT is owed from HMRC.

Example of a VAT control account

VAT control account

Date	Details	Amount £	Date	Details	Amount £
30 Apr	Cash purchases	635	1 Apr	Balance b/d	2391
30 Apr	Credit purchases	3450	30 Apr	Cash sales	6780
30 Apr	Discounts allowed	54	30 Apr	Credit sales	13667
30 Apr	Sales returns	120	30 Apr	Purchase returns	468
30 Apr	Bank (payment of VAT)	2391	30 Apr	Discounts received	23
30 Apr	Balance c/d	16679			
	Total	23329		**Total**	23329
			1 May	Balance b/d	16679

Calculating VAT amounts

- 1/5 x the net amount (excluding VAT) = the VAT amount.
- 1/6 x the total amount (including VAT) = the VAT amount.

The wages control account

A wages control account is a 'liability' account representing net salaries (money) owed to employees, it also records the total summary from payroll reports such as amounts owed to HMRC (income tax and national insurance), pension contributions and trade union subscriptions.

The wages control account keeps a record of the total (summary) of payroll transactions for a period. The control account acts as a 'check' for wages paid to employees and ensures the correct payroll liabilities have been recorded.

The exam will not require tax and national insurance to be calculated. According to the logic of DEAD CLIC a credit entry will increase the balance for a liability and a debit entry will decrease a balance for a liability.

A proforma wages control account is shown below. A tip to learn payroll entries would be that all payroll entries will always be a debit or credit entry to the wages control account, so if you are familiar with these entries in the wages control then you can work out the other side of the double entry required for a journal entry.

Wages control account

Details	Amount £	Details	Amount £
HMRC liability	1157	Wages expenses	4103
Pensions liability	780		
TU liability	26		
Bank (net salaries paid)	2140		
Total	4103	**Total**	4103

Period end adjustments

The reason for period end adjustments to the final accounts is because of the accruals (or matching) concept. The accruals (or matching) concept is an accounting principle that recognises revenues such as sales income and all its related expenses in the same accounting period.

Irrecoverable (bad) debts

An **irrecoverable debt** is a debt that **'definitely will not be paid'** and cannot be collected because a customer is unable to pay the amount owed. The business is also not willing to take any action to collect it. The debt must be removed from the receivables ledger control account (RLCA) in the general ledger and from the customer's account in the receivables ledger.

Journal entry for irrecoverable debts (no VAT charged on sales)

- **Debit** Irrecoverable debts (expenses increase)
- **Credit** Receivables ledger control account (the 'asset' decreases)

Journal entry for irrecoverable debts (VAT charged on sales)

- **Debit** Irrecoverable debts (expenses increase)
- **Debit** VAT control account (liability to pay VAT to HMRC decreases)
- **Credit** Receivables ledger control account (the 'asset' decreases)

Bad debt recovery

A bad (irrecoverable debt) may have been written off and subsequently the money owed is then recovered from the customer in a future accounting period. The accounting adjustment would be the reverse of the accounting entries shown above.

Allowances for doubtful receivables

A **doubtful receivable** is a debt that is **'unlikely, or uncertain to be paid'**. Allowances for doubtful receivables are matched as expenses against the sales income earned in the same accounting period.

Specific allowances for doubtful receivables may be set aside for money owed by certain customers because of the customers position, such as a long overdue account or an on-going trade dispute.

General allowances for doubtful receivables may be set aside that anticipate that some customers in the future may become uncollectible, but without knowing any specific customer names. History and experience may suggest that a certain percentage of the receivables ledger balance owed may not pay due to unforeseen circumstances.

Accounting for doubtful receivables

- The percentage for a general allowance is calculated after deducting irrecoverable debts and specific allowances for doubtful receivables from the RLCA. This avoids double counting.
- Specific and general allowances are added together and compared to the total credit balance for allowances for doubtful receivables at the beginning of the accounting year.
- The credit balance for allowances for doubtful receivables is increased or decreased at the end of each accounting year.

Increasing allowances for doubtful receivables.

- **DEBIT** ALLOWANCE FOR DOUBTFUL RECEIVABLES: ADJUSTMENT (statement of profit or loss)
- **CREDIT** ALLOWANCE FOR DOUBTFUL RECEIVABLES (statement of financial position)

Decreasing allowances for doubtful receivables.

- **DEBIT** ALLOWANCE FOR DOUBTFUL RECEIVABLES (statement of financial position)
- **CREDIT** ALLOWANCE FOR DOUBTFUL RECEIVABLES: ADJUSTMENT (statement of profit or loss)

Summary of irrecoverable debts and doubtful receivables

<table>
<tr><th></th><th>Nature</th><th>Action</th><th>Statement of financial position</th><th>Statement of profit or loss</th></tr>
<tr><td>Irrecoverable debts</td><td>Customer amounts owed that definitely will not be paid.</td><td>Write off the debt from the RLCA and close the receivables ledger account of the customer.</td><td>RLCA</td><td>Irrecoverable debts</td></tr>
<tr><td>Specific allowances for doubtful receivables</td><td>Specific customers that are unlikely to pay.</td><td>Record an allowance for doubtful receivables.</td><td rowspan="2">Allowance for doubtful receivables</td><td rowspan="2">Allowance for doubtful receivables adjustment</td></tr>
<tr><td>General allowances for doubtful receivables</td><td>General percentage for customers that are unlikely to pay.</td><td>Record an allowance for doubtful receivables.</td></tr>
</table>

Closing inventory

Closing inventory is the cost of ‘unsold goods for resale’ (purchases) at the end of an accounting period. At the end of an accounting period the cost of closing inventory (unsold goods) is removed from cost of sales in a profit or loss account and recognised as an asset in the statement of financial position.

Journal entries for closing inventory

- **DEBIT** Closing inventory
  (increase assets in the statement of financial position)
- **CREDIT** Closing inventory
  (decrease cost of sales in the statement of profit or loss)

Valuing closing inventory

The accounting standard that regulates the accounting treatment of inventory is international accounting standard (IAS) 2 Inventory. IAS 2 defines inventories as assets which are held for sale in the ordinary course of business.

Inventory must be valued at the lower of purchase cost or net realisable value (NRV). Net realisable value (NRV) means the estimated selling price of the inventory less any costs to complete the sale. Obsolescence, damage or falling market prices are likely reasons why inventory can be worth less than its purchase cost.

What can be included in the value of closing inventory

- Purchase cost (less any trade or bulk discount).
- Delivery cost (also called carriage inwards).
- Import duties paid on the goods.

What cannot be included in the value of closing inventory

- Storage (warehouse) costs.
- Administrative costs.
- Selling costs e.g. advertising and marketing.
- VAT (if the business is registered for VAT).

Accruals and prepayments of income and expenditure

Exam tasks may require you to account for period end adjustments for accruals and prepayments, including the reversal of these entries at the beginning of the accounting year. The general ledger accounts examined include accrued expenses, accrued income, prepaid expenses and prepaid income.

A period end adjustment for accruals and prepayments will be made on the last day of an accounting period. The double entry is shown below.

Account	Nature	Debit	Credit
Accrued Expenses (Liability)	Expenses consumed but not paid for in an accounting period.	Expenses	Accrued Expenses
Prepaid Expenses (Asset)	Expenses paid for but not consumed in an accounting period.	Prepaid Expenses	Expenses
Accrued Income (Asset)	Income earned but not received in an accounting period.	Accrued Income	Income
Prepaid Income (Liability)	Income received but not earned in an accounting period.	Income	Prepaid Income

The reversal of accruals and prepayments on the first day of the next accounting year would be the opposite to the double entry shown above.

Capital expenditure

International Accounting Standard (IAS) 16 is the accounting standard that regulates the accounting treatment of property, plant and equipment. IAS 16 defines tangible non-current assets as ‘assets with physical substance and held for a continual (long-term) purpose’. Examples include land, buildings, machines, furniture, computers and motor vehicles. Current assets (rather than non-current assets) are assets that are quickly converted into cash typically within one year e.g. closing inventory, trade receivables, prepaid expenses, accrued income, money in the bank and cash in hand.

Costs included as capital expenditure

- Purchase price of the non-current asset.
- Delivery cost.
- Installation, assembly and fitting costs.
- Site preparation costs.

Costs excluded as capital expenditure

- VAT if the amount is reclaimed.
- Revenue expenditure.
- Non-current assets costing less than a materiality threshold.

Capital v revenue expenditure

- Capital expenditure means acquiring non-current assets that are permanent, long-lasting and used in a business beyond one year. Capital expenditure will be recorded as a ‘non-current asset’ in a statement of financial position at the end of the year.
- Revenue expenditure is an expense that is consumed quickly and the benefit of consumption is short-lived (within one year or less) e.g. rent, staff wages and advertising expenses. Revenue expenditure is matched as an ‘expense’ with sales income earned in a statement of profit or loss for the year.

Journal entries for the purchase (acquisition) of non-current assets

- **DEBIT** Non-current assets - at cost
  (increase assets in the statement of financial position)
- **CREDIT** Bank
  (decrease assets in the statement of financial position)

Alternatively, if the purchase was funded by a bank loan then credit bank loan (increase liability) rather than credit bank (decrease asset).

Business policies

Formal organisational policies can help control non-current assets and include authorisation of capital expenditure prior to purchase, materiality limits for accounting treatment of capital expenditure, maintaining a non-current asset register and regular physical inspection of assets for wear and tear, obsolesce, damage, or theft.

Materiality limits

Materiality limits may exist as policy to govern the accounting treatment of capital expenditure. Materiality disregards ‘trivial’ or ‘small’ matters and materiality thresholds are common as business policy to determine the accounting treatment for new assets. If the amount spent on an asset is below a certain materiality (trivial) threshold then expenditure is treated as a revenue ‘expense’ rather than a ‘non-current asset’.

Exam instructions will always explain the materiality policy of a business.

Depreciation

When a non-current asset is used over time it will generally lose value due to wear and tear, obsolescence or damage. The matching (accruals) concept would account for this loss of value (depreciation) during an assets lifetime and match this ‘expense’ to sales income earned in each accounting year.

Different methods exist to calculate the amount for depreciation charges to be recognised as an expense in the statement of profit or loss for each accounting year.

The straight-line method

Depreciation charge each year = (Cost - Residual Value) ÷ Useful Life (Years).

The diminishing (reducing) balance method

Depreciation charge each year = Carrying value of NCA x Rate of depreciation (%).

This method calculates a depreciation amount for each year by multiplying a constant percentage rate by the carrying value of a non-current asset at the beginning of the accounting year. The carrying value is the original cost of the asset less any accumulated depreciation. The percentage rate already accounts for any residual (resale) value of the NCA at the end of its useful economic life and is therefore excluded from the depreciation calculation.

Journal entries for depreciation charges

- **DEBIT** Depreciation charges
  (increase expenses in the statement of profit or loss account)
- **CREDIT** Accumulated depreciation
  (decrease carrying value of the NCA in the statement of financial position)

Accumulated depreciation is a credit balance to represent the amount of depreciation charges accumulated to date for a non-current asset. Accumulated depreciation (a credit balance) is often referred to as a ‘contra asset’ account because its credit balance is netted off against the original cost of an NCA (a debit balance) to calculate the carrying value of the asset in the statement of financial position.

Terminology to learn

Original cost	The purchase price of a non-current asset, including installation, assembly, fitting, site preparation and delivery costs.
Accumulated depreciation	The total amount of depreciation charged to date for a non-current asset.
Carrying (value) amount	The original cost of the non-current asset less any accumulated depreciation. Carrying value may also be called 'net book value'.
Useful economic life	The period of time a non-current asset is expected to be used by the business.
Residual (resale) value	The estimated sale value of a non-current asset at the end of its useful economic life.
Depreciable amount	The original cost of a non-current asset less any residual value.
Depreciation charge	The amount charged as an expense in the statement of profit or loss, to recognise a fall in value for a non-current asset.

Recording the disposal (sale) of non-current assets

A disposal (sale) account is a general ledger account used to calculate a gain or loss on the sale of a non-current asset. The disposal account records the proceeds received from the sale (disposal) of the asset and the carrying value of the asset sold (its original cost - accumulated depreciation). The difference between sale proceeds and the carrying value of the asset is the gain or loss arising on disposal. An example of a disposal account is shown below.

Disposal account

Details	Amount £	Details	Amount £
Forklift truck - at cost	20,000	Forklift truck - accum depn	6,000
Profit or loss account	1,000	Bank	15,000
	21,000		21,000

Journal to remove the original cost of an NCA

- Debit Disposals
- Credit Non-current asset - at cost

Journal to remove accumulated depreciation for an NCA

- Debit Accumulated depreciation
- Credit Disposals

Journal to record the sale proceeds (money) received

- Debit Bank
- Credit Disposals

The disposals account is closed at the end of the accounting year and any balance remaining is transferred as a gain (income) or loss (expense) to the statement of profit or loss account.

- A gain means that the sale proceeds received were more than the carrying value of the asset sold - Debit Disposals and Credit Profit or loss (income).
- A loss means that the sale proceeds received were less than the carrying value of the asset sold - Debit Profit or loss (expense) and Credit Disposals.

Recording a part exchange value for the disposal of a non-current asset

A part-exchange is when an existing asset owned by the business is ‘traded in’ to fund the purchase cost for a new asset.

Journal to record a part-exchange value received

- Debit Non-current assets - at cost
- Credit Disposals

The non-current asset register

The general ledger provides only a summarised total balance for the original cost and accumulated depreciation for all assets owned by the business. A non-current asset (or fixed asset) register keeps a detailed record of all the individual non-current assets owned by a business. Details include a description of each asset, its acquisition date, original cost (£), accumulated depreciation (£), carrying value (£) and method of funding.

Example of a non-current asset register

Description /Serial number	Acquisition date	Cost £	Depreciation charges £	Carrying amount £	Funding method	Disposal proceeds £	Disposal date
Computer equipment							
PC ZX100	01/09/X4	1300.00			Cash		
Year ended 31/01/X5			250.00	1050.00			
Year ended 31/01/X6			250.00	800.00			
Year ended 31/01/X7			250.00	550.00			
PC ZX200	01/09/X4	1800.00			Cash		
Year ended 31/01/X5			375.00	1425.00			
Year ended 31/01/X6			375.00	1050.00			
Year ended 31/01/X7			0.00	0.00		200.00	31/01/X7
Office equipment							
Furniture and printer	01/12/X6	2638.00			Cash		
Year ended 31/01/X7			395.70	2242.30			
Motor vehicles							
Car RBV007	23/01/X6	16700.00			Hire Purchase		
Year ended 31/01/X6			3340.00	13360.00			
Year ended 31/01/X7			2672.00	10688.00			

Preparing final accounts for a sole trader

The layout for a statement of profit or loss and statement of financial position would be provided in the exam task if you are required to construct a set of final accounts. Picklists would be provided for you to make your text entries and boxes provided in the layout for you to enter amounts.

Statement of profit or loss for the year ended 30 April 20X8

	£	£
Sales revenue		96,100
Opening inventory	5,500	
Purchases	23,650	
Closing inventory	-4,100	
Cost of goods sold		25,050
Gross profit		71,050
Add:		
Discounts received	500	
Interest received	650	
		1,150
Less:		
Depreciation charges	8,000	
Discounts allowed	5,560	
Irrecoverable debts	5,000	
Light and heat	1,870	
Advertising	3,000	
Telephone expenses	1,340	
Motor vehicle expenses	5,920	
Staff wages	10,200	
Rent	12,000	
Total expenses		52,890
Net profit		19,310

Terminology to learn

- Sales revenue = sales - sales returns.
- Net purchases = purchases - purchases returns + carriage inwards.
- Cost of sales = opening inventory + net purchases - closing inventory.

Statement of financial position as at 30 April 20X8

	Cost £	Accumulated depreciation £	Carrying amount £
Non-current assets			
Office equipment	18,000	4,500	13,500
Motor vehicles	14,500	3,500	11,000
			24,500
Current assets			
Closing inventory		4,100	
Trade receivables		22,300	
Cash at bank		14,600	
		41,000	
Current liabilities			
HMRC liability	1,500		
VAT owed to HMRC	5,410		
Trade payables	13,400		
		20,310	
Net current assets			20,690
Net assets			45,190
Financed by			
Opening capital			49,880
Add: Profit for the year			19,310
Less: Drawings			24,000
Closing capital			45,190

The capital account

Exam tasks can expect you to complete ledger entries for a sole traders capital account. The amounts included in the statement of financial position above are entered in the capital account shown below.

Capital account

Details	Amount £	Details	Amount £
Drawings	24,000	Balance b/d	49,880
Balance c/d	45,190	Profit or loss account	19,310
Total	69,190	**Total**	69,190
		Balance b/d	45,190

Preparing final accounts for a partnership

1. The statement of profit or loss is prepared for a partnership in exactly the same way as a sole trader.
2. The appropriation account is then prepared to allocate the net profit (or net loss) to each partner.
3. The current accounts for each partner are then updated using the appropriation account and each partners drawings figure for the year.
4. A financial position is prepared in a similar way to a sole trader. The ‘financed by’ section shows the closing capital and current account balances for each partner.

The key components of a partnership agreement

The Partnership Act 1890 defines a partnership as persons carrying on a business in common with a view of profit. It is advisable in a partnership to have a partnership agreement which sets out the rights, duties and obligations of each partner. If a partnership agreement does not exist, the Partnership Act 1890 states simply that ‘profits or losses will be shared equally’ between each partner.

Example of an appropriation account

The profit or loss for appropriation would be the net profit or net loss figure taken from the statement of profit or loss account.

	£
Profit or loss for appropriation	45,160
Add:	
Interest on drawings – A	1,000
Interest on drawings – B	600
Deduct:	
Interest on capital – A	-1,500
Interest on capital – B	-1,000
Salary - A	0
Salary - B	-6,000
Sales commission – A	-3,450
Sales commission – B	-2,900
Residual profit or loss available for distribution	31,910
Share of residual profit or loss:	
Share of residual profit - A	19,146
Share of residual profit - B	12,764
Total residual profit distributed	31,910

Interest of drawings

Partners maybe penalised for taking drawings from the business and interest on drawings charged to each partner. The amounts are added to the net profit or loss available for appropriation.

Interest of capital

Partners maybe allocated interest on their capital invested in the partnership business. Interest on capital is deducted from the net profit or loss for appropriation.

Salaries

Partners maybe entitled to a salary. Salaries are deducted from the net profit or loss for appropriation.

Sales commission

Partners maybe entitled to sales commission on their sales results achieved. Sales commission is deducted from the net profit or loss for appropriation.

The 'residual' profit or loss

The net profit or loss after adjustment for salaries, sales commission, interest on capital and interest on drawings, is the 'residual' profit or loss. Residual means 'whatever is remaining'. The residual profit or loss will be shared according to the profit or loss sharing agreement of each partner (by ratio, fraction or percentage).

Partnership capital and current accounts

Partners would normally keep two accounts for their private transactions which is a capital account and current account. Capital accounts record the permanent (fixed) capital invested by each partner in the business. Current accounts record the current balance that each partner can withdraw from the business at any time they choose. The balance in a current account will fluctuate from year to year and is kept separate from the capital account of each partner. A balance for a current account can also be overdrawn (debit balance) when a partner takes more drawings than their share of profits allocated.

Drawings taken by each partner each year is also debited to their current account which decreases the current account balance available for each partner. Drawings is not an entry in an appropriation account because it is not an appropriation of profit, it is money taken by a partner after profits have been appropriated.

A sole trader only needs to keep one capital account to record their profits (or losses) and drawings taken for each accounting year because 100% of the net assets of the business belong wholly to the sole trader. Sole traders do not keep a current account.

Example of current accounts for a partnership

Current accounts

Details	Anne £	Burt £	Details	Anne £	Burt £
Balance b/d		2,420	Balance b/d	9,450	
Interest on drawings	1,000	600	Interest on capital	1,500	1,000
Drawings	20,000	12,000	Salaries	0	6,000
Balance c/d	12,546	7,644	Sales commission	3,450	2,900
			Share of profit or loss	19,146	12,764
Total	33,546	22,664	**Total**	33,546	22,664

Accounting entries for current accounts

Interest on drawings or a share of a residual loss.

- **Debit** Current account (decrease balance owed to partner)
- **Credit** Appropriation account

Interest on capital, salaries, sales commission or a share of a residual profit.

- **Debit** Appropriation account
- **Credit** Current account (increase balance owed to partner)

REMEMBER! Drawings are never included in an appropriation account.

Drawings taken by each partner.

- **Debit** Current account (decrease balance owed to partner)
- **Credit** Drawings (decrease drawings to close the account)

Example of a statement of financial position for a partnership

The statement of financial position for a partnership is prepared in exactly the same way as a sole trader. The only difference is how the 'financed by' section would be completed. A partnership would show the closing capital and closing current account balances of each partner for the end of the year.

Statement of financial position as at 31 March 20X5

	Cost £	**Accumulated depreciation £**	**Carrying amount £**
Non-current assets			
Office equipment	18,000	4,500	13,500
Motor vehicles	14,500	3,500	11,000
			24,500
Current assets			
Closing inventory		4,100	
Trade receivables		22,300	
Cash at bank		14,600	
		41,000	
Current liabilities			
HMRC liability	1,500		
VAT owed to HMRC	5,410		
Trade payables	13,400		
		20,310	
Net current assets			20,690
Net assets			45,190
Financed by	**Anne**	**Burt**	**Total**
Capital accounts	15,000	10,000	25,000
Current accounts	12,546	7,644	20,190
	27,546	17,644	45,190

An overdrawn current account would be represented as a negative figure in a statement of financial position. Neither partner has an overdrawn current account balance.

The financial statements

- The statement of profit or loss (SPL) inform users about the ability of the business to generate profits. It also shows information about sales and the nature of expenses incurred.
- The statement of financial position (SFP) inform users about the current status of the business which include its net assets, liquidity, debt levels and funding.

The primary users of financial statements

The primary (most important) users of final accounts are investors, lenders and other creditors of the business.

Users	Reasons why final accounts are needed
Owner	To assess how much profit has been generated by the business and the value of its net assets. To assess whether the business will be able to pay dividends (or drawings) in the future. To assess the risk and return from their investment and whether they should continue to invest.
Bank	To assess current debt levels of the business and its ability to meet future loan repayments and interest.
Supplier	To assess any risk of supplying goods or services on credit to the business and whether the supplier will get paid.
Management	To assess how well the business is being managed in terms of utilising assets and resources to generate cash-flows and profit.
Employee	To assess the security of their employment and the continuing profitability of the business. Interested in employment prospects, pension funding and the security of their retirement benefits.
Customer	To assess any going concern problems of the business and its ability to continue to supply goods or services in the future.
Government	HMRC, Companies House and the Office for National Statistics are examples of government agents that are interested in accounting information. HMRC needs to know the amount of tax that should be paid by the business.
General public	Individuals and groups in society may have varied interests in the activities and performance of a business. Especially if the business is well-known in the media.

The qualitative characteristics of useful financial information

Qualitative characteristics are the attributes that make financial information useful to the users of final accounts. Each characteristic can be remembered using the acronym **VCRUFT**.

- **V**erifiability.
- **C**omparability.
- **R**elevance.
- **U**nderstandability.
- **F**aithful representation.
- **T**imeliness.

The 'fundamental' qualitative characteristics of useful financial information is relevance and faithful representation. There are four 'enhancing' qualitative characteristics, which include comparability, verifiability, timeliness and understandability.

Relevance

Financial information must be capable of influencing and making a difference to the decisions of users. Relevance means information that is both material and useful to users of the final accounts.

Faithful representation

Financial information must be complete and free from material error and omission. The final accounts need to paint an objective, transparent and honest financial picture of what really happened.

Comparability

Information about a business is more useful if it can be compared with similar information to a previous year, or to another business in the same industry.

Verifiability

Verifiability gives assurance to the user that the information provided is faithfully represented. Auditing accounts using an independent and external auditor can lend more credibility for information contained within the final accounts.

Timeliness

Timeliness means that the information is available and capable of influencing users to make economic decisions in a timely manner.

Understandability

Presenting information clearly and concisely makes it more understandable. Final accounts are prepared for users who should have reasonable knowledge of the business and its economic activities.

Accounting concepts that govern the financial statements

The materiality concept

The materiality concept is an accounting rule that dictates that any transaction that significantly has an impact on the final accounts must be recognised.

The prudence concept

The prudence concept is an accounting rule that exercises conservatism and caution when making judgements about accounting transactions under conditions of uncertainty.

The accruals (matching) concept

The accruals (matching) concept recognises sales income and all related expenses which belong to the same accounting period.

The going concern concept

The going concern concept means to recognise the business can continue to operate and remain in business for the foreseeable future.

The business (separate) entity concept

The separate entity concept states that business transactions and the personal transactions of its owners must be kept separate for accounting purposes.

The consistency concept

The consistency concept states that, once a business has adopted an accounting policy then it must continue to follow it consistently in future accounting years. This ensures that results reported from one year to another are comparable.

The money measurement concept

The money measurement concept states that a business should only record an accounting transaction, if it can be reliably measured and expressed in terms of money.

Calculating and interpreting profitability ratios

The objective of the financial statements is to provide information to all users of accounts to help make decisions. A ratio is a measure of the relationship between two quantities, normally expressed as one figure divided by the other, it is an effective way of analysing the financial statements and for comparing performance.

A single ratio on its own is meaningless unless:

- Results compared to another period of time.
- Results compared to another organisation.
- Results compared to an industry average (or standard).

Limitations of ratio analysis

- Historical information is not necessarily a guide for predicting the future.
- Different accounting policies may significantly effect comparison.
- Business and product changes over time may significantly effect comparison.
- Non-financial performance is not understood e.g. customer satisfaction.
- Manipulation of financial statements may significantly effect comparison.

Examinable profitability ratios

- **Sales (also called gross profit) margin** = gross profit / sales revenue × 100.
- **Mark-up** = gross profit / cost of goods sold × 100.
- **Net profit margin** = net profit for the year / sales revenue × 100.
- **Expense/sales revenue percentage** (a 'specified expense' including cost of sales as a % of sales revenue) = 'specified expense' / sales revenue × 100. Exam task instructions would state which expense to measure as a percentage of sales.
- **ROCE** (return on capital employed) = net profit for the year / capital employed × 100 (where capital employed = capital + non-current liabilities).

Principles of ethics for professional accountants

The code of ethics establishes the fundamental principles of ethics for professional accountants and can be remembered using the acronym **PIPCO**.

- **P**rofessional competence and due care
- **I**ntegrity
- **P**rofessional behaviour
- **C**onfidentiality
- **O**bjectivity

Professional behaviour

Members should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Integrity

Members should be straightforward and honest in all professional and business relationships.

Professional competence and due care

Members have a continuing duty to maintain professional knowledge and skill at a level required to ensure competent professional services based on current developments in practice, legislation and techniques. Members should act diligently and in accordance with applicable technical and professional standards when providing professional services.

Confidentiality

Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority or unless there is a legal or professional right or duty to disclose.

Objectivity

Members should not allow bias, conflicts of interest or undue influence of others to override professional or business judgements.

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Mock Exam One - Solutions

AAT L3 Financial Accounting: Preparing Financial Statements

Task 1 - Solutions (28 marks)

This task is about using daybooks, and accounting for and monitoring non-current assets.

(a) Complete the following sentences about using daybooks.

(3 marks)

A sales invoice for £3,600 issued to a customer for the sale of goods on credit would be recorded in the **Sales Day Book**.

A small transaction of £3.40 paid in cash for postage stamps would be recorded in the **Petty Cash Book**.

A credit note received from a supplier for a prompt payment discount would be recorded in the **Discounts Received Day Book**.

(b)(i) For the year ended 31 August 20X7, record the following in the extract from a non-current asset register below.

- Any acquisitions of non-current assets
- Any disposals of non-current assets
- Depreciation

(12 marks)

Description /Serial number	Acquisition date	Cost £	Depreciation charges £	Carrying amount £	Funding method	Disposal proceeds £	Disposal date
Plant and machinery							
Machine AX56	01/09/X4	13000.00			Loan		
Year ended 31/08/X5			3250.00	9750.00			
Year ended 31/08/X6			2437.50	7312.50			
Year ended 31/08/X7			**0.00**	**0.00**		2000.00	24/07/X7
Machine AZ50	01/09/X6	**21390.00**			Part Exchange		
Year ended 31/08/X7			**5347.50**	**16042.50**			
Motor vehicles							
Car EN65 RBV	23/01/X6	6700.00			Loan		
Year ended 31/08/X6			2345.00	4355.00			
Year ended 31/08/X7			**1524.25**	**2830.75**			
Car BN60 DFV	26/08/X5	7800.00			Finance lease		
Year ended 31/08/X5			2730.00	5070.00			
Year ended 31/08/X6			1774.50	3295.50			
Year ended 31/08/X7			1153.43	2142.07			

Workings:

To: A. Business	From: ZAR Traders Invoice number: 1123	Date: 1 Sept 20X6
Item	**Details**	**£**
Machine AZ50	AZ50	**19,000.00**
Software	for AZ50	**1,290.00**
2 x PC Monitors (screens)	@ £150 each for AZ50	**300.00**
Delivery and installation	for AZ50	**800.00**
Net total		**21,390.00**
VAT 20%		4,278.00
Total		25,668.00

Machine AX56 (sold)

- This machine would be removed from the accounting records of the business by posting both its original cost and accumulated depreciation to a disposal account. The carrying value would therefore always be zero when an asset has been removed. **1 mark for the correct amount.**
- Depreciation charged is 0.00 because the accounting policy of the business is to apply none in the year of disposal. **1 mark for the correct amount.**

Machine AZ50 (purchased)

Capitalisation of cost for this machine

- Machine AZ50 £19000 is capital expenditure.
- The software and 2 monitors are also capital expenditure. Even the though the monitors are below the cost of £200 each (the accounting policy for not capitalising expenditure), machine AZ50 (in total) costs more than £200 for all items relating to this machine 'in aggregate'. The entire purchase cost should be capitalised.
- Delivery and installation cost is always treated as capital expenditure if an asset is capitalised.
- VAT should be ignored as the business will reclaim all VAT from the purchase cost of the asset. The VAT on the transaction would be posted to a VAT control account.
- The total cost that should be capitalised (items highlighted in bold on the invoice above) is £21390.00. **3 marks for the correct amount. 1 mark for the picklist 'Machine AZ50'.**

Depreciation charges for machine AZ50

- Plant and machinery is depreciated at 25% per annum on a diminishing balance basis.
- A full year's depreciation is applied in the year of acquisition.
- £21390 is the carrying value (the asset has just been acquired) x 25% = £5347.50 depreciation charged. **2 marks for the correct amount.**
- The carrying value at the year-end would be the original cost £21390.00 less accumulated depreciation £5347.50 = £16042.50. **1 mark for the correct amount.**

Car EN65 RBV

- Motor vehicles are depreciated at 35% per annum on a diminishing balance basis.
- The carrying value of the car at the beginning of the year was £4355.00 x 35% depreciation rate = £1524.25 depreciation charges. **2 marks for the correct amount.**
- The carrying value at the beginning of the year was £4355.00 less depreciation charged for the year £1524.25 = £2830.75 carrying value for the car at the end of the year. **1 mark for the correct amount.**

(b)(ii) Complete the following calculation (3 marks)

Calculate the gain or loss on disposal of Machine AX56 for the year ended 31 August 20X7. **Show your answer rounded to TWO decimal places. Use a minus sign or brackets to indicate a loss on disposal.**

Answer -5312.50

Workings

Carrying value at the beginning of the year	7312.50
Part exchange value	2000.00
Loss on disposal	-5312.50

The original cost of the old machine was £13000.00. Accumulated depreciation for the old machine sold was £5687.50 (depreciation charges recorded in the NCA register was £3250.00 + £2437.50). The carrying value of the old machine sold was £13000.00 - £5687.50 = £7312.50. The part exchange value of £2,000 given was lower compared to the carrying value of £7312.50 for the old machine. Whenever the sale proceeds (cash, or part exchange value) are less than the carrying value, then a loss on disposal would arise. A disposal account is provided below to help improve your understanding of the ledger entries required.

Disposals (Statement of profit or loss)

Details	Amount £	Details	Amount £
Old machine - at cost	13,000.00	Old machine - accumulated depreciation	5,687.50
		New machine - at cost	2,000.00
		Profit or loss account	5,312.50
Total	13,000.00	**Total**	13,000.00

(c) Drag and drop two items that are included as capital expenditure and two items that are excluded from capital expenditure.

(2 marks)

Costs included
Site preparation costs
Delivery cost

Costs excluded
VAT
Revenue expenditure

(d)(i) Calculate the depreciation charge of the new machine for the year ended 31 August 20X7

(2 marks)

The straight-line method calculates a constant amount of depreciation for each year.

Straight Line Depreciation per annum = (Cost - Residual Value) / Useful Life of Asset.

Straight Line Depreciation per annum = (£18,930 - £2,000) / 5 years = £3,386 every year.

(d)(ii) Make entries in the accounts below for:

- **The acquisition of the new machine**
- **The depreciation charges for the new machine**

(6 marks)

Machinery at cost

	£		£
Balance b/d	84900	Balance c/d	103830
Bank	18930		
	103830		103830

Machinery accumulated depreciation

	£		£
Balance c/d	52586	Balance b/d	49200
		Deprciation charges	3386
	52586		52586

Depreciation charges

	£		£
Balance b/d	22600	Profit or loss account	25986
Machinery accumulated depreciation	3386		
	25986		25986

The balance b/d was already entered in the task information for all three ledger accounts. 1 mark is given for each correct entry and correct amount entered on the debit or credit side.

Task 2 - Solutions (14 marks)

This task is about recording period end adjustments.

(a)(i) Complete the following statement.

(4 marks)

Prepaid expenses	of	£	300	dated	31/12/X7

1 mark is given for each correct picklist and 2 marks are given for the correct amount of £300. The amount paid of £900 for 12 months of insurance. 8 months of this payment relates to this accounting period (1/5/X7 to 31/12/X7) and 4 months of this payment relates to the next accounting period (1/1/X8 to 30/4/X8). 4 months insurance has been prepaid in advance for the year ended 31 December 20X7. £900 ÷ 12 months = £75 per month x 4 months = £300 prepaid expenses. A prepaid expense is an asset because the business has paid for expenses which have not yet been consumed. Accruals and prepayments are period end adjustments and entries would be made in the general ledger on the year-end date of 31 December 20X7.

The amount paid of £567 wholly relates to the accounting year ended 31 December 20X7 and no period end adjustment is required.

(a)(ii) Update the motor vehicle expenses account

(6 marks)

Motor vehicle expenses

	£		£
Bank	8042	Prepaid expenses	300
		Profit or loss account	7742
	8042		8042

The cash book for the year shows payments for motor vehicle expenses of £8,042. The double entry would be:

- Debit £8,042 Motor vehicle expenses (increase expenses)
- Credit £8,042 Bank (decrease asset)

Prepaid expenses is an asset in the statement of financial position. The double entry at the year ended would be:

- Debit £300 Prepaid expenses (increase asset)
- Credit £300 Motor vehicle expenses (decrease expenses)

The balance of £7,742 at the year-end for motor vehicle expenses would be transferred as an expense to the statement of profit or loss account.

(b) Show the journal entries that will be required to adjust for closing inventory of £13,422 for the year ended 31 December 20X7.

(4 marks)

Account	Dr £	Cr £
Closing inventory (statement of financial position)	13422	
Closing inventory (statement of profit or loss account)		13422

Closing inventory is a reduction in cost of sales (expenses) for the year in the statement of profit or loss, and an asset in the statement of financial position because it is something that the business owns. A journal entry is made to increase (debit) assets and decrease (credit) expenses.

Task 3 - Solutions (24 marks)

(a) Enter the figures in the table shown below to the appropriate trial balance debit or credit columns. Do not enter zeros in unused column cells. Do NOT use minus signs or brackets.

(2 marks)

Extract from the trial balance

	Ledger balance	Trial balance	
Account	**£**	**£ DR**	**£CR**
Prepaid income (liability)	1000		1000
Drawings (see DEADCLIC) drawings a DR	8900	8900	
Carriage inwards (expense)	1029	1029	
Accrued income (asset)	1504	1504	

(b)(i) Refer to the extract from the extended trial balance below. Calculate the value of the adjustment required (to the nearest £).

(2 marks)

£ 82

The allowance for doubtful debts account is a contra account (credit balance) to the receivables ledger control account (debit balance), to work out net trade receivables in the statement of financial position. The general allowance for the year ended should be compared to the total credit balance brought forward at the beginning of the accounting year, and the allowance for doubtful receivables credit balance is either increased or decreased by the adjustment required.

The general allowance for doubtful debts needs to be adjusted to 2% of outstanding trade receivables. In the ETB the receivables ledger control account is £24,090. £24,090 x 2% = £482 allowance for doubtful receivables for the year ended. The current balance in the allowance for doubtful receivables account is a credit balance of £400. The credit balance of £400 needs to be increased to a £482 credit balance, so the double entry would be to credit £82 to increase the allowance for doubtful receivables balance and debit the allowance for doubtful debts - adjustment (an expense) in the profit or loss account.

General ledger accounts are shown below to improve logic and understanding of the double entry.

Allowance for doubtful receivables (statement of financial position)

Details	Amount £	Details	Amount £
Balance c/d	482	Balance b/d	400
		Allowance for doubtful receivables adjustment	82
Total	482	**Total**	482

Allowance for doubtful receivables adjustment (statement of profit or loss)

Details	Amount £	Details	Amount £
Allowance for doubtful receivables	82	Profit and loss account	82
Total	82	**Total**	82

(b)(ii) Record the adjustment in (b)(i) and the following adjustments in the extract from the extended trial balance below.

(8 marks)

Ledger account	Ledger balances		Adjustments	
	Dr £	Cr £	Dr £	Cr £
Bank	21932			
Opening inventory	6781			
Irrecoverable debts	750			
Capital		24976		
Office expenses	4200		90	1080
Staff wages	16339		1080	
Allowance for doubtful receivables		400		82
Allowance for doubtful receivables - adjustment			82	
Depreciation charges	2952			
Van at cost	17400			
Van accumulated depreciation		6090		
Purchases	45688			
Payables ledger control		5999		740
Sales		79991		
Receivables ledger control	24090			
Suspense		650	740	90

Workings

- Office expenses of £90 have been correctly posted to the cashbook but no corresponding debit entry was made to office expenses. This is a single sided error where a credit to the cash book was made but no debit entry. A debit entry is required to increase office expenses by £90 and a credit entry made to the suspense account of £90. If only £90 was credited to the bank then a £90 debit entry would be required in a suspense account to ensure the trial balance will balance. The credit entry of £90 to the suspense account would help clear the suspense account balance.
- The payables ledger control account in the general ledger has been extracted and included in the trial balance incorrectly as £5,999. This is an extraction error. The correct balance to be included was £6,739. The PLCA balance is £6,739 - £5,999 = £740 understated on the credit side. An entry is required to increase (credit) the PLCA balance by £740. A debit entry is also required to the suspense account of £740. If only £5,999 was included as a credit balance in the trial balance, then a £740 credit entry would be required in a suspense account to ensure the trial balance will balance. The debit entry of £740 to the suspense account would help clear the suspense account balance.
- Staff wages of £1,080 were posted in error to office expenses. This is an error of commission. Decrease (credit) office expenses by £1,080 and increase (debit) staff wages by £1,080. No imbalance between debits and credits exist with this type of error, so no suspense account entry is required.

(c) Using the table below show THREE adjustments that should appear in the payables ledger control account. Enter only ONE figure for each line. Do not enter zeros in unused cells. Do NOT use minus signs or brackets. (6 marks)

Account	Dr £	Cr £
Adjustment 1		1000
Adjustment 2	11280	
Adjustment 3		240

1.	The total column in the purchases daybook was undercast by £1,000. The amount posted to the payables ledger control account was £131,673 but the correct amount should have been £132,673. **The total column of a purchase daybook would be credited to the PLCA. Given the total was undercast (under added) by £1,000 then we need to post another £1,000 more to the PLCA. A credit entry is made to the PLCA of £1,000 to increase liability to suppliers.**
2.	Purchases returns of £5,640 have been credited to the payables ledger control account in error. The correct entries have been made in the payables ledger accounts for suppliers. **Purchase returns should be a debit, not a credit entry to the PLCA because credit notes for goods returned reduce the liability to pay suppliers. We need to debit the PLCA by £5,640 to cancel the credit error and then debit the PLCA again by £5,640 to record the correct entry (2 x £5,640) = £11,280 debit entry is made to the PLCA.**

3.	A purchase invoice of £240 from Streets Ltd was omitted from purchases daybook. The correct entry was made in the payables ledger account of the supplier. **A purchase daybook would be used to credit the PLCA by the total for all supplier invoices. Given £240 was omitted in the PLCA a credit entry of £240 is required to be made to the PLCA to increase liability to suppliers.**
4.	A set-off entry of £5,042 was omitted from the payables ledger account of M. Smith. The correct entry was made in payables ledger control account. **The PLCA has been correctly updated, but the purchase ledger account of the supplier needs to be reduced by £5,042.**
5.	Purchase returns of £120 were debited in error to the payables ledger account of Winkle Traders Ltd instead of the payables ledger account of Traders RUS Ltd. **An entry was made to the wrong supplier account in the payables ledger but a correct debit posting was made to the payables ledger and PLCA. Both the PLCA and payables ledger balance would still agree.**
6.	A purchase invoice was sent by a supplier for £360 in error, the correct amount should have been £3,600. The incorrect amount of £360 was posted to both the payables ledger and payables ledger control account. **This is a supplier error and both the PLCA and payables ledger were updated by only £360. When the correct invoice is received, both ledgers will be adjusted but currently both balances still agree because they contain an entry for the same amount.**

A payables ledger control account (PLCA) showing the error adjustments and a reconciliation (agreement) to the total of all balances in the payables ledger accounts is shown below to further the logic and understanding.

PLCA (Trade Payables)

	£		£
Adjustment 2	11280	Balance b/d	27042
Balance c/d	17002	Adjustment 1	1000
		Adjustment 3	240
	28282		28282

Adjustment to the payables ledger accounts

	£
Total balances in the payables ledger	22044
Adjustment 4	-5042
Revised (corrected) balance from PLCA	17002

(d) You are to compete the extended trial balance shown below. Ensure you calculate the profit or loss and specify in the appropriate space in the first column whether it is a profit or a loss.

(6 marks)

Extended Trial Balance

Ledger account	Ledger balances		Adjustments		Statement of profit or loss		Statement of financial position	
	Dr £	Cr £	Dr £	Cr £	Dr £	Cr £	Dr £	Cr £
Bank	18,533			800			17,733	
Opening inventory	4,500				4,500			
Capital		22,622						22,622
Drawings	8,000						8,000	
Office expenses	4,589				4,589			
Van expenses	12,320		360		**12,680**			
Staff wages	13,239				13,239			
Discounts allowed	471				471			
Discounts received		579				579		
Carriage outwards	540				540			
Loan		20,000						20,000
Closing inventory			3,300	3,300		3,300	3,300	
Advertising expenses	8,000		800		**8,800**			
Depreciation charges			6,234		6,234			
Vans at cost	27,400						27,400	
Vans - accumulated depreciation		9,590		6,234				15,824
Purchases	19,680				19,680			
Payables ledger control		1,009	550					**459**
Accrued expenses				360				360
Irrecoverable debts			240		240			
Sales		68,612				68,612		
Receivables ledger control	3,090			240			2,850	
Loan interest paid	1,500				1,500			
Suspense	550			550				
Profit for the year					**18**			**18**
Total	122,412	122,412	11,484	11,484	72,491	72,491	59,283	59,283

Task 4 - Solutions (24 marks)

This task is about producing financial statements for sole traders and partnerships.

(a)(i) Prepare a partnership appropriation account for the year ended 31 March 20X7. Use a minus sign for deductions or where there is a loss to be distributed. You must enter zeros where appropriate in order to obtain full marks.

(10 marks)

	£
Profit for appropriation	97,000
Salary - A	-18,000
Salary - B	-24,000
Sales commission - A	-7,560
Sales commission - B	-3,450
Residual profit available for distribution	43,990
Share of residual profit or loss:	
Share of residual profit - A	30,793
Share of residual profit - B	13,197
Total residual profit or loss distributed	43,990

Workings

- **2 marks for the correct entry of profit for appropriation £97,000.**
- **1 mark for each correct entry for sales commission.**
- Salaries were paid each month: Albert £1,500 x 12 months = £18,000. Brenda £2,000 per month x 12 months = £24,000. **1 mark for each correct entry.**
- After salary and commission has been appropriated, the residual profit is £43,990. The share agreement is Albert gets 70% and Brenda gets 30%. £43,990 residual profit ÷ 100% x 70% = Alberts residual profit share £30,793. £43,990 residual profit ÷ 100% x 30% = Brenda's residual profit share £13,197. **2 marks for each correct entry.**
- Drawings you never include in an appropriation account (only interest on drawings). Drawings is money taken by each partner from the business after profits have been appropriated and the amount is posted to the current account of each partner.

(a)(ii) Complete the following sentences about Brenda's current account:

(5 marks)

Brenda's current account will be shown in the **Statement of financial position**.

Brenda's current account as at 31 March 20X7 would be a **Debit** balance of £**19,963**.

1 mark is given for selecting 'Debit' balance and 'Statement of financial position'. 3 marks are given for calculating the correct balance of £19,963.

A current account for Brenda has been constructed below to help with the logic and understanding. When the entries for the accounting year are made and the account is totalled and balanced, the balance c/d is on the credit side. At the start of the next accounting year the balance b/d will be on the debit side (her current account is overdrawn and is a debit balance).

Current account (Brenda)

	£		£
Balance b/d	340	Salary	24000
Drawings	60000	Sales commission	3450
		Share of residual profit	13197
		Balance c/d	19693
	60340		60340

(b) Complete the capital account for the year ended 31 March 20X7. Show clearly the balance carried down to the next financial year.

(6 marks)

Capital

	£		£
Drawings	1300	Balance b/d	19228
Balance c/d	31156	Profit for the year	13228
	32456		32456

1 mark is given for the drawings picklist and 1 mark given for the amount of £1,300 entered on the debit side. 1 mark is given for the profit for the year picklist and 1 mark given for the amount of £13,228 entered on the credit side. 1 mark is given for the balance b/d and balance c/d only if the correct picklist and correct amount is entered.

Assets, goods or money taken by a sole trader is a debit entry to the drawings account of a sole trader. Drawings are posted to the capital account at the end of the accounting year, and the entry would be Debit Capital £1,300 (decrease money owed by the business to its owner) and Credit Drawings (to close the account). Profits for the year are a Credit entry to capital (increase money owed by the business to its owner) and a Debit entry to the statement of profit or loss (to close the account).

(c) Show whether the following statements are TRUE or FALSE

(3 marks)

	TRUE	FALSE
The calculation of cost of sales in a statement of profit or loss account is equal to opening inventory plus net purchases less closing inventory.	☑	☐
Capital injections and profits earned during a period are both credit entries in the capital account of a partner.	☐	☑
A bank overdraft and the payables ledger control account are presented as non-current liabilities in the statement of financial position.	☐	☑

- **TRUE.** The calculation of cost of sales in a statement of profit or loss account is equal to opening inventory plus net purchases less closing inventory.
- **FALSE.** Capital injections and profits earned during a period are both credit entries in the capital account of a partner. Capital injections would be a credit entry in a partners capital account but any share of profits would be a credit to the current account (not the capital account) of a partner.
- **FALSE.** A bank overdraft and the payables ledger control account are presented as non-current liabilities in the statement of financial position. Non-current liabilities are obligations expected to be settled (paid) by the business beyond a period of one year. A bank overdraft and a payables ledger control account are presented as current liabilities, which are obligations expected to be settled (paid) by the business within a period of one year or less.

Task 5 - Solutions (18 marks)

This task is about accounting principles, qualities of useful financial information and interpreting financial statements using profitability ratios.

(a) Reconciliation of a cash book balance to the bank statements, or a payables ledger account balance to a supplier statement received, is more likely to support which one of the following qualitative characteristics of useful financial information. Choose ONE answer only.

(2 marks)

Verifiability	☑
Timeliness	☐
Comparability	☐
Relevance	☐

Verifiability gives 'assurance for information'. Timeliness would mean to receive information on time to make effective decisions. Comparability would mean the information can be compared with other years or to other businesses. Relevance means information is both material and useful for its users.

(b) Show whether the following is TRUE or FALSE.

(2 marks)

True	☐
False	☑

The above ratio is for sales margin (not mark-up).

(c) Which ONE of the following is NOT a likely response given to the management accountants request.

(2 marks)

Seek guidance from your practice manager regarding the posting of this journal.	☐
Discuss the matter with the management accountant to see if there is a valid case for posting this journal.	☐
Post the journal without question as the management accountant is your client.	☑

To post the journal without question would be breaching the ethical principle of objectivity (scepticism is to question and not just accept someone else's opinion).

(d) Calculate the following ratios based on the information above. Answers should be rounded to two decimal places.

(6 marks)

- **ROCE** (return on capital employed) = net profit for the year £8,806 / capital employed × 100 (where capital employed = capital £19,030 + non-current liabilities £14,000). £8,806 / £33,030 × 100 = 26.66%.
- **Sales margin** = gross profit £21,706 / sales revenue £53,508 × 100 = 40.57%.
- **Expenses as a percentage of sales** = expense £12,900 / sales revenue £53,508 × 100 = 24.11%.

(e) Show whether the following statements are TRUE or FALSE

(3 marks)

	TRUE	FALSE
The return on capital employed ratio could be improved if a business repays a 5 year bank loan.	☑	☐
Whether a ratio is better or worse requires a comparison to be made with another organisation, or to a different time period.	☑	☐
The sales margin ratio could be improved if a business repays its 5 year bank loan.	☐	☑

- **TRUE.** ROCE (return on capital employed) is calculated as net profit divided by capital employed (capital + non-current liabilities). Therefore either an increase in net profit or a decrease in capital employed would improve the ratio. The repayment of a long-term bank loan would reduce non-current liabilities and therefore the amount of capital employed, the ratio is therefore likely to improve.
- **TRUE.** Whether a ratio is better or worse requires a comparison to be made with a different organisation, or to a different time period or to an industry standard.
- **FALSE.** Sales margin is gross profit divided by sales. The repayment of a long-term bank loan would reduce non-current liabilities, but gross profit and sales would remain unchanged. The ratio is therefore likely to remain the same.

(f) Complete the following sentences about accounting principles.

(3 marks)

The **prudence concept** is an accounting rule that exercises conservatism and caution when making judgements about accounting transactions under conditions of uncertainty.

The **going concern** concept means to recognise the business can continue to operate and remain in business for the foreseeable future.

The **separate entity** concept states that business transactions and the personal transactions of its owner are different for accounting purposes.

Task 6 - Solutions (12 marks)

This task is about preparing accounting records from incomplete information.

(a)(i) Find the total purchase returns figure including VAT by completing the payables ledger control account for the year ended 31 August 20X8.

(5 marks)

Payables ledger control

	£		£
Receivables ledger control	1200	Balance b/d	29522
Bank	69627	Purchase daybook	82680
Purchase returns daybook	**5703**		
Balance c/d	35672		
	112202		112202

The missing figure for purchase returns is £5,703. This is calculated by totalling and balancing the control account, once all items including the balance b/d and balance c/d has been entered in the control account. Exam tasks would normally provide an autosum function for calculating the debit and credit totals (£112,202). Cash purchases are not included in a payables ledger control.

(a)(ii) Find the missing drawings figure the owner has taken for personal use by completing the cash account for the year ended 31 August 20X8.

(4 marks)

Cash account

	£		£
Balance b/d	2300	Bank	15000
Cash sales (£32,600 plus VAT at 20%) =	39120	**Drawings (missing figure)**	**20990**
		Balance c/d	5430
	41420		41420

A cash account follows the same principle as the bank (an asset). You would debit receipts (including VAT) to increase the cash balance (total cash sales) and credit payments (including VAT) to decrease the cash balance (amounts banked, or taken as drawings). The missing figure for drawings is £20,990. This is calculated by totalling and balancing the cash account, once all items including the balance b/d and balance c/d has been entered in the cash account. Exam tasks would normally provide an autosum function for calculating the debit and credit totals (£41,420).

(b) Which of the following is most likely to be the total balance in the payables ledger control account at the year end.

(2 marks)

- £15,000 ☐
- £10,000 ☑
- £5,000 ☐

The trader is allowed by its suppliers to settle its accounts 60 days after purchase, so on average it owes 60 days of purchases. Purchases were £60,000. The balance in the payables ledger control account on ‘average’ would be £60,000 (purchases for the year) ÷ 365 days = £164 of purchases per day x 60 days owed to suppliers = £9,863 PLCA balance (an ‘average’). The figure closest to £10,000 would be the answer.

(c) Using the information above calculate sale income earned for the year ended.

(1 mark)

£170,000 x 30% = GP	£51,000
£170,000 COS + £51,000 GP =	£221,000

SALES = £221,000.

Mark-up is calculated as Gross profit / Cost of sales × 100. If mark-up is 30%, then 30% of cost of sales is gross profit (£51,000 gross profit is calculated above). If £51,000 of gross profit is added to cost of sales (£170,000), the total amount would be sales income earned of £221,000 for the year ended.