

Partnership

Q: State **one** advantage and **one** disadvantage of two sole traders entering into a partnership.

A: Advantages:

Share losses/arrange own workload/share workload with partner(s) shares risk/wider access to investment capital/cover for illness and holidays.

Disadvantages:

Share profits/personal assets at risk for partner's debts/less control/conflict between partners difficult to resolve.

Q: State **two** differences between a limited liability partnership (LLP) and a general partnership.

A:

Partners in a limited liability partnership have limited liability whereas with a general partnership liability is unlimited **(1)**.

There must be one partner with unlimited liability within a limited liability partnership whereas there is no such restriction in a general partnership **(1)**.

Limited liability

Q: State **two** advantages of a business having limited liability.

A: Reduced risk as liability is limited up to the amount invested in the business by the owners **(1)**.

More scope to raise finance as shares can be issued **(1)**.

Q: Describe what is meant by the term unlimited liability.

A: The term unlimited liability means that the **personal** assets of the owner of the business can be used to pay off business debts **(1)**.

For the sole trader: in the event of the business running up debts, in order to pay debts, the personal possessions of the sole trader may be used to pay the debts **(1)**.

Q: State **two** differences between a private limited company (Ltd) and a public limited company (plc).

A:

- There is no restriction for minimum authorised capital for a private company⁽¹⁾, whereas a public limited company must have at least £50 000 as a minimum authorised capital.⁽¹⁾
- Private limited company's shares are not traded on the stock exchange **(1)**, but public limited company's shares are **(1)**.
- Private limited companies cannot advertise their shares for sale **(1)**, public companies can **(1)**.

Purpose of financial statements

Q: Explain the purpose of financial statements.

A: The financial statements **provide information to users** to make economic decisions (1).

The financial statements must provide the **faithful representation** of:

financial position (1) (SOFP)

performance (1) (SOPL)

changes in financial position (1) (SCF).

Q: State with a reason why **three** different categories of stakeholder, other than employees, would be interested in the financial statements of a business.

A:

Stakeholder	Reason
Employee	To ensure continuity of employment
Owners/ Shareholders	Security of investment/Return of investment
Potential investors	Security of investment
Bank	Ability to repay any loans or overdrafts
Customers	To ensure continuity of supply of goods and services
Suppliers	To ensure payment will be made
Government	To ensure that taxes are paid
Trade unions	To ensure that their members are protected
Trade associations	To ensure their members are protected/shortfalls in skills are identified/updated with latest developments in the industry
Community/ Public	To ensure the company is complying with environmental requirements and/or creating employment opportunities.

Characteristics of financial reporting

Q: State **four** qualitative characteristics of financial reporting that support relevance and faithful presentation according to the International Accounting Standards Board (IASB) framework.

A:

1. Comparability (1)
2. Verifiability (1)
3. Timeliness (1)
4. Understandability (1)

Accounting concepts

Q: Explain **two** accounting concepts that are relevant to the charging of depreciation on non-current assets.

A:

Consistency concept (1) states that once the business has decided the accounting treatment for an item such as method of depreciation of non-current assets the business should continue to use the same method **(1)** otherwise it will be difficult to compare the business's performance over the years **(1)**.

• **Accruals concept (1)** states that income generated by using non-current assets and expenditure in the form of depreciation on non-current assets **(1)** should be matched in the period incurred **(1)**.

Professional ethics

Q: State which **two** principles of professional ethics will be questioned due to her relationship with her firm's client.

A: Objectivity **(1)** and **independence (1)**

Q: Doug Harrison, a business's accountant, has noticed that the business underpaid tax last year. He informed the finance director and suggested rectifying the error by disclosure. The finance director informed him that by doing so the business would have to pay additional tax and penalties, which may result in the business ceasing trading with loss of all employees' jobs. Explain **two** principles of professional ethics that are affected.

The principle of **integrity (honesty)(1)**. The integrity of Doug is compromised by not declaring the correct amount of tax **(1)**.

The principle of **objectivity (independence)(1)**. His objectivity is at risk due to fear of loss of his and his fellow colleagues' jobs **(1)**.

Q: Explain how the principles of professional ethics can be applied under each of the following headings.

A:

Integrity

A company making a rights issue of shares, would state an accurate financial position of the company, and the reason for the rights issue, not giving an unrealistic, optimistic picture of the company **(1)**.

Objectivity

A business may have to write down the value of assets in the statement of financial position, giving an accurate market value at the time of the end of the financial period **(1)**.

Independence

An auditor needs to carry out their duties in an independent way, and not be influenced by personal friendship with clients, or the possibility of further paid work with the client **(1)**.

Q: Identify, with reasons, which principles of professional ethics would be compromised in the following situation. **(4)**

Anna and Raminder are friends who work for an accounting firm. Raminder offered to buy lunch for Anna. In return, Anna would sign an overdue audit report without reading it and send it to the client stating that the delay was due to computer failure.

Principles of professional ethic	Reason
<ul style="list-style-type: none"> • Integrity (1) • Honesty (1) 	<ul style="list-style-type: none"> • Anna will compromise her integrity/honesty by signing the report without reading it (1). • Lying to the client in saying the reason for the delay was computer failure (1).
<ul style="list-style-type: none"> • Objectivity (1) • Independence(1) 	<ul style="list-style-type: none"> • Anna's objectivity / independence will be at risk as they are friends (1). • Raminder also offered free lunch for the favour in return (1).

A:

Franchisee

Q: State **one** advantage and **one** disadvantage **for the franchisee** of a franchise business organisation.

A: Advantage: able to use the brand name of an established business which will enable them to attract customers and higher sales than trading under their own name (1).

Disadvantage: there will be limited flexibility on how the outlet is run for example product range, pricing, marketing may be decided by the franchisor (1).

Inventory

Q: State how inventory should be valued according to the International Financial Reporting Standards

A: Inventory is valued at cost or net realisable value (1) whichever is lower (1).

Q: State **two** purposes of preparing a trial balance

A: The arithmetical accuracy of the ledger accounts **(1)**.

To aid in the preparation of the financial statements of the business **(1)**.

Q: State **two** purposes of financial statements.

A: The purpose of financial statements is to:

show the financial performance (profitability) of the business for the period **(1)**

show the change change in liquidity position of the business for the period **(1)**

show the financial position on a specific date **(1)**

show the change in the equity of the business over a period **(1)**

enable the stakeholders to make (economic) decisions **(1)**.

Ratios – How to score marks

1 mark for each ratio analysed

1 mark for development/ explanation

1 mark for overall comment

Example

Gross profit margin - has slightly improved, shows better control over cost of sales (1) or sales increased more in proportion to cost of sales compared to last year. (1)

Net profit margin – has improved since last year, indicating better control over operating expenses (1) or could be due to increase in gross profit. (1)

Return on capital employed – has improved significantly, indicating better utilisation of resources compared to last year. (1) The increase in the ratio is due to increase in the net profit margin for 2015. (1)

Trade receivables collection period – has improved, receivables are paying much quicker than the last year which helps to improve cash flow. (1) It could be due to incentives given to the receivables for early payment as the days for payment are less than the normal credit period of 30 days. (1)

Trade payment period – has decreased, payments to payables are made 3 days earlier than last year. This year the business is collecting money from the receivables before it is making payment to payables, which is better to improve cash flow position, which is indicated by the increase in the bank balance of \$11 000.(1) This will also improve the relationship with the suppliers. (1)

Inventory turnover – the inventory is being sold slower than last year. It could be that the demand for the product has gone down either due to less money spent on advertising/ marketing, (1) which is indicated by an increase in net profit margin ratio or due to tightening the credit period offered for credit customers (receivables). (1) Overall, the profitability and performance of the business has improved in 2016 compared to 2015. (1)

Inventory turnover for Mr Solanki is a matter of concern as his inventory moves only 6 times compared to Mr Kay's business and this could be the reason for his higher trade receivables collection period (1). The reason for this could be that Mr Kay may have a wholesale business which means the inventory moves in higher volume at a lower selling price (1) which could be the reason for his lower gross profit margin as well (1). **Max 2**

Quick ratio (acid test) again is higher for Mr Solanki's business in comparison to Mr Kay's business. The change in the ratio from the current ratio for Mr Solanki's business is 3.2:1 compared to Mr Kay's business which is 0.85:1, which indicates that Mr Solanki's capital is tied up too much in inventory (1) which could have been utilised in business more efficiently (1).

Trade payables payment period for Mr Solanki is higher than the Mr Kay's business, which is higher than normal credit period of 30 days. Mr Kay's business shows good liquidity as it pays its suppliers on time (1) and utilises the resources efficiently as it has 30 days in between collecting money from customers and paying to its suppliers compared to Mr Solanki's business, who pays its suppliers 13 days after collecting money from its customers (1).

Q: Explain how the trade receivables collection period can be used to measure the efficiency of the business.

A: Trade receivables collection period indicates how efficient the business is in collecting money from trade receivables promptly **(1)**. The increase may indicate that the cash flow may worsen which could lead to liquidity problems **(1)**.

Q: Explain how the trade payables payment period can be used to measure the efficiency of the business.

A: Trade payables payment period indicates how efficiently the business is using the full credit term allowed by trade payables **(1)**. The decrease may indicate that the cash flow may worsen which could lead to liquidity problems **(1)**.

Q: Evaluate the profitability and liquidity of the business.

Profitability

Gross profit margin has deteriorated **(1)** this may be due to cost of sales increasing in a higher proportion to the sales **(1)**

The profit for the year revenue percentage has deteriorated **(1)** but the business has maintained control over its operating expenses as the decrease in net profit margin is lower than gross profit margin **(1)**

The return on capital employed has deteriorated **(1)** this may be due to the decrease in profit for the year in relation to capital employed **(1)**

Liquidity

Current ratio has improved **(1)** which indicates that the business would not struggle to meet its short term liabilities **(1)**

The quick (acid test) ratio has improved **(1)** which indicates that the business is able to pay its short term debts from its liquid assets **(1)**