NCUK INTERNATIONAL YEAR ONE BUSINESS

IDBFN001 Financial Accounting 1

2019-2020

Exam

Mark Scheme

Question A1

a)

Working Notes:

1. Vehicle depreciation

Cost

	£		£
Bal b/f	75,000	Disposal	10,000
		Bal c/f	65,000
	75,000		75,000

Provision for depreciation

	£		£
Disposal (2 x 2,000)	4,000	Bal b/f	45,000
Bal c/f	54,000	P&L (20% x 65,000)	13,000
	58,000		58,000

Disposal

	£		£
Vehicle	10,000	Prov. for depreciation	4,000
		Bank	4,000
		Loss on disposal	2,000
	10,000		10,000

2. Drawings
   - Year total = £36,000
   - Accrual = £8,000

3. Commission
   - Charge = £2,300 (on rounded down sales)
   - Accrual =£600

4. Electricity charge = £5,500 - £800 + £700 (accrual) = £5,400

Newport and Family: Statement of Profit or Loss for Year Ending 31st December 2019

	£	£
Sales		230,700
Less cost of sales:		
Opening inventory	71,250	
Purchases	105,400	
Purchase returns	(400)	
Carriage in	1,000	
	177,250	
Less closing inventory	82,900	
		94,350
Gross Profit		136,350

Less expenses:		
Wages	36,000	
Depreciation charges:		
Premises	5,000	
Plant	35,000	
Fixtures	5,000	
Vehicle [13 + 2]	15,000	
Commission	2,300	
Irrecoverable debts [net]	1,600	
Marketing fee	8,000	
Increase allowance on receivables	500	
Electricity	5,400	
Vehicle expenses	4,100	
Loan interest	12,500	
		130,400
Net Profit		5,950

Marks allocated:

- Gross profit correctly calculated. (1)
- Depreciation:
  - Premises. (1)
  - Plant. (1)
  - Fixtures. (1)
  - Vehicle. (2)
  - Loss on disposal. (1) (either included with depreciation or shown separately in P&L)
- Correct treatment of the following:
  - Accrued wages. (1)
  - Accrued drawings. (1)
  - Commission owing. (1)
  - Interest charge. (1)
  - Marketing fee. (1)
  - Irredeemable debt **and** allowance for receivables. (1)
  - Electricity charge. (1)
- Correct net profit, reflecting overall accuracy and adherence to principles. (1)

[15 marks]

Newport and Family: Statement of Financial Position as at 31st December 2019

	Cost [£]	Depreciation [£]	NBV [£]
Assets			
Non-current assets			
Premises	250,000	65,000	185,000
Plant	350,000	175,000	175,000
Fixtures	50,000	35,000	15,000
Vehicles	65,000	54,000	11,000
			386,000

Current assets			
Inventory		82,900	
Receivables	37,000		
Allowance	(1,000)	36,000	118,900
			504,900
Capital and liabilities			
Capital (1-1-19)			231,750
Profit		5,950	
Drawings		(36,000)	(30,050)
			201,700
Non-current liabilities			
5% Loan			250,000
Current liabilities			
Payables		14,900	
Loan interest		12,500	
Wages		1,000	
Commission		600	
Drawings		8,000	
Marketing fee		8,000	
Electricity		700	
Bank [11,500-4,000]		7,500	53,200
			504,900

Marks allocated:

- Correct vehicle balance. (1)
- Correct overall non-current asset balance. (1)
- Adjustment to receivables. (1)
- 1 mark for each of the following current liability adjustments: (7)
  - Loan interest
  - Wages
  - Commission
  - Drawings
  - Marketing
  - Electricity
  - Bank overdraft
- Final balances in agreement, reflecting accuracy and adherence to principles throughout the question. (1)
- Layout and terminology in line with accepted modern practice. (1)

[12 marks]

Overall: 27 marks

b)

- **Going concern**: This refers to the underlying assumption in the preparation of financial statements.
    - It is assumed that accounts are prepared on the basis that the business will continue in operation for the foreseeable future.
    - The business is not about to go into liquidation or even scale back operations in a substantial manner over the next account period or periods.
    - If that were not the case the accounts would be presented on a 'break-up' basis – in particular non-current assets would not be presented at cost - depreciation (a method of valuation that assumes continuing operation) but at what the assets might yield in a forced sale.

Marks allocated:

- Identifying as underlying assumption. (1)
- A reasonable explanation of the meaning of 'going concern'. (1)
- Up to 2 marks for clear explanation of impact on financial statements if going concern does not apply.

- **Accrual basis:** Not actually an underlying assumption but the Conceptual Framework is clear that financial statements should be presented on the accruals basis.
    - Transactions and other financial events are recognised when they occur – not when cash transaction occurs – and are recorded in the financial statements in the period to which they relate.
    - Since both revenues and costs should be recorded in the period to which they relate it follows that related costs and revenues should be **matched** to ensure an accurate recording of net revenue. (matching convention)
    - One example of this would be the recording of depreciation as a revenue expense. A non-current asset with, say, a 5-year life span will generate benefit to the business over the 5 years and the depreciation charge in each of the 5 years is an attempt to match the costs of the asset to the income it generates.

Marks allocated:

- A reasonable explanation of accruals as opposed to 'cash basis'. (1)
- Understanding and commenting on 'matching convention'. (1)
- Up to 2 marks for clear explanation of one specific example of accruals/matching.

[8 marks]

Section B

Question B1

a)

Electricity Account

	£		£
2018		Bal b/fwd.	500
1st Aug. Bank	800		
1st Oct. Bank	600		
2019			
1st Feb. Bank	1,000		
30th June Bank	900	30th June P&L	3,400
30th June accrual c/d [2/3 x £900]	600		
	3,900		3,900

Marks allocated:
- Enter opening accrual as credit balance. (1)
- Cash debits correctly entered. (1)
- Closing accrual correctly calculated and carried down as credit. (1)
- Correct transfer to P&L. (1) (note, errors c/fwd)

[4 marks]

b)

Fuel Payable Account

	£
Bal b/f	(2,200)
Payments	92,300
Bal c/f	1,750
Purchases	91,850

(This could, of course, have been presented as 't' account).

Cost of fuel used:
- Opening inventory: £20,500
- Purchases: £91,850
- Closing inventory: (£14,270)
- Fuel used (P&L) **£98,080**

Marks allocated:
- Correct opening and closing balances in fuel payable. (1)
- Correct calculation of period purchases. (1)
- Correct adjustments for opening and closing inventory. (1)
- Identification of fuel used to P&L, reflecting accuracy and understanding of principle. (1)

[4 marks]

c)

Utility Account (Gas & Electricity)

	£		**£**
2019		2019	
Jan 1 Electricity p/paid b/d	1,500	Jan 1 gas accrued b/d	700
Dec 31 Bank: electricity	7,000	Dec 31 gas p/paid c/d	300
Dec 31 Bank: gas	4,600	Dec 31 P&L: gas	3,600
Dec 31 electricity accrued c/d	700	Dec 31 P&L: electricity	9,200
	13,800		13,800
2020		2020	
Jan1 Gas p/paid b/d	300	Jan 1 Electricity accrued b/d	700

Marks allocated:
- Enter opening balances correctly as debit or credit. (2)
- Enter cash/bank payments. (1)
- Enter closing balances as debit or credit. (2)
- Correctly derive P&L charge (either as separate or combined also accepted). (1)

[6 marks]

d) Capital and revenue expenditure:

The following would comprise a reasonably complete answer:
- Revenue expenditure is incurred in running the business on a day to day basis. So, petrol for a vehicle fleet, wages of the drivers, heat and light for the office, maintenance of plant or vehicles etc would all be revenue expenditure.
- Revenue expenditure would be collected under various expense heads and matched and charged against revenue in the statement of profit or loss to determine period profit.
- Capital expenditure relates to expenditure on non-current (fixed) assets that will yield benefit to the business over several accounting periods, certainly for longer than 12 months.
- Capital expenditure would therefore include the purchase of non-current assets like buildings, plant, vehicles but also the costs of getting these assets ready for use. So, installation and set-up costs, transport costs (inwards) related to the asset, professional advice related to the acquisition (e.g. legal or architects fees) would all be regarded as capital expenditure.
- As capital expenditure provided benefit to the business over a number of years it should not be charged against business revenue in the year of purchase, as this would counter the accruals basis of preparing financial statements.
- Rather, the asset is entered into the position statement at cost in the year of acquisition and written down (depreciated) over its appropriate life span to the profit statement. Depreciation therefore is the revenue expense of the non-current (capital) asset while the position statement records the continuing net book value (cost – depreciation to date) of the asset.

Marks allocated:
- 1 mark for each of the points made above, however ordered. (centres will use a degree of professional judgement in assessing the responses of the student).

[6 marks]

Question B2

a)
i)
Inventory valuation 2019:

	Purchases [units]	**Sales [units]**	**Balance [units]**	**Inventory Value [£]**	**Unit Cost [£]**	**Cost of Sales [£]**
Jan.	20		20	8,000	400	
March	25			7,500	300	
			45	15,500		
April		15		(6,000) (1)		6,000
			30	9,500		
July	10			2,500	250	
			40	12,000		
Oct.		20*		(6,500) (1)		6,500
			20	5,500		12.500

*(5x400) + (15x300)

Inventory valuation 2020:

	Purchases [units]	**Sales [units]**	**Balance [units]**	**Inventory Value [£]**	**Unit cost [£]**	**Cost of sales [£]**
Bal b/fwd			20	5,500		
Feb.	20			5,000	250	
			40	10,500		
May		10		(3,000) (1)		3,000
			30	7,500		
Sept.	25			5,000	200	
			55	12,500		
Nov.		55*		(12,500) (1)		15,500
			Nil	-		

*(10 x 250) + (20 x 250) +(25 x 20)

In summary:

- Inventory valuation at 31st December 2019 is £5,500
- Inventory valuation at 31st December 2020 is zero

Marks allocated:

- Student shows clear understanding of FIFO principles. (1)
- Statements laid out in a clear logical manner (not necessarily as above). (1)
- Four calculations as given. (4)
- Correct final inventory balances for both years (reflecting accuracy and adherence to principle). (2)

[8 marks]

ii) Profit Statements Cod Traders:

Statement of profit or loss y/e 31st December 2019

	£	£
Sales [35 x £600]		21,000
Less cost of sales:		
Opening inventory	Nil	
Purchases	18,000	
Closing inventory	(5,500)	12,500
Gross Profit		8,500 (1)
Less expenses [25%]		2,125
Net Profit		6,375 (1)

Statement of profit or loss y/e 31st December 2020

	£	£
Sales [65 x £600]		39,000
Less cost of sales:		
Opening inventory	5,500	
Purchases	10,000	
Closing inventory	-	15,500
Gross Profit		23,500 (1)
Less expenses [25%]		5,875
Net Profit		17,625 (1)

Marks allocated:

- 4 marks as indicated above. (Note: credit may still be earned if errors b/fwd from previous calculations).

[4 marks]

b) AVCO method:

Key points for complete answer:

- In 2019 with stock prices falling AVC0's closing inventory valuation will place more weight on earlier higher priced inventory than would FIFO. The greater the closing inventory valuation, the higher the gross profit. So recorded profit would be higher in 2019 under AVCO than FIFO.
- With a higher opening inventory in 2020 and a zero -losing balance the AVCO cost of sales would be greater (than FIFO) and hence profit would be less - over the two-year period the overall profit would be identical.

Marks allocated:

- Clear explanation of profit difference in 2019. (1)
- Clear explanation of profit difference in 2020. (1)
- Recognising that over the total period profits will be identical. (1)

[3 marks]

c) Costs of inventory:

Costs are essentially related to either:
- Costs of purchase, or
- Costs of conversion (i.e. converting basic raw material to finished goods inventory)

Costs of purchase would include:
- Purchase price
- Any import or other added taxes/duties
- Transport inward costs
- Deducting any relevant trade discounts

Costs of conversion would include:
- Costs directly related to units of production, i.e. other materials in the conversion process and direct labour.
- Fixed and variable production overhead costs incurred in converting the raw materials and allocated on some agreed, systematic basis.

Marks allocated:
- Correctly identifying the two key components of cost. (1)
- Identifying all four elements of purchase cost (marks can be pro-rated). (2)
- Identifying and briefly explaining the two elements of conversion cost. (2)

[5 marks]

Question B3

a)
i)

Providence Receivables Control Account 2019

	£		£
Jan 1 Bal b/fwd	9,145	Jan 1 Bal b/fwd	115
Dec 31 Sales	70,700	Dec 31 Cash (customers)	59,384
Bal c/f	115	Returns	1,117
		Irr. Debts written off	296
		Contra entries	470
		Allowance damaged goods	260
		Bal c/f	18,318
	79,960		79,960

Marks allocated:
- Correctly entering both opening balances. (1)
- 1 mark for each correct entry. (6)
- 1 mark for including credit balance c/f at year end. (1)
- Correct closing balance, reflecting accuracy throughout. (1)

[9 marks]

ii)

Providence Payables Control Account 2019

	£		**£**
Jan 1 Bal b/fwd	130	Jan 1 Bal b/fwd	7,140
Dec 31		Dec 31	
Cash (suppliers)	39,265	Purchases	41,650
Discounts received	1,510	Cash	130
Returns outwards	490		
Contra entries	470		
Bal c/f	7,055		
	48,920		48,920

Marks allocated:

- Correctly entering both opening balances. (1)
- 1 mark for each correct entry. (6)
- Correct closing balance, reflecting accuracy throughout. (1)

[8 marks]

b)

Briefly control accounts will:

- Provide an accuracy check of entries made in the personal accounts within the payables and receivables ledger, simply by comparing the total balance on the control account with the balances in the personal accounts of the ledger (whether receivables or payables).
- Assist in the location of errors when they occur by making regular comparisons between the updated control account and the personal account balances.
- Help in maintaining internal check of the accuracy and probity of the accounting system where different staff maintain the ledgers and the control accounts.
- Provide useful management information by enabling the total receivables figure or payables figure to be produced quickly for management reports.

Marks allocated:

- 1 mark for each of any three valid points made. (Note, a well-informed student might make comment that a computerised system would produce individual receivables/payables balances and control balances automatically – credit also for this observation.)

[3 marks]