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ADMISSION EXAMINATION

Summer 2008

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 2008

PAPER 6 : ACCOUNTS II

Monday 19th May 2008 - 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)**

Accounts II Summer 2008 Paper

SECTION A

Answer ALL Four Questions in this Section

QUESTION 1

Paul, Robin and Trevor were in partnership sharing profits and losses in the ratio 2 : 2 : 1.

The following was the balance sheet of the partnership as at 31st December 2007:

BALANCE SHEET AS AT 31st DECEMBER 2007

	£/€	£/€	£/€
Fixed Assets:			
Freehold premises			750,000
Computer equipment.....			220,000
Motor vehicles			85,000
			<u>1,055,000</u>
 Current Assets:			
Stocks.....		65,000	
Debtors.....		94,000	
Prepayments.....		5,000	
Loan to Robin		25,000	
Cash		3,000	
		<u>192,000</u>	
 Current Liabilities:			
Creditors	87,000		
Accrued expenses	7,000		
Bank overdraft	<u>17,000</u>		
		<u>111,000</u>	
 Net Current Assets:			<u>81,000</u>
			<u><u>1,136,000</u></u>
 Financed by:			
Capital Accounts:			
Paul		300,000	
Robin.....		300,000	
Trevor.....		<u>300,000</u>	
			900,000
 Current Accounts:			
Paul		40,000	
Robin.....		(30,000)	
Trevor.....		<u>26,000</u>	
			36,000
 Bank Loan - Jones Bank Ltd.			<u>200,000</u>
			<u><u>1,136,000</u></u>

ADDITIONAL INFORMATION

The partners decided to form a limited company P.R.T. Ltd which would take over certain of the assets and liabilities of the partnership as at 31st December 2007. The remaining assets were sold or taken over by the partners as follows:

- (1) Two motor vehicles with book values of £/€ 30,000 each were taken over by Paul and Robin at their book value. The other motor vehicle with a book value of £/€ 25,000 was sold for £/€15,000 and the money was lodged to the partnership bank account.

QUESTION 1 (*Cont'd.*)

(2) Computer equipment with a book value of £/€40,000 was taken over by Trevor at an agreed value of £/€35,000.

The remaining assets and liabilities, including the loan to Robin and the loan from JONES BANK Ltd, but excluding the bank and cash balances, were taken over by P.R.T. Ltd at the values stated in the partnership books as at 31st December 2007. The purchase consideration of £/€1,000,000 was to be satisfied by the issue of £/€ 400,000 ordinary shares of £/€1 each at par and the issue of £/€600,000 of debenture stock at par.

Expenses of £/€20,000 relating to the conversion to a limited company were borne by the partnership.

The shares in P.R.T. Ltd were divided between the partners in profit sharing ratio and the debenture stock was to be divided between the partners equally.

Requirement

You are required to prepare:

- | | |
|---|------------------------------|
| (a) The realisation account | 11 Marks |
| (b) The partners combined capital and current accounts | 5 Marks |
| (c) The partnership bank and cash account | 3 Marks |
| (d) The balance sheet of P.R.T. Ltd after the above events have taken place | 6 Marks |
| | Total <u>25</u> Marks |

Accounts II Summer 2008 Paper

QUESTION 2

Set out below is the 'DRAFT' trading and profit and loss account of BETA Ltd. for the year ended 31st December 2007.

BETA Ltd
Draft Trading and Profit and Loss Account

	£/€	£/€
Sales		7,200,000
Opening stock	225,000	
Purchases	<u>3,300,000</u>	
	3,525,000	
Less: closing stock.....	<u>420,000</u>	3,105,000
Gross profit		4,095,000
Distribution expenses		(1,450,000)
Bank interest payable		(54,000)
Debenture interest payable		(60,000)
Administrative expenses.....		(610,000)
Deposit interest received		53,000
Training grants received		30,000
Royalty income.....		62,000
Dividends paid		
Ordinary.....		(120,000)
Preference		(60,000)
Transfer to general reserve		(80,000)
Taxation paid		<u>(18,000)</u>
Retained profit		1,788,000
Retained profit forward at start of year		<u>300,000</u>
Retained profit at end of year.....		<u><u>2,088,000</u></u>

ADDITIONAL INFORMATION

Sales on credit of £/€132,000, inclusive of V.A.T. of 10%, have been omitted from the accounts.

(2) The closing stock is comprised of:

	COST	NET REALISABLE
	£/€	VALUE
		£/€
Product A.....	140,000	135,000
Product B.....	70,000	77,000
Product C.....	<u>210,000</u>	<u>202,000</u>
.....	<u>420,000</u>	<u>414,000</u>

(3) The figure for administration expenses *includes* the charge for depreciation of all fixed assets for the year of £/€160,000 and the charge for auditors remuneration of £/€ 48,000.

(4) Directors emoluments of £/€110,000 *have not* yet been provided for. The wages and salaries of £/€79,000 of all other staff are *already included* as follows in:

	£/€
Distribution expenses	85,000
Administration expenses.....	94,000

(5) The training grants received are in respect of training new staff, the cost of which is included in the administration expenses.

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QUESTION 2 (*Cont'd.*)

(6) Accrued expenses which *have not* yet been provided in the draft accounts are as follows:

	£/€
Distribution expenses	43,000
Administrative expenses.....	23,000
Bank interest.....	24,000

(7) Royalty income due at 31st December 2007 of £/€37,000 has not been accounted for.

(8) The taxation paid of £/€18,000, included in the draft profit and loss account, is taxation paid during the year, in respect of the year ended 31st December 2006, which was underprovided for that year. The estimated taxation charge on the profit for the current year is £/€950,000.

Requirement

You are required, taking the above information into account, to:

(a) Re-draft the profit and loss account, taking into account the additional information in items (1) to (8) above, in a form which complies with the format requirements of the current law in Northern Ireland/ Republic of Ireland; and

16 Marks

(b) Draft the note to the accounts backing up the heading 'Profit on ordinary activities before taxation' included in the profit and loss account prepared at (a) above.

4 Marks

Total 20 Marks

N. B. *You are not required to prepare other 'notes to the accounts' other than the note on 'Profit on ordinary activities before taxation'.*

You are required to prepare workings to back up the figures included in the profit and loss account. Marks will be awarded for presentation.

QUESTION 3

The following extracts are from the management accounts of LEATHER GOODS Ltd. a retailer of shoes and handbags, for the year ended 31st December 2007:

TRADING & PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31st DECEMBER

	Shoes		Handbags		Total	
	£/€	£/€	£/€	£/€	£/€	£/€
Sales		180,000		240,000		420,000
Cost of goods sold						
Opening Stock.....	72,000		66,000		138,000	
Purchases.....	72,000		108,000		180,000	
	<u>144,000</u>		<u>174,000</u>		<u>318,000</u>	
Closing stock.....	48,000		54,000		102,000	
		<u>96,000</u>		<u>120,000</u>		<u>216,000</u>
Gross profit		<u>84,000</u>		<u>120,000</u>		<u>204,000</u>
Expenses.....						<u>72,000</u>
						<u>132,000</u>

BALANCE SHEET AS AT 31st DECEMBER

	2007		2006	
	£/€	£/€	£/€	£/€
Fixed assets:				
Premises		504,000		306,000
Plant and machinery.....		36,000		36,000
		<u>540,000</u>		<u>342,000</u>
Current assets:				
Stock.....	102,000		138,000	
Debtors.....	168,000		90,000	
Bank balance.....	-		36,000	
	<u>270,000</u>		<u>264,000</u>	
Creditors: Amounts falling due within 1 year:				
Trade creditors	90,000		114,000	
Bank overdraft	36,000		-	
	<u>126,000</u>		<u>114,000</u>	
Net current assets.....		<u>144,000</u>		<u>150,000</u>
		<u>684,000</u>		<u>492,000</u>
Financed by.....				
Share Capital.....		360,000		300,000
Profit and Loss account		144,000		12,000
		<u>504,000</u>		<u>312,000</u>
10% Debentures		180,000		180,000
		<u>684,000</u>		<u>492,000</u>

Requirements

You are required to:

- (a) Calculate appropriate liquidity and profitability ratios for LEATHER GOODS Ltd. **7 Marks**
- (b) Comment on the liquidity of LEATHER GOODS Ltd. **7 Marks**
- (c) Indicate whether LEATHER GOODS Ltd. should concentrate on selling shoes or handbags and why. **6 Marks**

Total 20 Marks

QUESTION 4

TREES Ltd. is preparing its budgets for the three months ended 30th September 2008.

At 30th June 2008, the following information is available from the accounting records:

Stock of raw materials at 30 th June 2008	£/€1,000
Stock of finished goods at 30 th June 2008	170 units
 Debtors at 30 th June 2008	
re: April credit sales of £/€3,300	£/€1,100
re: May credit sales of £/€3,600	£/€2,400
re: June credit sales	£/€4,200
 Creditors at June 30 th 2008	
re: June purchases of raw materials	£/€1,200
re: June variable overheads	£/€800
Bank balance at 30 th June 2008	£/€600

The budgets for the *three* months to 30th September 2008 are as follows:

- (1) Sales will be as follows:

Month	Units	@ £/€ per unit
July	280	33
August	290	36
September	310	39

One half of the sales are cash sales. The remaining sales are credit sales and will be paid, one third in each of the three months following sale.

- (2) Production will be as follows:

Month	Units
July	300
August	310
September	300

- (3) Production costs will be as follows:

Production Costs	@ £/€ per unit
Direct Materials	10.40
Direct labour	3.20
Variable overheads	3.10

Purchases of raw materials will be as follows:

Months	£/€
July	2,900
August	3,000
September	3,100

- (5) Fixed production overheads will be £/€360 per month and will be paid in the month incurred.
- (6) Creditors in respect of raw materials and variable overheads will be paid one month after the costs are incurred.
- (7) Direct labour is paid in the month incurred.

The company owns computers which cost £/€40,000 four years ago. During July 2008 £/€60,000 will be spent on new computers and the old computers will be sold for £/€12,000. The new computers will be partly financed by a separate bank loan of £/€50,000 to be received in July.

From 1st July 2008, depreciation will be charged on the new computers at 10% per annum (no depreciation on the old computers).

QUESTION 4 (Cont'd.)

Requirements

Prepare each of the following budgets, on a month-by-month basis, for the three months ended 30th September 2008:

- | | |
|----------------------------------|-----------------------|
| (a) Sales budget | 2 Marks |
| (b) Production budget (in units) | 3 Marks |
| (c) Production cost budget | 3 Marks |
| (d) Materials purchases budget | 3 Marks |
| (e) Cash budget | 9 Marks |
| | <u>Total 20 Marks</u> |

SECTION B

Answer EITHER Question 5 OR Question 6 in this Section

QUESTION 5

Explain your understanding of each of the following statements in the context of the Financial Reporting Standards issues by the Accounting Standards Board (give practical examples as appropriate).

- | | |
|---|-----------------------|
| (a) In valuing stocks, for inclusion in the financial statements, they should be valued at the lower of cost or net realisable value on an item by item basis. | 3 Marks |
| (b) An entity should prepare its financial statements on the assumption that the entity is a 'going concern' at the balance sheet date. | 4 Marks |
| (c) Most fixed assets have a 'finite life' and should be written down to their residual value by the date that it is anticipated that they will be of no further use. | 4 Marks |
| (d) Government grants should be distinguished between those that are of a capital and those of a revenue nature. | 4 Marks |
| | <u>Total 15 Marks</u> |

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] to [4]

BROOKS Ltd. prepares its accounts to the 31st December 2007. The following information should be used to answer questions [1] to [4]

	Cost 1/1/2007 £/€	Accumulated Depreciation 1/1/2007 £/€	Basis of Depreciation
Freehold premises	1,400,000	140,000	4% P.A on cost
Leasehold premises, 10yr lease	300,000	60,000	Over the period of the lease
Plant and machinery	240,000	48,000	10% P.A on cost
I.T. Equipment	45,000	30,000	25% reducing balance method

It is the company policy to provide a full year's depreciation in the year of purchase and none in the year of sale, with the exception of leasehold premises, which are depreciated on a strict time basis.

- [1] The charge for depreciation of freehold premises for the year ended 31st December 2007 will be:
- (a) £/€50,400
 - (b) £/€56,000
 - (c) £/€5,040
 - (d) £/€5,600
- [2] On 1st April 2007 the company leased a second premises at a cost of £/€120,000 on a 5 year lease from that date. The total charge for depreciation of leasehold premises for the year ended 31st December 2007 will be:
- (a) £/€48,000
 - (b) £/€54,000
 - (c) £/€42,000
 - (d) £/€60,000
- [3] During 2007 the company sold, for £/€9,000, some IT equipment which cost £/€20,000 in March 2005. The profit/Loss on disposal was:
- (a) Profit of £/€1,000
 - (b) Loss of £/€1,000
 - (c) Profit of £/€2,250
 - (d) Loss of £/€2,250

QUESTION 6 (Cont'd.)

- [4] On the 1st January 2007 the company decided that the remaining effective useful life of the plant and machinery had reduced from 8 to 6 years. The charge for depreciation of plant and machinery for the year ended 31st December 2007 will be:
- (a) £/€24,000
 - (b) £/€32,000
 - (c) £/€40,000
 - (d) £/€60,000

- [5] If an item costs £/€30,000 and is sold for £/€40,000, then:
- (a) the mark up is 33% and the gross profit percentage is 25%
 - (b) the mark up is 25% and the gross profit percentage is 33%
 - (c) the mark up and gross profit percentage is 25%
 - (d) the mark up and gross profit percentage is 33%

SUB-SECTION B – 1 MARK PARTS

- [6] If a business sells some goods on which it charges V.A.T and sells other goods which are exempt from VAT, then, in respect of VAT on purchases:
- (a) none of the VAT on purchases can be recovered
 - (b) all of the VAT on purchases can be recovered
 - (c) only the VAT on purchases relating to the sale of goods on which it charges VAT can be recovered
 - (d) only the VAT on purchases relating to the sale of exempt goods can be recovered
- [7] If a business decides not to put a value on small stocks of stationery items, such as paper clips, in its accounts at the year end then it is applying the:
- (a) prudence concept
 - (b) entity concept
 - (c) materiality concept
 - (d) going concern concept
- [8] Which of the following could 'not' result in a loss on the disposal of a fixed asset:
- (a) a rate of depreciation which was too low
 - (b) an incorrect estimate of the residual value of the asset
 - (c) an incorrect estimate of the useful life of the asset
 - (d) disposal for cash of the asset which had a zero book value
- [9] If a golf club does not account for the subscriptions due (to the club) but unpaid by its members at the year end, then it is applying the:
- (a) going concern concept
 - (b) accruals concept
 - (c) consistency concept
 - (d) prudence concept
- [10] Under the provisions of S.S.A.P. 9 *Stocks and Work-in-Progress* (I.A.S.2 Inventories) which of the following is 'not' acceptable in arriving at the cost of stock:
- (a) F.I.F.O
 - (b) L.I.F.O
 - (c) average cost
 - (d) actual cost

STANDARD ANSWER SHEET FOR ALL MULTIPLE CHOICE QUESTIONS

THE INSTITUTE OF
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IN IRELAND



Candidates are required to insert the following details:

Examination Session

Examination Number.....

Examination Part

Examination Paper.....

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 2008

SOLUTIONS TO PAPER 6

ACCOUNTS II

Author : Mr Brian Hayden, FCA

Solution to question 1

Realisation Account

	£/€		£/€
Freehold premises	750	Creditors	87
Stocks	65	Accrued expenses	7
Debtors	94	Bank : Motor car sale	15
Prepaid expenses	5	Cap.a/c Trev.: Comp.Equip	35
Loan to Robin	25	Cap.a/c Paul : Motor veh.	30
Motor vehicles	85	Cap.a/c Robin : Motor veh.	30
Computer equipment	220	Bank loan	200
Conversion expenses	20		
Profit on revaluation		P.R.T. Ltd.	1,000
Paul	56		
Robin	56		
Trevor	28		
	<u>140</u>		
	<u>1,404</u>		<u>1,404</u>

Capital Accounts

	P	R	T		P	R	T
	£/€	£/€	£/€		£/€	£/€	£/€
Bal b/d : Curr.a/c	-	30	-	Bal b/d : Cap a/c	300	300	300
Real a/c : Comp Eq.			35	Curr.a/c	40	-	26
Real a/c : Mot.Veh.	30	30		Profit on realisation	56	56	28
PRT Ltd. Ord. Shares	160	160	80				
Debenture Stock	200	200	200	Bank		64	
Bank	6		39				
	<u>396</u>	<u>420</u>	<u>354</u>		<u>396</u>	<u>420</u>	<u>354</u>

Solution to question 1 continued on next page

Solution to question 1 (Cont'd)

Bank and Cash Account

	£/€		£/€
Cash Bal b/d	3	Bank bal b/d	17
Sale of car	15	Conversion expenses	20
Capital a/c : Robin	64	Capital a/c : Trevor	39
		Capital a/c : Paul	6
	<u>82</u>		<u>82</u>

PRT Limited
Balance Sheet as at 31st December 2008

	£/€	£/€	£/€
Fixed Assets			
Freehold premises			750
Computer Equipment			<u>180</u>
			930
Goodwill (W1)			<u>175</u>
			1,105
Current Assets			
Stock		65	
Debtors		94	
Prepaid expenses		5	
Loan to Robin		<u>25</u>	
		189	
Current Liabilities			
Creditors	87		
Accrued expenses	<u>7</u>		
		(94)	
Net Current Assets			<u>95</u>
			1,200
Financed by:			
Share Capital : Ordinary shares			400
Debenture Stock			600
Bank Loan : Jones Bank Ltd.			200
			<u>1,200</u>

Working :

Proof of Goodwill

Purchase consideration		1,000	
Net assets acquired			
Freehold premises	750		
Computer equipment	180		
Stock	65		
Debtors	94		
Prepayments	5		
Loan to Robin	25		
Creditors	(87)		
Accrued expenses	(7)		
Loan : Jones Bank Ltd.	<u>(200)</u>		
		825	
Goodwill		<u>175</u>	

Solution to question 2(a)

Beta Ltd.

Profit and loss account for the year ended 31st December 2007

	£/€'000
Turnover (W.1)	7,320
Cost of sales (W.2)	<u>(3,118)</u>
Gross profit	4,202
Distribution costs (W.3)	(1,493)
Administration expenses (W.4)	<u>(713)</u>
	1,996
Other operating income (W.5)	152
Interest payable (W.6)	<u>(138)</u>
Profit on ordinary activities before taxation	2,010
Taxation (W.7)	<u>(968)</u>
Profit on ordinary activities after taxation	1,042
Transfer to general reserve	(80)
Dividends paid	<u>(180)</u>
Retained profit for the year	782
Retained profit forward at 1 st January 2007	<u>300</u>
Retained profit forward at 31 st December 2007	<u><u>1,082</u></u>

Solution to question 2 continued on next page

Solution to question 2(b)

Beta Limited
Notes to the Accounts

Note 1

Profit on ordinary activities before taxation

The profit on ordinary activities before taxation has been arrived at after charging/ (crediting):

Depreciation	£/€ 160
Auditors remuneration	48
Directors remuneration	110
Wages and salaries	179

Workings:

(1)	Turnover	£/€
	Per T/B	7,200
	Add; Unrecorded sales (132,000 *100/110)	<u>120</u>
		<u>7,320</u>
(2)	Cost of sales	
	Opening stock	225
	Add : Purchases	<u>3,300</u>
		<u>3,525</u>
	Less : Closing stock	
	Product A 135	
	Product B 70	
	Product C <u>202</u>	<u>(407)</u>
		<u>3,118</u>
(3)	Distribution costs	
	Per T/B	1,450
	Add : Accrued expenses	<u>43</u>
		<u>1,493</u>
(4)	Administration expenses	
	Per T/B	610
	Add : Accrued expenses	<u>23</u>
		633
	Less : Training grant	<u>(30)</u>
		<u>603</u>
	Add : Directors emoluments	<u>110</u>
		<u>713</u>
(5)	Other operating income	
	Royalty income(62 + 37)	99
	Deposit interest received	<u>53</u>
		<u>152</u>
(6)	Interest payable	
	Bank interest (54 + 24)	78
	Debenture interest	<u>60</u>
		<u>138</u>
(7)	Taxation	
	Tax on current years profit	950
	Underprovided in previous year	<u>18</u>
		<u>968</u>

Solution to question 3

(a)	2007	2006	
Current ratio			
270,000/126,000	2.14 : 1		
264,000/114,000		2.32 : 1	
Acid test ratio			
168,000/126,000	1.33 : 1		
126,000/114,000		1.10 : 1	
Gross profit %			
84,000 * 100 / 180,000	Shoes 46.7	Handbags	Total
120,000 * 100 / 240,000		50.0%	
204,000 * 100 / 420,000			48.6%
Net profit %			
132,000 * 100 / 420,000			31.4%

(b)

The short term liquidity of Leather goods has, as can be seen from the current ratio, reduced slightly in 2007 but is still very good. Indeed, the acid test ratio has improved marginally due to the change in the proportion of stocks held at each year end.

The company has managed to keep its short term liquidity on line despite a substantial increase in its investment in fixed assets This investment has been financed by means of **(a)** an issue of ordinary shares and **(b)** out of cash generated from profits.

(c)

The company makes a marginally better gross margin on the sale of handbags over the sale of shoes. However both products are complimentary to each other and it would be advantageous from a marketing point of view to continue to offer customers both products as many people who come in to buy a handbag may buy shoes as well and *vice versa*.

Solution to question 4

(a) Sales budget

		£/€
July	280 @ 33	9,240
Aug	290 @ 36	10,440
Sept	310 @ 39	<u>12,090</u>
		<u>31,770</u>

(b) Production budget (in units)

	July £/€	Aug £/€	Sept £/€	Total £/€
Opening stock	170	190	210	170
Production	300	310	300	910
	<u>470</u>	<u>500</u>	<u>510</u>	<u>1,080</u>
Sales	(280)	(290)	(310)	(880)
Closing stock	<u>190</u>	<u>210</u>	<u>200</u>	<u>200</u>

(c) Production cost budget

Direct materials	3,120	3,224	3,120	9,464
Direct labour	960	992	960	2,912
Variable overheads	930	961	930	2,821
Fixed overheads	360	360	360	1,080
Depreciation	500	500	500	1,500
	<u>5,870</u>	<u>6,037</u>	<u>5,870</u>	<u>17,777</u>

(d) Materials purchases budget

Opening stock	1,000	780	556	1,000
Purchases	<u>2,900</u>	<u>3,000</u>	<u>3,100</u>	<u>9,000</u>
	<u>3,900</u>	<u>3,780</u>	<u>3,656</u>	<u>10,000</u>
Used in production	(3,120)	(3,224)	(3,120)	(9,464)
Closing stock	<u>780</u>	<u>556</u>	<u>536</u>	<u>536</u>

(e) Cash budget

	July £/€	Aug £/€	Sept £/€	Total £/€
Receipts				
Bank loan	50,000	-	-	50,000
Sale of computer	12,000	-	-	12,000
Cash sales	4,620	5,220	6,045	15,885
Credit sales (working)	<u>3,700</u>	<u>4,140</u>	<u>4,680</u>	<u>12,520</u>
	<u>70,320</u>	<u>9,360</u>	<u>10,725</u>	<u>90,405</u>
Payments				
Materials	1,200	2,900	3,000	7,100
Direct labour	960	992	960	2,912
Variable overheads	800	930	961	2,691
Fixed overhead	360	360	360	1,080
New machine	60,000	-	-	60,000
	<u>63,320</u>	<u>5,182</u>	<u>5,281</u>	<u>73,783</u>
Net inflows	7,000	4,178	5,444	16,622
Opening balance	600	7,600	11,778	600
Closing balance	<u>7,600</u>	<u>11,778</u>	<u>17,222</u>	<u>17,222</u>

Solution to question 4 continued on next page

Solution to question 4 (Cont'd)

Working:

Receipts from credit sales

	July	Aug	Sept
	£/€	£/€	£/€
April credit sales	1,100		
May credit sales	1,200	1,200	
June “ “	1,400	1,400	1,400
July “ “		1,540	1,540
Aug “ “			1,740
	3,700	4,140	4,680

Solution to question 5

- (a) Stocks should be valued at the lower of cost or net realisable value in order to ensure that any potential loss is accounted for as soon as it is anticipated. They should be valued on an item by item basis in order to ensure that a loss on one product will not be set off against a profit on another product.

An example of the above is as follows:

	Product A	Product B	Total
	£/€	£/€	£/€
Cost	100	120	220
Net Realisable Value	90	125	215

The correct valuation in the above circumstances is 210 (i.e. 90 + 120), the lower of cost or net realizable value for each product.

- (b) The reader of the accounts of a business is entitled to assume that the accounts were prepared on the basis that the business was a going concern, i.e. was likely to continue in operation for the foreseeable future, unless stated otherwise.

The importance of the above assumption is that if the company was not a going concern then the assets would most likely have a lower value as they would have to be disposed of quickly.

- (c) Fixed assets with the exception of freehold land will eventually lose their value due to wear and tear or obsolescence and therefore their cost or valuation should be written off in the profit and loss account as an expense over the life of the asset. This is the application of the matching concept. The method used to write down the fixed asset to its residual should be the one that most fairly represents the rate of consumption of the asset's economic value.
- (d) Revenue grants are grants towards the cost of revenue expenditure (i.e. training grants). Capital grants are grants towards the cost of capital expenditure.(i.e. towards the cost of fixed assets) It is important that government grants are distinguished between the two types as they should be accounted for differently. Revenue grants should be expensed to profit and loss account in the same period as the related expense is incurred. Capital grants should be amortised to the profit and loss account at the same rate as the related fixed asset is depreciated either by **(a)** deducting the grant from the initial cost of the fixed asset and depreciating the net cost or **(b)** by treating the grant as a deferred credit and crediting it to profit on the same basis as the related fixed asset is depreciated

Solution to question 6

- [1] (b) [2] (a) [3] (d) [4] (b) [5] (a)
 [6] (c) [7] (c) [8] (d) [9] (d) [10] (b)

Workings ; (Not required by students)

(1) $1,400,000 * 4\% = 56,000$
Answer is (b)

(2)

Second premises	£/€	
$120,000 / 5 = 24,000 * 9/12$	= 18,000	
First premises		
$300,000 / 10 =$	<u>30,000</u>	
	<u>48,000</u>	

Answer is (a)

(3)

Cost	20,000	
Depreciation 2005 25%	<u>5,000</u>	
	15,000	
Depreciation 2006 $150,00 * 25\%$	<u>3,750</u>	
	11,250	
Selling price	<u>9,000</u>	
Loss	<u>2,250</u>	

Answer is (d)

(4)

Net Book Amount of Plant
 and Machinery at 1/1/2007 $240,000 - 48,000 = 192,000$

$192,000 / 6 = 32,000$

Answer is (b)

(5)

Profit is $40,000 - 30,000 = 10,000$

Mark up is $10,000 * 100/30,000 = 33 \frac{1}{3}\%$

Gross profit percentage is $10,000 * 100/40,000 = 25\%$

Answer is (a)

EXAMINERS REPORT

ACCOUNTS II

Summer 2008

General comment

The overall standard of answer was a reasonably good with an average mark of 57%. Questions 1 and 4 were well answered but questions 2 and 3 were poorly answered.

Question 1

This partnership question was well answered by most candidates with an average mark of 60% . The area of the question which caused candidates most difficulty was the computation of the goodwill paid by the new company and its inclusion in the balance sheet of the company. Also quite a number of candidates did not divide up the shares and debentures as instructed in the question.

Question 2

This question which required candidates to prepare the profit and loss account in the correct format was poorly answered with an average mark of 45%. In particular, the majority of candidates either failed to answer part (b) of the question or to understand what was required. It would appear that most students do not know what 'Notes to the accounts,' are. Also many candidates were unable to deal with the taxation charge correctly.

Many candidates were also unable to deal with the sales omitted. Many candidates miscalculated the "VAT Exclusive" sales of 120,000 ($132,000 * 100/1,100$). They should then have been added to sales in the profit and loss account.

Question 3

Surprisingly, this straightforward analysis and interpretation of accounts question was also poorly answered including the calculation of basic ratios such as the gross profit and net profit ratios. Many candidates also misread the question as stating that the balance sheets for the current and comparative years were balance sheets for the shoes and handbags divisions.

Question 4

This budgeting question was well answered with an average mark of 66%. The principle error made was, as usual with this type of question, in respect of the treatment of depreciation. Depreciation is not a cash transaction and should therefore not appear in the cash budget. It is however a cost and therefore should be included in the appropriate cost budget.

Question 5

Only a small number of candidates answered the discursive question which was generally well answered.

Question 6

The multiple choice question was attempted by the vast majority of students caused few problems.

