Drafting Financial Statements

(UK Stream)

Paper T6(GBR)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

MONDAY 6 JUNE 2005

QUESTION PAPER

Time allowed **3 hours**

ALL FOUR questions are compulsory and MUST be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

ALL FOUR questions are compulsory and MUST be attempted

1 The trial balance of Adnett Ltd at 31 May 2005 was as follows:

	Dr	Cr
	£000	£000
Sales		3,500
Discounts received		80
Discounts allowed	70	
Bank balance	147	
Buildings at cost	1,040	
Buildings, accumulated depreciation, 1 June 2004		160
Plant at cost	1,200	
Plant, accumulated depreciation, 1 June 2004		400
Land at cost	345	
Purchases	2,170	
Returns inwards	15	
Returns outwards		17
Heating and lighting	270	
Administrative expenses	60	
Trade creditors		1,030
Trade debtors	700	
Carriage inwards	105	
Wages and salaries	250	
10% Debentures		580
General reserve		35
Provision for doubtful debts, at 1 June 2004		30
Director's remuneration	60	
Profit and loss account, at 1 June 2004		115
£1 Ordinary shares		800
Stock at 1 June 2004	515	
Share premium account		200
	6,947	6,947

Additional information as at 31 May 2005

(i) Closing stock has been counted and is valued at £560,000.

(ii) There are wages and salaries to be paid of £42,000.

(iii) Debenture interest has not been paid during the year.

(iv) The provision for doubtful debts is to be increased to £40,000.

(v) Plant is depreciated at 25% per annum using the reducing balance method. The entire charge is to be allocated to cost of sales.

(vi) Buildings are depreciated at 5% per annum on their original cost, allocated 25% to cost of sales, 50% to distribution costs and 25% to administrative expenses.

(vii) On 1 August 2004 Adnett Ltd purchased and absorbed another business as a going concern. Adnett Ltd paid £85,000 for goodwill and £35,000 for the business' stock. The purchase was paid for by the issue of 100,000 ordinary shares. This transaction has not yet been recorded in the books of Adnett Ltd. The purchased goodwill has an estimated economic life of five years. It is company policy to charge for a full year of amortisation in the first year of purchase.

(viii) During May 2005 a bonus (or scrip) issue of one for five was made to ordinary shareholders. This has not been entered into the books. The share premium account is to be used for this purpose.

(ix) No dividends have been paid or declared.

(x) The directors have agreed a transfer of £35,000 to the general reserve from the profits for the year.

(xi) Corporation tax has been calculated as £70,000 for the year.

(xii) The expenses listed below should be apportioned as indicated:

	Cost of Sales	Distribution Costs	Administrative Expenses
Discounts allowed and received	–	–	100%
Heating and lighting	40%	20%	40%
Wages and salaries	50%	25%	25%
Goodwill amortisation	–	–	100%

Required:

(a) Prepare, for external use, the following financial statements for Adnett Ltd in accordance with the Companies Act 1985 and current accounting standards.

(i) the profit and loss account for the year ended 31 May 2005; and (15 marks)

(ii) the balance sheet as at 31 May 2005. (17 marks)

(Notes to the financial statements are not required)

(b) Briefly explain the accounting treatment of purchased goodwill. (3 marks)

(35 marks)

2 The following information has been extracted from the draft financial statements of Snowdrop Ltd.

Snowdrop Ltd
Balance Sheets as at 31 May

	2005		2004	
	£000	£000	£000	£000
Fixed assets		4,600		2,700
Current assets				
Stock	580		500	
Trade debtors	360		230	
Bank	0		170	
	940		900	
Current liabilities				
Trade creditors	(450)		(365)	
Taxation	(180)		(145)	
Bank overdraft	(58)		0	
	(688)		(510)	
Net current assets		252		390
		4,852		3,090
10% Debentures (redeemable 31 May 2005)		0		(100)
		4,852		2,990
Capital and reserves				
Ordinary share capital		3,500		2,370
Share premium		300		150
Profit and loss account		1,052		470
		4,852		2,990

Additional Information

(i) The profit and loss account for the year ended 31 May 2005 shows the following:

	£000
Operating profit	1,042
Interest	(10)
Profit before taxation	1,032
Taxation	(180)
Profit after taxation	852

(ii) During the year dividends paid were £270,000.

(iii) Profit before taxation had been arrived at after charging £700,000 for depreciation on fixed assets.

(iv) During the year fixed assets with a net book value of £200,000 were sold for £180,000.

Required:

(a) Prepare a cash flow statement for Snowdrop Ltd for the year ended 31 May 2005 in accordance with FRS1 'Cash Flow Statements', using the indirect method.

(Note: The reconciliation of 'net cash flow to movement in debt' and the 'analysis of changes in net funds' are not required) (20 marks)

(b) Comment on the financial position of Snowdrop Ltd as shown by the cash flow statement you have prepared. (6 marks)

(c) Briefly state some of the ways in which companies could manipulate their year end cash position. (4 marks)

(30 marks)

3 A. Little and B. Sutton were two sole traders in the same line of business. On 1 June 2005 they decided to merge their businesses to form a partnership called Little Sutton. It was agreed that the profits from the partnership should be split between A. Little and B. Sutton in the ratio 2:1.

The balance sheets for the two sole traders as at 31 May 2005 were as follows:

Balance Sheets as at 31 May 2005

	A Little		B Sutton	
	£000	£000	£000	£000
Fixed assets				
Freehold property		110		–
Plant and equipment		25		70
		135		70
Current assets				
Stock	15		12	
Trade debtors	10		8	
Bank and cash	15	40	8	28
		175		98
Current liabilities				
Trade creditors		(15)		(19)
		160		79
Proprietors' Capital				
A. Little		160		
B. Sutton				79
		160		79

Additional information not included in the balance sheets above:

(i) The freehold property was revalued at £120,000 on 31 May 2005.
(ii) The plant and equipment which originally belonged to B. Sutton was revalued to £55,000 on 31 May 2005.
(iii) Goodwill is agreed at 31 May 2005 to be £35,000 for A. Little and £25,000 for B. Sutton. Goodwill is not to be carried in the partnership balance sheet.
(iv) All assets and liabilities are taken over by the partnership.

Required:

(a) Prepare the:

(i) capital accounts of A. Little and B. Sutton as at 31 May 2005 prior to the formation of the partnership; (4 marks)

(ii) partners' capital accounts as in the new partnership as at 1 June 2005; (3 marks)

(iii) opening balance sheet for the Little Sutton partnership. (4 marks)

(b) Briefly state two advantages and two disadvantages of A. Little and B. Sutton becoming partners rather than continuing as sole traders. (4 marks)

(15 marks)

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Question 4 begins on page 8.

4 You are presented with the following summarised accounts for F. Raser Ltd.

F. Raser Ltd
Profit and loss account for the year ended 31 May 2005

	£000
Sales	160
Cost of sales	(100)
Gross profit	60
Distribution & administrative expenses	(35)
Operating profit	25
Debenture interest	(5)
Profit before taxation	20
Taxation on profit	(10)
Profit after taxation	10
Dividends	(5)
Retained profit	5

F. Raser Ltd
Balance sheet as at 31 May 2005

	£000		£000
Fixed assets			150
Current assets			
Stock	45		
Trade debtors	25		
Cash and bank	5	75	
Current liabilities			
Trade creditors	(30)		
Taxation	(10)		
Dividends	(5)	(45)	30
Net current assets			180
Loans: 10% Debentures			(50)
Net assets			130
Capital and reserves			
£1 Ordinary shares			100
Reserves			30
			130

The ratio values for F. Raser Ltd for 2003 and 2004 as well as the current average ratio values for the industry sector in which F. Raser Ltd operates are as follows:

Ratio	Historical Data		Industry Average
	2003	**2004**	**2005**
Return on capital employed (%)	16·2	14·7	16·2
Gross profit percentage (%)	30·4	34·7	32·3
Net profit percentage (%)	19·3	17·7	17·3
Quick/Acid test ratio	1·5	1·1	1·5
Debtors collection period (days)	32·0	44·0	35·0
Earnings per share (pence)	18·0	13·0	15·0

Required:

(a) Calculate the following ratios for F. Raser Ltd for the year ended 31 May 2005. State clearly the formulae used for each ratio.

(i) Return on capital employed
(ii) Gross profit percentage
(iii) Net profit percentage
(iv) Quick/Acid test ratio
(v) Debtors collection period
(vi) Earnings per share (9 marks)

(b) Using the additional information given and the ratios you calculated in part (a), write a brief report on the financial performance of F. Raser Ltd. Indicate in your report what additional information might be useful to help interpret the ratios. (11 marks)

(20 marks)

End of Question Paper