Accounting Technicians Ireland

Financial Accounting II

Autumn 2009

Paper, Solutions & Examiner's Report

NOTES TO USERS ABOUT THESE SOLUTIONS

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Although they are published by us, we do not necessarily endorse these solutions or agree with the views expressed by their authors.

There are often many possible approaches to the solution of questions in professional examinations. It should not be assumed that the approach adopted in these solutions is the ideal or the one preferred by us.

This publication is intended to serve as an educational aid. For this reason, the published solutions will often be significantly longer than would be expected of a candidate in an examination. This will be particularly the case where discursive answers are involved.

NEW SYLLABUS
Accounting Technicians Ireland

(Formerly The Institute of Accounting Technicians in Ireland)

2nd Year Examination: Autumn 2009

Paper: FINANCIAL ACCOUNTING II

Monday 17th August 2009 - 2.30 p.m. to 5.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

Candidates must indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

In this examination paper the £ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and the € symbol by candidates in the Republic of Ireland to indicate the Euro.

Answer ALL THREE questions in Section A and TWO of the THREE questions in Section B. If more than TWO questions are answered in Section B, then only the first TWO questions, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All workings should be shown.

All figures should be labelled, as appropriate, e.g. €, £, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

The following insert is enclosed with this paper:

Multiple choice question answer sheet [QUESTION 2]

Note:
This paper uses both the language of International Accounting Standards (I.A.Sôs) and Financial Reporting Standards (F.R.Sôs) where appropriate (e.g. Receivables/Debtors). Examinees are permitted to use <u>either terminology</u> when preparing financial statements but the use of the language of the International Accounting Standards (e.g. Receivables rather than Debtors) is preferred.

SECTION A

Answer ALL THREE Questions in this Section

QUESTION 1

BANANAS Ltd. has an authorised share capital of £/ú1,400,000 comprised of 4,000,000 ordinary shares of 25 pence/cent each and £/ú 400,000 of 6% preference shares of £/ú1 each.

The following trial balance was extracted from the books at 31st December, 2008:-

	Dr £/ú	Cr £/ú
Ordinary share capital		800,000
6% preference share capital		200,000
4% debenture stock (2010/2015)		250,000
General reserve		80,000
Retained profits at 1st January 2008		126,000
Freehold premises	1,220,000	
Freehold premises: accumulated depreciation		82,000
Plant and machinery	640,000	
Plant and machinery: accumulated depreciation		144,000
Motor vehicles	60,000	
Motor vehicles: accumulated depreciation		34,000
Inventories (stock) at 31st December 2007	140,000	
Trade receivables (debtors)	84,000	
Trade payables (creditors)		56,000
Goodwill	60,000	
Long term investments	120,000	
Bank overdraft		150,000
Sales		2,400,000
Sales returns	40,000	
Purchases	1,200,000	
Purchases returns		16,000
Administration expenses	410,000	
Distribution expenses	320,600	
Bank interest paid	16,000	
Investment income		3,600
Debenture interest paid	5,000	
Dividends paid		
Ordinary	24,000	
Preference	12,000	
Revenue grant received		10,000
	4,351,600	4,351,600

ADDITIONAL INFORMATION

(1) Goods costing £/ú18,000 were bought on credit on 29th December 2008. The purchase was not accounted for by 31st December 2008.

(2) Closing Inventories (stock), as per the physical stock count, was £/ú189,000. The goods bought at (1) above are included in this figure as they had been received at the time of the physical count.

QUESTION 1 *(Cont'd.)*

(3) The revenue grant received is in respect of training costs incurred in 2008. These costs are part of the administration expenses in the above trial balance.

(4) The long-term investments, owned since 2003, earn an annual fixed rate of interest of 5% per annum.

(5) Depreciation is to be charged as follows:-

Freehold premises :	4 % on cost.
Plant and machinery :	10 % on cost.
Motor vehicles :	20 % on reducing balance method.

Depreciation of freehold premises should be included as an administration expense. Depreciation of plant and machinery should be included as part of cost of sales and depreciation of motor vehicles should be included as distribution expenses.

(6) There are accrued administration expenses of £/ú37,000 and prepaid distribution expenses of £/ú3,400 at 31st December 2008.

(7) The charge for corporation tax for the year ended 31st December 2008 is estimated at £/ú180,000.

(8) The directors are proposing to pay the second half yearôs debenture interest. They also propose to pay a further dividend to the ordinary shareholders of 2 pence/cent per share but this has not been approved by the board at the year end.

Requirement

(a) Prepare, in a form suitable for publication, the Income Statement for BANANAS Ltd. for the year ended 31st December 2008, in as far as the information provided permits.

20 Marks

(b) Explain your treatment of the proposed dividend mentioned at (8) above.

3 Marks

Total 23 Marks

N. B. You are **NOT** required to prepare a balance sheet or notes to the accounts. You are required to prepare workings to show the make up of the figures in the Income Statement.

Marks will be awarded for presentation.

QUESTION 2

The following multiple choice question consists of NINE parts, each of which is followed by FOUR possible answers. There is ONLY ONE right answer in each part.

There are SIX parts in **Sub-Section A** of the question and THREE parts in **Sub-Section B**. Each part in **Sub-Section A** carries 2 Marks and each part in **Sub-Section B** carries 1 Mark.

Requirement

Indicate the right answer to each of the following NINE parts. **Total 15 Marks**

N.B. *Candidates should answer this question by ticking the appropriate boxes on the special green answer sheet which is supplied with the examination paper.*

SUB-SECTION A – 2 MARKS EACH

BACKGROUND INFORMATION FOR PARTS [1] to [4]

The following information relates to Tables Ltd. for the year ended 31st December 2008:

	£/ú
Authorised Share Capital:	
3,200,000 ordinary shares of 50pence/cent each	1,600,000
300,000 5% preference shares of £/ú1 each	300,000
Issued Share Capital:	
1,300,000 ordinary shares of 50pence/cent each	650,000
200,000 5% preference shares of £/ú1 each	200,000
Revenue reserves	80,000
Share premium account	70,000
6% Debenture stock	200,000
Income Statement/Profit and loss account	80,000
Long term investments	190,000

[1] Capital and Reserves/Shareholders funds, as stated in the balance sheet of Tables Ltd., will be:

(a) £/ú1,080,000
(b) £/ú1,280,000
(c) £/ú1,470,000
(d) £/ú1,680,000

[2] If the directors pay a dividend of 4p/c per ordinary share and pay the preference dividend for the year, then the total dividends for the year will be:

(a) £/ú26,000
(b) £/ú36,000
(c) £/ú52,000
(d) £/ú62,000

[3] If the 6% Debenture stock is repaid at par and the Long-term investments are sold at book value, to help finance the repayments, then the effect on Capital and Reserves/Shareholders funds will be:

(a) an increase of £/ú200,000
(b) no effect on Capital and Reserves/Shareholders funds
(c) a decrease of £/ú200,000
(d) an increase of £/ú110,000

QUESTION 2 *(Cont'd.)*

[4] If the preference shares are redeemed at par and financed partly by the issue of 200,000 ordinary shares at a premium of 20p/c per share, then the effect on Capital and Reserves/Shareholders funds will be:

(a) no effect on Capital and Reserves/Shareholders funds
(b) an increase of £/ú60,000
(c) a decrease of £/ú60,000
(d) a decrease of £/ú140,000

BACKGROUND INFORMATION TO PARTS [5] & [6]

Kevin and Larry are in partnership. Their Capital account balances are £/ú76,000 and £/ú64,000.respectively.

The partnership agreement details the appropriation of partnership profits as follows:

Kevin	Larry	
Annual salary..	£/ú18,500	£/ú24,000
Interest on capital..	10%	10%
Share of residual profit.......................................	40%	60%

If the profit before appropriation was £/ú126,500, then:-

[5] Kevinôs entitlement will be, in total.

(a) £/ú 28,000
(b) £/ú 46,500
(c) £/ú 54,100
(d) £/ú 76,000

[6] Larryôs entitlement will be, in total.

(a) £/ú 42,000
(b) £/ú 66,000
(c) £/ú 64,000
(d) £/ú 72,400

SUB-SECTION B – 1 MARK EACH

[7] Which of the following documents is **not** a component of financial statements according to I.A.S. 1 *"Presentation of Financial statements*ò

(a) the Balance Sheet.
(b) the Annual Budget.
(c) the Cash Flow Statement.
(d) the Income Statement.

[8] In accordance with I.A.S. 10 Events after the Balance Sheet Date, which of the following statements is correct:-

(a) an adjusting event is an event which confirms conditions that existed at the balance sheet date.
(b) a non-adjusting event is an event which confirms conditions that existed at the balance sheet date.
(c) a non-adjusting event is always disclosed by way of note to the accounts.
(d) an adjusting event is an event which confirms conditions that did not exist at the balance sheet date.

QUESTION 2 *(Cont'd.)*

[9] In accordance with I.A.S.16 Property, Plant and Equipment subsequent expenditure is:-

- **(a)** the costs of new tangible fixed assets
- **(b)** repairs and maintenance expenditure that ensures that an asset maintains its originally assessed standard of performance
- **(c)** the legal costs incurred to acquire tangible fixed assets
- **(d)** the replacement cost of tangible fixed assets recently sold

QUESTION 3

The following trial balance was extracted from the books of Tim Marsh for the year ended 31st December 2008.

	Dr.	Cr.
	£/ú	£/ú
Inventories at 1st January 2008:-		
Stock of raw materials	16,000	
Stock of finished goods	32,000	
Stock of work-in-progress	14,500	
Direct wages	245,000	
Factory indirect wages	86,000	
Carriage inwards on raw materials	4,500	
Royalties	7,000	
Purchases of raw materials	360,000	
General factory expenses	24,000	
Light and heat	9,600	
Factory power	25,000	
Administration expenses	65,000	
Sales		1,170,000
Rent	15,000	
Selling expenses	26,000	
Carriage outwards	5,000	
Bank charges and fees	4,500	
Manufacturing Equipment at cost	120,000	
Manufacturing Equipment: accumulated depreciation at 1/1/2008		30,000
Office Equipment at cost	30,000	
Office Equipment: accumulated depreciation at 1/1/2008		5,000
Trade receivables/Debtors	236,000	
Bank	10,000	
Trade payables/Creditors		70,000
Discount allowed	7,600	
Discount received		4,600
Drawings	22,000	
Capital at 1/1/2008		85,100
	1,364,700	1,364,700

ADDITIONAL INFORMATION

(i) Inventories at 31st December 2008:-

Stock of raw materials	28,000
Stock of finished goods	46,000
Stock of work ï in ï progress	16,000

(ii) Light and heat and rent are to be apportioned: Factory ¼ Administration ¾.

(iii) Depreciation of Manufacturing Equipment is to be charged at 10% on cost. Depreciation of Office Equipment is to be charged at 20% on cost.

Requirement

Prepare the Manufacturing and Trading and Profit and Loss account for the year ended 31st December 2008. A Balance Sheet is **NOT** requested.

Total 22 Marks

SECTION B

Answer TWO of the THREE questions in this Section

BACKGROUND INFORMATION TO QUESTIONS 4 & 5

The income statement (profit and loss account), balance sheet and appropriate other information of STABLE Ltd., for the year ended 31st December 2008 (with comparative figures for the year ended 31st December 2007) are as follows:-

INCOME STATEMENT FOR THE YEAR ENDED 31st DECEMBER

	2008		**2007**	
	£/úĉ000	£/úĉ000	£/úĉ000	£ /úĉ000
Revenue (Sales)..		2,200		2,000
Less: Cost of sales				
Opening inventory/stock	320		300	
Purchases..	860		700	
....	1,180		1,000	
Closing inventory/stock..............................	280		320	
....		900		680
Gross profit		1,300		1,320
Government grants released to profit and loss account		40		60
		1,340		1,380
Less: Expenses				
Depreciation	320		300	
Loss on disposal of fixed assets....................	10		-	
Other expenses	480	810	360	660
Operating profit before interest		530		720
Interest received	60		20	
Interest paid (including debenture interest).............	(40)	20	(60)	(40)
Profit before taxation		550		680
Taxation		260		340
Profit after taxation		290		340
Dividends...		120		100
Retained profit for the year		170		240
Retained profit/(loss) forward from last year		40		(200)
Retained profit at end of year		210		40

P.T.O. Ÿ

BACKGROUND INFORMATION TO QUESTIONS 4 & 5 *(Cont'd.)*

BALANCE SHEET AS AT 31st DECEMBER

	2008		2007	
	£/úô000	£/úô000	£/úô000	£/úô000
Non ï current assets / Fixed assets				
Cost		2,080		1800
Accumulated Depreciation		1,080		840
		1,000		960
Current Assets				
Inventories (stocks).....................................	280		320	
....				
Receivables(debtors)..................................	700		600	
Bank..	100		-	
	1,080		920	
Current Liabilities				
Bank overdraft...	-		80	
Payables(creditors)	360		310	
Taxation	300		320	
Dividends owing...	100		80	
	760		790	
Net Current Assets......................................		320		130
Government grants		(150)		(120)
Debenture loan		(320)		(200)
		850		770
Financed by:				
Share Capital				
Ordinary shares of £/ú1 each.......................	300		200	
7% Preference shares..................................	200	500	430	630
Share premium account		140		100
Profit and Loss Account		210		40
		850		770

ADDITIONAL INFORMATION

During the year ended 31st December 2008 the company bought fixed assets which cost £/ú380,000. It sold other fixed assets for £/ú10,000.

Requirement

Prepare a cash flow statement in accordance with I.A.S.7, Cash Flow Statements including relevant notes, for STABLE Ltd. for the year ended 31st December 2008:-

Total 20 Marks

QUESTION 5

Requirement

Calculate the following ratios for the two years ended 31st December 2008 and 2007:-

(i) Current ratio
(ii) Acid test ratio
(ii) Stock turnover ratio
(iv) Debtors days outstanding
(v) Return on capital employed to ordinary shareholders (assuming the preference shares redeemed were redeemed on 1st January 2008)
(vi) Earnings per share
(vii) Gearing ratio

Total 20 Marks

QUESTION 6

(i) Define:

(a) A lease.
(b) An operating lease.
(c) A finance lease.

7 Marks

(ii) On 1st January 2008, Dusty Rooms bought a commercial cleaning machine. The machine was acquired on a finance lease. The lease payments are £/ú 15,000 per annum for 5 years. The first payment is made upon delivery and subsequent payments are made annually in advance. The interest rate agreed is 12% and the machine has an estimated useful life of 8 years.

Requirement

(a) Calculate the present value of the minimum lease payments.

3 Marks

(b) For each of the years ended 31st December 2008 and 2009 calculate the following:-

(i) Balance sheet ï fixed asset balance and finance lease obligation.

(ii) Income Statement ï depreciation charge and finance charge.

Discount rates applicable;

Year	Discount rate
1	0.893
2	0.797
3	0.712
4	0.636
5	0.567
6	0.507

10Marks
Total 20Marks

2nd Year Examination: Autumn 2009

Financial Accounting II

Solutions

Solution 1

(a)

BANANAS Limited

INCOME STATEMENT
FOR THE YEAR ENDED 31st December 2008

Turnover		2,360,000
Cost of sales (Working 1)		1,217,000
Gross Profit		1,143,000
Distribution Expenses (Working 2)		(322,400)
Administration Expenses (Working 3)		(485,800)
		334,800
Income for Financial Assets		6,000
		340,800
Interest Payable (Working 4)		(26,000)
Profit before Taxation		314,800
Taxation		(180,000)
Profit after Taxation		134,800

Dividends paid

Preference	(12,000)	
Ordinary	(24,000)	(36,000)
Retained profit		98,000
Retained profit forward for previous period		126,000
Retained profit forward at end of period		224,800

(b)

As the final dividend is not approved before the year end, it should not be provided for in the income statement.

Solution 1 (Cont'd)

Workings

(1) Cost of Sales

Opening stocks	140,000
Purchases	1,200,000
Purchases returns	(16,000)
Unrecorded purchases	18,000
Closing stock	(189,000)
Depreciation ï P & M 640k x 10%	
	64,000
	1,217,000

(2) Distribution Costs

P & T/B	320,600
Depreciation ï M.V.	5,200
Prepaid	(3,400)
	322,400

(3) Administration expenses

Grand per trial balance é é é é é ..é	410000
Revenue received	(10,000)
Depreciation - Premises...	48,800
Accrued expensesé é é é é é é	37,000
	485,800

(4) Interest payable

Bank Interest for T/B...	16,000
Debenture Int (5,000 + 5,000)...	10,000
	26,000

Solution 2

(1) (a) 650 + 200 +80 + 70 + 80

(2) (d) 200,00 x 5% Pref: 10,000
1,300,00 x 4 Ord: 52,000

(3) (b)

(4) (c)

(5) (c)

	Kevin	Larry	Total
Salary	18,500	24,000	42,500
Interest	7,600	6,400	14,000
Profit Share	28,000	42,000	70,000
	54,100	72,400	126,500

(6) (d)

(7) (b)

(8) (a)

(9) (b)

Solution 3

Tim Marsh
Manufacturing, Trading and Profit and Loss account
or the year ended 31 December 2008

	€	**€**	**€**
Stock of raw materials at 1/1/08			16,000
Add purchases			360,000
Add carriage inwards on raw materials			4,500
Less discounts received			(4,600)
			375,900
Less stock of raw materials 31/12/08			(28,000)
Cost of raw materials consumed			347,900
Direct Factory wages		245,000	
Royalties		7,000	252,000
Prime cost			599,900
Factory overhead expenses			
Indirect factory wages		86,000	
General factory expenses		24,000	
Light & heat (1/4)		2,400	
Rent (1/4)		3,750	
Factory power		25,000	
Depreciation on Manufacturing Equipment		12,000	153,150
			753,050
Add WIP at 1/1/08			14,500
			767,550
Less WIP at 31/12/08			(16,000)
Production cost of goods completed c/d			751,550
Sales			1.170,000
Less Cost of goods sold			
Stock of finalised goods 31/12/08		32,000	
Add Production cost of goods consumed		751,550	
		783,550	
Less stock of finished goods 31/12/08		(46,000)	737,550
Gross profit			432,450
Administrative Expenses			
General Admin Expenses	65,000		
Light & Heat (3/4)	7,200		
Rent (3/4)	11,250		
Depreciation on office equipment	6,000	89,450	
Selling and Distribution expenses			
General Selling expenses	26,000		
Carriage outwards	5,000	31,000	
Financial Charges			
Bank charges & fees	4,500		
Discount allowed	7,600	12,100	132,550
Net Profit			299,900

Solution 4

Stable Ltd
Cash Flow Statement
for the year ended 31 December 2008

Cash flow from operating activities		
Profit on ordinary activities before taxation		530
Adjustment for		
Depreciation	320	
Loss on disposal of fixed assets	10	
Government grant released	(40)	
		290
		820
Operating profit from working capital changes		
Decrease in inventories	40	
Increase in receivables	(100)	
Increase in payables	50	
		(10)
Cash generated from operations		810
Interest paid	(40)	
Income tax paid (W.1)	(280)	
		(320)
Net cash flow from operating activities		490
Cash flow from investing activities		
Purchase of non current assets/fixed assets	(380)	
Proceeds of sale of fixed assets/non current assets	10	
Government grants received	70	
Interest received	60	
Net cash from investing activities		(240)
		250
Cash flow from financing activities		
Proceeds from issue of ordinary shares (100 + 40)	140	
Redemption of preference shares	(230)	
Proceeds from long term borrowing	120	
Dividends paid	(100)	(70)
Net increase in cash and cash equivalents		180
Cash and cash equivalents at beginning of year		(80)
Cash and cash equivalent at end of year		100

Solution 4 *(cont'd)*

Workings

(1) Taxation paid

Due at 1/1/08	320
Charge for year	260
	580
Due at 31/12/08	300
Tax Paid	280

(2) Government grants received

Deferred at 1/1/08	120
Released to Income during year	(40)
	80
Deferred at 31/12/08	150
Received	70

(3) Proceed for issue of ordinary shares

Increase in ordinary share capital	100
Increase in share premium	40
	140

(4) Dividend paid

Owing at 1/1/08	80
Dividends for year	120
	200
Owing at 31/12/08	100
Paid	100

Solution 5

		2008	2007
(1)	Current ratio	1.42: 1	1.16: 1
(2)	Acid Test ratio	1.05: 1	0.76: 1
(3)	Stock Turnover ratio	900 / (320 +280)/2 = 3.00	680 / (300 + 320)/2 = 2.19
(4)	Debtors Days Outstanding	700 x 365 / 2200 = 116 days	600 x 365 / 2000 109 ½ days
		€/£	**€/£**
(5)	Profit after taxation	290.00	340.00
		-	(30.1)
	Profit attributable to Ordinary shareholders	290.00	309.9
	Ordinary Share Capital	300	200
	Share premium account	140	100
	Profit & Loss Account	210	40
		650	340
	Return on Capital Employed	44.6%	91.1%

(6)

		2008	2007
EPS	=	290 / 300	309.9 / 200
	=	0.97	1.55

(7) Gearing Ratio

		2008	2007
Loan Capital / Equity Capital	=	(200 + 320) / (300 + 140 + 210)	(430 + 200) / (200 + 100 + 40)
	=	80%	185%

Solution 6

(a) A lease is an agreement whereby the lessor conveys an asset to the leasee in return for a series of payments or a single payment then the lease has the right to use the asset for an agreed period of time.
(b) An operating lease involves the lease paying a rental for the hire of an asset for a period of time which is normally substantially less than its useful economic life. The lessor retains most of the risks and rewards of ownership of the asset in the case of an operating lease.
(c) A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset (to the leasee). The exact transfer of ownership may happen at the end of the lease. In any case, the lease controls the use of the asset throughout its economic life.

(ii) NPV of minimum lease payments

Lease Payments	**Discount Rate**	**€**
15,000	1.00	15,000
15,000	0.893	13,395
15,000	0.797	11,955
15,000	0.712	10,680
15,000	0.636	9,540
75,000		60,570

2 (b) (ii)

	2008	**2009**
Balance Sheet		
(Asset)		
Fixed assets balance (w.1)	52,999	45,428
(Liability)		
Lease Obligation (w.2)	51,038	40,362
Income Statement		
Depreciation charge	7,571	7,571
Finance charge	5,468	4,324

Workings

(1) Fixed asset balance		
Cost	60,570	52,999
Depreciation	7,571	7,571
	52,999	45,428
(2) Lease obligation		
Cost	60,570	51,038
Payment 1/108	15,000	15,000
	45,570	36,038
Interest accrued at 31/12/08	5,468	4,324
	51,038	40,362

2nd Examination: Autumn 2009

Financial Accounting II

Examiner's Report

General

The overall standard of answers was poor with an average mark of only %.Many candidates failed to answer one or more of the required number of questions

Question 1

This preparation of financial statements question was the best answered question on the paper. However, most candidates were not aware that dividends should not be provided in the accounts unless they have been approved by the board prior to the year end. A number of candidates wasted time preparing a balance sheet although the question specifically stated that this was not required.

Question 2

The multiple choice question was reasonably well answered by most candidates.

Question 3

The answers to this manufacturing account question varied with some candidates knowing the format of the accounts of a manufacturing company and others clearly having no idea of the format.

Question 4

This cash flow statement question was poorly answered by those candidates who attempted it Many candidates did not know which Income Statement figures to use, which should of course have been the current year figures (and not the previous year figures or the difference between the current and previous year figures) Also many candidates could not correctly calculate taxation paid or dividends paid.

Question 5

This ratios question was very poorly answered. In particular very few candidates were able to calculate the Return on Capital Employed, Earnings per share or Gearing ratios.

Question 6

This leasing question was again poorly answered by those who attempted it. Many examinees made reasonable attempts at defining a lease and the difference between an operating lease and a finance lease but the answers to part (b) of the question were very poor.