Answers

1 (a) (i)

Malright
Income statement for the year ended 31 October 2007

	$000	Marks	Workings $000
Income statement for the year ended 31 October 2007		0·5	
Revenue	1,765	1·0	(1,800 – 35)
Cost of sales (W1)	(1,343)	4·0	
Gross profit	422		
Distribution costs (W1)	(80)	1·5	
Administrative expenses (W1)	(192)	4·5	
Profit from operations	150		
Finance cost	(5)	1·0	
Profit before tax	145		
Tax	(45)	1·0	
Profit for the period	100	0·5	
		14·0	

(ii)

Malright
Balance sheet as at 31 October 2007

	$000	$000	Marks	Workings
Balance sheet as at 31 October 2007			0·5	
Assets				
Non-current assets				
Property, plant and equipment (W2)		966	3·5	
Current assets				
Inventory	75		0·5	
Trade receivables	304	379	1·0	(320 – 16)
Total assets		1,345	0·5	
Equity and liabilities				
Capital and reserves				
$1 Ordinary shares		650	0·5	
Share premium account		80	0·5	
Retained earnings		200	2·0	(130 + 100 – 30)
		930		
Non-current liabilities				
10% Loan notes		50	1·0	
Current liabilities				
Bank overdraft	50		1·0	
Trade payables	250		0·5	
Current tax	45		1·0	
Energy expenses accrual	15		1·0	
Loan notes interest	5	365	1·0	
Total equity and liabilities		1,345	0·5	
			15·0	

Workings

W1

	Cost of Sales $000	Distribution Cost $000	Administrative Expenses $000	
Purchases	1,105			
Discounts received			(90)	(*1 mark*)
Wages (40:25:35)	72	45	63	
Energy expenses ($105 + $15) (40:20:40)	48	24	48	
Opening inventory	160			
Administrative expenses			80	
Increase in allowance for receivables ((320 x 0·05) – 10)			6	(*1 mark*)
Director's remuneration			70	
Closing inventory	(75)			(*1 mark*)
Depreciation – buildings (30:30:40)	11	11	15	
Depreciation – plant	22			
	1,343	80	192	
	(*4 marks*)	(*1·5 marks*)	(*4·5 marks*)	

W2 Non-current assets

	Land $000	Buildings $000	Plant $000	Total Property, Plant & Equipment $000
Cost	235	740	220	1,195
Accumulated depreciation b/f	–	(60)	(110)	(170)
Current year's depreciation:				
Buildings $740 x 5%		(37)		(37)
Plant ($220 – $110) x 20%			(22)	(22)
	235	643	88	966
	(*0·5 mark*)	(*1·5 marks*)	(*1·5 marks*)	(*3·5 marks*)

(b) Accounting ratios for Malright

(i) Quick ratio (acid test ratio) $\frac{\text{Current assets – inventory}}{\text{Current liabilities}}$:1 $= \frac{379 - 75}{365} = 0{\cdot}83{:}1$

(ii) Interest cover $\frac{\text{Profit before interest and tax}}{\text{Interest}} = \frac{150}{5} =$ 30 times

(iii) Earnings per share $\frac{\text{Profit after tax}}{\text{No of ordinary shares}} = \frac{100}{650} =$ 15·4 cents

(iv) Price earnings ratio $\frac{\text{Current share price per share}}{\text{Earnings per share}} = \frac{130}{15{\cdot}4} = 8{\cdot}4$

Marking scheme: A total of 6 marks – 0·5 mark for stating the correct formula and 1 mark for the correct ratio.

2 (a) Appropriation Account for the year ended 31 October 2007

	$	$		Marks
Net profit		134,904		0·5
Less partners' salaries				
Alan	30,000		)	
Bob	35,000		)	1
Colin	28,000	(93,000)	)	
Less interest on capital				
Alan	4,000		)	
Bob	3,500		)	1
Colin	3,000	(10,500)	)	
Net profit available for appropriation		31,404		
Alan 3/6		15,702		0·5
Bob 2/6		10,468		0·5
Colin 1/6		5,234		0·5
		31,404		4

(b) Partners' Current Accounts

	Alan $	Bob $	Colin $		Alan $	Bob $	Colin $	Marks
Bal b/f	–	–	1,600	Bal /b/f	2,800	1,200	–	1 + 1
Drawings	22,000	17,000	25,000	Int on cap	4,000	3,500	3,000	1 + 1
Capital a/c	30,502			Salaries	30,000	35,000	28,000	1 + 1
Bal c/f		33,168	9,634	Profit	15,702	10,468	5,234	1 + 1
	52,502	50,168	36,234		52,502	50,168	36,234	8

(c) Partners' Capital Accounts

	Alan $	Bob $	Colin $		Alan $	Bob $	Colin $	Marks
Goodwill		28,800	43,200	Bal b/f	40,000	35,000	30,000	1 + 1
Loan a/c	109,502			Cash		15,000	15,000	1 + 1
Bal c/f		47,200	14,800	Revaluation a/c	3,000	2,000	1,000	1 + 2
				Goodwill: 3:2:1	36,000	24,000	12,000	1
				Current a/c	30,502			1
	109,502	76,000	58,000		109,502	76,000	58,000	9

Working for Revaluations

	Book Value $	Revalued amount $	Change $
Property	120,000	136,000	16,000
Equipment and machinery	40,000	35,000	(5,000)
Inventory	22,000	18,000	(4,000)
Receivables	18,000	17,000	(1,000)
Net Change			6,000

New valuations apportioned to each partner

Alan	3/6	3,000
Bob	2/6	2,000
Colin	1/6	1,000
		6,000

(d) Advantages of operating as a partnership:

(i) Business risk is spread amongst more people.
(ii) Individual partners may be able to specialise in particular activities within the business.
(iii) Access to a larger pool of capital.

Disadvantages of operating as a partnership:

(i) Disputes might arise between the partners.
(ii) Decision making may take longer if all partners have to be consulted.

Marking scheme: 1 mark for each relevant point up to a maximum of 4 marks

3 (a)

Goodwill on acquisition	$000	$000	Workings $000	Marks
Cost of investment		3,345		0·5
Share capital	2,800			1
Retained earnings	42	(2,842)	(70% x 60)	1·5
Goodwill		503		3

(b) Prestend
Consolidated Balance Sheet as at 31 October 2007

	$000	$000	Workings $000	Marks
				0·5
Assets				
Non-current assets				
Property, plant and equipment		7,500	(4,200 + 3,300)	0·5
Current assets				
Inventory	2,280		(1,500 + 800 – 20)	1·5
Trade receivables	2,520		(1,800 + 750 – 30)	1·5
Bank	950	5,750	(600 + 350)	0·5
Total assets		13,250		
Equity and liabilities				
Capital and reserves				
$1 Ordinary shares		9,000		1
Retained earnings		100	(W1)	4·5
Minority Interest		1,260	(W2)	2
		10,360		
Current liabilities				
Payables		1,390	(1,220 + 200 – 30)	1·5
Tax		1,500	(700 + 800)	0·5
Total equity and liabilities		13,250		
				14

Workings

W1 Retained earnings

Prestend balance		525	0·5
Retained earnings of Northon (70% x $200,000)		140	1
Pre acquisition reserves (70% x $60,000)	(42)		1
Less Goodwill	(503)		1
Unrealised profit on purchases from Prestend	(20)	(565)	1
Reserves		100	4·5

W2 Minority Interest

Share Capital (30% x $4,000,000)	1,200	1
Retained earnings (30% x $200,000)	60	1
Minority Interest	1,260	2

(c) The existence of significant influence might be demonstrated where there is:

(a) A holding of 20% or more of the shares in the investee company, but less than 50%.
(b) Participation in the policy making process of the investee company.
(c) Material transactions between the two companies.
(d) An interchange of management personnel beween the companies.
(e) The provision of essential technical information by the investor company.
(f) A representative of the investor company on the board of directors of the investee company.

Marking scheme: 1 mark for each circumstance up to a maximum of 3 marks.

4 (a) Prepared in accordance with IAS 7

Geofost
Cash flow statement for the year ended 31 October 2007

	$000	$000	Marks
Cash flows from operating activities			
Net profit before tax	15,000		0·5
Adjustments for:			
Depreciation	4,658		1
Finance cost	730		0·5
Profit on disposal of non-current assets	(720)		1
Operating profit before working capital changes	19,668		
Decrease in inventory	6,075		1
Increase in receivables	(1,863)		1
Increase in payables	3,178		1
Cash generated from operations	27,058		
Interest paid (100 – 120 + 730)	(710)		1·5
Tax paid (W1)	(4,090)		1
Net cash from operating activities		22,258	
Cash flows from investing activities			
Payments to acquire property, plant & equipment	(24,340)		1
Proceeds from sale of property, plant & equipment	2,694		0·5
Net cash used in investing activities		(21,646)	
Cash flows from financing activities			
Proceeds from issue of share capital	1,869		1
Repayment of long term borrowing	(2,300)		1
Dividend paid	(1,486)		1
Net cash used in financing activities		(1,917)	
Net increase (decrease) in cash and cash equivalents		(1,305)	0·5
Cash and cash equivalents at the beginning of period		634	0·5
Cash and cash equivalents at end of period		(671)	
			14

Examiner's note

IAS 7 allows interest paid and dividend paid to be an operating cash flow or a financing cash flow.

Workings (all in $000):

W1 Taxation

Paid	4,090	B/f	2,760
C/f	3,020	Income statement	4,350
	7,110		7,110

Note: The 'Paid' entry is the 'balancing figure'.

(b) Over the period there was a net cash outflow from the business of $1,305,000.

The company purchased non-current assets of $24,340,000. The purchase of new non-current assets may help the future operational efficiency of the business and therefore improve future cash flows.

The company generated additional cash by selling non-current assets for $2,694,000 which yielded a profit on their NBV of $720,000.

Loan notes of $2,300,000 were repaid, this will reduce interest payments in the future. However, the bank overdraft has increased by $801,000. This will inevitably increase the cost of finance from the bank.

Inventory levels were reduced by $6,075,000. This had a positive impact on the cash flow of the business.

Receivables have increased by $1,863,000. This might suggest increased sales or that debt collection arrangements need tightening up.

The payables increase is good for cash flow but potentially may lead to problems with suppliers if the company does not stay within agreed credit terms. Payables have almost doubled and the company may find they are no longer given credit.

Marking scheme – Other relevant comments may be acceptable. Maximum of 6 marks