



Introduction to Accounting

NQF

Subject Examiner's Report

Unit Title: 1.3 Introduction to Accounting

Unit Code: IA

NQF Level: 3

Session: December 2016

Question 1

(a) Prepare journal entries to record the corrections of the above errors and omissions. (Narrations for each journal entry are not required.) **(6 marks)**

(b) Prepare the following ledger accounts for the adjustments above and the information from the trial balance:

- Provision for doubtful debts
- Provision for depreciation – fixtures and fittings
- Salaries and wages
- Rent and rates.

Balance the accounts and bring down the balances.

(16 marks)

(c) Ravena paid George Prosser by cheque in settlement of a debt of £500 and took advantage of a cash discount of £10 which was offered by George. Describe how this transaction would be recorded in the books of George Prosser's business. **(3 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 an unpopular question and was generally not well answered. Of the candidates who attempted the question, a significant number prepared a trial balance which was not required. Few prepared any journal entries and ledger accounts generally included opening balances but rarely any transfers to the income statement or closing balances. A minority of candidates were able to include balances in some accounts and it was pleasing to see good presentation including dates in some of those.

Most candidates who attempted the question answered part (c) in a general way which did not specifically address the double entry aspects.

2. Mark scheme

(a)

		Journal			
		£		£	
Purchases		2,800	(1)		
Bluestem Limited				2,800	(1)
Suspense		4,310	(1)		
General expenses		90	(1)		
Cash		100	(1)		
Revenue				4,500	(1)

(6 marks)

(b)

		Provision for doubtful debts			
		£		£	
2016					
31 Oct	Balance c/d	317	(1)		
		<u>317</u>			
2015					
1 Nov	Balance b/d	160	(1)		
2016					
31 Oct	SOCI/Income statement			<u>157</u>	(1)
				<u>317</u>	
1 Nov	Balance b/d			317	(1)of

Provision for depreciation – fixtures and fittings

2016		£	
31 Oct	Balance c/d	6,000	(1)
		<u>6,000</u>	

2015		£	
1 Nov	Balance b/d	4,000	(1)
2016			
31 Oct	SOCI/Income statement	<u>2,000</u>	(1)
		<u>6,000</u>	
1 Nov	Balance b/d	6,000	(1)of

Salaries and wages

2016		£	
31 Oct	Balance b/d	28,240	(1)
		<u>2,320</u>	(1)
		<u>30,560</u>	

2016		£	
31 Oct	SOCI/Income statement	30,560	(1)
		<u>30,560</u>	
1 Nov	Balance b/d	2,320	(1)of

Rent and rates

2016		£	
31 Oct	Balance b/d	19,600	(1)
		<u>19,600</u>	
1 Nov	Balance b/d	1,600	(1)of

2016		£	
31 Oct	SOCI/Income statement	18,000	(1)
31 Oct	Balance c/d	<u>1,600</u>	(1)
		<u>19,600</u>	

(16 marks)

(c) The payment would be included in the accounts as follows:

Dr Bank £490 (1) Dr Discount allowed £10 (1) Cr Ravenna £500 (1)

(3 marks)

Total Maximum Marks for Q1

25 marks

3. Recommendations

Double entry principles underlie the financial statements and provide the background to recordkeeping in business. It is important for learners to be able to post entries to ledger and to understand the principles behind the records. There are many financial questions managers will ask about finance in business such as how much credit have we given to customers or how much do we owe to suppliers? Understanding how those figures are calculated and what further information, say about specific customers or suppliers, would be available is essential. Practice in making entries in the book-keeping will help future managers visualise that information and what is available, even if a learner now does not specialise in accounting in future.

Learners should use an appreciation of the benefits in the future of achieving a good understanding now to help motivate them to learn and practice double entry principles. Practice the ledger account and making the links to the final accounts and understand how the ledgers fit into the assessment of business performance.

Examiner's tips

1. Understand what is being recorded – an asset, liability, income, expense.
2. Appreciate that asset and expense accounts usually have a debit balance and income and liabilities a credit balance.
3. Use that knowledge to help decide what entries to make for specific transactions.

Question 2

- (a) Prepare for Moorgrass Limited for the year ended 31 October 2016.
- (i) A reconciliation of the operating profit before tax to net cash inflow. **(8 marks)**
(ii) A Statement of Cash Flows. **(11 marks)**
- (b) Explain how the direct method used for the preparation of a Statement of Cash Flows differs from the indirect method. Explain how the differences would be reflected in the Statement of Cash Flows. **(4 marks)**
- (c) Explain how the Increase/decrease in cash and cash equivalents is calculated in a Statement of Cash Flows. **(2 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 most candidates were able to gain some credit in the reconciliation of the operating profit before tax to net cash inflow and the statement of cash flows, only a few were able to score high marks. A number of candidates were unclear about the difference between cash and profit so found the calculations difficult. Some repeated information in both the reconciliation and in the statement of cash flows.

In the statement of cash flows a few candidates differentiated between financing and investing activities but most simply included items without headings.

Only a few candidates were able to explain the direct or indirect method or understand the difference between them. Most explained the increase or decrease in cash and cash equivalents as being the residual figure of the statement of cash flows rather than the difference between cash and bank balances between the start and end of year.

2. Mark scheme

(a) (i) Reconciliation of the operating profit before tax and net cash inflow

	£'000	
Operating profit before interest and taxation	181	(1)
Depreciation	112	(1)
Decrease in inventory	15	(1)
Increase in accounts receivable	(3)	(1)
Increase in accounts payable	4	(1)
Interest paid	16	(1)
Tax paid	<u>30</u>	(1)
Net cash inflow from operating activities	<u>355</u>	(1)

(8 marks)

(a) (ii)

Moorgrass Limited

Statement of Cash Flows for the year ended 31 October 2016

	£'000	£'000	
Cash inflow from operating activities (1)		355	(1) of
Investing activities (1)			
Receipts from sales of non-current assets	72	(1)	
Purchases of non-current assets	(295)	(1)	(223)
Financing activities (1)			
Issue of ordinary shares	50	(1)	
Decrease in long-term loans	(140)	(1)	
Dividends paid	(25)	(1)	(115)
Increase in cash and cash equivalents (1)		<u>17</u>	(1) of

(11 marks)

- (b) The direct method uses cash-based information rather than accruals/profit based information. (1)
The cash flows are categorised, in the calculation of net cash flow from operating activities as follows :
- cash received from customers (1)
 - cash paid to suppliers (1)
 - cash paid to and on behalf of employees (1)
- Separate records need to be kept in the organisation using the direct method for these payments and receipts. (1)
Transactions for financing activities and investing activities are accounted for as cash-based information under both methods. (1)

(4 marks)

N.B. Accept appropriate alternatives.

- (c) The change in cash and cash equivalents is calculated as the total of cash and bank at the end of the year (1) less the total of cash and bank at the start of the year. (1)

(2 marks)

Total Maximum Marks for Q2

25 marks

3. Recommendations

A statement of cash flows has a specific format in the same way as an income statement and candidates are good at remembering the latter. A similar amount of time and practice spent on preparing statements of cash flows should help learners be able to prepare them with the same amount of success as income statements. In fact, as the statement of cash flows is more straightforward and entries easier to anticipate it tends to be easier to understand a statement of cash flows.

Working step by step through each item in the reconciliation and the statement itself should assist in remembering what each item represents.

Similar questions arise in this topic and practice on past examinations should help understanding.

Examiner's tips

The increase/decrease in working capital items in the reconciliation can be difficult to understand. The change in inventory seems to be the most straightforward for candidates. An increase in inventory means that more cash has been spent in the year. So this is an outflow. Accounts receivable are assets like inventory so flows for accounts receivable are in the same direction. Accounts payable, current liabilities, flow in the opposite direction.

Question 3

- (a) For each user group, state **two** information needs. Identify an accounting statement that would meet each of the needs that you have identified. (12 marks)
- (b) Explain how a sole trader, partnership and limited company differ in respect of:
- (i) Ownership of the business. (3 marks)
 - (ii) Sharing of profits. (3 marks)
 - (iii) Liability of the business owner(s) on liquidation of the business. (3 marks)
- (c) Explain the difference between an accounting concept and an accounting standard. (4 marks)

(Total 25 marks)

Learning Outcome

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

1. Comments on learners' performance

Most candidates attempted this question and achieved a range of results. Some were able to express the needs of lenders and other user groups and link those with specific financial statements. Others were unclear about needs and statements. There was also some confusion between types of business and the ways in which they differ. Particular confusion existed between partnerships and companies with partners being discussed as featuring in companies and directors and shareholders in partnerships.

Few had an understanding of the difference between accounting concepts and standards although a number of examples of accounting concepts were provided.

2. Mark scheme

(a)

User Groups	Information needs	Financial statement
Shareholder/potential shareholder	To check a company has cash to pay dividends.	Statement of Cash Flows
	To check if the business is increasing profitability.	Statement of Comprehensive Income
Lender	Ability to repay loan (1)	Statement of Financial Position (1)
	Ability to meet interest payments (1)	Statement of Comprehensive Income/ Statement of Cash Flows (1)
Accounts receivable/ accounts payable	Liquidity/ terms of trade (1)	Statement of Financial Position (1)
	Checking likelihood that the business will continue / will fulfil contracts /meet warranties (1)	Statement of Comprehensive Income/ Statement of Financial Position (1)
Government / Tax authorities	Profits earned (1)	Statement of Comprehensive Income (1)
	Ensure business will be able to pay taxes/meet other commitments to government (1)	Statement of Cash Flows (1)

(12 marks)

N.B. Accept appropriate alternatives.

- (b) A sole trader has sole ownership of the business. (1)
All profits belong to the owner. (1)
On liquidation, a sole trader's personal assets may be taken to meet the debts of the business. (1)
(3 marks)
- In a partnership, the ownership is shared between the partners. (1)
All profits are shared according to agreement. (1)
On liquidation, the personal assets of the partners may be taken to meet the debts of the business. (1)
(3 marks)
- A company is an entity in its own right, owned by shareholders. (1)
Annually some profits may be distributed as dividends and the remainder may be retained. (1)
On liquidation, shareholders pay no further amounts other than the paid up value of the shares.
The company will be wound up. (1)
(3 marks)

N.B. Accept appropriate alternatives.

- (c) An accounting concept is a broad based assumption which underlies the periodic financial accounts of businesses. (1) The concept is used for a range of transactions. (1) For instance prudence is used for bad debts, provisions for doubtful debts and stock valuation. (1)

An accounting standard is a specific set of rules/principles (1) issued by accounting standards authorities. (1) They are for specific situations such as the preparation of Statements of Cash Flow. (1)

(max 4 marks)

N.B. Accept appropriate alternatives.

Total Maximum Marks for Q3

25 marks

3. Recommendations

As the relationship between a business and its owner(s) is important to the presentation of the appropriation account and statement of financial position in particular. Therefore it is important to understand how capital is provided by each owner and profit is returned to them. For instance, a company has share capital in its capital and reserves which appears in the statement of financial position. Dividends are paid to shareholders and these will be seen in the statement of cash flows. Partners provide capital which is seen in the capital accounts. Share of profits each year is calculated and included in the appropriations and the current accounts of each partner.

And if you consider the different people who have contact with a business, thinking about what they need to know about the business it will help in appreciating user needs and how these are fulfilled. For instance a supplier needs to know that its customer has good liquidity to be able to pay for goods supplied. And profitability is a likely indication of the customer continuing in business and remaining as a customer for the future.

There are links between accounting concepts, accounting bases and accounting standards and all underlie financial statements. Each need to be understood well to appreciate how decisions can impact on profits and values. It is useful to remember an example or two. For example, 'matching' is a concept which is used to recognise that costs are associated with the generation of income. Over time, a non-current asset is used to generate income and the cost 'depreciation', an accounting base is used to apply the matching concept. Accounting for a non-current asset and depreciation is detailed within an 'accounting standard' (IAS 16, Plant, Property and Equipment). This specifies a limited number of ways in which large organisations must account for non-current assets and depreciation to apply the matching concept. Accounting standards, accounting bases and accounting concepts help those who use financial statements understand the underlying accounts.

Examiner's tips

Rather than learn individual facts, developing a story about a particular sole trader, partnership and company helps in remembering matters such as ownership and financing. This can be further developed to look at how this information reflects on the various financial statements.

Question 4

- (a) Prepare the Statement of Comprehensive Income (Trading, Profit and Loss and Appropriation Account) for Gabriel and Charles for the year ended 31 October 2016. **(11 marks)**
- (b) Prepare the current accounts in columnar form for Gabriel and Charles to 31 October 2016. **(6 marks)**
- (c) Prepare the Statement of Financial Position (Balance Sheet) for Gabriel and Charles at 31 October 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

This was a very popular question with a range of performance. This question was exceptionally well answered by more candidates than any of the other question. Candidates presented the financial statements well and were generally able to include items within the appropriate sections.

The main difficulties candidate experienced were in dealing with adjustments. For instance, some candidates added closing inventory and prepayments rather than deducting them. There was also some lack of clarity of understanding in calculating depreciation. The various adjustments are tested in each examination so it is important to recognise how to deal with them.

The current account was generally understood but entries were posted to the credit rather than the debit side of the account and vice versa.

The statement of financial position was not completed by all candidates perhaps because of time pressure. Hence, practice is essential to build accuracy and speed. The assets and liabilities were generally included under the appropriate headers.

2. Mark scheme

- (a) Gabriel and Charles
Statement of Comprehensive Income (Trading, Profit and Loss and Appropriation Account)
for the year ended 31 October 2016

	£'000		£'000	
Revenue			168,000	(1/2)
Inventory at 1 November 2015	5,100	(1/2)		
Purchases	56,000	(1/2)		
	61,100			
Inventory at 31 October 2016	11,300	(1/2)		
Cost of sales			49,800	(1/2)
Gross profit			118,200	(1/2)of
Rent and rates (12,100 (1/2) - 700 (1/2))	11,400			
Salaries and wages (38,400 (1/2) + 1,100 (1/2))	39,500			
General expenses	9,200	(1/2)		
Provision for depreciation:				
Equipment (32,000 (1/2) / 4 (1/2))	8,000			
Motor vehicles (40,000 (1/2) - 20,000 (1/2) x 50% (1/2))	10,000		78,100	
Net profit			40,100	(1/2)of
Partnership salary - Gabriel	14,600	(1/2)		
Interest on capital:				
- Gabriel (20,000 x 5%)	1,000	(1/2)		
- Charles (10,000 x 5%)	500	(1/2)	16,100	
			24,000	

Share of profit:			
- Gabriel (2/3 x 24,000)	16,000	(1/2) of	
- Charles (1/3 x 24,000)	8,000	(1/2) of	24,000

(11 marks)

(b)

Current accounts									
	G		C		G		C		
	£		£		£		£		
Drawings	10,300	(1/2)	9,600	(1/2)	Balance b/d	3,500	(1/2)	300	(1/2)
Balance c/d	24,800	(1/2)			Partnership salary	14,600	(1/2)		
					Interest on capital	1,000	(1/2)	500	(1/2)
					Share of profit	16,000	(1/2)	8,000	(1/2)
					Balance c/d			800	(1/2)
	<u>35,100</u>		<u>9,600</u>			<u>35,100</u>		<u>9,600</u>	
Balance b/d			800		Balance b/d	24,800	(1/2) of for balances		

(6 marks)

(c)

Gabriel and Charles
Statement of Financial Position (Balance Sheet) at 31 October 2016

	Cost £'000		Depr'n £'000		NBV £'000	
<i>Non-Current Assets</i>						
Equipment	32,000	(1/2)	16,000	(1/2)	16,000	(1/2) of
Motor vehicle	<u>40,000</u>	(1/2)	<u>30,000</u>	(1/2)	<u>10,000</u>	(1/2) of
	<u>72,000</u>		<u>46,000</u>		26,000	
<i>Current Assets</i>						
Inventory			11,300	(1/2)		
Accounts receivable			14,600	(1/2)		
Bank			7,100	(1/2)		
Prepaid rent and rates			<u>700</u>	(1/2)	<u>33,700</u>	
					<u>59,700</u>	
<i>Capital accounts:</i>						
- Gabriel					20,000	(1/2)
- Charles					<u>10,000</u>	(1/2)
<i>Current accounts:</i>						
- Gabriel			24,800	(1/2) of		
- Charles			<u>(800)</u>	(1/2) of	<u>24,000</u>	
					54,000	
<i>Current liabilities</i>						
Accounts payable			4,600	(1/2)		
Accrued salaries and wages			<u>1,100</u>	(1/2)	<u>5,700</u>	
					<u>59,700</u>	

(8 marks)

Total Maximum Marks for Q4

25 marks

3. Recommendations

Final accounts are commonly well answered in the examination so teachers and candidates are to be congratulated on their hard work. Questions tend to require a good understanding of the financial statements and for sufficient practice to be completed in their preparation to ensure they can be completed with speed and accuracy.

The most straightforward final accounts are for sole traders and questions on that topic are likely to contain a number of adjustments. In partnerships and companies appropriations will also be tested as well as an understanding of the differences in capital, liabilities and the ways in which profits are shared out. So, it is

important for candidates to have a clear view of the different types of organisation and the implications of the differences for the financial statements.

Examiner's tips

ACCRUED expenses are **ADDED** to the expense in the statement of comprehensive income. The accrued expense is included as a current **ASSET** in the statement of financial position.

Therefore, prepaid expenses are deducted and included in current liabilities.

Remember that straight line depreciation is calculated on cost. And reducing balance depreciation is based on net book value.

Question 5

(a) Calculate the following ratios (to one decimal place) for Fountaingrass Limited.

- (i) Gross profit ratio. (2 marks)
- (ii) Net profit ratio. (2 marks)
- (iii) Return on capital employed (use share capital plus retained profits). (3 marks)
- (iv) Working capital ratio. (2 marks)
- (v) Acid test (liquidity) ratio. (2 marks)
- (vi) Accounts receivable collection period (in days). (2 marks)
- (vii) Accounts payable payment period (in days). (2 marks)
- (viii) Inventory days ratio (in days). (2 marks)

(b) Compare the results of the ratios for the years ended 31 October 2015 and 31 October 2016, respectively. Identify and explain potential reasons for the changes in the results of ratios during the period (8 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 question was popular with candidates who were generally able to attempt a number of ratios with some success. So, the question was generally well answered in respect of the calculations. The main ratios causing difficulties were return on capital employed and the accounts payable payment period.

Comparison between the ratios calculated and the ones for the previous year and the analysis of the ratios was limited and few candidates were able to explain reasons for changes. A minority of candidates suggested that ratios improved, say, from 2016 to 2015 rather than the usual trend of looking forward in time.

2. Mark scheme

- (a)
- (i) Gross profit to sales (as a percentage)
$$\frac{(3,200 \text{ (}\frac{1}{2}\text{)} - 1,920 \text{ (}\frac{1}{2}\text{)})}{3,200 \text{ (}\frac{1}{2}\text{)}} \times 100 = 40\% \text{ (}\frac{1}{2}\text{)}$$
(2 marks)
 - (ii) Net profit to sales (as a percentage)
$$\frac{(3,200 \text{ (}\frac{1}{2}\text{)} - 1,920 \text{ (}\frac{1}{2}\text{)} - 960 \text{ (}\frac{1}{2}\text{)})}{3,200 \text{ (}\frac{1}{2}\text{)}} \times 100 = 10\%$$
(2 marks)
 - (iii) Return on capital employed
$$\frac{(3,200 \text{ (}\frac{1}{2}\text{)} - 1,920 \text{ (}\frac{1}{2}\text{)} - 960 \text{ (}\frac{1}{2}\text{)})}{800 \text{ (}\frac{1}{2}\text{)} + 858 \text{ (}\frac{1}{2}\text{)}} \times 100 = 19.3\% \text{ (}\frac{1}{2}\text{)}$$
(3 marks)
 - (iv) Current ratio
$$(158 \text{ (}\frac{1}{2}\text{)} + 263 \text{ (}\frac{1}{2}\text{)} + 53 \text{ (}\frac{1}{2}\text{)}) : 316 \text{ (}\frac{1}{2}\text{)} = 1.5:1$$
(2 marks)
 - (v) Acid test ratio
$$(263 \text{ (}\frac{1}{2}\text{)} + 53 \text{ (}\frac{1}{2}\text{)}) : 316 \text{ (}\frac{1}{2}\text{)} = 1:1 \text{ (}\frac{1}{2}\text{)}$$
(2 marks)
 - (vi) Accounts receivables collection days
$$\frac{263 \text{ (}\frac{1}{2}\text{)}}{3,200 \text{ (}\frac{1}{2}\text{)}} \times 365 \text{ (}\frac{1}{2}\text{)} = 30 \text{ days (}\frac{1}{2}\text{)}$$
(2 marks)
 - (vii) Accounts payables payment days
$$\frac{316 \text{ (}\frac{1}{2}\text{)}}{1,920 \text{ (}\frac{1}{2}\text{)}} \times 365 \text{ (}\frac{1}{2}\text{)} = 60.1 \text{ days (}\frac{1}{2}\text{)}$$

(2 marks)

(viii) Inventory days ratio

$$\frac{158 \text{ (}\frac{1}{2}\text{)} \times 365 \text{ (}\frac{1}{2}\text{)}}{1,920 \text{ (}\frac{1}{2}\text{)}} = 30 \text{ days (}\frac{1}{2}\text{)}$$

(2 marks)

(b) There has been an increase in the net profit percentage. (1)

This suggests better control over overheads. (1)

There has been a similar change in return on capital employed to confirm this. (1)

Alternatively there may have been a drop in the amount of capital employed in the business. (1)

For instance, shares may have been redeemed. (1)

Or retained profits paid out as dividends. (1)

The company is slightly more liquid. (1)

This is possibly due to a higher level of accounts receivable. (1)

This can be seen from the changes in receivables days. (1)

(max 8 marks)

N.B. Accept appropriate alternatives.

Total Maximum Marks for Q5

25 marks

3. Recommendations

Candidates should continue to practice calculating ratios from given information. It can be useful to present the underlying information both in lists and in the format of financial statements to build understanding of the necessary items to include in the ratio calculations. This should also add to the candidates' confidence.

When providing analysis, it is good practice to consider points such as liquidity and profitability. This requires understanding the relevant ratios which show that information and making comments based on the ratios. If the viewpoint of a particular user group is required, that should be addressed with proper focus.

Examiner's tips

If a recommendation or conclusion is required it should be clearly stated. And assertions such as profitability has improved should be confirmed by referring to a specific change in ratios.

In making calculations, full workings should be shown.

Question 6

- (a) Explain what is meant by:
- (i) variable cost (2 marks)
 - (ii) fixed cost (2 marks)
 - (iii) overhead cost. (2 marks)
- (b) Calculate the balance of inventory held in the business after each purchase and each issue of inventory using the:
- (i) FIFO method of stock valuation; and. (4 marks)
 - (ii) AVCO method of stock valuation. (6 marks)
- (c) Calculate the wages for Asha, Mbali, Jakob and Uzoma for October. (9 marks)

(Total 25 marks)

Learning Outcome

6 Describe, explain and calculate accurately different elements of costs

7. Describe, explain and calculate labour and material costs

1. Comments on learners' performance

This was a fairly popular question. Some candidate were unable to attempt sections (b) and (c) but most were able to explain what was meant by a variable cost and a fixed cost. A few confused the explanations and examples between the two. Overhead cost was not well explained.

Well prepared candidates were able to calculate at least the inventory values using FIFO and could make an attempt at AVCO. Less well prepared candidates simply made the calculations of issues and/or purchases without inventory values.

Some candidates were able to calculate wages for Asha and Mbali but most candidates were unable to calculate wages for the other employees. It was usual for calculations to be made on a single rate rather than different rate bands for each set of units produced in an accumulated total.

2. Mark scheme

- (a) (i) Variable cost varies in total more or less (1) according to the level of output. (1) (2 marks)
- (ii) Fixed cost is a cost that remains constant in total (1) over a wide range of output levels. (1) (2 marks)
- (iii) Overhead cost comprises the total (1) of indirect materials, indirect labour and indirect expenses. (1) (2 marks)

N.B. Accept appropriate alternatives.

(b) (a) (i) FIFO

Date	Units	Unit Cost £	Amount £	
1 Oct	Opening balance	500	4.00	2,000
7 Oct	Issue	<u>250</u>	4.00	<u>1,000</u>
	Balance	250		1,000 (1)
15 Oct	Purchase	<u>250</u>	4.20	<u>1,050</u>
		500		2,050 (1)
19 Oct	Issue	250	4.00	1,000
	Issue	<u>50</u>	4.20	<u>210</u>
	Balance	200		840 (1)
31 Oct	Purchase	<u>200</u>	4.40	<u>880</u>
	Balance	400		1,720 (1)

(4 marks)

(ii) AVCO

Date		Units	Unit Cost £	Amount £	
1 Oct	Opening balance	500	4.00	2,000	
7 Oct	Issue	<u>250</u>	4.00	<u>1,000</u>	
	Balance	250	4.00	1,000	(1)
15 Oct	Purchase	<u>250</u>	4.20	<u>1,050</u>	
	Balance	500	4.10 (1)	2,050	(1)
19 Oct	Issue	<u>300</u>	4.10	<u>1,230</u>	
	Balance	200	4.10	820	(1) Of
31 Oct	Purchase	<u>200</u>	4.40	<u>880</u>	
	Balance	400	4.25 (1) of	1,700	(1) of

(6 marks)

(c) Wages calculations for October 2016

Asha	
	£
18,000 / 12	= 1,500 (1)
Overtime 4 x 12	<u>48</u> (1)
	<u>1,548</u>

Mbali	
	£
50 x 8	400 (1)
8 x 10	<u>80</u> (1)
	<u>480</u>

Jakob	
	£
100 x £4.50	450 (1)
98 x £5.00	<u>490</u> (1)
	<u>940</u>

Uzoma	
	£
100 x £4.50	450 (1)
100 x £5.00	500 (1)
20 x £5.50	<u>110</u> (1)
	<u>1,060</u>

(9 marks)

Total Maximum Marks for Q6

25 marks

3. Recommendations

Definitions are regularly tested in the examination. So, as in other subject areas the terminology associated with the learning outcome should be known.

Inventory valuation is regularly tested in the examination using a common format. When candidates practice the approach thoroughly, they are usually able to gain good credit in the examination. Previous examination answers should be noted for guidance on format and for practice.

Candidates should also practice calculations of wages, particularly when based on units of production.

Examiner's tips

When wages are based on units, each level of units is calculated and the total added. Hence, if the first 100 units are paid at £1 per unit and the unit price increases for items made over 100 units to £1.20 per unit, wages for 150 units are 100 x £1 + 50 x £1.20 making a total of £160.

Question 7

- (a) (i) Calculate the break-even point in units. (4 marks)
(ii) Calculate the margin of safety in units. (2 marks)
(iii) Calculate the profit for the month if all units made were sold. (4 marks)
- (b) (i) Calculate the break-even point in units. (3 marks)
(ii) Calculate the profit for the month. (3 marks)
(iii) Explain whether Ahmed should accept the contract. (2 marks)
- (c) (i) Calculate the profit or loss that would be generated by this approach. (5 marks)
(ii) Explain whether Ahmed should adopt this approach. (2 marks)

(Total 25 marks)

Learning Outcome

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 one of the less popular questions. Some candidates understood and performed exceptionally well. But others gained a little credit for break-even and/or profit calculations only.

Margin of safety was not well understood by most candidates and profit figures were calculated in different ways as opposed to using contribution per unit. Although the approach used, similar to a gross profit calculation, took longer, reward was provided for appropriate answers.

It was good to see that most candidates stated whether profits were higher or lower, based on their calculations which has not always been the case in the past.

2. Mark scheme

- (a) (i) The break-even point = $\frac{18,000 \text{ (1)}}{42 \text{ (1)} - 9 \text{ (1)} - 24 \text{ (1)}} = 2,000 \text{ units}$ (4 marks)
- (ii) Margin of Safety $3,500 \text{ (1)} - 2,000 \text{ (1)of} = 1,500 \text{ units}$ (2 marks)
- (iii) Profit $3,500 \text{ (1)} \times \text{contribution per unit } \text{£}9 \text{ (1)} = 31,500 - \text{fixed costs } 18,000 \text{ (1)} = \text{£}13,500 \text{ (1)of}$ (4 marks)
- (i) The break-even point = $\frac{54,000 \text{ (1)}}{9 \text{ (1)}} = 6,000 \text{ units (1)of}$ (3 marks)
- (ii) Profit $8,000 \times \text{contribution per unit } \text{£}9 = 72,000 \text{ (1)of} - \text{fixed costs } 54,000 \text{ (1)} = \text{£}18,000 \text{ (1)of}$ (3 marks)
- (iii) Yes. (1) The profit will be higher. (1) (2 marks)
- (b) (i) $[10,000 \text{ (1)} \times \text{£}(38 \text{ (1)} - 33 \text{ (1)})] = 50,000 \text{ (1)} - \text{fixed costs } 54,000 \text{ (1)} = \text{Loss } \text{£}4,000$ (5 marks)
- (ii) The reduction in selling price would lead to a loss (1) and hence Ahmed should not adopt this approach. (1) (2 marks)

Total Maximum Marks for Q7

25 marks

3. Recommendations

Although break-even is generally well understood, candidates should also ensure that they understand and are able to calculate margin of safety and profits based on contribution. There are a limited number of calculations required for this topic so candidates should work through past examinations for practice and ensure they understand the terminology.

Break-even is a useful technique for management and its use in analysis should be known.

Examiner's tips

Remembering and stating the formula for the break even calculations can be useful in providing guidance for calculations.

Question 8

(a) Explain what is meant by each of the following and discuss their benefits:

- Fixed budgets (3 marks)
- Flexible budgets (3 marks)
- Incremental budgets (3 marks)
- Zero-based budgets (3 marks)
- Key factor (limiting factor) (3 marks)

(b) Prepare a cash budget for Delia to identify the maximum overdraft needed for the period January to March 2017. State the month in which the maximum overdraft would be required. (10 marks)

(Total 25 marks)

Learning Outcome

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

1. Comments on learners' performance

This was not a popular question and, with some exceptions, was generally not well answered. Candidates were able to explain fixed and flexible budgets to some extent but experienced more difficulty in explaining other aspects of budgeting.

The format for a cash budget is not required by accounting standard or the law. However, the format used is commonly accepted and used. Candidates should practice using it and learn to include the monthly figures within the relevant rows and columns. This is a topic which can be combined with a study of spreadsheets if applicable.

2. Mark scheme

(a) Fixed budgets use figures set at the beginning of a budget period. (1)

The budgets are adhered to and monitored, irrespective of circumstances. (1)

Fixed budgets are uncomplicated and easier to prepare than flexible budgets which may make allowance for exceeding and/or falling short of expectations. (1)

Fixed budgets are inflexible. (1)

(max 3 marks)

Flexible budgets change with the level of activity. (1)

Variable costs alter with the level of production. (1)

Flexible budgets allow a business to accommodate different possible outcomes. (1)

The flexibility allows a business to easily address the effects of external influences. (1)

(max 3 marks)

Incremental budgets build on previous budgets. (1)

A percentage is added to costs for inflation. (1)

Advantages – easy to understand. (1)

– easy to implement. (1)

Disadvantages – inefficiencies are not challenged. (1)

– wastage and overspending. (1)

(max 3 marks)

Zero-based budgets do not rely on any earlier budget. (1)

Every item within the budgets has to be justified. (1)

Advantages – overspending is avoided. (1)

– inefficiencies are avoided. (1)

Disadvantages – time consuming. (1)

– expensive to operate. (1)

(max 3 marks)

A key or limiting budget factor is a constraint which limits the activities of a business. (1)

Often the limiting factor is the maximum sales that an organisation can make. (1)

The budget related to the limiting factor is the first one which would be calculated. (1)

Other budgets are then contingent on the budget restricted by the limiting factor. (1)

(b)

Delia
Cash Budget

	Jan £		Feb £		Mar £	
Receipts						
Sales			10,000		12,000	(1) for line
Payments						
Materials	5,000		6,000		7,500	(1) for line
Labour			1,000		1,000	(1) for line
Equipment					9,000	(1)
	<u>5,000</u>		<u>7,000</u>		<u>17,500</u>	
Opening balance	0	(1)	(5,000)		(2,000)	
Net cash flow	<u>(5,000)</u>		<u>3,000</u>		<u>(5,500)</u>	
Closing balance	<u>(5,000)</u>	(1)	<u>(2,000)</u>	(1)	<u>(7,500)</u>	(1)

The maximum overdraft required will be £7,500 (1) of required in March. (1)of

(10 marks)

Total Maximum Marks for Q8

25 marks

3. Recommendations

As in the case of other learning outcomes, the terminology should be well understood. Each type of budget should be understood as budgeting is commonly used in business and any manager should be aware of the operation of budgets and the relative merits of different types of budget.

Calculations of budgets in the examination commonly focus on the cash budget although other calculations and budgets may be required. There are common features in cash budgets that it is useful to remember. Inflows and outflows should be clearly dealt with separately.

Some inflows and outflows take place in the months the transactions occur so they can be placed immediately in the relevant rows. If candidates are uncertain about calculations, entering these transactions into the cash budget first they will be able to start to earn credit

Other figures, typically income from sales and payments for materials involve part cash and part credit transactions. Candidates should practice how to deal with these. They may also need to think about proportions, for instance 25% of sales made for cash and so immediate receipt and 75% on one month's credit. In the latter case the income will be received a month later.

Examiner's tips

Clarity in calculations is important so outflows should be clearly shown under a heading of outflows and/or as negative figures (in brackets).

Practice making calculations of proportions and think about the impact of credit periods to enhance understanding.