Institute of Credit Management

Accounting Principles

Question Paper, Answers and Examiners Comments

Level 3 Diploma **June 2013**

Institute of Credit Management
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Accounting Principles Questions, Answers and Examiners' Comments

LEVEL 3 DIPLOMA IN CREDIT MANAGEMENT

JUNE 2013

Instructions to candidates

Answer any **FIVE** questions.   All questions carry equal marks.
Time allowed: 3 hours

All ledger accounts must be prepared in continuous balance format
Final accounts must be prepared in vertical format

Where appropriate, VAT is to be calculated at 20%

Questions start on the next page

Generally candidates performed reasonably well and this assessment series witnessed an 88% pass rate.

Questions one, two and six were the most popular: questions five and eight the least with learner preferences equally shared between the other three questions. Although like previous years many candidates are not adequately prepared for an examination of this type. All learners and centres need to look at previous examiners comments to identify what is required.

Format and presentation of answers varied from excellent to dire. Many candidates still are confused about the differences between debits and credits and a minority fail to bracket credit balances which is disappointing. Some learners' answers to narrative questions were extremely poor with guesswork being the order of the day. Nevertheless there are some very good learners taking this exam and scoring well which is to be commended.

1. a) The trial balance of UK Kneads, a sole trader, as at 31 December 2012 was as follows:

	Debit	Credit
	£	£
Capital		69,585
Land and buildings	60,000	
Office equipment at cost	13,000	
Motor vehicles at cost	18,000	
Drawings	10,100	
Sales and purchase returns	1,250	1,000
Carriage in	750	
Carriage out	1,125	
Stock as at 1.1.2012	9,000	
Bank	1,200	
Sales and purchases	101,000	142,360
Motor expenses	2,400	
Provision for doubtful debt		240
Provision for depreciation:		
Land and buildings		2,400
Office equipment		1,300
Motor vehicles		3,600
Sundry expenses	2,760	
Wages and salaries	12,500	
Debtors and creditors	10,200	10,000
Telephone and insurance	2,200	
Bank loan		15,000
	245,485	245,485

You are given the following additional information:

- Closing stock, as at 31.12.2012, £10,200
- Depreciation is to be charged as follows:
  Land and buildings 1% straight-line method
  Office equipment 10% straight-line method
  Motor vehicles 20% reducing balance method
- Wages owing £1,200
- Insurance paid in advance £200
- Provision for doubtful debts is to be maintained at 5% of debtors.

TASK

a) Prepare the Trading & Profit & Loss Account for UK Kneads for the year ended 31 December 2012 taking into account the notes to the trial balance. (15 marks)

b) Describe the merits and limitations of using a bank overdraft to finance working capital arrangements. (5 marks)

Total 20 marks

Question aims

- To assess the candidate's knowledge and understanding of how a trial balance and adjustments are used to compile the final accounts of a sole trader
- To test that the candidate appreciates the alternative sources of short-term finance available to a sole trader to satisfy working capital arrangements.

Suggested answer

a) **The Trading and Profit and Loss Accounts of UK Kneads for the year ended 31 December 2012**

		£	£
Sales		14,2360	
Sales returns		1.250	
			141,110
Less: Cost of sales			
Opening stock		9,000	
Purchases	101,000		
Add carriage in	750		
Less purchase returns NB	(1,000)	100,750	
		109,750	
Less closing stock		10,200	
			99,550
Gross profit			41,560
Less expenses:			
Carriage out		1,125	
Motor expenses		2,400	
Increase in the provision for doubtful debt W1		270	
Sundry expenses		2,760	
Wages and salaries		13,700	
Telephone and insurance		2,000	
Provision for depreciation:			
Land and buildings W2		600	
Motor vehicles W3		2,880	
Office equipment W4		1,300	27,035
Net profit			14,525

Workings

W1 Provision for doubtful debt

10,200 X 5%	510
Less provision brought forward	(240)
Increase in provision	270

W2 Provision for depreciation

Land and building	600
1% of 60,000	

W3 Provision for depreciation

Office equipment	1,300
10% of 13,000	

W4 Provision for depreciation

Motor vehicles	
Cost	18,000
Less provision	3,600
NBV	14,400
20% of 14,400	2,880
New NBV	11,520

b) A bank overdraft is a short-term form of bank lending which is used by many organisations to fund day-to-day operational activities, sometimes called working capital. It is used to finance short-term cash shortfalls during the period before income is received so that the bank current account will have a negative balance (credit) and is shown as a current liability on the balance sheet.

Advantages

- Fairly simple to arrange
- It is flexible as it can be altered to reflect changing financial situations
- It is relatively cheap as interest is charged on the daily amount outstanding.

Disadvantages

- They are repayable on demand
- If the amount is too high, the bank might seek security and additional fees
- If the overdraft has not been agreed in advance then the interest charges are likely to be high.

A very popular question and in the main well answered. Most students are aware of the form and content of a trading and profit and loss account though presentation at times did let some of the candidates down. Some could not distinguish between sales and purchases from balances given in the trial balance and the same could be said for returns. The calculation of depreciation in both its forms continues to cause problems for many as does accounting adjustments for accruals and prepayments.

2. Phil Wall is a sole trader who has provided his accountant with the following account balance as at 31 December 2012:

Account	Balance £
Sales	2,500.00
Bank	3,750.00
Purchases	1,700.00
C Evans (customer)	790.00
T Agale (supplier)	950.00
Discount allowed	70.00
Discount received	90.00
VAT owing to HMRC	1340.75

The following transactions took place during January 2013. VAT is levied at 20%

January 2	Sales to C Evans on credit £600.00 plus VAT
January 3	Purchases from T Agale £400.00 plus VAT
January 8	A credit note was sent to C Evans for goods returned of £150.00 plus VAT
January 9	A credit note was received from T Agale for £100.00 inclusive of VAT
January 14	C Evans pays Phil £1,250.00 by cheque in full settlement of her account; the remainder being treated as a discount
January 19	Phil pays T Agale by cheque £1,300.00 in full settlement of his account with anything remaining to be treated as a discount
January 26	Phil takes £200.00 out of the bank account for his own personal use.
January 31	Phil pays HM Revenue and Customs for the amount owing as at 31 January 2013.

TASK

a) Open the ledger balances as at 1 January with the opening balances. (4 marks)

Record all the transactions for January in the relevant ledger accounts, opening new accounts where necessary. All credit balances should be shown in brackets or noted 'Cr'. (13 marks)

b) Briefly explain the difference between a liability and an asset. (3 marks)

Total 20 marks

Question aims:

To test the candidate's ability to:

- Compute and correctly account for VAT on sales, purchases and returns
- Post entries from purchase and sales invoices and credit notes to their relevant accounts in the sales, purchase and general ledger
- Correctly open individual ledger accounts with given balances and make relevant entries to record transactions
- Correctly compute and calculate for VAT.

Account: Sales

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			(2,500)
2 February 2013	C Evans		600	(3,100)

Account: Bank

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			3,750.00
14 January 2013	C Evans	1,250.00		5,000.00
19 January 2013	T Agale		1.300.00	3,700.00
20 January 2013	Drawings		200.00	3,500.00
31 January 2013	Revenue and customs		1,367.42	2,132.58

Account: Purchase

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			1,700.00
7 January 2013	T Agale	400.00		2,100.00

Account: C Evans

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			790.00
2 January 2013	Sales	720.00		1,510.00
8 January 2013	Sales returns		180.00	1,330.00
14 January 2013	Bank		1,250.00	80.00
14 January 2013	Discount allowed		80.00	nil

Account: T Agale

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f		950.00	(950)
3 January 2013	Purchases		480.00	(1,430)
9 January 2013	Purchase returns	100.00		(1,330)
19 January 2013	Bank	1,300		(30)
19 January 2013	Discount received	30.00		0.00

Account: Discount allowed

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			70.00
14 January 2013	C Evans	80.00		150.00

Account: Discount received

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			(90.00)
14 January 2013	T Agale		30.00	(120.00)

Account: Drawing

Date	Details	Dr	Cr	Balance
26 January 2013	Bank	200.00		200.00

Account: VAT

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f			(1,340.75)
2 January 2013	C Evans		120.00	(1,460.75)
3 January 2013	T Agale	80.00		(1,380.75)
8 January 2013	C Evans	30.00		(1,350.75)
9 January 2013	T Agale		16.67	(1,367.42)
31 January 2013	Bank	1,367.42		0.00

Account: Sales return

Date	Details	Dr	Cr	Balance
8 January 2013	C Evans	150.00		150.00

Account: Purchase returns

Date	Details	Dr	Cr	Balance
9 January 2013	T Agale		83.33	(83.33)

b) An asset is something a business owns, an item of monetary value which is used to operate the business e.g. premises, fixtures and fittings, stock, debtors and cash/bank.

A liability is something a business owes to a third-party which will have to be repaid in the next financial year e.g. bank loans, or within one accounting year e.g. creditors, bank overdraft, VAT.

As with previous examinations, answers to this very popular type of question were either very good, with full marks being awarded in many cases, to extremely poor. A common error for many was to incorrectly insert, in the first instance, the original debit or credit balances in the individual accounts. There still remains confusion with VAT and settlement discounts.

Part b) was handled well by most students

3. Paula Scott is a trade supplier who has been approached by KMF Builders who are requesting credit terms for the first time. Their managing director has provided Paula with the following extracts from the final accounts for the past two years and Paula has approached you for advice.

	2011 £	2012 £
Sales turnover	600,000	650,000
Opening stock	268,000	148,000
Closing stock	148,000	126,000
Purchases	225,000	268,000
Operating expenses	190,000	250,000
Ordinary share capital	300,000	300,000
Long term loan	40,000	70,000
Retained earnings	175,000	240,000
Bank	(30,000)	15,000
Debtors	28,000	48,000
Creditors	85,000	90,000

TASK

a) Calculate the following ratios for **both** years:

i) Gross profit margin (2 marks)

ii) Net profit (operating) margin (1 marks)

iii) Return on capital employed (2 marks)

iv) Current ratio (2 marks)

v) Debtor days (1 marks)

vi) Gearing ratio (2 marks)

b) Given the calculations in a) offer advice to Paula with regards to the viability of engaging in a credit relationship with KLF. (10 marks)

Total 20 marks

Question aims

- To test the candidate's knowledge and understanding of financial ratios and how they can be employed in the credit risk process
- To test the candidate's knowledge and understanding of how the ratios can be computed and applied.

Suggested answer

a)

2011

Sales		
<u>Less cost of sales</u>		600,000
Opening stock	268,000	
Purchases	<u>225,000</u>	
	493,000	
Less closing stock	<u>148,000</u>	<u>345,000</u>
Gross profit		255,000
<u>Less</u>		
Operating expenses		<u>190,000</u>
Net profit (operating profit)		65,000

2011

Gross profit margin $\frac{255{,}000 \times 100}{600{,}000} = 42.5\%$

Net profit (operating) margin $\frac{65{,}000 \times 100}{600{,}000} = 10.83\%$

Return on capital employed $\frac{65{,}000}{300{,}000 + 175{,}000 + 40{,}000} = 12.62\%$

Current ratio 148,000 + 28,000: 85,000 + 30,000 = 1.53:1

Debtor days $\frac{28{,}000 \times 365}{600{,}000} = 17$ days

Gearing ratio $\frac{40{,}000 \times 100}{300{,}000 + 175{,}000 + 40{,}000} = 7.77\%$

2012

Sales		650,000
Less cost of sales		
Opening stock	148,000	
Purchases	268,000	
	416,000	
Less closing stock	126,000	290,000
Gross profit		360,000
Less		
Operating expenses		250,000
Net profit		110,000

Gross profit margin $\frac{360{,}000 \times 100}{650{,}000} = 55.38\%$

Net profit margin (operating) $\frac{110{,}000 \times 100}{650{,}000} = 16.92\%$

Return capital employed $\frac{110{,}000 \times 100}{300{,}000 + 240{,}000 + 70{,}000} = 18.03\%$

Current ratio 126,000 + 48,000 + 15,000:90,000 = 2.1:1

Debtor days $\frac{48{,}000 \times 365}{650{,}000} = 27$ days

Gearing ratio $\frac{70{,}000 \times 100}{300{,}000+240{,}000+70{,}000} = 11.48\%$

b)
- Both turnover and profits have been increased showing that the company is clearly expanding
- Return on capital employed which measures how much profit has been earned in preparation to the long-term capital invested and is the return on the owner's investment. It is clear from the figures that KMF have managed the assets of the business efficiently on behalf of the shareholders as it has shown a marked increase from 12.62% to 18.03%
- Gross profit means the amount of profit earned from sales in relation to their cost. It measures how effectively a company has controlled its cost of goods and sold them at the right price to give maximum gross profit. Again clearly KME has performed well as it has increased from 42.5% to 55.38%

- Net profit measures the amount of profit earned from sales after all overheads have been deducted, and how well the company is controlling its overheads. This too has increased from 10.83% to 16.92% displaying sound performance

- The current ratio measures current assets against current liabilities. It compares assets that will be turned into cash within the next twelve months with any liabilities that will have to be paid within the same period, and how quickly a firm can pay its debt as and when they fall due. As seen there has been an improvement shown by the change in the ratio from 1.53:1 to 2.10:1

- The debtor days figure shows how long it takes for debtors to pay what they owe. It is important that businesses ensure that their customers pay in terms so that liquidity and profitability is maintained. Debtor days have deteriorated by 10 days from 17 to 27 days. This would need to be monitored closely as a continuation of this trend will have negative effects on the business's working capital.

Gearing measures the long-term debt of the company to the total capital employed, including the debt. There has been deterioration in this ratio though the ratio in the first instance was quite low. The firm has borrowed more money but this appears to have been employed efficiently as turnover and profit levies have all increased as indicated earlier.

On the basis of the ratios calculated, it is clear that KME is profitable, efficient and can pay its short-term liabilities quite easily. Despite a small increase in the gearing ratio there is no problem with its longer term financial commitments. However given the debtor days situation it might be pertinent to discuss existing credit control practices, policies and procedures with the customer and request sight of more up-to-date management accounts before offering a credit facility. If credit is subsequently offered, it should be monitored closely in the early months of trading.

Although this area of the syllabus is important and therefore candidates should be well-prepared for questions in this area, in most cases, candidates struggled.

There are many who struggle to calculate simple ratios. Even those that made a good attempt at the calculations their interpretation in the second part of the question was lacking in many cases. This area is an important part of the syllabus and will continue to be examined in future examinations so it is important that students address these issues.

4. a) Describe **four** errors that will not be disclosed by a trial balance and provide an example of each. (8 marks)

b) Carol Eaton's accountant has prepared her trial balance which did not balance (below).

	Dr	Cr
Returns	2,500	2,710
Capital		45,000
Sales		30,000
Purchases	25,000	
Drawings	8,220	
Rent/Rates	7,000	
Motor vehicles	8,000	
Discounts	800	600
Debtors and creditors	32,900	5,000
	84,420	83,310

Realising that this did not balance, the following errors were discovered by Mike the internal auditor.

i) A credit note for £2,850 was entered on the customer account of P Scott but no entry was made in the returns account.

ii) The sales account was overcast by £4,800

iii) £2,970 of goods withdrawn for Carol's personal use was entered into the drawings account but no other entries were made

iv) A discount allowed of £2,520 was credited in error to the discount received account

v) Cash sales of £19,780 had not been entered into the sales account

vi) A bad debt of £6,300 had been entered in the customer's account but not the bad debt account

vii) The purchases account had been under cast by £2,650.

TASK

Prepare a suspense account to correct the errors discovered showing clearly the opening and closing balances.

Note: journal entries are not required. (12 marks)

Total 20 marks

Question aims

- To test the candidate's understanding of errors that will not be identified by the trial balance
- To test the candidate's understanding of how errors can be corrected through the opening and closing of a suspense account.

Suggested answer

a) Any **four** from:

i) **Error of commission**
When a correct amount is entered in books, but in the wrong person's account e.g. D Smith paid as a cheque for £500 on 31/12/2012 which is correctly entered in the cash book but entered in error to the account of D Smythe.

ii) **Error of principle**
Where a transaction is entered in the wrong type of account. For instance the purchase of a fixed asset should be debited to a fixed asset account. If this is debited in error to an expense account then this has been debited to the wrong type of account.

iii) **Error of original entry**
Where an original amount is incorrect and is then entered in the double entry. For example a credit sale of £650.00 has been posted in the correct accounts but recorded as £560.00.

iv) **Error of omission**
Where transactions are not recorded in the books at all. A credit sale to J Smith of £600.00 was not entered in either of the two accounts.

v) **Compensating errors**
Errors which cancel each other out. For example, the trial balance might balance but a credit entry and debit entry are both incorrect cancelling each other out.

vi) **Complete reversal of entries**
This is where correct amounts are entered in the correct accounts but each item is shown on the wrong side of the accounts. For instance, a credit sale to J Smith of £4,000.00 was recorded as debit sales and credit J Smith when it should have been credit sales and debit J Smith £4,000.00.

b) **Suspense Account**

Date	Details	Dr £	Cr £	Balance
	Trial balance		1,110	(1,110)
	Sales returns		2,850	(3,960)
	Sales		4,800	(8,760)
	Purchases	2,970		(5,790)
	Discount received		(2,520)	(8,310)
	Discount allowed		(2,520)	(10,830)
	Sales	19,780		8,950
	Bad debts		6,300	2,650
	Purchases		2,650	nil

Most candidates who attempted this question made a bold attempt in part a) with many securing full marks.

Part b) caused problems for some, especially with regards to accounting entries for the correction of discount allowed and discount received. However a number of candidates correctly cleared the suspense account and scored well.

5. a) Explain the importance of budgeting to an organisation. (8 marks)

b) From the following information for Mike and Ian Ltd, prepare a cash budget for the period January to March 2013:

	Sales £	Purchases £	Wages £	Var O/H £
November 2012	20,000	20,000	20,000	5,000
December 2012	30,000	25,000	20,000	10,000
January 2013	40,000	30,000	30,000	5,000
February 2013	60,000	45,000	20,000	8,000
March 2013	60,000	50,000	20,000	6,000

- The bank balance on 1 January 2013 is £25,000
- Fixed overheads are £2,000 per month, payable in the same month. The £2,000 included £100 depreciation
- Receipts for sales follow this pattern:
  - 50% during the month of sale
  - 25% during the following month
  - 25% during the next following month
- It is the policy of the firm to pay trade creditors as follows:
  - one-fifth in the month of purchase
  - two-fifths in the following months
  - two-fifths paid in the next following month.
- Wages are paid 50% in the month earned and 50% in the following month
- Variable overheads are incurred and paid in the same month
- Mike is to receive a legacy of £40,000 on 1 February 2013 which he intends to put into the business
- Fixed assets of £30,000 are paid for on 1 March 2013. (12 marks)

Total 20 marks

Question aims:
- To test the candidate's appreciation of budgeting and how it is crucial to the financial success of any organisation
- To test the candidate's ability to construct a cash budget incorporating credit sales, credit purchases, fixed and variable overheads and wages.

Suggested answer

a) A budget is a financial plan, expressed in monetary terms of what is thought likely to happen based on historical information and projections for the future. It is prepared and approved prior to the period in which it relates.

A budget facilitates planning and control. A firm will be more efficient if it plans its activities in advance. It helps firms exercise control, especially over its costs. Performance too can be monitored and corrective action taken if there are shortfalls in targets or if you go over budget.

Budgets are an important means of communication between different departments and managers who are involved in the budget setting process.

Cash budgets in particular indentify the amounts expected to be received and paid for and identifies their timings. If the budget highlights an excess of outflows during a particular period, the firm can take steps to secure temporary funds to meet the shortfall.

b) **Mike and Ian Ltd cash budget January to March 2013**

	January	**February**	**March**
Receipts			
Sales	32,500	47,500	55,000
Legacy		40,000	
Total	32,500	87,500	55,000
Payments			
Purchases	24,000	31,000	40,000
Fixed overheads	1,900	1,900	1,900
Wages	25,000	25,000	20,000
Variable overheads	5,000	8,000	6,000
Fixed assets			30,000
Total	55,900	65,900	97,900
Receipts/payments	23,400	21,600	(42,900)
Balance b/f	25,000	1,600	23,200
Balance c/f	1,600	23,200	(19,700)

Calculations

Sales	**November**	**December**	**January**	**February**	**March**
November	10,000	5,000	5,000		
December		15,000	7,500	7,500	
June			20,000	10,000	10,000
February				30,000	15,000
March					30,000
			32,500	47,500	55,000

Purchases

	November	**December**	**June**	**February**	**March**
November	40,000	8,000	8,000		
December		5,000	10,000	10,000	
June			6,000	12,000	12,000
February				90,000	18,000
March					10,000
			24,000	31,000	40,000

Not a popular choice for candidates which is a little surprising as management accounts are part of the syllabus and are examined quite frequently. Those who did opt for this question scored well in part a) in the section about what is a cash budget.

Part b) was a disaster for many. Structure, format and presentation were woefully lacking in many cases and most candidates believed that depreciation is a cash item which is worrying. Still a number of learners scored full marks for this part of the question.

6. The following are extracts from the accounts of XYZ Ltd for the year ended 31 December 2012.

Account	£
Corporation tax owing	68,000
Motor vehicles	70,000
Cash	2,000
Provision for depreciation of motor vehicles	20,000
Authorised and issued share capital (£1 shares)	150,000
Stock as at 31 December 2012	16,000
Prepaid rates	600
Debtors	25,000
Share premium	80,000
Proposed dividends	30,000
8% debenture (interest already paid)	50,000
Premises	265,000
Provision for bad debts	3,500
Creditors	18,000
Retained profit	80,000
Revenue reserves	70,000
Bank	?

TASK

a) Present a balance sheet in appropriate format from the figures above. (18 marks)

b) Calculate the bank balance as the missing figure on the balance sheet. (2 marks)

Total 20 marks

Question aims

To test the candidate's ability to construct a trial balance and use it to construct a final set of accounts of a limited liability company.

Suggested answer

Balance sheet of XYZ Ltd as at 31 December 2012

		£	£	£
Fixed assets				265,000
Premises		256,000		
Vehicles		70,000	20,000	50,000
				315,000
Current assets				
Stock		16,000		
Debtors	25,000			
Provision	3,500	21,500		
Prepayment		600		
Bank		OF 190,900		
Cash		2,000	231,000	
Current liabilities				
Creditors		18,000		
Proposed dividends		30,000		
Corporation tax		68,000	116,000	
Net current assets				115,000
				430,000
Less long-term liabilities				
Debenture				50,000
Total net assets				380,000
Financed by				
Authorised and issued share capital				150,000
Share premium				80,000
Revenue reserves				70,000
Retained profit				80,000
				380,000

Trial balance		
	Dr	Cr
Corporation tax owing		68,000
Motor vehicles	70,000	
Cash	2,000	
Provision for depreciation		20,000
Authorised and issued share capital		150,000
Stock	16,000	
Prepaid rates	600	
Debtors	25,000	
Share premium		80,000
Proposed dividends		30,000
8% debenture		50,000
Premises	265,000	
Provision for:		
Bad and doubtful debts		3,500
Creditors		18,000
Refund profit		80,000
Revenue reserves		70,000
Bank	190,900	
	569,500	569,500

Bank is £190,900 debit

The format and content of a balance sheet is an integral part of the syllabus so it is important that students practice as many of these documents from all business sectors as possible. Many confused fixed assets and current assets, a number thought that the provision for bad and doubtful debts was a current liability. The 'financed by' section was another area that students had problems with. Only a few could calculate the cash/bank balance from a list of ledger balances which is a cause for concern.

7. a) Explain three advantages to an organisation of preparing control accounts (6 marks)

b) Using the following information, construct both a sales ledger and purchase ledger control account for the month end of January 2013 and so calculate the creditor and debtor final position. (14 marks)

	£
Debtors at 1 January	27,971
Creditors at 1 January	15,725
Credit sales	42,500
Returns from debtors	800
Returns to suppliers	650
Payment received from debtors	35,675
Bad debts written off	450
Payment to creditors	19,750
Credit purchases for month	22,750
Discounts allowed	400
Discounts received	380

Total 20 marks

Question aims:

To test the candidate's ability to:

- Identify the purpose and use of control accounts
- Prepare sales and purchase ledger control accounts
- Highlight the advantages of control accounts.

Suggested answer

a)
- Control accounts check the arithmetical accuracy of the balances of all the creditors' accounts in the purchase ledger and all the debtors' accounts in the sales ledger. The balance on the control account should be sure as the total of all the individual balances in the purchase and sales ledger

- Errors can be identified early. These errors can then be found more easily which reduces the time spent in identifying and correcting them

- They make fraud more difficult. If a fraudulent transaction is to be recorded on a personal account, the transaction must also be entered in the control account. As the control account will be either maintained by a supervisor, or checked regularly by the manager, the control accounts add another level of security within the accounting system

- They also save time when extracting the trial balance. The control account enables the total debtor and creditors figure to be entered into the trial balance in one entry rather than having to enter every single debtor and creditor balance.

b) **Sales ledger control account**

Date	Details	Dr	Cr	Balance
1 January 2013	Balance b/f	27,971.00		27,971.00
31 January 2013	Total invoiced sales	42,500.00		70,471.00
	Total receipts from debtors		35,675.00	34,796.00
	Total discount allowed		400.00	34,396.00
	Total sales returns		800.00	33,596.00
	Bad debts written off		450.00	33,146.00

Purchase ledger control account

Date	Details	Dr	Cr	Balance
31 January 2013	Balance b/f		15,725.00	(15,725.00)
	Total invoiced purchase		22,750.00	(38,475.00)
	Total payment to creditors	19,750.00		(18,725.00)
	Total discount received	380.00		(18,345.00)
	Total purchase returns	650.00		(17,695.00)

Answers to this were rather indifferent though a number scored full marks for entries and balances of the two control accounts. A number of candidates got the two accounts confused and consequently failed to score any marks at all. Part a) was handled well by most and most candidates secured some marks here.

8. In the Annual Report, a great deal of information is available to the credit manager to help him/her in making a more informed credit decision about an incorporated business.

TASK

For each of the following, describe the key information that would be provided and assess its usefulness to the credit manager:

a) The director's report (10 marks)

b) The auditor's report (8 marks)

c) The cash flow statement (2 marks)

Total 20 marks

Question aims

To test the candidate's knowledge and understanding of the director's report, the auditor's report and the cash flow statement and how it can be employed to help the credit manager in making more informed decision with regard to granting credit, setting terms and extending provision.

Suggested answer

c) Director's report would include:

- A review of the year's activities and the major developments of the company and subsidiaries, if applicable, during the last financial year. This could indicate to the credit manager not only continuity of the business but its future plans

- The company's financial position at the end of the accounting period including changes to share capital, proposed dividends and transfers to reserves. This will indicate to the credit manager the strength of its capital structure and more importantly its profitability

- Details of any substantial shareholders showing to the credit manager any key interests in the running of the company

- Principal activities and any changes in these which have impacted on the results. This would show to the credit manager overall performance and how trading has impacted upon the company's success or failure

- Major developments which will affect future performance and results. This could show any investments in capital equipment or the acquisition of other businesses or movement into new markets, all sound intelligence which will impact on the decision of the credit manager

- Post balance sheet events such as insolvency of customers which will affect results. This would affect the decision of the credit manager

- An indication of the research and development carried on by the company. This indicates perhaps a forward looking company and so gives the credit manager some confidence for future trading

- Charges in fixed assets during the year and the difference between book value and market value of land

- Supplier payment policy which would shoe how many days the company takes to pay it suppliers, which has important credit control implications

- Details of any changes with regards to the directors, their shareholding etc. This will have important implications on how the business is run and structured.

b) The auditors report will contain the following:

- The Companies Act requires an independent audit of the company's financial affairs. The accounts may be signed by the auditors as clean, unqualified or qualified, which suggest that there may be some aspects of the information contained in the accounts that gives some measure of concern

- A clean or unqualified audit report suggests a well-managed company. The report will confirm, or otherwise, that the accounts have been prepared in accordance with the requirements of current accounting practices and legislation

- The audit report is also one of the tools the credit manager uses to assess the creditworthiness of a potential customer. It is an examination and analysis of their financial statements. To have confidence

- It will also state whether the accounts provide a 'true and fair view' of a company's trading and financial affairs

- A qualified audit report should act as a warning sign to the credit manager. The qualification may indicate anything from disagreement in an area of fundamental importance to the company to uncertainty in an area that might affect the granting of credit. So that the credit manager is alerted to possible problems that may arise if credit is granted.

c) This appears with the profit and loss account and the balance sheet. It reconciles the balance of cash recorded in the balance sheet in one year with that of the following year. This story of cash can give the credit manager a plethora of information with regards to stock management, credit control, investments, share management, borrowing and investment. All will help the credit manager in making a more informed decision.

Generally candidates who attempted this question tended to be weak in their attempts with the numerical questions. Most candidates scored points though there still remains confusion about what is included in the directors' report.

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