NCUK INTERNATIONAL YEAR ONE BUSINESS

IDBFN001 Financial Accounting 1

2020-2021

Exam

Mark Scheme

Error Carried Forward:

Whenever a question asks the student to calculate - or otherwise produce - a piece of information that is to be used later in the question, the marker should consider the possibility of error carried forward (ECF). When a student has made an error in deriving a value or other information, provided that the student correctly applies the method in subsequent parts of the question, the student should be awarded the Method marks for the part question. The student should never be awarded the Accuracy marks, unless a follow through is clearly indicated in the mark scheme. When this happens, write ECF next to the ticks.

Section A

Question A1

a) Down: final accounts

Working Notes:

1) Accumulated depreciation and disposal

Vehicle a/c

	£		£
Bal b/fwd	80,000	Disposal	15,000
		Bal c/fwd	65,000
			80,000

Accumulated depreciation

	£		£
Disposal*	9,000	Bal b/fwd	32,000
Bal c/fwd	36,000	P&L	13,000
	45,000		45,000

*[3,000 x 3 = 9000]

Disposal

	£		£
Vehicles	15,000	Acc. depreciation	9,000
		Cash	4,800
		Disposal loss	1,200
			15,000

2) Inventory:
   Valuation = [60,600-12,000] + 2,000 x 0.9 = £50,400
3) Rent = £12,000 pa (3,000 p/paid)
4) Electricity = £19,000 pa (3,000 accrued)
5) Wages = £96,000 pa (3,500 accrued)
6) Vehicle costs = £18,000 (1,000 accrued)
7) Interest charge = £9,000 (4,500 owing)

Down: Statement of Profit or Loss for y/e 31st December 2020

	£	£
Sales		610,900
Less returns		900
		610,000
Less cost of sales:		
Opening inventory	51,900	
Purchases	315,000	
Carriage in	1,890	
	368,790	

Less closing inventory (note 2)	50,400	
		318,390
Gross profit		291,610
Less expenses:		
Wages	96,000	
Rent	12,000	
Electricity	19,000	
Vehicle costs	18,000	
Interest	9,000	
Carriage out	1,700	
Discount allowed	2,400	
Irr. Debts (less reduction in allowance)	700	
Depreciation: vehicles	13,000	
Loss on vehicle disposal	1,200	
Depreciation: fixtures	25,000	
		198,000
Net Profit		**93,610**

Marks Allocated:

- Correctly identifying balance c/fwd on vehicle account. (1)
- On accumulated depreciation account, correctly:
  - Calculating disposal figure (note 3 years). (2)
  - Calculate year's P&L. (1)
  - Identify balance c/fwd. (1)
- On disposal account correctly calculate disposal loss. (1)
- Re-state closing inventory correctly. (2)
- Correctly calculate year's rental charge and identify p/payment. (2)
- 1 mark for each of the four adjustments identified above. (4)
- 1 mark for gross profit figure correctly identified. (1)
- 1 mark for adjusting allowance on receivables (whether netted or not). (1)
- 1 mark for correct net profit, reflecting accuracy and adherence to principle throughout. (1)

Down: Statement of Financial Position as at 31st December 2020

	Cost	Depreciation	NBV
	£	£	£
Assets			
Non-current assets			
Fixtures and fittings	100,000	75,000	25,000
Vehicles	65,000	36,000	29,000
			54,000

Current assets			
Inventory		50,400	
Receivables	51,000		
Less allowance	1,000	50,000	
Pre-paid rent		3,000	
Bank [61,000 + 4,800]		65,800	
			169,200
			223,200
Capital and Liabilities			
Capital (1-1-20)			26,390
Profit		93,610	
Less drawings		30,600	
			63,010
			89,400
Non-current liabilities			
10% Bank loan			90,000
Current liabilities			
Accounts payable		31,800	
Interest owing		4,500	
Wages owing		3,500	
Accrued expenses		4,000	43,800
			223,200

Marks Allocated:

- 17 marks as per statement of P&L allocation.
- Non-current asset balance shown correctly. (1)
- Receivables adjusted correctly. (1)
- Prepayment rental shown correctly as current asset. (1)
- Bank adjusted in line with disposal. (1)
- Interest owing shown correctly as current liability. (1)
- Wages owing shown as current liability. (1)
- Accrued expenses shown correctly as current liability. (1)
- Final balances agree, reflecting accuracy and adherence to correct principle across the question. (2)
- Additional mark for accounts displayed in a clear and logical manner and for use of appropriate terminology. (1)

[Total marks: 27]

b) Student might make three separate points to further explain this issue:

- Basic point: Wages are in almost all cases a revenue expense – they should be matched against expenditure for the period to determine net income and hence **not** treated as a capital expense.
- In a few particular and specific instances labour costs might be capitalised (i.e. treated as fixed asset in SoFP). This might occur where the labour costs are a necessary and integral part of creating or improving a non-current asset. Examples might include the architects fee for a new building programme or staffing costs incurred in the installation of new plant and equipment (but not the maintenance of that plant).
- Final point to be noted is that even when staffing costs are capitalised, they will be subject to depreciation, so any benefit to profit will be temporary as future costs of depreciation will increase.

Marks Allocated:

- Student makes the basic point of labour costs being a revenue expense. (1)
- Student understands and explains limited circumstances where costs may be capitalised. (2)
- Student clearly explains limited time frame of any benefit, due to depreciation. (2)

[Total marks: 5]

c) Student identifies and briefly explains any two disadvantages of partnership:

- Key issue: Partners are jointly personally liable for all debts incurred. They have no limited liability – neither does Down as a sole proprietor but he is acting on his own behalf, without the worry of how another partner or partners might act.
- Other disadvantages could include:
  - Costs of setting up a partnership agreement
  - Issues of continuity of the business if one partner wishes to leave the business (or passes away)
  - Issues of disagreement between partners.

Marks Allocated:

- Student clearly explains issue of unlimited liability and relates to Down's circumstance. (2)
- Identify any other valid disadvantage of partnership. (1)

[Total marks: 3]

Section B

Question B1

a)

i) Credit sales = £90,000 - £18,000 + £14,000
= £86,000

Marks Allocated:
- Netting off receipts from cash sales. (1)
- Adjusting correctly for opening/closing receivables. (1)

[Total marks: 2]

ii)

		£
Sales		60,000
Less returns in		(6,000)
		54,000
Less cost of sales:		
Opening inventory	7,000	
Purchases	25,000	
Returns out	(4,000)	
Closing inventory	(4,000)	24,000
Gross profit		30,000

Marks Allocated:
- Adjust correctly for both returns. (2)
- Gross profit calculated correctly. (1)

[Total marks: 3]

iii)

- Vehicle maintenance cost overstated by: £40,0000
- Depreciation understated by:
  - £36,000/4 x3/12 £2,250
- Profit understated by £37,750

Marks Allocated:
- Clearly stating that maintenance costs have been over stated by the error. (1)
- Calculating correctly the depreciation that would have been charged on the asset. (2)
- Clearly stating the correctly calculated understated profit. (1)

[Total marks: 4]

iv)

Electricity

2020	£		£
Sep1 Cash	1,000	Aug 1Bal b/d	500
Dec1 Cash	1,250		
2021			
Mar1 Cash	1,300	July 31 P&L	4,050
July 31 Cash	1,200	July 31 Bal c/d	200*
	4,750		4,750

*1,200/6

Marks Allocated:

- Entering open balance as credit. (1)
- Calculating closing balance. (1)
- Recognising as a debit balance b/d (i.e. prepayment). (2)
- Correct P&L charge shown. (1)

[Total marks: 5]

b) Depreciation and accrual assumption:

Key points to be covered in answer

- As cash is expended in acquiring the asset it must be charged against profit at some point. (1)
- The asset yields benefit to the business over a number of periods, so not appropriate to charge against profit in any one period. (1)
- There is therefore a need to spread the cost of the asset over a number of periods to match the benefit accruing from that asset over the same time period. (2)
- Depreciation is therefore a means of allocating the cost of the asset over its useful life. (1)
- Using various techniques (e.g. straight line) depreciation spreads the cost of the asset less any residual value over its estimated life span. Note residual value is an estimate and life span is also an estimate – depreciation will rarely be an exact measurement of the asset's use.
- Worth noting in the answer what depreciation is **not –** an estimate of the assets saleable value at any point, and certainly not a means of providing funds to replace the asset.

Marks Allocated:

- 5 marks as indicated above.
- 1 additional mark for comment /discussion on either of the issues raised in points 5/6.

[Total marks: 6]

Question B2

a) Kildare Journal:

	Dr [£]	Cr [£]
1) Suspense	2,090	
Sales		
		2,090
2) Discount received	410	
J Offaly		410
3) Vehicle account	3,500	
Vehicle expenses account		3,500
4) Suspense	360	
Purchases		360
5) Stationery inventory	290	
Stationery expenses		290
6) Purchase returns	475	
Sales returns	475	
Suspense		950

Marks Allocated:

- 1 mark for completely correct double entry adjustment in J1-5. (5)
- 2 marks for correct entries in J6 (added difficulty). (2)

[Total marks: 7]

b) Suspense Account

	£		£
Sales	2,090	Bal b/fwd (TB)	1,500
Purchases	<u>360</u>	Purchase/sales returns	<u>950</u>
	2,450		2,450

Marks Allocated:

- 1 mark for transferring balance from TB as credit entry. (1)
- 1 mark for each of the other entries. (3)

[Total marks: 4]

c) Profit adjustment:

	£
Gross profit per draft accounts	45,700
Sales omitted	2,090 (1)
Purchases over stated	360 (1)
Sales credit note wrongly allocated	(950) (1)
	47,200
Net profit per draft	31,000
GP adjustment [47,200 – 45,700]	1,500 (1)
Vehicle purchase treated as revenue	3,500 (1)
Cash discount wrongly claimed	(410) (1)
Stationery expenses	290 (1)
Adjusted net profit	35,880

Marks Allocated:

- 7 marks as indicated above.
- Additional 2 marks for correct adjusted net profit, reflecting accuracy and (importantly) the inclusion of relevant items only.

[Total marks: 9]

Question B3

a) Benefits of control account:

A full answer would include the following:

- They provide a check on the accuracy of the entries made to the personal accounts in the receivables and payables ledger. The business will compare:
    - Total balance on the receivables control account with the individual (customer) balances on the many personal accounts in the receivables ledger.
    - Similarly, the total balance on the payables control account will be compared with the total of individual personal (supplier)balances in the payables ledger.
- Control accounts assist in the speedy location of errors – by posting the control accounts on (say) a weekly basis it becomes easier to spot a recording error (say missing an invoice) or transposition error in the personal accounts. Trying to uncover such errors end the year end would be enormously difficult.
- Control accounts can assist with **internal check and control** where one accounts assistant is responsible for maintaining the control account and another for posting to the personal accounts in the ledger.

- Maintaining control accounts makes it easier to quickly identify total receivables and payables figures for the trial balance or statement of financial position.
- Where control accounts are maintained, they can be part of the double entry system with the personal accounts maintained as memorandum (back-up/information) accounts. This can greatly reduce the number of accounts within the double entry system and hence simplify the double entry.

Marks Allocated:

- 2 marks for each point – identify the benefit with accompanying brief narrative.

[Total marks: 10]

b) Year-end entries, 2020:

Purchases

	£		£
Bal b/fwd	10,000	P&L	10,000

P&L

	£		£
Purchases	10,000	Inventory (year end)	1,500

Inventory

	£		£
P&L (year end count)	1,500		

Opening entry 2021:

Inventory

	£		£
		Bal b/fwd to P&L	1,500

P&L

	£		£
Inventory (opening entry)	1,500		

Marks Allocated:

- 2 marks for each completed double entry, i.e.:
  - Cr purchases: Dr P&L (2020). (2)
  - Cr P&L: Dr Closing inventory (2020). (2)
  - Cr opening inventory: Dr P&L (2021). (2)

[Total marks: 6]

c) Kerry's profit:

	£
Opening net assets:	
Inventory	7,000
Bank	4,000
	11,000
Closing net assets:	
Inventory	9,000
Bank	11,000
Payables	(4,000)
	16,000
Increase in capital (net assets)	5,000
Less capital paid in	(3,000)
Plus drawings [1,000 + (200 x 52)]	11,400
Net Profit	13,400

Marks Allocated:

- Identify the increase in capital (net assets). (1)
- Deduct capital introduced (either gross or net of £1,000). (1)
- Add back drawings (see above). (1)
- Identify the correct net profit figure. (1)

[Total marks: 4]