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**ADMISSION EXAMINATION**

**Summer 2004**

**ACCOUNTS II**

**PAPER, SOLUTIONS**

**and**

**EXAMINERS REPORT**

## **NOTES TO USERS ABOUT THESE SOLUTIONS**

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This publication is intended to serve as an educational aid. For this reason, the published solutions will often be significantly longer than would be expected of a candidate in an examination. This will be particularly the case where discursive answers are involved.

The solutions are relevant to the tax rates in the year the Examination was sat. A copy of the tax rates is enclosed with the solutions.

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# **The Institute of Accounting Technicians in Ireland**

## **Admission Examination : Summer 2004**

### **PAPER 6 : ACCOUNTS II**

Monday 17<sup>th</sup> May 2004 - 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 FOUR questions in Section A and EITHER of the TWO questions in Section B.**

**If more than ONE question is answered in Section B, then only the first question, 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 next page.**

**The following insert is enclosed with this paper.**

- **Multiple choice question answer sheet (QUESTION 6)**

**SECTION A**

**Answer ALL Four Questions in this Section**

**QUESTION 1**

Susan, Tara and Ursula are in partnership sharing profits and losses in the ratio 3 : 2 : 1. The net profit of the partnership for the year ended 31<sup>st</sup> December 2003 (before making adjustments for the items set out below) was £/€60,000:

- (i) Rates prepaid of £/€2,500 had not been accounted for.
- (ii) Purchases on credit of £/€8,500 (exclusive of VAT of £/€2,000) on 31<sup>st</sup> December had not been accounted for (but are included in stocks in the draft balance sheet set out below).
- (iii) Wages of £/€4,000 were owing at 31<sup>st</sup> December.

The following was the draft balance sheet of the partnership (before making adjustment for the items set out above):

**DRAFT BALANCE SHEET AS AT 31<sup>st</sup> DECEMBER 2003**

	£/€	£/€	£/€
<b>Fixed Assets</b>			
Leasehold premises .....			400,000
Machinery .....			250,000
Motor vehicles .....			<u>60,000</u>
			<u>710,000</u>
<b>Current Assets</b>			
Stocks .....		65,000	
Debtors .....		47,000	
Bank .....		<u>20,000</u>	
		<u>132,000</u>	
<b>Current Liabilities</b>			
Creditors .....	30,000		
V.A.T. owing .....	<u>4,000</u>		
		<u>34,000</u>	
<b>Net Current Assets</b>			<u>98,000</u>
			<u><u>808,000</u></u>
<b>Represented by:</b>			
<b>Capital Accounts</b>			
Susan .....			200,000
Tara .....			200,000
Ursula .....			<u>200,000</u>
			600,000
<b>Current Accounts</b>			
Susan .....		60,000	
Tara .....		50,000	
Ursula .....		<u>38,000</u>	
			148,000
<b>Net Profit for the year</b>			<u>60,000</u>
			<u>808,000</u>

**ADDITIONAL INFORMATION**

- (1) The partners are to receive a salary of £/€4,000 each and are entitled to interest on capital of 4% per annum based on their capital balances at the balance sheet date.
- (2) On 1<sup>st</sup> January 2004 Susan retired from the partnership. Apart from the adjustments to the net profit and the related effect of those adjustments on the assets and liabilities at that date, no other asset or liability, other than goodwill, required adjustment at the date of Susan's retirement.

**QUESTION I** (*Cont'd*)

- (3) Goodwill was valued at £/€30,000 on 31<sup>st</sup> December 2003 but the partners do not wish it to be shown as an assets in the books.
- (4) The partners agreed to share profits equally after the retirement of Susan.
- (5) The amount due to Susan on retirement is to be paid in two equal instalments on 30<sup>th</sup> June 2004 and 30<sup>th</sup> June 2005.

**Requirement**

You are required to prepare:

- (a) a statement adjusting the net profit for the year ended 31<sup>st</sup> December 2003; **3 Marks**
  - (b) a statement setting out the appropriation of the 'adjusted' net profit between Susan, Tara and Ursula; **4 Marks**
  - (c) the current accounts of the partners; **4 Marks**
  - (d) the capital accounts of the partners; and **3 Marks**
  - (e) the revised balance sheet of the partnership after the retirement of Susan as a partner. **9 Marks**
- Total 23 Marks**

QUESTION 2

BACKGROUND INFORMATION TO QUESTIONS 2 & 3

The following is the profit and loss account, balance sheet and additional information to the accounts of HOME FURNITURE Ltd., for the year ended 31<sup>st</sup> December 2003 (with comparative figures for the year ended 31<sup>st</sup> December 2002).

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31<sup>st</sup> DECEMBER

	2003		2002	
	£/€'000	£/€'000	£/€'000	£/€'000
Sales .....		5,300		4,800
Less: cost of goods sold .....		4,150		4,000
Gross profit .....		1,150		800
Government grants released to profit and loss account		40		20
		<u>1,190</u>		<u>820</u>
Less: Expenses				
Loss on disposal of fixed assets .....	10		6	
Depreciation .....	100		80	
Other administration expenses .....	390		214	
Distribution expenses .....	230	730	180	480
Operating profit before interest .....		460		340
Interest received .....	40		40	
Interest paid (including debenture interest) .....	(20)	20	(30)	10
Profit before taxation .....		480		350
Taxation .....		192		140
Profit after taxation .....		<u>288</u>		<u>210</u>
Dividend				
Paid .....	50		60	
Proposed .....	60	110	20	80
Retained profit for the year .....		178		130
Retained profit forward from last year .....		210		80
		<u>388</u>		<u>210</u>

BALANCE SHEET AS AT 31<sup>st</sup> DECEMBER

	2003		2002	
	£/€'000	£/€'000	£/€'000	£/€'000
Fixed Assets				
Cost .....		2,200		1,800
Accumulated depreciation .....		(1,000)		(950)
			1,200	850
Current Assets				
Stock .....	806		710	
Debtors .....	540		440	
Bank .....	-		100	
	<u>1,346</u>		<u>1,250</u>	
Current Liabilities				
Bank overdraft .....	158		-	
Creditors .....	220		220	
Taxation .....	170		150	
Proposed dividends .....	100		70	
	<u>648</u>		<u>440</u>	
Net Current Assets .....		698		810
Government grants .....		(70)		(60)
		<u>1,828</u>		<u>1,600</u>

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**QUESTION 2** (*Cont'd.*)

	2003		2002	
	£/€'000	£/€'000	£/€'000	£/€'000
Financed by:				
Debenture stock .....		190		150
Share Capital				
Ordinary shares .....	1,150		1,100	
Preference shares .....	<u>—</u>	1,150	<u>70</u>	1,170
Share Premium Account .....		100		70
Profit and Loss Account .....		<u>388</u>		<u>210</u>
		<u><u>1,828</u></u>		<u><u>1,600</u></u>

**ADDITIONAL INFORMATION**

During the year ended 31<sup>st</sup> December 2003 HOME FURNITURE Ltd., bought fixed assets which cost £/€600,000 and sold other fixed assets for £/€140,000.

No preference dividend was paid during 2002 or 2003.

**Requirement**

Prepare a cash flow statement in accordance with F.R.S.1, including relevant notes, for HOME FURNITURE Ltd., for the year ended 31<sup>st</sup> December 2003.

**Total 18 Marks**

**QUESTION 3**

**USING THE INFORMATION PROVIDED IN QUESTION 2.**

**Requirement**

(a) Calculate appropriate ratios in respect of the profitability and liquidity of HOME FURNITURE Ltd., for the years ended 31<sup>st</sup> December 2003 and 2002.

**12 Marks**

(b) Based on the ratios calculated at (a) above and on the cash flow statement prepared for **QUESTION 2**, *briefly* comment on the performance of HOME FURNITURE Ltd., during 2003.

**8 Marks**

**Total 20 Marks**

**QUESTION 4**

Alan Sharkey has been trading as a sole trader since 1997. He does not maintain a full nominal ledger accounting system and has asked you to prepare the accounts of his business for the year ended 31<sup>st</sup> December 2003.

A summary of the business bank account for the year ended 31<sup>st</sup> December 2003 is as follows:

**BANK ACCOUNT**

	<i>Notes</i>	£/€		<i>Notes</i>	£/€
Lodgements			Balance at 1 <sup>st</sup> January 2003		2,800
Sales receipts	(1)	103,000	Payment to creditors		54,000
Sale of building	(2)	63,000	Insurance	(5)	2,400
Rental income	(3)	3,000	Postage and telephone		1,600
			Printing and stationery	(5)	2,300
			Rent and rates		2,400
			General office expenses		850
			Drawings		6,400
			Purchase of new premises	(2)	54,000
			Purchase of office equipment	(4)	4,050
			Wages and salaries		34,000
		<u>169,000</u>	Balance at 31 <sup>st</sup> December 2003		<u>4,200</u>
Balance brought down at 1 <sup>st</sup> January 2004		4,200			<u>169,000</u>

**ADDITIONAL INFORMATION**

- (1) The following cash payments were made out of sales receipts before the lodgements were made to the bank.

	£/€
General office expenses .....	450
Payments to creditors .....	400
Casual wages .....	2,200

- (2) The building which the business owned on 1<sup>st</sup> January 2003 was valued at £/€52,000 at that date. This premises was sold on 30<sup>th</sup> April 2003 for £/€63,000. A new premises was purchased on 1<sup>st</sup> May 2003 for £/€54,000 and is to be depreciated at 2% per annum from that date on a month by month basis.
- (3) Rental income due to the business amounts to £/€500 at 31<sup>st</sup> December 2003.
- (4) At 1<sup>st</sup> January 2003 the business owned office equipment with a book value of £/€6,000. Further office equipment was purchased during the year for £/€4,050. All office equipment owned at 31<sup>st</sup> December 2003 is to be depreciated by 10% for a full year (regardless of date of purchase).
- (5) Details of other assets and liabilities are as follows:

	At 1 <sup>st</sup> January 2003 £/€	At 31 <sup>st</sup> December 2003 £/€
Debtors .....	6,000	7,000
Stock .....	4,000	3,000
Creditors .....	5,400	6,200
Insurance prepaid .....	500	700
Stock of stationery .....	300	350

**QUESTION 4 (Cont'd)**

**Requirement**

- |  |                              |
|--|------------------------------|
| (a) Prepare a statement of affairs for Alan Sharkey as at 1 <sup>st</sup> January 2003;                | <b>5 Marks</b>               |
| (b) Prepare the trading and profit and loss account for the year ended 31 <sup>st</sup> December 2003; | <b>11 Marks</b>              |
| (c) Prepare the balance sheet as at 31 <sup>st</sup> December 2003                                     | <b>8 Marks</b>               |
|  | <b>Total <u>24 Marks</u></b> |

**SECTION B**

**Answer EITHER Question 5 OR Question 6 in this Section**

**QUESTION 5**

At 31<sup>st</sup> December 2003 the closing stock as stated by the management accounts of MOBILE PHONES Ltd., was as follows:

	£/€'000
Stocks	
Raw materials stocks at cost	
Material A (see note 1 below) .....	600
Material B (see note 2 below) .....	500
Material C .....	300
	1,400
Finished goods (see note 3 below) .....	1,200
	2,600

**NOTES**

- (1) Due to poor market conditions the net realisable value of the stocks of Material A is only £/€500,000.
- (2) The stocks of Material B can only be sold to a restricted market, for £/€560,000, and it will be necessary to spend £/€80,000 on marketing costs to sell them.
- (3) The valuation of finished goods stocks comprises the following:

	£/€'000
Material costs .....	250
Production costs .....	650
Packaging costs .....	120
Proposed selling costs .....	180
	1,200

**Requirement**

- |   |                              |
|---|------------------------------|
| (a) State how stocks should be valued in accordance with Statement of Standard Accounting Practice No 9. "Accounting of Stocks" (SSAP 9). | <b>9 Marks</b>               |
| (b) Calculate the correct valuation of the closing stock of MOBILE PHONES Ltd., in accordance with SSAP 9.                                | <b>6 Marks</b>               |
|   | <b>Total <u>15 Marks</u></b> |

**QUESTION 6**

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.

There are FIVE parts in **Sub-Section A** of the question and FIVE parts in **Sub-Section B**. Each part in **Sub-Section A** carries 2 Marks and each part in **Sub-Section B** carries 1 Mark.

**Requirement**

Indicate the right answer to each of the following TEN parts.

**Total 15 Marks**

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

**SUB-SECTION A - 2 MARK PARTS  
BACKGROUND INFORMATION TO PARTS [1] & [2]**

A golf club introduced a life membership scheme on 1<sup>st</sup> January 2001. Under the scheme life membership subscriptions are apportioned to revenue over a ten year period. The following life subscriptions were received in the three years ended 31<sup>st</sup> December 2003.

Year ended:	£/€
31 <sup>st</sup> December 2001 .....	20,000
31 <sup>st</sup> December 2002 .....	25,000
31 <sup>st</sup> December 2003 .....	28,000

[1] The amount credited to income for life subscriptions in the year ended 31<sup>st</sup> December 2003 will be:-

- (a) £/€2,800
- (b) £/€7,300
- (c) £/€28,000
- (d) £/€73,000

[2] The amount carried forward in the balance sheet at 31<sup>st</sup> December 2003 as life subscriptions not yet credited to income is:

- (a) £/€45,000
- (b) £/€51,100
- (c) £/€59,200
- (d) £/€65,700

**BACKGROUND INFORMATION TO PARTS [3] - [5]**

The following information relates to DRESSER Ltd.:

Authorised Share Capital:-

	£/€
2,000,000 ordinary shares of 50 p/c each .....	1,000,000
200,000 5% preference shares of £/€1 each .....	200,000

Issued Share Capital:-

1,000,000 ordinary shares of 50 p/c each .....	500,000
150,000 5% preference shares of £/€1 each .....	150,000

Revenue reserves .....	60,000
Share premium account .....	40,000
4% Debenture stock .....	100,000
Profit and loss account .....	70,000
Short-term investments .....	50,000

[3] Shareholders funds as stated in the balance sheet of DRESSER Ltd. will be:-

- (a) £/€820,000
- (b) £/€920,000
- (c) £/€970,000
- (d) £/€1,370,000

QUESTION 6 (Cont'd)

- [4] If the directors propose to pay a final dividend of 6 p/c per ordinary share and to pay the preference dividend for the year, then the total of proposed dividends for the year will be:-
- (a) £/€27,500
  - (b) £/€37,500
  - (c) £/€67,500
  - (d) £/€130,000
- [5] If the 4% DEBENTURE stock is repaid at par and the short term investments are sold at cost to help finance the repayment, then the effect on shareholders funds will be:-
- (a) no effect on shareholders funds
  - (b) an increase of £/€100,000
  - (c) a decrease of £/€100,000
  - (d) an increase of £/€50,000

SUB-SECTION B -1 MARK PARTS

- [6] When preparing the Production Cost Budget of a business which of the following will be included:-
- (a) direct materials, variable overheads and fixed overheads
  - (b) direct materials and variable overheads only
  - (c) direct materials and fixed overheads only
  - (d) variable overheads and fixed overheads only
- [7] When preparing the budget of a business, depreciation of production equipment is:-
- (a) included in the Production Cost Budget and the Cash Budget
  - (b) included in the Production Cost Budget only
  - (c) included in the Cash Budget only
  - (d) excluded from both the Production Cost Budget and the Cash Budget
- [8] The production of an Extended Trial Balance is used to:-
- (a) confirm that the total debits and credits in the nominal ledger are equal
  - (b) put through adjustments after the preparation of the trial balance, in a columnar format, to arrive at the profit and loss and balance sheet
  - (c) make late adjustments to the accounting records
  - (d) prepare year end budgets
- [9] If a business is Zero Rated for V.A.T. purposes then:-
- (a) it cannot reclaim V.A.T. on items purchased on which V.A.T is paid
  - (b) it can reclaim V.A.T. on items purchased on which V.A.T. is paid
  - (c) it is never charged V.A.T. on any items purchased
  - (d) it will not be registered for V.A.T. purposes
- [10] The debtors ledger control account of a business did not agree with the list of balances which totalled £/€45,700. On investigation the following errors were discovered:-
- (1) a credit balance of £/€200 in the debtors ledger was listed as a debit balance
  - (2) the tot of the list of balances had been overstated by £/€120

The balance on the debtors ledger control account was:

- (a) £/€45,180
- (b) £/€45,380
- (c) £/€45,780
- (d) £/€46,020

**STANDARD ANSWER SHEET FOR ALL MULTIPLE CHOICE QUESTIONS**

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Candidates are required to insert the following details:

Examination Session .....

Examination Number.....

Examination Part .....

Examination Paper.....

**QUESTION NUMBER** .....

**To answer each section, please tick appropriate box.**

Part	Part	Part	Part	Part
1 (a) <input type="checkbox"/>	6 (a) <input type="checkbox"/>	11 (a) <input type="checkbox"/>	16 (a) <input type="checkbox"/>	21 (a) <input type="checkbox"/>
(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>
(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>
(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>
2 (a) <input type="checkbox"/>	7 (a) <input type="checkbox"/>	12 (a) <input type="checkbox"/>	17 (a) <input type="checkbox"/>	22 (a) <input type="checkbox"/>
(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>
(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>
(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>
3 (a) <input type="checkbox"/>	8 (a) <input type="checkbox"/>	13 (a) <input type="checkbox"/>	18 (a) <input type="checkbox"/>	23 (a) <input type="checkbox"/>
(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>
(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>
(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>
4 (a) <input type="checkbox"/>	9 (a) <input type="checkbox"/>	14 (a) <input type="checkbox"/>	19 (a) <input type="checkbox"/>	24 (a) <input type="checkbox"/>
(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>
(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>
(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>
5 (a) <input type="checkbox"/>	10 (a) <input type="checkbox"/>	15 (a) <input type="checkbox"/>	20 (a) <input type="checkbox"/>	25 (a) <input type="checkbox"/>
(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>	(b) <input type="checkbox"/>
(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>	(c) <input type="checkbox"/>
(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>	(d) <input type="checkbox"/>



## The Institute of Accounting Technicians in Ireland

### Admission Examination : Summer 2004

### SOLUTIONS TO PAPER 6

### ACCOUNTS II

Author : Mr Brian Hayden, FCA

#### Solution to Question 1

(a) Net profit for the year (before adjustment)	£/€	60,000
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Adjustments:

(i) Rates prepaid	2,500	
(ii) Purchases	(8,500)	
(iii) Wages owing	<u>(4,000)</u>	

Adjusted profit	<u>50,000</u>	
-----------------	---------------	--

#### (b) Profit and Loss Appropriation Accounts for the year ended 31st December 2003

Adjusted profit (as above)	£/€	£/€	50,000
----------------------------	-----	-----	--------

Partners' Salaries

Susan	4,000	
Tara	4,000	
Ursula	<u>4,000</u>	
		(12,000)
		<u>38,000</u>

Interest on Capital

Susan	8,000	
Tara	8,000	
Ursula	<u>8,000</u>	
		(24,000)
		<u>14,000</u>

Split as follows:

Susan	7,000	
Tara	4,667	
Ursula	<u>2,333</u>	
		<u>14,000</u>

Solution to question 1 continued on next page

**Solution to question 1 (Cont'd)**

(c) **Partners' currents accounts**

	S £/€	T £/€	U £/€		S £/€	T £/€	U £/€
Capital a/c	79,000			Balance b/d	60,000	50,000	38,000
Balance c/d	<u>79,000</u>	<u>66,667</u>	<u>52,333</u>	Salaries	4,000	4,000	4,000
				Interest on cap	8,000	8,000	8,000
				Share of Profit	<u>7,000</u>	<u>4,667</u>	<u>2,333</u>
				Balance c/d		66,667	52,333

(d) **Partners' Capital Accounts**

	S £/€	T £/€	U £/€		S £/€	T £/€	U £/€
Goodwill (written off)		15,000	15,000	Balance b/d	200,000	200,000	200,000
Loan a/c	294,000			Goodwill	15,000	10,000	5,000
Balance c/d	<u>294,000</u>	<u>195,000</u>	<u>190,000</u>	Current a/c	<u>79,000</u>		
				Balance b/d		195,000	190,000

(e) **Balance Sheet at 1<sup>st</sup> January 2004**

	£/€	£/€	£/€
<b>Fixed Assets</b>			
Leasehold Premises			400,000
Machinery			250,000
Motor Vehicles			<u>60,000</u>
			710,000
<b>Current Assets</b>			
Stocks	65,000		
Debtors	47,000		
Bank	20,000		
Repayment	<u>2,500</u>		
		134,500	
<b>Current Liabilities</b>			
Creditors (30,000 + 10,500)		40,500	
Accrued wages		4,000	
V.A.T. (4,000 – 2,000)		2,000	
Loan a/c - Susan		<u>147,000</u>	
			<u>193,500</u>
<b>Net Current Assets / (Liabilities)</b>			<u>(59,000)</u>
			<u>651,000</u>
<b>Represented by:</b>			
<b>Capital Accounts</b>			
Tara			195,000
Ursula			<u>190,000</u>
			385,000
<b>Current Accounts</b>			
Tara	66,667		
Ursula	<u>52,333</u>		
			119,000
Loan a/c - Susan			<u>147,000</u>
			<u>651,000</u>

**Solution to Question 2**

**Reconciliation of opening profit to net cash flow from operating activities**

	£/€
Opening profit	460
Depreciation	100
Loss on disposal of fixed assets (w.4)	10
Government grants released to profit	(40)
Increase in stock	(96)
Increase in debtors	(100)
	<u>334</u>

**Cash Flow Statement**

Net cash flow from operating activities	334
Returns on investments and servicing of finance (Note 1)	20
Taxation (W.1)	(172)
Capital Expenditure (Note 2)	(410)
Equity dividends paid (W.3)	(80)
	<u>(308)</u>
Financing (Note 3)	50
Decrease in bank & cash balances	<u>(258)</u>

**Notes to the Cash Flow Statement**

<b>(1) Returns on investments and servicing of finance</b>	
Interest received	40
Interest paid	(20)
	<u>20</u>
<b>(2) Capital Expenditure</b>	
Paid to acquire tangible fixed assets	600
Proceeds of sale of tangible fixed assets	(140)
Government grant received (w.2)	(50)
	<u>410</u>
<b>(3) Financing</b>	
Issue of Ordinary Shares (50 + 30)	80
Issue of Debentures	40
	<u>120</u>
Redemption of preference shares	70
	<u>50</u>

**Workings**

<b>(1) Taxation paid</b>	
Due 1 <sup>st</sup> January 2003	150
Charge for year	192
	<u>342</u>
Due at 31 <sup>st</sup> December 2003	170
	<u>172</u>
<b>(2) Government grants</b>	
Deferred at 1 <sup>st</sup> January	60
Released to P/L a/c	40
	<u>20</u>
Deferred at 31 <sup>st</sup> December	70
Received during year	50
	<u>50</u>
<b>(3) Equity dividends paid</b>	
Due at 1/1/2003	70
Change for year	110
	<u>180</u>
Due at 31/12/2003	100
	<u>80</u>

Solution to Question 2 continued on next page

**Solution to Question 2 (Cont'd)**

**Workings (Cont'd)**

**(4) Fixed Assets**

Cost at 1/1/2003	1,800	
Additions	<u>600</u>	
	2,400	
Cost at 31/12/2003	<u>2,200</u>	
Cost of asset disposed of	<u>200</u>	200
Acc. Depr.		
At 1/1/2003	950	
Charge for you	<u>100</u>	
	1,050	
At 31/12/2003	<u>1,000</u>	
Acc depr of asset disposed of	<u>50</u>	<u>50</u>
Net book amount of asset disposed of		<u>150</u>
Sale proceeds		<u>140</u>
Loss on sale		<u>10</u>

**Solution to Question 3 (a)**

<b>Profitability</b>	<b>2003</b>	<b>2002</b>
<i>Gross Profit Percentage</i>		
2003: $\frac{1,150 \times 100}{5,300}$	21.7%	
2002: $\frac{800 \times 100}{4,800}$		16.7%
<i>Net Profit Percentage</i>		
2003: $\frac{460 \times 100}{5,300}$	8.7%	
2002: $\frac{340 \times 100}{4,800}$		7.1%
"or" (using profit before tax)	9.05%	7.29%
<i>Return on Capital Employed</i>		
2003: $\frac{288 \times 100}{1,638}$	17.6%	
2002: $\frac{210 \times 100}{1,450}$		14.48%

(Note: there are other acceptable answers to the return on capital employed ratio)

**Solution to Question 3(a) continued on next page**

**Solution to Question 3(a) (Cont'd)**

<b>Liquidity</b>	<b>2003</b>	<b>2002</b>
<i>Current Ratio</i>		
2003: $\frac{1,346}{648}$	2.1:1	
2002: $\frac{1,250}{440}$		2.8:1
<i>Acid Test (Quick) Ratio</i>		
2003: $\frac{540}{648}$	0.8:1	
2002: $\frac{540}{440}$		1.2:1
<i>Debtors Days Outstanding</i>		
2003: $\frac{540 \times 365}{5,300}$	37 days	
2002: $\frac{440 \times 365}{4,800}$		33 days
<i>Creditors Days Outstanding</i>		
2003: $\frac{220 \times 365}{4,150}$	19 days	
2002: $\frac{220 \times 365}{4,000}$		20 days

(using cost of goods sold as purchases figure is not available for 2002)

**(b)**

The turnover of Home Furniture Ltd. has increased in 2003 by 10%. At the same time the company has managed to control its costs with the result that the gross profit percentage has increased from 17% to 22% and its net profit percentage has also increased, if only marginally.

The return (on capital employed) from the shareholders point of view has also increased from 14.5% to 17.5%.

Looking at the liquidity position of the company the short term liquidity position has deteriorated somewhat. This would be explained by the fact that the company has incurred expenditure on capital expenditure of £/€ 410,000 (net) (see cash flow statement) without a corresponding increase in its medium to long term financing. The company is presumably trying to find the expenditure out of retained profits which will probably be successful if its bankers are willing to allow it to maintain a bank overdraft over the next year and it continues to trade as successfully as in 2002 and 2003.

**Solution to Question 4**

(a)

**Statement of affairs at 1<sup>st</sup> January 2003**

	£/€	£/€
Building		52,000
Office Equipment		6,000
Debtors		6,000
Stock		4,000
Insurance prepaid		500
Stock of stationery		300
		<u>68,800</u>
Bank overdraft	2,800	
Creditors	<u>5,400</u>	
		<u>8,200</u>
Capital at 1 <sup>st</sup> January 2003		<u><u>60,600</u></u>

**Trading and Profit and Loss Account  
for the year ended 31st December 2003**

	£/€	£/€	£/€
Sales (W.1)			107,050
<i>Less: Cost of goods sold</i>			
Opening stock		4,000	
Purchases (W.2)		<u>55,200</u>	
		59,200	
<i>Less Closing stock</i>		<u>3,000</u>	
			<u>56,200</u>
Gross profit			50,850
Rental income (W.3)			3,500
Profit on sale of building (W.9)			<u>11,000</u>
			<u>65,350</u>
<i>Less: Expenses</i>			
Insurance (W.4)		2,200	
Postage and Telephone		1,600	
Printing & Stationery (W.5)		2,250	
Rent and Rates		2,400	
General Office Expenses (W.6)		1,300	
Wages & Salaries (W.7)		36,200	
Depreciation (W.8)	720		
Office Equipment	<u>1,005</u>		
		<u>1,725</u>	
Net Profit			<u><u>47,675</u></u> <u><u>17,675</u></u>

Solution to Question 4 continued on next page

Solution to Question 4 (Cont'd)

Balance Sheet as at 31<sup>st</sup> December 2003

Fixed Assets (W.8)	Cost £/€	Accumulative Depreciation £/€	Net Book Amt. £/€
Building	54,000	720	53,280
Office Equipment	<u>10,050</u>	<u>1,005</u>	<u>9,045</u>
	<u>64,050</u>	<u>1,725</u>	<u>62,325</u>
<b>Current Assets</b>			
Stocks		3,000	
Debtors		7,000	
Bank		4,200	
Insurance Prepaid		700	
Stock of stationery		350	
Rental income due		<u>500</u>	
		<u>15,750</u>	
<b>Current Liabilities</b>			
Creditors		<u>6,200</u>	
Net Current Assets			<u>9,550</u>
			<u>71,875</u>
<b>Financed by:</b>			
Capital at 1 <sup>st</sup> January 2003			60,600
Add: Net profit			<u>17,675</u>
			<u>78,275</u>
Less: Drawings			<u>(6,400)</u>
			<u>71,875</u>

Solution to question 4 continued on next page

**Solution to question 4 (Cont'd)**

**Workings**

**(1) Sales**

	£/€
Receipts per bank account	103,000
Receipts not lodged (450 + 400 + 2,200)	<u>3,050</u>
	106,050
Opening Debtors	<u>(6,000)</u>
	100,050
Closing Debtors	<u>7,000</u>
	<u><u>107,050</u></u>

**(2) Purchases**

Payment to creditors	54,000
Cash payments for creditors	<u>400</u>
	54,400
Opening creditors	<u>(5,400)</u>
	49,000
Closing creditors	<u>6,200</u>
	<u><u>55,200</u></u>

**(3) Rental Income**

Per bank account	3,000
Add: Due (receivable at 31/12)	<u>500</u>
	<u><u>3,500</u></u>

**(4) Insurance**

Per bank account	2,400
Prepaid at 1/1/2003	<u>500</u>
	2,900
Prepaid at 31/12/2003	<u>700</u>
	<u><u>2,200</u></u>

**(5) Printing & Stationery**

Per bank account	2,300
Stock of stationery at 1/1/2003	<u>300</u>
	2,600
Stock of stationery at 31/12/2003	<u>350</u>
	<u><u>2,250</u></u>

**(6) General office expenses**

Per bank account	850
Paid in cash	<u>450</u>
	<u><u>1,300</u></u>

**(7) Wages & Salaries**

Per bank account	34,000
Paid in cash	<u>2,200</u>
	<u><u>36,200</u></u>

Solution to question 4 continued on next page

**Solution to question 4 (Cont'd)**

**(8) Depreciation**

Building = 54,000 x 2% = 1,080 x 8/12	£/€	£/€
		<u>720</u>
Equipment:		
Value at 1/1/2002	6,000	
New equipment	<u>4,050</u>	
	<u>10,050</u>	
@ 10%		<u>1,005</u>

**(9) Sale of building**

Value at 1/1/2003	(52,000)
Selling price	<u>63,000</u>
Profit on sale of building	<u>11,000</u>

**Solution to Question 5**

**(a)**

Stocks should be valued at the lower of cost and net realisable value.

Cost includes a normal allocation of production overheads along with all direct costs associated with its production and bringing it to a finished state prior to sale.

Net realisable value is defined as selling price after deduction of anticipated selling costs which will be required in order to secure the sale proceeds.

**(b)**

**Calculation of valuation of Closing Stocks**

	£/€'000
Product A	500
Product B	480
Product C	<u>300</u>
	1,280

	£/€'000
<b>Finished goods</b>	
Material Costs	250
Production Costs	650
Packaging Costs	<u>120</u>
	<u>1,020</u>
	<u>2,300</u>

**Solution to question 6**

- [1] B            [2] C            [3] A            [4] C            [5] A  
 [6] A            [7] B            [8] B            [9] B            [10] A

*see Workings on next page*

*Solution to question 6 (Cont'd)*

**Multiple Choice - Workings** (not requested in exam)

(1)  $73,000 \times 10\% = 7,300$  **B**

(2)  $20,000 \times 70\% = 14,000$   
 $25,000 \times 80\% = 20,000$   
 $28,000 \times 90\% = 25,200$   
59,200 **C**

(3)  $650,000$   
 $60,000$   
 $40,000$   
70,000      820,000 **A**

(4)  $1,000,000 \times 6\% = 60,000$   
 $150,000 \times 5\% = 7,500$   
67,500 **C**

(10)  $45,700$   
 $120$   
45,580  
 $400$   
45,180 **A**

# EXAMINERS REPORT

## ACCOUNTS II

### SUMMER 2004

#### General Comment

The average pass mark on the paper was 52%, which was two percentage points down on Summer 2003. This drop was mainly due to a lower than usual mark being obtained in the partnership question (see below)

#### Question 1

Students did not score as highly as usual in this question. In **Part (a)** many students made the adjustment to profit the wrong way around. In **Parts (c) and (d)** entries to the capital and current accounts were made to the wrong accounts and goodwill was not written off correctly in a lot of cases. Very few students made the correct adjustment to creditors and VAT in **Part (e)**.

On the other hand students scored highly in **Part (b)** for the appropriation of partner salaries and interest on capital. Also, many students recognised that the balance of money owing to Susan was required to be split between creditors falling due within one year and after one year.

#### Question 2

This “cash flow statement” question was not well answered. The two main areas, which caused difficulty, were that:

- (i) candidates had difficulty dealing with the movements in respect of fixed assets,
- (ii) candidates often did not know which figure to use as operating profit in the “reconciliation of operating profit to net cash flow from operating activities”.

#### Question 3

This “ratio analysis” question was, as usual, well answered in respect of the calculation of appropriate profitability and liquidity ratios but not in respect of the commentary on the performance of the company. Candidates rarely, as suggested by the question, used the information in the cash flow statement to assist in framing their commentary.

#### Question 4

This “incomplete records” question was the best-answered question on the paper although some candidates still do not seem to understand the difference between payment to creditors and purchases or sales receipts and sales.

#### Question 5

As usual only about 10% of candidates attempted this question. Those who did scored reasonably well. The most common error made was in respect of the treatment of selling costs in respect of the valuation of stock at cost and at net realizable value.

#### Question 6

90% of candidates attempted this question. Most scored reasonably well and there were no particular parts that caused specific difficulty.