



Association of Taxation Technicians

Examination

May 2007

PRINCIPLES OF ACCOUNTING

ANSWERS
(without marking guide)

MAY 2007

Answer 1

Workings

Cost of purchase of fixed assets (£150,000 + £180,000 + £30,000)	<u>360,000</u>
Proceeds from sale of fixed assets (£95,000 + £12,000)	<u>107,000</u>
Proceeds from issue of shares - 50,000 @ £2.00	<u>100,000</u>
Depreciation charge for the year:	
	£
Land and buildings £600,000 @ 4%	24,000
Plant and machinery	
NBV at 31.03.06	650,000
Additions	180,000
Disposals	<u>(80,000)</u>
(being £600,000 x 100/80)	<u>750,000</u>
Depreciation @ 20%	150,000
Motor vehicles	
NBV at 31.03.06	65,000
Additions	30,000
Disposals	<u>(15,000)</u>
(being £60,000 x 100/75)	<u>80,000</u>
Depreciation @ 25%	<u>20,000</u>
	<u>194,000</u>
Profit on sale of fixed assets	
Profit on sale of plant and machinery	15,000
Loss on sale of motor vehicles	<u>(3,000)</u>
	<u>12,000</u>
Profit before tax calculated as follows:	
Retained profits for the year per the question	176,000
Add: Dividends paid in the year	180,000
Corporation tax charge for the year	<u>119,000</u>
	<u>475,000</u>
Increase in cash	
Bank overdraft at 31 March 2006	300,000
Cash at bank at 31 March 2007	<u>25,000</u>
	<u>325,000</u>

MAY 2007

Answer 1 (continued 1)

Movements in stocks etc.

	2007 £'000	2006 £'000	Increase/ (Decrease) in cashflow £'000
Stock and work in progress	400	500	100
Debtors	575	525	(50)
Creditors (incl VAT)	630	490	140

Hornby Limited

Cash Flow Statement for the year ended 31 March 2007

	£'000
Profit for the year before tax	475
Adjustment for non-cash items	
Depreciation	194
Profit on sale of fixed assets	<u>(12)</u>
	657
Decrease in stocks	100
Increase in trade debtors	(50)
Increase in creditors	<u>140</u>
	847
Proceeds from sale of fixed assets	107
Payments to purchase fixed assets	(360)
Proceeds from issue of shares	100
Dividends paid	(180)
Corporation tax paid	<u>(89)</u>
Increase in cash	<u>425</u>
Represented by:	
Increase in cash at bank and in hand	325
Reduction in bank loans	<u>100</u>
	<u>425</u>

MAY 2007

Answer 1 (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.

ATT - PRINCIPLES OF ACCOUNTING

MAY 2007

Answer 2

	£	£
a) Sales		183,000
Less: Cost of Sales:		
Purchases	156,000	
Less: Closing stock (workings)	<u>(43,875)</u>	<u>12,125</u>
Gross profit		<u>70,875</u>

Workings

Closing stock on the average basis is calculated as follows:

$$\text{Average cost of widgets purchased} = \frac{\pounds 156,000}{160}$$

$$= \pounds 975$$

Number of widgets in stock at the year end = 45

Closing stock value = 45 @ £975

$$= \pounds 43,875$$

MAY 2007

Answer 2 (continued)

	£	£
b) Sales		183,000
Less: Cost of Sales:		
Purchases	156,000	
Less: Closing stock (workings)	<u>(44,440)</u>	<u>111,560)</u>
Gross profit		<u>71,440</u>

Workings

Closing stock on a FIFO basis would be calculated as follows:

Date	No.	<u>Receipts</u>		Date	No.	<u>Issues</u>		<u>Balance</u>	
		Price £	Amount £			Price £	Amount £	No.	Amount £
May	30	1,000	30,000	June	20	1,000	20,000		
				Sept.	10	1,000	10,000		
Aug.	40	950	38,000	Sept.	20	950	19,000		
				Dec	20	950	19,000		
Nov.	50	968	48,400	.					
				Jan	30	968	29,040		
				April	15	968	14,520	5	4,840
Feb	40	990	39,600	.				40	39,600

ATT - PRINCIPLES OF ACCOUNTING

MAY 2007

Answer 2 (continued 2)

	£	£
c) Sales		183,000
Less: Cost of Sales:		
Purchases	156,000	
Less: Closing stock (workings)	<u>(44,250)</u>	
		<u>111,750</u>
Gross profit		<u>71,250</u>

Workings

Closing stock on a LIFO basis would be calculated as follows:

<u>Receipts</u>				<u>Issues</u>				<u>Balance</u>	
Date	No.	Price £	Amount £	Date	No.	Price £	Amount £	No.	Amount £
May	30	1,000	30,000	June	20	1,000	20,000	10	10,000
Aug.	40	950	38,000	Sept.	30	950	28,500	10	9,500
Nov.	50	968	48,400	Dec.	20	968	19,360		
				Jan.	30	968	29,040		
Feb	40	990	39,600	April.	15	990	14,850	25	24,750

- 2) Under the concept of prudence, stock should not be valued at cost if it is anticipated that the net realisable value of the stock will be less than cost. If this is expected to be the case stock should be valued at net realisable value. Net realisable value is defined as:

	£
Expected selling price	X
Less: all further costs to completion	<u>X</u>
	<u>X</u>

This value is used when it is lower than cost in order to accord with the concept of prudence.

ATT - PRINCIPLES OF ACCOUNTING

MAY 2007

Answer 2 (continued 3)

3) The two concepts that play a persuasive role in financial statements and hence the selection of accounting policies are the going concern and accruals concepts.

An entity should prepare its financial statements on a going concern basis unless the entity has been liquidated or has ceased trading or the directors have no realistic alternative but to liquidate the entity or to cease trading.

The accruals basis of accounting requires the non-cash effects of transactions and other events to be reflected as far as is possible in the financial statements for the accounting period in which they occur and not for example in the period in which any cash involved is received or paid.

4) The reserves of a company represent the cumulative total of the company's retained profits. These are the profits after taxation and after the distribution of any profits to the shareholders by way of dividends. The reserves form part of the shareholders' funds along with the share capital and the share premium account.

5) The 4 different ways in which a business can be carried on are:

- a) sole trader;
- b) partnership;
- c) limited liability partnership; and
- d) limited company.

Proprietors capital account			
	£		£
Balance c/f	<u>45,000</u>	Bank	<u>45,000</u>
		Balance b/f	45,000

Bank			
	£		£
Proprietors capital account	45,000	Car	21,000
Debtors	97,000	Creditors	71,000
		Rent	4,800
		Rates	1,600
		Telephone	900
		Motor expenses	3,100
		Wages	5,400
		Drawings	5,600
		Balance c/f	<u>28,600</u>
	<u>142,000</u>		<u>142,000</u>
Balance b/f	28,600		

Car			
	£		£
Bank	<u>21,000</u>	Balance c/f	<u>21,000</u>
Balance b/f	21,000		

Depreciation expense			
	£		£
Provision for depreciation	W1 <u>3,500</u>	P&L account	<u>3,500</u>

Provision for depreciation			
	£		£
Balance c/f	<u>3,500</u>	Depreciation expense	W1 <u>3,500</u>
		Balance b/f	3,500

Purchases			
	£		£
Creditors	<u>108,000</u>	P&L account	<u>108,000</u>

Creditors			
	£		£
Bank	71,000	Purchases	108,000
Balance c/f	<u>37,000</u>		
	<u>108,000</u>		<u>108,000</u>
		Balance b/f	37,000

Stock			
	£		£
P&L account	<u>36,000</u>	Balance c/f	W2 <u>36,000</u>
Balance b/f	36,000		

Sales			
	£		£
P&L account	<u>120,000</u>	Debtors	W2 <u>120,000</u>

Debtors			
		£	£
Sales	W2	120,000	Bank
			Balance c/f
		<u>120,000</u>	<u>97,000</u>
			<u>23,000</u>
Balance b/f		23,000	<u>120,000</u>

Rent			
		£	£
Bank		4,800	P&L account
Balance c/f		3,200	
		<u>8,000</u>	<u>8,000</u>
			Balance b/f
			3,200

Rates			
		£	£
Bank		1,600	P&L account
		<u>1,600</u>	<u>1,600</u>

Telephone			
		£	£
Bank		900	P&L account
		<u>900</u>	<u>900</u>

Motor expenses			
		£	£
Bank		3,100	Balance c/f
			P&L account
		<u>3,100</u>	<u>150</u>
			<u>2,950</u>
Balance b/f		150	<u>3,100</u>

Wages			
		£	£
Bank		5,400	P&L account
Balance c/f		600	
		<u>6,000</u>	<u>6,000</u>
			Balance b/f
			600

Drawings			
		£	£
Bank	£800 x 7	5,600	Balance c/f
		<u>5,600</u>	<u>5,600</u>
Balance b/f		5,600	

Mr Jones - Answers

W1	Depreciation	
	$\text{£}21,000 \times 20\% \times 10/12$	<u><u>3,500</u></u>
W2	Sales	
	Purchases	108,000
	Closing stock - $\text{£}108,000 \times 1/3$	<u>36,000</u>
		72,000
	Margin - $\text{£}72,000 \times 40/60$	48,000
	Sales	<u><u>120,000</u></u>
W3	Prepaid motor expenses	
	$\text{£}900 \times 2/12$	<u><u>150</u></u>
W4	Rent accrual	
	$\text{£}800 \times 4$	<u><u>3,200</u></u>

Mr Jones - Answers

Mr Jones

Profit and Loss account for 10 months ending 31 March 2007

	£	£
Sales		120,000
Less cost of sales:		
Purchases	108,000	
Less closing stock	<u>(36,000)</u>	
Gross profit		<u>(72,000)</u> 48,000
Less expenses:		
Rent	8,000	
Rates	1,600	
Telephone	900	
Motor expenses	2,950	
Wages	6,000	
Depreciation	<u>3,500</u>	
Net loss for the period		<u>(22,950)</u> <u>25,050</u>

Mr Jones

Balance Sheet as at 31 March 2007

	£	£	
	Cost £	Depn £	
Fixed Assets			
Car	<u>21,000</u>	<u>3,500</u>	17,500
Current Assets			
Stock		36,000	
Debtors		23,000	
Prepayments		150	
Bank account		<u>28,600</u>	
		87,750	
Current Liabilities			
Trade creditors		37,000	
Accruals		<u>3,800</u>	
			<u>46,950</u>
Financed by:			<u>64,450</u>
Capital introduced		45,000	
Profit for the period		25,050	
Drawings		<u>(5,600)</u>	
			<u>64,450</u>

Maple Limited - Answers

1. Balance sheet amounts		Dr	Cr
		£	£
Motor vehicles account	W2	26,000	
Provision of depreciation of motor vehicles	W3		6,500
Machinery account	W4	155,000	
Provision of depreciation of machinery	W4		106,000
Property account	W5	460,000	
Provision of depreciation of property	W5		9,200
Grant creditor	W7		206,400
Hire purchase creditor	W8		11,247
Finance lease creditor	W9		27,710

2. Profit and loss account amounts		Dr	Cr
		£	£
Loss on disposal of motor vehicles	W1	4,750	
Depreciation	W6	34,700	
Sundry income - grants	W7		33,600
Hire purchase interest	W8	747	
Finance lease interest	W9	960	

Workings

W1	Mercedes car	£	
	Cost in 2004	28,000	
	2004 depn - 25%	<u>(7,000)</u>	
		21,000	
	2005 depn - 25%	<u>(5,250)</u>	
	NBV at 31/12/2005	15,750	
	Disposal proceeds	<u>11,000</u>	
	Loss on disposal	<u><u>4,750</u></u>	
W2	Motor vehicles account	£	
	Mercedes b/wd	28,000	
	Disposal	<u>(28,000)</u>	
	BMW - full cost	<u>26,000</u>	
		<u><u>26,000</u></u>	
W3	Depn of BMW	£	
	Charge for year - 25% x £26,000	<u><u>6,500</u></u>	
W4	Machinery account	£	£
	Cost in 2001	60,000	
	Cost in 2003	45,000	
	Addition in 2006 - full cost	<u>50,000</u>	
		<u><u>155,000</u></u>	
	Depn to 2005 on 2001 addition - 5 years at 20% p.a	60,000	
	Depn to 2005 on 2003 addition - 3 years at 20% p.a	<u>27,000</u>	
		87,000	
	Depn for 2006		
	on 2001 addition - nil as already fully written of	-	
	on 2003 addition - 20%	9,000	
	on 2006 addition - 20%	<u>10,000</u>	
		19,000	
		<u><u>106,000</u></u>	

Maple Limited - Answers

W5	Property	£
	Cost (grant is not netted off the cost)	<u>460,000</u>
	Depn for 2006 - 2%	<u>9,200</u>

W6	Depreciation charge for 2006		£
	Property	W5	9,200
	Machinery	W4	19,000
	Motor vehicles	W3	6,500
			<u>34,700</u>

W7	Government grant		£
	Total received		240,000
	Re property - 3/4		<u>180,000</u>
	Re wages		<u>60,000</u>

Grant re revenue is recognised in P&L in period expense it related to is incurred

	Total grant re wages	60,000
	Re 2006 - 1/2	<u>30,000</u>
	Grant creditor at 31 December 2006	<u>30,000</u>

Grant re property is held on balance sheet and spread over life of property

	Capital grant re property	180,000
	To P&L - 2%	<u>3,600</u>
	Grant creditor at 31 December 2006	<u>176,400</u>

Total grant to P&L in 2006	wages	30,000
	property	<u>3,600</u>
		<u>33,600</u>

Grant creditor at 31/12/2006	wages	30,000
	property	<u>176,400</u>
		<u>206,400</u>

W8	BMW HP		£
	HP advance - £26,000 - £11,000		15,000
	Repayments - 36 x £500		<u>18,000</u>
	Total HP interest		<u>3,000</u>

HP interest per instalment	<u>83</u>
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Instalments in 2006	<u>9</u>
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HP interest charge - 9 x £83	<u>747</u>
(or 9/36 x 3,000 depending on rounding)	<u>750</u>

HP creditor at 31 December 2006	
Advance	15,000
Instalments - 9 x £500	(4,500)
Interest	747
	<u>11,247</u>
(or depending on rounding)	<u>11,250</u>

Maple Limited - Answers

W9 Machinery lease	£
Advance	50,000
Deposit - 30% x £50,000	<u>(15,000)</u>
	35,000
Total payments - 24 x £1,650	<u>39,600</u>
Finance charge	<u><u>4,600</u></u>
Charge per instalment	<u>192</u>
Instalments in 2006	<u><u>5</u></u>
Finance charge for year - 5 x £192	<u>960</u>
(or 5/24 x 4,600 depending on rounding)	<u><u>958</u></u>
Finance lease creditor at 31 December 2006	
Advance	35,000
Instalments - 5 x £1,650	(8,250)
Interest	960
	<u>27,710</u>
(or depending on rounding)	<u><u>27,708</u></u>