Answers

1 (a)

Guyridge
Income statement for the year ended 31 October 2004

	$	$	$	*Marks*	*Workings ($)*
				0·5	
Sales revenue (W1)			395,000	3·0	
Opening inventory		25,000		0·5	
Purchases (W2)		195,000		2·0	
Carriage inwards		4,500		0·5	
		224,500			
Less closing inventory		(37,000)		0·5	
Cost of goods sold			(187,500)	0·5	
Gross profit			207,500	0·5	
Expenses					
Vehicle running expenses		13,500		0·5	
Insurance		8,000		1·5	(5,000 + 4,000 – 1,000)
Heating and lighting		6,250		1·5	(7,000 – 3,000 + 2,250)
Telephone		3,500		0·5	
Advertising		4,250		1·5	(2,250 + 2,000)
Rent and rates		14,000		1·5	(15,000 – 1,000)
Office supplies		1,250		0·5	
Depreciation for: Vehicles	6,000			1·0	
Equipment	12,000	18,000		1·0	
Bad debts		15,000		0·5	
Discounts allowed		5,000		0·5	
			(88,750)		
Net profit before appropriation			118,750	0·5	
Interest on drawings: Kevin		2,000		0·5	
David		1,000	3,000	0·5	
			121,750		
Interest on capital: Kevin		8,000		0·5	
David		5,000	(13,000)	0·5	
			108,750		
Share of Profit: Kevin $^{2}/_{3}$			72,500	1·0	
David $^{1}/_{3}$			36,250	1·0	
			108,750		
				23	

(b) Current Accounts

Kevin

	$		$	Marks
Drawings	60,000	Balance b/f	23,000	1·0
Interest on drawings	2,000	Interest on capital	8,000	1·0
Balance c/f	41,500	Share of profit	72,500	0·5
	103,500		103,500	

David

	$		$	Marks
Drawings	30,000	Balance b/f	21,000	1·0
Interest on drawings	1,000	Interest on capital	5,000	1·0
Balance c/f	31,250	Share of profit	36,250	0·5
	62,250		62,250	
				5·0

Marks

(c)

Guyridge
Balance Sheet as at 31 October 2004 — 0·5

	Cost	Provision for Depreciation	Net Book Value	Marks
	$	$	$	
Non-current assets				
Vehicles	32,000	14,000	18,000	1·0
Equipment	60,000	24,000	36,000	1·0
	92,000	38,000	54,000	1·0
Current Assets				
Inventory		37,000		0·5
Trade receivables (W1)		55,000		0·5
Prepayments		1,000		1·0
Bank (W3)		68,000	161,000	3·0
			215,000	
Partners' capital accounts				
Kevin		80,000		0·5
David		50,000	130,000	0·5
Partners' current accounts				
Kevin		41,500		0·5
David		31,250	72,750	0·5
			202,750	
Current liabilities				
Trade payables (W2)		10,000		0·5
Accruals		2,250	12,250	1·0
			215,000	
				12

Workings — *Allocation of marks*

W1 **Trade Receivables Control Account**

	$		$	Allocation of marks
Receivables b/f	80,000	Bad debts	15,000	0·5 + 0·5
Sales (bal. fig)	395,000	Settlement discounts	5,000	0·5 + 0·5
		Bank	400,000	0·5
		Receivables c/f	55,000	0·5
	475,000		475,000	

W2 **Trade Payables Control Account**

	$		$	Allocation of marks
Bank	200,000	Trade payables b/f	15,000	0·5 + 0·5
Payables c/f	10,000	Purchases (bal. fig)	195,000	0·5 + 0·5
	210,000		210,000	

W3 **Bank**

	$		$	Allocation of marks
Balance b/f	10,000	Trade payables control	200,000	0·5 + 0·5
Receivables control	400,000	Drawings: Kevin	60,000)	0·5 + 0·5
		David	30,000)	
		Carriage inwards	4,500)	
		Vehicle expenses	13,500)	
		Insurance	5,000)	
		Heating and lighting	7,000)	1
		Telephone	3,500)	
		Advertising	2,250)	
		Rent and rates	15,000)	
		Office supplies	1,250)	
		Balance c/f	68,000	
	410,000		410,000	

		$000	$000	Marks
2 (a)	**Goodwill on acquisition of Bury**	**$000**	**$000**	
	Cost of investment		24,000	0·5
	Share capital ($30,000 x 70%)	21,000		0·5
	General reserve ($500,000 x 70%)	350		1·0
	Accumulated profits ($1,500,000 x 70%)	1,050	(22,400)	1·0
			1,600	
			Total	**3**

(i) Black — 0·5

Consolidated income statement for the year ended 31 October 2004

	$000	Marks	Workings ($000)
Sales revenue	323,200	2·0	245,000 + 95,000 – 16,800
Cost of sales	(176,640)	2·5	140,000 + 52,000 – 16,800 + 1,440*
Gross Profit	146,560		
Distribution costs	(22,000)	0·5	
Administrative expenses	(68,000)	0·5	
Goodwill impairment	(160)	1·0	(960 – 800)
Profit before tax	56,400		
Income tax expense	(18,250)	0·5	
Profit after tax	38,150		
Minority interest	(4,500)	2·0	30% x 15,000
Net profit for the period	33,650	0·5	
Total		**10·0**	

(ii) Black — *Marks*

Consolidated Balance Sheet as at 31 October 2004 — 0·5

Assets	**$000**	**$000**	Marks	
Non-current assets				
Intangible – goodwill		800	2·0	
Property, plant and equipment		150,000	0·5	(110,000 + 40,000)
		150,800		
Current assets				
Inventory, at cost	15,810		1·5	(13,360 + 3,890 – 1,440*)
Trade receivables	12,420		2·5	(14,640 + 6,280 – 7,000** – 1,500***)
Bank	6,070	34,300	0·5	(3,500 + 2,570)
Total assets		185,100		
Equity and liabilities				
Capital and Reserves				
$1 Ordinary shares		100,000	0·5	
General reserves		9,550	1·5	(9,200 + ((1,000 – 500) x 70%)
Accumulated profits (W1)		30,506	3·0	
Minority interest		12,084	1·0	(30% x 40,280)
		152,140		
Current liabilities				
Trade payables	9,960		2·0	(9,000 + 2,460 – 1,500***)
Dividends payable to Minority Interests	3,000		1·0	(10,000 – 7,000)
Dividends	20,000	32,960	0·5	
Total equity and liabilities		185,100		
			17·0	

Notes:

* Exclusion of unrealised profit held in inventory ($1,440,000)

** Exclusion of the intragroup dividends from trade receivables ($7,000,000)

*** Intracompany indebtedness

Working Paper

W1 Accumulated profits as at 31 October 2004

	$000	$000	
Black balance sheet		27,300	
Less unrealised profit		(1,440)	
Bury:			
Retained profits	9,280		
Pre-acquisition reserves	(1,500)		
	7,780		
Group share (70% x $7,780,000)		5,446	
Less cumulative goodwill impairment as at 31 October 2004		(800)	(1600 – (960 – 160))
		30,506	

				Marks
3 (a) Dividend per share	$\frac{\text{Dividend for the year}}{\text{Number of shares in issue}}$	$\frac{10,000}{50,000}$	= 20 cents per share	1·5
Dividend cover	$\frac{\text{Profit after tax for ord sh'holders}}{\text{Dividend}}$	$\frac{11,150}{10,000}$	= 1·1 times	1·5
Earnings per share	$\frac{\text{Net Profit after tax}}{\text{No. of ordinary shares}}$	$\frac{11,150}{50,000}$	= 22 cents	1·5
Price earnings ratio	$\frac{\text{Price per share}}{\text{Earnings per share}}$	$\frac{150}{22{\cdot}3}$	= 6·7	1·5
Debt/equity ratio	$\frac{\text{Debt}}{\text{Equity}}$	$\frac{1,000}{32,520}$	= 3%	1·5
Interest cover	$\frac{\text{Profit before interest and taxation}}{\text{Interest}}$	$\frac{12,715}{50}$	= 254 times	1·5
			Total marks	**9**

(b) (i) & (ii)

Notes on Tressven's ratios

Ratio	Tressven	Hilladay	Comment on the ratio calculated
Dividend per share	20c	10c	The level of dividend per share available to Tressven shareholders is double that available to Hilladay. This may suggest a generous level of dividend which will please shareholders in the short term.
Dividend cover	1·1	5	The level of dividend does not appear to be justified by the available profit. It also suggests that this level of dividend may not be sustainable in the future.
Earnings per share	22c	20c	The EPS for Tressven is similar to Hilladay's EPS. However, Hilladay has retained half its earnings for future investment. This is not the case for Tressven and would suggest profit levels may stagnate.
Price earnings ratio	6·7	13·4	A comparison of the PE ratio suggests that investors are keener to invest in Hilladay than Tressven. This may be because of concerns regarding the future profitability of Tressven.
Debt/equity ratio	3%	15%	The gearing ratio for Tressven seems low in comparison with Hilladay. It may be that Tressven is not borrowing sufficiently to invest in the future of the company. Alternatively Hilladay may have high borrowings.
Interest cover	254	100	Tressven can comfortably afford to meet its interest charges, so can Hilladay. This suggests that Tressven could afford to increase its borrowing to invest.

There should be some evidence of trying to interpret the ratios, while acknowledging the limitations of the information available. Other comments, if appropriate, will also be given credit.
1 mark for making a relevant comment about each ratio up to 6 marks.

4 **(a)** The main purposes of the *'Framework for the Preparation and Presentation of Financial Statements'* are:

(i) To provide a framework for the future development of international accounting standards and the review of existing ones.

(ii) To inform interested parties (e.g. national standard setting bodies) of the approach taken by the IASB in formulating standards.

(iii) To provide guidance to practitioners when applying international accounting standards.

(iv) To provide a basis for reducing the number of alternative accounting treatments permitted by international accounting standards and thereby promoting harmonisation of regulations, accounting standards and procedures.

(v) To assist auditors in forming an opinion as to whether financial statements conform with international accounting standards.

(vi) To assist the users of financial statements when interpreting the information.

(1 mark for each reason up to a maximum of 5 marks)

(b)

User Group	Information needs
Current (and future) investors	They need to assess the financial performance of the organisation to understand the level of risk and the returns provided by their investment. Key information requirements: ability to generate cash, level of profitability, and dividends.
Lenders	They need information on the ability of the organisation to repay loans and any interest. Key information: profitability, ability to manage working capital (liquidity), current level of borrowing, value of assets.
Customers	Customers that are dependent on the organisation for significant levels of business or are considering placing long term contracts will need to know whether it will stay in business or not. Key information requirements: ability to generate cash, and profitability.
Suppliers (and trade creditors)	They will want to know whether the organisation will stay in business and whether they will be paid. Key information requirements: ability to generate cash, and profitability.

Marking scheme
$^1/_2$ mark for identifying the user group and up to 2 marks for stating their information requirements. Maximum of 10 marks.