FINANCIAL ACCOUNTING

Foundation stage examination
3 December 2002

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.

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.

CIPFA

SECTION A (Answer all questions)

1

Emma is a sole trader operating from rented premises. She prepares accounts to 31 August each year. Her balance sheet at 31 August 2001 was as follows:

Balance Sheet as at 31 August 2001

	£	£	£
Fixed assets			
Shop equipment at cost		7,400	
Less: Depreciation to date		2,880	4,520
Current assets			
Stock		21,730	
Prepaid rent, rates and insurance		3,170	
Cash in hand		420	
		25,320	
Current liabilities			
Bank overdraft	2,450		
Trade creditor	10,590		
Accrued heat and light	170	13,210	
Net current assets			12,110
			16,630
Capital			
As at 31 August 2001			16,630

The following information is available in relation to the year ended 31 August 2002.

1 All of Emma's sales are to customers who pay immediately either in cash or by cheque. She sells goods at a constant markup of 40% on cost.

2 At the end of each week, Emma uses £200 of the week's takings to pay her assistant's wages and a further £300 to pay her own salary. She then pays most of the remainder into her business bank account, retaining only a small cash float. Cash in hand at 31 August 2002 was £400.

3 All of Emma's purchases of stock for resale are from a single supplier who offers a 2.5% discount for prompt payment. Emma always takes advantage of this discount. She owed £11,980 to her supplier at 31 August 2002.

4 The business bank statements for the year to 31 August 2002 show the following receipts and payments:

	£	£
Receipts:		
Takings paid into bank	169,470	
Business loan from Emma's sister	5,000	
Sale of shop equipment	200	174,670
Payments:		
Cheques paid to supplier	139,230	
Purchase of shop equipment	3,200	
Rent, rates and insurance	16,850	
Heat and light	6,110	
Sundry expenses	2,920	
Bank interest and charges	740	169,050

Takings of £3,350 paid into the bank on 31 August 2002 did not appear on the bank statement until 2 September 2002.

5 Rent of £12,000 per annum is paid quarterly in advance on 1 January, 1 April, 1 July and 1 October. Insurances and business rates are payable annually in advance on 1 January and 1 April respectively. The insurance premium paid on 1 January 2002 was £1,260 and the rates payment made on 1 April 2002 was £3,600.

6 During the year to 31 August 2002, Emma began paying for heat and light by monthly direct debit. The monthly payments are based on an estimate of her electricity consumption for the year ahead. A statement received from the electricity company at 31 August 2002 showed that she was in credit by £140.

7 Shop equipment bought in January 1998 for £1,000 was sold in February 2002 for £200. Depreciation on shop equipment is provided at 12.5% per annum on the straight line basis, with a full charge in the year of acquisition and no charge in the year of disposal. None of Emma's shop equipment had been fully depreciated by 31 August 2001.

8 The business loan from Emma's sister is interest-free. Emma repaid £300 of this loan out of her own private bank account during the year to 31 August 2002.

9 Unfortunately, Emma forgot to take stock on 31 August 2002. In consequence, she now has no idea of the value of her stock on that date.

- **Requirement for question 1**

(a) Prepare Emma's trading and profit and loss account for the year to 31 August 2002. *15*

(b) Prepare Emma's balance sheet as at 31 August 2002. *10*

(25)

2 Eric's draft accounts for the year to 30 June 2002 showed a net profit of £14,576. However, these accounts were drawn up before Eric had prepared a bank reconciliation for the month of June 2002. When the cashbook and bank statement for the month were compared, the following items were discovered:

1 Cheques to suppliers totalling £4,976 were recorded in the cashbook in late June but did not appear on the bank statement.

2 Cheques totalling £2,114 received from customers and paid into the bank account on 30 June 2002 were recorded in the cashbook but did not appear on the bank statement.

3 A cheque payment to a supplier of £2,450 had been recorded in the cashbook as £2,540. The relevant supplier's account in the purchase ledger had then been debited with £2,540.

4 A cheque for £1,629 received from a customer in early June had been recorded in the cashbook but had then been paid into Eric's own personal bank account.

5 Bank charges of £85 were shown on the bank statement but had not been recorded in the cashbook.

6 A customer who owed Eric £1,420 had paid this sum by credit transfer. The credit transfer was shown on the bank statement but not in the cashbook.

7 Eric bought a new business motor vehicle on 1 June, paying by cheque. The amount of the cheque was £9,060 but this was recorded both in the cashbook and in the nominal ledger as £9,600. Eric depreciates motor vehicles at 20% per annum on the straight line basis with a full charge in the year of acquisition.

8 Eric had received a letter from his bank in mid-June, informing him that interest of £37 was being charged to his account. This amount was shown on the June bank statement. However, Eric had misunderstood the letter and had recorded interest received of £37 in his cashbook.

9 The bank statement showed a dishonoured cheque of £798. This was not recorded in the cashbook. Eric has now decided to increase his provision for doubtful debts at 30 June 2002 by £798.

10 The credit side of the cashbook had been overcast by £100. Eric is pleased to discover this error, since it explains why his trial balance totals failed to agree. He can now dispense with the £100 suspense account which he had shown as one of the items in his draft profit and loss account.

The bank balance at 30 June 2002 according to Eric's cashbook (before adjusting for any of the above items) was an overdraft of £3,553.

- **Requirement for question 2**

(a)	Write up Eric's cashbook as necessary to reflect the items listed above.	*8*
(b)	Prepare a bank reconciliation as at 30 June 2002. (The balance shown on the bank statement at 30 June 2002 is to be derived).	*3*
(c)	Calculate Eric's corrected net profit for the year to 30 June 2002.	*5*
(d)	Prepare a schedule of the changes that will need to be made to Eric's draft balance sheet as at 30 June 2002 under the headings Assets, Liabilities and Capital. Show how your schedule proves that the balance sheet will still balance after these changes have been made.	*4*
		(20)

3

Paragraph 26 of accounting standard SSAP9 (Stocks and long-term contracts) states the following:

> *"The amount at which stocks are stated in periodic financial statements should be the total of the lower of cost and net realisable value of the separate items of stock or of groups of similar items."*

The standard recognises that it is not always practicable to relate costs to specific units of stock and therefore permits stock valuation methods such as First In First Out (FIFO) and weighted average cost (AVCO). The Last In First Out (LIFO) method is described as "*not usually appropriate*".

Eastwood plc is a manufacturing company which prepares annual accounts to 31 July. On 1 July 2002, the company had a stock of 13,000 units of raw material X. These units had cost £6 each. During July 2002, purchases and sales of material X were as follows:

	Bought	*Sold*
7 July	8,000 units at £7 each	
10 July		12,000 units
18 July	15,000 units at £8 each	
25 July		20,000 units
30 July	3,000 units at £10 each	

The stock of Eastwood plc at 31 July 2002 also included 1,000 units of product Y. These units had been manufactured by the company in late July but were not complete at the year-end. Manufacturing costs of £11,500 had been incurred in relation to these units so far and it was anticipated that further costs of £3,400 would be necessary in order to complete production. The units had an estimated selling price of £18,000. When the units were sold, the company would incur delivery costs of £500 and selling expenses amounting to 5% of selling price.

- **Requirement for question 3**

(a) Calculate the cost of the closing stock of raw material X at 31 July 2002, using each of the following stock valuation methods:

(i) FIFO *3*
(ii) LIFO *3*
(iii) AVCO. *4*

(b) Explain why SSAP9 regards the LIFO method as generally inappropriate and state the circumstances in which LIFO may nonetheless be used. *3*

(c) Explain how the cost and net realisable value of a manufactured item are calculated. *4*

(d) Calculate the value at which the 1,000 units of product Y should be shown in the financial statements of Eastwood plc at 31 July 2002. *3*

(20)

4 The balance sheets of Essex Ltd at 30 September 2001 and 2002 are as follows:

	Balance sheets as at			
	30/9/01		***30/9/02***	
	£000	**£000**	**£000**	**£000**
Tangible fixed assets:				
At cost or valuation	3,770		4,890	
Depreciation to date	1,420	2,350	1,660	3,230
Current assets:				
Stocks	1,760		1,860	
Trade debtors	1,300		1,550	
Cash at bank	990		-	
	4,050		3,410	
Current liabilities:				
Trade creditors	900		1,190	
Corporation tax	720		-	
Proposed dividends	1,400		-	
Bank overdraft	-		510	
	3,020		1,700	
Net current assets		1,030		1,710
		3,380		4,940
7% debentures		-		1,000
		3,380		3,940
Capital and reserves:				
Ordinary shares of 50p		1,000		1,200
Share premium account		750		1,070
Revaluation reserve		-		500
Profit and loss account		1,630		1,170
		3,380		3,940

The following information is also available:

1 During the year to 30 September 2002, freehold land included in tangible fixed assets was revalued from its cost of £400,000 to its estimated market value of £900,000.

2 In January 2002, tangible fixed assets which had cost £600,000 in 1998 were sold for £250,000. The accumulated depreciation provided in relation to these assets at the date of disposal was £320,000.

3 The 7% debentures were issued on 1 October 2001. Interest is payable annually on 30 September and has been paid on the due date.

4 Bank overdraft interest paid during the year to 30 September 2002 was £27,000.

5 No interim dividend was paid during the year to 30 September 2002 and no final dividend is proposed. The previous year's proposed dividend was paid in December 2001.

6 The corporation tax creditor at 30 September 2001 was underestimated by £26,000.

7 In March 2002, 400,000 ordinary shares were issued at £1.30 per share.

- **Requirement for question 4**

(a) Prepare a cash flow statement for Essex Ltd for the year to 30 September 2002 in accordance with the requirements of accounting standard FRS1 (Revised) using the indirect method. The reconciliation to movement in net debt is not required. *16*

(b) Briefly explain why the cash position of Essex Ltd has deteriorated during the year to 30 September 2002. *4*

(20)

SECTION B (Answer question 5 or question 6)

5

In recent years, many manual accounting systems have been replaced by computer-based systems and the use of computers in book-keeping and accounting is now commonplace.

- **Requirement for question 5**

(a) Outline the advantages and disadvantages of computer-based accounting systems in comparison with manual systems. *4*

(b) Give three examples of book-keeping errors which could arise if a manual accounting system were used but which could *not* arise in a computer-based system. *3*

(c) Give three examples of book-keeping errors which could arise if a manual accounting system were used and which *could* also occur in a computer-based system. *3*

(d) Explain why spreadsheet software is particularly useful in accounting work. *5*

(15)

6

For many years, financial accounting has had no coherent theoretical basis. Without such a basis, accountants have had to rely for guidance upon a set of pragmatic accounting concepts (or conventions) which have developed out of accounting practice.

- **Requirement for question 6**

(a) List five accounting concepts and explain the guidance provided by each. *10*

(b) Explain the extent to which the accounting concepts have received official recognition in company law and by the Accounting Standards Board. *5*

(15)