Preparing Financial Statements

(International Stream)

Paper 1.1 (INT)

PART 1

THURSDAY 9 JUNE 2005

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into two sections

Section A	ALL 25 questions are compulsory and MUST be answered
Section B	ALL FIVE questions are compulsory and MUST be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Section A – All 25 questions are compulsory and MUST be attempted

Please use the Candidate Registration Sheet provided to indicate your chosen answer to each multiple choice question. Each question within this section is worth 2 marks.

1 B, a limited liability company, receives rent for subletting part of its office premises to a number of tenants.

In the year ended 31 December 2004 B received cash of $318,600 from its tenants.

Details of rent in advance and in arrears at the beginning and end of 2004 are as follows:

	31 December 2004	31 December 2003
	$	$
Rent received in advance	28,400	24,600
Rent owing by tenants	18,300	16,900

All rent owing was subsequently received

What figure for rental income should be included in the income statement of B for 2004?

A $341,000

B $336,400

C $300,800

D $316,200

2 The following information is available for the year ended 31 December 2004 for a trader who does not keep proper accounting records:

	$
Inventories at 1 January 2004	38,000
Inventories at 31 December 2004	45,000
Purchases	637,000
Gross profit percentage on sales	30%

Based on this information, what was the trader's sales figure for the year?

A $900,000

B $819,000

C $920,000

D $837,200

3 The following bank reconciliation statement has been prepared for a company:

	$
Overdraft per bank statement	39,800
add: Deposits credited after date	64,100
	103,900
less: Outstanding cheques presented after date	44,200
Overdraft per cash book	59,700

Assuming the amount of the overdraft per the bank statement of $39,800 is correct, what should be the balance in the cash book?

A $158,100 overdrawn

B $19,900 overdrawn

C $68,500 overdrawn

D $59,700 overdrawn as stated

4 **Which, if any, of the following journal entries is correct according to their narratives?**

		Dr $	Cr $
(1)	B receivables ledger account	450	
	Bad debts account		450
	Irrecoverable balance written off		
(2)	Investments: Q ordinary shares	100,000	
	Share capital		100,000
	80,000 shares of 50c each issued at $1·25 in exchange for shares in Q.		
(3)	Suspense account	1,000	
	Motor vehicles account		1,000
	Correction of error – debit side of Motor vehicles account undercast by $1,000		

A None of them

B 1 only

C 2 only

D 3 only

5 An enterprise has made a material change to an accounting policy in preparing its current financial statements.

Which of the following disclosures are required by IAS 8 *Accounting policies, changes in accounting estimates and errors* in these financial statements?

1 The reasons for the change.
2 The amount of the consequent adjustment in the current period and in comparative information for prior periods.
3 An estimate of the effect of the change on future periods, where possible.

A 1 and 2 only

B 1 and 3 only

C 2 and 3 only

D All three items

6 At 31 December 2003 Q, a limited liability company, owned a building that had cost $800,000 on 1 January 1994. It was being depreciated at two per cent per year.

On 31 December 2003 a revaluation to $1,000,000 was recognised. At this date the building had a remaining useful life of 40 years.

Which of the following pairs of figures correctly reflects the effects of the revaluation?

	Depreciation charge for year ended 31 December 2004	Revaluation reserve as at 31 December 2003
	$	$
A	25,000	200,000
B	25,000	360,000
C	20,000	200,000
D	20,000	360,000

7 The inventory value for the financial statements of Q for the year ended 31 December 2004 was based on an inventory count on 4 January 2005, which gave a total inventory value of $836,200.

Between 31 December and 4 January 2005, the following transactions took place:

	$
Purchases of goods	8,600
Sales of goods (profit margin 30% on sales)	14,000
Goods returned by Q to supplier	700

What adjusted figure should be included in the financial statements for inventories at 31 December 2004?

A $838,100

B $853,900

C $818,500

D $834,300

8 P and Q are in partnership, sharing profits in the ratio 2:1. On 1 July 2004 they admitted P's son R as a partner. P guaranteed that R's profit share would not be less than $25,000 for the six months to 31 December 2004. The profit-sharing arrangements after R's admission were P 50%, Q 30%, R 20%. The profit for the year ended 31 December 2004 is $240,000, accruing evenly over the year.

What should P's final profit share be for the year ended 31 December 2004?

A $140,000

B $139,000

C $114,000

D $139,375

9 **Which of the following items must be disclosed in a company's published financial statements (including notes) if material, according to IAS1 *Presentation of financial statements*?**

1 Finance costs.
2 Staff costs.
3 Depreciation and amortisation expense.
4 Movements on share capital.

A 1 and 3 only

B 1, 2 and 4 only

C 2, 3 and 4 only

D All four items

10 **Which of the following costs should be included in valuing inventories of finished goods held by a manufacturing company, according to IAS2 *Inventories*?**

1 Carriage inwards.
2 Carriage outwards.
3 Depreciation of factory plant.
4 Accounts department costs relating to wages for production employees.

A All four items

B 2 and 3 only

C 1, 3 and 4 only

D 1 and 4 only

11 During 2004, B, a limited liability company, paid a total of $60,000 for rent, covering the period from 1 October 2003 to 31 March 2005.

What figures should appear in the company's financial statements for the year ended 31 December 2004?

	Income statement	Balance sheet
A	$40,000	Prepayment $10,000
B	$40,000	Prepayment $15,000
C	$50,000	Accrual $10,000
D	$50,000	Accrual $15,000

12 Wanda keeps no accounting records. The following information is available about her position and transactions for the year ended 31 December 2004:

	$
Net assets at 1 January 2004	210,000
Drawings during 2004	48,000
Capital introduced during 2004	100,000
Net assets at 31 December 2004	400,000

Based on this information, what was Wanda's profit for 2004?

A $42,000

B $242,000

C $138,000

D $338,000

13 The following receivables ledger control account has been prepared by a trainee accountant:

Receivables ledger control account

2005		$	2005		$
1 Jan	Balance	318,650	31 Jan	Cash from credit customers	181,140
	Credit sales	161,770		Interest charged on overdue accounts	280
				Bad debts written off	1,390
	Cash sales	84,260		Sales returns from credit customers	3,990
	Discounts allowed to credit customers	1,240		Balance	379,120
		565,920			565,920

What should the closing balance at 31 January 2005 be after correcting the errors in the account?

A $292,380

B $295,420

C $292,940

D $377,200

14 At 31 December 2004 a company's trade receivables totalled $864,000 and the allowance for doubtful debts was $48,000.

It was decided that debts totalling $13,000 were to be written off, and the allowance for doubtful debts adjusted to five per cent of the receivables.

What figures should appear in the balance sheet for trade receivables (after deducting the allowance) and in the income statement for the total of bad and doubtful debts?

	Income statement Bad and doubtful debts $	Balance sheet Net trade receivables $
A	8,200	807,800
B	7,550	808,450
C	18,450	808,450
D	55,550	808,450

15 A trader who fixes her prices by adding 50% to cost actually achieved a mark-up of 45%.

Which of the following factors could account for the shortfall?

1 Sales were lower than expected.
2 The opening inventories had been overstated.
3 The closing inventories of the business were higher than the opening inventories.
4 Goods taken from inventories by the proprietor were recorded by debiting drawings and crediting purchases with the cost of the goods.

A All four factors

B 1, 2 and 4 only

C 2 only

D 3 and 4 only

16 Which of the following statements about accounting concepts and conventions are correct?

(1) The entity concept requires that a business is treated as being separate from its owners.
(2) The use of historical cost accounting tends to understate assets and profit when prices are rising.
(3) The prudence concept means that the lowest possible values should be applied to income and assets and the highest possible values to expenses and liabilities.
(4) The money measurement concept means that only assets capable of being reliably measured in monetary terms can be included in the balance sheet of a business.

A 1 and 2

B 2 and 3

C 3 and 4

D 1 and 4

17 A business income statement for the year ended 31 December 2004 showed a net profit of $83,600. It was later found that $18,000 paid for the purchase of a motor van had been debited to motor expenses account. It is the company's policy to depreciate motor vans at 25 per cent per year, with a full year's charge in the year of acquisition.

What would the net profit be after adjusting for this error?

A $106,100

B $70,100

C $97,100

D $101,600

18 How should interest charged on partners' drawings appear in partnership financial statements?

A As income in the income statement

B Added to net profit and charged to partners in the division of profit

C Deducted from net profit and charged to partners in the division of profit

D Deducted from net profit in the division of profit and credited to partners

19 Which of the following statements about intangible assets in company financial statements are correct according to international accounting standards?

1 Internally generated goodwill should not be capitalised.
2 Purchased goodwill should normally be amortised through the income statement.
3 Development expenditure must be capitalised if certain conditions are met.

A 1 and 3 only

B 1 and 2 only

C 2 and 3 only

D All three statements are correct

20 Which of the following events occurring after the balance sheet date are classified as adjusting, if material?

1 The sale of inventories valued at cost at the balance sheet date for a figure in excess of cost.
2 A valuation of land and buildings providing evidence of an impairment in value at the year end.
3 The issue of shares and loan notes.
4 The insolvency of a customer with a balance outstanding at the year end.

A 1 and 3

B 2 and 4

C 2 and 3

D 1 and 4

21 Which of the following statements about contingent assets and contingent liabilities are correct?

1 A contingent asset should be disclosed by note if an inflow of economic benefits is probable.
2 A contingent liability should be disclosed by note if it is probable that a transfer of economic benefits to settle it will be required, with no provision being made.
3 No disclosure is required for a contingent liability if it is not probable that a transfer of economic benefits to settle it will be required.
4 No disclosure is required for either a contingent liability or a contingent asset if the likelihood of a payment or receipt is remote.

A 1 and 4 only

B 2 and 3 only

C 2, 3 and 4

D 1, 2 and 4

22 Which of the following statements about limited liability companies' accounting is/are correct?

1 A revaluation reserve arises when a non-current asset is sold at a profit.
2 The authorised share capital of a company is the maximum nominal value of shares and loan notes the company may issue.
3 The notes to the financial statements must contain details of all adjusting events as defined in IAS10 *Events after the balance sheet date*.

A All three statements

B 1 and 2 only

C 2 and 3 only

D None of the statements

The following information is relevant for questions 23 and 24:

On 1 January 2004, J, a limited liability company, acquired 80% of the ordinary share capital of K, another limited liability company, for $160,000.

The balance sheets of the two companies at 31 December 2004 were as follows:

	J	K
	$	$
Net assets	130,000	120,000
Investment in K	160,000	–
	290,000	120,000
Issued share capital	200,000	50,000
Retained earnings		
At 31 December 2003	40,000	30,000
Profit for 2004	50,000	40,000
	290,000	120,000

Goodwill as calculated at 1 January 2004 is to be reduced in value by $24,000 because of impairment during 2004.

23 What figure should appear in the consolidated balance sheet of the J group as at 31 December 2004 for goodwill?

A $48,000

B $96,000

C $72,000

D $64,000

24 What figure should appear in the consolidated balance sheet of the J group as at 31 December 2004 for minority interest?

A $32,000

B $16,000

C $10,000

D $24,000

25 On 1 April 2000, X, a limited liability company, paid $120,000 for 48,000 $1 shares in Y, another limited liability company, representing 80% of Y's $60,000 share capital. The retained earnings of Y at that date were $70,000.

At 31 March 2005 the retained earnings of the companies were:

	$
X	180,000
Y	100,000

All goodwill arising has been written off because of impairment.

What figure should appear in the consolidated balance sheet of the X group at 31 March 2005 for retained earnings?

A $208,000

B $8,000

C $204,000

D $188,000

(50 marks)

Section B – ALL FIVE questions are compulsory and MUST be attempted

1 The draft balance sheet shown below has been prepared for Shuswap, a limited liability company, as at 31 December 2004:

	Cost	Accumulated depreciation	Net book value
Assets	$000	$000	$000
Non-current assets			
Land and buildings	9,000	1,000	8,000
Plant and equipment	21,000	9,000	12,000
	30,000	10,000	20,000
Current assets			
Inventories			3,000
Receivables			2,600
Cash at bank			1,900
Total assets			27,500
Equity and liabilities			
Capital and reserves			
Issued share capital (ordinary shares of 50c each)			6,000
Retained earnings			12,400
Non-current liabilities			
Loan notes (redeemable 2010)			2,000
Current liabilities			
Trade payables			2,100
			22,500
Suspense account			5,000
			27,500

The following further information is available:

1 It has been decided to revalue the land and buildings to $12,000,000 at 31 December 2004.
2 Trade receivables totalling $200,000 are to be written off.
3 During the year there was a contra settlement of $106,000 in which an amount due to a supplier was set off against the amount due from the same company for goods sold to it. No entry has yet been made to record the set-off.
4 Some inventory items included in the draft balance sheet at cost $500,000 were sold after the balance sheet date for $400,000, with selling expenses of $40,000.
5 The suspense account is made up of two items:
   (a) The proceeds of issue of 4,000,000 50c shares at $1·10 per share, credited to the suspense account from the cash book.
   (b) The balance of the account is the proceeds of sale of some plant on 1 January 2004 with a net book value at the date of sale of $700,000 and which had originally cost $1,400,000. No other accounting entries have yet been made for the disposal apart from the cash book entry for the receipt of the proceeds.
   Depreciation on plant has been charged at 25% (straight line basis) in preparing the draft balance sheet without allowing for the sale. The depreciation for the year relating to the plant sold should be adjusted for in full.

Required:

Prepare the company's balance sheet as at 31 December 2004, complying as far as possible with IAS1 *Presentation of financial statements*.

Details of non-current assets, adjusted appropriately, should appear as they are presented in the question.

(12 marks)

2 The draft financial statements of Choctaw, a limited liability company, for the year ended 31 December 2004 showed a profit of $86,400. The trial balance did not balance, and a suspense account with a credit balance of $3,310 was included in the balance sheet.

In subsequent checking the following errors were found:

(a) Depreciation of motor vehicles at 25 per cent was calculated for the year ended 31 December 2004 on the reducing balance basis, and should have been calculated on the straight-line basis at 25 per cent.
Relevant figures:
Cost of motor vehicles $120,000, net book value at 1 January 2004, $88,000

(b) Rent received from subletting part of the office accommodation $1,200 had been put into the petty cash box. No receivable balance had been recognised when the rent fell due and no entries had been made in the petty cash book or elsewhere for it. The petty cash float in the trial balance is the amount according to the records, which is $1,200 less than the actual balance in the box.

(c) Bad debts totalling $8,400 are to be written off.

(d) The opening accrual on the motor repairs account of $3,400, representing repair bills due but not paid at 31 December 2003, had not been brought down at 1 January 2004.

(e) The cash discount totals for December 2004 had not been posted to the discount accounts in the nominal ledger. The figures were:

	$
Discount allowed	380
Discount received	290

After the necessary entries, the suspense account balanced.

Required:

Prepare journal entries, with narratives, to correct the errors found, and prepare a statement showing the necessary adjustments to the profit.

(10 marks)

3 The following information is available for Sioux, a limited liability company:

Balance sheets

	31 December			
	2004		2003	
	$000	$000	$000	$000
Non-current assets				
Cost or valuation		11,000		8,000
Accumulated depreciation		(5,600)		(4,800)
Net book value		5,400		3,200
Current assets				
Inventories	3,400		3,800	
Receivables	3,800		2,900	
Cash at bank	400	7,600	100	6,800
		13,000		10,000
Equity and liabilities				
Capital and reserves				
Ordinary share capital	1,000		1,000	
Revaluation reserve	1,500		1,000	
Retained earnings	3,100	5,600	2,200	4,200
Non-current liabilities				
10% Loan notes		3,000		2,000
Current liabilities				
Trade payables	3,700		3,200	
Income tax	700	4,400	600	3,800
		13,000		10,000

Summarised income statement for the year ended 31 December 2004

	$000
Profit from operations	2,650
Finance cost (loan note interest)	(300)
	2,350
Income tax expense	(700)
Net profit for the period	1,650

Notes

(1) During the year non-current assets which had cost $800,000, with a net book value of $350,000, were sold for $500,000.

(2) The revaluation surplus arose from the revaluation of some land that was not being depreciated.

(3) The 2003 income tax liability was settled at the amount provided for at 31 December 2003.

(4) The additional loan notes were issued on 1 January 2004. Interest was paid on 30 June 2004 and 31 December 2004.

(5) Dividends paid during the year amounted to $750,000.

Required:

Prepare the company's cash flow statement for the year ended 31 December 2004, using the indirect method, adopting the format in IAS7 *Cash flow statements*.

(11 marks)

4 **(a)** A company may choose to finance its activities mainly by equity capital, with low borrowings (low gearing) or by relying on high borrowings with relatively low equity capital (high gearing).

Required:

Explain why a highly geared company is generally more risky from an investor's point of view than a company with low gearing. (3 marks)

(b) Ratio analysis in general can be useful in comparing the performance of two companies, but it has its limitations.

Required:

State and briefly explain three factors which can cause accounting ratios to be misleading when used for such comparison. (6 marks)

(9 marks)

5 The directors of Quapaw, a limited liability company, are reviewing the company's draft financial statements for the year ended 31 December 2004.

The following material matters are under discussion:

(a) During the year the company has begun selling a product with a one-year warranty under which manufacturing defects are remedied without charge. Some claims have already arisen under the warranty. (2 marks)

(b) During the inventory count on 31 December, some goods which had cost $80,000 were found to be damaged. In February 2005 the damaged goods were sold for $85,000 by an agent who received a 10% commission out of the sale proceeds. (2 marks)

(c) In August 2004 it was discovered that the inventory at 31 December <u>2003</u> had been overstated by $100,000. (4 marks)

Required:

Advise the directors on the correct treatment of these matters, stating the relevant accounting standard which justifies your answer in each case.

NOTE: The mark allocation is shown against each of the three matters.

(8 marks)

End of Question Paper