Association of Taxation Technicians

Examination

November 2006

PRINCIPLES OF ACCOUNTING

TIME ALLOWED – 1 HOUR 30 MINUTES

- 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. Morris Ltd draws up its accounts to 30 September each year. An extract from the balance sheet at 30 September 2005 showed the following:

<u>Issued share capital</u>

	£
Ordinary shares of 25 pence each	125,000
Preference shares of £1 each	200,000
Share premium	175,000

During the year ended 30 September 2006 the following transactions took place:

1) On 31 December 2005 there was a bonus issue of seven ordinary shares for every two held.

2) On 30 June 2006 there was a rights issue of two ordinary shares for every five ordinary shares held at 90 pence per share. The rights issue was taken up by all shareholders.

3) On 31 July 2006 the company issued a further 40,000 preference shares. The issue price was at a premium of 20 pence per share.

You are required to:

1) Prepare ledger accounts ('T' accounts) reflecting the above transactions in the year ended 30 September 2006. You should show all your workings. (18)

2) Explain the difference between ordinary and preference shares. (3)

3) Explain what is meant by a bonus issue and why a company would make such an issue. (5)

4) Explain what is meant by a rights issue, why a company would make such an issue and the options available to shareholders when a company makes a rights issue. (6)

5) Explain how the above transactions would be reflected in the cash flow statement for the year ended 30 September 2006. (3)

Total (35)

2. Mr Ripley runs a business of buying and selling a number of products.

He prepares accounts to 31 May each year and detailed below is information relating to the trading activities of the business for the year ended 31 May 2006.

1) During the year ended 31 May 2006 Mr Ripley purchased 820 units of product A at a cost of £140 each. Three quarters of these were sold during the year realising a gross profit of 30%.

2) During the year ended 31 May 2006 Mr Ripley made sales of product B totalling £725,000. All units of product B were bought and sold during the year and there was no opening or closing stock. The sales of product B were at a mark up of 45%.

3) In March 2006 Mr Ripley sold 520 units of product C for £580 per unit. At 31 May 2005 Mr Ripley held in stock 210 units which had a cost of £270 each. In January 2006 Mr Ripley had purchased a further 440 units for £300 each. The accounting policy used by Mr Ripley for valuing stock is the average method.

4) The following expenses were incurred and paid for during the year:

	£
Telephone	580
Electricity	980

5) Mr Ripley has agreed with his accountant a fee of £1,400 for the preparation of the business accounts for the year ended 31 May 2006.

6) Mr Ripley rents the premises from which he operates the business. The rent charged by the landlord which is paid annually in advance was £9,000 for the year ended 31 December 2005 and £10,200 for the year ended 31 December 2006.

7) During the year ended 31 May 2006 Mr Ripley paid employees wages totalling £2,100. The payments made included bonuses of £350 due to employees in respect of the year ended 31 May 2005.

8) At 31 May 2006 trade debtors totalled £58,000. This includes one particular debt of £3,000 which needs to be provided against as it is considered doubtful as to whether this will be paid. In addition to this Mr Ripley requires a general provision of 2% of remaining debts. At 31 May 2005 there was a specific provision of £6,500 and a general provision of £1,190. In September 2005, £3,600 of the £6,500 debt specifically provided for at 31 May 2005 was received and the balance was written off.

9) In July 2005 a customer went into liquidation owing Mr Ripley £1,200. There was no likelihood of any amounts being recovered and the debt was therefore written during the year ended 31 May 2006.

You should ignore VAT.

You are required to:

1) Prepare the profit and loss account for the year ended 31 May 2006. You should show all your workings. You are NOT required to prepare a balance sheet. (31)

2) Briefly explain the uses of a profit and loss account. (4)

Total (35)

3. Lever Ltd prepares its accounts to 31 December each year. During the year to 31 December 2005 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 was paid as follows:

	Gross interest paid
	£
6 April 2005	10,000
28 June 2005	12,000
29 September 2005	11,000
24 December 2005	15,000

The Income Tax withheld was paid over on the due dates.

2) The company submitted the following VAT returns during the year:

Quarter to	VAT Output	VAT Input	VAT payment (refund)	Date paid (received)
	£	£	£	
31 December 2004	150,000	90,000	60,000	28 January 2005
31 March 2005	160,000	110,000	50,000	29 April 2005
30 June 2005	140,000	150,000	(10,000)	15 August 2005
30 September 2005	180,000	120,000	60,000	29 October 2005

3) The company's Corporation Tax liability based on the profits for the year ended 31 December 2003 and 2004 were agreed following enquiries raised by HM Revenue & Customs as follows:

	2004	2003
	£	£
Final agreed liability	295,375	265,400
Paid as follows:		
30 September 2005	(284,500)	
17 November 2005	(10,875)	
30 September 2004		(260,000)
17 November 2005		(5,400)

The Corporation Tax provision based on the profits for the year to 31 December 2005 is £300,000. The Corporation Tax that has been provided for in the accounts in respect of the 2003 and 2004 Corporation Tax is as follows:

	£	£
Year to 31 December 2003		
Amount provided in 2003 accounts	260,000	
Less tax paid	260,000	
Corporation Tax creditor at 31 December 2004		-
Year to 31 December 2004		
Amount provided in 2004 accounts		284,500
Corporation Tax creditor at 31 December 2004		284,500

Interest on the overdue Corporation Tax in respect of the additional tax liability for the years to 31 December 2003 and 2004 amounted to £461 and was paid on 17 November 2005.

(continued)

3. (continuation)

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

	£
31 December 2004	364,000
31 December 2005	353,000

The company makes full provision for its deferred tax liability.

You are required to:

1) **Show how the above transactions would be shown in the 'T' accounts (ledger accounts) of Lever Ltd. You should include a bank account.** (20)

2) **Show how the corporation tax and deferred tax would be disclosed in the profit and loss account and balance sheet of Lever Ltd for the year to 31 December 2005.** (5)

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

4) **Explain how VAT is accounted for in the accounts of a company.** (5)

5) **Explain the difference between the presentation of tax in company accounts and sole trader accounts.** (2)

Total (35)

4. **You are required to answer the following:**

1) **What is the purpose of accounting standards?** (2)

2) **Name the four objectives which an entity should use to judge the appropriateness of accounting policies to its particular circumstances.** (4)

3) **In the context of FRS12 what is meant by a provision and when should a provision be recognised in the accounts of a company?** (4)

4) **In the context of FRS12 what is meant by a contingent liability and how should contingent liabilities be dealt with in the financial statements of a limited company?** (4)

5) **What is a contingent asset and how should contingent assets be dealt with in the financial statements of a company?** (4)

6) **Describe the two concepts that play an important role in the selection of accounting policies.** (4)

7) **Explain the purpose of an accounting system.** (5)

8) **Explain what is meant by reserves of a company.** (4)

9) **Name the different ways in which a business can be carried on.** (4)

Total (35)