Accounting

Theory In Leaving Certificate Accounting

PDST
Professional Development Service for Teachers
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CONTENTS

CASH FLOW STATEMENTS

2022

(i) Financial Reporting Standard 1 requires companies to prepare a cash flow statement. What is a Financial Reporting Standard?

A Financial Reporting Standard is a rule that must be applied to all financial statements in order to give a true and fair view of the company's financial position. It sets out best practice in accounting that allows accounts to be compared from year to year and from company to company

(ii) Distinguish between a cash gain and a non-cash gain for Puspure plc. Give one example of each from the financial statements of Puspure plc.

A cash gain - increases profit and cash e.g. investment income €3,700.
A non-cash gain - increases profit but not cash e.g. profit on sale of fixed asset €1,000.

2021

(i) Explain why earning profit may not always result in a corresponding increase in cash balances. Use figures from this question to support your answer.

(ii) Outline reasons why Reid plc would prepare a cash flow statement.

Suggested Solution

(i)
P. Reid plc's Profit and Loss a/c and Cash Flow Statement show that an operating profit of €295,600 was made but the increase in cash for the year was only €41,000.

Reasons:

Profit, but not Cash

1. Credit sales increase profit, but do not increase cash. Debtors increased by €70,000.
2. Profit on disposal of fixed assets, increases profit by €18,000 but does not increase cash by the same amount.
3. Depreciation on fixed assets of €34,000 reduces profit but does not reduce cash.
4. Patents written off €9,000 reduces profit but does not reduce cash.
5. Increase in bad debts provision of €3,400 reduces profit but does not reduce cash.

Cash, but not Profit

1. Receipts from the sale of fixed assets €90,000 increases cash but has no immediate effect on profit.
2. Payments for the purchase of fixed assets €330,000 reduces cash but has no immediate effect on profit.

3. Receipts from issue of shares and premium, €180,000 increase cash but has no immediate effect on profit.
4. Payments to redeem debentures, €50,000, reduce cash but has no immediate effect on profit.

(ii)

1. To show cash inflows and cash outflows during the year.

2. To assist in predicting future cash flows.

3. To aid financial planning.

4. To provide information for assessing liquidity.

5. To highlight that profit does not always equal cash.

6. To assist in applications for loans from financial institutions.

7. To comply with Company Law.

2019

(i) Explain what is meant by a non-cash item. Give three examples, using the figures provided.

(ii) Explain two items that affect cash but not profit.

Suggested Solution

(i) Non-cash items are items in the profit and loss account that affect the net profit, but they do not affect the cash situation. E.g. depreciation €72,000, increase in bad debt provision €400, goodwill written off €11,000, loss on sale of fixed asset €1,700

(ii) The purchase of fixed assets decreases cash but does not affect profit **OR** the sale of fixed assets increases cash but does not affect profit. The introduction of capital increases cash but not profit **OR** Drawings reduce cash but has no effect on profit. Loans received or repaid can also be used as an example, as can investments bought or sold

2017

(i) Cash flow statements are useful in assessing <u>solvency.</u> Explain the underlined term.

(ii) Financial Reporting Standard 1 requires companies to prepare a cash flow statement. What is a Financial Reporting Standard?

(iii) Grant plc has reduced its gearing significantly between 2015 and 2016. What are the implications of this change?

Suggested Solution

(i) **Solvency** is the ability of the company to pay all its debts as they fall due for payment (long term). A firm is solvent if total assets are greater than total external liabilities.

(ii) A **Financial Reporting Standard** is a rule that must be applied to all financial statements in order to give a true and fair view of the company's financial position. It sets out best practice in accounting that allows accounts to be compared from year to year and from company to company.

(iii) **Implications of reduced gearing.**

1. Low interest repayments increase the amounts of profits available for investment elsewhere in the business.
2. Shareholders are more likely to get a dividend when gearing is low.
3. The business has greater financial stability as it is less affected by rises in interest rates.
4. The business should find it easier to raise additional loan finance.

2015

(i) Outline the purposes of cash flow statements.

(ii) Explain why having earned a profit during 2014, the company's cash balance declined.

Suggested Solution

(i) **Purposes of Cash Flow Statements**

To show that profits do not always equal cash

To show the cash inflows and outflows during the past year

To help predict future cash flows

To help financial planning

To provide information to assess liquidity/solvency

To comply with legal requirements

To aid application for loans

(ii) **Explain the decline in the company's cash balance in 2014**

Purchase of fixed assets reduced cash by €220,000 but did not reduce profit

Purchase of Government securities reduced cash by €56,000 but did not reduce profit

Payment of dividends €55,000 and tax €57,000 reduced cash by €112,000 but did not reduce profit

Increase in stock, debtors and increase in creditors reduced cash by €148,000 but didn't reduce profit

2014

(ii) List **three** accounting obligations of a large public company under the Companies Act.

Suggested Solution

Accounting Obligations of a large public company

Provide a full set of accounts, balance sheet and a cash flow statement to shareholders at AGM

File/register a full set of accounts and balance sheet with the registrar of companies

Provide explanatory notes to these accounts

Must have its accounts audited

They must also present an annual report to the company shareholders at its AGM. This report should include a director's report as well as the published accounts.

2012

(ii) Outline two responsibilities of the Directors of a plc.

Suggested Solution

Responsibility of Directors

To comply with the Companies Acts

To keep proper accounting records enabling financial statements to be prepared

Prepare annual financial statements

Select suitable accounting policies

Sign financial statements

Safeguard the assets of the company

Publish Final Accounts and Cash Flow Statement at least once a year

Present an <u>Annual</u> Report to shareholders at <u>AGM</u> to include:

Director's Report

Auditor's Report

Financial Statements

2010

Question 3 (b)

(i) Outline the benefits of preparing a Cash Flow Statement

(ii) Distinguish between a cash expense and a non-cash expense.

Suggested Solution

(i) It shows the cash inflows and outflows during the past year

It shows that profits do not always equal cash

It aids financial planning/ it is used to predict future cash flows

It provides information to assess current liquidity

(ii) **Cash Expense** – reduces both profit and cash e.g. wages

Non-cash expense – reduces profit but not cash e.g. depreciation, provision for bad debts

2008

(i) Explain why earning profit does not always result in a corresponding increase in cash balances.

(ii) Write a note on the Accounting Standards Board. In your answer refer to the main activity of the Board and how it has influenced the preparation of Cash Flow Statements.

Suggested Solution

(i) Credit sales/purchases affect profit but do not affect cash.

Non-cash losses and gains affect profit but not cash.

Purchase and sale of fixed assets by cash affect cash but not profit.

Introduction or withdrawal of capital in cash affects cash but not profit.

(ii) **The Accounting Standards Board** issues new accounting standards called Financial Reporting Standards (FRS). It also amends and withdraws old accounting standards.

FRS 1, which was issued by the ASB in 1991 and revised in 1996 requires large companies to prepare a Cash Flow Statement for each activity period.

It requires that individual cash flows should be entered under standard headings according to the activity that gives rise to them.

2006

(b) Explain why Cash Flow Statements are prepared

(c) Identify a Non-Cash expense and a Non Cash gain.

Suggested Solution

(b) To show the cash inflows and outflows during the past year

To help predict future cash flows

To help financial planning

To provide information to assess liquidity

To show that profits do not equal cash

To comply with legal requirements

(c) **Non-cash expense** – Depreciation, increase in provision for bad debts

Non-cash gain – Reduction in provision for bad debts, profit on sale of assets

2004

(c) Explain why profit does not always mean a corresponding increase in cash and list two non-cash items.

Suggested Solution

(c) Credit sales/purchases affect profit but do not affect cash

Non-cash losses and gains affect profit but not cash

Purchase and sale of fixed assets by cash affect cash but not profit

Introduction or withdrawal of capital in cash affect cash but not profit

Non-cash items – Depreciation, Provisions against losses, losses/profits from sale of assets

INTERPRETATION OF ACCOUNTS

2022

The gross profit percentage of Watson plc in 2020 was 36%.
(i) Calculate the gross profit percentage for Watson plc in 2021.

The gross profit percentage is 28.21% a disimprovement of 7.79% from last year.

(ii) Give possible reasons for the change in gross profit percentage in 2021.

This could be caused by

- Reduction in selling price without a corresponding fall in cost of sales
- Cost of sales increased without the increase being passed on to the consumer
- Cash Losses. Cash sales are not recorded or theft of cash
- Stock losses - theft of stock or obsolete stock
- Change in sales mix - more low margin items being sold and less high margin items being sold
- Incorrect valuation of stock overvaluing opening stock and/or undervaluing closing stock
- Increased competition in the market reducing profit margins
- Reduction in selling price to get rid of old stock

(iii) Outline how a company could improve their gross profit percentage.

This could be improved by

- Changing the sales mix to sell more high margin items
- Increasing selling price without an increase in purchase prices
- Reducing cost of sales bu shopping around to find cheaper more competitive suppliers
- Avail of discounts from suppliers for bulk buying or paying more promptly
- Avail of cash discount rather than relying on credit

2021

(i) What are the disadvantages to a business of having a high gearing?

(ii) Explain two ways to reduce gearing of a company.

Suggested Solution

(i) When fixed interest debt is a high proportion of overall capital it has the following disadvantages:

1. High interest repayments means less profits are available for investment else where in the business
2. Shareholders are less likely to get a good dividend when gearing is high

3. The business would find it more difficult to raise additional loan finance
4. There is a higher risk of liquidation due to not being able to make interest payments

(ii)

1. Sell more ordinary shares to increase shareholders equity as a proportion of capital employed.
2. Reduce or repay loans to reduce fixed interest debt as a proportion of capital employed.
3. Increase reserves/retained profits to increase shareholders equity as a proportion of capital employed.
4. Convert long-term debt to ordinary shares reducing fixed interest debt and increasing shareholders equity term.

2020

(c) Explain how a faster stock turnover can increase the profitability of a business.

Suggested Solution

(c)

- Each time stock is sold, because it contains a mark-up, profitability increases
- If the cost of buying the extra stock increases at a slower rate than the mark-up then profitability increases
- The more times the stock is turned over the greater the mark-up and profit will be increased
- Where stock turnover is high less stock may be held resulting in reduced stock holding costs (insurance, waste etc.) which could lead to an increase in profitability
- A faster stock turnover means that the firm may enjoy economies of scale, such as bulk-buying discounts, which will reduce costs and increase profitability

2019

(ii) Using the calculated figures explain why it is important for Shannon plc to analyse the liquidity position for Gener8 Ltd.

Suggested Solution

(ii) The current ratio is 1.29:1, the acid test ratio is 0.68:1.

Gener8 Ltd is not liquid which is very serious, as a company that is not liquid may be forced into bankruptcy. Therefore Shannon plc will want to know if the company can take any positive action to improve its liquidity position. The poor liquidity of Gener8 Ltd could be a significant factor in whether Shannon plc decides to buy this company or not.

2018

(c) Born2Run plc is considering expansion by purchasing a small sportswear company. It has obtained the following information relating to this company:

	2014	**2015**	**2016**	**2017**
Period of credit allowed to debtors	60 days	54 days	46 days	40 days
Period of credit received from creditors	20 days	26 days	30 days	34 days
Stock Turnover	12 times	11 times	9 times	6 times

Having analysed the information in the above table, what advice would you give Born2Run plc regarding this purchase?

Suggested Solution

(c) **Period of credit allowed to debtors**

The length of time it takes a debtor to settle their account has improved by 20 days (from 60 days to 40 days). This is a good trend. The liquidity position of the business is improving as it is collecting debts more efficiently/quickly. However, while its liquidity position has improved, the collection period from debtors is longer than the average credit period of 34 days received from creditors.

Period of credit received from creditors

The length of time the business has to settle accounts with suppliers has improved by 14 days. (It has increased from 20 – 34 days). This is improving the liquidity position as it is taking longer to settle its accounts with suppliers. However, the business may lose out on discounts for prompt payment which may have a negative effect on its liquidity.

Stock Turnover

Stock turnover has worsened. It has fallen from 12 times to 6 times. This is a negative trend. The liquidity position of the business has worsened as it is taking much longer to sell stock. This may mean it may have too much money tied up in stock, when it could have been used for other purposes. If the decrease in stock turnover is as a result of decreasing sales, this will also have a negative effect on liquidity as it will have less revenue.

I would not recommend that Born2Run plc should invest in this business.

2017

(i) Employees are users of financial information. If you were an employee of JB plc explain why the financial information of the company would be of interest to you.

(ii) Identify **two** other users of financial information

Suggested Solution

(i) **As an employee I would be interested in the financial information for the following reasons:**

- To assess job security
- To see if shareholder dividends are increasing which could be used as a negotiation strategy
- To see if the company can continue to pay existing wage rates or can it afford a pay rise
- To see if the company plans to expand and thereby assess the prospects for promotion
- To assess pension security

(ii) Two other users of financial information are; lending institutions, trade creditors, shareholders, the revenue, competitors, and directors.

2016

(i) Explain the term "Gearing"

(ii) What are the benefits to a business of having a low gearing?

(iii) State **two** ways to reduce the gearing of a company.

Suggested Solution

(i) **Gearing –** This is a measure of how a business is financed on a long-term basis. It measures the relationship between fixed interest debt (loans/debentures + preference shares) and total capital employed/equity. When this is less than 50%, the business is lowly geared. Above 50% is highly geared. Low gearing is preferable.

(ii) **Benefits of low gearing** – When fixed interest debt is a small proportion of overall capital it has the following benefits:

1. Low interest repayments means more profits are available for investment elsewhere in the business
2. Shareholders are more likely to get a dividend when gearing is low
3. The business should find it easier to raise additional loan finance
4. Less risk of liquidation due to not being able to make interest payments

(iii) **Possible ways to reduce gearing:**

1. Sell more ordinary shares
2. Reduce or repay loans
3. Increase reserves/retained profits
4. Convert long-term debt to ordinary shares

2015

(i) State the limitations of ratio analysis as a financial analysis technique.

Suggested Solution

(i) **Limitations of ratio analysis**

- It analyses past performance only and these figures are quickly out of date (historical). It merely gives us clues to the future
- Ratios do not show seasonal fluctuations
- Firms use different accounting bases and therefore company comparisons are not accurate
- Financial statements give limited pictures of a business
- Financial statements do not reveal other important aspects of a company
- Accounts alone cannot measure aspects which may be extremely significant such as monopoly position, economics climate, staff morale and management/staff relationships

2014

(c) Explain the difference between the terms 'Liquidity' and 'Solvency' when used in Ratio Analysis. Refer to relevant ratios in your explanation.

Suggested Solution

(c) **Liquidity** measures the ability of the company to pay its short term debts as they fall due. The acid test ratio is a good indicator of liquidity as it includes only liquid assets i.e. cash and debtors.

Solvency is the ability of a company to pay all of its debts as they fall due for payment (long term). Solvency is the most important indicator of a business's ability to survive in the long term. A business is solvent if its total assets exceed its outside liabilities. Debt to equity or total debt to total assets are good guides.

2013

(c) Dantzig plc is considering expansion by purchasing another food business. The following information for 2012 has been obtained on two possible purchases of similar companies:

	AB Foods	XY Traders
Return on Capital Employed	8%	6%
Current Ratio	3.2:1	1.9:1
Liquid (Acid Test) Ratio	0.6:1	1.3:1

Advise Dantzig plc which business, if any, should be purchased on the basis of the information provided.

Suggested Solution

(c) **AB Foods**

The Return on Capital Employed in AB foods is 8%. This is better than XY traders at 6% and also better than Dantzig plc at 5.37%

The current ratio of AB Ltd of 3.2 to 1 is very high. This is possibly indicating excess stock. This is well above that of XY Traders of 1.9 to 1. This indicates poor stock control.

Acid test ratio of 0.6 to 1 is low. It is well below the ratios of both XY Traders and Dantzig plc. This indicates a shortage of cash.

XY Traders

The Return on Capital Employed of 6% is lower than in AB Foods but higher than Dantzig plc at [5.37%]. Both these figures are below the cost of borrowing of 8%.

Current ratio is good and within the range of accepted norms.

Acid Test ratio at 1.3 to 1 is better than AB Foods at 0.6 to 1, but high. This high ratio indicates high debtors or excess cash. Either there is poor cash management or poor debt collection.

My advice to Dantzig plc is to purchase XY Traders.

2012

(c) The gross profit percentage in 2010 was 36%.

(i) Calculate the gross profit percentage for 2011.

(ii) Give 5 different explanations for the decrease/increase in 2011.

Suggested Solution

(c) (i) Gross Profit percentage = 24.68%

(ii)

Cash losses – cash sales not recorded

Stock losses – pilferage of stock or obsolescent stock

Change in sales mix – more sales of low mark-up goods

Mark downs during sales – to get rid of out-of-date stock

Incorrect valuation of stock – overvalue of opening stock, undervaluing of closing stock

Increased cost of sales – without an increase in sales price

Falling sales price – without corresponding drop in cost of sales

2011

(c) Explain the limitations of ratio analysis.

Suggested Solution

(c) **Limitations of ratio analysis**

- It analyses past performance only and these figures are quickly out of date (historical). It merely gives us clues to the future
- Ratios do not show seasonal fluctuations
- Firms use different accounting bases and therefore company comparisons are not accurate
- Financial statements give limited pictures of a business
- Financial statements do not reveal other important aspects of a company
- Accounts alone cannot measure aspects which may be extremely significant such as monopoly position, economics climate, staff morale and management/staff relationships

2010

(c) A friend of yours has been given the opportunity to buy ordinary shares in Hebe plc but before doing so asks for your opinion. What advice would you give? Use ratios, percentages and any other information from the above to support your conclusions.

Suggested Solution

(c)

I would advise my friend **not** to buy shares in Hebe plc for the following reasons:

Share Price
The share value has fallen from €1.80 to €1.50 [30c] since 2009 and is likely to continue in its downward movement based on current year performance. There is a lack of stock market confidence and may discourage investment.

Dividends
Dividend per share is 11.25c. The dividend per share has dropped from 15c. The dividend yield has dropped from 8.3% to 7.5%. Whilst the rate is good the trend is not.

Reserves
The dividend cover is low and dropping. The firm is not retaining enough profits to build up reserves. The company's dividend cover has dropped from 1.4 times to 1.33 times.

Sector
Dairy industry is not performing well and the future is unsure.

Liquidity
Company has a serious liquidity problem. The company now has only 36c available to pay every €1 owed in the short term.

Profitability
Profitability is worsening. The return on capital employed for 2009 is 11.80%. Last year the return was 13%. It has disimproved by 1.20% and this fall indicates an unhealthy trend.

Price Earnings Ratio
Ratio is ten. It would take 10 years to earn back the current price at current earnings.

2009

(c) Having assessed Watson plc what actions would you advise the company to take?

Suggested Solution

(c) Acid Test Ratio is only 0.74 to 1. Ratio dropped from 0.98 to 1 in 2007. Company has a liquidity problem

Raise cash and improve liquidity by:

1. Paying out lower or no dividends

2. Selling investments rather than issuing debentures
3. Issue the remaining 50,000 shares
4. Improving gross profit percentage of 19.9% by reducing cost of sales or by passing on the increased costs
5. Diversifying into other areas
6. Collection of debts more quickly
7. Sale and lease back

2008

(c) A rising liquidity ratio is a sign of prudent management. Briefly discuss.

Suggested Solution

(c) A rising liquidity ratio is not **always** a sign of prudent management.

A rising liquidity ratio could be a sign of prudent management because it indicates that it is easier for the firm to pay its short term debts on time and thus avoid paying interest or enables it to avail of cash discounts.

However, if the liquidity ratio rises significantly above 1:1, it could mean that too much of the company's resources are tied up in liquid assets when they could be used to earn more profits. Management may be leaving cash resources idle.

2007

(c) Advise the bank manager as to whether a loan of €150,000, on which an interest rate of 10% would be charged, should be granted to Mila Plc. For future expansion. Use relevant ratios and other information to support your answer.

Suggested Solution

(c) **Bank Loan Application**
Yes/No

Gearing
The company is highly geared.
The gearing will get worse with a further loan of €150,000.
The gearing with the loan will be 65%.
The Interest Cover will get worse.

Return on Capital Employed
The ROCE will be 8.5% next year which is less than the 10% interest to be charged on the loan.

Dividend Cover/policy
The Dividend Cover is 1.1 times and is projected to increase to 1.31 times.
The Dividend Cover is low.
Not enough earnings are retained for repayment of the loan.

Purpose for which loan is required
The loan is required for future expansion and should generate extra income to service the loan.

Security
The Fixed Assets are valued at €680,000 but one should question depreciation policy to ascertain the real value of the assets.
The Investments alone have a market value of €210,000 which would provide security for the loan of €150,000.
The security is adequate.

Liquidity
The liquidity ratio of 0.99 to 1.
It is expected to improve to 1.1 to 1 in 2007.
However the extra interest payment will cause this to be less favourable.

2006

(c) What actions would you advise the company to take?

Suggested Solution

(c) **Raise cash and improve liquidity by:**

1. Paying out lower dividends
2. Selling investments rather than issuing debentures
3. Issuing more shares
4. Improving gross profit percentage of 21.9% by reducing cost of sales or by passing on the increased costs
5. Diversifying into other areas
6. Collection of debts more quickly
7. Sale and lease back

2005

(c) The gross profit percentage for 2003 was 32%. Give 5 different explanations for the increase/decrease in 2004.

Suggested Solution

(c) The gross profit percentage has dropped from 32% in 2003 to 22% in 2004.

This could be caused by:

- Cash losses
- Stock losses
- Mark downs during sales
- Incorrect valuation of stock
- Increased cost of sales without an increase in sales price
- Change in sales mix

BUDGETING/STOCK VALUATION

2018

(iii) Explain how the concept of prudence applies to the valuation of closing stock.

Suggested Solution

(iii) The prudence concept states caution should be exercised when preparing financial statements. Therefore, only realised profits should be included in the accounts. However, provision should be made for all expected expenses and losses. The prudence concept ensures that profits are not overstated and losses not understated. If closing stock was overvalued then profits would be overstated. Therefore stocks should be valued at the lower of cost or net realisable value.

2017

(e) Why is it important that a business prepares regular budgets?

Suggested Solution

(e) The importance of budgeting:

1. Budgeting is <u>part of the planning process.</u> It is a financial road map for a business
2. Budgeting helps define areas of responsibility for staff and motivates staff to achieve targets, improves communication and builds teamwork
3. The resources of the organisation are used as efficiently as possible and it can adapt quickly to changing circumstances
4. Budgeted figures can be compared with actual performance. Adverse variances can be investigated and action taken to ensure it does not happen again

2015

(iii) Outline the implications of an incorrect stock valuation

Suggested Solution

(iii) Incorrect valuation of stock affects:

- The financial statements of two years or two accounting periods i.e. the closing stock of one accounting period and the opening stock of the next accounting period
- The figures for cost of sales, gross profit, net profit and subsequent figures in the balance sheet

- In the balance sheet it will affect the figures for current assets and working capital/net assets
- In carrying out ratio analysis the figure for stock will affect the stock turnover, percentage mark-up on cost, gross profit percentage, net profit percentage and the current ratio
- The opinion of the firm in financial circles, its tax liability, its ability to borrow, public opinion and consequently its share price

The mark-up on cost in an industry provides a valuable measure for any firm in that industry. A mark-up that is out of line with the norm is a cause for concern and should lead to immediate investigation to locate the reason and take remedial action

Stock turnover determines the total volume of profit. Therefore, the higher the better.

2015

(iii) Explain, with examples, “controllable” and “uncontrollable” costs.

Suggested Solution

(iii) **Controllable Costs:** are costs that can be controlled by the manager of a cost centre. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.

E.g. – all variable costs are controllable. Commission to sales personnel can be controlled by the sales manager.

Uncontrollable Costs: are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs. E.g. – rates to the local authority are uncontrollable.

2015

(c) (i) What options does a business have when it has (a) a cash surplus and (b) a cash deficit?

(ii) On the basis of the cash budget you have prepared, what advice would you give the management of Retro Ltd?

Suggested Solution

(c) (i) **Cash Surplus:** This money can be placed in short term investment opportunities in order to gain the most interest. When the company predicts that it will have a cash surplus this allows it to arrange for short-term investment of surplus funds to gain maximum interest. The surplus could be used to pay off any loans or purchase fixed assets.

Cash Deficit: The business needs to arrange alternative sources of finance e.g. a bank overdraft to get them over the period of the deficit. When the company predicts that it will experience cash deficits this enables management to arrange for alternative sources of finance, e.g. longer periods of credit or bank overdraft accommodation to cover such deficits.

(ii) **Advice**

There are serious cash shortages in both July and August. Retro Ltd should change the credit terms for debtors to encourage more prompt payment for example 6% discount for cash payment in month of sale.

Hire equipment instead of buying it to reduce cash expenditure or delay the start date for repayment of loan/repay loan over a longer period of time.

Agree better credit terms with creditors.

Examine variable overheads to see if they can be reduced.

Examine the wage bill to see if it can be reduced.

2014

(e) (i) Define what is meant by a Cash Budget and explain **two** advantages of a Cash Budget.

(ii) The Principal Budget factor is sales demand in most organisations. State **two** other factors that could also be considered to be the Principal Budget factor.

Suggested Solution

(i) A cash budget is a plan or forecast that summarises the expected inflows and outflows of cash during a period. This budget is prepared by the management accountant of the financial accountant.

A cash budget will anticipate periods when the organisation will have cash surpluses and will enable it to arrange short term investments.

A cash budget will anticipate periods when the organisation will have cash deficits and will enable it to make arrangements for a loan or overdraft.

A cash budget will help in making sure that there is always enough funds available to meet the day to day needs of the business.

(ii) Apart from sales demand the principal budget factor could also be:

- Availability of materials
- Availability of labour
- Capacity of the plant
- Availability of capital

2013

(e) (i) What useful information is available to Murray Ltd from the completed cash budget?

(ii) Explain what is meant by a capital budget.

Suggested Solution

(e) (i) Murray Ltd will be able to see in which months there will be a deficit of cash which will enable it to make arrangements for a loan or overdraft.

It will see which months will have a surplus of cash and will be able to arrange short term investments.

There was a surplus of cash in March and April.

The trend of cash shortages is getting smaller – [normal for new business].

Overdraft facilities will be required each month up to a maximum of €135,800 in any month. The closing cash shortage is €4,850.

(ii) The capital budget deals with planned capital expenditure for example the purchase of a fixed asset. Decisions regarding capital items are the responsibility of the board of directors. Carrying out of the capital budget is the responsibility of the financial controller.

2012

(c) What factors should be taken into account by Din Ltd in arriving at the expected sales of €3,600,000 for the six months of 2012?

Suggested Solution

(c) Last year's sales from other stores

Market research/ opinion of sales manager and sales representatives

Trends/ State of Economy

Price to be charged/ Sales price

Competition

Luxuries versus necessities

2011

(e) (i) Explain the term 'Master Budget'.

(ii) List the components of a Master Budget for a manufacturing firm.

Suggested Solution

A master budget is a summary of all the other budgets and provides an overview of the operations for the planned period.

A master budget for a manufacturing firm consists of:

- Budgeted manufacturing account
- Budgeted trading account and profit and loss account
- Budgeted balance sheet

2010

(c) What is an adverse variance? State why adverse variances may arise in direct materials costs.

Suggested Solution

(c) An adverse variance is when actual costs exceed the budgeted costs. Adverse variances may arise in direct material costs because of an increase in the price of materials or an increase in quantities used.

2009

(e) Prepare a note on the factors taken into account by Greene Ltd in arriving at the expected sales of 59,000 units for the six months of 2010.

Suggested Solution

(e) Last year's sales from other stores

Market research/ opinion of sales manager and sales representatives

Trends/ State of Economy

Price to be charged/ Sales price

Competition

Luxuries versus necessities

2008

(e) (i) Explain what is meant by a capital budget.

(ii) The principal budget factor is sales demand in most organisations. State two other items that could also be considered to be the principal budget factor.

Suggested Solution

(e)(i) The capital budget deals with planned capital expenditure for example the purchase of a fixed asset. Decisions regarding capital items are the responsibility of the board of directors. Carrying out of the capital budget is the responsibility of the financial controller.

(ii) Apart from sales demand the principal budget factor could also be:

- Availability of materials
- Availability of labour
- Capacity of the plant
- Availability of capital

2007

(c) Define 'Cash Budget' and describe two of its advantages.

Suggested Solution

(c) A cash budget is a forecast or plan of cash inflow and cash outflow over a period.

Advantages:

Highlights whether enough cash will be available to meet future needs.

Helps to give advance knowledge so that overdraft can be arranged if shortfall occurs.

Helps to predict future surpluses so that short-term investment can be made.

2006

(b) What is an adverse variance? State why adverse variances may arise in direct material costs.

(c) Explain, with examples, 'uncontrollable' and 'uncontrollable' costs.

Suggested Solution

(b) An adverse variance is when actual costs exceed the budgeted costs. Adverse variances may arise in direct material costs because of an increase in the price of materials or an increase in quantities used.

(c) **Controllable Costs:** are costs that can be controlled by the manager of a cost centre. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.

E.g. – all variable costs are controllable.

Uncontrollable Costs: are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs. E.g. – rates to the local authority are uncontrollable.

2005

(e) Note one of the factors taken into account by Spencer Ltd. in arriving at the expected sales in 2006 of 11,700 units.

Suggested Solution

(e)

- Market research
- Trends
- Last year sales
- Opinion of sales manager and sales representatives
- Price to be charged
- State of economy
- Competition
- Luxury versus necessities

INCOMPLETE RECORDS

2022

There are four fundamental accounting concepts applied in the preparation of accounts. Explain two fundamental accounting concepts, with reference to how they apply to the accounts of McSharry.

Going Concern
It must be assumed when preparing financial statements that the business will continue to operate in its present form into the foreseeable future. Indications of Going Concern are that McSharry has recently purchased and invested heavily in the business in the form of new equipment of €60,000 and a new delivery van of €56,000, capital introduced of €290,000.

Accruals (matching)
All expenses incurred/income earned that belong to an accounting period must be recorded in that accounting period regardless of whether payment/receipts have occurred or not. We see in McSharry's business, account has been taken of amounts due and prepaid at both the beginning and end of the year e.g. total investment income earned of €2,880 has been included in the profit and loss account even though €480 has yet to be received by year end. Rates prepaid of €8,100 at the beginning of the year was included in the rates bill for this year even though paid in 2020 and rates prepaid at the end of the year was excluded from this year's profit and loss account even though it was paid in 2021.

Consistency
Items must be treated the same way from accounting period to the next. We cannot tell from just one set of accounts if this is the case. We would need for example to examine the depreciation policy of next year's accounts to examine consistency from one year to the next. Example equipment 12.5%, vans 20%.

Prudence
When preparing accounts, caution should be exercised. Possible losses must be recorded immediately but income must not be recorded until it is reasonably certain/realised (deferred revenue recognition). McSharry was being prudent when a bad debt provision of €3,645 was created, which is 3% of debtors.

2020

(b) Illustrate how the accruals concept applies to these accounts.

Suggested Solution

(b) The accruals concept states that all expenses incurred in a particular period are recorded in that period regardless of whether they are paid or not. For example in the year ending 31/12/2019 electricity due of €960 must be recorded in the accounts of 2019 even though it won't be paid until 2020. Also even though rates paid in 2019 is €10,320 only the portion of this applying to 2019 would be included in the figure for rates in the profit and loss account and the remainder was shown in the balance sheet as a current asset of €2,480.

All incomes earned must be included in the accounts of that period whether received or not.

Investment income €1,000 must be included in the profit and loss account for 2019 even though €250 of it has yet to be received.

2018

(b) (i) Explain why Walsh should keep records of the amounts taken out as drawings.

(ii) Explain the importance of double entry bookkeeping for Walsh.

Suggested Solution

(b) (i) If drawings are not treated correctly they may be entered in error as a business expense with the result that the profit figure will be reduced/understated. It is also essential to control/monitor how much is taken from the business in the form of drawings.

(ii) Importance of double entry bookkeeping for Walsh:

- It provides a more accurate look at the financial position of a business than single entry bookkeeping due to the matching principle which uses accrual accounting rules to record revenue and expenses
- It reduces errors by providing checks and balances
- It reduces fraud because it allows transactions to be traced/audited
- It can be used in the preparation of financial statements

2016

(b) What advice would you give O'Neill in relation to record keeping?

Suggested Solution

(b) O'Neill should keep a detailed cash book and general ledger supported by appropriate subsidiary day books. This would enable O'Neill to prepare an accurate trading and profit and loss account and therefore would avoid reliance on estimates or net worth to ascertain profit.

2015

(c) Explain the "Accruals Concept" and why it is fundamental to accounting practice.

Suggested Solution

(c) The accruals concept matches expenses and gains to a specific period. All expenses incurred and income gained in a particular period must be included in the accounts of that period regardless of whether they are paid/received or not e.g. electricity due for the current year must be included in the accounts, although the bill may not be paid until the following year as the expense refers to the current year. Advertising prepaid should not be included in the current year's accounts as the payment refers to the following year.

Similarly, all revenue income must be included in the accounts of that period whether received or not. Items sold on credit must be treated as income immediately and not when the money is actually received.

Financial statements are prepared on an accruals rather than on a cash basis. If financial statements are not prepared on an accruals basis profits and assets will be overstated or understated for the period covered by the statements because expenses and income included or excluded may refer to a past or future period.

2013

(c) What additional information would be available to Kelly if he used the "double entry" system to record financial transactions?

Suggested Solution

(c) Additional Information

- General/Nominal Ledger Accounts
- Trial Balance
- Total sales figures (credit and cash)
- Total purchases figure (credit and cash)
- Bank balance
- Capital and drawings
- Bad debts, Expenses due and prepaid
- Discounts allowed or received

2011

(b) What advice would you give O'Hagan in relation to record keeping?

Suggested Solution

(b) O'Hagan should keep a detailed cash book and general ledger supported by appropriate subsidiary day books. This would enable O'Hagan to prepare an accurate trading and profit and loss account and therefore would avoid reliance on estimates.

2009

(c) Summary of the advice you would give to Fuller in relation to the information given above.

Suggested Solution

(c) Fuller should keep a detailed cash book and general ledger supported by appropriate subsidiary day books. This would enable Fuller to prepare an accurate trading and profit and loss account and therefore avoid reliance on estimates.

2007

(c) (i) Explain the term accounting concept?

(ii) Name TWO fundamental accounting concepts.

(iii) Illustrate an accounting concept applying to the accounts of P.Lynch.

Suggested Solution

(i) Accounting concepts are the accounting practices or rules that are applied in the preparation of financial statements.

(ii) **Fundamental Accounting Concepts**

Accruals, Going Concern, Consistency and Prudence

(iii) The accruals concept – All expenses incurred in a particular period must be included in the accounts of that period regardless of whether they are paid or not.

Similarly, all revenue income must be included in the accounts of that period whether received or not. E.g. Electricity due for the current year must be included in the accounts, although the bill may not be paid until the following year as the expense refers to the current year. Insurance prepaid should not be included in the current year's accounts as the payment refers to the following year.

2005

(c) What additional information would be available if Connolly's accounts were prepared using the "double entry" system?

Suggested Solution

(c)

- Total sales figure
- Total purchases figure
- Trial balance
- Bank balance
- Capital
- Goodwill
- Bad debts

PUBLISHED ACCOUNTS

2021

(b) (i) State what is meant by an “Exceptional Item” and give an example.

(ii) Explain what is meant by an auditor’s qualified report.

Suggested Solution

(b) (i) **Exceptional Item –** This is a material item of significant size. It is a profit or loss that must be shown separately in the profit and loss account because of its size. Example: Profit or loss on sale of land or a large bad debt.

(ii) An auditor’s qualified report is when an auditor in his or her opinion is not satisfied that all of the following apply:

- The financial statements give a true and fair view of the state of affairs of the company at the end of the year
- The financial statements are prepared in accordance with the Companies Acts
- All the information given by the directors is consistent with the financial statements
- The net assets are more than 50% of the called-up capital

The report will state the elements of the accounts that are not satisfactory.

2020

(b) Explain **three** reasons why a public limited company publishes its annual report and accounts.

Suggested Solution

(b)

1. To comply with legal requirements. The companies’ acts require the publication of a profit and loss account and balance sheet.
2. To report to shareholders, final accounts are prepared along with a directors’ report and an auditor’s report.
3. To attract investors who might be interested in the financial position of the company to determine whether or not to invest funds.

2018

(b) Explain how an auditor safeguards the interests of shareholders.

Suggested Solution

(b)

- By examining the financial statements and giving an assurance that they give a true and fair view
- By preparing an audit report and giving an assurance that the financial statements have been prepared in accordance with the Companies Acts and accounting standards and practices
- By being able to threaten a qualified audit report thereby discouraging fraud
- Being independent of the directors, the auditor is appointed by the shareholders and is responsible for them

2016

(b) (i) Explain why it is important that financial statements are properly regulated.

(ii) How does the European Union regulate the presentation of accounts?

Suggested Solution

(b) (i) Regulation is important for the following reasons:

1. To ensure that financial statements are consistent from year to year.
2. To ensure that financial statements can be easily compared with other businesses.
3. To ensure that financial statements comply with national and international law.
4. To ensure that the required accounting information is available to external users (e.g. banks)
5. Good regulation makes fraud less likely and builds trust among the investing public.

(ii) The European Union influences regulation by issuing directives. Directives are instructions that are binding on member states. Member states are given a fixed period of time to implement the directive into national law. The purpose of directives is to harmonise accounting practice in member states. An example would be the fourth directive.

2014

(b) (i) State **three** items of information that must be included in a Directors' Report.

(ii) Explain the term "Exceptional Item" and use an example to support your answer.

Suggested Solution

(b) (i) A Director's Report must include the following:

- The amount to be transferred to reserves
- A report of any changes in the nature of the company's business during the year
- A fair review of the development of the business of the company during the year and of the position at the end of the year
- The principal activities of the company and any changes therein
- Details of any important events affecting the company since the end of the year
- Any likely future developments in the business
- An indication of activities in the field of research and development
- Significant changes in fixed assets
- Details of own shares purchased
- A list of the company's subsidiaries and affiliates
- Evaluation of company's compliance with its safety statement
- Details of directors' shareholdings and dealings during the year

(ii) **Exceptional Item –** This is a material item of significant size. It is a profit or loss that must be shown separately in the profit and loss account because of its size. Example: Profit or loss on sale of land or a large bad debt.

2013

(b) (i) Name the bodies/institutions that regulate the production, content and presentation of company financial statements.

(ii) What is an audit? Explain a qualified auditor's report.

Suggested Solution

(b) (i)

- The Government – Legislation
- The European Union – Directives
- Accounting Standards Board – FRS's and SSAP's
- The Stock Exchange – Listing Rules

(ii) An audit is an examination of the financial statements of an enterprise by an appointed auditor. The audit is conducted by an auditor who is independent. The auditor expresses an opinion and certifies whether the accounts give a true and fair view of the financial position of the business. The Companies Acts require the auditor to certify that the accounts give a *true and fair view* of the financial position of the business.

A qualified auditor's report is when an auditor in his/her opinion is ***not satisfied*** or is unable to conclude that all or any of the following apply:

- The financial statements give a true and fair view of the state of affairs of the company at the end of the year
- The financial statements are prepared in accordance with the Companies Acts
- All the information necessary for the audit was available
- The information given by the directors is consistent with the financial statements
- The net assets are more than 50% of the called-up capital

The report will state the elements of the accounts that are unsatisfactory.

2011

(b) (i) State how a company should deal with a contingent liability which is probable.

(ii) Explain the difference between an auditor's qualified and unqualified report.

Suggested Solution

(b) (i) When a contingent liability is probable, the estimated amount should be provided for in the accounts and a note should show the nature of the loss.

(ii) An unqualified auditor's report is often referred to as a clean report. A report is unqualified when the auditor in his/her opinion **is satisfied** that the following apply:

- The financial statements give a true and fair view of the state of affairs of the company at the end of the year and of its profit and loss account for the year
- The financial statements are prepared in accordance with the Companies Acts
- All the information necessary for the audit was available
- The information given by the directors is consistent with the financial statements
- The net assets are more than 50% of the called-up capital

A qualified auditor's report is when an auditor in his/her opinion is **not satisfied** or is unable to conclude that all or any of the above apply:

The report will state the elements of the accounts or of the director's report that are unsatisfactory.

2009

(b) (i) State three items of information that must be included in a director's report.

(ii) Explain the term "exceptional item" and give an example.

Suggested Solution

(i) A Director's Report must include the following:

- The amount to be transferred to reserves
- A report of any changes in the nature of the company's business during the year
- A fair review of the development of the business of the company during the year and of the position at the end of the year
- The principal activities of the company and any changes therein
- Details of any important events affecting the company since the end of the year
- Any likely future developments in the business
- An indication of activities in the field of research and development
- Significant changes in fixed assets
- Details of own shares purchased
- A list of the company's subsidiaries and affiliates
- Evaluation of company's compliance with its safety statement
- Details of directors' shareholdings and dealings during the year

(ii) **Exceptional Item –** This is a material item of significant size. It is a profit or loss that must be shown separately in the profit and loss account because of its size. Example: Profit or loss on sale of land or a large bad debt.

2008

(b) (i) State how a company would deal with a contingent liability which is possible but unlikely.

(ii) What regulations must accountants observe when preparing financial statements for publication?

Suggested Solution

(i) When a contingent liability is possible but unlikely, it is not necessary to make provision in the accounts. However, a note should show the nature of the liability, an estimate of the amount and an opinion regarding the outcome.

(ii) Accountants must observe regulations laid down by:

The Companies Acts

The Financial Reporting council/Accounting Standards Board

The Stock Exchange

2006

(b) What is an audit? Describe an auditor's report that is "qualified".

Suggested Solution

(b) **Audit**

An audit is the independent examination of the expression of opinion on the financial statements of an enterprise by an appointed auditor. The main objective of an audit is to enable the auditor, in keeping with the requirements of the Companies Acts, to report on the truth and fairness shown by:

- The balance sheet, the profit or loss shown by the profit and loss account and
- Any other information required to be disclosed in the financial accounts

The Companies Acts do not require the auditor to certify that the company records are correct or accurate but that the accounts give a true and fair view of the financial position of the business.

Qualified Auditor's Report

A qualified auditor's report is when an auditor in his/her opinion is <u>**not satisfied**</u> or is unable to conclude that all or any of the following apply:

- The financial statements give a <u>true and fair view</u> of the state of affairs of the company at the end of the year and of its profit and loss account for the year
- The financial statements are prepared in accordance with the Companies Acts
- All the information necessary for the audit was available
- The information given by the directors is consistent with the financial statements
- The net assets are more than 50% of the called-up capital

The report will state the elements of the accounts or of the director's report that are unsatisfactory.

2005

(b) State three items of information that must be included in a Directors' Report.

(c) Explain the term "exceptional item" and give an example

Suggested Solution

(b) A Director's Report must include the following:

- The dividends recommended for payment
- The amount to be transferred to reserves
- A report of any changes in the nature of the company's business during the year
- A fair review of the development of the business of the company during the year and of the position at the end of the year
- The principal activities of the company and any changes therein
- Details of any important events affecting the company since the end of the year
- Any likely future developments in the business
- An indication of activities in the field of research and development
- Significant changes in fixed assets
- Details of own shares purchased
- A list of the company's subsidiaries and affiliates
- Evaluation of company's compliance with its safety statement
- Details of directors' shareholdings and dealings during the year

(c) **Exceptional Item –** This is a material item of significant size. It is a profit or loss that must be shown separately in the profit and loss account because of its size. Example: Profit or loss on sale of land or a large bad debt.

CLUB ACCOUNTS

2022

(i) Explain with the use of an example what is meant by a Special Purpose Profit & Loss Account.

Many not-for-profit organisations run activities to raise funds for the organisation. These activities are intended to generate profits to invest in the organisation.

The expenses and revenues relating to that particular activity are entered in a "special profit and loss account" and the profit is then transferred to the income and expenditure account.

Examples - Running a bar, a restaurant, a lotto, a dance.

(ii) There is a proposal to reduce annual subscriptions by 10% for the next three years. As Treasurer of Abbey Hockey Club, what points would you make in favour of this proposal?

The proposal to reduce subscriptions by 10% will reduce income by €35,534 per year based on current subscriptions.

Points in favour
The club is in a healthy financial position with a bank balance of €239,170 which is considerably higher than the bank balance at the beginning of the year €9,800. Excluding the once off grant of €120,000 this is still very healthy.

They have investments of €25,200

They have paid back a loan with interest of €273,480 in total.

The club has a current surplus income of €329,845 which will reduce to €294,291 with the reduction of €35,534 in subscriptions which is a very healthy surplus.

This may bring in extra members which may counteract the reduction in the subs rate and result in revenue remaining the same.

The club has net expenditure on fixed assets of €40,000 which it may not have in the coming years.

The club is well able to financially sustain a reduction in the subscription fee of 10%.

2016

(c) Distinguish between "levy" and "life membership". Explain how both are treated in the accounts.

Suggested Solution

(c) **Levy**

This is a payment made to a club by its members to fund a special project such as a clubhouse extension. It must be used for the purpose for which it is collected. It is a capital receipt (on a once off basis or for a specific number of years) and is credited to a reserve fund. It is due to the members until it is used so it is treated as a long-term liability in the balance sheet.

Life Membership

This is where a club member pays a fee that entitles her/him to use the facilities of the club for the rest of her/his life. It is treated as a long-term liability in the balance sheet and can be written off to income over a stated number of years.

2013

(c) (i) Explain with the use of an example what is meant by a Special Purpose Profit & Loss Account.

(ii) The club has decided to lay an all-purpose floor at a cost of €150,000. The Treasurer has proposed to increase the levy by €120 per annum and extend it for five more years. As an ordinary member what arguments would you make against this proposal?

Suggested Solution

(c) (i) Sometimes non-profit making organisations such as a club prepare a profit and loss account for activities that are carried out to make a profit e.g. running a club lotto, dances, bar, restaurant etc. All expenses and revenues relating to the particular activity are entered in a special purpose profit and loss account and the profit/loss is then transferred to the income and expenditure account.

(ii) The proposed levy would raise €150,000 over the next 5 years [200 x 150 x 5]
The club has funds amounting to:

Investments	30,000
Building Society	28,000
Cash	4,310
	62,310

As a member I would make the case:

The proposed levy of €200 [120 + 80] amounts to 66% of the annual subscription. An increased levy would discourage new members and perhaps cause a drop in membership.

The club is capable of generating enough income from within as it has a surplus of income amounting to €69,099 and it is financially sound as it has a cash balance of €4,310, building society investment of €29,000 and 4% Government investments totalling €62,310.

Although a sizable proportion of the surplus is provided by sponsorship of €73,000 and it cannot be guaranteed in future years it should be noted that this figure is well below the non-recurring capital amounts paid during the year i.e. equipment €41,000 and loan €44,800 amounting to €85,800.

The club should use the cash and investments totalling €62,310 and borrow the remainder of €90,000 approx. or continue with levy of €80 for five years plus use current funds and borrow €28,000 approx.

The improved facilities could:

- Increase the rent earned from the arena
- Increase membership
- Encourage increased advertising income

2011

(d) (i) State and explain **two** limitations of a Receipts and Payments Account.

(ii) The club is considering the installation of floodlights at a cost of €70,000. What advice would you give to the Treasurer of the club?

Suggested Solution

(d) (i) **Limitations of a Receipts and Payments Account.**

- Does not show whether the club is raising enough funds to cover its running costs
- Amounts due but unpaid at the end of the accounting period are not included
- Only shows an increase or decrease in cash although there could be outstanding bills
- Does not take into account losses such as depreciation
- Does not show whether the club bar or restaurant are profitable
- Does not distinguish between receipts for the current year and other years

(ii) Yes I would advise the treasurer to go ahead and install the floodlights. The improved facilities would allow longer use of club courts resulting in added income from usage. This could enable the club to increase its membership and thereby increase the annual surplus of income as well as greater usage of the restaurant and the bar.

The club is in a strong financial position: It has a surplus of income over expenditure of €34,894 in the current year. At this rate of surplus enough funds would be generated in little over two years.

The club has increased its bank balance to €45,180 after paying off a loan of €30,000 during the year. [includes levy €20,000].

To fund the expenditure of €70,000 the club could use the cash balance of €45,180, the prize bonds of €4,400 and withdraw €20,420 from the investment fund.

The club should avoid using any of the funds raised through the levy as this is more than likely earmarked for other purposes and these funds may be needed for future capital expenditure.

Funds available without Reserve Fund

Investments	50,000
Prize bonds	4,400
Bank balance	45,180
	99,580
Less Levy	(40,000)
Net available	59,580

Borrow the remainder in the short term as the club is capable of paying back quickly through its regular income sources.

2008

(c) (i) Explain with the use of an example what is meant by a Special Purpose Profit & Loss Account.

(ii) If it was proposed to introduce a further four year levy to fund a €250,000 extension what points would you as an ordinary member now make.

Suggested Solution

(c) (i) Sometimes non-profit making organisations such as a club prepare a profit and loss account for activities that are carried out to make a profit e.g. running a club lotto, dances, bar, restaurant etc. All expenses and revenues relating to the particular activity are entered in a special purpose profit and loss account and the profit/loss is then transferred to the income and expenditure account.

(ii) The proposed levy would raise €200,000 over four years [250 x 200 x 4]

Yes/No

As a member I would make the case that the club is capable of generating enough income from within as it has a surplus of income of €63,180. The club is financially sound as it has cash of €13,960, building society investment of €60,000 and 5% government investments €24,000 totalling €97,960 even after it has paid off a loan and interest of €33,600 and had purchased equipment for €45,000.

However a sizeable proportion of the surplus is provided by entrance fees of €15,000 and sponsorship of €25,000. This income cannot be guaranteed in future years.

2004

(d) Indicate the points you, as treasurer, might make if the members at the AGM of the club proposed to reduce the annual subscription by 20%.

Suggested Solution

(d) A reduction in subscriptions of 20% for 2004 would involve a reduction in club income of €36,000.

Although the club is financially sound as it has €5,190 in the bank, €70,000 in the building society, investments worth €40,000 and has paid off a loan of €30,000 these funds are set aside for future capital expenditure.

The club's surplus of income for the year 2003 of €50,015 would seem to indicate that the club is capable of bearing a reduction of 20%. However almost all of this surplus is provided by entrance fees of €17,000 and sponsorship of €33,000 and this income cannot be guaranteed in future years.

It can be argued that a reduction in membership fees could attract more members and thus bring in entrance fees as well as increase bar profit. However it would not be prudent to reduce subscription fees at present and instead it would be advisable to retain the present level of fees and use these fees to provide improved facilities for the members and thus attract more members.

SERVICE FIRMS

2018

(c) Dr. Noctor is considering updating the IT system and requires a loan of €150,000. Outline the factors a lender should consider before granting the loan.

Suggested Solution

(c) Factors to be considered before granting loan of €150,000:

- Gearing – The firm has no long term loans at the moment which would encourage a lender to grant a loan
- Ability to pay interest – The net profit is €44,745 with no interest charges at present. The acid test ratio is 1.92:1 meaning the firm is liquid and could easily meet future interest charges
- What is the purpose of the loan? The purpose of the loan is to update the IT system making the company more efficient going into the future
- What security can she offer? Security is adequate with fixed assets of €174,800 and investments of €100,000 to cover a loan of €150,000

FARM ACCOUNTS

2020

(e) Outline the implications of an incorrect closing stock valuation for McAteer

Suggested Solution

(e) Incorrect valuation of stack affects:

1. The financial statements of two years or two accounting periods i.e. the closing stock of one accounting period and the opening stock of the next accounting period.
2. The figure for cost of sales, gross profit, net profit and the farm's tax liability.
3. In carrying out ratio analysis the figure for stock will affect the stock turnover, percentage mark-up on cost, gross profit percentage, net profit percentage and the current ratio.
4. The amount it may be able to borrow.

2015

(e) (i) For what purposes does a farmer prepare a General Profit & Loss Account?

(ii) Outline the advantages of preparing farm enterprise analysis accounts.

Suggested Solution

(e) (i) **Purposes of a general Profit & Loss Account**

- Expenses or gains that cannot be allocated directly to the individual farm enterprises are included in this account
- It is used to ascertain the overall profit or loss of a farm

(ii) **Advantages of preparing farm enterprise analysis accounts**

This allows better planning and decision making and resources can be diverted elsewhere if necessary.

Preparing farm enterprise analysis accounts allows costs to be allocated to the relevant individual activity within the farm.

The farmer can find the profit/loss on each individual farm activity. The contribution of an individual enterprise towards total profit can be seen.

CORRECTION OF ERRORS/SUSPENSE

2022

(i) What is the purpose of preparing a trial balance?

A trial balance is prepared in order to check/test the accuracy of double before preparing the income statement, (Final Accounts) and the statement position. (Balance Sheet)

A trial balance should have the same total of debits and credits because bookkeeping every debit entry should have a corresponding credit entry.

(ii) Outline different types of errors that may affect the balancing of t

1. Entering one figure on one side of a ledger account, but entering a the other side of another ledger account
2. Entering one figure on one side of a ledger account, but entering a same side of another ledger account
3. Entering one figure on one side of a ledger account but entering no side of another ledger account
4. Mathematical errors/errors of calculation, addition, subtraction in off

2020

(e) Give an example of an error of commission. Will this type of error be revealed by a trial balance? Explain your answer.

Suggested Solution

(e) Error of Commission

This is where the correct amount is posted to the correct side of the incorrect account. For example sales of €5,000 debited to M O'Flaherty's account instead of D O'Flaherty.

This will not be revealed by the trial balance as the correct amount has been entered on the debit side even though in the wrong account. The debit side and credit side of the trial balance will agree so it will not be obvious that an error has been made.

2018

(e) Outline the purpose of a suspense account

Suggested Solution

(e) Purpose of a suspense a/c

- A suspense a/c is used when there is a mistake in the accounts that prevents the trial balance from balancing

- The difference between the debit and credit side of the trial balance is entered in the suspense a/c, until the errors are discovered, in order to allow the trial balance to balance. The relevant errors are corrected through the suspense account and the balance is then eliminated

2016

(e) Explain

(i) Compensating errors.

(ii) Errors of original entry.

Suggested Solution

(e) (i) **Compensating Errors:** This is where an error on the debit side of one account is compensated by another error of an equal amount on the credit side of another account. For example, a cash payment of €550 for repairs entered as €55 on the debit of the repairs account and on the credit side of the cash account.

(ii) **Errors of original entry:** These are errors made in the books of first entry which are then, subsequently, posted to the appropriate ledger accounts. For example, credit purchases from T. Long €223 entered as €322 in the purchases book and posted accordingly to both the purchases account and to Long's account.

2014

(e) Identify **three** types of errors that affect the balancing of a Trial Balance.

Suggested Solution

(e) Errors in figures and addition.

Posting only one side of the double entry.

Entering one amount on the debit side of one ledger account and a different amount on the credit side of another ledger account.

2012

(c) (i) What is the purpose of preparing a Trial Balance?

(ii) State and explain **two** types of errors not revealed by the Trial Balance.

Suggested Solution

(c) (i) A Trial Balance is prepared in order to test the accuracy of double entry bookkeeping before preparing Final Accounts. A Trial Balance should have the same total of debits and credit and have the same amounts because under double entry bookkeeping every debit entry should have a corresponding credit entry.

(ii) **Errors not revealed by a trial balance:**

Errors of original entry – errors made in the books of first entry

Errors of principle – incorrect class of account – entering an asset in an expense account

Errors of complete omission – where both debit and credit are omitted

Errors of commission – posting to wrong account but to correct side of correct type of account

Compensating errors – where errors of equal value cancel each other out

Reversal of entries – where the debit entry is on the credit side and the credit entry is on the debit

2010

(e) Identify **three** different types of errors that affect the balancing of a Trial Balance.

Suggested Solution

(e) Entering one amount on the debit side of one ledger account and entering a different amount on the credit side of another ledger account.

Mathematical errors – figures and additions

Posting only one side of the double entry

2008 & 2006

(e) Explain with examples what is meant by:

(i) Error of Commission;

(ii) Error of Principle.

Suggested Solution

(e) (i) An error of commission occurs when the correct amount is posted to the correct side of the incorrect account. Example: Goods sold on credit to Brian Brady debited in error to John Brady's account.

(ii) An error of principle arises when an item is posted to the incorrect class of account. Example: A boutique owner purchased a vehicle and treated it as a purchase of stock.

COSTING

2022

(i) Explain why overhead absorption rates are based on budgeted costs rather than actual costs.

Overhead absorption rates are based in budgeted costs rather than actual costs because;

The product needs to be costed at the time of order but actual costs may often not be known until the end of the year. A business cannot wait till then to set the selling price of a product for a customer.

(ii) Explain, under-absorption of overheads, and how it might arise in a manufacturing firm.

Under-absorption is when costs are under-recovered. Budgeted costs are less than actual costs. This may be due to -

1. Actual labour hours used in the manufacturing process could be higher than budgeted for.
2. There could have been errors in estimating overheads.
3. Overhead expenses are higher due to unforeseen events e.g. oil prices higher on world markets or depreciation of assets higher than estimated.
4. There could have been unexpected changes in method of production causing higher than expected prices e.g. more fuel required to power machines.
5. Cleaning costs have increased due to the wages of the staff increasing because of inflation.
6. Light and heat costs have increased due to oil and gas prices rising.
7. Insurance costs have increased due to higher premiums as a result of higher risks.
8. Transport costs have increased due to diesel prices increasing.
9. Depreciation expenses have increased due to higher expenditure on fixed assets.

2020

(v) Explain what is meant by a step fixed cost and give an example.

(ii) Outline the differences between marginal and absorption costing. Indicate which method should be used for financial accounting purposes. Explain your answer.

Suggested Solution

(v) Step fixed costs

Step fixed costs are costs that are fixed within a certain range of activity but change outside of that range.

E.g. rent could be fixed up to a certain level of production. However if production increases and results in the rental of more factory space, then the rent would increase to a new level. Thus, the fixed costs would increase in steps.

(ii) **Marginal v Absorption Costing**

There is a different profit figure because closing stock is valued differently.

Marginal costing does not include fixed costs when costing a product whereas absorption costing does include the fixed costs.

Therefore, closing stock under marginal costing is valued lower than under absorption costing because a share of fixed costs is included in the value of stock under absorption costing but not included under marginal costing.

Under absorption costing, closing stock is valued at 20% of the production cost of €36,150. Under marginal costing, closing stock is valued at 20% of the production cost of €27,750.

Closing stock under absorption costing is €7,230.

Closing stock under marginal costing is €5,550.

This is a difference of €1,680.

The profit difference is €21,480 - €19,800 = €1,680

Absorption costing should be used as it agrees with standard accounting practice concepts and matches costs with revenues.

2019

(e) (i) Explain why it is necessary to transfer service department overheads to production departments.

(ii) Distinguish between the allocation, apportionment and absorption of costs.

Suggested Solution

(e) (i) Service departments cannot recover costs because no production takes place in these departments. Service departments are secondary to production departments and as a result, service department costs must be transferred to production departments on an equitable basis e.g. machine hours. Overheads can only be recovered through production i.e. they are included as a cost of production.

(ii) Allocation is where overhead costs can be specifically identified and charged to a particular department or cost centre. These overheads are allocated to that department.

Apportionment is where overheads cannot be specifically identified but are shared or divided between departments using an appropriate basis of apportionment.

Absorption is the method by which costs are charged to cost units/units of products in order to be recovered. An overhead absorption rate for each department can be calculated using a suitable basis such as rate per unit, per labour hour and per machine hour.

2018

(iv) Outline the role of the management accountant within an organisation.

Suggested Solution

(iv) Role of the Management Accountant

The management accountant is a key member of an organisation's management team who makes a vital contribution to the managerial functions of planning, controlling and decision making.

The management accountant is responsible for:

1. Preparing data/gathering information required for formulating plans.
2. Recording costs and providing details of the cost of products and departments.
3. Participation in the creation and executing of budgets.
4. Assisting in the control of operations by comparing actual costs with budgeted costs.
5. Providing data for decisions that require managers to select between alternative courses of action.
6. Ensuring that relevant data is provided to managers on a timely basis and that the data is readily understandable.
7. The valuation of closing stock which is then used in the preparation of financial statements.

2017

(f) What is meant by the term "Sensitivity Analysis"?

Suggested Solution

(f) Sensitivity analysis is also known as "what if" analysis. It is a technique used by the management accountants to show the effect on profit brought about by changed in the following:

1. Selling price
2. Sales volume
3. Variable costs
4. Fixed costs

2016

(e) (i) Explain what is meant by reapportionment of overheads.

(ii) Name **three** overhead absorption rates and state why they are based on budgeted figures.

Suggested Solution

(i) The reapportionment of overheads is the term used where service department costs are reapportioned/divided between production departments because overheads can only be recovered by being included in the costs of production.
(ii) Absorption rates:

- Per labour hour
- Per machine hour
- Per unit
- Percentage of prime cost

Overhead absorption rates are based on budgeted rather than actual costs because actual costs may not be known until the end of the year and the business cannot wait until then to decide the costs of the product as they need to decide on the selling price to charge for tendering purposes.

2014

(ii) Outline the differences between Marginal and Absorption costing.

Indicate which method should be used for financial accounting purposes and why.

Suggested Solution

(ii) There is a difference in the profit figures because closing stock is valued differently. Closing stock under marginal costing is valued lower than under absorption costing. When costing a product, marginal costing does not include fixed costs whereas in absorption costing the fixed costs are included. Therefore a share of fixed costs is included in the value of stock under absorption costing and not included under marginal costing.

Under absorption costing, closing stock is valued at a 1/10 of the production cost of €19,000

Under marginal costing, closing stock is valued at a 1/10 of the variable cost of €15,000

Closing stock – absorption costing	1900
Closing stock – marginal costing	(1500)
Difference	400

The profit difference is 18,900 – 18,500 = 400

Absorption costing should be used as it agrees with standard accounting practice and concepts and also matches costs with revenues.

2012

(iii) Explain, with examples, “controllable” and “uncontrollable” costs.

Suggested Solution

(iii) **Controllable Costs:** are costs that can be controlled by the manager of a cost centre. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.

E.g. – all variable costs are controllable. Commission to sales personnel can be controlled by the sales manager.

Uncontrollable Costs: are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs. E.g. – rates to the local authority are uncontrollable.

2011 & 2009 d (i)

(f) (i) List and explain **two** limitations/assumptions of marginal costing.

(ii) Explain what is meant by a step fixed cost.

Roughly sketch a graph of step fixed costs using the following rental payments

Rent €	€5,000	€12,000	€19,000	€28,000
Output (units)	20,000	30,000	40,000	50,000

Suggested Solution

(f) (i) **Limitations/assumptions**

Variable costs are assumed to be completely variable at all levels of output. However variable costs may decrease due to economies of scale **or** may increase because of increased costs.

It is assumed that in marginal costing fixed costs remain the same although most fixed costs are step-fixed and are only fixed within a relevant range.

It is assumed that all mixed costs are easily separated into fixed or variable. The high low method can be used for this purpose but it is not always possible to do this.

It is assumed that the selling price per unit is constant and does not allow for discounts.

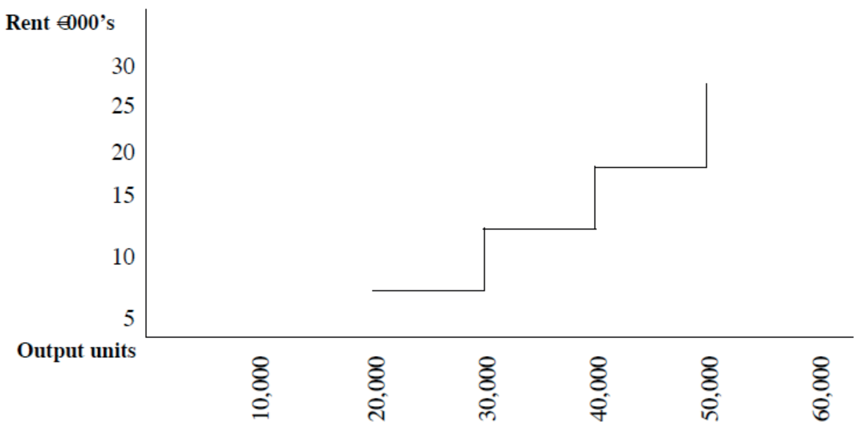
Production in a period usually equals sales. Fixed costs are charged in total to a period and are not carried forward to the next period.

(ii) **Step fixed costs**

Step fixed costs are costs that are fixed within a certain range of activity but change outside of that range.

E.g. rent could be fixed up to a certain level of production. However if production increases and results in the rental of more factory space, then the rent would increase to a new level. Thus, the fixed costs would increase in steps.

<u>Graph</u> [5]



2009

(d) (ii) Outline two differences in focus between Management and Financial accounting.

Suggested Solution

(d) (ii)

Management Accounting	Financial Accounting
Is concerned with planning for the future and provides information for planning and budgeting.	Is concerned with recording past events. Information is provided in the form of a profit and loss account, balance sheet and cash flow statement.
Has an internal focus and furnishes information to aid planning and decision making.	Has both internal and external focus and furnishes information to stakeholders such as managers, shareholders and creditors.
Is not governed or restricted by legislation or legal requirements.	Is governed and regulated by both legislation and accounting standards such as FRS's.
Reports are prepared as often as the managers require them.	Reports are prepared usually once a year
Reports are prepared for cost centres/departments.	Reports are prepared about the whole business.

2007

(iv) Explain what is meant by "re-apportionment" of overheads.

(v) Illustrate and explain "over-absorption" of overheads.

Suggested Solution

(iv) **Re-apportionment**:

This is the term used where service department costs are re-apportioned between production departments because overheads can only be recovered by being included in the costs of production.

(v) **Over-absorption:**

Over-absorption is when costs are over recovered – budgeted costs are greater than actual costs. The cost of fuel/power reduced.

2006

(b) Outline the differences between Marginal and Absorption costing. Indicate which method should be used for financial accounting purposes and why.

Suggested Solution

(b) There is a difference in the profit figures because closing stock is valued differently.

Marginal costing does not include fixed costs when costing a product whereas absorption costing does include the fixed costs.

Therefore closing stock under marginal costing is valued lower than under absorption costing because a share of fixed costs is included in the value of stock under absorption costing and not included under marginal costing.

Under absorption costing, closing stock is valued at a ¼ of the production cost of 17,400.

Under marginal costing, closing stock is valued at ¼ of the production cost of 14,400.

Closing stock – Absorption costing	4,350
Closing stock – Marginal costing	(3,600)
Difference	750

The profit difference is 22,950 – 22,200 = 750

Absorption costing should be used as it agrees with standard accounting practice and concepts and matches costs with revenues.

2005

(d) Name three overhead absorption rates and why they are based on budgeted rather than actual figures.

Suggested Solution

(d) Absorption rates

Per Labour Hour

Per Machine Hour

Per Unit

Per percentage of Prime Cost

Overhead absorption rates are based on budgeted rather than actual costs because actual costs may not be known until the end of the year and the business cannot wait until then to decide the cost of the product as they need to decide on the selling price to charge.

2004

(f) List and explain two limitations/assumptions of marginal costing.

Suggested Solution

(f) **Limitations/assumptions**

Variable costs are assumed to be completely variable at all levels of output. However variable costs may decrease due to economies of scale or may increase because of increased costs.

It is assumed that in marginal costing fixed costs remain the same although most fixed costs are step-fixed and are only fixed within a relevant range.

It is assumed that all mixed costs are easily separated into fixed or variable. The high low method can be used for this purpose but it is not always possible to do this.

It is assumed that the selling price per unit is constant and does not allow for discounts.

Production in a period usually equals sales. Fixed costs are charged in total to a period and are not carried forward to the next period.

BUDGETING

2022

(i) Outline why budgetary control is necessary in an organisation.

Budgetary control is necessary to

1. Draw up a plan of performance - budgets are a roadmap for the business.
2. Identify areas of responsibility to provide direction and motivation to staff to achieve targets.
3. To identify future costs and revenues in order to plan cash inflows and outflows and control costs.
4. Plan raw material requirements to ensure production levels can be achieved.
5. Plan labour requirements to ensure adequate staffing levels in all areas.
6. To ensure resources are used efficiently and to be capable of adapting to changing circumstances.
7. To compare budgeted figures with actual figures and to identify variances.

(ii) In relation to budgets, explain what is meant by a favourable variance and give an example of how it might arise in the direct costs of a manufacturing firm.

A favourable variance occurs when actual costs are less than budgeted costs.

A favourable variance might arise if

- The purchase price of raw materials is less than expected because of economies of scale or lower import charges/discount on early payments
- Less labour hours (lower wage costs) were required due to improved productivity from employees
- Hire costs of special equipment is less than expected due to a surplus of equipment on the rental market
- Patent royalty costs are less than anticipated due to the patents coming close to their retirement date

2021

(c) (i) What is meant by the term sensitivity analysis?

(ii) Outline why Henry Ltd would prepare a flexible budget.

Suggested Solution

(c) (i) Sensitivity analysis is also known as “what if” analysis. It is a technique used by management accountants to show the effect on profit brought about by changes in the following:

1. Selling price
2. Sales volume
3. Variable costs
4. Fixed costs

The examples in part (b) of the question are examples of sensitivity analysis.

(ii) Henry Ltd would prepare a flexible budget:

1. To show management the cost levels at different levels of production. It is misleading to compare the budgeted costs at one level of activity with the actual costs at a different level of activity.
2. To compare actual costs and budgeted costs at the same level of activity in order to determine if actual costs exceeded or were less than budgeted costs.
3. To compare budgeted costs and actual costs in order to identify variances. This allows corrective action to be taken.
4. To help in controlling costs or planning production levels.

2020

(e) (i) What useful information is available to Houghton Ltd from the cash budget?

(ii) Explain what is meant by a master budget.

Suggested Solution

(e) (i) In July and August the company had a maximum cash deficit of €110,920. The company needs to arrange a bank overdraft of €110,920 or else take corrective action by leasing the equipment, saving €12,000, or extending the period of credit received from one month to two months.

The company could also try and get customers to buy more goods for cash rather than credit. This shortfall is eliminated in September and October with a cash surplus at the end of October of €345,078. This could be used to purchase new fixed assets increasing the productive capacity of the firm or purchase investments which increase investment income and profit.

(ii) **Master Budget**

A master budget is a summary of all the other budgets and provides an overview of the operations for the planned period. For example; a manufacturing budget, a sales budget, a cash budget.

2019

(e) Explain **three** reasons for product costing.

Suggested Solution

(e)

1. Establishes the selling price for tendering purposes.
2. Controls costs by comparing budgeted costs with actual costs.
3. Helps with planning and decision making.
4. To find the value of closing stock to be used when calculating profit.

2018

(c) (i) Distinguish between the terms “contribution” and “profit”.

(ii) Outline why Conlon Ltd would prepare a flexible budget.

Suggested Solution

(c) (i) Contribution is sales revenue less variable costs. This goes towards paying off the fixed costs. Once the fixed costs are paid off, any further contribution goes towards profit. Profit is sales revenue less total costs (fixed and variable)

(ii) Conlon Ltd would prepare a flexible budget:

1. To show management the cost levels at different levels of production.
2. To compare actual costs and budgeted costs at the same level of activity.
3. To compare budgeted costs and actual costs in order to identify variances. This allows corrective action to be taken.
4. To help in controlling costs or planning production levels. It is misleading to compare the budgeted costs at one level of activity with the actual costs at a different level of activity.

2016

(e) (i) What recommendations would you make to Irwin Ltd based on the budgets you have prepared?

(ii) Outline the factors which Irwin Ltd should take into account when estimating future sales figures.

Suggested Solution

(e) (i) **Recommendations**

1. Reduce requirement for closing stock of finished goods, particularly in earlier months to reduce the costs of production.
2. Negotiate a lower price than the €4 per kg, from suppliers when buying raw materials and this will reduce cash expenditure

3. Encourage debtors to pay earlier by offering discounts for early payment/reduce the period of credit allowed from 2 months to one month, which will increase receipts.
4. Postpone the purchase of equipment in July and instead lease the equipment. This will reduce the deficit in July by €12,000 (€60,000 - €48,000) and by the interest and loan repayments €1,400 thereafter.

(ii) **Factors**

1. Market research and trends/opinions of sales representatives may be a reliable indicator of potential sales.
2. What is the price to be charged for the product or service?
3. Is the level of competition in the marketplace intense or not?
4. Is the economy expected to grow over the coming months?

2014

(e) (i) Define what is meant by a cash budget and explain **two** advantages of a cash budget.

(ii) The principal budget factor is sales demand in most organisations. State **two** other factors that could also be considered to be the principal budget factor.

Suggested Solution

(e) (i) **Cash Budget**

A Cash Budget is a plan or forecast that summarises the expected inflows and outflows of cash during a period. This budget is prepared by the management accountant or the financial accountant.

A cash budget will anticipate periods when the organization will have cash surpluses and will enable it to arrange short term investments.

A cash budget will anticipate periods when the organization will have cash deficits and will enable it to make arrangements for a loan or overdraft.

A cash budget will help in making sure that there is always enough funds available to meet the day to day needs of the business.

(ii) **Principal Budget Factor:**

Apart from sales demand the principal budget factor could also be:

- Availability of materials
- Availability of labour
- Capacity of the plant
- Availability of capital

2013

(e) (i) What useful information is available to Murray Ltd from the completed cash budget?

(ii) Explain what is meant by a capital budget.

Suggested Solution

(e) (i) Murray Ltd will be able to see in which months there will be a deficit of cash which will enable it to make arrangements for a loan or overdraft.

It will see which months will have a surplus of cash and will be able to arrange short term investments.

There was a surplus of cash in March and April.

The trend of cash shortages is getting smaller- [normal for new business].

Overdraft facilities will be required each month up to a maximum of €135,800 in any month.

Closing cash shortage is €4,850.

(ii) The Capital Budget deals with planned capital expenditure for example the purchase of a fixed asset and planned capital receipts for example the sale of a fixed asset.

Decisions regarding capital items are the responsibility of the Board of Directors.

Carrying out of the capital budget is the responsibility of the Financial Controller.

2012

(c) What factors should be taken into account by Din Ltd in arriving at the expected sales of €3,600,000 for the six months of 2012?

Suggested Solution

(c) Last year sales from other stores

Market research/opinion of sales manager and sales representatives

Trends/State of economy

Prices to be charged/Sales price

Competition

Luxuries versus necessities

2011

(e) (i) Explain the term "Master Budget".

(ii) List the components of a Master Budget for a manufacturing firm.

Suggested Solution

(e) (i) A master budget is a summary of all the other budgets and provides an overview of the operations for the planned period.

(ii) A master budget for a manufacturing firm consists of:

- Budgeted manufacturing account
- Budgeted trading account and profit and loss account
- Budgeted balance sheet

2010

(c) What is an adverse variance? State why adverse variances may arise in direct material costs.

Suggested Solution

(c) An adverse variance is when actual costs exceed budgeted costs. Adverse variances may arise in direct materials costs because of an increase in the price of materials or an increase in quantities used.

2008

(e) (i) Explain what is meant by a capital budget.

(ii) The principal budget factor is sales demand in most organisations. State two other factors that could also be considered to be the principal budget factor.

Suggested Solution

(e) (i) **Capital Budget:**

This budget deals with any planned capital expenditure e.g. purchase of a fixed asset and planned capital receipts such as the sale of a fixed asset.

Decisions relating to these items would be the responsibility of the board of directors.

The carrying out of the capital budget is the responsibility of the financial controller.

(ii) **Principal Budget Factor:**

Apart from sales demand the principal budget factor could also be:

- Supply of materials
- Availability of labour
- Capacity of the plant
- Availability of capital

2007

(c) Define "cash budget" and describe two of its advantages.

Suggested Solution

(c) A cash budget is a forecast or plan of cash inflow and cash outflow over a period.

Advantages:

Highlights whether enough cash will be available to meet future needs

Helps to give advance knowledge so that overdraft can be arranged if shortfall occurs

Helps to predict future surpluses so that short-term investment can be made

2006

(b) What is an adverse variance? State why adverse variances may arise in direct material costs.

(c) Explain, with examples, "controllable" and "uncontrollable" costs.

Suggested Solution

(b) An adverse variance is when actual costs exceed budgeted costs.

An adverse variance in direct materials costs may arise if the purchase price of materials is higher than expected or if the quantities of material used are higher than expected.

(c) **Controllable Costs:** are costs that can be controlled by the manager of a cost centre. She/he will make the decision about the amount of the cost or if the cost should be incurred and can be held responsible for variances in these costs.

E.g. – all variable costs are controllable.

Uncontrollable Costs: are costs over which the manager of a cost centre has no control and therefore cannot be held responsible for variances in these costs. E.g. – rates to the local authority are uncontrollable.

DEPRECIATION

2021

(d) (i) Explain why a company charges depreciation in calculating profit.

Suggested Solution

(d) (i) Depreciation is charged so as to write off the cost of the tangible fixed asset over its useful economic life. Depreciation is an expense in the Income Statement/ Profit and Loss Account.

Failure to include depreciation in the final accounts causes

- The profit to be overstated
- The net worth to be overstated

The financial statements would not show a true and fair view of the business.

2018

(d) (i) Explain what is meant by "depreciation".

(ii) Distinguish between the straight line method and reducing balance method of depreciation.

Suggested Solution

(d) (i) Deprecation is the measure of loss in value of a fixed asset over its useful economic life as a result of wear and tear, passage of time, obsolescence and extraction. The amount allocated in each accounting period is treated as an expense to be set against revenue in the calculation of profit. Depreciation is an example of the matching concept in practice. The value of the asset is used up in the business (its depreciable amount) is matched to those accounting periods that are expected to benefit from it.

(ii) The straight line method is where the same amount of the cost of the asset is written off each year. It is appropriate in the case of an asset that remains in the business over a long period of time and loses value slowly, for example assets such as buildings that generate profit over many years.

The straight-line method involves spreading the depreciable amount evenly over the estimated useful life of the asset. Using this method, the depreciation is the same figure each year, which suggests that the asset is being used up at an even rate.

The reducing balance applies a constant percentage to the gradually carrying amount balance so that the amount of depreciation expense diminishes over the useful life of the asset. The amount written off is high in early years and reduces each year until written off.

This method is appropriate in the case of an asset which loses most of its value in the years immediately after purchase e.g. vehicles, computer, equipment etc., (assets that become obsolete quickly because of changes in technology).

It should be noted that relatively few businesses use the reducing balance method and, where it is used, the percentage figure is often an approximation.

2015

(d) (i) Explain why a company charges depreciation in calculating profit.

(ii) List the factors which should be considered when determining the depreciation policy on a particular asset.

Suggested Solution

(d) (i) Depreciation is an expense. Depreciation is charged so as to write off the cost of the fixed asset over its useful economic life. Failure to include depreciation in the final accounts will result in the profit being overstated and the net worth being overstated in the Balance Sheet and will not show a true and fair view (true value).

(ii) The factors to be considered when accounting for depreciation are:

- Type of asset
- Estimated life of asset
- Cost of asset
- Scrap value of asset at end of life
- Method of depreciation

2013

(d) (i) Why does a company charge depreciation in calculating profit?

(ii) Why would a company choose one method of depreciation over another?

Suggested Solution

(d) (i) Depreciation is an expense. Failure to include depreciation in the final accounts will result in the profits being overstated and the net assets in the balance sheet will not show a true value.

(ii) A method of depreciation is chosen by a company because of its policy on depreciation and ensuring that the consistency concept is applied when preparing accounts.

Straight Line Method is where the same amount of the cost of the asset is written off each year. It is appropriate in the case of an asset that remains in the business over a long period of time and loses value slowly, for example Buildings, (assets that generate profit over many years).

Reducing Balance Method is where a fixed percentage of the value of the asset is written off each year. The amount written off is high in early years and reduces each year until written off.

This method is appropriate in the case of an asset which loses most of its value in the years immediately after purchase e.g. vehicles, computer, equipment etc., (assets that become obsolete quickly because of changes in technology).

The general principle of providing depreciation is based on the matching concept.

2010

(d) (i) Explain what is meant by depreciation.

(ii) Why does a company charge depreciation in calculating profit?

Suggested Solution

(d) (i) Depreciation is the measure of the wearing away or loss in value of a fixed asset as a result of wear and tear, passage of time, obsolescence or extraction

(ii) Depreciation is an expense. Failure to include depreciation in the final accounts will result in the profits being overstated and the net assets in the balance sheet will not show a true value.

2005

(d) What factors are taken into account in arriving at the annual depreciation charge?

Suggested Solution

(d) Cost of asset

Estimated life of asset

Scrap value of asset

Method of depreciation

REVALUATION

2022

(i) Distinguish between the straight line method and reducing balance method of depreciation.

Straight Line Method

The straight line method is where the same amount of the cost of the asset is written off each year. It is appropriate in the case of an asset that remains in the business over a long period of time and loses value slowly, for example assets such as buildings that generate profit over many years. The straight line method involves spreading the depreciable amount evenly over the estimated useful life of an asset. Using this method, the depreciation is the same figure each year, which suggests that the asset is being used up at an even rate.

Diminishing Balance Method

The reducing balance method applies a constant percentage to the gradually reducing carrying amount balance so that the amount of depreciation expense diminishes over the useful life of the asset. The amount written off is high in early years and reduces each year until written off. This method is appropriate in the case of an asset which loses most of its value in the years immediately after purchase e.g. vehicles, computers, equipment etc., (assets that become obsolete quickly because of changes in technology). It should be noted that relatively few businesses use the reducing balance method and, where it is used, the percentage figure is often an approximation.

(ii) Why would a company choose one method of depreciation over another?

A method of depreciation is chosen by a company depending on the type of the asset and its policy on depreciation and ensuring that the consistency concept is applied when preparing accounts.

2019

(b) (i) Distinguish between capital and revenue expenditure.

(ii) Explain what is meant by a revenue reserve in the context of revaluation.

Suggested Solution

(b) (i) Capital Expenditure – refers to expenditure on items where the benefit derived is expected to last a long time (for more than one year).

E.g. Purchase of land, erection of buildings, purchase of machinery etc.

Revenue Expenditure – refers to expenditure where the benefit derived is of a temporary nature (less than one year). E.g. Annual rates, light and heat, repairs, etc.

(ii) Revenue reserve is undistributed profit not paid out to the owners in dividends, it is profit retained by the business.

A revaluation reserve arises when land and buildings are increased in value but the profit made on these revalued fixed assets isn't transferred to the revenue reserve until the fixed asset is sold off. Up until the sale of the fixed asset this profit cannot be distributed to the owners.

2017

(b) (i) Explain why it is important for firms to revalue their fixed assets.

(ii) Outline the factors that affect the price of property on the market.

Suggested Solution

(b) (i) Importance of revaluation:

1. The accounts will show fixed assets at their true market value and thereby show a true and fair view of the financial position of the company.

2. It provides useful information to users of the accounts (lenders, takeover bidders etc.).

3. It enables ratios to be calculated more accurately (e.g. ROCE).

4. Depreciation will not be understated and therefore profits will not be overstated.

(ii) Factors that influence the price of property on the market:

1. The use of the land – zoning, commercial or private.

2. New investments and projects nearby – for example a new Luas line.

3. Overall state of the property market – boom, recession.

4. Tax rates/breaks etc. to encourage development.

5. The overall levels of supply and demand and the availability of credit from financial institutions

CONTROL ACCOUNTS

2021

(c) Explain the importance of control accounts.

Suggested Solution

(c)

1. They act as a check on the accuracy of the ledgers by comparing the balance of the control account with the total as per the schedule.
2. They help to locate errors quickly by narrowing the search to confined areas.
3. They allow the total amount owed by debtors/total amount owed to creditors to be ascertained quickly by simply balancing the control accounts.
4. They are useful when a firm wishes to find credit sales/credit purchases when having to do final accounts from incomplete records.

2019

(c) (i) Explain the purpose of a creditors' control account.

(ii) Explain how a contra entry may arise.

Suggested Solution

(c) (i)

- They are prepared to check the accuracy of the ledgers by comparing the balance in the control account to the balance in the list of creditors
- Mistakes are noticed more easily and more quickly when using a creditor control account system because it narrows searching for errors to confined areas.
- When preparing final accounts from incomplete records, creditor control accounts are used to find the amount of credit purchases.
- The amount owed by the company to the creditors can be easily found.

(ii) A contra entry can arise when a customer is also a supplier of the business instead of the customer paying us for goods supplied; their balance is offset against the amount owing to them for goods or services supplied.

2016

(c) (i) Give **two** reasons for preparing debtors' control accounts.

(ii) Explain **one** limitation of using control accounts

Suggested Solution

(c) (i) Why debtors control accounts should be prepared.

1. They act as a check on the accuracy of the ledgers by comparing the balance of the control account with the total as per the schedule.

2. They locate errors quickly and narrow searching for errors to confined areas.

3. They are useful when a firm needs to find credit sales from incomplete records.

4. They allow amounts owed by debtors to be ascertained quickly by simply balancing the control accounts.

(ii) Limitations of control accounts

1. Control accounts do not identify which ledger account may contain an error.

2. Some types of errors are not revealed by the control account such as errors of commission, errors of omission, compensating errors, and errors of original entry.

2014

(c) Explain (i) Contra item

(ii) How “an opening balance of €490” above might arise.

Suggested Solution

(c) (i) A contra item is an offset of a debtor against a credit where the debtors and the creditor are the same person/business.

(ii) Opening balance of €490 could arise as a result of:

- A full payment of the debt followed by a credit note (returns or reduction) or full payment followed by a discount
- Over payment of a debt

2011

(c) (i) Which of the books of first entry are used in the production of Debtors Control Accounts?

(ii) Explain the importance of Control Accounts.

Suggested Solution

(c) (i) Books of first entry

Sales

Sales Returns

General Journal

Cash Book – Receipts and Payments

(ii)

1. They act as a check on the accuracy of the ledgers by comparing the balance of the control account with the total as per the schedule.
2. They help to locate errors quickly and narrow searching to confined areas.
3. They allow amounts owed by debtors and amounts owed to creditors to be ascertained quickly by simply balancing the control accounts.
4. They are useful when a firm wishes to find credit sales or credit purchases from incomplete records.

2010

(c) Give reasons why the balance in the creditors control account may not agree with the balance in the schedule of creditors.

Suggested Solution

(c) Errors in either the control account or in the schedule but not in the other

Failure to complete the double entry/ Errors in the ledgers

Incorrect totalling of subsidiary books sent to control account

2008

(c) Outline the advantages of control accounts to a firm.

Suggested Solution

(c)

1. They act as a check on the accuracy of the ledgers by comparing the balance of the control account with the total as per the schedule.
2. Errors can be found more speedily using control accounts.
3. They allow amounts owed by debtors and amounts owed to creditors to be ascertained quickly by simply balancing the control accounts.

4. They are useful when a firm wishes to find credit sales or credit purchases from incomplete records.

2007

(c) Explain: (i) Contra item.

(ii) How “opening balance €530” above could arise.

Suggested Solution

(i) A contra item is an offset of a debtor against a creditor where debtor and creditor are the same person.

(ii) Opening balance €530

- A full payment of the debt followed by a credit note (returns or reduction)
- Full payment followed by a discount
- Over payment of a debt

2005

(c) Explain why creditors control accounts are prepared.

Suggested Solution

(c) To check accuracy of figures related to creditors by comparing balance in the control account with balance in the list of creditors.

To locate errors quickly and to narrow searching for errors to confined areas

Professional Development Service for Teachers | An tSeirbhís um Fhorbairt Ghairmiúil do Mhúinteoirí

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An Roinn Oideachais
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