Introduction to Accounting

NQF

Subject Examiner's Report

Unit Title:	**Introduction to Accounting**
Unit Code:	**1.3 IA**
Session:	June 2016

Question 1

(a) Explain what is meant by each of the following terms:

(i) Direct cost
(ii) Indirect cost

(4 marks)

(b) Copy the following table into your answer book. The costs listed are for a company that makes clothing.

Cost	Direct	Indirect
Factory heat and light		✓
Cloth and buttons		
Machine maintenance		
Factory manager's salary		
Machinist's wages		
Royalties payable on sales		
Factory security costs		

Identify whether each cost is either a direct cost or an indirect cost, by ticking the appropriate boxes in the table. The first cost has been completed as an example. **(6 marks)**

(c) Nicole is planning to launch a new product and is considering various options. The following information summarises the costs and income for one of the options, Product A:

- Nicole expects to be able to sell 1,000 units of Product A at a price of £6.00 per unit.
- The projected variable costs per unit are £4.50.
- The fixed costs involved in Product A are expected to be £3,000.

Required:

(i) Calculate the break-even point in units for Product A. **(4 marks)**
(ii) Calculate the profit/(loss) in £ if Nicole is only able to sell 500 units of Product A. **(4 marks)**
(iii) Calculate the break-even point, in units, if the sales price per unit is set at £8.50 per unit. Assume the other details remain the same as in the original plan. **(3 marks)**
(iv) Calculate the lowest sales price Nicole could charge for Product A and still break-even. (Assume the fixed and variable costs remain as in the original plan and the projected sales remain at 1,000 units). **(4 marks)**

(Total 25 marks)

Learning Outcome
6 Describe, explain and calculate accurately different elements of costs
8 Describe and explain the essential concepts and principles of break-even analysis and undertake calculations accurately to demonstrate their overall understanding and knowledge

1. Comments on learners' performance

This was a popular question and candidates performed reasonably well on the first two parts. Although there was some confusion among the less well prepared, most candidates were able to explain the terms direct and indirect costs well. Some used correct examples to illustrate their answer which helped to enhance their answers. Others could explain the terms but illustrated with incorrect examples. This was compounded in part (b) where candidates were required to categorise examples.

Part (c) proved to be a difficult area for many candidates. They tended to be able to calculate the break-even point but found it difficult to make adjustments to the figures to assist in decision making. Parts (ii), (iii) and (iv) are typical scenarios which management might consider at work and future managers should aspire to achieve understanding of scenarios like this. When calculating the profit or loss, a number of answers used the calculation of the income (1,000 units at £6) but then only deducted £4.50 for variable costs. It is important to remember that variable costs should also be multiplied by the number of units (i.e. 1,000 at £4.50 in this case).

2. Mark scheme

(a) (i) A direct cost is directly identified with a product. A product cannot be made without direct costs. **2**
(ii) An indirect cost is an expense which is not directly identified with a product. It is incurred in a business and does not change directly with the number of units made. **2**

(4 marks)

(b)

Cost	Direct	Indirect
Factory heat and light		√
Cloth and buttons	√ **1**	
Machine maintenance		√ **1**
Factory manager's salary		√ **1**
Machinist's wages	√ **1**	
Royalties payable	√**1**	
Factory security costs		√ **1**

(6 marks)

(c) (i) Break-even point = $\frac{\text{Fixed costs}}{\text{Contribution per unit}} = \frac{3{,}000 \quad \mathbf{1}}{6.00 - 4.50 \quad \mathbf{1 + 1}}$ = 2,000 units **1**

(ii) Loss - £1.50 contribution x 500 = £750 **1** - £3,000 **1** fixed costs = £2,250 loss **1**

(iii) Break-even point for changed sales price = $\frac{3{,}000 \quad \mathbf{1}}{8.50 - 4.50 \quad \mathbf{1 + 1}}$ = 750 units **1**

(iv) Lowest sales price to break-even - 1,000 units **1** = $\frac{3{,}000 \quad \mathbf{1}}{x - 4.50 \quad \mathbf{1}}$ $x =$ £7.50 **1**

(15 marks)

3. Recommendations

Learners should aim to remember definitions of direct and indirect costs together with relevant examples. It is important for learners to understand how direct costs relate directly to the product whereas indirect costs are more general costs. Indirect costs are also referred to as overheads.

By understanding what is meant by break-even, margin of safely and contribution learners will be able to deal with short-term decision making in business. They should note that these terms rely on an understanding of fixed and variable costs as opposed to direct and indirect costs. Contribution is often used as the starting point from which to calculate profit in different circumstances in questions which feature fixed and variable costs. Contribution should, therefore, be well understood.

Examiner's tips

Once the basic calculations are mastered with a given set of figures try changing one variable at a time in, say, calculations of profit. This approach is useful in answering 'what if' questions and provides learners with the skills to understand the implications on the outcome of a plan if the inputs are not as expected.

Question 2

Tati Ltd has provided the following summary information from its final accounts for the year to 30 April 2016:

	£000
Revenue (sales)	180
Cost of sales	(100)
Sundry expenses	(60)

Notes:
1. The inventory (stock) at 1 May 2015 cost £10,000.
2. The retained profits at 1 May 2015 were £20,000.

Non-current assets (net book value)	100
Current assets	
Inventory (stock)	10
Trade receivables (debtors)	15
Cash at bank	5
	130
Capital and reserves	
Ordinary share capital (£1 shares) (issued in 2011)	60
Retained profits	40
	100
Current liabilities	
Trade payables (creditors)	30
	130

Required:

(a) Calculate, to two decimal places, the following at 30 April 2016:

(i) Return on average capital employed
(ii) Gross profit to sales
(iii) Net profit to sales
(iv) Asset turnover
(v) Working capital ratio
(vi) Acid test ratio
(vii) Trade receivables (debtor) days
(viii) Trade payables (creditor) days

(15 marks)

(b) The following ratios were calculated for the year to 30 April 2015:

Return on average capital employed	35%
Gross profit to sales	60%
Asset turnover	3 times
Working capital ratio	3:1
Trade receivables (debtor) days	30 days
Trade payables (creditor) days	60 days

Required:

Discuss the performance of Tati Ltd over the period, highlighting any areas of concern about the business at 30 April 2016. **(10 marks)**

(Total 25 marks)

Learning Outcome
5. Undertake some financial ratio analysis of a company's accounts and make reasoned judgements and comments on company performance based on their figures

1. Comments on learners' performance

This was not one of the more popular questions and few candidates were able to correctly calculate and comment upon the ratios. Many of the less well prepared candidates appeared to be unsure of the constituents of the ratios and confused profitability ratios with those focused on liquidity. This was evidenced by current assets and liabilities, receivables and payables being included in the calculation of profit ratios and profit calculations in liquidity ratios. Without an understanding of the calculations, the candidates found themselves in the position of trying to compare significantly different figures in part (b)

Analysis of performance [part (b)] was largely limited to a recognition of whether a ratio increased or decreased or, indeed, where candidates recognised that they were unclear about the calculation of the ratio, to an attempted comparison between elements of the ratio calculation with the ratio given for the previous year.

A minority of candidates, as noted in previous examination reports, provided an analysis which seem to confuse the years suggesting that the previous year's figures followed the calculations made for the current year.

2. Mark scheme

(a)

(i) Return on average capital employed

$$\frac{(180 - 100 - 60)\ \ {}^1/_2 + {}^1/_2 + {}^1/_2}{(80 + 100) / 2\ \ {}^1/_2} \times 100 = 22.22\%\ \ ½\ \ \textbf{OF}$$

(ii) Gross profit to sales $\frac{180 - 100\ \ {}^1/_2 + {}^1/_2}{180\ \ {}^1/_2} \times 100 = 44.44\%$ ½ **OF**

(iii) Net profit to sales $\frac{(180 - 100 - 60)\ \ {}^1/_2\ \textbf{OF}}{180\ \ ½} \times 100 = 11.11\%$ ½ **OF**

(iv) Asset turnover ratio $\frac{180\ \ ½}{100\ \ ½} = 1.8$ times ½ **OF**

(v) Working capital ratio 10 + 15 + 5 : 30 $^1/_2$ + $^1/_2$ + $^1/_2$ + $^1/_2$ = 1:1 $^1/_2$ **OF**

(vi) Acid test ratio 15 + 5 : 30 $^1/_2$ + $^1/_2$ + $^1/_2$ = 0.67:1 $^1/_2$ **OF**

(ix) Trade receivables (debtor) days $\frac{15\ \ {}^1/_2}{180\ \ {}^1/_2} \times 365 = 30.42$ days ½ **OF**

(x) Trade payables (creditor) days $\frac{30\ \ {}^1/_2}{100\ \ {}^1/_2} \times 365 = 109.5$ days ½ **OF**

(15 marks)

(b) Profitability has declined significantly over the period as can be seen from the return on capital employed for the year to 30 April 2016 compared with the previous period. **1**
There has been no change in capital structure. **1**
So too has gross profit to sales. **1**
Either the sales price per unit has declined **1** or the purchase price per unit has increased, perhaps because of competitive pressure. **1**
The ability of the company to use its non-current assets has declined as can be seen the asset turnover. **1**
Perhaps the assets have become less efficient as they are older or have suffered breakdowns. **1**
Liquidity was high at 30 April 2015 but at 30 April 2016 the company can only just meet its short-term liabilities. **1**
The situation would have been worse if the suppliers had not allowed the company to take credit of 109.5 days. **1**
Despite changes in liquidity the company has continued to offer one month's credit to customers. **1**

The concerns which the company needs to address are:

- the fall in gross margin which is adversely affecting profitability. **1**
- non-current assets may need replacing/significant work to enhance their effectiveness.**1**
- suppliers reducing the credit limit or taking action to recover the amount owed. **1**
- the general poor level of liquidity. **1**

(max 10 marks)

3. Recommendations

As the required ratios to be known are specified in the syllabus, learners should remember the formulae and be able to make calculations based on either a list of information or information within the format of final accounts. In the latter case, learners should be able to select the relevant data required.

Calculation of the ratios is usually the first step in questions like this where the main focus is in interpreting the ratios. Some credit may be given for the recognition of whether ratios have increased or decreased but the examiner is more interested in what the changes signify. By working through a number of past examination questions the common reasons for change can be better understood.

Examiner's tips

Ratio formulae can be written on 'flash cards' or learners to use to help them learn and revise. Grouping ratios together as, for example, liquidity ratios or profitability ratios helps in learning as similar figures are used within the groupings (e.g. current assets and liabilities for the working capital and acid test ratios).
Common features arise in questions on ratio analysis such as reducing or increasing profits, difficulty in paying outstanding liabilities because of lack of cash and working capital and inability to earn as much profit as rival organisations. If learners compare these features with the ratios in past examination questions it will be easier to recognise the focus of an examination question.

Question 3

(a) Sashe Ltd is preparing its budgets for the forthcoming year and has determined that its limiting budgeting factor is the number of units of product that it can sell.

Explain the order in which the sales budget, labour costs budget and materials, and production budgets would need to be completed. Your answer should include a discussion of the factors that management would need to consider in setting the budgets. **(9 marks)**

(b) Sashe Ltd is preparing its cash budget for the three months July, August and September 2016. The projected balances on the following accounts at 1 July 2016 are expected to be:

Bank	£1,000	Dr
Trade receivables	£10,500	
Trade payables	£6,300	

Sashe Ltd allowed one month's credit on customers and took one month's credit from suppliers each month until 30 June 2016. In respect of purchases from 1 July 2016 onwards, suppliers have agreed to allow two month's credit.

The following are projected for the three months July to September 2016:

	July	**August**	**September**
	£	**£**	**£**
Sales	16,800	18,000	18,400
Purchases	8,000	8,100	7,000
Wages	4,000	4,000	3,900
Other expenses	1,400	1,400	1,400

25% of sales income is expected to be received immediately in cash with the remaining 75% due to be received one month after sale.

Wages and other expenses will be paid for in the month incurred.
Included in other expenses is £400 per month for depreciation.

New equipment is to be bought in July for £32,000.
It is to be paid for in four equal quarterly instalments, starting in August 2016.

Required:

Prepare the cash budget for Sashe Ltd for each of the three months July, August and September 2016 in columnar form. Show the cash balance at the end of each month.

(16 marks)
(Total 25 marks)

Learning Outcome x
9. Describe and explain the concepts and principles of budgeting and the essential factors behind budgetary control

1. Comments on learners' performance

This was the least popular question and was generally not well answered. Some candidates wrote a 'stock answer' on the advantages of budgeting rather than addressing the process of budgeting and the order in which budgets would be set. Those who considered the order of budgets tended to begin with production or sales budgets. The limiting factor points towards the sales budget as being the starting point. Nevertheless, the discussions of what takes place at each stage of budgeting were reasonably well structured if not in full detail.

Those candidates who attempted the cash budget generally used a columnar approach for which they are to be congratulated. However, a number simply added all the figures together in a column rather than recognising that sales provides an inflow of cash and purchases of materials and payments of expenses are an outflow of cash. The fact that a minority labelled the result of the calculations as profit and treated each column as an isolated calculation emphasised lack of understanding in this subject.

2. Mark scheme

(a) As sales are the limiting budget factor management need first to consider the sales budget. **1**
And, the number of units the business expects to sell. **1**
As well as the price to charge per unit. **1**
It is then important to have sufficient goods to sell so the materials and production budget would likely to be compiled next. **1**

In this case, management would consider the number of units the business intends to make,**1**
the level of inventory it needs to maintain, **1**
the amount of raw materials it needs to purchase, **1**
the cost of raw materials. **1**
Finally the need for sufficient numbers of employees to fulfil various tasks would need to be considered and management would review: **1**
The number of employees. **1**
The employee skills necessary for the tasks to be fulfilled. **1**
The cost of labour. **1**

Budgeting is a repetitive process so negotiation may be needed if, during the planning, it is found that there might be difficulties in employing sufficient skilled employees or there are problems in obtaining the right materials. **1**

(max 9 marks)

(b) **Sashe Ltd - Cash Budget**

	July		August		September	
	£		**£**		**£**	
Receipts						
Sales - cash	4,200	1	4,500	1	4,600	1
Sales – 1 month credit	10,500	1	12,600	1	13,500	1
	14,700		17,100		18,100	
Payments						
Purchases	6,300	1	-	1	8,000	1
Wages	4,000		4,000		3,900	1 for line
Other expenses	1,000		1,000		1,000	1 for line
Equipment			8,000	1		
	11,300		13,000		12,900	
Opening balance	1,000	1	4,400		8,500	
Receipts	14,700		17,100		18,100	
	15,700		21,500		26,600	
Payments	11,300		13,000		12,900	
Closing balance	4,400	1 OF	8,500	1 OF	13,700	1 OF

(16 marks)

3. Recommendations

Budgets may be assessed in a variety of narrative and calculation questions and practice will help with familiarity with the different styles of question to expect. Often the advantages of budgets are tested but learners should also be clear about the wider budget process. Limiting (key) factor is a way of determining the aspect of business which drives the budgets and the sales budget is often the limiting or key factor for budgets. It is important in reality to be clear about what element of business is the limiting factor so that budgeting can be implemented effectively. There is no point producing many goods which cannot be sold so the sales budget and maximum that a business can expect to sell is more useful information that the production budget which indicates the maximum production.

Numerical calculations often focus on cash budgets in the examination although other budgets can be tested. There are a number of past examples of cash budgets which should be used for practice because the general technique is used again and again. Candidates should be able to deal with credit periods and proportions, e.g. 50% of sales for cash and 50% on one month's credit.

Examiner's tips

If learners are at work and their business uses budgeting, they should talk to those involved in setting up and managing the budget as this will aid understanding of the topic. It can also be useful for tutors to invite finance managers, who are good communicators, into the classroom to share experiences and real life examples.

In the case of calculations, learners should practice to ensure they understand what is involved in drawing up budgets. They should learn the format, which is often in a columnar form, month by month and note how the balance of one month is carried forward to the next month.

In cash budgets information must be in the form of cash so it is helpful for learners to think about when cash is received and paid out and not the time when a transaction tales place (accruals based information). Depreciation is not a movement of cash and understanding of this is regularly tested in examinations.

Question 4

(a) Explain why it is both required and advisable for incorporated organisations to prepare a Statement of Cash Flows. **(6 marks)**

(b) Explain how the direct method for preparing a Statement of Cash Flows differs from the indirect method. **(4 marks)**

(c) The following information relates to Kgale Ltd for the year ended 30 April 2016:

	£	
Bank at 1 May 2015	2,150	Dr
Bank at 30 June 2016	750	Cr
Cash received from customers	133,100	
Cash paid to suppliers	64,300	
Cash paid to and on behalf of employees	38,700	
Interest paid for the year	3,000	
Tax paid for the year	6,000	
Purchase of non-current (fixed) assets	75,000	
Issue of debentures	30,000	
Share issue	20,000	
Dividends received	1,000	

Required:

Prepare for Kgale Ltd the Statement of Cash Flows, using the direct method of calculating net cash inflow from operating activities, for the year ended 30 April 2016. **(15 marks)**
(Total 25 marks)

Learning Outcome
4. Understand the need for and complete accurately a cash flow statement

1. Comments on learners' performance

This was not a popular question and although a number of candidates made use of the figures the presentation of a Statement of Cash Flows was not well understood.

Candidates provided some good answers in (a) and a number referred to the relevant accounting standard which governs Statements of Cash Flows. In addition, most candidates also referred to how Statements of Cash Flows could be used which has been tested in past examinations. There was some confusion between a Statement of Cash Flows and a Cash Budget and comments made addressed monthly information which relates to cash budgets so it is important to be clear about the difference between the statements. A minority on candidates attempted to produce Statements of Comprehensive Income and Statements of Financial Position.

The direct method is rarely used in practice but is occasionally examined instead of the indirect method so it is perhaps not too surprising that part (b) was either not attempted by candidates or not understood well. There was some clue in the information in (c) to assist candidates with (b) in the mention of cash receipts and payments items but unfortunately only a few candidates made the connection. Different financial statements were seen as mentioned above as were different formats and reward was given for relevant understanding. The well prepared candidates knew the format of the Statement of Cash Flows and were able to enter the relevant figures under correct headings.

2. Mark scheme

(a) A Statement of Cash Flows is required by accounting standards. If not provided, auditors could qualify the accounts of a company. **2**
It is considered to be one of the primary statements to be included with the Statement of Comprehensive Income and Statement of Financial Position. **2**
The presentation and contents of the Statement of Cash Flows is prescribed by accounting standard. **2**
It is advisable to provide the Statement of Cash Flows so that users can clearly see how cash has been generated and used. **2**
It gives a view of the liquidity of an organisation. **2**

(max 6 marks)

(b) The direct method is cash based. **1**
The indirect method adjusts accruals based information. **1**
The difference in calculation of accruals to cash focuses on the operating activities. **1**
Financing and investing activities are the same under both methods **1**
Adjustments for items like depreciation, differences in inventory between the start and end of the period reconcile profit based measures to cash-based ones when using the indirect method. **1**

(max 4 marks)

(c)

Kgale Ltd

Statement of Cash Flows for the year ended 30 April 2016 **1**

	£		£	
Cash inflow from operating activities				
Cash received from customers			133,100	**1**
Cash payments to suppliers			(64,300)	**1**
Cash paid to and on behalf of employees			(38,700)	**1**
Interest paid			(3,000)	**1**
Tax paid			(6,000)	**1**
Net cash inflow from operating activities **1**			21,100	**1 OF**
Investing activities **1**				
Purchase of non-current (fixed) assets	(75,000)	1		
Dividends received	1,000	**1**	(74,000)	
Financing activities **1**				
Issue of debentures	30.000	**1**		
Issue of shares	20,000	**1**	50,000	
Decrease in cash and cash equivalents			2,900	**1**

(15 marks)

3. Recommendations

A Statement of Cash Flows is detailed within an accounting standard and although it is unnecessary to be aware of the full details of the accounting standard it is useful to be aware –

- Why the statement is prepared
- How it differs from the Statement of Comprehensive Income and Statement of Financial Position
- The basic format of the financial statement
- The difference between the indirect method and direct method

The indirect method and its presentation and reconciliation of profit based measures and cash based ones should be well known. The direct method is rare in reality and the examination but the only difference in presentation is within the section for cash inflow from operating activities.

In Introduction to Accounting it is more likely that learners will need to prepare statements from given information and without having to make significant adjustments for specific items so practice should be concentrated on relevant past examination questions. Some textbooks can give examples which are too complex and will confuse at this stage.

It is important to be aware of the difference between recording cash movements (e.g. when bills are paid and cash is received) rather than accruals based movements (e.g. when an invoice is recorded in the accounts). Understanding this particular distinction will make the calculation of Statements of Cash Flows, Cash Budgets and the final accounts statements much easier.

Examiner's tips

Learners should remember that the Statement of Cash Flows includes operating activities, investing activities and financing activities. Then, even if they cannot remember the full statement format in the examination they should be able to include appropriate items under each heading.

The term 'investing activities' is used differently in a Statement of Cash Flows than learners may expect from their understanding of other financial statements because it means investing in non-current assets in the business. Learners should ensure you are clear to avoid confusion.

Question 5

(a) Explain the information **each** of the following groups of users might be interested in obtaining from the published accounts of a large company:

(i)	Lenders	**(3 marks)**
(ii)	Employees	**(3 marks)**
(iii)	Customers	**(3 marks)**
(iv)	Environmental pressure groups.	**(3 marks)**

(b) Explain what is meant by the following accounting concepts, and explain how they are applied in a Statement of Financial Position of a company, giving an example of the application of **each** concept:

(i)	Prudence	**(3 marks)**
(ii)	Accruals	**(3 marks)**
(iii)	Business entity	**(3 marks)**

(c) Explain two benefits to business owners of forming a limited company rather than a partnership.

(4 marks)

(Total 25 marks)

Learning Outcome x

1. Describe and explain briefly the nature and scope of accounting

1. Comments on learners' performance

This was a very popular question and part (a) was well answered. Unfortunately some candidates explained what lenders, employees, etc. were and their part in business. However, most had a good understanding of their needs as regards financial information.

The accounting concepts in (b) were less well understood. Accruals was the best explained. Business entity was the least well known.

Part (c) is regularly asked in various forms and here, as in past examination questions, there was some confusion between sole traders, partnerships and companies. Mention was made of directors and shareholders in partnerships and confusion about which type of organisation had the benefit of limited liability.

2. Mark scheme

(a) (i) Lenders would want information indicating that:
– the borrower could pay back any loans made. **1**
– the borrower could pay interest charges on time **1**
– there are sufficient assets as security. **1**
– it is sufficiently up to date to judge liquidity properly so a cash budget may be required. **1**

(ii) Employees would want information indicating that:
– employment was secure for the future. **1**
– wages and salaries, including agreed increases could be paid. **1**
– any profit sharing schemes, pensions are being well managed so the employees will not lose contributions. **1**
– employee would also be seeking information about the benefits of a career in the organisation and the indications of the highest salaries may motivate employees. **1**

(iii)Customers would want information indicating that:
– the business would continue and be able to service warranties. **1**

– the business provided credit and the extent of credit normally offered and there were no apparent changes to credit period which might be detrimental. **1**
– there would not be sudden changes in products and services that might damage the customers' plans. **1**

(iv) Environmental pressure groups would want information:
– about the business record in protecting/not damaging the environment. **1**
– about financial and other commitments the business had and was willing to make to groups lobbying on behalf of the environment. **1**
– about plans for the future to reduce any harmful impact on the community. **1**

(max 12 marks)

(b) Prudence is concerned with not overstating profits and understating asset values. **1**
There is evidence of its application in the accounting policies used in the Statement of Financial Position not to overstate asset values. **1**
An example is in the valuing of inventory at the lower of cost and net realisable value. **1**

Accruals matches the costs of an expense or asset against the use of that expense/asset in the period of use in the business. **1**
The Statement of Financial Position reflects a number of assets and liabilities which are held over more than one accounting period. **1**
The accruals concept is seen in accruals, prepayments, and depreciation. **1**

The business entity concept recognises that the business is separate from the owner(s). **1**
A company Statement of Financial Position is prepared under the name and with the assets and liabilities of the business and not one or more of the shareholders. **1**
The information about share capital indicates the amounts provided by the owners to the business from their own resources. **1**

(max 9 marks)

(c) A company offers limited liability so the owners will not lose more than their investment in paid up shares unless they are guilty of misconduct. **2**
Companies usually have greater access to capital for growth. **2**
Risk is more widely shared with fellow shareholders. **2**
There is stricter regulation and control over the distribution of profits and management of finance. **2**

(max 4 marks)

3. Recommendations

These topics generally call for a comparison such as between types of organisation, different accounting concepts or principles, or user groups. It is therefore useful, once the topic has been studied, for learners to practice answering a number of questions in which comparisons are made to ensure that there is clarity in understanding.

This question is also useful in highlighting the need for learners to ensure the question is answered as is it given (i.e. it is about information needs and not what the groups are and the needs are not general ones but specifically those linked to the information in the financial accounts).

Examiner's tips

When addressing the needs of users, please focus on the needs of a specific user, say, a customer, and do not bring in the possibility of the customer seeking a job at the organisation.
Aim to learn the definitions of accounting concepts and an example of how each is used. Typically an accounting concept can be linked with an accounting base (e.g. accruals and depreciation) so tutors can explain to learners that depreciation is an application of accruals when considering concepts and then revise this when addressing depreciation by explaining that depreciation is an application of accruals to the cost of a non-current asset,

Question 6

(a) Silvia buys and sells knives and forks. During April 2016, the following inventory movements took place in her business:

1 April	Opening inventory	100 units at £1.00 each
5 April	Purchases	400 units at £1.10 each
14 April	Issues	300 units
18 April	Purchases	400 units at £1.05
27 April	Issues	500 units

Required:

Calculate the value of the inventory for Silvia, after each issue and purchase, using each of the following methods of valuation:

(i) FIFO (first in, first out) **(9 marks)**
(ii) AVCO (average cost) **(8 marks)**

(b) Silvia has three employees:

- Jake, a manager, who earns a salary of £26,520 per year and is paid every four weeks throughout the year. His next pay date is 29 April 2016.
- Cindy, who is paid £9.00 per hour for the first 35 hours each week and at time and a quarter for overtime. In April 2016, Cindy worked one week of 38 hours, one week of 39 hours and the remaining two weeks of 40 hours each.
- Kevin, who is paid on a piece rate basis. The rates are as follows:

Range	**Rate**
0 – 50 units	£1.00 per unit
51 – 150 units	£1.10 per unit
151 – 250 units	£1.20 per unit

Kevin made 155 units in the first week ended 8 April, 170 units in the week ended 15 April, 220 units in the week ended 22 April and 180 units in the week ended 29 April 2016.

Required:

Calculate the weekly wages of Jake, Cindy and Kevin for the four-week period ended 29 April 2016. **(8 marks)**

(Total 25 marks)

Learning Outcome
7. Describe, explain and calculate labour and material costs

1. Comments on learners' performance

This was quite a popular question as expected. Candidates usually prepare FIFO calculations particularly well. There was evidence in this examination that a larger minority than normal of candidates were unaware of the usual format expected for answers on inventory valuation. Having said that, the well prepared candidates were able to prepare perfect answers for both FIFO and AVCO gaining full marks for part (a) of the question.

Part (b) on the calculation of wages is a topic not well understood and the variety of approaches introduced in this question caused candidates difficulty, especially the idea of four weekly wages payments and the piece rate approach.

2. Mark scheme

(a) (i) FIFO

Date	Purchases	Issues	Units	Unit Cost £	Total £	
1 Apr	Opening inventory		100	1.00	100	
5 Apr	400 x 1.10		400	1.10	440	
			500		540	1
14 Apr		100 x 1.00	(100)	1.00	(100)	1
		200 x 1.10	(200)	1.10	(220)	1
			200	1.10	220	1 OF
18 Apr	400 x 1.05		400	1.05	420	1
			600		640	1 OF
27 Apr		200 x 1.10	(200)	1.10	(220)	1
		300 x 1.05	(300)	1.05	(315)	1
			100	1.05	105	1 OF

(ii) AVCO

Date	Purchases	Issues	Units	Unit Cost £		Total £	
1 Apr	Opening inventory		100	1.00		100	
5 Apr	400 x 1.10		400	1.10		440	
			500	1.08	1	540	
14 Apr		300 x 1.08	(300)	1.08		(324)	1
			200	1.08		216	1 OF
18 Apr	400 x 1.05		400	1.05		420	1
			600	1.06	1	636	1 OF
27 Apr		500 x 1.06	(500)	1.06		(530)	1
			100	1.06		106	1 OF

(17 marks)

(b) Jake $\frac{26,520}{52/4}$ = £2,040 **1**

Cindy

	£				£	
315.00 + 56.25	371.25	½				
315.00 + 45.00	360.00	½		4 x 35 x 9.00	1,260.00	1
315.00 + 33.75	348.75	½	OR	17 x 9 x 1.25	191.25	1
315.00 + 56.25	371.25	½			1,451.25	1 OF
	1,451.25	1 OF				

Kevin

	£				£	
w/e 8 April 50 + 110 + 6	166.00	1		200 x 1.00	200.00	1
w/e 15 April 50 + 110 + 24	184.00	1		400 x 1.10	440.00	1
w/e 22 April 50 + 110 + 84	244.00	½	OR	125 x 1.20	150.00	1
w/e 29 April 50 + 110 + 36	196.00	½			790.00	1 OF
	790.00	1 OF				

(8 marks)

3. Recommendations

Practice is essential to ensure learners understand the calculations for stock valuation. Detailed transaction by transaction calculations are the clearest way of showing the balances after each inflow or outflow of inventory and that is usually required in examinations.

In the calculation of wages, learners should understand what is meant by the terminology used in questions. Annual salary figures can be divided by 12 to arrive at a monthly salary.

If salary is paid every four weeks then the annual salary should be divided by 52 initially to arrive at a weekly salary/wage.

When an employee is entitled to overtime payments, the overtime is only related to hours in addition to the basic hours. So, if an employee earns £10 per hour for 35 hours and time and a quarter for overtime the wage for 39 hours of work means that the salary will be 35 hours x £10 plus 4 hours at £12.50.
In the case of piece rate a change of rate per unit only applies to items after the ‘hurdle figure’ and not to all units made. This is illustrated in the case of Kevin in the question and answer.

Examiner’s tips

Practice is invaluable in the calculations of inventory valuation and wages. Learners should expect to make mistakes initially because of the volume of information and the need to work quickly. The degree of accuracy will increase over time
Learners should ensure that they are able to understand the different approaches to inventory valuation and wage calculations and to be able to make accurate calculations using each of them.
When rounding is necessary, use good judgement. For instance, currencies are calculated to two decimal places – UK pounds and pence, US dollars and cents, pula and thebe in Botswana.

Question 7

David and Samuel are in partnership sharing profits and losses in the ratio 3:1 respectively. The following trial balance was extracted from the books at 30 April 2016:

	£	£
Land – at cost	80,000	
Buildings – at cost	92,000	
– accumulated depreciation		27,600
Fixtures and fittings – at cost	12,000	
– accumulated depreciation		4,800
Opening Inventory (stock) at 1 May 2015	3,400	
Trade receivables (debtors)	5,000	
Trade payables (creditors)		1,700
Bank overdraft		1,250
Revenue (sales)		69,900
Purchases	24,600	
Rent and rates	4,800	
Sundry expenses	1,300	
Heat and light	4,750	
Salaries and wages	12,700	
Capital – David		111,000
– Samuel		37,000
Current – David	1,070	
– Samuel	1,130	
Drawings – David	6,300	
– Samuel	4,200	
	253,250	253,250

The following information is also available at 30 April 2016:

1. Closing inventory (stock) is valued at £3,720.
2. Wages and salaries of £250 have been prepaid.
3. Rent and rates of £600 are accrued due.
4. Depreciation for the year to 30 April 2016 is to be provided as follows:
   – Land – nil
   – Buildings – 5% per year on a straight line basis, assuming no residual value
   – Fixtures and fittings – 40% per year on the reducing balance basis
5. Partnership salaries are to be provided as follows:
   – David £3,300
   – Samuel £1,800
6. Interest on partners' capital is payable at 4% on the opening capital balance per year.

Required:

(a) Prepare the Statement of Comprehensive Income for David and Samuel for the year ended 30 April 2016. **(11 marks)**

(b) Prepare the current accounts for David and Samuel, in columnar form, for the year ended 30 April 2016. **(6 marks)**

(c) Prepare the Statement of Financial Position for David and Samuel at 30 April 2016.
(8 marks)
(Total 25 marks)

Learning Outcome
3. Prepare a set of final annual accounts, including any appropriate adjustments needed, for a sole trader, a partnership and a limited company

1. Comments on learners' performance

As is usual in the examination this topic was popular although was not tackled by virtually all of the candidates as is common. Candidates were generally able to calculate a net profit figure using a Statement of Comprehensive Income and in including the assets and liabilities in a Statement of Financial Position. The aspects of partnership were less well understood although well prepared candidates were able to achieve excellent marks.

Overall the calculation of gross profit was completed exceptionally well. The adjustments for accruals, prepayments and depreciation were ignored by the less well prepared and others achieved mixed results from the calculations.

There was some confusion about which entries to add and which to subtract in the appropriation account and some candidates included drawings at this stage.

The majority who attempted the current accounts generally had a good understanding and were able to produce consistent accounts based on their earlier calculations. Some, who omitted the appropriation account, were still able to produce the current accounts, having made the necessary calculations.

Accuracy in the Statement of Financial Position depended on the successfulness of earlier calculations and consistency of approach was rewarded. A number of candidates seemed unsure about what depreciation figures to include in the Statement of Financial Position. Some took the figures from the trial balance in the question, some just the depreciation calculated for the Statement of Comprehensive Income and others correctly combined the two in an accumulated depreciation figure.

The less well prepared showed some lack of understanding of capital and revenue expenditure and included revenue expenditure in current assets and liabilities and non-current assets in the Statement of Comprehensive Income.

2. Mark scheme

(a) David and Samuel - Statement of Comprehensive Income (Trading, Profit and Loss and Appropriation Account) for the year ended 30 April 2016

	£		£	
Revenue (sales)			69,900	½
Opening inventory (stock)	3,400	½		
Purchases	24,600	½		
	28,000			
Closing inventory (stock)	3,720	½		
Cost of goods sold			24,280	
Gross profit			45,620	½ OF
Rent and rates (4,800 + 600)	5,400	1		
Sundry expenses	1,300	½		
Heat and light	4,750	½		
Salaries and wages (12,700 – 250)	12,450	1		
Depreciation:				
- Buildings (92,000 x 5%)	4,600	1		
- Fixtures and fittings (12,000 – 4,800) x 40%	2,880	1	31,380	
Net profit			14,240	½ OF
Interest on capital				
- David (111,000 x 4%)	4,440	½		
- Samuel (37,000 x 4%)	1,480	½	5,920	
			8,320	
Partnership salaries				
- David	3,300	½		
- Samuel	1,800	½	5,100	
Share of profit			3,220	
- David (¾)	2,415	½ OF		
- Samuel (¼)	805	½ OF	3,220	

(11 marks)

(b) Current Accounts

	David		Samuel			David		Samuel	
	£		**£**			**£**		**£**	
Balance b/d	1,070	½	1,130	½	Int. on capital	4,440	½OF	1,480	½ OF
Drawings	6,300	½	4,200	½	Salary	3,300	½	1,800	½
Balance c/d	2,785	½OF			Share of profit	2,415	½OF	805	½ OF
					Balance c/d			1,245	½ OF
	10,155		5,330			10,155		5,330	

(6 marks)

(c) David and Samuel - Statement of Financial Position (Balance Sheet) at 30 April 2016 ½

	£	£		£	
Non-current assets					
Land	80,000	-		80,000	½
Buildings	92,000	32,200	½ OF	59,800	½ OF
Fixtures and fittings	12,000	7,680	½ OF	4,320	½ OF
	184,000	39,880		144,120	
Current assets					
Inventory		3,720	½		
Trade receivables		5,000	½		
Prepayments		250	½	8,970	
				153,090	
Capital accounts					
David				111,000	½
Samuel				37,000	½
				148,000	
Current accounts					
David		2,785	½ OF		
Samuel		(1,245)	½ OF	1,540	
Current liabilities					
Trade payables		1,700	½		
Bank overdraft		1,250	½		
Accruals		600	½	3,550	
				153,090	

(8 marks)

3. Recommendations

Final accounts of sole traders, partnerships and companies are a comprehensive test of understanding. Learners must be able to work quickly and accurately to be able to complete questions on this topic. That means ample practice before the examination and that is a characteristic of well-prepared candidates in the examination.

Learners should have a good understanding of the incomes and expenses in a Statement of Comprehensive Income and know how to deal with accruals and prepayments which they should expect to see. It is important to understand the constituents of the calculation of gross profit and net profit. These aspects apply to all types of organisation so it is easiest to learn about and practice these initially for sole trader businesses.

However partnerships and limited companies have their own additional adjustments in an appropriation account and learners should be clear on the different adjustments and how they are presented.

Both capital and current accounts for partnerships should be well understood.

Statements of Financial Position are similar between types of business but learners should be clear about the differences, particularly in the capital or financed by sections of sole traders, partnerships and companies.

Examiner's tips

Many points seen within the final accounts are also studied separately and learners should take the opportunity to (a) understand them in isolation (e.g. methods of depreciation) and also in the context of final accounts (e.g. annual depreciation in the Statement of Comprehensive Income and accumulated depreciation in Statements of Financial Position)

Calculations are often shown using plusses and minuses in answers to questions. Learners may find the calculations easier to understand if they draw up ledger accounts for the calculations instead. Both approaches should be tried to check which the learner prefers.

Question 8

At 1 April 2016 the following draft trial balance was extracted from the accounts of Vivian:

	£	£
Revenue (sales)		47,300
Purchases	21,400	
Opening inventory (stock)	4,900	
Salaries	10,300	
Rent	4,800	
Sundry expenses	1,100	
Drawings	10,200	
Bank	1,900	
Cash	100	
Trade receivables (debtors)	5,300	
Trade payables (creditors)		3,700
Equipment – at cost	10,000	
– accumulated depreciation		6,000
Capital		13,000
	70,000	70,000

The following transactions took place in April 2016:

7 April	Paid supplier, Anne, by cheque £950 for amount owed after taking £50 discount.
12 April	Bought goods on credit, £1,200.
13 April	Paid rent by cheque, £2,000.
15 April	Paid for sundry expenses by cash, £50.
20 April	Cheque for £570 received from customer, Simon, in full settlement of an account of £600.
25 April	Paid for new equipment by cheque, £2,100.
27 April	Cheque received for cash sales paid directly into the bank, £3,400.
28 April	Paid salaries by cheque, £900.
29 April	Vivian took drawings of £500 by cheque.

Required:

(a) Prepare the three column cash book for Vivian for April 2016, balancing the cash and bank accounts at 30 April. **(12 marks)**

(b) Prepare the trial balance of Vivian at 30 April 2016. **(13 marks)**

(Total 25 marks)

Learning Outcome
2. Describe, explain and accurately reflect double entry bookkeeping principles and adjustments from books of original entry such as day books to the trial balance stage

1. Comments on learners' performance

This was one of the more popular questions in the examination but was generally not well answered. A number of candidates were uncertain about whether expenses were recorded as debits or credits in the cash book and many experienced difficulties in recording discounts. However, the majority of candidates presented the cash book in an appropriate format and balanced the accounts.

Many candidates were unsuccessful in preparing the end of month trial balance because they did not include the figures from the start of the month. Instead they simply included the transactions for the month. However, this tended not to be consistent with cash and bank balances perhaps because they noticed that the cash would have a negative balance.

There were a minority who used the start of period figures and included the transactions for the month who produced an excellent answer.

The occasional trial balance was presented as one of the final accounts or in ledger account style despite both this question and the previous one having shown the correct format for a trial balance.

2. Mark scheme

(a) Vivian - Cash Book

Date	Details	Disc. All £	Cash £	Bank £		Date	Details	Disc. Rec £	Cash £		Bank £	
1 Apr	Balance b/d		100	1,900		7 Apr	Anne	50 **1**			950	**1**
20 Apr	Simon	30 **1**		570	**1**	13 Apr	Rent				2,000	**1**
27 Apr	Sales			3,400	**1**	15 Apr	Sundry expenses		50	**1**		
30 Apr	Balance c/d			580	**1 OF**	25 Apr	Equipment				2,100	**1**
						28 Apr	Salaries				900	**1**
						29 Apr	Drawings				500	**1**
						30 Apr	Balance c/d		50	**1**		
			100	6,450					100		6,450	

(12 marks)

(b) Vivian - Trial Balance at 30 April 2016

	£		£	
Revenue (sales) (47,300 + 3,400)			50,700	**1**
Purchases (21,400 + 1,200)	22,600	**1**		
Opening inventory (stock)	4,900			
Salaries (10,300 + 900)	11,200	**1**		
Rent (4,800 + 2,000)	6,800	**1**		
Sundry expenses (1,100 + 50)	1,150	**1**		
Drawings (10,200 + 500)	10,700	**1**		
Bank			580	**1 OF**
Cash	50	**1 OF**		
Trade receivables (debtors) (5,300 – 600)	4,700	**1**		
Trade payables (creditors) (3,700 – 1,000 + 1,200)			3,900	**1**
Equipment – at cost (10,000 + 2,100)	12,100	**1**		
– accumulated depreciation			6,000	
Discount allowed	30	**1**		
Discount received			50	**1**
Capital			13,000	
	74,230		74,230	

(13 marks)

3. Recommendations

It is important for learners to understand double-entry principles and to be able to post entries to ledger accounts including the cash and bank account in the cash book. It can be a useful exercise to look at a completed cash book and prepare relevant ledger accounts to complete the double entry to emphasise understanding. Or for a tutor to ask what each transaction in a cash book represents.

Learners should understand the implication of a cash discount and that is means that the person or firm paying a bill does not pay the full amount invoiced. Therefore the amount actually paid by cheque appears in the bank column. And the amount of the discount (invoice amount less cheque amount) appears in the discount column.

The trial balance includes the balances of all ledger accounts in the business on any one day so it accumulates day after day. Only at the end of the financial year will the sales account balance, the purchases and expense account balances be transferred to the Statement of Comprehensive Income. And even then, after the final accounts have been prepared, assets and liabilities remain on the trial balance for the next accounting period. Learners should practice adjusting a trial balance for examples of weekly or monthly transactions to understand how it works as a control to check that debit balances equal credit balances.

Examiner's tips

In a cash book, money received is recorded on the left hand (Dr) side and payments are recorded on the right hand (Cr) side. Remembering this helps in understanding how the double-entry system operates.

The trial balance is comprised of the balances of the ledger accounts on a specific day so it can be more understandable to draw up each ledger account when preparing a trial balance after transactions have been made rather than using the +/- calculations as shown in the answers to questions on the topic.