Instructor's Manual

Financial Accounting and Reporting

Nineteenth edition

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ISBN: 978-1-292-25605-4

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This edition published 2019

ISBN 978-1-292-25605-4

Brief contents

PART 1

Introduction to accounting on a cash flow and accrual accounting basis

Accounting and reporting on a cash flow basis

Question 1 – Sasha Parker

(a) *Cash budget (£000)*

	Jan	*Feb*	*Mar*	*Apr*	*May*	*June*	*Total*
Initial capital	150.00			82.50			232.50
Customers					60.00	75.00	135.00
Total receipts	**150.00**			**82.50**	**60.00**	**75.00**	**367.50**
Machinery	30.00						30.00
Motor vehicles	24.00						24.00
Premises	75.00						75.00
Drawings	1.20	1.20	1.20	1.20	1.20	1.20	7.20
Suppliers		30.00	48.00	60.00	60.00	60.00	258.00
Rates		1.20					1.20
Wages	2.25	2.25	2.25	2.25	2.25	2.25	13.50
General expenses		0.75	0.75	0.75	0.75	0.75	3.75
Insurance						2.10	2.10
Total payments	**132.45**	**35.40**	**52.20**	**64.20**	**64.20**	**66.30**	**414.75**
Net cash flow	17.55	(35.40)	(52.20)	18.30	(4.20)	8.70	
Balance b/f		17.55	(17.85)	(70.05)	(51.75)	(55.95)	
Balance c/f	**17.55**	**(17.85)**	**(70.05)**	**(51.75)**	**(55.95)**	**(47.25)**	**(47.25)**

(b) *Statement of cash flows (£000)*

Realised operating cash flows for the period ended 30 June 20X1

Receipts from customers	**135.00**
Payments:	
Suppliers	258.00
Rates	1.20
Wages	13.50
General expenses	3.75
Insurance	2.10
	278.55
	(143.55)

For information only

Statement of financial position as at 30 June 20X1

		£000
Capital – introduced		232.50
– withdrawn		(7.20)
Net operating cash flows:	Realised	(143.55)
	Unrealised	(7.80)
		73.95
Premises (NRV)		75.00
Vehicles (NRV)		19.20
Machinery (NRV)		27.00
Net cash balance		(47.25)
		73.95

(c) *Further information regarding Sasha Parker*

Nature of business linked to Parker's business background, technical ability, special skills, know-how, existing/terminated business involvement, contacts, associates and related parties.

Type of business unit to be used and rationale for its selection.

Sources of long- and short-term capital.

Products' life cycle and cash flow projections over product life cycle.

Initial investment in fixed assets and their terminal value at the end of the life cycle.

Parker's attitude to risk, and how this affects the choice of discount rate and payback period.

Question 2 – Mr Norman

(a) *Purchases budget (€000)*

	Jan	*Feb*	*Mar*	*Apr*	*May*	*June*
Sales	15.00	20.00	35.00	40.00	40.00	45.00
Gross profit	3.00	4.00	7.00	8.00	8.00	9.00
Purchases	12.00	16.00	28.00	32.00	32.00	36.00
Payments		**12.00**	**16.00**	**28.00**	**32.00**	**32.00**

Notes:

This is a start-up situation.

Purchases equal projected sales less a gross margin on sales at 20%.

Goods are bought in the month of sale; assume stocks remain constant.

(b) *Statement of cash flows (£000)*

	Jan	*Feb*	*Mar*	*Apr*	*May*	*June*	*Total*
Initial capital	50.00						50.00
Cash sales	7.50	10.00	17.50	20.00	20.00	22.50	97.50
Credit sales	–	7.50	10.00	17.50	20.00	20.00	75.00
	57.50	**17.50**	**27.50**	**37.50**	**40.00**	**42.50**	**222.50**
Premises	80.00						80.00
Rent and rates	2.20	2.20	2.20	2.20	2.20	2.20	13.20
Suppliers		12.00	16.00	28.00	32.00	32.00	120.00
Commission		0.30	0.40	0.70	0.80	0.80	3.00
Wages	0.60	0.60	0.60	0.60	0.60	0.60	3.60
Insurance	3.50	–	–	–	–	–	3.50
	86.30	**15.10**	**19.20**	**31.50**	**35.60**	**35.60**	**223.30**
Net cash flow	(28.80)	2.40	8.30	6.00	4.40	6.90	
Balance b/f	–	(28.80)	(26.40)	(18.10)	(12.10)	(7.70)	
Balance c/f	**(28.80)**	**(26.40)**	**(18.10)**	**(12.10)**	**(7.70)**	**(0.80)**	**(0.80)**

(c) *Statements of operating cash flows and financial position*

Realised operating cash flows for the period ended 30 June 20X8

	£000
Receipts from customers	172.50
Payments:	
Suppliers	120.00
Rates	13.20
Wages	3.60
Commission	3.00
Insurance	3.50
	143.30
	29.20

Notes:

The cash flow statement with summary attached is effectively a six-month cash budget showing the cash received, cash paid each month and the resulting month-end balances.

It is necessary to separate sales and purchase transactions into cash and on-credit, and to identify clearly the month of receipt and payment.

Commission is paid in the month after the sale is made, and all other cash flows are clearly indicated and allocated to specific months.

Note that the format of the cash flow statement brings out key figures – for management decision and control. For example:

month-end balances – assist in the control of liquidity;

cash deficiencies – identify how much must be financed;

early warning – allows management to approach appropriate sources;

cash surpluses – identify amounts to be invested on the best terms.

Statement of financial position as at 30 June 20X8

	£000
Capital – introduction	50.00
Net operating cash flows: **Realised**	29.20
: **Unrealised**	(4.00)
	75.20
Premises **(NRV)**	76.00
Net cash balance	(0.80)
	75.20

Notes:

This statement shows net assets of £75,200.

Make up: premises £76,000 less the negative cash balance £800.

The negative cash balance indicates the need for overdraft arrangements.

The statement is based on cash flow concept: It ignores accrual-based figures (£36,900 less £25,250).

Accruals are not regarded as real assets and liabilities.

Critics of the cash flow concept would maintain that its utility has, therefore, been seriously diminished.

(d) *Letter to the bank requesting an overdraft facility*

The maximum overdraft facility of £28,800:

will be required at the end of January;

will be eliminated by July.

Overdraft will fall progressively as per the cash budget.

It might be practical to request a limit of £30,000:

for the full six-month period;

reducing it to £15,000 thereafter to allow for contingencies. The facility is only to be called on as required.

Refer to the cash budget to support the request:

confirm that it is based on the most likely scenario;

agree to a repayment schedule.

Specify that collateral security is available in the form of premises if it should be required.

If not an existing customer:

give outline details of business background;

explain future plans;

market.

CHAPTER 2

Accounting and reporting on an accrual accounting basis

Question 1 – Sasha Parker

(a) *Cash budget (€000)*

	Jan	*Feb*	*Mar*	*Apr*	*May*	*June*	*Total*
Initial capital	150.00					75.00	225.00
Customers				60.00	75.00	75.00	210.00
Total receipts	**150.00**			**60.00**	**75.00**	**150.00**	**435.00**
Machinery	30.00						30.00
Motor vehicles	24.00						24.00
Premises	75.00						75.00
Drawings	1.50	1.50	1.50	1.50	1.50	1.50	9.00
Suppliers		30.00	48.00	60.00	60.00	60.00	258.00
Rates							
Wages	2.25	2.25	2.25	2.25	2.25	2.25	13.50
General expenses		0.75	0.75	0.75	0.75	0.75	3.75
	132.75	34.50	52.50	64.50	64.50	64.50	413.25
Net cash flow	17.25	(34.50)	(52.50)	(4.50)	10.50	85.50	
Balance b/f	–	17.25	(17.25)	(69.75)	(74.25)	(63.75)	
Balance c/f	**17.25**	**(17.25)**	**(69.75)**	**(74.25)**	**(63.75)**	**(21.75)**	**(21.75)**

All balances are overdrawn except for January 20X1

	Feb	*Mar*	*Apr*	*May*	*June*
o/d	**17.25**	**69.75**	**74.25**	**63.75**	**4.65**

Note:

No entries will be made for the 20X0/X1 local taxes that are paid in Feb 20X2 – this situation arose because Sasha Parker had assumed that the business would only pay the taxes from the start of the tax year, i.e. 1 April 20X1.

However, there will be an entry in the profit and loss account and the statement of financial position.

(b) *Sasha Parker – profit and loss account for six months ended 30 June 20X1*

	€000	*€000*
Sales [60.00 + (5 × 75.00)]		435.00
Purchases	378.00	
Closing inventory	(30.00)	
Cost of sales		348.00
Gross profit		87.00
Wages	13.50	
General expenses	4.50	
Local taxes (1.1.X1–30.6.X1)	4.00	
Insurance	13.20	
Depreciation:		
– Vehicles	2.40	
– Machinery	1.50	39.10
Net profit		**47.90**

Budgeted statement of financial position as at 30 June 20X1

Capital			225.00
Net profit			47.90
Less: drawings			(9.00)
			263.90
Non-current assets			
Premises			75.00
Vehicles	24.00		
Less: depreciation	2.40		21.60
Machinery	30.00		
Less: depreciation	1.50		28.50
Current assets			
Inventory	30.00		
Trade receivables (3 × 75.00)	225.00		
Insurance	13.20	268.20	

Current liabilities			
Trade payables	120.00		
Local taxes (1.1.X1–30.6.X1)	4.00		
Bank overdraft	4.65		
General expenses	0.75	(129.40)	
Net current assets			138.80
			263.90

(c) *Possible action to deal with exceeding agreed overdraft limit*

Approach the bank to re-negotiate the overdraft or arrange a loan facility for an agreed term.

The amount and the period for which additional facilities are required depend on preparing a projected cash flow statement for a longer period taking into account future plans, e.g. owner's drawings requirement and any additional capital expenditure.

In particular, consider alternatives such as the following:

Leasing vehicles and/or machinery

Mortgaging the property

Getting debts in quicker manner

Introducing more capital

Obtaining or providing loan capital.

Question 2 – Mr Norman

(a) *Purchases budget ($000)*

	Jan	*Feb*	*Mar*	*Apr*	*May*	*Jun*
Sales units	1.65	2.20	3.85	4.40	4.40	4.95
– Closing inventory		0.55	0.96	1.10	1.10	1.24
+ Closing inventory	0.55	0.96	1.10	1.10	1.24	1.38
Purchases units	**2.20**	**2.61**	**3.99**	**4.40**	**4.54**	**5.09**

		Purchases *$000*	*Sales* *$000*	
Jan	(2,200 × 40)	88.00	82.50	(1,650 × 50)
Feb	(2,610 × 40)	104.40	110.00	(2,200 × 50)

Mar	(3,990 × 40)	159.60	192.50	(3,850 × 50)
Apr	(4,400 × 40)	176.00	220.00	(4,400 × 50)
May	(4,540 × 40)	181.60	220.00	(4,400 × 50)
Jun	(5,090 × 40)	203.60	247.50	(4,950 × 50)
		913.20	**1,072.50**	

(b) *Cash flow forecast ($000)*

	Jan	*Feb*	*Mar*	*Apr*	*May*	*June*	*Total*
Initial capital	150.00						150.00
Cash sales	41.25	55.00	96.25	110.00	110.00	123.75	536.25
Credit sales		41.25	55.00	96.25	110.00	110.00	412.50
	191.25	**96.25**	**151.25**	**206.25**	**220.00**	**233.75**	**1,098.75**
Premises	80.00						80.00
Commission		1.65	2.20	3.85	4.40	4.40	16.50
Suppliers		88.00	104.40	159.60	176.00	181.60	709.60
Administration	8.00	8.00	8.00	8.00	8.00	8.00	48.00
Wages	17.00	17.00	17.00	17.00	17.00	17.00	102.00
Insurance	0.35						0.35
Total payments	**105.35**	**114.65**	**131.60**	**188.45**	**205.40**	**211.00**	**956.45**
Net cash flow	85.90	(18.40)	19.65	17.80	14.60	22.75	
Balance b/f	–	85.90	67.50	87.15	104.95	119.55	
Balance c/f	**85.90**	**67.50**	**87.15**	**104.95**	**119.55**	**142.30**	

(c) *Budgeted statement of income for six months ended 30 June 20X8*

	$000	*$000*
Sales		1,072.50
Purchases	913.20	
Closing inventory (1,380 units × £40)	(55.20)	
Cost of sales	858.00	
Gross profit		214.50
Wages		102.00
Administration		48.00
Commission (2% of 1,072.50)		21.45
Insurance		0.18
Amortisation of lease		8.00

	179.63
Net profit	34.87

Budgeted statement of financial position as at 30 June 20X8

	$000	*$000*
Capital		150.00
Net profit		34.87
		184.87
Non-current assets		
Leasehold premises	80.00	
Less: amortisation	(8.00)	
		72.00
Current assets		
Inventory	55.20	
Trade receivables	123.75	
Pre-payments – insurance	0.17	
Cash	142.30	
	321.42	
Current liabilities		
Trade payables	203.60	
Commission	4.95	
	208.55	
Net current assets		112.87
		184.87

(d) *Investment of surplus funds*

Acid test ratio

At the end of the first six-month trading, Norman's statement of financial position shows that the acid test ratio is 1.28:1 (266.22/208.55) – this is higher than the basic 1:1 ratio but it should be compared with the ratio of similar businesses in the same industry in order to establish a norm. It would appear, however, that the business has surplus funds to invest.

Amount to invest

A projected cash flow statement is required, taking into account future plans regarding the owner's drawing requirements, future capital commitments and working capital criteria, e.g. debtor collection and creditor payment terms.

Period to invest

The projected cash flow will give an indication of the period of the investment, e.g. it could range from overnight on the money market to term investments.

The important aspect is that the owner should be aware of the projected cash flows, so that return on surplus funds can be maximised.

PART 2

Preparation of internal and published financial statements

CHAPTER 3

Preparation of financial statements of comprehensive income, changes in equity and financial position

Question 1 – Old NV

(a) *Statement of income (internal) for the year ended 31 December 20X1*

		€000
Sales		12,050
Less: returns		350
		11,700
Inventory at 1.1. 20X1	825	
Purchases	6,263	
Carriage on purchases	13	
Less: returns	(313)	
	6,788	
Inventory at 31.12.20X1	1,125	
	5,663	
Depreciation of plant	313	
		5,976
Gross profit		5,724
Administration:		
Wages		738
Administration expenses (286 – 12)		274
Directors' remuneration		375
Selling:		
Salesmen's salaries		800
Distribution:		
Distribution expenses		290
Depreciation of vehicles		187
Carriage		125

Financial:	
Goodwill impairment	177
Audit fee	38
Debenture interest	25
Rent receivable	(100)
	2,929
	2,795
Tax	562
Profit for year	2,233

(b) *Statement of comprehensive income for publication*

Statement of comprehensive income of Old NV for the year ended 31 December 20X1

	€000	*€000*
Sales		11,700
Cost of sales		5,976
Gross profit		5,724
Distribution costs W1	1,402	
Administrative expenses W2	1,602	
Other operating income	(100)	
		2,904
Trading profit		2,820
Interest payable		25
Profit on ordinary activities before tax		2,795
Income tax		562
Profit for the period		2,233
Other comprehensive income:		
Land revaluation		50
		2,283

W1

Salesmen's salaries	800
Distribution expenses	290
Depreciation of vehicles	187
Carriage	125
	1,402

W2

Wages	738
Administrative expenses	274
Directors' remuneration	375
Goodwill impairment	177
Audit fee	38
	1,602

There will be a disclosure note as follows:

Profit on ordinary activities after tax is after charging

Goodwill impairment	177
Audit fee	38
Depreciation	500
Directors' remuneration	375

Statement of financial position of Old NV as at 31 December 20X1

		€000	*€000*
Non-current assets			
Intangible assets (1,062 – 177)			885
Property, plant and equipment	Note 1		1,074
Land			150
Current assets			
Inventories		1,125	
Receivables		3,875	
Cash at bank and in hand		1,750	
Pre-payments		12	
		6,762	
Current liabilities			
Payables		738	
Provision for income tax		562	
Accrued charges		63	
		1,363	
Net current assets			5,399
Total assets *less* current liabilities			7,508
Non-current liabilities			
Debentures			250
			7,258

Equity		
Ordinary shares of €1 each		3,125
Preference shares of €1 each		625
Share premium		350
Retained earnings	Note 2	3,158
		7,258

Disclosure notes to show make-up of statement of financial position balances

Note 1: Property, plant and equipment

Property, plant and equipment	*Plant*	*Motor vehicles*	*Total*
	€000	*€000*	*€000*
Cost			
At 1.1.20X1	1,200	1,125	2,325
Additions	362		362
Disposals			
At 31.12.20X1	1,562	1,125	2,687
Accumulated depreciation			
At 1.1.20X1	738	375	1,113
Charge for year	313	187	500
At 31.12.20X1	1,051	562	1,613
Net book value			
At 31.12.20X1	511	563	1,074
At 31.12.20X0	462	750	1,212

Working: accrued expenses	**€000**
Audit fee	38
Debenture interest	25

Note 2: Movements on reserves

	€000
Retained earnings at 1.1.20X1	875
Amount transferred from statement of comprehensive income	2,283
Balance at 31.12.20X1	3,158

Question 2 – Formatone plc

(i) *Statement of income*

Statement of income for the year ended 30 June 20X6

	£000
Sales	9480.6
Cost of sales (N1)	(6,625.8)
Gross profit	2,854.8
Distribution cost	(529.2)
Administrative expenses	(946.8)
Operating profit	1,378.8
Taxation (N2)	(181.8)
Profit after taxation	1,197.0

N1 cost of sales

N1 cost of sales

		£000
As per trial balance		5,909.4
Depreciation of buildings	(1,620/30)	54.0
Depreciation of plant	(1,728 – 504) @ 10%	122.4
Write-down of intangible assets		540.0
		6,625.8

N2 taxation

Over provision	(14.4)
Current tax	169.2
Deferred tax	27.0
	181.8

(ii) *Statement of financial position*

Statement of financial position as at 30 June 20X6

			£000
Non-current assets			
Land at valuation			5,400.0
Buildings at valuation	1,620.0	(54.0)	1,566.0
Plant and equipment	1,728.0	(626.4)	1,101.6
Intangible assets			270.0
Current assets			
Inventory		586.8	
Trade receivables		585.0	
Cash		41.4	1,213.2
			9,550.8
			£000
Equity and reserves			
Ordinary shares of 50p		2,160.0	
Share premium account		432.0	
Revaluation reserve		4,179.6	
Retained earnings		1,796.4	8,568.0
Non-current liability			
Deferred tax			64.8
Current liabilities			
Trade payables		532.8	
Taxation		169.2	
Dividend declared		216.0	918.0
			9,550.8

(iii) *Statement of changes in equity*

Statement of changes in equity	*Share capital*	*Share premium*	*Revaluation reserve*	*Retained earnings*	*Total*
Balance b/f	2,085.0	387.0	–	891.0	3,363.0
New issue of shares	75.0	45.0	–	–	120.0
Land and buildings	–	–	4,212.0	–	4,212.0
Transfer N3	–	–	(32.4)	32.4	–
Retained profit for the year	–	–	–	1,197.0	1,197.0
Interim dividend paid	–	–	–	(108.0)	(108.0)
Interim dividend declared	–	–	–	(216.0)	(216.0)
Balance c/f	2,160.0	432.0	4,179.6	1,796.4	8,568.0

N3 Transfer from revaluation reserve

Revaluation surplus	£972,000
Transfer 1/30	£ 32,400

Question 3 – Basalt plc

(i) *Statement of income for the year ended 31 December 20X0*

		£000
Turnover (962 – 27 returns)		935
Cost of sales	Note 1	460
Gross profit		475
Distribution costs	Note 2	218
Administrative expenses	Note 3	118
		139
Other operating income (i.e. rent receivable)		7
Profit on ordinary activities before tax		146
Tax on profit of ordinary activities		58
Profit for the year		88
Other comprehensive income:		
Revaluation of land		55
		143

		£000	
Note 1:	Opening inventory	66	
	Purchases	500	
	Carriage inwards	9	
	Returns out	(25)	
	Closing inventory	(90)	
		460	
Note 2:	Warehouse wages	101	
	Salesmen's salaries	64	
	Distribution expenses	6	
	Hire of vehicles	19	
	Depreciation	28	(7/11 of 20% of £220,000)
		218	
Note 3:	Administrative wages	60	
	Administrative expenses	10	
	Directors' remuneration	30	
	Auditors' remuneration	2	
	Depreciation (4/11)	16	
		118	

(ii) *Statement of financial position as at 31 December 20X0*

	£000
Non-current assets	
Tangible assets	
Plant and machinery	
(cost 220 – Depreciation b/f 49 – depreciation for year 44)	127
Current assets	
Inventory	90
Trade receivables	326
Cash at bank	62
	478
Liabilities	
Amounts falling due within one year:	
Trade payables	66
Other payables (Audit 2 + corporation tax 58)	60
	126

Net current assets	352
Total assets *less* current liabilities	**479**
Equity	
Called-up share capital	300
Share premium a/c	20
General reserve	16
Retained earnings	143
	479

(a) **Directors' report** must deal with certain matters by law, e.g.:

Proposed dividends.

Likely future developments in the company's business.

Principal activities of the company.

Political and charitable contributions.

Consistency with other statements – reviewed by auditors.

(b) Chairman's report

May be a highly personalised review of the business, its developments and the environment in which it operates.

Not subject to audit.

(c) **Auditors' report** expresses an opinion as to whether the financial statements give a 'true and fair view'.

Question 4 – HK Ltd

(a) *Statement of comprehensive income for the year ended 30 June 20X1*

	$000	*$000*
Turnover		381,600
Cost of sales		
Per trial balance		318,979
+ Hire 2,400 + depreciation 799*		
– Insurance 150*** + inventory loss 250		3,299
		322,278
Gross profit		59,322

Administration expenses	
Per trial balance 9,000 + directors 562 +	
Bad debt 157 + auditor remuneration 112	9,831
Distribution costs	35,100
	44,931
	14,391
Profit on disposal of non-current assets	536
Profit before tax and interest	14,927
Interest payable (454 + 151 tax on interest)	605
	14,322
Other operating income**	17
Profit before tax	14,339
Income tax	5,348
Profit for the year	8,991
Other comprehensive income	
Revaluation gain	400
Total comprehensive income for the year	9,391

Note: *Depreciation consists of Buildings 94 + Plant 619 + Fixtures 86

**Development grant	85
Transfer versus income statement	
(20% of 85)	(17)
To statement of financial position	68

***Insurance is treated as an adjusting event.

Statement of financial position as at 30 June 20X1

Intangible non-current assets		
Goodwill		480
Tangible non-current assets		
Freehold land		2,500
Freehold buildings	4,680	
Aggregate depreciation	648	4,032
Plant and machinery	3,096	
Aggregate depreciation	1,857	1,239
Fixtures and fittings	864	
Aggregate depreciation	259	605
		8,376
		8,856

Current assets		
Inventory to read (11,794 −250 obsolescence)	11,544	
Receivables (7,263 + 150 insurance)	7,413	
Cash and cash equivalents	11,561	
	30,518	
Current liabilities		
Payables	2,591	
Dividends (Preference 162 + Ordinary 324)	486	
Tax	5,348	
	8,425	
Net current assets		22,093
Non-current liabilities		
9% loan		7,200
		23,749
Deferred income – government grant (see Note)		68
		23,681
Equity		
Ordinary shares 50c each		3,600
9% preference shares of $1 each		5,400
Revaluation reserve		400
Retained earnings (6,364 + 8,991 − 1,074 dividends)		14,281
		23,681

Note: The grant could be deducted from the cost of the plant under IAS 20.

(b) *The usefulness of the non-current asset schedule*

(i) The column headings allow the user to see the type of non-current assets owned by the business. This can give helpful initial indications, e.g.

Realisability – intangible assets might be more difficult to sell than property.

Appreciation – land is more likely to appreciate than office equipment.

Depreciation – licences are subject to amortisation and possible fall in value due to competition.

Security – land and buildings are more likely to be accepted as security for loans and overdrafts than intangible assets.

(ii) The carrying values may be at cost or revaluation.

If at cost, it may be that the statement of financial position gives too low an indication of current market values – this is often an important consideration if existing shareholders are assessing a takeover offer.

(iii) The accumulated depreciation figure when related to the cost gives an indication of the age of the assets and possible need for capital outlays to replace with cash flow implications.

(iv) Disposals may be an indication of the occurrence of replacement, which could indicate growth or maintenance of existing capacity. If there is no replacement, then consider implications for future capacity or other reasons, e.g. change of direction and disposal of non-profit-making parts of the business.

Question 5 – Phoenix plc

(a) *Statement of comprehensive income for the year ended 30 June 20X7*

	£000
Revenue	6,465
Cost of sales (4,165 + 196 depreciation)	(4,361)
Gross profit	2,104
Distribution cost	(669)
Administration expense (1,126 + 31 depreciation + 415)	(1,572)
Operating loss	(137)
Exceptional item:	
Gain on disposal of warehouse	**75**
Dividend received	80
Profit before taxation	18
Taxation	(96)
Loss for the year	(78)
Other comprehensive income	
Revaluation gain	700
Total comprehensive income for the year	**622**

(b) *Statement of financial position as at 30 June 20X7*

Property, plant and equipment		4,243
Investment		365
Current assets		
Inventory	1,468	
Trade receivables	947	
Cash at bank	175	
Current liabilities	(868)	
Net current assets		1,722
		6,330
Share capital and reserves		
Share capital		4,500
Share premium		500
Revaluation reserve		1,270
Retained earnings		60
		6,330

(c) *Statement of movement of property, plant and equipment*

	L&B	*P&M*	*F&F*	*Total*
Balance b/f	2,400	1,800	620	4,820
Disposal	(150)			(150)
Revaluation reserve		160		160
Balance c/f	**2,250**	**1,960**	**620**	**4,830**
Accumulated depreciation				
Balance b/f		540	360	900
Revaluation reserve		(540)		(540)
P&L charge		**196**	**31**	**227**
Balance c/f		196	391	587
WDV at 30.6.20X7	**2,250**	**1,764**	**229**	**4,243**

Current assets	
Trade receivables	947
Creditors	
Trade payables	566
Taxation	122
Dividend proposed	180
	868

Balances in revaluation reserve and retained earnings are made up as follows:

	Revaluation reserve	*Retained earnings*
Balance b/f	600	488
Plant and machinery revaluation	700	
Transfer on disposal	(30)	30
Loss for year		(78)
Dividends		(380)
Balance c/f	1,270	60

Question 6 – Olive A/S

(a) *Statement of comprehensive income for the year ended 30 September 20X4*

Revenue		3,460
Cost of sales	W1	(1,557.1)
Gross profit		**1,902.9**
Distribution cost	W2	(362)
Administration expenses	W3	(917.9)
Operating profit		**623**
Exceptional items: **gain – disposal of non-current assets**		**6**
Investment income		45
Interest and similar charges		(30)
		644
Taxation (Sch 1)		(197)
Profit for the year		**447**

Other comprehensive income	
Revaluation gain on property	380
Total comprehensive income for the year	**827**

(b) *Statement of financial position as at 30 September 20X4*

Non-current assets	
Intangible assets – development costs	425
Tangible assets (Sch 2)	1,480
Investments	248
Current assets	
Inventory (364 + 40)	404
Receivables (Sch 3)	599
Cash and bank	38
Current liabilities (Sch 4)	(636)
Net current assets	**405**
	2,558
Non-current liabilities	
12% debentures	500
Net capital employed	**2,058**
Share capital: ordinary shares of £1 each	600
Share premium account	30
Retained earnings (Sch 5)	1,055
Revaluation reserve	373
	2,058

Schedule 1: Taxation charge

Income tax	185
Under-provision 20X3 (140 – 128)	12
	197

Schedule 2: Statement of movement of non-current assets

	Land and buildings	*Plant and machinery*	*Fixtures and fittings*	*Pre-payments*	*Total*
Balance b/f	600	520	80	–	1,200
Revaluation	300	–	–	–	300
Acquisitions	–	320	40	60	420
Disposal	–	(240)	–	–	(240)
Balance c/f	**900**	**600**	**120**	**60**	**1,680**
Balance b/f	80	160	26	–	266
Revaluation	(80)	–	–	–	(80)
Income charge	**15 (W4)**	**54**	**11**	–	**80**

Disposal	–	(66)	–	–	(66)
Balance c/f	15	148	37	–	200
WDV 30.9.X4	**885**	**452**	**83**	**60**	**1,480**
WDV 30.9.X3	520	360	54	–	934

Schedule 3: Receivables

Trade receivables	584
Prepaid rent	15
	599

Schedule 4: Current liabilities

Trade payables	296
Debenture interest (three months)	15
20X3 Income tax	140
20X4 Income tax	185
	636

(c) *Schedule 5: Statement of changes in equity*

	Share premium	*Revaluation reserve*	*Retained earnings*
Balance b/f	150	–	661
Formation expenses w/off	(120)	–	–
Profit for the year	–	–	447
Dividend paid	–	–	(60)
Revaluation gain	–	380	–
Transfer – extra depreciation	–	(7)	7
Balance c/f	30	373	1,055

Notes

Expenses charged in the year include the following:

Depreciation written off		€80,000
Directors' emoluments		€180,000
Directors' pension	€18,000	€198,000
Audit fees and expenses		€65,000

Company employs 646 persons, of whom 428 work at the factory and the rest work at the head office.

Land and Buildings were revalued during the year by Messrs XYZ, Chartered Valuers at open market value on existing use basis, and the surplus was recorded in a revaluation reserve.

Administration expenses include an exceptional item of €60,000 which is the under-provision for a claim that arose in a previous year and the balance of retained earnings b/f has been restated as 661,000.

Workings

W1 – Cost of Sales

Inventory on 1.10.20X3	211
Purchases	925
Carriage inwards	162
Depreciation – Building	9
Depreciation – Machinery (18 + 28 + 8)	54
Salaries (55% of 820)	451
Pension cost (10% of 451)	45.1
Heat and light (80% of 80)	64
Inventory 30.9.20X4	(364)
	1,557.1

W2 – Distribution cost

Advertising	112
Sales commission	92
Bad debts	158
	362

W3 – Administration expenses

Depreciation – Buildings		6
Depreciation – Fixtures and equipment (8 + 3)		11
Under-provision for litigation		60
Salaries	369	
Directors' emoluments	180	549
Pension costs (10% of 549)		54.9
Heat and light		16
Audit fees and expenses		65
Stationery		28
Other administrative expenses		128

	917.9

W4 – Depreciation of buildings

Original cost	400
Revaluation increase	380
	780
2% of 780 = approximately	15

Question 7 – Imecet

(a) *Statement of income for Imecet for the year ended 31 October 2005*

	$000	*$000*
Sales		10,300.0
Less:		
Opening inventory	1,100.0	
Purchases	6,350.0	
Factory wages	575.0	
Factory depreciation	135.0	
	8,160.0	
Closing inventory	1,150.0	
Cost of sales		7,010.0
Gross profit		3,290.0
Distribution costs	492.5	
Administrative expenses	176.0	668.5
Operating profit		2,621.5
Interest		200.0
Profit before tax		2,421.5
Taxation		
Income tax	350.0	
Deferred tax	75.0	425.0
Profit after tax		1,996.5

(b) ***Statement of changes in equity for the year ended 31 October 2005 ($000)***

	Share capital	*Share premium*	*Accumulated profit*	*Revaluation reserve N1*	*Total*
1.11.2004	3,000.0	750.0	3,701.0	2,500.0	9,951.0
Change	1,000.0	750.0	1,996.5	1,200.0	4,946.5
31.10.2005	4,000.0	1,500.0	5,697.5	3,700.0	14,897.5

N1 – Revaluation change would be reported as other comprehensive income.

Question 8 – Scott Ross discussion points

Nathan Davison is obviously still in the family business mentality, where the affairs of the business are kept secret as far as possible. He has not taken on board the idea that now it is a public company; it is no longer his business and he has a moral obligation to keep external investors fully informed on the nature of the business and of events affecting the business and its profitability and financial stability.

Under the law, he has a legal obligation to provide accounts that show a true and fair view which means he has to review the standards compliant accounts and ask what additional information is needed for readers of the annual report in order to understand the major elements of the business.

The suggestion of a footnote should be vague or that you should do the minimum that is necessary to protect yourself from prosecution is contrary to the spirit of open markets. If you cannot keep external shareholders informed, then perhaps you were immoral to take their money in the first place. It is interesting to note that the famous US investor Warren Buffett has stated that if a footnote was unclear, then he would assume that it was unclear by deliberate design. Then he would not invest in the company.

Just think of what impact that could have on a share price if a number of sophisticated investors take that view.

Then the suggestion that there be a deliberate attempt to mislead investors regarding the profitability of a segment is clearly both legally and morally wrong. Further, the admission that the company has been smoothing income is an interesting moral issue. If smoothing income was just an attempt to counter the fact that during booms the company is likely to view allowances for bad debts and outstanding through rose-coloured glasses and during busts they are likely to be too pessimistic in their accruals, then perhaps it could be justified. But if the motivation is to make life easier for executives or to report rosy steady upward trends to investors that contradict the reality of the business cycle, then the objective is immoral and the results are fraudulent misrepresentation. In the famous Royal Mail case, where profits were manipulated through transfers to and from reserves, the managing director went to jail and the auditor avoided the same fate on a technicality that he had included a footnote mentioning the transfers. However, it is unlikely that the auditor would be able to make the same claims today by giving differences in accounting regulations and laws.

Question 9 – TYV

TYV – *Statement of profit or loss for the year ended 30 September 2014 (in accordance with the requirements of IFSS)*

	$000	*$000*
Revenue		19,460
Cost of sales (W2)		(11,119)
Gross profit		8,341
Administrative expenses (W2)	(1,954)	
Distribution costs	(1,110)	
		(3,064)
Profit from operations		5,277
Finance cost (W4)		(378)
Profit before tax		4,899
Income tax expense (W5)		(971)
Profit for the period		3,928

TYV – *Statement of changes in equity for the year ended 30 September 2014 (in accordance with the requirements of IFSS)*

	Equity shares	*Share premium*	*Retained earnings*	*Total*
	$000	*$000*	*$000*	*$000*
Balance as at 30 September 2013	6,000	850	491	7,341
Profit for period			3,928	3,928
Dividend paid			(350)	(350)
Balance at end	6,000	850	4,069	10,919

TYV – *Statement of financial position as at 30 September 2014*
(in accordance with the requirements ofIFSS)

	$000	$000
Non-current Assets		
Property, plant and equipment (W1)		16,415
Current Assets		
Inventory	575	
Trade receivables	2,250	
Cash and cash equivalents	272	
Non-current assets held for sale		3,097
		1,420
Total Assets		**20,932**
Equity and Liabilities		
Equity		
Share capital	6,000	
Share premium	850	
Retained earnings	4,069	
Total equity		10,919
Non-current Liabilities		
7% Loan	5,000	
Deferred tax (W5)	576	
Total non-current liabilities		5,576
Current Liabilities		
Trade payables	1,880	
Tax payable	940	
Short-term loan	1,500	
Interest	117	
Total current liabilities		4,437
Total equity and liabilities		

Workings – All figures in $000

W1 – Tangible Non-current Assets

	Land	*Buildings*	*Plant and equipment*	*Total*
Cost/Valuation				
Balance 30/9/13	11,000	6,386	7,750	
Disposal factory B	(1,120)	(325)		
Transfer factory A – held for sale	(1,375)	(455)		
Plant and equipment scrapped			(175)	
New factory building		1,099		
	8,505	6,705	7,575	
Depreciation				
Balance 30/9/13		1,700	4,510	
Disposal factory B		(286)		
Transfer factory A – held for sale		(384)		
Plant and equipment scrapped			(120)	
Charge for year		134	796	
		1,164	5,186	
Net book value at 30/9/14	8,505	5,541	2,369	16,415

Depreciation buildings

$6{,}705 \times 2\% = 134$

Plant and equipment reducing balance $= 7{,}575 - (4{,}510 - 120) = 3{,}185 \times 25\% = 796$

W2

	Cost of sales	*Administrative expenses*
	$000	*$000*
Balance per trial balance	10,200	1,820
Depreciation buildings (W1)		134
Loss on factory closures Factory A (W3)	46	
Loss on factory closures Factory B (W3)	29	
Loss on plant and equipment (W3)	48	
Depreciation plant and equipment (W1)	796	
	11,119	1,954

W3 – Loss on factory closures

Factory A

Carrying value:			
Land	1,375		
Buildings	455	1,830	
Less depreciation		(364)	
		1,466	
Fair value 30/9/2014		1,420	
Write-down			(46)

Factory B

Carrying value:			
Land	1,120		
Buildings	325	1,445	
Less depreciation		(286)	
		1,159	
Cash received		1,130	
Loss on disposal			(29)