ACCOUNTING THEORY AND PRACTICE

Professional 1 examination
June 2000

MARKING SCHEME

CIPFA

Question 1

(a)

Aggrey plc

Profit and loss account for the year end 31 March 2000

	£000	£000	
Turnover		21,000	
Opening stock	2,174		
Purchases	2,457		
Closing stock	(1,749)		
Production costs	4,596	7,478	
Gross profit		13,522	*1*
Admin expenses	887		
Research and development	50		*1*
Provision – legal action	500		*1*
Doubtful debts	100		*1*
Debtor write off	157		*1*
Distribution expenses	2,478		
Depreciation provision			
buildings	3,383		*1*
plant and machinery	546		*1*
motor vehicles	386	8,487	*1*
Operating profit		5,035	
Investment income		32	
Debenture interest paid		(350)	
Profit on ordinary activities		4,717	½
Preference dividends			
paid	35		½
Ordinary dividends			
paid	62		½
proposed	1,200	1,297	½
Retained profit for year		3,420	
			(10)

Balance sheet as at 31 March 2000

	£000 cost	£000 depcn	£000 total	
Fixed assets				
Intangibles – Development costs			200	*1*
Tangible				
Land & buildings	43,750	25,383	18,367	*1*
Plant & machinery	6,214	2,396	3,818	*1*
Vehicles	2,575	1,954	621	*1*
Investments			1,789	

			24,795	
Current assets				
Stock		1,749		
Debtors		1,699		*1*
Bank		2,322		
		5,770		
Creditors<one year				
Creditors	1,895			
Proposed dividends	1,200	3,095	2,675	*1*
Creditors>one year				
15% debentures		3,500		
Provisions for liabilities and charges				
Legal action		500	(4,000)	*1*
			23,470	
Ordinary share capital £1			15,000	
7% cumulative preference shares			500	
Share premium			300	
P&L reserve			4,250	
P&L for year			3,420	
			23,470	*1*

(8)

(b) FRC given financial support by accountancy bodies, stock exchange, bank of england and government

responsibility for overseeing the procedure	*½*
ASB and Review panel operational aspects	*1*
UITF deals with urgent issues	*1*
ASB- 9 members all accountants	*½*
Standards called FRS	*½*
Reasons for standards	*½*
Method -identify topics -research -discussion draft -FRED -FRS	*2*
SORPS	*1*

(7)

(25)

Question 2

(a)

Cost of control in R

cost ord shares		700	½	Ord shares	1000*60%	600	½
cost pref shares		500	½	pref shares	500*80%	400	½
Negative goodwill w/o	55/20	3	½	Revaluation	250*60%	150	½
Neg goodwill	bal	52					
				revenue res	175*60%	105	½
		1,255				1,255	*(3½)*

Cost of control in M

cost of shares		700	½	ord shares	800*70%	560	½
revenue reserve	50*70%	35	½	goodwill		175	
		735				735	*(1½)*

Minority interest in r

		£000	
ordinary shares	1,000*40%	400	½
pref shares	500*20%	100	½
revaluation	250*40%	100	½
revenue	10*40%	4	½
		604	*(2)*

Minority interest in m

		£000	
ordinary shares	800*30%	240	½
pref shares			
revaluation	50*30%	15	½
revenue	300*30%	90	½
		345	*(1½)*

Consolidated revenue reserve

pre acq-r	175*60%	105	½	bal g		650	
min int-r	40%*10	4	½	bal r		10	
min int-m	300*30%	90	½	bal m		300	
goodwill w/o	175-3	172	*1*	pref divi	500 x 80% x 5%	20	*1*
bal		644		pre acq m		35	½
		1,015				1,015	*(4)*

Consolidated balance sheet as at 31 March 2000

Fixed assets tangible	2,700+1,000+750+250	4,700	*1*
Negative goodwill		(52)	*1*
Current assets	1,480+500+600+40	2,620	*1*
Current liabilities	-2,790-50-120+20	(2,940)	*1*
		4,328	
Share capital & reserves			
Ordinary shares		2,700	*1*
Revaluation reserve		35	*½*
Revenue reserve		644	
Minority interest		949	
		4,328	

(5½)

(18)

(b) FRS 10 Goodwill *½*

- positive goodwill must be amortised over useful life
- impairment test if not amortised or useful life > 20 years *1*
- negative goodwill appears with positive goodwill on balance sheet and is released to reserves over useful life *1*
- goodwill previously w/o to reserves immediately on acquisition (before April 1998) can stay w/o under transitional arrangements, and therefore Mud left w/o to reserves *1*
- Rubettes negative goodwill should therefore be released over 20 years ie £3,000 pa, leaving £52,000 as negative goodwill, an intangible fixed asset, as at 31 March 2000 (strictly speaking the negative goodwill should be released at the same rate that the non-monetary assets of Rubettes are disposed of or used up). *1*
- any other reasonable point *½*

(5)

(23)

Question 3

(a)

Cash flow statement

		£000	£000	
Net cash flow from operating activities			583	w1
Returns on investments				
Interest received	12-7+19	24		*1*
Interest paid	9-9-29	(29)	(5)	*1*
Taxation	40-53-142		(155)	*1*
Capital: Payments to acquire fixed assets		(113)		w3
Proceeds from sale of fixed assets		250	137	*½*
Equity dividends paid	16-21-49		(54)	*1*
Management of liquid rescs	70-36		34	*1*
Financing			(14)	w2
Cash movement			526	*(5½)*

w1 operating profit		385	*½*	
depcn		60	*½*	
profit sale of equip	200-250	(50)	*1*	
stock	564-549	15	*1*	
debtors	630-225	405	*1*	
creditors	235-462	(227)	*1*	
interest	7-12	(5)	*1*	
		583	*(6)*	

w3 Fixed Assets		
Opening Bal	2,616	*½*
Revaluation	(90)	*½*
Depreciation	(60)	*½*
Asset sold	(200)	*½*
	2,266	
Closing balance	2,379	
Acquired	113	*½*
		(2½)

w2

share capital	1536-1500	36	*1*
share premium	105-96	9	*1*
creditors>1yr	234-293	(59)	*1*
		(14)	*(3)*

(17)

(b)

Reconciliation of the movement in cash to the movement in net debt which shows:

- Movement in cash for the period.
- Adjusted for movement in other net debt items eg borrowing, finance leases and liquid resources (movements should be split between cash movements and non-cash movements eg finance leases).
- Equals movement in net debt.
- Add net debt at start of year equals net debt at year end. *1½*

Analysis of net debt showing:

- Opening balance for each net debt item (borrowings, finance leases, cash, liquid resources).
- Movement of each item split between cash flow and other movements (eg movements on finance leases which are not cash flow).
- Closing balance for each net debt item.

1½

(3)

(20)

Question 4

(a)

		31 March 1999		31 March 2000	
Eps	4,760/9,920	47.98p	5,830/9,920	58.77p	*1½*
Dividend cvr	4,760/1,120	4.25	5,830/1,200	4.86	*1½*
Price earning ratio	150/48	3.125	270/59	4.58	*1½*
Dividend yield	(1,120/9,920)/1.50	7.5%	(1,200/9,920)/2.70	4.48%	*1½*

(6)

(b) **Dividend yield**
measures real rate of return by comparing dividend paid to the market price of the share *1*
EPS
Indicates how much of the company profit can be attributed to each ordinary share *1*
Dividend cover
Compares net profit after tax with dividend paid showing how many times the dividend due could have been met from net profit. *1*
P/E Ratio
Relates market value of share with earnings per share, showing number of years before current annual earnings per share covers the market value of the share. *1*

EPS ratio has increased, profit after tax has increased due to increase in operating profit. *1½*
Dividend cover increased, increase in operating profit and increase in dividends. *1½*
P/E has increased, market price of shares have increased from 150 to 270. *1½*
Dividend yield had decreased, dividend increase is less than increase in the market price of the shares. *1½*
Summary
The company's performance has improved; this is reflected in the increased market price of the shares. *1*

(11)

(17)

Question 5

(a) -substance over form *1*
-definition of finance lease – transfers substantially all risks and rewards of ownership of the asset to the lessee. *2*

Balance sheet of lessee

Application of FRS 5 Substance over form.
Record asset in balance sheet at fair value initially.
Asset is then depreciated over useful economic life or lease period (whichever is the shorter).
Liability is recorded on the balance sheet.
Lease payments are split between finance charge and principle element.
Finance charge, debited to Profit and loss account as interest paid.
Principal element debited to reduce the liability in the balance sheet. *3*

(b) Straight line method, ignores the time value of finance, allocates finance costs equally over periods of lease. *2*
Actuarial method present value tables used to allocate finance at constant percentage charge over the term of the lease. *3*
Sum of the digits method, approximation of actuarial method, uses formula
n (*n* + 1)/2, where *n* = number of payments to be made eg Finance charge £5,000, term 10 payments = 10(10+1)/2 = 55 Year 1 = $\frac{10}{55}$ x 5,000 = 900 *4*

(15)

Question 6

(a) goods or other assets purchased for resale:
consumable stores;
raw materials;
wip;
long term contracts;
finished goods. *½ mark each up to a maximum of 3*

(b) description - legal title held by one party, stock held by other party;
- customer has right to return the good;
- payment for good is not made until customer sells to third party;
- HM Customs and Excise accepts that no sale has taken place and VAT is due. *3*

Reasons for different treatment are:
Substance over form- although legally the stock may belong to one party, which balance sheet the stock appears on will depend on where the commercial risks and benefits of ownership of the stock lies. *3*

Disclosure re reservation of title:
The manufacturers right of return;
The dealers right of return;
The stock transfer price and deposits;
The dealers right to use the stock. *2*

(8)

(c) Definition – time taken to complete contract means the activity falls into several accounting periods. Usually a period over 1 year. *½*
accounting treatment
-contract by contract; *½*
-P&L turnover and related costs as the contract progresses; *1*
-turnover is ascertained according to stage of completion; *½*
-attributable profit; *½*
-foreseeable losses. *1*

(4)

(15)