QUESTION 1

(a)

Swanage
Income Statement
Year ended 31 December 2004

	\$000	**\$000**
Turnover		5,173
Change in inventories of finished goods and work in-progress (78-101)	23	
Raw materials and consumables (51+2,427-60)	(2,418)	
Depreciation (90 + 38)	(128)	
Other operating charges	(201)	
		2,724
		2,449
Accumulated profits at 1 January		156
Accumulated profits at 31 December		2,605

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QUESTION 1 CONTINUED

Swanage
Balance Sheet
As at 31 December 2004

	$000	$000
ASSETS		
Non current assets		
Tangible (working 1)		4,262
Current assets		
Inventory	161	
Receivables	342	
Bank	13	
		516
Total assets		4,778
EQUITY AND LIABILITIES		
Capital and reserves		
Ordinary share capital		2,000
Accumulated profits		2,605
Equity		4,605
Current liabilities		173
		4,778

Workings

	Cost	Accumulated Depreciation At 1 January	Charge	Accumulated Depreciation At 31 December	
	$000	$000	$000	$000	$000
Local and buildings	5,000	800	90*	890	4,110
Plant and machinery	470	280	38*	318	152
					4,262

* .03 (5,000 – 2,000)
* .20 (470 – 280)

(20 marks)

(b)

(1) External auditors are required to be independent from the company, internal auditors are not.

(2) External auditors report to the shareholders, internal auditors normally report to management.

(3) External auditors are a legislative requirement, internal auditors normally are not.

(5 marks)

(Total 25 marks)

QUESTION 2

(a)

8% Debentures in Patel

Date	Description	Nom $	Income $	Capital $	Description	Nom $	Income $	Capital $
Jan 1	Bank	800,000	10,667[1]	829,333[2]				
April 15					Bank	200,000		218,000[3]
April 15	Contra		667[4]		Contra			667[4]
April 15	P & L			11,334[5]				
April 30					Bank		32,000[6]	
June 15					Bank	400,000	4,000[7]	376,000[8]
June 15					P & L			38,667[9]
Oct 31					Bank		8,000[10]	
Nov 30					Bank	100,000	667[11]	103,333[12]
Nov 30					P&L			334[13]
Dec 31	P & L (R)		34,666		Bal c/d	100,000	1,333[14]	103,666[15]
		800,000	46,000	840,667		800,000	46,000	840,667

Notes:

(1) 2/12 x 800,000 x 8/100 = 10,667

(2) (800,000 x 1.05) − 10,667 = 829, 333

(3) 200,000 x 1.09 = 218, 000

(4) .5/12 x 8/100 x 200,000 = 667

(5) (218,000 + 667) − {(200,000/800,000) x 829,333} = 11,334

(6) 8/100 x 800,000 x 6/12 = 32,000

(7) 1.5/12 x400,000 x 0.8 = 4,000

(8) 400,000 x .95) − (4,000) = 376,000

(9) 400,000/800,000 X 829,333) − 376,000 = 38,667

(10) 8/100 x 200,000 x 6/12 = 8000

(11) 1/12 x 100,000x.08 = 667

(12) (100,000 x 1.04) − (667) = 103,333

(13) 103,333 − (100,000/800,000 X 829,333) = 334

(14) 100,000 x 8/100 x 2/12 = 1,333

(15) 100,000/800,000 x 829,333 = 103,666

(b)

(i) Capitalisation issue of ordinary shares
(i) Write off preliminary expenses
(ii) Write off discount on the issue of debentures
(iii) Write off premium on the redemption of preference shares

(4 marks)

QUESTION 2 CONTINUED

(c) Variable interest rates vary across time periods, usually reacting to changes in the general level of interest rates in a country. Fixed interest rates do not vary and are fixed for the life of the investment.

If interest rates are expected to rise, a company should normally invest in variable rate investments, as the interest payable is likely to increase, whereas the interest on a fixed interest investment will not.

(5 marks)

(Total 25 marks)

QUESTION 3

(a)

RISK	BRIEF EXPLANATION
Importing Clothing	Frant will be exposed to risks of foreign exchange movement.
Bad publicity re. poor wages in Asia	Customers may refuse to buy the company's products.
Purchases sole responsibility of Grant Frant	What happens if Grant leaves or retires, especially in view of him being 83 years of age?
Grant is not as up to date as he used to be	Clothing is an industry where fashions can change hourly.
Company sells to only two stores	Over reliance on two customers, more of a problem as one is struggling.
Finance Director has recently left	Problem exacerbated by inexperience of his temporary replacement, lack of accounting expertise.
Profits have fallen	Possible going concern issues and may mean increased risk of management bias, as company wishes to become a public company

(21 marks)

(b) Strengths
Weaknesses
Opportunities
Threats

(4 marks)

(Total 25 marks)

QUESTION 4

(a) **Acquisition of Galton**

		$000	**$000**
Purchase price			2,000
Less:	Share capital	2,200	
	Accumulated profits	1,200	
		3,400	
	x 70%		2,380
Negative goodwill			380
Written off ($\frac{1}{5}$)			76
			304

Acquisition of Bridge

		$000	**$000**
Purchase price			4,700
Less:	Share capital	1,800	
	Accumulated profits	600	
		2,400	
	x 80%		1,920
Positive goodwill			2,780
Written off			NIL
			2,780

(7 marks)

(b)

	$000
In Galton (3,600 x30%)	1,080
In Bridge (2,400 x 20%)	480
	1,560

(2 marks)

(c) (i) and (ii)

The most likely explanation is that the original holders decided to sell at a bargain price. This is because Galton's accumulated profits have increased in the year ended 31 December 2003.

(3 marks)

(d) The accountancy firm is well respected, which in itself is likely to increase the value of goodwill. In addition the accountancy firm is likely to have few tangible assets, its primary asset being the ability and reputation of its partners and staff.
The engineering firm in contrast has reported poor results in recent years, which is likely to reduce the value of goodwill. It is likely to have more tangible assets because it is likely to be machine intensive.

(5 marks)

(e) Goodwill will be written off in the consolidated accounts and will not reduce the distributable profits of Smethwick.
In addition, if the acquisitions are successful they may be able to pay high dividends to Smethwick, which may lead to the possibility of paying increased dividends.
In any event, at present, Smethwick has substantial retained earnings.

(3 marks)

QUESTION 4 CONTINUED

(f) Directors
Shareholders
Bankers
Government
Employees

(5 marks)

(Total 25 marks)

QUESTION 5

		Q1	Q2	Q3	Q4	
(a)	Working Capital (000's)	$240	$240	$240	$240	(4 marks)
(b)	Working Capital ratio	4.0:1	2.5:1	1.8:1	9.0:1	(4 marks)
(c)	Acid test ratio	1.5:1	1.0:1	1.0:1	5.3:1	(4 marks)
(d)	Sales (000's)	$120	$480	$800	$150	(2 marks)
(e)	Credit period for customers	1.0 month	1.0 month	1.1 months	1.0 month	(6 marks)

Calculations

			$000
Working capital	**Q1**	200 + 40 + 80 – 80	= 240
	Q2	240 + 160 – 60 – 100	= 240
	Q3	250 + 300 – 160 – 150	= 240
	Q4	110 + 50 + 110 – 30	= 240
Working capital ratio	**Q1**	(200 + 40 + 80)/80	= 4.0:1
	Q2	(240 + 160)/(60 + 100)	= 2.5:1
	Q3	(250 + 300)/(160 + 150)	= 1.8:1
	Q4	(110 + 50 + 110)/30	= 9.0:1
Acid test ratio	**Q1**	(40 + 80)/80	= 1.5:1
	Q2	160/(60 + 100)	= 1.0:1
	Q3	300/(160 + 150)	= 1.0:1
	Q4	(50 + 110)/30	= 5.3:1
			$000
Sales	**Q1**		= 120
	Q2	(600 – 120)	= 480
	Q3	(1,400 – 600)	= 800
	Q4	(1,550 – 1,400)	= 150
Credit period for customers	**Q1**	(40/120) x 3	= 1.0 month
	Q2	(160/480) x 3	= 1.0 month
	Q3	(300/800) x 3	= 1.1 months
	Q4	(50/150) x 3	= 1.0 month

(f) Quarter four because:
it is the best quarter seasonally
showing the most favourable bank balance

(5 marks)

(Total 25 marks)

