Model answers

NVQ/SVQ Level 4 in Accounting

Drafting Financial Statements
(Accounting Practice, Industry and Commerce) (DFS)
2003 Standards

Diploma in Accounting
(Diploma Pathway)

Drafting Financial Statements
(Accounting Practice, Industry and Commerce) (DFS)
2003 Standards

December 2007

Note:
The model answers may, in parts, be longer than would be expected of candidates in the exam. The fuller version is given for tutorial purposes.

Section 1

Part A

Task 1.1

			£000	£000
1.	DR	Trade and other receivables	3,564	
	CR	Sale		3,564
2.	DR	Inventories (balance sheet)	9,786	
	CR	Inventories (income statement)		9,786
3.	DR	Trade and other payables	127	
	CR	Returns out		127
4.	DR	Prepayments	32	
	CR	Administration expenses		32
5.	DR	Interest	560	
	CR	Interest payable		560
6.	DR	Taxation	1,254	
	CR	Taxation payable		1,254

Workings

Interest: £16,000,000 × 7% × ½ = £560,000

Prepayment £48,000 **×** 8/12 **=** £32,000

Task 1.2
(a)

Benard Ltd
Income statement for the year ended 31 October 2007

	£000
Continuing operations	
Revenue	53,761
Cost of sales	33,335
Gross profit	20,426
Distribution costs	6,654
Administration expenses	4,120
Profit from operations	9,652
Finance costs	1,120
Profit before tax	8,532
Tax	1,254
Profit for the period from continuing operations attributable to equity holders	7,278

Workings (all £000)

W1 Revenue

Sales	50875	
	3564	54,439
Less: returns in		-678
		53,761

W2 Cost of sales

Opening inventory			8,456
Purchases		35,245	
Less: returns out	453		
	127	-580	34,665
			43,121
Less: closing inventory			-9,786
			33,335

W3 Administration expenses

Per TB	4,152
Prepayment	(32)
	4,120

W4 Finance costs

Per TB	560
Accrual	560
	1120

(b)

Benard Ltd

Balance sheet as at 31 October 2007

	£000
Non-current assets	
Property, plant and equipment	30,489
Current assets	
Inventories	9,786
Trade and other receivables	10,286
Cash and cash equivalents	1,184
	21,256
Total assets	51,745
Current liabilities	
Trade and other payables	(4,168)
Tax liability	(1,254)
	5,422
Net current assets	15,834
Non current liabilities	
Bank loans	(16,000)
Total liabilities	(21,422)
Net assets	30,323
Equity	
Share capital	12,000
Retained earnings	18,323
Total equity	30,323

Workings (all £000)

W1 Property, plant and equipment

Cost per TB	58,463
Accumulated depreciation per TB	27,974
	30,489

W2 Trade and other receivables

Per TB	6690
October sales	3564
Prepayment	32
	10,286

W3 Trade and other payables

Trade and other payables per TB	3,348
Interest	560
Accruals	387
Less: returns out	(127)
	4,168

W4 Retained earnings

Balance at 1 Nov 2006	12,345
Profit for the year	7,278
	19,623
Final dividend for 2006	(700)
Interim dividend for 2007	(600)
Balance at 31 Oct 2007	18,323

Part B

Task 1.3

Consolidated balance sheet as at 31 October 2007

	Dumyat plc
	£000
Non-current assets	
Intangible - goodwill	2,711
Property, plant and equipment	100,275
	102,986
Current assets	
Inventories	33,839
Trade and other receivables	16,662
Cash and cash equivalents	2,214
	52,715
Total assets	155,701
Current liabilities	
Trade and other payables	(15,029)
Tax liabilities	(6,248)
	(21,277)
Net current assets	31,438
Non current liabilities	
Long-term loans	(29,000)
Total liabilities	(50,277)
Net assets	105,424
Equity	
Share capital	25,000
Share premium	12,000
Retained earnings	59,401
Equity attributable to equity holders of the parent	96,401
Minority interest	9,023
Total equity	105,424

Wk 1 **Goodwill**		**Attributable to Hold Company**	**Wk 3** Retained Earnings	**Wk 4** **Minority Interest**
Share capital	12,000	9,000		3,000
Share premium	4,000	3,000		1,000
Revaluation	3,000	2,250		750
Post acquisition	5,040		3,780	1,260
Pre acquisition	12,052	9,039		3,013
	36,092	23,289	3,780	9,023
Consideration		26,000		
Goodwill		2,711		
Holding Company - Retained Earnings			55,621	
			59,401	

Working 2
Dumyat plc holding in Devon Ltd.
9,000,000/12,000,000 = 75%

Working 3
Revaluation of assets in Devon Ltd to fair value at date of acquisition

Dr	Non current assets	£3,000,000	
Cr	Revaluation		£3,000,000

Working 4
Non current assets (65,388 + 31,887 + 3,000 = 100,275)

Task 1.4

(a) What is "business combination"?

- "the bringing together of separate entities or businesses into one reporting entity" (paragraph 4).

(b) How is the acquirer of a business combination identified?

- "the combining entity that obtains control of the other combining entities or businesses" (paragraph 17).

(c) Explain why Dumyat plc is the acquirer in the business combination.

- a combining entity has obtained control of another combining entity
- control obtained when it acquires more than one-half of that other entity's voting rights
- Dumyat plc acquired control of Devon Ltd
- by obtaining more than one-half of the voting rights

Part C

Task 1.5

Lochnagar Ltd

Reconciliation of profit from operations to net cash from operating activities

	£000
Profit from operations	3,360
Adjustments for:	
Depreciation	3,545
Gain on disposal of property, plant and equipment	(224)
Operating cash flows before movements in working capital	6,681
Decrease/(Increase) in inventories	(1,232)
Decrease/(Increase) in trade and other receivables	(896)
(Decrease)/Increase in trade and other payables	(616)
Cash generated by operations	3,937
Tax paid	(944)
Interest paid	(91)
Net cash from operating activities	2,902

Task 1.6

Lochnagar Ltd

Cash flow statement for year ended 31 October 2007	£000
Net cash from operating activities	2902
Investing activities	
Proceeds on disposal of property, plant and equipment	845
Purchases of property, plant and equipment	(5237)
Net cash used in investing activities	(4392)
Financing activities	
New bank loans raised	500
Proceeds of share issue	500
Net cash from financing activities	1000
Net increase/(decrease) in cash and cash equivalents	(490)
Cash and cash equivalents at beginning of year	129
Cash and cash equivalents at end of year	(361)

Workings (all figures £000)

(i) Fixed asset additions:
Opening balance £24,100 - depreciation £3,545 - Net book value of asset sold £621 + additions ? = Closing balance £25,171
therefore ? = £5,237

(ii) Proceeds from sale – NBV of asset sold £621 = Profit £224
therefore, Proceeds from sale = NBV of asset sold £621 + Profit £224 = £845

Section 2

Task 2.1

Report

To: Sally Forth
From: A Student
Subject Analysis of efficiency and effectiveness of Tay Ltd
Date 5 December 2007

This report has been prepared to analyse the efficiency and effectiveness of Tay Ltd for 2006 and 2007.

(a) and (b) Calculation of the ratios

		2007			2006		
Gross profit ratio							
Gross profit x 100		1,008			945		
Sales		2,400	42.00%		2,100	45.00%	
Net profit ratio							
Net profit x 100		228			158		
Sales		2,400	9.50%		2,100	7.52%	
Inventory turnover days							
Inventory x 365	365 x	320			208		
Cost of sales		1,392	84.0	days	1,155	65.7	days
Trade receivable days							
Trade receivable x 365	365 x	360			231		
Sales		2,400	54.8	days	2,100	40.2	days

(c) Comment on the relative performance of the company for the two years and what this tells you about the company:

The gross profit ratio has deteriorated which means that less gross profit is being generated by sales, therefore the gross profit margin on sales has fallen. This deterioration may be due to decreasing its sales price or increasing the cost of sales or both.

The net profit ratio has improved which indicates that more net profit is being generated from sales. This could be due to either an increase in the sales margins or an decrease in expenses, or both. Since the margins have deteriorated this must be the result of an decrease in expenses and this can be confirmed by the expenses ratio which has gone down.

The inventories/stock turnover ratio has deteriorated, this indicated by the fact that it now takes 18 days more to sell the inventory, on average, than it took the year before.

The trade receivables/debtors turnover ratio has also deteriorated since it now takes 15 days more to collect the debts, on average, than it took the year before.

(d) One suggestion as to how each of the ratios might be improved:

The gross profit could be improved if either, sales prices were increased without an increase in cost of sales, or cost of sales could be decreased without a decrease in sales prices.

The net profit ratio could be improved by, further reducing either the distribution costs or administration expenses, or both. Given the expenses ratio perhaps attention should be given to trying to reduce the distribution expenses.

The inventories/stock turnover ratio could be improved by, cutting the amount of inventory held in the warehouse or it may be that the increase might be due to slow moving inventory that might indicate possible obsolescence problems, ineither case this should be reviewed by management.

The trade receivables/debtor turnover ratio might be improved by, ensuring that credit control procedures are tightened up, ensuring that terms of sale are enforced and that the company collect debts within the time specified and that old debts are chased up

Task 2.2

(a) The accounting equation is:

Assets – Liabilities = Equity

(i) “An asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.”

(ii) “A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in the outflow from the entity of resources embodying economic benefits.”

(iii) “Equity is the residual interest in the assets of the entity after deducting all its liabilities.”

(b)

The profit for the year increases the equity in the accounting equation and this is matched by an increase in the net assets of the business that amount to the difference between the other elements in the equation, namely, the assets minus the liabilities.