FINANCIAL ACCOUNTING

Certificate stage examination

5 December 2006

From 10.00am to 1.00pm
plus ten minutes reading time from 9.50am to 10.00am

Instructions to candidates

*Answer **five** questions in total:*
All three** compulsory questions from **Section A
Two** of the three questions from **Section B

The questions each carry a total of 20 marks

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

A Proforma booklet, graph paper and cash analysis paper are available from the invigilator.

Candidates may use the Proforma sheets provided and submit them as part of their answer.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

AT THE HEART OF
YOUR CAREER

SECTION A (Answer all three questions)

1 Vixen Ltd prepares accounts to 30 June each year. The company's balance sheets as at 30 June 2005 and 2006 are as follows:

	Balance sheet as at 30 June 2005		Balance sheet as at 30 June 2006	
	£	£	£	£
Fixed assets:				
Tangible assets		178,360		157,290
Investments		20,000		34,900
		198,360		192,190
Current assets:				
Stocks	123,220		139,440	
Debtors and prepayments	82,100		96,780	
Treasury Bills	-		50,000	
Cash at bank	-		26,390	
	205,320		312,610	
Current liabilities:				
Creditors and accruals	65,310		89,730	
Taxation	38,400		56,600	
Dividends payable	30,000		25,000	
Bank overdraft	21,050		-	
Loan	20,000		-	
	174,760		171,330	
Net current assets		30,560		141,280
		228,920		333,470
Long-term loan		60,000		60,000
		168,920		273,470
Capital and reserves:				
Ordinary shares of £1		100,000		120,000
Share premium account		30,000		30,000
Profit and loss account		38,920		123,470
		168,920		273,470

The following information is also available:

1 Tangible fixed assets are shown at cost less depreciation to date. Depreciation is calculated at 30% per annum on the reducing balance basis, with a full charge in the year of acquisition and none in the year of disposal. Tangible fixed assets costing £50,000 in November 2002 were sold in May 2006 for £15,000.

2 Fixed asset investments are shown at cost. Investments costing £7,500 in 1998 were sold in February 2006 for £45,000. Dividends received during the year amounted to £1,200.

3 The Treasury Bills rank as a liquid resource.

4 The taxation creditor at 30 June 2005 was underestimated by £3,700.

5 Dividends were declared and paid as follows:

Date declared	**Date paid**	**Amount £**
31 May 2005	1 July 2005	30,000
30 November 2005	1 January 2006	10,000
31 May 2006	1 July 2006	25,000

6 The company borrowed £80,000 some years ago. Interest was charged on this loan at 9% per annum, payable in arrears on 30 June and 31 December each year. £20,000 of the loan was repaid on 31 December 2005.

7 Bank overdraft interest paid during the year to 30 June 2006 was £1,050. Bank interest received was £390.

- **Requirement for question 1**

(a) Calculate the company's operating profit for the year to 30 June 2006. *5*

(b) Prepare a cash flow statement for the year to 30 June 2006 in accordance with the requirements of accounting standard FRS1. (The reconciliation to movement in net debt is not required). *12*

(c) Explain the purposes of producing a cash flow statement. *3*

(20)

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2 Victoria is self-employed and prepares accounts to 30 September each year. Her trial balance as at 30 September 2006 showed that total credit balances exceeded total debit balances by £1,000. Despite this discrepancy, she proceeded to prepare draft accounts for the year to 30 September 2006, treating the £1,000 difference as an expense in her draft profit and loss account. The draft accounts showed a net loss of £8,375.

As well as resolving the £1,000 difference mentioned above, a number of other tasks must be completed before the accounts for the year can be finalised. These tasks are as follows:

1 **Bank reconciliation**

Victoria's draft balance sheet at 30 September 2006 shows a bank overdraft of £1,428. This is the figure in her cashbook, but she has not yet performed a bank reconciliation and the bank statement for September shows a positive bank balance of £1,960 on 30 September 2006. A review of the cashbook and the bank statement reveals the following:

- Bank charges of £102 are shown on the bank statement but not in the cashbook.
- The bank statement shows that a £500 cheque received from a customer has been dishonoured. The cheque was recorded in the cashbook when it was received, but the fact that the cheque has been dishonoured has not been recorded in the cashbook.
- A cheque for £1,315 received from a customer has been recorded in the cashbook (and in the customer's sales ledger account) as £1,513.
- The debit side of the cashbook has been undercast by £1,000.
- Cheques to suppliers totalling £5,637 were recorded in the cashbook in late September but do not appear on the bank statement.
- Cheques totalling £2,449 received from customers and paid into the bank account on 30 September 2006 were recorded in the cashbook but do not appear on the bank statement.

2 **Accruals and prepayments**

Victoria's accounts have not yet been adjusted to reflect her accruals and prepayments as at 30 September 2006. The following information is relevant:

- Her most recent electricity bill was dated 31 August 2006. The estimated cost of the electricity consumed during September 2006 is £110.
- Her most recent telephone bill was also dated 31 August 2006. This bill included line rental for the following three months of £156. The estimated cost of the calls made during September 2006 is £65.
- On 1 February 2006, Victoria paid an insurance premium of £744 for the 12 months to 31 January 2007.

3 **Bad and doubtful debts**

A bad debt of £217 is to be written off. This amount was previously included in Victoria's specific provision for doubtful debts and can now be removed from that provision. However, the provision needs increasing by £500 because of the dishonoured cheque mentioned above.

4 **Depreciation**

No depreciation has been charged in the draft accounts. The only asset which requires depreciating is plant and machinery, which is depreciated over 5 years on the straight line basis assuming a residual value equal to 10% of cost (with a full year's charge in the year of acquisition). The cost of plant and machinery at 30 September 2006 is £6,320 made up as follows:

Date acquired	*Cost*
	£
May 2001	1,720
July 2002	2,550
February 2004	1,300
June 2006	750
	6,320

There were no disposals of plant and machinery during the year to 30 September 2006.

- **Requirement for question 2**

(a) Write up Victoria's cashbook at 30 September 2006 and prepare a bank reconciliation on that date. *4*

(b) Write journal entries for the required adjustments relating to accruals and prepayments, bad and doubtful debts and depreciation. (Narratives are **not** required). *7*

(c) Calculate Victoria's corrected net profit or loss for the year to 30 September 2006. *4*

(d) Prepare a schedule of the changes that will have to be made to the draft balance sheet as at 30 September 2006 under the headings “Assets”, “Liabilities” and “Capital”, which demonstrates that the balance sheet will still balance after these changes have been made. *5*

(20)

3

Vijay has decided to invest his life savings in the ordinary shares of either Alpha plc or Beta plc. Both companies prepare accounts to 31 October each year, have an issued share capital consisting of 2 million £1 ordinary shares and are of similar size. They are both in the same line of trade. Extracts from the companies' financial statements for the year to 31 October 2006 are as follows:

	Alpha plc	**Beta plc**
	£'000	**£'000**
Profit and loss account items:		
Turnover	12,750	13,660
Cost of sales	8,890	9,550
Operating profit	1,630	2,360
Interest payable	170	60
Taxation charge	430	690
Profit after tax	1,030	1,610
Balance sheet items:		
Net book value of fixed assets	6,230	5,170
Stock	1,640	1,530
Trade debtors	1,620	1,750
Cash at bank	nil	230
Trade creditors	1,480	1,600
Bank overdraft	670	-
Long-term loans	1,000	600
Share capital and reserves	6,340	6,480

Further information is available as follows:

1 Each company incurred development costs of £700,000 during the year to 31 October 2006. In both cases, accounting standard SSAP13 would have allowed the company concerned to capitalise these costs, but Alpha plc chose to write off the entire £700,000 as an administrative expense. In contrast, Beta plc capitalised the development costs and then wrote off amortisation of £70,000 during the year. This amortisation was charged to administrative expenses.

2 In accordance with the requirements of accounting standard SSAP9, Alpha plc values its stocks on the FIFO basis, whereas Beta plc uses weighted average cost (AVCO). If Alpha plc had also used AVCO, its closing stock figure at 31 October 2006 would have been lower by £220,000. This would have had no material effect on cost of sales, since the company's opening stock would also have been lower by approximately the same amount. However, the value of the reserves at 31 October 2006 would have changed as a result of this amended stock valuation.

3 In accordance with accounting standard FRS15, Alpha plc depreciates tangible fixed assets on the reducing balance basis. Beta plc adopts the straight line basis. If Alpha plc had also used the straight line basis, its depreciation charges for the year to 31 October 2006 (charged to administrative expenses) would have been lower by £380,000.

4 Again in accordance with FRS15, Alpha plc revalued its non-depreciable land on 31 October 2006, giving rise to a revaluation surplus of £500,000. Beta plc shows its land at cost.

5 On 31 October 2006, Alpha plc purchased fixed assets at a cost of £900,000, paying immediately by cheque. These assets were neither used nor depreciated in the year to 31 October 2006. Beta plc made a similar purchase of fixed assets on 1 November 2006.

- **Requirement for question 3**

(a) Perform a ratio analysis for each company, basing your calculations **solely** on the information given in the extracts from the financial statements and **not** taking into account the further information which is provided beneath these extracts. The ratios to be calculated are:

- return on capital employed
- gross profit percentage
- current ratio
- quick assets ratio ("acid test")
- stock holding period
- capital gearing ratio
- earnings per share. *7*

(b) Based only on this ratio analysis, indicate with brief reasons which company appears to be the better investment. *2*

(c) Adjust the extracts from the financial statements of Alpha plc to show the figures as they would have been if the company had adopted the same accounting policies as Beta plc and had delayed for one day its purchase of fixed assets for £900,000. (Ignore any tax consequences of these changes). Then re-calculate the above ratios and comment briefly on your results. *9*

(d) Explain the extent to which the further information supplied above would have been available in the companies' published financial statements. *2*

(20)

SECTION B (Answer two questions from this section)

4 The Valley Association Football Club (Valley AFC) was founded in 1953 with its own ground and changing rooms, which were purchased at that time at a cost of £10,000. The club's accounts have always taken the form of a simple receipts and payments account, but the treasurer would like to produce more comprehensive accounts for the year to 31 May 2006. A summary of receipts and payments for the year to 31 May 2006 is as follows:

Receipts:	**£**
Subscriptions	5,970
Life membership fees	900
Donations	386
Sale of football match tickets	3,695
Sale of annual dinner tickets	640
Sale of motor mower	70
Sale of roller	20
Payments:	
Wages to part-time ground staff	2,600
Electricity and water	926
Insurance	360
Repairs	1,263
Fee to Football Association	150
Treasurer's fee	100
Charitable donations	344
Costs of annual dinner	965
Bank charges	64
Sundry expenses	1,137
New football kit for 1st team	480
Purchase of motor mower	650
Purchase of roller	320

The following information is also available:

1 On 31 May 2005, the club had cash in hand of £96 and an overdraft of £120 on its bank current account. Cash in hand on 31 May 2006 was £87.

2 On 31 May 2005, subscriptions owing to the club were £230 and subscriptions received in advance were £370. The equivalent figures on 31 May 2006 were £290 and £410 respectively.

3 A life membership scheme was introduced on 1 June 2000. At that time life membership of Valley AFC could be obtained at a cost of £250. This was increased to £300 with effect from 1 June 2004. As at 31 May 2006, the club had 12 life members, as follows:

Joined 1 June 2000	6
Joined 1 June 2002	1
Joined 1 June 2003	2
Joined 1 June 2005	3

Life membership fees are to be allocated to income in equal instalments over a period of 5 years.

4 It has been decided that the ground and changing rooms should not be depreciated, but that equipment should be depreciated over its useful life on the straight line basis, assuming a residual value of zero. Motor mowers have a useful life of 5 years and all other equipment has a useful life of 10 years. A full year's depreciation charge is made in the year of acquisition, but none is charged in the year of disposal. Equipment owned by the club at 31 May 2005 was as follows:

	Cost
	£
Motor mower bought July 2001	440
Roller bought August 1994	250
Miscellaneous small items all bought in 1995 or earlier	1,820

5 The cost of the new football kit for the first team is to be written off immediately.

6 Accruals and prepayments are as follows:

	31 May 2005	*31 May 2006*
	£	**£**
Accrued electricity charges	110	125
Prepaid water rates	475	500
Prepaid insurance premiums	190	210

- **Requirement for question 4**

(a) Calculate the balance of the members' accumulated fund as at 31 May 2005. *4*

(b) Prepare a subscriptions account and a life membership fees account for the year to 31 May 2006. *5*

(c) Prepare an income and expenditure account for the year to 31 May 2006 and a balance sheet as at that date. *11*

(20)

5

An important function of financial accounting is to produce financial statements which provide information "*that is useful to a wide range of users*" (ASB Statement of Principles for Financial Reporting).

Although financial accountants will always be responsible for producing useful information, it is clear that financial accounting will continue to change and develop in response to a variety of influences. One such influence is the increasing availability of computer-based accounting systems.

- **Requirement for question 5**

(a) Identify the main user groups which could benefit from the information produced by financial accountants and explain why these user groups are interested in such information. *7*

(b) Outline the main advantages and disadvantages of using a computer-based accounting system, rather than a manual system. *4*

(c) Other than the use of computer systems, identify THREE further influences which are currently affecting the development of financial accounting. *3*

(d) Explain the main ethical requirements which qualified accountants should adhere to, in order to maintain professional standards. *6*

(20)

6

Vulcan Ltd prepares accounts to 30 November each year. The company's tangible fixed assets include its freehold premises and a small number of motor vehicles. Details are as follows:

1 The company's freehold premises were acquired on 1 June 2000 at a total cost of £320,000, comprising land £140,000 and buildings £180,000. The land is non-depreciable but the buildings were estimated to have a useful life of 50 years (with no residual value) and were depreciated accordingly, using the straight line basis. On 1 December 2005, a professional valuer revalued the premises at £375,000, comprising land £200,000 and buildings £175,000, and it was decided to incorporate these valuations into the company's financial statements. The land remained non-depreciable, but the useful life of the buildings was now estimated to be a further 50 years, as from the date of the valuation, with no residual value.

2 Motor vehicles are depreciated on the straight line basis over four years with an estimated residual value equal to 40% of cost. At 30 November 2005, the company owned the following vehicles:

	Date purchased	*Cost*
		£
Vehicle A	1 December 2002	14,400
Vehicle B	1 April 2003	19,200
Vehicle C	1 June 2004	14,800
Vehicle D	1 August 2005	21,600

On 1 July 2006, Vehicle A was part-exchanged for Vehicle E. The company paid £11,200 to the supplier of Vehicle E. This was net of a £6,000 part-exchange allowance.

3 Partial depreciation charges (calculated on the number of full months) are made in the years of acquisition and disposal of both freehold premises and motor vehicles.

The company's financial statements for the year to 30 November 2006 cannot be completed until the assets described above have been dealt with in accordance with the requirements of accounting standard FRS15 (Tangible Fixed Assets).

- **Requirement for question 6**

(a) Briefly explain the purposes of accounting standards. *3*

(b) Explain the extent to which compliance with UK accounting standards is mandatory for:

(i) UK sole traders.
(ii) UK partnerships.
(iii) UK limited companies. *5*

(c) Prepare relevant ledger accounts for the year to 30 November 2006 in relation to the freehold land, freehold buildings and motor vehicles of Vulcan Ltd. *12*

(20)