# FINANCIAL REPORTING

## Certificate stage examination
## 10 June 2005

From 10.00am to 1.00pm
plus ten minutes reading time from 9.50am to 10.00am

***Instructions to candidates***

*Answer **four** questions in total: **Two** questions from **Section A** and **two** questions from **Section B**. The marks available for each question are shown in italics in the right hand margin.*

*All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examination room.*

*Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.*

*Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.*

*Proforma profit and loss account, balance sheet, cash flow statement and statement of total recognised gains and losses are appended to this paper and may be submitted as part of an answer.*

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## SECTION A (Compulsory)

**1** The following list of balances has been extracted from the records of Claudel Ltd as at 31 March 2005, the end of Claudel Ltd's most recent financial year.

**Claudel Ltd**
**List of balances as at 31 March 2005**

| | *Note* | £000 |
|---|---|---|
| Sales | | 11,664 |
| Purchases | | 7,232 |
| Stock as at 1 April 2004 | *1* | 517 |
| Selling and distribution costs | | 880 |
| Administrative expenses | | 720 |
| Other operating income | | 148 |
| Goodwill, at cost | *7* | 180 |
| Interest receivable | | 74 |
| Interest payable | | 81 |
| Land, at cost | *5* | 1,400 |
| Freehold buildings, valuation as at 1 April 2004 | *4* | 3,120 |
| Equipment | *4* | 1,660 |
| Accumulated depreciation, as at 31 March 2004 | | |
| Freehold buildings | *5* | 468 |
| Equipment | *5* | 996 |
| Proceeds on sale of fixed assets | *4* | 244 |
| Investment properties | *6* | 450 |
| Trade Debtors | | 972 |
| Trade Creditors | | 603 |
| Short-term investments | | 101 |
| Cash at bank and in hand | | 27 |
| Bank loans due within 1 year | | 50 |
| Bank loans due after more than 1 year | | 150 |
| Debentures, repayable in 2009 | | 300 |
| Debentures, repayable in 2007 | | 200 |
| Ordinary shares of 50 pence | *10* | 1,000 |
| Share premium | *10* | 400 |
| Investment properties revaluation reserve | | 158 |
| Retained profits | | 858 |
| VAT account | *12* | 220 |
| Corporation tax | *3* | 28 |
| Provision for doubtful debts, as at 31 March 2004 | *2* | 17 |
| Deferred tax, as at 31 March 2004 | *3* | 109 |
| Development expenditure | *8* | 187 |
| Dividends paid | *11* | 160 |

The following additional information is available:

1 Stock as at 31 March 2005 has been valued at £626,000.

2 The provision for doubtful debts is to be updated so that it is 3% of trade debtors as at 31 March 2005.

3 The balance on the corporation tax account represents an over provision for corporation tax for the financial year ended 31 March 2004. Corporation tax payable for the year ended 31 March 2005 has been estimated at £102,000. The transfer to deferred taxation for the year has been calculated at £25,000 on a partial provision basis and £41,000 on a full provision basis.

4 The proceeds on sale of fixed assets account has a credit balance which represents the cash proceeds from the sale of tangible fixed assets during the year ended 31 March 2005. These amounts were also debited to bank account but no other entries in connection with these transactions have been made. The net book values of the assets sold during the year were:

| | | |
|---|---|---|
| Freehold buildings | £362,000 | (cost £400,000) |
| Equipment | £247,000 | (cost £355,000) |

5 The company's depreciation policies are:

| | |
|---|---|
| Freehold buildings | 2.5% straight-line method |
| Equipment | 30% diminishing balance method |

Land is not depreciated, but the directors now agree that some of the company's land was impaired by £130,000 during the year ended 31 March 2005 and that this should be reflected in the accounts.

6 The market value of the company's investment properties was estimated at £540,000 as at 31 March 2005.

7 The goodwill arose on 1 April 2004 when Claudel Ltd purchased and absorbed another business as a going concern. The goodwill is to be written off over its estimated life of 20 years.

8 The balance on development expenditure consists of:

- £143,000 spent during the year on developing distribution links and sales outlets in a new overseas market. However, Claudel Ltd decided in February 2005 to abandon this project because of the significant political risks it would be exposed to.

- £44,000 spent during the year developing a new product. Claudel Ltd expects to incur a further £26,000 development costs. Production of the new product will be subcontracted to a local manufacturer and production will commence in September 2005. This product is expected to be profitable and recover its development costs.

Claudel Ltd wishes to apply the provisions of SSAP 13 *Accounting for research and development* in a way that will minimise the impact on reported profits for the year ended 31 March 2005.

9 On 1 December 2002 Claudel Ltd guaranteed a five-year bank loan of £57,000 to Tranto Ltd which was at that time one of its suppliers. Since then the financial position of Tranto Ltd has deteriorated and it announced on 30 April 2005 that it was going into liquidation. It is unlikely that Tranto Ltd will be able to repay the bank loan.

10 Claudel Ltd used the share premium account to finance a bonus issue of 400,000 shares on 1 March 2005. This has not yet been recorded in the accounts. The bonus shares will qualify for all dividends payable after 31 March 2005.

11 During the year ended 31 March 2005 Claudel Ltd paid the final dividend of 7 pence per share for the year ended 31 March 2004 and an interim dividend of 8 pence per share for the year ended 31 March 2005. The directors of Claudel Ltd will be proposing a final dividend of 9 pence per share at its annual general meeting which will be held in July 2005 and the shareholders are expected to approve the proposal.

12 The balance on the VAT account represents the excess of valued added tax on outputs over value added tax on inputs for the last quarter of the financial year.

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- **Requirement for question 1**

(a) Prepare the Balance Sheet of Claudel Ltd as at 31 March 2005. *22*

**Please note:**
You are *not* required to prepare Claudel Ltd's profit and loss account. Insert the figure for retained profits as a balancing figure.

(b) Prepare a calculation of Claudel Ltd's net profit before tax for the year ended 31 March 2005. *5*

**Please note:**
You should calculate this figure *without* preparing the profit and loss account for the year ended 31 March 2005 – use the increase in retained profits and the other information provided.

(c) Explain the difference between the partial provision method and the full provision method of providing for deferred taxation, justifying your choice of method in your answer to part (a). *3*

***(30)***

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# 2

The following ratios have been calculated from the published financial statements of two companies which operate similar businesses.

| | Company A | | Company B | |
|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 |
| Profit to turnover | 14% | 11% | 14% | 14% |
| Turnover to net assets | 2.3 | 2.3 | 2.3 | 1.8 |
| Return on capital employed | 33% | 25% | 33% | 25% |

- **Requirement for question 2**

(a) (i) Compare and contrast the performance of these two companies over the two years 2003 and 2004 as evidenced by these ratios. *4*

(ii) Make recommendations on how each company could restore its performance in the future. *4*

(b) Return on capital employed is one of the most important performance indicators for profit making enterprises.

Describe some of the limitations in calculating and interpreting return on capital employed using conventional financial statements. *6*

(c) The following ratios are sometimes used by investors in a company:

(1) Interest cover
(2) Dividend yield
(3) PE ratio

For *each* ratio:

(i) Define how the ratio is calculated.
(ii) Describe what the ratio measures.
(iii) Describe how an investor might interpret the ratio. *12*

(d) Explain what is meant by multivariate analysis and how it can be used to assess the prospects for a quoted limited company. *4*

***(30)***

**SECTION B (Answer two questions from this section)**

# 3

**Rezia plc**

Rezia plc's financial year ended on 31 May 2005. Its profit and loss account reports a profit (after a taxation charge of £450,000) of £4,284,000. During the year ended 31 May 2005 Rezia plc had in issue 16,000,000 ordinary shares of 25 pence each, 900,000 10% preference shares of £1 each, and £500,000 of 12.5% debentures.

**Huon plc**

Huon plc's financial year ended on 31 May 2005. On 1 February 2005 the company made a bonus issue of 1 for 5 which brought the total number of issued shares to 6,000,000. The profit reported for the year ended 31 May 2005 was £1,300,000 before a taxation charge of £320,000. The earnings per share figure reported in the financial statements for the year ended 31 May 2004 was 15.7 pence.

**Fatima plc**

Fatima plc's financial year ended on 31 May 2005. Fatima plc has an issued share capital comprising 7,500,000 ordinary shares of £1. There are also share options which would enable the holders to take up 1,500,000 ordinary shares at £5.60 each. The quoted share price of Fatima plc's ordinary shares was £9.60 as at 31 May 2004, £11.60 as at 31 May 2005 and is currently £11.00. Fatima plc's profit after tax for the year ended 31 May 2005 was £2,170,000. This was after a total taxation charge of £810,000.

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- **Requirement for question 3**

(a) Calculate Rezia plc's basic earnings per share for the year ended 31 May 2005. *3*

(b) Calculate the *two* earnings per share figures that would be reported in the financial statements of Huon plc for the year ended 31 May 2005. *3*

(c) Calculate Fatima plc's *fully diluted* earnings per share figure for the year ended 31 May 2005. *7*

(d) Identify two ways (other than the existence of share options) in which earnings per share may be diluted explaining in each case how earnings would be diluted. *4*

(e) Briefly summarise the disclosure requirements of FRS 14 Earnings per share. *3*

***(20)***

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# 4

During its financial year ended 31 May 2005 Newbilt plc started three projects building schools for the Weber Schools Initiative. The three school projects are the Sherasmin School, the Mermaid School and the Puck School.

The following information for each of the three contracts relates to the year ended 31 May 2005:

| | **Sherasmin** | **Mermaid** | **Puck** |
|---|---|---|---|
| | £m | £m | £m |
| Contract value (as originally agreed) | 40.0 | 50.0 | 28.0 |
| Certified value of work completed | 21.0 | 2.5 | 19.0 |
| Value of work invoiced to The Weber Schools Initiative | 18.0 | 2.5 | 16.0 |
| Payments received from The Weber Schools Initiative | 16.0 | 1.5 | 10.0 |
| Costs to date | 17.0 | 3.1 | 25.5 |
| Estimated future costs to complete | 13.0 | 33.9 | 12.5 |

Difficulties had been encountered with preparing the foundations for the Puck School. However, these problems had been anticipated and the contract provides for an increase to the contract price of 12.5% if problems are encountered.

Newbilt plc uses a revenue approach to calculate the percentage of work completed to date. Revenue is to be based on independent surveyors' certificates.

Cost of sales is to be calculated by adjusting turnover for attributable profit. All the amounts invoiced to date are expected to be collected and no provision is to be made for bad debts.

- **Requirement for question 4**

(a) Calculate the estimated total profit or loss on each of the three contracts. *4*

(b) Calculate the attributable profit or loss on each of the three contracts. *3*

(c) Calculate the figures which would be shown in Newbilt plc's profit and loss account for the year ended 31 May 2005 for turnover, cost of sales and profit or loss for each of the three contracts. *4*

(d) Calculate the figures which would be shown in Newbilt plc's balance sheet as at 31 May 2005 for work in progress, amounts recoverable on contracts and trade debtors for each of the three contracts. *9*

***(20)***

# 5

The following information comes from the audited profit and loss account of Oberon Ltd for its financial year ended 31 March 2005:

| | £000 |
|---|---|
| Profit on ordinary activities before taxation | 12,800 |
| Tax on profit on ordinary activities | 3,500 |
| Profit on ordinary activities after taxation | 9,300 |

You have the following additional information:

1. Shareholders' funds as at 31 March 2004 totalled £14,889,000.
2. Following poor sales, stocks had been written down by £288,000 on 31 March 2004.
3. Dividends paid during the year ended 31 March 2005 totalled £2,750,000.
4. An additional 2,000,000 shares of £1 each were issued at a price of £1.50 during the financial year ended 31 March 2005.
5. In March 2005 an investment was sold for £575,000. In April 2002 this investment had a book value of £350,000 and was revalued upwards by £150,000.
6. In April 2003 the company revalued an investment property upwards by £410,000. During the financial year ended 31 March 2005 the directors decided to write this investment down by £210,000.
7. A tangible fixed asset was revalued upwards on 1 April 2004 by £280,000. The remaining economic life of the asset was estimated at 6 years as from 31 March 2005.
8. Three years ago the company started development of a new product. In the financial years ended 31 March 2003 and 31 March 2004 development expenditure was capitalised as an asset. However, in March 2005 the directors decided that with immediate effect all development expenditure would be written off as incurred. Development expenditure capitalised in the years ended 31 March 2003 and 31 March 2004 totalled £300,000.

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- **Requirement for question 5**

Prepare, in so far as the above information permits, the following statements for the year ended 31 March 2005 as required by FRS 3:

(a) The Statement of Total Recognised Gains and Losses. *7*

(b) The Reconciliation of Movements in Shareholders' Funds. *9*

(c) The note of Historical Cost Profits and Losses. *4*

***(20)***

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