



**Association of Taxation Technicians**

## **Examination**

May 2006

### **PRINCIPLES OF ACCOUNTING**

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TIME ALLOWED – 1 HOUR 30 MINUTES

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- You should answer **three** out of the four questions set.
- Each question carries 35 marks.
- Start each answer on a new sheet of paper.
- 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. ABC Ltd prepares its financial statements to 30 November each year.
  - 1) The accounts for the year to 30 November 2005 included trade debtors, before any provisions for doubtful debts, of £1.75 million at 30 November 2005. The provision for specific doubtful debts at 30 November 2005 is £200,000.
  - 2) The company's policy regarding doubtful debts is to provide for 4% of the debts after allowing for specific provisions.
  - 3) The general bad debt provision at 30 November 2004 was £54,000.
  - 4) The specific bad debt provision at 30 November 2004 was £164,000. This provision related to the following debts:
    - (a) EFG Ltd £24,000  
In the year to 30 November 2005 £18,000 was received in full and final settlement of this debt.
    - (b) MNO Ltd £140,000  
During the year to 30 November 2005 the liquidator of MNO Ltd made a liquidation distribution of 40p in the £1. No further distributions will be received.
  - 5) During the year to 30 November 2005 a customer, RST Ltd, went into liquidation owing ABC Ltd £15,000. There is no likelihood of any amounts being recovered and the debt was therefore written off during the year.
  - 6) During the year to 30 November 2005 the liquidator of XYZ Ltd made a distribution of 30p in the £1. XYZ Ltd owed ABC Ltd £10,000 at 30 November 2001 and this amount had been fully written off in the year to 30 November 2002 as a bad debt.

**You are required to:**

- 1) **Show the double entry to record each of the above transactions and to then prepare 'T' accounts reflecting them in the year to 30 November 2005. You should show all your workings.** (22)
- 2) **Explain the difference between a bad debt and a doubtful debt.** (5)
- 3) **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.** (8)

Total (35)

2. Bloggs Ltd is a manufacturer and it prepares its financial statements to 31 December each year. During the year to 31 December 2005 the following events took place:
- 1) A new packing machine, costing £100,000, was purchased. The machine is to be depreciated on a straight line basis over a period of ten years. The depreciation charged in the accounts to 31 December 2005 was £10,000. Bloggs Ltd obtained a grant of £30,000 in respect of this expenditure.
  - 2) An unemployed person was recruited in September 2005 on a salary of £20,000 per annum and as a consequence a Government grant of £2,000 was received in October 2005.
  - 3) Research expenditure of £200,000 was incurred on a new method of manufacturing. The expenditure related to employment costs only.
  - 4) The company commenced the production of a revised version of its main product after incurring £50,000 of development expenditure. All this expenditure took place in 2005, prior to the commencement of production of the revised version in November 2005. The directors believe that it will be necessary to revise the product still further in five years time.
  - 5) The company acquired the trade and assets of a competitor business and paid £500,000 for the goodwill of the trade. The directors consider that the useful life of the goodwill of this business to be no more than ten years.
  - 6) A van was purchased under a finance lease agreement. The cash price was £20,000 but the agreement required an initial deposit of 10% and 48 monthly instalments of £500 each.
  - 7) A motor vehicle was acquired under an operating lease agreement. The agreement was for a period of three years with a monthly lease payment of £400.

**You are required to:**

- 1) **Explain how Bloggs Ltd should account for the above transactions. If you consider there to be more than one option available to Bloggs Ltd you should explain the alternatives available and indicate in your answer your own preferred alternative.** (25)
- 2) **Explain the difference between research expenditure and development expenditure.** (4)
- 3) **Explain the difference between capital expenditure and revenue expenditure.** (3)
- 4) **Explain the difference between a finance lease and an operating lease.** (3)

**You should ignore VAT.**

Total (35)

3. Alpha Ltd prepares its accounts to 31 December each year. The balance sheets as at 31 December 2004 and 2005 are as follows:

	<u>2005</u> £	<u>2005</u> £	<u>2004</u> £	<u>2004</u> £
<u>Tangible Fixed Assets</u>				
Machinery (at net book value)		170,000		192,000
<u>Current Assets</u>				
Stock	22,000		14,000	
Trade debtors	47,000		52,000	
Cash at bank	-		27,000	
	<u>69,000</u>		<u>93,000</u>	
<u>Creditors: amounts falling due within one year</u>				
Trade creditors	11,000		34,000	
Bank overdraft	31,000		-	
Corporation Tax creditor	12,000		6,000	
Proposed dividend	-		14,000	
Debenture loan stock	-		80,000	
	<u>54,000</u>		<u>134,000</u>	
Net current assets/(liabilities)		<u>15,000</u>		<u>(41,000)</u>
		185,000		151,000
<u>Creditors: amounts falling due after one year</u>				
Debenture loan stock		(70,000)		(70,000)
Net assets		<u>£115,000</u>		<u>£81,000</u>
Share capital		45,000		38,000
Share premium account		26,000		23,000
Profit and loss account		<u>44,000</u>		<u>20,000</u>
		<u>£115,000</u>		<u>£81,000</u>

During the year ended 31 December 2005 Alpha Ltd purchased a new machine at a cost of £45,000.

During the year ended 31 December 2005 Alpha Ltd disposed of machinery which had a net book value of £36,000. This disposal realised a loss on sale of £6,000.

During the year ended 31 December 2005 Alpha Ltd redeemed £80,000 of the debenture loan stock.

The total interest charge in the profit and loss account for the year ended 31 December 2005 was £17,000.

The Corporation Tax charge in the profit and loss account for the year ended 31 December 2005 was as follows:

	£
Current year provision	12,000
Prior year under provision	<u>2,000</u>
Charge per profit and loss account	<u>14,000</u>

In March 2005 Alpha Ltd paid the proposed dividend in respect of the year ended 31 December 2004. In September 2005 the company paid a dividend of £16,000 in respect of the year ended 31 December 2005.

(Continued)

3 (Continuation)

**You are required to:**

1) **Produce a cashflow statement for the year ended 31 December 2005 showing all your workings. You do NOT need to produce the cashflow statement in FRS1 format.** (30)

2) **Explain the importance of cashflow statements and why they are prepared.** (5)

Total (35)

4. Mrs Warner commenced in business as a sole trader on 1 July 2005. Detailed below are the activities that occurred in the first nine months of trading:

- 1) Mrs Warner introduced initial capital of £30,000 into the business.
- 2) On 1 July 2005 a van was purchased at a cost of £18,000. Depreciation at 25% reducing balance is to be charged on the van.
- 3) Goods for resale were purchased for £84,000. All these purchases were on credit and £24,000 were not paid for at 31 March 2006.
- 4) Three quarters of the goods for resale had been sold at a 30% mark up. The rest were still held at 31 March 2006.
- 5) All sales were on credit and £12,000 remained due by customers at 31 March 2006. The £12,000 includes one particular debt of £1,500 which needs to be provided for as it is considered doubtful. In addition to this Mrs Warner requires a general provision of 2% of all remaining debts.
- 6) The following expenses were paid by Mrs Warner during the period to 31 March 2006:

	£
Rent	3,600
Rates	1,400
Telephone	850
Motor expenses	2,250
Employee wages	4,800

- 7) Included within motor expenses is £800 for insurance of the van which was the full cost for the year to 30 June 2006.
- 8) The rent of £3,600 only includes the six months to 31 December 2005. The rent for January, February and March 2006 of £600 per month had not been paid for by 31 March 2006.
- 9) The employee was due a bonus of £350 for the period ended 31 March 2006 which was paid in April 2006.
- 10) Mrs Warner took drawings of £500 per month from July 2005 onwards.
- 11) Mrs Warner is not registered for VAT.

**You are required to:**

1) **Show how the above transactions would be recorded in the ledger ('T' accounts) of the business.** (25)

2) **Prepare the profit and loss account for the period ended 31 March 2006.** (5)

3) **Prepare the balance sheet as at 31 March 2006.** (5)

Total (35)