



2009 Accounting and Finance

Standard Grade – Credit

Solutions

Finalised Marking Instructions

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Apply VAT where appropriate at 17.5% throughout the paper.

1. (a) Use the information below to make the entries in the ledger accounts of the partnership Maxwell and Bell.

Ledger balances at 1 May 2009:

Bank Overdraft £1,000
 Equipment £5,500
 M Faraday (Creditor) £ 800

7 May Bought goods £200 (plus VAT) from Lavoiser on credit
 12 May Purchased equipment from Faraday on credit for £8,000 (plus VAT). A cheque for £2,000 was paid to Faraday with the balance on credit
 18 May Paid for repairs to equipment by cheque for £120 (plus VAT)
 22 May Returned faulty equipment to M Faraday for £80 (plus VAT)

Account Name: Bank							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
1 May	Balance			(1) 1,000	00	1,000	00
12 May	Equipment/Faraday			(1) 2,000	00	3,000	00
18 May	Repairs/VAT			(1) 141	00	3,141	00

Account Name: Equipment							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
1 May	Balance	5,500	00	(1)		5,500	00
12 May	Faraday	8,000	00	(1)		13,500	00
22 May	Faraday			(1) 80	00	13,420	00

Account Name: M Faraday - Creditor							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
1 May	Balance			(1) 800	00	800	00
12 May	Equipment/VAT			(2) 7,400	00	8,200	00
22 May	Equipment/VAT	94	00	(1)		8,106	00

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OR

Account Name: M Faraday - Creditor							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
1 May	Balance			(I) 800	00	800	00
12 May	Equipment/VAT			(I) 9,400	00	10,200	00
12 May	Bank	2,000	00	(I)		8,200	00
22 May	Equipment/VAT	94	00	(I)		8,106	00

Account Name: VAT							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
7 May	Lavoiser	35	00	(I)		35	00
12 May	Faraday	1,400	00	(I)		1,435	00
18 May	Bank	21	00	(I)		1,456	00
22 May	Faraday			(I) 14	00	1,442	00

Account Name: Purchases							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
7 May	Lavoiser	200	00	(I)		200	00

Account Name: Lavoiser - Creditor							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
7 May	Purchases/VAT			(I) 235	00	235	00

Account Name: Repairs							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
18 May	Bank	120	00	(I)		120	00

(b) Explain the meaning of the term **double entry**.

- For every debit there is a credit entry (2)
- For each transaction the total debited should be the same as the total credited (2)

(Any one)

- (c) Maxwell and Bell are considering forming a plc. Justify **one** advantage of the proposed change in relation to each of the points below.
- (i) Capital invested
- **This would be much greater/more money (2) (potentially) as a plc as there are far more individuals to invest in the business (2)**
- (ii) Borrowing
- **Borrowing may be easier to arrange with banks (2)**
 - **Borrowing may be cheaper (2) – lower rate of interest if borrowing a larger amount (2)**
 - **Greater variety of borrowing is possible (2) – eg debentures, long term borrowing (2)**
 - **A larger sum may be borrowed (2)**
(Any one)
- (iii) Owners' liability
- **Unlike a partnership liability is limited (2)**
 - **Shareholders would only lose at most their share holding in the plc (2)**
 - **Partners' personal assets are at risk in the event of bankruptcy but not in the case of a plc (2)**
(Any one)

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2. (a) From the information below, and **using the Worksheet provided**, complete the Statement of Account which Frege plc would send to Moore Motors at the end of May 2009.

1 May Moore Motors owed Frege plc £500
7 May Frege plc sold goods to Moore Motors for £846 (plus VAT). The terms of payment were 5% – 30 days and 10% trade discount was allowed
21 May Damaged goods were returned by Moore Motors – their debt was reduced by £90
28 May Moore Motors paid £470 by cheque in full settlement of the balance outstanding on 1 May

Account Name: Moore Motors							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
1 May	Balance	500	00	(1)		500	00
7 May	Sales	887	98	(5)		1,387	98
21 May	Sales Returns			(1)	90 00	1,297	98
28 May	Bank			(1)	470 00	827	98
28 May	Discount			(1)	30 00	797	98

Working

Goods £846.00
Less 10% Trade Discount £84.60 (1)
£761.40
Add VAT £126.58 * (3)
£887.98 (1)

*£761.40 x 0.05 = £38.07 (1)
£761.40 - £38.07 = £723.33 (1)
£723.33 x 0.175 = £126.58 (1)

- (b) Frege plc sells goods on credit. Describe **one** advantage and **one** disadvantage, to Frege plc, of operating this policy.

Advantage

- Develop customer loyalty (2)
- A greater number of customers (2). Encourages more sales (2)

(Any one)

Reject: customers have more time to pay (0) unless followed by something to indicate how this will benefit Frege plc

Reject: attract customers by offering trade discount (0)

Disadvantage

- May cause cash flow problems (2)
- Debtors may become bankrupt (2)
- May lead to bad debts (2)

(Any one)

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(c)	Name the document used in the transaction on 21 May and state its effect on the Gross Profit of Frege plc.		
	<ul style="list-style-type: none"> • Credit note (1) • Gross profit would fall (2) 	3	
(d)	Explain why a business may need to reconcile the balances on the Bank Statement and Bank Account.		
	<ul style="list-style-type: none"> • To explain why their own bank balance is different from that on the bank statement (2) • To ensure an error has not been made by the bank (2) • To ensure an error has not been made in your own bank account (2) • Owing to delays in the banking system – unpresented cheques (1) and lodgements (1) • Items recorded on the bank statement but not included in the business' bank account (2) eg standing order (1), direct debit (1), charges (1), BGC (1) etc maximum 2 examples (Any 3) 	6	

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3. Alistair Milestones, a sole trader, discovered his Trial Balance failed to agree. The debit column exceeded the credit by £81. On checking his ledger accounts, he discovered the following errors.

- (1) A payment of £92 for rent had been correctly entered in the Bank Account but was entered as £29 in the Rent Account
 - (2) Discount received for £12 had been entered on the wrong side of the Discount Received Account
 - (3) An invoice received from B Skinner, a supplier, for £120 (including VAT) has been omitted from B Skinner's account only
- (a) (i) Open the required account to make the Trial Balance agree.
(ii) Make the entries in this account **only** to correct the errors.

Account Name: Suspense (1)							
Date	Details	Dr		Cr		Balance	
		£	p	£	p	£	p
30 April	Balance			(1)	81 00	81	00
	Rent			(2)	63 00	144	00
	Discount Received	24	00	(2)		120	00
	B Skinner	120	00	(2)		-	

- (b) Explain why the Bank Account can be either a debit or credit entry in the Trial Balance.
- **If the bank is an asset (1)/there is money in the bank (1) it will have a debit balance (2)**
 - **If it is an overdraft (1)/money is owed to the Bank (1) it will have a credit balance (2)**
- (c) Explain why capital expenditure should not be included in the Profit and Loss Account.
- **Only revenue expenditure should be recorded (2)**
 - **Capital expenditure would give an unrealistic profit/loss figure (2)**
 - **It may lead to poor decisions (2) – eg raising prices in the mistaken belief this is necessary as the business has a loss because it wrongly included capital expenditure (2)**
 - **Capital expenditure is recorded in the Balance Sheet (2)**
 - **Capital is expenditure on fixed assets (2) which last longer than a year (2)**
- (Any 2)

(d) Suggest **2** sources of finance, other than a bank loan, Alistair Milestones could use to expand. Outline **one** advantage and **one** disadvantage of each source. (Outline different advantages and disadvantages for each source).

Source	Advantage	Disadvantage
Grant (not lottery) (1)	<ul style="list-style-type: none"> Do not need to repay (2) No interest repayments (2) 	<ul style="list-style-type: none"> Time consuming to apply (2) May not be successful (2) May have to wait a considerable time for response to application (2) Conditions may have to be met (2)
Loan from family/friend (1)	<ul style="list-style-type: none"> Simple to arrange (2) Possibly greater flexibility in repaying (2) Possibly lower or no interest charge on loan (2) 	<ul style="list-style-type: none"> Interest may have to be paid (2) Loan must be repaid (2) Could cause family/friend tensions about business (2)
Mortgage/remortgage (once only) (1)	<ul style="list-style-type: none"> Relatively simple to arrange (2) Money can be made available relatively quickly (2) Cost of repayment known in advance (2) Could be spread over a longer period of time, eg 25 years (2) Access to a large sum of money (2) 	<ul style="list-style-type: none"> Interest rate may be variable (2) Additional expense (2) Possible reduction in profits (2) Must be repaid (2) May not be enough (2)
Personal savings (1)	<ul style="list-style-type: none"> Easy to arrange (2) No repayment costs (2) 	<ul style="list-style-type: none"> Heavier commitment (2) Opportunity cost (2)
Partnership (1)	<ul style="list-style-type: none"> Considerably larger capital possible (2) Do not need to repay (2) 	<ul style="list-style-type: none"> Any profits will have to be shared (2) Time consuming to organise (2) Still unlimited liability (2)
Plc (1)	<ul style="list-style-type: none"> Considerably larger capital possible (2) Do not need to repay (2) Limited liability (2) 	<ul style="list-style-type: none"> Any profits will have to be shared (2) Time consuming to organise (2) Expensive to launch (2)

Suggested source 2 x 1 mark each
Advantage 2 x 2 marks each
Disadvantage 2 x 2 marks each

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4. Rorty plc provides the following information at 30 April 2009.

	£000
VAT (Dr)	5
Interim Ordinary Share Dividend	1
Bank Overdraft	10
Provision for Depreciation of Vehicles	6
Net Profit	30
5% Debentures	40
Creditors	53
Vehicles	228
Unappropriated Profit on 1 May 2008	9
Issued Share Capital:	
10,000 10% Preference Shares	10
100,000 Ordinary Shares	100
Debenture interest owing	2
Provision for Bad Debts	3
Debtors	22
Electricity paid in advance	4
Expenses owing	2
Stock on 30 April 2009	5

The Board of Directors proposed that:

- the Preference Share dividend is to be paid in full;
- a final Ordinary Share dividend of 2% is to be paid.

(a) Prepare Rorty plc's Appropriation Account and Balance Sheet using the above information.

Appropriation Account
for year ended 30 April 2009

	£000	£000
Net Profit		30 (1)
Add: Unappropriated Profit 1 May 2008		<u>9 (1)</u>
		39
Less:		
Interim Ordinary Dividend	(1) 1	
Proposed Preference Dividend	(2) 1	
Proposed Ordinary Dividend	(2) <u>2</u>	4
Unappropriated Profit/ Profit & Loss Account Balance 30 April 2009		<u>35 (1)</u>

Balance Sheet as at 30 April 2009

	£000	£000 Cost	£000 Prov for dep	£000 NBV
<u>Fixed Assets</u>				
Vehicles		228 (1)	6 (1)	222 (1)
<u>Current Assets</u>				
Stock			5 (1)	
Debtors	22 (1)			
Less Prov for Bad Debts	3 (1)	19		
VAT			5 (1)	
Electricity paid in advance		4 (1)		
			33	
<u>Less Current Liabilities</u>				
Creditors		53 (1)		
Bank Overdraft		10 (1)		
Debenture Interest Owing		2 (1)		
Proposed Ord Dividend		2 (1)		
Proposed Pref Dividend		1 (1)		
Expenses owing		2 (1)		
			70	
Working Capital			(37) (1)	
			£185	
<u>Issued Share Capital</u>				
10% Preference Shares			10 (1)	
Ordinary Shares			100 (1)	
			110	
			(1)	
<u>Reserves</u>				
Profit & Loss Balance			35 (1)	
			145	
<u>Long Term Liabilities</u>				
5% Debentures			40 (1)	
			£185	

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<p>(b) The Board of Directors of Rorty plc have a policy of retaining profits in the business.</p> <p>(i) Explain why the Board of Directors operate this policy.</p> <ul style="list-style-type: none"> • Funds for expansion (2) at no monetary cost (2) • No interest, or dividends have to be paid for profits retained (2) • To set aside resources for any unforeseen events (2) • To allow the purchase of fixed assets (2) • To reduce chance of liquidity problems (2) <p>(Any one)</p> <p>(ii) Explain one advantage and one disadvantage of this policy to the shareholders.</p> <p>Advantage</p> <ul style="list-style-type: none"> • Expansion of business (0) – potential higher profits (2) • Greater stability (2) • More profits available for distribution in future as dividends (2) • An increase in the share price (2) – potential capital gains (2) (in the longer term – as a result of higher profits) <p>(Any one)</p> <p>Disadvantage</p> <ul style="list-style-type: none"> • Lower dividends (2) (in the short term) • Market value of shares may fall (2) (in the short term – if dividend is lower than expected) • If forced to sell shares a loss on capital invested may result (2) <p>(Any one)</p> <p>(c) Explain the difference between bad debts and provision for bad debts.</p> <ul style="list-style-type: none"> • Bad debts is a past event (2) – the money has been lost (2) • Provision for bad debts is an attempt to anticipate bad debts in the future (2) • Bad debts are an expense (2) • Provision for bad debts can be reduced (2); this adds to the profit • Bad debts are always deducted from the profit (2) • Provision for bad debts are deducted from debtors in the balance sheet (2) • Bad debts do not appear in the balance sheet (2) <p>Any Bad Debt explained – 2 marks Any Provision for Bad Debt explained – 2 marks</p>	<p>2</p> <p>2</p> <p>2</p> <p>4</p>		

5. The following data is taken from the books of Peter Lyola.

	2008	2009
	£	£
Current Liabilities	5,000	7,000
Closing Capital	106,000	126,000
Fixed Assets	99,000	125,000
Net Profit	26,000	20,000
Current Assets	12,000	8,000
Opening Capital	80,000	106,000

(a) Use the data above to calculate appropriate ratios for the 2 years.

	2008	2009
Current Ratio	$\frac{12,000}{5,000}$ = 2.4:1 (I) 2:1 (1) 1:0.42 (1)	$\frac{8,000}{7,000}$ = 1.14:1 (I) 1:1 (1) 1:0.88 (1) 1:0.9 (1)
RCI	$\frac{26,000}{80,000} \times 100$ = 32.5% (I) 33% (1)	$\frac{20,000}{106,000} \times 100$ = 18.87% (I) 19% or 18.9% (1)

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<p>(b) Comment on any variation in the ratios between the years and suggest why the change may have occurred.</p> <p>Current Ratio</p> <ul style="list-style-type: none"> • There has been a deterioration in the liquidity position (2) • Purchase of fixed assets (2) • Moved from a situation where current liabilities can be met with ease (2) to one where it may be very difficult to meet them (2) • Current assets have dropped significantly (2); current liabilities have increased (2). This may be because of not keeping sufficient money in the bank to pay debts (2) <p>Reject: they have more liabilities (0) Not: up or down</p> <p>Any suitable comment – 2 marks Any suitable reason for change – 2 marks</p> <p>RCI</p> <ul style="list-style-type: none"> • There has been a dramatic deterioration on the profit as a percentage of the capital invested at the start of the year (2) • Despite the business expanding (capital increasing by £26,000) (2) the net profit has declined by £6,000 (2) • This could have been caused by a number of factors: an increase in selling price resulting in a significant fall in sales (2); an increase in the cost of purchases (2) and or expenses (2); a slow down in the economy (2); more competition etc (2) <p>Any suitable comment – 2 marks Any suitable reason for change – 2 marks</p>			
<p>(c) Suggest 2 other ratios that might be used to analyse the performance of the business and explain the importance of each.</p> <ul style="list-style-type: none"> • <i>Gross profit ratio</i> (1) informs the business how successful it is at buying and selling the product (2) – compared to previous years (2) and similar businesses (2); shows how much out of every £ of sales is profit (2) • <i>Net profit ratio</i> (1) informs the business how successful it is at controlling its expenses (2) – compared to previous years and similar businesses (2) • <i>Rate of stock turnover</i> (1) informs the business how successful it has been at moving its stock (2) – compared to previous years and similar businesses (2) <p>Suggested ratio 2 x 1 mark each Importance of ratio 2 x 2 marks each</p>			

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- (d) “When 2 firms are in the same industry, the one with the largest net profit is not necessarily the most successful.” Explain this statement.
- **The absolute net profit can be misleading (2)**
 - **What matters is the net profit relative to turnover (2) and capital invested (2)**
 - **A small business may have a much higher net profit ratio (2) and RCI than a much larger business (2). However the larger business’ net profit may be significantly larger than that of the smaller business (2)**
 - **The business with the largest net profit may have liquidity problems (2)**
 - **Examples of the above points would be acceptable (2)**
- Any 2 suitable points explaining the statement – 2 marks each**

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<i>Marks</i>	
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6. Godel's Trading, Profit and Loss Account for the year ended 30 April 2009 is shown below:

	£
Sales	50,000
Less Cost of Goods Sold	20,000
Gross Profit	30,000
Less Expenses	8,000
Net Profit	22,000

(a) Using the above information, and the notes below, prepare Godel's estimated Trading, Profit and Loss Account for the year ended 30 April 2010.

- It is anticipated that Sales will increase by 10%
- The Gross Profit ratio will be the same as 2009
- £5,000 will be received for renting out property
- Existing expenses will increase by 25%

In addition:

- a bonus of 10% of any sales above £50,000 will be paid to the sales team.
- a bank loan of £2,000 will incur interest of 8% per annum.

Trading, Profit and Loss Account
for year ended 30 April 2009

	£	£	
Sales		55,000	<i>(1)</i>
Less cost of Goods Sold		22,000	<i>(1)</i>
Gross Profit		33,000	<i>(2)</i>
Rent received		5,000	<i>(1)</i>
		38,000	
Less Expenses	10,000		<i>(1)</i>
Sales Bonus	500		<i>(2)</i>
Bank Interest	160		<i>(1)</i>
		10,660	
Net Profit		27,340	<i>(1)</i>

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<p>(ii) Name and justify 2 additional financial statements which may be prepared to present to members at the AGM.</p> <p>Refreshments/Bar Trading Account (1)</p> <ul style="list-style-type: none"> • Shows whether Club Bar is making a profit/loss (2) for financial period (2) • Decide if prices need to be increased (2) • See if worthwhile to continue running it (2) <p>Fund-raising Income Statements (1)</p> <ul style="list-style-type: none"> • Shows whether these events are making a profit/loss (2) • See if worthwhile doing again next year (2) <p>Income and Expenditure Account (1)</p> <ul style="list-style-type: none"> • Shows profit/loss from fund raising events or bar etc (2) • Contains all revenue income/expenditure for financial period (2), adjusted where necessary, for prepayments (2) and accruals (2) • The Income and Expenditure Account shows if the Club has made a surplus/deficit (2) <p>Balance Sheet (1)/Statement of Affairs (1)</p> <ul style="list-style-type: none"> • Shows what the Club is worth (2) • Shows Working Capital of Club (2) • Shows NBV of Club's Fixed Assets (2) • Shows the assets (1)/liabilities (1) of the Club (2) • Shows the amount of Accumulated Funds at the year end (2) • Shows the liquidity of the club (2) <p>Cash Budget (1)</p> <ul style="list-style-type: none"> • Help plan for the future (2) • Identify cash shortages (2) • Identify cash surpluses (2) - when fixed assets could be bought (2) • Identify opening and closing balances (2) • Can see estimated income (2) and expenditure (2) - max (2) • Identify when to cut down on purchases/expenses (2) <p>Any 2 statements – 2 x 1 mark Any 2 justifications – 2 x 2 marks</p>	6

[END OF MARKING INSTRUCTIONS]