NCUK INTERNATIONAL YEAR ONE BUSINESS

IDBFN001 Financial Accounting 1

2018-2019

Exam

Mark Scheme

Notice to Markers

This mark scheme should be used in conjunction with the NCUK Centre Marking and Recording results policy, available from the secure area of the NCUK website (http://www.ncuk.ac.uk). Contact your Principal/Academic Manager if you do not have login details.

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) Winston

Working note – Winston, vehicle depreciation:

Cost

	£		**£**
Bal b/d	100,000	Disposal	40,000
		Bal c/d	60,000
	100,000		100,000

Provision for depreciation

	£		**£**
Disposal	30,000	Bal b/d	50,000
Bal c/d	35,000	P&L depreciation	15,000
	65,000		65,000

Disposal

	£		**£**
Vehicle (cost)	40,000	Depreciation	30,000
		Cash/bank	7,000
		Loss on disposal	3,000
	40,000		40,000

Winston: Statement of Profit or Loss y/e 31st December 2018

	£	**£**
Sales		415,700
Less returns		800
		414,900
Less cost of sales:		
Opening inventory	47,500	
Purchases	210,600	
Carriage-in	1,750	
	259,850	
Less closing inventory	55,900	203,950
Gross Profit		210,950
Less expenses:		
Depreciation: vehicles (inc. loss on disposal)	18,000	
Depreciation: fixtures	10,000	
Wages and salaries (£2,700 accrued)	84,000	
Carriage-out	2,400	

Discounts allowed	2,600	
Electricity (£4,000 accrued)	22,000	
Rent (£3,000 p/paid)	12,000	
Irrecoverable debt	1,800	
Increase in allowance for receivables	1,000	
Interest on loan (£3,200 owing)	6,400	
		160,200
Net Profit		**50,750**

Marks allocated:

- Correct calculation of GP (inclusive of carriage in but excluding carriage out). **(1)**
- Calculating vehicle depreciation for the year. **(2)**
- Calculating loss on vehicle disposal. **(2)**
- Correct treatment of wages and salaries – i.e. recognising and including accrued wages. **(1)**
- Correct treatment of rent – i.e. recognising and including rent prepaid. **(1)**
- Correct treatment of utility charge – i.e. recognising and including accrued charge. **(1)**
- Correctly adjusting the specific allowance on receivables. **(1)**
- Identifying the correct interest charge on the loan. **(2)**
- Correct calculation of net profit, reflecting arithmetic accuracy and correct principle throughout the question. **(1)**

Winston: Statement of Financial Position as at 31st December 2018

	£	£	£
	Cost	**Depreciation**	**NBV**
Non-current Assets			
Fixtures	50,000	40,000	10,000
Vehicles	60,000	35,000	25,000
			35,000
Current Assets			
Inventory		55,900	
Receivables	49,000		
Less allowance	3,000	46,000	
Pre-paid rent		3,000	
Bank (£30,750 + £7,000)		37,750	142,650
			177,650
Capital and Liabilities			
Capital [1-1-18]			35,250
Profit for year		50,750	
Less drawings		24,900	25,850
			61,100
Non-current Liabilities			

8% Loan			80,000
Current Liabilities			
Payables		26,650	
Accrued expenses		6,700	
Interest owing		3,200	36,550
			177,650

Marks allocated:

- Correct fixtures balance. **(1)**
- Correct vehicles balance. **(1)**
- Adjusting correctly for receivables. **(1)**
- Correctly including rent prepaid. **(1)**
- Adjusting bank balance to reflect sale of vehicle. **(2)**
- Adjusting opening capital with profit and drawings (errors b/fwd allowable) in correct manner. **(1)**
- Correctly including both accrued expenses. **(2)** (1 mark each)
- Correctly including interest owing. **(1)**
- Balances agree, reflecting accuracy and understanding of principles across the question. **(1)**

[23 marks]

b) Advantages of a partnership might include:

- Ability to raise additional capital for expansion
- Ability to divide roles and encourage specialist skills of each partner
- Share the risks and losses between the various partners

Disadvantages might include:

- Partners are jointly personally liable for all debts – i.e. no limited liability
- Need for consensus between the partners before major decisions can be made
- Continuity problems for the business if one partner dies or wishes to leave the partnership

Marks allocated:

- 0.5 marks for each valid point, per above (or others as deemed appropriate by the centre) to a maximum of two marks. **(2)**

[2 marks]

c) Limited liability company:

Key points:

- The business is incorporated to give the various owners (shareholders) the benefit of limited liability.
- Shareholders are therefore only liable for the amount of shares they have subscribed into the business – i.e. the maximum loss is the value of shares subscribed.
- Limited liability companies are regarded as a separate legal entity from the owners and can enter into contracts and sue (and be sued) on its own account.
- As the business grows there is likely to be increasing distinction between the shareholders who own the business and directors who run the business on a day to day basis.
- Directors are responsible to the shareholders and report to them annually through the AGM.

Key Advantages:

- Limited liability provides great safeguard to investors – without this, investors could lose not only their investment but also personal wealth.
- The ability to raise finance allows the business to expand more easily than other business structures.
- Because the company has its own legal identity it continues in existence regardless of who the shareholders are.
- There may be tax advantages to being a limited company, if the company tax rate is lower than the individual rates.
- Especially if the company is quoted on a stock market it is easy to transfer shares from one individual to another and hence liquidise one's wealth.

Possible disadvantages:

- Limited companies must publish annual accounts which as well as being an onerous task does open up the company's affairs to the wider public.
- Limited companies need to comply with legal and accounting requirements which are stricter than for sole trader/partnerships.
- Larger limited companies need to have their accounts audited – this will be expensive and fairly intrusive.

Marks allocated:

- A reasonably full and comprehensive description of what a limited liability company is – as a guide the five points above should (broadly) be covered. **(5)**
- Five advantages/disadvantages of a limited liability company, including at least one disadvantage and at least two advantages, for a maximum of five marks. **(5)**

[10 marks]

Section B

Question B1

a) Denmark & Co

i) Denmark & Co Receivables Control Account

	£		£
Uncorrected bal. b/d	16,320	Contra entry omitted	210
Sales omitted	1,150	Irrecoverable debt omitted	320
Bank: dishonoured cheque	500	Returns-in omitted	145
		Amended balance c/d	17,295
	17,970		17,970

Marks allocated:

- Correct opening balance on debit of account. **(1)**
- 5 entries correctly identified and entered on correct side of account. **(5)**
- Final balance correct, reflecting arithmetic accuracy and, more importantly, the non-inclusion of incorrect items. **(2)**

[8 marks]

ii) Denmark & Co Statement of adjusted personal balances:

	£	£
Original balance		17,390
Add:		
Debit balance omitted (iii)	400	
Debit balance understated (v)	90	490
		17,880
Less:		
Transposition error, understating cash received (ii)	90	
Debit instead of credit (£180 x 2) (vi)	360	
Understatement of cash received (£150-£15) (viii)	135	585
		17,295

Marks allocated:

- Using given figure as opening balance. **(1)**
- Identifying and adjusting correctly each of the five relevant items. **(5)**
- Agreeing final balance to control account balance, reflecting both accuracy and the understanding to include only relevant items. **(2)**

[8 marks]

b) Capital and revenue expenditure

In the explanation the student must show he/she understands the distinction between capital and revenue expenditure:

- Capital expenditure results in the acquisition of or improvement to non-current assets (i.e. equipment, buildings etc that will remain in the business for longer than a single accounting period [year]) whereas revenue expenditure is incurred either for the purpose of day to day trade or to maintain non-current assets. **(1)**

That being explained the distinction in accounting treatment is clear:

- Revenue expenditure is charged as an expense to profit and loss for the period in which the expense in incurred. **(1)**
- Capital expenditure is:
  - Recognised in the statement of financial position as a non-current asset. **(1)**
  - Charged to profit and loss by making a reasonable estimate of the useful life of the asset and then charging a portion of that cost to P&L. This is termed *depreciation.* **(1)**

[4 marks]

Question B2

a) Dutch Traders inventory valuation

i) FIFO basis

Date of issue	Quantity [units]	Issues	Cost of Issues £	£
9th Oct	500	400 @ £4.00 (open bal) 100 @ £5.00	1,600 500	 2,100
23rd Oct	600	500 @ £5.00 100 @ £5.50	2,500 550	 3,050
31st Oct	Closing balance	300 @ £5.50 400 @ £5.75	1,650 2,300	 **3,950**

Marks allocated:

- 1 mark for correct issue valuation for 9th and 23rd October. **(2)**
- Correct closing inventory valuation of £3,950, reflecting both arithmetic accuracy and application of correct principle. **(2)**

[4 marks]

ii) AVCO basis

Date	Received Units	Issued Units	Balance Units	Inventory Value [£]	Unit Cost [£]	Price of Issue [£]
Oct 1			400	1,600	4.00	
Oct 3	600			3,000	5.00	
			1,000	4,600	4.60	
Oct 9		500		(2,300)	4.60	2,300
			500	2,300		
Oct 10	400			2,200	5.50	
			900	4,500	5.00	
Oct 15	400			2,300	5.75	
			1,300	6,800	5.23	
Oct 23		600		(3,138)	5.23	3,138
			700	3,662		
Oct 31	Closing Balance		**700**	**3,662**		

(Note issues + closing valuation equals £9,100, as it must do).

Marks Allocated:

- 2 marks for indicating a clear understanding of AVCO principle. **(2)**

- 2 marks for each of the issues, correctly priced (very minor rounding error can be accepted for Oct 23). **(4)**
- 1 mark for correct final balance and additional mark for noting that the figure must equal £9,100. **(2)**

[8 marks]

iii) Key points:

- Student understands and explains the fundamental point – higher the closing inventory – lower cost of sales – higher GP. **(1)**
- Relates principle to inventory – with prices rising FIFO **must** result in higher end of period inventory valuation, as lower priced inventory issued first. **(1)**
- Clear conclusion – FIFO will always result in higher gross profit figures than AVCO, but **only** so long as prices continue to rise. **(1)**

[3 marks]

b) The sequence would be:

- Inventory count at year end (however carried out) creates the value for year-end inventory, resulting in:
  - Debit: Inventory account (closing inventory)
  - Credit: Profit or loss account (cost of sales)

- In the financial statements:
  - Closing inventory is shown as a deduction in arriving at cost of sales (i.e. adding to gross profit)
  - The debit balance on the inventory account is a year-end asset and will be shown as a current asset in the statement of financial position

- The closing inventory as measured above becomes the opening inventory for the new period, resulting in:
  - Debit: Profit or loss (cost of sales)
  - Credit: Inventory account (opening inventory)

No impact on the financial statements until the period end when:

- Opening inventory is added to purchases to create cost of sales
- New closing inventory valuation, treated as above

Marks allocated:

- Correct double entry for closing inventory. **(1)**
- Understand and explain impact of closing inventory on financial statements. **(2)**
- Correct double entry for opening inventory. **(1)**
- Understand and explain impact of opening inventory on financial statements. **(1)**

[5 marks]

Question B3

a)

i) Opening capital + profit – drawings + liabilities = assets (or variant of). **(1)**

ii) Closing net assets = opening net assets + fresh capital + profit – drawings. **(1)**

Closing net assets = £210,500. **(1)**

iii) Assets and liabilities. **(1)**

iv) Capital; expenses; liabilities. **(1)**

v)

	Dr [£]	**Cr [£]**
Revenue		195,750
Opening inventory	35,650	
Purchases	141,210	
Expenses	37,100	
Non-current assets	89,600	
Trade receivables	31,220	
Trade payables		24,300
Bank		27,150
Capital		87,580
	334,780	334,780

Marks allocated

- Correct identification and listing of debit balances. **(1)**
- Correct identification and listing of credit balances. **(1)**
- Additional mark for correctly balanced totals. **(1)**

[3 marks]

b)

i)

- Student identifies *going concern* as the underlying assumption. **(1)**
- Additional commentary:
  - The assumption is that the business will continue in operation for the foreseeable future and has no need or intention to liquidate its assets. **(1)**
  - If this key assumption does not hold then non-current assets (in particular) must be valued at break-up, i.e. what they might realise in a quick forced sale – likely very different from (say) cost less depreciation. **(1)**

[3 marks]

ii)

Relevance. Key points:

- Information will useful if it is relevant and it must therefore be capable of making a difference to the decision making of the users.
- To make a difference information must have value either as a predictor (i.e. giving accurate information on things that are likely to happen) or as confirmation (i.e. giving accurate details as to what has actually happened).
- Relevance is directly affected by materiality – if the level/detail of the information is so trivial that it adds nothing to the overall understanding of the business then resources need not be expended to include/analyse the detail of such information

Faithful Representation. Key points for financial information to faithfully represent the underlying reality it purports to represent:

- Information must be *complete* – should include all necessary information to allow the user to understand the phenomenon being described.
- Information should be *neutral* – it should be free of bias and not have been manipulated to influence the user.
- Information should be *free from error* – there should be no errors or omissions in the description of the phenomena and the underlying processes (e.g. the ledger accounts) should be free from error. Of course, estimates are made in financial accounting and these may prove to be inaccurate.

Marks allocated:

- 1 mark for each point identified above (or broadly similar).

[6 marks]

iii)

Student could identify, for example, *comparability; verifiability; timeliness; understandability.*

Marks allocated:

- 1 mark for identifying the characteristic
- Up to 2 further marks for reasonable description/commentary on the chosen characteristic.

[3 marks]