Drafting Financial Statements
(International Stream)

Paper T6(INT)

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, a limited liability company, at 31 May 2005 was as follows:

	Dr $000	Cr $000
Revenue		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 payables		1,030
Trade receivables	700	
Carriage inwards	105	
Wages and salaries	250	
10% Loan notes		580
General reserve		35
Allowance for doubtful debts, at 1 June 2004		30
Director's remuneration	60	
Retained earnings at 1 June 2004		115
$1 Ordinary shares		800
Inventory at 1 June 2004	515	
Share premium account		200
	6,947	6,947

Additional information as at 31 May 2005

(i) Closing inventory has been counted and is valued at $560,000.
(ii) There are wages and salaries to be paid of $42,000.
(iii) Loan note interest has not been paid during the year.
(iv) The allowance 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 purchased and absorbed another business as a going concern. Adnett paid $85,000 for goodwill and $35,000 for the business' inventory. 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. At 31 May 2005 the fair value of the goodwill was $68,000.
(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 profits for the period.
(xi) 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 impairment	–	–	100%

Required:

(a) Prepare, for external use, the following financial statements for Adnett in accordance with IAS 1 Presentation of Financial Statements:

(i) the income statement 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 for purchased goodwill. (3 marks)

(35 marks)

2 The following information has been extracted from the draft financial statements of Snowdrop, a limited liability company.

Snowdrop
Balance Sheets as at 31 May

	2005		2004	
	$000	$000	$000	$000
<u>Assets</u>				
Non-current assets		4,600		2,700
Current assets				
Inventory	580		500	
Trade receivables	360		230	
Bank	0	940	170	900
Total assets		5,540		3,600
<u>Equity and liabilities</u>				
Capital and reserves				
Ordinary share capital		3,500		2,370
Share premium		300		150
Retained earnings		1,052		470
		4,852		2,990
Non-current liabilities				
10% Loan note (redeemable 31 May 2005)		0		100
Current liabilities				
Trade payables	450		365	
Taxation	180		145	
Bank overdraft	58	688	0	510
Total equity and liabilities		5,540		3,600

Additional Information

(i) The income statement for the year ended 31 May 2005 shows the following:

	$000
Operating profit	1,042
Interest payable	(10)
Profit before taxation	1,032
Taxation	(180)
Profit for financial year	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 non-current assets.

(iv) During the year non-current assets with a net book value of $200,000 were sold for $180,000.

Required:

(a) Prepare a cash flow statement for Snowdrop for the year ended 31 May 2005 in accordance with IAS 7 'Cash Flow Statements', using the indirect method. (20 marks)

(b) Comment on the financial position of Snowdrop 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 were as follows:

Balance Sheets as at 31 May 2005

	A. Little		B. Sutton	
	$000	$000	$000	$000
<u>Assets</u>				
Non-current				
Freehold property		110		–
Plant and equipment		25		70
		135		70
Current assets				
Inventory	15		12	
Trade receivables	10		8	
Bank and cash	15	40	8	28
Total assets		175		98
<u>Capital and liabilities</u>				
Proprietors' Capital				
A. Little		160		
B. Sutton				79
Current liabilities				
Trade payables		15		19
Total capital and liabilities		175		98

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, a limited liability company.

F. Raser
Income statement for the year ended 31 May 2005

	$000
Revenue	160
Cost of sales	(100)
Gross profit	60
Distribution & administrative expenses	(35)
Profit from operations	25
Finance cost	(5)
Profit before tax	20
Tax expense	(10)
Net profit for the period	10

F. Raser
Balance sheet as at 31 May 2005

	$000	$000
Assets		
Non-current assets		150
Current assets		
Inventory	45	
Trade receivables	25	
Cash and bank	5	75
Total Assets		225
Equity and liabilities		
Capital and reserves		
$1 Ordinary shares		100
Reserves		30
		130
Non-current liabilities		
10% loan notes		50
Current liabilities		
Trade payables	30	
Taxation	10	
Dividends (for the year)	5	45
Total equity and liabilities		225

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

Ratio	Historical Data 2003	Historical Data 2004	Industry Average 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
Receivables collection period (days)	32·0	44·0	35·0
Earnings per share (cents)	18·0	13·0	15·0

Required:

(a) Calculate the following ratios for F. Raser 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) Receivables 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. Indicate in your report what additional information might be useful to help interpret the ratios. (11 marks)

(20 marks)

End of Question Paper