## Association of Taxation Technicians

# Examination

November 2007

## PRINCIPLES OF ACCOUNTING

Answers (without marks)

Wall Limited - Answers

1. Cashflow statement

**Wall Limited**

**Cashflow Statement for the year ended 31 May 2007**

| | | £ |
|---|---|---|
| Profit for year before taxation | W1 | 95,650 |
| Adjustments for items not involving movement of funds: | | |
| Depreciation | W2 | 13,350 |
| Loss on sale of fixed assets | W3 | 3,000 |
| | | 112,000 |
| Increase in stock | W4 | (7,000) |
| Decrease in trade debtors | W4 | 6,000 |
| Decrease in trade creditors | W4 | (17,000) |
| Net cash inflow from operating activities | | 94,000 |
| Proceeds from issue of shares | W5 | 12,000 |
| Proceeds from sale of fixed assets | | 19,000 |
| Payments made to purchase fixed assets | | (25,000) |
| Corporation Tax paid | | (51,000) |
| Dividends paid | | (28,000) |
| Increase in cash | | 21,000 |
| Represented by: | | |
| Decrease in cash at bank | W6 | (19,000) |
| Decrease in bank loan | W6 | 40,000 |
| | | 21,000 |

2.Importance of cashflows

Cash is of great importance to the survival of a business.

The profit and loss account due to accruals, depreciation etc does not provide information regarding the cash movements of a business so on its own could be misleading.

Due to depreciation, stock valuation policies etc it is possible to manipulate the results in the P&L account.  A cashflow staement is not as easily mainipulated

Many users of accounts find a cashflow statement easier to understand

FRS 1 was introduced as it was felt an additional statement detailing the difference between cash and profit provided added value to the users of accounts.

Wall Limited - Answers

Workings

| | | | | £ |
|---|---|---|---|---|
| W1 | Retained earnings at 31/05/2007 | | | 180,650 |
| | Less retained earnings at 31/05/2006 | | | (134,000) |
| | Increase in retained earnings | | | 46,650 |
| | Add Corporation Tax charge | | | 21,000 |
| | Add dividends | | | 28,000 |
| | Profit for year before taxation | | | 95,650 |

| | | P&E | MV | |
|---|---|---|---|---|
| W2 | NBV bfwd | 30,000 | 8,000 | |
| | Disposals at NBV | (18,000) | (4,000) | |
| | Additions at cost | 14,000 | 11,000 | |
| | | 26,000 | 15,000 | |
| | Depreciation charge - 20%/25% | 5,200 | 3,750 | 8,950 |
| | Depreciation of land and buildings - £220,000 x 2% | | | 4,400 |
| | | | | 13,350 |
| W3 | NBV of disposals | 18,000 | 4,000 | |
| | Proceeds | 13,000 | 6,000 | |
| | Loss/(profit) | 5,000 | (2,000) | 3,000 |

| | | 31/05/07 | 31/05/06 | |
|---|---|---|---|---|
| W4 | Stock | 35,000 | 28,000 | 7,000 |
| | Debtors | 41,000 | 47,000 | (6,000) |
| | Creditors | 45,000 | 62,000 | (17,000) |
| W5 | | | | |
| | Proceeds from issue of shares - 6,000 x £2 | | | 12,000 |

| | | 31/05/07 | 31/05/06 | |
|---|---|---|---|---|
| W6 | Bank | (7,000) | 12,000 | (19,000) |
| | Loan | - | 40,000 | (40,000) |

Jools Limited - Answers

1

VAT account

| | | £ | | | £ |
|---|---|---|---|---|---|
| 31/07/2006 | Bank account | 8,500 | 01/07/2006 | Balance b/f | 8,500 |
| 30/09/2006 | VAT inputs | 68,000 | 30/09/2006 | VAT outputs | 62,500 |
| 31/12/2006 | VAT inputs | 78,100 | 31/10/2006 | Bank account | 5,500 |
| 31/03/2007 | VAT inputs | 77,400 | 31/12/2006 | VAT outputs | 75,600 |
| 30/04/2007 | Bank account | 6,000 | 31/01/2007 | Bank account | 2,500 |
| 30/06/2007 | VAT inputs | 66,200 | 31/03/2007 | VAT outputs | 83,400 |
| | | | 30/06/2007 | VAT outputs | 54,200 |
| | | | 30/06/2007 | Balance c/f | 12,000 |
| | | 304,200 | | | 304,200 |
| 01/07/2007 | Balance b/f | 12,000 | | | - |

Bank account (extract)

| | | £ | | | £ |
|---|---|---|---|---|---|
| 31/10/2006 | VAT | 5,500 | 31/07/2006 | VAT | 8,500 |
| 31/01/2007 | VAT | 2,500 | 30/04/2007 | VAT | 6,000 |
| | | | 01/04/2007 | Corporation Tax | 64,600 |
| | | | 01/01/2007 | Interest account | 3,200 |
| | | | 01/04/2007 | Interest account | 3,680 |
| | | | 14/01/2007 | Income Tax account | 800 |
| | | | 14/04/2007 | Income Tax account | 920 |

Corporation Tax account

| | | £ | | | £ |
|---|---|---|---|---|---|
| 01/04/2007 | Bank account | 64,600 | 01/07/2006 | Balance b/f | 62,000 |
| | | | | P&L account | |
| | | | | Underprovision 30/06/06 | 2,600 |
| | | | 30/06/2007 | P&L account | |
| | | | | Provision for 30/06/07 | 74,000 |
| 30/06/2007 | Balance c/f | 74,000 | | | |
| | | 138,600 | | | 138,600 |
| | | | 01/07/2007 | Balance b/f | 74,000 |

Deferred Tax account

| | | £ | | | £ |
|---|---|---|---|---|---|
| 30/06/2007 | Balance c/f | 17,500 | 01/07/2006 | Balance b/f | 21,500 |
| | P&L account | 4,000 | | | |
| | | 21,500 | | | 21,500 |
| | | | 01/07/2007 | Balance b/f | 17,500 |

Interest account

| | | £ | | | £ |
|---|---|---|---|---|---|
| 01/01/2007 | Bank account | 3,200 | | | |
| 01/01/2007 | Income Tax account | 800 | | | |
| 01/04/2007 | Bank account | 3,680 | | | |
| 01/04/2007 | Income Tax account | 920 | | | |
| 30/06/2007 | Balance c/f | 4,800 | | | |
| | | | 30/06/2007 | P&L account | 13,400 |
| | | 13,400 | | | 13,400 |

| | | | | | |
|---|---|---|---|---|---|
| 01/07/2007 | Bank account | 3,840 | 01/07/2007 | Balance b/f | 4,800 |
| 01/07/2007 | Income Tax account | 960 | | | |

Income Tax account

| | | £ | | | £ |
|---|---|---|---|---|---|
| 14/01/2007 | Bank account | 800 | 01/01/2007 | Interest account | 800 |
| 14/04/2007 | Bank account | 920 | 01/04/2007 | Interest account | 920 |
| | | 1,720 | | | 1,720 |
| | | | | | - |
| 14/07/2007 | Bank account | 960 | 01/07/2007 | Interest account | 960 |

**Mr Meredith - Answers**

1. Profit and loss account

**Mr Meredith**

**Profit and Loss Account**

**Year Ended 30 September 2007**

| | | £ | £ |
|---|---|---|---|
| Sales | W8 | | 804,000 |
| Less cost of sales: | | | |
| Opening stock | W9 | 52,800 | |
| Purchases | W10 | 506,000 | |
| | | 558,800 | |
| Closing stock | W11 | (59,400) | |
| | | | (499,400) |
| Gross profit | | | 304,600 |
| Less expenses: | | | |
| Bad debts | W1 | 2,880 | |
| Repairs | | 375 | |
| Telephone | | 480 | |
| Bank charges | | 230 | |
| Accountancy | | 2,250 | |
| Rent | W2 | 21,000 | |
| Subscriptions | W3 | 100 | |
| Electricity | W4 | 1,230 | |
| | | | (28,545) |
| Net profit | | | 276,055 |

2. Uses of the profit and loss account

The profit and loss accounts is a financial statements for a business and has the following uses:

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

Enables comparisons to previous periods to identify changes

Starting point for tax computations

Useful to provide to lenders

Answer: Dallas Ltd

Ordinary share capital account

| | | |
|---|---|---|
| | | £ |
| 01.01.06 | Balance b/f | 2,000,000 |
| 30.04.06 | Share issue<br>(400 000 at £1) | 400,000 |
| 30.09.06 | Bonus issue<br>(240 000 at £1) | 240,000 |
| 31.12.06 | Rights issue<br>(132 000 at £1) | 132,000 |

Preference share capital account

| | | |
|---|---|---|
| | | £ |
| 01.01.06 | Balance b/f | 500,000 |

Share premium account

| | | |
|---|---|---|
| | | £ |
| 01.01.06 | Balance b/f | 400,000 |
| 30.04.06 | Share issue<br>(400 000 at £2) | 800,000 |
| 31.12.06 | Rights issue<br>(132 000 at £2) | 264,000 |

Bank account

| | | | |
|---|---|---|---|
| | £ | | £ |
| 30.04.06 Share issue (400 000 at £3) | 1 200 000 | 30.11.06 Preference dividend | 25 000 |
| 31.12.06 Rights issue<br>(132 000 at £3) | 396 000 | | |

Profit and loss account

| | |
|---|---|
| | £ |
| 30.09.06 Bonus issue | 240 000 |

Dividends paid account

| | |
|---|---|
| | £ |
| 30.11.06 Preference dividend | 25 000 |

2) The effect of a bonus issue is to reduce the market value of each share. A company may therefore have a bonus issue with a view to making its shares more marketable. Unlike a rights issue a bonus issue does not raise any additional finance for the company. A bonus issue simply capitalises part of the company's reserves. A rights issue is a way of raising additional finance by offering new shares to existing share holders in proportion to their existing holdings.

3). A shareholder who receives a rights offer has three options available to him:

a. he can take up the rights by paying the amount required to the company and thereby increasing his shareholding;

b. he can sell his rights to a third party who may then buy the shares from the company at the offer price; or

c. he can decide to do nothing and as a consequence his rights will lapse.

Normally a shareholder will take up his rights but if he is not in a position to do so he would normally try to sell his rights to a third party. If this is not possible and the offer is allowed to lapse then the company will sell the rights for him and send him the proceeds.

4) The cash flow statement would show the cash generated by the issue of the new shares and the rights issue. As the bonus issue does not generate any cash this would not affect the cash flow.

The payment of the preference dividend would be an outflow of funds.

Financing

| | £ |
|---|---|
| Issue of ordinary share capital | 1 596 000 |
| Dividend paid | (25 000) |

5) The difference between these two classes of shares is in essence the difference between the ordinary share holders whose reward will be geared to how well the company performs and the preference shareholders whose entitlement is fixed.

6) As a limited company Dallas Ltd could issue a capital instrument in order to raise finance. Usually capital instruments are issued in respect of debentures, loans and debt instruments.