FINANCIAL ACCOUNTING

Foundation stage
June 2001

MARKING SCHEME

Question 1

(a)

Cashbook

	£		£	
Balance b/d	1,326			
Creditor	10			*1*
		Bank charges	43	*½*
		Debtor (dishonoured cheque)	200	*1*
		Drawings	2,400	*½*
Balance c/d	1,307			
	2,643		2,643	
		Balance b/d	1,307	

Bank reconciliation

	£	
Overdraft per bank statement	7,477	
Add: Unpresented cheques	1,350	*1*
	8,827	
Less: Outstanding lodgements	7,520	*1*
Overdraft per cashbook	1,307	
		(5)

(b)

Bad debts

	£		£	
Balance b/d	7,474			
Debtors (debt written off)	200			*½*
		Debtors (debt recovered)	270	*1*
		Profit and loss account	7,404	
	7,674		7,674	

Provision for doubtful debts

	£		£	
		Balance b/d	456	
Profit and loss account	32			*1*
Balance c/d £16,960 x 2.5%	424			*½*
	456		456	
		Balance b/d	424	
				(3)

(c)

Bernard

Profit and Loss Account for the year to 31 March 2001

	£	£	£	
Sales			197,214	
Less: Returns inwards			7,444	
			189,770	*½*
Less: Cost of sales				
Stock at 1 April 2000		14,228		
Purchases	64,847			
Carriage inwards	1,260			
	66,107			
Less: Returns outwards	6,119	59,988		
		74,216		*1½*
Stock at 31 March 2001 (£15,661 + £1,000)		16,661	57,555	*1*
Gross profit			132,215	
Discounts received			725	*½*
Reduction in provision for doubtful debts			32	*½*
			132,972	
Carriage outwards		988		*½*
Wages and salaries (95,412 – 24,000)		71,412		*½*
Rent, rates and insurance (10,550 + 450 – 850 – 735)		9,415		*1*
General expenses		4,386		*½*
Bank interest and charges (590 + 43)		633		*½*
Discounts allowed		4,820		*½*
Bad debts		7,404		*½*
Depreciation:				
Motor vehicles (25% x (31,200 – 15,120))		4,020		*1*
Equipment (20% x (23,650 – 5,200)		3,690	106,768	*1*
Net profit			26,204	

(10)

(d)

Bernard
Balance Sheet as at 31 March 2001

	£	£	£	
Fixed assets				
Motor vehicles at cost		31,200		
Less: Depreciation to date (15,120 + 4,020)		19,140	12,060	*1*
Equipment at cost		23,650		
Less: Depreciation to date (9,110 + 3,690)		12,800	10,850	*1*
			22,910	
Current assets				
Stock		16,661		
Trade debtors (16,960 + 270)	17,230			
Less: Provision for doubtful debts	424	16,806		*1*
Prepayments (850 + 735)		1,585		*1*
		35,052		
Current liabilities				
Bank overdraft	1,307			
Trade creditors (9,427 + 10)	9,437			*1*
Accruals	450	11,194		*1*
Net current assets			23,858	
			46,768	
Capital				
As at 1 April 2000		46,964		
Net profit for the year		26,204		
		73,168		
Less: Drawings (24,000 + 2,400)		26,400	46,768	*1*
			46,768	

(7)

(25)

Question 2

(a)

Bartholemew Ltd
Cash flow statement for the year to 31 December 2000

Reconciliation of operating profit to net cash inflow from operating activities	**Working**	**£000**	
Operating profit	W1	212	*3*
Depreciation charge	W2	117	*1*
Loss on disposal of tangible fixed assets (40 – 27 – 11)		2	*1*
Profit on disposal of fixed asset investments (17 – 10)		(7)	½
Increase in stocks (245 – 195)		(50)	½
Increase in trade debtors (190 – 130)		(60)	½
Increase in trade creditors (100 – 90)		10	½
Net cash inflow from operating activities		224	

	Working	**£000**	**£000**	
Cash flow statement				
Net cash inflow from operating activities			224	
Returns on investments and servicing of finance				
Dividends received		2		½
Interest paid		(13)	(11)	½
Taxation (65 – 4)			(61)	*1*
Capital expenditure and financial investment				
Purchase of tangible fixed assets	W2	(350)		*1*
Sale of tangible fixed assets		11		½
Sale of fixed asset investments		17	(322)	½
Equity dividends paid			(40)	½
Cash outflow before financing			(210)	
Financing				
Issue of ordinary share capital		50		½
Issue of debentures		50	100	½
Decrease in cash during the year (10 – 120)			(110)	½

(13)

Workings

W1 Operating profit for the year

	£000
Increase in retained profit (255 – 185)	70
Proposed dividends for the year	60
Profit after tax	130
Taxation (75 – 4)	71
Profit before tax	201
Interest payable (5 + 2 + 6)	13
Income from fixed asset investments	(2)
Operating profit	212

W2 Tangible fixed assets	**£000**
Cost at 31/12/99	420
Cost of disposals	(40)
	380
Acquisitions year to 31/12/00 (derived figure)	350
Cost at 31/12/00	730
Accumulated depreciation at 31/12/99	215
Depreciation on disposals	(27)
	188
Depreciation year to 31/12/00 (derived figure)	117
Accumulated depreciation at 31/12/00	305

(b) According to FRS1, a cash flow statement helps users to assess a company's "*liquidity, solvency and financial adaptability*". In general, a cash flow statement helps to answer such questions as:

– what is the company's cash position?
– how and why has the company's cash position changed since last year?
– do the company's day-to-day operations generate a cash inflow or cash outflow?
– how does the company finance its operations if they generate a cash outflow?
– how does the company finance its investments in new fixed assets?
– even if the company is reporting healthy profits, is its cash situation a cause for concern?

1 mark per point up to a maximum of *(3)*

(c) Although Bartholemew Ltd has made a profit after tax of £130,000 in the year to 31 December 2000, its cash position has worsened by £110,000 during the year. This is despite the injection of an extra £100,000 of finance raised by means of a share issue and a debenture issue.

It is clear that the main cause of this deterioration is the very high investment in tangible fixed assets. The £100,000 of extra finance brought in from outside the company has partly covered this expenditure but over £200,000 has been obtained by using all of the company's internally generated cash and then extending the bank overdraft by £110,000.

The company's liquidity position has worsened significantly during the year and this may be causing problems. It would be interesting to know whether the new fixed assets are expected to facilitate an expansion of the company's business and a rapid increase in the flow of cash from operations. If so (and if the bank manager is willing to be patient) all may be well. If not, the company may find that it has to obtain further long-term finance in the near future.

1 mark per valid point up to a maximum of *(4)*

(20)

Question 3

(a)

Journal

		£	£	
1	Suspense account	9		
	Debtors		9	*1*
2	Drawings	500		
	Wages and salaries		500	*1*
3	Suspense account	100		
	Sales		100	*1*
4	Suspense account	250		
	Heating and lighting		250	*1*
5	Returns inwards	1,250		
	Returns outwards	1,250		
	Suspense account		2,500	*1*
6	Suspense account	20		
	Creditors		20	*1*
7	Debtors	2,475		
	Sales		2,475	*1*
8	Suspense account	84		
	Debtors		84	*1*
9	Equipment at cost	2,000		
	Repairs and renewals		2,000	*1*
	Depreciation for the year (2,000 - 200)/5	360		
	Provision for depreciation of equipment		360	*1*
10	Bank charges	72		
	Suspense account		72	*1*

Suspense account

	£		£	
Balance b/d	2,109			
Debtors (1)	9			
Sales (3)	100			
Heating and lighting (4)	250			
Creditors (6)	20			
Debtors (8)	84			
		Returns inwards (5)	1,250	
		Returns outwards (5)	1,250	
		Bank charges (10)	72	
	2,572		2,572	*3*

(14)

(b)

Statement of corrected net loss

	£	£	
Net loss per draft accounts		14,526	½
Add:			
Returns inwards (5)		1,250	½
Returns outwards (5)		1,250	½
Depreciation (9)		360	½
Bank charges (10)		72	½
		17,458	
Less:			
Wages and salaries (2)	500		½
Sales (3)	100		½
Heating and lighting (4)	250		½
Sales (7)	2,475		½
Repairs and renewals (9)	2,000		½
Suspense account removed from expenses	2,109	7,434	*1*
Corrected net loss		10,024	

(6)

(20)

Question 4

(a)

The *realisation* convention provides guidance as to when the revenue from a sale should be recognised in the profit and loss account. The convention is that the revenue from a sale of goods or services should be recognised only when:

- the goods have been passed to the customer (or the service has been performed), and
- the customer is under an obligation to pay for the goods or services.

This convention is a compromise between two extreme positions (ie recognise a sale as soon as an order is received or wait to recognise a sale until payment has been received) and seems to work reasonably well in practice. However, a problem arises in connection with bad debts. If a bad debt occurs, the revenue from the relevant sale might already have been recognised in a previous accounting period, even though this revenue will never be received. *3*

The *matching* (or accruals) convention provides guidance as to when expenses should be recognised in the profit and loss account. The convention is that expenses should be matched against the revenue to which they relate, so that revenue and the expenses incurred in order to generate that revenue are recognised in the same accounting period. Some of the consequences of this convention include:

- accounting for accruals and prepayments
- accounting for depreciation
- taking closing stock into account when computing the cost of goods sold. *3*

The *consistency* convention requires that like items should be treated in like ways, both in the same accounting period and in different accounting periods. This convention would not exist if there were only one way of dealing with any given item. However, despite the guidance provided by accounting conventions (and standards) the accountant is often faced with a choice of accounting treatments. For example, there are several different depreciation methods or stock valuation methods which could be adopted by a business.

The point of consistency is that it aids comparability, an important characteristic which should be possessed by accounting information. *2*

The *going concern* convention is that financial statements are prepared on the assumption that the business concerned will continue trading for the foreseeable future, unless there is reason to believe otherwise. One consequence of this convention is that the cost of fixed assets may be spread over their expected useful lives. Another is that stock may be valued on the assumption that it will eventually be sold in the normal course of trade. *2*

The *prudence* convention is often described as the most important and influential convention of all. The convention does not require accountants to be over-cautious or pessimistic but it does recognise that accountants have to form judgements and make estimates when preparing financial statements. In conditions of uncertainty, the prudent accountant will "err on the side of caution", trying to ensure that assets and revenues are not overstated and that liabilities and expenses are not understated. *2*

(12)

(b)

One example of a clash between accounting conventions arises in connection with fixed assets. The matching convention requires the cost of a fixed asset to be spread over its useful life, which might stretch several years into the future. On the other hand, the prudence convention might lead us to write off the full cost of the asset immediately, especially in the case of intangible assets such as research and development expenditure.

In some such cases, further guidance is provided by accounting standards (eg SSAP13 in the case of research and development costs). Failing this, the accountant must use his or her judgement and try to strike a sensible balance between the alternative treatments suggested by different accounting conventions. *4*

(c)

Company law ensures that the financial statements of companies adhere to a standard format and disclose some important financial information. However, company law does not generally insist that companies adopt a specific accounting treatment for any of the items shown in their accounts. This means that there can be significant differences between the treatments adopted by different companies, so making it difficult to compare company accounts. Without regulation, a company might also be tempted to adopt accounting treatments which show its financial affairs in the most favourable light possible.

Accounting standards attempt to address these problems. Some of the standards specify accounting treatments which all companies must adopt in relation to certain items in their accounts and many of the standards have extensive disclosure requirements.

A company's accounts must comply with all relevant accounting standards unless it can be demonstrated that compliance with a standard would prevent the accounts from showing a true and fair view. *4*

(20)

Question 5

(a)

Motor vehicles at cost

	£		£	
Balance b/d	37,600			½
Bank	5,600			½
Disposal a/c (part-ex allce)	3,000			1
		Disposal a/c	7,400	1
		Balance c/d	38,800	
	46,200		46,200	
Balance b/d	38,800			

Provision for depreciation of motor vehicles

	£		£	
		Balance b/d	19,190	½
		Profit and loss a/c (see note)	5,820	2
Disposal a/c (see note)	4,440			1
Balance c/d	20,570			½
	25,010		25,010	
		Balance b/d	20,570	

Disposal of motor vehicle

	£		£	
Motor vehicles	7,400			½
		Provision for dep'n	4,440	1
		MV a/c (part-ex allce)	3,000	½
Profit and loss a/c	40			1
	7,440		7,440	

Note:
The depreciation policy amounts to 15% per annum on cost. The vehicle disposed of in the year was acquired during the year to 30 September 1996 and had accumulated depreciation of £7,400 x 15% x 4 years = £4,440. The depreciation charge for the year is £38,800 x 15% = £5,820.

(10)

(b) If part-year depreciation charges are made, the depreciation charge for the year to 30 September 2000 is as follows:

	£
Vehicle sold in the year £7,400 x 15% x 8/12	740
Vehicles owned all year £30,200 x 15%	4,530
Vehicle acquired in the year £8,600 x 15% x 4/12	430
	5,700

The vehicle sold during the year was owned for a total of 4 years and 4 months (52 months) and so incurred total depreciation of £7,400 x 15% x 52/12 = £4,810. This increases the profit on disposal to £410 (£7,400 - £4,810 - £3,000).

5

(15)

Question 6

(a)

The main function of accounting is to provide economic information which helps the users of that information to make better economic decisions. In general terms, this involves the following activities:

– collecting, measuring and recording economic data relating to an organisation (this is often referred to as book-keeping)
– processing this data so as to produce useful economic information which meets users' needs
– communicating this information to users and (if necessary) interpreting or analysing the information and explaining its meaning. *3*

Financial accounting is concerned with providing useful information to owners, investors and to other external users (eg lenders, the tax authorities). This information takes the form of a set of financial statements, usually prepared annually. For a small business the financial statements will generally consist of only a profit and loss account (reporting financial performance) and a balance sheet (reporting financial position). For a large company, these basic statements are supplemented by other financial statements (eg a cash flow statement) and accompanied by a voluminous set of explanatory notes. *3*

Management accounting is concerned with providing useful information to the managers of an organisation, supporting their role in planning, controlling and decision making. This information is much more detailed than that provided to external users and is generally prepared on a continual basis. An example might be a monthly expenditure report, analysing expenditure over cost headings and highlighting significant variances from budget. The information may often involve making projections and forecasts, whereas the information produced by financial accountants is usually historical in nature. *3*

(9)

(b)

Influences which could be suggested include:

– the increasing use of cheap, powerful computer systems for collecting, storing, processing and communicating information
– the very rapid growth of the Internet and its potential for the dissemination of information

– the breaking down of international barriers (especially in Europe), the development of a common currency and the move towards the adoption of international accounting standards
– the emergence of very large powerful corporations whose actions can have a significant impact on the environment and on society as a whole

– the development of new methods of accounting for public sector bodies.

2 marks per influence up to a maximum of 6 marks

(15)