Answers

1 (a) (i)

Sondaw
Income Statement for the year ended 31 May 2004

	$000	*Marks*
		0·5
Revenue	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
Profit from operations	1,549	0·5
Finance cost	(30)	0·5
Profit before tax	1,519	0·5
Tax	(250)	0·5
Net profit for the period	1,269	0·5
	Total	**18·0**

(ii)

Sondaw
Balance sheet as at 31 May 2004

		$000	Marks
			0·5
Assets			
Non-current assets			
Property, plant and equipment (W2)		3,193	3·0
Current assets			
Inventory	800		0·5
Trade and other receivables ($438 – $38 – $20 + $6)	386		2·5
Cash	50	1,236	1·0
Total assets		4,429	
Equity and liabilities			
Capital and reserves			
$1 Ordinary shares		1,500	1·0
Accumulated profits ($280 + $1,269)		1,549	1·0
		3,049	
Non-current liabilities			
5% loan notes		600	0·5
Current liabilities			
Trade and other payables ($500 + $10 + $20)	530		3·5
Taxation	250	780	0·5
Total equity and liabilities		4,429	
		Total	**14·0**

Note to marker: Although the B/S layout above is that illustrated in FRS 1, it is not the only acceptable layout. Alternative layouts are common in Singapore too. As long as the candidate demonstrates ability in current vs non-current classifications, appropriate credit should be given.

Marks

Workings

1		Cost of Sales	Distribution Costs	Administrative Expenses
		$000	$000	$000
	Opening inventory	1,200		
	General expenses (10:40:50)	60	240	300
	Electricity expenses (50:30:20)	45	27	18
	Marketing and advertising expenses ($248 – $6)			242
	Wages ($490 + $10) (60:30:10)	300	150	50
	Purchases	2,200		
	Discounts received	(150)		
	Closing inventory	(800)		
	Bad debt expense			38
	Allowance for bad and doubtful debts ($438 – $38) x 5%			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

2	Non current assets ($000)	Buildings	Motor Vehicles	Plant & Equip	Total Property Plant & Equip
		$	$	$	$
	Cost	5,000	160	700	5,860
	Accumulated depreciation b/f	(2,000)	(60)	(240)	(2,300)
	Current year's depreciation:				
	Buildings $5,000 x 5%	(250)			(250)
	Motor vehicles ($160 – $60) x 25%		(25)		(25)
	Plant & equipment ($700 – $240) x 20%			(92)	(92)
		2,750	75	368	3,193

(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**

2	Nobrie Cash flow statement for the year ended 31 May 2004			*Marks* 0·5
		$000	$000	
	Cash flows from operating activities			
	Net profit before tax	41,738		0·5
	Adjustments for:			
	Depreciation	5,862		0·5
	Investment income	(146)		0·5
	Interest paid	1,177		0·5
	Profit on equipment disposal	(1,540)		1·5
	Operating profit before working capital changes	47,091		
	Increase in inventory	(866)		1·5
	Increase in trade receivables	(5,684)		1·5
	Decrease in trade payables	(3,625)		1·5
	Cash generated from operations	36,916		
	Interest received	146		0·5
	Interest paid	(1,177)		0·5
	Tax paid	(9,191)		2·0
	Net cash from operating activities		26,694	1·0
	Cash flows from investing activities			
	Purchase of property, plant and equipment	(28,048)		4·0
	Proceeds from sale of equipment	3,053		1·0
	Net cash used in investing activities		(24,995)	1·0
	Cash flows from financing activities			
	Proceeds from issue of share capital	7,450		2·0
	Repayment of long term borrowing	(6,244)		1·0
	Net cash used in financing activities		1,206	0·5
	Net increase in cash and cash equivalents		2,905	1·0
	Cash and cash equivalents at the beginning of period		(4,749)	1·0
	Cash and cash equivalents at end of period		(1,844)	1·0
			Total	**25·0**

Examiner's note

FRS 7 allows interest paid to be an operating cash flow or a financing cash flow. Interest received can be an operating cash flow or an investing cash flow. (Same rule applies for dividends received and paid.)

Workings

1 Taxation

	$000		$000
Paid (Balancing figure)	9,191	Balance b/f	7,323
Balance c/f	7,989	Income statement	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 Non-current Asset NBV

	$000		$000
B/fwd	88,466	Depreciation	5,862
Revaluation	8,272	Disposal NBV (W2)	1,513
Additions (Balancing figure)	28,048	C/Fwd	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	
		$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	7·0

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	Bal b/f	500,000	260,000	330,000	–	
Loan a/c	–	–	480,000	–	0·5	G'dwill 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			Angela	Brenda	Christine	Hannah	
	$	$	$	$			$	$	$	$	
Drawing	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

4 (a)

	Formula		2003		2004	
Gross profit percentage	$\frac{\text{Gross profit}}{\text{Sales revenue}} \times 100$	$\frac{4,600}{20,000} \times 100$	= 23·00%	$\frac{4,950}{26,000} \times 100$	= 19·04%
Net profit percentage	$\frac{\text{Net profit}}{\text{Sales revenue}} \times 100$	$\frac{2,140}{20,000} \times 100$	= 10·70%	$\frac{2,180}{26,000} \times 100$	= 8·38%
Return on equity	$\frac{\text{Net Profit}}{\text{Equity}} \times 100$	$\frac{2,140}{11,120} \times 100$	= 19·24%	$\frac{2,180}{13,300} \times 100$	= 16·39%
Inventory turnover	$\frac{\text{Cost of sales}}{\text{Inventory}}$	$\frac{15,400}{6,000}$	= 2·57 times	$\frac{21,050}{6,700}$	= 3·14 times
Quick ratio	$\frac{\text{Current assets – inventory}}{\text{Current liabilities}}$	$\frac{4,520}{3,200}$	= 1·41 :1	$\frac{7,700}{4,200}$	= 1·83 :1
Receivables collection period	$\frac{\text{Receivables}}{\text{Sales revenue}} \times 365$	$\frac{4,400}{20,000} \times 365$	= 80·30 days	$\frac{6,740}{26,000} \times 365$	= 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 inventory turnover has improved which might suggest that profitability in the future will improve.
- 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 receivables collection period has increased which may indicate poor credit control, or longer credit terms being offered to customers, or increased sales due to the success of the expansion.

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

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

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

2 Loan note holders are non-current creditors of the company and therefore do not control the company, unlike shareholders who own the company and will be able to vote on issues affecting the company.

3 If company profits fall then share dividends do not have to be paid. However, the interest on loan notes 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 loan note holders would rank higher than ordinary shareholders.

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

Total 20 marks