



# Study Support

## Financial Statements (PFSK)

### **Disclaimer**

Study Support materials comprise **non live** assessments that were created for the **2003/2006 standards** and **do not** resemble assessments designed for the AAT Accountancy Qualification (launched July 2010).

There are some topic similarities between the 2003/2006 standards and the AAT Accounting Qualification (launched July 2010).

**Practice assessments, guidance and standards** for the AAT Accountancy Qualification (launched July 2010) can be found on the AAT website.

The Association of Accounting Technicians

# Contents

- Support book Part 1** Unit 19: Personal Tax Computations (PTC)  
2003/2006 standards exam; June 2009 sitting, FA2008
- Support book Part 2** Unit 19: Personal Tax Computations (PTC)  
2003/2006 standards exam; December 2009 sitting

# Support book Part 1

## Questions

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**Source:**

2003/2006 standards exam; June 2009 sitting

**Contents:**

Unit 11 Drafting Financial Statements (DFS)

AAT Level 4 Technician Pathway/Diploma Pathway (2003/2006 standards)

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**Wednesday 17 June 2009 (morning)**

Time allowed - 3 hours plus 15 minutes' reading time

This exam paper is in **TWO** sections.

You must show competence in both sections. So, try to complete EVERY task in BOTH sections.

Section 1 contains 6 tasks and Section 2 contains 2 tasks.

Please use the answer booklet provided. You should include all your workings and essential calculations in your answers.

The answer booklet includes the following pro-formas:

- Journal
- Company income statement
- Company balance sheet
- Consolidated balance sheet
- Cash flow statement

You should spend about 125 minutes on Section 1 and about 55 minutes on Section 2.

Against each task is the recommended time for that task, but please note that these times are **guidelines** only.

## Section 1

This section is in three parts.

### Part A

You should spend about 45 minutes on this part.

### Data

You have been asked to help prepare the financial statements of Nevis Ltd for the year ended 31 March 2009. The company's trial balance as at 31 March 2009 is shown below.

#### Nevis Ltd

#### Trial balance as at 31 March 2009

	Debit £000	Credit £000
Share capital		14,000
Trade and other payables		2,642
Property, plant and equipment – cost	54,670	
Property, plant and equipment – acc depreciation		28,980
Trade and other receivables	4,567	
Accruals		239
6% bank loan repayable 2016		12,000
Cash at bank	3,519	
Retained earnings		6,590
Interest	360	
Sales		65,677
Purchases	48,900	
Returns inwards	564	
Returns outwards		766
Distribution costs	4,555	
Administrative expenses	6,589	
Inventories as at 1 April 2008	5,640	
Final dividend for year ended 31 March 2008	840	
Interim dividend for year ended 31 March 2009	690	
	130,894	130,894

### **Further information**

- The share capital of the company consists of ordinary shares with a nominal value of £1.
- The inventories at the close of business on 31 March 2009 were valued at £6,806,000.
- The company hired some temporary office space for the period 1 March to 31 May 2009. The contract price for the three months was £144,000 and this was paid in full on 8 March.
- The company bought billboard advertising space for a period of three months from 1 February to 30 April 2009. The invoice for the full three months of £180,000 was paid on 10 April. No entry has been made in the accounts for this transaction.
- Interest on the bank loan for the last six months of the year has not been included in the accounts in the trial balance.
- The corporation tax charge for the year has been calculated as £2,540,000.
- All of the operations are continuing operations.

### **Task 1.1 (15 mins)**

Using the pro-forma in your answer booklet, make the necessary journal entries as a result of the further information given above.

### **Task 1.2 (30 mins)**

- (a) Using the pro-forma in your answer booklet, draft the income statement for Nevis Ltd for the year ended 31 March 2009.
- (b) Using the pro-forma in your answer booklet, draft the balance sheet for Nevis Ltd as at 31 March 2009.

## **Part B**

You should spend about 55 minutes on this part.

### **Data**

The Managing Director of Ard plc has asked you to prepare the balance sheet for the group. Ard plc has one subsidiary undertaking, Ledi Ltd. The balance sheets of the two companies as at 31 March 2009 are set out below.

#### **Balance sheets as at 31 March 2009**

	<b>Ard plc</b>	<b>Ledi Ltd</b>
	<b>£000</b>	<b>£000</b>
<b>Non-current assets</b>		
Property, plant and equipment	45,210	27,480
Investment in Ledi Ltd	23,000	
	<u>68,210</u>	<u>27,480</u>
<b>Current assets</b>		
Inventories	21,450	4,222
Trade and other receivables	9,874	6,486
Cash and cash equivalents	1,458	127
	<u>32,782</u>	<u>10,835</u>
<b>Total assets</b>	<u>100,992</u>	<u>38,315</u>
<b>Current liabilities</b>		
Trade and other payables	(11,234)	(4,445)
Tax liabilities	(4,232)	(130)
	<u>(15,466)</u>	<u>(4,575)</u>
<b>Net current assets</b>	<u>17,316</u>	<u>6,260</u>
<b>Non-current liabilities</b>		
Long-term loans	(14,000)	(4,000)
<b>Total liabilities</b>	<u>(29,466)</u>	<u>(8,575)</u>
<b>Net assets</b>	<u>71,526</u>	<u>29,740</u>
<b>Equity</b>		
Share capital	38,000	12,000
Share premium	11,000	6,000
Retained earnings	22,526	11,740
<b>Total equity</b>	<u>71,526</u>	<u>29,740</u>

### **Further information**

- The share capital of Ledi Ltd consists of ordinary shares of £1 each. Ownership of these shares carries voting rights in Ledi Ltd. There have been no changes to the balances of share capital and share premium during the year. No dividends were paid or proposed by Ledi Ltd during the year.
- Ard plc acquired 7,200,000 shares in Ledi Ltd on 1 April 2008.
- On 1 April 2008 the balance of retained earnings of Ledi Ltd was £9,640,000.
- The fair value of the non-current assets of Ledi Ltd at 1 April 2008 was £29,800,000. The book value of the non-current assets at 1 April 2008 was £25,800,000. The revaluation has not been recorded in the books of Ledi Ltd (ignore any effect on the depreciation for the year).
- Included in Trade and other receivables for Ard plc and in Trade and other payables for Ledi Ltd is an inter-company transaction for £3,000,000 that took place in early March 2009.
- The directors of Ard plc have concluded that goodwill has been impaired by 25% during the year.

### **Task 1.3 (35 mins)**

**Using the pro-forma in your answer booklet, draft a consolidated balance sheet for Ard plc and its subsidiary undertaking as at 31 March 2009.**

### **Task 1.4 (20 mins)**

**Prepare brief notes to answer the following points for the directors:**

- (a) State how, according to IAS 36, an impairment loss is calculated and which two figures are needed.**
- (b) Explain what is meant by each of these figures.**
- (c) State how an impairment loss is to be treated in the financial statements.**

## **Part C**

You should spend about 25 minutes on this part.

### **Data**

You have been asked to prepare the cash flow statement for Thehoose Ltd, for the year ended 31 March 2009. The most recent income statement and balance sheets of Thehoose Ltd for the past two years are set out below.

#### **Thehoose Ltd**

##### **Income statement for the year ended 31 March 2009**

**£000**

##### **Continuing operations**

Revenue	37,680
Cost of sales	<u>(22,608)</u>
Gross profit	15,072
Gain on disposal of property, plant and equipment	376
Distribution costs	(6,782)
Administrative expenses	<u>(3,014)</u>
Profit from operations	5,652
Finance costs	<u>(280)</u>
Profit before tax	5,372
Tax	<u>(1,484)</u>
<b>Profit for the period from continuing operations attributable to equity holders</b>	<u><b>3,888</b></u>

**Thehoose Ltd**  
**Balance sheets as at 31 March**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Non-current assets</b>		
Property, plant and equipment	27,570	21,340
<b>Current assets</b>		
Inventories	5,426	4,069
Trade and other receivables	3,768	4,145
Cash and cash equivalents	335	0
	<u>9,529</u>	<u>8,214</u>
<b>Total assets</b>	<u>37,099</u>	<u>29,554</u>
<b>Current liabilities</b>		
Trade and other payables	(2,261)	(4,069)
Tax liability	(1,484)	(887)
Bank overdraft	0	(132)
	<u>(3,745)</u>	<u>(5,088)</u>
<b>Net current assets</b>	<u>5,784</u>	<u>3,126</u>
<b>Non-current liabilities</b>		
Bank loans	(4,000)	(1,500)
<b>Total liabilities</b>	<u>(7,745)</u>	<u>(6,588)</u>
<b>Net assets</b>	<u>29,354</u>	<u>22,966</u>
<b>Equity</b>		
Share capital	4,500	3,000
Share premium	3,000	2,000
Retained earnings	21,854	17,966
<b>Total equity</b>	<u>29,354</u>	<u>22,966</u>

**Further information:**

- The total depreciation charge for the year was £3,469,000.
- Property, plant and equipment costing £764,000, with accumulated depreciation of £347,000, were sold in the year.
- All sales and purchases were on credit. Other expenses were paid for in cash.

**Task 1.5 (10 mins)**

Prepare a reconciliation of profit from operations to net cash from operating activities for Thehooose Ltd for the year ended 31 March 2009.

**Task 1.6 (15 mins)**

Using the pro-forma in your answer booklet, prepare the cash flow statement for Thehooose Ltd for the year ended 31 March 2009.

## Section 2

You should spend about 55 minutes on this section.

### Data

Lewis Lindsay is a shareholder in Lomond Ltd. He wishes to assess the level of profitability and the level of risk of maintaining his investment in the company. He has asked you to assist him by analysing the financial statements of the company for the last two years. The financial statements of Lomond Ltd are set out below:

#### Lomond Ltd

##### Income statements for the year ended 31 March

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Continuing operations</b>		
Revenue	14,800	11,600
Cost of sales	<u>(7,770)</u>	<u>(6,380)</u>
Gross profit	7,030	5,220
Distribution costs	(3,700)	(2,320)
Administrative expenses	<u>(2,072)</u>	<u>(1,508)</u>
Profit from operations	1,258	1,392
Finance costs	<u>(630)</u>	<u>(420)</u>
Profit before tax	628	972
Tax	<u>(294)</u>	<u>(133)</u>
<b>Profit for the period from continuing operations attributable to equity holders</b>	<u>334</u>	<u>839</u>

**Lomond Ltd****Balance sheets as at 31 March**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Non-current assets</b>		
Property, plant and equipment	18,916	16,200
<b>Current assets</b>		
Inventories	1,632	894
Trade and other receivables	1,776	1,044
Cash and cash equivalents	0	65
	<u>3,408</u>	<u>2,003</u>
<b>Total assets</b>	<u>22,324</u>	<u>18,203</u>
<b>Current liabilities</b>		
Trade payables	(855)	(766)
Tax liabilities	(294)	(133)
Bank overdraft	(537)	0
	<u>(1,686)</u>	<u>(899)</u>
<b>Net current assets</b>	<u>1,722</u>	<u>1,104</u>
<b>Non-current liabilities</b>		
Bank loans	(9,000)	(6,000)
<b>Total liabilities</b>	<u>(10,686)</u>	<u>(6,899)</u>
<b>Net assets</b>	<u>11,638</u>	<u>11,304</u>
<b>Equity</b>		
Share capital	6,500	6,500
Retained earnings	5,138	4,804
<b>Total equity</b>	<u>11,638</u>	<u>11,304</u>

### **Task 2.1 (40 mins)**

Prepare a report for Lewis Lindsay that includes:

- (a) The formulas that are used to calculate each of the following ratios:
  - (i) Gross profit percentage ratio
  - (ii) Net profit percentage ratio
  - (iii) Gearing ratio
  - (iv) Interest cover ratio
- (b) A calculation of the above ratios for the two years
- (c) Comments on the relative performance of the company, giving possible reasons, for the two years based on the ratios calculated
- (d) Advice on whether he should continue to invest based on the overall position suggested by the ratios calculated.

### **Task 2.2 (15 mins)**

Lewis is slightly confused by some of the terms used in the balance sheet, in particular by the terms labelled 'current'. On checking the internet he has found out that these terms are defined in something called IAS 1, but he has been unable to find any further information.

**Write short notes to explain how IAS 1 defines the following terms:**

- (a) **Current assets**
- (b) **Current liabilities.**

# Answer Booklet

Please write your answers in this booklet

## Task 1.1

### Journal

Account	Dr £000	Cr £000

## Task 1.2 (a)

### Nevis Ltd Company income statement for the year ended 31 March 2009

£000

#### Continuing operations

Revenue

Cost of sales

Gross profit

Distribution costs

Administrative expenses

Profit from operations

Finance costs

Profit before tax

Tax

Profit for the period from continuing operations

#### Discontinued operations

Loss for the period from discontinued operations

**Profit for the period attributable to equity holders**

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\_\_\_\_\_

**Task 1.2 (b)**

**Nevis Ltd**  
**Company balance sheet as at 31 March 2009**

**£000**

**Non-current assets**

**Current assets**

**Total assets**

**Current liabilities**

**Net current assets**

**Non-current liabilities**

**Total liabilities**

**Net assets**

**Equity**

**Total equity**

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\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

### Task 1.3

Ard plc  
Consolidated balance sheet as at 31 March 2009

£000

Non-current assets

Current assets

Total assets

Current liabilities

Net current assets

Non-current liabilities

Total liabilities

Net assets

Equity

Equity attributable to equity holders of the parent

Minority interest

Total equity

\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

## Task 1.6

Thehoose Ltd

Company cash flow statement for the year ended 31 March 2009

£000

Net cash from operating activities

Investing activities

Net cash used in investing activities

Financing activities

Net cash (used in)/from financing activities

Net increase/ (decrease) in cash and cash equivalents

Cash and cash equivalents at beginning of year

Cash and cash equivalents at end of year

# Model Answers

**Note:**

The model answers may, in parts, be longer than would be expected of candidates in the exam. The fuller version is given for teaching purposes.

## Section 1

### Part A

#### Task 1.1

	<b>Journal entries</b>	<b>£000</b>	<b>£000</b>
DR	Inventory (BS)	6,806	
CR	Inventory (IS)		6,806
DR	Prepayment	96	
CR	Administrative expenses $144,000 \times 2 / 3$		96
DR	Distribution costs	120	
CR	Accruals $180,000 \times 2 / 3$		120
DR	Interest	360	
CR	Interest payable $6,000,000 \times 6\% / 2$		360
DR	Taxation	2,540	
CR	Taxation payable		2,540

## Task 1.2

**Nevis Ltd**  
**Income statement for the year ended 31 March 2009**  
**Continuing operations**

	<b>£000</b>
Revenue	65,113
Cost of sales	<u>(46,968)</u>
Gross profit	18,145
Distribution costs	(4,675)
Administrative expenses	<u>(6,493)</u>
Profit from operations	6,977
Finance costs	<u>(720)</u>
Profit before tax	6,257
Tax	<u>(2,540)</u>
<b>Profit for the period from continuing operations attributable to equity holders</b>	<u><u>3,717</u></u>

W 1	Sales	65,677
	Less: Returns in	(564)
		65,113
W 2	Opening inventories	5,640
	Purchases	48,900
	Less: Returns out	<u>(766)</u>
		48,134
	Less: Closing inventories	53,774
		<u>(6,806)</u>
		46,968
W 3	Distribution costs	4,555
	Accrual	120
		4,675
W 4	Administrative expenses	6,589
	Prepayment	(96)
		6,493
W 5	Finance costs	360
	Accrual	360
		720

## Task 1.2 continued

(b)

**Nevis Ltd**

**Balance sheet as at 31 March 2009**

	<b>£000</b>
<b>Non-current assets</b>	
Property, plant and equipment	25,690
<b>Current assets</b>	
Inventories	6,806
Trade and other receivables	4,663
Cash and cash equivalents	3,519
	<u>14,988</u>
<b>Total assets</b>	<u>40,678</u>
<b>Current liabilities</b>	
Trade and other payables	(3,361)
Tax payable	(2,540)
	<u>(5,901)</u>
<b>Net current assets</b>	<u>9,087</u>
<b>Non-current liabilities</b>	
Bank loans	(12,000)
<b>Total liabilities</b>	<u>(17,901)</u>
<b>Net assets</b>	<u>22,777</u>
<b>Equity</b>	
Share capital	14,000
Retained earnings	8,777
<b>Total equity</b>	<u>22,777</u>

## Task 1.2 continued

W 1	Property, plant and equipment – cost	54,670
	Property, plant and equipment – accumulated depreciation	(28,980)
		25,690
W 2	Trade and other receivables	4,567
	Prepayment	96
		4,663
W 3	Trade and other payables	2,642
	Accruals	239
	Interest	360
	Distribution costs	120
		3,361
W 4	Retained earnings	6,590
	From income statement	3,717
	Final dividend for year ended 31 March 2008	(840)
	Interim dividend for year ended 31 March 2009	(690)
		8,777

## **Part B**

### **Task 1.3**

**Ard plc**

**Consolidated balance sheet as at 31 March 2009**

		<b>£000</b>
<b>Non-current assets</b>		
Intangible - Goodwill	W 1	3,012
Property, plant and equipment	W 2	<u>76,690</u>
		<u>79,702</u>
<b>Current assets</b>		
Inventories		25,672
Trade and other receivables	W 3	13,360
Cash and cash equivalents		<u>1,585</u>
		<u>40,617</u>
<b>Total assets</b>		<u>120,319</u>
<b>Current liabilities</b>		
Trade and other payables	W 4	(12,679)
Tax liabilities		<u>(4,362)</u>
		<u>(17,041)</u>
<b>Net current assets</b>		<u>23,576</u>
<b>Non-current liabilities</b>		
Long-term loans		(18,000)
<b>Total liabilities</b>		<u>(35,041)</u>
<b>Net assets</b>		<u>85,278</u>
<b>Equity</b>		
Share capital		38,000
Share premium		11,000
Retained earnings	W 5	<u>22,782</u>
<b>Equity attributable to equity holders of the parent</b>		<u>71,782</u>
Minority interest	W 6	<u>13,496</u>
<b>Total equity</b>		<u>85,278</u>

### Task 1.3 continued

W1 Goodwill			W5 Retained earnings	W6 Minority interest
		Attributable to holding company		
Share capital	12,000	7,200		4,800
Share premium	6,000	3,600		2,400
Revaluation	4,000	2,400		1,600
Post acquisition	2,100		1,260	840
Pre acquisition	<u>9,640</u>	<u>5,784</u>		<u>3,856</u>
	33,740	18,984	1,260	13,496
Consideration		<u>23,000</u>		
Goodwill		4,016		
Less:				
Impairment		<u>(1,004)</u>	(1,004)	
		3,012		
Holding company – Retained earnings			<u>22,526</u>	
			22,782	

W2 Property, plant and equipment	
Ard plc	45,210
Ledi Ltd	27,480
Revaluation	<u>4,000</u>
	76,690

W3 Trade and other receivables	
Ard plc	9,874
Ledi Ltd	6,486
Inter-company debt	<u>(3,000)</u>
	13,360

W4 Trade and other payables	
Ard plc	(11,234)
Ledi Ltd	(4,445)
Inter-company debt	<u>3,000</u>
	(12,679)

## Task 1.4

- (a) An impairment loss arises when the recoverable amount falls below the carrying amount. The loss is thus calculated as the difference between the asset's recoverable amount and its carrying amount.
- (b) The 'carrying value' of an asset is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation (amortisation) and accumulated impairment losses.

The 'recoverable amount' is the higher of an asset's fair value less costs to sell and its value in use. The latter is the present value of the future cash flows expected to be derived from an asset, including cash from its ultimate disposal.

- (c) The impairment loss is treated as an expense in the income statement unless it relates to a revalued asset when the loss is recognised as a revaluation decrease and hence debited to the revaluation surplus up to the maximum of any previously recognised surpluses on the asset.

## Task 1.5

### Thehooose Ltd

#### Reconciliation of profit from operations to net cash from operating activities for the year ended 31 March 2009

	<b>£000</b>
Profit from operations	5,652
Adjustments for:	
Depreciation	3,469
Gain on disposal of property, plant and equipment	<u>(376)</u>
Operating cash flows before movements in working capital	8,745
Decrease/(Increase) in inventories	(1,357)
Decrease/(Increase) in trade receivables	377
(Decrease)/Increase in trade payables	<u>(1,808)</u>
Cash generated by operations	5,957
Tax paid	(887)
Interest paid	<u>(280)</u>
<b>Net cash from operating activities</b>	<u><b>4,790</b></u>

## Task 1.6

### Thehoose Ltd Cash flow statement for the year ended 31 March 2009

<b>Net cash from operating activities</b>		4,790
<b>Investing activities</b>		
Proceeds on disposal of property, plant and equipment	W 1	793
Purchases of property, plant and equipment	W 2	<u>(10,116)</u>
<b>Net cash used in investing activities</b>		(9,323)
<b>Financing activities</b>		
New bank loans raised		2,500
Proceeds of share issue		<u>2,500</u>
<b>Net cash from financing activities</b>		5,000
<b>Net increase/(decrease) in cash and cash equivalents</b>		467
<b>Cash and cash equivalents at beginning of year</b>		<u>(132)</u>
<b>Cash and cash equivalents at end of year</b>		<u>335</u>

W1 NBV	417
Add: Profit	<u>376</u>
	793

W2 PPE at start	21,340
Less: Depreciation	(3,469)
Less: Book value of sold assets	(417)
Less: PPE at end	<u>(27,570)</u>
Purchases	(10,116)

## Task 2.1

**To:** Lewis Lindsay  
**From:** AAT student  
**Subject:** Investment in Lomond Ltd.  
**Date:** 17 June 2009

I have summarised below relevant ratios for Lomond Ltd.

	<b>2009</b>	<b>2008</b>
<b>Gross profit ratio</b>		
<u>Gross profit x 100</u>	<u>7,030</u>	<u>5,220</u>
Sales	14,800 <u>47.50%</u>	11,600 <u>45.00%</u>
<b>Net profit ratio</b>		
<u>Profit from operations x 100</u>	<u>1,258</u>	<u>1,392</u>
Sales	14,800 <u>8.50%</u>	11,600 <u>12.00%</u>
<b>Gearing</b>		
<u>Debt</u>	<u>9,000</u>	<u>6,000</u>
Debt + equity	20,638 <u>43.61%</u>	17,304 <u>34.67%</u>
<b>Alternative gearing</b>		
<u>Debt</u>	<u>9,000</u>	<u>6,000</u>
Equity	11,638 <u>77.33%</u>	11,304 <u>53.08%</u>
<b>Interest cover</b>		
<u>Profit from operations</u>	<u>1,258</u>	<u>1,392</u>
Interest paid	630 <u>2.0 times</u>	420 <u>3.3 times</u>

- (c) **The gross profit ratio has improved. This could be due to increased sales price or to reduced cost of sales.**

**In contrast, the net profit ratio has deteriorated. Normally, this could be due to reduced margin (but not in this case) or increase in expenses which looking at the large increase in distribution expenses would seem to be the problem.**

**The gearing ratio has deteriorated. This is due to an increase in loans and would tend to make the firm look more risky.**

**The interest cover ratio has deteriorated as shown by the fact that payments of interest have increased. This worsens the cash flow situation and makes the company look more risky.**

- (d) **In conclusion, only the gross profit ratio has improved, whilst the other ratios have deteriorated. The financial position ratios suggest that the investment is now much riskier than previously. Interest cover is especially worrying.**

**My advice is to withdraw your investment; you should sell your shares.**

## **Task 2.2**

Current assets are cash; cash equivalent; assets held for collection, sale, or consumption within the enterprise's normal operating cycle; or assets held for trading within the next 12 months. All other assets are noncurrent. [IAS 1.57]

Current liabilities are those to be settled within the enterprise's normal operating cycle or due within 12 months, or those held for trading, or those for which the entity does not have an unconditional right to defer payment beyond 12 months. Other liabilities are noncurrent. [IAS 1.60]

# Chief Assessor's report

The logo for the Accounting Association of Teachers (AAT) is displayed in white lowercase letters on a black rectangular background.

**AAT Accounting Qualification  
NVQ/SVQ in Accounting  
Level 4  
Drafting Financial Statements  
(Accounting Practice, Industry  
and Commerce) (DFS)  
2003 Standards**

**AAT Accounting Qualification  
Diploma pathway  
Diploma level  
Drafting Financial Statements  
(Accounting Practice, Industry  
and Commerce) (DFS)  
2003 Standards**

June 2009

## General comments

This was the seventh exam that assessed financial statements in accordance with international accounting standards (IAS) and it is very pleasing to note that, on the whole, candidates were very well prepared. It is a credit to their lecturers and to the publishers of textbooks and accounting manuals, as well as the efforts of students themselves, that the requirements of IAS were so well understood. Many candidates demonstrated high levels of competence across a range of tasks. Their performance was particularly strong in drafting financial statements in accordance with the requirements of IAS 1 and IAS 7. A grasp of the new terminology used in IAS caused little difficulty for the majority of candidates. Knowledge of the requirements of other accounting standards was more patchy and there is room for improvement here. Performance was stronger in computing and analysing ratios and in reporting conclusions than in some of the more recent exams.

## Section 1

### Task 1.1

This task required the drafting from scratch of journal entries from information provided in the question. Candidates coped reasonably well with this task.

Fewer candidates than usual achieved full marks in this task. This is because many of them were unable to deal with the accrued and prepaid expenses required. The accounts to be debited and credited caused difficulty for some candidates. In particular, determining the amount of both the accrual and the prepayment was problematic for some. The accounting for inventories, taxation and interest payable was, in general, accurately recorded in the journal.

### Task 1.2

The drafting of the company income statement and balance sheet was generally very well done. It was not uncommon for candidates to obtain full marks in this task. Surprisingly, a number of candidates who did not correctly adjust the journal entries in the previous task went on to make the appropriate entries in the financial statements. Candidates were given credit for carrying through incorrect entries to the financial statements, but a minority of candidates ignored their journal entries and made adjustments to the figures in the financial statements unsupported by journal entries. Sometimes the journal was correct but it was incorrectly implemented in the figures in the financial statements.

### Task 1.3

This task involved preparing a consolidated balance sheet using the pro-forma in accordance with IAS 1. This task was, in general, very well done. A number of candidates used different percentages to the

correct one, with a particular preference for 72 and 75%. It was pleasing to see that candidates, in the main, could cope with reporting not only individual balances but also the sub-totals of total assets, total liabilities and net current assets required in the pro-formas. A significant number obtained full marks in this task. As was the case in previous exams, many candidates clearly demonstrated a grasp of the appropriate technique of consolidation and of the mechanics of calculating goodwill and the minority interest. However, those without a clear grasp of the point of consolidation or of the appropriate technique experienced difficulties with the task. Some weak candidates attempted proportional consolidation of assets and liabilities rather than using the parent company approach. Even some of the better candidates had problems with particular balances. Some included balances between the parent and the subsidiary undertaking in the consolidated balance sheet. The investment in the subsidiary was sometimes included as well, even where the goodwill and the minority interest had been correctly calculated. Both of these demonstrate a lack of grasp of the underlying concept of consolidation. A minority of candidates omitted to include the revaluation in their calculations.

#### **Task 1.4**

This task required the candidate to define what is meant by impairment and what figures are required to calculate impairment in the financial statements. Finally, candidates were asked to consider what effect impairment would have on the financial statements. The student needed to demonstrate a knowledge and understanding of the requirements of IAS 36. Answers to this task were rather patchy. As task 1.4 followed the consolidation question, which included impairment of goodwill, many candidates answered the question from this perspective rather than thinking about non-current assets in general. Often they described the mechanical process of impairing the goodwill for which there were no marks. Encouragingly, a reasonable number of candidates did achieve good or even full marks in this task. Once again, this task is more evidence of 'standards overload', that is, the failure to adequately cover the assessable accounting standards.

#### **Task 1.5**

The drafting of a reconciliation of operating profit to net cash flows from operating activities was generally well done. The inclusion of income taxes and interest paid in the reconciliation did not provide any problem for most candidates. Some adopted the alternative method allowed by IAS 7 of including interest paid in the cash flow statement itself and were not penalised for this. Some candidates also included income taxes paid in the cash flow statement rather than in the computation of net cash from operating activities. IAS 7 makes it clear that this is not normally to be done unless there is clear evidence that the tax paid is attributable to investing or financing activities. Weaker candidates imported cash flows that are shown in the cash flow statement into the reconciliation. There was the occasional failure to use correct signs - addition or subtraction - for reconciling items.

#### **Task 1.6**

This task asked the student to prepare a cash flow statement using a pro-forma that follows the requirements of IAS 7. Most candidates did not have any problem in coping with the pro-forma required under IAS and many candidates obtained full marks on this task. Some candidates had problems in computing the capital expenditure during the year and the proceeds from the disposal of a fixed asset during the year, demonstrating the lack of a clear technique for calculating cash flows from these sources. Weaker candidates included balances from the financial statements rather than cash flows, which suggests that they did not quite grasp the point of the cash flow statement.

## **Section 2**

#### **Task 2.1**

This task asked the candidate to identify the formulas used to compute ratios and to compute and analyse the ratios concerned. Candidates were also asked to advise on whether or not to invest in the business. This task was not as well answered as similar tasks concerning ratios in some of the recent exams. The ratios were profitability ratios, the gearing ratio and the interest cover ratio. The candidates were able to provide the correct formulas and to use them correctly in calculating the ratio for gross profit, net profit and interest cover, but a significant number of them failed to calculate gearing correctly, many using variations on ROCE. A significant minority used the incorrect profit figure for the net profit ratio

using profit before tax or profit after tax rather than profit before finance costs (interest) and tax (that is, profit from operations).

Most candidates correctly commented on the relative performance as indicated by the change in the ratios, stating whether the ratio has increased or decreased, but the question clearly asks them to indicate whether the change in the ratio meant that the ratio had improved or deteriorated and thus indicate a knowledge of the significance of the ratio change. However, some candidates indicated this through further comments on the performance of the company. Many candidates tried to prevaricate when asked to give advice saying "more information" or "next year's results" would help them to reach a decision. Given that advice is asked for, this prevarication gives a certainty of no marks being gained!

### **Task 2.2**

This was a new task which had not previously been set. The candidates were asked to define current assets and current liabilities as per IAS 1. This was a surprise to many candidates who tried to use "old" answers to answer the question. The most common answer was to define assets and liabilities as has been asked in previous sittings. This attracted no marks. A significant minority did score well because they attempted to answer the question as asked rather than use the one they had mentally prepared in advance.

Overall the inclusion of two extra pages in the exam book at the back for any "overspill" for questions was successful in reducing extra pages asked for, but caused some problems because only two pages were allowed for task 2.1 and these proved to be insufficient.

# Support book Part 2

## Questions

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**Source:**

2003/2006 standards exam; December 2009 sitting

**Contents:**

Unit 11 Drafting Financial Statements (DFS)

AAT Level 4 Technician Pathway/Diploma Pathway (2003/2006 standards)

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Time allowed - 3 hours plus 15 minutes' reading time

This exam paper is in **TWO** sections.

You must show competence in BOTH sections. So, try to complete EVERY task in BOTH sections.

Section 1 contains 7 tasks and Section 2 contains 2 tasks.

Please use the answer booklet provided. You should include all your workings and essential calculations in your answers.

The answer booklet includes the following pro-formas:

- Journal entries
- Company income statement
- Company statement of financial position (balance sheet)
- Consolidated statement of financial position (balance sheet)
- Statement of cash flows (cash flow statement)

You should spend about 125 minutes on Section 1 and about 55 minutes on Section 2.

Against each task is the recommended time for that task, but please note that these times are guidelines only.

## Section 1

You should spend about 125 minutes on this section.

This section is in three parts.

### Part A

You should spend about 55 minutes on this part.

## Data

You have been asked to help prepare the financial statements of Martin Ltd for the year ended 31 October 2009. The company's trial balance as at 31 October 2009 is shown below.

### **Martin Ltd**

#### **Trial balance as at 31 October 2009**

	<b>Debit</b>	<b>Credit</b>
	<b>£000</b>	<b>£000</b>
Share capital		9,000
Trade and other payables		1,347
Property, plant and equipment – cost	39,880	
Property, plant and equipment – accumulated depreciation		21,780
Trade and other receivables	2,234	
Accruals		146
8% bank loan repayable 2016		14,000
Cash at bank	9,654	
Retained earnings		3,465
Interest	560	
Sales		46,777
Purchases	32,776	
Returns inwards	344	
Returns outwards		223
Distribution costs	2,450	
Administrative expenses	3,444	
Inventories as at 1 November 2008	4,466	
Final dividend for year ended 31 October 2008	540	
Interim dividend for year ended 31 October 2009	390	
	<hr/>	<hr/>
	96,738	96,738

## Additional data

- The share capital of the company consists of ordinary shares with a nominal value of £1.
- The inventories at the close of business on 31 October 2009 were valued at £4,987,000.
- The company paid £512,000 for one year's insurance on 1 February 2009, this is due to expire on 31 January 2010.
- The company hired vehicles to distribute finished goods locally. It was able to negotiate a deal with a local company for the period 1 September to 30 November 2009 at a cost of £99,000. This was invoiced on 6 November 2009 and paid, in full, on 1 December 2009. No entry has been made in the accounts.
- Interest on the bank loan for the last six months of the year has not been included in the accounts in the trial balance.
- The corporation tax charge for the year has been calculated as £980,000.
- All of the operations are continuing operations.

## Task 1.1 (10 minutes)

Using the pro-forma in your answer booklet, make the necessary journal entries as a result of the additional data given above.

## Task 1.2 (30 minutes)

- (d) Using the pro-forma in your answer booklet, draft the income statement for Martin Ltd for the year ended 31 October 2009.
- (e) Using the pro-forma in your answer booklet, draft the statement of financial position (balance sheet) for Martin Ltd as at 31 October 2009.

## Task 1.3 (15 minutes)

The objective of IAS 16 is to prescribe the accounting treatment for property, plant and equipment.

- (a) Identify the principal issues in the accounting treatment of property, plant and equipment.
- (b) When should items of property, plant and equipment be recognised as assets?
- (c) Which costs should be included on initial recognition of property, plant and equipment?

## **Part B**

You should spend about 45 minutes on this part.

### **Data**

- The Managing Director of Wells plc has asked you to prepare the statement of financial position (balance sheet) for the group.
- Wells plc has one subsidiary undertaking, Wilkie Ltd.
- The statements of financial position (balance sheets) of the two companies as at 31 October 2009 are set out below.

#### **Statements of financial position (balance sheets) as at 31 October 2009**

	<b>Wells plc</b>	<b>Wilkie Ltd</b>
	<b>£000</b>	<b>£000</b>
<b>Non-current assets</b>		
Property, plant and equipment	44,352	19,884
Investment in Wilkie Ltd	19,000	
	<hr/> 63,352	<hr/> 19,884
<b>Current assets</b>		
Inventories	14,670	3,432
Trade and other receivables	6,756	2,249
Cash and cash equivalents	1,245	342
	<hr/> 22,671	<hr/> 6,023
<b>Total assets</b>	<hr/> 86,023	<hr/> 25,907
<b>Current liabilities</b>		
Trade and other payables	(8,877)	(1,445)
Tax liabilities	(2,110)	(130)
	<hr/> (10,987)	<hr/> (1,575)
<b>Non-current liabilities</b>		
Long-term loans	(14,000)	(4,000)
<b>Total liabilities</b>	<hr/> (24,987)	<hr/> (5,575)
<b>Net assets</b>	<hr/> 61,036	<hr/> 20,332
<b>Equity</b>		
Share capital	28,000	8,000
Share premium	7,000	4,000
Retained earnings	26,036	8,332
<b>Total equity</b>	<hr/> 61,036	<hr/> 20,332

## Additional data

- The share capital of Wilkie Ltd consists of ordinary shares of £1 each. Ownership of these shares carries voting rights in Wilkie Ltd. There have been no changes to the balances of share capital and share premium during the year. No dividends were paid or proposed by Wilkie Ltd during the year.
- Wells plc acquired 6,000,000 shares in Wilkie Ltd on 1 November 2008.
- At 1 November 2008 the balance of retained earnings of Wilkie Ltd was £5,344,000.
- The fair value of the non-current assets of Wilkie Ltd at 1 November 2008 was £22,200,000. The book value of the non-current assets at 1 November 2008 was £16,200,000. The revaluation has not been recorded in the books of Wilkie Ltd (ignore any effect on the depreciation for the year).
- Included in trade and other receivables for Wells plc and in trade and other payables for Wilkie Ltd is an inter-company transaction for £1,250,000 that took place in early October 2009.
- The directors of Wells plc have concluded that goodwill has been impaired by 25% during the year.
- Wells plc has decided non-controlling interest (minority interest) will be valued at their proportionate share of net assets.

## Task 1.4 (35 minutes)

Using the pro-forma in your answer booklet, draft a consolidated statement of financial position (balance sheet) for Wells plc and its subsidiary undertaking as at 31 October 2009.

## Task 1.5 (10 minutes)

- (a) Briefly explain why confidentiality is necessary in the preparation of financial statements.
- (b) Give examples of ways in which confidentiality is assured in the preparation of financial statements.

## **Part C**

You should spend about 25 minutes on this part.

## **Data**

You have been asked to prepare the statement of cash flows (cash flow statement) for Adlington Ltd for the year ended 31 October 2009.

The most recent income statement and statements of financial position (balance sheets) of the company for the past two years are set out below.

### **Adlington Ltd Income statement for the year ended 31 October 2009**

	<b>£000</b>
<b>Continuing operations</b>	
Revenue	45,500
Cost of sales	(27,300)
Gross profit	<u>18,200</u>
Gain on disposal of property, plant and equipment	455
Distribution costs	(6,825)
Administrative expenses	(5,005)
Profit from operations	<u>6,825</u>
Finance costs	(595)
Profit before tax	<u>6,230</u>
Tax	<u>(1,757)</u>
<b>Profit for the period from continuing operations attributable to equity holders</b>	<u><u>4,473</u></u>

**Adlington Ltd**  
**Statements of financial position (balance sheets) as at 31 October**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Non-current assets</b>		
Property, plant and equipment	31,989	22,246
<b>Current assets</b>		
Inventories	6,552	4,914
Trade and other receivables	4,550	4,641
Cash and cash equivalents	450	0
	<u>11,552</u>	<u>9,555</u>
<b>Total assets</b>	<u>43,541</u>	<u>31,801</u>
<b>Current liabilities</b>		
Trade and other payables	(3,822)	(4,368)
Tax liability	(1,757)	(658)
Bank overdraft	0	(1,286)
	<u>(5,579)</u>	<u>(6,312)</u>
<b>Non-current liabilities</b>		
Bank loans	(8,500)	(3,500)
<b>Total liabilities</b>	<u>(14,079)</u>	<u>(9,812)</u>
<b>Net assets</b>	<u>29,462</u>	<u>21,989</u>
<b>Equity</b>		
Share capital	10,000	8,000
Share premium	4,000	3,000
Retained earnings	15,462	10,989
<b>Total equity</b>	<u>29,462</u>	<u>21,989</u>

### **Additional data**

- The total depreciation charged for the year was £4,398,000.
- Property, plant and equipment costing £568,000 with accumulated depreciation of £226,000 was sold in the year.
- All sales and purchases were on credit. Other expenses were paid for in cash.

### **Task 1.6 (10 minutes)**

Prepare a reconciliation of profit from operations to net cash from operating activities for Adlington Ltd for the year ended 31 October 2009.

### **Task 1.7 (15 minutes)**

Using the pro-forma in your answer booklet, prepare the statement of cash flows (cash flow statement) for Adlington Ltd for the year ended 31 October 2009.

## Section 2

You should spend about 55 minutes on this section.

### Data

Louise Michaels is a shareholder in Hoy Ltd. She wishes to assess the effectiveness of the management in using its resources. She has asked you to assist her by analysing the financial statements of the company, which are set out below.

#### Hoy Ltd

#### Income statements for the year ended 31 October

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Continuing operations</b>		
Revenue	27,800	29,600
Cost of sales	<u>(14,178)</u>	<u>(16,280)</u>
Gross profit	13,622	13,320
Distribution costs	(6,950)	(5,920)
Administrative expenses	<u>(3,892)</u>	<u>(3,848)</u>
Profit from operations	2,780	3,552
Finance costs	<u>(840)</u>	<u>(560)</u>
Profit before tax	1,940	2,992
Tax	<u>(894)</u>	<u>(1,233)</u>
<b>Profit for the period from continuing operations attributable to equity holders</b>	<u>1,046</u>	<u>1,759</u>

**Hoy Ltd****Statements of financial position (balance sheets) as at 31 October**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
<b>Non-current assets</b>		
Property, plant and equipment	23,016	16,422
<b>Current assets</b>		
Inventories	3,261	2,605
Trade and other receivables	1,946	1,776
Cash and cash equivalents	0	875
	<u>5,207</u>	<u>5,256</u>
<b>Total assets</b>	<u>28,223</u>	<u>21,678</u>
<b>Current liabilities</b>		
Trade payables	(1,276)	(1,954)
Tax liabilities	(894)	(1,233)
Bank overdraft	(516)	0
	<u>(2,686)</u>	<u>(3,187)</u>
<b>Non-current liabilities</b>		
Bank loans	(12,000)	(8,000)
<b>Total liabilities</b>	<u>(14,686)</u>	<u>(11,187)</u>
<b>Net assets</b>	<u>13,537</u>	<u>10,491</u>
<b>Equity</b>		
Share capital	8,500	6,500
Retained earnings	5,037	3,991
<b>Total equity</b>	<u>13,537</u>	<u>10,491</u>

**Additional data**

- Louise has obtained a report from the internet that gives the industry ratio averages for the sector in which Hoy Ltd operates.
- She is happy with the level of the gross and net profit ratios, as these are in line with the industry averages, and feels that she understands them, but is not sure how to calculate the other ratios and what their results mean.
- She has emailed you and asked you to explain some of the points she is unsure about. A copy of the email is shown on page 13.

**From:** lm1000@warmmail.com  
**To:** aatstudent@dfsexam  
**Date:** 27 November 2009  
**Subject:** Accounting ratios

Hi

I found these sector ratios on the internet. This is the same sector as the company I have invested in. The profit figures are straightforward but I'm a bit lost about the rest. Can you help?

Many thanks  
Louise

**Industry averages for 2009**

Gross profit ratio	49.00%
Net profit ratio	10.00%
Gearing	65.00% (2008: 76.26% for Hoy Ltd)
Interest cover	6 times
Current ratio	1.6:1
Acid test	0.9:1
Trade receivable days	33 days
Trade payable days	36 days

**Task 2.1 (40 minutes)**

Prepare an email reply for Louise that includes:

- The formulas that are used to calculate the other ratios (that is, not the gross and net profit ratios) shown above
- A calculation of those ratios for 2009 only for Hoy Ltd
- Comments on whether the company has performed better or worse, in respect of the calculated ratios only, as compared to the industry averages that Louise has found
- Advice, with reasons, to Louise as to whether or not to continue with her investment.

**Task 2.2 (15 minutes)**

- List the elements that appear in financial statements according to the Framework for the Preparation and Presentation of Financial Statements.
- Define the elements that appear in the statement of financial position (balance sheet) of a company in accordance with the definitions in the Framework for the Preparation and Presentation of Financial Statements.

# Model Answers

**Note:**

The model answers may, in parts, be longer than would be expected of candidates in the exam. The fuller version is given for teaching purposes.

## Section 1

### Part A

#### Task 1.1

Journal entries	Dr	Cr
	£000	£000
Inventory (SFP/(BS))	4,987	
Inventory (IS)		4,987
Prepayment	128	
Administrative expenses		128
Distribution costs	66	
Accruals		66
Interest	560	
Interest payable		560
Taxation	980	
Taxation payable		980

W1	Prepayment $3/12 \times 512,000 = 128,000$
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W2	Accrual $2/3 \times 99,000 = 66,000$
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W3	Interest $14,000,000 \times 8\% \times 0.5 = 560,000$
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## Task 1.2 (a)

### Martin Ltd Income statement for the year ended 31 October 2009

<b>Continuing operations</b>	<b>£000</b>
Revenue	46,433
Cost of sales	<u>(32,032)</u>
Gross profit	14,401
Distribution costs	(2,516)
Administrative expenses	<u>(3,316)</u>
Profit from operations	8,569
Finance costs	<u>(1,120)</u>
Profit before tax	7,449
Tax	<u>(980)</u>
<b>Profit for the period from continuing operations attributable to equity holders</b>	<u>6,469</u>

W 1	Sales	46,777
	Less returns in	<u>(344)</u>
		46,433
W 2	Opening inventories	4,466
	Purchases	32,776
	Less returns out	<u>(223)</u>
		32,553
		37,019
	Less closing inventories	<u>(4,987)</u>
		32,032
W 3	Distribution costs	2,450
	Accrual	66
		<u>2,516</u>
W 4	Administrative expenses	3,444
	Prepayment	<u>(128)</u>
		3,316
W 5	Finance costs	560
	Accrual	560
		<u>1,120</u>

## Task 1.2 (b)

### Statement of financial position(balance sheet) as at 31 October 2009

	<b>£000</b>
<b>Non-current assets</b>	
Property, plant and equipment	18,100
<b>Current assets</b>	
Inventories	4,987
Trade and other receivables	2,362
Cash and cash equivalents	9,654
	17,003
<b>Total assets</b>	35,103
<b>Current liabilities</b>	
Trade and other payables	(2,119)
Tax payable	(980)
	(3,099)
<b>Net current assets</b>	13,904
<b>Non-current liabilities</b>	
Bank loans	(14,000)
<b>Total liabilities</b>	(17,099)
<b>Net assets</b>	18,004
<b>Equity</b>	
Share capital	9,000
Retained earnings	9,004
<b>Total equity</b>	18,004

W 1	Property, plant and equipment – cost	39,880
	Property, plant and equipment – acc depreciation	(21,780)
		18,100
W 2	Trade and other receivables	2,234
	Prepayment	128
		2,362
W 3	Trade and other payables	1,347
	Accruals	146
	Interest	560
	Distribution costs	66
		2,119
W 4	Retained earnings	3,465
	From income statement	6,469
	Final dividend for year ended 31 October 2008	(540)
	Interim dividend for year ended 31 October 2009	(390)
		9,004

### Task 1.3

- (a) The principal issues are the timing of recognition of assets, the determination of their carrying amounts, and the depreciation charges to be recognised in relation to them.
- (b) Items of property, plant, and equipment should be recognised as assets when it is probable that: [IAS 16.7]
- the future economic benefits associated with the asset will flow to the enterprise; and
  - the cost of the asset can be measured reliably.
- (c) This recognition principle is applied to all property, plant, and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

## **Part B**

### **Task 1.4**

#### **Wells plc: Consolidated statement of financial position (balance sheet) as at 31 October 2009**

		<b>£000</b>
<b>Non-current assets</b>		
Intangible - Goodwill	W 1	1,119
Property, plant and equipment	W 2	70,236
		<u>71,355</u>
<b>Current assets</b>		
Inventories		18,102
Trade and other receivables	W 3	7,755
Cash and cash equivalents		1,587
		<u>27,444</u>
<b>Total assets</b>		<u>98,799</u>
<b>Current liabilities</b>		
Trade and other payables	W 4	(9,072)
Tax liabilities		(2,240)
		<u>(11,312)</u>
<b>Net current assets</b>		<u>16,132</u>
<b>Non-current liabilities</b>		
Long-term loans		(18,000)
<b>Total liabilities</b>		<u>(29,312)</u>
<b>Net assets</b>		<u>69,487</u>
<b>Equity</b>		
Share capital		28,000
Share premium		7,000
Retained earnings	W 5	27,904
<b>Equity attributable to equity holders of the parent</b>		<u>62,904</u>
Non-controlling (minority) interest	W 6	6,583
<b>Total equity</b>		<u>69,487</u>

W1 Goodwill			W5 Retained earnings	W6 Non-controlling interest (Minority interest)
		<b>Attributable to holding company</b>		
Share capital	8,000	6,000		2,000
Share premium	4,000	3,000		1,000
Revaluation	6,000	4,500		1,500
Post acquisition	2,988		2,241	747
Pre acquisition	5,344	4,008		1,336
	<u>26,332</u>	<u>17,508</u>	<u>2,241</u>	<u>6,583</u>
Consideration		19,000		
Goodwill		<u>1,492</u>		
Less impairment		(373)	(373)	
		<u>1,119</u>		
Holding company - Retained earnings			26,036	
			<u>27,904</u>	

W2 Property, plant and equipment	
Wells plc	44,352
Wilkie Ltd	19,884
Revaluation	6,000
	<u>70,236</u>

W3 Trade and other receivables	
Wells plc	6,756
Wilkie Ltd	2,249
Inter-company debt	(1,250)
	<u>7,755</u>

W4 Trade and other payables	
Wells plc	(8,877)
Wilkie Ltd	(1,445)
Inter-company debt	1,250
	<u>(9,072)</u>

## **Task 1.5**

### **(a) Why is confidentiality necessary?**

- Obligation to keep client's information secret/private/secure/confidential.
- To prevent information from falling into the hands of those who do not have a right to such information such as competitors, investors or friends.

### **(b) Examples of how confidentiality is assured:**

- Not disclosing information to those who do not have a right to access such information
- Not discussing client affairs with those outside the company who do not have a right to such information
- Keeping information secure
- Being aware of who is able to receive the appropriate level of secure information

## **Part C**

### **Task 1.6**

#### **Adlington Ltd**

#### **Reconciliation of profit from operations to net cash from operating activities for year ended 31 October 2009**

	<b>£ 000</b>
Profit from operations	6,825
Adjustments for depreciation	4,398
Gain on disposal of property, plant and equipment	<u>(455)</u>
Operating cash flows before movements in working capital	10,768
Decrease/(Increase) in inventories	(1,638)
Decrease/(Increase) in trade receivables	91
(Decrease)/Increase in trade payables	<u>(546)</u>
Cash generated by operations	8,675
Tax paid	(658)
Interest paid	<u>(595)</u>
<b>Net cash from operating activities</b>	<u><b>7,422</b></u>

## Task 1.7

### Statement of cash flows for year ended 31 October 2009

		<b>£000</b>
<b>Net cash from operating activities</b>		7,422
<b>Investing activities</b>		
Proceeds on disposal of property, plant and equipment	W 1	797
Purchases of property, plant and equipment	W 2	<u>(14,483)</u>
Net cash used in investing activities		(13,686)
<b>Financing activities</b>		
New bank loans raised		5,000
Proceeds of share issue		<u>3,000</u>
Net cash from financing activities		8,000
<b>Net increase/(decrease) in cash and cash equivalents</b>		1,736
<b>Cash and cash equivalents at beginning of year</b>		<u>(1,286)</u>
<b>Cash and cash equivalents at end of year</b>		<u>450</u>

W1	
N B V	342
Add Profit	455
	<u>797</u>

W2	
PPE at start	22,246
Less depreciation	(4,398)
Less book value of sold assets	(342)
Add Purchases	14,483
PPE at end	<u>31,989</u>

## Section 2

### Task 2.1

**From:** aatstudent@dfsexam  
**To:** lm1000@warmmail.com  
**Date:** 2 December 2009  
**Subject:** Re: Accounting ratios

As requested I have looked into the financial situation of Lewis Ltd. The ratio calculations are shown in the table below followed by a summary of performance against the industry averages. Finally I have given my advice with reasons as to what you should do with your investment.

<b>Gearing</b> <u>Debt</u> Equity	$\frac{12,000}{13,537} = 88.65\%$
<b>Interest cover</b> <u>Profit from operations</u> Interest paid	$\frac{2,780}{840} = 3.3 \text{ times}$
<b>Current ratio</b> <u>Current assets</u> Current liabilities	$\frac{5,207}{2,686} = 1.94 :1$
<b>Acid test</b> <u>Current assets - Inventory</u> Current liabilities	$\frac{1,946}{2,686} = 0.72 :1$
<b>Trade receivable days</b> <u>Trade receivable x 365</u> Sales	$365 \times \frac{1,946}{27,800} = 25.6 \text{ days}$
<b>Trade payable days</b> <u>Trade payable x 365</u> Cost of sales	$365 \times \frac{1,276}{14,178} = 32.9 \text{ days}$

#### (c) Comment on the relative performance

	Industry averages	Hoy Ltd
Gearing	65.00%	88.65%
Interest cover	6 times	3.3
Current ratio	1.6:1	1.94
Acid test	0.9:1	0.72

Trade receivable days	33 days	25.6
Trade payable days	36 days	32.9

The current ratio and trade receivable days are better than the industry average but the other four ratios all show worse results than the industry average. The company has a higher gearing ratio and lower interest cover than the average, which may give problems when applying for loans, and the acid test shows a lack of liquid assets whilst at the same time paying their creditors quicker than the industry average.

**(d) A conclusion advising Louise whether or not to continue with her investment**

I would advise you not to continue with the investment since only the current ratio and trade receivable days are better than the industry averages whilst liquidity is worse and any investment would be risky considering the gearing ratio and the fact that Hoy Ltd is unable to cover debts without inventory.

**Task 2.2**

**(a) The elements that appear in financial statements according to the Framework for the Preparation and Presentation of Financial Statements are:**

- Income
- Expenses
- Assets
- Liabilities
- Equity

**(b) The elements that appear in the balance sheet of a company in accordance with the definitions in the Framework for the Preparation and Presentation of Financial Statements are:**

- (i)** “An asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.”
- (ii)** “A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in the outflow from the entity of resources embodying economic benefits.”
- (iii)** “Equity is the residual interest in the assets of the entity after deducting all its liabilities.”

## Technician/Level 4 Diploma (QCF) Drafting financial statements (DFS)

December 2009

### General comments

On the whole, candidates were very well prepared for this exam. It is a credit to their lecturers and to the publishers of textbooks and accounting manuals, as well as the efforts of students themselves, that the requirements of IAS were so well understood. Many candidates demonstrated high levels of competence across a range of tasks. Their performance was particularly strong in drafting financial statements in accordance with the requirements of IAS 1 and IAS 7. A grasp of the terminology used in IAS caused little difficulty for the majority of candidates. Knowledge of the requirements of other accounting standards was more patchy and there is room for improvement here. Performance was stronger in computing and analysing ratios and in reporting conclusions than in some of the more recent exams.

Overall the inclusion of two extra pages in the exam book at the back for any 'overspill' for questions was successful in reducing extra pages asked for. However a number of centres were still handing out extra pages and treasury tags, while the extra pages in the booklet remained untouched.

### Section 1

#### Task 1.1

This task required the drafting from scratch of journal entries from information provided in the question. Candidates coped reasonably well with this task.

Fewer candidates than usual were able to achieve full marks in this task. This is because many of them were unable to deal with the accrued and prepaid expenses required. The accounts to be debited and credited caused difficulty for some candidates. In particular, determining the amount of both the accrual and the prepayment was problematic for some. The accounting for inventories, taxation and interest payable was, in general, accurately recorded in the journal.

#### Task 1.2

The drafting of the company income statement and balance sheet was generally very well done. It was not uncommon for candidates to obtain full marks in this task. Surprisingly, a number of candidates who did not correctly adjust the journal entries in the previous task went on to make the appropriate entries in the financial statements. Candidates were given credit for carrying through incorrect entries to the financial statements, but a minority of candidates ignored their journal entries and made adjustments to the figures in the financial statements unsupported by journal entries. Sometimes the journal was correct but it was incorrectly implemented in the figures in the financial statements.

#### Task 1.3

This task required the candidate to identify the principal issues in the accounting treatment of property, plant and equipment, to decide when items of property, plant and equipment should be recognised as assets and finally to state which costs should be included on initial recognition of property, plant and equipment. The student needed to demonstrate a knowledge and understanding of the requirements of IAS 16. Answers to

this task were sometimes rather patchy. Whilst the question was clearly structured into three parts, candidates appeared to be responding with a general discussion on the accounting treatment for property, plant and equipment. The difficulty here was a lack of detailed knowledge of IAS16. Encouragingly, a reasonable number of candidates did achieve good or even full marks in this task. Once again, this task is more evidence of 'standards overload', that is, the failure to adequately cover the assessable accounting standards.

#### **Task 1.4**

This task involved preparing a consolidated balance sheet using the pro-forma in accordance with IAS 1. In general, it was very well done. A number of candidates used different percentages to the correct one, with a particular preference for 72 and 80%. It was pleasing to see that candidates, in the main, could cope with reporting not only individual balances but also the sub-totals of total assets, total liabilities and net current assets required in the pro-formas. A significant number obtained full marks in this task. As was the case in previous exams, many candidates clearly demonstrated a grasp of the appropriate technique of consolidation and of the mechanics of calculating goodwill and the minority interest. However, those without a clear grasp of the point of consolidation or of the appropriate technique experienced difficulties with the task. Some weak candidates attempted proportional consolidation of assets and liabilities rather than using the parent company approach. Even some of the better candidates had problems with particular balances. Some included balances between the parent and the subsidiary undertaking in the consolidated balance sheet. The investment in the subsidiary was sometimes included as well, even where the goodwill and the minority interest had been correctly calculated. Both of these demonstrate a lack of grasp of the underlying concept of consolidation. A minority of candidates omitted to include the revaluation in their calculations.

#### **Task 1.5**

This task required the candidate to explain why confidentiality is necessary in the preparation of financial statements and to give ways in which confidentiality is assured in their preparation. Answers to this task were rather patchy. In general many candidates were aware that accountants had an obligation to keep their work confidential and that security of some kind (for example, paper records locked away, computer passwords) was required for the statements. Many candidates merely repeated the same information in (b) as they had written in (a). As usual, there is some evidence of 'standards overload'.

#### **Task 1.6**

The drafting of a reconciliation of operating profit to net cash flows from operating activities was generally well done. The inclusion of income taxes and interest paid in the reconciliation did not provide any problem for most candidates. Some adopted the alternative method allowed by IAS 7 of including interest paid in the cash flow statement itself and were not penalised for this. Some candidates also included income taxes paid in the cash flow statement rather than in the computation of net cash from operating activities. IAS 7 makes it clear that this is not normally to be done unless there is clear evidence that the tax paid is attributable to investing or financing activities. Weaker candidates imported cash flows that are shown in the cash flow statement into the reconciliation. There was the occasional failure to use correct signs - addition or subtraction - for reconciling items.

#### **Task 1.7**

This task asked the student to prepare a cash flow statement using a pro-forma provided that follows the requirements of IAS 7. Most candidates did not have any problem in coping with the pro-forma required under IAS and many candidates obtained full marks on this task. Some candidates had problems in computing the capital expenditure during the year and the proceeds from the disposal of a fixed asset during the year, demonstrating the lack of a clear technique for calculating cash flows from these sources. Weaker candidates included balances from the financial statements rather than cash flows, which suggests that they did not quite grasp the point of the cash flow statement.

## **Section 2**

#### **Task 2.1**

This task asked the candidate to identify the formulas used to compute ratios and to compute and analyse the ratios concerned. Candidates were also asked to advise on whether or not to invest in the business. This

task was slightly different to recent sittings in that candidates were asked to evaluate performance against the industry averages provided.

Those candidates who followed the precise requirements of the question produced excellent answers; however problems arose where candidates failed to follow these. Specifically, many forgot that they were required to assess the effectiveness of the management in using resources as this was not reiterated in the requirements section. Similarly, the need for an email styled response was overlooked. In part (a) several wasted time calculating gross profit and net profit (which they were specifically told were not needed) and a significant proportion ignored the obvious clue to which form of the gearing ratio to use. In part (b) a number of candidates calculated ratios for both years in line with the requirements of past papers. In part (c) weaker candidates were reluctant to say if the performance was better or worse than average and preferred to discuss the meaning of the ratios in more general terms.

Most candidates correctly commented on the relative performance as indicated by the comparison with the industry average as to whether the ratio has increased or decreased, but the question clearly asks them to indicate whether the change in the ratio meant that the ratio was better or worse and thus indicate a knowledge of the significance of the ratio change. However, some candidates indicated this through further comments on the performance of the company. Many candidates tried to prevaricate when asked to give advice saying "more information" or "next year's results" would help them to reach a decision. Given that advice is asked for, this sort of prevarication gives a certainty of no marks being gained!

### **Task 2.2**

This task asked for the elements that appear in financial statements and for a definition of the elements in the balance sheet. This was generally well done.

The elements that appear in financial statements was poorly done by some candidates who listed the titles of all different kinds of financial statement or listed every subsection, which could have been achieved by copying all the headings from the proformas in the answer booklet.

The balance sheet elements were accurately set out and it was pleasing to see that a significant number of candidates were able to give a reasonably accurate definition of the elements in accordance with the IASB's conceptual framework, the *Framework for the Preparation and Presentation of Financial Statements*. Some weaker candidates merely talked about assets as something owned by the entity or liabilities as something owed by the entity. These are only partial explanations of the elements and it is best practice to use the definitions set out in the IASB's conceptual framework. It is not necessary to rote learn these definitions but the essence of the definitions should be grasped.