S6 Business, Accounting and Financial Studies Practice Paper: Limited Company Share Capital and Dividends, Bad Debts and Allowance for Doubtful Debts, Bank Reconciliation, Job and Absorption Costing, Financial Statement Ratio Analysis, Capital Investment Appraisal

S6 | Business, Accounting and Financial Studies | Time: 75 minutes | Total: 100 marks | 24 questions

---

Part A - Limited Company Share Capital and Dividends (18 marks)

Show your working in calculations; in explanation questions give one concrete effect or limit.

1. A company issues 200,000 ordinary shares with a nominal value of $2 each at $3.5 per share. Find the share capital and the share premium. [5]

Answer: Share capital = 200,000 x $2 = $400,000; share premium = 200,000 x $1.5 = $300,000.

2. A company earns a profit after tax of $840,000 with 300,000 ordinary shares in issue. The directors declare a dividend of $0.8 per share. Find the total dividend and the increase in retained profits. [5]

Answer: Total dividend = 300,000 x $0.8 = $240,000; increase in retained profits = $840,000 - $240,000 = $600,000.

3. A company has 400,000 10% preference shares of $1 each and 600,000 ordinary shares. The profit for the year is $520,000. Find the preference dividend and the profit available to ordinary shareholders. [4]

Answer: Preference dividend = 400,000 x $1 x 10% = $40,000; available to ordinary shareholders = $520,000 - $40,000 = $480,000.

4. State the class of equity under which share premium and retained profits appear in the statement of financial position, and give one restriction on the use of each. [4]

Answer: Both are equity reserves. Share premium normally cannot be used to pay cash dividends; retained profits may be distributed, but enough funds must be kept for operations and debt repayment.

Part B - Bad Debts and Allowance for Doubtful Debts (16 marks)

Write both debit and credit accounts in journal entries; show the computation of amounts.

5. Trade receivables at the start of the year were $250,000. Credit sales were $960,000, cash collected was $910,000 and bad debts of $8,000 were written off. Find the trade receivables at the year end. [4]

Answer: Closing receivables = 250,000 + 960,000 - 910,000 - 8,000 = $292,000.

6. The allowance for doubtful debts is 4% of year-end receivables. The opening allowance was $9,000 and year-end receivables are $292,000. Find the required closing allowance and the increase or decrease to be charged for the year. [4]

Answer: Required allowance = 292,000 x 4% = $11,680; increase charged for the year = $11,680 - $9,000 = $2,680.

7. Bad debts of $8,000 were written off during the year and the opening allowance was $9,000. Find the allowance balance after the write-off and state whether the write-off directly affects this year profit. [4]

Answer: Allowance after write-off = 9,000 - 8,000 = $1,000. It does not directly affect this year profit, because the expense was recognised when the allowance was created; the write-off only reduces both the allowance and the receivables.

8. A customer pays $3,000 that had been written off in an earlier year. Write the two journal entries required and state the effect on the allowance for doubtful debts. [4]

Answer: (1) Dr Receivables $3,000 / Cr Allowance for doubtful debts $3,000; (2) Dr Cash $3,000 / Cr Receivables $3,000. The allowance rises by $3,000, which increases profit by $3,000.

Part C - Bank Reconciliation (16 marks)

State whether each adjustment belongs to the cash book or to the bank statement.

9. The bank statement shows a balance of $21,900. Cheques issued but not yet presented total $4,200 and deposits not yet credited total $700. Find the adjusted bank statement balance. [4]

Answer: Adjusted balance = 21,900 - 4,200 + 700 = $18,400.

10. The cash book (bank column) shows $18,600. Bank charges of $200 have not yet been entered in the cash book. Find the adjusted cash book balance. [4]

Answer: Adjusted cash book balance = 18,600 - 200 = $18,400.

11. The bank has credited a deposit of $3,000 to another customer account by mistake; the company books are correct. Explain the treatment in the reconciliation and whether the company needs a journal entry. [4]

Answer: This is a bank error, so $3,000 is added back to the bank statement balance. The company books are correct, so no journal entry is needed; the bank should be asked to correct it.

12. Explain why unpresented cheques make the bank statement balance higher than the cash book balance. [4]

Answer: The company deducts the cheque in the cash book as soon as it is issued, but until the payee presents it the bank has not yet deducted it, so the statement balance is higher.

Part D - Job and Absorption Costing (18 marks)

Production overhead is absorbed on direct labour hours; list each cost element.

13. Job 108 uses direct materials of $24,000 and 400 direct labour hours at $95 per hour. Production overhead is absorbed at $60 per direct labour hour. Find the total production cost of the job. [4]

Answer: Direct labour = 400 x $95 = $38,000; overhead = 400 x $60 = $24,000; total cost = 24,000 + 38,000 + $24,000 = $86,000.

14. The job in the previous question produced 500 units, with selling and administrative expenses of $9,000 apportioned to it. Find the production cost per unit and the total cost per unit. [5]

Answer: Production cost per unit = 86,000 / 500 = $172; total cost per unit = (86,000 + 9,000) / 500 = $190.

15. A product has a variable cost of $45 per unit and total fixed costs of $70,000. Find the total cost per unit when output is 2,000 units and when it is 2,500 units, with fixed cost spread over output. [5]

Answer: At 2,000 units: $45 + 70,000 / 2,000 = $80; at 2,500 units: $45 + 70,000 / 2,500 = $73. Fixed cost per unit falls as output rises, so the total cost per unit falls.

16. Compare absorption costing and marginal costing in the valuation of inventory, and state which cost is excluded from the income statement under marginal costing. [4]

Answer: Under absorption costing inventory includes variable production cost plus absorbed fixed production overhead; under marginal costing inventory includes only variable production cost and the whole fixed production overhead is written off in the period.

Part E - Financial Statement Ratio Analysis (16 marks)

Show the formula for each ratio; give percentages to the nearest whole number and turnover ratios to 2 decimal places.

17. Sales for the year were $1,200,000 and cost of sales was $720,000. Find the gross profit and the gross profit ratio. [4]

Answer: Gross profit = 1,200,000 - 720,000 = $480,000; gross profit ratio = 480,000 / 1,200,000 x 100% = 40%.

18. Using the same data with an operating profit of $180,000, find the operating profit ratio and state what the gap between it and the gross profit ratio represents. [4]

Answer: Operating profit ratio = 180,000 / 1,200,000 x 100% = 15%; the gap of 25 percentage points is the operating expenses as a share of sales.

19. Current assets are $260,000 including inventory of $120,000; current liabilities are $130,000. Find the current ratio and the quick ratio to 2 decimal places. [4]

Answer: Current ratio = 260,000 / 130,000 = 2.00; quick ratio = (260,000 - 120,000) / 130,000 = 1.08.

20. Operating profit is $180,000, capital employed (total assets less current liabilities) is $900,000, cost of sales is $720,000 and inventory is $120,000. Find the return on capital employed and the inventory turnover. [4]

Answer: ROCE = 180,000 / 900,000 x 100% = 20%; inventory turnover = 720,000 / 120,000 = 6 times.

Part F - Capital Investment Appraisal (16 marks)

Show cumulative cash inflows for payback; use the discount factors given for net present value.

21. Project A costs $500,000 and generates net cash inflows of $125,000 each year for 5 years. Find the payback period. [4]

Answer: Payback period = 500,000 / 125,000 = 4 years.

22. Project B costs $600,000 with net cash inflows of 200,000, 180,000, 160,000 and 140,000 in the first four years. Find the payback period in years and months. [4]

Answer: Cumulative inflow for the first three years is 540,000, leaving 60,000; in year 4 the fraction is 60,000 / 140,000 = 0.43 year, about 5 months, so payback is about 3 years 5 months.

23. Project C costs $220,000 and gives net cash inflows of $100,000 for 3 years. The discount factors are 0.909, 0.826 and 0.751. Find the total present value, the net present value and state whether the project should be accepted. [4]

Answer: Present value = 100,000 x (0.909 + 0.826 + 0.751) = $248,600; net present value = 248,600 - 220,000 = $28,600. It is positive, so the project is acceptable.

24. State two weaknesses of the payback period method of investment appraisal. [4]

Answer: (1) It ignores cash flows after the payback period. (2) It ignores the time value of money because the flows are not discounted.
