Answers

1 (a) (i)

Sondaw Ltd
Profit and loss account for the year ended 31 May 2004

	£000	*Marks*
(heading)		0·5
Turnover	5,876	0·5
Cost of sales (W1)	(3,072)	5·0
Gross profit	2,804	0·5
Distribution costs (W1)	(492)	3·0
Administrative expenses (W1)	(763)	6·0
Operating profit	1,549	0·5
Interest payable	(30)	0·5
Profit before taxation	1,519	0·5
Taxation	(250)	0·5
Retained profit for the year	1,269	0·5
Retained profit b/f	280	
Retained profit c/f	1,549	
	Total	18·0

(ii)

Sondaw Ltd
Balance sheet as at 31 May 2004

	£000	£000	Marks
(heading)			0·5
Fixed assets (W2)			
Buildings		2,750	1·0
Plant and equipment		368	1·0
Motor vehicles		75	1·0
		3,193	
Current assets			
Stock	800		0·5
Debtors (W3)	380		1·5
Prepayments	6		1·0
Bank	50		1·0
	1,236		
Creditors: amounts falling due within one year (W4)	(780)		4·0
Net current assets		456	
Creditors: amounts falling due after more than one year			
5% Debentures		(600)	0·5
		3,049	
Capital and reserves			
£1 Ordinary shares		1,500	1·0
Profit and loss account		1,549	1·0
		3,049	
		Total	14

Marks

Workings

		Cost of Sales	Distribution Costs	Administrative Expenses
1		£000	£000	£000
	Opening stock	1,200		
	General expenses (10:40:50)	60	240	300
	Heat and light (50:30:20)	45	27	18
	Marketing and Advertising (£248 – £6)			242
	Wages and salaries (£490 + £10) (60:30:10)	300	150	50
	Purchases	2,200		
	Discounts received	(150)		
	Closing stock	(800)		
	Bad debt expense			38
	Bad debt provision			20
	Depreciation – buildings (50:20:30)	125	50	75
	Depreciation – motor vehicles		25	
	Depreciation – plant and equipment	92		
	Audit-fee			20
		3,072	492	763

		Buildings	Motor Vehicles	Plant & Equip
2	Fixed Assets (£000)	£	£	£
	Cost	5,000	160	700
	Depreciation b/f	(2,000)	(60)	(240)
	Current year's depreciation:			
	Buildings £5,000 x 5%	(250)		
	Motor vehicles (£160 – £60) x 25%		(25)	
	Plant & equipment (£700 – £240) x 20%			(92)
		2,750	75	368

3	Bad debt provision (£000)	£
	Debtors per trial balance	438
	Less bad debts written off	(38)
		400
	5% provision	(20)
		380

4	Creditors within one year (£000)	£
	Trade creditors	500
	Wages accrual	10
	Corporation tax	250
	Audit accrual	20
		780

(b) The purpose of depreciation is to spread the cost of an asset, less its residual value, over its productive (economic) life. 1·0

When deciding the method of calculating depreciation the following factors are relevant:

Pattern of usage – If the main value from the asset is obtained during its earliest years then it might be appropriate to use reducing balance. 1·0

Life of the asset – The time period in which wear and tear, obsolescence or depletion takes place. 1·0

Total **3·0**

				Marks
2	Nobrie plc **Cash flow statement for the year ended 31 May 2004**			0·5
		£000	£000	
	Net cash inflow from operating activities (Note 1)		36,916	1·0
	Returns on investments and servicing of finance			
	Interest received	146		1·0
	Interest paid	(1,177)	(1,031)	1·0
	Taxation paid (W1)		(9,191)	2·0
	Capital Expenditure			
	Payments for tangible fixed assets (W3)	(28,048)		4·0
	Proceeds from disposals	3,053		1·0
	Net cash outflows from capital expenditure		(24,995)	1·0
	Net cash inflow before financing		1,699	1·0
	Financing			
	Issue of ordinary share capital	7,450		2·0
	Redemption of debentures	(6,244)		1·0
	Net cash inflows from financing		1,206	1·0
	Increase in cash		2,905	1·0

Notes to the cash flow statement

1 **Reconciliation of operating profit to net cash flow from operating activities**

	£000	£000		
Operating profit		42,769		1·0
Depreciation	5,862			0·5
Profit on disposal	(1,540)			1·5
Increase in stock	(866)			1·5
Increase in debtors	(5,684)			1·5
Decrease in creditors	(3,625)			1·5
		(5,853)		
Net cash inflow from operating activities		36,916	**Total**	**25·0**

Workings

1 **Taxation**

	£000		£000
Paid (Balancing figure)	9,191	Balance b/f	7,323
Balance c/f	7,989	Profit & loss a/c	9,857
	17,180		17,180

2

	£000
Disposal of assets	
Proceeds	3,053
Less NBV (Balancing figure)	(1,513)
Profit on sale	1,540

3 **Fixed Asset NBV**

	£000		£000
Brought Forward	88,466	Depreciation	5,862
Revaluation	8,272	Disposal NBV (W2)	1,513
Additions (Bal figure)	28,048	Carried Forward	117,411
	124,786		124,786

Marks

3 Partnership profit statement for the year ended 31 May 2004

		3 months to 31 August 2003		9 months to 31 May 2004	Total	Marks
		£000		£000	£000	
Unadjusted profit		200,000		600,000	800,000	1·0
Bad debt written off		(25,000)		–	(25,000)	1·0
Loan interest (W1)		–		(18,000)	(18,000)	1·0
		175,000		582,000	757,000	
Division of Profit						
Angela	4/7	100,000	4/10	232,800	332,800	1·0
Brenda	2/7	50,000	3/10	174,600	224,600	1·0
Christine	1/7	25,000	–	–	25,000	0·5
Hannah	–	–	3/10	174,600	174,600	0·5
		175,000		582,000	757,000	6·0

Capital accounts

Pre 31/8/03	Angela	Brenda	Christine	Hannah	Marks		Angela	Brenda	Christine	Hannah	Marks
	£	£	£	£			£	£	£	£	
G'dwill 2:1	466,667	233,333	–	–	1·0	Balance b/f	500,000	260,000	330,000	–	
Loan a/c	–	–	480,000	–	0·5	G'will 4:2:1	400,000	200,000	100,000	–	1·5
Balance c/d	633,333	326,667	–	–		F Prop 4:2:1	200,000	100,000	50,000	–	1·5
	1,100,000	560,000	480,000	–			1,100,000	560,000	480,000	–	
Post 31/8/03											
G'dwill 4:3:3	280,000	210,000	–	210,000	1·5	Balances b/d	633,333	326,667	–	–	
Bal c/f	820,000	350,000	–	250,000		Cash – capital	–	–	–	250,000	0·5
						Cash – g'dwill	–	–	–	210,000	0·5
						G'dwill	466,667	233,333	–	–	1·0
	1,100,000	560,000	–	460,000			1,100,000	560,000	–	460,000	
					3·0						5·0

Current accounts

Pre 31/8/03	Angela	Brenda	Christine	Hannah	Marks		Angela	Brenda	Christine	Hannah	Marks
	£	£	£	£			£	£	£	£	
Drawings	20,000	10,000	35,000	–	1·5	Bal b/f	60,000	40,000	10,000	–	
Bal c/d	140,000	80,000	–	–		Profit to 31/8/03	100,000	50,000	25,000	–	1·5
	160,000	90,000	35,000	–			160,000	90,000	35,000	–	
Post 31/8/03											
Drawings	40,000	40,000	–	30,000	1·5	Bal b/d	140,000	80,000	–	–	
Bal c/f	332,800	214,600	–	144,600		Profit to 31/5/04	232,800	174,600	–	174,600	1·5
	372,800	254,600	–	174,600			372,800	254,600	–	174,600	
					3·0						3·0

Working

(W1) Interest on Christine's loan

Closing capital	£480,000
Interest at 5% for 9/12 =	£18,000

4 (a)

	Formula		2003			2004		
Gross profit percentage	Gross profit / Sales	x 100	4,600 / 20,000 x 100	=	23·00%	4,950 / 26,000 x 100	=	19·04%
Net profit percentage	Net profit / Sales	x 100	2,140 / 20,000 x 100	=	10·70%	2,180 / 26,000 x 100	=	8·38%
Return on equity	Net Profit / Equity	x 100	2,140 / 11,120 x 100	=	19·24%	2,180 / 13,300 x100	=	16·39%
Stock turnover	Cost of goods sold / Stock		15,400 / 6,000	=	2·57 times	21,050 / 6,700	=	3·14 times
Quick ratio	Current assets – stock / Current liabilities		4,520 / 3,200	=	1·41 :1	7,700 / 4,200	=	1·83 :1
Debtors collection period	Debtors / Sales	x 365	4,400 / 20,000 x 365	=	80·30 days	6,740 / 26,000 x 365	=	94·62 days

Marking Scheme

$^1/_2$ mark for correctly stating the formula and $^1/_2$ mark for each correct ratio

(b) Relevant comments could include:

– It is difficult to judge the success of the expansion over such a short period of time.
– The profitability ratios have deteriorated.
– The reduction in the gross profit percentage could be due to difficult trading conditions or that the selling prices have been lowered to generate sales.
– The deterioration in the net profit percentage is partly due to the reduced gross profit.
– The rate of stock turnover has improved which might suggest that profitability in the future will improve if (a) the capital employed reduces because of the more efficient stock levels and/or (b) the funds liberated are invested more profitably elsewhere.
– The quick ratio has improved, this is partly due to the increase in cash which may indicate that not all the cash raised from issuing the debentures has been invested.
– The debtors collection period has increased which may indicate poor credit control, or longer credit terms being offered to customers.

Marking scheme

1 mark for each relevant comment up to a maximum of 7 marks.

(c) Some of the factors Egriff Ltd should consider when deciding whether to raise finance by issuing debentures rather than issuing more shares:

1 Debentures pay a fixed level of interest. Therefore, the company will find budgeting for the cash flows straight-forward.

2 Debenture holders are long term creditors of the company and therefore do not control the company, unlike shareholders who own the company and can vote on issues affecting the company.

3 If company profits fall then share dividends do not have to be paid. However, the interest on debentures will still have to be paid regardless of the level of profit.

4 Shareholders will often expect dividend payments to grow over time, therefore increasing the costs to the company.

5 If the company was to be wound up then debenture holders would rank higher than ordinary shareholders.

Marking scheme

1 mark for each relevant comment up to a maximum of 4 marks.