

# FRANK WOOD'S **BUSINESS ACCOUNTING**

ALAN SANGSTER  
LEWIS GORDON



An introduction to  
**FINANCIAL ACCOUNTING**

 Pearson

**15th edition**

FRANK WOOD'S  
**BUSINESS ACCOUNTING**

If (a) is greater than (b) then the balance must be paid to HMRC. Businesses must submit the return and electronically pay any tax due within about a month of the end of the quarter.

Occasionally, for some businesses (b) may be greater than (a) so HMRC will refund the difference to the business.

The figures entered on a business's VAT return must be checked very carefully because the potential penalties for any errors can be very severe.

Smaller businesses are allowed to submit their VAT returns annually rather than quarterly. This reduces the administrative burden on small businesses.

#### Activity 16.5

Why do you think that it is rare for a business's Input VAT (i.e. VAT on goods and services bought) for the period to be greater than its Output VAT (i.e. VAT on goods and services sold)? Can you think of any circumstances where it might happen?

## 16.14 HM Revenue and Customs (HMRC) VAT Guides and Notices

The detailed rules surrounding VAT are exceptionally complex and are beyond the scope of this book. However, all the rules (as well as introductory guidance) are available online and (at the time of writing) can be found from the GOV.UK website. Searching online for 'HMRC VAT videos' might be a good place to start.

### Learning outcomes

You should now have learnt:

- 1 VAT is a tax charged on the supply of the majority of goods and services in the UK and the standard rate of VAT is 20%.
- 2 Most businesses must 'register' for VAT, which means they must charge VAT on their sales and (in due course) pay this 'Output VAT' to HMRC.
- 3 VAT-registered businesses are also allowed to reclaim from HMRC the VAT they pay on the goods and services they buy.
- 4 Amounts excluding VAT are known as 'net' and those including VAT are referred to as 'gross'.
- 5 The VAT on every credit sale must be separately recorded in a separate column in the sales day book. The total amount due from each customer will be debited to the personal accounts; the net amount of the sales made will be credited to the sales account; and the VAT on these sales is credited to the Output VAT account.
- 6 A VAT-registered business must record the VAT on credit purchases in a separate column in the purchases day book. The total amount owed to each supplier will be credited to the personal accounts; the net amount of the purchases will be debited to the purchases account; and the VAT on the purchases made is debited to the Input VAT account.
- 7 At the end of each period (normally every three months) VAT-registered businesses must submit a VAT return to HMRC which states (a) the total Output VAT charged on sales for

the period; and (b) the total Input VAT incurred on goods and services bought during the period. Usually (a) will exceed (b) and this excess must be paid to HMRC.

- 8 To calculate the VAT included in a gross amount you can simply multiply the gross amount by  $1/6$  ( $1/6$  being the 'VAT fraction' when the rate of VAT is 20%).

Now attempt Set 2 of multiple-choice questions. (Answers to all the multiple-choice questions are given in Appendix 2 at the end of this book.)

## Answers to activities

- 16.1** There are various reasons. Above all, it will ease the administrative burden on small firms. Many small businesses are 'sole traders' who have to perform virtually all business tasks on their own, and VAT record-keeping means a lot of extra work. Second, it will potentially give small businesses a competitive advantage because their prices will be 20 per cent lower than those of larger rivals who must add VAT. This is good for encouraging small businesses and is also beneficial for consumers. Finally, it makes life simpler for HMRC. HMRC's resources are not unlimited, so exempting small businesses means that HMRC can focus its efforts on checking that larger businesses are accounting for VAT correctly.
- 16.2** The simple answer is that the final consumers pay  $£2,200 \times 20\% = £440$  in VAT for their furniture and this will be the total that is collected by HMRC. However, the actual chain of events can be quite confusing:
- X receives £1,200 (i.e.  $£1,000 + 20\%$  VAT) from Y and X must hand over the **£200** VAT on this transaction to HMRC.
  - Y receives £1,800 (i.e.  $£1,500 + 20\%$  VAT) from Z and Y owes the **£300** VAT on this transaction to HMRC. But Y can also reclaim the **£200** VAT it paid on its purchase from X, so only actually hands over the difference (**£100**) to HMRC.
  - Z receives £2,640 (i.e.  $£2,200 + 20\%$  VAT) from its customers. Z therefore collects **£440** in VAT on these sales which it owes to HMRC, but it can also reclaim the **£300** VAT it paid to Y, so only hands over the difference (**£140**) to HMRC.

So the customers have paid a total of **£440** in VAT and cannot reclaim it. But this VAT has actually been collected by HMRC by way of **£200** from X, **£100** from Y and **£140** from Z as described above!

- 16.3** The advantage of registration would be that all the input VAT paid on the goods and services that the business buys can be reclaimed from HMRC. In the early stages of a new business, this could be advantageous if it is investing a lot in inventory and non-current assets. Another possible advantage is that registering for VAT may help the business appear big and reputable. The final (and perhaps most important) factor is whether most of the small business's customers are themselves VAT-registered. If they are, they will be able to reclaim all the VAT that the small business charges on its sales. Such customers won't be affected by whether the small business adds 20 per cent VAT to its prices. In these circumstances voluntary registration would probably be a good idea.
- 16.4** Smaller businesses are allowed to account for VAT on a 'cash basis' rather than the standard method described in this chapter. The 'cash basis' means that the small business only has to pay the output VAT on its sales to HMRC after the money has been received from the customer. If a few credit customers don't pay their bills (i.e. there are 'bad debts') then the VAT on these sales will never have to be paid to HMRC. It is usually a good idea for eligible small businesses to adopt the 'cash basis' for VAT because this method will generally be better for the business's cash flow.
- 16.5** Businesses normally aim to make a profit, so the sales revenue of the business will normally exceed the cost of goods and services purchased in the period. The output VAT at 20 percent on sales will therefore be greater than the input VAT at 20 per cent on goods and services purchased. However, input VAT might exceed output VAT for a new business in its first few months of trading: a new business might buy large quantities of inventory, equipment and advertising but sales may be very low initially.
- Another example might be a highly seasonal business. Some businesses may make the bulk of their annual sales in one particular quarter of the year. In preparation, such businesses may purchase large quantities of inventory

in the preceding quarter. For such a business, input VAT could therefore exceed output VAT during that preceding quarter.

A third example would be a trader that only sold zero-rated goods (such as young children's clothes). The output VAT on sales would be zero but the business could still reclaim input VAT on many of its expenses.

## Review questions

**16.1** On 1 March 2024, A. Cook, 7 Down Road, Middlefield, sold the following goods on credit to B. Pitt, Ballano Golf Club, Ringlee, Yorkshire:

Order No. B/162  
 5 sets golf clubs at £1,250 per set.  
 500 golf balls at £25 per 10 balls.  
 5 golf bags at £370 per bag.

Trade discount is given at the rate of 30%.

All goods are subject to VAT at 20%.

- Prepare the sales invoice. The invoice number will be 4231.
- Show the entries in the personal ledgers of A. Cook and B. Pitt.

**16.2A** On 1 March 2020, B. Cox, Middle Road, Paisley, a VAT-registered business, sold the following goods on credit to T. Ross, 24 Peter Street, Loughborough, Order No. 9841:

20,000 Coils Sealing Tape	@ £6.70 per 1,000 coils
40,000 Sheets Bank A5	@ £5.20 per 1,000 sheets
24,000 Sheets Bank A4	@ £9.00 per 1,000 sheets

All goods are subject to VAT at 20%.

- Prepare the sales invoice (the invoice number will be 4632).
- Show the entries in the personal ledgers of B. Cox and T. Ross.

**16.3** The following sales have been made by C. Rice during the month of March 2024. All the figures are shown net after deducting trade discount, but before adding VAT at the rate of 20%.

		£
March	2 to G. Bush	430
	6 to A. Gray	290
	14 to L. Rowe	560
	31 to S. Pegg	320

You are required to enter up the Sales Day Book, Sales Ledger and General Ledger in respect of the above items for the month.

**16.4** The following sales and purchases were made by C. West during the month of May 2024.

		Net	VAT added
		£	£
May	1 Sold goods on credit to J. Royce	290	58
	4 Sold goods on credit to D. Player and Co	440	88
	10 Bought goods on credit from:		
	B. Hunter	360	72
	R. Dixon Ltd	230	46





		<i>Net</i>	<i>VAT added</i>
		£	£
14	Bought goods on credit from G. Melly	80	16
16	Sold goods on credit to D. Player and Co	170	34
23	Bought goods on credit from G. Gooch	120	24
31	Sold goods on credit to N. Foster	110	22

Enter up the Sales and Purchases Day Books, Sales and Purchases Ledgers and the General Ledger for the month of May 2024.

**16.5** You are informed that J. Beckham is a VAT-registered retailer. Her total sales for the week just ended amounted to £14,540 excluding VAT. All the business's sales are subject to VAT at 20%. Beckham deposited the entire week's takings in the business bank account. What will be the entries in the business's general ledger that record this information?

**16.6** Ghadiali & Co is a VAT-registered business. In the three months ended 31 July the business sold goods with a net value of £143,200, all of which were subject to VAT at standard rate (20%). In the same quarter, the business bought goods and services (all of which were subject to VAT at standard rate) totalling £104,550 including VAT.

After preparing its VAT return for the quarter ending 31 July, how much VAT must the business pay to HMRC?

**16.7A** Robles & Co is a VAT-registered business. During the quarter just ended, it bought goods and services to the value of £51,690 excluding VAT, and its sales were £81,906 including VAT. All of the business's sales are subject to VAT at 20%. However, only two-thirds of the goods and services it buys are subject to VAT at 20%. The other third are either zero-rated or exempt.

After preparing its VAT return for the quarter just ended, how much must the business pay to HMRC?

**16.8** Up until December 2020, K. Heitinga sold T-shirts for £12 including VAT at 20%.

Suppose that the government announces a reduction in the rate of VAT to 15%, effective from 1 January 2021 onwards.

If Heitinga reduces her selling price to exactly reflect the change in VAT rate, what will the selling price of her T-shirts be in 2021?

**16.9A** G. Brown's sales including VAT were £130,000 in November 2020, then £150,000 in December 2020, and £110,000 during January 2021.

Suppose that the rate of VAT was 20% until 31 December 2020 and 22.5% from 1 January 2021. Exactly three-fifths of Brown's net sales are subject to VAT, the rest being zero-rated.

What is the correct total credit to Output VAT in Brown's general ledger for the quarter to 31 January 2021?

**16.10** Louise Baldwin commenced business as a wholesaler on 1 March 2019.

Her sales on credit during March 2019 were:

March 9	Neville's Electrical
	4 computer monitors list price £180 each, less 20% trade discount
March 17	Maltby plc
	20 computer printers list price £200 each, less 25% trade discount
March 29	Neville's Electrical
	Assorted software list price £460, less 20% trade discount

All transactions are subject to Value Added Tax at 10%.

- (a) Rule up a Sales Day Book and head the main columns as follows.

<i>Date</i>	<i>Name and Details</i>	<i>List price less trade discount</i>	<i>VAT</i>	<i>Total</i>
		<i>£-p</i>		<i>£-p      £-p</i>

Enter the above information in the Sales Day Book, totalling and ruling off at the end of March 2019.

- (b) Make the necessary postings from the Sales Day Book to the personal and nominal accounts in the ledger.
- (c) Prepare a trial balance as at 31 March 2019.

(Edexcel Foundation, London Examinations: GCSE)

**16.11A** Mudgee Ltd issued the following invoices to customers in respect of credit sales made during the last week of May 2020. The amounts stated are all net of Value Added Tax. All sales made by Mudgee Ltd are subject to VAT at 15%.

<i>Invoice no.</i>	<i>Date</i>	<i>Customer</i>	<i>Amount</i>
			<i>£</i>
3045	25 May	Laira Brand	1,060.00
3046	27 May	Brown Bros	2,200.00
3047	28 May	Penfold's	170.00
3048	29 May	T. Tyrrell	460.00
3049	30 May	Laira Brand	1,450.00
			<u>£5,340.00</u>

On 29 May Laira Brand returned half the goods (in value) purchased on 25 May. An allowance was made the same day to this customer for the appropriate amount.

On 1 May 2020 Laira Brand owed Mudgee Ltd £2,100.47. Other than the purchases detailed above Laira Brand made credit purchases (including VAT) of £680.23 from Mudgee Ltd on 15 May. On 21 May, Mudgee Ltd received a cheque for £2,500 from Laira Brand.

**Required:**

- (a) Show how the above transactions would be recorded in Mudgee Ltd's Sales Day Book for the week ended 30 May 2020.
- (b) Describe how the information in the Sales Day Book would be incorporated into Mudgee Ltd's double entry system.
- (c) Reconstruct the personal account of Laira Brand as it would appear in Mudgee Ltd's ledger for May 2020.

(Association of Accounting Technicians)



## Multiple-choice questions: Set 2

Each of these multiple-choice questions has four suggested answers, (A), (B), (C) and (D). You should read each question and then decide which choice is best, either (A) or (B) or (C) or (D). *Write down your answers on a separate piece of paper.* You will then be able to redo the set of questions later without having to try to ignore your answers from previous attempts.

**MC21** Gross profit is

- (A) Excess of sales over cost of goods sold
- (B) Sales less purchases
- (C) Cost of goods sold + opening inventory
- (D) Net profit less expenses of the period

**MC22** Net profit is calculated in the

- (A) Trading account
- (B) Profit and loss account
- (C) Trial balance
- (D) Balance sheet

**MC23** To find the value of closing inventory at the end of a period we

- (A) Do this by physically counting the inventory (i.e. stocktaking)
- (B) Look in the inventory account
- (C) Deduct opening inventory from cost of goods sold
- (D) Deduct cost of goods sold from sales

**MC24** The credit entry for net profit is on the credit side of

- (A) The trading account
- (B) The profit and loss account
- (C) The drawings account
- (D) The capital account

**MC25** Which of these best describes a balance sheet?

- (A) An account proving the books balance
- (B) A record of closing entries
- (C) A listing of balances
- (D) A statement of assets

**MC26** The descending order in which current assets should be shown in the balance sheet is

- (A) Inventory, Trade receivables, Bank, Cash
- (B) Cash, Bank, Trade receivables, Inventory
- (C) Trade receivables, Inventory, Bank, Cash
- (D) Inventory, Trade receivables, Cash, Bank

**MC27** Which of these best describes non-current assets?

- (A) Items bought to be used in the business
- (B) Items which will not wear out quickly
- (C) Expensive items bought for the business
- (D) Items having a long life and not bought specifically for resale