CIPFA

FINANCIAL ACCOUNTING

Certificate stage examination

5 June 2007

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

Instructions to candidates

*There are **six** questions on this question paper*

*Answer **five** questions in total*

Three** compulsory questions from **Section A
Two** of the three questions from **Section B

*The questions in Section A carry, in total, **60** marks*
*The questions in Section B 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.

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.

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.

AT THE HEART OF
YOUR CAREER

SECTION A (Compulsory – answer all three questions)

1 The following trial balance has been extracted from the books of Walrus plc as at 31 March 2007:

	£000	£000
Land, at cost	120	
Buildings, at cost	250	
Equipment, at cost	196	
Vehicles, at cost	284	
Goodwill, at cost	300	
Accumulated depreciation at 1 April 2006:		
Buildings		90
Equipment		76
Vehicles		132
Inventory at 1 April 2006	107	
Trade receivables and payables	183	117
Allowance for receivables		8
Bank balance		57
Corporation tax		6
Ordinary shares of £1 each		200
Retained earnings at 1 April 2006		503
Sales		1,432
Purchases	488	
Directors' fees	150	
Wages and salaries	276	
General distribution costs	101	
General administrative expenses	186	
Dividend paid	20	
Rents received		30
Disposal of vehicle		10
	2,661	2,661

The following information is also available:

1. The company's non-depreciable land was valued at £300,000 on 31 March 2007 and this valuation is to be incorporated into the accounts for the year to 31 March 2007.

2. The company's depreciation policy is as follows:

Buildings	4% p.a.	straight line
Equipment	40% p.a.	reducing balance
Vehicles	25% p.a.	straight line

   In all cases, a full year's depreciation is charged in the year of acquisition and no depreciation is charged in the year of disposal. None of the assets had been fully depreciated by 31 March 2006.

   On 1 February 2007, a vehicle was sold for £10,000. The sale proceeds were banked and were credited to a disposal account but no other entries were made in relation to this disposal. The vehicle had cost £44,000 in August 2003. This was the only disposal of a non-current asset made during the year to 31 March 2007 and any profit or loss on this disposal is to be allocated to administrative expenses.

3. Depreciation is apportioned between distribution costs and administrative expenses as follows:

	Distribution costs	*Administrative expenses*
Buildings	50%	50%
Equipment	25%	75%
Vehicles	70%	30%

4. The company's inventory at 31 March 2007 is valued at £119,000.

5. Trade receivables include a debt of £8,000 which is to be written off. The allowance for receivables is to be adjusted to 4% of the receivables which remain after this debt has been written off.

6. Corporation tax for the year to 31 March 2006 was over-estimated by £6,000. The corporation tax liability for the year to 31 March 2007 is estimated to be £30,000.

7. One-quarter of wages and salaries were paid to distribution staff and the remaining three-quarters were paid to administrative staff.

8. General administrative expenses include bank overdraft interest of £9,000.

9. A dividend of 10p per ordinary share was paid on 31 December 2006. No further dividends are proposed for the year to 31 March 2007.

- **Requirement for question 1**

Prepare the following financial statements for Walrus plc in accordance with the requirements of International Accounting Standards:

(a) an income statement for the year to 31 March 2007 *9*

(b) a balance sheet as at 31 March 2007 *8*

(c) a statement of changes in equity for the year to 31 March 2007. *3*

Formal notes to the accounts are not required, but all workings should be shown.

(20)

2

Wiqar is a sole trader who prepares accounts to 31 May each year. He has a manual double-entry bookkeeping system and maintains a receivables control account which forms part of his double-entry system. Therefore the balance on this control account is included in his trial balance. The personal accounts of individual customers are held as memorandum records only. Wiqar does not maintain a payables control account.

Wiqar's trial balance at 31 May 2007 showed total debit balances of £107,998 and total credit balances of £102,421. The difference between these totals has been entered into a suspense account.

The debit balance on the receivables control account at 31 May 2007 was £26,212. A list of balances extracted from the receivables ledger on that date showed total debit balances of £23,693 and total credit balances of £861.

On investigation, the following bookkeeping errors were discovered:

1. A purchase invoice for £1,526 had been recorded correctly in the purchases daybook but had then been posted to the supplier's personal account in the payables ledger as £1,256.

2. The sales daybook for the month of May 2007 had been undercast by £900.

3. Bank interest received of £17 had been recorded in the cashbook only.

4. Sales invoices totalling £466 had been entirely omitted from the accounting records.

5. A credit balance of £574 on a customer's personal account had been shown as a debit balance on the list of balances extracted from the receivables ledger on 31 May 2007.

6. A debit balance of £119 on a supplier's personal account had been shown as a credit balance on the list of balances extracted from the payables ledger on 31 May 2007.

7. Cash discounts allowed in the year to 31 May 2007 totalled £2,714. These had been entered on the wrong side of the receivables control account but had been dealt with entirely correctly otherwise.

8. The debit side of a supplier's personal account in the payables ledger had been overcast by £100.

- **Requirement for question 2**

(a) Write journal entries as necessary to correct the bookkeeping errors listed above (narratives are not required). *12*

(b) Write up the suspense account. *3*

(c) Write up the receivables control account and reconcile the balance on this account to the total of the list of balances extracted from the receivables ledger. *5*

(20)

3 Western Trading plc is a company which uses a variety of component parts in its manufacturing operations. One of the company's suppliers has recently gone out of business and therefore Western is now seeking an alternative (and reliable) source of supply for the component parts which were previously purchased from that supplier. Two companies have been identified as potential suppliers. Both of these companies prepare accounts to 31 December each year and Western has obtained copies of each company's financial statements for the year to 31 December 2006. A summary of these statements is as follows:

Income statements for year to 31 December 2006

	X Ltd	**Y Ltd**
	£000	**£000**
Sales revenue	5,720	6,310
Cost of sales	3,840	4,240
Gross profit	1,880	2,070
Operating expenses	760	1,080
Operating profit before interest	1,120	990
Debenture interest payable	50	350
Profit before taxation	1,070	640
Taxation	320	210
Profit after taxation	750	430

Balance sheets as at 31 December 2006

	X Ltd		**Y Ltd**	
	£000	**£000**	**£000**	**£000**
Non-current assets		4,570		6,330
Current assets				
Inventories	510		890	
Trade receivables	670		1,090	
Bank balance	340		-	
	1,520		1,980	
Current liabilities				
Trade payables	450		1,130	
Taxation	320		210	
Bank balance	-		440	
	770		1,780	
Net current assets		750		200
		5,320		6,530
Non-current liabilities				
Debenture loans		500		3,500
		4,820		3,030
Share capital		2,000		2,000
Retained earnings		2,820		1,030
		4,820		3,030

For both companies, all purchases and sales are made on credit terms.

- **Requirement for question 3**

(a) Calculate THREE profitability ratios, TWO liquidity ratios, THREE efficiency ratios and ONE gearing ratio for X Ltd and for Y Ltd. *9*

(b) Use the information provided by the ratio analysis in (a) to explain to the management of Western Trading plc which of the two companies seems likely to be the more reliable source of supply. *8*

(c) Identify any further information which should be obtained before a decision is made. *3*

(20)

SECTION B (Answer two from three questions)

4

In 1989, the International Accounting Standards Committee (IASC), which has since become the International Accounting Standards Board (IASB), published its *Framework for the Preparation and Presentation of Financial Statements*. Amongst other matters, this document deals with:

- the objective of financial statements;
- the underlying assumptions which underpin financial accounting;
- the qualitative characteristics possessed by useful information.

As well as the *Framework* document, the IASC/IASB has also published nearly 50 International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs).

- **Requirement for question 4**

(a) State the main objectives of the IASB. *3*

(b) Explain the main purposes of the *Framework* document. *3*

(c) Identify the objective of financial statements. *1*

(d) Identify and explain the TWO underlying assumptions which are referred to in the *Framework* document. *2*

(e) Identify and explain the FOUR qualitative characteristics which should be possessed by useful information and identify any factors which contribute to the achievement of each characteristic. *8*

(f) State the main uses and applications of IASs and IFRSs. *3*

(20)

5

Wendy and Yvonne are in partnership. Their profit-sharing agreement states that the partners are entitled to interest on capital of 4% per annum and that remaining profits should be split Wendy 60% and Yvonne 40%. Accounts are prepared to 30 April each year.

The balance sheet at 30 April 2006 showed that each partner had a £10,000 capital account balance. Current account balances on that date were Wendy £1,520 (credit) and Yvonne £890 (debit).

The partnership does not have a double-entry bookkeeping system but does maintain a simple cashbook in which all bank transactions are recorded. The following information relates to the year ended 30 April 2007:

1. Goods are bought on credit from suppliers and sold on to customers at a consistent markup of 50%. All sales are cash sales.

2. Takings are banked at regular intervals after paying certain cash expenses and retaining a small cash float. This float stood at £250 on 30 April 2006 but was increased by £100 on 1 January 2007. Cash expenses for the year to 30 April 2007 were as follows:

	£
Drawings - Wendy	6,400
Drawings - Yvonne	8,000
Miscellaneous expenses	4,130

3. A summary of the cashbook for the year to 30 April 2007 is as follows:

		£	**£**
Bank balance at 1 May 2006			2,640
Add:	Takings paid into bank	93,270	
	Sale of equipment (31/10/06)	350	
	Capital introduced by Yvonne (1/8/06)	3,000	96,620
			99,260
Less:	Cheques paid to suppliers	76,830	
	Rent, rates and insurance	12,680	
	Heat, light and telephone	2,170	
	Miscellaneous expenses	2,270	
	Bank charges	410	
	Purchase of equipment (1/11/06)	2,900	97,260
Bank balance at 30 April 2007			2,000

This summary was prepared before reconciling the cashbook with the bank statement for April 2007, which was received in early May. This statement agreed with the cashbook except for the following items:

- Takings of £1,340 paid into the bank on 21 April 2007 had been incorrectly recorded in the cashbook as £1,430.
- Cheque payments of £3,620 made in late April were not yet shown on the bank statement.
- Bank charges of £50 which were shown on the bank statement on 30 April 2007 had not been recorded in the cashbook.

4. Equipment is depreciated at 20% per annum of cost on the straight line basis, with calculations being made for each month of ownership in both the years of acquisition and disposal. The equipment sold in October 2006 had been acquired for £2,000 on 1 February 2003. All other equipment owned by the partnership at 30 April 2006 was over five years old.

5. Apart from equipment, inventories and cash and bank balances, the partnership's only assets and liabilities at 30 April 2006 and 2007 were as follows:

	30 April 2006	**30 April 2007**
	£	**£**
Amounts owed to suppliers of goods	7,240	7,610
Accrued heat, light and telephone	330	350
Prepaid rent, rates and insurance	2,190	2,680

- **Requirement for question 5**

(a) List the partnership's assets, liabilities and capital at 30 April 2006 and hence calculate the inventory figure on that date. *3*

(b) Prepare the partnership's income statement for the year to 30 April 2007 and show how the profit for the year is divided between the partners. *10*

(c) Prepare the partnership's balance sheet as at 30 April 2007. *7*

(20)

6

Wilson plc is a manufacturing company which prepares accounts to 31 March each year. On 31 March 2007, the company's inventory included the following items of work in progress (i.e. partly-completed products):

	Product A	**Product B**
Number of units held at 31 March 2007	500	720
Manufacturing costs incurred to date (per unit)	£25	£30
Expected further manufacturing costs necessary to complete production (per unit)	£12	£21
Expected selling price (per unit)	£50	£55
Expected selling expenses (per unit)	£7	£5

The company's inventory on 31 March 2007 also included a quantity of raw material X. Receipts and issues of this raw material during the month of March 2007 were as follows:

		Number of units	**Cost per unit**
March 1	Opening inventory	2,500	£12.50
March 3	Issued to production	1,800	
March 8	Received	2,000	£11.90
March 11	Issued to production	1,900	
March 16	Issued to production	400	
March 24	Received	3,000	£11.30
March 30	Issued to production	2,200	

Financial statements for the year to 31 March 2007 cannot be completed until the value of the company's inventory on that date has been determined in accordance with the requirements of accounting standard IAS2 (Inventories).

- **Requirement for question 6**

(a) Explain the meaning of the term "inventories" as defined by IAS2. *3*

(b) Explain how the cost of inventories should be determined, giving examples of costs which should be *included* in the cost of inventories and costs which should be *excluded* from the cost of inventories. *5*

(c) Explain the term "net realisable value" in relation to inventories. *2*

(d) Calculate the value at which the work-in-progress of Wilson plc should be shown in the company's balance sheet as at 31 March 2007. *3*

(e) Explain the circumstances in which a company is allowed to use a cost formula such as first-in, first-out (FIFO) or weighted average cost (AVCO) when determining the cost of inventories. *2*

(f) Calculate the cost of the company's inventory of raw material X as at 31 March 2007, using each of the following cost formulae:

(i) First-in, first-out (FIFO)
(ii) Weighted average cost (AVCO) *5*

(20)