



General Certificate of Education

Applied Business 8616/8619

BS15 Financial Accounting for Managers

Mark Scheme

2007 examination - January series

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	Assessment Objectives
	The Assessment Objectives represent those qualities which can be demonstrated in candidates' work and which can be measured for the purposes of assessment.
AO1 Knowledge, skills and understanding	Candidates demonstrate knowledge and understanding of the specified content and relevant business skills.
AO2 Application of knowledge, skills and understanding	Candidates apply knowledge and understanding of the specified content and relevant business skills.
AO3 Research and analysis	Candidates use appropriate methods in order to obtain and select information from a range of sources to analyse business problems.
AO4 Evaluation	Candidates evaluate evidence to reach reasoned judgements.
Quality of Written Communication	<p>The quality of written communication is assessed in all assessment units where candidates are required to produce extended written material. Candidates will be assessed according to their ability to:</p> <ul style="list-style-type: none"> • select and use a form and style of writing appropriate to purpose and complex subject matter • organise relevant information clearly and coherently, using specialist vocabulary when appropriate • ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear. <p>The assessment of the quality of written communication is included in Assessment Objective 4.</p>

1

Total for this question: 17 marks

(a) (i) Using **Item A**, complete the invoice below and calculate the correct value that FFG should send to Better Homes for the garden furniture ordered on 2 November 2006. (3 marks)

	£	p	
Garden furniture	20000	00	
Less 5% trade discount	1000	00	(1)
Sub total	19000	00	
Add VAT @ 17.5%	3325	00	(1) OFR
Total	22325	00	(1) OFR

(ii) On 12 November 2006, Better Homes returned garden furniture worth £600 to FFG because it had been damaged in transit to Better Homes.

Which financial document would FFG use to deal with this returned garden furniture? Explain the purpose of the document. (2 marks)

Relevant answers might include the following:

- FFG will use a credit note to refund the cost of the damaged items
- a credit note will reduce the amount that is owed by *Better Homes* as the goods have been sold on credit and as yet no money has changed hands.

States credit note (1 mark). Defines credit note (1 mark).

(b) On the 30 November 2006, FFG sent a Statement of Account to Better Homes.

(i) Explain, with reference to the transactions in (a)(i) and (a)(ii), the purpose of this document. (2 marks)

Relevant answers might include the following:

- to indicate how much *Better Homes* owes *FFG*
- summary of all invoices and credit notes outstanding.

Level	Descriptor	Marks	Assessment Objective
2	Explains purpose of document.	2	AO1
1	States purpose of document.	1	

(ii) Calculate the amount *Better Homes* now owes *FFG*. (1 mark)

£22325 - £600 = £21725 (1)

OFR applies

(c) Explain why it is important to *FFG* to ensure that its financial documents are accurate when selling garden furniture to *Better Homes*. (3 marks)

Relevant answers might include the following:

- to ensure good relationships with customer *Better Homes*. If the customer is not happy then they may stop buying from *FFG*. This is an important contract and if the customer is lost it could have devastating effects for the business
- to ensure that payment is received on time from *Better Homes*. Incorrect financial documents will mean that mistakes will need to be corrected and this will take time. *FFG* is already holding high stock levels which could mean that the business could have solvency problems.

Level	Descriptor	Marks	Assessment Objective
3	Fully explains reason for importance.	3	AO1
2	Partially explains reason for importance.	2	
1	States reason for importance.	1	

(d) The flow chart below shows how a recent transaction at FFG would have been recorded in the business's accounting system.

Complete the flow charts for the situations set out below by filling in the shaded boxes with the correct information. (6 marks)

Transaction	Book of Original Entry	Ledger Account involved	Where the account appears in Final Accounts
(i)			
Sale of stock on credit	Sales Book (1)	Sales Account	Trading Account (1) (Profit and Loss Account)
		Debtors Account (1)	Balance Sheet – current asset
(ii)			
Purchase of new equipment by cheque	Cash Book	Equipment Account (1)	Balance Sheet – fixed asset (1)
		Bank Account (1)	Balance Sheet – current asset

2

Total for this question: 26 marks

(a) *Identify and explain the effect of **one** error that could be made in the books of FFG that would **not** be identified by the preparation of a trial balance. (3 marks)*

Types of error might include the following:

- error of commission: when one or both double entries is entered in the correct class of account but entered in the wrong account
- error of omission: when both double entries required for a transaction are completely omitted from the books of account
- error of principle: when one or both double entries are made in the wrong class of account
- compensating error: where one mistake exactly cancels out the effect of the second mistake
- error of original entry: where the double entry is made but using the wrong figure
- reversal of entries: where the double entries are made in the correct accounts using the correct amounts, but the amount to be debited is credited and the amount to be credited is debited.

Level	Descriptor	Marks	Assessment Objective
3	Fully explains error.	3	AO1
2	Partially explains error.	2	
1	States error.	1	

(b) *An amount for distribution expenses of £5000 was outstanding at 31 December 2006. Calculate the amount for distribution expenses that should be included in the profit and loss account. Show your workings. (2 marks)*

Distribution expenses £15000 (1) + £5000 = £20000 (1)

Award 2 marks for correct answer, ie £20000 shown.

(c) *The amount for insurance in the trial balance included £6000 for the following year. Calculate the amount for insurance that should be included in the profit and loss account for the year ending 31 December 2006. Show your workings. (2 marks)*

Insurance £18000 (1) – £6000 = £12000 (1)

Award 2 marks for correct answer, ie £12000 shown.

(d) *The machinery was bought on 1 January 2006.*

FFG expects the machinery listed in the trial balance to have a working life of four years and it will have no re-sale value when disposed of.

The machinery is to be depreciated using the straight-line method.

Calculate the amount that should be charged for the depreciation of machinery in the profit and loss account for the year ending 31 December 2006. Show your workings. (2 marks)

£180000 (1) / 4 = £45000 (1)

Award 2 marks for correct answer, ie £45000.

(e) Complete the Manufacturing and Trading and Profit and Loss Account below. Use **Item B** and the answers that you calculated in questions **2(b)**, **(c)** and **(d)**.

The information should be entered in the shaded boxes.

(3 marks)

Furniture for Gardens Ltd
Manufacturing and Trading and Profit and Loss Account
for the year ending 31 December 2006

	£	£
Stock of raw materials at 1 January 2006	40 000	
Add purchases of raw materials	450 000	
	490 000	
Less stock of raw materials at 31 December 2006	50 000	
Cost of raw materials consumed	440 000	
Direct labour	90 000	
Prime cost	(1)530 000	
Factory power	55 000	
Depreciation of factory machinery	45 000	
Production cost of goods completed	630 000	
Turnover		820 000
Less cost of sales:		
Stock of finished goods at 1 January 2006	50 000	
Production cost of goods completed	630 000	
	680 000	
Less stock of finished goods at 31 December 2006	75 000	(1) 605 000
Gross profit		215 000
Less expenses:		
Office salaries	75 000	
Insurance	12 000	
Distribution expenses	20 000	
Administration expenses	18 000	(1) ofr 125 000
Net profit		90 000

(f) Complete the Balance Sheet below. Use the information from the answer that you calculated in question 2(d).

The information should be entered in the shaded boxes.

(4 marks)

Furniture for Gardens Ltd
Balance Sheet as at 31 December 2006

	Cost £	Total depreciation £	Net Book Value (NBV) £
Fixed assets:			
Premises	295 000	–	295 000
Machinery	180 000	45 000	(1) ofr 135 000
			(1) ofr 430 000
Current assets:			
Stocks			
Raw materials	50 000		
Finished goods	75 000		
Debtors	140 000		
Expenses prepaid	6 000	271 000	
Less Current liabilities			
Trade creditors	85 000		
Bank overdraft	64 000		
Expenses owing	5 000	154 000	(1) 117 000
Net total assets			(1) ofr 547 000
Financed by:			
Share capital at 1 January 2006			457 000
Add net profit			90 000
Capital employed			547 000

(g) *The Sales Director of FFG is concerned that stocks of finished goods have been valued at cost price. She has suggested that if these stocks had been valued at selling price then both profits and asset values would be higher.*

Why should stocks of finished goods be valued at cost price? Use accounting concepts to justify your answer. (10 marks)

Answers could include reference to the following accounting concepts:

- prudence – it is better to anticipate losses than profits. The prudence concept implies that it is better to anticipate losses than profits. Valuing stock at selling price would be anticipating a profit as it would assume that the stock of goods would be sold. This could result in both profits and assets being overvalued. This could mean that managers could make incorrect decisions
- consistency – the continued adoption of policies for dealing with financial records. Misleading to change
- realisation: where revenue is regarded as having been received only when the ownership of goods are exchanged
- accruals (or matching): the matching of costs and revenues to the final accounts in which goods and services were used.

Analysis could include the use of calculations to illustrate the effects on profits.

Level	Descriptor	Marks	Assessment Objective
3	Analyses why stocks should be valued at cost price.	4–5	AO3
2	Explains why stocks should be valued at cost price.	3	AO2
1	Identifies reason(s) why stocks should be valued at cost price.	1–2	AO1

For AO4, you should award marks using the grid below.

Note: AO4 also assesses candidates' quality of written communication. When deciding on the AO4 level to be awarded, consider the degree to which the candidate orders and communicates his/her ideas.

Level	Descriptor	Marks	Assessment Objective
3	Uses accounting concepts to fully justify why stocks should be valued at cost. Ideas are communicated in a coherent structure with consistent and appropriate use of technical terms. There are few errors in accepted conventions of written communication.	5	AO4 and Quality of written communication
2	Uses accounting concepts to partially justify why stocks should be valued at cost. Ideas are communicated in a logical structure, with some appropriate use of technical terms. There are occasional errors in accepted conventions of written communication.	3–4	
1	Some attempt to use accounting concepts to support reason why stocks should be valued at cost. Ideas are communicated with some structure evident with occasional use of appropriate technical terms. There are some errors in accepted conventions of written communication.	1–2	

3

Total for this question: 37 marks

Accounting ratios

Ratio		31/12/06	31/12/05
Efficiency	Stock turnover	9.68 times	12 times
	Debtors collection period	62 days	35 days
	Creditors payment period	69 days	28 days
	Asset turnover (sales/fixed assets)	1.91:1	3:1
Solvency	Current ratio	1.76:1	2.05:1
	Acid test ratio	0.95:1	1.32:1
Profitability	Gross profit margin	26.22%	20%
	Net profit margin	10.97%	8%
	Return on capital employed ratio	16.45%	15%

(a) *Both the Managing Director and the Purchasing Director of FFG have expressed concerns about the efficiency of the business.*

*Using **Item C**, to what extent do you agree with these concerns? Justify your answer. (8 marks)*

Relevant answers might include the following:

- the business sells its average stock 9.68 times per year so stock turnover is worse
- normal period of trade credit 28/30 days therefore debt collection high/bad
- taking a longer time to pay creditors may improve cash flow
- compared with previous years creditors payment period much slower/longer this year
- asset turnover is worse but this could be due to an installation settling down period rather than long-term issues
- the business is profitable which is arguably the most important thing, all these efficiency issues can be fixed.

Level	Descriptor	Marks	Assessment Objective
3	Uses Item C to judge the efficiency of <i>FFG</i> .	6–8	AO4
2	Uses Item C to analyse the efficiency of <i>FFG</i> .	3–5	AO3
1	Uses Item C to state an aspect of the efficiency of <i>FFG</i> .	1–2	AO2

(b) *The Financial Director of FFG has commented that the solvency position of FFG has weakened.*

*Using **Item C**, to what extent do you agree with his concern? Justify your answer.*

(8 marks)

Relevant answers might include the following:

- current ratio has fallen
- acid test has fallen below 1:1
- too much tied up in stock
- cash flow problem, but not major as the acid test ratio is only just below 1:1 creditors are unlikely to force the business into liquidation
- comparison with previous years, business is less solvent.

Better Homes contract has resulted in:

- longer credit period meaning taking longer to receive cash
- carrying more stock because of the order.

Level	Descriptor	Marks	Assessment Objective
3	Uses Item C to judge the solvency position of <i>FFG</i> .	6–8	AO4
2	Uses Item C to analyse the solvency position of <i>FFG</i> .	3–5	AO3
1	Uses Item C to state the solvency position of <i>FFG</i> .	1–2	AO2

(c) *The Sales Director does not pay attention to accounting ratios believing that the level of profit is the most important indicator of success.*

*Using **Item C**, to what extent do you agree with her view? Justify your answer.*
(9 marks)

Relevant answers might include the following:

In favour of the view of the Sales Director:

- ratios are not needed as the profit and loss account will show that the business has made a profit
- ratios do not tell everything about a business and have limitations.

Against the view of the Sales Director:

- ratios will give an indication of how profitable the business is not just whether it has made a profit or not
- making a profit is not enough for business success. Many profitable businesses close because of cash flow problems
- the ratios of *FFG* indicate a possible cash flow problem
- ratios can identify areas of weakness that can be improved.

Level	Descriptor	Marks	Assessment Objective
3	Uses Item C to judge the value of accounting ratios to <i>FFG</i> .	6–9	AO4
2	Uses Item C to analyse the value of accounting ratios to <i>FFG</i> .	2–5	AO3
1	States a reason for or against the value of accounting ratios to <i>FFG</i> .	1	AO2

(d) Using **Item C** and any other data, discuss the actions that could be taken to improve the financial performance of FFG. (12 marks)

Actions might include the following:

- try and collect debts more quickly. *Better Homes* has negotiated a period of 60 days' trade credit yet the actual debt collection period is higher so there is scope for chasing *Better Homes* as they are not sticking to the agreement
- may not be feasible to try and get the trade credit period down from 60 days as it may risk a very lucrative contract
- ensure that adequate overdraft facilities exist to ensure that there is no cash flow problem, even if high interest rate needs to be paid, the *Better Homes* contract will still be very profitable
- negotiate with suppliers to extend the period of credit received, the *Better Homes* contract will be making them money as well
- the business could consider its stock control, does it really need to hold as much stock? *FFG* should have a good idea of the demand for its products given that it has a major contract with *Better Homes*
- profit ratios are good so no action may be needed
- the profit ratios could be allowed to drop by less aggressively chasing sales and balancing profit v cash.

Actions taken in context would be proportionate to the problem.

Level	Descriptor	Marks	Assessment Objective
3	Analyses more than one financial problem.	5–6	AO3
2	Analyses a financial problem.	3–4	
1	Identifies a financial problem.	1–2	AO2

For AO4, you should award marks using the grid below.

Note: AO4 also assesses candidates' quality of written communication. When deciding on the AO4 level to be awarded, consider the degree to which the candidate orders and communicates his/her ideas.

Level	Descriptor	Marks	Assessment Objective
3	Evaluates actions. Ideas are communicated in a coherent structure with consistent and appropriate use of technical terms. There are few errors in accepted conventions of written communication.	5–6	AO4 and Quality of written communication
2	Judges the suitability of an action. Ideas are communicated using a logical structure, with some appropriate use of technical terms. There are occasional errors in accepted conventions of written communication.	3–4	
1	Supports an action. Ideas are communicated with some structure evident with occasional use of appropriate technical terms. There are some errors in accepted conventions of written communication.	1–2	