



ICM

JUNE 2016

ACCOUNTING III

Instructions to candidates:

- a) Time allowed: Three hours (plus an extra ten minutes' reading time at the start – do not write anything during this time)
- b) Answer ALL questions in Part A and any ONE question in Part B
- c) Part A carries 85% of the marks and Part B carries 15% of the marks. Marks for each question are shown in []
- d) Non-programmable calculators are permitted in this exam

PART A

1. The following trial balance has been extracted from the books of K and L Ltd for the year ended 31 May 2016:

	DR £000	CR £000
Bank		15
Administration expenses	850	
Distribution costs	730	
5% Debentures		1,300
Interest paid	65	
Non-current assets (net)	1,500	
Retained earnings (01/06/15)		360
Purchases	2,450	
Sales (all on credit)		4,090
Equity share capital (£1 ords.)		1,000
Inventory (stock) (01/06/15)	250	
Accounts receivable (debtors)	1,420	
Accounts payable (creditors)		500
	----- 7,265 =====	----- 7,265 =====

NOTES at 31 May 2016:

- Stock (inventory) was valued at £280,000
- Corporation tax is estimated to be £5,000
- The directors have declared an ordinary dividend of 2p per share
- The market price of a single equity (ordinary share) was £0.40

TASKS

- a) Prepare the income statement (profit and loss account) for the year ended 31 May 2016. [3]
- b) Prepare the position statement (balance sheet) as at 31 May 2016. [6]
- c) Calculate the following ratios:
 - i The gearing percentage
 - ii The operating profit (PBIT) as a percentage of sales
 - iii The EPS
 - iv The PE ratio [4]
- d) Comment on the financial performance of K and L Ltd. Mention any weaknesses. [9]
- e) Explain the importance of using a range of ratios to monitor the financial performance of a company. [3]

continued overleaf

2. You are presented with the following information from the Bailey group of companies for the year to 31 May 2016:

	Bailey plc	Pierce plc	Eli plc
	£000	£000	£000
Tangible non-current assets	<u>900</u>	<u>500</u>	<u>450</u>
Investments:			
Shares in Pierce plc	700		
Shares in Eli plc	<u>450</u>		
	<u>1,150</u>		
Current assets:			
Inventory	430	320	120
Accounts receivable	450	290	100
Bank	<u>10</u>	<u>10</u>	<u>30</u>
	<u>890</u>	<u>620</u>	<u>250</u>
Current liabilities:			
Accounts payable	<u>(350)</u>	<u>(280)</u>	<u>(140)</u>
Net current assets	<u>540</u>	<u>340</u>	<u>110</u>
Total net assets	<u>2,590</u>	<u>840</u>	<u>560</u>
	=====	=====	=====
Capital and reserves:			
Ordinary shares (£1)	1,500	600	400
Profit and loss account	<u>1,090</u>	<u>240</u>	<u>160</u>
	<u>2,590</u>	<u>840</u>	<u>560</u>
	=====	=====	=====

Additional information:

- A Bailey plc purchased 400,000 shares in Pierce plc on 17 November 2015, when Pierce plc's profit and loss account balance stood at £120,000.
- B Bailey plc purchased 300,000 shares in Eli plc on 30 December 2015, when Eli plc's profit and loss account balance stood at £120,000.
- C During the year ended 31 May 2016 Bailey plc had sold goods to Pierce plc for £14,000. These goods had cost Bailey plc £8,000. Half these goods are still in stock. Minority interests are not charged with their share of unrealised stock profits.
- D Included in the respective creditor balances were the following inter-company debts:
- Bailey plc owed Eli plc £4,000
 - Eli plc owed Pierce plc £7,000
 - Pierce plc owed Bailey plc £3,000
- E Bailey plc writes off any goodwill arising on consolidation to reserves.

TASK

Prepare the Bailey plc's group position statement (balance sheet) as at 31 May 2016. Your workings MUST be included. [25]

3. From the balance sheet of an unquoted limited company it is possible to estimate the value of a single share in that company by using the net assets method of valuation.
- a) Explain how you would attempt to calculate the value of a share using the net assets method and what alternative bases of calculation you might consider. [4]
- b) What are the shortcomings of this method of valuation? Give examples to illustrate your answer. [4]
- c) Describe briefly ONE other method used by analysts to value shares. [2]

4. The balance sheets of Woking Ltd at 31 May 2015 and 31 May 2016 were as follows:

	2015		2016	
	(£000)	(£000)	(£000)	(£000)
NON-CURRENT ASSETS				
Buildings		900		1,000
Equipment	600		800	
Less depn.	<u>(350)</u>	250	<u>(550)</u>	250
Vehicles	220		300	
Less depn.	<u>(145)</u>	<u>75</u>	<u>(200)</u>	<u>100</u>
		1,225		1,350
CURRENT ASSETS				
Inventory	430		400	
Accounts receivable	470		490	
Bank/cash	—	900	<u>15</u>	905
CURRENT LIABILITIES				
Accounts payable	(260)		(270)	
Overdraft	(20)			
Dividend owing	(50)		(70)	
Tax owing	<u>(30)</u>	<u>(360)</u>	<u>(40)</u>	<u>(380)</u>
		1,765		1,875
LONG-TERM LOAN				
		<u>(100)</u>		<u>(100)</u>
		1,665		1,775
		=====		=====
CAPITAL AND RESERVES				
£1 shares		1,000		1,000
Retained profit		<u>665</u>		<u>775</u>
		<u>1,665</u>		<u>1,775</u>

NOTE: Interest on the loan paid in year ended 31 May 2016 was £5,000.

TASKS

- a) Calculate the profit (before tax) for the year ended 31 May 2016. [3]
- b) Prepare the cash flow statement for the year ended 31 May 2016. [9]
- c) Explain the principal cash movements in the past year. [8]
- d) IAS 7 also allows the statement of cash flows to be prepared using the 'direct method'. Explain the differences between the 'indirect' and 'direct' methods, and why companies usually prefer to use the 'indirect' method. [5]

PART B

5. A machine is bought by Langdon for £7,236 on hire purchase from Courthill Ltd on 1 June 2013. It is paid for in three instalments of £2,412 on 31 May 2014, 2015, and 2016. The cash price is £6,000. The rate of interest is 10% per annum on the balance outstanding at the start of the year. The cost of the machine to Courthill Ltd is £4,000. The profit on the cash price is to be shown as profits in the year of sale.

TASKS

You are required to show the following accounts as they would appear in Courthill Ltd's books:

- a) HP Sales
- b) Langdon
- c) HP Interest
- d) HP Goods
- e) Bank
- f) HP Trading [15]

6. Explain why historical cost financial statements are deficient in times of rising prices, and describe different valuation methods. [15]