## 2011 Accounting \& Finance

## Standard Grade - Credit

## Solutions

## Finalised Marking Instructions

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1. Robert \& Tommy Rose are in a partnership which specialises in golf equipment. Credit customers are offered the following terms.

| Trade Discount | $10 \%$ |
| :--- | :--- |
| VAT | $17.5 \%$ |
| Cash Discount | $5 \%$ one month |

On 31 March 2011 a Statement of Account is sent to Terry Woods containing the following details.

| 1 March | Balance due £524.81 |
| :--- | :--- |
| 7 March | Terry Woods bought equipment costing £780.00 <br> (before the above terms were applied) |
| 10 March | Terry Woods paid Robert \& Tommy Rose £502.31 by <br> cheque in full settlement of the balance outstanding <br> on 1 March |
| 15 March | Terry Woods returned some of the equipment <br> purchased on 7 March as it was faulty. The value of <br> the goods (after the above terms were applied) was <br> $£ 265.00$ |

(a) Complete the Statement of Account (on the Worksheet provided) to be sent to Terry Woods on 31 March.

| Date | Details | $\begin{aligned} & \mathrm{Dr} \\ & £ \end{aligned}$ | $\begin{aligned} & \hline \mathrm{Cr} \\ & £ \end{aligned}$ | $\begin{aligned} & \text { Balance } \end{aligned}$ |
| :---: | :---: | :---: | :---: | :---: |
| 01/03/11 | Balance | 524.81 (1) |  | 524.81 dr |
| 07/03/11 | Sales | 818.70 (5) |  | 1,343.51 dr |
| 10/03/11 | Bank |  | 502.31 (1) | 841.20 |
| 10/03/11 | Discount |  | 22.50 (1) | 818.70 |
| 15/03/11 | Returns |  | 265.00 (1) | 553.70 dr |


| 07/03/11 | Sales | 780.00 |
| :---: | :---: | :---: |
|  | LESS Trade Discount (10\%) | 78.00 |
|  | NGV | 702.00 |
|  | ADD VAT* | 116.70 |
|  | TOTAL | £818.70 |
| *VAT | NGV | 702.00 |
|  | LESS Cash Discount (5\%) | 35.10 |
|  |  | 666.90 |
|  | VAT (17.5\%) | £116.70 |

## 1. (continued)

SALES 07/03 - ALTERNATIVE SOLUTIONS

## CORRECT

| GOODS | 780.00 |  |
| :---: | :---: | :---: |
| -TRADE DISCOUNT - 10\% | 78.00 (1) |  |
| = NGV | 702.00 |  |
| + VAT - 17.5\% | 116.70* |  |
| = TOTAL | 818.70 (1) |  |
| *NGV | 702.00 |  |
| -CASH DISCOUNT - 5 | 35.10 (1) |  |
|  | 666.90 |  |
| VAT - 17.5\% | 116.70 (1) | = 4 marks + 1 for correct |

## ALTERNATIVE 1

| GOODS | 780.00 |  |
| :---: | :---: | :---: |
| -TRADE DISCOUNT - 10\% | 78.00 (1) |  |
| = NGV | 702.00 |  |
| + VAT -17.5\% | 122.85 (1) |  |
| = TOTAL | 824.85 (1) | = 3 marks + 1 for correct |

## ALTERNATIVE 2

| GOODS | 780.00 |  |
| :---: | :---: | :---: |
| -TRADE DISCOUNT - 10\% | 78.00 (1) |  |
| = NGV | 702.00 |  |
| -CASH DISCOUNT - 5\% | 35.10 (1) |  |
|  | 666.90 |  |
| +VAT -17.5\% | 116.70 (1) |  |
| = TOTAL | 783.60 (0) | = 3 marks + 1 for correct |
|  |  | entry $=4$ marks |

## ALTERNATIVE 3

| GOODS |  |  |
| :--- | :--- | :--- |
| +VAT -17.5\% |  |  |
| = TOTAL | 780.00  <br> 136.50 (1) |  |
| 9 | (1) | $=2$ marks +1 for correct |
| entry $=3$ marks |  |  |


| Marks |  |
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1. (continued)
(b) Suggest a reason why Robert \& Tommy Rose offer Cash Discount to their customers.

To encourage their customers to pay:

- within the time mentioned in the "terms"/within the month
- promptly
- to help their cash flow.
(Any one for 2 marks)
(c) Name the document which would have been sent by Robert \& Tommy Rose on 15 March and explain its use.

Credit Note (1) Used to record a return of goods (1) Previously bought on credit (1) States reason for return (1)
Reduces amount originally owed (1) Used to record entries in the ledger (1) Shows details of goods returned (1)
(d) Robert \& Tommy Rose are considering becoming a plc.

Suggest 2 advantages and 2 disadvantages of this to the partners.

| ADVANTAGES | DISADVANTAGES |
| :--- | :--- |
| More capital (available <br> from shares) | No longer in control of <br> business |
| More expertise (from BOD) | Profits shared between <br> people/shareholders |
| More sources of finance <br> (debentures) | Legal requirements have to <br> be met/must publish <br> accounts/must hold AGM |
| Limited liability | May not receive any <br> dividends |
| Easier to borrow (due to <br> size) | Shares may lose value |
| More purchasing power | Expensive to set up |

(Any 2 advantages and 2 disadvantages for 2 marks each)

| Marks |  |
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2. Maggie MacIntyre operates a small business buying and selling beauty products. The following balances were taken from her ledger on 1 March 2011.

| Cash | $£ 455 \cdot 00$ |
| :--- | ---: |
| Bank Overdraft | $£ 220.00$ |
| Equipment | $£ 2,100.00$ |

(a) Open the accounts with the above balances.
(b) Record the following transactions in the ledger.

| 2 March | Paid by cheque for 4 desktop fans for office <br> use. Fans cost £30.00 each plus VAT |
| :--- | :--- |
| 4 March | Maggie decided to take one of the fans <br> purchased on 2 March for her own use at |
| 6 March | home <br> Cash sales £200.00 plus VAT |
| March | One of the fans bought on 2 March was <br> returned as it was faulty. A cash refund <br> was received |
| March | Maggie kept £50.00 cash in the till and <br> transferred the rest to the bank |


| Marks |  |
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2. (a) \& (b) (continued)

| DATE | DETAILS | DR | CR | BAL |
| :---: | :---: | :---: | :---: | :---: |
| CASH ACCOUNT |  |  |  |  |
| 01/03/11 | Balance | 455.00 (1) |  | 455.00 dr |
| 06/03/11 | Sales \& VAT | 235.00 (1) |  | 690.00 dr |
| 08/03/11 | Equipment \& VAT | 35.25 (1) |  | 725.25 dr |
| 10/03/11 | Bank |  | 675.25 | 50.00 dr |


| DATE | DETAILS | DR | CR | BAL |
| :---: | :---: | :---: | :---: | :---: |
| BANK ACCOUNT |  |  |  |  |
| 01/03/11 | Balance |  | 220.00 (1) | 220.00 cr |
| 02/03/11 | Equipment \& VAT |  | 141.00 (1) | 361.00 cr |
| 10/03/11 | Cash | 675.25 (1) |  | 314.25 dr |
|  |  |  |  |  |


| DATE | DETAILS | DR | CR |  | BAL |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| EQUIPMENT ACCOUNT |  |  |  |  |  |  |
| 01/03/11 | Balance | 2,100.00 (1) |  |  | 2,100.00 | dr |
| 02/03/11 | Bank | 120.00 (1) |  |  | 2,220.00 | dr |
| 04/03/11 | Drawings |  | 30.00 | (1) | 2,190.00 | dr |
| 08/03/11 | Cash |  | 30.00 | (1) | 2,160.00 | dr |


| DATE | DETAILS | DR | CR | BAL |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| VAT ACCOUNT |  |  |  |  |  |  |
| 02/03/11 | Bank | 21.00 | (1) |  | 21.00 | dr |
| $04 / 03 / 11$ | Drawings |  | 5.25 | (1) | 15.75 | dr |
| $06 / 03 / 11$ | Cash |  | 35.00 | (1) | 19.25 | cr |
| $08 / 03 / 11$ | Cash |  | 5.25 | (1) | 24.50 | cr |


| DATE | DETAILS | DR | CR | BAL |
| :--- | :--- | :--- | :--- | :--- |
| DRAWINGS ACCOUNT |  |  |  |  |
| 04/03/11 | Equipment <br> \& VAT | $\mathbf{3 5 - 2 5} \quad$ (1) |  | $35 \cdot 25 \quad$ dr |


| DATE | DETAILS | DR | CR | BAL |
| :--- | :--- | :--- | :--- | :--- |
| SALES ACCOUNT |  |  |  |  |
| $06 / 03 / 11$ | Cash |  | 200.00 | (1) |

## 2. (continued)

(c) At the moment, Maggie operates her business on a strictly "cash only" basis ie all customers pay at the time of sale. Suggest 2 benefits and $\mathbf{2}$ costs of operating on a credit basis.

Advantages of operating on a credit basis include:

- wider range of customers - increased sales (2)
- increased customer loyalty (2)
- larger orders more likely (2).

Disadvantages of operating on a credit basis include:

- (likelihood of) bad debts (2) cost of credit checks (2)
- liquidity/cashflow problems (2)
- cost of borrowing (2)
- increased accounting procedures (2).
(Any 2 advantages and disadvantages for 2 marks each)

| Marks |  |
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## 2. (continued)

(d) Maggie is also a member of her local Tennis Club. The club only provides its members with a Receipts and Payments Account. Maggie has complained that this does not provide enough information. Suggest 2 other Financial Statements which could be provided and explain their significance.

- Refreshments/Shop/Bar Trading A/c (1)
to show profit/loss made on bar (2)
to indicate how bar expenses may be controlled (2) to show cost of bar supplies (2).
- Income Statements (1)
can show profit/loss made by events/activities (2).
- An Income \& Expenditure A/c (1)
to show revenue income (1) and expenditure (1) to show Surplus/Deficit for the year (as opposed to cash position) (2)
to indicate how profitability may be improved (2).
- Balance Sheet (1)
to show what the club is worth/accumulated fund (2) to show assets owned by club (2) to show liabilities of the club (2).
- Cash Budget (1)
can predict future cash surpluses (2)
arrange payment of debts (2)
arrange purchase of assets (2)
can predict future cash shortages (2)
arrange overdrafts (2)
arrange loans (2)
you know your opening/closing balances (2)
you can plan for the future (2)
can be used to support applications for loans/show prospective investors (2).

One mark for each financial statement name
2 marks for explanation of each financial statement named

| Marks |  |
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3. JMac plc make and sell hamburgers for the catering trade. The following Profit Statement relates to last month when 30,000 hamburgers were made and sold.

Profit Statement

|  | £ | £ |
| :---: | :---: | :---: |
| Sales |  | 15,000 |
| Less Cost of sales |  | 9,000 |
|  |  | 6,000 |
| Less Expenses |  |  |
| Rent | 2,000 |  |
| Insurance | 200 |  |
| Wages | 1,800 | 4,000 |
| Profit |  | 2,000 |

(a) Calculate how many hamburgers JMac plc must sell to break even.

Sales/qty = SP
$\frac{(1)}{£ 15,000 / 30,000}$
$=£ 0.50$
(1)

Cost of Sales/qty = VC

Total Exp $=\mathrm{FC}$
£2,000 + £200 + £1,800
$=£ 4,000$ (1)

> (1) (1)

SP - VC = Unit Contribution $£ 0 \cdot 50-£ 0 \cdot 30$
$=£ 0.20$ (1)
FC/Unit Contribution $=$ BEP $\quad £ 4,000 / £ 0 \cdot 20$
$=20,000$ (1) hamburgers
(b) Wages are expected to increase to $£ 2,000$ next month. Calculate how many hamburgers JMac plc will have to sell to break even.

New FC/Unit Contribution = New 4,200 (2)/£0.20 (1) BEP $\quad=21,000$ hamburgers (1)
(c) If the wages rise, as expected, calculate how many hamburgers JMac plc will have to sell to make a profit of $£ 5,000$.

| Required Profit |
| :--- |
| $(£ 5000)+\mathrm{FC}(£ 4200)$ |
| $(1)$ |$=\quad$| Required Contribution |
| :--- |
| $(£ 9200)$ |

## Required Contribution/Unit Contribution per hamburger = No of hamburgers

$£ 9,200 / £ 0 \cdot 20=46,000$ hamburgers

| Marks |  |
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## 3. (continued)

(d) State the effect each of the following will have on the break-evenpoint and explain why.
(i) Selling price increases while all costs remain the same.

It will decrease the BEP (1) as the contribution per unit will be a higher figure (2) being divided into the same (fixed) costs to get BEP (2), contribution will change (1)
(ii) Cost of sales decreases while all other costs and selling price remain constant.

It will decrease the BEP (1) as the contribution per unit will again be a higher figure (2) being divided into the same fixed costs (2), contribution will change (1)
(One mark for effect and 2 marks for explanation $\times 2$ )

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3. (e) (ii) (continued)

## DEBENTURES

Advantages - Only interest is paid until repayment date (2)
Final payment in future giving time to save/organise (2)
No loss/dilution of ownership/ control (2)
Long term loan (2)
Can get a large sum of money (2)
Disadvantages - Interest has to be paid (2)
Final repayment has to be made in lump sum (2)
Profits reduced due to interest (2)
Extra liability (2)
One mark for source and 2 marks for any advantage and disadvantage

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4. Malcolm Docherty operates a small fishing supplies business called "Flies Are Us". The following information was extracted from his ledger on 30 April 2011.

5. (continued)
(a) Select the necessary information and prepare the Trading, Profit and Loss Accounts for the year.

FLIES ARE US
TRADING, PROFIT \& LOSS ACCOUNT FOR YEAR ENDED 30 APRIL 2011

4. (b) (continued)
(ii) Debtors and Creditors

A debtor is someone we have sold goods on credit to (1) and they therefore owe us money (1). They are shown in the (Balance Sheet) as a Current Asset (1).

A creditor is someone we have purchased goods on credit from (1) and we therefore owe them money (1). They are shown in the (Balance Sheet) as a Current Liability (1).
(iii) Bad Debts and Provision for Bad Debts

Bad Debts occur when debtors fail to pay the amount owed (2). It is an expense in the P\&L Account (1). It does not affect the Debtors total as the account has already been closed (1).

MUST IMPLY THE PAST
The Provision for Bad Debts is an attempt to anticipate future Bad Debts (2).
Only the difference from one year to another is shown in the P\&L Account (1).
An increase is an Expense (1), a decrease is Other Income (1). It is deducted from Debtors in the Balance Sheet (1) to give a more realistic Debtors figure (1).

MUST IMPLY THE FUTURE
In parts (i), (ii) \& (iii) both sides must be explained to gain full marks 12 KU

| Marks |  |
| :---: | :---: |
| $\mathbf{K U}$ | $\mathbf{H I}$ |
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5. Brian and Pat Boyle run a corner shop. The total of the Dr column in the Trial Balance was $£ 89,260$ and the total of the Cr column was £90,152.
(a) Open the necessary account which will allow the Trial Balance to balance.

On checking the entries it was discovered that the following errors had been made.

- Sales Returns of $£ 250$ had been correctly entered in the Debtor and VAT Accounts, but had been recorded on the wrong side of the Sales Returns Account.
- Although recorded in the Bank Account, there was no other record made of $£ 466$ withdrawn by the owner Brian Boyle.
- Cash Sales of $£ 240$ were correctly entered in the Sales and VAT Accounts but recorded as $£ 24$ in the Cash Account.
- The Purchases Account was over-added by £290.
(b) Correct these errors showing only the necessary entries to be made in the account opened in part (a) above.

| DATE | DETAILS | DR | CR | BAL |
| :---: | :---: | :---: | :---: | :---: |
| SUSPENSE ACCOUNT (1) |  |  |  |  |
| 1 March | Difference on TB | 892.00 (1) |  | 892.00 dr |
|  | Sales Returns |  | 500.00 (2) | 392.00 dr |
|  | Drawings - B Boyle |  | 466.00 (1) | 74.00 cr |
|  | Cash |  | 216.00 (2) | 290.00 cr |
|  | Purchases | 290.00 (1) |  | 0 |


| Marks |  |
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5. (continued)

The following errors were discovered after the corrections above were made.

- Payment of $£ 45$ for the purchase of petrol for the Delivery Van was correctly entered in the Bank Account, but mistakenly entered in the Delivery Vans Account.
- Purchases of £157 on credit from Jack Green had been recorded in the account Jim Green.
(c) State the name given to each of the above types of error.

Error of principle (1)
Error of commission (1)
(d) Describe 2 other types of error which would not have been detected by the Trial Balance.

- Error of Omission (1). When no entries have been made for a transaction either in dr or cr (2) eg an invoice falling down the back of the filing cabinet and being forgotten about (2).
- Error of Original Entry (1). When the wrong figure is used in all entries for a transaction (2) eg payment of an expense of $£ 624$ is recorded in the expense and money accounts as $£ 642$ (2).
- Compensating Errors (1). When one or more errors cancel each other out (2) eg a wrong dr of $£ 50$ is cancelled out by wrong cr entries of $£ 23$ and $£ 27$ (2).
- Complete Reversal (1). When the entries for a transaction are completely reversed (2) ie the account that should have been dr is cr whilst the account that should have been cr is dr (2) eg payment of an expense is cr to expense account and dr to money account (2).

Any 2 of above for 2 marks each
(e) Explain why the above errors would not have been detected by the Trial Balance.

The above errors would not affect the balancing of the Trial Balance as in all cases the Debit entries made are equal to the Credit entries made (2).
The double entry has been completed (2).
MUST BE SOME REFERENCE TO DOUBLE ENTRY OR DR \& CR

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6. The following information was extracted from the Balance Sheets of 2 firms in the same line of business.

|  | Peddlars | Cycling World |
| :---: | :---: | :---: |
| Fixed Assets | £100,000 | £40,000 |
| Current Assets | £11,000 | £4,500 |
| Current Liabilities | £7,750 | £1,500 |
| Working Capital | £3,250 | £3,000 |
|  | £103,250 | £43,000 |
| Financed by |  |  |
| Opening Capital | £85,000 | £30,000 |
| Net Profit | £35,000 | £25,000 |
|  | £120,000 | £55,000 |
| Drawings | £16,750 | £12,000 |
| Closing Capital | £103,250 | £43,000 |

(a) Calculate appropriate ratios for both firms.

| RATIO | PEDLARS | CYCLING WORLD |
| :---: | :---: | :---: |
| WORKING CAPITAL/ CURRENT RATIO $=C A: C L$ | $\begin{aligned} \text { (1) } 11000: 7750(1) \\ 1.42: 1(1) \\ 1: 0.7 \text { ACCEPT } \end{aligned}$ | $\begin{aligned} 4500 & : 1500 \\ 3 & : 1(1) \end{aligned}$ |
| RETURN ON CAPITAL <br> EMPLOYED <br> (INVESTED) <br> NP/CAP AT <br> BEGINNING * 100 | $\begin{gathered} \text { (1) } 35000 / 85000(1) * 100 \\ 41.18 \%(1) \end{gathered}$ | $\begin{gathered} 2500 / 30000 \text { * } 100 \\ 83.33 \%(1) \end{gathered}$ |

6. (continued)
(b) Name and explain the possible use of 2 other accounting ratios.
(Give a different use for each ratio named.)

- Gross Profit \% (1) = GP/Sales x 100 (1) one mark for name OR formulae

Shows \% profit being made from buying/selling stock (2) Can show if Selling Price needs to be increased (2) Shows how well business is doing (2)
Can be compared to: previous years (2)
other businesses (2)
Industry Average (2)
Any one for 2 marks

- Rate of Stock turnover (1) = Cost of Sales/Av St (1) one mark for name OR formulae

Shows how quickly stock is being sold (2)
Can avoid build up of stock (2)
Lets you know how quickly to re-order (2)
Any one for 2 marks

- Net Profit \% (1) = NP/Sales x 100 (1) one mark for name OR formulae

Shows how profitable the company is after expenses have been deducted (2)
Can indicate changes in GP\% (2)
Any one for 2 marks
ACCEPT MARK-UP \%/ACID TEST/EXPENSE \%
(Any 2 ratios from above)
(c) Identify the type of business organisation of the 2 firms. Give a reason to support your answer.

A Sole Trader (1)
The business has only one person injecting Capital (2)
The Net Profit is going in full to the owner (2)
The Drawings are being taken from the owner's capital (2)
Any one for 2 marks

6. (continued)
(d) State $\mathbf{2}$ reasons why "Closing Capital" may be less than "Opening Capital".

Closing Capital may be less than Opening Capital because:
the owner has taken TOO much out in Drawings (2) more drawings than NP (2) drawings on its own = 1 mark the business made a Net Loss (2) the owner has withdrawn some of their capital (2).

Any 2 for 2 marks each
(e) Suggest 2 banking services a business could use to pay an electricity bill and justify the most appropriate service.

Banking Services to pay an electricity bill could be:
Direct Debit (1)
Standing Order (1)
BGC (1)
Any 2 of above for one mark each
Most appropriate method is Direct Debit as:
the amount can vary (2)
the recipient informs bank of amount due (2) the date can vary (2)

Any one of above for 2 marks
If only SO and BCG suggested, then accept:
Justification of SO as "amount paid automatically" only and if justification of BGC as "amount paid can vary" only

| Marks |  |
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