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OLLSCOIL NA hÉIREANN, GAILLIMH

NATIONAL UNIVERSITY OF IRELAND, GALWAY

AUTUMN EXAMINATIONS 2002

B. COMM. DEGREE EXAMINATION

FINANCIAL ACCOUNTING II (AY 305)

Professor N. Garrod
Professor S. 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

PART A
(Answer TWO QUESTIONS from this Part)

Question 1

Briggs plc acquired 400,000 shares in Stratton Ltd. in January 1999. At the date of acquisition the reserves of Stratton Ltd. consisted of a profit and loss account balance of €295,000 and a revaluation reserve of €40,000. The draft balance sheets of the two companies as at 31 December 2001 are given below:

	Briggs plc.		Stratton Ltd.	
	€000s	€000s	€000s	€000s
Fixed assets				
Tangible assets		1,312		790
Financial assets – shares in Stratton Ltd. at cost		700		—
		2,012		790
Current assets				
Stocks	311		158	
Debtors	383		180	
Current account with Stratton Ltd.	20			
Cash at bank	149		47	
	863		385	
Creditors: amounts due within one year				
Trade and other creditors	338		140	
Current account with Briggs plc.			5	
Proposed dividend	120		45	
	458		190	
Net current assets		405		195
Total assets less current liabilities		2,417		985
Capital and reserves				
€1 ordinary shares		1,500		500
Revaluation reserve		225		55
Profit and loss account		692		430
		2,417		985

The draft profit and loss accounts of the two companies for the year ended 31 December 2001 are as follows:

	Briggs plc.		Stratton Ltd.	
	€000s	€000s	€000s	€000s
Sales		3,038		1,485
Cost of sales		1,566		837
Gross profit		1,472		648
Operating expenses		942		411
Operating profit		530		233
Investment income		20		-
Profit before taxation		550		233
Taxation		135		108
Profit after taxation		415		125
Ordinary dividends paid	180		25	
Ordinary dividends proposed	120	300	45	70
Retained profit for the year		115		55

The following additional information is available:

(1) Briggs plc has not yet accounted for its share of the proposed dividend from Stratton Ltd.

(2) On 30 December 2001 Stratton Ltd. sent a cheque for €15,000 to Briggs plc which was not received until 2 January 2002.

(3) During the year Briggs plc sold goods to Stratton Ltd. at an invoice price of €180,000. The goods were invoiced at cost plus 20%. Forty per cent of these goods were still in Stratton Ltd.'s stock at 31 December 2001.

(4) The tangible fixed assets of Stratton Ltd., which had a net book value of €725,000 on 1 January 1999, the date of acquisition, had a fair value of €740,000 and €790,000 on 1 January 1999 and 31 December 2001 respectively.

(5) Goodwill arising on the acquisition of Stratton Ltd. is being amortised over five years.

Required:

(a) Prepare the consolidated profit and loss account of Briggs plc. for the year ended 31 December 2001 and the consolidated balance sheet at that date.

(33 marks)

(b) Explain the treatment which should be adopted where one company in a group sells a fixed asset to another company in the group at a figure in excess of depreciated cost.

(7 marks)

Total: 40 marks

Question 2

The summarised balance sheet of Porton Ltd. at 31 December 2000, prepared on the historical cost basis, was as follows:

	€	€
Fixed assets		775,000
Current assets		
Stocks	386,000	
Debtors	316,000	
	702,000	
Current liabilities		
Bank overdraft	130,000	
Trade creditors	287,000	
	417,000	
Net current assets		285,000
		1,060,000
Long-term loans		200,000
		860,000
Share capital		300,000
Profit and loss account		560,000
		860,000

[Question 2 continues on the next page]

Stocks at 31 December 2000 consisted of 125,000 units of Product A at a cost of €2.00 each and 3,400 units of Product B at a cost of €40.00 each. In the case of both products they had been purchased very shortly before the balance sheet date. The company calculates the cost of stocks on a first in, first out (FIFO) basis.

On 1 February 2001, the company purchased 75,000 units of Product A at a cost of €2.20 each. On I March, when it still would have cost €2.20 per unit to purchase Product A, 120,000 units were sold for €3.60 each. On 1 July 2001, the company bought 80,000 units of Product A at a cost of €2.40 each. On 1 October, when the replacement cost had increased to €2.50, 100,000 units were sold for €3.80 each. At 31 December 2001, it would have cost the company €2.50 to purchase a unit of Product A.

On 1 February 2001, the company bought 2,000 units of Product B at a cost of €42.00 each. On I May, when it would have cost €44.00 per unit to purchase Product B, 2,700 units were sold for €60.00 each. On 1 August 2001, the company purchased 3,000 units of Product B at a cost of €45.00 each. On 1 November, when the replacement cost was still €45.00, 2,000 units were sold for €63.00 each. At 31 December 2001, it would have cost the company €47.00 to purchase a unit of Product B.

During the year ended 31 December 2001, the company paid cash expenses of €82,000. At 31 December 2001, debtors were €126,000 and creditors €135,000.

At 31 December 2001, fixed assets, depreciation on which can be ignored, were valued at €845,000 (their value had been €825,000 a year earlier).

During 2001, the consumer price index rose from 200 to 210.

Required:

(a) Prepare the profit and loss account for Porton Ltd. for the year ended 31 December 2001 and its balance sheet on that date on a replacement cost basis, maintaining capital on a money capital basis and showing how the holding gains arise.

(30 marks)

(b) Explain how your answer to part (a) would differ if the operating capacity basis of capital maintenance were to be used, and discuss the arguments for and against the operating capacity approach.

(10 marks)

Total: 40 marks

Question 3

The accountant of Hando Ltd. has produced the following list of balances from the company's financial records at 30 June 2002:

	€000s
Accruals	19
Accumulated depreciation on factory buildings	40
Accumulated depreciation on plant and machinery	412
Administrative expenses	696
Cash at bank	229
Cost of sales	3,295
Distribution costs	698
Factory buildings at cost	500
Freehold land at valuation	780
Government grants	48
Interest paid	37
Plant and machinery at cost	2,680
Prepayments	26
Profit and loss account, 1 July 2001	546
Research and development expenditure	154
Revaluation reserve	180
Sales	5,510
Share capital	2,450
Share premium account	790
Stocks at 30 June 2002	483
Trade creditors	519
Trade debtors	936

The accountant has also produced the following summary of further matters to be considered in the preparation of the financial statements of Hando Ltd. for the year ended 30 June 2002:

(1) Factory buildings are depreciated at the rate of 2% per annum on the cost at the end of the financial year. Plant and machinery is depreciated on the straight-line basis, assuming a zero residual value and a useful economic life of 10 years; the calculation is based on the amount at the end of the financial year. Depreciation has not yet been included for the year ended 30 June 2002.

(2) Government grants amounting to €60,000 were received in the year ended 30 June 2000 in relation to plant and machinery bought during that year.

(3) Due to continuing economic uncertainty, the value of the freehold land (and its recoverable amount) is considered to have dropped to €680,000.

(4) Administrative costs include redundancy payments of €200,000 as a result of the outsourcing of some of the work previously carried out by the company's employees.

(5) Interest paid was incurred on a bank overdraft required before an issue of shares improved the company's financial situation.

(6) The balance shown for research and development consists of two elements. During the year ended 30 June 2002, €70,000 was incurred on applied research. €84,000 was incurred over several years on development work for a manufacturing process; this

work was completed in July 2001, and it is expected that Hando Ltd. will be able to use the new process commercially until June 2008.

Required:

(a) Prepare the profit and loss account of Hando Ltd. for the year ended 30 June 2002, and the balance sheet on that date, in compliance with accounting standards and company legislation as far as the available information permits.

(28 marks)

(b) Discuss the conditions necessary to allow the treatment of development expenditure as an asset.

(12 marks)

Total: 40 marks

PART B
(Answer ONE QUESTION from this Part)

Question 4

In the course of an evening with friends where there was a discussion of *Enron* and other financial scandals, you hear the following three remarks:

- "As the professional accountants involved, the auditors are responsible for ensuring that the financial statements are correct."
- "Without the audit report guarantee of the company's financial future, no investor would be prepared to put money into company shares."
- "The audit report is supposed to set out all the matters in the financial statements that the auditor considers inaccurate or doubtful."

Explain the role of the auditor and the major elements of the audit report, responding briefly as you do to each of the remarks quoted above.

20 marks

Question 5

(a) The objective of FRS 3 *Reporting financial performance* was stated to be "to highlight a range of important components of financial performance." Discuss the ways in which the standard attempted to meet this objective.

(12 marks)

(b) Explain briefly the requirements of FRS 3 in relation to exceptional items.

(8 marks)

Total: 20 marks