Financial Accounting
Module 8
June 2011

Suggested Solutions

Question 1 - Sandra & Mike Hairdressers Solution

Profit & Loss appropriation account		
Loss for the year	€1,500	
Salary-Mike	€12,000	
Interest on capital		
Sandra	€2,100	
Mike	€1,500	
Loss c/d	______	€17,100
	€17,100	**€17,100**
Loss b/d	€17,100	
Share of Loss- Sandra 60%		€10,260
Share of Loss-Mike 40%		€6,840

	Realisation account	
Payables		€150.
Receivables	€8,500.	
Shop Unit in main square	€38,400.	
Hairdressing equipment	€15,313.	
Furnishings	€5,625.	
Inventory	€3,000.	
Receivables		€8,075.
Shop Unit in main square		€38,400.
Hairdressing equipment		€12,250.
Furnishings		€2,250.
Legal fees	€3,500.	
c/d Loss on Realisation	________.	€13,213.
	€74,338	**€74,338**
Loss b/d	€13,213.	
Share of Realisation loss- Sandra 60%		€7,928.
Share of Realisation loss-Mike 40%	.	€5,285.

Combined Capital & Current Accounts	**Sandra**	**Mike**	**Total**
Capital	€35,000	€25,000	€60,000
Current a/c	€4,560	(€2,130)	€2,430
Loss on Realisation	(€7,928)	(€5,285)	(€13,213)
Salary		€12,000	€12,000.
Shop Unit in main square	(€38,400)		(€38,400)
Interest on Capital	€2,100.	€1,500.	€3,600
Share of Current Year's Loss	(€10,260)	(€6,840)	(€17,100)
Payables		€7,350	€7,350
Receivables		(€8,075)	(€8,075)
	(€14,928)	**€23,520**	**€8,593**

Net balance at 30/04/11 Debit /|\ Credit /|\

	Cash at Bank	
Balance b/d		€2,408
Furnishings	€2,250	
Hairdressing equipment	€12,250	
Legal fees		€3,500
Sandra	€14,928	
Mike		€23,520
	€29,428	**€29,428**

Sandra will be required to obtain cash of €14,928 from her own personal resources and put it into the partnership bank account in order to ensure full payment of overdraft , legal fees and Mike’s final Capital/Current balance

Question 2 Hardwood Furniture solution

Income statement of Hardwood Furniture Ltd for the year ended 31/03/11

		€	€
Revenue	**W/N 2**		729,000
Cost of sales	**W/N 3**		(541,088)
Gross Profit			187,912
Selling and distribution	**W/N 3**	(44,050)	
Administration expense	**W/N 3**	(39,017)	
			(83,067)
Operating profit			104,845
Loss on disposal of asset	**W/N 1**		(18,870)
Finance Cost			
Debenture interest	**½ years**	(500)	
			(500)
Profit before tax			85,475
Income tax expense	(14,000)	(1,200)	(15,200)
Net Profit for the year			**70,275**

Answer (b) Statement of Changes in Equity for year ended 31/03/11

	Preference Share Capital	**Share Premium**	**Retained Earnings**	**Total**
Balance as at 01/04/10	100,000	45,000	95,000	465,000
Profit			70,275	70,275
Preference Dividend paid			(3,000)	(3,000)
Preference divided payable			(3,000)	(3,000)
Ordinary Dividends paid			(1,500)	(1,500)
BALANCE AT 31/03/10	**100,000**	**45,000**	**157,775**	**527,775**

On the 15/04/11 the company proposed to pay an Ordinary dividend of €0.01 per share amount to €3,000 in total.

Answer (c) Note on Non Current Assets

Non Current Assets				

	Premises	Equipment	Vehicles	Total
	€	€	€	€
Cost or value 01/04/10	600,000	250,000	125,000	975,000
Disposal		(85,000)		(85,000)
	-	-	-	-
Cost or value 31/03/11	**600,000**	**165,000**	**125,000**	**890,000**
Accumulated Depreciation				
Balance at 01/04/10	240,000	47,500	62,500	350,000
Disposal		(16,130)		(16,130)
Charged to I/S for y/e 31/03/11 W/N 1	12,000	13,363	12,500	37,863
Accumulated Depreciation 31/03/11	**252,000**	**44,733**	**75,000**	**371,733**
Net Book value 01/04/10	**360,000**	**117,500**	**62,500**	**540,000**
Net Book value 31/03/11	**348,000**	**120,267**	**50,000**	**518,267**

W/N 1
Computation of depreciation
Premises 2% straight line
€600,000 x 2% straight line =€12,000 allocated as follows:

70% Production ie. €8,400 ; 10% Distribution €1,200 and 20% Admin €2,400

Equipment 10% Reducing balance.
T/B [250,000 - 47,500] minus [85,000-16,130]=133,630 x 10% equals 13,363
Allocated as follows;100% to production

Profit on sales of Equipment €50,000 less €68,870 equals €18,870

Vehicles 10% straight line
€125,000 x 10% equals €12,500 allocated as follows;
70% Distribution €8,750 30% Admin €3,750

Statement of Financial Position of Hardwood Furniture Ltd as at 31/03/11
. Included for revision purposes

		€	**€**	**€**
Non current Assets				
Property, Plant and Vehicles				**518,267**

Current Assets				
Inventory			55,000	
Receivables		35,000		
less sale or return		(12,500)		
bad debts		(1,400)		
Provision for doubtful debts		(1,266)		
			19,834	
Prepaid			2,250	
Total Current Assets				77,084
Total Assets				**595,351**
Equity and Liabilities				
Equity				
Ordinary Share capital		225,000		
Share Premium		45,000		
6% Preference Shares		100,000		
Retained Profits		157,775		
Total Equity				**527,775**
Non Current Liabilities				
5% Debentures				20,000
Current Liabilities				
Payables				
Creditors		22,000		
Preference dividend payable		3,000		
Taxation		14,000		
Interest on debentures owing		500		
VAT		2,800		
Bank		5,276		47,576
Total Equity and Liabilities				**595,351**

W/N 2
Computation of Sales revenue

T/B sales	**€800,000**
T/B returns	**(€8,500)**
sold on approval	**(€12,500)**
Machine sale	**(€50,000)**

€729,000

W/N 3

Allocation of costs amongst Production, Distribution and Administration

	Notes	Production	Distribution	Admin	Total
Premises depreciation	**W/N 1**	8,400	1,200	2,400	12,000
Equipment depreciation	**W/N1**	13,363			13,363
Vehicles depreciation	**W/N 1**		8,750	3,750	12,500
Inventory		30,000			30,000
Purchases		450,000			450,000
Purchase Returns		(4,200)			(4,200)
Settlement discount allowed				1,900	1,900
Bad debts per T/B				7,000	7,000
Additional bad debts	**W/N 4**			1,400	1,400
Increase in doubtful debts	**W/N 4**			342	342
Rent Rates	**W/N 5**	11,025	3,150	1,575	15,750
Sundry expenses				5,600	5,600
Wages and salaries		87,500	25,000	12,500	125,000
Transport expenses			5,950	2,550	8,500
Inventory as at 31/03/11		(45,000)			(45,000)
Goods on approval include in stock		(10,000)			(10,000)
Totals		**541,088**	**44,050**	**39,017**	**624,155**

W/N 4-
Bad debts and provision for doubtful debts

€2,000 x [1-.30] equals €1,400 uncollectible

Receivables per T/B 35,000 less €1,400 equals €33,600
less **Goods on approval at S.P**. (€12,500) [€10,000/80%]
€21,100

Closing provision is €21,100 x 6% equals €1,266
Less opening provision per T/B (€ 924)
Increase in provision for y/e 31/03/11 € 342

W/N 5 Rent and Rates

Rent €9,000 includes prepayment of €9,000 x 3 months/12 months =€2,250

€18,000 less €2,250 equals €15,750 allocated as follows;
70% Production €11,025 ; 20% Distribution €3,150 and 10% Admin €1,575

Question 3 Ratios and Commentary

Liquidity

Current Ratio

(iv)	Current Asset: Current Liabilities	€15,505 / €36,556	0.42 to 1	€33,209 / €5,034	6.60 to 1		
(v)	Quick assets: Same as 3 but exclude stock	€8,860 / €36,556	0.24 to 1	€29,613 / €5,034	5.88 to 1		

Profitability Ratios

(i)	Gross profit x 100% / Sales	€20,213 / €80,850	x100%	25.00%	€22,500 / €75,000	x100%	30.00%
(ii)	Operating Profit to Sales / Sales	€8,085 / €80,850	x 100%	10.00%	€9,000 / €75,000	x 100%	12.00%

Return on Capital Employed

(iii)	Profit before % and Tax / Share Capital + Reserves + NCL	€8,085 / €88,949	x 100%	9.09%	€9,000 / €85,175	x 100%	10.57%

Alternatively
Capital employed turnover

Sale / Capital Employed	€80,850 / €88,949 = .91	€75,000 / €85,175 = .88

Alternatively
ROCE equals ratio (ii) x C/E turnover 10% x .91 =9.10% 12% x .88 =10.57

To the Board
From Pat Bloggs consultant
Date : x/y/z

A suggested outline of contents but NOT "THE" answer

Dear Sir or Madam
We have carried out a review of the financial statements for the past two years. Computations in relation to same are set out on appendix

Assumptions
We have assumed that the accounts were prepared on a consistent and comparable basis and in accordance with GAAP

Further information
It would have been helpful if industry ratios had been made available to us

Report

Profitability
Reference to the decline in profitability with a suggestion as to possible causes
Possibly a strategy of cutting margins and extending credit to increase volumes.

Liquidity
Reference to excessive current and quick asset ratios above the ideals of 2:1 and 1:1 respectively and their decline to below it
In that regard it might appear that some of the short term funding ie. bank overdraft is being unwisely used for long term being greater than the debenture loans.

Efficiencies
Decline in minimising stock holding and debt collection periods

Return on Capital employed
Distortion of ratio because of the exclusion of the Bank overdraft which should perhaps be treated as long term for computational purposes

Threat to liquidity if banks in current climate demand closure of overdraft facilities
Failure to match long term expenditure €90,000 on machinery with long term funds

Recommendations??

Question 4 Multi-choice
Item

1 (b)

2 (c)

3 (d)

4 (c)

5 (b)

6 (d)

7 (c)

8 (c) Gain on payment of $40,000 i.e. €1,174 plus
€402 Gain on translation of balance

9 (c)

10 (b)