Association of Taxation Technicians

Examination

November 2004

PRINCIPLES OF ACCOUNTING

TIME ALLOWED - 1 HOUR 30 MINUTES

Candidates should answer **three** out of four questions set.
Each question carries 35 marks.
Start each answer on a fresh sheet.
All workings should be shown and made to the nearest month and pound unless the question requires otherwise.
Marks are specifically allocated for good presentation.

1. Hughes Ltd prepares its accounts to 31 December each year. During the year to 31 December 2003 the following transactions took place:

1) Interest was paid on a loan from the directors. Income Tax was withheld at the rate of 20%. The gross interest paid was as follows:

	Gross interest paid
	£
6 April 2003	15,000
30 June 2003	14,000
30 September 2003	16,000
31 December 2003	20,000

The Income Tax withheld was paid on the due dates.

2) The company submitted the following VAT returns:

Quarter to	VAT Output	VAT Input	VAT paid (refund)	Date paid (received)
	£	£	£	
31 December 2002	150,000	90,000	60,000	31 January 2003
31 March 2003	160,000	105,000	55,000	30 April 2003
30 June 2003	140,000	150,000	(10,000)	31 July 2003
30 September 2003	180,000	120,000	60,000	31 October 2003
31 December 2003	200,000	130,000	70,000	31 January 2004

3) The company's Corporation Tax liabilities based on the profits for the year ended 31 December 2001 and 2002 were agreed as follows:

	2001	2002
	£	£
Final agreed liability	162,500	154,000
Paid as follows:		
30 September 2002	-150,000	
31 August 2003	-12,500	
30 September 2003		-154,000

The Corporation Tax provision based on the profits for the year to 31 December 2003 is £250,000. The Corporation Tax that has been provided for in the accounts in respect of the 2001 and 2002 Corporation Tax is as follows:

	£	
Year to 31 December 2001		
Amount provided in 2001 accounts	150,000	
Less tax paid	-150,000	
Corporation Tax creditor at 31 December 2002		0
Year to 31 December 2002		
Amount provided in 2002 accounts		165,000
Corporation Tax creditor at 31 December 2002		165,000

Interest on the overdue Corporation Tax in respect of the additional tax liability for the year to 31 December 2001 amounted to £625 and was paid on 15 September 2003.

4) The potential liability to deferred tax is as follows:

31 December 2002 £175,000
31 December 2003 £145,000

The company makes full provision for its deferred tax liability.

(Continued)

1. (Continuation)

You are required to:

1) **Show how the above transactions would be shown in the 'T' accounts (ledger accounts) of Hughes Ltd. You should include a bank account.** (24)

2) **Show how the Corporation Tax and deferred tax would be disclosed in the profit and loss account and balance sheet of Hughes Ltd for the year to 31 December 2003.** (5)

3) **Explain why deferred tax is shown in company accounts.** (3)

4) **Explain the difference between the presentation of tax in company accounts and sole trader accounts.** (3)

Total (35)

2. Ascot Ltd prepares its accounts to 31 May each year. Detailed below is information relevant to the business activities for the year ended 31 May 2004:

   1) On 1 November 2003 the company acquired a Fiat car with a cash price of £21,000 on a finance lease. The terms of the lease required an initial deposit of 30% followed by 24 monthly instalments of £750 commencing in November 2003.

   2) The company owns a factory that was acquired in June 1999 at a cost of £180,000. Due to a reduction in the level of its manufacturing activities the company no longer required use of the entire factory and so from 1 February 2004 it commenced renting out part of the premises. The company charged the tenant rental of £48,000 per annum which was paid quarterly in arrears.

   3) During the year ended 31 May 2004 the company paid wages of £56,700 to its employees. This included bonuses of £7,200 due to employees at 31 May 2003. At 31 May 2004 employees were due bonuses of £3,600 which were paid in September 2004.

   4) On 1 January 2004 the company paid for an advert in a trade magazine. The cost was £3,000 and the advert is to appear in the magazine throughout the year ended 31 December 2004.

   5) At 31 May 2004 trade debtors before any provisions for doubtful debts totalled £160,000 of which £6,000 were over six months old. The company's accounting policy for doubtful debts is to make a specific provision for all debts over six months old at the balance sheet date and to provide a general provision of 2% of all remaining debts. At 31 May 2003 the specific bad debt provision was £17,000 and the general bad debt provision was £1,900.

   6) In August 2003 the company received £1,500 from the liquidator of Jones Ltd. The company had not expected to receive anything from the liquidator and had written off the debt in 2001.

   The company's accounting policies in respect of depreciation are as follows:

Property	2% straight line
Motor vehicles	25% straight line

   A full year's charge is made in the year of acquisition but no depreciation is charged in the year of disposal.

   You should ignore VAT.

   You are required to show how the company would record the above transactions in the ledger accounts (T accounts) for the year ended 31 May 2004. (35)

3. Charles Ltd prepares its accounts to 30 September each year. The balance sheets as at 30 September 2003 and 2004 are as follows:

	2004	2004	2003	2003
	£	£	£	£
Tangible Fixed Assets				
Machinery (at net book value)		64,000		78,000
Current Assets				
Stock	37,000		42,000	
Trade debtors	47,000		46,000	
Cash at bank	17,000		-	
	101,000		88,000	
Current Liabilities				
Trade creditors	19,000		27,000	
Corporation Tax creditor	12,000		33,000	
Proposed dividend	-		16,000	
Bank overdraft	-		6,000	
		70,000		6,000
		£134,000		£84,000
Share Capital		26,000		5,000
Share Premium Account		46,000		6,000
Profit and Loss Account		62,000		73,000
		£134,000		£84,000

During the year ended 30 September 2004 Charles Ltd disposed of machinery which had a net book value of £26,000. This disposal realised a profit on sale of £6,000.

During the year ended 30 September 2004 Charles Ltd purchased a new machine at a cost of £27,000.

In December 2003 Charles Ltd paid the proposed dividend in respect of the year ended 30 September 2003 of £16,000. In June 2004 the company paid a further dividend of £65,000.

The Corporation Tax charge in the profit and loss account for the year ended 30 September 2004 was as follows:

	£
Current year provision	12,000
Prior year over provision	(2,000)
Charge per profit and loss account	£10,000

You are required to:

1) **Produce a cashflow statement for the year ended 30 September 2004 showing all your workings. You do NOT need to produce the cashflow statement in FRS 1 format.** (30)

2) **Explain why cashflow statements are prepared and their importance.** (5)

Total (35)

4. Parkes Ltd is a trader dealing in secondhand machines. During its first year of trading to 30 September 2004 the following transactions took place:

Purchases		£
October 2003	3 machines @ £10,000 each	30,000
December 2003	4 machines @ £12,500 each	50,000
March 2004	6 machines @ £12,000 each	72,000
July 2004	7 machines @ £9,000 each	63,000

Sales		
November 2003	2 machines @ £15,000 each	30,000
January 2004	2 machines @ £14,000 each	28,000
February 2004	1 machine @ £16,000	16,000
April 2004	3 machines@ £15,000 each	45,000
May 2004	1 machine @ £17,000	17,000
August 2004	4 machines @ £16,000 each	64,000

The customer to whom Parkes Ltd sold the machine in February 2004 has gone into liquidation owing Parkes Ltd £6,000. The liquidator has informed the directors of Parkes Ltd that there will be no funds available to distribute to them.

The directors are also concerned that a further amount of £5,000 due from a customer, Mr James, may not be recoverable.

You are required to:

1) Calculate the gross profit achieved by Parkes Ltd during its first year of trading if the closing stock at 30 September 2004 was valued on the:

(a) Average basis (7)

(b) FIFO basis (7)

(c) LIFO basis (7)

2) State when it would not be appropriate to use any of the above bases for valuing stock? (4)

3) Prepare the bad debt expense and the provision for doubtful debts ledger accounts (T accounts) for the year to 30 September 2004. (4)

4) Explain the difference between a specific doubtful debt provision and a general doubtful debt provision and explain why they are treated differently in the tax computation. (6)

You should show all your workings.

Total (35)