



ICM

MARCH 2017

ACCOUNTING III

Instructions to candidates:

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

PART A

1. The following trial balance has been extracted from the books of Waterlilly Ltd for the year ended 28 February 2017:

	DR £000	CR £000
Bank		45
Administration expenses	850	
Distribution costs	730	
5% Debentures		1,300
Interest paid	65	
Non-current assets (net)	1,500	
Retained earnings (01/03/16)		360
Purchases	2,450	
Sales (all on credit)		4,090
Equity share capital (£1 ords.)		1,000
Inventory (stock) (01/03/16)	280	
Accounts receivable (debtors)	1,420	
Accounts payable (creditors)		500
	----- 7,295 =====	----- 7,295 =====

NOTES at 28 February 2017:

- 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

- Prepare the income statement (profit and loss account) for the year ended 28 February 2017. [3]
- Prepare the position statement (balance sheet) as at 28 February 2017. [6]
- Calculate the following ratios:
 - The gearing percentage
 - The operating profit (PBIT) as a percentage of sales
 - The EPS
 - The PE ratio [4]
- Comment on the financial performance of Waterlilly Ltd. Mention any weaknesses. [9]
- 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 Acorn group of companies for the year to 28 February 2017:

	Acorn plc £000	Black plc £000	Clunes plc £000
Tangible non-current assets	<u>900</u>	<u>500</u>	<u>450</u>
Investments:			
Shares in Black plc	700		
Shares in Clunes 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 Acorn plc purchased 400,000 shares in Black plc on 17 March 2014, when Black's profit and loss account balance stood at £120,000.
- B Acorn plc purchased 300,000 shares in Clunes plc on 30 November 2015, when Clunes' profit and loss account balance stood at £120,000.
- C During the year ended 28 February Acorn plc had sold goods to Black plc for £14,000. These goods had cost Acorn 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:
- Acorn plc owed Clunes plc £4,000
 - Clunes plc owed Black plc £7,000
 - Black plc owed Acorn plc £3,000
- E Acorn plc writes off any goodwill arising on consolidation to reserves.

TASK

Prepare the Acorn group position statement (balance sheet) as at 28 February 2017. 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 Baldwin Ltd at 29 February 2016 and 28 February 2017 were as follows:

	2016 (£000)		2017 (£000)	
NON-CURRENT ASSETS				
Buildings		900		1000
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 28 February 2017 was £5,000.

TASKS

- a) Calculate the profit (before tax) for the year ended 28 February 2017. [3]
- b) Prepare the cash flow statement for the year ended 28 February 2017. [9]
- c) Explain the principal cash movements in the past year. [8]
- d) IAS7 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 Watson for £7,236 on hire purchase from Turner Ltd on 1 June 2014. It is paid for in three instalments of £2,412 on 28 February 2015, 2016 and 2017. The cash price is £6,000. Rate of interest is 10% per annum on the balance outstanding at the start of the year. The cost of the machine to Turner 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 Turner Ltd's books:

- a) HP Sales
- b) Watson
- 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]