ACCOUNTING THEORY AND PRACTICE

Professional 1 examination
7 December 1999

From 2.00 pm to 5.00 pm
plus ten minutes reading time from 1.50 pm to 2.00 pm

Instructions to candidates

Answer ***five*** *questions in total: All* ***four*** *from Section* ***A****, and* ***one*** *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 examinations room.

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

A proforma profit and loss account and balance sheet are appended to this paper and can be submitted as part of an answer.

SECTION A (Answer all four questions)

1

Three Lions PLC has three main classes of business: sports equipment, sports clothing and sports books. The trial balance of Three Lions PLC as at 31 October 1999 is as follows:

	£000	**£000**
Ordinary share capital, 75p shares		43,870
Retained profit 1 November 1998		74,610
Dividends net		3,500
Equipment @ cost	174,820	
Vehicles @ cost	8,900	
Turnover		
-Sports equipment		255,410
-Sports clothing		94,370
-Sports books		19,870
Cost of sales		
-Sports equipment	146,730	
-Sports clothing	76,070	
-Sports books	8,500	
Administrative expenses		
-Sports equipment	24,650	
-Sports clothing	11,690	
-Sports books	680	
Distribution expenses		
-Sports equipment	12,350	
-Sports clothing	8,180	
-Sports books	920	
Audit Fee	100	
Stock 31 October 1999	11,730	
Investments	54,400	
Debtors	22,270	
Creditors		25,930
Bank	6,708	
Deferred tax		228
Cash	2,320	
Corporation tax	100	
Provision for Depreciation 1 November 1998		
-Equipment		49,250
-Vehicles		4,080
	571,118	571,118

Further information:

(i) Equipment is to be depreciated at 20% per annum straight line, and Vehicles at 30% per annum on the reducing balance method.

(ii) As at 31 October 1999 the company was involved in legal action. It is probable that a charge of £250,000 will be made against the company.

(iii) On the 5 November 1999 a debtor owing £90,000 was declared bankrupt.

(iv) Equipment is assessed as being used:
50% for cost of sales
40% for distribution
10% for administration

(v) Vehicles are assessed as being 100% distribution.

(vi) Equipment is utilised:
50% on the production of sports equipment
40% on the production of sports clothing
10% on the production of sports books

(vii) Vehicles are utilised:
25% on the distribution of sports equipment
65% on the distribution of sports clothing
10% on the distribution of sports books

(viii) Dividends of 1p per share are proposed as at 31 October 1999.

(ix) There were no intersegment sales.

(x) A transfer to deferred tax for the year to 31 October 1999 of £100,000 is to be made.

(xi) The balance on the corporation tax account of £100,000 is the underestimation of the previous years corporation tax. The corporation tax for the year ended 31 October 1999 is estimated at £500,000. Ignore ACT. The tax credit fraction is 20/80.

- **Requirement for question 1**

(a) Prepare the profit & loss account for the year ended 31 October 1999 and the balance sheet as at that date for Three Lions PLC (notes to the accounts are not required). *15*

(b) Prepare the disclosure notes required by SSAP 25, Segmental Reporting, as far as the information provided allows. *5*

(c) According to SSAP 25 what constitutes a segment? *2*

(d) Justify your treatment of items (ii) and (iii) above referring to the relevant SSAPs/FRSs. *3*

(25)

(Round all figures to the nearest £000)

2

The following are the summarised accounts of two companies, Um PLC and Bongo PLC, for the year ended 30 September 1999.

Profit and Loss Account

	Um PLC		**Bongo PLC**	
	£000	**£000**	**£000**	**£000**
Turnover		900		250
Cost of sales	(450)		(90)	
Distribution expenses	(200)			
Admin expenses	(55)	(705)	(80)	(170)
		195		80
Other income				
Interest	15			
Other	20	35		
Interest payable		(12)		(30)
		218		50
Dividends paid	(50)		(10)	
Dividends proposed	(90)	(140)	(20)	(30)
Retained profit		78		20

Balance Sheets as at 30 September 1999

	Um PLC		Bongo PLC	
	£000	**£000**	**£000**	**£000**
Fixed assets				
Land and buildings	820		300	
Plant and machinery	900		1,200	
Vehicles	500	2,220	830	2,330
Investment in subsidiary		960		
Current assets				
Stock	166		140	
Debtors	310		160	
Cash	77		25	
	553		325	
Creditors due within one year				
Creditors	(250)	303	(178)	147
Creditors due after one year				
6% Debentures		(200)		—
		3,283		2,477
Share capital & reserves				
£1 Ordinary shares		1,700		—
£5 Ordinary shares		—		1,000
Share premium		500		100
General reserve		—		500
Asset revaluation		—		150
Profit & Loss account		1,083		727
		3,283		2,477

Additional information:

(i) Um PLC acquired 137,000 £5 Ordinary shares in Bongo PLC on 1 October 1993 when the fair values of Bongo's assets were the same as the net book values except for the following:-

	Fair value	Book value
	£000	**£000**
Buildings	320	200
Vehicles	700	750

As at 1 October 1993:
Buildings had a useful life of 50 years.
Vehicles had a useful life of 5 years.

(ii) Bongo's reserves at 1 October 1993 were:
Share premium account £100,000
General reserve £300,000
Asset revaluation £50,000
Retained profit account £20,000 debit

(iii) In September 1999 Um PLC sold Bongo PLC £60,000 of goods at sale value at a mark up of 40%. Bongo PLC has not paid for the goods but has included them in the closing stock.

(iv) Um's policy on dividends and debenture interest is to record sums received. Um PLC does not accrue proposed dividends.

- **Requirement for question 2**

(a) Prepare the consolidated Profit and Loss account balance carried forward as at 30 September 1999 and prepare the group consolidated balance sheet as at 30 September 1999. (**Round to nearest £000**) *15*

(b) Explain why acquisition accounting requires that assets of the acquired company are taken over and recorded at fair value in accordance with FRS 7 "Fair values in acquisition accounting". *5*

(20)

3

The trainee accountant of Gotitwrong PLC has prepared draft accounts for the year ended 30 September 1999. To get the balance sheet to balance a suspense account had been opened.

The following items were found to be outstanding:

(i) Government grants of £350,000 received during the year were credited to the suspense account. The two grants were:
£275,000 towards the capital cost of vehicles with an estimated life of 5 years.
£75,000 towards a job creation scheme (contribution to wages).

(ii) Gotitwrong PLC lets some investment properties to other companies. These have been recently valued and are included in the accounts at the new value of £1,000,000. They were purchased five years ago for £200,000 and have a useful economic life of 50 years.

(iii) Research and development of £150,000 had been debited to the suspense account. This had been expended on 2 schemes:
£70,000 on a project which should become profitable next year.
£80,000 on a project which has now been scrapped.
Company's policy is to amortise capitalised development expenditure over 5 years.

(iv) A large item of plant was leased by finance lease on 1 October 1998. The fair value was £300,000, the finance charge was £60,000, the lease term was 20 quarterly payments in arrears, starting 31 December 1998. All four payments in the year ending 30 September 1999 were debited to the suspense account. The company accounts for finance leases using the sum of the digits method.

(v) There was a delivery of stock on 26 September 1999. This was included in the stock take. The invoice for £75,000 did not arrive until after the 30 September and was not included in the creditors figure at the 30 September 1999.

- **Requirement for question 3**

Consider each of the above outstanding items and explain how each should be dealt with according to current company legislation and accounting standards. State how each would affect the Profit and Loss Account and the Balance Sheet in the current and future financial years. *(20)*

4

The following information has been taken from the accounts of Anfield PLC for the years ended 30 September 1998 and 30 September 1999. The company, in an effort to increase sales and profit, reduced the price of its produce and extended the credit terms to its customers.

Profit and Loss Accounts for the years ended 30 September 1998 and 30 September 1999

	30 September 1998 £000	**30 September 1999 £000**
Sales	2,250	7,000
Cost of sales	(900)	(4,200)
Gross profit	1,350	2,800
Selling expenses	(375)	(675)
Bad debts written off	(45)	(350)
Depreciation	(145)	(520)
Interest	(30)	(480)
Net profit	755	775
Net profit b/f	815	1,570
	1,570	2,345

Balance sheet as at 30 September 1998 and 30 September 1999

		30 September 1998		30 September 1999
	£000	£000	£000	£000
Fixed Assets				
Land & Buildings		1,125		1,100
Plant & Machinery		1,225		4,480
		2,350		5,580
Current Assets				
Stock	75		595	
Debtors	205		1,455	
Bank	30		—	
	310		2,050	
Creditors due within one year				
Creditors	(90)		(440)	
Bank	—		(25)	
Current assets less liabilities		220		1,585
Creditors due after one year				
Borrowing		(250)		(4,000)
		2,320		3,165
Share capital		750		820
Profit & loss account		1,570		2,345
		2,320		3,165

- **Requirements for question 4**

You are an advisor to a shareholder of Anfield PLC and you are required to submit a report to him on the effect that the policy has had on the financial position of the company, supporting your views with appropriate ratios. *(20)*

SECTION B (Answer one question)

5

Critically discuss the practice of "off balance sheet financing" and explain how FRS 5 attempts to prevent it. *(15)*

6

(a) Identify the circumstances that could give rise to the need to value a business. *2*

(b) Identify and appraise the various methods available for valuation of a business. *13*

(15)

Question Number ⇩

SHEET NUMBER ⇦⇨

Profit and loss account format 1 from 4th Schedule, Companies Act 1985

		£	£	£
1	Turnover			
2	Cost of sales		(_____)	
3	Gross profit or loss			
4	Distribution costs			
5	Administrative expenses	_____		
				(_____)
6	Other operating income			
7	Income from shares in group undertakings			
8	Income from shares in participating interests			
9	Income from other fixed asset investments			
10	Other interest receivable and similar income	_____		
				_____
11	Amounts written off investments	( )		
12	Interest payable and similar charges	(_____)		
			(_____)	
	Profit/loss on ordinary activities before taxation			
13	Tax on profit or loss on ordinary activities		(_____)	
14	Profit/loss on ordinary activities after taxation			
15	Minority interests		(_____)	
16	Extraordinary income			
17	Extraordinary charges	( )		
18	Extraordinary profit or loss			
19	Tax on extraordinary profit or loss	( )		
20	Minority interests	(_____)		
			_____	
21	Other taxes not shown under the above items		(_____)	
22	Profit or loss for the financial year			

Question Number ⇩

SHEET NUMBER ⇦ ⇨

Balance sheet Format 1 from 4th Schedule, Companies Act 1985

	£	£	£
A *Called-up share capital not paid*			
B *Fixed assets*			
I Intangible assets			
1 Development costs			
2 Concessions, patents, licences, trademarks and similar rights and assets			
3 Goodwill			
4 Payments on account	______		
II Tangible assets			
1 Land and buildings			
2 Plant and machinery			
3 Fixtures, fittings, tools and equipment			
4 Payments on account and assets in course of construction	______		
III Investments			
1 Shares in group undertakings			
2 Loans to group undertakings			
3 Shares in participating interests			
4 Loans to participating interests			
5 Other investments other than loans			
6 Other loans			
7 Own shares	______		
		______	

Question Number ⇩

SHEET NUMBER ⇦ ⇨

	£	£	£
C *Current assets*			
I Stocks			
1 Raw materials and consumables			
2 Work in progress			
3 Finished goods and goods for resale			
4 Payments on account	______		
II Debtors			
1 Trade debtors			
2 Amounts owed by group undertakings			
3 Amounts owed by participating interests			
4 Other debtors			
5 Called-up share capital not paid			
6 Prepayments and accrued income	______		
III Investments			
1 Shares in group undertakings			
2 Own shares			
3 Other investments	______		
IV Cash at bank and in hand			
D *Prepayments and accrued income*		______	
E *Creditors: amounts falling due within one year*			
1 Debenture loans			
2 Bank loans and overdrafts			
3 Prepayments received on account			
4 Trade creditors			
5 Bills of exchange payable			
6 Amounts owed to group undertakings			
7 Amounts owed to participating interests			
8 Other creditors including taxation and social security			
9 Accruals and deferred income	______		

(_____)

Question Number ⇩

SHEET NUMBER ⇦ ⇨

	£	£	£
F *Net current assets (liabilities)*			_____
G *Total assets less current liabilities*			
H *Creditors: amounts falling due after more than one year*			
1 Debenture loans			
2 Bank loans and overdrafts			
3 Payments received on account			
4 Trade creditors			
5 Bills of exchange payable			
6 Amounts owed to group undertakings			
7 Amounts owed to participating interests			
8 Other creditors including taxation and social security			
9 Accruals and deferred income	_______		
I *Provisions for liabilities and charges*			
1 Pensions and similar obligations			
2 Taxation including deferred taxation			
3 Other provisions			
J *Accruals and deferred income*		_______	
			(______)
			_______

Question Number ⇩

SHEET NUMBER ⇦⇨

	£	£	£
K *Capital and reserves*			
I Called-up share capital			
II Share premium account			
III Revaluation reserve			
IV Other reserves:			
1 Capital redemption			
2 Reserve for own shares			
3 Reserves provided for by the articles of association			
4 Other reserves			
V Profit and loss account			
L *Minority interests*			