

# Paper P2

## Performance Management

Step one is to establish the position. In this case, if KL were to replace its non-current assets with new equipment at a cost of \$1.2m, this would cause a significant increase in the depreciation charge for the year.

Step two is to calculate the new depreciation figure for 2013. In this case the charge would be  $\$1,200,000 \times 25\% = \$300,000$ .

Step three is to calculate the new fixed cost for 2013 as follows:

	\$000
Original fixed production costs	200
Administration costs	80
Additional fixed costs (£60,000 a year)	60
New depreciation	300
Total fixed cost	640

Step four is to calculate the new C/S ratio. The existing C/S ratio in this case is  $590 \div 990 = 59.6\%$ , which we calculated in step one of answering part (b). We need to repeat this calculation to help us understand the change that gives rise to the new C/S ratio. Because the variable production

costs are expected to fall by \$80,000 a year, the new C/S ratio will be  $(590 + 80) \div 990 = 67.677\%$ .

Step five is to calculate the new break-even sales value by dividing the new total fixed cost by the new C/S ratio:  $\$640,000 \div 67.677\% = \$945,668$ .

Step six is to establish the difference in break-even sales values. Without the investment, the break-even sales value is \$649,119. With the investment, it's \$945,668, revealing an increase of  $\$296,549$  – a 45.7 per cent rise.

When you have finished your answer, you should ask yourself the following questions:

- Have I written clearly? Will a marker be able to read my answer easily?
- Are all the figures clearly labelled?
- Are my calculations legible? Are my workings referred to clearly?
- Is the answer sensible – i.e. does it fit the context of the question?
- Have I used the units specified in the question – e.g. dollars or pounds?
- Have I answered the question, as opposed to answering the question I'd like to have seen?

# Paper C02

## Fundamentals of Financial Accounting

**As with many topics, you would be well advised to practise a methodical approach to answering questions about suspense accounts, which are highly likely to appear in the C02 exam**

By Cathy Sibley  
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A suspense account is a temporary account in the nominal ledger that is used in two main situations. The first is where a trial balance does not balance: a suspense account is opened, which will be investigated and cleared later. The second is when a transaction needs to be recorded, but its exact details are not

known – e.g. a receipt has appeared in the bank account but the source of that money is unclear. The entry would be Dr Bank, Cr Suspense until the source of the receipt can be found and the suspense account cleared.

For the purposes of the C02 exam, a suspense account balance will be provided, probably based on the first type of situation I have described, together with a number of errors that have been uncovered. Your task will be to resolve these and clear the suspense account. Although the use of computerised accounting systems has rendered any failure of a trial balance to balance unlikely – or even impossible, according to some – such scenarios are still extremely examinable. Questions involving suspense accounts are a good test of your double-entry skills, requiring you to establish what has happened and decide how to correct it. ►

# Paper C02

## Fundamentals of Financial Accounting

Let's work through a typical example involving suspense accounts to show how to tackle such questions in the exam.

A trial balance has an excess of debits over credits of \$8,800. A suspense account has been opened to make it balance. It's later discovered that:

1. The discount allowed balance of \$6,000 and the discount received balance of \$14,000 had both been entered on the wrong side of the trial balance.
2. An item of \$500 had been omitted from the sales records – i.e. the sales day book.
3. The purchase ledger control account balance of \$467,572 had been included in the trial balance as \$474,772.

The first step is to open a suspense account. As there are more debits than credits, you will need to start with a credit balance of \$8,800 to balance the account:

Suspense account	
Dr	Cr
	TB difference 8,800

Let's consider each piece of information in turn. Note 1 states that the discount allowed balance of \$6,000 and the discount received balance of \$14,000 were both entered on the wrong side of the trial balance, so first we need to establish what should have been recorded:

Discount allowed is a debit entry:

Dr Discount allowed: \$6,000.

Cr (unknown account):

Discount received is a credit entry:

Dr (unknown account):

Cr Discount received: \$14,000.

For discount allowed you must move the entry from the credit side to the debit side. To do this, the account will need to be debited twice: once to cancel the credit entry and a second time to create the correct debit balance. For discount received you must move the entry from the debit side to the credit side. To do this, the account will need to be credited twice: once to cancel the debit entry and a second time to create the correct credit balance.

Rather than record two journal entries, it is just as easy to double the amount of the adjustment. So, if the error is \$6,000, use \$12,000 (2 x \$6,000) to correct it.

Note 1 tells us nothing about the other side of the entry, as shown in our journal entries above. If the opposite side of an entry is not mentioned,

it's safe to assume that there are no problems and it will not need correcting.

That leaves us with two correcting entries that do not balance each other:

Dr Discount allowed: 2 x \$6,000 = \$12,000.

Cr Discount received: 2 x \$14,000 = \$28,000.

Each journal is completed with the suspense account as the opposite entry:

Dr Discount allowed: 2 x \$6,000 = \$12,000.

Cr Suspense: \$12,000.

Dr Suspense: \$28,000.

Cr Discount received: 2 x \$14,000 = \$28,000.

Now we can update the suspense account:

Suspense account		
	Dr	Cr
Discount received	28,000	TB difference 8,800
		Discount allowed 12,000

As the suspense account has not yet been cleared, we must move on to note 2, which tells us that an item of \$500 was omitted from the sales records – ie, the sales day book. This error of omission means that neither side of the transaction was recorded and the entry is completely missing from the trial balance.

All that's required is for the correct entry to be recorded for sales from the sales day book:

Dr Sales ledger control account: \$500.

Cr Sales: \$500.

As you can see in this case, not all errors will require an adjustment in the suspense account.

With no impact on the suspense, we now need to look at note 3 to help clear the balance. It states that a purchase ledger control account balance of \$467,572 had been included in the trial balance as \$474,772. This is an extraction error, whereby the balance of a ledger account is entered incorrectly in the trial balance. The correct balance must be shown in the trial balance for accuracy, so the balance needs to be adjusted.

The purchase ledger control account needs to reduce from \$467,572 to \$474,772 – i.e. a decrease of \$7,200.

This is a credit balance, so to reduce it you must post a debit. With an extraction error there is no opposite side to the correction, because all other balances are correct. The balancing entry will go to the suspense account:

Dr Purchase ledger control account: \$7,200.

Cr Suspense account: \$7,200.

Now we can update the suspense account again:

Suspense account			
	Dr		Cr
Discount received	28,000	TB difference	8,800
		Discount allowed	12,000
		Purchase ledger	
		control account	<u>7,200</u>
	<u>28,000</u>		<u>28,000</u>

The account is now cleared.

Let's work through another exam example, which does *not* represent a typical exam question.

The trial balance of Cuan, a limited-liability company, at 31 December 2011 did not balance. There was an excess of debits over credits of \$19,960. On investigation, the following errors and omissions were found (when all of these were corrected, the trial balance agreed):

1. On 31 December 2011 the purchase of a delivery vehicle on credit for \$57,200 had been recorded by debiting the supplier account and crediting the motor vehicle expense account.
2. A cheque for \$1,600 received from a customer to whom goods are regularly supplied on credit was correctly entered into the cash book, but posted to the debit side of the sales account.

3. A loan of \$40,000 from one of the directors had been entered correctly in the cash book but posted to the wrong side of the loan account.

4. The company had purchased some plant on 1 January 2011 for \$32,000. The payment was correctly entered in the cash book but credited to the plant cost account. The depreciation rate for such plant is 20 per cent a year on the straight-line basis.

5. When the company's cash book was reconciled with the bank statement, it was found that bank charges of \$380 had not been entered correctly in the bank charges expense account. They had been debited to bank.

You are required to prepare journal entries and write up the suspense account to correct all of the errors listed.

First, we need to set up the suspense account as follows:

Suspense account		
	Dr	Cr
	TB difference	19,960

Next, we go through the notes in order again. Note 1 tells us that the whole entry is wrong, so this will not affect the suspense account. The ►

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# Paper C02

## Fundamentals of Financial Accounting

supplier account ought to show a credit balance of \$57,200, with a corresponding debit balance in the delivery vehicle cost account, and the expense entry must be cleared:

Dr Delivery vehicle cost: \$57,200 – to show the purchase of the asset.

Dr Motor vehicle expense: \$57,200 – to clear the incorrect entry to expenses.

Cr Supplier account:  $2 \times \$57,200 = \$114,400$  to turn the debit balance to a credit balance.

Note 2 tells us that a cheque for \$1,600 received from a customer to whom goods are regularly supplied on credit was entered correctly in the cash book, but posted to the debit side of the sales account. Here, the correct entry has gone to the cash book but the opposite side is incorrect.

The right entry would have been:

Dr Cash book: \$1,600.

Cr Receivables (customer account): \$1,600.

But the actual entry was:

Dr Cash book: \$1,600.

Dr Sales: \$1,600.

The original entry does not balance owing to the use of two debits – instead of showing the reduction in the balance owed by the customer, it has cancelled the sale. This cancellation must be reversed and the reduction in the customer's account balance must be recognised.

The correcting entry is therefore as follows:

Cr Sales: \$1,600 – to reverse the cancellation.

Cr Receivables: \$1,600 – to recognise the reduction in the balance owing.

Dr Suspense: \$3,200 – because the cash book side of the entry is correct.

Note 3 tells us that a loan of \$40,000 from one of the directors had been entered correctly in the cash book, but posted to the wrong side of the loan account. The accounts used are correct but the debit and credits are not.

The right entry would have been:

Dr Cash book: \$40,000.

Cr Loan account: \$40,000.

But the actual entry was:

Dr Cash book: \$40,000.

Dr Loan account: \$40,000.

The loan account entry must be changed from a debit to a credit, so the amount of \$40,000 will be posted twice and then the suspense account is used to balance the entry.

The correcting entry is therefore as follows:

Cr Loan account:  $2 \times \$40,000 = \$80,000$ .

Dr Suspense: \$80,000.

Note 4 tells us not only that the \$32,000 entry to the plant cost account on 1 January 2011 was incorrect but also that it affects depreciation.

The right entry would have been:

Dr Plant cost: \$32,000.

Cr Cash book: \$32,000.

But the actual entry was:

Cr Plant cost: \$32,000.

Cr Cash book: \$32,000.

We need to convert the credit entry to plant cost to its correct debit entry, so again the amount of \$32,000 will be posted twice and the suspense account used to balance the entry as follows:

Dr Plant cost:  $2 \times \$32,000 = \$64,000$  – to recognise the asset.

Cr Suspense: \$64,000.

As a result, the balance on the plant cost account will be \$64,000 higher, so the depreciation charge needs to be adjusted as follows (this won't affect the suspense account, but it will change the profit and carrying value for non-current assets):

Dr Depreciation expense:  $\$64,000 \times 20\% = \$12,800$ .

Cr Accumulated depreciation: \$12,800.

Note 5 tells us that bank charges of \$380 hadn't been entered correctly in the bank charges expense account but had been debited to bank.

The correct entry would have been:

Dr Bank charges: \$380.

Cr Bank: \$380.

But the actual entry was:

Dr Bank charges: \$380.

Dr Bank: \$380.

The debit entry needs to be made into a credit entry, so \$380 will be posted twice and the suspense account used to balance the entry as follows:

Cr Bank:  $2 \times \$380 = \$760$ .

Dr Suspense: \$760.

We can now put all the entries into the suspense account and see that they've cleared the balance:

Suspense account		
	Dr	Cr
Credit customer receipt (note 2)	3,200	TB difference 19,960
Loan account (note 3)	80,000	Plant cost (note 4) 64,000
Bank (note 5)	760	
	<u>83,960</u>	<u>83,960</u>