

Preparation of financial statements AS

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Read first: [The accounting system](#), [Accounting for non-current assets](#), [Types of business entity](#)

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What you need to know

By the end of this topic you should be able to:

1. **Adjust draft figures** and show the effect on the financial statements for: accruals and prepayments of expenses **and** income; irrecoverable debts, debts recovered and the allowance for irrecoverable debts; depreciation; inventory valuation; and the correction of errors.
2. **Prepare a sole trader's statement of profit or loss and statement of financial position** from full records or from incomplete records, for a trading business or a service business.
3. **Prepare a partnership's statement of profit or loss, appropriation account and statement of financial position**, again from full or incomplete records, trading or service.
4. **Explain why partners keep separate capital and current accounts**, and prepare both.
5. **State what a partnership agreement contains**, and its advantages and disadvantages to the partners.
6. **Apply the Partnership Act 1890** when there is no agreement: salaries, sharing profit or loss, interest on partners' loans, interest on capital and interest on drawings.
7. **Describe and account for a company's ordinary shares, bonus issues, rights issues, debentures, dividends and reserves**. Preference shares are not examined.
8. **Give the advantages and disadvantages**, to the company and to its shareholders, of a bonus issue, a rights issue, and of issuing shares compared with debentures.
9. **Distinguish capital reserves** (share premium, revaluation reserve) **from revenue reserves** (retained earnings, general reserve).
10. **Prepare ledger accounts** for an issue of ordinary shares at par or at a premium, a rights issue and a bonus issue (the revaluation reserve is never used for a bonus issue).
11. **Prepare a company's statement of profit or loss, statement of financial position and statement of changes in equity**, trading or service.
12. **Choose sources of finance** suited to a purpose, and use all of this to judge information and advise owners and directors.

Partnership admission, retirement, goodwill and dissolution appeared in 2021–2022 papers but are not in the 2026–2028 syllabus, so they are left out. Depreciation methods are covered fully in "Accounting for non-current assets"; here they are one adjustment among many.

Understand it

Why adjust the trial balance?

A trial balance shows what was **recorded** during the year: cash paid, invoices entered. Profit must show the income **earned** and the expenses **used up** in the year, whenever the cash moved. This is the **accruals (matching) concept**. **Prudence** adds that assets and profit should not be overstated. Every adjustment below comes from one of these ideas. When a question asks which concept an adjustment applies, match it like this:

Adjustment	Concept
Accruals and prepayments; depreciation over the asset's life	Matching (accruals): costs and income belong to the year they relate to
Allowance for irrecoverable debts; damaged inventory at net realisable value	Prudence: don't overstate assets or profit
Goods taken for own use recorded as drawings	Business entity: the owner's private affairs are kept apart from the business
The same depreciation method and rate every year	Consistency: results can be compared from year to year
Revenue recorded only when goods are delivered or invoiced	Realisation

Accruals and prepayments. An expense owing at the year end (an **accrual**) is added to the expense and shown as a current liability ("other payables"). An expense paid in advance (a **prepayment**) is taken off the expense and shown as a current asset ("other receivables"). Income works the other way: income owing to the business (**accrued income**) is a current asset; income received in advance is a current liability.

For example, rent paid in the year was \$11 000, with \$1000 owing at the start and \$1500 owing at the end. The payments include last year's \$1000, so take it off, and add this year's \$1500 not yet paid: the rent expense is $11\,000 - 1000 + 1500 = 11\,500$. An insurance premium of \$4800 paid on 1 October for twelve months, with a 31 December year end, gives an expense of $\frac{3}{12} \times 4800 = 1200$ and a prepayment of \$3600.

Irrecoverable debts. A debt that will never be paid is written off: Dr irrecoverable debts (an expense), Cr the customer. If it is paid later, it is **irrecoverable debts recovered**, which is income. Some other debts may not be paid, so a prudent business keeps an **allowance for irrecoverable debts**, usually a percentage of the receivables **left after** the write-offs. Only the **change** in the allowance goes through the statement of profit or loss: an increase is an expense, a decrease is income. In the statement of financial position, trade receivables are shown **net** of the allowance.

For example, receivables are \$30 000 before writing off \$800, and the allowance is to be 5% (it was \$1300). New allowance = $5\% \times 29\,200 = 1460$, an increase of \$160 (an expense). The statement of financial position shows receivables of $29\,200 - 1460 = 27\,740$.

Depreciation spreads the cost of a non-current asset over its useful life (straight-line: a fixed amount each year; reducing balance: a fixed percentage of the carrying value). If you are given a carrying value **after** a reducing-balance charge at rate r , the value before the charge was carrying value $\div (1 - r)$. For example, \$170 000 after a 15% charge was \$200 000 before; if the rate should have been 20%, the charge is \$40 000, not \$30 000, and profit falls by \$10 000.

Inventory is valued at the **lower of cost and net realisable value (NRV)**, item by item. Cost includes the purchase price and carriage inwards, not selling costs. NRV is the selling price less any costs still needed to sell it (such as repairs). An item that cost \$900 and will sell for \$1000 after \$250 of repairs has NRV \$750, so it is valued at \$750. Damaged goods that can't be sold are valued at nil.

Goods taken for own use are drawings, recorded **at cost**: Dr drawings, Cr purchases. Purchases fall, so cost of sales falls and **profit rises**. Goods with a selling price of \$600 and a mark-up of 20% cost $600 \div 1.2 = 500$.

The formats

Sole trader and partnership: statement of profit or loss

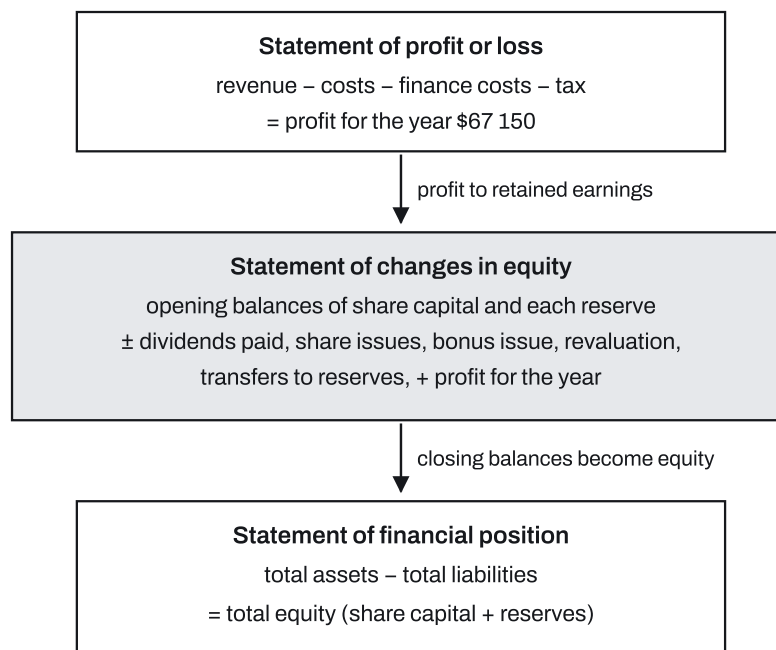
	\$	\$
Revenue (less sales returns)		X
Less cost of sales: opening inventory	X	
add purchases (less purchases returns, less goods for own use)	X	
add carriage inwards	X	
less closing inventory	(X)	(X)
Gross profit		X
Add other income (discounts received, rent received, profit on disposal, decrease in allowance)		X
Less expenses (wages, rent, depreciation, irrecoverable debts, carriage outwards, discounts allowed, loan interest ...)		(X)
Profit (or loss) for the year		X

A **service business** (cleaning, consulting) has no inventory or cost of sales: it lists fee income, adds other income and takes off expenses. There is no gross profit.

Company: statement of profit or loss. Revenue, cost of sales, **gross profit**, other income, **distribution costs** (selling and delivery: sales staff, advertising, delivery vans and their depreciation, carriage outwards), **administrative expenses** (office staff, directors, office rent, irrecoverable debts, office equipment depreciation), **profit from operations**, **finance costs** (debenture and loan interest), profit before tax, **tax**, **profit for the year**. Expenses shared between the two headings are split in the percentages the question gives. **Dividends never appear here**: they are a share of profit, shown in the statement of changes in equity.

Statement of financial position. Non-current assets (at carrying value), current assets (inventory, trade receivables less allowance, other receivables, bank), **total assets**. Then capital or equity, **non-current liabilities** (loans and debentures due after more than a year) and **current liabilities** (trade payables, other payables, tax, bank overdraft, and any loan or debenture due within 12 months), **total equity and liabilities**. The two totals must agree.

- Sole trader: capital at start + capital introduced + profit – drawings.
- Partnership: capital accounts and current accounts, a column for each partner and a total; a debit current account balance is shown in brackets and subtracted. A loan from a partner is a liability, not capital.
- Company: share capital, share premium, revaluation reserve, general reserve, retained earnings, **total equity**.



Incomplete records

Many small traders keep only a bank account and a box of invoices. You rebuild the missing figures from what is known.

- **Statement of affairs:** a list of assets and liabilities at a date. Capital = assets – liabilities.
- **Profit from the change in net assets:** capital grows by profit and capital introduced, and falls by drawings, so profit = closing capital – opening capital + drawings – capital introduced. For example, capital went from \$45 000 to \$52 000, drawings were \$18 000 and \$5000 was introduced: profit = 52 000 – 45 000 + 18 000 – 5000 = 20 000.
- **Credit sales** from a total trade receivables account: receipts from customers + discounts allowed + irrecoverable debts + closing receivables – opening receivables.
- **Credit purchases** from a total trade payables account: payments to suppliers + discounts received + closing payables – opening payables.

- **Cash sales** that were not all banked: amount banked + cash spent before banking (cash drawings, wages paid in cash).
- **Mark-up and margin** turn one trading figure into another.

		Gross profit
Cost of sales \$100		\$25
Selling price (revenue) \$125		

Mark-up = gross profit ÷ cost = $25 \div 100 = 25\%$

Margin = gross profit ÷ selling price = $25 \div 125 = 20\%$

Mark-up is gross profit as a percentage of **cost**; **margin** is gross profit as a percentage of **selling price**. The same \$25 profit is a 25% mark-up but a 20% margin. With a 25% mark-up, cost of sales = revenue ÷ 1.25; with a 20% margin, cost of sales = revenue × 0.8. Mixing them up is the most common error in these questions.

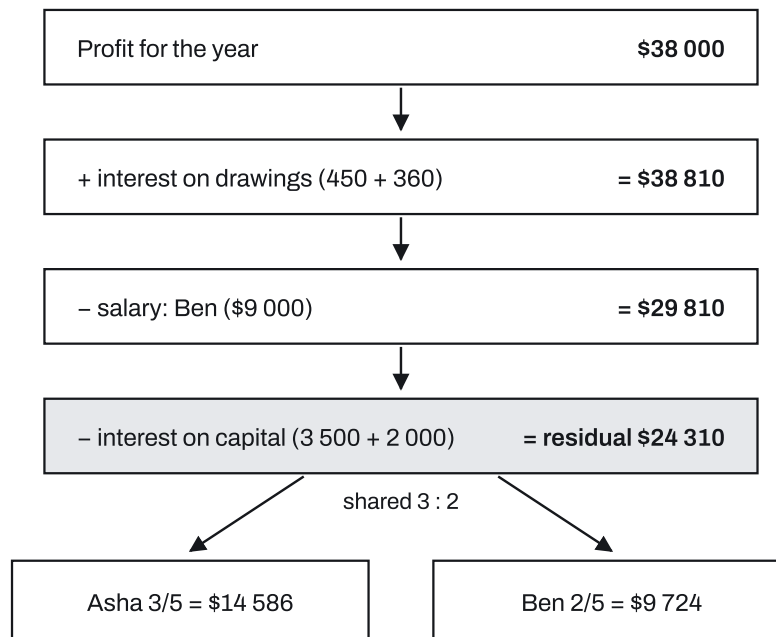
Partnerships

Why separate capital and current accounts? The **capital account** holds the long-term amount each partner agreed to invest; it stays fixed unless a partner adds or withdraws capital, and interest on capital is based on it. The **current account** records the year-to-year items: salary, interest on capital, share of profit (credits), drawings, goods taken and interest on drawings (debits). Keeping them apart shows at a glance how much each partner has invested and whether a partner has drawn more than they earned (a **debit** current account balance).

Partnership agreement. It usually sets out: the capital each partner contributes; the profit-sharing ratio; interest on capital and its rate; salaries; interest on drawings; interest on partners' loans; limits on drawings; each partner's duties; and how disputes, a new partner or a partner leaving are handled. Advantages: everyone knows the rules, so disputes are fewer and easier to settle, and rewards can match each partner's work and capital. Disadvantages: legal costs and time to draw it up, and it must be formally changed when circumstances change.

The Partnership Act 1890 applies where there is no agreement (or the agreement is silent): profits and losses are shared **equally**; **no** salaries; **no** interest on capital; **no** interest on drawings; partners' loans earn interest at **5% per annum**.

The appropriation account shares out the profit for the year. Interest on a partner's **loan** is not part of it: it is an **expense** in the statement of profit or loss, like interest on a bank loan, so it is taken off **before** the profit for the year.



Credited to current accounts: salary, interest on capital, share
 Debited to current accounts: interest on drawings

Interest on drawings is **added** (the partners pay it to the business); salaries and interest on capital are **deducted**; what is left, the **residual profit** (or loss), is shared in the profit-sharing ratio. Each item then goes to the partner's current account: Dr appropriation, Cr current account for salary, interest on capital and share of profit; Dr current account, Cr appropriation for interest on drawings. A partner's reason for charging interest on drawings is to discourage drawings and to reward the partners who draw least; interest on capital rewards the partners who invest most.

Limited companies

Ordinary shares give part-ownership of the company, votes at general meetings and a dividend the directors choose to pay (it can be nil). Share capital is permanent: it isn't repaid while the company exists, and shareholders are paid last if it is wound up. Each share has a **nominal (par) value**, such as \$1 or \$0.50; number of shares = share capital ÷ nominal value.

Debentures are long-term loans to the company, often secured on its assets. Holders are creditors, not owners: no votes, a fixed **interest** that must be paid whether or not there is a profit (an expense, in finance costs), and repayment on a set date. "8% debentures (2030)" pays 8% a year and is repaid in 2030; in the year it is due it becomes a current liability.

Dividends. An **interim** dividend is paid during the year; a **final** dividend is proposed at the year end, approved by the shareholders and paid next year. Only dividends **paid** in the year are recorded (in the statement of changes in equity); a proposed dividend is not a liability and is not recorded. Dividend = amount per share × shares in issue **on the date of payment**, or a percentage × nominal share capital. Before deciding a dividend, directors consider the profits available for distribution, the cash available, shareholders' expectations and the company's future plans for its funds.

Reserves belong to the shareholders.

Capital reserves	Revenue reserves
Share premium: the amount above nominal value received for shares	Retained earnings: profits kept in the business
Revaluation reserve: the gain when non-current assets are revalued upwards	General reserve: profits transferred from retained earnings for general use
Arise from capital transactions, not trading	Arise from trading profits
Cannot be used to pay dividends	Can be used to pay dividends

Share premium can be used for a bonus issue; the revaluation reserve cannot. So the maximum dividend is the total of the revenue reserves (if there is the cash), and the maximum bonus issue is all reserves except the revaluation reserve.

Share issues and their ledger entries.

- **Issue at par or at a premium** for cash: Dr bank (all the cash), Cr share capital (nominal value), Cr share premium (the rest). 100 000 shares of \$0.50 issued at \$0.80: Dr bank \$80 000, Cr share capital \$50 000, Cr share premium \$30 000.
- **Rights issue**: new shares offered to existing shareholders in proportion to their holding ("1 for 4"), usually below market price. The entries are the same as any issue for cash. Shareholders who take up their rights keep the same share of control.
- **Bonus issue**: free shares made from reserves; **no cash** moves. Dr the reserve, Cr share capital. To keep reserves "in their most flexible form", use capital reserves (share premium) first, then revenue reserves (retained earnings), because revenue reserves can pay dividends and share premium cannot. For 800 000 shares of \$1 with a 1-for-4 bonus issue: 200 000 new shares, \$200 000; with share premium of \$150 000, Dr share premium \$150 000, Dr retained earnings \$50 000, Cr share capital \$200 000.
- **Revaluation**: an increase is Dr the asset, Cr revaluation reserve. A decrease first uses up any revaluation reserve on that asset; the rest reduces retained earnings. With a reserve of \$30 000 and a fall of \$42 000, the reserve goes to nil and retained earnings fall \$12 000.
- **Dividend paid**: Dr retained earnings, Cr bank. **Transfer to general reserve**: Dr retained earnings, Cr general reserve. **Profit for the year**: Cr retained earnings.

Advantages and disadvantages.

	To the company	To the shareholders
Bonus issue	+ no cash needed; reserves become permanent capital, which reassures lenders; a lower share price makes shares easier to trade. – fewer distributable reserves; costs of the issue; shareholders may expect the same dividend per share on more shares	+ more shares at no cost, which can be sold; control unchanged. – no real gain: the company is worth the same, so each share is worth less; less left for dividends

	To the company	To the shareholders
Rights issue	+ raises cash; cheaper and quicker than a public issue; permanent; no interest; control stays with existing shareholders. – may not be fully subscribed; shares sold below market price; more shares to pay dividends on	+ cheap shares; keep their share of control. – they need cash to take it up; if they don't, their share of control falls (they can sell the rights)
Shares v debentures	Shares: + permanent, dividends optional, no security needed, gearing falls. – control diluted (unless a rights issue), issue costs, shareholders expect dividends. Debentures: + no votes so control unchanged, fixed interest is easy to budget. – interest must be paid and cuts profit, must be repaid, gearing rises, may need security	Shares: votes and dividends, but dividends can be nil and they are paid last. Debentures: fixed interest and security, but no say in the company

Sources of finance for a purpose. Match the finance to how long the need lasts. Long-term needs (premises, machinery, repaying a debenture): share issues, debentures, long-term bank loans, a mortgage, leasing, or for a sole trader or partnership more capital from the owner or a new partner. Short-term needs (working capital, a cash shortage): a bank overdraft, trade credit, reducing inventory, collecting debts faster, selling unused assets. Retained profits are free of cost but may not be enough.

Key facts and formulas

There is no formula list in the 9706 exam, so learn all of these.

Formula	Status
Expense for the year = paid – opening accrual + closing accrual + opening prepayment – closing prepayment	Learn it
Income for the year = received – opening accrued income + closing accrued income + opening income in advance – closing income in advance	Learn it
Allowance = rate × (receivables – irrecoverable debts written off); only the change goes to profit	Learn it
Inventory = lower of cost and NRV, item by item; NRV = selling price – costs to complete and sell	Learn it
Capital = assets – liabilities	Learn it
Profit = closing capital – opening capital + drawings – capital introduced	Learn it
Credit sales = receipts + discounts allowed + irrecoverable debts + closing receivables – opening receivables	Learn it

Formula	Status
Credit purchases = payments + discounts received + closing payables – opening payables	Learn it
Mark-up = $\frac{\text{gross profit}}{\text{cost of sales}} \times 100$; margin = $\frac{\text{gross profit}}{\text{revenue}} \times 100$	Learn it
Cost of sales = revenue $\div$ (1 + mark-up) = revenue $\times$ (1 – margin)	Learn it
Cost of sales = opening inventory + purchases + carriage inwards – closing inventory	Learn it
Residual profit = profit for the year + interest on drawings – salaries – interest on capital	Learn it
Interest for part of a year = rate $\times$ amount $\times \frac{\text{months}}{12}$	Learn it
Number of shares = share capital $\div$ nominal value per share	Learn it
Share premium = number of shares $\times$ (issue price – nominal value)	Learn it
Shares before an "a for b" issue = shares after $\times \frac{b}{a + b}$	Learn it
Maximum dividend = revenue reserves (retained earnings + general reserve)	Learn it
Carrying value before a reducing-balance charge = carrying value after $\div$ (1 – r)	Learn it

How to do it

We have 359 tagged questions for this topic from 2021 to 2025 (348 different, as some appear on two paper variants): 1-mark multiple-choice questions in Paper 1 and parts of the 30- and 15-mark structured questions in Paper 2. 77 questions mix more than one type, so the counts add up to more than 359. The types are grouped by kind of business or task (the bold rows), so related methods sit together; the groups are ordered by their most common type, and types are most common first within each group:

Question type	Questions
Sole trader	
Find missing figures from incomplete records	52
Partnerships	
Prepare or use a partnership appropriation account	42

Question type	Questions
Prepare or use partners' current and capital accounts	23
Apply partnership agreement terms and the Partnership Act 1890	20
Companies	
Prepare or use a statement of changes in equity	39
Calculate the effect of share issues (bonus, rights, new issue)	31
Distinguish capital and revenue reserves; maximum dividend or bonus issue	25
Calculate dividends and state what directors consider	13
Prepare share capital and reserve ledger accounts or journal entries	12
Statements and adjustments	
Prepare a statement of profit or loss (sole trader, partnership, company)	38
Correct errors and calculate revised profit, retained earnings or net assets	36
Adjust for irrecoverable debts, recoveries and the allowance	31
Adjust for accruals and prepayments of expenses and income	30
Prepare a statement of financial position (full or a section)	19
Value inventory	19
Account for goods taken for own use	16
Classify items: where and how they appear in the statements	13
Calculate the cash effect of transactions	4
Written advice	
Explain or advise on sources of finance	31
Advise on a business decision (supplier, premises, credit terms, prices)	17
Not in the current syllabus	
Partnership changes: admission, retirement, goodwill, dissolution (2021–2022 only)	28

Sole trader. The most common single type: rebuilding figures a trader never recorded.

1. Find missing figures from incomplete records (52 questions)

- Decide what is missing** and pick the tool: a total receivables or payables account for credit sales or purchases; a cash or bank summary for drawings or cash stolen; mark-up or margin for revenue or cost of sales; the change in net assets for profit; a statement of affairs for capital.
- Write the working as a sum** with a label on every figure, for example credit sales = receipts 58 300 + discounts allowed 900 + . . . Each correct element usually earns a mark.

3. **Feed the results into the statement** asked for (often a statement of profit or loss for a service business or a partnership), using your own figures if an earlier one was wrong.

Variations you will meet:

- **Opening capital:** from a statement of affairs at the start, or worked back: opening = closing – profit + drawings – capital introduced. A loan is a liability, never part of capital.
- **Revenue from receipts:** add cash sales, and add back any cash spent before it was banked (drawings, wages).
- **Inventory lost** in a fire or theft: expected closing inventory = opening + purchases – cost of sales (from the mark-up); the loss is expected less what was left.
- **Missing drawings or cash stolen:** the balancing figure in the cash summary.
- **Inventory turnover:** cost of sales = turnover (times) × average inventory.
- **Paper 2 first asks** "state two reasons a trader keeps only minimal records": they are cheaper and quicker, and the owner may lack bookkeeping skills.
- **Full records (or accounting software): advantages and disadvantages.** For: an accurate profit figure and statement of financial position; control of receivables and payables (who owes what, when to pay); errors and fraud are found sooner; better information for decisions; lenders and the tax authorities can rely on the figures. Against: the cost (software, a bookkeeper or training), the time it takes, and the skills needed. For "advise", weigh both sides for this trader, then give a decision with a reason.

Partnerships. Sharing the profit, the partners' accounts, and the rules that set the shares.

2. Prepare or use a partnership appropriation account (42 questions)

1. **Start from the profit for the year**, after interest on partners' loans (an expense). Label a loss as a loss.
2. **Add interest on drawings** for each partner. If it is a percentage per annum, charge it on each drawing for the months left in the year, or on total drawings if the question says so. Include every drawing, including extra ones mentioned later in the question.
3. **Deduct salaries and interest on capital.** Time-apportion interest on capital introduced or withdrawn mid-year, and follow the agreement exactly (for example "interest on drawings above \$10 000 only").
4. **Share the residual profit or loss** in the ratio. Write each partner's full name on every line.

Variations you will meet:

- **Paper 1 working backwards:** the profit before appropriation from one partner's share; or the effect of adding a term. For example, adding interest on drawings of \$90 and \$50 for partners sharing 4 : 3 raises the residual by \$140, so the first partner gains $\frac{4}{7} \times 140 = 80$ but is charged \$90: a fall of \$10.
- **What is in the account:** interest on capital, salaries, interest on drawings and shares of profit. Not drawings, goods taken, capital introduced or loan interest.
- **Minimum profit for a target** (for example each partner to receive a set amount): work the account backwards from the target.

- **A change in agreement part-way through the year:** split the profit by months and appropriate each part under its own terms.

3. Prepare or use partners' current and capital accounts (23 questions)

1. **Two columns per side**, one per partner. Credit: balance b/d (credit), salary, interest on capital, interest on loan (if credited, not paid), share of profit. Debit: balance b/d (debit), drawings, goods taken, interest on drawings, share of loss.
2. **Balance each column**, balance c/d on the smaller side, and bring it down on the other.
3. **Read the opening balance side carefully:** a debit balance b/d means the partner owed the business.

Variations you will meet:

- **No current accounts kept:** the same items go through the capital account.
- **Items posted to the wrong side:** the balance is wrong by twice each item. A salary of \$5000 and interest on drawings of \$800 both on the wrong side understate a credit balance by $10\,000 - 1600 = 8400$.
- **Working backwards** to an opening balance or a share of profit: it is the balancing figure.
- **Balance if there had been no agreement:** redo the appropriation under the Act (equal shares, no salary or interest on capital or drawings, 5% on loans), then redo the current account.

4. Apply partnership agreement terms and the Partnership Act 1890 (20 questions)

1. **Learn the five Act rules:** equal shares; no salaries; no interest on capital; no interest on drawings; 5% a year on partners' loans.
2. **For "explain why" parts**, give the point and its effect: separate capital and current accounts keep the agreed capital fixed and show whether drawings exceed earnings; interest on capital rewards partners who invest more; interest on drawings discourages drawings.
3. **Contents, advantages and disadvantages** of an agreement: as in "Understand it", one point per mark, developed when the command word is "explain".

Companies. Share capital, reserves and dividends, and the statement that records their changes.

5. Prepare or use a statement of changes in equity (39 questions)

1. **Columns:** share capital, share premium, revaluation reserve, general reserve, retained earnings, total (only those the company has). First row "At 1 January", last row "At 31 December", both labelled with the date.
2. **Work out the opening share capital** if it is missing, by working back through the issues (type 6).
3. **One row per event, in date order:** dividends paid (on the shares in issue on that date), rights or new issues (share capital and premium), bonus issue (Dr the reserves in brackets, Cr share capital: the total column doesn't change), revaluation, transfer to general reserve (brackets in retained earnings, plus in general reserve: total unchanged), profit for the year.
4. **Add down each column** and check that the totals column adds across.

Variations you will meet:

- **Paper 1:** total equity after a list of events; which items appear (proposed dividends and debentures do not); the profit for the year found as the balancing figure in retained earnings.
- **A revaluation fall** larger than the revaluation reserve: the reserve goes to nil and the rest comes out of retained earnings.

6. Calculate the effect of share issues (31 questions)

1. **Convert values to numbers of shares** with the nominal value: \$700 000 of \$2 shares is 350 000 shares.
2. **Work in date order.** A "2 for 5" issue on 250 000 shares creates $\frac{2}{5} \times 250\,000 = 100\,000$ shares.
3. **Working backwards:** shares before an a -for- b issue = shares after $\times \frac{b}{a+b}$. Undo the issues in reverse order.
4. **Cash:** a rights or new issue raises number $\times$ issue price; the premium is number $\times$ (price – nominal). A bonus issue raises nothing.

Variations you will meet:

- **Bonus issue after a rights issue:** the premium from the rights issue is available for the bonus issue.
- **Maximum retained earnings left after a bonus issue:** use all the share premium first.
- **Nominal values like \$0.25 or \$0.50:** a premium "of \$0.20" is per share on top of the nominal value; an issue "at \$0.80" is the full price.

7. Distinguish capital and revenue reserves; maximum dividend or bonus issue (25 questions)

1. **Classify each reserve** with the table in "Understand it".
2. **Maximum dividend** = general reserve + retained earnings (including this year's profit), never share premium or revaluation reserve, and not limited to the profit for the year.
3. **Maximum bonus issue** = share premium + general reserve + retained earnings (no revaluation reserve).
4. **"State two differences":** write a pair each time (capital reserves can't pay dividends / revenue reserves can; capital reserves come from capital transactions / revenue reserves from trading profits). Examples alone are not differences.

8. Calculate dividends and state what directors consider (13 questions)

1. **Shares in issue on the payment date** $\times$ dividend per share; or rate $\times$ nominal share capital (7.5% on \$720 000 is \$54 000).
2. **Only dividends paid** go in the statement of changes in equity; a proposed final dividend is not recorded.
3. **Factors** (one per mark): profits available for distribution; cash available; shareholders' expectations; future plans and other needs for funds.

9. Prepare share capital and reserve ledger accounts or journal entries (12 questions)

1. **Reserves and share capital have credit balances:** balance b/d on the credit side.
2. **Details column names the other account:** "Bank" for a dividend paid or cash from an issue; "Share premium" and "Retained earnings" on the share capital account for a bonus issue; "Share capital" on the reserve accounts; "Profit for the year" (or "Statement of profit or loss") for the profit; "Property" for a revaluation; "General reserve" for a transfer.
3. **Balance** each account with balance c/d and bring down the balance b/d.
4. **Journal entries:** Dr line first, then Cr; for a bonus issue Dr share premium (and retained earnings), Cr share capital.

Statements and adjustments. The statements for any business, and each adjustment that goes into them.

10. Prepare a statement of profit or loss (38 questions)

1. **Workings first:** one line for each adjusted figure (expense + accrual – prepayment; the allowance change; depreciation; loan interest for the right months; closing inventory at the lower of cost and NRV).
2. **Lay out the statement** in the right format (sole trader, partnership or company), with every heading written in full.
3. **Company:** allocate shared expenses by the percentages given; put interest in finance costs; deduct tax; leave dividends out.
4. **Finish** with "Profit for the year" (or "Loss for the year").

Variations you will meet:

- **Sale or return goods** included in revenue: take off their selling price, and add their cost to closing inventory.
- **Carriage inwards** belongs in cost of sales, carriage outwards in expenses; purchases returns reduce purchases, sales returns reduce revenue.
- **Discounts allowed** are an expense, not a reduction in revenue; discounts received are income.
- **Starting from gross profit** (an extract), or working back to profit from operations from the profit for the year (add back tax and finance costs).
- 2021–2022 papers call it the "income statement".

11. Correct errors and calculate revised profit, retained earnings or net assets (36 questions)

1. **Draft profit**, then one line per error with its effect, then the revised profit.
2. **Decide each direction** by asking what the correction does to income or expenses:
 - closing inventory overstated: profit down;
 - a prepaid part of an expense charged in full: add back the prepaid part;
 - missing accruals, interest or tax: deduct;

- depreciation at the wrong rate or method: adjust by the difference;
- dividends, drawings or personal expenses charged as expenses: add back;
- goods for own use not recorded: add their cost;
- sale or return goods, or an order not yet delivered, recorded as a sale: take off only the profit on them (selling price less cost), since the goods go back into inventory;
- an asset written down to its resale value although it will still be used (going concern): add back.

3. **Show workings** for anything calculated (depreciation often carries 2 marks).

Variations you will meet:

- **A fully revised company statement of profit or loss:** correct each line, not just the profit. Mis-split wages: find both splits and move the difference. Tax "overstated by 5%": correct tax = draft $\div$ 1.05.
- **Corrected retained earnings or net assets:** the same profit changes, plus any asset or liability effect.
- **Paper 1 "effect on profit and assets":** a closing inventory error overstates or understates both this year's profit and assets, and has the opposite effect on next year's profit (it becomes opening inventory).

12. Adjust for irrecoverable debts, recoveries and the allowance (31 questions)

1. **Write off first**, then calculate the allowance on what is left.
2. **Profit effect:** irrecoverable debts are an expense; recovered debts are income; the increase in the allowance is an expense, a decrease is income.
3. **Statement of financial position:** trade receivables less the new allowance.

Variations you will meet:

- **Allowance account over two years:** balance b/d, the increase (Cr, "Statement of profit or loss") or decrease (Dr), balance c/d.
- **Aged receivables:** a different percentage for each age band; add them up.
- **Journals:** write off Dr irrecoverable debts, Cr the customer; a recovery Dr bank, Cr irrecoverable debts recovered.
- **"Why keep an allowance?":** prudence (receivables not overstated) and matching (the likely loss is charged in the year of the sale). **Setting the rate:** past experience, the age of debts, the economy, the customers' circumstances.

13. Adjust for accruals and prepayments of expenses and income (30 questions)

1. **Use the formula** in "Key facts", or draw the ledger account with the balances.
2. **Time-apportion** when a rate changes mid-year, or a campaign or premium spans two years: charge only the months in this year.
3. **Classify:** accrued expenses and income in advance are current liabilities; prepaid expenses and accrued income are current assets.

For example, rent of \$500 a month from 1 January: \$5500 received in the year means \$500 is owing (accrued income, a current asset). A refundable deposit held is a liability, not income.

14. Prepare a statement of financial position (19 questions)

1. **Carry forward adjusted figures** from earlier parts: corrected inventory, receivables plus prepayments, payables plus accruals, tax owing, non-current assets after the corrected depreciation.
2. **Classify liabilities by date:** a loan or debenture repayable within 12 months is current.
3. **Show subtotals and both totals;** they must agree.

Variations you will meet:

- **Only a section:** "equity and liabilities" (partners' capital and current accounts with debit balances in brackets; a partner's loan as a non-current liability; overdraft, other payables as current); "assets" only; or current assets only.
- **Bank overdraft** is a current liability, not a negative asset.

15. Value inventory (19 questions)

1. **Compare cost and NRV for each item** separately; take the lower. Scrapped items are nil.
2. **Cost** includes purchase price and carriage inwards; not selling, storage or advertising costs.
3. **Count on a different date:** work back to the year end at cost. For a count on 5 January valued at \$18 000 at cost, with sales of \$2500 at selling price (mark-up 25%) and purchases of \$1200 between 1 and 5 January: $\text{inventory at 31 December} = 18\,000 + 2500 \div 1.25 - 1200 = 18\,800$.

16. Account for goods taken for own use (16 questions)

1. **At cost:** convert a selling price with the mark-up.
2. **Dr drawings, Cr purchases:** cost of sales falls, profit rises, drawings rise.
3. **Missing own-use figure:** expected gross profit (from the mark-up) less the actual gross profit gives the goods taken at selling price; convert to cost.
4. **Recorded wrongly as a sale at selling price:** revenue falls by the selling price and purchases by the cost, so profit falls by the profit element.

17. Classify items: where and how they appear (13 questions)

1. **Equity** of a company: share capital and reserves. Loans and debentures are liabilities.
2. **Non-current or current:** instalments due within 12 months are current.
3. **Gross profit** is affected only by revenue, returns, purchases, carriage inwards, inventory and own-use goods.
4. **Sole traders and partnerships** have no dividends, share capital or general reserve.

18. Calculate the cash effect of transactions (4 questions)

1. **Cash in:** share and rights issues (at the full issue price), loans received, asset disposals. **Cash out:** dividends paid, loan repayments, asset purchases.
2. **No cash:** bonus issues, revaluations, depreciation, transfers between reserves, proposed dividends.

Written advice. The 6–7-mark "advise" parts that usually end a Paper 2 question.

19. Explain or advise on sources of finance (31 questions)

1. **For each option, give points for and against** (up to about 4 marks each), specific to the business: permanence, cost (dividends or interest), control, gearing, repayment, security, issue costs, whether the issue will be fully subscribed.
2. **Match the finance to the purpose** (long-term for long-term assets or repaying a debenture; short-term for working capital).
3. **Finish with a decision and a reason** (1 mark), for example "A share issue: it is permanent and does not add interest costs when the debenture must be repaid."

Variations you will meet:

- **Short parts:** features of debentures and ordinary shares; reasons for a bonus or rights issue; why lenders like a bonus issue (reserves become permanent capital that can't be paid out as dividends).
- **Sole trader or partnership:** bank loan v overdraft v lease v owner's capital v a new partner (more capital and skills, but profit and control shared).

20. Advise on a business decision (17 questions)

1. **Calculate the effect on profit if asked.** Change in gross profit — change in costs. For example, revenue \$200 000 at a 40% margin gives gross profit \$80 000. Option A raises the margin to 45%: $90\,000 - 80\,000 = +10\,000$. Option B raises sales by 10% at the same margin but rent by \$3000: $8000 - 3000 = +5000$.
2. **Discuss each option**, for and against, financial and non-financial: profit and liquidity; reliability and quality of a new supplier; storage and deterioration of bulk orders; delivery costs; running out of inventory and losing customers; the cost of moving; whether forecasts will prove right; losing regular customers.
3. **Decide**, with a supporting comment.

Options to improve liquidity come up often:

- **Offer customers a cash discount for paying early.** For: cash comes in sooner, receivables fall, fewer irrecoverable debts. Against: discounts allowed are an expense, so profit falls; customers who would have paid promptly anyway take it too; some may take the discount and still pay late.
- **Delay payments to suppliers.** For: cash stays in the business longer at no direct cost. Against: cash discounts from suppliers are lost; supplier goodwill suffers, so credit terms may be withdrawn, deliveries put last or prices raised.

- **Reduce inventory.** For: less cash tied up, lower storage costs. Against: bulk discounts lost, risk of running out and losing customers.

Not in the current syllabus.

21. Partnership changes: admission, retirement, goodwill, dissolution (28 questions)

Not in the 2026–2028 syllabus (set only in 2021–2022 papers), so skip these questions when you practise.

Worked examples

The bold codes show where marks are earned, as in Cambridge mark schemes. The number is how many marks.

- **M1** method mark: for a correct method, even if the numbers slip.
- **A1** accuracy mark: for a correct answer; it needs the M mark before it.
- **B1** mark for a correct result on its own, with no method needed.

Example 1

Mei is a retailer who does not keep full records. For the year ended 31 December 2025:

- trade receivables were \$6400 at 1 January and \$7100 at 31 December; she received \$58 300 from credit customers, allowed discounts of \$900 and wrote off an irrecoverable debt of \$400;
- she banked \$19 000 of cash sales, after taking \$3600 as drawings and paying wages of \$2400 from the cash;
- trade payables were \$4200 at 1 January and \$5000 at 31 December; she paid suppliers \$69 500 and received discounts of \$600;
- inventory at 1 January was \$8000; all goods are sold at a mark-up of 25%.

(a) Calculate the credit sales and the total revenue. **[4]**

(b) Calculate the purchases. **[2]**

(c) Calculate the cost of sales and the closing inventory. **[3]**

(d) Mei counted inventory of \$9860 at 31 December. She says the difference is goods she took for her own use. Calculate the goods taken, and state how they are recorded. **[2]**

(a) Credit sales = $58\,300 + 900 + 400 + 7100 - 6400 = 60\,300$. **B1** receipts with discounts and irrecoverable debt, **B1** change in receivables.

Cash sales = $19\,000 + 3600 + 2400 = 25\,000$. **B1**

Revenue = $60\,300 + 25\,000 = 85\,300$. **B1**

(b) Purchases = $69\,500 + 600 + 5000 - 4200 = 70\,900$. **B1** discounts received, **B1** change in payables.

(c) Cost of sales = $85\,300 \div 1.25 = 68\,240$. **M1 A1** (not $85\,300 \times 0.75$: that uses 25% as a margin).

Closing inventory = $8000 + 70\,900 - 68\,240 = 10\,660$. **B1** (own figure)

(d) $10\,660 - 9860 = 800$ at cost. **B1** Dr drawings, Cr purchases \$800. **B1**

Example 2

Asha and Ben are in partnership, sharing profits and losses 3 : 2 after:

- interest on capital at 5% per annum;
- a salary of \$9000 a year for Ben;
- interest on drawings at 3% of each partner's total drawings for the year.

At 1 January 2025 their capital accounts were Asha \$60 000 and Ben \$40 000; their current accounts were Asha \$2100 credit and Ben \$800 debit. Asha paid in extra capital of \$20 000 on 1 July 2025. Drawings for the year were Asha \$15 000 and Ben \$12 000.

The draft profit for the year ended 31 December 2025 was \$38 450. No entry has been made for interest at 6% per annum on a loan of \$10 000 from Ben, received on 1 April 2025; the interest is to be credited to his current account.

(a) Calculate the profit for the year. **[2]**

(b) Prepare the appropriation account for the year ended 31 December 2025. **[6]**

(c) Prepare the partners' current accounts. Dates are not required. **[6]**

(d) Prepare the capital and current accounts section of the statement of financial position at 31 December 2025, and state where the loan from Ben is shown. **[3]**

(a) Loan interest = $6\% \times 10\,000 \times \frac{9}{12} = 450$ (**B1**), an expense, so profit for the year = $38\,450 - 450 = 38\,000$. **B1**

(b)

Asha and Ben: appropriation account for the year ended 31 December 2025		\$	\$
Profit for the year			38 000
Add interest on drawings: Asha		450	
Ben		360	810
			38 810
Less salary: Ben			(9 000)

Asha and Ben: appropriation account for the year ended 31 December 2025			\$	\$
Less interest on capital: Asha			3 500	
Ben			2 000	(5 500)
Residual profit				24 310
Share of residual profit: Asha			14 586	
Ben			9 724	24 310

B1 interest on drawings ($3\% \times 15\,000$ and $3\% \times 12\,000$); **B1** salary; **B1** Asha's interest on capital $5\% \times 60\,000 + 5\% \times 20\,000 \times \frac{6}{12} = 3\,500$; **B1** Ben's \$2000; **B1** residual profit (own figure); **B1** shares $\frac{3}{5}$ and $\frac{2}{5}$ (own figure).

The loan interest is **not** in this account: it was an expense in part (a).

(c)

Details	Asha \$	Ben \$	Details	Asha \$	Ben \$
Balance b/d		800	Balance b/d	2 100	
Drawings	15 000	12 000	Salary		9 000
Interest on drawings	450	360	Interest on capital	3 500	2 000
Balance c/d	4 736	8 014	Interest on loan		450
			Share of profit	14 586	9 724
	20 186	21 174		20 186	21 174
			Balance b/d	4 736	8 014

B1 opening balances on the correct sides; **B1** drawings and interest on drawings; **B1** salary and interest on capital; **B1** interest on loan; **B1** shares of profit (own figure); **B1** balances b/d (own figure).

(d)

	Asha \$	Ben \$	\$
Capital accounts	80 000	40 000	120 000
Current accounts	4 736	8 014	12 750
Total capital			132 750

B1 capital including Asha's extra \$20 000; **B1** total (own figure). The loan from Ben is a **non-current liability** of \$10 000, not part of capital. **B1**

Example 3

The following balances were extracted from the books of K Limited at 31 December 2025.

	Debit \$	Credit \$
Revenue		612 000
Sales returns	7 000	
Purchases	348 000	
Inventory at 1 January 2025	41 000	
Carriage inwards	3 000	
Wages and salaries	96 000	
Rent and insurance	24 000	
Advertising	15 000	
Irrecoverable debts	1 800	
Allowance for irrecoverable debts		2 400
Trade receivables	52 000	
Delivery vans: cost	80 000	
Delivery vans: provision for depreciation		30 000
Office equipment: cost	60 000	
Office equipment: provision for depreciation		18 000
6% debentures (2032)		150 000
Debenture interest	3 000	
Dividends paid	20 000	

Additional information at 31 December 2025:

1. Inventory at cost was \$44 000. This includes damaged goods which cost \$3000 and can be sold for \$2200 after repairs of \$400.
2. Rent and insurance includes \$3000 paid in advance.
3. A debt of \$2000 is to be written off. The allowance for irrecoverable debts is to be 4% of trade receivables.
4. Delivery vans are depreciated at 25% per annum by the reducing balance method; office equipment at 10% per annum by the straight-line method.
5. The debentures were issued on 1 April 2025.
6. Tax for the year is \$28 000.
7. Wages and salaries are split 40% distribution costs, 60% administrative expenses. Advertising and the vans are distribution costs; rent and insurance, irrecoverable debts and office equipment are administrative expenses.

(a) Prepare the statement of profit or loss for the year ended 31 December 2025. **[14]**

(b) State where the dividends paid are shown. **[1]**

Workings

- Closing inventory: NRV of damaged goods = $2200 - 400 = 1800 < 3000$, so $44\,000 - 3000 + 1800 = 42\,800$.
- Cost of sales = $41\,000 + 348\,000 + 3000 - 42\,800 = 349\,200$.
- Allowance = $4\% \times (52\,000 - 2000) = 2000$; it was \$2400, so a **decrease** of \$400.
- Irrecoverable debts = $1800 + 2000 = 3800$.
- Van depreciation = $25\% \times (80\,000 - 30\,000) = 12\,500$; equipment = $10\% \times 60\,000 = 6000$.
- Distribution costs = $40\% \times 96\,000 + 15\,000 + 12\,500 = 38\,400 + 15\,000 + 12\,500 = 65\,900$.
- Administrative expenses = $60\% \times 96\,000 + (24\,000 - 3000) + 3800 - 400 + 6000 = 57\,600 + 21\,000 + 3800 - 400 + 6000 = 88\,000$.
- Debenture interest = $6\% \times 150\,000 \times \frac{9}{12} = 6750$ (\$3000 paid, \$3750 accrued).

(a)

K Limited: statement of profit or loss for the year ended 31 December 2025	\$
Revenue (612 000 – 7000)	605 000
Cost of sales	(349 200)
Gross profit	255 800
Distribution costs	(65 900)
Administrative expenses	(88 000)
Profit from operations	101 900
Finance costs	(6 750)
Profit before tax	95 150
Tax	(28 000)
Profit for the year	67 150

B1 revenue; **B1** closing inventory \$42 800; **B1** cost of sales with carriage inwards; **B1** van depreciation; **B1** equipment depreciation; **B1** wages split; **B1** distribution costs total (own figure); **B1** rent after the prepayment; **B1** irrecoverable debts \$3800; **B1** allowance decrease \$400; **B1** administrative expenses total (own figure); **B1** finance costs \$6750; **B1** tax; **B1** profit for the year (own figure).

(b) In the retained earnings column of the statement of changes in equity, not the statement of profit or loss.

B1

Example 4

L plc's equity at 1 January 2025 was:

	\$
Ordinary shares of \$0.50 each	?
Share premium	20 000
Revaluation reserve	40 000
Retained earnings	210 000

During 2025:

- 1 March: paid a final dividend of \$0.04 per share on all shares in issue.
- 1 May: made a rights issue of 1 share for every 4 held, at \$0.80 per share. It was fully subscribed.
- 1 August: made a bonus issue of 1 share for every 5 held, keeping reserves in their most flexible form.
- 30 September: property was revalued downwards by \$55 000.
- 31 December: transferred \$25 000 to a general reserve. The profit for the year was \$118 000.

Share capital at 31 December 2025 was \$900 000.

(a) Calculate the number of ordinary shares in issue at 1 January 2025. **[3]**

(b) Prepare the statement of changes in equity for the year ended 31 December 2025. **[9]**

(c) State the maximum dividend the company could legally pay at 31 December 2025. **[1]**

(d) Give two advantages to the shareholders of the bonus issue. **[2]**

(a) Shares at 31 December = $900\,000 \div 0.50 = 1\,800\,000$. **B1**

Before the bonus issue: $1\,800\,000 \times \frac{5}{6} = 1\,500\,000$. Before the rights issue: $1\,500\,000 \times \frac{4}{5} = 1\,200\,000$ shares (\$600 000). **M1 A1**

(b) Workings: dividend = $1\,200\,000 \times 0.04 = 48\,000$. Rights issue: 300 000 shares; share capital $300\,000 \times 0.50 = 150\,000$; premium $300\,000 \times 0.30 = 90\,000$. Bonus issue: 300 000 shares, \$150 000: all the share premium ($20\,000 + 90\,000 = 110\,000$) first, then \$40 000 from retained earnings. Revaluation: the reserve covers \$40 000; the other \$15 000 comes out of retained earnings.

	Share capital \$	Share premium \$	Revaluation reserve \$	General reserve \$	Retained earnings \$	Total \$
At 1 January 2025	600 000	20 000	40 000	–	210 000	870 000
Dividend paid					(48 000)	(48 000)
Rights issue	150 000	90 000				240 000
Bonus issue	150 000	(110 000)			(40 000)	–

	Share capital \$	Share premium \$	Revaluation reserve \$	General reserve \$	Retained earnings \$	Total \$
Revaluation			(40 000)		(15 000)	(55 000)
Transfer to general reserve				25 000	(25 000)	–
Profit for the year					118 000	118 000
At 31 December 2025	900 000	–	–	25 000	200 000	1 125 000

B1 opening row; **B1** dividend; **B1** rights issue share capital and premium; **B1** bonus issue from share premium; **B1** bonus issue from retained earnings; **B1** revaluation split; **B1** transfer; **B1** profit; **B1** closing row (own figure).

(c) Revenue reserves: $25\,000 + 200\,000 = 225\,000$. **B1** (Whether it should is another matter: it needs the cash.)

(d) They receive extra shares without paying anything, which they could sell (**B1**); their share of control is unchanged (**B1**).

Common mistakes

- **Putting interest on a partner's loan in the appropriation account.** It is an expense in the statement of profit or loss. Examiners report that including it (or the loan itself) costs the residual-profit mark.
- **Missing drawings when calculating interest on drawings.** Include every drawing, including extra ones mentioned later in the question.
- **Calling a loss a profit**, and writing partners' initials instead of names. Label "Loss for the year" and "Share of residual loss" clearly.
- **Treating goods for own use as reducing profit.** They reduce purchases, so profit goes **up**. Record them at cost.
- **Confusing mark-up and margin.** A 25% mark-up means cost of sales is $\text{revenue} \div 1.25$, not $\text{revenue} \times 0.75$.
- **Calculating the allowance before writing off the irrecoverable debt**, or charging the whole allowance instead of the change.
- **Treating discounts allowed as a reduction in revenue.** They are an expense.
- **Leaving carriage inwards out of cost of sales**, or putting carriage outwards in it.
- **Putting dividends in a company's statement of profit or loss**, or recording a proposed dividend. Only dividends paid go in the statement of changes in equity.
- **Using the wrong number of shares.** Dividends and rights issues are based on the shares in issue **on that date**; working back, use $\frac{b}{a+b}$, not $\frac{a}{b}$.

- **Using the revaluation reserve for a bonus issue**, or retained earnings before share premium when reserves are to be kept flexible.
- **Omitting the profit for the year** from the statement of changes in equity.
- **Wrong narratives in ledger accounts.** A dividend paid is "Bank", not "Dividend"; reserves have credit balances; bring every balance down.
- **Labelling a partner's loan as a bank loan**, forgetting capital introduced during the year, or leaving items out of current liabilities.
- **Abbreviations and missing labels.** Write "Gross profit", "Total equity", "Total equity and liabilities" in full.
- **One-word answers to "explain" and advice without a decision.** Develop each point, discuss both options, and give a decision with a reason.

How to get the marks

- **Show workings** in the space given, one labelled line per adjustment. A wrong total with a right working still earns most marks, and later totals earn own-figure (**OF**) marks.
- **Statements:** correct title with the business name and the date ("for the year ended" for the statement of profit or loss and statement of changes in equity; "at" for the statement of financial position). Standard headings in the standard order, every subtotal labelled.
- **Appropriation and current accounts:** a mark per line; names in full; residual shares are own-figure marks, so finish the account even if the profit is wrong.
- **Statement of changes in equity:** a mark per correct row; the closing row is an own-figure mark. A bonus issue and a transfer show brackets in one column and a plus in another.
- **"Calculate"** needs the working and the answer; **"prepare"** needs the full format; **"state"** needs one short point per mark; **"explain"** needs the point and its effect.
- **"Advise" (usually 6–7 marks):** up to about 4 marks for each option (points for and against, financial and non-financial), and 1 for a clear decision supported by a reason. Missing the decision loses a mark every time.
- **Round money to the nearest dollar** unless told otherwise, and keep workings exact until the end.
- **Multiple choice:** work out the answer before you look at the options; the distractors come from one slip (margin for mark-up, a missed write-off, a wrong side).

Quick check

1. A trader's revenue was \$72 000 and she sells at a gross margin of 25%. Opening inventory was \$6500 and purchases were \$55 000. Calculate the closing inventory, and state the mark-up.
2. Trade receivables are \$40 000 before writing off a debt of \$1500. The allowance for irrecoverable debts was \$1400 and is to be 3% of trade receivables. Calculate the effect of these adjustments on profit, and the net trade receivables in the statement of financial position.

3. X and Y share profits 3 : 1 after a salary of \$8000 for Y, interest on capital (X \$3000, Y \$2000) and interest on drawings (X \$600, Y \$400). The profit for the year was \$50 000. (a) Calculate the residual profit and each partner's share. (b) By how much would the total credited to X, net of the interest on drawings, change if interest on drawings were not charged?
4. A company has ordinary shares of \$1 each, \$400 000; share premium \$60 000; revaluation reserve \$80 000; general reserve \$50 000; retained earnings \$120 000. (a) What is the maximum dividend it can pay? (b) What is the largest number of bonus shares it could issue? (c) It paid a dividend of \$0.05 per share on 1 March and proposes one of \$0.06 per share at the year end. What amount goes in the statement of changes in equity?
5. During a year a business paid rent of \$13 000. At the start \$1000 was prepaid; at the end \$1500 was owing. It also received rent of \$7800 from a tenant, including \$600 for the following January. Calculate the rent expense, the rent income, and the total of these items in current liabilities.

Answers

1. Cost of sales = $72\,000 \times 0.75 = 54\,000$. Closing inventory = $6\,500 + 55\,000 - 54\,000 = 7\,500$. Mark-up = $\frac{18\,000}{54\,000} = 33\frac{1}{3}\%$.
2. New allowance = $3\% \times 38\,500 = 1\,155$, a decrease of $1\,400 - 1\,155 = 245$ (income). Profit falls by $1\,500 - 245 = 1\,255$. Net receivables = $38\,500 - 1\,155 = 37\,345$.
3. (a) Residual = $50\,000 + 1\,000 - 8\,000 - 5\,000 = 38\,000$: $X \frac{3}{4} = 28\,500$, Y 9 500. (b) Without interest on drawings the residual falls by \$1000, so X's share falls by \$750, but X is no longer charged \$600: a net fall of \$150.
4. (a) $50\,000 + 120\,000 = 170\,000$. (b) $60\,000 + 50\,000 + 120\,000 = 230\,000$, so 230 000 shares of \$1 (not the revaluation reserve). (c) Only the dividend paid: $400\,000 \times 0.05 = 20\,000$.
5. Expense = $13\,000 + 1\,000 + 1\,500 = 15\,500$. Income = $7\,800 - 600 = 7\,200$. Current liabilities: rent owing \$1500 + rent received in advance \$600 = \$2100.

Past questions to try

- **9706/22/M/J/24 Q1**: incomplete records for a sole trader, then the statement of profit or loss.
- **9706/22/F/M/25 Q1**: revised profit, appropriation account, current accounts and the equity section for a partnership.
- **9706/22/O/N/24 Q3**: revised company profit and a statement of changes in equity.
- **9706/21/O/N/24 Q1**: a company statement of profit or loss from a trial balance, then the equity and liabilities section of the statement of financial position.