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OLLSCOIL NA hÉIREANN, GAILLIMH

NATIONAL UNIVERSITY OF IRELAND, GALWAY

SEMESTER ONE EXAMINATIONS 2001/2002

B. COMM. DEGREE EXAMINATIONS

FINANCIAL ACCOUNTING II (AY 305)

Professor N. Garrod
Professor J. F. Collins
Mr K. Warnock

Time allowed: TWO HOURS

Candidates are required to attempt TWO QUESTIONS from Part A and ONE QUESTION from Part B

Separate answer books are not required

Share capital (£1 shares)	800	200
Share premium account	250	210
Revaluation reserve	80	70
Profit and loss account	630	480
	1,760	960

Simon plc had purchased 60% of the 200,000 £1 shares of Stephen Ltd. on 1 January 2000 for £600,000. At that time Stephen Ltd.'s financial statements showed a balance of £320,000 on its profit and loss account and a revaluation reserve of £70,000. It held various intangible fixed assets with book values at their original cost of £80,000 and market values of £180,000; in all other cases fair values approximated book values.

In January 2000 Simon plc purchased from its newly-acquired subsidiary intangible fixed assets, which had cost Stephen Ltd. £20,000, at their market value of £70,000. Stephen continued to hold its remaining intangible fixed assets at their original cost.

In November 2000, Stephen Ltd. sold goods with a cost of £80,000 to Simon plc for £120,000. Half of these goods remained unsold at 31 December 2000, and no payment had yet been made by the parent to the subsidiary in respect of any of them.

The directors of Simon plc have decided that goodwill arising on the acquisition of Stephen Ltd. should be amortised over a period of five years.

You are required to:

(a) prepare a consolidated profit and loss account for Simon plc and its subsidiary for the year ended 31 December 2000;

(11 marks)

(b) prepare a consolidated balance sheet at the same date;

(23 marks)

(c) explain briefly the major principles underlying the legislative rules which determine whether or not one company is the subsidiary of another.

(6 marks)

Total: 40 marks

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Question 2

Stanislaus Ltd. is involved in four long-term contracts; details of the position of each of these contracts at 30 September 2001 are provided below. The company has recently received a number of grants from government agencies. The directors require advice on the appropriate accounting treatment of the contracts and the grants in the financial statements of the company for the year ended 30 September 2001.

Contract AD
The total contract price is £1,600,000. Costs incurred to 30 September 2001 amount to £750,000, and it was estimated that further costs of £450,000 would be required to complete the contract. In accordance with the terms of the contract the client has been invoiced for £900,000, all of which had been received in cash by 30 September 2001.

Contract AE
The total contract price is £4,800,000. Total costs for the contract are estimated at £4,000,000, of which £2,200,000 had been incurred to 30 September 2001. Of the costs incurred, £2,100,000 related to Phase 1 of the contract (the remainder related to preliminary work on Phase 2); Phase 1 had been completed to the client's satisfaction, and according to the terms of the contract the balance of the agreed portion of the contract price for this phase had become due for payment. The agreed portion was £2,520,000, of which £500,000 had been received as a deposit on 25 September 2000.

Contract AF
The total contract price is £1,200,000. Costs incurred to 30 September 2001 amounted to £750,000, and it was estimated that the costs of completing the contract would be £500,000. The client had made total payments of £800,000 in relation to this contract by 30 September 2001.

Contract AG
The total contract price is £2,800,000. Costs incurred to 30 September 2001 amounted to £140,000, and it was estimated that further costs of £2,560,000 would be required to complete the contract. The client had made an initial payment of £100,000 by 30 September 2001.

Grant 1
The company has agreed to participate in a government training scheme for the construction industry. The company hired two training consultants for a two year period commencing 1 April 2001, at an annual cost of £40,000 per consultant. There will be additional direct costs of the scheme amounting to £5,000 in the year ended 30 September 2001, £30,000 in the year ended 30 September 2002 and £5,000 in the year ended 30 September 2003. In return the government paid the company £40,000 on 31 August 2001 and has agreed to make two further payments of £30,000 each on 28 February 2002 and 31 August 2002.

Grant 2
The company has received a capital grant in relation to machinery bought for *Contract AG*. The machinery cost £600,000, and is being depreciated over ten years on the straight-line basis, with depreciation charged to the contract. (A full year's depreciation is charged in the year of acquisition.) The machinery was bought on 1

May 2001, and the related government grant of £120,000 was received in full on 31 August 2001.

You are required to:

(a) prepare calculations to show how each of the contracts should be reflected in the profit and loss account and balance sheet of Stanislaus Ltd. for the year ended 30 September 2001;

(24 marks)

(b) show how each of the grants should be reflected in the profit and loss account and balance sheet of Stanislaus Ltd. for the year ended 30 September 2001, explaining by reference to the provisions of the relevant accounting standard the treatment you recommend in relation to *Grant 1*.

(16 marks)

Total: 40 marks

Question 3

The balance sheet of Dilly Ltd. at 1 January 2000, prepared on a replacement cost basis, was as follows:

		£
Fixed assets, at replacement cost		760,000
Stocks	348,000	
Debtors	420,000	
Bank	32,000	
	800,000	
Creditors	240,000	
Net current assets		560,000
		1,320,000
Long-term loans		500,000
		820,000
Share capital		500,000
Capital maintenance reserve		180,000
Profit and loss account		140,000
		820,000

The capital maintenance reserve consisted of the difference between the historical cost and the replacement cost of the fixed assets (£136,000) and the differences between the historical cost and replacement cost of 10,000 units of Product 1 (£16 and £18 per unit respectively) and of 6,000 units of Product 2 (£24 and £28 per unit respectively).

[Question 3 continues on the next page]

[Question 3 continued from the previous page]

The following purchases and sales took place during the year ended 31 December 2000:

On 31 March, the company bought on credit 8,000 units of Product 1 and 4,000 units of Product 2 at a cost per unit of £17 and £30 respectively. On the same date the company sold on credit 9,000 units of Product 1 for £22 per unit and 5,000 units of Product 2 for £36 per unit. The company received cash from the debtors of the previous year and paid the creditors; the company also paid £24,000 in cash expenses.

On 30 September, the company bought on credit 12,000 units of Product 1 and 5,000 units of Product 2 at a cost per unit of £16 and £32 respectively. On the same date the company sold on credit 10,000 units of Product 1 for £22 per unit and 8,000 units of Product 2 for £37. The company received cash from the debtors created by the March sales, paid the creditors created by the March purchases, and paid £28,000 in cash expenses.

On 31 December 2000, the replacement cost per unit of Product 1 was £15 and the replacement cost per unit of Product was £33. On that date the company paid final cash expenses for the year of £18,000 and its annual interest cost of £25,000.

The replacement cost of fixed assets at 31 December 2000 was £780,000; depreciation on fixed assets can be ignored.

The Consumer Price Index increased by 5% during the year ended 31 December 2000.

You are required to:

(a) prepare the profit and loss account of Dilly Ltd. for the year ended 31 December 2000 and its balance sheet on that date, using a replacement cost basis and maintaining capital on an operating capacity basis (and showing the calculation of the change in the capital maintenance reserve);

(28 marks)

(b) calculate the appropriate capital maintenance adjustment to be made if the company decided to employ a shareholders' purchasing power approach to capital maintenance, explaining the main arguments against and in favour of this alternative method of capital maintenance.

(12 marks)

Total: 40 marks

[PART B IS ON THE NEXT PAGE]

PART B
(ANSWER ONE QUESTION)

Question 4

(a) SSAP 13 *Accounting for research and development* contains provisions designed to ensure that costs of research and development are not recognised as assets when it would not be prudent to do so. Outline these provisions.

(14 marks)

(b) SSAP 2 *Disclosure of accounting policies*, which lists prudence as one of four fundamental accounting concepts, is being replaced by FRS 18 *Accounting policies*. Explain whether or not you consider that this change, related to the development of the Accounting Standards Board's *Statement of principles*, is likely to lead to a revision of SSAP 13.

(6 marks)

Total: 20 marks

Question 5

Outline the major stages involved in the audit of a limited liability company, and explain the importance of an adequate plan for the audit.

20 marks