



**THE LAW SOCIETY OF SCOTLAND
EXAMINATIONS**

**ACCOUNTING
PAPER TWO**

Tuesday 13 August 2019

**1330 – 1630
(Three Hours)**

Candidates should

**Answer BOTH Questions in Section A
And
Three of the Four Questions in Section B**

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SECTION A

Question 1

Jeff Tracey died on 1 May 2018 domiciled in Scotland. By his Trust Disposition and Settlement he bequeathed his estate to his sister, Penelope, in liferent and to his nephew, Scott, in fee. The Apportionment Act 1870 **was** excluded.

The estate as given up in the inventory was as follows:

| | £ |
|---|----------------|
| £180,000 8% (gross) Debenture Stock, Virgil Ltd | 150,000 |
| 150,000 3% Preference Shares, Alan Ltd | 90,000 |
| 60,000 Ordinary Shares of £1 each, Gordon Ltd | 120,000 |
| Cash in Bank | <u>30,000</u> |
| | <u>390,000</u> |

The following is the Factor's Cash Account for the year to 30 April 2019:

Receipts

2018

| | | | |
|-----|----|---|--------|
| Jul | 1 | Uplifted Cash in Bank | 30,000 |
| Aug | 31 | Half-year's interest to date on £180,000 8% (gross) Debenture Stock, Virgil Ltd | 7,200 |
| Sep | 30 | Final Dividend of 10p for year to 30 June 2018 on 60,000 Ordinary Shares of £1, Gordon Ltd (An interim dividend of 6p was paid on 15 March 2018) | 6,000 |
| Nov | 30 | Dividend for year to date on 150,000 3% Preference Shares, Alan Ltd | 4,500 |
| Dec | 15 | Proceeds of sale of 150,000 3% Preference Shares, Alan Ltd | 81,000 |

2019

| | | | |
|-----|----|--|----------------|
| Feb | 28 | Half-year's interest to date on £180,000 8% (gross) Debenture Stock, Virgil Ltd | 7,200 |
| Mar | 15 | Interim Dividend of 10p for year to 30 June 2019 on 60,000 Ordinary Shares of £1, Gordon Ltd | 6,000 |
| Apr | 30 | Dividend of 12p for year to 31 January 2019 on 90,000 Ordinary Shares of £1, John Ltd | <u>10,800</u> |
| | | | <u>152,700</u> |

Payments

2018

| | | | |
|-----|----|--|---------|
| Aug | 31 | Paid Debts due by deceased | 6,000 |
| Oct | 31 | Paid Liferentrix to account of Revenue | 7,500 |
| Dec | 15 | Purchase of 90,000 Ordinary Shares of £1, John Ltd | 108,000 |

2019

| | | | |
|-----|----|--|----------------|
| Apr | 30 | Paid Liferentrix to account of Revenue | 7,500 |
| Apr | 30 | Paid Factor's business account, outlays and commission | |
| | | Capital | 6,000 |
| | | Revenue | <u>1,500</u> |
| Apr | 30 | Balance in hand | 16,200 |
| | | | ————— |
| | | | <u>152,700</u> |

Required

Prepare a Capital and Revenue Account of the intrusions of the Trustees for the year to 30 April 2019. (You should ignore the questions of Capital Gains Tax and Income Tax).

(15 marks)

QUESTION 2

One of your clients is considering making a bid for either one of two companies, Burns Limited or Scott Limited. Both companies trade as wholesale book sellers. Summaries of the financial statements for the year ended 31 January 2019 for both Burns Limited and Scott Limited are attached:

Required

- (a) Calculate for each company a total of **eight** ratios which will comprehensively measure the following areas:
- (1) Profitability (Gross Profit / Operating (Net) Profit / Return on Capital Employed)
 - (2) Liquidity (Current / Acid-Test)
 - (3) Efficiency of working capital management (Stock turnover / Debtors turnover / Creditors turnover)

Show the definition of each ratio used.

(16 marks)

- (b) Based on the above ratios, comment on the differences in the businesses' profitability, liquidity and working capital management positions and indicate how they might be favourably improved as appropriate after acquisition.

(24 marks)

- (c) Calculate the gearing ratio (where applicable) for each company from both a Balance Sheet and a Profit and Loss Account perspective and state the advantages and disadvantages of gearing in general.

(4 marks)

- (d) Based on the above, advise your client on which company is the better investment. Your answer could include comments on what further information you would require to support the advice given.

(5 marks)

(Question total 49 marks)

| | Burns | Scott |
|---|----------------------|----------------------|
| Profit and loss accounts for the year ended 31 January | 2019 £000 | 2019 £000 |
| Turnover | 6,000 | 9,000 |
| Cost of sales | <u>4,500</u> | <u>7,200</u> |
| Gross profit | 1,500 | 1,800 |
| Selling and distribution | 300 | 225 |
| Administration | <u>435</u> | <u>375</u> |
| Operating profit before interest | 765 | 1,200 |
| Interest payable | <u>15</u> | <u>600</u> |
| Profit before taxation | 750 | 600 |
| Taxation | <u>180</u> | <u>135</u> |
| Profit after taxation | <u>570</u> | <u>465</u> |

Balance sheets at 31 January

Fixed assets

| | | | |
|------------------------|------------|--------------|-------|
| Land and building | 1,800 | 7,500 | |
| Equipment and vehicles | <u>900</u> | <u>1,500</u> | |
| | 2,700 | | 9,000 |

Current assets

| | | |
|----------------|--------------|--------------|
| Stock | 600 | 1,200 |
| Trade debtors | 1,200 | 1,350 |
| Sundry debtors | 225 | 120 |
| Cash | <u>-</u> | <u>150</u> |
| | <u>2,025</u> | <u>2,820</u> |

Creditors due within one year:

| | | |
|-----------------|--------------|--------------|
| Trade creditors | 1,200 | 1,200 |
| Accruals | 120 | 150 |
| Taxation | 180 | 135 |
| Bank overdraft | <u>300</u> | <u>-</u> |
| | <u>1,800</u> | <u>1,485</u> |

Net current assets

225 1,335

Creditors due after one year:

| | | |
|----------------------------------|--------------|----------------|
| Bank loan (10%) – repayable 2021 | <u>-</u> | <u>(6,000)</u> |
| | <u>2,925</u> | <u>4,335</u> |

Represented by: -

| | | |
|----------------------------|--------------|--------------|
| Ordinary shares of £1 each | 1,500 | 2,400 |
| Share premium | - | 750 |
| Profit and loss account | <u>1,425</u> | <u>1,185</u> |
| | <u>2,925</u> | <u>4,335</u> |

END OF SECTION A

SECTION B

Answer any **three** of the **four** Questions in **Section B**.

Question 4

Financial accounts have always been a useful starting point for assessing a company's financial performance and standing.

Required

Identify four separate user groups with an interest in limited company accounts and which particular aspects are relevant to them.

(12 marks)

Question 5

Risk and reward are inextricably linked in any consideration of business finance.

Required

- i. Compare and contrast the various rights held by Shareholders and Debenture holders in a limited company.
- ii. Analyse how these rights are reflected in terms of their income and capital receivable.
- iii. State how each party's interest is reflected in a company's financial statements.

(12 marks)

Question 6

Selecting the appropriate source(s) of short and medium term finance is an important decision for many small businesses.

Required

What are the principal sources of short and medium term finance available to a small family-owned business? State the advantages and disadvantages of each source.

(12 marks)

Question 7

Ratio analysis is only a useful tool if the information produced is taken in a wider context.

Required

Explain how ratio analysis can be a useful tool in interpreting accounting information, giving examples of the types of ratios that can be calculated, and of the additional information it may be necessary to take into account in order to arrive at meaningful conclusions.

Conclude by stating the limitations of ratio analysis.

(12 marks)

END OF SECTION B

END OF QUESTION PAPER