Answers

1 Consolidated balance sheet of Pacemaker as at 31 March 2009:

	£million	£million
Fixed assets		
Intangible		
Goodwill (20 – 8) (w (i))		12
Brand (25 – 5 (25/10 x 2 years post-acq. amortisation))		20
Tangible (w (ii))		818
Investments		
Investment in associate (w (iii))		144
Other available-for-sale investments (82 + 37)		119
		1,113
Current assets		
Stock (142 + 160 – 16 URP (w (iv)))	286	
Debtors (95 + 88)	183	
Cash and bank (8 + 22)	30	
	499	
Creditors: amounts falling due within one year (200 + 165)	(365)	
Net current assets		134
Total assets less current liabilities		1,247
Creditors: amounts falling due after more than one year		
10% loan notes (180 + 20)		(200)
		1,047
Capital and reserves		
Equity shares (500 + 75 (w (iii)))		575
Share premium (100 + 45 (w (iii)))	145	
Profit and loss account (w (iv))	239	384
		959
Minority interest (w (v))		88
		1,047

Workings (all figures in £ million)

The investment in Syclop represents 80% (116/145) of its equity and is likely to give Pacemaker control thus Syclop should be consolidated as a subsidiary. The investment in Vardine represents 30% (30/100) of its equity and is normally treated as an associate that should be equity accounted.

(i) Goodwill in Syclop:

Investment at cost – cash			210
– loan note (116/200 x £100)			58
			268
Equity shares	145		
Pre-acquisition profit	120		
Fair value adjustments – property (w (ii))	20		
– brand	25		
Fair value of net assets at acquisition	310	x 80%	(248)
Goodwill			20

At 31 March 2009 there will be two years amortisation of goodwill = 8 (20/5 years x 2)

(ii) Tangible fixed assets:

Pacemaker	520
Syclop	280
Fair value property (82 – 62)	20
Post-acquisition depreciation (2 years) (20 x 2/20 years)	(2)
	818

		£million
(iii)	Investment in associate:	
	Investment at cost (30 x 5/2 x £1·60)	120
	Share of post-acquisition profit (100 – 20 x 30%)	24
		144

The purchase consideration by way of a share exchange (75 million shares in Pacemaker for 30 million shares in Vardine) would be recorded as an increase in share capital of £75 million (£1 nominal value) and an increase in share premium of £45 million (75 million x £0·60).

As the goodwill of Vardine has an indefinite life, it will not be amortised and therefore it does not need to be calculated.

(iv)	Consolidated profit and loss account reserve:		
	Pacemaker's profits		130
	Syclop's post-acquisition profits (130 x 80% see below)		104
	Goodwill amortisation (w (i))		(8)
	Gain on investments – Pacemaker (see below)		5
	Vardine's post-acquisition profits (w (iii))		24
	URP in stocks (56 x 40/140)		(16)
			239
	Syclop's profits:		
	Pre-acquisition		120
	Post-acquisition (260 – 120)	140	
	Additional depreciation/amortisation (5 + 2) (w (i) and (ii))	(7)	
	Loss on available-for-sale investments (40 – 37)	(3)	
	Adjusted post-acquisition profits		130
	Adjusted profits		250
	Gain on the value of Pacemaker's available-for-sale investments:		
	Carrying amount at 31 March 2008 (345 – 210 cash – 58 loan note)		77
	Carrying amount at 31 March 2009		82
	Gain to profit and loss account reserve (or 'other components of equity')		5

(v)	Minority interest	
	Equity shares (145 x 20%)	29
	Adjusted profits (250 x 20% (w (iv)))	50
	Fair value adjustments for brand and property ((25 + 20) x 20%)	9
		88

2 (a) Pricewell – Profit and loss account for the year ended 31 March 2009:

	£'000
Turnover (310,000 + 22,000 (w (i)) – 6,400 (w (ii)))	325,600
Cost of sales (w (iii))	(255,100)
Gross profit	70,500
Distribution costs	(19,500)
Administrative expenses	(27,500)
Finance costs (4,160 (w (v)) + 1,248 (w (vi)))	(5,408)
Profit before tax	18,092
Corporation tax (4,500 +700 – (8,400 – 5,600) deferred tax)	(2,400)
Profit for the year	15,692

(b) Pricewell – Balance sheet as at 31 March 2009:

	£'000	£'000
Fixed assets (w (iv))		
Land and buildings		24,900
Plant and equipment		41,500
		66,400
Current assets		
Stock	28,200	
Contract stock (w (i))	800	
Debtors	33,100	
Amounts recoverable on contracts (w (i))	16,300	
Bank	5,500	
	83,900	
Creditors: amounts falling due within one year:		
Trade creditors	33,400	
Finance lease obligation (10,848 – 5,716 (w (vi)))	5,132	
Corporation tax	4,500	
	(43,032)	
Net current assets		40,868
Total assets less current liabilities		107,268
Creditors: amounts falling due after more than one year		
Finance lease obligation (w (vi))	5,716	
6% redeemable preference shares (41,600 + 1,760 (w (v)))	43,360	(49,076)
Provision for liabilities		
Deferred tax		(5,600)
		52,592
Capital and reserves		
Equity shares of 50 pence each		40,000
Profit and loss account (w (vii))		12,592
		52,592

Workings (figures in brackets in £'000)

(i) Long-term contract:

	£'000
Selling price	50,000
Estimated cost	
To date	(12,000)
To complete	(10,000)
Plant	(8,000)
Estimated profit	20,000

Work done is agreed at £22 million so the contract is 44% complete (22,000/50,000).

Revenue	22,000
Cost of sales (= balance)	(13,200)
Profit to date (44% x 20,000)	8,800
Cost incurred to date materials and labour	12,000
Plant depreciation (8,000 x 6/24 months)	2,000
Charged to cost of sales	(13,200)
Included in balance sheet stock	800
Recognised in turnover	22,000
Cash received	(5,700)
Amounts recoverable on contracts	16,300

(ii) Pricewell is acting as an agent (not the principal) for the sales on behalf of Trilby. Therefore the profit and loss account should only include £1·6 million (20% of the sales of £8 million). Therefore £6·4 million (8,000 – 1,600) should be deducted from turnover and cost of sales. It would also be acceptable to show agency sales (of £1·6 million) separately as other income.

		£'000
(iii)	Cost of sales	
	Per question	234,500
	Contract (w (i))	13,200
	Agency cost of sales (w (ii))	(6,400)
	Depreciation (w (iv)) – leasehold property	1,800
	– owned plant ((46,800 – 12,800) x 25%)	8,500
	– leased plant (20,000 x 25%)	5,000
	Surplus on revaluation of leasehold property (w (iv))	(1,500)
		255,100
(iv)	Fixed assets	
	Leasehold property	
	valuation at 31 March 2008	25,200
	depreciation for year (14 year life remaining)	(1,800)
	carrying amount at date of revaluation	23,400
	valuation at 31 March 2009	(24,900)
	revaluation surplus (to profit and loss account – see below)	1,500

The £1·5 million revaluation surplus is credited to the profit and loss account as this is the partial reversal of the £2·8 million impairment loss recognised as an expense in the previous period (i.e. year ended 31 March 2008).

Plant and equipment	
– owned (46,800 – 12,800 – 8,500)	25,500
– leased (20,000 – 5,000 – 5,000)	10,000
– contract (8,000 – 2,000 (w (i)))	6,000
Carrying amount at 31 March 2009	41,500

(v) The finance cost of £4,160,000 for the preference shares is based on the effective rate of 10% applied to £41·6 million balance at 1 April 2008. The accrual of £1,760,000 (4,160 – 2,400 dividend paid) is added to the carrying amount of the preference shares in the balance sheet. As these shares are redeemable they are treated as debt and their dividend is treated as a finance cost.

(vi)	Finance lease liability	
	balance at 31 March 2008	15,600
	interest for year at 8%	1,248
	lease rental paid 31 March 2009	(6,000)
	total liability at 31 March 2009	10,848
	interest next year at 8%	868
	lease rental due 31 March 2010	(6,000)
	total liability at 31 March 2010	5,716
(vii)	Profit and loss account reserve	
	balance at 1 April 2008	4,900
	profit for year	15,692
	equity dividend paid	(8,000)
	balance at 31 March 2009	12,592

3 (a) Coaltown – Cash flow statement for the year ended 31 March 2009:

Note: figures in brackets in £'000
Reconciliation of operating profit to net cash inflow from operating activities

	£'000	£'000
Operating profit		10,800
Adjustments for:		
depreciation of fixed assets (w (i))	6,000	
loss on disposal of displays (w (i))	1,500	7,500
increase in warranty provision (1,000 – 300)		700
Working capital adjustments:		
increase in stock (5,200 – 4,400)		(800)
increase in debtors (7,800 – 2,800)		(5,000)
decrease in creditors (4,500 – 4,200)		(300)
Net cash inflow from operating activities		12,900

Cash flow statement

Net cash inflow from operating activities		12,900
Servicing of finance – interest paid		(600)
Tax paid (w (ii))		(5,500)
Capital expenditure (note 1)		(21,000)
Equity dividends paid		(4,000)
Cash outflow before financing		(18,200)
Financing (note 1)		13,900
Decrease in cash (700 + 3,600)		(4,300)

Note 1

Capital expenditure		
Purchase of fixed assets (w (i))	(20,500)	
Disposal costs of fixed assets	(500)	(21,000)
Financing		
Issue of equity shares (8,600 capital + 4,300 premium)	12,900	
Issue of 10% loan notes	1,000	13,900

Workings

	£'000
(i) Fixed assets	
Cost	
Balance b/f	80,000
Revaluation (5,000 – 2,000 depreciation)	3,000
Disposal	(10,000)
Balance c/f	(93,500)
Cash flow for acquisitions	20,500
Depreciation	
Balance b/f	48,000
Revaluation	(2,000)
Disposal	(9,000)
Balance c/f	(43,000)
Difference – charge for year	6,000
Disposal of displays	
Cost	10,000
Depreciation	(9,000)
Cost of disposal	500
Loss on disposal	1,500

	£'000
(ii) Taxation:	
Provision b/f	(5,300)
Profit and loss account charge	(3,200)
Provision c/f	3,000
Difference – cash paid	(5,500)

(b) (i) Workings – all monetary figures in £'000

(Note: references to 2008 and 2009 should be taken as to the years ended 31 March 2008 and 2009)

The effect of a reduction in purchase costs of 10% combined with a reduction in selling prices of 5%, based on the figures from 2008, would be:

Sales (55,000 x 95%)	52,250
Cost of sales (33,000 x 90%)	(29,700)
Expected gross profit	22,550

This represents an expected gross profit margin of 43·2% (22,550/52,250 x 100)

The actual gross profit margin for 2009 is 33·4% (22,000/65,800 x 100)

(ii) The directors' expression of surprise that the gross profit in 2009 has not increased seems misconceived.

A change in the gross profit margin does not necessarily mean there will be an equivalent change in the absolute gross profit. This is because the gross profit figure is the product of the gross profit margin and the volume of sales and these may vary independently of each other. That said, in this case the expected gross profit margin in 2009 shows an increase over that earned in 2008 (to 43·2% from 40·0%) and the sales have also increased, so it is understandable that the directors expected a higher gross profit. As the actual gross profit margin in 2009 is only 33·4% something other than the changes described by the directors must have occurred. Possible reasons for the reduction are:

The opening stock being at old (higher) cost and the closing stock is at the new (lower) cost will have caused slight distortion.

Stock write downs due to damage/obsolescence.

A change in the sales mix (i.e. from higher margin sales to lower margin sales).

New (lower margin) products may have been introduced from other new suppliers.

Some selling prices may have been discounted because of sales promotions.

Import duties (perhaps not allowed for by the directors) or exchange rate fluctuations may have caused the actual purchase cost to be higher than the trade prices quoted by the new supplier.

Change in cost classification: some costs included as operating expenses in 2008 may have been classified as cost of sales in 2009 (if intentional and material this should be treated as a change in accounting policy) – for example it may be worth checking that depreciation has been properly charged to operating expenses in 2009.

The new supplier may have put his prices up during the year; due to market conditions the company may have felt it could not pass these increases on to its customers.

(iii) Note – all monetary figures in £'000

Debtors' collection period in 2008:

2,800/28,500 x 365 = 35·9 days

Applying the 35·9 days collection period to the credit sales made in 2009:

53,000 x 35·9/365 = 5,213, the actual debtors are 7,800 thus potentially increasing the bank balance by 2,587

A similar exercise with the trade creditors' payment period in 2008:

4,500/33,000 x 365 = 49·8 days

Note the 33,000 above is the cost of sales for 2008. This was the same as the credit purchases as there was no change in the value of stock. However, in 2009 the credit purchases will be 44,600 (43,800 + 5,200 closing stock – 4,400 opening stock).

Applying the 49·8 days payment period to purchases made in 2009 gives:

44,600 x 49·8/365 = 6,085, the actual creditors are 4,200 thus potentially increasing the bank balance by 1,885.

Inevitably a shortening of the period of credit offered by suppliers and lengthening the credit offered to customers will put a strain on cash resources. For Coaltown the combination of maintaining the same credit periods for both trade receivables and payables would have led to a reduction in cash outflows of 4,472 (2,587 + 1,885), which would have eliminated the overdraft of 3,600 leaving a balance in hand of 872.

4 (a) Events after the balance sheet date are defined by FRS 21 *Events after the Balance Sheet Date* as those events, both favourable and unfavourable, that occur between the balance sheet date and the date that the financial statements are authorised for issue (normally by the Board of directors).

An adjusting event is one that provides further evidence of conditions that existed at the balance sheet date, including an event that indicates that the going concern assumption in relation to the whole or part of the entity is not appropriate. Normally trading results occurring after the balance sheet date are a matter for the next accounting period. However, if there is an event which would normally be treated as non-adjusting that causes a dramatic downturn in trading (and profitability) such that it is likely that the entity will no longer be a going concern, this should be treated as an adjusting event.

A non-adjusting event is an event after the balance sheet date that is indicative of a condition that arose after the balance sheet date and, subject to the exception noted above, the financial statements would not be adjusted to reflect such events.

The outcome (and values) of many items in the financial statements have a degree of uncertainty at the balance sheet date. FRS 21 effectively says that, where events occurring after the balance sheet date help to determine what those values were at the balance sheet date, they should be taken in account (i.e. adjusted for) in preparing the financial statements.

If non-adjusting events, whilst not affecting the financial statements of the current year, are of such importance (i.e. material) that without disclosure of their nature and estimated financial effect, users' ability to make proper evaluations and decisions about the future of the entity would be affected, then they should be disclosed in the notes to the financial statements.

(b) (i) At first sight this is a non-adjusting event as there was no reason to doubt that the value of warehouse and the stock it contained was worth less than its carrying amount at 31 March 2009 (the balance sheet date). The total loss suffered as a result of the fire is £16 million. The company expects that £9 million of this loss will be recovered from an insurance policy. Recoveries from third parties should be assessed separately from the related loss. As this event has caused serious disruption to trading, FRS 21 would require the details of this non-adjusting event to be disclosed in the financial statements for the year ended 31 March 2009 as a total loss of £16 million and the effect of the insurance recovery to be disclosed separately.

The severe disruption in Waxwork's trading operations since the fire, together with the expectation of large trading losses for some time to come, may call in to question the going concern status of the company. If it is judged that Waxwork is no longer a going concern, then the fire and its consequences become an adjusting event requiring the financial statements for the year ended 31 March 2009 to be redrafted on the basis that the company is no longer a going concern (i.e. they would be prepared on a liquidation basis).

(ii) 70% of the stock amounts to £322,000 (460,000 x 70%) and this was sold for a net amount of £238,000 (280,000 x 85%). Thus a large proportion of a class of stock was sold at a loss after the reporting period. This would appear to give evidence of conditions that existed at 31 March 2009 (i.e. that the net realisable value of that class of stock was below its cost). Stock is required to be valued at the lower of cost and net realisable value, thus this is an adjusting event. If it is assumed that the remaining stock will be sold at similar prices and terms as that already sold, the net realisable value of the whole of the class of stock would be calculated as:

£280,000/70% = £400,000, less commission of 15% = £340,000.

Thus the carrying amount of the stock of £460,000 should be written down by £120,000 to its net realisable value of £340,000.

In the unlikely event that the fall in the value of the stock could be attributed to a specific event that occurred after the balance sheet date then this would be a non-adjusting event.

(iii) The date of the government announcement of the tax change is beyond the period of consideration in FRS 21. Thus this would be neither an adjusting nor a non-adjusting event. The increase in the deferred tax liability will be provided for in the year to 31 March 2010. Had the announcement been before 6 May 2009, it would have been treated as a non-adjusting event requiring disclosure of the nature of the event and an estimate of its financial effect in the notes to the financial statements.

5 Flightline – Profit and loss account for the year ended 31 March 2009:

	£'000
Depreciation (w (i))	13,800
Loss on write off of engine (w (iii))	6,000
Repairs – engine	3,000
– Exterior painting	2,000

Balance sheet as at 31 March 2009

Fixed asset – Aircraft	cost	accumulated depreciation	carrying amount
	£'000	£'000	£'000
Exterior (w (i))	120,000	84,000	36,000
Cabin fittings (w (ii))	29,500	21,500	8,000
Engines (w (iii))	19,800	3,700	16,100
	169,300	109,200	60,100

Workings (figures in brackets in £'000)

(i) The exterior of the aircraft is depreciated at £6 million per annum (120,000/20 years). The cabin is depreciated at £5 million per annum (25,000/5 years). The engines would be depreciated by £500 (£18 million/36,000 hours) i.e. £250 each, per flying hour.

The carrying amount of the aircraft at 1 April 2008 is:

	Cost	accumulated depreciation	carrying amount
	£'000	£'000	£'000
Exterior (13 years old)	120,000	78,000	42,000
Cabin (3 years old)	25,000	15,000	10,000
Engines (used 10,800 hours)	18,000	5,400	12,600
	163,000	98,400	64,600

Depreciation for year to 31 March 2009:		£'000
Exterior (no change)		6,000
Cabin fittings	– six months to 30 September 2008 (5,000 x 6/12)	2,500
	– six months to 31 March 2009 (w (ii))	4,000
Engines	– six months to 30 September 2008 (500 x 1,200 hours)	600
	– six months to 31 March 2009 ((400 + 300) w (iii))	700
		13,800

(ii) Cabin fittings – at 1 October 2008 the carrying amount of the cabin fittings is £7·5 million (10,000 – 2,500). The cost of improving the cabin facilities of £4.5 million should be capitalised as it led to enhanced future economic benefits in the form of substantially higher fares. The cabin fittings would then have a carrying amount of £12 million (7,500 + 4,500) and an unchanged remaining life of 18 months. Thus depreciation for the six months to 31 March 2009 is £4 million (12,000 x 6/18).

(iii) Engines – before the accident the engines (in combination) were being depreciated at a rate of £500 per flying hour. At the date of the accident each engine had a carrying amount of £6 million ((12,600 – 600)/2). This represents the loss on disposal of the written off engine. The repaired engine's remaining life was reduced to 15,000 hours. Thus future depreciation on the repaired engine will be £400 per flying hour, resulting in a depreciation charge of £400,000 for the six months to 31 March 2009. The new engine, with a cost of £10.8 million and a life of 36,000 hours, will be depreciated by £300 per flying hour, resulting in a depreciation charge of £300,000 for the six months to 31 March 2009. Summarising both engines:

	cost	accumulated depreciation	carrying amount
	£'000	£'000	£'000
Old engine	9,000	3,400	5,600
New engine	10,800	300	10,500
	19,800	3,700	16,100

This marking scheme is given as a guide in the context of the suggested answers. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned conclusions are provided. This is particularly the case for written answers where there may be more than one acceptable solution.

			Marks
1	goodwill		$4^1/_2$
	brand		1
	tangible fixed assets		2
	investment in associate		2
	other investments		1
	stock		2
	debtors, cash and bank		1
	creditors due within one year		$^1/_2$
	loan notes		$^1/_2$
	equity shares		1
	share premium		1
	profit and loss account		$6^1/_2$
	minority interest		2
		Total for question	**25**

2	**(a)**	Profit and loss account		
		turnover		2
		cost of sales		5
		distribution costs		$^1/_2$
		administrative expenses		$^1/_2$
		finance costs		2
		corporation tax		2
				12
	(b)	Balance sheet		
		land and buildings		1
		plant and equipment		$1^1/_2$
		stock		$^1/_2$
		contract stock		1
		debtors		$^1/_2$
		amounts recoverable on contracts		1
		bank		$^1/_2$
		trade creditors		$^1/_2$
		finance lease – creditor due within one year		1
		corporation tax		1
		finance lease – creditor due after one year		$^1/_2$
		preference shares		1
		deferred tax		1
		equity shares		$^1/_2$
		profit and loss account (1 for dividend)		$1^1/_2$
				13
			Total for question	**25**

			Marks
3	**(a)**	operating activities	
		operating profit	1
		depreciation	2
		loss on disposal	1
		warranty adjustment	$^1/_2$
		working capital items	$1^1/_2$
		servicing of finance	1
		tax paid	1
		purchase of fixed assets	2
		disposal cost of fixed assets	1
		dividend paid	1
		issue of equity shares	1
		issue of 10% loan note	1
		decrease in cash	1
			15
	(b)	**(i)** calculation of expected gross profit margin for 2009	**2**
		(ii) comments on directors' surprise and other factors	**4**
		(iii) calculate credit periods (debtors and creditors) in 2008	2
		apply to 2009 credit sales/purchases	1
		calculate 'savings' and effect on closing bank balance	1
			4
		Total for question	**25**
4	**(a)**	definition	1
		discussion of adjusting events	2
		reference to going concern	1
		discussion of non-adjusting events	1
			5
	(b)	**(i)** to **(iv)** 1 mark per valid point as indicated	10
		Total for question	**15**
5	Profit and loss account		
	depreciation – exterior		1
	– cabin fittings		2
	– engines		2
	loss on write off of engine		1
	repairs		1
	Balance sheet		
	carrying amount at 31 March 2009		3
		Total for question	**10**