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Accounting Technicians Ireland

Financial Accounting II

2nd Year Examination

August 2010

Paper, Solutions & Examiner's Report

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Accounting Technicians Ireland

2nd Year Examination: Autumn 2010

Paper : FINANCIAL ACCOUNTING II

Monday 16th August 2010 – 2.30 p.m. to 5.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

Candidates must indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

In this examination paper the £ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and the € symbol by candidates in the Republic of Ireland to indicate the Euro.

Answer ALL THREE questions in Section A and TWO of the THREE questions in Section B. If more than TWO questions are answered in Section B, then only the first TWO questions, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All workings should be shown.

All figures should be labelled, as appropriate, e.g. €'s, £'s, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

The following insert is enclosed with this paper:

- **Multiple choice question answer sheet [QUESTION 2]**

Note:
This paper uses both the language of International Accounting Standards (I.A.S's) and Financial Reporting Standards (F.R.S's) where appropriate (e.g. Receivables/Debtors). Examinees are permitted to use <u>either terminology</u> when preparing financial statements but the use of the language of the International Accounting Standards (e.g. Receivables rather than Debtors) is preferred.

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SECTION A

Answer ALL THREE Questions in this Section

QUESTION 1 *(Compulsory)*

(a) IAS 1, Presentation of Financial Statements, sets down a number of principles that govern the preparation and presentation of financial statements.

Describe the following principles as discussed in the standard:

i. Accruals
ii. Going concern
iii. Materiality and aggregation
iv. Consistency

12 Marks

(b) Both internal and external auditors play a very important role in ensuring that financial statements show a true and fair view of the financial performance of a company. However the role and function of the internal and external auditor is very different.

Briefly discuss three key differences between the role of the internal and external auditor.

8 Marks

Total 20 Marks

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QUESTION 2 *(Compulsory)*

The following multiple choice question consists of TEN parts, each of which is followed by FOUR possible answers. There is ONLY ONE right answer in each part.

Each part carries 1½ marks.

Requirement

Indicate the right answer to each of the following ten parts. **Total 15 Marks**

NB *Candidates should answer this question by ticking the appropriate boxes on the specified green answer sheet which is supplied with the examination paper.*

[1] With regard to IAS 16 (Property, Plant and Equipment), which of these statements is true?

[a] If an item of plant and equipment is re-valued, the entire class of property, plant and equipment to which it belongs must be re-valued.

[b] If an item of plant and equipment is re-valued, there is no obligation to re-value other assets within the same class of property, plant and equipment.

[c] If an item of plant and equipment is re-valued, the same item must be re-valued annually thereafter to ensure that the carrying value of the asset does not differ materially from the fair value at the balance sheet date.

[d] If an item of plant and equipment is re-valued depreciation continues to be calculated on the original cost price as the revaluation surplus/deficit is not a realised gain/loss.

[2] With regard to IAS 7 (Cash flow Statement), which of the following statements is true:

[a] The acquisition of assets by means of a finance lease must be excluded from a cash flow statement.

[b] The direct method of preparing the cash flow statement is often used as the information required is available in the financial statements.

[c] An increase in payables reflects a cash inflow and therefore should be added back when calculating net cash flow from operating activities.

[d] Dividends must always be shown as a cash flow from operating activities.

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QUESTION 2 *(Cont'd)*

[3] In January 2009, ENVY Limited acquired a new machine with a list price of £/€180,000. Spare parts totalling £/€12,000 for future repairs were also purchased and delivery costs of £/€4,500 were also paid. The company incurred £/€8,800 site preparation costs, which was made up of material costs of £/€4,800 and labour costs of £/€4,000. All work was carried out by employees of ENVY.

How much of the above expenditure may ENVY capitalise in its balance sheet?

[a] £/€193,300

[b] £/€205,300

[c] £/€184,500

[d] £/€189,300

[4] According to IAS 17 (Leases), which of the following statements is true:

[a] A finance lease is a lease which has a minimum period of over 5 years.

[b] A finance lease is a lease that transfers substantially all of the risks and rewards of ownership to the lessee.

[c] A lease of land would normally be treated as a finance lease.

[d] IAS 17 applies to all leases including lease agreements to explore for, or use, natural resources.

[5] Where a partnership exists and there is no partnership agreement, then:

[a] the partners share profits in relation to the combined balances on their capital and current account.

[b] the partners share profits equally and interest is paid on capital balances at 5% per annum.

[c] the partners share profits in relation to the balances on their capital accounts.

[d] the partners share the profits equally and no remuneration is paid to the partners for acting in the business.

[6] Partners drawing are:

[a] charged against the partners in their current accounts.

[b] charged against the partners in their capital accounts.

[c] credited to the partners capital accounts.

[d] credited to the partners current accounts.

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QUESTION 2 (*Cont'd*)

[7] Interest paid to a partner for a loan extended to the business must be accounted for:

[a] in the partners current account.

[b] in the appropriation account.

[c] in the partners capital account.

[d] in the income statement as an expense.

[8] The IASB Framework for the Preparation and Presentation of Financial Statements lists four qualitative characteristics of financial information. These are:

[a] Relevance, reliability, materiality and comparability.

[b] Understandability, relevance, reliability and comparability.

[c] Relevance, prudence, materiality and comparability.

[d] Understandability, relevance, materiality and prudence.

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QUESTION 2 (*Cont'd*)

BACKGROUND INFORMATION TO PARTS [9] & [10]

Jen and Brad are in partnership and their capital account balances are £/€63,000 and £/€92,000 respectively. The partnership agreement details appropriation of partnership profits as follows:

	Jen	**Brad**
Annual salary	£/€18,000	£/€24,000
Interest on capital	8%	8%
Share of residual profit	45%	55%

[9] If the profit for the year, before appropriation, was £/€124,000, what would Jen's entitlement be in total:

[a] £/€23,040
[b] £/€36,360
[c] £/€54,360
[d] £/€49,320

[10] If the profit for the year, before appropriation, was £/€124,000, what would Brad's entitlement be in total:

[a] £/€69,640
[b] £/€45,640
[c] £/€31,360
[d] £/€62,280

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QUESTION 3 *(Compulsory)*

(a) The Statement of Financial Position, Statement of Changes in Equity and other relevant information of BUBBLES Limited, for the year ended 31 December 2009, are as follows:

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER

	2009 £/€'000	**2009 £/€'000**	**2008 £/€'000**	**2008 £/€'000**
ASSETS				
Non current assets				
Property, plant & equipment		143,000		114,400
Investments		6,500		19,500
Current assets				
Inventory	47,200		65,000	
Receivables	65,000		32,500	
Cash & cash equivalents	130,000		1,300	
		242,200		98,800
Total assets		**391,700**		**232,700**
EQUITY and LIABILITIES				
Capital and reserves				
Ordinary share capital	58,500		26,000	
Share premium	45,500		32,500	
Revaluation reserve	9,750		6,500	
Retained earnings	239,200		109,200	
Total shareholders equity		352,950		174,200
Current liabilities				
Trade & other payables	21,200		39,000	
Bank overdraft	9,750		6,500	
Tax	7,800	38,750	13,000	58,500
Total equity and liabilities		**391,700**		**232,700**

STATEMENT OF CHANGES IN EQUITY

	Ordinary share capital £/€'000	**Share premium £/€'000**	**Reval-uation reserve £/€'000**	**Retained profits £/€'000**	**Total equity £/€'000**
As at 1 January 2009	26,000	32,500	6,500	109,200	174,200
Net profit for year end 31 December 2009				149,500	149,500
Share issue	32,500	13,000			45,500
Land revaluation			3,250		3,250
Ordinary dividends				(19,500)	(19,500)
	58,500	45,500	9,750	239,200	352,950

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QUESTION 3 (*Cont'd*)

NOTE: Disclosure notes for Non-Current Assets

	Property €/£'000	Plant & Equipment €/£'000	Total €/£'000
Cost			
At 1 January 2009	58,500	84,500	143,000
Additions	16,250	45,500	61,750
Revaluations	3,250		3,250
(Disposals)		(19,500)	(19,500)
At 31 December 2009	78,000	110,500	188,500
Accumulated depreciation			
At 1 January 2009	5,850	22,750	28,600
(Disposals)		(13,000)	(13,000)
Charge for year	650	29,250	29,900
At 31 December 2009	6,500	39,000	45,500
Net book value			
At 1 January 2009	52,650	61,750	114,400
At 31 December 2009	71,500	71,500	143,000

The following additional information was also available:

1. Proceeds from the sale of equipment and investments amounted to £/€3,900,000 and £/€19,500,000 respectively.

2. During the year ordinary dividends of £/€19,500,000 were declared and paid.

3. The tax charge in the income statement for the year was £/€6,500,000.

4. There was no interest charged or paid during the year.

Requirement

Prepare a cash flow statement for BUBBLES Limited for the year ended 31 December 2009 in accordance with the requirements of IAS 7 Cash Flow Statement. Notes to the cash flow statement are not required.

18 Marks

(b) 'Profits do not always translate into a positive cash balance at year end'. Briefly discuss two reasons why profit and cash are different.

5 Marks

Presentation 2 Marks

Total 25 Marks

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SECTION B

Answer TWO of the THREE questions in this Section

QUESTION 4

WAVERLEY Limited, which operates a chain of restaurants, made up its financial statements to 31 December 2009. During a year end review of the accounts, and before approval of the financial statements by the Board of Directors, the external auditor identified the following:

(i) Slow moving goods which cost £/€60,000 are included in inventory at year end. This inventory is expected to realise £/€40,000 at a discount warehouse. Commission costs of 2.5% will be incurred.

(ii) Receivables at year end, valued at £/€520,000, include a debt of £/€15,000 owing by a company which the auditor knows has ceased trading and will be unable to meet its debts. Additionally the company has not made any adjustments for the general bad debt provision, which has always been calculated to be 5% of receivables. The provision for bad debts at the start of the year was £/€35,000.

(iii) The company opened a new restaurant during the year however the following costs were not provided for in the accounts at year end:

Promotional and advertising costs £/€35,000

Equipment testing costs £/€22,000

No depreciation is charged in the first year of operation.

(iv) On 12 December 2009 the board of directors decided to close down one of the restaurants as it continued to make losses. The directors estimate that closure costs will amount to approximately £/€110,000. No other steps were taken to implement the decision or communicate it to the people affected.

(v) On 30 November 2009 a provision had been made for £/€45,000 in respect of any remedial work required on restaurant equipment supplied and installed as part of a joint venture. No remedial work had been carried out and on 30 March 2010 it was confirmed that no remedial work would be required and no further liability would be incurred.

Requirement

(a) Prepare the journal entries to show how each of the above items should be dealt with in the final accounts for the year ended 31 December 2009. You should use your understanding of the relevant IAS's in dealing with each item.

14 marks

(b) Compute the adjusted net profit before taxation for the year ended 31 December 2009 taking into account the adjustments made at (a) above. The net profit before taxation as per the draft accounts was £/€410,000.

4 marks

Presentation 2 marks

Total 20 marks

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QUESTION 5

JACK N JILL Limited has an authorised share capital of £/€2,500,000 made up of 5,000,000 ordinary shares of 50 pence/cent each.

The following trial balance was extracted from the books and records of the company at 31 December 2009.

TRIAL BALANCE AS AT 31 DECEMBER 2009

	£/€'000	**£/€'000**
Ordinary share capital @ 1 January 2009		1,100
Share premium account @ 1 January 2009		170
Retained profits at 1 January 2009		185
General reserve @ 1 January 2009		145
6% Debenture loan		450
Premises at cost @ 1 January 2009	1,150	
Premises accumulated depreciation @ 1 January 2009		210
Plant and machinery at cost @ 1 January 2009	780	
Plant and machinery accumulated depreciation @ 1 Jan 2009		300
Motor vehicles at cost @ 1 January 2009	155	
Motor vehicles accumulated depreciation @ 1 January 2009		55
Goodwill	140	
Long term investments	110	
Short term investments	20	
Inventory @ 31 December 2009	375	
Receivables	425	
Trade payables		230
Bank		45
Cash	25	
Accrued expenses		80
Prepaid expenses	120	
Corporation tax		65
Government grants		25
Retained profit for the year		180
Director's loan		60
	3,300	**3,300**

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QUESTION 5 *(Cont'd)*

ADDITIONAL INFORMATION

1. Depreciation is to be provided on non-current assets as follows:

Premises	2% on cost
Plant and machinery	15% reducing balance
Motor vehicles..........................	20% on cost

A full year's depreciation is charged in year of acquisition and none in the year of disposal.

2. During the year motor vehicles that cost £/€30,000 in 2006 were sold for £/€5,000. No entries were made to record this transaction.

3. The government grant of £/25,000 that was received during the year relates to staff training costs incurred, however, it was treated as a capital grant in error.

4. Expenses in the Income Statement include £/€25,000 that relates to prepaid insurance costs.

5. Full year debenture interest to be provided for.

6. Ordinary dividend of 1.5pence/cent per share to be provided for at year end.

Requirement

Prepare, in a form suitable for publication, the Statement of Financial Position as at 31 December 2009

18 marks

Presentation 2 marks

Total 20 marks

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QUESTION 6

(a)

George, Penny and Chloe are in partnership, sharing profits in the ratio 4:4:2. The following information is available for the partnership for the year ended 31 December 2009:

Profit for the year £/€64,500

	George £/€	Penny £/€	Chloe £/€
Drawings	12,000	6,500	3,700
Salary		17,000	8,500
Balance on capital accounts 31 December 2009	13,500	21,000	16,500
Balance on current accounts 31 December 2009	2,600	4,700	5,100

Interest on drawings is charged at 10% per annum.

Interest on capital is paid at 5% per annum.

Requirement

(a) Prepare the appropriation account for the year ended 31 December 2009.

3marks

(b) Prepare the partner's current accounts for the year ended 31 December 2009.

3 marks

Presentation 1 mark

QUESTION 6 CONTINUED OVERLEAF

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QUESTION 6 *(Cont'd)*

(b)

The following are the Income Statement, Statement of Financial Position and appropriate notes to the accounts of TREETOPS Limited for the year ended 31 December 2009 (with comparative figures for the year ended 31 December 2008).

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	2009		**2008**	
	£/€'000	**£/€'000**	**£/€'000**	**£/€'000**
Sales (90% of which are credit sales)		5,600		4,300
Less: Cost of goods sold		3,500		2,900
Gross profit from trading		2,100		1,400
Administration expenses	1,060		660	
Distribution expenses	560		320	
		1,620		980
Profit before interest		480		420
Interest paid		(60)		(45)
Profit before tax		420		375
Taxation		(210)		(145)
Profit after tax		210		230
Dividends		(60)		(85)
Retained profit for the year		150		145
Retained profit brought forward		725		580
		875		725

QUESTION 6 CONTINUED OVERLEAF

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QUESTION 6 (*Cont'd)*

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER

	2009		**2008**	
	£/€'000	**£/€'000**	**£/€'000**	**£/€'000**
ASSETS				
Non-current assets				
Property, plant & equipment		1,850		1,750
Current assets				
Inventory	330		360	
Receivables	290		310	
Cash at bank	30		10	
		650		680
Total assets		**2,500**		**2,430**
EQUITY and LIABILITIES				
Capital and reserves				
Ordinary share capital	860		780	
Retained earnings	875		725	
Total shareholders equity		1,735		1,505
Non-current liabilities				
10% debenture stock		365		365
Current liabilities				
Payables	180		235	
Bank overdraft	-		20	
Taxation	160		220	
Dividends	60	400	85	560
Total equity and liabilities		**2,500**		**2,430**

ADDITIONAL INFORMATION

Inventory at 1 January 2008 was £/€310,000.

QUESTION 6 CONTINUED OVERLEAF

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QUESTION 6 (*Cont'd*)

Requirement

Calculate each of the following ratios for TREETOPS Limited for the years ended 31 December 2009 and 2008 and comment briefly on the performance of the company in 2009 using the ratios calculated.

- **(i)** Current ratio
- **(ii)** Liquid ratio (acid test)
- **(iii)** Stock turnover ratio
- **(iv)** Gross profit %

12 marks

Presentation 1 mark

Total 20 marks

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2nd Year Examination: August 2010

Financial Accounting II

Solutions

Students please note: These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

Solution 1
[a]

(i) Accruals

Financial statements, with the exception of the cash flow statement, are prepared on the accruals basis of accounting where transactions are recognised in the period in which they take place irrespective of the when the cash flow arising from these transactions occurs.

(ii) Going concern

Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Foreseeable future is considered to be twelve months from the date the financial statements are signed. In the event that management decide that it is no longer appropriate to prepare the financial statements on a going concern basis this must be disclosed.

(iii) Materiality

Information is material to a set of financial statements if its omission or misstatement could influence the economic decisions of users. However some transactions are deemed to be material by their very nature for example, all transactions involving a company and a director of that company are deemed to be material regardless of the value of the transaction. With respect to aggregation, each material class of similar items must be presented separately in the financial statements. Items of dissimilar nature should be presented separately unless they are immaterial.

(iv) Consistency

The presentation and classification of items in the financial statements should be consistent from one reporting period to the next unless a change is justified by a change in circumstance or by a new IFRS. If there were no regulations in this regard and changes in the presentation of financial statements were allowed then the comparability of financial statements would be greatly compromised.

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Solution 1 *(Cont'd)*

[b]

The role of the *external auditor* is to examine the financial statements and books and records of a company in order to form an opinion as to whether the information contained in the financial statements can be relied upon.
The role of the *internal auditor* is to help directors discharge their responsibility for the prevention and detection of fraud and error. The internal audit department, where one exists within a company, will examine the internal controls within an organisation to help determine if they are operating efficiently and effectively.
Key differences between the external and internal auditor:

1. Scope of their work

   The external auditor has a narrow focus that is the truth and fairness of the financial statements. The external auditor must also consider such matters as compliance with legislation to ensure that the financial impact of new legislative requirements is reflected in the financial statements.

   The internal auditor has a much wider focus which is looking at the internal operations of the entire business. The internal auditor must make sure that the operational, compliance and financial controls within a company are operating effectively.

2. Independence

   The external auditor is an accountant from an independent firm of accountants. The external auditor must be independent of the company it audits. The independence of the auditor is critical and is a key factor which enables users of financial statements to rely upon the opinion expressed regarding the truth and fairness of the financial statements.
   The internal auditor is employed by the company and therefore is not independent. However, the independence of the internal auditor can be improved by deciding to whom the internal auditor reports. If the internal auditor reports directly to an audit committee this is considered to be more independent and therefore objective than if it were to report to the head of the finance function on which it is reporting.

3. Reporting

   The reporting lines of both the external and internal auditor are very different. The external auditor reports externally to the shareholders on the truth and fairness of the financial statements. The internal auditor usually reports to the board of directors, or the audit committee who in turn report to the board of directors, on the effectiveness of the internal control environment within the company.

4. Legal requirement

   There is a legal requirement in Ireland and the UK for all companies, other than those which meet the criteria to avail of audit exemption, to engage an external auditor to undertake an audit of the year end financial statements. There is

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currently no legal requirement, in Ireland or the UK, for companies to have an internal audit function. However, best practice, as outlined in the Combined Code of Corporate Governance, states that public limited companies should have an internal audit function and where one does not exist directors must assess the need for one on an annual basis.

Solution 1 *(Cont'd)*

NOTE:
The question asks for only three differences. Four differences are discussed above as a study aid. No additional marks were awarded where more than three differences were given.

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Solution 2

MCQ

1. A
2. C
3. A (£/€180,000 + £/€4,500 + £/€8,800 = £/€193,300)
4. B
5. D
6. A
7. D
8. B
9. C (see below)
10. A (see below)

Workings to Q9 and Q10 Jen & Brad

	Jen	**Brad**
Capital	**63,000**	**92,000**
Salary	18,000	24,000
Interest on capital		
(8% x 63,000)	5,040	
(8% x 92,000)		7,360
Subtotal	**23,040**	**31,360**
Profit avail for distribution: (124,000 – 23,040 – 31,360 = 69,600)		
Profit share		
69,600 x 45%	31,320	
69,600 x 55%	38,280	
TOTAL	**54,360 (c)**	**69,640 (a)**

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Solution 3
[a]

BUBBLES Limited
Statement of Cash Flows for the year ended 31 December 2009

		£/€'000	**£/€'000**
Cash flows from operating activities			
Net profit before tax	W1		156,000
Adjustments for:			
Depreciation		29,900	
Interest		0	
Loss on sale of non-current assets	W2	2,600	
Profit on sale of investments	W3	(6,500)	
Changes in working capital			
(Increase)/Decrease in inventory		17,800	
(Increase)/Decrease in receivables		(32,500)	
Increase in prepayments			
Increase/(Decrease) in payables		(17,800)	
			(6,500)
Cash generated from operations			149,500
Interest paid		0	
Tax paid	W4	(11,700)	
			(11,700)
Net cash from operating activities			**137,800**
Cash flows from investing activities			
Payments to acquire non-current assets		(61,750)	
Receipt from sale of non-current assets		3,900	
Receipt from sale of investments		19,500	
Net cash used in investing activities			(38,350)
Cash flows from financing activities			
Proceeds of share issue, incl premium		45,500	
Dividends paid		(19,500)	26,000
Increase in cash and cash equivalents			**125,450**
Cash and cash equivalents at start of year	W5		(5,200)
Cash and cash equivalents at end of year			**120,250**

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Solution 3 *(Cont'd)*

Note: Cash and cash equivalents

	2009	**2008**	**Change in year**
	£/€'000	**£/€'000**	**£/€'000**
Bank	130,000	1,300	128,700
Bank overdraft	(9,750)	(6,500)	(3,250)
	120,250	(5,200)	125,450

Workings

1	Net profit before interest	**£/€'000**
	Net profit for the year	149,500
	Tax charge for the year	6,500
		156,000

2	Disposal of equipment	**£/€'000**
	Cost	19,500
	Acc depreciation	(13,000)
		6,500
	Sale proceeds	**(3,900)**
	Loss on sale of equipment	2,600

3	Disposal of investments	**£/€'000**
	Sale proceeds	19,500
	Cost	13,000
	Profit on sale	6,500

4 Tax paid

Taxation

Bank	11,700	Opening balance	13,000
		P&L	6,500
Closing balance	7,800		
	19,500		19,500

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Solution 3
(Cont'd)

5

Cash and cash equivalents at start of year
£/€'000

Cash at bank	1,300
Bank overdraft	(6,500)
	(5,200)

[b] Profit versus cash

While businesses need both profits and cash to survive in the long term, businesses can survive without profits in the short term however a company can only survive for a much shorter period without cash. Businesses need cash on a daily basis to meet all the expenses incurred while running the business, for example wages, electricity, purchases. The following briefly discusses the key differences between profit and cash:

1. Treatment of capital expenditure

   Capital expenditure is expenditure on items which are used by the companies in the production and/or supply of goods or services. Capital expenditure can be quite significant and is long term in nature. Capital expenditure will have a negative impact on cashflow as the organisation has to meet the cost of the capital expenditure however the capital expenditure incurred will not have any effect on the income statement and therefore on profit.

2. Non-cash items

   The income statement will usually contain transactions which have no cash impact on the business and these items are referred to as non-cash items. An example of a non-cash item is depreciation. Depreciation is charged to the income statement on an annual basis and accordingly reduces profit, however it has no cash implications for the business in the period in which it is charged to the income statement.

3. Accruals concept

   IAS 1 states that with the exception of the cash flow statement the financial statements of an organisation are to be prepared using the accruals concept. The accruals concept states that transactions must be recorded in the period in which they were incurred not the period in which the corresponding cash transaction too place. This concept therefore gives rise to timing differences between when the profit/loss from an activity is recorded and when the cash is received/paid.

   NOTE:
   The question asks for only two differences. Three differences are discussed above as a study aid. No additional marks were awarded where more than two differences were given.

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Solution 4

WAVERLEY Limited

[a]	**Journal**	**DR**	**CR**
		£/€	**£/€**
a)	Inventory (P&L a/c)	21,000	
	Inventory (B/S)		21,000
	[Being slow moving stock written down to net realisable value as per IAS 2]		
b)	Bad debt (P&L a/c)	15,000	
	Receivables (B/S)		15,000
	[Being write-off of bad debt at year end]		
	Bad debt provision (B/S)	9,750	
	Bad debt provision (P&L a/c)		9,750
	[Being reduction in bad debt provision at year end]		
c)	Selling and distribution cost (P&L a/c)	35,000	
	Trade payables (B/S)		35,000
	[Being promotional and advertising costs not capitalised]		
	Non-current assets (B/S)	22,000	
	Trade payables (B/S)		22,000
	[Being capitalisation of equipment testing costs per IAS 16]		
d)	No provision required as per IAS 37. No obligating event so there is no obligation.		
e)	Provision (B/S)	45,000	
	Remedial work expense (P&L a/c)		45,000
	[Being reversal of provision for remedial work]		

[b]			**£/€**
	Profit before taxation per draft accounts		410,000
	Adjustments:		
	Inventory write down	(21,000)	
	Bad debt at year end	(15,000)	
	Decrease in bad debt provision	9,750	
	Promotional and advertising costs	(35,000)	
	Remedial work	45,000	
			(16,250)
	Adjusted profit before taxation		393,750

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Solution 5

JACK N JILL Limited

Statement of Financial Position as at 31 December 2009

		£/€'000	£/€'000
Non-current assets			
Property, plant and equipment (Note 1)	W1		1,388
Goodwill			140
Other financial assets			110
			1,638
Current assets			
Inventories		375	
Trade receivables		425	
Prepayments	W5	145	
Cash and cash equivalents	W4	50	995
Total assets			**2,633**
Equity and liabilities			
Capital and reserves			
Issued share capital			1,100
Share premium			170
Reserves			145
Retained earnings	W3		228
Total equity			1643
Non-current liabilities			
Long term borrowings		450	
Loan from director		60	510
Current liabilities			
Overdraft		45	
Trade and other payables		310	
Interest payable	W6	27	
Dividend payable	W7	33	
Tax payable		65	480
Total equity and liabilities			**2633**

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Solution 5 *(Cont'd)*

Workings

1 Depreciation

	Freehold premises 2% cost	**Plant & machinery** 15% red bal	**Motor vehicles** 20% cost	**TOTAL**
Cost at 1 January	1,150	780	155	2,085
Disposals			(30)	(30)
Additions				0
Cost at 31 December	**1150**	**780**	**125**	2,055
Depreciation at 1 January	210	300	55	565
Disposals			(18)	(18)
Charge for year	23	72	25	120
Depreciation at 31 December 2009	**233**	**372**	**62**	667
NBV at 1 January	940	480	100	1,520
NBV at 31 December	917	408	63	1,388

2 Disposal

Cost	30
Acc depreciation	(18)
	12
Sale proceeds	5
Loss on disposal	**(7)**

3 Retained earnings

Per trial balance		180
Less:		
Depreciation	(120)	
Loss on disposal	(7)	
Dividend	(33)	
Debenture interest	(27)	(187)
Add:		
Government grant	25	
Prepaid expenses	25	50
Revised retained earnings		**43**
Retained profit brought fwd		185
Retained profits at year end		228

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4 **Solution 5** *(Cont'd)*

Cash and cash equivalents

Cash per trial balance	25
Short term investments	20
Add:	
Sale of motor vehicles	5
	50

5 Prepayments

Prepayments per trial balance	120
Prepayments included in P&L in error	25
	145

6 Debenture interest

Debenture loan (6%)	450
Interest accrued	27

7 Dividend

No shares	2,200,000
Dividend per share	0.015
Total dividend payable	33,000

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Solution 6
[A]

(a) Statement of appropriated profits

			£/€	£/€
Profit for the year				64,500
Salaries	George		0	
	Penny		(17,000)	
	Chloe		(8,500)	(25,500)
Interest on drawings				
	George	12,000	1,200	
	Penny	6,500	650	
	Chloe	3,700	370	2,220
Interest on capital accounts				
	George	13,500	(675)	
	Penny	21,000	(1,050)	
	Chloe	16,500	(825)	(2,550)
				38,670
Share of profit	George		15,468	
	Penny		15,468	
	Chloe		7,734	
			38,670	

(b) Partners current accounts

Current Accounts

	G	P	C		G	P	C
	£/€	£/€	£/€		£/€	£/€	£/€
Drawings	12,000	6,500	3,700	Balance b/d	2,600	4,700	5,100
Interest on drawings	1,200	650	370	Salaries	0	17,000	8,500
				Interest on capital	675	1,050	825
Balance c/d	5,543	31,068	18,089	Share of profit	15,468	15,468	7,734
	18,743	38,218	22,159		18,743	38,218	22,159

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Solution 6
(Cont'd)

[B] TREETOPS Ltd

		2009	2008
Current ratio			
	Current assets/ current liabilities		
	650/400	1.625 : 1	
	680/560		1.214 : 1
Liquid ratio			
	Current assets less stock/current liabilities		
	320/400	0.80 : 1	
	320/560		0.57 : 1
Stock turnover			
	Cost of goods sold/average stock		
	3,500/(330+360)/2	10.1 times (36 days)	
	2,900/(360+310)/2		8.7 times (42 days)
Gross profit percentage			
	Gross profit/sales * 100		
	2100/5600	37.50%	
	1400/4300		32.50%

Commentary on financial performance in 2009

As can be seen from the current ratio and the acid test ratio the liquidity position of the company has improved in 2009. The company is less likely to experience cash difficulties and should be able to pay its debts as they fall due. The acid test ration has shown a much needed improvement from what was a very low ratio of 0.57:1. The company's healthier cash position is also helped by a reduction in trade creditors and the return to a positive bank balance.
The stock turnover has also improved with the company now turning its stock over an average of 10 times. This reduces the amount of finance tied up in stock and reflects a quicker conversion of stock into debtors and subsequently cash. The gross profit percentage has also improved in 2009. The company has effectively increased its turnover whilst controlling direct costs which increased at a slower rate.
Overall the company performed well in 2009.

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2nd Examination: August 2010

Financial Accounting

Examiner's Report

General comment

The students who studied and prepared well for the autumn exam did well. However, for many students it appeared that they weren't prepared and this manifest itself in a poor attempt at all questions rather than being caught out by one or two particular questions. As with the summer paper, cash flow statements and journals are two areas in which students clearly struggle. This perhaps caused greater difficult for students as the cash flow question appeared on the compulsory section of the paper. Having said the above the pass rate increased this year which is a positive move.

Question 1

This question was made up of two parts, part (a) which sought definitions and part (b) which asked for differences between internal and external auditors. Part (a) included two definitions which were straight from the compulsory section of the summer paper and a surprising number of candidates were unable to provide reasonable answers. This should have been an easy start to the exam.
Part (b) was met with a surprising amount of difficulty and this was the main cause of such a low average mark for this question (7.9%). Many students were just unfamiliar with the role of either auditor and therefore made very poor attempts at answering this part. Again, this was an easy 8 marks for those who knew the area.

Question 2

Students made reasonable attempts at the multiple choice question. However while most students answered the partnership theoretical questions correctly many were unable to calculate partner entitlements correctly as per question 9 and 10.

Question 3

Although this cash flow question was a compulsory question there was a very obvious bias away from it and an obvious high level of discomfort from those who attempted it. The average mark was 8.2% out of a possible 25%. Most candidates were unable to calculate the correct net profit before interest. Once again, the tax paid and depreciation figures caused the greatest difficulties. Students need to be a lot more comfortable with the preparation and presentation of cash flow statements.
There was a part (b) to this question which asked students to discuss two differences between profit and cash. This part was very poorly answered with many students opting to discuss the 'cash is king' principle and the intangible nature of profit versus cash rather than differences between cash and profit.

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Question 4

This question asked students to prepare journal entries and then calculate the adjusted profit figure. Only 39 students attempted this question. As with the summer exam this question highlights a very poor working knowledge of journals and basic double entry accounting. Very few students correctly calculated the reduction in bad debt provision or the correct inventory write down. Additionally very few students knew which costs should or should not be capitalised as per IAS 16. Overall both knowledge and presentation were poor.

Question 5

This question required students to prepare a Statement of Financial Position taking into account year end adjustments and therefore re-calculating retained earnings. While students were familiar with the layout of the statement the adjustments were very poorly dealt with. Most students failed to identify the need to re-calculate retained earnings and out of those who did few, if any, correctly calculated this figure. Also, most students failed to address the profit/loss on disposal. And once again dividends and the simple maths involved caught most students out.

Question 6

This question was made up of two topics, partnerships and ratios. In relation to the ratios part of the question students have shown a good ability in this area and are comfortable calculating ratios, their understanding of what the ratios actually mean is less fluid.
In respect of the partnership section it was surprising how many students struggled, it seemed as though students had not studied this topic as many solutions were muddled and unsure. Where students were familiar with this topic it was an easy and quick 7 marks.