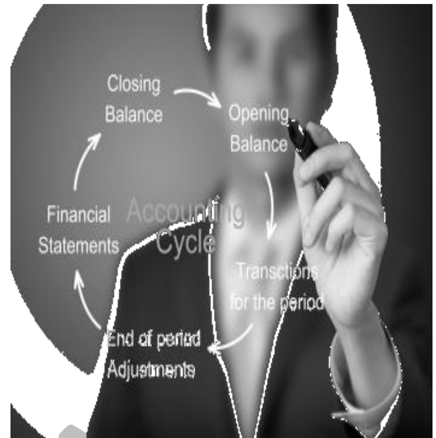


ACCOUNTING IGCSE

0452

General Revision

Prepared By:

Maryam A. Ghazy

Definitions

1- Assets & Liabilities

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

2- Carriage inwards & Carriage outwards.

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

3- Accounting & Bookkeeping

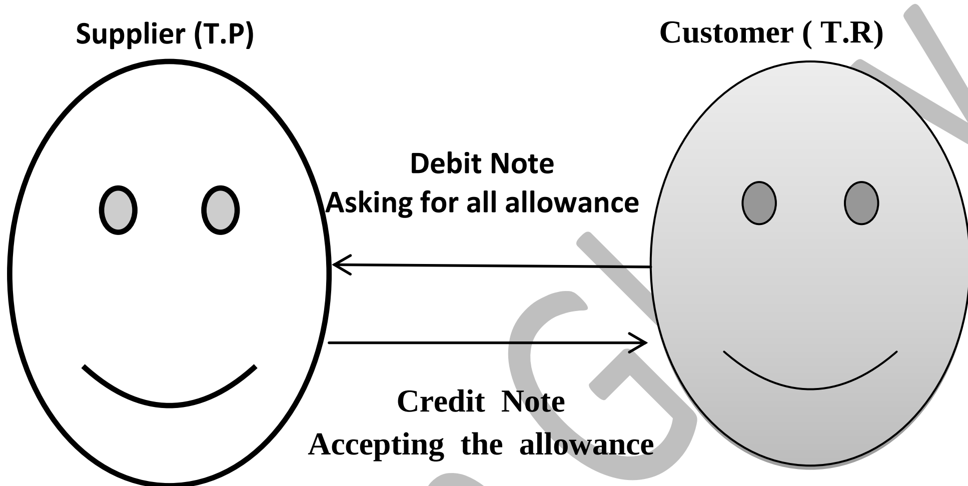
- Accounting : is an information system – includes the process of recording, classifying, summarizing, reporting, analyzing and interpreting the financial condition and performance of a business – in order to communicate it to stakeholders for business decision making.
- Bookkeeping: is the process of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

4- Error of principle & Error of Commission.

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

5- Debit Note& Credit note

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



6- Gross Profit & Net Profit.

- Gross Profit : It's that profit achieved by the business without taking in consideration the operating expenses as electricity and rent (the difference between the selling price and the cost price)
  Gross profit = Net Sales – Cost of Sales
- Net Profit : It's the final profit that is awarded to the owner of the business at the end of each financial year after deducting all the expenses from all the revenue.
  Net profit = Gross profit + other revenue – other expenses.

7- Service business & trading business

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

8- Current Liabilities & non- Current Liabilities

- Current Liabilities : represents amounts payable with in a period of 12 months from the balance sheet date as (Bank overdraft – trade payables – owing expenses)
- Non- Current Liabilities: : There are the amounts payable more than 12 months after the balance sheet date as (Loans)

9- Trade payable & Trade Receivables.

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

10- Capital expenditure & Revenue expenditure.

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

11- Bad debts & Provision for doubtful debts.

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

12- Bank Statement & bank Reconciliation Statement.

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

13- Margin & Mark – up

- Margin : Is the gross profit measured as a percentage of selling price
  (Gross profit ÷ Sales) × 100
- Mark – up: Is the gross profit measured as a percentage of cost price
  (Gross profit ÷ cost of sales) × 100

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

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

15- Prime Cost & Cost of production.

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

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

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

17- Preference shares & Ordinary shares.

- Preference shares & Ordinary Shares are a Shares in a company (equity shares) but the Preference shares give their holders an entitlement to a fixed dividend but which do not usually carry voting rights. The important difference between preference and ordinary shares are:

1. The dividend on ordinary shares is uncertain and variable (high when the company does well, poor or non-existent when it does badly). Preference shareholders get a fixed dividend which, if not paid, usually accrues until it can be.
2. Each ordinary share usually carries a vote. Preference shares do not usually carry a vote unless dividends fall into arrears.

3. In the event of a winding up, preference shares are usually repayable at par value, and rank above the claims of ordinary shareholders (but behind bank and trade creditors).

- Preference shares may be issued with the right of conversion into ordinary shares. These are called convertibles.

18- Capital owned &Capital employed.

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

19- Current Ratio & quick Ratio

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

20- Liquidity ratios & profitability ratios & Efficiency ratios

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

21- Statement of financial position & Income Statement

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

22- Trade discount & cash discount

- Trade discount : A reduction given by the supplier to the customer for bulk purchases. Are not shown in the double entry account only appear in the invoice And are deducted from the list price of the goods when recording in the day book.

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

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

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

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

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

BOOKS OF ORIGINAL ENTRIES

These are the books of first entry. The transactions are first recorded in these books before being entered in the ledger books. These books are also called as books of Prime entry or Subsidiary books. They are six in number.

1. **Purchases Journal (or Purchases Book)**	Is used to record all credit purchases of goods. It is written up from invoice.
2. **Sales Journal (or Sales Book)**	Is used to record all the credit sales of goods. It is written up from the invoice.
3. **Sales Returns Journal (or Return Inwards Book):**	It is used to record all returns inwards. It is written up from the copies of the credit notes send to customers.
4. **Purchases Return Journal (or Returns Outwards Book):**	It is used to record all purchases returns. It is written up from the credit notes received from the suppliers.
5. **Cash Book:**	It is used to record all receipts and payments of cash and cheques. It is been given the ruling in such a way that it acts both as a book of original entry and ledger account
6. **General Journal (or Journal):**	This book is used to record all those items or transactions that can’t be recorded in any other book of original entry like i. Correction of errors ii. Provision of depreciation & provision of doubtful debts iii. Opening entries iv. Purchase or Sale of Assets on Credit etc.

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

Journal provides the only prime entry for certain types of transaction e.g. purchases / sales of Non- current assets , error correction
Gives explanation also reduces risk of omission , error, fraud

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

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

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

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

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

Less risk of errors
Less risk of fraud
Easier to refer to previous transactions
Financial position can be ascertained
Easier to prepare financial statements
Easier to make business decisions
Easier to calculate accounting ratios

BOOKS OF FINAL ENTRY

LEDGER BOOKS

Ledger books are the books of final entry which contains the various accounts to which the entries made in the Books of Original entry are transferred.

DIVISION OF LEDGER :

Purchases Ledger Book:	Contains all the accounts of Suppliers.
Sales Ledger Book:	Contains all the accounts of Customers.
General Ledger Book:	Contains all the rest of the accounts like, Assets Accounts, expenses account, losses account, etc., and also the Total purchases account, Total sales account, Total Sales returns account, Purchases Returns account. It is also called as Nominal ledger

Advantages Of Dividing The Ledger:

1. It facilitates division of labour in the maintenance of ledger.
2. It becomes easy to locate errors in ledger accounts.
3. It helps the ledger clerks to complete their respective work in time with perfection.
4. It becomes easy to refer to any particular account.

- **State and explain one advantage of dividing the ledger into these three sections**.

Work can be shared between several people.
Easier for reference as same type of accounts are kept together .
Easier to introduce checking procedures.

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

General ledger : Any non-current asset, inventory, capital, drawings, loan, sales, purchases, returns, expenses, incomes, etc
Sales ledger : Credit customers/debtors/trade receivables
Purchases ledger : Credit suppliers/creditors/trade payables

BUSINESS DOCUMENTS

Invoice	Whenever there is a credit sale, the selling business will send a document to buyer showing full details of the goods sold. This document is called as Invoice. It is known to the buyer as a "Purchases invoice". And to the seller as a "Sales invoice".
Debit Note	This document is prepared by the purchaser and it is sent to the supplier to report him if any faulty goods are been sent or shortages or overcharges are been made.
Credit Note	When goods are returned, or there has been an over-charge, a supplier may issue a credit note to the buyer. This reduces the amount owed by the customer.
Statement of Account	This document is prepared and sent to the customer by the supplier. It is issued to remind the customer about his due amount. It is basically a summary of the transaction of a customer during the month like sales made, Returns received and Cash received

Notes:

- Entries in the sales book and the purchases Book are made with the help of an invoice.
- Credit note is used to make the entries in both the purchases returns Book and the sales returns Book.

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

Send statement
Offer cash discount (not trade discount)
Limit credit (no more credit sales)
Charge interest on overdue amounts
Use debt collection methods

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

To inform or remind the customer of the amount due
To confirm the settlement terms
To ensure that no errors have been made by customer or supplier

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

To show all transaction for period
To show amount owing
To agree records, settle difference
To act as reminder to pay

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

Customer is in same type of trade; for bulk purchases.

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

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

- **Suggest two ways in which Owner might be able to encourage his customers to pay their invoices.**
    1. Send statement
    2. Offer cash discount (not trade discount)
    3. Limit credit (no more credit sales)
    4. Charge interest on overdue amounts
    5. Use debt collection methods

CASH BOOK

Cash book is the only book of original entry which is given ruling in such a way that it could act at the same time as a book of original entry and as a ledger account.

Trade Discount	It is an allowance or deduction given by the supplier to the retailer on the catalogue price or list price. i. It is given to encourage him to buy in bulk. ii. It is given so that retailer could make some profit.
Cash Discount	It is an allowance or deduction given by the receiver of cash to the payer of cash for prompt payment. It is of two types discount allowed and discount received. It is given to encourage the payer to pay on or before the due date

- **Trade discount** is not recorded in the books either by the seller or the buyer.
- **Cash discount** is recorded in the Cash Book. Discount allowed is recorded at the debit side and discount received on the credit side.
- **Discount columns** are never balanced. It is just totaled.
- **Every month** the Total's of discount allowed column is transferred to debit side of Discount allowed account in General ledger and the total of discount-received column is transferred to the credit side of Discount received account in the General ledger.
- **Contra Entry:** When a transaction effects both cash and bank accounts at the same time, such entries are called as Contra Entries.

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

Overdraft may be reduced by collecting debtors, reducing inventory, delaying payment of creditors, delaying drawings, increasing capital , Sell Non- current assets, Long Term Loan

- **Explain how a bank overdraft can arise**.

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

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

To avoid recording small cash payments in the main cash book
To reduce the number of entries in the main cash book

PETTY CASH BOOK

Imprest System: It is a system where a reimbursement is made of the total amount paid in a period or it can also be called as a system where petty cashier begin each new accounting period with the same amount of petty cash.

Advantages Of Petty Cash Book:

1. The number of entries in the main cashbook is reduced.
2. The main cashier's burden is reduced.
3. The chances of mistakes in recording is minimised.
4. Posting become more easy with the Total's Analysis Columns.

Advantages of using Analysis columns:

It let us know the money spent on each different nature of small expense.

The double entry for each analysis column by transferring the totals of the analysis columns to their respective accounts which are available in the General ledger.

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

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

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

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

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

To remove small cash payments from the main cash book.
To reduce the number of entries in the main cash book and the expenses in the ledger.
To allow the chief cashier to delegate some of the work.

- **State one advantage of the imprest system**
  1. The chief cashier is aware of exactly how much is spent in each period.
  2. The cash remaining and the total of the vouchers received should always be equal to the imprest amount.

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

  1. Lost or missing voucher
  2. Lost or stolen cash
  3. Error brought forward or in counting cash
  4. Amount not recorded

TRIAL BALANCE

Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy.

Objectives Or Advantages Of Trial Balance (reason for preparing a trial balance)

1. It checks the arithmetical accuracy of ledger accounts.
2. It gives material for preparing Final accounts.
3. To have a proof that the double entry of each transaction is made.

Important Points To Prepare Trial Balance:

1. It should be remembered that all the Assets and expenses accounts are always debited.
2. All liabilities and incomes are always credited.
3. All provisions are always credited.
4. Closing inventory is never taken in trial balance. (it is to be shown out of the trial balance).

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

To prepare final account / To check arithmetical accuracy of books
To check accounts balance / To locate errors

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

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

Final Accounts

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

Capital receipts: are amounts received from the sale of Non- current assets
Revenue receipts: are sales and other items of income which are recorded in the trading and profit and loss account.

- **State the effect on gross profit & profit for the year with opening inventory and Closing inventory.**

If Opening inventory is overstated the net profit is understated vice versa
If Closing inventory is overstated the net profit is overstated vice versa

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

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

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

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

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

Expenses are overstated
Profit for the year is understated

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

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

Concepts & Principle

Concept	Definition	Applications
1- Business Entity	This rule states that only the transactions of the business should be recorded and NOT the owner's private transactions.	- The owner is treated as a T.P when he introduce more capital - He treated as T.R when he making any withdrawals - Any personal expenses are not included in the firm books.
2- Money Measurement	Only transactions that can be expressed in monetary terms are to be recorded.	- Non- monetary items such as goodwill and management skills do not appear in the books. - We record non- current assets in the SOF without mentioning whether they have high or low quality.
3- Historic Cost	All transactions are recorded at their cost to the business.	Recording non- current assets in the SOF at their historic cost , regardless of their current market value.
4- Realization	Profits are realized (actually earned) when cash or a debtor replaces the goods or services. A transaction is NOT realized when an order is received or when a debtor pays his debt.	- Goods sent to customer are not recorded as sales until the customer accepts the invoice. - We cannot assume achieving profit on the revaluation of non- current asset
5- Duality	Every transaction will affect two items in the business – this is represented by both a debit AND a credit entry in the ledger.	Any transaction will apply this concept. Ex. Dr (cash book) cr (sales account)
6- Consistency	Transactions of a similar nature should always be recorded in the same way. This is to ensure that the Profit and Loss Accounts and Statement of financial positions can be meaningfully compared each year	- Provision for depreciation. - Inventory valuation

Concept	Definition	Applications
7- Materiality	This concept implies that you should not waste time recording transactions that are trivial (involving very small amounts of money).	When using the straight line method of depreciation . it's assumed that the asset will be equally consumed every year while tis is untrue.
8- Accruals (Matching)	The Trading and Profit and Loss Account should only include the income earned and expenses incurred for the current financial year.	- Other payable at the end of the period should be subtracted from the profit by added to expenses - Other receivables at the end of the period should be subtracted from expenses and added to profit - Provision for depreciation & provision for doubtful debts & bad debts
9- Prudence	profits must not be overstated and the value of Assets must not be shown to be too high. The accountants' duty is to ensure that the readers of the final accounts get a true and proper picture of the financial state of the business.	- Provision for depreciation. - Provision for doubtful debts. - Inventory valuation
10- Going Concern	It is assumed that a business will continue to exist for a long period of time. If business weren't assumed to be going concerns , assets are shown in the SOF at their **realizable value**	- Spreading the cost of the non-current assets over its estimated useful lifetime. - Paying in advance and delaying some of the payments to the future.
11- Accounting Period	An accounting period is a period of time such as the 12 months of January 1 through December 31. It is the period for which financial statements are prepared.	

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

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

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

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

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

Relevance : Financial information is only relevant if it can be used –
To confirm or correct prior expectations about past events
To assist in forming, revising or confirming expectations about the future
As the basis for financial decisions
Reliability : information must be capable of being:
Independently verified.
Free from bias
Free from significant errors.
Prepared with suitable caution applied to any judgments which are necessary.
Comparability : information must be compared with other similar information about the same business for another period or at another point in time.
Understandability: : Financial statement can be understood by users of these statements.

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

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

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

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

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

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

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

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

- **State one reason why should maintain a provision for doubtful debts.**
  1. Ensures that profits are not overstated (prudence)
  2. Ensures that debtors are shown in balance sheet at more realistic amount (prudence)
  3. Application of matching principle as the amount of sales unlikely to be paid for are treated as an expense of that particular year

- **State the difference between cost and net realisable value**.
  - Cost is the actual purchase price plus any additional costs incurred in bringing the inventory (stock) to its present condition and position.
  - Net realisable value is the estimated receipts from the sale of the inventory (stock), less any costs of completing or selling the goods.

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

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

BANK RECONCILIATION STATEMENT

The purpose of bank reconciliation statement is to explain any difference between the bank balance appearing on the bank statement provided by the bank..

Reasons For Difference:

Sometimes it so happen that some entries are made in cash book but they are not recorded in the bank. Like.

1. Cheques deposited but not credited in the Bank.
2. Cheques issued but are not presented in the bank.

Sometimes it so happens that some entries are made in bank statement but they are not recorded in cashbook. Like.

1. Direct deposits in the bank by our customers
2. Direct collections made by the bank on our behalf
3. Direct payments made by bank
4. Interest allowed by the bank and charged by the bank
5. Dishonoured cheques.

Therefore a statement is prepared to reconcile this difference. This statement is called as "Bank Reconciliation statement".

Methods Of Preparing Bank Reconciliation Statement:

Step I: Compare the bank column of the cashbook with the bank statement. Tick all those receipts and payments which can be found in both the cash book and the bank statement, when this has been done, there remains some unticked items in cash book and the bank statement.

Step II: Make Adjusted cash book by taking into account all the existing cash book entries plus the unticked bank statement items into the cash book and calculate the new balance. This balance is considered as the true bank balance of the business and this figure will be shown in the statement of financial position as bank balance.

Step III: Prepare Bank Reconciliation Statement.

Note: When we prepare B.R.S. we do not look at the entries of bank statement. We just take into account the entries which are in Cash Book but not in Bank Statement.

1. Start with the balance shown in the Adjusted cash book.
2. Add the entries that are credited in the cash book but not debited on the bank statement. (unpresented cheques)
3. Deduct any items that are debited in the cash book but are not credited in the bank statement.

The resulting figure should be equal to Bank Statement balance.

Reasons For Preparing bank Reconciliation Statement:

1. To ensure that the cash book entries are complete.
2. To discover bank errors.
3. To discover errors in cash book.
4. To check Fraud and embezzlement.
5. To discover dishonoured cheques.

-Bank Statement & bank Reconciliation Statement.

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

- **Give two examples of adjustments made in a bank reconciliation statement.**
  1. Uncredited or unpresented cheques
  2. Items found in updating cash book, e.g. direct debits, bank interest, charges,
  3. Dishonoured cheques
  4. bank or cash book errors

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

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

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

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

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

1. Items on bank statement not shown in cash book (accept individual items, bank charges, bank interest, etc.)
2. Items in cash book not on bank statement (accept individual items, cheques not yet presented, etc.)
3. Errors in cash book or made by bank (accept only one type of error) Dishonoured cheques

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

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

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

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

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

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

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

- **State two reasons, other than finding errors, why we should reconcile cash book with the statement received from the bank.**
  1. Ascertain the true bank balance at a certain date
  2. Assist in detecting fraud and embezzlement
  3. Identify any "stale" cheques
  4. Demonstrate that any differences between the cash book balance and that on the statement are due to genuine reasons

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

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

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

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

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

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

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

END OF YEAR ADJUSTMENTS

Types of Adjusting Entries

Generally, there are 4 types of adjusting entries. Adjusting entries are prepared for the following:

1. Accrued Income – income earned but not yet received
2. Accrued Expense – expenses incurred but not yet paid
3. Deferred Income – income received but not yet earned
4. Prepaid Expense – expenses paid but not yet incurred

Also, adjusting entries are made for:

5. Depreciation

Doubtful Accounts or Bad Debts, and other allowances

- "Adjusting entries" refer to the 6 entries mentioned above. However, in some branches of accounting (especially auditing), the term *adjusting entries* could refer to any entry that aims to adjust incorrect account balances.

- As a result, there is little distinction between "**adjusting entries"** and **"correcting entries**", however, adjusting entries are those made at the end of the period to take up accruals, deferrals, prepayments, depreciation and allowances.

Beginning

- **Prepaid** **Add**
- **Accrued** **Less**

End of the year

- **Prepaid** **Less**
- **Accrued** **Add**

- **Expenses of the period (Income Statement) = Payment of the period – opening unpaid + Closing unpaid**
- **Expenses of the period (Income Statement) = Payment of the period + opening prepaid - Closing prepaid**
- **Revenue of the period (Income Statement) = Payment of the period – opening unpaid + Closing unpaid**
- **Revenue of the period (Income Statement) = Payment of the period + opening prepaid - Closing prepaid**

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

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

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

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

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

CAPITAL AND REVENUE EXPENDITURE

Capital Expenses:	1. All expenses for acquiring the fixed Assets like, Machinery, Building, Furniture etc; 2. All expenses incidental to the acquisition of Fixed Assets. Examples: Transporting of Machinery and Fixing and Registration of Land and Building or Business. 3. All expenses to improve the existing Assets to increase Profit earning capacity. 4. Major repairs and renewals to increase the efficiency of the business.
Revenue Expenses:	All regular expenses which are incurred in the daily course of business. Example: Wages, Salaries, Repairs, Administration expenses. 2. Purchase of Raw Material and goods. 3. Losses through bad debts and depreciation. 4. Interest paid on borrowed funds. Etc.
Capital Income/ Capital Receipt:	The receipt of money, which arise not from regular source of income Examples: i. Capital bought in to the business. ii. Income through bank loan. iii. Income through sale of fixed Assets.
Revenue Incomes/Revenue Receipts:	The receipt of money, which arises in regular course of business. 1. Sales proceeds of business 2. Commission or Interest received 3. Discount received. etc.

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

Expenses are overstated
Profit for the year is understated

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

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

FINAL ACCOUNTS

I. **Trading Account:** As the name itself implies this account deals with trading i.e. buying and selling of goods. This account shows the Gross Profit earned or loss incurred on the goods sold.

II. **Profit and Loss Account:** As the name implies this account deals with profits and losses, gains and expenses. This shows the calculation of Final Profit or loss of a business.

III. **Statement of financial position:** "This is not an account" but it is a statement of financial position of a business on a certain date.

ADJUSTMENTS

Accruals: It is the due, which has to be paid for the benefit or service enjoyed during an accounting period. It can also be called as due, an outstanding or an arrears.

Prepayments: It is a payment for the benefit which has not yet been enjoyed.

Bad Debts: It is a debt which is deemed to be irrecoverable.

Bad Debts Recovered: It is a debt which was previously written off and is now paid to us.

Provision For Bad Debts: It is a saving from profit for a possible future loss that may or may not occur.

- **Bad debts & Provision for doubtful debts.**

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

- **Explain two ways in which reduce the risk of bad debts.**
  1. Obtain reference from new credit customers
  2. Fix a credit limit for each customer
  3. Issue invoices and statements promptly
  4. Follow up overdue accounts promptly
  5. Supply goods on a cash basis only
  6. Refuse further supplies until outstanding account is paid

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

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

CONTROL ACCOUNT

Control accounts are sometimes known as total accounts. A control account act as a summary of the ledger which it controls. There are two control accounts.

1. Sales ledger control account / Total debtors account
2. Purchases ledger control account / Total creditors account.

1. **Sales Ledger Control Account:** It resembles the account of an individual debtor. It is an account recording in total the transactions affecting all the debtors.

Sources Of Information For Sales Ledger Control Account:

Sales	Sales Book
Cash and Cheques received	Cash Book
Dishonoured Cheques	Cash Book
Discount allowed	Cash Book
Bad debts	Journal

2. **Purchases Ledger Control Account:** It resembles the account of an individual creditor. It records the transactions effecting all the creditors.

Sources Of Information For This Account

Purchases	Purchase Book
Purchases Returns	Purchase Returns Book
Cash and cheque paid	Cash Book
Discount received	Cash Book
Cash refund's from creditors	Cash Book

Notes:

1- Cash sales / purchases are not recorded in the ledger control account
2- Provision for doubtful debts don't feature in sales ledger control account because the provision accounts are kept in the general ledger not the sales ledger.
3- Bad debts recovered are not recorded in sales ledger control accounts.
4- **Contra (inter- ledger transfer) or " set off" it's a double entry which may arise when we have one person who is trade receivable (debtor) and trade payable (creditor) at the same time ,so we off set S.L.C.A credit against P.L.C.A debit by the same amount**

<u>Advantages Of Control Account:</u>

1. It helps in locating errors.
2. It helps in checking the arithmetical accuracy of the ledger it controls.
3. It gives us readymade figures for Total debtors and Total creditors on a certain date.
4. Fraud is made more difficult by the use of control account.

Form of control accounts:

Sales Ledger Control Account

Debit side	Credit side
- Total of sales ledger debit balances brought forward from previous period (b/d) - Credit sales for period - Refunds to customers (cash book) - Dishonored cheques cash book) - Interest charged to customers on overdue accounts. (journal) - Total any sales ledger credit balances at end of period carried forward. Anything ↑ debtors	- Total of sales ledger credit balances brought forward from previous period - Sales returns for period - Cash received from trade receivables - Cash discount allowed . (cash book) - Bad debts written off. (journal) - Sales ledger balances in purchases ledger " contra" (journal) - Total any sales ledger debit balances at end of period carried forward. Anything ↓ debtors

Purchases Ledger Control Account

Debit side	Credit side
- Total of Purchases ledger debit balances(if any) brought forward from previous period - Total of goods returns to suppliers - Total cash paid to suppliers. - Cash discount received . (cash book) - Purchase ledger balances off set against balances in sales ledger "contra" (journal) - Total of credit balances at end of period carried forward. ↓ Anything creditor	- Total of Purchases ledger credit balances brought forward from previous period - Total Credit purchases for period - Refunds from suppliers (cash book) - Interest charged by suppliers on overdue invoices - Total of debit balances if any at end of period carried forward. ↑ Anything creditor

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

Reason for using a purchases journal:

• Fewer transactions recorded in the purchases account

• Bookkeeping can be spread between several people

• Can be analyzed into products/areas etc.

• To identify credit purchases (can be useful for comparison purposes)

• Provides information for the purchases ledger control account.

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

• Provides instant totals of debtors and creditors

• Prove the arithmetical accuracy of the ledgers they control

• Enable the Balance Sheet to be prepared quickly

• May be used to identify ledgers in which there are errors when a trial balance does not agree

• Provides a summary of the transactions relating to debtors/creditors for the period

• Provides an internal check on the appropriate ledgers – may reduce fraud

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

Item : Cash sales

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

Item : Provision for bad debts

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

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

1. Overpayment of amount due
2. Cash discount not deducted before payment made
3. Returned goods after payment of amount due
4. Payment made to creditor in advance

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

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

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

A contra entry is where a transfer is made from an account of a person/business in the sales ledger to an account of the same person/business in the purchases ledger. This may occur when a person/business is both a customer and a supplier

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

Overpayment of amount due by debtor
Cash discount not deducted by debtor before payment made
Goods returned by debtor after payment of amount due
Payment made in advance by debtor

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

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

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

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

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

1. Overpayment of amount due by a debtor
2. Cash discount not deducted by debtor before payment made
3. Goods returned by debtor after payment of amount due
4. Payment made in advance by debtor

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

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

DEPRECIATION

“Depreciation is It’s an estimate of loss in the Non-Current assets from any cause over the period of its useful life

Causes Of Depreciation:

- **Wear and tear (physical deterioration):** as assets are used overtime, they lose their value. This causes the asset to wear out.
- **Passage of time** : this arises where a fixed assets, has a fixed life of a set number of years.
- **Depletion :** this arise in connection with fixed assets such as wells and mines

Obsolete inventory (Economic reasons): when newer and better products come out, this reduces the demand for existing assets.

- E.g. computers/laptops/vehicles

Reasons For Providing Depreciation:

1. To reveal the correct profit or loss of a business.
2. To show correct financial position of a business.
3. To make provision for replacement of an asset.

Three ways to calculate deprecition

Straight Line Method

The simplest and most common method

The net cost of an asset is written off in equal amounts over its life.

$$\frac{\text{Purchase cost - residual value}}{\text{Expected life (years)}}$$

Reducing Balance Method

This depreciates the value of an asset by a predetermined percentage.This reduces the value of the asset by a larger amount in the earlier years of its useful life

Revaluation Methods

the assets are valued at the end of the year and compare this value with previous year . the difference amount is the depreciation for the year

<u>Provision For Depreciation:</u> It means saving a part of profit for the replacement of the Asset

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

<u>Prudence Concept:</u> According to this concept all the losses incurred or expected to be incurred are to be taken in to account but not all anticipated profits to be taken into consideration while finding the profit. To apply this concept that we take depreciation in the profit and loss account.

<u>Consistency Concept</u> keeping the percentage rate of depreciation the same every year

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

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

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

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

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

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

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

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

Net book value = Cost less accumulated depreciation

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

1. Land has an indefinite expected life.
2. Land does not wear out.

3. Land is not consumed by use.
4. Land increases in value over time

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

1. To spread the cost of fixed assets over their useful lives.
2. To apply the accruals principle – recognizing the time difference between payment for the fixed asset and its loss in value.
3. To provide a more realistic view of the fixed assets.
4. To record the loss in value of fixed assets – the part of the cost of the fixed asset consumed during the period of use.
5. The annual depreciation charge represents the cost of using the fixed asset to earn revenue.

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

To spread the cost of the asset over its useful life **(not to calculate profit or loss on sale etc.)**

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

- **State two causes of depreciation.**

1. Physical deterioration
2. Economic reasons
3. Passage of time
4. Depletion

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

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

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

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

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

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

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

The asset is valued at the end of each year and the difference between the opening and closing value is the depreciation for the year. This method is used where it is impractical or difficult to maintain detailed records of the asset. Ex. Loose tools, packing cases, small items of equipment

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

Machinery’s value may not fall heavily in
Maintenance costs may not rise disproportionately
Straight line easier to calculate, same amount each suitable year development
Difficulty in choosing reducing balance rate or acceptable alternative

CORRECTION OF ERRORS

Type of error	Nature of error	Examples
1. Error of Omission	A transaction is completely omitted from the books.	A purchase of goods is not recorded because the purchase invoice has been mislaid
Error of Commission	A purchase or sale is entered in the wrong creditor or debtor account	A sale of goods to J Tyler is posted to J Taylor's account
3. Error of Principle	An item is entered in a completely wrong class of account.	A purchase of a fixed asset is posted to the purchases account.
4. Error or Original Entry	A wrong amount is entered in a book of original entry and this figure is then used for posting to the ledger	A sales clerk in a hurry reads an invoice of £10,000 as £1,000 and enters the latter figure in the sales day book
5. Compensating Errors I	By coincidence, an error on the debit side cancels out a separate and independent error of the same amount on the credit side.	The wages account is overcast by £200 and the creditors are also overstated by £200.
6. Compensating Errors II	Two errors compensate for each other on the same side.	Advertising is understated by £50 and electricity is overstated by £50.
7. Reversal of Entries	The debit entry is written on the credit side and the credit entry is written on the debit side.	A cash sale is debited to the sales account and credited to the cash account
8. Entries Done twice	The double entry is correctly completed but two debits and two credits are entered	A purchase of goods by cheque is debited twice to the purchases account and credited twice to the bank account

Effect of Errors on Profit or Loss : Some errors affect the profit while others do not. This distinction does not always coincide with whether or not the trial balance balances.

Errors affecting Profit or Loss : These errors affect those accounts which are included in the Trading and Profit and Loss Account eg purchases, sales, expenses etc. We must ask the following questions:

1) **Does the error affect the gross profit, the net profit or both?**

(a) Errors which affect items that go into the trading account affect gross profit **and** net profit to the same extent and in the same direction. Such items are sales, purchases, returns, inventory, carriage inwards etc.
(b) Errors which affect items that are entered in the profit and loss section of the account, i.e. operating expenses, affect only net profit. Purchases of fixed assets affect profit only indirectly through provisions for depreciation.

2) In what direction is profit affected?

(a) If sales are overstated or purchases understated, both gross profit and net profit are too high and must be reduced by the relevant amount. The same applies if sales returns are understated or purchases returns overstated.

(b) If sales are understated or purchases overstated, both gross profit and net profit are too low and must be increased by the relevant amount. The same applies if sales returns are overstated or purchases returns understated.

(c) If miscellaneous receipts are overstated or if expenses are understated, gross profit is not affected but net profit will be high and must be reduced.

(d) If miscellaneous receipts are understated or if expenses are overstated, again gross profit is not affected but net profit is too low and must be increased.

(e) If capital expenditure is wrongly treated as revenue expenditure, eg if the purchase of a fixed asset is treated as an expense, then net profit will be too low and must be increased. The opposite applies if revenue expenditure is treated as capital expenditure.

3) **Does the errors that affect items in the statement of financial position affect profit as well?** The answer is only those that were adjusted after the trial balance was prepared. Errors affecting fixed assets, current assets and liabilities do not normally affect profit but if one of these items has changed as a result of an adjustment, then profit is affected. For example:

(a) If the closing inventory has been overvalued, the inventory figure in the statement of financial position is too high and so are the gross profit and the net profit. The opposite is true of a closing inventory which is undervalued. Remember that closing inventory adds on to gross profit and opening inventory takes away from it.
(b) If an accrued or prepaid expense is the wrong amount, both profit and the item in the statement of financial position are wrong. If an amount owing is overstated or a prepayment is understated, profit is too low and must be increased, and vice versa.
(c) The opposite to (b) applies in the case of accrued or prepaid receipts.

Estimating the effects of errors can be confusing and you must keep a clear mind. Think how the original figure has affected profit and then try to see in which direction the error is affecting the profit.

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

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

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

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

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

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

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

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

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

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

MANUFACTURING ACCOUNT

Manufacturing businesses prepare manufacturing account in addition to the usual final Accounts. Manufacturing account shows how much does it cost the business to manufacture the goods in a financial year.

Cost Of Raw Material Consumed: It is the value of Raw material used in production. It consist of net purchases of Raw Material, carriage on raw material opening inventory of raw material closing inventory of Raw material.

Prime Cost: It is the basic cost of manufacturing the goods. It consists of direct raw material direct labour and direct expenses.

Production Cost: It is the total cost of manufacturing the goods. It consist of prime cost plus factory expenses, and it is after any adjustment for work-in-progress.

Work-in-progress: These are the goods which are partly made, but which are not yet completed are known as work-in-progress.

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

Production did not meet demand
It was cheaper to buy rather than make
Could not make those particular items
Not economical to make such a small amount

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

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

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

Production did not meet demand.
It was cheaper to buy the goods rather than make them.
Those particular items could not be made by the business.

PARTNERSHIP BUSINESS

A partnership business is an Association of two or more persons formed with the object of sharing profits arising out of business.

Advantages	Disadvantages
- **Huge Capital:** More capital can be secured than in the case of a sole trading business. - **Wise decision:** It enjoys the benefit of combined ability. - **Introduction of Division of labour:** Partnership enjoys all advantages of Division of labour. Duties can be assigned to different partners according to their qualifications and specialisation. - **Greater borrowing capacity:** - Diffusion of risk. - More contact with the customers.	- Unlimited liability - Delay in decision. - Difference in opinions. - No perpetual existence. - Secrets cannot be maintained.

Accounts of Partnership Firm

Partnership firms prepare the following final accounts:

1. Income statement
2. Appropriation A/c
3. Current Accounts
4. Partners Capital Accounts
5. Statement of financial position.

Appropriation Account : This account is a continuation of the profit and loss account and it is prepared to show the appropriation of profits and losses among the partners.

Current Accounts: In a partnership business amount withdrawn by a partner is generally accounted for separately by debiting the current accounts of the partner who withdraws the amount from the business.

Capital Accounts: In a partnership business there are as many capital accounts as are partners. A partner's contribution to the business is called his capital. It always shows a credit balance which is always fixed. It has changes only when extra capital is bought in to the business are a new partner enters into the business.

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

Interest on drawings discourages large or early cash withdrawals
Thus could improve cash/working capital position
Also produces additional residual income/profits for division between
Partners

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

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

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

Advantage of maintaining separate current accounts
Easier to see profit retained by each partner
Easier to calculate interest on capital (if allowed)

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

Contribute further capital – but not by taking (bank) loan
Obtain capital by taking partner / Reduce drawings
Increase net profit (reduce loss if shown Loss) (e.g. by increasing fees/commissions, reducing expenses (or any one specific expense)

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

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

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

- **Explain the purpose of a partnership appropriation account.**
  To show how the profit for the year is shared between the partners

INCOMPLETE RECORDS/SINGLE ENTRY SYSTEM

It is a system which is defined as any system which is not exactly the double entry system. It is developed by certain small business people.

Computation of Profit:

Profit for the year:

(Closing Capital + Drawings) – (Opening Capital + Additional Capital)

Mark-up: gross profit calculation as a percentage of cost price

$$\text{Mark-up} = \frac{\text{Profit}}{\text{Cost price}} \times 100$$

Margin: The calculation of Gross Profit as a percentage of Selling price.

$$\text{Margin} = \frac{\text{Profit}}{\text{Selling price}} \times 100$$

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

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

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

Sales = Cash sales + Credit Sales **Credit sales = received from T.R** **+ T.R (closing)** **- T.R (opening)** **+ Sales Returns** **+ discount allowed.** **+ bad debts.**	**Purchases = Cash Purchases + Credit Purchases** **Credit Purchase = Paid to T.P** **+ T.P (closing)** **- T.P (opening)** **+ Purchases Returns** **+ discount received.**

ACCOUNTS OF CLUBS AND SOCIETIES

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

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

Receipts and Payments Accounts: It is a summary of cashbook, i.e. all cash and bank transactions during a given period of time. It starts with an opening balance and debited with all items of receipts irrespective of whether they are of capital nature or revenue nature and whether they are pertaining to the current period or not. It is credited with all payments made during the year. Those payments may be of Capital or Revenue nature whether pertaining to the current year or not.

Note: This account does not take into account outstandings and prepayments.

Income and Expenditure Account: Income and expenditure account is a nominal account. It is debited with all expenses and losses and credited with all incomes and gains. This account serves exactly the same purpose as the profit and loss account in a trading concern.

Accumulated Fund: It is the surplus accumulated with in the organisation.

Difference Between The Terms Used In

Trading Business	**Non-Trading Business**
1. Cash Book	Receipts and payments account
2. Profit and Loss Account	Income and expenditure account
3. Net Profit	Surplus
4. Net Loss	Deficit
5. Capital	Accumulated fund

Sources Of Income To Club:

1. Donations
2. Subscriptions
3. Entrance fees
4. Sales of Old Assets
5. **Explain the term 'Accumulated Fund' in connection with the accounts of a non-trading organization such as a club.**

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

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

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

R & P A/c shows total money paid and received
I & E A/c adjusts figures for accruals and prepayments
I & E A/c includes non-monetary items such as depreciation
I & E A/c includes only revenue items

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

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

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

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

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

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

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

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

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

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

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

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

ANALYSIS AND INTERPRETATION

1. What is the other name of Gross Profit Ratio?

Gross profit as a percentage of Turnover.

2. What is the formula to find out the GP%?

$\frac{GP}{Sales} \times 100$

3. State two ways in which the percentage of net profit to sales could be improved

1. Increase gross profit e.g. increase profit margin, increase selling prices etc.
2. Increase sales
3. Reduce expenses e.g. reduce staffing levels, reduce advertising etc.
4. Increase other income e.g. rent out part of premises, earn more discount

4. What would be the reason for *decrease* in the GP%? Give 2 reasons.

(a) Selling goods at Lower prices.
(b) Offering Trade discounts.
(c) Not passing on increase prices.
(d) Holding seasonal sales.

5. What is the formula to find out NP Ratio?

$\frac{NP}{Sales} \times 100;$

6. What is the other name of NP Ratio?

NP as a % of sales

7. What is meant by liquidity?

It is the ability of the business to convert its assets into cash.

8. What is meant by working capital?

It is the money required to meet its every day expenses.

9. What does current Ratio measure?

It measures the ability of the business to meet its current liability as they fall due.

10. What is the standard current Ratio for a business?

Somewhere between **1.5 – 2:1**.

11. What are the effects of not having enough working capital?

(i) Problems in meeting debts as they fall due.
(ii) Inability to take advantage of cash discount.
(iii) Difficulty in obtaining further supplies.
(iv) Inability to take advantage of business opportunity as they arise.

12. Quote 5 ways of improving working capital.

(i) Introduction of further capital.
(ii) Obtaining long-term loan.
(iii) Reducing owners drawings.
(iv) Selling out useless fixed assets.

13. What is the other name of Quick ratio?

Acid test Ratio

14. What is the formula to find out Quick Ratio?

$$\frac{\text{CA – inventory}}{\text{CL}}$$

15. What is the standard quick ratio?

1:1

16. What is the formula to calculate inventory turnover ratio?

$$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

17. In what way knowing the rate of inventory turnover will be useful to the businessmen.

(i) For inventory replacement.
(ii) For comparison.
(iii) For corrective action.
(iv) For identifying causes of changes.

18. What are the other names of debtors ratios?

Debtors Ratio/ Sales Ratio.

19. Give 4 ways of improving the collection period from debtors.

(i) Offer cash discount.
(ii) Charge interest on over dues.
(iii) Refuse further supplies.
(iv) Send regular reminder.

20. Give four ways of reducing the risk of bad debts.

(i) Obtain reference from new credit customers
(ii) Fix a credit limit for each customer
(iii) Issue invoices and statements promptly
(iv) Follow up overdue accounts promptly
(v) Supply goods on a cash basis only
(vi) Refuse further supplies until outstanding account is paid

21. Give two problem of inter-firm comparison.

1. All businesses are not same in all sense.
2. Different businesses follow different accounting policies.
3. One business may not be of the same size like the other.
4. Location of the business may not be at the same place.
5. They might have started at different dates.

22. What are the limitations of ratio analysis?

Accounting statements and ratio analysis provide valuable information about the business's performance but it's important to remember, however that they do have limitations. The comparison with other firms or previous years should be undertaken with caution for the following reasons:

(i) Difference in the type of inventory which affects the rate of inventory turnover and the gross profit margin.
(ii) Difference in the firm's policy because some firms are selling on cash and on credit terms. Others do not use the same policy.
(iii) Difference in experience because some firms may not operate profitably in their early years of trading but this should not necessarily be the case expected in future years.
(iv) Difference in management: Because small firms such as a sole trader are not expected to use an efficient managers as well as large firms.

(v) Difference in location: because income and tastes and perhaps government policies may vary from one area to another, which will affect the performance of the firm.
(vi) Different accounting periods: because different firms are not expected to start their trading activities at the same date.
(vii) Difference in capital employed because some firms may have enough capital employed to finance purchases of premises and machinery while others do not and forced to pay more expenses.
(viii) Difference in accounting policies such as the application of the accounting concepts and methods of depreciation.

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

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

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

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

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

1. Effect on staff morale
2. Effect on Customers.
3. Effect on reputation of the business.
4. Effect on Suppliers.

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

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

- **If The bank decided to refuse the application for a loan. Suggest two reasons for the bank's decision**
  1. There are not enough non-current assets for security of the loan
  2. There is not enough profit to cover the loan interest
  3. The business would not be able to re-pay the loan on time
  4. Drawings for the year exceed the profit for the year

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

1. Introduce additional capital
2. Admit a partner/form a limited company
3. Mortgage
4. Loans from other sources
5. Sell surplus non-current assets

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

N.P. as percentage of capital employed:
- Measures overall profitability of the business in relation to resources used
- Indicates adequacy of return on owner's investment
- Enables comparisons to be made, e.g. against other investments, earlier years, similar firms
- Assists decision-making, e.g. in production, cost of borrowing

- State the effect on gross & net profit with opening stock and Closing stock.
If Opening stock is overstated the net profit is understated vice versa
If Closing stock is overstated the net profit is overstated vice versa

- **State two possible disadvantages to Owner of not paying her creditors promptly**
  1. Creditors may refuse further supplies of goods.
  2. Good relationship between company and supplier is damage.

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

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

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

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

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

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

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

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

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

1. Increase in current liabilities greater than the increase in current assets
2. Increase in creditors and no significant change in current assets
3. Decrease in debtors and no significant change in current liabilities
4. Decrease in bank and no significant change in current liabilities
5. Decrease in stock and no significant change in current liabilities

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

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

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

Different type of business / Different products

Capital/labour intensive business / Business with Different net profit

Business with Different capital

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

1- Reduce stock levels
2- Generate more sales activity

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

1. Look for cheaper supplies
2. Increase selling prices
3. Change proportions of different types of goods sold

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

1- **Bank manager** :

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

2- Lenders:

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

3- Creditor for goods :

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

4- Managers :

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

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

To be able to meet debts when they fall due
To be able to take advantage of cash discounts
To be able to take advantage of business opportunities as they arise
To ensure that there is not difficulty in obtaining further supplies

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

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

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

- **Collection period for debtors.**

Less efficient credit control
Allowing longer credit to maintain sales
Not allowing cash discounts to debtors

- **Payment period for creditors.**

Shortage of liquid funds
Knock-on effect of debtors taking longer to pay
Suppliers not allowing cash discounts

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

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

Ratio Analysis can be used for:

- **Inter-firm Comparisons:** Comparing the performance of one firm with another firm in the same industry.
- **Intra-firm Comparisons**: Comparing the performance of a firm with previous years performance

This ratio as indicator of " expenses control" If the NP% increase that will mean :

- Business is becoming more profitable.
- It's a direct result of better control on expenses
- The difference between a business's GP & NP ratios indicates its ability to control expenses (overheads) – rent – salaries – utilities

- **state the expenses in % of sales if the GP to sales is 25% & the NP to sales is 14%**
  11%

if the ROCE% increase that will mean :

- Capital is considered to be employed more efficiently & more profitable.
- Higher selling price.
- Business is dealing with cheaper suppliers.
- Better control on overhead expenses.

- **What is the indication of a lower rate of inventory turnover?**

1. Reduced profitability
2. Increase the possibility of inventory damage & going out of date, due to storage for a long period.

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

Percentage of gross profit to sales:

1. This measures the success in selling goods
2. The ratio shows the gross profit earned per $100 of sales The ratio can be compared with previous years
3. The ratio can be compared against other businesses

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

1. Percentage of profit for the year (net profit) to sales
2. This measures the overall success of the business
3. The ratio shows the net profit earned per $100 of sales
4. The ratio can be compared with previous years
5. The ratio can be compared against other businesses
6. The ratio indicates how well the business controls its expenses

Return on capital employed (ROCE)

1. The ratio shows the profit earned per $100 employed in the business
2. The ratio can be compared with previous years
3. The ratio can be compared against other businesses
4. The ratio measures the profitability of the investment in the business
5. The ratio shows how efficiently the capital is being employed

Uses of working Capital:

- Paying wages on time to keep employees moral
- Distributing dividends to shareholders to keep them satisfied.
- Paying rent and insurance on time.
- Paying trade payables on time to benefit from trade and cash discount.

<u>Disadvantages of having excess working capital</u>

- Holding too much inventory where the money tied up in inventory could have been used in a better investment. Also, the inventory could be expired, thus causing loss.
- Too much Trade receivables may increase the risk of bad debts.
- Too much cash in hand represents idle resources which could have been invested in expansion or deposited in a bank account to gain extra income (interest received)

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

Inventory is not regarded as a liquid asset – a buyer has to be found and then the money collected. Some inventory may prove to be unsalable

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

- State the Reasons for the change in rate of inventory turnover from one year to another:

- Changes in prices.
- Changes in customer's demand.
- Changes in competition.
- Changes in the firm policies.

- **Suggest two reasons why a trader wants to know his profit for the year**
  1. To see the return on his investment
  2. To see if he is generating funds for re-investment
  3. To decide whether to continue in business or close the business
  4. To compare the profit with previous years
  5. To compare the profit with that of other businesses
  6. To ensure that drawings do not exceed profit
  7. To plan for the future/assist decision-making
  8. To know if expenses can be controlled better/if improvements can be made
  9. To calculate ratios/calculate profitability/measure performance
  10. To compare profit with the salary if he worked elsewhere

Possible Reasons for improvement of ratios:

Measure	Possible Reasons for improvement
Current Ratio	**More cash introduced to the firm through:** - Loans and borrowing. - Selling old non-current assets. - Selling goods. - Introducing further equity by the owner. - Less drawings. - Admission of new partner
Quick Ratio	- Selling inventory (holding too little inventory) - Improvement in current ratio
Gross Profit %	- Buying from cheaper suppliers. - Buying in bulk at reduced prices. - Charging higher prices. - Overvaluation of closing inventory. - Undervaluation of opening inventory.
Net profit %	- Controlling the overhead expenses. - New sources of income. - Improvement in gross profit%
ROCE	- Better investments. - Controlling the overhead expenses. - Improvement in gross profit %
Rate of Inventory Turnover	- Effective sales department and efficient sales team - Successful selling strategy. - Successful advertising campaign. - Lack of competition. - High level of sales, thus reducing inventory level
Trade receivables Collection Period	- Effective collection system. - Offering better deal to customers such as cash discount.
Trade payables payment Period	- Improvement in the liquidity of the firm - Better offers (credit facilities) from suppliers

LIMITED COMPANY

One of the main reasons for forming a limited company is to raise large amounts of capital to finance the business. The way in which companies raise capital is by issuing (selling) two types of shares to investors:

1- ***Preference Shares*** – owners of preference shares will:
   - receive a fixed rate of dividend.
   - not be entitled to vote in the shareholders' annual general meeting.
   - receive their dividends of profit before the ordinary share dividend (higher priority).
   - receive capital before ordinary shareholders in the event the company is closed down.

2- **Ordinary Shares** – owners of ordinary shares will:
   - receive variable dividends each year.
   - be entitled to vote in shareholders' meetings with one vote per share.
   - be given their dividends of profit after the preference share dividend.
   - be the last to receive their share capital if the company goes bankrupt.

Share Capital

The share capital is the capital of a company which is divided into preference and ordinary shares which are then bought and owned by the shareholders. There are two main types of share capital:

1- **Authorized share capital** is the maximum amount of share capital a company is allowed to sell to shareholders.

2- **Issued share capital** is the amount of share capital actually issued (sold)

Furthermore the issued share capital falls into two categories:

a- **Called-up capital** is the total amount of capital a company has asked for from its preference and ordinary shareholders.

b- **Paid-up capital** is the part of the called-up capital where money has actually been received from the ordinary and preference shareholders.

c- **Calls in arrears** the part of the called-up capital where money has still **not** been received from shareholders.

Dividends

Dividends are paid to shareholders as a way of distributing the profits of the company. Dividends are normally expressed as "dollars per share" eg $0.10 for every share held.

Directors decide if a company will be paying out a dividend or not. They look at factors such as:

1. the availability of profits
2. the availability of cash to pay the dividend
3. whether it would be better to keep the profits in the company to allow it to grow
4. whether the market price of the shares will be affected or not.

Directors may pay out a dividend more than once per year. A dividend paid half way through the year is called an **INTERIM** dividend, and at the end of the year it is called a **FINAL** dividend.

Dividends payable (preference proposed dividend) at the end of the year are entered in the *Profit and Loss Appropriation Account (Income Statement) and as a Current Liability in the statement of financial position* . This is because at the end of the year when the *statement of financial position* t is drawn up the dividend payable to the shareholder will not have yet been paid and so the company is still liable in the short term.

Dividend of preference shareholders is calculated using this formula:

Number of shares issued × Nominal value × Percentage

Or

Share capital in $ amount × Percentage

A debenture is a document given to someone who has loaned the company money. It states *the amount of the loan, the interest payable each year, and the date on which the loan is to be repaid.*

1-Debenture holders are liabilities of the company – NOT owners as it is with shareholders.

2-The interest must be paid regardless of the profitability of the company.

3-Debentures due to be paid within a year are shown on the statement of financial position as CURRENT LIABILITIES.

4-Those due to be paid in more than one year are shown as LONG TERM LIABILITIES.

5-Debenture holders have no voting rights within the company's meetings.

6-Debenture holders receive a fixed rate of interest

7-Debenture holders are repaid before any shareholders in case the company is closed down.

Interest Payable on debentures is shown as an *expense in the Profit and Loss account* (Income Statement) and a *Current Liability in the Statement of financial position* . This is because at the end of the year when the Statement of financial position is drawn up the interest payable to the debenture holder will not have yet been paid and so the company is still liable in the short term.

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

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

<u>Statement of changes in Equity :</u> Often referred to as Statement of Retained Earnings, details the change in owners' equity over an accounting period by presenting the movement in reserves comprising the shareholders' equity.

It’s a financial statement that presents a summary of the changes in shareholders’ equity accounts over the reporting period.

It reconciles the opening balances of equity accounts with their closing balances.

Components of statement of changes in equity : there are 4 common columns:

Share capital	Retained profit	General reserve	Total
Any new issues of ordinary shares will increase the share capital. If no issues take place during the year, then the beginning balance will remain the same in this column	Where net profit is added to this column **minus** any ordinary dividends paid during the current year **minus** final ordinary dividend proposed and paid related to previous year **minus** any transfer to the general reserve	Any transfers from the retained profit to the general reserve will increase this column.	In which totals are inserted.

- **Explain the meaning of the term 'limited liability'.**

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

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

To set aside profit for re-investment

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

To set aside profit for payment of future dividends

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

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

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

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

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

1. For reinvestment in the business
2. To plough back profits
3. For allocating dividends in the future
4. If there is not enough actual cash available to pay a dividend