Higher Accounting

Exemplification with new terminology

This edition: January 2018, version 1.1

1 The following balances were extracted from the books of Uryside plc:

	Dr £000	Cr £000
Opening Inventory — Raw Materials	20	
Purchases of Raw Materials	140	
Factory Wages	180	
Royalties	20	
Depreciation of Factory Machinery		30
General Factory Expenses	60	
Factory Rent and Rates	31	
Factory Insurance	35	
Opening Inventory: Work-in-progress	12	
Sales Revenue		800
Sales Returns	20	
Opening Inventory: Finished Goods	40	
Carriage on Purchases of Raw Materials	20	
Purchases Returns on Raw Materials		5
Provision for Bad Debts		11
Office Expenses	36	
Selling Expenses	40	
Bad Debts	6	
Unappropriated Profit		14
Ordinary Dividend	6	
Property	215	
Equipment	100	
Provision for Depreciation Equipment		6
Factory Machinery	80	
Preliminary Expenses	9	
Share Premium		110
Investments	100	
Goodwill	30	
Trade Receivables	80	
VAT	11	
Trade Payables		50
Cash and Cash Equivalents		5
10% Debentures		60
100,000 7% Preference Shares of £1·00 each		100
100,000 Ordinary Shares of £1·00 each		100
	1,291	1,291

(1 continued)

NOTES AT 31 DECEMBER YEAR 5

1	Closing Inventory:	Raw Materials	£18,000
		Work-in-progress	£16,000
		Finished Goods	£55,000

2 Factory wages are to be split 80% direct factory wages, 20% indirect factory wages.

3 Market value of production is £500,000.

4 Office expenses prepaid — £4,000.

5 Selling expenses due — £10,000.

6 The provision for doubtful debts is to be adjusted to 10% of closing trade receivables.

7 Preliminary expenses are to be written down by transfer from the share premium account.

8 Non-current assets are to be depreciated as follows:

Factory Machinery 10% of the reduced balance
Equipment — 5% on cost

9 Property was professionally revalued at £250,000.

10 Dividends of £5,000 were owing on the quoted investments.

11 Provide for corporation tax at 25% of profit for the year.

12 Goodwill is to be written down by £20,000.

13 The preference dividend was paid in full by cheque, but omitted from the accounts in error.

You are required to **prepare** (for internal use)**,** from the trial balance and notes:

(a) Manufacturing Account for the year ended 31 December Year 5	**10**
(b) Income Statement for the year ended 31 December Year 5	**16**
(c) Statement of Financial Position as at 31 December Year 5	**14**
	(40)

2 The following budgeted data relates to the firm of Selbie plc, for the period July to December Year 2.

	July	August	September	October	November	December
Sales (units)	5,600	5,800	5,900	6,100	6,200	6,300

- Closing inventory at the end of each month is equal to the level of credit sales revenue of the following month.
- Credit Sales are 20% of total sales.

(a) **Prepare** the Production Budget for the period August to November. **4**

The following information is also available:

1. Cash balance at 1 September is expected to be £9,500
2. The retail selling price per unit will be £40:
   - Credit sales which are to trade customers, receive a 10% discount on the retail selling price.
   - Credit sales are paid one month after sale, however, 5% of the amounts due from these customers are expected to be bad debts.
3. A sales commission of £2·00 per unit is to be paid on all sales in the month of sale.
4. Unit costs will be as follows:
   - Materials £13 per unit, payable in the month **before** production.
   - Labour £14 per unit, payable in the month of production.
   - Variable overheads £8·00 per unit, 3/4 payable in the month of production and the remainder payable the month following production.
5. Fixed overheads, including depreciation of £2,000, are £6,000 per month.
6. New machinery is to be purchased in August for £100,000. This is to be repaid in four equal quarterly instalments, beginning in September.
7. 10,000 £1·00 shares are to be issued in August, at a premium of 50p per share. Full payment for the issue will be received in October.

(b) **Prepare** the cash budget for September and October. **14**

(c) Give **two** advantages, for a management accountant, of using a spreadsheet to prepare a cash budget. **2**

(20)

3 PART A

The following information is available for **two** companies:

	Barclay plc	**Harlaw plc**
Net Profit after Interest and Tax	£600,000	£200,000
Ordinary Shares of £1·00 each	£500,000	£250,000
5% Preference Shares	£400,000	
Ordinary Shares Market Price	£2·50	£4·00
Ordinary Dividend per share	10p	12p

(a) Calculate for **each** company:

(i) Dividend Yield **2**
(ii) Dividend Cover **2**
(iii) Earnings per share **2**
(iv) Price/earnings Ratio **2**

Answers should be given to **two** decimal places.

(b) Analyse the ratios calculated above and give advice to a potential investor. **4**

3 PART B

(a) Explain the steps necessary when admitting a new partner to a business. **4**

(b) Explain **four** duties of a financial accountant. **4**

(20)

4 The following data relates to Year 1 of the firm Daviot plc, which manufactures **three** luxury soft toys — Ellie, Leo and Bunny.

	Ellie	**Leo**	**Bunny**
Selling Price per unit	£16	£41	£40
Material Cost per unit	£4	£9	£12
Labour Cost per machine hour	£3	£2	£3
Variable Overheads per unit	£2	£2	£4
Machine Hours per unit	2	3	4
Sales and Production (units)	10,000	6,000	5,000

Annual Fixed Costs are £200,000

(a) **Calculate:**

(i) Total Machine Hours Worked in Year 1
(ii) Unit Contribution
(iii) Total profit for the Year 1 **9**

In Year 2, it is estimated that the total machine hours will be reduced by 10% and that the demand for unit sales of each product will continue at the same level as Year 1.

In Year 2, annual fixed costs will decrease by 20%.

(b) You are required to **calculate** for Year 2:

(i) Quantity of each product to be produced and sold to maximise profits

(ii) Increase/decrease in total profit

10

(c) Explain the term "opportunity cost" in relation to decision-making. **1**

(20)

Higher Accounting

Exemplification with new terminology: solutions

1 (a)

Uryside plc

Manufacturing Account for year ending 31 December Year 5

	£000		**£000**	
Raw Materials Cost				
Opening Inventory — Raw Materials			20	
Add Purchases of Raw Materials	140			
Add Carriage on Raw Materials	20	**(1)**		
	160			**(1)**
Less Purchases Returns	5		155	
			175	
Less Closing Inventory — Raw Materials			18	
COST OF RAW MATERIALS CONSUMED			157	
Add Direct Costs				
Direct Wages (80%)	144	**(1)**		
Royalties	20	**(1)**	164	
PRIME COST OF MANUFACTURE			321	
Add Factory Overheads				
Indirect Wages (20%)	36	**(1)**		
Depreciation of Factory Machinery	5	**(1)**		
General Factory Expenses	60			
Factory Rent and Rates	31	**(1)**		
Factory Insurance	35		167	
			488	
Add Inventory: Work-in-progress at start			12	
			500	**(1)**
Less Inventory: Work-in-progress at end			16	
FACTORY COST OF PRODUCTION			484	
Add Profit on Manufacture			16	**(1)**
WHOLESALE VALUE OF FINISHED GOODS			500	**(1)**

10

1 (b)

Uryside plc	**£000**		**£000**	
Income Statement for y/e 31 December Year 5				
Sales Revenue			800	
Less Sales Returns			20	
Net Sales Revenue			780	**(1)**
Less Cost of Sales				
Opening Inventory of Finished Goods	40*****			
WHOLESALE VALUE OF FINISHED GOODS	500	**(1)**		
	540			**(1)*both figures**
Less Closing Inventory of Finished Goods	55*****			
COST OF SALES			485	
Gross Profit			295	
Add Profit on Manufacture			16	**(1)**
			311	
Less Expenses				
Office Expenses (36 − 4)	32	**(1)**		
Selling Expenses (40 + 10)	50	**(1)**		
Bad Debts	6	**(1)**		
Debenture Finance Cost Due	6	**(1)**		
Provision for Depreciation: Equipment (5% × 100)	5	**(1)**	99	
			212	
Add Income				
Dividends Due on Investments	5	**(1)**		
Decrease in Provision for Bad Debts	3	**(1)**	8	
NET PROFIT BEFORE TAX			220	
LESS Corporation Tax (25%)			55	**(1)**
NET PROFIT AFTER TAX			165	
ADD Unappropriated Profit			14	**(1)**
			179	
Less Appropriations				
Preference Dividend (7% × 100)	7	**(1)**		
Goodwill Written Down	20			
Ordinary Dividend	6	**(1)**	33	
UNAPPROPRIATED PROFIT C/F			146	

Labels, headings and arithmetic **(1)**

16

1 (c)

Statement of Financial Position as at 31 December Year 5

	£000	**£000**		**£000**	
Non-current Assets					
Property	215	-35		250	**(1)**
Equipment	100	11		89	
Factory Machinery	80	35		45	**(1)**
Intangible Assets [Goodwill (30 − 20)]				10	
Investments				100	**(1)**
				494	
Current Assets					
Inventory		89	**(1)**		
Trade Receivables (80 − 8)		72	**(1)**		
Dividends Receivable		5			
General Expenses Receivable		4	**(1)**		
VAT		11	**(1)**		
		181			
Less Current Liabilities					
Trade Payables	50				
Debenture Finance Cost Due	6				
Corporation Tax Due	55	**(3)**	**(for each missing, reduce by 1)**		
Selling Expenses Payable	10				
Cash and Cash Equivalents	12	133			
WORKING CAPITAL				48	
TOTAL NET ASSETS				542	
Less Long-term Liabilities					
Debentures				60	**(1)**
				482	
EQUITY					
SHARE CAPITAL					
100,000 7% Preference Shares of £1·00 each		100			
100,000 Ordinary Shares of £1·00 each		100	**(1)**	200	
		with no/value			
RESERVES					
Share Premium (110 – 9)		101	**(1)**		
Equity Reserve		35			
Unappropriated Profit		146	**(1)**	282	
				482	

14

2 (a)

SELBIE PLC

	Jul	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
Credit Sales	1,120	1,160	1,180	1,220	1,240	1,260
Cash (Retail) Sales	4,480	4,640	4,720	4,880	4,960	5,040
Total Sales	5,600	5,800	5,900	6,100	6,200	6,300

PRODUCTION BUDGET	**Aug**	**Sep**	**Oct**	**Nov**		
Sales	5,800	5,900	6,100	6,200		
Less Opening Inventory	1,160	1,180	1,220	1,240	**(1) line**	
	4,640	4,720	4,880	4,960		
Add Closing Inventory	1,180	1,220	1,240	1,260	**(1) line**	
PRODUCTION	5,820	5,940	6,120	6,220	**(2) line**	
						4

UNIT DATA	**Cash**	**Credit**
Selling Price	£40	£36.00
Material	£13	
Labour	£14	
Variable Overheads	£8	
Sales Commission	£2	

(b) **CASH BUDGET — SEPTEMBER AND OCTOBER**

	Sep		**Oct**		
Opening Balance	9,500	**(1)**	-12,828		
RECEIPTS					
Cash Sales Revenue	188,800		195,200	**(1) line**	
Credit Sales Revenue	39,672	**(1)**	40,356	**(1)**	
Share Issue/Share Premium			15,000	**(1)**	
TOTAL RECEIPTS	228,472		250,556		
PAYMENTS					
Materials	79,560		80,860	**(1)**	
Labour	83,160		85,680	**(1)**	
Variable Overheads 3/4	35,640		36,720	**(1)**	
Variable Overheads 1/4	11,640		11,880	**(1)**	
Fixed Overheads	4,000		4,000	**(1)**	
New Machine	25,000	**(1)**			
Sales Commission	11,800	**(1)**	12,200	**(1)**	
TOTAL PAYMENTS	250,800		231,340		
Closing Balance	-12,828		6,388		
Layout, arithmetic, heading & closing balances				**(1)**	**14**

(c)

Possible answers at 1 mark each:

- Use of formulae to calculate figures, reduces human error.
- Can show the effects of “what if” scenarios in, for example, purchase of new fixed assets.
- Changes to any data in the spreadsheet are automatically updated with the use of formulae.
- Use of multiple worksheets to link statements.
- Use of templates from year to year. **2**

3 PART A

(a) (i) Dividend yield

		Barclay plc		**Harlaw plc**	
Ordinary dividend per share / Market price per share	x 100	0·10 * 100 / 2·5		0·12 * 100 / 4	
		4%	**(1)**	3%	**(1)**

(ii) Dividend cover

	Barclay plc		Harlaw plc	
PfY (NP) − pref div / Ord div	600,000 − (5% * 400,000) / 0.10*500,000		200,000 / 0.12*250,000	
	11.60 times	**(1)**	6.67 times	**(1)**

(iii) Earnings per share

	Barclay plc		Harlaw plc	
PfY (NP) − Pref div / No of ord shares	600,000 − 20,000 / 500,000		200,000 / 250,000	
	£1·16	**(1)**	£0·80	**(1)**

(iv) Price/earnings ratio

	Barclay plc		Harlaw plc		
Market price per shares / Earnings per share	£2·50 / £1·16		£4·00 / £0·80		
	2·16 times	**(1)**	5·00 times	**(1)**	**8**

(b)

Possible answers at 1 mark each:

- Barclay plc has a slightly better dividend yield than Harlaw plc, indicating that they have a better performance than Harlaw plc and that the client would receive a better return on their investment.
- The dividend cover shows that Crichic plc retains more of its profits in the business in reserves for reinvestment, which may benefit the investor with increased share price.
- If the investor is looking for income, Harlaw plc distributes more of its profits to the shareholders.
- Barclay plc shows better earnings per share than Harlaw plc, which may be a better indicator to potential investors than dividend yield or rate of dividend.
- It would cost 3·69 times its earnings to buy shares in Barclay plc but 4·57 times to buy Harlaw plc, so it would be a better time to purchase shares in Barclay plc.
- Taking into account all the above the best recommendation for a potential investor would be to invest in Barclay plc. **4**

PART B

(a) **Possible answers at 1 mark each:**

- Revaluation of assets.
- Sharing of any profit or loss on revaluation among existing partners.
- Valuation of goodwill.
- Sharing of goodwill among existing partners.
- Goodwill can be written off between the new partners.
- Update capital accounts.
- Revision of the partnership agreement to include the financial (**1 mark**) details of the new partner — and the new profit sharing ratio (**max 1 mark**) capital, drawings, interest on each, salary, premium for goodwill.

4

(b) **Possible answers at 1 mark each:**

- Reports to the owners of the firm the effect of managerial decisions on the performance of the firm.
- Keeps accurate records of the daily financial transactions of the firm.
- Checks the financial records to maintain accuracy and reduce fraud.
- Prepares periodic financial statements to show profit/loss, balance sheet, etc.
- Prepares accounts for auditing and publication, as and if required.
- Ensures that the firm is operating within the rules laid down by legislation from government or professional bodies.
- Taxation calculations.
- Ratio analysis.

4

4

(a)			Ellie		Leo		Bunny		Total			
	(i)	Machine Hours Per Unit	2		3		4					
		Production	10,000		6,000		5,000					
		Total Machine Hours	**20,000**		**18,000**		**20,000**		**58,000**		2	
	(ii)	Unit Contribution	£	£	£	£	£	£				
		Selling Price		16		41		40				
		Less Variable Costs:										
		Materials	4		9		12					
		Overheads	2		2		4					
		Labour	6	12	6	17	12	28				
		Unit Contribution		£4	1	£24	1	£12	1		3	
	(iii)	Contribution per unit		£4		£24		£12				
		Production		10,000	**1**	6,000	**1**	5,000	**1**			
		Total Contribution per unit		**£40,000**		**£144,000**		**£60,000**	**£244,000**			
		Less Fixed Overheads							200,000	**1**		
		Total Profit							**£44,000**		4	**9**
(b)	(i)	Number of machine hours available for Year 2		= 90% * 58,000 = 52,200 hours			**1**				1	
			Ellie		Leo		Bunny		Total			
	(ii)	Contribution per Machine Hour	£4		£24		£12					
			2	**1**	3	**1**	4	**1**				
			2		**8**		**3**					
		Order of priority	3		1		2					
		Machine Hours Allocated to each product	= 52200 - (18000 + 20000)									
			14,200		18,000		20,000		52,200			
		Quantity of each product to be produced:	**7,100**	**1**	**6,000**	**1**	**5,000**				5	
	(iii)	Total Contribution (units hrs x cont per un	7100 * 4									
									£			
			28,400		144,000		60,000		232,400	2		
		Less Fixed Costs							160,000	**1**		
		Total Profit **1**							**£72,400**			
		Increase in Total Profit = £44,000 - £72,400 = £28,400									4	**10**
		"Increase" must be stated to gain award.										
(c)	Explain the term Opportunity Cost in relation to Decision Making.											
	Opportunity Cost refers to what has to be given up to make another product or to make component parts.											1
												20