



**Accounting Principles**  
**Question Paper, Answers and**  
**Examiner's Comments**

**Level 3 Diploma**

**January 2014**



© Copyright of the Institute of Credit Management

Institute of Credit Management

The Water Mill, Station Road, South Luffenham, Oakham, Leicestershire LE15 8NB

Bookshop Tel: 01780 722901. Education Tel: 01780 722909

Switchboard Tel: 01780 722900. Fax: 01780 721333

January 2014

7B/PQP/1

continued





Institute of Credit Management

## **Accounting Principles questions, answers and examiners' comments**

Level 3 Diploma in Credit Management

### **JANUARY 2014**

Instructions to candidates

Answer any **FIVE** questions. All questions carry equal marks.

Time allowed: 3 hours

---

**All ledger accounts must be prepared in continuous balance format**  
**Final accounts must be prepared in vertical format**

**Where appropriate, VAT is to be calculated at 20%**

**Questions start on the next page**

*There appears to be a distinct improvement on the last exam series with most students achieving either a Level 2 or 3 pass. Learners seemed better prepared this time with some very good marks being secured. Format, structure and presentation are definitely on the up especially with regards to the trading and profit and loss account (income statement) and the balance sheet (statement of financial position) which has caused a few problems with learners in the past. Those questions that require some narrative are still lacking in some cases with only a few words offered being the order of the day. In some instances the question was totally ignored, forfeiting valuable marks.*

*It is important too that students cover all parts of the syllabus in their preparation. Management accounting does form an integral part of the indicative content so questions on areas such as budgeting and variance analysis can and will appear again in future diets.*

*Questions one, two, seven and four were the most popular, question 6 the least, with student preferences being equally divided amongst the other three.*



1. Selected account balances brought forward on 1/1/2014 in the ledger of P. Scott, a sole trader are as follows:

Balances as at 31 December 2013	£
Bank	1,750.00 overdrawn
VAT	50.00 owed by HMRC
Purchases	2,750.00
Sales	12,500.00
C Evans	500.00 dr
T Andrews	300.00 cr
Discount allowed	75.00
Discount received	50.00

During January the following transactions were recorded:

- January 2 A cheque for £460.00 was received from C Evans in full settlement of her debt. The rest is to be treated as a discount
- January 3 An invoice was received from T Andrews for £800.00 plus VAT
- January 6 Invoice was raised for £600.00 inclusive of VAT for C Evans
- January 8 P Scott pays T Andrews £1,200.00 in full settlement of his account. The balance is to be treated as a discount
- January 14 P. Scott takes £900.00 out of the bank for his own personal use
- January 21 P. Scott purchases a new photocopier from Xyes Ltd for £1,800.00 plus VAT.

### TASK

- a) Open all accounts that are necessary to record the above transactions and enter the balance brought forward from the previous accounting period. All credit balances must be shown in brackets. (4 marks)
- b) Post necessary entries in the relevant accounts to record transactions, ensuring that you account correctly for any discounts and VAT. (12 marks)
- c) Explain the difference between trade and cash discount and how they are treated in the accounts. (4 marks)

Total 20 marks

### Question aims

To test the candidate's ability to:

- Prepare double entry accounts
- Calculated VAT
- Deal correctly with discounts, drawings and the purchase of a fixed asset.



**Suggested answer**

a) &amp; b)

**Account: Bank**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			(1,750)
2 January 2014	C Evans	460		(1,290)
8 January 2014	T Andrews		(1,200)	(2,490)
14 January 2014	Drawings		(900)	(3,390)
21 January 2014	Photocopier		(2,160)	(5,550)

**Account: VAT**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			50
3 January 2014	T Andrews	160		210
6 January 2014	C Evans		(100)	110
21 January 2014	Bank	360		470

Comment [GD1]: 21

**Account: Purchases**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			2,750
3 January 2014	T Andrews	800		3,550

**Account: Sales**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			(12,500)
6 January 2014	C Evans		(500)	(13,000)

**Account: C Evans**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			500
2 January 2014	C Evans		(460)	40
2 January 2014	Discount allowed		(40)	Nil
6 January 2014	Sales	600		600

**Account: T Andrews**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			(300)
3 January 2014	Purchases		(800)	(1,100)
3 January 2014	VAT		(160)	(1,260)
8 January 2014	Bank	1,200		(60)
8 January 2014	Discount received	60		Nil

**Account: Discount Allowed**

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			75
2 January 2014	C Evans	40		115

January 2014

7B/PQP/4

continued



Account: Discount Received

Date	Details	Dr £	Cr £	Balance
1 January 2014	Balance b/f			(50)
8 January 2014	T Andrews		(60)	(110)

Account: Drawings

Date	Details	Dr £	Cr £	Balance
14 January 2014	Bank	900		900

Account Photocopier

Date	Details	Dr £	Cr £	Balance
21 January 2014	Bank	1,800 <sup>½</sup>		1,800

Comment [GD2]: 21

- c) Trade discount is the selling or list price reduction offered to trade customers to encourage customer loyalty and possibly more frequent and larger orders. It is applied at the time that goods and services are purchased and is calculated and shown on the invoice. Trade discounts do not appear in the account at any stage.

Cash discount is a reduction from the invoiced goods value which is deducted if payment is made within a certain period. This is often a tactic used to encourage payment to terms or early payment. Cash discounts appear in both the ledger and final accounts of a business.

**Total 20 marks**

*A very popular question, as ever. Most candidates have no trouble opening individual accounts with an opening balance but unfortunately in some cases there was a problem in differentiating between debit and credit balances in part a).*

*Posting individual transactions to ledgers was well handled in part b) in the main, though some did fail to identify in the balance column (by using brackets) whether they were a debit or credit balance – thus making the closing balance incorrect, forfeiting valuable marks.*

*In some cases presentation and format could have been better.*

*With regard to part c), most students made a sound attempt at describing each but a number failed to identify how each type of discount is handled in the accounts.*



2. The managing director of Knox Limited has approached your organisation requesting a substantial increase in their credit facilities in order to fund an expansion programme. You are presented with the latest set of abridged accounts below.

Knox Limited Profit and Loss Account for the year ended 31 December 2013

	2013		2012	
	£	£	£	£
Turnover		8,030		7,300
Cost of sales		<u>4,818</u>		<u>4,234</u>
Gross profit		3,212		3,066
Distribution costs	1,606		1,320	
Admin expenses	<u>600</u>		480	
		<u>2,206</u>		<u>1,800</u>
Operating profit		1,006		1,266
Interest		<u>200</u>		<u>200</u>
Profit before tax		806		1,066
Tax		<u>286</u>		<u>372</u>
Profit attributable to shareholders		520		694
Dividend		<u>320</u>		<u>400</u>
Retained profit		<u>200</u>		<u>294</u>

Balance sheet as at 31 December 2013

	2013		2012	
	£	£	£	£
<b>Fixed assets</b>				
Plant and machinery		<u>4,000</u>		<u>3,960</u>
<b>Current assets</b>				
Stocks	1,800		1,392	
Debtors	960		800	
Bank	40		238	
	<u>2,800</u>		<u>2,430</u>	
<b>Current liabilities</b>				
Trade creditors	520		200	
Proposed dividend	320		400	
Taxation	160		170	
Accruals	100		120	
	<u>1,100</u>		<u>890</u>	
<b>Net current assets</b>		<u>1,700</u>		<u>1,540</u>
		5,700		5,500
10% debenture		2,000		2,000
Financed by:				
Ordinary shares of £1		<u>900</u>		<u>900</u>
Retained profit		<u>2,800</u>		<u>2,600</u>
		<u>3,700</u>		<u>3,500</u>

Comment [GD3]: Should be bold

Comment [GD4]: Should be on the next line down

Comment [GD5]: Should be on the next line down

Comment [GD6]: Missing figures here;  
1,392  
800  
238  
2,430



## TASK

a) You need to assess the viability of this proposition by calculating the following financial ratios:

- i) Gross profit margin. (2 marks)
- ii) Operating margin. (2 marks)
- iii) The return on capital employed. (2 marks)
- iv) Current ratio. (2 marks)
- v) Quick ratio. (2 marks)
- vi) Debtor days (receivables). (2 marks)
- vii) Creditor days (payable). (2 marks)
- viii) Stock turnover in day's inventory. (2 marks)

Total 16 marks

b) Using the results on above, indicate whether your organisation could grant the request made by the managing director and any other information which might help you make a more informed credit decision. (4 marks)

Total 20 marks

## Question Aims

To test the candidate's knowledge and understanding of financial ratios and how they can be applied to a given business scenario.

## Suggested answer

a)

	2012	2013
Gross profit margin	$\frac{3066 \times 100}{7300} = 42\%$	$\frac{3212 \times 100}{8030} = 40\%$
Operating margin	$\frac{1266 \times 100}{7300} = 17.34\%$	$\frac{1006 \times 100}{8030} = 12.53\%$
ROCE	$\frac{1266 \times 100}{3500 + 2000} = 23.02\%$	$\frac{1006 \times 100}{3700 + 2000} = 17.65\%$
Current ratio	2430:890 2.73:1	2800:1100 2.55:1
Acid test/Quick ratio	2430 – 1392:890 1.17:1	2800 – 1800:1100 0.91:1
Debtor days (receivables)	$\frac{800 \times 365}{7300} = 40 \text{ days}$	$\frac{960 \times 365}{8030} = 44 \text{ days}$

Comment [GD7]: 0.91:1



Creditor days (payable)	$\frac{200 \times 365}{4234} = 17 \text{ days}$	$\frac{520 \times 365}{4818} = 39 \text{ days}$
Stock turnover (inventory)	$\frac{1392 \times 365}{4234} = 120 \text{ days}$	$\frac{1800 \times 365}{4818} = 136 \text{ days}$

- b) All the profitability ratios are showing an adverse movement, but the company is still profitable and turnover has increased. The current ratio has worsened but this was from an already high level, contributed in the main from a very high bank balance. This could have been utilised elsewhere. Stock and debtor levels have increased quite considerably which needs to be discussed with the managing director as to the reasons why. The acid test trend indicates a slight problem with regard to liquidity which needs to be addressed. There has also been a massive increase in the value of creditors which needs flagging as to the reasons why. The company is taking longer to collect its monies from debtors, though this is neutralised somewhat by the fact that the company is now taking longer to pay its suppliers. The stock though is taking longer to clear which also needs investigation.

Comment [GD8]: collect

The company is profitable though its liquidity position, given the results from the acid test, is of some concern. On balance there could be grounds to meet the managing director's request but more questions need to be asked with regard to the individual components on the balance sheet, and maybe some sight of the components of the management accounts might be apt.

**Total 20 marks**

*This question also proved very popular with students. Much better responses this time were documented, with a number of students securing full marks for their calculation of the various financial ratios, though the return on capital employed proved problematic for a few candidates.*

*Part b) was not handled as well as it could have been. Identifying whether there had been an improvement or worsening of the situation given the student's calculation is an integral part of the answer and it is likely that questions of this ilk will be examined in future diets. There were some excellent responses however with very pertinent credit management observations being made.*



3. The following trial balance has been taken from MAW Ltd on 30 April 2013, after the preparation of the Trading and Profit and Loss Account for the year.

	Dr	Cr
Ordinary shares (£1)		310,000
10% preference shares		100,000
10% debenture 2010		120,000
Profit for year ended 30/04/2013		137,000
Profit for year ended 30/04/2012		120,000
Stock	250,000	
Premises	300,000	
Plant and machinery	200,000	
Motor vehicles	70,000	
Office equipment	60,000	
Depreciation provisions:		
Premises		118,000
Plant and machinery		100,000
Motor vehicles		60,000
Office equipment		50,000
Debtors	445,000	
Creditors		170,000
Provision for bad and doubtful debt		16,000
Prepayments	6,000	
Accruals		18,000
Bank		12,000
	<u>1,331,000</u>	<u>1,331,000</u>

Comment [GD9]: 1,331,000

### TASK

- a) Draw up the appropriation section of the Profit and Loss Account (Income Statement) and prepare a balance sheet (Statement of Financial Position), taking into account the following:
- Corporation tax of £40,000 is to be allowed for
  - The preference share dividend is to be paid as is a 15% ordinary share dividend
  - Interest on the debenture needs to be accounted for. (14 marks)
- b) What information could be gleaned from an auditor's report which might be of use to the credit manager? (6 marks)

Total 20 marks

### Question aims

To assess the candidate's ability to construct an appropriation account from a trial balance and present a balance sheet for the company for the year end.



## Suggested answer

a) MAW Ltd Profit and Loss Account (Income statement) for the year ended 30 April 2013

	£
Profit for the year before interest and taxation	137,000
Less: interest (W1)	(12,000)
Profit after interest	125,000
Less: corporation tax	(40,000)
Profit for the year after interest taxation	85,000
Less: Preference share dividend (W2)	(10,000)
Ordinary share dividend (W3)	(46,500)
Retained profit for the year 30/04/2013	28,500
Retained profit for the year ended 30/04/2012	120,000
Retained profit b/d 1 May 2013	148,500

Comment [GD10]: underline

Comment [GD11]: underline

Comment [GD12]: underline

Comment [GD13]: underline

Comment [GD14]: In the above statement the dividends are bracketed to indicate deduction yet the other expenses are not

Statement of Financial Position (Balance Sheet) of MAW as at 30 April 2013

	£	£	£
<b>Fixed assets</b>			
Premises	300,000	118,000	182,000
Plant and machinery	200,000	100,000	100,000
Office equipment	60,000	50,000	100,000
Motor vehicles	70,000	60,000	10,000
	630,000	328,000	302,000

<b>Current assets</b>			
Stock	250,000		
Debtors	445,000		
Less provision	16,000	42,9000	
Prepayments	6,000	685,000	

<b>Less current liabilities</b>			
Creditors	170,000		
Accruals	18,000		
Bank	12,000		
Interest	12,000		
Tax	40,000		
Dividends	56,500	308,500	
			376,500
			678,500

Comment [GD15]: 56,500

Comment [GD16]: Layout is confusing  
685,000 above less 308,500 = 376,500

Comment [GD17]: underline

<b>Less long-term liabilities</b>			
10% debenture 2010			120,000
Net worth /assets			558,500

Comment [GD18]: underline

<b>Financed by:</b>			
<b>Capital and Reserves</b>			
Issued ordinary shares		310,000	
10% preference shares		100,000	
Profit and loss		148,500	
			558,500

Comment [GD19]: need to show the total i.e. 558,500



- b) One of the most important responsibilities of the appointed auditor is to give a true and fair view of the final accounts. This shows that the accounts have been drawn up following accepted accounting principles. The implication is that all Financial Reporting Standards and Statements of Standard Accounting Practice have been duly complied with. This gives the credit manager the confidence that the final accounts can be relied upon when s/he is assessing the credit worthiness of a new or existing customer. Furthermore, a clean audit implies that proper records have been kept and that the final accounts are in agreement with these underlying records.

Comment [GD20]: is to comment on the truth and fairness of the final accounts

If the report is qualified, this should be a warning sign to the credit manager. This could indicate some serious misgivings on the part of the auditor with regard to the way the accounts have been compiled, or problems of underlying accounting principles. A qualified report is saying that less reliance can be placed on the information in the accounts, as opposed to an unqualified report.

Workings:

W1 120,000 x 10% = 12,000 interest

Comment [GD21]: 10%

W2 100,000 x 10% = 10,000 dividend

Comment [GD22]: 10%

W3 310,000 x 15% = 46,500.

Comment [GD23]: 15%

Comment [GD24]: dividend

Total 20 marks

*The question on company accounts was handled well in the main. The appropriation section in part a) was correctly computed in many cases though the accounting treatment of debenture interest caused a few problems for the minority.*

*Part b) though was not handled as well, unfortunately. Students should give equal priority to the technical issues of company accounts preparation as well as to the various additional legal requirements that are needed for incorporated businesses' published accounts such as the auditor's report (required here), the directors' report, et al.*



4. The following trial balance has been extracted by the book-keeper of Paul Scott, who owns a small manufacturing business, as at 30 June 2013.

	Dr	Cr
	£	£
Capital		36,175
Drawings	19,050	
Purchases and sales	105,240	168,432
Stock at 1 July 2012	9,427	
Debtors and creditors	3,840	5,294
VAT		1,492
Returns	975	1,237
Discounts	127	643
Wages and salaries	30,841	
Motor vehicle expenses	1,021	
Rent and rates	8,796	
Heating and lighting	1,840	
Telephone	355	
General expenses	1,752	
Bad debts written off	85	
Motor vehicle at cost	8,000	
Provision for depreciation on motor vehicles		3,500
Shop fittings at cost	6,000	
Provision for depreciation on shop fittings		2,000
Provision for bad debts		150
Cash	155	
Bank	21,419	
<b>Total</b>	<b>218,923</b>	<b>218,923</b>

Notes as at 30 June 2013:

1. Stock was valued at £11,517.
2. Motor vehicles expenses owing £55.
3. Rent prepaid £275.
4. Depreciate shop fittings at 10% using the straight line method and motor vehicles at 25% employing the reducing balance method.
5. The provision for bad debts is to be equal to 2.5% of debtors.

### TASK

Use the trial balance and accompanying notes to prepare the final accounts of the business for the year ended 30 June 2013.

Total 20 marks

Comment [GD25]: Balance and

### Question aims

To test the candidate's knowledge and understanding of the form, content and construction of the final accounts of a sole trader, taking into account consideration adjustments.



## Suggested answer

Trading and profit and loss account (Income statement) for P. Scott for the year ended 30 June 2013

	£	£	£
Sales			168,432
– Sales returns			<u>975</u>
			167,457
<b>Less cost of sales</b>			
Opening stock		9,427	
Purchases	105,240		
– Purchase returns	<u>1,237</u>	<u>104,003</u>	
		113,430	
– Closing stock		<u>11,517</u>	<u>101,913</u>
Gross profit			65,544
+ Discount received			643
+ Change in provision W1			<u>54</u>
			66,241
<b>Less expenses</b>			
Discount allowed		127	
Wages and salaries		30,841	
Motor vehicles expenses (1021 + 55 AC)		1,076	
Rent and rates (8,796 – 275pp)		8,521	
Heat and light		1,840	
Telephone		355	
General expenses		1,752	
Bad debts written off		85	
<b>Provision for depreciation</b>			
Motor vehicles W2		600	
Shop fittings W3		<u>1,125</u>	<u>46,322</u>
Net profit			<u>19,919</u>

**Comment [GD26]:** subtraction sign here is OK yet below purchase returns and closing stock have a bullet point?

**Comment [GD27]:** 19,919

W1  $3,840 \times 2.5\% = 96$

Current provision = 150

$150 - 96 = 54$  decrease in provision to be added to net profit

W2  $\text{£}6,000 \times 10\% = \text{£}600$  charge to PL for motor vehicles =  $\text{£}600$

W3 Motor vehicles at cost – provision for depreciation  $\times 25\%$

$\text{£}8,000 - 3,500 = 4,500 \times 25\% = 1,125$

**Comment [GD28]:**  $(8,000 - 3,500)$



Balance sheet (statement of financial position) for P Scott as at 30 June 2013

	£	£	£	£
<b>Fixed assets</b>				
Vehicle		8,000	4,625	3,375
Fittings		6,000	2,600	3,400
		<u>14,000</u>	<u>7,225</u>	<u>6,775</u>
<b>Current assets</b>				
Stock		11,517		
Debtors	3,840			
Less provision	<u>96</u>	<u>3,744</u>		
Prepayment		275		
Cash		155		
Bank		<u>21,419</u>	<u>37,110</u>	
<b>Current liabilities</b>				
Creditors		5,294		
Accruals		55		
VAT		<u>1,492</u>	<u>6,841</u>	
Net current working assets (working capital)				<u>30,269</u>
Net worth				<u>37,044</u>
<b>Financed by</b>				
Capital				36,175
Net profit			19,919	
Less drawings			<u>19,050</u>	<u>869</u>
				<u>37,044</u>

**Total 20 marks**

*This was probably the most popular question on the paper with the vast majority of students securing a pass mark. The format and presentation of the final accounts were appropriate and most adjustments were handled well apart from depreciation which causes some problems in isolated instances. Also, at times the order of current assets in the balance sheet (statement of financial position) was incorrect and the "financed by" section was a little untidy.*



5. You have been asked to prepare the final accounts for W Smith, a sole trader, for the year ended 31 December 2013. W Smith has forwarded to you all books of prime entry and ledgers, and in addition has given you the following information:

- i) Mr Smith had taken £2,000 out of the business bank account to take his wife on holiday.
- ii) Up to last year the machinery and vehicle used in the business had been depreciated using the reducing balance method. W Smith thinks that they should now be treated as an expense using the straight line method.
- iii) Mr Smith is confident, given his order book, that the business will continue to operate in its present form for many years.
- iv) Mr Smith had purchased ten staplers, four flip charts and four packets of whiteboard markers which will be used in the business for the next couple of years.
- v) Mr Smith informs you that he has just found an unopened electricity bill for £900 which was for the quarter October to December 2013.

**Comment [GD29]:** This does not make sense

### TASK

In each case, identify and then explain the main accounting concepts being highlighted and indicate how each should be treated in the final accounts.

Total 20 marks

### Question aims

To test the candidate's appreciation of accounting concepts and conventions and how they apply to the structure, form and content of the final accounts.

### Suggested answer

- a) i) This is referred to as the business entity concept. The financial transactions of a business have to be treated as separate from the non-business activities of the owner of the business. Only the financial transactions of the business are recorded and not those of the owner. The firm, or business, is regarded as a separate business entity. If the owner takes money out of the business for his own personal use, the accounts transactions show a debit on drawings to maintain this concept.
- ii) This is the consistency concept which determines that accountants should treat some items in the financial statements on a consistent basis and adopt the same accounting policies from one year to the next. In the question the owner requests that the accountant should use a different way of calculating depreciation that had been used in previous years. This would contravene the principle of consistency.
- iii) This is called the going concern concept. It assumes that the business will continue to operate as a viable concern for the foreseeable future with sufficient assets and cash reserves. The accounting treatment then is that assets are valued at cost less accumulated depreciation, which is their value to a continuing business. If a firm is not deemed to be a going concern, due to lack of cash reserves, then the assets would have to be written down to their net realisable value, what they would get if they were sold.



- iv) This is the materiality concept which is applied to try to stop the book-keeper wasting time and effort doing complicated and unnecessary work. Small expense items do not justify their own separate expense account; instead they are grouped together in a sundry expense account, examples include window cleaning, plants for the office. In the example quoted in the question, low cost fixed assets such as staplers are charged as an expense in profit and loss instead of being classed as capital expenditure. Strictly these should be regarded as fixed assets and treated accordingly in the accounts and depreciated each year over their estimated life. In practice, because the amounts involved are not material, they are treated as profit and loss account expenses. Also, white board markers could be considered end of year stocks but because the value of them is not material it does not justify the time and effort involved to open an individual account and post the entries. Invariably they are treated as an expense in the final accounts instead.
- v) This is the accruals concept. An accrual is something that becomes due especially an amount of money that is yet to be paid, or received, at the end of the accounting period. The profit and loss contains a firm's income and expenditure for the financial year and a calculation of profit. To produce an unbiased and objective profit position, the profit and loss account is drawn up on an accruals not cash basis. This means that all income and expenditure for the year will be charged in the profit and loss account of the year in which it was incurred, not when it is paid or received. Therefore an adjustment for an accrual of an expense in the account is completed by adjusting the expense in the profit and loss for this year and carrying a balance over either in the specific expense or in an accruals account.

Comment [GD30]: cost

Comment [GD31]: staplers

Comment [GD32]: are they?

Comment [GD33]: The answer does not refer to the flipcharts

Comment [GD34]: Is owing

**Total 20 marks**

*Answers to this question were rather indifferent. Most students identified at least two of the accounting concepts being described – very few though got them all correct. The two that caused the main problem were the materiality and business entity concept. Only in a few cases could candidates describe how each could be treated in the final accounts.*



6. DEF Ltd sells furniture to hotels. The following data refers to the budgeted cash payments and receipts for the six month period ending 30 June 2014.

- i) Bank balance on 1 January 2014 is judged to be £175,000 overdrawn.
- ii) Sales for the six months are budgeted as follows:

January	£425,000
February	£375,000
March	£400,000
April	£275,000
May	£375,000
June	£350,000

- 30% are paid in the month of sale
- 20% are paid one month after sale
- 50% are paid two months after sale.

Comment [GD35]: sale

- iii) The following miscellaneous payments are budgeted to be:

Rent	£1,800 every month
Rates	£2,500 every month
Heating and lighting	£4,000 for June and January
Electrics	£1,000 every month
Stationery	£1,500 every month

- iv) Two computers are budgeted to be bought in February and March, the former costing £85,000 and the latter costing £100,000.
- v) Purchases of raw materials each month are budgeted as follows:

January	£140,000
February	£200,000
March	£220,000
April	£180,000
May	£200,000
June	£175,000

Purchases are paid one half in the month of purchase and the other half in the following month.

### TASK

- a) Complete a cash budget for the half year ended 30 June 2014. (16 marks)
- b) Explain why cash budgets are important for organisations. (4 marks)

Total 20 marks

### Question aims

- To test the candidate's understanding of the importance of cash ledgers for organisations
- To assess the candidate's ability to construct such a document taking into account staggered payments and receipts.



## Suggested answer

a) Budget Template DEF Ltd

	January	February	March	April	May	June
<b>Receipts</b>	127,500	85,000	212,500			
		112,500	75,000	187,500		
			120,000	80,000	200,000	
				82,500	55,000	105,000
					112,500	137,500
						75,000
<b>Total receipts</b>	127,500	197,500	407,500	350,000	367,500	317,500
<b>Expenses</b>						
Rent	(1,800)	(1,800)	(1,800)	(1,800)	(1,800)	(1,800)
Rates	(2,500)	(2,500)	(2,500)	(2,500)	(2,500)	(2,500)
Heat and light	(4,000)	-	-	-	-	(4,000)
Electric	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Stationery	(1,500)	(1,500)	(1,500)	(1,500)	(1,500)	(1,500)
CAPEX - IT		85,000	100,000			
Raw material 1	(70,000)	(70,000)	(110,000)	(110,000)	(100,000)	(100,000)
Raw material 2	-	(100,000)	(100,000)	(90,000)	(90,000)	87,500
<b>Total expenses</b>	(80,800)	(261,800)	(316,800)	(206,800)	(196,800)	(198,300)
<b>Net cash flow</b>	46,700	(64,300)	90,700	143,200	170,700	119,200
<b>Balance b/f</b>	(175,000)	(128,300)	(192,600)	(101,900)	41,300	212,000
<b>Balance c/f</b>	(128,300)	(192,600)	(101,900)	41,300	212,000	331,200

**Comment [GD36]:** This 105,000 should be on the line below.....below the 75,000

**Comment [GD37]:** delete

**Comment [GD38]:** 85,000

**Comment [GD39]:** 100,000

**Comment [GD40]:** 87,500

b) Cash is the lifeblood for any organisation as it must have sufficient to be able to trade.

Cash budgets identify the amounts expected to be received and paid out and most importantly the timings of these receipt and payments. This enables the business to plan its expenditure based on when it expects its receipts. Where an excess of outflows is identified, the organisation can take steps to secure temporary funds by transferring them from elsewhere or through an overdraft facility.

**Comment [GD41]:** these

**Total 20 marks**

*Not a popular option with candidates. Answers, though, were either very good or poor. In the former case maximum marks were awarded with some excellent cash budgets being offered in the appropriate format, structure and presentation required. The major problem for weaker scripts was calculating cash receipts correctly. Even when this and the cash outgoings were computed correctly, the handling of the final cash position at the end of each month using b/f and c/f proved problematic. Again, the narrative part of the answer in b) could have been tackled better.*



7. There are many stakeholders who would have a vested interest in the final accounts of an organisation.

### TASK

Name **three** external and **three** internal stakeholders and what type of information would they be looking for?

Total 20 marks

### Question aims

To test the candidate's understanding of the stakeholders of business and why the accounts might be of interest to them.

### Suggested answer

- a) The internal stakeholders would be the owners, employees and management.

The external stakeholders would be lenders, customers, the government and suppliers.

#### Owners

This could be the sole trader or the shareholders in an incorporated business. Either will need to know how well the business is performing with regard to profit and loss. With a limited company the shareholders would want to know what return they are getting on their investment and is it worth keeping it in this particular business.

#### Employees (and Trade Unions)

These will be concerned about job security and for pay bargaining. The accounts will show whether the firm is trading profitably and how well sales are going.

- What are the expenses of the business?
- What are the salaries and bonuses of directors?
- How much does the business owe?
- What reserves does it have?

#### Management

These will assess performance and make future plans. Management will also be concerned with:

- profitability levels
- costs
- general performance with regard to sales and cash flow.

They will be looking at loans and overdrafts but also the structure, form, value and type of fixed assets in existence.

Comment [GD42]: accounts



### Customers

Customers are concerned with the price paid for the product but they must also be confident of receiving the goods and services that have been ordered. They will want to be sure that the company will still exist for after sales service and warranties. To this end customers will require to know from the final accounts how financially stable the company is, how efficient it is and what plans it has for the future.

Comment [GD43]: delete

Comment [GD44]: accounts how

### Suppliers

Most organisations purchase their raw material or stock on credit from their suppliers. These suppliers will want to ensure that they are paid. There is a plethora of information available in the final accounts to satisfy this requirement. Again, profitability and such data are very important, but also their ability to pay their debts as and when they fall due, which can be gleaned from the liquidity ratios. The debtor days, creditor days and stock turnover figures will help in the process.

Comment [GD45]: ??

### Government

The government will be interested to see whether the correct amount of Corporation Tax, VAT Income Tax and National Insurance contributions have been paid. The performance overall of the organisation is important for the government with regard to:

- future plans
- investment
- training
- regulations
- employment.

### Lenders

Many organisations cannot completely finance their operation from their own funds. Sometimes they may have to use external funding sources, usually banks. The banks will need to be satisfied that the firm has the resources and ability to repay a loan or overdraft. The accounts will highlight whether the organisation is profitable, efficient and able to pay its debts as and when they fall due (liquidity).

### The community

The community will have an interest in the accounts of a business to see whether it has an environmentally friendly stance and what impact its operation will have upon local issues. Some organisations are major employers in certain areas so the financial performance of the organisation is an important variable to this key stakeholder.

Total 20 marks

Comment [GD46]: I think the mark scheme is odd here. If the student identifies 3 external stakeholders as requested and then comments on them they will never be able to achieve full marks as the answer allocates marks over 4 stakeholders

*This question did not require any accounting activity and proved popular amongst many of the candidates. Most could identify and differentiate between internal and external stakeholders though the description of each in some cases was vague. There was some confusion with regard to shareholders, management and employees as to which category they could be put into. The major problem with answers was that although candidates had a broad idea of each they failed to detail the accounting information that would be of interest to each group.*



8. a) What are suspense accounts and why are they used? (6 marks)
- b) Identify **six** errors that might be revealed by a trial balance. (6 marks)
- c) On 31 December 2013, the trial balance of MTC Ltd did not agree with the debits totalling £1,860 more than the credits. The following errors were found:
- i) Discount received of £80 had been debited to the discount allowed account.
  - ii) Motor repairs of £150 had been debited to the motor car account.
  - iii) A bad debt of £309 had been entered into the customer's account but not the bad debt account.
  - iv) £78 paid for a telephone bill had been entered in the telephone account as £87.
  - v) Cash sales of £2,000 had not been entered into the sales account.
  - vi) An invoice of £1,750 to Scotts Garage had been posted into the accounts twice.

Comment [GD47]: accounts

#### TASK

Prepare a suspense account to correct the errors (no journal entries required). (8 marks)

Total 20 marks

#### Question aims

- To test the candidate's understanding of the purpose of suspense accounts in the final year end accounts
- To assess the candidate's knowledge and understanding of the type of errors that will be highlighted by the trial balance
- To test the candidate's ability to use the double entry system to correct errors from the trial balance via a suspense account.

#### Suggested answer

- a) A suspense account is a temporary account used for holding the difference between the debit and credit balances pending the location and then correction of the error. As each of the errors is identified, the suspense account is used to record one half of the double entry required to correct the error. The other part of the double entry will be made in the account requiring the correction. When all errors have been identified, the balance on the suspense account will be nil.
- b) Any six from:
- Incomplete double entry, one debit and no credit or no debit and one credit
  - Incorrect figure in one entry
  - Balance on the wrong side of the trial balance
  - Failure to include a balance in the trial balance
  - Incorrect balancing of individual accounts



- Two debit or two credits instead of one of each
- Over/under casting of totals.

Comment [GD48]: casting

c) Suspense Account

Date	Details	Dr	Cr	Balance
		£	£	£
31 December 2013	Balance			(1,860)
	Discount allowed	80		(1,780)
	Discount received	80		(1,700)
	Bad debts		309	(2,009)
	Telephone	87		(1,922)
	Telephone		78	(2,000)
	Sales	2,000		NIL

Note: (ii) and (vi) would not impact on the trial balance so no posting to the suspense account is required.

**Total 20 marks**

*Those who attempted this question could detail the purpose and use of suspense accounts in part a).*

*Part b) did cause a problem with a few candidates who talked about errors of commission, omission etc which are **not** picked up by the trial balance.*

*The majority of candidate handled the accounting entries required in part c) with maximum marks sometimes being awarded in this section.*

---oOo---