FINANCIAL ACCOUNTING

Foundation stage examination
4 December 2001

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

Instructions to candidates

Answer five questions in total. ***All four*** *questions from Section* ***A****, and* ***one*** *of the 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.

CIPFA

SECTION A (Answer all questions)

1 The treasurer of the Cardale Lawn Tennis Club has prepared the following receipts and payments account for the year to 30 September 2001:

Cardale Lawn Tennis Club
Receipts and Payments Account for the year to 30 September 2001

		£			£
Receipts			**Payments**		
Balances b/f:			Charitable donations		500
Cash	43		Wimbledon trip - tickets		475
Bank	2,218	2,261	Wimbledon trip - coach hire		120
Subscriptions:			Cost of annual dinner		493
Year to 30 September 2000		60	Raffle prizes		300
Year to 30 September 2001		3,990	Heat, light and power		509
Year to 30 September 2002		220	Insurances		130
Life membership fees		500	Repairs to pavilion		1,314
Donations		384	Postage and stationery		788
Wimbledon trip receipts		530	Cost of new motor mower		520
Sale of annual dinner tickets		740	Purchase of tennis clothing		
Sale of raffle tickets		473	and equipment for resale		4,822
Sale of tennis clothing and			Affiliation fee to Lawn Tennis		
equipment		5,117	Association		100
Sale of old motor mower		50	Bank charges		59
Bank interest received		96	Balances c/f:		
			Cash	39	
			Bank	4,252	4,291
		14,421			14,421

The following information is also available:

1 The club owns its own tennis courts and pavilion. The land on which the courts are situated was acquired many years ago at a cost of £3,000 and the pavilion was built at a cost of £2,500. The pavilion is being depreciated at the rate of 4% per annum on the straight line basis. This depreciation process began in the year to 30 September 1981.

2 The club depreciates motor mowers at 20% per annum on the straight line basis, with a full charge in the year of acquisition and none in the year of disposal. At 30 September 2000, the club owned only one mower, which was bought for £420 on 1 April 1997. This mower was replaced during the year to 30 September 2001.

3 As at 30 September 2000, the club had received £190 of subscriptions in advance for the year to 30 September 2001. It is the club's policy to ignore subscriptions in arrears when preparing its financial statements.

4 Since 1994, it has been possible to secure life membership of the club by paying a one-off fee of £200. This fee was raised to £250 with effect from 1 October 2000. The club currently has ten life members, as follows:

Joined during year to 30 September	**Number of life members**
1994	2
1995	1
1997	3
1999	2
2001	2

The club's policy is to allocate life membership fees to the income and expenditure account in equal instalments over a period of 5 years.

5 One of the functions of the club is to sell tennis clothing and equipment to its members at low prices. At 30 September 2001, members owed the club a total of £486 for clothing and equipment sold to them. The corresponding figure at 30 September 2000 was £294.

6 Other than the items mentioned above, the club's only other assets and liabilities are as follows:

	As at 30 September 2000	**As at 30 September 2001**
	£	**£**
Stock of clothing and equipment for resale	725	319
Owed to suppliers of clothing and equipment	162	417
Accrued heat, light and power	35	40
Prepaid insurance	60	65

7 The treasurer of the club is concerned that members may vote for a reduction in the annual subscription when they see that the club's bank balance has nearly doubled during the year to 30 September 2001. This would be undesirable since the pavilion is now reaching the end of its useful life and will have to be replaced in the next few years at an estimated cost of at least £15,000.

- **Requirement for question 1**

(a) Prepare a subscriptions account and a life membership fees account for the year to 30 September 2001. *4*

(b) Prepare a clothing and equipment trading account for the year to 30 September 2001. *3*

(c) Prepare an income and expenditure account for the year to 30 September 2001. *8*

(d) Prepare a balance sheet as at 30 September 2001. *8*

(e) Suggest a way in which these financial statements could be amended so as to show clearly to members that the pavilion will need to be replaced in due course and that part of the club's net assets are intended to be used for this purpose. *2*

(25)

2 Catherine is in business as a sole trader. Her balance sheet at 31 March 2001 is as follows:

Catherine
Balance sheet as at 31 March 2001

	£	**£**	**£**
Fixed assets			
Freehold premises at cost			45,000
Equipment at cost		13,190	
Less: Depreciation to date		7,350	5,840
			50,840
Current assets			
Stock		6,434	
Trade debtors	7,177		
Less: Provision for doubtful debts	251	6,926	
Prepaid insurance premium		235	
		13,595	
Current liabilities			
Trade creditors	11,223		
Rent received in advance	250		
Accrued telephone charges	190		
Accrued electricity charges	230		
Bank overdraft	8,333	20,226	
Net current liabilities			6,631
			44,209
Long term liabilities			
Loan from father			10,000
			34,209
Capital			
As at 1 April 2000		32,551	
Net profit for the year		11,419	
		43,970	
Less: Drawings		9,761	
			34,209

Her analysed cashbook for the month of April 2001 is as follows:

Receipts

Date		Discount allowed	Amount paid into bank	Sales ledger	Other receipts
		£	£	£	£
1/4/01	E Morris	72	1,368	1,368	
2/4/01	A Johnson		762	762	
5/4/01	P Thomas	26	494	494	
7/4/01	Cash sales		731		731
8/4/01	Thurlstone Ltd	53	1,007	1,007	
11/4/01	G Harris		211	211	
14/4/01	Cash sales		659		659
17/4/01	S Singh		162	162	
18/4/01	T Lewis	64	1,216	1,216	
19/4/01	Harby Ltd		667	667	
21/4/01	Cash sales		688		688
24/4/01	J Cooper (rent received)		250		250
28/4/01	Cash sales		802		802
		215	9,017	5,887	3,130
30/4/01	Balance c/f		10,118		
			19,135		

Payments

Date		Discount received	Amount paid out of bank	Purchase ledger	Other payments
		£	£	£	£
1/4/01	Balance b/f		8,333		
3/4/01	Motor expenses		274		274
4/4/01	Stationery		115		115
8/4/01	P Smith Ltd	106	2,544	2,544	
8/4/01	J Kelly Ltd	123	3,977	3,977	
12/4/01	Motor expenses		43		43
13/4/01	W Wilson		1,750	1,750	
20/4/01	Drawings		1,000		1,000
21/4/01	Equipment (fixed asset)		550		550
27/4/01	Motor expenses		47		47
27/4/01	Telephone		219		219
28/4/01	Electricity		283		283
		229	19,135	8,271	2,531

The following information is also available:

1 Catherine maintains sales ledger and purchase ledger control accounts which form part of her double-entry book-keeping system. The individual debtor and creditor accounts are not part of her double-entry system.

2 Catherine's daybooks for the month of April 2001 show the following totals:

	£
Sales daybook	7,629
Sales returns daybook	171
Purchases daybook	5,228
Purchases returns daybook	33

3 One of Catherine's customers is also one of her suppliers and has accounts in both her sales ledger and her purchase ledger. At 30 April 2001, these accounts showed a debtor of £420 and a creditor of £650. It has been agreed that a contra should pass between these two accounts on 30 April 2001.

4 During April 2001, Catherine took some stock from the business for her own use. This stock had cost the business £320.

- **Requirement for question 2**

(a) Open ledger accounts for each of the items shown in Catherine's balance sheet at 31 March 2001 (except for the bank account which is already provided in the question) and record opening balances in these accounts as at 1 April 2001. Leave sufficient room between your ledger accounts to complete the entries required in part (b). *4*

(b) Record the transactions for the month of April 2001, opening additional accounts as necessary. If there is more than one entry in an account, calculate and show the balance on the account at 30 April 2001. *10*

(c) Prepare a trial balance as at 30 April 2001. *4*

(d) Explain the purpose of maintaining daybooks for sales, purchases and returns. *2*

(20)

3

Colin is a dealer in second-hand motor vehicles and motor spares. He prepares accounts to 31 July each year. On 31 July 2001, his stock includes the following vehicles which have been acquired recently and which have not yet been fully prepared for sale:

	Acquisition cost	**Preparation costs incurred to date**	**Expected further preparation costs before sale**	**Expected selling price**
	£	**£**	**£**	**£**
Vehicle A	8,700	150	200	10,000
Vehicle B	11,925	220	200	12,500
Vehicle C	8,475	0	400	9,500
Vehicle D	12,800	130	600	14,500
Vehicle E	9,500	200	200	10,000

Colin pays his sales staff a commission when a vehicle is sold. This commission is equal to 2% of selling price.

On 31 July 2000, Colin's provision for doubtful debts was £2,340. Debts totalling £5,470 were written off in the year to 31 July 2001, including debts of £1,650 which were included in the doubtful debts provision at 31 July 2000. However, a bankrupt debtor whose £1,200 debt had been written off in 1999 paid a final settlement of 30p in the £. Total debtors at 31 July 2001 are £41,800, of which £900 is to be written off. The provision for doubtful debts at 31 July 2001 is to be £1,810.

- **Requirement for question 3**

(a) Accounting standard SSAP9 requires that stocks should be valued at the lower of cost and net realisable value. Explain the meaning of the terms "cost" and "net realisable value" in this context. *5*

(b) Calculate the total value at which the five vehicles shown above should be included in Colin's closing stock as at 31 July 2001. *5*

(c) If stocks are valued at the lower of cost and net realisable value, does this policy accord with all of the generally accepted accounting conventions? *4*

(d) Write up Colin's ledger accounts for bad debts, bad debts recovered and provision for doubtful debts for the year to 31 July 2001. Also show relevant extracts from the profit and loss account for the year to 31 July 2001 and the balance sheet as at that date. *6*

(20)

4 Coniston Ltd is a manufacturing company which relies upon a single product for the majority of its turnover and profits. The company has recently been experiencing difficulty in obtaining supplies of a vital raw material and is now searching for a reliable source of supply for the future. Two companies are being considered as potential suppliers and the directors of Coniston Ltd have obtained the most recent financial statements of each company. These financial statements are set out below.

Profit and loss accounts

	Company A		**Company B**	
	£000	**£000**	**£000**	**£000**
Turnover		3,200		2,900
Cost of sales:				
Opening stock	390		270	
Purchases	2,080		1,840	
Closing stock	(420)	2,050	(260)	1,850
Gross profit		1,150		1,050
Operating expenses		420		300
Operating profit		730		750
Interest payable:				
Overdraft interest	10		-	
Debenture interest	140	150	10	10
Profit before tax		580		740
Taxation		120		150
Profit after tax		460		590
Dividends		200		200
Retained profit		260		390

Balance sheets

	Company A		Company B	
	£000	**£000**	**£000**	**£000**
Fixed assets		2,700		2,200
Current assets:				
Stock	420		260	
Trade debtors	670		340	
Cash at bank	-		190	
	1,090		790	
Current liabilities:				
Trade creditors	510		230	
Bank overdraft	120		-	
Taxation	120		150	
Dividends	200		200	
	950		580	
Net current assets		140		210
		2,840		2,410
Long-term liabilities:				
Debenture loans		1,400		100
		1,440		2,310
Share capital		1,000		1,000
Profit and loss account		440		1,310
		1,440		2,310

For each company, all sales are credit sales and all purchases are credit purchases.

- **Requirement for question 4**

(a) Conduct a ratio analysis on the financial statements of Company A and Company B, calculating **three** profitability ratios, **two** liquidity ratios, **three** efficiency (management of working capital) ratios, and **one** capital gearing ratio for each company. *9*

(b) Write a short report to the directors of Coniston Ltd, presenting the results of this ratio analysis. Your report should indicate which of the two companies is the more likely to be a reliable source of supply. The report should also identify any further financial information which would be needed before a final decision could be taken. *11*

(20)

SECTION B (Answer question 5 or question 6)

5

Combined Chemicals plc is a manufacturer of pharmaceuticals and cosmetics. The company operates several distinct businesses and prepares accounts to 31 August each year. The accounts for the year to 31 August 2001 are now being prepared and the following matters must be dealt with before these accounts can be finalised:

1 A fixed asset was acquired on 1 September 1998 at a cost of £100,000. At that time it was expected than the asset's useful life would be 10 years and that it would have no residual value at the end of the 10 years. It was decided to depreciate the asset on the straight-line basis. However, on 1 September 2000, the company's estimate of the asset's remaining useful life was revised to 4 years, with a residual value of £8,000.

2 During the year to 31 August 2001, the company spent a total of £630,000 on research and development. Of this sum, £370,000 was spent on an attempt (unsuccessful so far) to find a cure for the common cold. The remaining £260,000 was spent on the development of a new range of cosmetics which will be launched in mid-2002.

3 During the year to 31 August 2001, the company closed down one of its businesses (which had been making a loss) and started up two new businesses. The company also spent £3 million on a fundamental reorganisation of its structure.

- **Requirement for question 5**

(a) By reference to 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 2001. It may be assumed that all of the items mentioned above are material. *11*

(b) Explain the purpose of accounting standards and briefly outline the standard-setting process. *4*

(15)

6

The profit and loss account of a sole trader for the year to 30 June 2001 shows a net profit for the year of £35,000. The owner of the business is puzzled by this, since the balance sheet at 30 June 2001 shows that the business bank balance has increased by only £500 during the year. He is wondering whether the accounts can possibly be correct and has asked you to explain the discrepancy to him.

- **Requirement for question 6**

(a) Explain **six** factors which may have caused this discrepancy for a sole trader, referring to accounting conventions where relevant. *9*

(b) Suggest an extra financial statement (in addition to the profit and loss account and balance sheet) which could be prepared for this sole trader each year and explain how it would help to clarify the distinction between profits and cash. Also list and explain the main headings which you would expect to find in this extra statement for this business. *6*

(15)