



Association of Taxation Technicians

Examination

November 2005

PRINCIPLES OF ACCOUNTING

ANSWERS WITHOUT MARKS

Q1 - Answer

1. Profit and loss account

| | | £ | £ |
|--------------------------------|-----|-----------------|-----------------------|
| Mrs Blythe | | | |
| Profit and Loss Account | | | |
| Year Ended 30 June 2005 | | | |
| | | £ | £ |
| Sales | W8 | | 743,520 |
| Less cost of sales: | | | |
| Opening stock | W9 | 52,800 | |
| Purchases | W10 | <u>481,200</u> | |
| | | 534,000 | |
| Closing stock | W11 | <u>(59,800)</u> | |
| | | | <u>(474,200)</u> |
| Gross profit | | | 269,320 |
| Less expenses: | | | |
| Bad debts | W1 | 2,060 | |
| Repairs | | 375 | |
| Telephone | | 480 | |
| Bank charges | | 230 | |
| Accountancy | | 1,250 | |
| Rent | W2 | 14,500 | |
| Subscriptions | W3 | 250 | |
| Electricity | W4 | <u>825</u> | |
| | | | <u>(19,970)</u> |
| Net profit | | | <u><u>249,350</u></u> |

2. Uses of the profit and loss account

The profit and loss account is a financial statement for a business and has the following uses:

Provides details of how profit/loss has arisen during a particular period

Enables comparisons to previous periods to identify changes

Starting point for tax computations

Useful to provide to lenders

| Workings | | £ |
|----------|--|---|
| W1 | Specific provision at 30/6/2005 | 2,500 |
| | General provision at 30/6/05 - (80,000 - 2,500) x 3% | 2,325 |
| | Provisions at 30/6/05 | <u>4,825</u> |
| | Provisions at 30/6/04 - 4,600 + 1,275 | <u>5,875</u> |
| | | (1,050) |
| | Bad debt written off - 4,600 - 850 | <u>3,750</u> |
| | Receipt of previously written off debt | <u>640</u> |
| | <u><u>2,060</u></u> | |
| W2 | Prepaid rent at 30/6/04 - 14,000 x 10/12 | 11,667 |
| | Rent paid in year | <u>17,000</u> |
| | | <u>28,667</u> |
| | Prepaid rent at 30/6/05 - 17,000 x 10/12 | <u>14,167</u> |
| | | <u><u>14,500</u></u> |
| W3 | Subscriptions paid in year | 600 |
| | Prepaid at 30/6/05 - 600 x 7/12 | <u>350</u> |
| | | <u><u>250</u></u> |
| W4 | Opening accrual | (170) |
| | Paid in year | 840 |
| | Closing accrual | <u>155</u> |
| | | <u><u>825</u></u> |
| W5 | Purchases of product A - 570 x 160 | <u>91,200</u> |
| | Cost of sales in year - 2/3 x 91,200 | <u>60,800</u> |
| | Sales - 60,800 x 140/100 | <u>85,120</u> |
| | Closing stock | <u>30,400</u> |
| | | <u><u>30,400</u></u> |
| W6 | Sales of product B - 520 x 420 | 218,400 |
| | | No £ |
| | | 240 52,800 |
| | | <u>400 104,000</u> |
| | | 640 156,800 |
| | Cost of sales - average method | <u>(520) (127,400)</u> |
| | closing stock | <u><u>120 29,400</u></u> |
| W7 | Sales | <u>440,000</u> |
| | Gross profit - 440,00 x 35% | <u>154,000</u> |
| | Therefore cost of sale being purchases - 440,000 - 154,000 | <u><u>286,000</u></u> |

Workings

£

| | | | | | |
|-----|---------------|-----------|----|--------|----------------|
| W8 | Sales: | Product A | W5 | 85,120 | |
| | | Product B | | W6 | 218,400 |
| | | Product C | | W7 | 440,000 |
| | | | | | <u>743,520</u> |
| W9 | Opening stock | | W6 | 52,800 | |
| | | Product B | | | <u>52,800</u> |
| W10 | Purchases | Product A | W5 | 91,200 | |
| | | Product B | | W6 | 104,000 |
| | | Product C | | W7 | 286,000 |
| | | | | | <u>481,200</u> |
| W11 | Closing stock | | W5 | 30,400 | |
| | | Product A | | W6 | 29,400 |
| | | Product B | | | <u>59,800</u> |

Q2 - Answer

Carson Limited

Balance sheet

As at 31 July 2005

| | | £ | £ | £ |
|---------------------------------------|----|---------|----------------|-----------------------|
| Fixed assets | | Cost | Depn | |
| Property | W2 | 800,000 | 80,000 | 720,000 |
| Machinery | W3 | 220,000 | 79,200 | <u>140,800</u> |
| | | | | 860,800 |
| Current assets | | | | |
| Stock | W7 | | 112,500 | |
| Trade debtors | W5 | | 344,400 | |
| Prepayments | W4 | | <u>5,600</u> | |
| | | | <u>462,500</u> | |
| Creditors falling due within one year | | | | |
| Bank overdraft | | | 47,400 | |
| Trade creditors | W6 | | 74,000 | |
| Proposed dividends | | | 80,000 | |
| Corporation tax creditor | | | 58,700 | |
| Accruals | | | 28,400 | |
| Hire purchase creditor | W3 | | <u>55,000</u> | |
| | | | <u>343,500</u> | |
| Net current assets | | | | <u>119,000</u> |
| | | | | 979,800 |
| Creditors falling due after one year | | | | |
| Hire purchase creditor | W3 | | | 13,750 |
| Net assets | | | | <u><u>966,050</u></u> |
| Represented by: | | | | |
| Share capital | W1 | | | 94,500 |
| Share premium | W1 | | | 262,500 |
| Profit and loss account | W8 | | | 609,050 |
| | | | | <u><u>966,050</u></u> |

| Workings | | £ |
|-------------------------------------|--|--------------------|
| W1 | Share capital at 31/7/04 - 420,000 x 20p | 84,000 |
| | Right issue - 420,000/6 x 75% x 20p | 10,500 |
| | As at 31/7/05 | <u>94,500</u> |
| | Share premium at 31/7/04 - 420,000 x 40p | 168,000 |
| | Right issue - 420,000/6 x 75% x 1.80 | 94,500 |
| | As at 31/7/05 | <u>262,500</u> |
| W2 | Cost of property | <u>800,000</u> |
| | Depreciation - 800,000 x 2% x 5 years | <u>80,000</u> |
| W3 | Cost of machinery | 220,000 |
| | Depreciation for 2004 - 220,000 x 20% | 44,000 |
| | | <u>176,000</u> |
| | Depreciation for 2005 - 176,000 x 20% | 35,200 |
| | | <u>140,800</u> |
| | Purchase cost on HP - 220,000 x 75% | <u>165,000</u> |
| | Capital per instalment - 165,00/36 | <u>4,583.33</u> |
| | Number of instalments left at 31/7/05 | 15 |
| | HP creditor at 31/7/04 | 68,750 |
| | Due within one year - 12/15 x 68,750 | 55,000 |
| | Due after one year | 13,750 |
| W4 | Prepaid insurance - 8,400 x 8/12 | <u>5,600</u> |
| W5 | | 114,000 |
| | Bad debt provision - 114,000 x 4/96 | 4,750 |
| | | <u>118,750</u> |
| | Sales | 3,550,000 |
| | Receipts | <u>(3,310,000)</u> |
| | Gross debtors at 31/7/04 | 358,750 |
| Provision at 31/7/05 - 4% x 358,750 | 14,350 | |
| | Net debtors at 31/7/05 | <u>344,400</u> |

Workings

£

W6 Trade creditors at 31/7/04
Movement in year
At 31/7/05

87,000
(13,000)
74,000

W7 Stock at 31/7/04
Movement in year
At 31/7/05

94,000
18,500
112,500

W8 Retained profit at 31/7/04
Retained profit for the year
At 31/7/05

455,050
154,000
609,050

Answer 3

Workings

| | |
|--|-----------------|
| Cost of purchase of fixed assets (£250,000 + £100,000 + £60,000) | <u>410,000</u> |
| Proceeds from sale of fixed assets (£75,000 + £47,000) | <u>122,000</u> |
| Proceeds from issue of shares - 100,000 @ £3.50 | <u>350,000</u> |
| Depreciation charge for the year: | |
| | £ |
| Land and buildings £600,000 @ 2% | 12,000 |
| Plant and machinery | |
| NBV at 31.03.04 | 720,000 |
| Additions | 100,000 |
| Disposals | <u>(70,000)</u> |
| (being £600,000 x 100/80) | <u>750,000</u> |
| Depreciation @ 20% | 150,000 |
| Motor vehicles | |
| NBV at 31.03.04 | 165,000 |
| Additions | 60,000 |
| Disposals | <u>(65,000)</u> |
| (being £120,000 x 100/75) | <u>160,000</u> |
| Depreciation @ 25% | <u>40,000</u> |
| | <u>202,000</u> |
| Loss on sale of fixed assets | |
| Profit on sale of plant and machinery (75,000- 70,000) | 5,000 |
| Loss on sale of motor vehicles (47,000- 65,000) | <u>(18,000)</u> |
| | <u>(13,000)</u> |
| Profit before tax calculated as follows: | |
| Retained profits for the year per the question | 43,000 |
| Add: Dividends in respect of the year to 31 March 2005 | 200,000 |
| Corporation tax charge for the year | <u>73,000</u> |
| | <u>316,000</u> |
| Dividends paid (120,000 + 50,000) | <u>170,000</u> |
| Corporation tax paid (62,000- 14,000) | <u>48,000</u> |
| Corporation tax charge (2,000+85,000-1,100-12,900) | <u>73,000</u> |
| Increase in cash at bank (10,000+ 215,000) | <u>225,000</u> |

November 2005

Answer 3 (continued 1)

Movements in stocks etc.

| | 2005 £'000 | 2004 £'000 | Increase/ (Decrease) in cashflow £'000 |
|-------------------------------|---------------|---------------|---|
| Stock and work in progress | 800 | 990 | 190 |
| Debtors | 975 | 845 | (130) |
| Creditors | 760 | 850 | (90) |

Boycott Ltd

Cash Flow Statement for the year ended 31 March 2005

| | £'000 |
|--------------------------------------|--------------|
| Profit for the year before tax | 316 |
| Add: adjustment for non-cash items | |
| Depreciation | 202 |
| Loss on sale of fixed assets | <u>13</u> |
| | 531 |
| Decrease in stocks | 190 |
| Increase in trade debtors | (130) |
| Decrease in trade creditors | <u>(90)</u> |
| | 501 |
| Proceeds from sale of fixed assets | 122 |
| Payments to purchase fixed assets | (410) |
| Proceeds from issue of shares | 350 |
| Dividends paid | (170) |
| Corporation tax paid | <u>(48)</u> |
| Increase in cash | <u>345</u> |
| Represented by: | |
| Increase in cash at bank and in hand | 225 |
| Reduction in bank loans | <u>120</u> |
| | <u>345</u> |

November 2005

Answer 3 (continued 2)

The cashflow statement looks at the cash inflows and outflows of a business in a particular accounting period.

The benefit of producing a cashflow statement is that it concentrates on cashflow. The profit and loss account provides information about a business' profitability over a period of time and the balance sheet gives information about its assets and liabilities at a given point in time. However, the accruals concept eliminates the effect of cash-flows from the profit and loss account. A profitable business could be running out of cash whilst a business which is making a loss could be generating cash. It is important to be able to recognise what is happening to cash and why because cash is of great importance to the survival of a business. It is, therefore, important for users of accounts to get information about the amount of cash available to and cash required by a business.

November 2005: Answers

Q4 - Answer

1. Gross profit and closing stock

Item A

| | | | | |
|---------------------|----|-----------------|---|----------------------|
| | | | £ | |
| Sales | W1 | | | 114,000 |
| Less cost of sales: | | | | |
| Opening stock | W1 | 3,600 | | |
| Purchases | W1 | 68,000 | | |
| Closing stock | W1 | <u>(12,500)</u> | | 59,100 |
| Gross profit | | | | <u><u>54,900</u></u> |

Item B

| | | | | |
|---------------------|----|--------------|---|-------------------|
| | | | £ | |
| Sales | W2 | | | 1,163 |
| Less cost of sales: | | | | |
| Opening stock | | - | | |
| Purchases | W2 | 1,000 | | |
| Closing stock | W2 | <u>(250)</u> | | 750 |
| Gross profit | | | | <u><u>413</u></u> |

Item C

| | | | | |
|---------------------|----|----------------|---|---------------------|
| | | | £ | |
| Sales | W3 | | | 4,523 |
| Less cost of sales: | | | | |
| Opening stock | W3 | 2,000 | | |
| Purchases | W3 | 1,800 | | |
| Closing stock | W3 | <u>(1,086)</u> | | 2,714 |
| Gross profit | | | | <u><u>1,809</u></u> |

Item D

| | | | | |
|---------------------|----|----------------|---|----------------------|
| | | | £ | |
| Sales | W4 | | | 29,800 |
| Less cost of sales: | | | | |
| Opening stock | W4 | 1,000 | | |
| Purchases | W4 | 16,950 | | |
| Closing stock | W4 | <u>(3,400)</u> | | 14,550 |
| Gross profit | | | | <u><u>15,250</u></u> |

2. Stock valuation

SSAP 9 deals with stock valuations

SSAP 9 suggests any method is acceptable if it gives a reasonable approximation to actual cost

SSAP 9 suggests that the LIFO method does not normally give a reasonable approximation to cost

3. Inappropriate method

FRS18 requires the adoption of an accounting policy to give a true and fair view. As such account should be taken of all losses as soon as they are foreseen.

If stock is expected to be sold at less than cost then it should not be valued at cost.

Instead it should be valued at Net Realisable Value.

NRV is expecting selling price less any further costs to completion

Workings:

| W1 | No | Cost | £ | Cost of sales |
|----------------------------|-----------------|------|-----------------|---------------|
| Opening stock | 2,000 | 1.80 | 3,600 | |
| Purchases - September 2004 | 14,000 | 2.00 | 28,000 | |
| | <u>16,000</u> | | <u>31,600</u> | |
| Sales - November 2004 | (2,000) | 1.80 | (3,600) | 3,600 |
| Sales - November 2004 | <u>(13,000)</u> | 2.00 | <u>(26,000)</u> | 26,000 |
| | 1,000 | | 2,000 | |
| Purchases - February 2005 | 16,000 | 2.50 | 40,000 | |
| | <u>17,000</u> | | <u>42,000</u> | |
| Sales - March 2005 | (1,000) | 2.00 | (2,000) | 2,000 |
| Sales - March 2005 | <u>(11,000)</u> | 2.50 | <u>(27,500)</u> | 27,500 |
| Closing stock | <u>5,000</u> | | <u>12,500</u> | <u>59,100</u> |
| Being: | | | | |
| Closing stock | <u>5,000</u> | 2.50 | <u>12,500</u> | |

| Sales: | No | Price | £ |
|-----------------------|--------|-------|----------------|
| Sales - November 2004 | 15,000 | 4.00 | 60,000 |
| Sales - March 2005 | 12,000 | 4.50 | 54,000 |
| | | | <u>114,000</u> |

| | | |
|----|-----------------------------|--------------|
| W2 | Purchases - 1,000 x £1.00 | <u>1,000</u> |
| | Cost of sales 3/4 x 1,000 | 750 |
| | Mark up - 750 x 55% | 413 |
| | Therefore sales | <u>1,163</u> |
| | Closing stock - 1,000 - 750 | <u>250</u> |

| W3 | No | Cost | £ |
|--------------------------|--------------------------|------|-------------------------------------|
| Opening stock | 4,000 | 0.50 | 2,000 |
| Purchases - January 2005 | 3,000 | 0.60 | 1,800 |
| | <u>7,000</u> | | <u>3,800</u> |
| Sales - March 2005 | <u>(5,000)</u> | | <u>(2,714)</u> = 5000/7000 x £3,800 |
| Closing stock | <u>2,000</u> | | <u>1,086</u> |
| | | | |
| | Sales - 2,714 x 100/60 = | | <u>4,523</u> |

Workings:

| W4 | No | Cost | £ | Cost of sales |
|---------------------------|-------------------|-------|----------------------|----------------------|
| Opening stock | 50 | 20 | 1,000 | |
| Purchases - February 2005 | 180 | 25 | 4,500 | |
| Purchases - March 2005 | 350 | 27 | 9,450 | |
| | <u>580</u> | | <u>14,950</u> | |
| Sales - April 2005 | (200) | 27 | (5,400) | 5,400 |
| Sales - May 2005 | (150) | 27 | (4,050) | 4,050 |
| Sales - May 2005 | (180) | 25 | (4,500) | 4,500 |
| Sales - May 2005 | (30) | 20 | (600) | 600 |
| Purchases - June 2005 | 100 | 30 | 3,000 | |
| Closing stock | <u><u>120</u></u> | | <u><u>3,400</u></u> | <u><u>14,550</u></u> |
| Being: | | | | |
| Closing stock | 100 | 30 | 3,000 | |
| Closing stock | <u>20</u> | 20 | <u>400</u> | |
| | <u><u>120</u></u> | | <u><u>3,400</u></u> | |
| Sales: | No | Price | £ | |
| Sales - April 2005 | 200 | 50 | 10,000 | |
| Sales - May 2005 | 360 | 55 | 19,800 | |
| | | | <u><u>29,800</u></u> | |