IIPA

Professional 2 – Module 8

Financial Accounting

August 2012

Marking Scheme

Question 1-Partnership	**25 marks**
Question 2-Company Accounts	**30 marks**
Question 3-Journal Entries	**25 marks**
Question 4 Multi-choice question	**20 marks**

Total	**100 marks**

Question 1

Question

Requirements

(a) Explain the Garner V Murray rule (3 marks)

(b) Compute the amount, if any, that can by paid out to all or any of the partners as at 31st March (7 marks)

(c) Set out the Realisation Account and Capital Accounts for the period 1ST February to 30th of June (15 marks)

Garner V Murray Rule

Where a partner's capital has a deficit, then normally that partner is obliged to make good that deficit by putting personal monies into the business. If the partner is unable then the Garner v Murray 1904 applied. The deficit of a partner shall be shared NOT in the profit sharing ratio amongst the remaining partners but in the last agreed Capital Balances.

(ii)

At 31st of March the Total asset[excluding Bank] were €100,000, which at that initial stage in the absence of later information, received €22,000 representation a lost of €78,000 which along with the yet to be accounted for legal fees of €5,000 totall €83,000

		Mary		John	Elizabeth
Capital Balance at 31/01/12		60,000		50,000	15,000
Loss		(41,500)		(24,900)	(16,600)
Balance at 31st March		18,500		25,100	(1,600)
Gardner V Murray	60/110	(873)	50/110	(727)	1,600
Payments		17,627		24,313	nil

Realisation Account

		Dr	Cr
	Buildings	€70,000	
	Machinery	€25,000	
	Inventory	€5,000	
	Legal fees	€5,000	
	Machinery sold for		€22,000
	Loss on Realisation	€0	€83,000
		€105,000	**€105,000**
Mar-01	b/d	€83,000	
	Inventory		€4,000
	Discount on payable on early settlement		800
	Buildings sold for		€100,000
Jun-30	Profit on Realisation	€21,800	€0
		€104,800	€104,800

Note it was not necessary to split realization account into two sections as set out above as the question did not request it.

Capital Current Accounts	**Mary**	**John**	**Elizabeth**
Capital Account	€60,000	€50,000	€15,000
Overall profit on realisation	€10,900	€6,540	€4,360
	€70,900	€56,540	€19,360
Less already paid	(€17,627)	(€24,373)	€0
Bank	€53,273	€32,167	€19,360

Question 1-Cash account-not asked for

CASH ACCOUNT			
		Dr	Cr
Balance b/d		48,000	
Machinery sold for		€22,000	
Capital Account	Mary		€17,627
Capital Account	John		€24,373
Balance c/d 31st March			€28,000
		€70,000	**€70,000**
Balance b/d 31st March		€28,000	
Inventory sold for		€4,000	
Buildings sold for		€100,000	
Payables after discount €800			€7,200
Loan paid in ful			€15,000
Legal fees paid by 30th June			€ 5,000
Capital accounts	Mary		€53,273
Capital accounts	John		€32,167
Capital accounts	Elizabeth	_	€19,360
		€132,000	**€132,000**

Question 2

Income statement of Meslin for the year ended 30/06/12 answer (a)

		€
Revenue W/N 2		731,200
Cost of sales W/N 1		(554,350)
Gross Profit		176,850
Other operating income-discounts		2,800
Selling and distribution W/N 1	(49,900)	
Administration expense W/N 1	(27,095)	
		(76,995)
Operating profit		102,655
Loss on disposal of asset		(38,000)
Finance Cost		
Debenture interest	(4,000)	
Redeemable Preference dividend	(12,000)	
		(16,000)
Profit before tax		48,655
Income tax expense		(16,000)
Profit for the year		32,655

W/N 1

	Production	**Distribution**	**Admin**	**Total**
Premises depreciation	21,000	6,000	3,000	30,000
Forklift depreciation	33,750			33,750
Inventory	24,000			24,000
Purchases	450,000			450,000
Purchase Returns	(5,800)			(5,800)
Bad debts per T/B			3,500	3,500
Additional bad debts			2,079	2,079
Estimate of doubtful debts			116	116
Rent Rates	13,300	3,800	1,900	19,000
Miscellaneous	0	0	7,200	7,200
Salaries	55,800	27,900	9,300	93,000
Advertising	0	12,200		12,200
Inventory Closing bal	(26,000)	-	-	(26,000)
Goods on approval stock	(11,700)			(11,700)
I/S for Y/E 30/06/12	**554,350**	**49,900**	**27,095**	**631,345**

W/N 2Revenue

T/B sales	780,000
T/B returns	(3,800)
sold on approval	(13,000)
	(32,000)
Income statement	**731,200**

Group Statement of Changes in Equity of Meslin for y/e 30/06/12 answer (b)

	Share Capital	**Share Premium**	**Retained Earnings**	**Total**	***NCI**
Balances at 30/06/11	300,000	45,000	132,000	477,000	
Issued	52,500	87,500		140,000	*€32,300
Profit for year ended 30/06/12			32,655	32,655	
Dividends				0	
Ordinary paid			(6,000)	(6,000)	
Balances as at 30/06/12	352,500	132,500	158,655	643,655	32,300

* N.C.I. i.e. Non Controlling Interests

<u>*Comment</u>
As the subsidiary was acquired on the last day of the year there were no post acquisition profits to be included in the income statement.

The Non Controlling interest arising on issue of the shares to acquire 80% of Dinlin Ltd was computed by 20% of Net Assets of €161,500 [€125,000+€32,000+€12,500 minus €8,000 payables]

Goodwill on acquisition -answer (c)

Net Asset of subsidiary at acquisition date is €161,500 x 80%	€129,200
Fair value of consideration-shares issued 70,000 x €2.00 equals	€140,000
Goodwill on acquisition	€ 10,800

Question 2 solution continued -answer (d)

Note xx on Group Non Current Assets of Meslin Ltd for year ended 30/06/12

	Premises	**Forlift trucks**
Cost or valuation 30/06/11	750,000	325,000
Disposal		(100,000)
Acquisition-subsidiary	125,000	_
Cost of valuation 30/06/12	**875,000**	**225,000**
Depreciation		
Accumulated depreciation 30/06/11	60,000	97,500
Disposal		(30,000)
Charged to I/S y/e 30/06/12	30,000	33,750
Accumulated depreciation 30/06/12	**90,000**	**101,250**

Net Book value at 30/06/11	**690,000**	**227,500**
Net Book value at 30/06/12	**785,000**	**123,750**

Depreciation rates
Forklift trucks are depreciated 15% straight line
Premises are depreciated 4% straight line
Depreciation policy
Depreciation is estimated so as to write off the cost or value of particular non current assets over their estimated useful lives.
Assets are depreciated in full in the year of their acquisition and are not depreciated in the year of their disposal.

Balance Sheet not asked for but is set out on the next page

W/N 3

Receivables	€30,500
bad debts	(€2,079)
Sale Return	(€13,000)
Prov Doubtful debts	(€234)
Per B/S	**€15,187**

Question 2 solution continued-Balance Sheet not asked for

Group statement of Financial Position of Meslin as at 30/06/12[not asked for]

Non current Assets			€
Property, Equipment -see **SOCE**			908,750
Intangible assets			
Goodwill			10,800
Current Assets			
Inventory		69,700	
Receivables	**W/N 3**	15,187	
VAT		1,500	
Total current assets			86,387
Total Assets			**1,005,937**
Equity and Liabilities			
Equity			
Ordinary Share capital		352,500	
Share Premium		132,500	
Retained Profits see **SOCE**		158,655	
			643,655
Non Controlling Interests			32,300
Total Equity			675,955
Non Current Liabilities			
Redeemable Preference share capital		200,000	
8% Debentures		50,000	
			250,000
Current Liabilities			
Payables			
Creditors		34,000	
Taxation		16,000	
Interest		4,000	
Bank		25,982	
			79,982
Total Equity plus Liabilities			**1,005,937**

Question 3-ratios

(i) Gross Profit (ii) Current ratio (iii) Return on Capital employed (iv) Gearing
(v) Earnings Yield (vi) Receivable days (vii) Inventory days (viii) Net Profit Margin

The ratios are computed and organised under the following headings
[1] Profitability [2] Liquidity [3] Efficiency [4] Investor appraisal

Ratio

	1/07/12	**31/07/11**
Profitability ratios		

Gross Profit (i)

Gross Profit x 100 / Sales/Revenue	€ 31,920 / 159,600 =20.00%	€37,500 / €150,000 =25.00%

Net Profit Margin* (viii)

Profit for the year / Sales/Revenue	€ 14,570 / €159,600 =9.12%	€ 15,312 / €150,000 = 10.28%

*Some other definitions if reasonable and properly described

Return on Capital Employed (iii)

Profit before interest & Tax x 100 / Equity plus N.Current Liabilities	€19,152 / €126,383 = 15.15%	€21,000 / €123,813 = 16.96%

[←------Capital Employed '---→]

Alternatively

Operating Profit / Sales/Revenue x Sales revenue / C/Employed	= 12% x 1.26=*15.12%	14% x 1.21 =*16.94%

* allow for rounding

Liquidity

Current ratio (ii)

Current Asset: Current Liabilities	€31,920 to €17,537 i.e. 1.82 to 1	€85,059 to €9,247 i.e 9.20 to 1

Efficiencies

Inventory days (vii)

Inventory x 365	€ 12,423 x365 =35 days	€ 9,247 x 365=30 days
Cost of sales	€127,680	€112,500

Receivable days (vi)

Receivables x 365 days	€ 19,677 x 365=45 days	€ 12,329 x365=30 days
*Sales on Credit	€159,600	€150,000

*Assumption That there were no significant amounts of cash sales in Revenue/Sales

Investor Appraisal

***Gearing** (iv)

Non Current Loans x 100	€ 25,000 = 19.78%	€ 35,000 = 28.27%
Equity+Non Current Loans	€126,383	€123,813

***** A measure of financial risk and the investor reaction to it in terms of share price

Earnings Yield (v)

Earning per share* x 100	**€0.15 =25.89%	€0.15 =17.85%
Market value per share	€0.58	€0.84

*Profit available to Ordinary share holders
Number of ordinary shares in issue

** Note rounding to three decimal places would give different EPS's

Inverse is the P/E ratio	3.86	5.6

<u>Report[</u>some areas that might be commented on]

To the members of the board

From J.J. Byrne IIPA

Date 30/06/12

Further to our meeting of T/Y/12 please find enclosed our report which consisted of an examination of the financial statements supplied by you to us and the application of ratios in analyzing those statement together with commentary.

<u>Assumption</u>
That the financial statements for both years are prepared on a consistent basis and in accordance with generally accepted accounting principles

<u>Other information</u>
It would have been helpful to have budgets for the forthcoming year together with industry ratios

The ratios were examined under the following headings
[1] Profitability [2] Liquidity [3] Efficiency [4] Investor appraisal

<u>Profitability</u>

Gross Profit fell from 25% to 20%
Using the volume unit supplied with the statement it can seen that the fall in Gross Profit was due to a fall in average unit sales price by 5% and corresponding increase in average production costs of about 1% . The increase in unit production costs by 1% -despite an increase in unit volumes -may signify that the additional machine capacity acquired may not yet have been fully utilized

Net Profit margin fell from 10.28% to 9.12%. This was in part due to the fall in Gross Profit margins but has been mitigated to some extent by an absolute fall in operating costs despite increased volumes and a fall in loan service costs.

Return of Capital employed
This has gone from 16.96% to 1515% The fall is due in part to the fall Net profit margins as outlined earlier. It was also affected by the fall in capital employed usage from 1.21 to 1.26

<u>Liquidity</u>

Ideal current ratio is considered to be 2:1 This went from 9.2 contributed in part by a large amount of bank cash to below the ideal ratio of 2 to 1. The company should try to maintain an approximate 2 to 1 balance.
It is assumed that adequate provision has been made for obsolete inventory and uncollectible receivables.

Efficiency

Both inventory and receivable days have increased and in the absence of any under provision for doubtful debts and uncollectibles it might suggest that the company is chasing volume through better credit terms to customers and maintaining perhaps a wider selection of stock on hand.

Investor appraisal

Gearing has been improved through reduction in long term debt which has also reduced finance charges.. Despite a fall in gearing, and a 33.33% increase in dividend payout, the fall in net profit margins, and coupled with a rise of only 12% in volume -despite a doubling of investment in machinery- the market has downgraded the share price[from €0.82 to €0.58] to reflect a higher risk profile consequent on a higher yield sought.
This suggests a lack of confidence in the company to generate future profits that would continue to justify last year's lower risk yield of 17.8%
However in the present economic climate it is important to contrast current high yields sought by the market with listed companies of a similar scale and nature.

Not asked for but an approximate estimate of cash flow movement ignoring IAS 7 requirements to explain approximately how cash flowed.

Capital Outflows/Inflows	
Profit after interest and tax	€14,571
Dividends paid	(€2,000)
Retained net of dividends	€12,571
(Increase)/Decrease in inventory	(€2,997)
(Increase)/Decrease in Receivables	(€7,348)
Increase/(Decrease) in Payables	€4,746
Increase in NBV amount of Machinery	(€64,000)
Issue of share capital	€none
Repayment of loans	(€10,000)
Net approximate cash flows	(€67,028)
Opening bank balance	€63,484
Closing bank balance	(€3,545)

Multi-choice answers

Item 1 (a) Present obligation arising from past events…………

Item 2 (b) a change in estimation but not a change in accounting policy

Item 3 (d) deductible temporary differences

Item 4 (b) Weighted shares Pre rights 100,000 x $\frac{€2.00}{€1.25}$ x $\frac{6mths}{12mths}$ 80,000 shares

Post right issue 125,000 shares x $\frac{6mths}{12 mths}$ 62,500

€30,000 divided by 142,500 shares equals €0.21 to decimal places

Item5(b) Total interest is Loan €15,000 minus repayments of €18,000=€3,000
Sum of digit of three payments is 6. First year is 3/6=50%
Interest for 1st year is thus €3,000 x 50% equals €1,500

Total amount owing is €15,000 plus €1,500 minus €6,000 =€10,500

Item 6 (a) Depreciation charge €36,000 [€200,000-€20,000]/5years
Less deferred credit <u>€10,000</u> [€200,000 x25%] divided by 5 years
Income statement €26,000

Deferred income=grant €50,000 x 4/5years equals € 40,000
Machine €200,000 minus €36,000 equals €164,000

Item7 (a) Debit Payables account Credit

				Purchases	$400,000	$1.25	€320,000
Bank	$200,000	A.R.	€153,846				
c/d	$200,000	$1.40	€ 142,857				
I/S Gain			**€ 23,297**				
	$400,000		€320,000		$400,000		€320,000

Item 8 (a)

Total Units in 1400. Total units out 11,00 units.

F.I.F.O out equals LIFO units remaining
300 units x €7.00

Item 9 (d)

Item 10 (b)