FINANCIAL ACCOUNTING

Foundation Stage
June 1999

MARKING SCHEME

CIPFA

Question 1

(a) Journal entries. *Award ½ mark per correct entry and ½ mark for a satisfactory narrative up to a total of 9 marks. No marks if not in journal format.*

		Debit £	Credit £
(i)	Final Dividend – ordinary shares	80,000	
	Accruals – dividends due		80,000
	Accrual of final dividend of 20p @ 400,000 shares as approved by...		
(ii)	Operating expenses -Audit fee	30,000	
	Accruals – audit fee		30,000
	Accrual of audit fee due re 1998/99 accounts as agreed by...		
(iii)	Cost of sales – closing stock	50,000	
	Current assets - closing stock		50,000
	Correction of over-valuation of closing stock at 31/3/99 per auditor's report		
(iv)	Operating expenses – bad debts	35,000	
	Trade debtors		35,000
	Write off bad trade debtors per auditor's report		
(v)	Turnover – sales	30,000	
	Trade debtors		30,000
	Elimination of sales re 99/00 included in the 98/99 accounts in error per auditor's report.		
(vi)	Operating expenses	15,000	
	Accruals		15,000
	Increase accrued expenses at 31/3/99 – underprovided per auditor's report		

(b) Workings – adjustments to draft accounts – for use in ratios:
Profit & Loss Act:

Award ½ mark per profit adjustment, 1 mark for updating balance sheet

	Per draft accounts £000	Dr £000	final figure £000
Turnover	1,880	30	1,850
Cost of sales	1,150	50	1,200
Gross profit	730	80	650
Operating expenses	250	80	330
Profit before interest	480	160	320
Debenture interest	75		75
Profit before tax	405	160	245

Taxation	120		120
Profit after taxation	285	160	125
Dividends	20	80	100
Retained profit for year	265	240	25
Retained profits b/f	115		115
Retained profits c/f	380	240	140

Adjusted balance sheet:

	£000	**£000**
Fixed assets		800
Current assets:		
Stocks	475	
Trade debtors	430	
Cash/Bank	80	
	985	
Creditors: less than 1 year	785	
Net current assets		200
		1,000
less Debentures		750
Net assets		250
Capital & reserves:		
Ordinary share capital 400,000 @ 25p		100
Share premium		10
Profit & loss		140
Shareholders' funds		250

(i) Return on capital employed (ROCE) = $\dfrac{£320,000}{£1,000,000} \times 100 = 32\%$

(ii) Net profit on sales = $\dfrac{£320,000}{£1,850,000} \times 100 = 17.3\%$

(iii) Gross profit margin = $\dfrac{£650,000}{£1,850,000} \times 100 = 35.1\%$

(iv) Acid test/quick ratio = £510,000 ——— = 0.65:1

£785,000

(v) Trade debtor days = $\frac{£430,000}{£1,850,000}$ x 365 = 85 days

(vi) Stock turnover period = $\frac{£475,000}{£1,200,000}$ x 365 = 144 days

(vii) Trade creditor days = $\frac{£600,000}{£1,200,000}$ x 365 = 183 days

Award 1 mark for each correct ratio up to the maximum of 7. Give full credit for correct use of a ratio but using an incorrect figure because of an error in part (a). Give ½ mark if the correct ratio is used but a new error in the calculation is made.

(c)

There are a number of indicators of the financial position which would interest a potential supplier or trade creditor. Some are of more direct interest but answers should focus on the main needs of these users. Give credit for a valid comment based on the student's figures. Possible comments:

- Trade creditor days of 183 are very high indicating an average 6 month wait for payment.
- A potential creditor would also be concerned about the ability of the Company to pay them at all. The quick ratio is well below 1:1, total creditors under 12 months exceed cash and debtors by £275,000.
- Non-trade suppliers would have similar worries to a trade creditor ie speed of payment and ability to pay. The information available suggests that Shipton is slow in paying its non-trade suppliers eg non trade accruals (excluding the dividend and audit fee) ie £75,000 based on operating expenses (net of audit fee) £300,000 gives an average payment days of 91. A rough guide based on available data.
- Profitability would be of general interest – there is a gross profit and net profit after tax. This is better than a loss but in the absence of trend data and external comparison this is not too helpful.
- Some potential creditors may be worried that the dividend distribution in 1998/99 left a comparatively small retained profit for the year.

Overall a potential trade creditor or supplier would have to consider whether the new business outweighed the concerns suggested by the above indicators. Further research may be needed but it will still be historical in nature. A potential creditor could try to insist on better payment terms.

1 mark for each valid point up to a maximum of 6

(25)

Question 2

(a)

Richard Ryedale
Trading & Profit & Loss Account for the year ended 31 March 1999

		£	£	
Sales	(1,027,300 – 32,200)		995,100	½
Less	Cost of Sales:			
	Stock 1/4/98	92,450		
	Purchases(688,120-26,950)	661,170		½
		753,620		
	Carriage inwards	2,600		*1*
		756,220		
Less	Stock 31/3/99	84,500	671,720	
Gross Profit			323,380	
Add Interest received			280	
			323,660	
Less Expenses:				
Salaries & wages (109,480 + 6,420)		115,900		*1*
Repairs & maint. (15,640 – 4,000)		11,640		*1*
Heating & lighting (7,250 + 4,500)		11,750		*1*
Insurance (5,500 – 800)		4,700		*1*
Rates		5,200		
Telephone, postage (3,620+2,300)		5,920		*1*
Interest (420 + 750)		1,170		*1*
Discounts allowed		12,000		
Motor expenses		24,630		
Bad debt written off		16,000		½
Provision for doubtful debts – reduction		(18,095)		*1*
Depreciation - motor vehicles		5,688		½
- buildings (4,000+114*)		4,114		½ ½
			200,617	
Net Profit for year			123,043	

* working 4,000 divided by 35 years' life remaining

1 presentation

(b)

Richard Ryedale
Balance Sheet as at 31 March 1999

	£	£	£	
FIXED ASSETS	COST	DEP'N	NET	
Buildings	164,000	24,114	139,886	*1½*
Motor vehicles	52,000	34,938	17,062	*½*
	216,000	59,052	156,948	
CURRENT ASSETS				
Stock		84,500		
Trade debtors (135,100 – 16,000)	119,100			*½*
Less Provision for doubtful debts	5,955			*½*
		113,145		
Prepayments		800		*½*
		198,445		
less CURRENT LIABILITIES				
Trade creditors	102,630			
Accruals (13,220 + 750)	13,970			*½ ½*
Bank	5,250			*½*
		121,850	76,595	
			233,543	
less Bank Loan – repayable 31/12/02			30,000	*½*
			203,543	
CAPITAL				
Balance b/f 1/4/98			106,000	*½*
Add net profit for year			123,043	
			229,043	
Less drawings			25,500	*½*
Balance 31/3/99			203,543	

1½ presentation

Question 3

(a)

J Scroggs

Trade Creditors Control Account

	£		£	
Bank – payments	260,000	Trade Purchases	283,000*	½
Bank –payment	9,000			½
Balance c/d	14,000			½
	283,000		283,000	

*Balancing item.

Purchases

Trade creditors	283,000	Balance- purchases for the year	283,000	

Trade Debtors Control Account

Trade Sales*	271,000	Bank	250,000	½
		Balance c/d	21,000	½
	271,000		271,000	

*Balancing item.

Sales

Sales for the year	383,900	Cash Sales	110,000	½
		Drawings –cash sales	6,000	½
		Drawings	2,900	½
		Trade Sales	271,000	½
	389,900		389,900	

NB Could adjust drawings of stock in Purchases. ½

Drawings

Sales – goods withdrawn	2,900	Balance – drawings		½
Suspense account – re cash	12,000	for the year	20,900	½
Cash sales – retained	6,000			½
	20,900		20,900	

(b)

	£000	
Gross Profit		
Sales	389,900	½
Less Cost of Sales (283,000 – 28,000 stock)	255,000	½ ½
Gross profit for year	134,900	½

Net Profit *(½ mark per item up to 2)*

	Gross profit b/d (student's figure if prior error)		134,900	*no mark*	
less	Business expenses:	**£**			
	From Suspense	49,000			½
	Rent (15+5)	20,000			½ ½
	Depreciation	6,000			½
			75,000		
	Net profit for year		59,900		

(c)

J Scroggs
Balance Sheet as at 31 May 1999

	£	£	£	
Fixed Assets			30,000	
Less depreciation			6,000	
			24,000	½
Current assets:				
Stock		28,000		½
Trade debtors		21,000		½
Bank		10,000		½
		59,000		
Less current liabilities:				
Trade Creditors	14,000			½
Rent accrued	5,000			½
		19,000		
			40,000	
Net Assets			64,000	
Capital:				
Introduced			25,000	½
Add net profit for year			59,900	½
			84,900	
Less drawings			20,900	½
Closing Capital			64,000	

presentation ½
(5)

(d)

(award ½ mark for each valid record and each valid routine up to 4 marks)

Students should be aware of a number of basic financial accounting records and accounting controls from throughout the open learning material. The scenario of the question should tell students that few records appear to have been kept eg no cash book so answers could be wide ranging. Possible advice:

Financial Accounting Record	**Accounting Control Routine**
Maintain a cash book – analysed over the main receipts and payments – as an absolute minimum.	Regular (say monthly) reconciliation with the Bank Account.
Advisable to have a double-entry system to reduce errors and omissions.	Periodical trial balance to prove double entries – year end as a minimum.
Use control or total accounts for debtors and creditors.	Regular (say monthly) reconciliation of these accounts with a listing of individual debtors and creditors.
Introduce a full set of records of prime entry eg journal, day books etc.	Journal entries fully described – narratives and authorised. Ledgers entered from prime record eg Sales Day Book.
Maintain a petty cash book on an imprest system.	Reconcile and reimburse monthly.
Prepare regular profit & loss statements.	Say monthly or quarterly ie a summarising routine.

Question 4

(a)

HOLEINONE GOLF CLUB
CASH BOOK MAY 1999

Date	**Details**	**£**	**Date**	**Details**	**Chq**	**£**	
31	Balance b/d	4,650					½
			4	Bank interest	dd	65	½
			4	Bank charge	dd	80	½
			15	Standing order	250	½	
			15	Underbanking re	033	20	½
			16	Deposit account	trans.	2,000	½
			26	Returned chq		800	½
			31	Balance c/d		1,435	
		4,650				4,650	*(3½)*
31	Balance b/d	1,435					

BANK RECONCILIATION STATEMENT AS AT 31 MAY 1999
CURRENT ACCOUNT

			£	
Balance in hand per bank statement			7,050	½
Add income not credited			1,600	½
			8,650	
Less unpresented cheques:		**£**		
201	Willis	1,805		½
204	Jackson	355		½
207	Archer	1,500		½
208	Bar wages	2,880		½
209	Inland Revenue	675		½
				(3½)
			7,215	
Balance in hand per Cash Book at 31 May 1999			1,435	

presentation 1

Workings: Reconciliation of opening balance:

		£	
Balance overdrawn per bank statement 1 May		5,020	
Add unpresented cheques:	£		
180	125		½
197	90		½
198	2,400		½
		2,615	
		7,635	
Less Bank credit 030		1,300	½
Balance overdrawn per cash book 1 May		6,335	*(2)*
			(10)

(b)

Report to Club Report format *1 mark*

(i) Overall cash position at 1 and 31 May 1999:

	1 May	**31 May**
	£	**£**
Balance on current account	6,335 overdrawn	1,435 in hand
Deposit account	1,700 in hand	3,745 in hand
Overall Cash Position	4,635 overdrawn	5,180 in hand
	1 mark	*1 mark*

3 ways club could have improved the use of cash in May eg:

- Prompter banking of receipts eg daily to reduce overdrawn balance.
- Transfer deposit account balance of £1,700 in early May to reduce overdraft and consequent interest charges.
- More considered transfers to deposit account – note overdrawn shortly after the £2,000 transfer to deposit.

1 mark for each valid point (based on students data if errors made) up to 3 marks

(ii) 4 benefits of computerising records eg:

- Speed of information eg on cash balances to help keep within overdraft limit. Reference to the club's overdraft limit.
- Accuracy – likely to be less mistakes than on manual system. Refer to the £20 error on the banking.
- Efficiency- daily reconciliation's possible if needed for better cash management eg refer to management of deposit account or overall cash balances.
- Co-ordination between systems eg cash, ledgers, final accounts, members records and fees. Overall – likely to lead to improved financial management of Club.

1 mark for each valid benefit up to 4 marks.

(20)

Question 5A

The wording and background to this question and answer is based on pages 352 to 360 of the Open Learning Material.

(a) Possible points: *1 mark for each valid point up to a maximum of 5 marks.*

- Companies are governed by Companies Acts which impose conditions on their operations.
- There are a number of requirements and costs associated with setting up a company eg registration with the Registrar of Companies.
- There are a number of ongoing requirements and costs eg maintaining share registers, minutes and submitting annual returns.
- A company has a separate legal existence from its members.
- A company's activities are governed by rules set out in the memorandum of association and articles of association.
- The liability of a shareholder is limited to any amounts due re share capital (eg unpaid calls).

(b) Schedule: *1 mark for each valid comparison up to 6 marks*

SOLE TRADER	LIMITED COMPANY
No requirement to keep accounting records, although likely to do so eg for business management or VAT purposes.	Legally obliged to keep proper accounting records
Accounts are not available to the public.	A copy of the accounts must be lodged with the Registrar of Companies and is available for public inspection.
No requirement to prepare annual accounts. Likely to do so but format is determined by sole trader.	Must prepare a profit & loss account and a balance sheet in a standard format laid down in the Companies Acts
No requirement to follow SSAPs, FRSs in preparing accounts.	Accounts must comply with accounting guidelines eg SSAPs, FRSs.
No statutory requirement for an audit.	Accounts must be audited.
If audited, no specific audit requirements of audit or qualifications of auditor.	Auditor must be qualified to audit a company and must give an opinion on the accounts and notes eg a true and fair view.

(c)

The total shareholders' interest comprises the capital and reserves of a company. The total could be made up of a number of items: *1 mark for each valid point up to a maximum of 4*.

- Share capital – reference to ordinary and preference shares and that issued share capital appears in the balance sheet.
- Profit & loss account – retained profits – accumulated profits not distributed - a revenue reserve – available for distribution to shareholders.
- Share premium – a reserve representing extra money received on the issue of shares – it is a capital reserve and not available for distribution to shareholders.
- Revaluation reserve – capital reserve - revaluation upwards of fixed assets eg land. *4*
  (15)

Question 5B

(a)

1 mark for a valid meaning of each concept and 1 mark for illustration of the concept. Financial accounting is based on a number of conventions and concepts:

Entity
A business is a separate entity from the owners – define limits of the entity or business. In compiling accounts of a sole trader, private transactions or drawings must be accounted for separately from the expenditure of the business.

Objectivity
The aim is to minimise subjective judgement in accounting for transactions wherever possible. For example a neutral view should be taken so that income or expenditure is not over/understated to increase net profits so that they can be withdrawn or distributed. But the use of judgement is still inescapable eg in assessing whether debtors are collectable. An age analysis of debtors and a reasoned assessment of doubtful debts and a provision would be more objective than no such analysis or making no provision based solely on past experience.

Realisation
Concerned with the time when it is possible to recognise a profit eg the results of a sale when the receipt of proceeds is reasonably certain.

Substance over form
This concept says that the substance of a transaction should determine the accounting transaction rather than the legal form of the transaction. This is a topical issue eg concerning the treatment of PFI transactions – should they be on or off balance sheet. One view is that they should be on balance sheet to reflect the substance of the transactions. The Treasury has taken the opposite view. This issue highlights the importance of having independent standards set by an ASB type body.

Materiality
Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. There is no precise measure or figure of materiality -it is a relative concept. An error of £1,000 would probably be material to a sole trader with a net profit of say £10,000, but not material if the profit was £100,000.

10

(b)

Company legislation, accounting guidelines and regulation still leave open the possibility that any accounting practice not specifically banned is allowable. Some accounts may comply with the rules and guidelines but are still potentially misleading. This has been termed "creative accounting". A number of company collapses in the 1980s and 1990s have involved these practices eg capitalising interest on borrowed money, off-balance sheet financing of assets, including the value of internally developed brand names as assets.

1 mark for explanation, 2 for examples

Measures taken to address this problem include - improvements to accounting regulation eg the establishment of an independent ASB in 1990, the role of the FRRP in investigating material departures from accounting standards or company legislation, development of ethical standards to its members by the accounting bodies eg CIPFA, development of "good governance"-Cadbury etc, development of audit standards – role of APB, the Audit Agenda – development of audit reporting and reducing the audit "expectation gap".

1 mark per valid example up to 2

5
(15)