FINANCIAL ACCOUNTING

Certificate stage examination
7 December 2004

From 2.00 pm to 5.00 pm
plus ten minutes reading time from 1.50 pm to 2.00 pm

Instructions to candidates

Answer five questions in total. ***All three*** *questions from* ***Section A****, and* ***two*** *of the three questions from* ***Section B****. There are 20 marks available for each question.*

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

Candidates may use the proforma sheets provided in the separate booklet and submit them as part of their answer.

CIPFA

SECTION A (Answer all three questions)

1

The following trial balance has been extracted from the books of Jefferson Ltd as at 30 June 2004:

	£	£
Bank balance		27,440
Corporation tax		2,330
Directors' fees	120,000	
Dividends paid	12,500	
Dividends received		2,640
Fixed asset investments, at cost	35,000	
Freehold property, at cost	350,000	
General administrative expenses	257,550	
General distribution costs	192,050	
Motor vehicles, at cost	85,800	
Office equipment, at cost	63,400	
Ordinary shares of 50p each		250,000
Prepayments and accruals	3,000	5,100
Profit and loss account at 1 July 2003		230,370
Provisions for depreciation at 1 July 2003:		
Motor vehicles		38,100
Office equipment		29,950
Purchases and sales	412,280	1,162,250
Stock at 1 July 2003	164,220	
Trade debtors and creditors	135,670	83,290
	1,831,470	1,831,470

The following additional information is also available:

1 The freehold property was valued at £500,000 on 30 June 2004. This revaluation is to be incorporated into the accounts. Depreciation of freehold property may be ignored.

2 Motor vehicles are depreciated at 30% pa on the reducing balance basis. Office equipment is depreciated over five years on the straight line basis, assuming zero residual value. All of the office equipment was less than four years old on 30 June 2003. There were no acquisitions or disposals of motor vehicles or office equipment during the year to 30 June 2004.

3 Motor vehicles are used entirely for distribution purposes, apart from a motor car which is used by Mr Jefferson, the company's managing director. This car cost £20,000 on 1 July 2002.

4 Stock was valued at £187,340 on 30 June 2004.

5 General administrative expenses include bank interest payable of £2,460.

6 On 1 March 2004, the company sold off one of its business operations, incurring a loss on the sale of £52,500 (which is included in general administrative expenses). Between 1 July 2003 and 29 February 2004, this operation yielded

sales of £102,000. Related costs were cost of sales £77,500, distribution costs £13,200 and administrative expenses £21,000.

7 The company acquired a new business operation on 1 August 2003. This operation generated sales of £233,650 between 1 August 2003 and 30 June 2004. Related costs were cost of sales £85,400, distribution costs £46,800 and administrative expenses £37,200.

8 The corporation tax figure shown in the trial balance is the difference between the estimated liability for the year to 30 June 2003 and the actual liability for that year. The estimated liability for the year to 30 June 2004 is £35,000.

9 An interim dividend of 2.5p per share was paid on 31 January 2004. It is proposed that a final dividend of 4p per share should be paid.

- **Requirement for question 1**

(a) Insofar as the information permits, prepare the company's profit and loss account for the year to 30 June 2004 and a balance sheet on that date, in a form which is suitable for publication. Formal notes to the accounts are not required, but workings should be shown. *18*

(b) Prepare a statement of total recognised gains and losses for the company for the year to 30 June 2004. *2*

(20)

2

You are provided with the following information relating to Jarvis Ltd, a company which prepares accounts to 30 September each year:

1 **Plant and machinery**

The company depreciates plant and machinery on the straight line basis over a period of five years, assuming a residual value equal to 20% of cost. Part-year depreciation charges (calculated on whole months) are made in the years of acquisition and disposal. The following balances appeared in the company's ledger at 30 September 2003:

	£
Plant and machinery, at cost (all acquired on or after 1 October 1999)	66,000
Provision for depreciation of plant and machinery	29,720

New plant costing £11,250 was acquired on 1 July 2004. On the same date, plant which had been acquired on 1 January 2001 for £9,750 was sold for £4,000.

2 **Accruals and prepayments**

(i) Telephone bills paid during the year to 30 September 2004 amounted to £7,490. Prepaid line rental at 30 September 2003 was £400 and accrued call charges were £1,730. The equivalent figures at 30 September 2004 were £450 and £1,660 respectively.

(ii) The company has a bank deposit account on which it receives interest quarterly (on 31 January, 30 April, 31 July and 31 October). Interest received during the year to 30 September 2004 was £16,940. Accrued interest at 30 September 2003 was £2,850 and accrued interest at 30 September 2004 was £3,420.

3 **Share capital**

The company's authorised share capital is one million ordinary £1 shares. On 30 September 2003 the issued share capital was 200,000 shares and the balance on the share premium account was £30,000. The following transactions occurred during the year to 30 September 2004:

(i) On 1 October 2003, a fully-subscribed issue of 150,000 shares was made at £1.40 per share.

(ii) On 1 August 2004, a 1 for 5 bonus issue was made (financed out of the share premium account).

4 **Suspense account**

The trial balance totals at 30 September 2004 did not agree. In consequence, a suspense account was opened with a credit balance of £5,650. On enquiry, the following errors were located:

(i) Purchase returns totalling £3,410 had been correctly posted to suppliers' accounts, but had then been debited to the sales returns account.

(ii) The debit side of a customer's account had been overcast by £100.

(iii) Cash purchases of £1,270 had been recorded in the cashbook only.

- **Requirement for question 2**

For the year to 30 September 2004:

(a) Prepare ledger accounts for plant and machinery, provision for depreciation of plant and machinery and disposal of plant and machinery. *5*

(b) Prepare ledger accounts for telephone charges and bank interest receivable. *4*

(c) Write journal entries to record the two share issues. *6*

(d) Write journal entries to correct the book-keeping errors made during the year (narratives are not required) and show that these corrections remove the need for the suspense account. *5*

(20)

3

Jones, Kumar and Lee are in partnership, preparing accounts to 31 October each year. Their partnership agreement states that:

(i) The partners are entitled to 5% pa interest on their capital accounts. No interest is allowed (or charged) on current account balances.

(ii) Interest is charged on the partners' drawings at 7% pa.

(iii) Partners' annual salaries are Jones £nil, Kumar £5,000 and Lee £12,000.

(iv) Remaining profits and losses are shared between Jones, Kumar and Lee in the ratio 5:4:1.

The partners' capital and current account balances as at 1 November 2003 and their drawings during the year to 31 October 2004 were as follows:

	Capital a/c at 1/11/03	*Current a/c at 1/11/03*	*Drawings for year to 31/10/04*
	£	**£**	**£**
Jones	50,000	16,320 cr	40,000
Kumar	30,000	1,110 cr	32,000
Lee	10,000	590 dr	6,000

The capital account balances remained unchanged during the year to 31 October 2004. Each partner's drawings were spread evenly throughout the year.

The partnership's net profit for the year to 31 October 2004 was £81,970.

- **Requirement for question 3**

(a) Prepare an appropriation account for the year to 31 October 2004. *4*

(b) Write up the partners' capital and current accounts (in columnar form) for the year to 31 October 2004. *7*

(c) Explain why it is generally thought preferable to maintain fixed capital accounts plus current accounts, rather than combining these into one account for each partner. *2*

(d) State what the accounting situation is if no partnership agreement exists (express or implied). *3*

(e) Explain the advantages and disadvantages of a partnership when compared with a sole trader. *4*

(20)

SECTION B (Answer two from three questions)

4 General Trading plc is a manufacturing company which prepares accounts to 31 August each year. The accounts for the year to 31 August 2004 cannot be finalised until the following matters have been dealt with:

1 A factory machine was acquired on 1 September 2001 for £250,000. At that time, the machine was expected to have a useful life of 5 years with a residual value of £100,000 at the end of those 5 years. The company depreciates factory machines on the straight line basis. However, on 1 September 2003, the company reviewed the expected useful lives and residual values of its plant and machinery and estimated that this machine's useful life would extend only until 31 August 2005, on which date its residual value would be £50,000.

2 On 1 September 1993, the company acquired land and buildings for £750,000 (including land £400,000). The land was not depreciable but it was decided to depreciate the buildings over 50 years on the straight line basis, assuming a zero residual value. However, on 1 September 2003, the land was revalued at £650,000 and the buildings were revalued at £300,000. It was decided to incorporate these valuations into the company's financial statements. The original estimates of the useful life and residual value of the buildings remain unchanged.

3 The company spent £520,000 on research and development during the year. Of this, £360,000 was spent on the development of a new product which will be launched in 2005. The remaining £160,000 was spent on research into new manufacturing technologies. The company's directors are keen to capitalise the entire £520,000, so as to avoid the adverse effect on the company's profit, which would occur if this amount was charged to the profit and loss account.

4 The company's stock at 31 August 2004 includes partly-manufactured goods (at cost) of £172,400. It is estimated that a further £50,000 will need to be spent in order to complete these goods and that they will then be sold for £260,000, less selling expenses of £12,000.

- **Requirement for question 4**

(a) State the main purpose of accounting standards. *2*

(b) With reference to the relevant accounting standards, explain how each of the above matters should be dealt with in the company's accounts for the year to 31 August 2004 (assuming that each item is material). *14*

(c) Explain the circumstances in which companies are allowed to show tangible fixed assets at a valuation. *2*

(d) Explain the circumstances in which companies are allowed not to depreciate tangible fixed assets. *2*

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5 The summarised financial statements of Jupiter Limited for the years to 31 March 2003 and 2004 are as follows:

Profit and loss accounts

	Year to 31/3/03		*Year to 31/3/04*	
	£000	**£000**	**£000**	**£000**
Turnover		4,640		6,420
Cost of sales		3,010		4,380
Gross profit		1,630		2,040
Distribution costs	310		430	
Administrative expenses	540		870	
		850		1,300
Operating profit		780		740
Interest payable		100		200
Profit before tax		680		540
Taxation		130		100
Profit after tax		550		440
Dividends		250		250
Retained profit		300		190

Balance sheets

	31/3/03		*31/3/04*	
	£000	**£000**	**£000**	**£000**
Fixed assets		3,450		5,190
Current assets:				
Stock	510		890	
Trade debtors	630		1,120	
Cash at bank	310		150	
	1,450		2,160	
Current liabilities:				
Trade creditors	600		1,090	
Corporation tax	130		100	
Dividends	250		250	
	980		1,440	
Net current assets		470		720
		3,920		5,910
10% Debenture loans		1,000		2,000
		2,920		3,910
Share capital		1,500		1,500
Revaluation reserve		-		800
Profit and loss account		1,420		1,610
		2,920		3,910

The following additional information is also available:

1 All purchases are credit purchases. One-quarter of sales are cash sales. The remaining three-quarters of sales are credit sales.

2 One of the company's fixed assets was revalued on 1 April 2003. There was a surplus on revaluation of £800,000.

3 £1 million of 10% debentures were issued on 1 April 2003.

- **Requirement for question 5**

(a) Insofar as the available information permits, compute for both the year to 31 March 2003 and the year to 31 March 2004:

- **three** profitability ratios
- **two** liquidity ratios
- **three** efficiency ratios. *8*

(b) Give possible reasons for the change in each ratio between the two years, indicating why your analysis of the situation is necessarily restricted. *10*

(c) Calculate the gearing ratio for each of the two years and briefly explain the consequences which may follow if a company becomes high-geared. *2*

(20)

6

Accounting has been in existence for many years and it could be argued that the basic functions of accounting have not changed during those years. However, accounting is a dynamic discipline which develops over time in response to a range of influences.

One way in which any proposed development in accounting may be judged is to ask whether the proposal would result in the production of better accounting information, as defined by the UK Accounting Standards Board in its *Statement of Principles for Financial Reporting*.

- **Requirement for question 6**

(a) Identify the main functions of accounting in general and financial accounting in particular. *5*

(b) Outline **five** of the main influences which seem likely to impact on the development of financial accounting over the next few years. *5*

(c) List and explain the "qualitative characteristics" which should be possessed by accounting information according to the *Statement of Principles*. *10*

(20)