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Accounting

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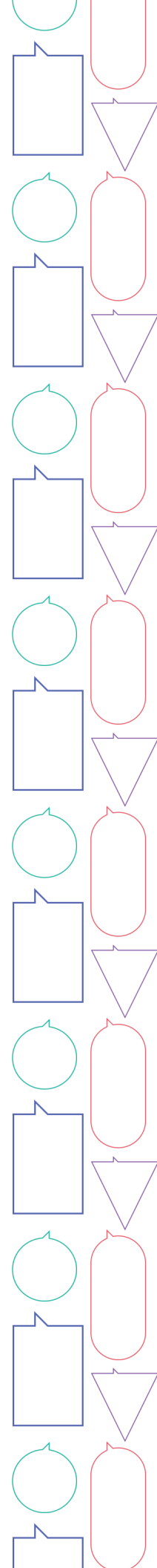
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6.1 Accounting for an organization with incomplete records

What are incomplete records?

Incomplete records are where a business does not keep a full set of accounting records, books and ledger accounts. This is usually because the owner(s) have decided not to keep a full set of accounting records, such as not using the double-entry system of recording transactions. For a sole trader, there are less legal requirements made on the type of financial records needed and therefore it may be easier and less costly not to keep full records. It could also be because the complete (full) records were lost or damaged in the business due to an accident, such as a fire on the premises.

Businesses must ensure that they pay the correct amount of tax. This can often be calculated without access to a full set of records. Sole traders and other businesses with fewer records than a large company may complete single-entry accounts. However, it is still possible to reconstruct important information, such as profit, from these incomplete records if you use a variety of accounting techniques.

Building skills

What sort of financial records would you keep if you started your own business tomorrow? Discuss this issue with a partner. What do you think you are legally required to keep in terms of financial records?

Calculation of profit where there is insufficient information to prepare income statements

Sometimes it may be possible to calculate profit even if an income statement cannot be prepared. If there is no record of all the transactions that have taken place for a period of time then it may not be possible to construct an income statement. For example, not knowing the level of sales, or the level of purchases, or all of the different expenses makes preparing an income statement impossible in most cases. However, even without these records, you can still calculate the profit for the period by using a **statement of affairs**.

Objectives

You will be able to:

- calculate profits where there is insufficient information to prepare income statements
- use statements of affairs to calculate profits
- use accounting techniques to prepare and analyse financial statements for businesses with incomplete records
- use the following techniques to find missing information: control/total accounts, cash and bank accounts, ratios, depreciation of non-current assets, calculation of profit or loss on disposal of assets, using financial statements to find missing figures
- understand the benefits and limitations of maintaining records using different systems such as single and double entry records.

Key terms

Incomplete records: where businesses do not maintain (or have lost access to) a full and complete system of accounting records (accounts and daybooks).

Statement of affairs: a statement which lists the assets and liabilities of an organization, often used to calculate capital.

Calculating profits from a statement of affairs

A statement of affairs uses the accounting equation to calculate the level of capital. Capital is the difference between the values for total assets and total liabilities. You should also know that if capital changes over time, then this must be due to any of the following occurring:

- capital contributions change from the owners (i.e. they place more of their own resources into the business)
- drawings change (i.e. the owner takes resources from the business for private use)
- profits (or losses) are generated.

As long as you know the values for further capital contributions and drawings, then adjustments can be made and therefore any further unexplained changes in capital must be the result of profits or losses being made.

$$\text{Profit} = \text{Change in capital} + \text{Drawings for period} - \text{Capital contributions during period}$$

Worked example 1: Preparing a statement of affairs to calculate capital

A sole trader knows that the value of their net assets (i.e. capital) as of 1 April 2025 was \$17,456. By 31 March 2026 they could supply the following data relating to the assets and liabilities of his business:

	\$
Non-current assets	21,456
Inventory	5,013
Trade receivables	1,948
Bank	1,376
Trade payables	2,412
Expenses owing	76
Prepayments	56

During the year they took cash drawings of \$50 per week. They also introduced new assets into the firm from their own private resources. These new assets have an estimated value of \$10,000.

You can use a statement of affairs to calculate their profit for the year ended 31 March 2026:

Statement of affairs as of 31 March 2026		
Assets	\$	\$
Non-current assets	21,456	
Inventory	5,013	
Trade receivables	1,948	
Bank	1,376	
Prepayments	<u>56</u>	<u>29,849</u>
Liabilities		
Trade payables	2,412	
Expenses owing	<u>76</u>	<u>2,488</u>
Net assets (i.e. capital)		<u>27,361</u>



Once you have the end of year capital figure, you can make adjustments to the changes in capital to estimate profit for the year.

To remove the effects of extra capital contributed, you subtract the capital contributions made. To remove the effects of drawings taken, you add back their value. Any remaining changes in capital will be the result of a profit being made (or a loss).

	\$
Capital at 1 April 2025	17,456
Capital at 31 March 2025	<u>27,361</u>
Change in capital	9,905
Add back drawings (52 × \$50)	<u>2,600</u>
	12,505
Less capital introduced	<u>10,000</u>
Profit for the year	2,505

Accounting techniques to prepare and analyse financial statements

There are a variety of accounting techniques that can be used where incomplete records exist. Some of these techniques have been covered earlier in the textbook in other topics.

Using control/total accounts

Control accounts (also known as total accounts) are used to verify the accuracy of the sales and purchases ledgers. However, they can also be used to find out missing information where only incomplete records are available.

Specifically, you can use control accounts when you lack information about the value of credit sales and credit purchases. As long as you have information relating to receipts and payments in respect of credit sales and credit purchases, and balances for trade receivables and trade payables, then you can calculate the missing figures as required.

Exam tip

Control accounts only help to calculate credit sales and credit purchases – look out for any sign of cash sales or cash purchases when completing questions and ensure these are added on to the totals where relevant for credit sales and credit purchases.

Worked example 2: Preparing control accounts to calculate credit sales

There is no information relating to credit sales for the year ending 31 December 2025. However, the following data is available:

	\$
Balances of trade receivables at 1 Jan 2025	5,420
Balances of trade receivables at 31 Dec 2026	4,975
Receipts for credit sales	26,540
Sales returns	1,048





By preparing a sales ledger control account you can calculate the total for credit sales.

Sales ledger control account

2025			\$	2025			\$
1 Jan	Balances b/d		5,420	31 Dec	Bank		26,540
31 Dec	Credit sales (*)		27,143	31 Dec	Sales returns		1,048
				31 Dec	Balance c/d		4,975
			<u>32,563</u>				<u>32,563</u>
2026							
1 Jan	Balance b/d		4,975				

(*) This is the figure needed that enables the account to total up correctly.

You can also calculate a missing figure for credit purchases if the information is not available.

Worked example 3: Preparing control accounts to calculate credit purchases

The following data is available for the year ended 30 June 2025:

	\$
Balance of trade payables at 1 July 2024	11,231
Balance of trade payables at 30 June 2025	7,810
Payments made for trade payables	88,888
Discounts received	2,280
Purchases returns	3,333

You can prepare a purchases ledger control account to calculate the figure for credit purchases for the year ended 30 June 2025.

Purchases ledger control account

2024/25			\$	2024/25			\$
30 Jun	Bank		88,888	1 Jul	Balance b/d		11,231
30 Jun	Discounts received		2,280	30 Jun	Credit purchases (*)		91,080
30 Jun	Returns outwards		3,333				
30 Jun	Balance c/d		7,810				
			<u>102,311</u>				<u>102,311</u>
				2025/26			
				1 Jul	Balance b/d		7,810

(*) This is the missing figure needed for the totals on each side to agree correctly.

Using cash accounts and bank accounts

It may be useful to reconstruct the cash and bank accounts in order to calculate missing figures. If cash has been stolen the reconstruction using actual sales figures and amounts paid or received may help the firm to actually work out how much cash should be there, and to compare those with the actual amounts of cash there.

It is often the case that, when calculating cash sales, we find that the money from this transaction has been banked after certain expenses (including drawings) have been paid. In this case, it would be necessary to 'add back' these expenses to arrive at the correct figure for cash sales.

An example covering this technique is included towards the end of this chapter.

Using ratios where incomplete records exist

Accounting ratios can be used to calculate missing information where incomplete records exist. Accounting ratios combine financial data to produce a number – either a ratio, a percentage or a number of times – which can then be used to interpret some aspect of business performance. However, if you know the formulae, you can manipulate these so as to calculate missing figures where you have incomplete information.

Mark-up and gross profit margin

One helpful piece of information is the relationship between the gross profit margin and the mark-up. Both include gross profit in their calculation but whereas gross profit margin uses revenue, the mark-up uses cost of sales instead.

Imagine a business purchases inventory for \$800 which is later sold for \$1000.

The gross profit margin will be:

$$\frac{\text{Gross profit}}{\text{Revenue}} \times 100 = \frac{\$200}{\$1000} = 20\% \text{ or } \frac{1}{5}$$

The mark-up will be:

$$\frac{\text{Gross profit}}{\text{Cost of sales}} \times 100 = \frac{\$200}{\$800} = 25\% \text{ or } \frac{1}{4}$$

The relationship between the two ratios can be summarized as follows:

Margin		Mark-up
$\frac{1}{n}$	therefore	$\frac{1}{n-1}$

Links

For more about these ratios, refer to topic 3.4.

This means that as long as you know the mark-up, or the margin as a percentage or fraction, you can calculate the other. An example of how this might work follows.

Worked example 4: Using the mark-up and margin relationship to calculate purchases

Opening inventory	\$12,000
Closing inventory	\$25,000
Sales	\$120,000
Mark-up	50%

You can use this information to calculate the value of purchases.

You know that mark-up is 50% or $\frac{1}{2}$. This means that from this you can calculate that the gross profit margin will be:

$$\frac{1}{(2 + 1)} = \frac{1}{3} \text{ or } 33.3\%.$$

In this case, you can calculate that the gross profit (measured in \$) will be:

$$\$120,000 \times 33.3\% = \$40,000.$$

If gross profit = \$40,000 then the cost of sales must be \$80,000 (Sales – Cost of sales = Gross profit).

Cost of sales = Opening inventory + Purchases – Closing inventory			
\$80,000	\$12,000	?	\$25,000

Therefore, purchases must be \$93,000.

You can also use knowledge of this relationship to calculate the value of any inventory that may have been stolen or damaged.

Worked example 5: Using the mark-up and margin relationship to calculate the value of stolen inventory

A local tennis club sells tennis shirts to its members at a discounted price in order to generate funds for the club. However, in December a number of shirts were stolen. The treasurer of the club is unaware of the exact value of the shirts stolen.

The following information is available:

	\$
Inventory of tennis shirts as at 1 December	130
Inventory of tennis shirts as at 31 December	30
Purchases of tennis shirts in December	880
Sales of tennis shirts in December	1,000





The tennis club sells all shirts at a mark-up of $\frac{1}{3}$.

You can use the relationship between mark-up and margin to calculate the cost value of the shirts that were stolen in December:

If mark-up is $\frac{1}{3}$ then the gross profit margin must be $\frac{1}{4}$ or 25%.

This means that from sales in December of \$1,000, \$250 must be gross profit and \$750 the cost of sales.

Cost of sales	=	Opening inventory	+	Purchases	–	Closing inventory
\$750		\$130		\$880		?

The closing inventory should have been \$260 for the above equation to be true but there are only shirts with a value of \$30 remaining.

This means the value of the shirts stolen is $\$260 - \$30 = \$230$.

Using inventory turnover

Inventory turnover can also be used when there are incomplete records. With the formula it may be possible to calculate values for opening or closing inventory, purchases and the cost of sales.

Worked example 6: Using inventory turnover to calculate purchases

From the following information, you can calculate the value of purchases for the year.

Inventory at start of year	\$7,000
Inventory at end of year	\$11,000
Inventory turnover	12 times

If you substitute numbers into the formula for inventory turnover:

$$\text{Inventory turnover} = \frac{\text{Cost of sales}}{\text{Average inventory}} = 12 = \frac{\text{Cost of sales}}{(\$7,000 + \$11,000) / 2}$$

$$12 = \frac{\text{Cost of sales}}{\$9,000}, \text{ therefore cost of sales} = 12 \times \$9,000 = \$108,000$$

From this, you can calculate purchases as $\$108,000 + \$11,000 - \$7,000 = \$112,000$.

Using profit in relation to revenue to calculate profit for the year

Profits can also be estimated using the profit in relation to revenue ratio (i.e. profit for year/revenue \times 100). As long as the ratio percentage is known, and the size of the revenue, the profit for the year can then be calculated.

Worked example 7: Calculating profit for the year

Morton does not keep complete records. The following information is available for the most recent financial year:

	\$
Inventory at the start of the year	8,000
Inventory at the end of the year	14,000
Purchases	50,000

Morton sells all their goods at a mark-up of 20%. They have a target for profit in relation to revenue of 5%.

Assuming Morton achieves their target, you can calculate the level of profit for the most recent financial year as follows:

Morton's cost of sales will be: $\$8,000 + \$50,000 - \$14,000 = \$44,000$.

In this case the value of sales will be 120% of $\$44,000 = \$52,800$.

Overall profit for the year will be 5% of $\$52,800 = \$2,640$.

Where incomplete records have been maintained there are other techniques that can be used to discover the correct values to be used.

Depreciation and profits and losses on disposal of non-current assets

Where the totals for depreciation are not present, it is possible to calculate the correct value by comparing the change in the net book value of any non-current assets over a period of time. This would need to be adjusted for any non-current assets purchased or disposed of during the current period.

Similarly, if non-current assets are sold during the current period, then it will be necessary to calculate the profit or loss on the disposal of these assets.

These techniques and ones covered earlier are included in the following worked example. This worked example also uses financial statements to find missing figures.

Exam tip

You may need to think carefully about which techniques to use when completing full financial statements from incomplete records. It is possible that you may select the wrong technique initially – keep trying and do not give up.

Worked example 8: Preparing financial statements using a variety of techniques

Martin Roach runs a successful coffee shop. He has not kept full records and wishes to prepare an income statement for the year ended 31 December 2025. He can supply the following information:

	1 Jan 2025	31 Dec 2025
	\$	\$
Non-current assets at net book value	25,000	???
Inventory	10,600	???
Cash	540	220
Expenses owing	–	150
Expenses prepaid	200	–
Trade payables	2,400	3,700

The following is a summary of the bank account of the shop for the full year:

Bank			
	\$		\$
Balance b/d	9,900	Wages	9,500
Non-current assets	10,000	Expenses	6,200
Receipts from customers	96,000	Drawings	3,500
Cash sales banked	21,020	Payments for purchases	69,500
		Non-current assets	4,500
		Balance c/d	43,720
	<u>136,920</u>		<u>136,920</u>

Additional information:

- Roach uses a mark-up of 50% on the drinks that he sells.
- His total sales for the year were \$120,000 with cash sales totalling \$24,000.
- All purchases were on credit.
- He banked all his cash sales but took personal drawings from this of \$150 every month.
- The non-current assets sold during the year originally cost \$8,000 and had been depreciated by \$2,200 when they were sold.
- Depreciation is to be provided on non-current assets at 20% using the straight-line method on the assets held at the close of the year.
- Roach believes he has been careless and misplaced some cash during the year and worries that it might have been stolen.

You can use the techniques covered in this chapter to prepare an income statement for Martin Roach for the year ended 31 December 2025 and a statement of financial position at that date.





Preparation of an income statement where there are incomplete records will require a variety of techniques to be used before you can start the income statement.

It is important that you spend time producing solutions and workings for figures before you even begin to prepare the full income statement.

You know that total sales were \$120,000. You also know that there is a mark-up of 50% (i.e. $\frac{1}{2}$).

This means that the profit margin must be 33.3% or $\frac{1}{3}$, based on the relationship between mark-up and margin.

This means that if sales are at \$120,000, then gross profit must be \$40,000 and cost of sales must be \$80,000.

You now need to calculate the purchases figure. This can be calculated using a control account.

Purchases ledger control account			
	\$		\$
Bank	69,500	Balance b/d	2,400
Balance c/d	3,700	Purchases	70,800
	<u>73,200</u>		<u>73,200</u>

There are no cash purchases so purchases, calculated as the missing figure in the above control account, are \$70,800.

The figure to be used for expenses will use the figure from the bank account adjusted for outstanding balances at the start of and at the end of the year.

Expenses			
	\$		\$
Balance b/d	200	Income statement	6,550
Bank	6,200		
Balance c/d	150		
	<u>6,550</u>		<u>6,550</u>

The profit or loss on asset disposal is calculated as follows:

	\$
Sales value of asset	10,000
Net book value of asset sold (\$8,000 – \$2,200)	5,800
Profit on disposal	4,200





To calculate the value of depreciation, you would need to know the value of non-current assets at cost at the year end. This can be calculated as shown (right).

The year's depreciation on non-current assets will be $20\% \times \$23,700 = \$4,740$

The amount of cash that might have been misplaced can be calculated as follows:

Non-current assets:	\$
Net book value at start of year	25,000
Add purchases during year	<u>4,500</u>
	29,500
Less net book value of asset disposal	<u>5,800</u>
Net book value at end of year (before depreciation)	<u>23,700</u>

Cash			
	\$		\$
Balance b/d	540	Cash banked	21,020
Cash sales	24,000	Cash drawings	1,800
		Cash misplaced (missing figure)	1,500
		Balance c/d	220
	24,540		24,540

The cash misplaced of \$1,500 is calculated in the account as the figure which allows the account to balance up correctly.

From all this information and all the workings completed, you can now prepare the income statement.

Martin Roach
Income statement for year ended 31 December 2025

	\$	\$
Revenue		120,000
Less cost of sales:		
Opening inventory	10,600	
Add Purchases	<u>70,800</u>	
	81,400	
Less Closing inventory (*)	1,400	80,000
Gross profit		40,000
Add Profit on disposal		4,200
		44,200
Less Expenses		
Expenses	6,550	
Cash misplaced	1,500	
Wages	9,500	
Depreciation	4,740	<u>22,290</u>
Operating profit		<u>21,910</u>

(*) This figure is based on what would produce a cost of sales figure of \$80,000.





To prepare the statement of financial position, you would need to know the opening balance for capital. To calculate this value, a statement of affairs can be used:

	\$
Assets	
Non-current assets	25,000
Inventory	10,600
Bank	9,900
Cash	540
Prepayments	<u>200</u>
	46,240
Liabilities	
Trade payables	2,400
Capital	43,840

The statement of financial position is as follows:

Martin Roach
Statement of financial position as of 31 December 2025

	\$	\$
Non-current assets	23,700	
Less depreciation	<u>4,740</u>	18,960
Current assets		
Inventory	1,400	
Bank	43,720	
Cash	<u>220</u>	<u>45,340</u>
Total assets		<u>64,300</u>
Current liabilities		
Trade payables	3,700	
Accrued expenses	<u>150</u>	3,850
Capital	43,840	
Add Operating profit	<u>21,910</u>	
	65,750	
Less Drawings	<u>5,300</u>	<u>60,450</u>
Total capital and liabilities		<u>64,300</u>

Exam tip

Look carefully at the wording of any exam question. If it asks for an income statement then that is what you must prepare, but if it asks only for profit, an income statement may not be necessary (or possible) to prepare.

Maintaining records using different systems of bookkeeping

So far in this book, you have assumed that all organizations will use a system of double-entry bookkeeping.

Double-entry bookkeeping

Most businesses will use double-entry bookkeeping when recording financial transactions. Increasingly this system will be automated through the use of computing software that automatically completes the double-entry records for the business. This system of bookkeeping certainly has benefits over other systems (such as single-entry bookkeeping) but it also has limitations.

Links

For more about double-entry bookkeeping, refer to topic 1.2.

Benefits of double-entry bookkeeping	Limitations of double-entry bookkeeping
It provides an arithmetic check on the accuracy of the bookkeeping. A trial balance can be prepared from the accounts and if this fails to agree then errors must be present in the double-entry system.	Not all errors are identified, even if the totals of the trial balance extracted from the double-entry accounts agree with one another.
It can act as a back-up in case some of the records are lost, or where not correctly entered in the first place. By recording each item twice, the chances of the entry being lost completely are reduced.	More expertise will be needed to prepare a double-entry set of accounts, compared with keeping basic, single records.
By keeping a full set of double-entry accounts, it makes it easier to analyse the various incomes and expenses and to get an overview of how the business is performing.	It takes more time to complete.

▲ **Table 6.1:** Benefits and limitations of double-entry bookkeeping.

Single-entry bookkeeping

Small non-profit making organizations, such as charities and clubs, may keep their financial records through a process of single-entry bookkeeping where each transaction is recorded as one single entry.

Benefits of single-entry bookkeeping	Limitations of single-entry bookkeeping
This form of financial record-keeping is simple. It can often be as straightforward as preparing only a receipts and payments account.	The receipts and payments account expenditure does not distinguish between day-to-day revenue expenditure and longer-term capital expenditure on assets. This is an important distinction for when a firm wants to calculate the level of profit for the period – assets would not normally be deducted as expenses.
A business that only prepares a receipts and payments account for its main financial records still needs to keep records and details of the types of payments and types of receipts in each transaction. This will enable a firm to calculate the level of profit or loss generated. However, this may not be necessary for a non-profit making organization.	Single-entry has no self-checking mechanism whereas double-entry bookkeeping includes built-in checks into it as an accounting system, such as the use of a trial balance in checking for certain types of errors. This makes it easier to spot mistakes with double-entry accounting (though mistakes still occur).
	Attempting to control spending within the business may require records of where the business spends money. This may not be easy to locate unless there are separate records (i.e. individual accounts) prepared for each type of expense.
	Not having full accounting records makes it easier for theft by business employees to take place. Obviously a one person organization will not face this as a problem.

▲ **Table 6.2:** Benefits and limitations of single-entry bookkeeping.

Summary questions

1. State two reasons why a sole trader may not maintain complete accounting records.
2. A business owner's net assets as of 1 January 2025 were valued at \$25,899. By 31 December 2025 they could supply the following data relating to the assets and liabilities of the firm:

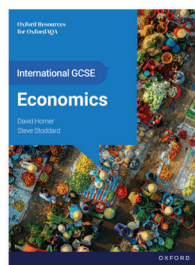
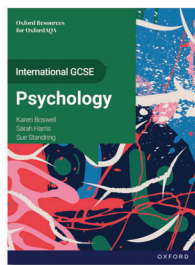
	\$
Non-current assets	34,000
Inventory	7,560
Trade receivables	3,290
Bank overdraft	8,768
Trade payables	4,310
Expenses owing	987
Cash in till	56
Prepayments	182

The owner used the business resources to pay for a family holiday which cost \$3,500. They also took cash drawings of \$50 per week. Calculate the profit for the year ending 31 December 2025 based on the information supplied.

3. Based on the following data, calculate the value of sales for the year of 2025:
 - Inventory at 1 January 2025 \$700
 - Inventory at 31 December 2025 \$900
 - Purchases for year \$5,000
 - Gross margin profit 50%

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