

Chapter 3 Introduction to Accounting

Section 2

The Accounting Cycle



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1. **C**

(1) is incorrect. According to the accounting equation,

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

$$\text{Non-current Assets} + \text{Current Assets} = \text{Capital} + \text{Non-current Liabilities} + \text{Current Liabilities}$$

(2) is correct.

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

$$\text{Assets} - \text{Liabilities} = \text{Closing Capital}$$

$$\text{Assets} - \text{Liabilities} = \text{Opening Capital} + \text{Revenue} - \text{Expenses}$$

(3) is correct.

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

$$\text{Non-current Assets} + \text{Current Assets} = \text{Capital} + \text{Non-current Liabilities} + \text{Current Liabilities}$$

$$\text{Non-current Assets} + (\text{Current Assets} - \text{Current Liabilities}) = \text{Capital} + \text{Non-current Liabilities}$$

$$\text{Non-current Assets} + \text{Working Capital} = \text{Capital} + \text{Non-current Liabilities}$$

2. **B**

Goods returned by customers who are the company's debtors are treated as returns inwards. Trade receivables accounts, which record entries related to debtors, should be credited.

3. **D**

The contribution of the van to the company is regarded as capital contribution from the owner. It thus increases the amount of capital.

The double entries should be:

Dr. Van \$4,000

Cr. Capital \$4,000

4. **B**
Regarding the transactions in which the sole proprietor borrows a bank loan for a purchase of an asset, the non-current asset account should be debited and the bank loan account should be credited. Since there is cash remained after buying the equipment, the double entries should be:
Dr. Cash \$10,000
Dr. Equipment \$40,000
Cr. Bank loan \$50,000
5. **A**
Capital is the investment of the owner. Purchasing a car through the bank account of the company is not an additional capital as the car is bought by the cash owned by the company. B, C and D are correct. They are examples of additional capital as the second-hand computer, \$1,000 and the building are the owner's personal assets and they are transferred to the company.
6. **C**
Cash is the most liquid asset so it is classified as a current asset. A, B and D are incorrect. They are examples of non-current assets as they can help generate income. A non-current asset refers to an asset which can bring probable economic benefits to the business and is relatively difficult to be converted into cash.
7. **A**
(1) and (2) are correct. By the accounting equation 'Assets = Liabilities + Capital', the sum of the amounts of liabilities and capital is equal to the total amount of assets. It is possible that a business holds more liabilities than capital if it heavily relies on debt financing instead of equity financing.
(3) is incorrect. By the accounting equation 'Assets = Liabilities + Capital', the total amount of assets must be equal to the sum of liabilities and capital.
8. **A**
(3) is incorrect. Purchases of non-current assets on credit will increase the asset value and the amount of liability. It involves no addition to or removal from the company in terms of the owners' assets, so the amount of capital remains unchanged.
9. **C**
The purchase of goods on credit increases the amount of accounts payable. The double entries should be:
Dr. Purchases \$50,000
Cr. Accounts payable \$50,000
10. **D**
When a debtor settles his account through the bank, his account would be credited and the bank account will be debited. Accounts receivable decreases while cash at bank increases by the same amount. Therefore, there is no change in assets and liabilities because both accounts receivables and cash at bank accounts are classified into assets.
11. **B**
The double entries for the repayment of debt to the creditors by the bank should be:
Dr. Accounts payable \$50,000
Cr. Bank \$50,000

12. **B**
The double entries for the purchase of computer using both cash in hand and cash at bank should be:
Dr. Computer \$40,000
 Cr. Cash \$20,000
 Cr. Bank \$20,000
13. **B**
The double entries for drawings of goods would be:
Dr. Drawings \$50,000
 Cr. Purchases \$50,000
14. **A**
The payment made by the owner's personal bank account amounting to \$10,000 is considered as the owner's capital contribution. The double entries are hence:
Dr. Rental expense \$10,000
 Cr. Capital \$10,000
15. **C**
When a debtor settles his account by cheque, the double entries should be:
Dr. Bank \$6,000
 Cr. Accounts receivable \$6,000

When the company purchases equipment by cash, the double entries should be:
Dr. Equipment \$26,000
 Cr. Cash \$26,000
16. **C**
When the owner withdraws cash from the company, the double entries should be:
Dr. Drawings \$5,000
 Cr. Cash \$5,000

When the owner contributes a computer to the company, the double entries should be:
Dr. Computer \$5,000
 Cr. Capital \$5,000
17. **A**
When Mr. Wong lends money to the company, its liabilities and assets will increase by \$500,000. Then, the company uses the amount to repay debts. The assets and liabilities will decrease by \$100,000. Holding the amount in bank account will have no effect on the accounting equation. Therefore, the net change will be an increase of \$400,000 in both assets and liabilities.
18. **D**
When Mr. Wong lends money to the company, the double entries should be:
Dr. Cash \$500,000
 Cr. Loan from Mr. Chan \$500,000

When the company repays debts, the double entries should be:
Dr. Accounts payable \$100,000
 Cr. Cash \$100,000

The remaining cash is deposited into the bank account. The double entries should be:
Dr. Bank \$400,000
 Cr. Cash \$400,000

The overall entries should be:

Dr. Accounts payable \$100,000
 Dr. Bank \$400,000
 Cr. Loan from Mr. Chan \$500,000

19. **D**

Assets = Capital + Liabilities
 $X = \$350,000 + \$40,000 + \$60,000$
 $X = \$450,000$

20. **C**

As the computers purchased on credit are for resale purpose, the double entries should be:

Dr. Purchases \$50,000
 Cr. Accounts payable – Mr. Chan \$50,000

21. **C**

A is incorrect. Assets must be equal to the sum of liabilities and capital.
 B and D are incorrect. There are no fixed rules over which accounts have to be changed. The only governing rule is C, that the change in a debit-side entry must be compensated by a change in a credit-side entry.

22. **D**

A is incorrect. An increase in cash is represented by a debit entry in cash account.
 B is incorrect. A capital injection is represented by a credit entry in capital account.
 C is incorrect. A purchase of fixtures by cheque involves a credit entry in bank account but not cash account.

23. **A**

An increase in assets means a debit entry in assets accounts.

24. **C**

A purchase of office equipment on credit is represented by a debit entry in office equipment account and a credit entry in non-trade payables account. This increases the liability of the firm.

25. **B**

The double entries for capital injection should be:

Dr. Cash \$20,000
 Cr. Capital \$20,000

The double entries for the acquisition of the air-conditioner should be:

Dr. Fixtures \$5,000
 Cr. Cash \$5,000

Therefore, the closing balance of cash account is a debit balance of $\$20,000 - \$5,000 = \$15,000$.

Note: It is impossible for cash account to have a credit balance.

26. **A**

	\$
Opening balance	100,000
Purchase of machinery	400,000
Sale of machinery	(20,000)
Opening balance of the next month	<u>480,000</u>

27. C

	\$
Office equipment	5,000
Inventory	3,000
Cash	8,000
Bank	<u>10,000</u>
Capital as at 1 April 20X6	<u><u>26,000</u></u>

Note: Lending cash to *AAA Limited* has no effect on the total amount of capital. Also, the \$20,000 bank loan which is used to buy premises simultaneously increases the amount of assets and liabilities. Thus, there is no effect on the amount of capital.

28. A

By doing so, the asset and the liability of the company will both increase by \$30,000.

C is incorrect. The loan is borrowed under the name of the company but not the name of the owner.

D is incorrect. The loan borrowed remains in the company and is not taken by the owner. No drawings are incurred.

29. C

	\$
Capital injection	40,000
Purchase of furniture	<u>(10,000)</u>
Closing balance of cash account	<u><u>30,000</u></u>

30. D

The double entries for the setting up of the business should be:

Dr. Cash \$40,000

Dr. Motor vehicle \$30,000

Cr. Capital \$70,000

31. B

A is incorrect. The goods are bought on credit.

C is incorrect. Only purchases of goods should be recorded in the purchases account while the purchases of non-current assets should be recorded in their respective asset accounts.

D is incorrect. It is the double entries for repayment of accounts payable.

32. A

(1) is correct. The discount stated on a sales invoice is a trade discount.

(2) is incorrect. When there is a cash discount given by the seller, the price stated on the sales invoice is still the price before cash discounts. The cash discount is granted for early repayment of debts from debtors and is therefore unrelated to the discount given to the sales of goods.

(3) is incorrect. Returns outwards are goods returned to suppliers. They are recorded in debit notes and are hence not related to the price stated on the sales invoice.

33. A

Since only transaction 1, being related to sales of goods, should be recorded in the sales account, the amount recorded is \$10,000.

34. **A**
The double entries for the sales of goods on credit should be:
Dr. Accounts receivable \$10,000
Cr. Sales \$10,000

35. **C**
Total amount recorded in the sales account in this month is the sum of cash sales and credit sales.

	\$
Total amount of cash sales (5,000 + 1,000)	6,000
Total amount of credit sales (4,000 + 5,000)	<u>9,000</u>
Total amount recorded in the sales account	<u><u>15,000</u></u>

36. **D**
Total amount recorded in the purchases account in this month is the sum of cash purchases and credit purchases.

	\$
Total amount of cash purchases	12,000
Total amount of credit purchases	<u>3,000</u>
Total amount recorded in the purchases account	<u><u>15,000</u></u>

37. **D**

	Fanny		
	\$	\$	
Sales	4,000	Returns inwards	500
		Cash	<u>3,500</u>
	<u>4,000</u>		<u><u>4,000</u></u>

38. **A**
Discounts allowed to debtors will lower the amounts paid by the debtors.
B, C and D are incorrect. They are reasons for allowing discounts to debtors as discounts can encourage debtors to settle their accounts earlier and thus improve the liquidity of the company as well as reduce the level of bad debts. The longer the debts have stayed outstanding, the higher the chance of bad debts.

39. **C**
Credit period means the period during which customers should settle all debts owed, or an interest will be charged.

A and B are incorrect. Cash discounts will only be granted for settlements of debts in the cash discount period, which is usually shorter than the credit period. The granting of cash discounts has no relation with any purchases of goods within the credit period nor the cash discount period.

D is incorrect. Interests are charged on any outstanding debts held beyond the credit period. Paying one-third of the debts owed does not waive the interests.

40. **C**
Since the customer settles the amount after the 10-day cash discount period subsequent to the transaction but still within the 30-day credit period, he cannot enjoy a cash discount. Yet, as a trade discount is offered, the actual amount he needs to pay is:
 $10 \times \$200 \times 0.95 = \$1,900$

49. **D**

	\$
Opening debit balance	800
Addition:	
Accounts receivable - Mr. Wong	380
Deductions:	
Cash	(200)
Wages	(5,000)
Closing balance	<u>(4,020)</u>

50. **B**

When *ABC Company* purchases a computer as a non-current asset on credit, the entries should be:

Dr. Computer
 Cr. Non-trade payables – Peter Lee

It is not considered as an addition of capital since the owner and his brother are two separate entities, even though they are siblings.

51. **A**

The entries for the purchase of computer should be:

Dr. Purchases
 Cr. Accounts payable - Peter Lee

52. **B**

The double entries should be:

Dr. Non-current assets
 Cr. Non-trade receivable – Mr. Chan

Since Mr. Chan is a non-trade debtor, the return of non-current assets means reversing the entries posted previously.

53. **D**

Since the company would pay cash immediately when Mr. Chan returns the non-current asset, we would credit the cash account instead of the non-trade receivable account of Mr. Chan. The double entries for the transaction are as follows:

Dr. Non-current assets
 Cr. Cash

54. **A**

Fixture contributed by the owner is a kind of capital. The correct double entries should be:

Dr. Fixtures \$3,000
 Cr. Capital \$3,000

55. **D**

It is true by definition.

56. **A**

The double entries for the purchase of furniture on credit should be:

Dr. Furniture
 Cr. Non-trade payable – Ms. Lee

Purchases account is used to record the purchases of trading goods, but not the purchases of non-current assets.

57. **B**
 Settling loans by inventory reduces the amount of inventory bought for the purpose of resale; thus, the correct double entries should be:
 Dr. Loan from Mr. Lam
 Cr. Purchases
 Similarly, we would credit the purchases account instead of the inventory account when an owner draws goods for his personal use. The inventory account is only amended at the end of the accounting period after stock-taking under periodic inventory system.
58. **A**
 According to business entity concept, the business is a separate entity from its owners. Withdrawal of assets from the company should be regarded as drawings.
59. **A**
 The return of fittings would increase the amount of fittings. As *ABC Company* refunds on credit, a new non-trade payables account (Ms. Chan) should be credited.
60. **C**
 It is a capital injection and the amount of automobile will increase.
61. **D**
 (1) is incorrect. Drawings account is closed off every year and the balance is recorded in the balance sheet.
 (2) is incorrect. Accounts other than capital, like assets and liabilities accounts, have opening entries every year.
 (3) is incorrect. When there is bank overdraft, the opening entry will be recorded on the credit side.
62. **B**
 (1) is incorrect. Bank overdraft is a liability. An increase in such a liability should be credited to the bank account instead.
 (2) is incorrect. Bank overdraft interest is an expense, so the bank charges expense account, or the interest charges account, should be debited. Interest income account should not be debited.
 (3) is correct. An increase in bank deposit is an increase in asset. Therefore, the cash at bank account should be debited.
63. **A**
 (1) is incorrect. Reductions in the retail prices by the manufacturers due to bulk purchases refer to trade discounts.
 (2) is correct. Cash discounts received from suppliers must be a revenue.
 (3) is incorrect. Accounts payable should be debited instead as it is a deduction in the amount of money we have to pay.
64. **A**
 Opening capital as at 1 April 20X6
 = \$100,000 + \$85,000 = \$185,000
 Net profit for the year ended 31 March 20X7
 = \$80,000 – \$37,000 = \$43,000
 Closing capital as at 31 March 20X7
 = \$185,000 + \$43,000 – \$500 (Drawings for the year)
 = \$227,500

65. **C**
Mary is May Company's customer and she is part of the accounts receivable of the company. The balance of accounts receivable should be a debit one.
Amount of Mary's account in May Company's book on 31 March 20X6
= $\$27,000 \times 2 \div 3 + \$55,000$
= $\$73,000$
66. **C**
The balance of Tim's account in Tom's book
= $\$75,000 \div (1 - 40\%) \times (1 - 5\%) \times (4 \div 5)$
= $\$95,000$
67. **D**
(1) is incorrect. A trial balance cannot prevent fraud because it only checks the agreement of the two sides. There can still be manipulation of figures even if the trial balance agrees.
(2) is correct. A trial balance can examine whether the total of debit balances is equal to that of credit balances.
(3) is correct. A trial balance can detect arithmetic errors in the ledgers.
68. **D**
Without a trial balance, we cannot easily know if the total of debit balances is equal to that of credit balances.
A is incorrect. Double-entry system can still be applied in the accounting system even without a trial balance. The trial balance is not part of the double-entry system and only serves as one way to locate errors.
B is incorrect. Trial balance is not the only way to identify errors. There are still other means in the accounting system for identifying errors.
C is incorrect. There is no certain relationship between accounting ratios and trial balance. Numbers used to calculate accounting ratios can be obtained in financial statements.
69. **D**
The trial balance is usually prepared right before the financial statements. Therefore, it depends on the financial period the company adopted.
70. **B**
Trade discounts are excluded from the trial balance. Only the sales and purchases figures net of trade discounts are included in the trial balance. In fact, trade discounts are never recorded separately in any parts of the accounting system.
71. **A**
The dates of transactions are not shown on the trial balance. A trial balance consists of ledger accounts, debit balances and credit balances.
72. **D**
(1) and (2) are correct. The trial balance agrees only when the total of debit balances is equal to the total of credit balances.
(3) is correct. It is true when errors made in the ledger accounts are transferred directly to the trial balance. There is then a possibility that the trial balance does not agree.

73. **C**
Sales transactions recorded in purchases account would increase the debit balance, making it greater than the total amount of credit balance.
A and B are incorrect. The total credit balance would be greater than the total debit balance in these cases.
D is incorrect. The debit balance will still be equal to the total credit balance in this case.
74. **B**
Accounts receivable in the trial balance is understated by \$100, so the total debit balance is smaller than total credit balance under this situation.
A is incorrect. Creditors normally have credit balances, so posting their balances to the wrong side in trial balance means that the total debit balance would be greater than the total credit balance.
C is incorrect. Treating sales of goods as purchases of goods would increase the total debit balance. Thus the total debit balance would be greater than the total credit balance.
D is incorrect. The debit balance will still be equal to the credit balance.
75. **B**
(1) is incorrect. This error would not affect the agreement of trial balance since both Ms. Lee and Ms. Chan are debtors.
(2) is correct. Posting a smaller amount of balance would result in a shortfall in the total credit balance. Thus, the total credit balance is smaller than the debit balance.
(3) is incorrect. The same amount is undervalued on both debit and credit sides.
76. **D**
The purchase of non-current assets being wrongly recorded on the credit side of the account will understate the debit balance while overstating the credit balance in the trial balance, making both sides of the trial balance disagree.
A is incorrect. Purchases of non-current assets and inventory will both debit the asset accounts. Therefore, the total debit balance still equals the total credit balance.
B is incorrect. This error will not affect the agreement of the trial balance as the debit balance is the same as if the transaction were recorded correctly.
C is incorrect. Confusing cash payment with cheque payment will not affect the debit balance of trial balance as it is only the matter of whether the bank or the cash account should be credited, so it cannot be identified in the trial balance.
77. **A**
Furniture is an asset account and the balance is stated on the debit side. Overvaluation of assets will lead to a surplus in the total debit balance.
78. **A**
(1) and (2) are incorrect. They would not affect the trial balance agreement.
(3) is correct. Recording the cash receipt as a cash payment would cause the debit balance to be understated by \$2,000.

79. **B**
Debit side is greater than credit side by \$4,000.

	Dr		Cr
	\$		\$
Non-current assets	10,000	Accounts payable	3,000
Cash and bank	5,000	Sales	15,000
Accounts receivable	3,000	Capital	30,000
Electricity	3,000		
Rates	1,000		
Purchases	30,000		
Total	52,000	Total	48,000

80. **A**
Electricity, an expense of the company, is stated as a debit balance in the trial balance.
81. **C**
The amount of capital should be \$4,000 higher to restore the trial balance agreement.
82. **D**
(1) is incorrect. It would not affect the trial balance agreement.
(2) is correct. The debit side will be overstated in this case.
(3) is correct. It will overstate the accounts receivable and understate the accounts payable.
83. **C**
Balance of capital account is on the credit side because it shows how the company finances the acquisition of assets.
84. **A**
(1) is correct. Trial balance can serve as a reference when preparing financial statements.
(2) is incorrect. Trial balance is prepared for internal use.
(3) is incorrect. Trial balance can only help spot some errors. Errors may still exist even if the trial balance agrees.
85. **A**
Balance of capital account is on the credit side of the trial balance because it shows how the company finances the acquisition of assets.
B is incorrect. Bank overdraft is stated on the credit side.
C is incorrect. Returns inwards is the contra account of sales. It should be stated on the debit side.
D is incorrect. Returns outwards is the contra account of purchases. It should be stated on the credit side.

86. **B**
(1) is incorrect. Having a credit balance in the bank statement means the bank owes the company money and the company will have a debit balance in the bank account. In short, the placement of entries in the debit or credit sides in the company's books is the reverse of that in a bank statement.
(2) is correct. Bank overdraft is a liability.
(3) is incorrect. The appearance of credit balance in the bank account may be a sign of the existence of a liquidity problem in the company but not a result of it.
87. **C**
(1) is correct. Normally, opening inventory but not closing inventory is recorded in the trial balance. Yet, the amount of inventory on the trial balance is the closing inventory if the trial balance is done after the preparation of the financial statements.
(2) is incorrect. There must be a debit balance for cash in hand account as the amount of cash in hand cannot be negative.
(3) is incorrect. Errors that do not affect the agreement of balances can still exist, such as omissions of entries.
88. **B**
Even though the total of the two sides are equal, there is still a mistake. The drawings account with a credit balance definitely indicates errors. It is not needed to prepare financial statements before determining the correctness of the trial balance.
89. **B**
Opening inventory should be recorded on the debit side.
A is incorrect. Returns outwards should be recorded on the credit side.
C is incorrect. Closing inventory will not be recorded in the trial balance until the financial statements are prepared. It is debited to the inventory account and credited to the cost of goods sold when preparing the income statement.
D is incorrect. Interest income is a revenue. It should be recorded on the credit side.
90. **D**
(1) is incorrect. Both income statement and statement of financial position are not parts of the double-entry system.
(2) is incorrect. Both income statement and statement of financial position need to be included in the audit report as they are financial statements required to be disclosed by regulations.
(3) is incorrect. Income statement shows the expenses and revenues of the company while statement of financial position shows the assets, liabilities and capital of the company.
91. **C**
By definition, current assets refer to the assets that can be easily converted into cash within 1 year.
92. **D**
Non-current liabilities refer to any debts that are to be repaid more than one year later.
A is incorrect. It is a current asset.
B and C are incorrect. Both of them normally have to be repaid within one year, i.e. they are current liabilities.

93. **D**
Non-current assets refer to any assets that are not expected to be converted into cash within one year and that can generate probable economic benefits as long as they are kept in the company and its accounts. Accounts receivable is usually repaid within one year.
94. **C**
By definition, current liabilities mean any debts that have to be repaid within one year.
95. **C**
It is impossible to have net current assets when current assets are smaller than the current liabilities. The company will have net current liabilities in this case.
A is incorrect. It is possible for the value of current assets to be greater than the value of current liabilities. In other words, the company has net current assets.
B is incorrect. It is impossible to have net current assets and net current liabilities at the same time. Either one of them will exist, depending on the respective values of current assets and current liabilities.
D is incorrect. When the value of current assets is larger than the value of current liabilities, the difference between them is called net current assets. Therefore, it is impossible to have net current liabilities in this case.
96. **D**
Since the question does not state the length of time the loan is borrowed, we cannot determine if it is a current or non-current liability. If it has to be repaid within one year, it is a current liability. Otherwise, it is a non-current liability.
97. **A**
Net profit appears in both income statement and statement of financial position as the net profit calculated in income statement would be added to the capital whose balance is shown in the statement of financial position.
B is incorrect as 'drawings' only appears in the statement of financial position.
C is incorrect as 'accounts receivable' only appears in the statement of financial position.
D is incorrect as 'electricity expenses' appears in the income statement only.
98. **B**
The amount of inventory stated under the current assets is closing inventory as all the balances stated in the statement of financial position reveal the values as at the end of the financial year.
99. **D**
The sequence from the most liquid current asset to the least liquid one is cash, bank, accounts receivable and inventory since it is more difficult to convert inventory into cash, compared with other current assets.
100. **A**
By definition, net current assets mean the surplus value of current assets over current liabilities.
B is incorrect. When the value of current assets is smaller than the value of current liabilities, the deficit is defined as net current liabilities.
D is incorrect. When there are no current liabilities in the company, net current assets may not exist in case the company holds no current assets.

101. **A**

Current assets – Current liabilities = Working capital

Cash + Bank + Inventory – Accounts payable = \$4,000 + \$1,000 + \$5,000 – \$3,000 = \$7,000

102. **B**

We should debit the profit and loss account and credit the capital account as it is an increase in capital if there is a net profit earned. Net profit is not recorded in a separate account but appears in the profit and loss account.

103. **A**

	\$
Opening balance of capital	40,000
Less: Net loss	1,000
	39,000
Less: Drawings	3,000
Closing balance of capital	36,000

104. **C**

Working capital is the difference between current assets and current liabilities. Only items classified as current assets and current liabilities can affect the amount of working capital. As bank overdraft is a current liability, it can affect working capital. A, B and D are incorrect. Drawings and net loss affect the capital while plant and machinery affects non-current assets.

105. **B**

Debts to be repaid after one year are classified as non-current liabilities. Yet, they are recorded as current liabilities when they have to be repaid within one year.

A is incorrect. Long-term investments should be classified as non-current assets.

C is incorrect. There is no minimum required amount for non-current liabilities.

D is incorrect. The classification depends on the repayment period. If the bank loan is to be paid within one year, it should be classified as a current liability.

106. **C**

Only cash and bank accounts which are both current assets are affected. The increase in cash cancels out the effect of the decrease in bank account. Thus, there is no change in the amount of current assets and current liabilities.

107. **C**

By definition, Gross profit = Net sales – Cost of goods sold

108. **D**

Gross profit – Net profit = Operating expenses

Among the four items, only carriage outwards account belongs to operating expenses.

A, B and C are incorrect. Returns inwards, returns outwards and carriage inwards are not operating expenses.

109. **A**
 In a services firm, there will not be any purchases or cost of goods sold. In other words, there is no trading account.
 B, C and D are incorrect. These kinds of expenses and revenues are also incurred and earned in a services firm.
110. **A**
 Gross profit
 = Net sales – Cost of goods sold
 = Gross sales – Returns inwards
 – (Opening inventory + Purchases + Carriage inwards – Returns outwards – Closing inventory)
 = \$160,000 – \$0 – (\$0 + \$140,000 + \$0 – \$0 – \$0)
 = \$20,000
111. **B**
 Net profit
 = Gross profit + Other revenues – Expenses
 = \$20,000 + \$40,000 – \$5,000 – \$10,000
 = \$45,000
112. **B**
 For closing entries, trading account should be debited and purchases account should be credited.
 A is incorrect. They are the double entries for closing the sales account.
 D is incorrect. They are the double entries for purchases transactions.
113. **A**
 Cost of goods sold
 = Opening inventory + Purchases – Returns outwards + Carriage inwards – Closing inventory
 = \$20,000 – \$1,000
 = \$19,000
114. **C**
 Gross profit
 = Net sales – Cost of goods sold
 = \$50,000 – \$19,000
 = \$31,000
115. **B**
 The purchase of stationery should be treated as an expense. When closing an expense account, we should debit the profit and loss account and credit the expense account.
116. **D**
 By definition, carriage inwards is an expense incurred to bring the inventory purchased from suppliers to the company.
 C is incorrect. It is the definition of carriage outwards.

117. **B**

$$\begin{aligned} & \text{Cost of goods sold} \\ &= \text{Purchases} + \text{Carriage inwards} - \text{Closing inventory} \\ &= \$10,000 + \$5,000 - \$7,000 \\ &= \$8,000 \end{aligned}$$

118. **A**

$$\begin{aligned} & \text{Gross profit} \\ &= \text{Net sales} - \text{Cost of goods sold} \\ &= \$40,000 - (\$10,000 + \$5,000 - \$7,000) \\ &= \$32,000 \end{aligned}$$

119. **A**

Net profit = Gross profit + Other revenue – Operating expenses
Carriage inwards is not an operating expense nor an other revenue but is included in the trading account.

120. **A**

$$\begin{aligned} & \text{Net profit} \\ &= \text{Gross profit} + \text{Other revenues} - \text{Expenses} \\ &= \$32,000 - \$9,000 - \$4,000 - \$3,000 \\ &= \$16,000 \end{aligned}$$

121. **A**

The opening inventory is part of the cost of goods sold. Therefore, we should debit the trading account and credit the inventory account for the transfer in this case.

C and D are incorrect. There is no such an account called ‘opening inventory’ account. Indeed, we need to close the ‘inventory’ account which is created at the end of the financial year. A new inventory account which shows the amount of closing inventory will be set up at the end of the financial year.

122. **B**

It is true by definition.

123. **B**

It is true by definition.

124. **C**

	\$
Opening inventory	50,000
Add: Purchases	45,000
	<u>95,000</u>
Less: Returns outwards	2,000
	<u>93,000</u>
Less: Closing inventory	5,000
Cost of goods sold	<u><u>88,000</u></u>

125. A

	\$
Sales	100,000
Less: Returns inwards	<u>1,000</u>
	99,000
Less: Cost of goods sold	<u>88,000</u>
Gross profit	<u><u>11,000</u></u>

126. A

	\$
Gross Profit	11,000
Less: Carriage outwards	<u>5,000</u>
Net Profit	<u><u>6,000</u></u>

127. A

(1) is correct. The carriage inwards is treated as cost of goods sold as it is the cost incurred to bring the inventory to the company's warehouse while carriage outwards is treated as operating expense.

(2) and (3) are incorrect. Both items are expenses.

128. C

	\$
Gross sales	400,000
Less: Returns inwards	<u>80,000</u>
Net sales	<u><u>320,000</u></u>

129. A

	\$
Gross purchases	90,000
Less: Returns outwards	<u>70,000</u>
Net purchases	<u><u>20,000</u></u>

130. B

Net sales	\$	\$
		320,000
Less: Cost of goods sold		
Opening inventory	30,000	
Add: Purchases	90,000	
Carriage inwards	<u>40,000</u>	
	160,000	
Less: Returns outwards	<u>70,000</u>	
Closing inventory	20,000	70,000
(balancing figure)		
Gross profit		<u><u>250,000</u></u>

131. **D**

	\$
Gross profit	250,000
Add: Other revenues	<u>4,000</u>
	254,000
Less: Carriage outwards	10,000
Salaries	9,000
General expenses	<u>7,000</u>
Net profit	<u><u>228,000</u></u>

132. **B**

- (1) is incorrect. Cash sale is relevant as it is a part of the total sales.
 (2) is incorrect. Returns inwards are to be deducted from the total sales to calculate net sales.
 (3) is correct. Discounts allowed is irrelevant when calculating net sales as they are cash discounts awarded for customers who settle debts early, which is an expense subtracted from the gross profit. Such an amount does not affect sales amount.

133. **A**

A debit balance in the profit and loss account means a net loss is incurred.

	\$
Opening capital	25,000
Less: Net loss	<u>7,000</u>
	18,000
Less: Drawings	<u>5,000</u>
Closing capital	<u><u>13,000</u></u>

134. **C**

	\$
Accounts payable	2,000
Bank overdraft	<u>3,000</u>
Total current liabilities	<u><u>5,000</u></u>

135. **A**

	\$
Accounts receivable	3,000
Cash	<u>5,000</u>
Total current assets	8,000
Less: Total current liabilities	<u>5,000</u>
Working capital	<u><u>3,000</u></u>

136. **D**

In an accounting cycle, bookkeepers have to record the transactions in the books of original entry first. Then, they should post the transactions under the respective ledger accounts. At the end of the financial period, they should prepare a trial balance and financial statements. Keeping the transaction records in a safety box is not one of the procedures.

137. **A**

Personal accounts are accounts that are registered in the name of legal entities. Debtors' and creditors' accounts are personal accounts while B, C and D are nominal accounts.

138. C

Sales revenue is the income from selling goods, so it is a nominal account.

A and D are incorrect. Most of the nominal accounts are temporary accounts and thus they will not be carried forward. Instead, they will be written off at the end of the accounting period.

B is incorrect. Nominal accounts refer to accounts representing revenues and expenses. Hence, accounts receivable is not an example of nominal accounts.

139. A

Real accounts represent assets and liabilities.

B, C and D are incorrect. They are nominal accounts.

140. B

	\$
Opening balance of capital	40,000
Add: Net profit (balancing figure)	<u>15,000</u>
	55,000
Less: Drawings	<u>5,000</u>
Closing balance of capital	<u><u>50,000</u></u>

141. D

	\$	\$
Sales		10,000
Less: Cost of goods sold		
Purchases	4,000	
Add: Carriage inwards	<u>4,000</u>	
	8,000	
Less: Closing inventory	<u>500</u>	7,500
Gross profit		2,500
Add: Other revenues		<u>2,000</u>
		4,500
Less: Rates expenses		<u>1,000</u>
Net profit		<u><u>3,500</u></u>

142. C

Among all options, only carriage inwards is a nominal account. All items in the income statement, except inventory, come from nominal accounts which will be closed off every year.

143. D

	\$
Opening balance of capital	75,000
Add: Net Profit	<u>3,500</u>
	78,500
Less: Drawings	<u>6,000</u>
Closing balance of capital	<u><u>72,500</u></u>

144. B

A and D are incorrect. They are current assets.

C is incorrect. Long-term loans are regarded as non-current liabilities.

145. B

	\$
Current assets	
Cash	5,000
Inventory	500
Accounts receivable	7,000
	12,500
Less: Current liabilities	
Accounts payable	5,000
Bank overdraft	3,000
Working capital	4,500

146. C

For all assets and liabilities, the more liquid items are usually placed at the bottom while those that are less liquid are placed on the top.

147. A

Working capital is the difference between current assets and current liabilities. A cash refund increases the amount of cash, which is a current asset. Therefore, working capital is increased. Net profit is not affected as there are no changes in expense and revenue.

148. C

	\$
Furniture	90,000
Machinery	45,000
Inventory	36,000
Bank	5,000
Capital balance as at 1 January 20X7	176,000

149. C

Real accounts are the accounts that do not close at the end of the financial year. Assets and liabilities are the examples of real accounts. Nominal accounts are the accounts that are closed at the end of each financial year.

The balance of loan account will be carried forward to become the beginning balance of the next accounting period. It is a real account.

A is incorrect. Stationery is an expense. The account will be closed at the end of the financial year. It is a nominal account but not a real account.

B is incorrect. Utilities are a kind of expense.

D is incorrect. Loan interest is an expense.