

FINANCIAL ACCOUNTING

**Certificate stage examination
7 June 2005**

From 10.00am to 1.00pm
plus ten minutes reading time from 9.50am to 10.00am

Instructions to candidates

Answer **five** questions in total. **Three** questions from **Section A**, and **two** questions from **Section B**. The marks available for each question are shown in italics in the right hand margin.

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.

Proforma profit and loss account, balance sheet, cash flow statement and statement of total recognised gains and losses are appended to this paper and may be submitted as part of an answer.



SECTION A (Compulsory)**1**

The Middleton Squash Racquets Club has been in existence for many years, preparing accounts to 31 March annually. The club has its own freehold premises in which there are four squash courts, changing facilities and a small bar and social room. The club treasurer has prepared the following receipts and payments account for the year to 31 March 2005:

Middleton Squash Racquets Club
Receipts and Payments Account for the year to 31 March 2005

	£	£		£	£
Receipts			Payments		
Balances at 1 April 2004:			Brewery		28,835
Cash	117		Bar staff wages		6,349
Bank	<u>1,081</u>	1,198	Cleaners' wages		3,120
Subscriptions received:			Repairs and maintenance		2,985
year to 31 March 2004		160	Heat, light and power		1,608
year to 31 March 2005		8,240	Insurance		780
year to 31 March 2006		660	Postage, stationery & sundries		1,851
Life membership fees		700	Fee to National Association		200
Bar takings		37,336	Charitable donations		1,800
Sale of Xmas raffle tickets		735	Xmas raffle prizes		875
Sale of tournament trip tickets		610	Trips to tournaments:		
Sale of racquets and balls		3,940	Travel expenses		120
Bank interest received		111	Admission tickets		590
			Purchase of racquets and balls		3,350
			Treasurer's honorarium		200
			New restringing machine		480
			Bank charges		151
			Balances at 31 March 2005:		
			Cash	143	
			Bank	<u>253</u>	396
		<u>53,690</u>			<u>53,690</u>

The following information is also available:

- The club's March 2005 bank statement arrived after the receipts and payments account had been prepared. This statement showed a closing bank overdraft of £385. The club treasurer has produced the following bank reconciliation:

	£	£	
Bank balance per cashbook		253	
Outstanding cheques		940	
Interest received (March) not in cashbook		<u>9</u>	
		1,202	
Less: Outstanding lodgements	1,570		
Charges (March) not in cashbook	<u>17</u>	<u>1,587</u>	
Bank overdraft per bank statement		<u>385</u>	

- The club does not depreciate land and buildings. Machinery is depreciated over four years on the straight-line basis with a full year's charge in the year of acquisition. At 31 March 2004, the club owned no machinery that was less than four years old.

- 3 It is club policy to ignore subscriptions in arrears when producing its income and expenditure account. Subscriptions of £210 for the year to 31 March 2005 had been received in advance by 31 March 2004.
- 4 Life membership of the club is available for a fee of £350. Life membership fees are transferred to the income and expenditure account over seven years in equal instalments. At 31 March 2004, the club had four life members. Three of these had become life members during the year to 31 March 2003 and one had become a life member during the year to 31 March 2004.
- 5 Other than the items mentioned above, the club's only other assets and liabilities are as follows:

	As at 31 March 2004	As at 31 March 2005
	£	£
Freehold land and buildings, at cost	18,000	18,000
Bar stock, at cost	2,190	2,370
Amount owed to brewery	1,927	3,644
Stock of squash racquets & balls	745	638
Amount owed to supplier of racquets & balls	430	225
Accrued heat, light and power	300	330
Amounts owed by members (racquet sales)	80	140

Insurance of £780 covering the year to 31 December 2005 was paid on 21 December 2004. The corresponding figure for the previous year was £744.

• **Requirement for question 1**

- (a) Prepare a subscriptions receivable account and a life membership fees account for the year to 31 March 2005. 3
- (b) Prepare a bar trading account and a squash racquets and balls trading account for the year to 31 March 2005. 3
- (c) Prepare an income and expenditure account for the year to 31 March 2005 and a balance sheet as at that date. 11
- (d) Briefly explain why a receipts and payments account is not as useful as an income and expenditure account and balance sheet. Also identify one limitation of the club's balance sheet. 3

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2

Majid is a sole trader who prepares accounts to 30 April each year. He uses a manual book-keeping system, but does not maintain control accounts for his sales ledger or purchase ledger. His trial balance as at 30 April 2005 showed the following totals:

	£
Debit balances	74,368
Credit balances	74,561

The difference between these totals was placed in a suspense account whilst Majid proceeded to prepare draft accounts for the year to 30 April 2005. These accounts (in which the suspense account balance was treated as an expense) showed a net loss of £1,412. On investigation, the following errors were discovered:

- 1 A sales return of £123 had been recorded in the sales daybook and debtor account as a credit sale.
- 2 Bank charges of £19 had been recorded in the cashbook only.
- 3 Capital introduced by Majid of £3,000 had been recorded correctly in the cashbook, but had then been credited to the sales account.
- 4 The purchase of a motor van on 1 February 2005 for £8,560 had been recorded correctly in the cashbook but had then been debited to motor expenses. In consequence, this van was not depreciated in the draft accounts. Majid depreciates motor vans on the straight-line basis over four years, assuming a residual value equal to 40% of the van's cost. He makes part-year depreciation charges in the years of acquisition and disposal.
- 5 The purchase daybook had been overcast by £1,000.
- 6 A cash discount received of £17 had been posted to the wrong side of the supplier's account in the purchase ledger.
- 7 The rent prepayment of £200 at 1 May 2004 had not been brought down in the rent account.
- 8 Sales invoices totalling £275 had been omitted from the accounting records.
- 9 Sales returns totalling £520 had been recorded correctly in the customers' sales ledger accounts, but had been credited to the purchase returns account.
- 10 The credit side of an account in the sales ledger had been undercast by £100.

• **Requirement for question 2**

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| (a) Prepare journal entries to correct the above errors (narratives are not required) and write up the suspense account. | 12 |
| (b) Calculate Majid's corrected net profit or loss for the year to 30 April 2005. | 6 |
| (c) Comment on Majid's treatment of the suspense account balance in his draft accounts. | 2 |

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3

The balance sheets of Malham Ltd as at 31 December 2003 and 2004 are as follows:

	Balance sheet as at 31 December 2003		Balance sheet as at 31 December 2004	
	£000	£000	£000	£000
Tangible fixed assets:				
Cost or valuation	570		785	
Depreciation to date	345	225	405	380
Investments at cost		30		-
		255		380
Current assets:				
Stocks	220		330	
Trade debtors	175		285	
Prepayments	10		5	
Cash on 7-day deposit	20		-	
Cash at bank	75		-	
	500		620	
Current liabilities:				
Trade creditors	110		121	
Accruals	5		9	
Corporation tax	85		17	
Proposed dividends	50		18	
Bank overdraft	-		130	
	250		295	
Net current assets		250		325
		505		705
8% debentures		-		50
		505		655
Capital and reserves:				
Ordinary shares of £1		100		225
Share premium account		50		-
Revaluation reserve		80		150
Profit and loss account		275		280
		505		655

The following information is also available:

- On 1 March 2004, the company made a bonus issue of 50,000 ordinary shares, financed out of the share premium account. On 1 July 2004, the company issued a further 75,000 ordinary shares at par.
- Tangible fixed assets at 31 December 2003 included land at a valuation of £120,000. This land was revalued to £190,000 on 31 December 2004.
- Tangible fixed assets which had cost £80,000 in 2001 were sold for £24,000 during the year to 31 December 2004. Accumulated depreciation on these assets at the time of disposal amounted to £45,000.
- The fixed asset investments were all sold in May 2004 for £23,000. The loss on sale was included in administrative expenses in the profit and loss account for the year to 31 December 2004. Dividends received during the year to 31 December 2004 were £1,000.
- Bank overdraft interest paid during the year to 31 December 2004 was £4,000.

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- 6 Interim dividends totalling £9,000 were paid during the year to 31 December 2004. The proposed dividend for the year to 31 December 2003 was paid in April 2004.
- 7 £50,000 of 8% debentures were issued on 1 April 2004. No interest was paid on these debentures during the year to 31 December 2004, but accrued interest was shown in the balance sheet at that date.
- 8 The corporation tax creditor at 31 December 2003 was overestimated by £5,000.
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• **Requirement for question 3**

- (a) Prepare a cash flow statement for Malham Ltd for the year to 31 December 2004 in accordance with the requirements of accounting standard FRS1 (Revised). The reconciliation to movement in net debt is not required. 14
- (b) Calculate the current and acid test ratios for 2003 and 2004. 2
- (c) Explain the limitations of the profit and loss account and balance sheet which have caused the Accounting Standards Board to require companies to produce a cash flow statement. 4
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SECTION B (Answer two questions from this section)**4**

The financial statements of limited companies are prepared in accordance with company law and all relevant accounting standards. In the absence of legal requirements or an applicable standard, the treatment of an item in the financial statements is generally determined by recourse to established accounting concepts (or conventions). The Accounting Standards Board has tried to rationalise these concepts in its *Statement of Principles for Financial Reporting*.

• Requirement for question 4

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|---|-------------|
| (a) Outline the main legal requirements which must be complied with when producing the financial statements of limited companies. | 8 |
| (b) Explain the main purposes of accounting standards. | 3 |
| (c) Explain briefly the extent to which the accounting concepts have been enshrined in company law or in accounting standards. | 2 |
| (d) Summarise the main features of the ASB <i>Statement of Principles</i> . | 7 |
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5

MTech Ltd buys used machines and reconditions these machines before selling them to customers. The company prepares accounts to 31 May each year. The company's stock at 31 May 2005 includes the following machines:

	<i>Purchase price</i>	<i>Reconditioning costs incurred to date</i>	<i>Expected further costs before sale</i>	<i>Expected selling price</i>
	£	£	£	£
Machine A	5,150	320	-	6,500
Machine B	7,650	410	230	8,500
Machine C	9,330	-	1,000	11,000
Machine D	3,870	270	400	4,600
	<u>26,000</u>	<u>1,000</u>	<u>1,630</u>	<u>30,600</u>

Expected selling expenses for each machine are 5% of the expected selling price.

The company operates a small fleet of motor vans. These vans are depreciated on the straight line basis over a period of five years, assuming a residual value equal to 25% of cost. Part-year depreciation charges are made in the years of acquisition and disposal. As at 31 May 2004, the company owned vans as follows:

	<i>Date bought</i>	<i>Cost</i>
		£
Van 1	1 June 2001	16,000
Van 2	1 October 2002	24,000
Van 3	1 February 2003	20,000
Van 4	1 December 2003	12,000

Van 1 was sold for £8,500 on 1 October 2004 and replaced on that date by Van 5 which cost £17,600.

• **Requirement for question 5**

- (a) Briefly explain the rules of accounting standard SSAP9 (Stocks and Long-term Contracts) which determine how the company's stock of machines should be valued. 4
- (b) Explain why it is not permissible to value the stock of machines at total purchase price (£26,000) or at total selling price (£30,600). 2
- (c) Compute the value at which the stock of machines should be shown in the balance sheet as at 31 May 2005. 4
- (d) Write up ledger accounts for motor vans, provision for depreciation of motor vans and disposal of motor vans for the year to 31 May 2005. 8
- (e) With reference to accounting standard FRS15 (Tangible Fixed Assets) explain the meaning of the term "depreciation" and the purpose of charging depreciation in the accounts of a business. 2

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6

A qualified accountant may specialise in financial accounting, management accounting, auditing or financial management. In each case, the accountant will be responsible for the production of useful economic information, but the types of information provided and the users of that information will differ.

- **Requirement for question 6**

(a) Contrast the roles of:

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|------------------------------|---|
| (i) a financial accountant | 4 |
| (ii) a management accountant | 4 |
| (iii) an external auditor | 2 |
| (iv) an internal auditor | 2 |
| (v) a financial manager | 2 |

For each of these roles, identify the main users of the information which the accountant provides and give examples of the uses to which this information may be put.

(b) Identify the main ethical requirements which qualified accountants must satisfy and give examples of situations in which accountants might encounter ethical difficulties.

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