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OLLSCOIL NA hÉIREANN, GAILLIMH

NATIONAL UNIVERSITY OF IRELAND, GALWAY

SUMMER EXAMINATIONS 2001

MASTER OF ACCOUNTING EXAMINATION

FINANCIAL ACCOUNTING (AY 507)

Mr K. Wallace
Professor S. Collins
Mr K. Warnock
Mr D. Palcic

Time allowed: THREE AND ONE HALF HOURS

Candidates are required to attempt ALL THREE QUESTIONS in Part A and ANY TWO QUESTIONS from Part A

Separate answer books are not required

Candidates are permitted to have in the examination the publication *Accounting Standards 1999/2000*

PART A
(ANSWER ALL QUESTIONS)

Question 1

The following multiple choice question consists of ten parts, each of which is followed by four possible answers. There is only one right answer to each part.

Required:

List the part numbers (1) to (10), and write the letter corresponding to your chosen answer beside the relevant part number.

2 marks per part

Total: 20 marks

(1) Analysis of the profit and loss account, balance sheet and notes to the financial statements of Jones Ltd. for the year ended 31 December 2000 shows operating profit of £1,565,000, an increase in stocks of £39,000, a decrease in debtors of £36,000 (including a decrease in prepayments of £6,000), a decrease in creditors of £58,000, an increase in accruals of £5,000, depreciation of £456,000, amortisation of goodwill of £68,000, and an exceptional loss of £325,000 on the sale of fixed assets. The net cash inflow from operating activities is:

(a) £2,027,000
(b) £2,033,000
(c) £2,352,000
(d) £2,358,000

(2) Ted Ltd. owns 60% of the ordinary share capital of Cooke Ltd. and 20% of the ordinary share capital of Bundle Ltd. Cooke Ltd. owns 55% of the share capital of Alley Ltd., 25% of the ordinary share capital and 80% of the preference share capital of Bundle Ltd. Bundle Ltd. owns 90% of the ordinary share capital of Cox Ltd. Bundle Ltd. has 200,000 ordinary shares of £1 each and 200,000 preference shares of £1 each.

The subsidiary undertakings of Ted Ltd. are:

(a) Cooke Ltd. only
(b) Cooke Ltd. and Alley Ltd. only
(c) Cooke Ltd., Bundle Ltd. and Cox Ltd. only
(d) Cooke Ltd., Bundle Ltd., Alley Ltd. and Cox Ltd.

(3) Godfrey Ltd. has recently established a new car dealership in Galway. Which of the following conditions would *not* be an indicator that the vehicles delivered by the manufacturer to Godfrey Ltd. should be treated as stocks in Godfrey's balance sheet from the date of delivery?

(a) Godfrey Ltd. has no right to return the stocks
(b) Godfrey Ltd. is not entitled to a fee for the transfer of stocks to another dealer
(c) The risk of obsolescence is born by the manufacturer
(d) The price charged is based on the manufacturer's prices at the date of delivery

(4) Huw plc and Kenneth Ltd. entered into a business combination on 31 March 2000, with Huw plc purchasing all of the shares of Kenneth Ltd in exchange for an issue of its own shares. The combination is to be accounted for using merger accounting. The profits of Huw plc and Kenneth Ltd. for 1999 were £3.2m and £2.6m respectively. In the period to 31 March 2000, their respective profits were £1.0m and £0.6m; in the period from 1 April 2000 to 31 December 2000 they were £2.1m and £3.0m respectively. In the group accounts of Huw plc for the year ended 31 December 2000 the profits for the two years would be reported as:

	2000	1999
(a)	£6.1m	£3.2m
(b)	£6.1m	£5.8m
(c)	£6.7m	£3.2m
(d)	£6.7m	£5.8m

(5) Rules on disclosure of related party transactions may require disclosure of:

(a) sale of property to a controlling shareholder
(b) emoluments paid to key directors as employees of the reporting entity
(c) group transactions even where these are eliminated on consolidation
(d) pension contributions paid to a pension fund

(6) Edmond Ltd. owns 40% of the share capital of Ross Ltd., a company which it controls jointly with Cromarty plc, and 30% of the share capital of Isles Ltd, a company over which it exercises significant influence. The turnover of the three companies for the year ended 31 December 2000 was as follows:

Edmond Ltd.	£5,000,000
Ross Ltd.	£4,000,000
Isles Ltd.	£2,000,000

The group turnover to be included in the consolidated profit and loss account for the year ended 31 December 2000 is:

(a) £5,000,000
(b) £5,600,000
(c) £6,600,000
(d) £7,200,000

(7) A provision may not be recognised in the financial statements of a company where:

(a) the amount is not known with certainty
(b) there is no legal obligation for a company to make a payment
(c) it is based on an executory contract
(d) it is not probable that a transfer of economic benefits will be required

(8) Comb Ltd. purchased a new computer system on 1 January 1999 for £1,600,000. The directors initially decided to depreciate the system at 40% on the reducing balance method. In December 2000 the directors concluded that they had been over-optimistic in their estimate of the system's life and its residual value, and decided to adopt the straight-line method of depreciation and estimate a zero residual value and an overall useful economic life from the date of purchase of four years. The charge for depreciation for the year ended 31 December 2000 should be:

(a) £240,000
(b) £320,000
(c) £400,000
(d) £576,000

(9) Park Ltd. has arranged government assistance for a marketing programme in Eastern Europe. The assistance takes the form of a cash grant and the provision of free consultancy services by a government-employed expert. The company has spent £45,000 on the marketing programme in the year ended 31 December 2000, and expects its expenditure in the following two years to be £35,000 and £40,000 respectively. The value of the consultancy services provided is estimated at £15,000 for the year ended 31 December 2000, and is expected to be £15,000 in each of the following two years. At 31 December 2000 the government has paid a cash grant of £20,000, and has undertaken to make a further final payment of £40,000 by 31 December 2001. The amount credited in respect of government grants to the profit and loss account of Park Ltd. for the year ended 31 December 2000 is:

(a) £20,000
(b) £22,500
(c) £35,000
(d) £60,000

(10) During 2000, Pert Ltd. purchased goods from Britain for £15,000 sterling when the exchange rate was £0.75 sterling = IR£1. The goods were re-sold before the end of the year for IR£32,000, and selling expenses in relation to the transaction were IR£2,500. At the year end, the exchange rate was £0.80 sterling = IR£1, and the purchase price has not yet been paid by Pert Ltd. What operating profit (in Irish pounds) should be reported on this transaction for the year 2000?

(a) £8,250
(b) £9,500
(c) £10,750
(d) £12,000

Question 2

In late December 1992, Mars Ltd. purchased 800,000 shares in Jupiter Ltd., whose share capital has remained the same since then, for £3,250,000; at that time the revaluation reserve of Jupiter was £120,000 and the balance on profit and loss account was £880,000. In late December 1998 Mars Ltd. purchased all of the share capital of Saturn Ltd. for £2,000,000. When this purchase took place, the balance on the profit and loss account of Saturn was £210,000. There has been no subsequent change in the share capital of Saturn.

In both cases the directors of Mars Ltd. decided that any goodwill arising should be written off over a period of ten years.

The summarised profit and loss accounts of the three companies for the year ended 31 December 2000, and the balance sheets of the companies on that date, were as follows:

Summarised profit and loss accounts
Year ended 31 December 2000

	Mars Ltd. £000s	Jupiter Ltd. £000s	Saturn Ltd. £000s
Turnover	18,650	9,280	6,420
Profit after taxation	2,100	1,330	770
Proposed dividend	600	500	200
Retained profit for the year	1,500	830	570

Balance sheets
31 December 2000

	Mars Ltd. £000s	Jupiter Ltd. £000s	Saturn Ltd. £000s
Tangible fixed assets	3,120	2,340	1,050
Investment in subsidiaries, at cost	5,250		
	8,370	2,340	1,050
Stocks	2,060	920	980
Debtors	2,210	960	1,010
Due from group companies	600	720	-
Cash at bank and in hand	940	1,210	830
	5,810	3,810	2,820
Trade creditors	1,230	760	430
Due to group companies	580		
Taxation	480	640	260
Proposed dividend	600	500	200
	2,890	1,900	890
Net current assets	2,920	1,910	1,930
	11,290	4,250	2,980

Ordinary share capital (£1 shares)	3,500	1,000	1,200
Share premium account	2,280	750	290
Revaluation reserve	860	380	
Profit and loss account	4,650	2,120	1,490
	11,290	4,250	2,980

The following additional information is available:

(1) During the year ended 31 December 2000 Jupiter Ltd. sold goods costing £1,200,000 to Mars Ltd. at a mark-up of 25% on cost. Goods costing Mars Ltd. £180,000 are still held in stocks. Mars sent a check to Jupiter for £140,000 on 29 December 2000 which was not received or recorded by Jupiter until 3 January 2001.

(2) Dividends receivable by Mars Ltd. from its subsidiaries are shown as amounts due from group companies.

Required

Prepare a summarised consolidated profit and loss account for Mars Ltd. and its subsidiaries for the year ended 31 December 2000, and the consolidated balance sheet on that date.

22 marks

Note: The possible tax affects of any adjustments required in arriving at group profit may be ignored

Question 3

You are employed as an assistant accountant by Pluto plc. The company is contemplating the purchase of one of two existing businesses in a specialist manufacturing area where there has been rapid development in recent years. Significant investment in fixed assets is necessary to compete successfully in the area. If either of the two companies is purchased, it is expected that expenditure on new fixed assets costing £1,500,000 will be required over the next two years.

The managing director of Pluto plc is interested in a comparison of the performance and financial position of the two companies. The latest profit and loss accounts and balance sheets for the two companies whose acquisition is under consideration are presented below.

Profit and loss accounts
Year ended 31 March 2001

	Star Ltd. £000s	Comet Ltd. £000s
Turnover	5,650	4,875
Cost of sales	3,280	3,025
Gross profit	2,370	1,850
Operating expenses	1,140	875
Operating profit	1,230	975
Interest payable	210	255
Profit before taxation	1,020	720
Taxation	250	190
Profit after taxation	770	530
Dividends	200	100
Retained profit for the year	570	430

Consolidated balance sheets
31 March 2001

		Star Ltd.		Comet Ltd.
		£000s		£000s
Tangible fixed assets (Note 1)		5,310		4,870
Current assets				
Stocks	1,080		850	
Debtors	1,140		870	
Cash at bank	1,070		1,480	
	3,290		3,200	
Creditors: amounts due within one year				
Trade creditors	460		320	
Taxation	260		200	
Proposed dividend	200		100	
	920		620	
Net current assets		2,370		2,580
		7,680		7,450
Creditors: amounts due after one year (Note 2)		2,650		3,650
		5,030		3,800
Ordinary share capital		2,000		1,500
Share premium account		470		750
Revaluation reserve		1,020		
Profit and loss account		1,540		1,550
		5,030		3,800

Note 1: The tangible fixed assets of Star Ltd. are stated at valuation carried out in March 2001; those of Comet Ltd. are stated at cost less accumulated depreciation.

Note 2: The amount of creditors falling due after one year consists in the case of both companies of long-term borrowings due for repayment in 2009.

Required

Prepare a memorandum for the managing director of Pluto Ltd., reviewing the comparative performance and financial position of the two companies under appropriate headings, and including as an appendix to your report the calculation of ratios to support your analysis.

22 marks

PART B
(ANSWER ANY TWO QUESTIONS)

Question 4

Venusa Ltd. is involved in the manufacturing of high quality glassware. The trial balance of the company as at 31 December 2000 is set out below:

Trial balance as at 31 December 2000

	Dr £000s	Cr £000s
Administrative expenses (see (1) below)	298	
Cash at bank and in hand	237	
Corporation tax (see (2) below)		12
Cost of sales	1,263	
Debenture interest (see (3) below)	40	
8% Debenture loan 2008		1,000
Deferred taxation (see (2) below)		237
Distribution costs (see (1) below)	417	
Dividend paid (see (4) below)	50	
Fixtures and fittings at cost (see (5) below)	248	
Fixtures and fittings: accumulated depreciation		93
Land and buildings at cost (see (5) below)	1,972	
Land and buildings: accumulated depreciation		122
Plant and machinery at cost (see (5) below)	1,290	
Plant and machinery: accumulated depreciation		219
Profit and loss account		688
Sales		3,176
Share capital (ordinary shares of £0.50 each)		1,100
Stocks	396	
Trade debtors and trade creditors	328	282
Wages and salaries (Non-manufacturing) (see (1) below)	390	
	6,929	6,929

Additional information

(1) Of non-manufacturing wages and salaries, 40% relate to administration and 60% to distribution.

(2) The corporation tax charge on the profits for the year ended 31 December 2000 has been calculated at £275,000. £45,000 is to be released from the provision for deferred taxation. Neither amount has been recognised in the trial balance.

(3) Provision is to be made for debenture interest for the period 1 July 2000 to 31 December 2000.

(4) In addition to the interim dividend paid in September 2000, the directors have proposed a final dividend of 5 pence per share.

(5) Depreciation on fixtures and fittings is to be calculated at 20% on the reducing balance method. Depreciation on buildings of £825,000 is to be calculated at 4% on cost. Depreciation on plant and machinery is to be calculated at 10% on cost. The

depreciation on buildings and plant and machinery relates to manufacturing, while that on fixtures and fittings relates to administration.

(5) Stocks included at cost of £98,000 were estimated to have a realisable value of £79,000.

(6) The relevant expense categories include directors' salaries amounting to £198,000. Provision is to be made for directors' fees amounting to £40,000. Included in administrative expenses is auditors' remuneration of £39,000.

(7) Amounts relating to certain discontinued operations are included in sales (£381,000), cost of sales (£240,000), administrative expenses (£50,000) and distribution costs (£75,000). Also included in cost of sales is a loss of £125,000 on the sale of these discontinued operations, which took place on 30 November 2000. The discontinued operations represented a distinct operational unit, whose sale had a material effect on the nature and focus of the company's operations.

(8) Amounts relating to acquisitions during the year are included in sales (£379,000), cost of sales (£164,000), administrative expenses (£35,000) and distribution costs (£45,000).

Required

Prepare the profit and loss account for Venusa Ltd. for the year ended 31 December 2000, and the balance sheet as at that date, in accordance with legislative and accounting standards requirements so far as the available information permits.

18 marks

Question 5

Stellar Systems plc has recently been experiencing liquidity problems and pressure from its bankers in relation to gearing levels. It would like to acquire significant additional fixed assets without any immediate net cash outlay, without significant requirement for cash outlays in the next three years, and, if possible, without affecting the levels of gearing apparent in its balance sheet. The finance director, who has a Master of Business Administration degree but no formal accounting qualification, has asked you to advise her on the consequences of the following possible methods for the acquisition of the assets.

Option 1

The company might enter into a lease which would have a primary period of six years from 1 July 2001. Annual payments of £200,000 would be required during this period, commencing on 30 June 2002. At the end of this period the company would have an option to extend the lease for a further six years on payment of a nominal annual amount. The estimated useful economic life of the assets, which could be bought outright on 1 July 2001 for £870,000, would be eight years. The lessors have advised that the implicit interest rate in the lease is 10%.

Option 2

The company might avail of a loan on special terms from the Flexible Investment Bank Ltd. The bank would be prepared to lend £870,000 on 1 July 2001, to allow the immediate purchase of the fixed assets. The bank would require payment of £1,072,500 in five years time. Interest would be paid at 5% on the amount borrowed for the first three years of the loan (payments

would be annually in arrears starting on 30 June 2002), and at 15% on the amount borrowed for the following two years. The bank have advised that the implicit interest rate is 12%.

Option 1a

The Flexible Investment Bank is keen to establish a relationship with Stellar Systems plc. Its marketing director knows about the leasing possibility, and although it undertakes no leasing business itself, it has offered to help to finance the first lease payment because of the pressures that Stellar Systems is under. It will offer to buy stocks from the company on 30 June 2002 for £200,000, provided the company includes in the sale agreement an option for the bank to re-sell the stocks to the company for £212,000 on 1 January 2003. The directors of Stellar have indicated that if they entered into this agreement, they would in turn require an option to re-purchase the stocks from the bank at a price of £212,000 on 1 January 2003, to prevent the bank making an excessive profit in the event of a significant increase in the value of the stocks.

Required

(a) Prepare calculations showing the amounts to be included in the profit and loss account and balance sheet of Stellar Systems plc for the TWO years ended 31 December 2001 and 31 December 2002 if *Option 1* is adopted, and justify briefly the approach you have adopted.

7 marks

(b) Prepare calculations showing the amounts to be included in the profit and loss account and balance sheet of Stellar Systems plc for the TWO years ended 31 December 2001 and 31 December 2002 if *Option 2* is adopted, and justify briefly the approach you have adopted.

7 marks

(c) Comment on the expected impact on the balance sheet as at 31 December 2002 of the proposal discussed as *Option 1a*.

4 marks

Total: 18 marks

Question 6

The directors of Planet plc are concerned about the effect of a number of matters on the financial statements of the company for the year ended 31 December 2000.

(1) They are concerned that because of changes in the amount of share capital in issue, earnings per share may appear to have deteriorated despite what the directors consider to be a satisfactory performance. In the year ended 31 December 1999, the net profit attributable to ordinary shareholders was £11,640,000, and the number of ordinary shares in issue was 60,000,000. In the year ended 31 December 2000, net profit attributable to ordinary shareholders has increased to an estimated £12,965,000. On 1 January 2000, Planet plc made a bonus issue of one share for every four held. On 1 October 2000, the company made a rights issue of one share for every five held at a price of £1.50. The fair value per share on 30 September 2000 was £2.00.

Required

Calculate the earnings per share to be included in the profit and loss account for the year ended 31 December 2000 on the basis of the estimated profit, together with the corresponding amount for the year ended 31 December 1999.

6 marks

(2) The company has been involved in two major long-term contracts during the year. The relevant details of these contracts, both of which were commenced during the year, were as follows:

	Central £000s	Docks £000s
Contract price	5,000	4,200
Progress payments received	3,000	2,650
Costs incurred to date	2,980	2,360
Estimated additional costs to complete	1,440	1,480
Costs of work completed to date	2,840	2,250

The costs of work completed to date are expressed as a proportion of the total expected costs of the contract to determine the proportion of the contract price earned to date.

Required

(a) Calculate the amounts to be included in relation to both contracts in the profit and loss account of Planet plc for the year ended 31 December 2000 and the balance sheet as at that date.

10 marks

Calculations should be made to the nearest £000.

(b) Explain, without producing detailed additional calculations, how the position would be affected if the estimated additional costs to complete the Docks contract were £1,980,000 instead of £1,480,000.

2 marks

Total: 18 marks