Answers

1 (a) Tonson

Income statement for the year ended 31 October 2006

	$000	$000	Marks
Tonson			
Income statement for the year ended 31 October 2006			0·5
Sales revenue		5,780	0·5
Less returns inward		(95)	1·0
		5,685	
Opening inventory	350		0·5
Add purchases	3,570		0·5
	3,920		
Less closing inventory (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
Loan note interest	33		0·5
Receivables 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	
Tax		(150)	0·5
Net profit for the period		239	
		Total	18·0

				Marks
(b)		**Tonson**		
		Balance sheet as at 31 October 2006		0·5
Assets	**Cost/ Valuation**	**Accumulated Depreciation**	**Net Book Value**	
Non-current assets	**$000**	**$000**	**$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				
Inventory		250		1·0
Trade receivables	900			0·5
Less allowance	(45)	855		1·0
Prepayments		5		1·0
Cash in hand		15	1,125	0·5
Total assets			4,333	0·5
Equity and liabilities				
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
Retained earnings ($315 + $239)			554	1·0
			3,289	
Non-current liabilities				
7% Loan notes			470	1·0
Current liabilities				
Trade payables		290		0·5
Tax		150		0·5
Accruals		40		1·0
Bank overdraft		94	574	1·0
Total equity and liabilities			4,333	
			Total	**17.0**

Working Papers

W1 **Marketing expenses**

	$		$
Balance as per TB	50,000	Income statement	45,000
		Prepayment c/f	5,000
	50,000		50,000

W2 **Wages and Salaries**

	$		$
Balance as per TB	675,000	Income statement	715,000
Wages accrued c/f	40,000		
	715,000		715,000

Marks

W3 **Receivables Expense**

	$		$
Balance as per TB	150,000	Income statement	155,000
Allowance for receivables	5,000		
	155,000		155,000

Allowance for receivables

	$		$
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
		Inc. Statem't (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
		Inc. Statem't 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.

			Marks
2 (a) Prepared in accordance with IAS 7			
H Marathon			
Cash flow statement for the year ended 31 October 2006			0·5
	$000	**$000**	
Cash flows from operating activities			
Net profit before tax	10,889		1
Adjustments for			
Depreciation	6,784		1
Interest received	(101)		0·5
Interest paid	1,749		0·5
Profit on equipment disposal	(1,806)		1
Operating profit before working capital changes	17,515		
Decrease in inventory	3,015		0·5
Decrease in receivables	3,034		0·5
Decrease in payables	(270)		0·5
Cash generated from operations	23,294		
Interest received	101		0·5
Interest paid	(1,749)		0·5
Tax paid (W4)	(2,395)		2
Net cash from operating activities		19,251	
Cash flows from investing activities			
Purchase of property, plant and equipment (W1 to W3)	(7,671)		3
Proceeds from sale of equipment	5,667		1
Dividends paid	(3,697)		1
Net cash used in investing activities		(5,701)	
Cash flows from financing activities			
Proceeds from issues of share capital	4,231		1
Repayment of long term borrowing	(16,889)		1
Net cash used in financing activities		(12,658)	
Net increase in cash and cash equivalents		892	1
Cash and cash equivalents at the beginning of the period		(4,806)	1
Cash and cash equivalents at the end of the period		(3,914)	
		Total	**18**

Examiner's note

IAS 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. Dividends paid can be shown as cash flows from investing activities or cash flows from financing activities.

Workings (all in $000):

W1 Non-current 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 dis-posals	*1,435*	b/f	25,629
		Charge	6,784
c/f	30,978		
	32,413		32,413

W3 Non-current 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	Inc. stat.	2,570
	4,496		4,496

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

Marks

Alternative workings:

Additions of non-current 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

Non-current 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

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

The company purchased non-current assets of $7,671,000. The purchase of new non-current assets may help operational efficiency and therefore improve future cash flows. (2 marks)

The company was able to generate additional cash by selling non-current assets for $5,667,000. (1 mark)

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

Inventory 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)

Receivables were reduced by $3,034,000 and there was a small decrease in payables. 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 $	Marks
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	Payables	26,500	0·5	0·5
Inventory		25,000			0·5	
Receivables		42,000			0·5	
Cash and bank:			Cash and bank:			
Loan		18,000	Furniture and fittings	48,800	0·5	0·5
Payables		25,440	Motor vehicles	29,500	0·5	0·5
Dissolution expenses		1,000	Inventory	27,750	0·5	0·5
Profit on realisation:	Nyfe 3/6	1,505	Receivables	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**

							Marks
(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	Payables		25,440	0·5	0·5	
Motor vehicles	29,500	Dissolution expenses		1,000	0·5	1	
Inventory	27,750	Partners a/c:	Nyfe	56,255	0·5	0·5	
Receivables	39,900		Ork	38,453	0·5	0·5	
			Poon	12,802		0·5	
	151,950			151,950			
					Total	6	

4 (a)

	Formula		Binky				Smokey			
Gross profit percentage	Gross profit / Sales x 100	129 / 284	x 100	=	45·4	%	154 / 305 x 100	=	50·5	%
Net profit percentage	Net profit / Sales x 100	61 / 284	x 100	=	21·5	%	47 / 305 x 100	=	15·4	%
Asset Turnover ratio	Sales / Capital employed x 100	284 / 258	x100	=	110·1	%	305 / 477 x 100	=	63·9	%
Current ratio	Current assets / Current liabilities	201 / 188		=	1·1	:1	383 / 325	=	1·2	:1
Quick ratio	Current assets – inventory / Current liabilities	110 / 188		=	0·6	:1	90 / 325	=	0·3	:1
Rec'bles collection period	Receivables / Sales x 365	46 / 284	x 365	=	59·1	days	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 has a higher gross profit percentage than Binky. Smokey may have a cheaper supplier than Binky 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 is significantly lower than Binky suggesting that Smokey is not controlling its expenses as tightly as Binky.
- Binky 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 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 inventory levels may indicate poor inventory control, it might be that some of the inventory is unsellable.
- The receivables collection period for Smokey is significantly higher than Binky. 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.