

**EDUCATION DEVELOPMENT INTERNATIONAL PLC
SAMPLE PAPER ANSWERS 2008
CERTIFICATE IN FINANCIAL ACCOUNTING (ASE4502)
LEVEL 4**

QUESTION 1

(a)

**Swanage plc
Profit and Loss Account
Year ended 31 December 2004**

	£000	£000
Turnover		5,173
Change in stocks 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	<u>(201)</u>	
		<u>2,724</u>
		2,449
Profit and Loss Account at 1 January		<u>156</u>
Profit and Loss Account at 31 December		<u><u>2,605</u></u>

QUESTION 1 CONTINUED

**Swanage plc
Balance Sheet
As at 31 December 2004**

	£000	£000
Fixed assets		
Tangible (working 1)		4,262
Current assets		
Stock	161	
Debtors	342	
Bank	<u>13</u>	
	516	
Creditors: amounts falling due within one year		
Creditors	<u>173</u>	
Net current assets		<u>343</u>
Total assets less current liabilities		<u>4,605</u>

Represented by:

Capital and reserves	
Ordinary share capital	2,000
Profit and loss account	<u>2,605</u>
	<u>4,605</u>

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	<u>152</u>
					<u>4,262</u>

* .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
		<u>800,000</u>	<u>46,000</u>	<u>840,667</u>		<u>800,000</u>	<u>46,000</u>	<u>840,667</u>

Notes:

- (1) $2/12 \times 800,000 \times 8/100 = 10,667$
- (2) $(800,000 \times 1.05) - 10,667 = 829,333$
- (3) $200,000 \times 1.09 = 218,000$
- (4) $.5/12 \times 8/100 \times 200,000 = 667$
- (5) $(218,000 + 667) - \left\{ (200,000/800,000) \times 829,333 \right\} = 11,334$
- (6) $8/100 \times 800,000 \times 6/12 = 32,000$
- (7) $1.5/12 \times 400,000 \times 0.8 = 4,000$
- (8) $400,000 \times .95 - (4,000) = 376,000$
- (9) $400,000/800,000 \times 829,333 - 376,000 = 38,667$
- (10) $8/100 \times 200,000 \times 6/12 = 8000$
- (11) $1/12 \times 100,000 \times .08 = 667$
- (12) $(100,000 \times 1.04) - (667) = 103,333$
- (13) $103,333 - (100,000/800,000 \times 829,333) = 334$
- (14) $100,000 \times 8/100 \times 2/12 = 1,333$
- (15) $100,000/800,000 \times 829,333 = 103,666$

(16 marks)

(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 about 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 plc**

	£000	£000
Purchase price		2,000
Less: Share capital	2,200	
Retained earnings	<u>1,200</u>	
	3,400	
x 70%		<u>2,380</u>
Negative goodwill		380
Written off ($\frac{1}{5}$)		76
		<u><u>304</u></u>

Acquisition of Bridge plc

	£000	£000
Purchase price		4,700
Less: Share capital	1,800	
Retained earnings	<u>600</u>	
	2,400	
x 80%		<u>1,920</u>
Positive goodwill		2,780
Written off		<u>NIL</u>
		<u><u>2,780</u></u>

(7 marks)

(b)

	£000
In Galton Plc (3,600 x 30%)	1,080
In Bridge Plc (2,400 x 20%)	<u>480</u>
	<u><u>1,560</u></u>

(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 Plc's retained earnings 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 of the Smethwick Group, and will not reduce the distributable profits of Smethwick Plc. In addition, if the acquisitions are successful they may be able to pay high dividends to Smethwick Plc, which may lead to the possibility of paying increased dividends. In any event, at present, Smethwick Plc 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

Working capital	Q1	$200 + 40 + 80 - 80$	£000 = 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
Sales	Q1		£000 = 120
	Q2	$600 - 120$	= 480
	Q3	$1,400 - 600$	= 800
	Q4	$1,550 - 1,400$	= 150
Credit period for customers	Q1	$(40/120) \times 3$	= 1.0 month
	Q2	$(160/480) \times 3$	= 1.0 month
	Q3	$(300/800) \times 3$	= 1.1 months
	Q4	$(50/150) \times 3$	= 1.0 month

- (f) Quarter 4 because:
 - it is the best quarter seasonally
 - it shows the most favourable bank balance

(5 marks)

(Total 25 marks)