Accounting Technicians Ireland

Financial Accounting II

2nd Year Examination

May 2010

Paper, Solutions & Examiner's Report

NOTES TO USERS ABOUT THESE SOLUTIONS

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Although they are published by us, we do not necessarily endorse these solutions or agree with the views expressed by their authors.

There are often many possible approaches to the solution of questions in professional examinations. It should not be assumed that the approach adopted in these solutions is the ideal or the one preferred by us. Alternative answers will be marked on their own merits.

This publication is intended to serve as an educational aid. For this reason, the published solutions will often be significantly longer than would be expected of a candidate in an examination. This will be particularly the case where discursive answers are involved.

Accounting Technicians Ireland

Accounting Technicians Ireland

2nd Year Examination: Summer 2010

Paper : FINANCIAL ACCOUNTING II

Monday 17th May 2010 - 2.30 p.m. to 5.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

Candidates must indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

Answer ALL THREE questions in Section A and TWO of the THREE questions in Section B. If more than TWO questions are answered in Section B, then only the first TWO questions, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All workings should be shown.

All figures should be labelled, as appropriate, e.g. €'s, £'s, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

The following insert is enclosed with this paper:

- **Multiple choice question answer sheet [QUESTION 2]**

Note:
This paper uses both the language of International Accounting Standards (I.A.S's) and Financial Reporting Standards (F.R.S's) where appropriate (e.g. Receivables/Debtors). Examinees are permitted to use either terminology when preparing financial statements but the use of the language of the International Accounting Standards (e.g. Receivables rather than Debtors) is preferred.

SECTION A

Answer ALL THREE Questions in this Section

QUESTION 1 (*Compulsory)*

The IASB developed a 'Framework for the Presentation and Preparation of Financial Statements' which provides critical guidance on the basic principles of financial accounting.

Requirement

(a) Explain briefly the purpose of the *Framework*. **6 Marks**

(b) Chapter One of the *Framework* states that the objective of financial statements is to provide information about an entity that is useful to a wide range of users in making economic decisions. Describe what useful information is provided by each of the following components of financial statements:

i. Income statement
ii. Balance sheet
iii. Cash flow statement

9 Marks

(c) Explain the terms 'accruals basis' and 'going concern' as discussed in Chapter Two of the *Framework*.

5 Marks
Total 20 Marks

QUESTION 2 (*Compulsory)*

The following multiple choice questions consists of TEN parts, each of which is followed by FOUR possible answers. There is ONLY ONE right answer in each part.

Each part carries 1½ marks.

Requirement

Indicate the right answer to each of the following ten parts. **Total 15 Marks**

NB *Candidates should answer this question by ticking the appropriate boxes on the specified green answer sheet which is supplied with the examination paper.*

[1] IAS 1 requires that financial statements are prepared on a going concern basis, which assumes that an entity will continue in business for a period of at least:

[a] twelve months from the end of the financial year.

[b] twelve months from the date the financial statements are signed.

[c] six months from the date the financial statements are signed.

[d] six months from the end of the financial year.

[2] If a business identifies a prior period error, IAS 8 states that in the first set of financial statements issued after the entity discovers the error, the entity must:

[a] correct all material errors retrospectively.

[b] correct all material errors as if they had occurred in the current year.

[c] correct all errors retrospectively.

[d] correct all errors as if they had occurred in the current year.

QUESTION 2 *(Cont'd)*

[3] An unqualified audit report, as issued by an external auditor, is:

[a] saying with certainty that the financial statements are accurate.

[b] saying that the financial statements do not show a true and fair view.

[c] saying that the financial statements show a true and fair view.

[d] saying with certainty that the financial statements are not accurate.

[4] In preparing a cash flow statement in accordance with IAS 7, an increase in receivables:

[a] is added back to profit when computing net cash flow from operating activities.

[b] is deducted from operating profit when computing net cash flow from operating activities.

[c] has no impact on cash flow from operating activities .

[d] is treated the same as an increase in payables when computing net cash flow from operating activities.

[5] In the event that partners do not draw up a partnership agreement, the Partnership Act 1890 applies and states that:

[a] Profits and losses are shared in accordance with capital account balances at start of year.

[b] Profits and losses are shared in accordance with current account balances at year end.

[c] Profits and losses are shared in accordance with capital account balances at year end.

[d] Profits and losses are shared equally.

QUESTION 2 *(Cont'd)*

[6] If the accounting records for a business show closing stock of £/€50,000 and £/€60,000 for the years ended 31 December 2007 and 31 December 2008 respectively and the turnover generated in 2008 amounts to £/€800,000 giving a gross margin of 17.5%, then the purchases for 2008 are:

[a] £/€670,000

[b] £/€550,000

[c] £/€690,851

[d] £/€790,000

[7] Company A has completed the construction of a new corporate head quarters. Construction costs are as follows:

	£/€
Site preparation	148,000
Materials	450,000
Labour	635,000
Professional fees	34,000
Re-design costs	75,000
Costs of re-locating to new head quarters	18,000

The original design needed to be revised two months into the project and it is estimated that 5% of professional fees and labour were incurred as a result of the re-design. The cost of the head quarters to be capitalised in accordance with IAS 16 'Property, plant and equipment' is:

[a] £/€1,267,000

[b] £/€1,360,000

[c] £/€1,251,550

[d] £/€1,233,550

QUESTION 2 *(Cont'd)*

[8] In accordance with IAS 2 'Inventories', which of the following costs cannot be included as part of the cost of inventory:

[a] Variable overheads.

[b] Import duties.

[c] Selling costs.

[d] Fixed overheads.

[9] According to IAS 17 'Leases', which of the following statements is true:

[a] A finance lease is a lease that has a minimum period of over five years.

[b] A finance lease is a lease that transfers substantially all the risks and rewards of ownership to the lessee.

[c] A finance lease is a lease which the lessee has the ability to continue for a secondary period at a rent greater than the market rent.

[d] A finance lease is a lease that is usually for a period greater than half the useful economic life of the asset.

[10] In accordance with IAS 20 'Government Grants', a grant should not be recognised in the income statement until:

[a] The conditions for its receipt have been complied with and there is reasonable assurance that the grant will be received.

[b] The conditions for its receipt have been complied with and the total value of the grant has been received.

[c] The majority of the conditions for its receipt have been complied with and there is reasonable assurance that the grant will be received.

[d] The majority of the conditions for its receipt have been complied with and the expense to which the grant relates has been incurred.

QUESTION 3 (*Compulsory)*

The following trial balance has been extracted from the records of CORCORAN Limited
31 December 2009:

TRIAL BALANCE AS AT 31 DECEMBER 2009

	DR £/€'000	CR £/€'000
Ordinary shares (of £/€0.50 ea)		15,000
10% debentures		13,000
Retained earnings at 1 January 2009		4,740
Freehold premises (land element £/€6,000,000)	10,500	
Freehold premises accumulated depreciation		1,800
Factory plant & equipment	4,000	
Factory plant & equipment accumulated depreciation		2,300
Motor vehicles	1,500	
Motor vehicles accumulated depreciation		650
Inventory at 1 January 2009	16,900	
Trade receivables	16,300	
Trade payables		2,750
Sales revenue		54,500
Sales returns	800	
Purchases	29,400	
Purchase returns		350
Administration expenses	6,500	
Distribution expenses	7,800	
Debenture interest	650	
Deferred income		40
Taxation	30	
Cash at bank	750	
	95,130	**95,130**

QUESTION 3 *(Cont'd)*

The following items are to be adjusted for in preparing the financial statements for the year ended 31 December 2009.

1. Depreciation is to be provided as follows:

Premises 2% per year on cost

Factory plant & equipment 5% per year on cost

Motor vehicles 20% reducing balance

Depreciation on premises is to be charged as follows:

60% to cost of sales

20% to each of distribution costs and administration costs

2. Sales of goods, which cost £/€45,000, were sold on credit for £/€55,000, inclusive of VAT of 10%. This sale was not accounted for at all in the accounts.

3. Closing inventory, as per the physical stock count, was £/€20,300,000. The goods sold at (2) above are included in this figure in error.

4. Government grants of £/€90,000 were due to the company at year end in respect of training costs which are included in administration costs.

5. The taxation charge of £/€30,000 included in the accounts is in respect of an under provision in the previous year. The estimated tax charge for the current year is estimated to be £/€3,800,000.

6. A final ordinary dividend of £/€0.05 per share has been approved by the shareholders. The dividend should be provided for in the year end financial statements.

7. Half year debenture interest to be provided for.

Requirement

(a) Prepare Corcoran Limited's Income Statement for the year ended 31 December 2009 in a form suitable for publication.

20 Marks

(b) Prepare a statement of changes in equity for the year ended 31 December 2009.

3 Marks

Presentation 2 Marks

Total 25 Marks

SECTION B

Answer TWO of the THREE questions in this Section

QUESTION 4

(A)

An 'event after the reporting period' is an event that occurs between the end of the reporting period and the date that the financial statements are authorised for issue. *IAS 10* differentiates between an adjusting event and a non-adjusting event after the reporting period.

[1] Explain what is meant by an 'adjusting event' and a 'non-adjusting event'.

3 Marks

[2] The following events, which are considered to be material, occurred after the date of the statement of financial position of SEASIDE Limited but before the completion of the financial statements.

i. A debtor, which owes £/€20,000 at year end, went into liquidation and available information has confirmed that there will be no dividend for creditors. The debt had increased to £/€30,000 by the date on which the debtor went into liquidation.

ii. There was a fire at the company's warehouse one month after year end when inventory to the value of £/€300,000 was destroyed. The company later realised that the inventory in the warehouse was under-insured by 50%.

Requirement

Explain how each of the above events should be treated in the financial statements of SEASIDE Limited, giving reasons to support your conclusions.

7 Marks

Presentation 1 Mark

QUESTION 4 *(Cont'd)*

(B)

During a review of the draft accounts of SEASIDE Limited the following was noted:

[1] A stock count performed on the second last day of the financial year identified 750 identical units of stock each of which cost £/€300. On the last day of the financial year, 50 units of stock were sold for £/€280 each. The accounts provided for closing inventory of 750 units at a cost of £/€300 each.

[2] A government grant of £/€35,000, to help meet the cost of wages and salaries incurred during the year to train staff, was treated as deferred income at year end.

[3] An amount of £/€10,000, which was written off in the previous financial year as a bad debt, was received from the debtor at year end. No entries were made to reflect the recovery of this debt.

Requirement

Prepare the journal entries to show how each of the above items should be dealt with in the final accounts for the year ended 31 December 2009. You should use your understanding of the relevant IAS's in dealing with each item.

8 Marks

Presentation 1 Marks

Total 20 Marks

QUESTION 5

TECHNOLOGY Limited manufacturers and retails computers and gaming products and has a number of outlets throughout Ireland and the UK. You have been provided with the following information relating to TECHNOLOGY Limited and the sector.

INCOME STATEMENT FOR YEAR ENDED 31 DECEMBER 2009

	2009	**2008**
	£/€'000	**£/€'000**
Revenue (credit sales)	8,125	6,750
Cost of sales	(6,840)	(5,760)
Gross profit	1,285	990
Depreciation	(75)	(55)
Administration	(175)	(170)
Distribution	(565)	(405)
Net profit before tax	470	360
Taxation	(189)	(108)
Net profit after tax	281	252
Ordinary dividends paid	(167)	(135)
	114	117

QUESTION 5 CONTINUED OVERLEAF

QUESTION 5 *(Cont'd)*

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	2009 £/€'000	2009 £/€'000	2008 £/€'000	2008 £/€'000
Non-current assets				
Land & buildings		4,400		4,250
Plant and equipment		1,800		1,500
Office equipment		781		950
		6,981		6,700
Current assets				
Inventory*	650		500	
Receivables	2,175		1,500	
Cash in hand	30		77	
		2,855		2,077
Total assets		**9,836**		**8,777**
EQUITY and LIABILITIES				
Capital and reserves				
Share capital	3,750		3,750	
Retained Profits	206		92	
		3,956		3,842
Non-current liabilities		3,000		3,000
Current liabilities				
Payables	1,850		1,500	
Accruals	492		339	
Taxation	63		36	
Bank overdraft	475		60	
		2,880		1,935
		9,836		**8,777**

* Inventory at 31 December 2007 was £/€430,000

Information relating to the sector

	2009	2008
Current ratio	1.07 : 1	1.12 : 1
Acid test ratio	0.86 : 1	0.98 : 1
Gross profit margin	14.90%	14.30%
Return on capital employed	10.20%	9.10%
Receivables days	81 days	75 days
Payables days	87 days	84 days
Inventory turnover	26 days	24 days

QUESTION 5 *(Cont'd)*

Requirement

(a) You are required to calculate two ratios, for 2008 and 2009, in respect of each of the following categories of ratios:

i. Profitability
ii. Liquidity
iii. Efficiency

9 Marks

(b) Based on your calculations in part (a) above write a short report to the management of TECHNOLOGY Limited commenting on the performance on the company in 2008 and 2009 and then comparing it with sector performance.

9 Marks

Presentation 2 Marks

Total 20 Marks

QUESTION 6

The Income Statement of ADAM Limited for the year ended 31 December 2009 and the Statement of Financial Position as at the same date (plus comparative figures as at 31 December 2008) are as follows:

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

	£/€'000	**£/€'000**
Sales revenue		318,600
Cost of sales		(254,880)
Gross profit		63,720
Other operating income (govt grant)		500
Depreciation	(7,500)	
Administration	(14,700)	
Distribution	(9,600)	
Loss on disposal of plant & equipment	(1,050)	(32,850)
Operating profit before interest		31,370
Interest		(420)
Profit on ordinary activities before tax		30,950
Taxation		(7,800)
Profit for the year		23,150
Ordinary dividend		(8,200)
Retained profit		14,950

QUESTION 6 *(Cont'd)*

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	2009	2009	2008	2008
	£/€'000	£/€'000	£/€'000	£/€'000
ASSETS				
Non current assets				
Property, plant & equipment		18,600		11,800
Current assets				
Inventory	20,600		7,500	
Receivables	38,900		14,200	
Prepayments	5,465		540	
Cash & cash equivalents	150		770	
		65,115		23,010
Total assets		**83,715**		**34,810**
EQUITY and LIABILITIES				
Capital and reserves				
Ordinary share capital	9,200		7,500	
Share premium	900		0	
Retained earnings	19,450		4,500	
Total shareholders equity		29,550		12,000
Non-current liabilities				
Debenture	1,125		640	
Deferred income - govt grants	4,000	5,125	0	640
Current liabilities				
Trade & other payables	24,000		13,500	
Bank overdraft	15,240		2,670	
Tax	7,800		4,800	
Interest payable	1,500		1,200	
Deferred income - govt grants	500	49,040	0	22,170
Total equity and liabilities		**83,715**		**34,810**

QUESTION 6 *(Cont'd)*

ADDITIONAL INFORMATION

1. Net book value of assets is made up as follows:

	2009 **£/€'000**	**2008** **£/€'000**
Property plant & equipment at cost	35,850	26,400
Acc depreciation	(17,250)	(14,600)
NBV	**18,600**	**11,800**

2. Interest for the year was £/€420,000. Actual interest paid was £/€50,000 in respect of the current year and £/€70,000 in respect of the previous year.

3. Ordinary dividends declared and paid during the year were £/€8,200,000.

4. During the year the company acquired new plant and equipment that was part financed by a government grant of £/€5,000,000. The government grant is to be credited to the profit and loss account evenly over a ten year period.

5. During the year an asset that cost £/€8,600,000 was sold for £/€2,700,000. The asset was depreciated by £/€4,850,000 at the date of sale.

6. During the year £/€2,600,000 was raised from an issue of ordinary shares. This includes a share premium of £/€900,000.

Requirement

Prepare a cash flow statement for ADAM Limited for the year ended 31 December 2009, in accordance with the requirements of IAS 7 Cash flow statement. Notes to the cash flow statement are not required.

18 Marks

Presentation 2 Marks
Total 20 Marks

2nd Year Examination: Summer 2010

Financial Accounting II

Solutions

Students please note: These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

Question 1

(a) The purpose of the IASB *Framework*

The IASB developed the Framework to act as a conceptual framework against which new accounting standards would be developed. The Framework is not an accounting standard however new standards issued following the publication of the Framework must be in line with the principles of the Framework. Going forward the incidents of conflict between the Framework and accounting standards will reduce thus leading to increased harmonisation in financial accounting regulations. However as the Framework is not an accounting standard it cannot override the principles of an existing accounting standard, where a conflict exists the principles as laid out in the standard must be complied with.

The Framework also provides very important definitions which were not previously defined, including the definitions of frequently used terms such as asset and liability. This eliminates the need to provide such definitions in each standard thereby decreasing the time it takes to develop and publish new standards.

Overall, the Framework promotes a more consistent regulatory environment which should help not only standard setting bodies but also preparers and users of financial statements.

(b)

(i) Income statement

Information on the financial performance of a company is contained in the income statement which highlights the entity's profitability, a key measure of performance. Profitability is an important measure of performance as it helps users of financial statements to assess an entity's ability to generate cash and remain in business.

(ii) Balance sheet

Information on the financial position of an entity is found in the balance sheet. Fundamentally the balance sheet is a list of an entity's assets and liabilities, however it provides very useful information on the financial structure of the company, in addition to both its liquidity and solvency.

QUESTION 1 *(Cont'd)*

(iii) Cash flow statement

Changes in the financial position of an entity are primarily found in the cash flow statement. This is a very important financial statement as it shows where the company generated cash from and how it used the cash. It also provides a summary of the enterprises investing, financing and operational activities.

(c)

(i) Accruals

Financial statements, with the exception of the cash flow statement, are prepared on the accruals basis of accounting where transactions are recognised in the period in which they take place irrespective of the when the cash flow arising from these transactions occurs.

(ii) Going concern

Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Foreseeable future is considered to be twelve months from the date the financial statements are signed. In the event that management decide that it is no longer appropriate to prepare the financial statements on a going concern basis this must be disclosed.

QUESTION 2

1. B
2. A
3. C
4. B
5. D
6. A (see below)
7. D (see below)
8. C
9. B
10. A

Working for Q6

(Turnover) £/€800,000 x 17.5% = £/€140,000 (gross profit)
£/€800,000 - £/€140,000 (gross profit) = £/€660,000 (cost of sales)
£/€660,000 + £/60,000 (closing stock) = £/€720,000
£/720,000 - £/€50,000 (opening stock) = £/€**670,000 PURCHASES (a)**

Working for Q7
£/€ 148,000
+ £/€ 450,000
+ £/€ 603,250 (635,000 – (635,000 x 5% = 31,750))
+ £/€ 32,300 (34,000 – (34,000 x 5% = 1,700))
= £/€ 1,233,550 (d)

Question 3

Corcoran Limited

Income Statement for the year ended 31 December 2009

	£/€'000
Sales revenue (w.2)	53,750
Cost of sales	(25,949)
Gross profit	27,801
Administration costs (w.4)	(6,428)
Distribution costs (w.5)	(7,988)
	13,385
Interest payable (w.6)	(1,300)
Profit on ordinary activities before tax	12,085
Taxation (w.7)	(3,830)
Profits on ordinary activities after taxation	8,255

Corcoran Limited

Statement on changes in equity for the year ended 31 December 2009

	Share capital £/€'000	Retained earnings £/€'000	Total £/€'000
As at 1 January 2009	15,000	4,740	19,740
Profit for the year		8,255	8,255
Ordinary dividends (w.8)		(1,500)	(1,500)
	15,000	11,495	26,495

Workings

1	**Depreciation**	**Total £/€'000**	**Cost of sales £/€'000**	**Distrib £/€'000**	**Admin £/€'000**
	Premises* (2% on cost of £/€4.5m)	90	54	18	18
	Factory plant & equipment (5% on cost of £/€4m)	200	200		
	Motor vehicles (20% on nbv of £/€850,000)	170		170	
		460	**254**	**188**	**18**

* As per IAS 16 land is not depreciated

2	**Turnover**		**£/€'000**
	Turnover per trial balance		54,500
	Add unrecorded sales	[55,000 *(100/110)]	50
	Less returns		(800)
			53,750

3	**Cost of sales**	**£/€'000**	**£/€'000**
	Opening inventory		16,900
	Purchases	29,400	
	Less: purchase returns	(350)	29,050
	Depreciation (per 1 above)		254
			46,204
	Closing inventory		
	Per physical count	20,300	
	Less inventory sold included in error	(45)	
			(20,255)
			25,949

4 Administration costs

	£/€'000
Cost per trial balance	6,500
Less government grants due*	(90)
Depreciation (per 1 above)	18
	6,428

* Government grants may also be included in other income and added to gross profit

5 Distribution

	£/€'000
Cost per trial balance	7,800
Depreciation (per 1 above)	188
	7,988

6 Debenture interest

	£/€'000
Per trial balance	650
To be provided for (£/€13m*10%*6/12)	650
	1,300

7 Taxation

	£/€'000
Tax on current years profits	3,800
Underprovided in previous year	30
	3,830

8 Ordinary dividend

		£/€'000
Ordinary shares	30,000,000	
Dividend per share	£/€0.05	
Dividend payable		1,500

Question 4

[A]

IAS 10 Events after the reporting period

(1) An adjusting event is an event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period, including an event that indicates that the going concern assumption in relation to the whole or part of the business is not appropriate.
A non-adjusting event is an event after the reporting period that is indicative of a condition that arose after the end of the reporting period.

(2)

i. This is an adjusting event and an adjustment should be made to the accounts in respect of the £/€20,000 owing at the date of the statement of financial position, putting through a charge in the statement of comprehensive income and writing off the debt in the statement of financial position. No adjustment should be made in respect of the £/€10,000 arising after the date of the statement of financial position as this is a non-adjusting event. However, if £/€10,000 is material in the context of the company's accounts then a note should be attached to the financial statements stating that further debts incurred in respect of the debtor after the date of the statement of financial position of £/€10,000 are unlikely to be recoverable.

ii. The destruction of inventory by a fire after the year end must be considered to be a non-adjusting event (i.e. a new condition which did not exist at year end). However it is very likely that the loss due to under-insurance is material, given its value of £/€150,000, and accordingly it should be disclosed by way of note to the accounts. The note should describe the nature of the event and an estimate of its financial effect. Non-reporting of this event would prevent users of the financial statements from reaching a proper understanding of the financial position.

[B]

	DR	**CR**
Inventory (income statement)	15,000	
Inventory (balance sheet)		15,000
[Being correction of quantity of stock included in closing inventory]		
Inventory (income statement)	14,000	
Inventory (balance sheet)		14,000
[Being write down of stock to net realisable value as per IAS 2]		
Deferred income	35,000	
Other income/Training costs		35,000
[Being correction of income related grant being treated as deferred income]		

Question 4 *(Cont'd)*

Bank/cash	10,000	
Bad debt expense		10,000

[Being bad debt written off in previous accounting period recovered at year end]

Question 5

TECHNOLOGY Limited

		2009	**2008**
Profitability ratios			
Gross profit	(1285/8125)*100	15.8%	
	(990/6750)*100		14.7%
Net profit	(470/8125)*100	5.8%	
	(360/6750)*100		5.3%
ROCE	(470/6956)*100	6.8%	
	(360/6842)*100		5.3%
Liquidity ratios			
Current ratio	(2855/2880)	0.99 : 1	
	(2077/1935)		1.07 : 1
Acid test ratio	(2855-650 /2880)	0.77 : 1	
	(2077-500 /1935)		0.81 : 1
Efficiency ratios			
Inventory turnover	((500+650)/2 /6840)*365	30.6 days	
	((430+500) /2 /5760)*365		29.4 days
Receivable days	(2175/8125)*365	97.7 days	
	(1500/6750)*365		81.1 days
Payable days	(1850/6840)*365	98.7 days	
	(1500/5760)*365		95 days
OR			
Purchases can also be used	*(1850/(6840+650-500))*365*	*96.6 days*	
	*(1500/(5760+500-430))*365*		*93.9 days*

Question 5 *(cont'd)*

Memorandum
TO : Management of Technology Limited
Date : 17 May 2009
RE : Financial performance during the financial year 2009
The company has done well again in terms of profitability in 2009. However its efficiency and liquidity have disimproved and should be reviewed in the context of the performance of the sector as a whole.

Profitability

Gross Profit Margin has increased from 14.7% in 2005 to 15.8% in 2009. These compare favourably with the sector average which stands at 14.9% in 2009. This indicates that the company is generating more profit per unit of sales than the sector average. The net profit has also improved in 2009 however net profit for the sector is not available for comparative purposes.

ROCE (Return on Capital Employed) has improved from 5.3% to 6.8%. Although this is lower than the sector average it is promising that it is increasing year on year. However management should investigate the reason why it is lower than the sector average as investors may become dissatisfied with the return unless there is a sound reason to support it.

Liquidity

Liquidity ratios, both the current ratio and the acid test ratio, have deteriorated in 2009. However the worsening position is mirrored by sector performance which has also seen deterioration in both ratios. Whilst this will be of some comfort, management should explore the causes of the worsening ratios to identify the reasons for the changes and ensure that measures are taken to avoid any further deterioration. The current ratio is lower than the sector average however it is not dramatically lower and therefore this should not alarm management, however measures should be taken to improve the acid test ratio to avoid experiencing cash flow difficulties going forward.

Efficiency

The efficiency ratios have deteriorated in 2009 however once again this is in line with performance in the sector which indicates that the sector is going through some changes in relation to payment and collection days. The biggest change has occurred in relation to receivables which took nearly 17 days longer to collect in 2009. This increase is greater than that experienced by the sector and therefore suggests that the company has experienced problems collecting debtors in 2009. The reason for this needs to be identified and debtor days brought back to more manageable levels. Creditor days also increased however only by less four days. While the company had the benefit of creditor days being approx. 17 days longer than debtor days in 2008, the payables days were only one day longer than receivables in 2009. Management should try to understand why debtor days increased so much and implement corrective procedures to try to return to the healthier 2008 position.

Inventory turnover increased and stock turnover days are higher than the sector average. Possible reasons for the higher than average turnover could be higher levels of obsolete stock or poor stock management. Stock controls must be reviewed by management to keep stock holding days to a minimum.

NOTE:
The above memorandum is longer than what would be expected in an exam situation however it is provided in such detail to aid understanding and study.

Question 6

* Some marks were awarded where students used Net profit before tax *and* the adjusted the profit figure for interest charge instead of using net profit before interest. However the correct figure to use is Net profit before interest.

ADAM Limited
Statement of Cash Flows for the year ended 31 December 2009

		€'000	€'000
Cash flows from operating activities			
Net profit before interest			31,370*
Adjustments for:			
Depreciation		7,500	
Loss on sale of non-current assets	W3	1,050	
Government grant		(500)	
Changes in working capital			
Increase in inventory		(13,100)	
Increase in receivables		(24,700)	
Increase in prepayments		(4,925)	
Increase in payables		10,500	
			(24,175)
Cash generated from operations			7,195
Interest paid		(120)	
Tax paid	W1	(4,800)	
			(4,920)
Net cash from operating activities			**2,275**
Cash flows from investing activities			
Payments to acquire non-current assets	W3	(18,050)	
Capital grants received		5,000	
Receipt from sale of non-current assets	W3	2,700	
Net cash used in investing activities			(10,350)
Cash flows from financing activities			
Issue of debenture loan		485	
Proceeds of share issue, incl premium		2,600	
Dividends paid		(8,200)	
Net cash used in financing activities			(5,115)
Decrease in cash and cash equivalents			**(13,190)**
Cash and cash equivalents at start of year			(1,900)
Cash and cash equivalents at end of year			**(15,090)**

Question 6 *(Cont'd)*

Note: Cash and cash equivalents

	2009	**2008**	**Change in year**
Bank	150	770	(620)
Bank overdraft	(15,240)	(2,670)	(12,570)
	(15,090)	(1,900)	(13,190)

Workings

1

	Tax paid		
Bank	*4,800*	opening balance	4,800
Closing balance	7,800	P&L	7,800
	12,600		12,600

2

	Interest	**paid**	
Bank	120	Opening balance	,1200
Closing balance	1,500	P&L	420
	1,620		**1,620**

3

	Fixed asset		
Opening balance	26,400	Disposal	8,600
Acquisition	*18,050*	Closing balance	35,850
	44,450		44,450

	Depreciation		
Disposal	*4,850*	Opening balance	14,600
Closing balance	17,250	P&L	7,500
	22,100		22,100

	Disposal		
Fixed asset	8,600	Acc depreciation	4,850
		Sale proceeds	2,700
		Loss - P&L	1,050
	8,600		8,600

2nd Examination: Summer 2010

Financial Accounting

Examiner's Report

General comment

The overall standard of answering was reasonably good with many students scoring highly in Questions 3 and 6. Questions 1 and 4 presented students with the most difficulties and therefore many students obtained very low marks in these questions.

Question 1

This question was made up of three distinct parts. The first part which asked students to explain the purpose of 'The Framework' was very poorly answered with most students discussing the objectives and qualitative characteristics of financial statements instead. The remaining two parts of the question were relatively well answered.

Question 2

Students made reasonable attempts at the multiple choice question however a surprising number of students failed to answer at least one part. Even if the student does not know the correct answer it is always worth selecting one of the possible answers as opposed to leaving it blank.

Question 3

While this Income Statement question was well answered by many students, who obtained very high marks, there were a number of problems experienced by others. The most common problem experienced in this question relates to the monetary denominations arising as a result of the stock adjustment in note 2. It is unclear why this presented the problem in the magnitude to which it did as students should be able to work with amounts presented in different denominations. The other areas which students had difficulty with are as follows:

- Calculation of depreciation on premises (many students included land value in error)
- Allocation of depreciation in Income Statement (very few students correctly included depreciation on factory plant and equipment in Cost of Sales)
- Incorrect dividend and interest calculations

Students were also asked to prepare a Statement of Changes in Equity. Some students made no attempt to answer this part and those who did attempt it presented various solutions ranging from 'Balance Sheet' type statements to correct 'Statements of Changes in Equity'. Students should be very familiar with this statement and therefore should have been able to answer this part of the question with little difficulty.
Please note that students should include all workings. A surprising number of students failed to include any workings in their solution and therefore more than likely lost out on valuable attempt marks.

Question 4

This question was certainly the worst answered question on the paper. Although it was an optional question on the paper, and therefore was avoidable, the majority of the students who attempted this question scored very low marks.
Part (a) of the question required knowledge of IAS 10 'Events after the reporting period' however many of those who attempted this question discussed materiality rather than the timing of events when distinguishing between adjusting and non-adjusting events. Part (b) of the question required students to prepare journal entries, again this part was very poorly answered with few, if any, students gaining full marks. The greatest difficulty experienced was in relation to note 1 stock valuation. Overall this question highlights a very poor working knowledge of journals and basic double entry accounting.

Question 5

This question was very well answered by students who showed a relatively good understanding of the ratios calculated. The category of ratios which caused most difficulty was profitability, very few students who opted to calculate ROCE actually calculated it correctly. Many students correctly identified worsening liquidity as a significant problem despite increasing profits. Students should resist rounding ratios as those who did missed the opportunity to identify trends.

Question 6

This cashflow question was relatively well answered however many students failed to use the correct opening figure which is 'net profit before interest'. Students seemed to be confused by the inclusion of prepayments in 'Current assets' and therefore very few students correctly included the movement in this asset when calculating 'changes in working capital'. Many students incorrectly calculated 'payments to acquire non-current assets' and interest and tax paid.