Answers

1 (a) Tonson Ltd

Trading and Profit and Loss Account for the year ended 31 October 2006

	£000	£000	Marks
			0·5
Sales		5,780	0·5
Less returns inward		(95)	1·0
		5,685	
Opening stock	350		0·5
Add purchases	3,570		0·5
	3,920		
Less closing stock (275 – 25)	(250)		1·0
Cost of sales		(3,670)	
		2,015	
Discounts received		50	1·0
Gross profit		2,065	0·5
General expenses	60		0·5
Insurance	75		0·5
Marketing expenses (W1)	45		1·5
Wages and salaries (W2)	715		1·5
Energy expenses	66		0·5
Telephone	80		0·5
Property expenses	100		0·5
Debenture interest	33		0·5
Debtors expense (W3)	155		1·5
Depreciation: Buildings	75		1·5
Motor vehicles	32		1·5
Furniture and equipment	240		1·5
		(1,676)	
Net profit before taxation		389	
Corporation tax		(150)	0·5
Net profit for the period		239	
		Total	18·0

				Marks
(b)	**Tonson Ltd**			
	Balance sheet as at 31 October 2006			0·5
Fixed Assets	**Cost/ Valuation £000**	**Accumulated Depreciation £000**	**Net Book Value £000**	
Land	740	0	740	0·5
Buildings	1,800	0	1,800	0·5
Furniture and equipment (W4)	1,200	660	540	1·0
Motor vehicles (W5)	240	112	128	1·0
	3,980	772	3,208	0·5
Current assets				
Stock		250		1·0
Debtors	900			0·5
Less allowance	(45)	855		1·0
Prepayments		5		1·0
Cash in hand		15		0·5
		1,125		
Creditors: amounts falling due within one year				
Trade creditors		290		0·5
Corporation Tax		150		0·5
Accruals		40		1·0
Bank overdraft		94		1·0
		574		
Net current assets			551	0·5
Total assets less current liabilities			3,759	
Creditors: amounts falling due after more than one year				
7% Debentures			(470)	1·0
			3,289	
Capital and reserves				
£1 Ordinary shares (£1,800 + £180)			1,980	1·0
Share premium account (£200 – £180)			20	1·0
Revaluation reserve (W6)			735	1·5
Profit and loss account (£315 + £239)			554	1·0
			3,289	
			Total	**17**

Working Papers

W1 **Marketing expenses**

	£		£
Balance as per TB	50,000	Profit and loss account	45,000
		Prepayment c/f	5,000
	50,000		50,000

W2 **Wages and Salaries**

	£		£
Balance as per TB	675,000	Profit and loss account	715,000
Wages accrued c/f	40,000		
	715,000		715,000

Marks

W3 **Debtors expense**

	£		£
Balance as per TB	150,000	Profit and loss account	155,000
Allowance for debtors	5,000		
	155,000		155,000

Allowance for Debtors

	£		£
Balance c/f	45,000	Balance as per TB	40,000
		Bad debts	5,000
	45,000		45,000

W4 **Furniture and Equipment Accumulated Depreciation**

	£		£
Balance c/f	660,000	Balance as per TB	420,000
		20% of £1,200,000	240,000
	660,000		660,000

W5 **Motor Vehicles Accumulated Depreciation**

	£		£
Balance c/f	112,000	Balance as per TB	80,000
		20% of (£240,000 – £80,000)	32,000
	112,000		112,000

W6 **Revaluation Reserve**

Depreciation on buildings for the year is calculated as £1,500,000 x 5% = £75,000
Therefore the net book value of the buildings is £1,065,000 at the end of the year, i.e. £1,500,000 – £360,000 – £75,000.
When the buildings are revalued at the end of the year a revaluation reserve is created of £735,000. i.e. £1,800,000 – £1,065,000 = £735,000.

2 (a) H Marathon Ltd

Cash flow statement for the year ended 31 October 2006 0·5

	£000	£000	Marks
Net cash inflow from operating activities (Note 1)		23,294	1
Returns on investments and servicing of finance			
Interest received	101		1
Interest paid	(1,749)		1
		(1,648)	
Taxation			
Corporation tax paid (W4)		(2,395)	2
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets (W1)	(7,671)		3
Receipts from sales of tangible fixed assets	5,667		1
		(2,004)	
Equity dividends paid		(3,697)	1
Net cash inflow before financing		13,550	
Financing			
Issues of ordinary share capital	4,231		1
Redemption of debentures	(16,889)		1
Net cash outflow from financing		(12,658)	
Increase in cash for the period		892	1

Marks

NOTES TO THE CASH FLOW STATEMENT:

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

	£000	
Operating profit	12,537	1
Depreciation	6,784	1
Profit on sale of tangible fixed assets	(1,806)	1
Decrease in stocks	3,015	0·5
Decrease in debtors	3,034	0·5
Decrease in creditors	(270)	0·5
Net cash inflow from operating activities	23,294	
	Total	18

For information only

2 **Reconciliation of net cash flow to movement in net debt**

	£000	£000
Increase in cash for the period	892	
Cash outflow from decrease in debt for period	16,889	
Change in net debt resulting from cash flows		17,781
Net debt at 1/11/2005		(27,438)
Net debt at 31/10/2006		(9,657)

3 **Analysis of changes in net debt**

	At 31/10/2005 £000	Cash flows £000	At 31/10/2006 £000
Cash at bank and in hand	3,036	(81)	2,955
Bank overdrafts	(7,842)	973	(6,869)
	(4,806)	892	(3,914)
Debt due after 1 year	(22,632)	16,889	(5,743)
Total	(27,438)	17,781	(9,657)

Workings (all in £000):

W1 **Fixed assets at cost**

B/f	124,252	Disposal	5,296
Reval'n	6,525		
Additions	*7,671*	c/f	133,152
	138,448		138,448

W2 **Accumulated depreciation**

On disposals	*1,435*	b/f	25,629
c/f	30,978	Charge	6,784
	32,413		32,413

W3 **Fixed assets disposal a/c**

Cost	*5,296*	Acc dep	1,435
Profit	1,806	Cash	5,667
	7,102		7,102

W4 **Taxation**

Paid	*2,395*	B/f	1,926
C/f	2,101	P&L	2,570
	4,496		4,496

Note: the entries in italics in these t-accounts are the 'balancing figures'.

Alternative workings:

Additions of fixed assets:

Opening net book value	98,623
Disposals (5,667 – 1,806)	(3,861)
Depreciation	(6,784)
Revaluation (12,554 – 6,029)	6,525
	94,503
Additions (Balancing figure)	*7,671*
Closing net book value	102,174

Fixed assets NBV

B/forward	98,623	Disposals	3,861
Revaluation	6,525	Depr'tion	6,784
Add'ns (bal)	*7,671*	C/f	102,174
	112,819		112,819

Marks

(b) Over the period there was a net cash inflow to the business of £892,000. (1 mark)

The company purchased fixed assets of £7,671,000. The purchase of new fixed assets may help operational efficiency and therefore improve future cashflows. (2 marks)

The company was able to generate additional cash by selling fixed assets for £5,667,000. (1 mark)

Debentures of £16,889,000 were redeemed, this will reduce interest payments in the future. (2 marks)

Stock levels were reduced by £3,015,000. This might indicate the company has adopted better inventory control procedures which should have a positive impact on future cash flows. (2 marks)

Debtors were reduced by £3,034,000 and there was a small decrease in creditors. These changes may indicate better cash flow management procedures being adopted by the company. (2 marks)

Marking scheme – Other relevant comments may be acceptable. Maximum of 8 marks

(c) Cash flow statements may be more useful than profit statements for the following reasons:

Cash flow statements help users understand where the company has generated its cash and how it has been applied during the period.

Cash flow statements are more objective than profit statements as they cannot be manipulated by choosing more favourable accounting policies.

Cash flow statements provide a useful insight into the changes in the structure of working capital.

Cash flow statements enable users to establish whether the company is able to repay its debts.

Marking scheme – Up to 4 marks for relevant comments

3 (i) **Partners' Accounts**

	Nyfe	Ork	Poon		Nyfe	Ork	Poon	
	£	£	£		£	£	£	
Realisation a/c			9,000	Capital a/cs	45,000	30,000	15,000	1
Cash	56,255	38,453	12,802	Current a/cs	9,750	7,450	6,300	2
				Realisation a/c	1,505	1,003	502	1
	56,255	38,453	21,802		56,255	38,453	21,802	
							Total	**4**

(ii) **Realisation Account**

		£		£		
Furniture & fittings (NBV)		50,000	Loan a/c	18,000	0·5	0·5
Motor vehicles (NBV)		35,000	Creditors	26,500	0·5	0·5
Stock		25,000			0·5	
Debtors		42,000			0·5	
Cash and bank:			Cash and bank:			
Loan		18,000	Furniture and fittings	48,800	0·5	0·5
Creditors		25,440	Motor vehicles	29,500	0·5	0·5
Dissolution expenses		1,000	Stock	27,750	0·5	0·5
Profit on realisation:	Nyfe 3/6	1,505	Debtors	39,900	1	0·5
	Ork 2/6	1,003	Poon (motor vehicle)	9,000	1	0·5
	Poon 1/6	502			1	
		199,450		199,450	**Total**	**10**

(iii) **Cash and bank**

	£			£		
Balance	6,000	Realisation A/c:			0·5	
Realisation a/c		Loan		18,000		0·5
Furniture and fittings	48,800	Creditors		25,440	0·5	0·5
Motor vehicles	29,500	Dissolution expenses		1,000	0·5	1
Stock	27,750	Partners a/c:	Nyfe	56,255	0·5	0·5
Debtors	39,900		Ork	38,453	0·5	0·5
			Poon	12,802		0·5
	151,950			151,950		
					Total	**6**

4 (a)

	Formula		Binky Ltd				Smokey Ltd			
Gross profit percentage	$\frac{\text{Gross profit}}{\text{Sales}}$	x 100	$\frac{129}{284}$	x 100	=	45·4 %	$\frac{154}{305}$	x 100	=	50·5 %
Net profit percentage	$\frac{\text{Net profit}}{\text{Sales}}$	x 100	$\frac{61}{284}$	x 100	=	21·5 %	$\frac{47}{305}$	x 100	=	15·4 %
Asset Turnover ratio	$\frac{\text{Sales}}{\text{Capital employed}}$	x 100	$\frac{284}{258}$	x100	=	110·1 %	$\frac{305}{477}$	x 100	=	63·9 %
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$		$\frac{201}{188}$		=	1·1 :1	$\frac{383}{325}$		=	1·2 :1
Quick ratio	$\frac{\text{Current assets – stock}}{\text{Current liabilities}}$		$\frac{110}{188}$		=	0·6 :1	$\frac{90}{325}$		=	0·3 :1
Debtors collection period	$\frac{\text{Debtors}}{\text{Sales}}$	x 365	$\frac{46}{284}$	x 365	=	59·1 days	$\frac{75}{305}$	x 365	=	89·8 days

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

(b) Relevant comments could include:

- Smokey Ltd has a higher gross profit percentage than Binky Ltd – Smokey Ltd may have a cheaper supplier than Binky Ltd or benefit from discounts. Alternatively, its market position or geographical location may enable the company to charge a premium.
- The net profit percentage for Smokey Ltd is significantly lower than Binky Ltd suggesting that Smokey Ltd is not controlling its expenses as tightly as Binky Ltd.
- Binky Ltd is able to obtain a significantly higher level of sales from its assets, suggesting the company is being run more efficiently.
- The current ratios indicate that both companies have sufficient current assets to meet their current liabilities. However, the quick ratios reveal a more worrying picture.
- The quick ratios for both companies are less than 1. Smokey Ltd has a very low quick ratio of 0·3 and may not be able to pay its debts as they become due. The very high stock levels may indicate poor stock control, it might be that some of the stock is unsellable.
- The debtors collection period for Smokey Ltd is significantly higher than Binky Ltd. This will obviously be contributing to the company's adverse liquidity position. Action is required to improve the debt collection procedures.
- Overall Binky appears to be the better company to invest in, from the information given.

Marking scheme
1 mark for each relevant comment up to a maximum of 6 marks.