



Chartered
Institute
of Credit
Management

**Accounting Principles
Question Paper, Answers and
Examiner's Comments**

Level 3 Diploma

January 2017

ADVICE TO CICM LEARNER CANDIDATES

HOW TO TACKLE YOUR ACCOUNTING PRINCIPLES EXAMINATION

1. Be prepared.

Read the Accounting Principles unit syllabus contained in the Level 2 and Level 3 Diploma in Credit Management Syllabus booklet, free to download from the CICM website if you do not already have an up-to-date copy. It contains all the learning objectives that might be tested in the examination, along with indicative content of what the unit is about. You can use it to help plan your learning and to check you are adequately prepared.

2. Examination structure and rubric.

Remember that the unit syllabus and examination rubric changed in Summer 2016. Some features of the examination are now fixed, so you know that:

- a) It is a three-hour, handwritten examination and a writing booklet for your answers is supplied.
- b) There will be five (5) questions each worth an overall 20 marks.
- c) There are no optional questions or elements in the exam, so you will need to attempt them all. This is consistent with CICM's other core units.
- d) Each question contains parts a), b) and c) which are worth different mark values up to the 20 available for the entire question. In each question, part a) will be a straight-forward task worth 4 marks, part b) will be some form of substantive task for between 10 and 12 marks, and part c) will be for remaining marks up to 20 and may have some connection with or develop the part b) task.
- e) A certain amount of account ledger paper is included in the supplied writing booklet, so you do not have to draw account grids if you need to tackle a book-keeping task.
- f) The pass mark for a Level 2 exam is 40% and marks of 50% and above will receive a Level 3 pass. Unfortunately, marks below 40% are not pass marks.
- g) The language and terminology of the examination is based upon International Accounting Standards as used in CICM's own learning materials for this unit.

3. General approach.

More exams are failed through poor technique during the examination than from poor knowledge and understanding. The key things to do are:

- a) Read the detail within each question task very carefully, so you are sure what the examiner is asking you to do.
- b) Allocate your examination time carefully. Remember that you should spend roughly the same time on each question overall, but that each question part will need a different amount of time to be spent within that.
- c) Remember to attempt all parts of all questions. It is always worth giving a response, even if you are unsure of it.

4. Giving an effective response.

As with any examination, preparation is the key and practising an effective response to an Accounting Principles task is a worthwhile exam room skill, so it is worth a reminder of what this unit and its exam is about.

- a) The unit and examination is written with the credit industry in mind, so often carries a viewpoint of a customer relationship or credit control situation.
- b) The exam will require skills in description/explanation, application of the practical principles of accounting, and commentary/narrative to convey the meaning of the principles, and the results of applying those principles.
- c) It is not, in itself, an assessment of mathematical ability, although accurate calculations are important and unavoidable in this type of subject.
- d) There is plenty to write about too! It is not just about identifying what a number is, but showing you understand what it means, and why or what its relevance is.
- e) The unit's learning objectives also ask that you construct recognised financial and management statements, undertake accurate tasks, and give explanations. Use the published exam materials to practice this.
- f) It is worthwhile practising in advance not just the subject matter, but also how to use your non-programmable calculator if you choose to bring one to your exam.

The following will help you give an effective response:

- a) Ensure you fully address the tasks set for you. They are not tripwires, but simply to ensure that everyone sits same tasks and that marks are awarded fairly.
- b) Stick to the task and avoid drifting from the set task onto a tangent. Frequently check with the task to ensure you are central to it, as that is where marks are available. Responses not on the set task, or which provide surplus-to-task material, waste exam time and are unlikely to score marks, even if accurate.
- c) Use clear, well-constructed, labelled and accurate layouts to help you get good marks. Where commentary or written explanation is required, it should be clearly expressed and relevant to the task. Whilst not needing a 'beginning, middle, and end' essay, remember these are opportunities for you to show your knowledge and understanding of the syllabus topics under question. A response which is easy to follow is easy to mark.
- d) Take great care to ensure responses are not too brief for purpose. If the task was to 'explain what steps might be needed?' there is a huge difference in response quality (and therefore numbers of marks awarded) between stating that, e.g. more care should be taken, and explaining *why* more care should be taken. Use linking words, such as 'because', or 'meaning that', or 'such as' to prompt a developed on-task response.
- e) Whilst bullet points can be carefully used in responses, ensure you develop each point you make, rather than simply leave a bullet list absent of meaning and understanding, and absent of marks. Go back over bullet points and make sure their meaning is clear. Note that whilst suggested response areas in unit past question papers may be in the form of bullet point responses, you will see that each bullet simply separates one discrete idea from another and that each bullet is extended and developed. This is a safe style if you choose to use bullet points.

- f) Show workings and calculations to support your figures even if you used a calculator to produce or check your response. Even if your 'number' is incorrect, it may still be possible to obtain marks from the methods you used where that was deemed part of the task.

- g) Practise extended writing by hand using a ball-point pen or similar – firstly, if you are accustomed to using a keyboard of whatever size to produce written text for work and study, you might find handwriting at length may be quite tiring; secondly, it is an ideal opportunity to practice accurate recall of frameworks, and the extended and developed writing techniques discussed on these pages! Keep handwriting as legible as you can and help the examiner to read your response.

Good luck!

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Accounting Principles questions, answers and examiners' comments

Level 3 Diploma in Credit Management

JANUARY 2017

Instructions to candidates

Answer all questions. All questions carry equal marks. Time allowed 3 hours

Candidates are reminded there are no optional elements in this examination

Ledger accounts must be prepared in continuous running account balance format.

Financial statements must be prepared in vertical format.

FRS terminology should be used in responses wherever possible.

Credit balances should be clearly shown in brackets () for clarity.

Where appropriate, VAT is to be calculated at 20%.

This is the first examination in the new format and was handled well in the main by the majority of candidates. There were some laudable performances with good scripts being submitted. Candidates achieving a pass mark at either Level for this examination are congratulated and it is hoped that candidates who were unsuccessful this time will be encouraged to continue study of this unit and achieve a pass mark next time.

As pointers to improving performance and as a guide to future candidates, it is clear that structure, format and presentation is still a basic issue with the content and layout of both the Income Statement and the Statement of Financial Position. Part of the rationale of accounting is communication, so attention to detail, appropriate headings and structures to financial statements, and accuracy in double-entry bookkeeping is assessed in this unit and rewarded accordingly. Particularly common errors seen this time include: failing to properly title or date financial statements; not following the convention of increasing liquidity when listing the current assets in the Statement of Financial Position; listing assets and liabilities in Income Statements; the 'Detail' column of double-entries containing one or more descriptions of the transaction or activity itself.

It is also worth mentioning that adopted terminology for this unit is based upon international accounting standards, so familiarisation with FRS terminology used in this unit is therefore strongly encouraged, as is its use in responses.

Another area worthy of attention is not just what numbers are, but what they might mean. A number of candidates, despite performing well in numerical parts of tasks, did not maximise their marks because they offered very weak or no responses to the narrative sections. It is important that candidates prepare better for these parts of questions as the interpretation of the answers arrived at is just as important as the numeric data being collated and presented. Whilst numbers and the manipulation of numeric detail are an unavoidable part of this unit, narrative and commentary are equally important along with the general focus upon relevance and accuracy. This will continue to be the brief in future examinations in this unit.

Finally, the key to success is for a candidate to be able to show knowledge and understanding. So, whilst the stated marks are available for directly addressing the set task, long and rambling responses are less effective, and few are achieved by generic three or four word comments such as 'better credit control needed', which is not likely to be a task response in isolation in any event. This is important as, with no optional elements in the examinations for this unit, candidates are encouraged to be fully conversant with the syllabus before their assessment date.

1. a) i) Explain what is meant by the 'cash operating cycle', and its importance to a business. (2 marks)
- ii) Explain the significance of a credit manager knowing the cash operating cycles of its largest customers. (2 marks)
- b) These figures are extracted from the financial statements of Rolling Stock Credit Limited for 2015 and 2016:

Rolling Stock Credit Limited	2015	2016
	£	£
Sales Revenue	350,000	230,000
Cost of Sales	227,500	149,500
Gross Profit	122,500	80,500
Net Worth	113,418	92,418
Ordinary Shares	70,000	70,000
Trade Receivables	61,475	38,815
Non-Current Assets	50,000	100,000
Retained Earnings	43,418	22,418
Cash	35,655	1,800
Inventory	26,690	19,164
Trade Payables	25,980	18,164
Long-term Loans	15,000	50,000
Bank	12,559	0
	overdrawn	
Expenses	7,500	65,000
Accrued Payables	7,400	0
Prepaid Receivables	537	803

TASKS for part b)

- i) Calculate Rolling Stock Credit Limited's cash operating cycle for 2015 and 2016, and comment on the organisation's performance in its management of cash. (8 marks)
- ii) How can the credit manager ensure in a practical way that good incoming cash flow is maintained? (4 marks)

- c) The following are financial ratios calculated from the books of two organisations, one of which is a supermarket business and the other is a heavy engineering business. Suggest which company (ABC Limited or XYZ Limited) is in which industry, and use the ratio results and other information to explain the reasons for your selection. (4 marks)

	ABC Limited	XYZ Limited
Current Ratio	1.7:1	1.0:1
Acid Test	0.9:1	0.7:1
Receivables Collection Period	47.0 days	3.0 days
Payables Settlement Period	67.0 days	51.0 days
Inventory Turnover Rate	43.0 days	16.0 days
Financial Gearing	65.0%	12.0%

Total 20 marks

Question aims

To test candidates' knowledge and understanding of cash operating cycle and how it impacts on an organisation's liquidity and working capital arrangements.

Suggested grounds for response include:

- a) i) The cash operating cycle (COC) is the period of time that elapses between the purchase and payment for raw materials or other inventory and sales receipts from credit and non-credit customers. Measured by inventory turnover rate days + receivables collection period days – payables settlement period days, it is the period of time that the business subsidises and finances the inventory, until it is paid by their customers for the ultimate sales of those goods.
- ii) It is important to credit managers in their assessment of customers as it measures how efficient an organisation is in managing its working capital. Generally, the shorter the time period in days, the better an organisation is with regard to liquidity and cash management, with factors such as industry sector taken into account.
- b) i) Cash operating cycle for 2015 and 2016 (ratio expressions to one decimal place):

<i>*nearest available acceptable data used</i>	2015	2016
Inventory Turnover Rate <u>Closing* Inventory x 365</u> Cost of Sales	$\frac{26,690 \times 365}{227,500}$ = 42.8 days	$\frac{19,164 \times 365}{149,500}$ = 46.8 days

Receivables Collection Period Trade Receivables x 365 Sales Revenue*	$\frac{61,475}{350,000} \times 365$ = 64.1 days	$\frac{38,815}{230,000} \times 365$ = 61.6 days
Payables Settlement Period Trade Payables x 365 Cost of Sales*	$\frac{25,980}{227,500} \times 365$ = 41.7 days	$\frac{18,164}{149,500} \times 365$ = 44.3 days
∴ Cash Operating Cycle =	42.8 + 64.1 – 41.7 = 65.2 days	46.8 + 61.6 – 44.3 = 64.1 days

There has only been a marginal improvement in the cash operating cycle between 2015 and 2016. The receivables collection period has improved slightly, probably due to better implementation of credit control policies and procedures, although still disappointing if agreed terms are 30 days. Inventory items are taking longer to move, caused by poor inventory management in holding proportionately higher levels of inventory during, as in this case, a downturn in sales.

Suppliers have not managed to get their invoices paid quicker in 2016 on average, although the delay of just over two days is not likely to be critical where credit terms are being broadly adhered to. The organisation is still not in a favourable position here. They are making payment to their suppliers before payment for sales is received and are funding the cash requirement meanwhile. Whilst the 2015 bank overdraft has apparently been repaid, the company is over £29,000 worse off in cash terms in 2016.

- ii) Examples of how good cash flow can be maintained include ideas based on:
- implementing and maintaining strict credit control policies and procedures for new and existing customers
 - vetting customers thoroughly including checking, validating and follow up references
 - setting and monitoring credit limits and terms, and ensuring they are adhered to
 - swift query resolution and constant liaison with customers
 - following up slow or non-paying customers
 - preparing detailed aged receivables schedules/reports and holding regular meetings with the credit control team

c) Organisation categorisation:

Ratio	ABC Limited	XYZ Limited
Current ratio	1.7:1	1.0:1
Acid test	0.9:1	0.7:1
Receivables collection period	47.0 days	3.0 days
Payables settlement period	67.0 days	51.0 days
Inventory turnover rate	43.0 days	16.0 days
Financial gearing	65.0%	12.0%

ABC Limited is probably a heavy engineering business, as although the liquidity ratios are a little on the low side, they are close to acceptable limits of 2.0: 1 (CR) and 1.0: 1 (AT). Receivables, Payables and Inventory days all point to this, and also that most sales are seemingly on credit. Receivables are typical of this sector and Payables are quite high. There is a significant amount of borrowing as suggested by the higher gearing ratio, but this is not too excessive.

XYZ Limited's ratios suggest that it sells mostly on cash terms with low working capital and liquidity ratios supporting the contention that this organisation is a probably a supermarket. Inventory turnover is quicker and Payables are paid close to two months after invoice. The Gearing ratio is low indicating that there is scope for more borrowing if required.

Total 20 marks

Most learners handled this question quite well for an item that has been on this unit's syllabus for some time. In part a)i), the definition of the cash operating cycle was satisfactorily addressed with most offering a clear definition. There were a few issues in part a)ii) which sometimes did not clearly show how important monitoring measurements are for management of working capital.

The vast majority of candidates could calculate parts of the cycle in part b)i) with full marks being awarded in many cases, but inventory turnover rates still caused a problem for a few. The organisational performance narrative in b)i) varied considerably from candidate to candidate, with many offering a sound commentary, but a few offering no comments at all. Learners could have made reference to inventory management and credit control in this context. Much the same could be said with the handling of b)ii) as more detail was required regarding how cash flow could be improved by looking at credit control, processes and procedures.

In part c), most candidates identified the two sectors that each cited organisation probably belonged to, but a common failing was to not justify their reasoning using the supplied ratios cited in the question.

2. a) With regard to accounting rules, explain what you understand by the expression 'dual aspect concept' (or 'duality concept'). (4 marks)
- b) Martha's Muffins is a small high street business selling various cakes and pastries. The following account balances were brought forward on 1 January 2017:

Account Name	Ledger Name	Balance £
Bank	?	(400.00)
Rent and Rates	?	(45.00)
Sales Revenue	?	(1,145.00)
Purchases	?	850.00
M Smith	?	(1,385.50)
J Jones	?	2,600.00
VAT	?	450.00

During the first week of January 2017, the following transactions were recorded:

January 1	Sales on credit for J Jones for £950.00 plus VAT.
January 2	Paid rent and rates outstanding balance by cheque.
January 3	A credit note was received from M Smith for £300.00 including VAT.
January 4	J Jones paid £3,500.00 by cheque in full and final settlement of the amount outstanding. Treat any balance remaining as a discount. <i>NOTE: Ignore VAT; there are no VAT implications</i>
January 5	Purchased additional inventory from M Smith on credit for £450.00 plus VAT.
January 7	Martha took £300.00 out of the business bank account for her own personal use.

TASKS for part b)

Write up Martha's Muffins' books for the first week of January 2017, ensuring you accurately:

- i) Open ledger accounts as required and correctly record the 'brought forward' balances on 1 January 2017.

- ii) Using the ledger accounts already opened and opening others as required, correctly record the six transactions which took place between 1 January and 7 January 2017. (12 marks)

- c) Explain the key differences between 'bookkeeping' and 'accounting'. (4 marks)

Total 20 marks

Question aims

To test candidates' knowledge and understanding of how accounting regulations and concepts impact on the nature, form and control of final accounts.

To test candidates' ability to open the appropriate individual ledger accounts with the correct balances and then post transactions to each using a double-entry system of bookkeeping.

To test candidates' knowledge and understanding of the key differences between bookkeeping and accounts.

Suggested grounds for response include:

- a) The regulatory framework of the accounting profession provides the rules that accountants should follow when preparing the final accounts of a business.

The **dual aspect** concept (or **duality** concept) states that there are two aspects of accounting. One represented by the assets for the business and the other by the claim against them. Put another way, each financial transaction is recorded by two equal and opposite transactions – one on the credit side and the other on the debit.

Double-entry bookkeeping is an example of the duality or dual aspect concept.

- b) Accounts necessary to record required transactions:

Account: Bank CB						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					(400.00)
2 January	Rent and Rates NL			45.00		(445.00)
4 January	J Jones SL	3,500.00				3,055.00
7 January	Drawings NL			300.00		2,755.00

Account: Rent and Rates NL						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					(45.00)
2 January	Bank CB	45.00				0.00

Account: Sales Revenue NL						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					(1,145.00)
1 January	J Jones SL			950.00		(2,095.00)

Account: Purchases NL						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					850.00
5 January	M Smith PL	450.00				1,300.00

Account: M Smith PL						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					(1,385.50)
3 January	Purchases Returns NL	300.00				(1,085.50)
5 January	Purchases NL			540.00		(1,625.50)

Account: J Jones SL						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					2,600.00
1 January	Sales Revenue NL	1,140.00				3,740.00
4 January	Bank CB			3,500.00		240.00
4 January	Discount Allowed NL			240.00		0.00

Account: VAT NL						
Date	Details	Dr		Cr		Balance
1 January	Balance b/fwd.					450.00
1 January	J Jones SL			190.00		260.00
3 January	M Smith PL			50.00		210.00
5 January	M Smith PL	90.00				300.00

Account: Purchases Returns NL						
Date	Details	Dr		Cr		Balance
3 January	M Smith PL			250.00		(250.00)

Account: Discount Allowed NL						
Date	Details	Dr		Cr		Balance
4 January	J Jones SL	240.00				240.00

Account: Drawings NL						
Date	Details	Dr		Cr		Balance
7 January	Bank CB	300.00				300.00

- c) **Bookkeeping** is the initial recording in financial terms of business transactions in the books and records of that business, the financial effect of such transactions, and managing and maintaining these records. This work takes place in ledger accounts, and is backed up by documentation. Details of the bookkeeper's work can be extracted and used in accounting. The border between bookkeeping and accounting is generally accepted to be the drawing up of the Trial Balance.

Accounting takes the information compiled by the bookkeeper and then presents it to the owner as management information (management accounting, budgeting and costing, decision-making) and/or in a specified formats governed by accounting standards and conventions as performance information (financial accounting, such as Income Statements, Statements of Financial Position, or Cash Flow Statements).

Total 20 marks

Probably the best answered question on the paper. Part a) was addressed well by the majority of learners, and the better ones developed their arguments by making a distinction between assets and liabilities in the context of the question.

All candidates could make a bold attempt at the double entry part of the question in b). Whilst many learners secured near maximum/maximum marks here, there still remains confusion for some regarding the double entry for drawings, sales returns and purchases returns and the entries for VAT. Also, a noticeable number of candidates had a habit of indicating an account nil balance by just leaving it blank or entering a dash ' – '; learners should insert a '0' figure, i.e. a zero, when this is the case and tutors may need to instruct their learners accordingly. Most used the account ledger templates available in current CICM supplied Answer Script booklets, although there were still some hand-drawn ledger accounts. In the future, the examining team anticipate candidates will cite alongside each individual account name what part of the ledger it is attached to, i.e. namely, sales ledger, purchase ledger, cash book or the nominal ledger, consistent with current CICM study materials.

Most secured some marks in part c) though in many cases there was a lack of detail and examples as to the key differences between bookkeeping and accounting.

- 3) a) i) Explain **two** reasons why organisations prepare budgets. (2 marks)
- ii) Explain why a cash budget is important in any business. (2 marks)
- b) The following information is given to you about 'Manufacturer X'.

Table 1 is taken from its **cash budget** for the last three months of 2016:

Table 1: Cash Budget 4 th Quarter 2016	October £000	November £000	December £000
Receipts			
From cash sales	1,500	1,200	1,200
From credit sales	1,200	1,150	1,200
	2,700	2,350	2,400
Payments			
Wages	80	70	80
Raw materials	1,700	1,700	1,800
Rent and rates	150	150	150
Electricity	200	240	260
Administration	128	140	145
	2,258	2,300	2,435
Summary			
Opening balance	20	?	?
Net cash flow	?	?	?
Closing balance	?	?	?

Table 2 relates to the **actual cash flows** arising from the budgeted activities, as this data is now available:

Table 2: Actual Cash Flows 4 th Quarter 2016	October £000	November £000	December £000
Receipts			
From cash sales	1,550	1,230	1,275
From credit sales	1,150	1,050	1,170
	2,700	2,280	2,445
Payments			
Wages	90	80	90
Raw materials	1,650	1,600	1,700
Rent and rates	160	160	160
Electricity	220	250	280
Administration	120	130	125
	2,240	2,220	2,355
Summary			
Opening balance	20	?	?
Net cash flow	?	?	?
Closing balance	?	?	?

Table 3 is a **Variance Control Sheet** between actual and budgeted cash flows and the budgeted 4th Quarter totals have already been transferred to it:

Table 3: Variance Control Sheet 4 th Quarter 2016	Budgeted £000	Actual £000	Variance £000	Fav/Adv.?
Cash sales receipts	3,900	?	?	?
Credit sales receipts	3,550	?	?	?
Wages	230	?	?	?
Raw materials	5,200	?	?	?
Rent and rates	450	?	?	?
Electricity	700	?	?	?
Administration	413	?	?	?

TASKS for part b)

- i) Plainly copy the Summary Template for Table 2 (below) into your Examination Response Book and accurately complete it there as appropriate. (4 marks)

Table 2 Actual Cash Flows Summary	October £000	November £000	December £000
Opening balance	20		
Net cash flow			
Closing balance			

- ii) Plainly copy the Template for Table 3 (below) into your Examination Response Book. Accurately complete it there in respect of the actual 4th quarter totals and the resulting variances as appropriate. (8 marks)

Table 3: Variance Control 4 th Quarter 2016	Budgeted £000	Actual £000	Variance £000	Show if Fav/Adv.
Cash sales receipts	3,900			
Credit sales receipts	3,550			
Wages	230			
Raw materials	5,200			
Rent and rates	450			
Electricity	700			
Administration	413			

- c) Offer a realistic suggestion for each variance you highlight as to factor(s) which might have caused the differences between the budgeted and actual figures. (4 marks)

Total 20 marks

Question aims

To test candidates' knowledge and understanding of the nature and purpose of cash budgets and their importance to business.

To test candidates' ability to assess the variances between actual figures and budgeted figures.

Suggested grounds for response include:

- a) i) The two major reasons why budgets are prepared are:
- **Planning.** A business will be more efficient and profitable if it plans its activities in advance.
 - **Control.** A business can exercise control over its costs if budgets are accurate and concise.
- ii) Organisations might be highly profitable, but if they do not have enough cash to pay their bills as and when they fall due, then they would easily be forced to cease trading. A cash budget highlights the amounts expected to be received and paid out and more importantly the timings of these.

Properly prepared cash budgets can pinpoint when there might be an excess of outgoings so the organisation can take steps to secure temporary funds by transferring them from elsewhere or through an overdraft facility, or plan investment of anticipated surpluses.

- b) i) Table 2 Actual Cash Flow Summary

Table 2: Actual Cash Flows 4th Quarter 2016	October £000	November £000	December £000
Receipts			
<i>From cash sales</i>	1,550	1,230	1,275
<i>From credit sales</i>	1,150	1,050	1,170
	<hr/> 2,700	<hr/> 2,280	<hr/> 2,445
Payments			
<i>Wages</i>	90	80	90
<i>Raw materials</i>	1,650	1,600	1,700
<i>Rent and rates</i>	160	160	160
<i>Electricity</i>	220	250	280
<i>Administration</i>	120	130	125
	<hr/> 2,240	<hr/> 2,220	<hr/> 2,355

Table 2: Actual Cash Flows 4 th Quarter 2016	October £000	November £000	December £000
Summary			
Opening balance	20	480	540
Net cash flow	460	60	90
Closing balance	480	540	630

ii) Variance between actual and budgeted cash flows:

Table 3: Variance Control Sheet 4 th Quarter 2016	Budgeted £000	Actual £000	Variance £000	Fav/Adv.?
Cash sales receipts	3,900	4,055	155	F
Credit sales receipts	3,550	3,370	(180)	A
Wages	230	260	(30)	A
Raw materials	5,200	4,950	250	F
Rent and rates	450	480	(30)	A
Electricity	700	750	(50)	A
Administration	413	375	38	F

c) Possible reasons for variances include, among other acceptable ideas:

- Improvement in cash sales – perhaps some customers have taken advantage of suddenly discounted prices, cash only sales campaign or special offer?
- Under target collections from credit sales – poor cash collection activities, policies and procedures
- Wages higher than budgeted – perhaps caused by unplanned overtime due to machine breakdown, etc. Labour could have secured a pay rise during the time period under pressure from trade union activity.
- Lower raw materials costs than expected – perhaps through more efficient use of materials, less wastage (better quality than expected) or anticipated price increase lower than feared or negotiated down.
- Rent and rates increase caused by unexpected bill for services or change of landlord followed by unexpected rent review.
- Electricity higher than planned which might be related to above issues or unexpected price hikes by the utilities
- Administration costs shows a favourable movement – perhaps related to efficiency savings in the department by reducing costs and waste

Total 20 marks

Contrarily, Question 3 was probably the least well answered overall. There were only a few candidates who could cite in part a)i) both main reasons why budgeting is undertaken and budgets prepared by businesses, although the majority made a bold attempt at it. With regard to a)ii), most candidates highlighted the importance of cash and liquidity for any organisation, but better responses indicated some context of timing and how planning cash inflows and outflows is crucial for any organisation's functioning.

The actual compilation of the cash budget was well handled in b)i) with many securing near full/full marks, but it was part b)ii) that tended to be problematic with some. Where so, there was confusion surrounding adverse and favourable variances, with a few unfortunately expressing them the wrong way round.

However, the major problem for the vast majority of candidates was part c) which required some evaluation and analysis gleaned from part b). As indicated previously, an understanding of the numbers is as important as the practical numerical tasks, so candidates do well to be prepared for this and practice those skills. Reasoning as to why some variances might have come about, such as causes of poor credit control or better use of raw materials, was required, but was lacking in many instances, and good reward was difficult for short responses such as 'less inventory used'. Management accounting is an important part of the syllabus and will continue to feature in future examinations..

4. a) Explain why profit is not the same as cash, supporting your response with appropriate examples. (4 marks)

b) A trial balance has been extracted from the books of Real Trading Solutions (an unincorporated business) as at 31 December 2016 and is given below:

Real Trading Solutions	DR	CR
	£	£
Purchases and Sales Revenue	45,000	97,500
Opening Inventory	19,000	
Rent and Rates	1,750	
Discounts	850	950
Returns	1,260	1,450
Wages and Salaries	13,600	
Bad debts written off	1,250	
Carriage in	650	
Carriage out	475	
Gas and electricity	950	
VAT		12,000
Trade Receivables and Trade Payables	14,500	10,750
Bank	13,000	
Capital		16,385
Drawings	3,950	
Motor Vehicles at cost	20,000	
Provision for depreciation [Accumulated depreciation]: Motor Vehicles		8,000
Fixtures and fittings at cost	50,000	
Provision for depreciation [Accumulated depreciation]: Fixtures and fittings		5,000
Loans [Long term]		34,000
Allowance for doubtful debt		1,000
Advertising	800	
	187,035	187,035

TASKS for part b)

You are required to prepare an Income Statement for the year end taking into account the trial balance opposite and the following information as appropriate:

- Closing inventory at year end has been valued at £14,500
 - £250 of the rent and rates figure refers to the quarter ending 31 March 2017
 - At the 31 December 2016 there is unpaid gas and electricity of £150
 - Depreciation of motor vehicles needs accounting for at 10% using the diminishing [reducing] balance method
 - Fixtures and fittings should be depreciated at 2½% of their original cost
 - A revised allowance for doubtful debts in 2017 has been agreed at £725. (12 marks)
- c) "If a Trial Balance 'balances', then the accounting entries must be correct". Say whether this statement is true or false, explaining your answer. (4 marks)

Total 20 marks

Question aims

To test candidates' knowledge and understanding of the importance of a trial balance in assessing the accuracy of the double-entry transactions.

To test candidates' understanding of the nature, form and structure of the Income Statement, including adjustments.

Suggested grounds for response include:

- a) Profit is not the same as cash. Profit is (e.g.) sales minus costs of sales, whereas cash is a current asset. For instance if goods are sold on credit this creates sales revenue but no cash is received. The business makes credit sales thus creating trade receivables. Costs of sales are entered to the relevant ledger accounts, but are accounted for in the income statement when they are incurred or the sale made, not when the cash is actually paid. Similarly, a business will buy goods on credit creating trade payables, not cash flows. Expenses such as depreciation are charged to the income statement in order to reduce operating profits, but have no impact upon cash or cash flows.

b) **Real Trading Solutions Income Statement for the year ended 31 December 2016**

	£	£	£
Sales Revenue			97,500
less Sales Returns			1,260
			<u>96,240</u>
Less cost of sales			
Opening Inventory		19,000	
Purchases	45,000		
less Purchases Returns	1,450		
	<u>43,550</u>		
plus Carriage in	650	44,200	
		<u>63,200</u>	
less Closing Inventory		14,500	48,700
Gross Profit			<u>47,540</u>
plus Additional Income			
Discount received			950
Reduction in Allowance for doubtful debt			275
			<u>48,765</u>
less Expenses			
Discount Allowed		850	
Rent and Rates		1,500	
£1,750 [- PPR £250]			
Wages and Salaries		13,600	
Bad Debts [written off]		1,250	
Carriage out		475	
Gas and Electricity		1,100	
£950 [+ ACP £150]			
Advertising		800	
Depreciation for:			
Motor Vehicles		1,200	
Fixtures and Fittings		1,250	22,025
Net Profit			<u><u>26,740</u></u>

- c) This statement is not true. A trial balance is a list of all ledger accounts and their balances at a specific date, which is prepared to check the arithmetical, not the technical, accuracy of the bookkeeping entries.

The total of all the debits may well equal all the credits but this does not confirm that there are no errors or incorrect postings at all. Certain errors (for example, such as those of commission, omission, principle, original entry, reversal, and compensating errors) may have taken place, but the trial balance would not detect them because they would never imbalance the Dr and Cr columns with each other.

Consequently, the trial balance may 'balance' because it is arithmetically correct, but still potentially contain no, several, or many accounting and bookkeeping errors.

Total 20 marks

For part a), many responses did mention profit and cash, but talked about the two in a general way without any real contrast or with the examples the task requested. Again, a reminder that the best chance of good marks is to ensure that responses stick to the centre of the set task. Better marks here were secured by mention for example that a credit sale impacts on sales revenue and therefore profits, but has no immediate impact on cash, or, maybe, that depreciation is an expense impacting upon profit, but not on cash.

Most candidates had a reasonable idea of the layout of an income statement for a sole trader in part b), and several candidates did very well, but unfortunately, there were still some basic errors to be seen. An appropriate heading for financial statements as stated is necessary in all cases, as is labels for individual items. Discount allowed and discount received can be confused and misposted, as can purchases and sales returns. Many were correctly presented here, but some were not. Changes in allowances for doubtful debts, especially as in this instance when the allowance decreases year-on-year and has a positive impact on net profit, was not handled particularly well, and sometimes current liabilities found their way onto the income statement. However, on a more positive note, there are many instances where full marks were awarded which was pleasing to witness.

Concerning part c), most learners identified that the statement was not correct and then cited a number of errors that would not be picked up from a trial balance construct – errors of commission, omission, original entry, etc. Only a handful of candidates could offer comment why these would not affect the trial balance figure.

5. a) Explain the meaning of the word **capital** from an accounting perspective, and describe the differences between the capital of a sole trader and the equity of an incorporated business. (4 marks)

b) Gill Bates has decided to start a business selling specialist computer software and has secured a £30,000 loan from her bank.

She buys shop premises for £60,000 and fits it out for £25,000. She also purchases a second-hand van costing £7,500 and inventory for £18,000.

Today, the first day of trading, Gill has £1,900 in the bank, £175 cash in the till and owes £2,750 to her inventory suppliers.

TASKS for part b)

i) Calculate the capital that Gill has introduced into her business. (5 marks)

ii) Using the available information, draw up a Statement of Financial Position for Gill's business as at today's date. (7 marks)

c) How does the accounting treatment of capital expenditure differ from that of revenue expenditure? (4 marks)

Total 20 marks

Question aims

To test candidates' knowledge and understanding of the specific definition of **capital** from an accounting perspective.

To test candidates' understanding of the broad differences in the capital composition of incorporated and unincorporated businesses

To test candidates' appreciation of the importance of the accounting equation and its key components.

To test candidates' understanding of the structure and composition of a Statement of Financial Position.

To test candidates' knowledge of the difference and accounting treatment of capital and revenue expenditure.

Suggested grounds for response include:

a) **Capital** is the amount of money invested in the business by the owner, or owners. The amount is owed by the business to the owner(s). Reference to the business entity concept might be apt here. It is unlikely to be paid back whilst the business continues its operations and whilst invested, it facilitates profits or other returns on investment for the owner(s) through the business.

For a sole trader the capital initially would come from the owner's savings or loans from financial institutions or from friends and relatives. As the business expands it can be added to with profits and reduced with losses. For limited companies its capital will commonly consist of share equity, reserves and retained profits/earnings.

b) i) Capital calculation

Assets	£
Shop Premises	60,000
Fixtures and fittings	25,000
Van	7,500
Inventory	18,000
Bank	1,900
Cash	175
	<u>112,575</u>
Liabilities	£
Bank loan	30,000
Trade Payables	2,750
	<u>32,750</u>
= Capital	112,575 - 32,750 = £79,825

b) ii) **Gill Bates's Software Business Statement of Financial Position as at 16 January 2017**

	£	£	£
Non-current assets			
Premises			60,000
Fixtures and fittings			25,000
Van			7,500
			<u>92,500</u>
Current assets			
Inventory	18,000		
Bank	1,900		
Cash	175	20,075	
	<u>20,075</u>		
Less current liabilities			
Trade Payables	2,750	2,750	
	<u>2,750</u>		
Net current assets/working capital			17,325
			<u>109,825</u>

Less Non-current liabilities

Loan	30,000
Net assets	<u>79,825</u>

Financed by

Capital	79,825
	<u>79,825</u>

- c) **Revenue expenditure** is incurred in the day-to-day running of a business, such as wages, salary, rent and rates, and in purchases of inventory, a current (short term) asset. These costs and expenses are normally paid from available cash flow or short term overdrafts, and are debited to relevant expense ledger accounts. Inventory costs appear within the costs of sale and influence Gross Profit. Since business expenses normally have no long term benefit beyond the current year, and are intended to generate short term benefits, they appear and are charged to the Income Statement.

Capital expenditure is the purchase of non-current assets, including the cost of organisation and installation, or additions to existing non-current assets. Non-current assets are shown on the Statement of Financial Position normally at cost price. Since they are held over several reporting periods and for long term benefit, they are subject to wear and tear over time, and obsolescence, etc. Consequently, prudence determines that an annual charge (expense) for their depreciation is shown on the Income Statement and that the Statement of Financial Position shows the depreciation to date and the asset's net carrying value, its current value to the business as determined by accounting convention.

Total 20 marks

Part a) was answered well by the vast proportion of learners though many looked at the concept from a sole trader perspective, and ignored equity and reserves as capital from an incorporated business standpoint.

Part b)i) was answered well in the main although some made hard work of calculating capital in the business. By applying the accounting equation, identifying and adding up all the assets and then identifying and subtracting all of the liabilities, would result in arriving at the unknown capital figure. In that task b)i) was 'Calculate the capital...' it was regrettable that a very few responses merely identified the end-figure without any supporting calculation. The Statement of Financial Position required in part b)ii) was generally well constructed, but there were still a few responses with no meaningful heading, a few issues with structure and content, and a lack of labelling.

Happily, most candidates secured some marks with part c), although in the rare instance, the distinction between revenue and capital expenditure was wholly incorrect.

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