Depreciation

Depreciation:

Depreciation is the fall in value of fixed assets over its useful life. Assets are depreciated for a number of reasons e.g. wear and tear, obsolescence, passage of time etc. Depreciation is spread over the useful life of an asset by one of the following methods in order to match the cost of that asset to the revenue earned by it.

1). Straight Line Method:

The depreciation is a fixed charge every year calculated as a percentage of the original cost, as follows:

$$= \frac{\text{Cost of Asset - Scrap/Disposable Value}}{\text{No. of useful years}}$$

2). Reducing Balance Method:

Depreciation is calculated as a fixed percentage of the written down value of the asset at the beginning of the year.

3). Revaluation Method:

Used for assets for which detailed records cannot conveniently be maintained, e.g. Loose tools and other small items of equipments.

Formula:

	Value of asset at beginning of year	---
+	Additions during the year	---
-	Value of asset at end of year	(---)
	Depreciation for the year	---

Example:

2006 Jan 01	-	Opening Loose tools bal	= $5,000
	-	Loose tools bought during the year	= $10,000
2006 Dec 31	-	Closing Loose tools bal	= $4,000

Req: Calculate Depreciation of Loose Tools.

Control Accounts:

Uses of Control Accounts:

1). To act as an independent checks on the arithmetical accuracy of the aggregate of the balances in the sales & purchase Ledger.
2). To provide totals of debtors & creditors.
3). To identify the ledger or Ledgers in which errors have been made when there is a difference on a trial balance.
4). To act as an independent internal check on the work of the sales & purchase ledger clerks, to detect errors and deter fraud.

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⋆ Limitation of Control A/c control accounts may themselves contain errors. If a transaction is omitted from a book of prime entry, it will be omitted from the personal account in the sales or purchase ledger and from the control account. Both records will be wrong and the control account will not reveal the error. (And the same if wrong amount is entered in the books of original entry)

Control accounts do not guarantee the accuracy of individual ledger accounts, which may contain compensating errors, for example items posted to wrong accounts.

Difference between Receipts and Payments A/c and Income & Expenditure A/c

1). Receipts & payments A/c basically is a cash book which records all the cash inflows and outflows of a business for a particular period of time. While I & Exp. A/c is made for Non-profit making organization to find out their performance, whether there is a surplus of income over expenditure and vice versa.

2). Income & Expenditure A/c is made on accrual basis/(matching concept) while Receipts & Payments A/c is not maintained on this basis.

Stock Turnover:

Stock turnover means that how many times a business has sold out its stocks. If a business has greater stock turnover than other businesses, then it would mean that business is more efficient & its solvency/liquidity position is stable. Greater stock turnover means that a business is experiencing low ordering, storing & holding cost and business is selling off stock more quickly before it goes obsolete/outdated/out of fashion.

→ *Ways to improve stock turnover:*

⋆
- Promotional schemes
- Sales Promotional → e.g. gifts
- Competition
- Large Discounts etc.

Note:- Daily bought items have a very high stock turnover than other goods e.g. selling off-Machines etc.

Working Capital:

Working Capital is the difference between current assets & current liabilities

Working Capital = Current Assets – Current Liabilities

Working Capital & Financial Position:

1). Current Ratio $= \dfrac{\textit{Current Assets}}{\textit{Current Liabilities}}$

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Benchmark

Answer → should be 1.5 – 2 less than 1.5 means that business liquidity position is not satisfactory to pay-off business short-term debts.

More than 2 means that business liquidity position is satisfactory but a business has tied up too much current assets and these funds can be used for another area of the business to increase profits.

2). Acid-Test Ratio:

$$\text{Acid Test Ratio} = \frac{\textit{Current Assets} - \textit{Stock}}{\textit{Current Liabilities}}$$

Acid-Test Ratio gives amore clear picture about the liquidity position of a business because stock most of the time can not be converted into cash readily as current liabilities arise. So stock is excluded from the Current Assets.

Benchmark

Answer → should be 1 – 1.5 less than 1 means that a business can not repay its liabilities in full as they arise.

More than 1.5 means that liquidity position is stable but a business has tied up too much current assets and these funds can be used for some other area of the business to increase profits.

Note:- Stock Turnover Ratio is also included to find out the liquidity position of a business.

High Ratio → means → stable liquidity position & vice versa.

Fixed Assets:

Fixed Assets are valued at cost less depreciation → it means at NBV.

Stock:

Stock at cost or Net realizable value which-ever is less. (Prudence Concept)

Debtor:

Gross Debtors – Bad Debts – Provision for Bad Debts – Provision for Discount on Debtors (Prudence Concept)

Comparing Profitability ratio of two businesses

Gross Profit Margin:

If a business has a high gross profit margin it would be because of the following;

- ⋆ Selling Price is high & higher Sales
- ⋆ Less Cost of Sales → Large Discount on purchases etc. thus reducing the cost of goods bought and increasing his gross profit margin and vice versa for those businesses which have lower G.P. Margin.

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Net Profit Margin:

If a business has high N.P. Margin, it would be due to

- ⋆ Very high G.P. margin
- ⋆ Efficient controlling of its overheads.

And vice versa for those businesses which have lower N.P. Margin.

Return on Capital Employed:

High ROCE means a business is more efficient earning more profit against the investment & Capital employed in the business.

If Revenue Expenditure treated as Capital Exp.

Then	G.P.	→ No Change
	N.P.	→ Overstated
	Capital	→ Overstated
	Fixed Assets	→ Overstated

If Capital Expenditure Treated as Revenue

G.P.	→ No Change
N.P.	→ Understated
Fixed Assets	→ Understated
Capital	→ Understated

Working Capital	= Current Assets – Current Liabilities
Owner's Capital	= Total Assets – Total Liabilities
Capital Employed	= Net Assets or Owner's Capital + Loan

Ordinary Shares:

- Ordinary Shares are the actual Owners of the Co.
- Ordinary Shareholders are paid dividends after the preference shareholders have been paid.
- All reserves belong to the Ordinary Shareholders.
- If a Company is liquidated, then in the end ordinary shareholders are paid.

Preference Shares:

- Fixed rate of dividends is paid to the preference shareholders.
- Preference Shares can be redeemed by the Company.
- If a Company is liquidated, preference shareholders are firstly paid & then ordinary shareholders.

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Debentures:

- Debentures are long-term loan certificates.
- Debentures carry a fixed rate of interest.
- Debentures are usually re-payable more than after 10 years.
- If a Company is liquidated, Firstly debenture holders are paid their share & then preference & ordinary Shareholders.

Accounting Concepts:

1). *Historical Cost Convention:*

Assets and expenses are recorded in ledger accounts at the actual amounts expended on these items because this has the virtue of being objective that is beyond dispute.

2). *Business Entity:*

For accounting purposes, the business is treated as completely separate from the owner of the business. The accounting records are the records from the viewpoint of the business – the assets of the business, the money spent by the business, and so on. The owner's personal assets, the owner's personal spending etc. do not appear in the accounting records of the business.

3). *Going Concept:*

Accounting always assumes that the business will continue to operate for a foreseeable future or an indefinite period of time. The final accounts of a business are prepared on the basis that there is no intention to close down the business, or to reduce the size of the business by any significant amount. Applying this concept, the fixed assets of a business appear in the balance sheet at book value, that is, at cost less depreciation to date, and stock appears at the lower of the cost or not realizable value, which ever is less.

4). *Duality:*

In accounting, all entries are made on the basis that for every transaction there are two aspects – a giving and a receiving. For every outgoing there is a benefit received. The term double entry is used to describe how the dual aspect of all transactions is recorded.

5). *Money Measurement:*

Only transactions which can be expressed in money terms are recorded in ledger accounts. For example, a business can not record in money terms its highly motivated staff or workforce etc.

6). *Realization:*

Revenue should not be recorded in the accounts before it has been realized. A sale is deemed to take place when the goods which are the subject of the sale have been replaced by cash or a debtor for the sale. A promise by a potential buyer to purchase goods at a future date does not amount to a sale. Goods sent on sale or return remains the property of the seller until the consignee intimates, or does some act to imply, that he has accepted the goods.

7). *Consistency:*

In some areas of accounting, a choice of method is available, e.g. depreciation or valuing stock. The accounting method which is likely to give most realistic outcome should be selected. Once a certain method is chosen it should be applied consistently from year to year. Changing to a different method would lead to profits being distorted and would make comparison of the financial results of different years impossible.

8). *Matching/Accrual Concept:*

The purpose of this concept is to ensure that revenue, other income and expenses are recognized in the financial period in which they accrue or are incurred no matter when cash is being received or being paid, so that the real profit or loss made by a business of a particular period of time can be calculated. (Depreciation of Fixed Assets is also accounted for to generate revenue in a given accounting period).

9). *Prudence/Conservation:*

Prudence concept states that a business should anticipate its probable losses but not its probable incomes. So that profit should not be overstated and show a realistic state of the business.

Example:

(i) Provision for Bad Debts

(ii) Valuation of stock, that is at cost or net realizable value, which ever is less.

10). *Materiality:*

Business should record only those items which have some material significant value and ignore insignificant ones and should write off.

Example:

A firm buys a dust bin which has a useful life more than one year so a business should write off this as an expense and should not treat it as fixed asset.

Payroll:

Methods of Remuneration

1. Time Rate: workers are paid an hourly or weekly rate.

Advantages;

- Workers are guaranteed a fixed wage each week provided they work the agreed hours.
- The method is uncomplicated and easy for the workers to understand.
- The wages ate easy to calculate.
- The method can be applied to all workers.
- Quality of work is not sacrificed as a consequence of attempts to increase earnings.

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2. Piece Rate: workers are paid an agreed amount for every completed unit of production, e.g. if they complete one unit, they are paid $1;if they complete 5 units, they are paid $5 and so on.

Advantages:

- Wages are proportionate to production.
- Wages are easy to calculate.
- The system encourages greater efficiency.
- The work is completed more quickly and time wasting is discouraged.

Bonus scheme:

Various schemes allow for rewarding individual workers whose efficiency is above that normally expected. The amount of the bonus increases with increased efficiency. Strict control must be exercised over production to ensure that the quality of the work does not suffer in an attempt to increase the bonus.

Payroll records: (Basic records)

Clock cards: clock cards are used for time rate workers. Clocking –in and out should be controlled to prevent 'clocking on' for late or absent workers.

Job cards: job cards are used for piece workers. These must be initialed by the foreman or manager as verification that the entries for work satisfactorily completed are correct.

Summaries

Details from the basic records should be copied onto summary sheets and the gross wages calculated and independently checked.

Payroll sheets;

The gross wages should be copied onto the payroll sheets and the deductions for tax etc. and net pay calculated. The calculations should be independently checked.

Accounting Basics

May 1994 Question # 2

Fill in the blanks:

(a) The purchase of a fixed asset is <u>Capital</u> Expenditure.

(b) Debentures earn a fixed rate of <u>Interest</u>.

(c) Preference Shareholders earn a fixed rate of <u>Dividend</u>.

(d) A debit balance on the sole trader capital account is meant that the business is <u>insolvent</u>.

(e) The issued capital of a company cannot exceed the <u>Authorized Capital</u>.

(f) Subscriptions in advance form club members are shown as <u>Current Liabilities</u> in the balance sheet.

(g) If closing stock is undervalued, net profit will be <u>under valued</u>.

(h) The value of the good reputation and profitability of a business is known as <u>Goodwill</u>.

(i) Working Capital is found by deducting current liability from current assets.

(j) Cash discount is an allowance for early payments.

(k) If a customer has been undercharged, he may be sent a debit note for the additional amount instead of the amended invoice.

November 1995 Question # 4

(a) Explain how the amounts of the following items are calculated:

(i) Working Capital (ii) Owners Capital

(iii) Capital Employed.

(i) *Working Capital:*

It is calculated by subtracting the total of current liability from the total of current assets.

Formula:

Working capital = Current Assets – Current Liabilities

(ii) *Owners Capital:*

It is calculated by deducting total liabilities (current and long term liability) from total assets (Current & Fixed)

Formula:

Owner’s Capital = Total Assets – Total liabilities

(iii) *Capital Employed:*

It can be calculated in two ways.

1. By adding Long term liabilities and owners capital

Formula:

Capital Employed = Owner’s Capital + Loan (long term liability)

2. By adding fixed assets and working capital.

Formula:

Capital Employed = Net Assets (Fixed Assets + Working Capital)

November 1995 Question 7

(a) Fill in the blanks:

(i) The purchase of a current asset is revenue expenditure.

(ii) The proprietor’s account is always called the capital account.

(iii) Stock is usually valued at cost price or replacement price or net realizable value which ever is the lowest.

(iv) A bank overdraft will be indicated by a credit balance in the bank account in the cash book.

(v) Two reasons why the bank statement credit balance may be larger than that in the cash book are direct credit & unpresented cheques.

May 1997 Question # 7

(b) Annie Sim needs to buy a new machine costing $12,000 but does not wish to increase the bank overdraft. Describe two ways she might be able to obtain the required cash from her business assets.

Ans. She can arrange the amount by either obtaining a long term loan from the bank against her premises (collateral security). Moreover the amount can be obtained by disposing off stocks at reduced rate. Another option is to obtain trade credit or negotiate with the creditors to increase the average credit period.

(c) Suggest three reasons why the bank balance is overdrawn although the net profit for the year is $12,000. Assume that there has been no fraud or dishonesty.

Ans. Firstly, a business has bought too many fixed at once for cash. Secondly, a business is buying stock for cash and selling it on credit. Thirdly, the owner of the business has made a high level of cash drawings.

May 1998 Question # 2

(a) Explain how the amounts of the following items are calculated:

(i) Working Capital (ii) Owners Capital
(iii)Capital Employed. (iv) Authorized Share Capital
(v) Loan Capital

(i) *Working Capital:*

It is the amount that the business uses to meet its day to day expenses.

Formula:

Working capital = Current Assets – Current Liabilities

(ii) *Owners Capital:*

The total amount invested by the owner within the business is called owners capital.

Formula:

Owner's Capital = Total Assets – Total liabilities

(iii) *Capital Employed:*

This represents the funds that have been invested on long term basis with in the business by both means i.e. from the owner and from outside of the business (loan).

Formula:

Capital Employed= Owner's capital + Loan

Capital Employed = Net Assets (Fixed Assets + Working Capital)

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(iv) *Authorized Capital:*

It represents the total value of shares which a company can legally issue or sell to the public.

(v) *Loan Capital:*

It is the term used to represent long term loans either from bank or by issuance of debentures etc.

(c) Explain the importance of working capital to a business.

Ans. Working Capital represents liquidity position of the business. And adequate amount of working capital is necessary for survival of any organization to meet its day to day expenses. If a business does not have sufficient working capital then its creditors may force to sell its fixed assets to settle their claims thus liquidation of the business may come to place.

November 1998 Q # 2

(b) Explain briefly the difference between capital & revenue expenditure. (3)

Ans. Capital expenditures are all those expenditures which benefits the business for more than one year whereas the revenue expenditure are all those expenses which account for the day to day running of the business. Capital expenditures are recorded as fixed assets whereas revenue expenditures are regards as expenses in profit & loss account.

May 2004 Q # 2

(a) Explain how one should value the following:

(i) Fixed Assets
(ii) Stock
(iii) Trade Debtors

Ans. (i) *Fixed Assets:*

They should be valued at net book value i.e. cost (purchase price) less total depreciation to date.

(ii) *Stock:*

They should be valued at cost or net realizable value which ever is lower where as net realizable value means estimated selling price less all expenses to be incurred to bring the stock into a saleable position.

(iii) *Trade debtors:*

Debtors should be valued at net realizable value the amount which business expects to realize from debtors) i.e. after deducting all bad debts, provision for doubtful debts and provision for discount allowed.

May 1997 Question # 3

(ii) State and explain two reasons why the depreciation of fixed assets should be provided for in business accounts.

Ans. 1). Spread the cost of fixed assets over their lives.

2). Match current year's expenses against current years revenue (for which they were incurred). This is called matching concept.

(b). (i) State and explain 2 methods of depreciation.

Ans. 1). <u>*Reducing balance Method:*</u>

This method assures that the asset is used up more in the first years of its life than the next year and so on. It is calculated by applying a fixed percentage to the reduced value of the asset i.e. (NBV) Net Book Value at the start of the year.

2). <u>*Straight line method:*</u>

It assures that the asset is used evenly every year throughout its expected life. It is calculated or the amount that is calculated remains the same throughout each year.

Formula:

$$= \frac{\text{Cost - Scrap / Disposable Value}}{\text{Estimated useful life of the asset (years)}}$$

(c) State one advantage of each of the method.

(i) <u>*Reducing Balance Method:*</u>

Reducing Balance Method is a useful way of calculating depreciation on assets, which operate faster, produce more and perform more accurately when they are new.

(ii) <u>*Straight Line Method:*</u>

This is useful for those assets which provide equal benefits to the business for each year of their lives.

May 2000 Q # 1

b). Explain why depreciation is important to be recorded in the business accounts.

Ans. It is important to record it as the fixed assets which are bought gradually lose their value as time passes so in order to know the current value of the asset and how much the asset has worn out depreciation is calculated and to apply the matching and prudence concept.

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May 2004 Q # 4

a). Explain Revaluation.

Ans. Revaluation is used for those tools which are loose and are quite a lot of in quantity but none the less of lasting value. Thus it is a method to calculate depreciation for such tools.

Formula:

Depreciation of Loose tools = Loose tools at the start of the year + Purchases of loose during the year – Closing stock of Loose tools.

Bad and Doubtful Debts

May 2002 Question # 3

Q. Identify and explain two concepts used when setting a provision for doubtful debts.

Ans. Prudence that the business should be pessimistic while recording its debtors balances and should make account of all the probable losses on the amount due by his debtors.

Where as matching concept emphasis that all expenses incurred should be matched with the income of the relevant period. So doubtful debts relating to the current year sales and likely to be confirmed in next year are matched against current year's income.

Correction of Errors

May 1995

7. b) Name or describe three types of errors, which do not affect the balancing of the trial balance.

A: The three types of errors which do not affect the trial balance are;

Firstly, error of principle occurs when a transaction is posted to a wrong account which is not of the same type as the correct account e.g. capital expenditure item is recorded as revenue capital item, vice-e-versa, they then do not affect the trial balance.

Secondly, error of omission arises when an entry is entirely ignored and hence it is not recorded.

Lastly, error of original entry is when both credit or debit transactions are entered correctly but the amounts are incorrect.

November 1999

7. a). State and explain the purpose of preparing a trial balance.

b). State three different types of errors which a trial balance will not reveal.

c). Explain, with examples, three errors of book keeping which could cause to disagree.

A. a). The whole basis of double-entry book keeping is a system of a debit and credit entries of equal amounts. When we prepare a trial balance, obviously the credit and debit balances should be equal. Hence, the purpose of a trial balance is to check the arithmetical accuracy of the book keeping records. If the debit and credit totals are equal it thus means that our book keeping records are correct. The trial balance is then used to draw up the final accounts of the trader.

b). It is mentioned in May 1995 Q. 7 b).

c). The errors which would affect the trial balance are:

Firstly, for example, if Michael's account had been debited by 239 but in the sales journal it was 329. This would cause an unbalanced trial balance.

Secondly, an error in addition, for example, discount allowed column in the cash book had been wrongly overcastted by $300.

Lastly, if the opening balance is posted on the wrong side, for example, the opening balance of electricity accrual has been brought forward on the wrong side (debit) of the ledger account.

Control Accounts

November 1994

4. b) (i) State and describe the method used by firms to check arithmetically that the totals of debtors and creditors ledger balances are correct.

(ii) Give the sources of numerical information which is used for this purpose.

4. b). (i) A control account is so called because it controls a section of the ledger. By control is meant that the balance on the control account should equal the total of the balances in the section of the ledger it is controlling. A sales ledger control account controls the sales ledger; a purchase ledger control account controls the purchase ledger. If there is a difference on the trial balance, the control accounts will show whether or not any of the difference is in the sales or purchase ledger accounts. If the control accounts agree with the balances on the sales and purchase ledgers, the difference must lie in the nominal or general ledger.

(ii) They are sales journal, purchase journal, return inwards journal, Return outwards journal, cash book and general journal.

May 1997

4. d). State tow advantages of keeping control accounts.

A. Control accounts allow any errors in the purchase and sales ledger account to be detected and rectified by the purchase control ledgers and sales control ledgers.
Secondly, it provides quick debtors and creditors balances when preparing the trial balance. Control accounts are also made to deter fraud and are also used to find out credit sales and credit purchases.

May 2005

3. b). Explain two ways in which control accounts can be used by Mary Goswing in her business.
c). Suggest two limitations to the usefulness of control accounts in Mary Goswing's approach to record keeping.

A. b). Firstly, it allows the owner to keep a check on the arithmetical accuracy of the total sales and purchase ledger balances.
Secondly, they allow quick balances, which can be easily found.
c). control accounts may themselves contain errors. If a transaction is omitted from a book of prime entry, it will be omitted from the personal account in the sales or purchase ledger and from the control account. Both records will be wrong and the control account will not reveal the error. (And the same if wrong amount is entered in the books of original entry)
Control accounts do not guarantee the accuracy of individual ledger accounts, which may contain compensating errors, for example items posted to wrong accounts.

Accounts from incomplete records

November 1994

5. b) (i) What is the usual basis for the stock valuation that is included in the year-end final account?
(ii) Explain the reason for choosing this basis.

A. c) (i) Stock is valued at lower of cost or net realizable value which ever is less.
(ii) This is done under the prudence concept. It sates that accountants should provide all probable losses which are likely to arise in the near future. As the stock is to be sold in the next year and if its net realizable value is less than its original value then the accountant mentions this loss by showing stock at lower value.

November 1996

1. c). (ii) Explain how Mr. Mashoko could use this information.

A. Stock turnover tells that how many times the stock has been turned to sales during the year. It allows the owner to compare his business with others. A faster rate of stock turn means that the business is more successful as less money is tied up in stocks.

November 1996

6. c). List four books of account that a business person should keep.

A. Sales journal to record the sales transactions. (Only Credit)
Purchase journal to record the purchase transactions. (Only Credit)
Returns in journal to record the sales returns. (Only Credit)
Returns out journal to record the purchase returns. (Only Credit)

November 1998

3 b). Owners need to check the progress of their business from year to year. State the ways in which a trading and profit and loss account drawn up from full double entry records gives the information about a business which the owner needs.

A. A trading and profit and loss account shows the profitability and financial performance of the business. Not only the owner views his yearly profit and loss, but he can also compare them with the previous years. It also gives the information to the owner about sales revenue, direct and indirect expenses and the profits obtained. Finally, the gross profit and net profit can take crucial role for future planning and important decisions.

Company Accounts

Ch-14 November 1998 Question # 6 b).

6. b). Ordinary shares are different form debentures. Describe two features of each.(6)

Ans. 6. b). Ordinary shares represent ownership of the company. While debentures are long-term loans for the company / business.

Ordinary Shares have voting rights in decisions to elect board of directors in the annual general meeting or regarding the management of the business. Debenture holders have no such type of privilege.

Ordinary shareholders are paid dividends with varying / changing rates which depend on the profits and policies of the company. Whereas, debenture holders are paid interest at a fixed rate, whether the company has made a profit or not.

Ch-14 May 1999 Question # 3 b).

3. b). Describe three features of each of the following different types of capital. (18)

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(i). Ordinary Shares (6)
(ii). Preference Shares (6)
(iii). Debentures (6)

Ans. (i). All Companies must have ordinary share capital and generally the ordinary shares comprise of most of the company's capital. Their prominent features include.

1. Ordinary share holders carry voting rights and are the owners of the company.
2. The ordinary share holders have no right to a fixed dividend but receive left over profits after the preference shareholders have been paid. The leftover profit after the ordinary shareholders have been paid is called retained profit.
3. When a company faces liquidation or bankruptcy, the ordinary shareholders are entitled to the whole of the company's assets; after all of the liabilities of the company and the preference shareholders have been paid their due amount.

Ans. (ii) There are different types of preference shares, the characteristics of which may vary from each other. However, the common features include.

1. Preference shares are entitled to a fixed rate of dividend each year before any dividend is paid on ordinary shares.
2. Preference shareholders don't have voting rights at shareholders meetings called (AGM) annual general meeting.
3. When a company is faced with bankruptcy or liquidation they are paid before ordinary shareholders are paid.

Ans. (iii)
1. Debenture holders are creditors or lenders not the owners of the company.
2. They get a fixed rate of interest whether a company makes a profit or loss.
3. When a company is wound up i.e. if it goes bankrupt, debenture holders are entitled to repayment of their debentures in preference to preference shareholders and ordinary shareholders.

Ch-14 November 2005 Question # 3

3. a). Explain what is meant by authorized share capital. (2)

Ans. Authorized share capital means maximum amount of capital which a company is authorized or allowed to issue.

3. b). Explain what is meant by issued share capital. (2)

Ans. Issued share capital represents part of the authorized share capital which a company issues to the general public for raising finance.

3. c). State one similarity and one difference between preference shares and debentures. (4)

Ans. *Similarity:* Preference shareholders are paid dividends at a fixed rate whereas debenture holders are also paid interest at a fixed rate.

Difference: Debenture holders are paid interest irrespective of the profit or loss made by the business or company. But payment of preference dividend is dependent on the profits made by the business.

Partnership

November 1999 Question # 4

(b). A person often has to pay for goodwill when admitted as a partner or when taking over a business state what factors are taking over a business state what factors are taking into account when goodwill is determined.Ans. Goodwill is regarded as an Intangible Fixed Asset that enables a business to earn more profit due to its good reputation.

The following factors contribute to goodwill:

(a). Strategic managerial staff.
(b). Experienced managerial staff.
(c). Reputation of products.
(d). Good Reputation with suppliers.
(e). Effective advertisement.
(f). Market dominance.

If there is no partnership agreement then there partnership act 1890 applies. According to this act, each partner would contribute equal amount of capital, profit and losses would be shared equally, there would be no interest on drawings, interest on capital and no partners' salaries. If a partner has given loan to its business then he is only entitled to get 5% interest on loan.

Manufacturing A/c

May 1998 Question # 3

(b). Why is cost of production important.

Ans. It is important in order to calculate how much amount is spent on the production of good. So that per unit cost can be found and selling price can be set. Another reason is that in order to compare the cost of production of goods in the previous year with the present year.

May 2005 Question # 4

(b). Explain the difference between direct costs and indirect cost.

Ans. Direct costs are included in the prime cost whereas indirect costs are included in the factory overheads. Direct costs are directly related to production whereas indirect are the classified as factory overheads or revenue expenses.

Interpretation of Accounts

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May 1995 Question # 4

(a). (ii) Give two examples of problems that a business may have if there is not enough working capital.

Ans. Firstly, the business would face a big problem in order to meet its day to day expenses. Secondly, it would not be able to pay back its liabilities when they are due.

(iii) Describe two ways to increase the working capital for a sole trader.

Ans. He can increase it by firstly reducing the period of credit allowed to its debtors. Moreover it can increase it by borrowing a long term loan for the business. He can also sell some of his idle fixed assets to solve his working capital problem.

November 2000 Question # 1

(b). Explain what is meant by a firm liquidity.

Ans. Liquidity is a position of a firm that states its ability to pay back its current liabilities when they are due. The more liquid the assets the better the liquidity position is of the firm. The current assets are said to be liquid when they can be converted into cash easily and quickly without a major loss in their value.

(c). State 3 disadvantages of having a less working capital.

Ans. (i) The business is unable to pay its short term debts when they are due.

(ii) Inability to take advantage of cash discount.

(iii) May not be able meet its sales requirement due to less stock.

November 2000 Question # 3

(c). Suggest two actions which a firm might do to improve its profitability.

Ans. He could sell his goods at comparative lower prices than its competitors to increase its turnover and profit. Moreover gaining its stock at cheaper rates would reduce the cost of goods sold and increase its profit. Moreover he may launch some promotional schemes to increase his profitability.

November 2001 Question # 4

(i) Explain 2 ways one could obtain the required cash to buy additional machinery from her business without increasing the bank over draft and yet still carrying the production process.

Ans. (i) They can sell the stock quickly at reduced rates to increase their turnover and in turn buy a machine.

(ii) Moreover a further investment in the form of a capital is useful step to buy the additional machinery.

November 2002 Q # 2

(b) (i) Explain two possible reasons for the fall in the rate of stock turn.

Ans. (i) Too much average stock piled up throughout the year and demand for the product has fallen.

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(ii) Too much cost of goods sold bear by the business resulting high prices and low sales.

(ii) Two reasons why a firm should calculate rate of stock turn every year.

Ans. Firstly to compare its cost of goods sold with previous year, whether a change in it has benefited to firm or not.

Secondly, to check the management problems such as over stocking or lack of trading in the financial year.

(iii) Two ways to increase rate of stock turn.

Ans. (i) By reducing the average stock held throughout the year by launching promotional schemes.

(ii) By reducing the cost of goods sold (by purchasing in bulk and getting large trade discounts) thus lower prices will be set and there will be more sales.

November 2004 Question # 4

(c). Identify two problems a business may face if its current liabilities are greater than its current assets. Suggest a solution for the problem too.

Ans. (i) A current liability surplus could cause the business to be insolvent at times i.e. to unable to pay back the debts when they are due. The solution is to get bank loan or sell some idle fixed assets.

(ii) The reputation loss that the firm would suffer through its potential investors who would hesitate to invest in the business. The investment of more capital by the firms' owner could be a solution to this problem as it would provide some sort of confidence to those potential investors.

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