

FINANCIAL ACCOUNTING

Foundation
December 1999

MARKING SCHEME

The logo for CIPFA, featuring the letters 'CIPFA' in a serif font. The letter 'I' is stylized with a decorative flourish that loops over the top of the 'P'.

Question 1

(a)

Annual subscriptions account

	£		£	
1 Oct 98 Opening arrears b/d	1,400	1 Oct 98 Payments in advance b/d	1,000	<i>1</i>
I&E Subscriptions due in year	22,400	Cash received in year (by diff)	23,400	<i>1</i>
30 Sept 99 Closing income in advance	1,200	30 Sept 99 Closing arrears	600	<i>1</i>
	25,000		25,000	<i>(3)</i>

Workings

- | | |
|--------------------------------------|------------------------|
| 1. Opening arrears | $£200 * 7 = £1,400$ |
| 2. Opening payments in advance | $£200 * 5 = £ 1,000$ |
| 3. Subscriptions due in year (120-8) | $£200 * 112 = £22,400$ |
| 4. Closing arrears | $£200 * 3 = £600$ |
| 5. Closing payments in advance | $£200 * 6 = £1,200$ |

(b)

Orinoco Croquet and Tennis Club
Bar Profit and Loss Account for the year ended 30 September 1999

Sales	£	34,470	<i>1/4</i>
Less: Cost of goods sold			
Opening stock	2,300		<i>1/4</i>
Purchases (27,580-3,400+ 3,100)	27,280		<i>1</i>
Closing stock	(1,890)		<i>1/4</i>
		(27,690)	
Gross profit		6,780	
Less barman's wages		(5,347)	<i>1/4</i>
Net profit		1,433	<i>(2)</i>

Orinoco Tennis and Croquet Club
Income and Expenditure Account for the year ended 30 September 1999

	£	£	
<i>Income</i>			
Subscriptions		22,400	<i>1/4</i>
Life membership subscriptions (£8,000/10)		800	<i>1</i>
Bar profits		1,433	<i>1/4</i>
Surplus on competition (W1)		770	<i>1</i>
Surplus on BBQ (W2)		495	<i>1</i>
Entrance fees		1,300	
Interest on deposit account		205	<i>1/2</i>
		27,403	
<i>Expenditure</i>			
Staff wages	2,670		
Interest on loan	7,200		
Rates	1,400		
Net U14 coach cost (3,200 - 2,400)	800		<i>1/2</i>
Upkeep of lawns (12,800+3,300-1,000)	15,100		<i>1/2</i>
Lighting, heating and cleaning (3,770-2,000)	1,770		<i>1/2</i>
Printing postage and stationery	120		
Depreciation (W3) (4,688+2,250)	6,938	(35,998)	<i>1 1/2</i>
Deficit for year		(8,595)	
			<i>Presentation 1</i> <i>(8)</i>

Workings

			£	£	
W1		Competition receipts		2,020	
		less competition prizes			
		opening stock	300		
		purchases	1,200		
		Closing stock	(250)		
			(1,250)		
		Surplus on competition		770	
			£	£	
W2		Barbecue & treasure hunt receipts		2,000	
		less barbecue supplies	(1,205)		
		Treasure hunt prize	(300)		
			(1,505)		
		Surplus on barbecue and treasure hunt		495	

W3 Buildings Depreciation $\frac{\pounds 45,000}{20} = \pounds 2,250$

Furniture and Equipment Depreciation $(25,000 - 6,250) * 25\% = 4,688$

(c)

Orinoco Croquet and Tennis Club
Balance Sheet as at 30 September 1999

	Cost	Accumulated depreciation	Net book value	
	£	£	£	
Fixed assets:				
Land	100,000	-	100,000	
Club house	45,000	(13,500)	31,500	1/2
Furniture and equipment	25,000	(10,938)	14,062	1/2
	170,000	(24,438)	145,562	
Investments			12,000	1/2
Current assets				
Stock (1,890 +250)		2,140		1/2
Interest due		205		1/2
Prepayments		1,000		1/2
Subscriptions in arrears		600		1/2
		3,945		
Current liabilities				
Trade creditors	(3,100)			1/2
Subscriptions in advance	(1,200)			1/2
Bank overdraft	(6,602)	(10,902)		1/2
Net current liabilities			(6,957)	
Net assets			150,605	
Long term liabilities				
Loan (90,000-10,000)			(80,000)	1/2
Life membership subscriptions (8,000-800)			(7,200)	1
Net assets			63,405	
Financed by:				
Accumulated fund				
Opening balance (W4)			62,400	3
Deficit for year			(8,595)	1/2
Closing balance			53,805	
Donation fund - grant received				1/2

- coaching under 14's	12,000	
Less utilised during year	<u>(2,400)</u>	1/2
Donation fund closing balance		
	9,600	
	<u>63,405</u>	

Presentation 1
(12)

W4 Accumulated fund at 1 October 1998

		£
Land		100,000
Club house - cost	45,000	
- depreciation	<u>(11,250)</u>	
		33,750
Furniture and equipment - cost	25,000	
- depreciation	<u>(6,250)</u>	
		18,750
Bar stock		2,300
Prizes in hand		300
Bank		2,300
Loan		(90,000)
Bar supplies owed		(3,400)
Lighting, heating and cleaning accruals		(2,000)
Opening arrears		1,400
Payments in advance		<u>(1,000)</u>
		<u>62,400</u>

(25)

Question 2

(a)

Sales Ledger Control a/c						
Date	Reference	Amount	Date	Reference	Amount	
		£			£	
1 Nov	Bal b/d	62,555	30 Nov	Bank	345,080	<i>1</i>
30 Nov	Sales	378,889	30 Nov	Returns inwards	12,345	<i>1</i>
30 Nov	Bank a/c	45	30 Nov	Bad debts w/o	934	<i>1</i>
			30 Nov	Cash	577	<i>1/2</i>
			30 Nov	Disc allowed	15,754	<i>1/2</i>
			30 Nov	Purchases ledger	3,452	<i>1/2</i>
				Bal c/d	63,347	<i>1/2</i>
		<u>441,489</u>			<u>441,489</u>	
1 Dec	Bal b/d	63,347				(5)

Purchase Ledger Control a/c						
Date	Reference	Amount	Date	Reference	Amount	
		£			£	
30 Nov	Bank	324,356	1 Nov	Bal b/d	49,356	<i>1</i>
30 Nov	Disc received	6,752	30 Nov	Purchases	412,421	<i>1</i>
30 Nov	Returns outwards	3,793				<i>1/2</i>
30 Nov	Cash	325				<i>1/2</i>
30 Nov	Sales ledger	3,452				<i>1/2</i>
	Bal c/d	75,667				<i>1/2</i>
		<u>414,345</u>			<u>461,777</u>	
			1 Dec	Bal b/d	75,667	(4)

(b) Procedures to identify any error(s) in purchase ledger control account.
Check:

- (i) additions of control account;
- (ii) postings from books of prime entry, journals and day books;
- (iii) additions in day books;
- (iv) balance brought forward;
- (v) additions of discounts received in cash book;
- (vi) bank reconciliations to prove payments total;
- (vii) total of list of balances to prove balance carried forward.

1/2 mark per point to a maximum of 3

(c) **The trial balance**

- Aim to check the double entry carried out in the ledgers.
- At the end of each accounting period a balance is struck on each ledger account.
- Balances are collected in a trial balance.
- The total of all credits should equal the total of all debits.
- The errors which may have occurred if the trial balance does not balance include:
 - incomplete double entry;
 - errors of transposition;
 - errors of addition.
- A trial balance does not guarantee accuracy, it will not pick up:
 - compensating errors;
 - errors of original entry;
 - errors of commission;
 - errors of omission;
 - errors of principle;
 - complete reversal of entries;
 - transposition errors.

Description 2
Types of error ½ each to a maximum of 2

Bank reconciliations

- Control exercised by comparing the bank account (in the business's ledger) with the bank statement (provided by the business's bankers).

It is unlikely that the two balances will equal due to:

- Timing differences - for example cheques are entered into the business's ledger as soon as they are written, but there may be a delay before the payee receives them and a further delay while they are processed through the bank clearing system.
- Omissions - items may appear on the bank statement which have not yet been entered in the cash book. These may include bank charges and payments made by direct debit
- Errors - entries on the bank statement may be incorrect, but more commonly errors may be found in the cash book.
- When these discrepancies are noticed, appropriate adjustments must be made:
 - errors must be corrected;
 - omissions from the business ledger must be made good.

1 mark per point to a maximum of 4
(8)
(20)

Question 3

(a)

Bulgaria
Profit and Loss Account for the year ended 30 September 1999

	Working	£	£	
Sales			349,321	
Less returns inwards			<u>(3,275)</u>	1
			346,046	
Less Cost of Goods Sold				
Opening stock		19,800		
Add purchases (252,400 - 740)		251,660		1
Less returns outwards		(2,597)		1
Plus carriage inwards		270		1
Less closing stock		<u>(15,700)</u>		
			(253,433)	
Gross profit			<u>92,613</u>	
Add Miscellaneous income				
Bad debts recovered			300	1
Less loss on disposal of fixed assets	(i)		<u>(5,133)</u>	2
			87,780	
Less Expenses:				
Wages and salaries (35,181+1,072)		36,253		1
Carriage outwards		325		
Rates and insurance (4,770-235)		4,535		1
Repairs to buildings		5,679		
General expenses		3,214		
Bad debts		3,400		
Increase in doubtful debts	(ii)	200		1
Depreciation (1,814+2,646+7,333)	(i)	<u>11,793</u>		2
			(65,399)	
			<u>22,381</u>	
				(12)

(b)

Bulgaria
Balance Sheet as at 30 September 1999

	£ Cost	£ Accumulated depreciation	£ NBV	
Fixed assets				
Land	27,000	-	27,000	
Buildings	90,000	(39,666)	50,334	<i>1</i>
Furniture and fittings	17,200	(11,758)	5,442	<i>1</i>
Motor vehicles	18,000	(11,826)	6,174	<i>1</i>
	152,200	(63,250)	88,950	
Current assets				
Stock		15,700		
Debtors		39,331		
Less provision for doubtful debts		(720)		<i>1</i>
Prepayments		235		<i>1/2</i>
Cash in hand		300		<i>1</i>
		54,846		
Less current liabilities				
Creditors	18,141			
Accrued expenses	1,072			<i>1/2</i>
Bank overdraft	4,271	(23,484)		<i>1</i>
		31,362		
Net current assets			31,362	
Net assets			120,312	
Financed by:				
Capital			109,671	
Plus profit for the year			22,381	
			132,052	
Less drawings (11,000+740)			(11,740)	<i>1</i>
			120,312	

(8)

Workings

(i) Fixed assets

Fixtures and fittings depreciation $(17,200-9,944) * 25\% = \mathbf{£1,814}$

Motor vehicles depreciation $(18,000 - 9,180) * 30\% = \mathbf{£2,646}$

Buildings			
	£		£
Balance b/d	120,000	Disposals a/c	30,000
	120,000	Balance c/d	90,000
			120,000

Buildings Provision for Depreciation			
	£	1998	£
Disposals	7,667	Balance b/d	40,000
Balance c/d	39,666	Profit and loss	7,333
	47,333		47,333

Buildings Disposal A/c			
Buildings	30,000	Cash	17,200
		Provision for depreciation	7,667
	30,000	Loss on disposal	5,133
			30,000

Disposal - accumulated depreciation

1 Aug 95- 30 Sept 95	2 months
1 Oct 95 - 30 Sept 96	12 months
1 Oct 96 - 30 Sept 97	12 months
1 Oct 97 - 30 Sept 98	12 months
1 Oct 98 - 31 May 99	8 months
	46 months

Disposal accumulated depreciation

$$30,000 * \frac{46}{180} = \text{£}7,667$$

Building depreciation charge for year

$$\frac{120,000-30,000}{15} + \frac{30,000 * 8}{15 * 12} = \text{£}7,333$$

(ii) Provision for doubtful debts

Provision required	720
Current provision	<u>520</u>
Increase in provision required	<u>200</u>

(20)

Question 4

(a)

Tobermoray Ltd
Reconciliation of operating profit to net cash inflow from operating activities

	£	
Operating profit (W1)	52,500	
Depreciation charge - property	46,500	1/2
- plant	37,500	1/2
Profit on sale of fixed asset	(975)	1
Increase in stock (63,000-31,500)	(31,500)	1/2
Increase in debtors (24,000-19,500)	(4,500)	1/2
Decrease in creditors (13,500-28,500)	(15,000)	1/2
	84,525	
		(3 1/2)

Working 1 operating profit

	£	
Retained profit for the year (82,500-72,000)	10,500	1/2
Add preference dividends (10% * 60,000)	6,000	2
Add ordinary dividends	7,500	1/2
Add corporation tax	7,500	1/2
Add debenture interest (10% * 210,000)	21,000	2
Operating profit before interest and tax	52,500	

(5 1/2)

Presentation 1

(10)

(b)

Tobermoray Ltd
Cash flow statement for the year ended 31 March 1999

	£	£	
Net cash inflow from operating activities		84,525	1/2
Returns on investments and servicing of finance			
Preference dividends paid	(6,000)		1
Interest paid	(21,000)		1/2
		(27,000)	
Taxation		(6,000)	1/2
Capital expenditure			
Payments to acquire fixed assets - land	(135,000)		1
- plant	(45,000)		1
Receipt from the sale of fixed assets	14,475		1
		(165,525)	
Equity Dividends paid		(9,000)	1
Net cash outflow before financing		(123,000)	1/2
Financing			
Issue of ordinary share capital (60,000 + 15,000)		75,000	1
Decrease in cash		(48,000)	1/2
		<i>presentation</i>	1 1/2
			(10)
			(20)

Question 5

Capital expenditure

- Expenditure relating to the acquisition or enhancement of fixed assets which improves the assets earning capacity of business eg land, buildings, plant, machinery, vehicles.
- Acquisitions are generally in order to assist or enhance profit generation within the business over a number of years.
- Capital expenditure not charged as an expense in the profit and loss account except as a depreciation charge - following the matching concept.
- Appears on the balance sheet as a Fixed Asset.

1 mark per point to a maximum of 4

Revenue expenditure

- Expenditure for the purpose of carrying on the organisation's normal business activities eg salaries, wages, energy costs.
- May be incurred to maintain fixed assets not to enhance their earning capability.
- Charged to the profit and loss account.

1 mark per point to a maximum of 3

Different definition of capital and revenue expenditure may occur depending on the view of materiality. Eg all capital expenditure under £5,000 in the NHS is treated as revenue.

1

Example of the different types of expenditure

A van which is purchased for delivery would be classified as a fixed asset on the balance sheet:

- Dr Fixed assets
- Cr Cash

The van is considered to be capital expenditure as it will assist the profit generation of the business over a number of years. The van would then be depreciated over the life of the asset and a charge made to the profit and loss account:

- Dr Profit and loss
- Cr Fixed assets

Any expenses incurred by the van, eg petrol, vehicle tax would be charged directly to the profit and loss account:

- Dr Profit and loss
- Cr Cash

This expenditure is considered to be revenue because the expenditure does not add to the value of the fixed asset. 4

Capital expenditure classified as revenue expenditure

The profit and loss account would be charged with too much expenditure during the year which will result in the net profit for the year being understated. The balance sheet will also be incorrect and understate the total assets of an organisation. 2

Revenue expenditure charged as capital

The profit and loss account would not be charged with enough expenditure and net profit would be overstated. The balance sheet would overstate the assets of an organisation. 1

(15)

Question 6

- (a) The purpose of accounting bases is to provide an orderly and consistent framework for periodic reporting of an organisations financial position.

2

	Definition	Example
Accounting concepts	The broad basic concepts underlying the preparation of financial statements	eg charge depreciation of fixed assets to the accounting period which benefits from usage (matching and prudence concept)
Accounting bases	Different ways of applying concepts	eg depreciation may be on a straight line or reducing balance method
Accounting policies	The particular bases selected by a business, appropriate to its needs	eg straight line on buildings and reducing balance for motor vans

1 mark for definition, 2 marks for example up to a maximum of 9

- (b) ***Circumstances of change:***
- under SSAP 2, consistency should apply same accounting policies year on year;
 - change if new accounting standard issued which supersedes prior accounting standards;
 - may change if new policy is believed to give a more true and fair view eg operating circumstances changed;
 - merger of businesses to ensure consistent policies;
 - need to disclose any change in accounting policies.

1 mark per valid comment up to a maximum of 4

(15)