ACCOUNTING THEORY AND PRACTICE

Professional 1 examination
8 June 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 The trial balance of Plainmoor plc as at 31 March 1999 is as follows:

	£000	**£000**
Turnover		4,900
Opening Stock 1 April 1998	205	
Purchases	995	
Production costs	1,200	
Distribution costs	957	
Administrative expenses	329	
Dividends received		19
Research & development	100	
Share premium account		100
Interim dividends paid:		
Ordinary	10	
Preference	5	
Debenture interest paid	60	
Ordinary shares £1		1,500
5% Cumulative £1 preference shares		200
6% Debentures		1,000
Investments	850	
P&L reserve		370
Land & buildings @ revalued cost	4,375	
Plant & equipment @ cost	1,375	
Vehicles @ cost	1,415	
Debtors & Creditors	700	500
Provision for doubtful debts		20
Provision for depreciation:		
Land & buildings		2,800
Plant and equipment		750
Vehicles		800
Cash & bank	383	
	12,959	12,959

The following information is available:

(i) Policy in respect of depreciation of fixed assets:
Land, with a value of £800,000, is not depreciated.
Buildings are depreciated at 4% per annum on revalued cost.
Plant & equipment are depreciated at 15% per annum on reducing balance.
Vehicles are depreciated at 20% per annum on cost.

(ii) Doubtful debt provision to be increased to represent 10% of debtors' figure after any bad debts written off.

(iii) Final dividend of 4p per ordinary share is proposed.

(iv) Closing stock is valued at £310,000.

(v) The research and development costs have been incurred on two projects, one to be launched shortly which should increase the profitability of the company.

The other project costing £20,000 is still embryonic and its outcome unknown. Company policy is to capitalise development costs wherever possible.

(vi) The following events occurred post 31 March 1999:

- a debtor owing £41,000 was declared bankrupt.
- a warehouse burglary occurred in May and stock valued at £25,000 was stolen.

(vii) As at 31 March 1999 the company was involved in a legal action, the outcome is a probable charge against the company of £90,000.

- **Requirement for question 1**

(a) Prepare a Profit and Loss Account for the year ending 31 March 1999 and a balance sheet for publication at that date, for Plainmoor plc (figures to be rounded to nearest £000). Detailed notes to the accounts are not required, but all the workings must be shown. *13*

(b) Justify your treatment of items (v), (vi) and (vii) above, with reference to relevant accounting standards. *12*

(25)

2

The following information has been extracted from the accounts of Molyneux plc.

BALANCE SHEET AS AT

	31 March 1998		**31 March 1999**	
	£000	**£000**	**£000**	**£000**
Fixed assets		1,407		1,585
Current assets				
Stock	332		365	
Debtors	320		153	
Investments	35		24	
	687		542	
Creditors: amounts falling due within one year	(527)		(316)	
Net current assets		160		226
Total assets less current liabilities		1,567		1,811
Creditors: amounts falling due after one year		(129)		(157)
Net assets		1,438		1,654
Financed by				
Ordinary shares £1		1,000		987
10% Preference shares £1		-		37
Share premium account		65		71
Revaluation reserve		90		60
Retained profits		283		499
		1,438		1,654

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 MARCH 1999

	£000	£000
Turnover		2,625
Cost of sales		(1,721)
Gross profit		904
Distribution costs	260	
Administrative costs	175	(435)
Operating profit		469
Interest receivable	17	
Interest payable	(35)	(18)
Profit before tax		451
Taxation		172
Profit after tax		279
Dividends		63
Retained profit for the year		216

Further available information:

	31 March 1998	31 March 1999
	£000	£000
(i) Analysis of creditors:		
Interest payable	4	7
Trade creditors	237	159
Taxation	41	30
Dividends	15	5
Bank overdraft	230	115
	527	316

(ii) Depreciation charged in the year ended 31 March 1999 was £27,000.

(iii) Some tangible fixed assets were revalued during the year ended 31 March 1999.

(iv) Assets with a book value of £100,000 were disposed of during the year, and receipts from their sales amounted to £125,000.

(v) Debtors' figures include interest receivable, as follows:

31 March 1998	£4,000
31 March 1999	£3,000

- **Requirement for question 2**

(a) Prepare the cashflow statement for Molyneux plc for the year ended 31 March 1999 so as to comply with FRS 1 (revised). Notes to the cashflow statement are not required. *13*

(b) The old FRS1- cashflow statement - included three additional notes:
(i) analysis of changes in cash, and cash equivalents during the year.
(ii) analysis of balances of cash, and cash equivalents during the year.
(iii) analysis of changes in finance during the year.

FRS 1 (revised) has replaced the above three notes with two new notes. Describe the contents of the two new notes. 7

(20)

3

Delboy plc holds shares in Rodney plc and Trigger pl. The details are as follows:

(a) **Delboy plc relationship with Rodney plc**

Delboy plc purchased its shareholding on the first day of the financial year reviewed below; which consists of:

- 75% of Rodney plc Ordinary shares;
- 66.67% of Rodney plc Preference shares;
- the valuation of the tangible assets of Rodney plc was £180,000 higher than the book value at the date of acquisition; and
- the retained profit balance of Rodney plc at the acquisition date was £300,000 credit.

(b) **Delboy plc relationship with Trigger plc**

Delboy plc purchased its shareholding a long time ago which consists of:

- 90% of Trigger plc Ordinary shares;
- at the date of purchase, the retained profit balance of Trigger was £100,000 debit;
- at the time of purchase, the revaluation reserve of Trigger had a nil balance.

The draft balance sheets for Delboy plc, Rodney plc and Trigger plc as at 31 March 1999 are as follows:

	Delboy plc £000	**Rodney plc £000**	**Trigger plc £000**
Fixed assets			
Tangible	3,255	580	1,175
Investments			
Ordinary shares in Rodney @ cost	1,000		
Preference shares in Rodney @ cost	210		
Ordinary shares in Trigger @ cost	475		
Total fixed assets	4,940	580	1,175
Current assets			
Stock	1,000	300	30
Debtors	900	40	250
Cash	0	1,000	20
Current account with Rodney	120		
Current account with Trigger	10	70	
	2,030	1,410	300
Creditors due within one year			
Bank overdraft	3,000		
Other	395	440	625
Current account with Delboy		90	10
Current account with Rodney			60
Net working capital	(1,365)	880	(395)
	3,575	1,460	780

	Delboy plc £000	Rodney plc £000	Trigger plc £000
Capital and reserves			
£1 Ordinary shares	3,175	680	630
£1 5% Preference shares		300	
Revaluation reserve			50
Revenue reserve	400	480	100
	3,575	1,460	780

Additional information

(i) Rodney has accrued its preference dividend for the year ending 31 March 1999. This is not reflected in the accounts of Delboy plc (policy is not to record dividends until it receives the cash).

(ii) No other dividends are proposed by any of the companies.

(iii) Goodwill is written off on acquisition.

(iv) The following cash was in transit at 31 March 1999 (ie recorded in the accounts of the sender but not in the books of the payee):
- Delboy sent Rodney a cheque for £30,000.
- Trigger sent Rodney a cheque for £10,000.

(v) The share capital of Trigger, as at 31 March 1999, is the same as at the time Delboy purchased its shareholding in the company.

(vi) The share capital of Rodney, as at 31 March 1999, is the same as at the time Delboy purchased its shareholding in the company.

- **Requirement for question 3**

(a) Prepare a consolidated balance sheet for the Delboy group of companies as at 31 March 1999. *14*

(b) If Delboy had purchased 25% of the share capital of Trigger for £155,000 instead of the 90% above (all the other information remaining the same), prepare the consolidated balance sheet extract to show the investment in the associated company assuming Trigger meets the requirements of an associated company of Delboy. *6*

(20)

4 The following information has been taken from three separate companies Basil plc, Cybil plc and Manuel plc:

PROFIT AND LOSS ACCOUNTS FOR THE YEAR END 31 MARCH 1999

	Basil plc £000	**Cybil plc £000**	**Manuel plc £000**
Operating profit before interest & tax	600	600	300
Interest Payable			(10)
Profit on ordinary activities before tax	600	600	290
Taxation	180	180	87
Profit on ordinary activities after tax	420	420	203
Dividends:			
Preference		(60)	(60)
Ordinary	(200)	(120)	(40)
Retained profit for year	220	240	103

BALANCE SHEETS AS AT 31 MARCH 1999

	Basil plc £000	**Cybil plc £000**	**Manuel plc £000**
Total assets less current liabilities	800	700	600
Creditors falling due > one year			
10% debenture stock			(100)
	800	700	500
Capital and reserves			
Ordinary £1 shares	500	300	200
6% £1 cumulative preference shares		100	100
Profit and Loss account	300	300	200
	800	700	500
Market price of ordinary shares at 31 March 1999	8.00	9.00	10.00

There were no changes in the share capital structure or in long term loans of any of the companies in the year to 31 March 1999.

- **Requirement for question 4**

(a) Calculate the following shareholders ratios for the above three companies.

(i) Earnings per share.
(ii) Price earnings ratio.
(iii) Gearing. *4½*

(b) Discuss the rationale of each of the ratios. *5*

(c) Evaluate the performance of each company. *10½*

(20)

SECTION B (Answer one question)

5

(a) What were the reporting requirements of SSAP 16 Current Cost Accounting? *3*

(b) Describe the adjustments required to convert historic cost profit into current cost profit (illustrate your answer with examples). *12*

(15)

6

Discuss the main changes brought about by FRS3 Reporting Financial Performance and the rationale for their introduction.

(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*			______
			______