



The Association of Business Executives
NQF
Introduction to Accounting
Mark Scheme

Unit Title: Introduction to Accounting

Unit Code: 1.03 IA

Session: June 2015

Question 1

- (a) Explain **four** reasons why management uses financial information. **(8 marks)**
(b) Describe **four** differences between financial and management accounting. **(8 marks)**
(c) Explain how the accounting concepts of objectivity, consistency and going concern help in meeting management needs. **(9 marks)**

Suggested Answer:

(a) Management uses financial information:

- to draw up plans for different periods of time **2**
- to compare actual outcomes with past decisions and forecasts **2**
- to communicate with other users, such as owners and shareholders, about results and plans **2**
- to share information between departments to gain a better understanding of the impact of decisions throughout the organisation. **2**

Accept reasonable alternatives

Maximum Marks for (a) 8 marks

(b) Financial accounting tends to be historic in nature, whereas management accounting usually looks forward. **2**

Financial accounting is used to produce external statements for reporting to shareholders and others, whereas management accounting provides information for internal use. **2**

Financial accounting is governed by statute and accounting rules. There are very few requirements for management accounting to follow. **2**

The objectivity of financial accounting may be assessed by external audit. There is no such discipline for management accounting. **2**

Financial accounting makes use of well recognised reports and documents in recording and reporting. Management accounting focuses on reports which are most appropriate for individual situations. **2**

Accept reasonable alternatives

Maximum Marks for (b) 8 marks

(c) Objectivity is applied by accountants and auditors to ensure that the financial results are reliable **2** and management can use them for decision making without concern about the impact of much subjectivity. **2**

Consistency is used to ensure that similar accounting policies (e.g. straight-line depreciation) are used year to year. **2** Management can better judge performance over time because consistency helps with comparisons. **2**

Going concern indicates that a business will continue for the foreseeable future. **2** This assumption will give focus to management plans and help them measure and value profits and assets. **2**

Up to 2 for each point

Accept reasonable alternatives

Maximum Marks for (c) 9 marks
Total Maximum Marks for Q1 25 marks

Question 2

(a) Explain the principles of double-entry bookkeeping and the roles of the different classes of ledger accounts. **(8 marks)**

(b) Balance the cash book at 30 March and, in your answer book, starting with the balances brought down, post the two cheques on 31 March, rebalancing the cash book at 31 March 2015. **(10 marks)**

(c) Prepare the bank reconciliation statement at 31 March 2015. **(7 marks)**

Suggested Answer:

(a) Double-entry bookkeeping is based on the dual aspect concept that for every transaction there is a debit entry and a corresponding credit. **2**

Ledger accounts record all double-entry transactions but different types of ledger accounts record various classes of accounts:

- personal ledger accounts which are accounts for named individuals such as for customers (accounts receivable/debtors) and suppliers (accounts payable/creditors). **2**
- Impersonal accounts which comprise all other accounts which are not those for people. They are divided into:
 - o Real accounts covering various assets such as land, equipment, inventory. **2**
 - o Nominal accounts which record items that cannot be physically touched such as sales, purchases and expenses. **2**

Alternatively,

- sales ledger for accounts of customers who have been given credit. **2**
- purchases ledger for accounts of suppliers from whom credit is taken. **2**
- nominal ledger for all accounts which are not named for a specific organisation or people. **2**
- private ledger (sometimes) for the capital, drawings and personal accounts of the business owner(s). **2**

Maximum Marks for (a) 8 marks

(b) All dates – 31 March

Details	Disc £	Cash £	Bank £	Details	Disc £	Cash £	Bank £
Balance b/d	40 1	294	475 1	J. Hague	10 1		160 1
D. Pope	15 1		340 1	Balance c/d		294	655
	55 1	294	815		10	294	815
Balance b/d		294 2 or 1 of	655 1 of				

Maximum Marks for (b) 10 marks

(c) Ahmed - Bank reconciliation statement at 31 March 2015 **1**

Balance as per cash book		655	1 of
Add: cheques drawn but not presented:	Equipment (115)	550 1	
	J Hague (116)	<u>160</u> 1	
		710	
		1,365	
Less: Amounts paid in but not yet credited:	K. Khan	130 1	
	D Pope	<u>340</u> 1	
Balance as per bank statement		<u>470</u>	
		<u>895</u>	1

Maximum Marks for (c) 7 marks
Total Maximum Marks for Q2 25 marks

Question 3

(a) Prepare a Statement of Comprehensive Income (Trading, Profit and Loss Account) for Hanna for the year ended 31 March 2015. **(15 marks)**

(b) Prepare a Statement of Financial Position (Balance Sheet) for Hanna at 31 March 2015. **(10 marks)**

Suggested Answer:

(a) Hanna - Statement of Comprehensive Income (Trading and Profit and Loss Account) for the year ended 31 March 2015

	£	£	£
Revenue (sales)			153,300 ^{1/2}
Less: returns inwards			<u>1,250</u> ^{1/2}
			152,050
Opening inventory (stock)		6,200 ^{1/2}	
Purchases	63,400 ^{1/2}		
Incorrectly posted	<u>600</u> ^{1/2}		
	64,000		
Carriage inwards	<u>3,200</u> ^{1/2}	<u>67,200</u>	
		73,400	
Less closing inventory (stock)		<u>6,450</u> ^{1/2}	
Cost of sales			<u>66,950</u> ^{1/2 of}
Gross profit			85,100 ^{1/2 of}
Discount received			<u>1,040</u> ^{1/2}
			86,140
Carriage outwards		4,300 ^{1/2}	
Salaries and wages	44,200 ^{1/2}		
Accrued	<u>3,685</u> ^{1/2}	47,885	
Rent and rates	12,720 ^{1/2}		
Prepaid	<u>530</u> ^{1/2}	12,190	
Motor expenses		4,240 ^{1/2}	
Sundry expenses		6,650 ^{1/2}	
Accountancy fees		300 ^{1/2}	
Provision for doubtful debts (4% x 9,500)		380 ^{1/2+1/2}	
Depreciation			
- fixtures and fittings [50% x (8,400 – 4,200)]		2,100 ^{1/2+1/2+1/2}	
- equipment (6,300 – 600)/3		1,900 ^{1/2+1/2+1/2}	
Motor vehicles (35% x 10,500)		<u>3,675</u> ^{1/2+1/2}	
Net profit			<u>2,520</u> ^{1/2+1/2}

Maximum Marks for (a)

15 marks

(b) Hanna - Statement of Financial Position (Balance Sheet) at 31 March 2015

	Cost £		Accumulated Depreciation £		NBV £
Non-current (fixed) assets					
Fixtures and fittings	8,400	^{1/2}	6,300	^{1/2} of	2,100 ^{1/2} of
Equipment	5,700	^{1/2}	3,800	^{1/2} of	1,900 ^{1/2} of
Motor vehicles	10,500	^{1/2}	3,675	^{1/2} of	6,825 ^{1/2} of
	24,600		13,775		10,825
Current assets					
Inventory (stock)			6,450	^{1/2}	
Accounts receivable (debtors)	9,500	^{1/2}			
- Provision for doubtful debts	380	^{1/2}	9,120		
Bank			980	^{1/2}	
Prepayment			530	^{1/2}	
			17,080		
Current liabilities					
Accounts payable	5,300	^{1/2}			
Accrued salaries and wages	3,685	^{1/2}			
Accrued accountancy fees	300	^{1/2}	9,285		
Net current assets					7,795
					18,620
Capital					21,100 ^{1/2}
Net profit					2,520 ^{1/2} of
					23,620
Drawings					5,000 ^{1/2}
					18,620

Maximum Marks for (b) 10 marks
Total Maximum Marks for Q3 25 marks

Question 4

- (a) Explain the differences between cash and profit, illustrating your answer with an example of the payment of rent. **(5 marks)**
- (b) Prepare for Green Ltd for the year ended 31 March 2015:
- (i) A Reconciliation of the Operating Profit Before Tax to Net Cash Inflow **(7 marks)**
- (ii) A Statement of Cash Flows **(9 marks)**
- (c) Describe two uses of a Statement of Cash Flows. **(4 marks)**

Suggested Answer:

(a) Cash is the amount actually received or paid out from cash or bank account. **2**
 Profit is measured as soon as an amount is realisable so includes credit transactions, accruals and prepayments as well as non-cash transactions. **2**

Example:

Rent paid in cash, say £8,000, may be partly for the year in which payment is made of £7,200 and partly in arrears or in advance - £800. **2**

Maximum Marks for (a) 5 marks

(b) (i) Reconciliation of operating profit before tax to net cash inflow

	£'000
Operating profit before interest and tax	48 1
Depreciation	30 1
Decrease in inventory (stock)	10 1
Increase in accounts receivable (debtors)	(20) 1
Decrease in accounts payable (creditors)	(15) 1
Net cash inflow	53 1 + 1 of

(ii) Green Ltd

Statement of cash flows for the year ended 31 March 2015 **1**

	£'000	£'000
Cash inflow from operating activities		
Net cash inflow from operating activities		53 1 of
Returns on investment and servicing of finance		
Interest paid		(3) 1
Taxation		(14) 1
Investing activities		
Purchase of non-current assets		(20) 1
Financing		
Increase in share capital	50 1	
Repayment of bank loan	(20) 1	<u>30</u>
Increase in cash and cash equivalents		46 1 + 1 of

Note: Accept any reasonable presentation

Maximum Marks for (b) 16 marks

(c) Two uses of a Statement of Cash Flows are;

- To show how the cash has been obtained and spent.
- To give information about liquidity.
- To show the relationship between profit and cash.
- To obtain a bank loan.

Award 2 marks per point, maximum 4

Maximum Marks for (c) 4 marks
Total Maximum Marks for Q4 25 marks

Question 5

(a) Calculate the following ratios (to two decimal places) for Orange Ltd:

- (i) Gross profit ratio
- (ii) Net profit ratio
- (iii) Return on capital employed (use share capital and retained profits)
- (iv) Working capital ratio
- (v) Acid test (liquidity) ratio
- (vi) Accounts receivable (debtors) collection period (in days)
- (vii) Accounts payable (creditors) payment period (in days)

(14 marks)

(b) Explain the purposes and limitations of accounting ratios, illustrating your answer with reference to part (a).

(11 marks)

Suggested Answer:**(a)***(i) Gross profit ratio*

$$\frac{3,600 - 2,160}{3,600} \times 100 = 40\%$$

(ii) Net profit ratio

$$\frac{3,600 - (2,160 - 1,134)}{3,600} \times 100 = 8.5\%$$

(iii) Return on capital employed

$$\frac{(3,600 - 2,160 - 1,134)}{300 + 750} \times 100 = 29.14\%$$

(iv) Working capital ratio

$$(250 + 300 + 50) : 200 = 600 : 200 = 3:1$$

(v) Acid test (liquidity) ratio

$$(300 + 50) : 200 = 350 : 200 = 1.75:1$$

(vi) Accounts receivable (debtors) collection period (in days)

$$\frac{300}{3,600} \times 365 = 30.42 \text{ days}$$

(vii) Accounts payable (creditors) payment period (in days)

$$\frac{200}{2,160} \times 365 = 33.80 \text{ days}$$

Maximum Marks for (a)**14 marks****(b)** Accounting ratios provide a means of comparison. **1**

- over time. **1**
- between organisations. **1**
- which are clearer than absolute figures. **1**

Limitations:

They are only a guide pointing towards further investigation. **1**In isolation are largely meaningless. **1**For instance, 3:1 for working capital may be high/low depending on the circumstances of Orange Ltd. **1**They can be distorted because of underlying accounting policies. **1**Some can be calculated in different ways such as return on capital employed used in (a) above making comparison difficult. **1**without understanding the underlying business some ratios. **1**which could be considered high for Orange Ltd. **1****Maximum Marks for (b)****11 marks****Total Maximum Marks for Q5****25 marks**

Question 6

- (a) Copy the following table into your answer book and tick the appropriate column showing how each of the expenses should be categorised. **(4 marks)**
- (b) Explain the distinctions between direct costs and indirect costs, comparing these with fixed costs and variable costs. **(8 marks)**
- (c) Calculate the break-even points in units and £s and the profit/(loss) that would be earned by each product if the expected levels of sales are achieved. Suggest which product John should select and give reasons for your selection. **(13 marks)**

Suggested Answer:

(a)

Expense	Direct cost	Indirect cost	Fixed cost	Variable cost
Materials to manufacture each unit	√ 1			
Hourly rate paid to office cleaner				√ 1
Annual office rent			√ 1	
Manufacturing manager's salary		√ 1		

Note: Accept alternative of Fixed cost for cleaner for mark.

Maximum Marks for (a) 4 marks

- (b) Direct costs relate to those items which can be directly applied to a product **2**
 Indirect costs relate to those items which cannot be directly applied to a product **2**
 Fixed costs relate to output and do not change in proportion to output within a specific range. **2**
 Variable costs relate to output and they change in proportion to the entire output. **2**
 Direct costs (materials, labour, expenses) are combined into prime cost. **2**
 Indirect costs are also called overheads. **2**

Direct and indirect costs are used in absorption costing. **2**
 Fixed and variable costs are used in marginal costing. **2**

Maximum Marks for (b) 8 marks

(c)	Product A	Product B
Sales price	10	12
Variable cost	<u>4</u>	<u>7</u>
Contribution	6	5

Break-even point $\frac{24,000}{6} = 4,000$ units **1 of** $\frac{60,000}{5} = 12,000$ units **1 of**
 £40,000 **1 of** £144,000 **1 of**

Profit (loss):	£	£
Total contribution	120,000	150,000
Fixed costs	<u>24,000</u>	<u>60,000</u>
Profit	<u>96,000</u> 1	<u>90,000</u> 1

- Product A is preferred. **1 of**
 Higher profit. **1 of**
 Lower break-even point. **1 of**

Maximum Marks for (c) 13 marks
Total Maximum Marks for Q6 25 marks

Question 7

- (a) Explain **five** main benefits of preparing budgets. **(10 marks)**
 (b) Prepare for Peter, in columnar form, a cash budget for the three months, July, August and September 2015. **(15 marks)**

Suggested Answer:

(a) Five main benefits of preparing budgets are:

- Planning: Which improves performance as managers need to be pro-active and consider events in advance of them occurring.
 Co-ordination: Which enhances the efficiency and effectiveness of management who work together to achieve common goods.
 Control: Differences between budget and actual outcomes are compared and performance evaluated and controls applied to bring outcomes back in line with the budget. Or management may consider accepting the variance if it is favourable.
 Motivation: Goals and targets are provided which are objectives for management and employees to work towards.
 Improved communication: So management and employees are clear about the tasks to be completed
 Authorisation and delegation: Budgets allow for management to be given authorisation over their areas of responsibility and expenditure, providing them with control.

5 x 2 marks

Maximum Marks for (a) 10 marks

(b)	July		August		September
	£		£		£
Receipts:					
Sales – cash	1,000	1	2,000	1	2,750
Sales – 1 month	1,000	1	1,000	1	2,000
Total receipts	1,000		3,000		4,750
Payments:					
Purchases-materials			3,000	1	2,500
Wages	500		1,000		1,000
Expenses	400		600		600
Equipment	1,000	1			
Drawings					325
Total payments	1,900		4,600		4,425
Opening balance	1,000	1	100		(1,500)
Receipts	1,000		3,000		4,750
	2,000		3,100		3,250
Payments	1,900		4,600		4,425
Closing balance	100	1 of	(1,500)	1 of	(1,175)

Maximum Marks for (b) 15 marks
Total Maximum Marks for Q8 25 marks

Question 8

- (a) Explain the purpose and objectives of cost accounting. (4 marks)
 (b) Calculate, using the AVCO method of stock valuation, the closing inventory (stock) value at 30 April 2014, showing the valuation after each purchase and issue. (13 marks)
 (c) Calculate Asif's total labour cost for the month of April 2014 from the following information about his three employees. The normal working hours are 150 per month. (8 marks)

Suggested Answer:

(a) Cost accounting:

- provides detailed statements and statistics to enhance information provided by financial accounts. **1**
- assists in monitoring and control. **1**

Its objectives are:

- cost control. **1**
- to provide advice for policy formulation. **1**
- to analyse the effects of management policy. **1**
- to assist in estimates and price setting. **1**

Maximum Marks for (a) 4 marks

(b) AVCO

		Units			£	
1 April	Opening balance	200	£3.50		700	
3 April	500 x £4.20	<u>500</u>	£4.20		<u>2,100</u>	1
		700	£4.00	1	2,800	1
12 April	600 x £4.00	<u>600</u>	£4.00		<u>2,400</u>	1
		100			400	1
15 April	500 x £4.30	<u>500</u>	£4.30		<u>2,150</u>	1
		600	£4.25	1 of	<u>2,550</u>	1 of
25 April	400 x £4.25	<u>400</u>	£4.25		<u>1,700</u>	1
		200	£4.25		850	1 of
30 April	300 x £4.35	<u>300</u>	£4.35		<u>1,305</u>	1
		500	£4.31	1 of	<u>2,155</u>	1 of

Maximum Marks for (b) 13 marks

(c) Sarah £1,200 **1** + $\left[10 \times \frac{1,200}{150} \times 1.5\right] **1** = £1,320$

Blossom 75 x £8 = 600 **1**
 Bonus 87 x £1 = 87 **1**
 £ 687

Daisy 500 x £0.50 = 250.00 **1**
 500 x £1.00 = 500.00 **1**
 238 x £1.20 = 285.60 **1**
 £1,035.60

Total labour cost £3,042.60 **1 of**

Maximum Marks for (c) 8 marks
Total Maximum Marks for Q8 25 marks