

IGCSE

Accounting

Prepayments

and Accruals

1 Explain the following accounting principles. Give one example of each principle.

(a) accruals (matching)

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Example

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(b) business entity

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Example

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Answer: (a) Accruals (matching)

Costs and revenues should be matched within an accounting period.

Any suitable example.

(b) Business entity

The business is treated as being separate from the owner. The business records are from the viewpoint of the business.

Any suitable example.

2 Complete the table by placing a tick () to indicate how the adjustment for goods for own use affects the following ratios.

	Increase	Decrease
Gross profit margin		
Rate of inventory turnover (in days)		
Net profit margin		
Return on capital employed		

Answer:

	Increase	Decrease
Gross profit margin	✓	
Rate of inventory turnover (in days)	✓	
Net profit margin	✓	
Return on capital employed	✓	

3 An insurance account shows an amount paid for the year of \$2000 and a prepayment at the end of the year of \$400.

Which entry appears in the insurance account to record the transfer to the income statement?

- A credit entry of \$1600
- B credit entry of \$2400
- C debit entry of \$1600
- D debit entry of \$2400

Answer: A. credit entry of \$1600

4 On 1 May 2014 Samuel's provision for doubtful debts account showed a balance of \$450. On 30 April 2015 his trade receivables amounted to \$9750. This included a debt of \$250 which had gone bad and should be written off. Samuel provides for doubtful debts at a rate of 4%.

REQUIRED

Prepare Samuel's provision for doubtful debts account. Bring down the balance on 1 May 2015.

Samuel Provision for doubtful debts account

Date	Details	\$	Date	Details	\$
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Answer:

Samuel
Provision for doubtful debts account

2015	\$	2014	\$
30 April <i>Income statement</i>	70	1 May <i>Balance b/d</i>	450
<i>Balance c/d</i>	<u>380</u>		—
	<u>450</u>		<u>450</u>
		2015 1 May <i>Balance b/d</i>	380

5 (a) State where the entry for doubtful debts will appear in the income statement.

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(b) Name the two accounting principles Samuel is applying by maintaining a provision for doubtful debts account.

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Answer: (a) *Below/after gross profit/after trading account/(on credit side) as other income. Profit and loss section/(debit side) as an expense*

(b) *Accruals/matching
Prudence*

6 Grace Zindi runs a secretarial agency. Her financial year ends on 31 July.

She provided the following information on 31 July 2015.

	\$
Capital 1 August 2014	85 000
Cash drawings	15 500
Fees from clients	28 500
Wages	21 600
Rates and insurance	3 900
General expenses	990
Heat and light	710
Commission receivable	7 600
Motor vehicles at cost 1 August 2014	12 500
Provision for depreciation of motor vehicles 1 August 2014	4 500
Office equipment at valuation 1 August 2014	11 400

Additional information

- 1 At 31 July 2015
Insurance prepaid amounted to \$300
Commission receivable of \$250 was outstanding
Fees from clients of \$3400 was outstanding.
- 2 Grace Zindi lives in a flat above the business premises. One quarter of the rates and insurance relate to the flat.
- 3 On 31 July 2015 Grace Zindi decided to create a provision for doubtful debts of 1% of the amount owed by clients.
- 4 The motor vehicles are being depreciated by 20% per annum on the reducing (diminishing) balance method.
- 5 The office equipment was valued at \$14 500 on 31 July 2015.
Additional office equipment costing \$6900 was purchased during the year. No office equipment was disposed of during the year.

REQUIRED

(a) Prepare Grace Zindi’s income statement for the year ended 31 July 2015.

Grace Zindi
Income Statement for the year ended 31 July 2015

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Answer:

Grace Zindi
Income Statement for the year ended 31 July 2015

	\$	\$
<i>Income from Clients (28 500 + 3400)</i>		31 900
<i>Commission receivable (7600 + 250)</i>		<u>7 850</u>
		39 750
<i>Wages</i>	21 600	
<i>Rates and Insurance ((3900 – 300) × ¾)</i>	2 700	
<i>General Expenses</i>	990	
<i>Heat and Light</i>	710	
<i>Provision for Doubtful Debts (1% × 3400)</i>	34	
<i>Depreciation motor vehicles (12 500 – 4500 (1) × 20%)</i>	1 600	
<i>Depreciation office equipment (11 400 + 6900 – 14 500)</i>	<u>3 800</u>	<u>31 434</u>
<i>Profit for the year</i>		<u>8 316</u>

(b) Prepare the capital account for Grace Zindi for the year ended 31 July 2015.

Balance the account and bring down the balance on 1 August 2015.

Grace Zindi
Capital account

Date	Details	\$	Date	Details	\$
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Answer:

Grace Zindi
Capital Account

		\$			\$
2015			2014		
31 July	<i>Cash/Drawings</i>	15 500	1 Aug	<i>Balance b/d</i>	85 000
	<i>Rates & Insurance</i>		2015		
	<i>Drawings</i>	900	31 July	<i>Profit</i>	8 316
	<i>Balance c/d</i>	<u>76 916</u>			
		<u>93 316</u>			<u>93 316</u>
			2015		
			1 Aug	<i>Balance b/d</i>	76 916

(c) State the meaning of the accruals (matching) principle. Give one example of how this principle was applied in the preparation of the income statement in (a).

Meaning

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Example

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Answer: Revenue for the year is matched against the costs of the same period

Example -

Either Insurance prepaid at year-end was deducted

Or Commission receivable outstanding at year-end was added

Or Amount owing from clients at year-end was added

(d) State the meaning of the business entity principle. Give one example of how this principle was applied in the preparation of the income statement in (a).

Meaning

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Example

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Answer: The business is treated as being separate from the owner

Example

The proportion of rates and insurance relating to the owner's flat was excluded from the business expenses (1)

7 Name one other accounting principle which is applied when charging depreciation.

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Answer: Accruals (matching)

- 8 State how providing depreciation is an application of the accounting principle of accruals (matching).

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Answer: *The cost of the non-current asset and the revenues arising from its use are matched in an accounting period.*

OR

The cost of the non-current asset is spread over its useful life.

- 9 State how reducing the value of inventory would be an application of the accounting principle of accruals (matching).

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Answer: *The loss arising from the damage is recorded in the same year as the damage occurred.*

- 10 Msamati Manufacturing provided the following information for the year ended 31 January 2017.

	\$
Revenue	816 370
Purchases of finished goods	17 200
Commission received	2 700
Administration expenses	38 160
Selling expenses	28 270
Inventory of finished goods 1 February 2016	56 120
Office equipment at cost	32 000
Delivery vehicles at cost	68 000
Provision for depreciation	
Office equipment	14 400
Delivery vehicles	17 000
Loan from A1 Loans received 1 April 2016	15 000
At 31 January 2017	
Inventory of finished goods	61 340
Commission receivable outstanding	130
Loan interest at 5% per annum is outstanding	

During the year ended 31 January 2017 the owner of the business took finished goods costing \$1620 for his own use.

Depreciation is charged as follows:

Office equipment at 15% per annum using the straight line (equal instalment) method

Delivery vehicles at 25% per annum using the reducing (diminishing) balance method.

REQUIRED

(a) Prepare the income statement for the year ended 31 January 2017.

Msamati Manufacturing
Income Statement for the year ended 31 January 2017

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Answer:

Msamati Manufacturing			
Income Statement for the year ended 31 January 2017			
	\$	\$	\$
Revenue			816 370
Opening inventory		56 120	
Cost of production	669 950		
Purchases of finished goods	17 200		
	<u>687 150</u>		
Less goods for own use	<u>1 620</u>	<u>685 530</u>	<u>685 530</u>
		<u>741 650</u>	<u>741 650</u>
Less Closing inventory		<u>61 340 *</u>	<u>680 310</u>
Gross profit			<u>136 060</u>
Commission receivable (2700 + 130)			<u>2 830</u>
			<u>138 890</u>
Administration expenses		38 160	
Selling expenses		28 270	
Loan interest (5% × 15 000 × 10 / 12)		625	
Depreciation			
Office equipment			
(15% × 32 000)		4800	
Delivery vehicles			
(25% × (68 000 – 17 000))		<u>12 750</u>	<u>84 605</u>
Profit for the year			<u>54 285</u>

(b) Explain how the accruals (matching) principle has been applied in the preparation of the income statement. Illustrate your answer by reference to **one** of the items in your answer to **(a)**.

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Answer: Either ~~the~~ The expenses of the year were matched against the revenue of the same period.
 Or
 Only the expenses for the year were included in the income statement.
 Example – Either Commission receivable outstanding was added.
 Or Loan interest outstanding was added.
 Or Depreciation for the year was included.

11 Lahiru's financial year ends on 28 February. He maintains a provision for doubtful debts of 4% of trade receivables at the end of each year.

On 1 March 2016 Lahiru's provision for doubtful debts amounted to \$500. On 28 February 2017 his trade receivables owed \$17 900.

REQUIRED

(a) Prepare the provision for doubtful debts account for the year ended 28 February 2017. Balance the account and bring down the balance on 1 March 2017.

Lahiru
Provision for doubtful debts account

Date	Details	\$	Date	Details	\$
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Answer:

Lahiru		Provision for doubtful debts account	
	\$		\$
2017 Feb 28 Balance c/d	716 <hr style="width: 50%; margin-left: auto; margin-right: 0;"/> 716	2016 Mar 1 Balance b/d 2017 Feb 28 Income statement	500 216 <hr style="width: 50%; margin-left: auto; margin-right: 0;"/> 716 716
		2017 Mar 1 Balance b/d	716

(b) Explain how Lahiru is applying the accounting principle of prudence by maintaining a provision for doubtful debts.

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Answer: *The profit for the year is not overstated.
The trade receivables (current assets) are not overstated.*

(c) Explain how Lahiru is applying the accounting principle of accruals (matching) by maintaining a provision for doubtful debts.

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Answer: *Either ---*

The sales for which a business is unlikely to be paid are regarded as an expense of the year in which those sales are made.

The provision for doubtful debts is an expense those debts are incurred.

12 Rashida is a wholesaler. Her financial year ends on 30 September. She provided the following information.

	\$
At 1 October 2016	
Fixtures and fittings at cost	65 000
Provision for depreciation of fixtures and fittings	23 500
Office equipment at valuation	21 000
Inventory	37 150
Trade receivables	34 800
During the year ended 30 September 2017	
Revenue	572 000
Purchases	455 900
Returns by customers	1 840
Returns to suppliers	2 750
Carriage inwards	6 940
Wages	74 200
General expenses	1 300
Rates and insurance	2 800
Loan interest	400
Office equipment	2 800

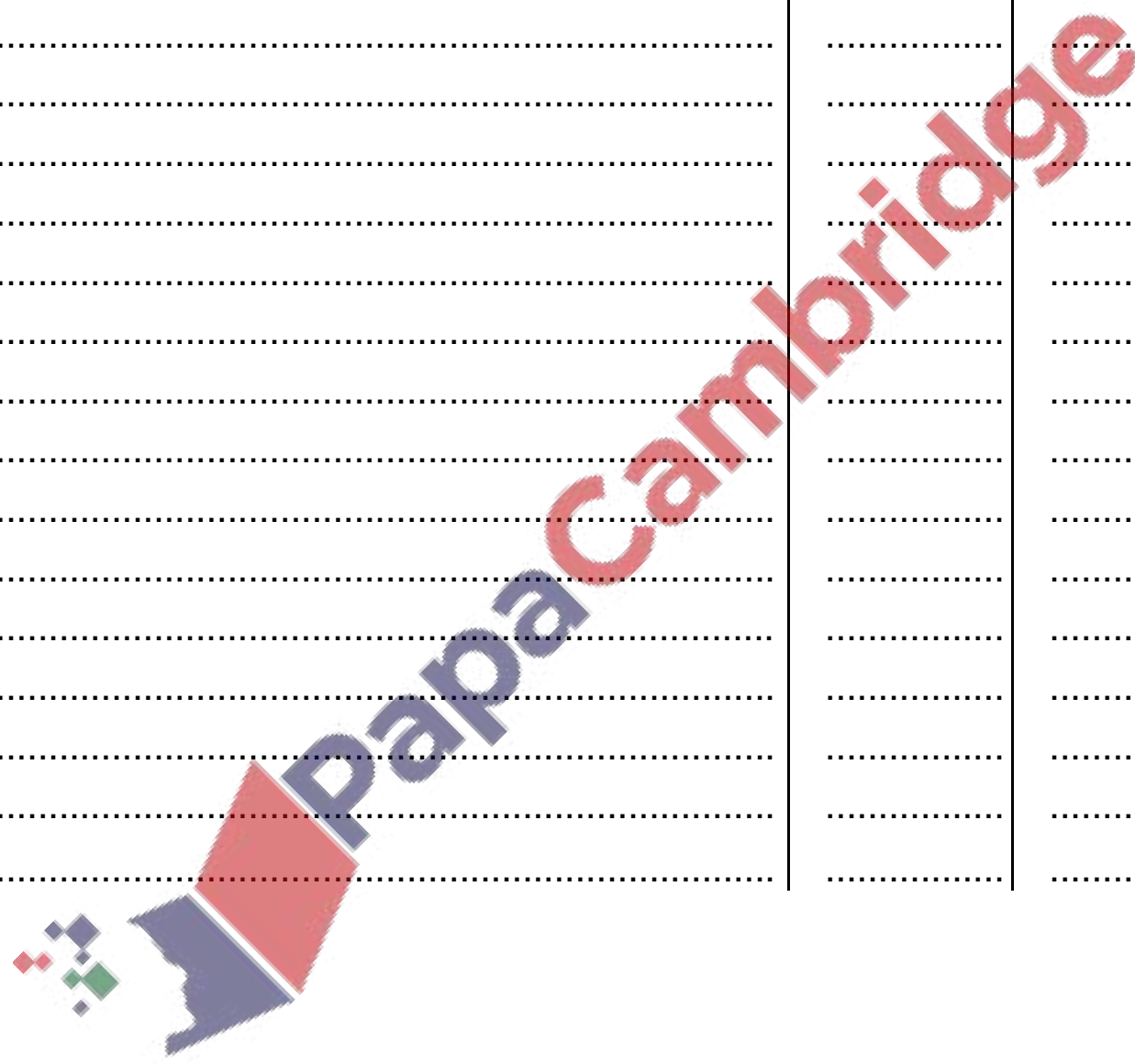
Additional information

- 1 Inventory at 30 September 2017 was valued at \$41 160.
- 2 A loan of \$20 000 was received on 1 April 2017. Interest is charged at 6% per annum.
- 3 Rashida lives in a flat above the business premises. One quarter of the rates and insurance relate to the flat.
- 4 The fixtures and fittings are being depreciated at the rate of 20% per annum using the reducing (diminishing) balance method.
- 5 The office equipment is revalued at the end of each financial year. The value at 30 September 2017 was \$20 600.
- 6 The trade receivables include \$300 which should be written off. A provision for doubtful debts of 2% of the remaining amount should be created.

REQUIRED

(a) Prepare the income statement for the year ended 30 September 2017.

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(b) Explain how the accruals (matching) principle has been applied in the preparation of the income statement. Support your answer by reference to **one** of the items in your answer to (a).

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(c) Explain how the business entity principle has been applied in the preparation of the income statement. Support your answer by reference to **one** of the items in your answer to (a).

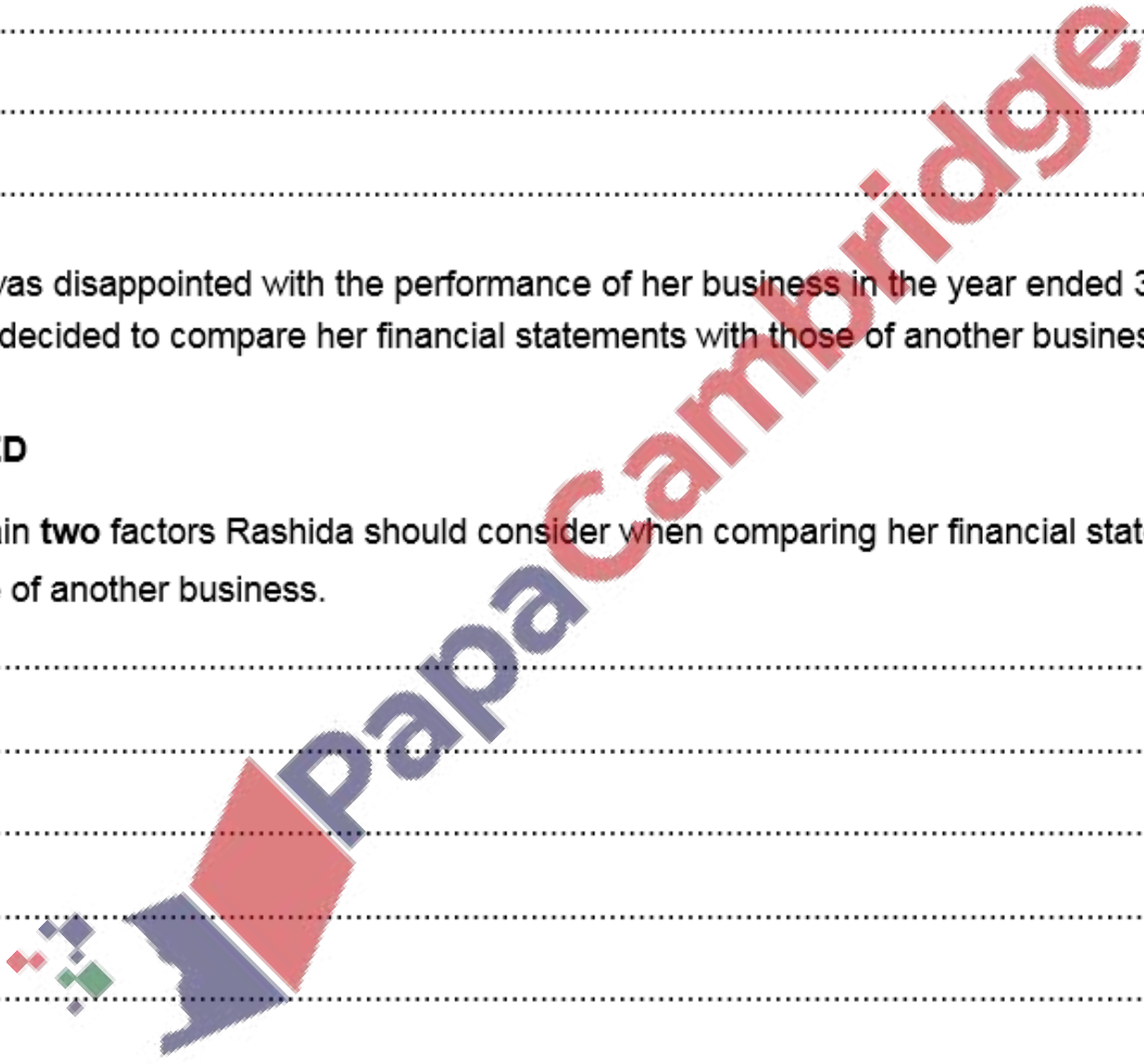
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Rashida was disappointed with the performance of her business in the year ended 30 September 2017 and decided to compare her financial statements with those of another business.

REQUIRED

(d) Explain **two** factors Rashida should consider when comparing her financial statements with those of another business.

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Answer: (a)

Rashida			
Income Statement for the year ended 30 September 2017			
	\$	\$	\$
Revenue		572 000	
Less Returns		<u>1 840</u>	570 160
Cost of sales			
Opening inventory		37 150 *	
Purchases	455 900		
Less Returns	<u>2 750</u>		
	453 150		
Carriage inwards	<u>6 940</u>	<u>460 090</u>	
		497 240	
Closing inventory		<u>41 160 *</u>	<u>456 080</u>
Gross profit			114 080
Less Wages		74 200	
General expenses		1 300	
Rates & insurance (2 800 × ¾)		2 100	
*Loan interest (400 + 200)		600	
Bad debts		300	
Provision for doubtful debts (2% × 34 500)		690	
Depreciation:			
Fixtures & fittings (20% × (65 000 – 23 500))		8 300	
Office equipment (21 000 + 2 800 – 20 600)		<u>3 200</u>	<u>90 690</u>
Profit for the year			<u>23 390</u>

*Alternative calculation 1 200 ÷ 2 = 600

- (b) Revenue for the year is matched against the costs of the same period.
 Example:
 Either -- The loan interest was adjusted for the outstanding amount.
 Or -- The loss in value of non-current assets in the year was included.
 Or -- A provision for doubtful debts was created.
- (c) The business is treated as being separate from the owner.
 Example --
 Rates and insurance for personal use were excluded.
- (d) Should compare with a business in the same trade.
 Should compare with a business of approximately the same size.
 Should compare with a business of the same type (sole trader).
 The financial statements may be for one year, which will not show trends.
 The financial statements may be for one year which is not a typical year.
 The financial year may end on different dates (when inventories are high/low).
 The businesses may apply different accounting policies.
 The statements do not show non-monetary factors.
 It may not be possible to obtain all the information needed to make comparisons.

13 The accounts of a business are prepared on the basis that the business will continue to operate for the foreseeable future.

Which accounting principle is being applied?

A accruals (matching)

B consistency

C going concern

D realisation

Answer: C. *going concern*

14 Insurance prepaid, \$120, was treated as an accrual in the income statement.

Which effect did this have on the profit for the year?

A overstated \$120

B overstated \$240

C understated \$120

D understated \$240

Answer: D. *understated \$240*

