

*New  
Curriculum*

# **A *Practical* Approach to Principles of Accounting 'O' Level Revision**

- With summary notes covering syllabus objectives
- Model ZIMSEC questions and answers



**A *Practical* Approach to**  
**Principles of**  
**Accounting**  
**'O' Level Revision**

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*Anchors of the schools curricula*

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## Introduction

Accounting is a commercial subject concerned with recording financial information pertaining to a business. It equips the learner with basic accounting skills and concepts necessary in the keeping of proper books of accounts that will enable him or her to prepare financial statements for different enterprises such as small to medium enterprises, sole proprietors, companies, partnerships and not for profit making organisations. Accounting O-Level Revision Book covers all the topics and concepts that are found in the ZIMSEC Syllabus and are structured according to the New Curriculum expectations. It summarises the twenty main topics that are in the Syllabus whilst equipping students with relevant information in their preparation for the O-Level Accounting examinations. You must work your way through this study guide to improve your understanding, identify your areas of weakness and correct your own mistakes. To ensure a high-quality pass, you should also substantiate your knowledge from other textbooks and your class notes. We are confident that this Accounting study guide can help you prepare well so that you pass the ZIMSEC O-Level exams.

### Overview of the exam for Accounting O level Study Guide

The exam questions have been arranged topically and in the respective order in which they are taught, for example, Introduction to accounting, The accounting cycle and Data processing methods. The questions are structured typical of ZIMSEC exam standard.

Paper 1 carries 40 multiple choice questions which carry one mark each and the student is required to answer all the questions.

Paper 2 has 5 questions and each question carries 20 marks. The candidate is required to answer all 5 questions in the paper.

### How to use this study guide

This study guide covers selected aspects of the different topics of O-Level Accounting curriculum in the order that it is usually taught during the year. The selected aspects of each topic are presented in the following way:

- An explanation of terms and concepts.
- Worked examples to explain and demonstrate.
- Activities with questions for you to answer.
- Answers for you to use to check your own work.
- There are exercises on the notes section based on exam-type questions. Cover the answers and do the exercises on your own. Then check your answers. Reward yourself for the things you get right. If you get any incorrect answers, make sure you understand where you went wrong before moving onto the next section.
- Typical ZIMSEC exam papers are included in the study guide for you to practice.



## Top 10 study tips

### Try these study tips to make learning easier

- Have all your materials ready before you begin studying – pencils, pens, highlighters, paper and all the other necessary material.
- Be positive. Make sure your brain holds on to the information you are learning by reminding yourself how important it is to remember the work and get the marks.
- Take a walk outside. A change of scenery will stimulate your learning. You will be surprised at how much more you take in being outside in the fresh air.
- Break up your learning sections into manageable parts. Trying to learn too much at one time will only result in a tired, unfocused and anxious brain.
- Keep your study sessions short but effective and reward yourself with short, constructive breaks.
- Teach your concepts to anyone who will listen. It might feel strange at first, but it is worth reading your revision notes aloud.
- Your brain learns well with colours and pictures. Try to use them whenever you can.
- Be confident with the learning areas you know well and focus your brain energy on the sections that you find more difficult to take in.
- Repetition is the key to retaining information you must learn. Keep going, do not give up.
- Sleeping at least 8 hours every night, eating properly and drinking plenty of water are all important things you need to do for your brain. Studying for exams is like strenuous exercise, so you must be prepared physically.

### Question words to help you answer questions

It is important to look for the question words (words that tell you what to do) to correctly understand what the examiner is asking. Use the following table as a guide when answering questions.

**Draw up** – prepare.

**List** – make a numbered list.

**Outline** – make a numbered or well organised list.

**Describe** – write as much as you can. Write about the subject so that it can be visualised.

**Explain** – give reasons for what is asked for. Provide causes.

**Calculate** – using figures provided, work out the following.

**Evaluate/Criticise** – discuss the good and the bad points of the subject and conclude whether it is primarily good or bad.

**Compute** – reckon or calculate (a figure or amount).

**Discuss** – write as much as you can.

**Compare** – discuss similarities and differences.

**Contrast** – discuss differences.

**Name** – give a name of something.

**Identify** – establish or indicate who or what (someone or something) is.

**Complete** – have all the necessary or appropriate parts.

**Give** – mentioned what you are asked.

**Distinguish** – discuss differences.

## Study skills to boost your learning

This guide makes use of three study techniques you can use to help you learn the material:

- Mobile notes
- Mnemonics

### Mobile notes

Mobile notes are excellent tools for learning all the key concepts in the study guide. Mobile notes are easy to make and you can take with them with you wherever you go:

1. Fold a blank piece of paper in half. Fold it in half again. Fold it again.
2. Open the paper. It will now be divided into 8 parts.
3. Cut or tear neatly along the folded lines.
4. On one side, write the basic concept.
5. On the other side, write the meaning or the explanation of the basic concept.
6. Use different colours and add pictures to help you remember.
7. Take these mobile notes with you wherever you go and look at them whenever you can.
8. As you learn, place the cards in three different piles:
  - I know well
  - Getting there
  - I need more practice
9. The more you learn them, the better you will remember them.

### Mnemonics

A mnemonic code is a useful technique for learning information that is difficult to remember. This is an example of a word mnemonic using the word **MAPPING** where each letter of the word stands for something else:

M – Make an effort

A – Apply yourself to your studies

P – Practise, practise, practise

P – Prepare well for the exams

I – Ignite your passion for Accounting

N – Notice your subject around you

G – Go for it – the stars are the limit!

### Mnemonics code information and make it easier

to remember. The more creative you are and the more you link your ‘codes’ to familiar things, the more helpful your mnemonics will be. This guide provides several ideas for using mnemonics. Be sure to make up your own.



## Top 10 exam tips

1. Make sure you have all the necessary stationery for your exam, for example, pens, pencils, eraser, as well as your ID document and exam admission letter.
2. Arrive on time, at least one hour before the start of the exam.
3. Go to the toilet before entering the exam room. You do not want to waste valuable time going to the toilet during the exam.
4. Use the 10 minutes reading time to read the instructions carefully. This helps to ‘open’ the information in your brain. Start with the question you think is the easiest to get the flow going.
5. Break the questions down to make sure you understand what is being asked. If you do not answer the question properly you will not get any marks for it. Look for the key words in the question to know how to answer it. A list of these words is on page (ii) of this study guide.
6. Try all questions. Each question has some easy marks in it so make sure that you do all the questions in the exam.
7. Never panic, even if the question seems difficult at first. It will be linked with something you have covered. Find the connection.
8. Manage your time properly. Do not waste time on questions you are unsure of. Move on and come back if time allows.
9. Check weighting – how many marks have been allocated for your answer? Take note of how marks are allocated to the questions in this study guide. Do not give more or less information than is required.
10. Write big and bold and clearly. You will get more marks if the marker can read your answer clearly.

## Common errors

Most candidates do not read instructions before attempting the paper.

Some candidates fail to pay attention to the keywords and do not understand the demands of the question.

Some of the candidates’ work is not clear and not readable.

Others fail to manage their time effectively to ensure that they do not spend more than enough time on one question.

Some students fail to number their work correctly.

Others fail to present information in correct formats, fail to align figures properly and they use wrong formulae when calculating figures.

## Chapter objectives

*By the end of the chapter, you should be able to:*

- *define accounting terms.*
- *state the different types of business activities and organisations.*
- *explain different types of business activities.*
- *explain the importance of accounting.*
- *identify the users of accounting information.*

## Introduction

Accounting is a process which involve the gathering, measuring, identifying and interpreting financial information so as to permit the users of the information to make decisions. Financial accounting information is used by many organisations such as sole traders, partnerships and limited liability companies. Accounting is important to various organisations as the information enables the management of such organisations to make decisions that lead to the success and efficient planning of resources.

### 1.1 Accounting terms

#### Bookkeeping

Is the systematic recording of business transactions in the books of accounts.

#### Accounting

Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.

#### Assets

- Is what a business owns or belongings of a business used to generate income.
- Assets are classified into **current assets** and **non-current assets**.
- **Non-current assets** are resources that stay in the business for a long period of time usually more than one financial period (12 months). Examples of non-current assets are *land, buildings, machinery, equipment, furniture and motor vehicles*.
- **Current assets** are resources that stay in a business for a short period of time usually less than one financial year. Examples of current assets are *inventory, trade receivables, prepayments, cash at bank and cash in hand*.

## Liabilities

- Are financial obligations of a business and in most cases are what a business owes.
- Liabilities can be *non-current liabilities* (long term) or *current liabilities*. **Non-current liabilities** are long term financial obligations of a business and they have a long repayment period which is more than one year.

Examples of long term liabilities are long term loan and debentures. **Current liabilities** are short term financial obligations of a business and they have a short repayment period which is less than one year.

## Capital

- Is the wealth or resources used to start a business.
- Is an amount of money that is used to start a business.
- Every business needs capital in order to start operations.
- The capital can be in the form of assets, money or human capital.

## Drawings

- Is money or goods taken by the owner from the business for personal use or private use.
- Drawings reduce the owner's capital.

## 1.2 Types of organisations

Organisations may be profit making organisations or non-profit making organisations. Profit making organisations include businesses such as sole traders, partnerships, joint ventures and limited liability companies. Non-profit making organisations are organisations that do not have any profit motive in mind. Most of non-profit making organisations offer goods and services to the people at affordable prices.

### Sole traders

Business which is owned by one person who puts capital into the business. The person who introduces capital in the business is known as the sole proprietor.

#### Advantages of sole traders

- Small amount of money can start a business.
- The owner can make swift decisions.
- The business is easy to start and operate.
- Can open for longer hours in order to increase profits.
- Less legal formalities, for example, a trading license is only needed.
- Fewer overheads costs (operating expenses).

#### Disadvantages of sole traders

- Poor decision making by the owner.
- The owner lacks adequate skills and knowledge.
- Lacks enough capital for business expansion.
- Suffers from unlimited liability.

- Lacks continuity of existence if the owner is ill or dead.
- Lacks collateral security which prohibits borrowing of loans from banks.

## **Partnerships**

Business which is formed by two people up to a maximum of twenty people who puts their resources together with the view of profit making.

### **Advantages of partnerships**

- More capital is raised.
- More ideas are contributed since there is consultation before implementation of ideas.
- Less legal formalities.
- Easy to run and control.
- Partners may share duties and responsibilities.
- Losses are shared between or amongst the partners.

### **Disadvantages of partnerships**

- Disputes or disagreements may dissolve the business.
- Lacks enough capital for business expansion.
- Active partners suffers from unlimited liability.
- Poor decision making by one partner binds all the partners.
- Lacks continuity of existence if the key partner is ill or dead.
- Less capital limits borrowing loans and overdrafts from banks and other financial institutions.

## **Limited liability companies**

A limited liability company is a separate legal entity which is distinguished from its owners. A limited company can sue or be sued in its own name for any wrong doings. Such a company can be a private limited company or public limited company.

### **Private limited company**

Formed by at least one shareholder up to a maximum of fifty shareholders. A private limited company raise capital from its own shareholders and shareholding is through private invitation. Also the affairs of the company are kept private.

### **Public limited company**

Formed by at least one shareholder to no upper limit. A public limited company raise capital through the issue of shares to the public. The affairs of the company should be made public such as the audited financial statements of the company at the end of the year should be published in the press.

### **Advantages of limited liability companies**

- The business enjoy limited liability, that is, failure to pay the debts of the company, the shareholders will not lose their personal properties but rather they will only lose the capital invested in the business.
- There is refined decision making.

- Can employ highly qualified personnel such as auditors, managers and accountants.
- Enjoy economies of scale.
- Public limited companies raise more money through the issue of shares to the public.
- Can borrow money from financial institutions.
- There is continuity of existence if the one shareholder is ill or dead.

### Disadvantages of limited liability companies

- Can suffer from diseconomies of scale.
- Complex legal formalities such as the preparation of the memorandum and articles of association.
- Financial affairs are made public for a public limited company.
- Large capital is required.
- Audited financial statements should be submitted to the registrar of companies.

## 1.3 Importance of accounting

- Helps to track the income of the business and the expenditure for the period.
- A very important indicator of how the business is operating financially.
- Gives owners some vital information such as the costs of resources or business operations.
- Gives management the current financial position of the firm.
- Helps the management to detect the amount of profit during the year.
- Keeps a systematic financial record of the firm's financial information.
- Helps the users of the information to compare trends in the operations of the business.

## 1.4 Users of accounting information

There are various stakeholders that are interested in accounting information of a firm. The stakeholders include the following:

- (a) **Investors** – refers to people who are willing to invest in the operations of the company. They use accounting information so as to decide whether to invest their money or not.
- (b) **Managers** – wants to know how well the business is progressing financially so that they make their decisions effectively leading to the success of the business.
- (c) **Suppliers or trade payables** – wants to assess the credit worthiness of a business so as to decide whether to grant goods on credit or not to the firm.
- (d) **Tax authority** – needs to verify the taxable income or tax refundable to the firm. Tax authority is a government firm which is responsible of collecting revenue on behalf of the government through taxes and fines.
- (e) **Financial institutions** – wants to know whether to lend or not to lend some money to the firm, for example, banks and other money launderers.
- (f) **Prospective buyer** – when the owner wants to sell the business, the buyer use some financial information so as to ascertain whether to buy the business or not.

## Summary of the chapter

- *Bookkeeping is the systematic recording of business transactions in the books of accounts.*
- *Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.*
- *An asset is what a business owns or belongings of a business used to generate income.*
- *Liabilities are financial obligations of a business and in most cases are what a business owes.*
- *Capital is the wealth or resources used to start a business.*
- *Drawings are goods or money taken by the owner from the business for personal use or private use.*
- *There are different types of organisations which include sole proprietorships, partnerships, private and public limited companies.*
- *The following are the importance of accounting: helps to track the income of the business and the expenditure for the period, a very important indicator of how the business is operating financially, gives owners some vital information such as the costs of resources or business or business operations, gives management the current financial position of the firm, helps the management to detect the amount of profit during the year, keeps a systematic financial record of the firm's financial information and helps the users of the information to compare trends in the operations of the business.*
- *There are several users of accounting information namely; investors, managers, suppliers or trade payables, tax authority, financial institutions, prospective buyer and competitors.*



## Chapter objectives

**By the end of the chapter, you should be able to:**

- *understand and use the original source documents.*
- *state the contents of each of the source documents.*
- *explain the type of discounts offered by some businesses.*
- *explain the importance of each type of discounts.*

## Introduction

Source document is a legal document that contains the details of a business transaction. In business, it is very important to use the source documents as they indicate a contract of purchase and sell between two or more parties. Examples of source documents include the invoice, receipt, debit note, credit note, cheques, voucher and statement of account. Also learners shall learn about the books of prime entry in which the source document information is firstly recorded in the books of accounts. There are two types of discounts that are offered by some businesses to encourage trade and the types of discounts are trade and cash discounts.

## Key words

**Source document** – is a legal document that contains details of a business transaction.

**Trade discount** – is an allowance that is given by a trader to another trader and is calculated on the gross invoice price.

**Cash discount** – is an allowance given to a customer and is calculated based on the net invoice price.

## 4.1 Source documents

The following are the major source documents which are mostly used in the business world.


	Source documents	Subsidiary books/Books of prime entry
1	Receipt/Till slips	Cash book
2	Cheques	Cash book
3	Bank statements	Cash book
4	Sales invoice	Sales Journal/Sales day book
5	Credit notes	Returns inwards Journal
6	Debit notes	Returns outwards Journal
7	Purchases invoice	Purchases Journal/Purchases day book
8	Deposit slips	Cash book

#### 4.1.5 Statement of account

The statement summarises all the transactions that took place over a certain period of time, for example, transactions that took place in one month.

The statement of account is mostly used to remind the customer on the outstanding amount at the end of the month. Also the statement of account is used by the customer to check records or query before payment is made. The statement of account shows the following:

- Amount due at the end of the month or year.
- Names of both the supplier and the buyer.
- Addresses of both the supplier and the buyer.
- Amount paid during the month or year.
- Balance brought forward to the new month or year.
- Date of issue.
- The rate of interest charged on the outstanding balance.
- Installment due date.

CITY OF MUTARE		STATEMENT OF ACCOUNT				
Water service statement		Account Number 020-64412			910 Mutare	
1073 3766 00						
DOKA N		Last receipt date				
Account date						
STD 3766 CHIKANGA II		24/01/22			01/01/22	
MUTARE						
DATE	REF	DETAILS	READING DATE 28/12/22		AMOUNT \$	
01/01/22	1	B/D BALANCE			3 579.60	
01/01/22	34	WATER (NEW) 6360 – 6330 = 30 M3			1 646.86	
01/01/22	6	SUPP CHRGS – CHIK			826.50	
01/01/22	16	FIRE CHARGE			124.11	
01/01/22	37	STREET LIGHTING			62.05	
01/10/22	27	SPECIAL ROADS CHARGE			124.11	
01/01/22	12	REFUSE			426.30	
01/01/22	13	EDUCATION LEVY			62.05	
31/01/22	2.5%	INTEREST RAISED			7.42	
CREDIT	90+	60	30	CURRENT	Pay before on	Amount due
00	748.37	386.10	2 100	3 624.53	31/01/22	6 859.00

## Chapter objectives

*By the end of the chapter, you should be able to:*

- *name the subsidiary books.*
- *describe the use of the subsidiary books.*
- *label the columns of the subsidiary books.*
- *classify transactions.*
- *explain the entries in the subsidiary books.*
- *define trade and cash discounts.*
- *calculate the trade and cash discounts.*
- *explain the purposes of a petty cash book.*
- *record the transactions in the appropriate books.*

## Introduction

Transactions are firstly recorded in the subsidiary books and these books are written from the source documents within the same period. Subsidiary books are also known as books of prime entry or books of original entry. The cash book is the only subsidiary book which is prepared based on double entry whilst other subsidiary books are prepared without applying the concept of double entry. There are two types of transactions that are the cash and credit transactions. Cash transactions are recorded in the cash book whilst credit and other transactions are recorded in other books of prime entry.

### Key words

**Cash book** – is a book of prime entry that is used to record all cash and bank transactions.

**Trade discount** – is an allowance or a deduction that is given by a trader to another trader based on the gross invoice price.

**Cash discount** – is an allowance or a deduction that is given to a customer after making payment based on net invoice price.

### 5.1 Subsidiary books

- (i) **Cash book** – the cash book is used to record cash transactions which include receipts and payments. The source document for transactions made on cash is the receipt, voucher, bank statement, cheque counterfoil, deposit slips and withdrawal slips.
- (ii) **Sales day book or sales journal** – this book of prime entry is used to record transactions of goods sold on credit. The source document for goods sold on credit is the sales invoice.

## Purchase ledger

### Mercy A/C

### Page 1

Date	Details	Folio	Amount	Date	Details	Folio	Amount
2020			\$	2020			\$
May 31	Balance	c/d	<u>2 000</u>	May 1	Purchases	PSI	<u>2 000</u>
				June 1	Balance	b/d	2 000

### Luke A/C

### Page 2

Date	Details	Folio	Amount	Date	Details	Folio	Amount
			\$				\$
May 31	Balance	c/d	<u>7 000</u>	May 1	Purchases	PJI	<u>7 000</u>
				June 1	Balance	b/d	7 000

### Grand foods A/C

### Page 3

Date	Details	Folio	Amount	Date	Details	Folio	Amount
			\$				\$
May 31	Balance	c/d	14 000	May 9	Purchases	PJI	5 000
			<u>14 000</u>	26	Purchases	PJI	9 000
							<u>14 000</u>
				June 1	Balance	b/d	14 000

### Lions limited A/C

### Page 4

Date	Details	Folio	Amount	Date	Details	Folio	Amount
			\$				\$
May 31	Balance	c/d	<u>10 000</u>	May 14	Purchases	PJI	<u>10 000</u>
				June 1	Balance	b/d	10 000

### General ledger

Date	Details	Folio	Amount	Date	Details	Folio	Amount
			\$				\$
May 31	Trade receivable		<u>33 000</u>	May 31	Balance	c/d	<u>33 000</u>
June 1	Balance	b/d	33 000				

## 5.5 Returns outwards journal

- Used to record unsatisfactory goods returned to suppliers.
- The source document is the debit note.

## Example 5.7

**Using facts from the previous example on returned unsatisfactory goods to the following suppliers**

May 9. Returned goods to grand foods worth \$2 000 with credit note number 264R.

16. Returned unsatisfactory goods to lions limited worth \$4 000 with credit note number F427401L.

29. Returned goods to grand foods worth \$1 000 credit note 3330.

**Prepare**

(a) Returns outwards journal.

(b) Purchases ledger.

(c) General ledger.

**Purchases returns journal**

**Page 1**

Date	Details	Folio	Credit note	Amount \$
May 9	Grand foods	PLI	264R	2 000
16	Lions limited	PL3	F4274011R	4 000
29	Grand foods	PL4	3330	1 000
31	Post the totals to the general ledger			<u>7 000</u>

**Lions limited A/C**

Date	Details	Folio	Amount	Date	Details	Folio	Amount
May 16	Returns out		4 000	May 14	Purchases	PJL	10 000
31	Balance	c/d	6 000				
			<u>10 000</u>				<u>10 000</u>

**Grand foods A/C**

Date	Details	Folio	Amount	Date	Details	Folio	Amount
May 9	Returns outwards		2 000	May 9	Purchases	PJL	5 000
29	Return out		1 000	26	purchases	PJI	9 000
31	Balance	c/d	<u>11 000</u>				
			<u>14 000</u>				<u>14 000</u>
				June 1	Balance	b/d	11 000

## Chapter objectives

**By the end of the chapter, you should be able to:**

- classify transactions before posting to the ledger.
- label different columns of the ledger.
- post entries from subsidiary books to the ledger showing folio numbers.
- balance the ledger accounts.
- interpret the ledger accounts.

## Introduction

The ledger is the book of accounts. Transactions are recorded in the books of accounts basing on the double entry system which states that a business should debit the receiver and credit the giver. All the transactions should be recorded first in the books of prime entry, then later transferred to the ledger. The ledger has two sides which is the debit side and the credit side. The receiving account is recorded on the debit side of an account whilst the giving account is recorded on the credit side.

## Key words

**Ledger** – comprises of accounts that are prepared basing on the concept of double entry which states that for every debit entry there must be a corresponding credit entry.

**Trade discount** – given to a trader by another trader basing on the gross invoice price.

**Trial balance** – a list of balances extracted from the ledger books of accounts.

## 6.1 Division of the ledger

- General ledger contains real accounts that include assets and liabilities accounts.
- Sales/trade receivables ledger which contains personal accounts of credit customers.
- The purchases/trade payables ledger contains personal accounts of credit suppliers.

The following is the format of the ledger.

## 6.2 Ledger

### Name of account

Date	Details	Folio	Amount	Date	Details	Folio	Amount
			\$				\$



# CHAPTER 10 CAPITAL AND REVENUE EXPENDITURE

## Chapter objectives

*By the end of the chapter, you should be able to:*

- *define capital and revenue expenditure.*
- *distinguish capital expenditure from revenue expenditure.*
- *classify cost into revenue and capital expenditure.*
- *show revenue and capital expenditure appropriately in the financial statements.*
- *state the effects of incorrect of incorrect classification of revenue and capital expenditure on profit, non-current assets and working capital.*

## Introduction

In this chapter, you will learn the differences between capital and revenue expenditure. You will also learn how to classify cost into revenue and capital expenditure. The reasons of classifying costs into revenue and capital expenditure will also be discussed in this chapter.

### 10.1 Capital expenditure

Capital expenditure refers to the cost incurred in buying non-current assets or add the value on non-current assets in an organisation. Capital expenditure includes:

- Cost of buying non-current assets
- Cost of bringing the non-current asset into the business, that is, carriage inwards.
- Legal costs of buying non-current assets.
- Cost of site preparation.

### 10.2 Revenue expenditure

Revenue expenditure refers to the cost incurred on day to day running of a business. It includes:

- Purchase of inventories.
- Administration costs.
- Repairs to non-current assets.
- Electricity and fuel expenses.

### Differences between capital expenditure and revenue expenditure

Capital expenditure	Revenue expenditure
Cost recorded in the statement of financial position.	Cost recorded in the income statement.
Usually large amount of money.	Usually small amounts of money.

## Chapter objectives

*By the end of the chapter, you should be able to:*

- *identify the causes of differences between cash book and bank balances.*
- *prepare an updated cash book.*
- *identify errors in the cash book and the bank statement.*
- *prepare bank reconciliation statement.*

## 12.1 Introduction

It is very rare that the bank statement balance at any given date be the same as the cash book balance, since these two are prepared by different businesses. In this chapter, you will learn about the causes of differences between the cash book and the bank statement balances, prepare an updated cash book, errors in the cash book and bank statement and preparing the bank reconciliation statement.

## 12.2 Bank reconciliation

To reconcile is to harmonise, so bank reconciliation can be defined as the process of bringing the cash book balance and the bank statement to an agreement. It is very rare for these two balances to be the same at any given time because the two are prepared by different businesses. The bank statement is provided by the bank on behalf of the business where the cash book is prepared by the business on behalf of the bank.

## 12.3 Causes of differences between the cash book and the bank statement

Differences between the two records usually occur because of timing differences and businesses not recording some items in the cash book. Some of the main causes include the following:

1. **Unpresented cheques** – refers to the cheques that have been paid by the business (entered on the credit side of the cash book) but has not yet been presented to the bank for payment.
2. **Uncredited deposits** – refers to the cash and cheques that have been paid into the bank (entered on the debit side of the cash book) but do not appear on the bank statement.  
*Note that, usually number 1 and 2 occurs because of timing differences.*
3. **Bank interest and charges** – the bank will debit business account without notifying them and this will not be shown in the business cash book.
4. **Dishonoured cheques** – these are cheques rejected by the bank when making payment because of different reasons which include insufficient funds or the cheque is stale.
5. **Credit transfers** – some customers will settle their accounts directly through the bank without notifying the business. The business will see this after getting the bank statement.

# CHAPTER 13 ACCOUNTING RATIOS

## Chapter objectives

*By the end of this chapter, you should be able to:*

- *define a ratio.*
- *list different types of ratios and give their formula.*
- *give the importance of ratios.*
- *calculate profitability and liquidity ratios.*
- *apply profitability and liquidity ratios to arrive at missing figures.*

## Introduction

In this chapter, you will learn about profitability ratios which include mark-up, margin, net profit and liquidity ratios which include current ratio, quick ratio, and rate of inventory turnover. You will also learn about how to apply profitability and liquidity ratios to arrive at missing figures.

### 13.1 Accounting ratios

A ratio is a figure expressed in terms of another. There are many classes of ratios but in this unit we are going to look at profitability and liquidity ratios.

#### Importance of accounting ratios

- Allows business to analyse and interpret financial statements.
- Allows business to calculate missing figures in the event of incomplete records.
- Allows firms to compare its performance with other firms.
- It shows a trend of business performance.
- Ratios highlight relationships which cannot be shown by financial statements.

### 13.2 Profitability ratios

- Mark up.
- Margin.
- Net profit percentage.

#### Mark up

This ratio expresses gross profit as a percentage of cost of sales. It is calculated as follows:

$$\text{Mark up} = \frac{\text{Gross profit}}{\text{Cost of sales}} \times 100$$

$$\begin{aligned}
 \text{Sales} &= \text{cost of sales} + \text{gross profit} \\
 &= \$50\,000 + \$10\,000 \\
 &= \underline{\$60\,000}
 \end{aligned}$$

## Net profit percentage of sales

This ratio expresses net profit as a percentage of sales. It can be calculated using the following formula:

$$\text{Net profit percentage} = \frac{\text{Net profit for the year}}{\text{Turnover}} \times 100$$

## 13.3 Liquidity ratios

Liquidity refers to how easily current assets can be converted into cash. The most illiquid current asset is inventory, that is why it is subtracted in the calculation of acid test or quick ratio.

### Inventory turnover

It is calculated by dividing cost of sales with average inventory. The following formula can be used to calculate inventory turnover.

$$\text{Inventory turnover} = \frac{\text{Cost of sales}}{\text{Average inventory}}$$

Average inventory is calculated by adding opening and closing inventory and divide by 2 as follows:

$$\text{Average inventory} = \frac{\text{Opening inventory} + \text{Closing inventory}}{2}$$

Inventory turnover measures the number of times inventory is turned over within a period. A high inventory turnover means the business is performing well in terms of selling its inventory.

### Example 13.3

Opening inventory	4 000
Sales	60 000
Purchases	52 000
Closing inventory	6 000

Required to calculate inventory turnover

$$\begin{aligned}
 \text{Cost of sales} &= (4\,000 + 52\,000 - 6\,000) \\
 &= 50\,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Average inventory} &= \frac{4\,000 + 6\,000}{2} \\
 &= 5\,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Therefore inventory turnover} &= \frac{50\,000}{5\,000} \\
 &= 10 \text{ times}
 \end{aligned}$$

## Current ratio

Measures the ability of a business to pay its short term debts before they are due. It is calculated as follows:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

## Acid test ratio/quick ratio

It also measures the ability of a business to meet its short term debts. Now the difference is that inventory is removed in the calculation as it is difficult to convert into cash. The following formula can be used to calculate acid test ratio:

$$\text{Acid test ratio} = \frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$$

## Trade receivables collection period

Measures the period taken by our trade receivables to pay what they owe to the business. It is calculated as follows:

$$\frac{\text{Trade receivables}}{\text{credit sales}} \times 365 \text{ days}$$

## Trade payables payment period

Measures the period of time a business takes to pay its trade payables. It is calculated as follows:

$$\frac{\text{Trade payables}}{\text{Credit purchases}} \times 365 \text{ days}$$

## Working capital

It is the difference between current assets and current liabilities. It can be calculated using the following formula:

Working capital = Current assets – Current liabilities

### Example 13.4

The following information was taken from the books of Tadiwanashe:

	\$
Inventory on 1 January, 2018	8 500
Sales	195 000
Returns inwards	15 000

Margin is  $\frac{1}{3}$  of turnover. Net profit turnover is 20% of turnover. The rate of inventory turnover is 10 times. Required to calculate for the year ended 31 December 2018 showing all your workings.

- (i) Turnover.
- (ii) Gross profit.
- (iii) Cost of sales.
- (iv) Net profit.
- (v) Expenses for running the business charged to the income statement.
- (vi) Closing inventory.

## Solution

(i)  $\text{Turnover} = \text{Sales} - \text{Sales returns}$   
 $= \$195\,000 - \$15\,000$   
 $= \mathbf{\$180\,000.}$

(ii)  $\text{Margin} = \text{Gross profit} / \text{Turnover}$   
 $\frac{1}{3} = (\text{GP} / \$180\,000)$   
 $3\text{GP} = 180\,000$   
**Gross profit = \$60 000.**

(iii)  $\text{Cost of sales} = \text{Turnover} - \text{Gross profit}$   
 $= \$180\,000 - 60\,000$   
 $= \mathbf{\$120\,000.}$

(iv)  $\text{Net profit} = 20\% \times 180\,000$   
 $= \mathbf{\$36\,000.}$

(v)  $\text{Expenses of running business} = \text{Gross profit} - \text{Net profit}$   
 $= 60\,000 - 36\,000$   
 $= \mathbf{\$24\,000.}$

(vi)  $\text{Cost of sales} \frac{\text{Closing inventory}}{\text{Average inventory}} = 10 \text{ times}$   
 $\frac{120\,000}{[(8\,500 + x) / 2]} = 10 \text{ times}$   
 $120\,000 = 42\,500 + 5x$   
 $77\,500 = 5x$   
 $x = \mathbf{\$15\,500.}$

Therefore closing inventory is \$15 500

## Example 13.5

Bee provided you with the following information for the year ended 31 December, 2018

	\$
Sales	100 000
Cost of sales	30 000
Purchases	20 000
Expenses	10 000
Inventory	4 500
Trade receivables	4 000
Bank (Cr)	6 500
Expenses accrued	500
Income accrued	5 000



### Required to calculate the following:

- (a) Working capital.
- (b) Margin.
- (c) Current ratio
- (d) Acid test/Quick ratio.
- (e) Net profit as a percentage of sales.

### Solution

- (a) Working capital = Current assets – Current liabilities

$$(4\,500 + 4\,000 + 5\,000) - (500 + 6\,500) \\ = \$6\,500.$$

- (b) Gross profit = Sales – Cost of sales

$$= 100\,000 - 30\,000$$

$$= 70\,000$$

$$\text{Therefore margin is } \frac{70\,000}{100\,000} \times 100 \\ = 70\%.$$

- (c) Current Ratio = Current asset/Current liabilities

$$= \frac{13\,500}{7\,000} \\ = 1.9:1.$$

- (d) Acid test ratio = (Current assets – Inventory)/Current liabilities

$$= \frac{13\,500 - 4\,500}{6\,500} \\ = 1.4:1.$$

- (e) Net profit = Gross profit – Expenses

$$70\,000 - 10\,500$$

$$= 59\,500.$$

$$\text{Therefore net profit percentage} = \frac{59\,500}{100\,000} \times 100 \\ = 59.5\%.$$

### Example 13.6

Karen made a gross profit of  $\frac{1}{3}$  on the net sales of \$75 000 during the year ended 31 December, 2020. The net profit was 15% of net sales. The rate of inventory turnover was 10 times and the opening inventory was \$6 000.

## Chapter objectives

**By the end of the chapter, you should be able to:**

- *define terms used such as capital, credit sales, credit purchases and drawings.*
- *calculate opening capital and closing capital using statements of affairs.*
- *calculate other missing figures such as credit sales, credit purchases and drawings.*
- *prepare end of year financial statements.*

## Introduction

Many store keepers fail to use the double entry system when recording their transactions. The main reason why store keepers fail to keep proper books of accounts is that they lack accounting knowledge and they do not have money to employ an accounting officer. When the shop owners try to record their transactions then that may result to incomplete records. In this chapter you will be able to calculate the missing figures such as capital, sales, purchases, expenses, net profit, drawings and income. Also the learners shall get enough exposure towards the preparation of financial statements.

## Key words

**Incomplete records** – this is when a business does not maintain proper records of accounting information.

**Single entry accounting** – when a business is not maintaining accounting records based on double entry system.

**Statement of affairs** – this is a statement of assets and liabilities of a business within a given period.

### 14.1 How do candidates identify an incomplete records question?

- When the business does not keep proper books of accounts.
- When accounting records are prepared in absence of double entry system.
- When the books are prepared by an inexperienced bookkeeper, that will definitely results in incomplete records.

### 14.2 Important calculations

#### Statement of affairs

This is a statement of assets and liabilities used to ascertain the proprietor's opening capital and closing capital for the period. Note that the accounting equation states that:

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

## Chapter objectives

*By the end of the chapter, you should be able to:*

- *define terms used in accounting.*
- *classify manufacturing costs.*
- *prepare manufacturing accounts.*
- *draft statement of financial position.*

## Introduction

A manufacturing account is prepared by those organisations who produce goods on their own. In addition to manufacturing account, a manufacturing business prepares the income statements and statements of financial position. The manufacturing account is prepared so as to calculate how much is spend by a business to covert raw materials to finished goods. A manufacturing account should show the prime cost of production and total production cost incurred by a business.

## Key words

**Direct costs** – costs which are directly associated with the goods produced, for example, direct material, direct labour, royalties, patents, trademarks and license fees.

**Indirect costs** – costs which do not vary and remain constant regardless of any change in the level of production. Indirect are also known as production overheads for example factory electricity, factory insurance, lubricants costs, supervisors wages, indirect materials and other factory costs.

**Finished goods** – are produced goods ready for sale.

**Work in progress** – are semi-finished or partly finished goods.

### 17.1 Types of costs

**Direct costs** – These are costs which vary with change in the level of output. Direct costs are costs which are directly attributable to the product that has been produced.

**Examples of direct costs are:**

1. Direct materials.
2. Direct labour/Wages/Manufacturing wages.
3. Direct expenses, that is, royalties and patents, trademarks and copyrights.

**Indirect costs** – these are the costs that remain constant regardless of any change in the level of production. Indirect costs are also known as production overheads. Indirect costs are costs which are not directly attributable to the product that has been produced.

- (i) **Raw materials consumed** = opening inventory of raw materials + purchases of raw materials + carriage of raw materials – closing inventory of raw materials.
- (ii) **Prime cost** = raw materials consumed + direct costs.
- (iii) **Total production cost** = prime cost + production overheads + opening inventory of work in progress – closing inventory of work in progress.

**NB:** *A manufacturing account is prepared on accruals basis, whether the amount has been paid or not the cost should be accounted for.*

### Income statement for the year ended 31 December, 2020 (format)

	\$	\$
Sales/Revenue		xxx
Less: Cost of sales		
Opening inventory	xxx	
Add: Total production cost of finished goods	<u>xxx</u>	
	xxx	
Less: Closing inventory	<u>xxx</u>	<u>xxx</u>
Gross profit		xxx
Less: Operating expenses		<u>xxx</u>
Net profit for the year		<u>xxx</u>

*Not that: Candidates should understand that the total production cost is part of cost of sales. Candidates should understand that there are some companies that produce their own goods for sale and at the same time they outsource some finished goods from other suppliers. In such a case, a firm can have both purchases and total production cost under cost of sales.*

### Worked example 17.1

**Eastern brakes** the manufacturer of brakes and clutches provides the following information taken from the business' financial records for the period ended 30 September, 2019.

	\$
Inventories: Raw materials	28 000
Work in progress	33 000
Finished goods	27 000
Buildings at cost	100 000
Machinery and equipment at cost	70 000
Delivery vehicles at cost	50 000
Provision for depreciation: Machinery and equipment	12 600
Delivery vehicles	7 000

Less: Closing inventory of raw materials		<u>24 000</u>
<b>Raw materials consumed</b>		101 000
Add: Manufacturing wages	15 000	
Royalties	16 000	
Copyrights	<u>20 000</u>	<u>51 000</u>
<b>Prime cost of production</b>		152 000
Add: Production overheads		
Supervisors wages	12 000	
Indirect materials	10 000	
Factory: Electricity and power	5 000	
Rent and rates	19 000	
Lubricants oils	1 000	
Cleaning expenses	2 000	
Depreciation of plant and machinery ( $\frac{14}{100} \times 70\,000$ )	<u>9 800</u>	<u>58 800</u>
		210 800
Add: Opening inventory of work in progress		<u>33 000</u>
		243 800
Less: Closing inventory of work in progress		<u>(43 800)</u>
<b>Total production cost</b>		<b><u>200 000</u></b>

#### Income statement for the year ended 30 September, 2019

	\$	\$
Sales of finished goods		393 000
Less: Cost of sales		
Opening inventory of finished goods	27 000	
Add: Total production cost	<u>200 000</u>	
	227 000	
Less: Closing inventory of finished goods	<u>18 000</u>	<u>(209 000)</u>
Gross profit		184 000
Less: <b>Operating expenses</b>		
Selling and administration cost	6 000	
Office: Insurance	11 000	
Electricity and power	9 000	
Rent and rates	13 000	
Delivery expenses	4 000	
Depreciation of delivery vehicles		
( $\frac{10}{100} \times 43\,000$ )	<u>4 300</u>	<u>(47 300)</u>
<b>Net profit for the year</b>		<b><u>136 700</u></b>

### Additional information for the year ended 31 December, 2015

- (i) Inventory was valued at: raw materials \$400 000, work in progress \$900 000, finished goods \$1 100 000.
- (ii) Supervisor's wages outstanding amounted to \$100 000 whilst direct wages prepaid amounted to \$200 000.
- (iii) Provision for depreciation of non-current assets was as follows:
  - Plant and machinery 15% at cost per annum.
  - Motor vehicles 20% using reducing balance method.

### Required: Prepare

- (a) Manufacturing account for the year ended 31 December, 2020.
- (b) Income statement for the year ended 31 December, 2020.
- (c) Statement of financial position as at 31 December, 2020.

### Solution

#### Manufacturing account for the year ended 31 December, 2020

	\$	\$
Opening inventory of raw materials		600
Add: Purchases of raw materials		2 800
Carriage inwards		<u>600</u>
		4 000
Less: Returns outwards		(800)
		3 200
Less: Closing inventory of raw materials		<u>(400)</u>
		2 800
Add: Direct wages (1 500 – 200)	1 300	
Direct expenses: Royalties and patents	<u>2 800</u>	<u>4 100</u>
Prime cost of production		6 900
Add: Production overheads		
Supervisors wages (500 + 100)	600	
Lubricants costs	400	
Lighting and heating	700	
Factory power	500	
Depreciation of plant & machinery ( $\frac{15}{100} \times 12\,000$ )	1 800	<u>4 000</u>
		10 900
Add: Opening inventory of work in progress		<u>800</u>
		11 700
Less: Closing inventory of work in progress		(900)
<b>Total cost of production or goods manufactured</b>		<b><u>10 800</u></b>



### Statement of financial position as at 31 December, 2020

	Cost	Acc. Dep.	N.B.V.
	\$	\$	\$
<b>Non current assets</b>			
Land and buildings	10 000	-	10 000
Plant and machinery	12 000	3 600	8 400
Motor vehicles	<u>8 000</u>	<u>2 880</u>	<u>5 120</u>
	<u>30 000</u>	<u>6 480</u>	<u>23 520</u>
<b>Current assets</b>			
Inventory: Raw materials		400	
Work in progress		900	
Finished goods		1 100	
Trade receivables		4 000	
Prepaid direct expenses		200	
Cash at bank		6 900	
Cash in hand		<u>2 400</u>	<u>15 900</u>
			<b><u>39 420</u></b>
<b>Equity and liabilities</b>			
<b>Equity</b>			
Capital			26 600
Add: Net profit			<u>1 520</u>
			28 120
Less: Drawings			<u>(900)</u>
			27 220
Add: Long term loan from <b>Econet</b> limited			<u>10 000</u>
			37 220
<b>Current liabilities</b>			
Trade payables		2 100	
Supervisors wages owing		<u>100</u>	<u>2 200</u>
			<b><u>39 420</u></b>

### Example 17.3

Leeds manufacturing business that concentrates with the production of rubber and other products made of rubber. The following are the balances extracted from their ledger books of accounts for the year ended 31 December, 2017.

**EXAMINATION PRACTICE 1****PAPER 1****TIME:** 1 hour 30 minutesAnswer **all** questions.

1. Which part of a computer that processes accounting data?
 

A. Keyboard	B. Random Access Memory
C. Mouse	D. Central processing unit
2. Which of the following is not a computer hardware device?
 

A. Monitor	B. Primary memory	C. Mouse	D. Keyboard
------------	-------------------	----------	-------------
3. Cash sales are recorded in the
 

A. cash book.	B. purchases journal.	C. sales journal.	D. sales ledger.
---------------	-----------------------	-------------------	------------------
4. Name the source document used when unsatisfactory goods are returned by a customer.
 

A. Debit note	B. Returns inwards journal
C. Credit note	D. Voucher
5. Putting extra headlights to the motor vehicle is a
 

A. operating expense.	B. revenue expenditure.
C. capital expenditure.	D. loss.
6. A person whom payment is made at the bank is called
 

A. drawer.	B. bank.	C. drawee.	D. payee.
------------	----------	------------	-----------
7. Which of the following does not appear in the statement of financial position?
 

A. Buildings	B. Motor vehicles
C. Rent received owing	D. Salaries paid
8. Which of the following best describes working capital?
 

A. Non-current assets + Current assets	B. Current assets – Liabilities
C. Current assets + Liabilities	D. Current assets – Inventory
9. A payment received from Washington of \$2 000 by cheque was recorded in the cash book but no record was made in his account. To correct the error
 

A. debit Suspense and credit Washington \$2 000.
B. debit Suspense and credit Sales \$2 000.
C. debit Washington and credit Suspense \$2 000.
D. debit Washington and credit Sales.
10. Insurance paid \$1 255 by cheque was recorded in the books as \$1 525. Which error is this?
 

A. Principle	B. Original entry
C. Commission	D. Transposition

17. Given:
- |                    |        |
|--------------------|--------|
|                    | \$     |
| Non-current assets | 60 000 |
| Current assets     | 40 000 |
| Capital            | 70 000 |
- Liabilities amount to
- A. \$30 000.                      B. \$100 000.                      C. \$40 000.                      D. \$170 000.
18. Which document is used to record goods that have been bought on credit?
- A. Voucher                      B. Invoice                      C. Credit note                      D. Debit note
19. A trader provided the following information

Trade receivables ledger account

2019		\$	2019		\$
June 1	Balance b/d	400	June 30	Bank	7 000
30	Credit sales	15 200		Returns inwards	700
	Dishonoured cheques	900		Discount allowed	300
	Interest charged	100		Bad debts written off	1 100
				Contra	800
		<b>16 600</b>			<b>16 600</b>

What is the account balance?

- A. \$6 700 Debit                      B. \$6 700 Credit                      C. \$16 600 Debit                      D. \$16 600 Credit
20. The following is the updated cash book of a trader

Updated cash book

2019		\$	2019		\$
June 1	Balance b/d	700	June 20	Insurance	600
24	Credit transfer	1 900	25	Zesa	700
27	Mickey	2 100	26	Leona	1 300
			30	Balance c/d	2 100
		<b>4 700</b>			<b>4 700</b>

The following information was shown in the original cash book

Unpresented cheques                      \$3 000

Bank lodgements                      \$2 700

What is the bank statement balance?

- A. \$2 100                      B. \$5 700                      C. \$4 700                      D. \$2 400
21. A partner who do not take day to day running of the partnership business is known as
- A. active partner.                      B. dead partner.  
C. sleeping partner.                      D. ordinary partner.

Use the following information to answer question 22 and 23.

The following information was taken from the books of the partnership of Junior and Cassie. Junior and Cassie share profit and losses in the ratio 3:2 respectively.

	\$
Net profit for the year	20 000
Capitals: Junior	50 000
Cassie	40 000
Current account: Junior	900 DR
Cassie	600 CR
Drawings: Junior	1 000
Cassie	2 000

- Interest on drawings is at 5% and interest on capital is at 10%.
- Cassie gets an annual salary of \$1 150.

22. Calculate the share of profit for each partner.

	Junior	Cassie
	\$	\$
A.	\$3 000	\$2 000
B.	\$4 000	\$3 000
C.	\$5 000	\$4 000
D.	\$6 000	\$4 000

23. If Cassie has been paid \$650 by cheque during the year, what is his current account balance

- A. \$7 000                      B. \$8 000                      C. \$10 000                      D. \$12 000

24. Production wages are

- A. production overheads.  
B. indirect costs.  
C. direct costs.  
D. operating expenses.

25. A manufacturer had the following costs:

	\$
Raw materials consumed	10 000
Direct materials	9 000
Royalties	2 000
Supervisors wages	5 000

How much is the prime cost?

- A. \$24 000  
B. \$26 000  
C. \$21 000  
D. \$30 000

26. A trader provided the following information:

Trade receivables 1 July, 2020	\$6 000
Trade receivables 31 December, 2020	\$9 000
Cheques received during the year	\$15 000

How much are the sales for the period?

- A. \$12 000                      B. \$20 000                      C. \$18 000                      D. \$25 000
27. A trader bought office machinery at a cost of \$10 000 on 30 June, 2018. Provision for depreciation is provided at the rate of 10% using reducing balance method. The year ends on 31 December each year. Calculate the provision for depreciation of office machinery on 31 December, 2020.
- A. \$1 000                      B. \$900                      C. \$700                      D. \$855

**The following information should be used to answer question 28 and 29.**

A trader bought goods on 19 April, 2020 for \$9 000. The trader was given a trade discount of  $33\frac{1}{3}\%$ . He was also given a cash discount of 5% if the goods are paid in full within 25 days from the date of purchase. On 11 May the trader settled his account in full by cheque.

28. How much is the trade discount?
- A. \$2 997                      B. \$4 000                      C. \$3 000                      D. \$5 000
29. How much was did the trader pay on the date of payment?
- A. \$5 700                      B. \$6 300                      C. \$8 550                      D. \$9 000
30. An amount written off in the books of a trader due to the fact that the customer has been declared bankruptcy is known as
- A. trade receivables.    B. trade payables.    C. bad debts.    D. arrears.
31. A firm has two departments; the electrical and hardware and the following information has been provided for the year ended 31 December, 2020.

	Electrical \$	Hardware \$
Sales	25 000	18 000
Purchases	10 000	7 000
Carriage inwards	2 000	3 000
Freight charges	1 000	-
Returns outwards	2 500	1 500
Inventory 1 January, 2020	6 000	4 500
Inventory 31 December, 2020	5 000	5 500

Calculate the combined gross profit

- A. \$20 000  
B. \$23 000  
C. \$22 000  
D. \$24 000

32. A trader provided the following:

Cost of sales	\$45 000
Opening inventory	\$9 000
Closing inventory	\$6 000

Calculate the rate of inventory turnover.

- A. 5 times.
  - B. 6 times.
  - C. 7.5 times.
  - D. 3 times.
33. Current assets less closing inventory divided by current liabilities is known as
- A. current ratio.
  - B. acid test ratio.
  - C. solvent ratio.
  - D. working capital.
34. The firm issued 100 000 Ordinary shares of \$2 each, calculate the value of shares
- A. \$50 000
  - B. \$200 000
  - C. \$100 000
  - D. \$250 000
35. The company had 12,5% Debentures valued at \$120 000, how much is the interest payable?
- A. \$9 600
  - B. \$10 000
  - C. \$15 000
  - D. \$20 000
36. The company had 100 000, 10% preference shares of \$1 each. During the year the preference shares were given an interim dividend of \$3 000, how much is the final dividend?
- A. \$10 000
  - B. \$8 000
  - C. \$3 000
  - D. \$7 000
37. A type of preference shares which the dividend is skipped due to insufficient profits and made good in future profitable years is known as
- A. cumulative preference shares.
  - C. non-cumulative preference shares.
  - B. redeemable preference shares.
  - D. non-redeemable preference shares.

38. Which of the following contain liabilities only?
- Payables, short term loans and insurance prepaid
  - Payables, short term loans and interest earned prepaid
  - Receivables, cash and bank overdraft
  - Payables, bank charges and subscription owing
39. The following information was obtained from a trader

Motor vehicles disposal account

2019 Dec 31	Motor vehicles	\$ 50 000	2019 Dec 31	Provision for depreciation	\$ 18 000
				Bank	20 000
				Profit and Loss	12 000
		<b>50 000</b>			<b>50 000</b>

What does the balance of \$12 000 profit and loss indicates?

- Provision for depreciation for the year
  - Net book value of the sold asset
  - Loss made on the sale of the asset
  - Profit made on the sale of the asset
40. A cost that is directly attributable to the goods produced is known as the
- revenue expenditure.
  - capital expenditure.
  - production overhead.
  - direct cost.

**EXAMINATION PRACTICE 1****PAPER 2****TIME:** 2 hours 30 minutesAnswer **all** questions.Use **black or blue ball-point pen only**.

All calculations must be shown adjacent to the answer.

Calculators **may** be used.

1. **S. Moyo**, a sole trader, provided the following trial balance extracted from his ledger books of accounts for the period ended 31 December, 2015

**Trial balance as at 31 December, 2015**

	<b>Debit \$</b>	<b>Credit \$</b>
Land and buildings at cost	10 000	
Plant and machinery at cost	12 000	
Motor vehicles at cost	8 000	
Provision for depreciation: Plant and machinery		2 000
Motor vehicles		1 000
Insurance	700	
Electricity and water	500	
Salaries and wages	1 500	
Trade receivables	4 000	
Trade payables		2 500
Purchases	2 800	
Sales		7 900
Cash at bank	1 900	
Cash in hand	2 400	
Drawings	900	
Carriage inwards	600	
Inventory on 1 January, 2015	2 600	
Carriage outwards	800	
Discount received		1 100
Discount allowed	400	
Long term loan from Agribank		10 000
Rent and rates	1 200	
General expenses	700	
Returns inwards	900	
Returns outwards		800
Capital		26 600
	<b><u>51 900</u></b>	<b><u>51 900</u></b>



**Additional information for the year ended 31 December, 2015**

- (i) Inventory was valued at \$2 400.
- (ii) Insurance paid in advance amounted to \$100.
- (iii) Rent owing \$300.
- (iv) Provision for bad debts was created at the rate of 5% per annum on the trade receivables figure.
- (v) Provision for depreciation of non-current assets was as follows;
  - Plant and machinery 10% per annum using straight line method.
  - Motor vehicles 20% per annum using reducing or diminishing balance method.

**Required to prepare:**

- (a) Income statement for the year ended 31 December, 2015. [14]
- (b) Statement of financial position as at 31 December, 2015. [13]

2. (a) The cash book of A. Alma showed a debit balance of \$50 300 at the bank on 31 July, 2020.  
The following details were made available:

	\$
Unpresented cheques	11 100
Deposits not credited by the bank	35 400
A standing order for insurance paid by the bank	2 000
A credit transfer received by the bank	5 000
Bank charges on the bank statement	2 900
Balance as per bank statement	25 100

A cheque for \$10 000 from a trade receivable was incorrectly entered as \$11 000 in the cash book.

**You are required to prepare:**

- (i) An updated cash book. [7]
- (ii) A bank reconciliation statement as at 31 July, 2020. [7]
- (b) Determine if whether the cost is a **capital or a revenue expenditure**
  - (i) Bought a machine for \$5 000.
  - (ii) Bought a second hand motor vehicle from Japan for \$10 000.
  - (iii) Cost of paying salaries to the administration workers \$8 000.
  - (iv) Cost of building a new administration block at the school for \$18 000.
  - (v) Cost of buying stationery for administration for \$1 000.
  - (vi) Cost of wages to the workers building the administration block for \$3 000
  - (vii) Installation costs of electric cables to the building for \$1 000.

3. The following information was extracted from the books of Garikai farming Club:

	1 January, 2020	31 December, 2020
	\$	\$
Subscriptions in arrears	5 000	4 000
Subscriptions in advance	3 900	4 400

Inventory of stationery	1 500	1 300
Electricity owing	400	500

The following transactions were undertaken during the year ending 31 December, 2020

- (i) Subscriptions paid by cheque amounted to \$12 000
- (ii) Subscriptions paid in cash totalled \$10 000
- (iii) Paid \$5 000 for stationery by cheque.
- (iv) Paid \$4 000 for electricity in cash.

You are required to prepare the:

- (a) Subscriptions account. [7]
- (b) Stationery account. [4]
- (c) Electricity account. [4]

4. The following information was taken from the books of Gym during the month of January 2020

	\$
Jan 1 Trade receivables balance	5 900 Dr
Trade payables balance	1 300 Cr
Jan 31 Credit sales	50 000
Credit purchases	28 000
Returns outwards	300
Returns inwards	200
Cheques and cash received from trade receivables	39 000
Cheques paid to trade payables	19 000
Customers' cheque dishonoured	1 500
Discount allowed	900
Discount received	800
Interest charges to customers on overdue account	400
Accounts settled by contra	3 300
Cash refund from suppliers for overpayments	100
Bad debts written off	800
Provision for bad debts	1 610
Debit balances in the purchases ledger	90
Credit balances in the sales ledger	80

#### Required to prepare

- (a) Sales ledger control account. [9]
- (b) Purchases ledger control account. [8]

5. The following information was taken from the books of **X limited** for the year ended 31 December, 2020.

<b>Authorised share capital</b>	<b>\$</b>
100 000 ordinary shares of \$1 each	100 000
50 000, 10% irredeemable preference shares of \$0.50 each	25 000

**Issued share capital**

\$100 000 ordinary shares of \$1 each	100 000
\$40 000, 10% irredeemable preference shares of \$0.50 each	20 000

The following information was made available for the year ended 31 December, 2019

	\$
Income statement (Profit and loss)	20 000
General reserves	15 000
500, 5% Debentures of \$100 each	30 000
Interim ordinary dividends	3 000
Interim preference dividends	2 000

The net trading profit of the company for the year was \$17 000 after debenture interest. The directors of X limited recommended that:

- (i) A transfer of \$4 000 to the general reserve
- (ii) A proposed ordinary dividend \$0.10 be paid to the ordinary shareholders.

**Required to prepare:**

- (a) Statement of changes in equity as at 31 December, 2019. [8]
- (b) Statement of financial position (extract) as at 31 December, 2019. [7]
- (c) Distinguish between ordinary shares and preference shares. [4]

**EXAMINATION PRACTICE 10****PAPER 2****TIME:** 2 hours 30 minutesAnswer **all** questions.Use **black or blue ball-point pen only**.

All calculations must be shown adjacent to the answer.

Calculators **may** be used.**Question 1**

1. The treasurer of Taka sports club did not keep full records. The following information is available on 31 December, 2018.

**Cash book**

Date	Details	Amount	Date	Details	Amount
2018		\$	2018		\$
Jan 1	Balance b/d	1 050		Purchase of refreshments	190 000
	<b>Subscription received:</b>			Rent and rates	12 000
	Year ended 31 Dec, 2017	1 500		Operating expenses	37 500
	Year ended 31 Dec, 2018	32 000		Purchase of equipment	9 000
	Year ended 31 Dec, 2019	3 100			
	Sales of refreshments	<u>250 000</u>		Balance c/d	<u>39 150</u>
		<b><u>287 650</u></b>			<b><u>287 650</u></b>

**Additional information**

(a) Balances	1 January, 2018	31 December, 2018
	\$	\$
Inventory of refreshments	22 000	7 000
Operating expenses	1 000 (prepaid)	250 (accrued)
Equipment Net book value	32 000	27 000
Subscriptions in advance	1 750	3 100
Subscription in arrears	2 700	900

- (b) Subscription not collected for the year ended 31 December are to be considered as irrecoverable

**Required:**

- (i) To calculate the accumulated fund on 1 January, 2018. [6]  
(ii) To reprepare the refreshment trading account for the year ended 31 December, 2018. [4]  
(iii) To prepare the income and expenditure account for the year ended 31 December, 2018. [10]

# PAPER 2 EXAMINATIONS SOLUTIONS

## EXAM 1: PAPER 2 ANSWERS

### 1. Income Statement for the year ended 31 December, 2015

	\$	\$
Sales		7 900
Less: Returns inwards		<u>(900)</u>
<b>Turnover/Net sales</b>		7 000
Less: <b>Cost of sales</b>		
Opening inventory	2 600	
Add: Purchases	2 800	
Carriage inwards	<u>600</u>	
	6 000	
Less: Returns outwards	<u>(800)</u>	
Goods available for sale	5 200	
Less: closing inventory		
Cost of goods sold	<u>(2 400)</u>	<u>2 800</u>
<b>Gross profit</b>		4 200
Add: <b>Other incomes</b>		
Discount received		<u>1 100</u>
Gross income		5 300
Less: <b>Operating expenses</b>		
Insurance (700 – 100)		
Electricity and water	600	
Salaries and wages	500	
Carriage outwards	1 500	
Discount allowed	800	
Rent and rates (1 200 + 300)	400	
General expenses	1 500	
Provision for bad debts ( $\frac{5}{100} \times 4\,000$ )	700	
Provision for depreciation:	200	
Plant and machinery ( $\frac{10}{100} \times 12\,000$ )		
Motor vehicles $\frac{20}{100} \times (8\,000 - 1\,000)$	1 200	<u>8 800</u>
Net loss for the year	<u>1 400</u>	<u>3 500</u>

**(b) Ratios**

(i) Working capital :  $(4\,500 + 4\,000 + 5\,000) - (6\,500 + 500)$   
 = **\$6500.**

(ii) Margin:  $\frac{(100\,000 - 30\,000)}{1\,000} \times 100\%$   
 = **70%.**

(iii) Current ratio:  $\frac{(4\,500 + 4\,000 + 5\,000)}{(6\,500 + 500)}$   
 = **1.9:1.**

(iv)  $\frac{\text{Acid test}}{\text{Quick ratio}} : \frac{(13\,500 - 4\,500)}{(6\,500 + 500)}$   
 = **1.3:1.**

Net profit as a percentage of sales:  $\frac{(70\,000 - 10\,000)}{100\,000} \times 100\%$   
 = **60%.**

**EXAM 7: PAPER 2 ANSWERS****Question 1****1. (a) Profit and loss Appropriation account for the year ended 31 December, 2018**

	\$	\$	\$
Net profit			2 560
Add interest on drawings: A (5% × 500)		25	
B (5% × 300)		<u>15</u>	<u>40</u>
			2 600
Less Appropriations			
Interest on capital: A (10% × 5000)	500		
B (10% × 3000)	<u>300</u>	800	
Salary A		<u>1 200</u>	(2 000)
Profit to be shared			<u>600</u>
Share of profit A ( $\frac{2}{3} \times 600$ )		400	
B ( $\frac{1}{3} \times 600$ )		<u>200</u>	<u>600</u>

**(b) Statement of financial position extract as at 31 December, 2018**

	\$	\$	\$
<b>Equity and non-current liabilities</b>			
Capital A		5 000	
B		<u>3 000</u>	8 000
		<b>Current</b>	
		<b>accounts</b>	
	A	B	

## EXAM 9: PAPER 2 ANSWERS

## Question 1

1. (a) Income statement for the year ended 31 December, 2018

Sales			15 500
Sales returns			<u>(950)</u>
Turnover			14 550
<b>Less cost of sales</b>			
Opening inventory		1 150	
Add purchases	7 000		
Add carriage inwards	<u>300</u>		
	7 300		
Less Drawings (goods taken for personal use)	<u>(125)</u>		
Net purchases		<u>7 175</u>	
Cost of goods available for resale		8 325	
Less closing inventory		<u>(1 460)</u>	
Cost of sales			<u>(6 865)</u>
<b>Gross profit</b>			<b>7 685</b>
<b>Add other incomes</b>			
Discount received		560	
Decrease in provision for doubtful debts			
$100 - [(2\,300 - 425) \times 4\%]$		<u>25</u>	<u>585</u>
Total income			8 270
<b>Less expenses</b>			
Salaries (2 375 + 260)		2 635	
Rent and rates		680	
Sundry expenses		1 415	
Advertising (620 – 30)		590	
Depreciation on motor vehicles			
$(4\,200 - 800 \times 25\%)$		850	
Depreciation on office equipment (2 600 × 10%)		260	
Bad debts		425	
Loan interest (1 000 × 5% × 0.5)		<u>25</u>	<u>(6 880)</u>
<b>Net profit</b>			<b><u>1 390</u></b>