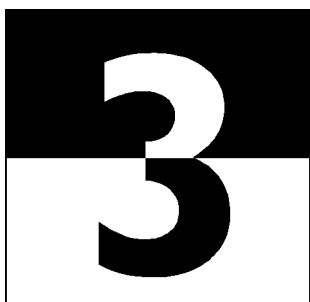


*Certificate in*

# **Accounting (IAS)**



*Level 3*

*Series 2 2004*

*(Code 3901)*

**Model Answers**



# **Certificate in Accounting (IAS) Level 3**

## **Series 2 2004**

### **How to use this booklet**

Model Answers have been developed by LCCIEB to offer additional information and guidance to Centres, teachers and candidates as they prepare for LCCIEB examinations. The contents of this booklet are divided into 3 elements:

- (1) Questions – reproduced from the printed examination paper
- (2) Model Answers – summary of the main points that the Chief Examiner expected to see in the answers to each question in the examination paper, plus a fully worked example or sample answer (where applicable)
- (3) Helpful Hints – where appropriate, additional guidance relating to individual questions or to examination technique

Teachers and candidates should find this booklet an invaluable teaching tool and an aid to success.

The London Chamber of Commerce and Industry Examinations Board provides Model Answers to help candidates gain a general understanding of the standard required. The Board accepts that candidates may offer other answers that could be equally valid.

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## Certificate in Accounting (IAS) Level 3 Series 2 2004

### SECTION A

(Answer Questions 1 and 2 in Section A – Compulsory)

#### QUESTION 1

Alex, Bert and Charles were in partnership. The partnership Trial Balance at 31 March 2004 was as follows:

	\$000	\$000
Purchases/Sales	780	1,250
Inventory at 1 April 2003	60	
Trade receivables/Trade payables	105	65
Discounts allowed/Discounts received	25	15
Machinery at cost	745	
Buildings at valuation	355	
Vehicles at cost	75	
General expenses	130	
Sales expenses	105	
Accumulated depreciation on machinery		545
Accumulated depreciation on vehicles		60
Capital Account:		
Alex		120
Bert		80
Charles		70
Current Account:		
Alex		20
Bert	12	
Charles	8	
Bank overdraft		175
	<u>2,400</u>	<u>2,400</u>

#### Notes

- (1) The Inventory at 31 March 2004 cost \$33,000.
- (2) Machinery is depreciated at 20% per year on cost, and vehicles are depreciated at 12% per year on cost.
- (3) Profits/losses were divided between Alex, Bert and Charles in the ratio 4 : 3 : 3 respectively.

#### REQUIRED

- (a) Prepare the Income Statement of the Alex, Bert and Charles partnership for the year ended 31 March 2004.**

(8 marks)

Alex retired on 1 April 2004 and Bert and Charles decided on that date to form a company, BC, with an authorised and issued share capital of 300,000 \$1 Ordinary Shares. The company took over all the partnership assets and liabilities at their book value. Goodwill was valued at twice the net profit for the year to 31 March 2004. It remained unrecorded but the necessary adjustments were made between the partners immediately prior to the formation of BC. The amount owing to Alex on the dissolution of the partnership was paid to him in cash and Bert and Charles received Ordinary Shares at par as their settlement.

The remaining Ordinary Shares were sold to friends at par.

**QUESTION 1 CONTINUED**

**REQUIRED**

- (b) Calculate the amount of cash received by Alex, and the number of Ordinary Shares issued to Bert and Charles respectively. (5 marks)
- (c) Prepare the Balance Sheet of BC at 1 April 2004 assuming all transactions indicated above have been completed and no trading has taken place. (7 marks)
- (Total 20 marks)**

**Model Answer to Question 1**

(a)

**Alex, Bert and Charles  
Income Statement  
for year ended 31 March 2004**

	\$000	\$000
Sales		1,250
Opening Inventory	60	
Add Purchases	<u>780</u>	
	840	
Less Closing Inventory	<u>33</u>	<u>807</u>
Gross profit		443
<i>Less</i>		
Discount allowed 25		
Discount received (15)	10	
General expenses	130	
Sales expenses	105	
Depreciation on machinery (.2 x 745)	149	
Depreciation on vehicles (.12 x 75)	<u>9</u>	<u>403</u>
Net profit		<u><u>40</u></u>

(b)

	Alex \$000	Bert \$000	Charles \$000
Amounts due to Partners			
Capital Accounts	120	80	70
Current Accounts	20	(12)	(8)
Share of profit (4 : 3 : 3)	16	12	12
Goodwill (40 x 2)(4 : 3 : 3)	32	24	24
Goodwill written off		<u>(40)</u>	<u>(40)</u>
	<u>188</u>	<u>64</u>	<u>58</u>
Cash received =	\$188,000		
Ordinary shares issued		64,000	58,000

**Model Answer to Question 1 continued**

(c)

**BC Balance Sheet  
at 1 April 2004**

	<b>\$000</b>	<b>\$000</b>
<b>Non-current Assets</b>		
Buildings		355
Machinery (745 – 545 – 149)		51
Vehicles (75 – 60 – 9)		<u>6</u>
		412
<b>Current Assets</b>		
Inventory	33	
Trade receivables	<u>105</u>	<u>138</u>
		<u>550</u>
<b>Capital and Reserves</b>		<b>\$000</b>
Ordinary Shares of \$1 each		300
Trade payables	65	
Bank overdraft	[1] <u>185</u>	<u>250</u>
		<u>550</u>

\*Bank

[1]  $175 + 188 - (300 - 64 - 58)$

## SECTION A CONTINUED

### QUESTION 2

Barchester Products had the following summarised Balance Sheets at 31 March 2003 and 31 March 2004 respectively:

	2003		2004	
	\$000	\$000	\$000	\$000
Land at cost	650		850	
Buildings (cost \$920,000)	828		810	
Machinery (cost \$1,450,000)	730		440	
Vehicles (cost \$220,000)	–		190	
Inventory	230		295	
Trade receivables	285		340	
Bank/Bank overdraft	35			50
Trade payables		360		370
Ordinary Shares of \$1		1,500		1,800
Retained profits		898		705
	<u>2,758</u>	<u>2,758</u>	<u>2,925</u>	<u>2,925</u>

#### Notes

In the year to 31 March 2004:

- (1) No fixed assets were sold and no buildings or machinery were purchased.
- (2) Dividends proposed and paid during the year amounted to \$150,000.
- (3) 90,000 shares were issued at par for cash and there was also a capitalisation issue.

#### REQUIRED

- (a) Calculate the operating profit for the year ended 31 March 2004 and reconcile it with the net cash inflow from operating activities. (11 marks)
- (b) Prepare the cash flow statement of Barchester Products for the year ended 31 March 2004 in accordance with IAS7. (9 marks)

**(Total 20 marks)**

## Model Answer to Question 2

(a)

<b>Operating profit</b>	<b>\$000</b>
Change in retained profits (705 – 898)	(193)
Capitalisation issue (1,800 – 1,500 – 90)	210
Dividend paid	<u>150</u>
	<u>167</u>

### Reconciliation of operating profit with net cash inflow from operating activities

	<b>\$000</b>
Operating profit	167
Add back depreciation:	
Buildings (828 – 810)	18
Machinery (730 – 440)	290
Vehicles (220 – 190)	30
Increase in inventory (295 – 230)	(65)
Increase in trade receivables (340 – 285)	(55)
Increase in trade payables (370 – 360)	<u>10</u>
Net cash inflow from operating activities	<u>395</u>

(b)

### Barchester Products Cash Flow Statement for year ended 31 March 2004

	<b>\$000</b>	<b>\$000</b>
<b>Net cash inflow from operating activities</b>		395
Equity Dividends paid		<u>(150)</u>
		245
<b>Capital Expenditure</b>		
Purchase of land (850 – 650)	200	
Purchase of vehicles	<u>220</u>	<u>(420)</u>
		(175)
<b>Financing</b>		
Ordinary share issue		<u>90</u>
<b>Decrease in cash (35 + 50)</b>		<u>(85)</u>

## SECTION B

(Answer any THREE questions from Section B)

### QUESTION 3

The following are the Balance Sheets of Holdings and its two subsidiaries Parts and Bits all at 31 March 2004:

<b>Holdings</b>	<b>\$000 Cost</b>	<b>\$000 Depreciation</b>	<b>\$000 Net</b>
Land and buildings	350	14	336
Office equipment	<u>75</u>	<u>25</u>	<u>50</u>
	<u>425</u>	<u>39</u>	<u>386</u>
Investment in Parts			150
Investment in Bits			140
Trade receivables			45
Bank			<u>30</u>
			<u>751</u>
Ordinary share capital (\$1 shares)			600
Retained profits			116
Trade payables			<u>35</u>
			<u>751</u>
<b>Parts</b>	<b>\$000 Cost</b>	<b>\$000 Depreciation</b>	<b>\$000 Net</b>
Land and buildings	150	21	129
Machinery	450	250	200
Office equipment	<u>15</u>	<u>5</u>	<u>10</u>
	<u>615</u>	<u>276</u>	<u>339</u>
Inventory			50
Trade receivables			<u>25</u>
			<u>414</u>
Ordinary share capital (\$1 shares)			300
Retained profits			20
Trade payables			60
Bank overdraft			<u>34</u>
			<u>414</u>

**SECTION B CONTINUED**

**QUESTION 3 CONTINUED**

<b>Bits</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
	<b>Cost</b>	<b>Depreciation</b>	<b>Net</b>
Machinery	235	125	110
Office equipment	<u>35</u>	<u>15</u>	<u>20</u>
	<u>270</u>	<u>140</u>	130
Inventory			70
Trade receivables			<u>55</u>
			<u>255</u>
Ordinary share capital (\$1 shares)			150
Retained profits			35
Trade payables			38
Bank overdraft			<u>32</u>
			<u>255</u>

**Notes**

- (1) Holdings purchased 60% of the shares of Parts on 1 April 2003 when Parts had a debit balance on its retained profits account of \$60,000.
- (2) Holdings bought 80% of the shares in Bits on 1 October 2003. Bits had retained profits of \$25,000 at 1 April 2003 and profits in that company are assumed to accrue evenly throughout the year.
- (3) None of the three companies have declared dividends in respect of the year to 31 March 2004 and there were no inter company debts at 31 March 2004.
- (4) Goodwill arising on consolidation is not to be amortised.

**REQUIRED**

**Prepare in good style the Consolidated Balance Sheet of Holdings and its subsidiaries at 31 March 2004.**

**(20 marks)**

### Model Answer to Question 3

#### Preliminary calculations

<b>Investment in Parts</b>	<b>\$000</b>
Paid	150
Net assets [0.6 x (300 – 60)]	<u>144</u>
Goodwill	<u>6</u>

<b>Investment in Bits</b>	<b>\$000</b>
Cost	140
Net assets [0.8 x (150 + 25 + .5 (35 – 25))]	<u>144</u>
Capital reserve	<u>4</u>

<b>Retained profits</b>	<b>\$000</b>
Holdings	116
Parts [0.6 x (60 + 20)]	48
Bits [0.8 x (0.5 (35 – 25))]	<u>4</u>
	<u>168</u>

<b>Minority Interest</b>	<b>\$000</b>
Parts [0.4 x (300 + 20)]	128
Bits [0.2 x (150 + 35)]	<u>37</u>
	<u>165</u>

#### Consolidated Balance Sheet of Holdings at 31 March 2004

<b>Non-current Assets</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
	<b>Cost</b>	<b>Depreciation</b>	<b>Net</b>
Land and buildings	500	35	465
Machinery	685	375	310
Office equipment	<u>125</u>	<u>45</u>	<u>80</u>
	<u>1,310</u>	<u>455</u>	855
Goodwill			<u>6</u>
			861
<b>Current Assets</b>			
Inventory		120	
Trade receivables		125	
Bank		<u>30</u>	<u>275</u>
			<u>1,136</u>
<b>Share Capital and Reserves</b>			<b>\$000</b>
Ordinary Share Capital			600
Retained profits			168
Capital reserve			<u>4</u>
			<u>772</u>
<b>Minority interest</b>			<u>165</u>
			937
<b>Current Liabilities</b>			
Trade payables		133	
Bank overdraft		<u>66</u>	<u>199</u>
			<u>1,136</u>

## SECTION B CONTINUED

### QUESTION 4

John Finlay is a sole trader, and the following figures have been extracted from his accounts:

(1) **Income Statement for year ended 31 March**

	<b>2002</b>	<b>2003</b>	<b>2004</b>
	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Sales	740	900	1,200
Gross Profit	250	300	350
Depreciation of machinery	50	60	60
Net profit	30	50	40

(2) **Balance Sheet at 31 March**

	<b>2002</b>	<b>2003</b>	<b>2004</b>
Machinery at book value	200	300	550
Inventory	50	55	75
Trade receivables	60	90	150
Bank (overdraft)	30	5	(75)
Trade payables	40	50	80
Capital	300	400	620

### REQUIRED

- (a) Calculate four appropriate ratios for each of the three years (ie 12 ratios in total). Your ratios should cover both profitability and liquidity. Turnover ratios should be expressed in days, and all ratios given to 2 decimal places.

(12 marks)

- (b) Comment on the progress of John Finlay's business on the basis of the data provided and the ratios that you have calculated in (a) above.

(8 marks)

**(Total 20 marks)**

### Model Answer to Question 4

(a)

	2002	2003	2004
<b>Profitability ratios</b>			
(1) Net profit : Capital	10.00%	12.50%	6.45%
(2) Gross profit : Sales	33.78%	33.33%	29.17%
(3) Net profit : Sales	4.05%	5.56%	3.33%
<b>Liquidity ratios</b>			
(4) Current	3.50 : 1	3.00 : 1	1.45 : 1
(5) Inventory turnover	37.24 days	33.45 days	32.21 days
(6) Trade receivables turnover	29.59 days	36.5 days	45.63 days
(7) Acid test	2.25 : 1	1.90 : 1	.97 : 1

### Calculations

	2002	2003	2004
(1) Net profit : Capital	$\frac{30}{300} \times 100$	$\frac{50}{400} \times 100$	$\frac{40}{620} \times 100$
(2) Gross profit : Sales	$\frac{250}{740} \times 100$	$\frac{300}{900} \times 100$	$\frac{350}{1,200} \times 100$
(3) Net profit : Sales	$\frac{30}{740} \times 100$	$\frac{50}{900} \times 100$	$\frac{40}{1,200} \times 100$
(4) Current	$\frac{50 + 60 + 30}{40}$	$\frac{55 + 90 + 5}{50}$	$\frac{75 + 150}{75 + 80}$
(5) Inventory turnover	$\frac{365}{\frac{740 - 250}{50}}$	$\frac{365}{\frac{900 - 300}{55}}$	$\frac{365}{\frac{1,200 - 350}{75}}$
(6) Trade receivables turnover	$\frac{365}{\frac{740}{60}}$	$\frac{365}{\frac{900}{90}}$	$\frac{365}{\frac{1,200}{150}}$
(7) Acid test	$\frac{60 + 30}{40}$	$\frac{90 + 5}{50}$	$\frac{150}{75 + 80}$

- (b) The business is expanding – see sales and capital  
 Year ending 31 March 2003 showed improved profitability and satisfactory liquidity  
 Year ending 31 March 2004 showed decline in profitability and liquidity  
 Inventory turnover has improved throughout  
 Trade receivables turnover has got worse throughout

## SECTION B CONTINUED

### QUESTION 5

The Trial Balance at 31 March 2004 of Jonas did not balance. A suspense account with a credit balance of \$280 was created. This was treated as a liability due within one year when preparing the draft year end accounts.

These accounts showed the following amounts:

Gross profit of \$43,450

Net profit of \$17,230

Current assets of \$3,250

Liabilities due within one year (including a bank overdraft of \$340) \$2,420

When checking the company's records the auditor discovered the following errors:

- (1) Postal expenses of \$84 had been correctly recorded in the bank account but debited in the expense account as \$48.
- (2) A returns inward of \$72 had been credited to sales revenue account and also credited to the customer's account.
- (3) A payment to bank from cash of \$180 had been debited to cash account and credited to the bank account.
- (4) The balance on a supplier's account of \$460 had been omitted from the trial balance.

### REQUIRED

- (a) Prepare the Suspense Account showing the effects of the auditor's discoveries. (5 marks)
- (b) Prepare a table showing the correction to gross profit, net profit, current assets and liabilities due within the year. Your table should include the final totals which would appear in the corrected set of accounts. (15 marks)

**(Total 20 marks)**

**Model Answer to Question 5**

(a)

**Suspense Account**

Trade payables(omitted)	\$ 460	Balance per TB	\$ 280
		Postal expenses (84 – 48)	36
		Sales	72
		Sales returns	72
	<u>460</u>		<u>460</u>

(b)

	<b>Gross Profit</b>	<b>Net Profit</b>	<b>Current Assets</b>	<b>Liabilities due within 1 year</b>
Original accs	43,450	17,230	3,250	2,420
Correction		(36)		
Correction	(144)	(144)		
Correction			(360) 20	(340)
Correction				460
Suspense account				<u>(280)</u>
Corrected balance	<u>43,306</u>	<u>17,050</u>	<u>2,910</u>	<u>2,260</u>

**Note**

That on correction (3), the bank moves from an overdraft to a debit balance and so from liability to asset.

## SECTION B CONTINUED

### QUESTION 6

Ralph Pearson intends starting up in business.

Premises will cost \$75,000 for a 20 year lease and office machinery will cost \$5,400. Ralph will buy his product for \$12 per unit and sell it for \$20 per unit and will hold one month's stock. Overheads, other than amortisation and depreciation, will amount to \$65,000 a year.

Ralph is now considering two alternative strategies:

#### Strategy A

Buy the product for cash earning a discount of 5%. Sell 12,000 units a year, on one month's credit, evenly over the year. Bad debts would be 1% of sales revenue. Depreciate the machinery over five years on a straight line basis assuming a residual value of zero.

#### Strategy B

Buy the product on one month's credit with no discount. Sell 10,800 units a year for cash evenly over the year. Depreciate the machinery over two years on a straight line basis assuming a residual value of \$2,000.

Ralph Pearson has an initial capital of \$50,000 from his own resources and can borrow additional funds at 15% per annum interest.

### REQUIRED

- (a) Calculate the additional funds Ralph Pearson would require to start his business (including working capital) for *each* of Strategies A and B.

(8 marks)

- (b) Calculate Ralph Pearson's budgeted net profit for his first year of business (assuming the initial borrowing is not repaid) for *each* of strategies A and B.

(12 marks)

**(Total 20 marks)**

### Model Answer to Question 6

(a) Additional Borrowed Capital

	<b>Strategy A</b>	<b>Strategy B</b>
	<b>\$</b>	<b>\$</b>
Lease	75,000	75,000
Machinery	5,400	5,400
Trade receivables (12,000 x 1/12 x 20)	20,000	
Inventory (12,000 x 1/12 x 12)	12,000	
(10,800 x 1/12 x 12)		10,800
	<u>112,400</u>	<u>91,200</u>
Trade payables (10,800 x 1/12 x 12)	<u>112,400</u>	<u>10,800</u>
	112,400	80,400
Initial Capital	<u>50,000</u>	<u>50,000</u>
	<u>62,400</u>	<u>30,400</u>

(b) Budgeted Net Profit

	<b>Strategy A</b>	<b>Strategy B</b>
	<b>\$</b>	<b>\$</b>
Gross Profit [12,000 x (20 – 12)]	96,000	–
[10,800 x (20 – 12)]	<u>–</u>	<u>86,400</u>
<i>Less</i>		
Overheads	65,000	65,000
Depreciation		
Lease (75,000/20)	3,750	3,750
Machinery (5,400/5)	1,080	
(5,400 – 2,000)/2		1,700
Discount received (0.05 x 12,000 x 12)	(7,200)	
Bad debts (0.01 x 12,000 x 20)	2,400	
Loan Interest (62,400 x .15)	9,360	
(30,400 x .15)		4,560
	<u>74,390</u>	<u>75,010</u>
Net Profit	<u>11,610</u>	<u>11,390</u>





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