



**THE LAW SOCIETY OF SCOTLAND  
EXAMINATIONS**

**ACCOUNTING  
PAPER TWO**

**Tuesday 7 August 2018**

**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**

Answer **both** questions in Section A

**QUESTION 1**

Robert Bruce died in 2015 leaving his estate in life rent to his wife Isabella and in fee for his two children. At 31 December 2016 the estate consisted of:

	£	
Investments	1,050,000	
Deposit Account	75,000	
Cash in Hands of Agents	3,600	
	_____	
		1,128,600
Less: Provision for Agents' Fees for year to 31 December 2016		9,000
		_____
		1,119,600
Less: Due to Revenue at 31 December 2016		12,000
		_____
		<u>1,107,600</u>

The Agents' cash transactions for the year to 31 December 2017 were summarised as follows:

	<u>Payments</u>	<u>Receipts</u>
	£	£
Investment Income Received		114,000
Paid to Liferenter	117,000	
Paid Agents' Fees for the Year to 31 December 2016	9,000	
Deposit Account at 31 December 2016 closed (inclusive of interest)		81,000
Sale of Investments		474,000
Purchase of Investments	541,500	
	_____	_____
	667,500	669,000
	=====	=====

The investments sold had a value of £397,500 in the opening estate.

**Required / ...**

*[Please turn over]*

**Required:**

From the foregoing information prepare a Capital and Revenue Account on behalf of the Trustees for the year to 31 December 2017. Provide for the Agents' fees of £10,500, chargeable £4,500 to Capital and £6,000 to Revenue.

**Notes**

- (a) The Apportionment Act 1870 was excluded by the Trust Deed.
- (b) Ignore the questions of any Capital Gains Tax and Income Tax arising on the Trust.

(15 marks)

*[Please turn over]*

## QUESTION 2

A corporate client has approached you as their solicitor for guidance regarding the acquisition of Libri Ltd, a wholesale book supplier. The latest summarised financial statements for Libri Ltd are attached.

The trade association to which Libri Ltd belongs has recently produced the following figures, based on averages calculated from the data submitted by members of the association:

1.	Gross profit margin	15%
2.	Net profit margin / operating profit margin	11%
3.	Return on shareholders' capital employed (ROSF)	12%
4.	Current assets to current liabilities	3.6:1
5.	Stock weeks (stock turnover ratio)	9 weeks
6.	Debtors weeks (debtors turnover ratio)	8 weeks
7.	Creditors weeks (creditors turnover ratio)	7 weeks

### **Required:**

- (a) Calculate the same figures in respect of Libri Ltd for the ratios numbered 1 to 7 above.

Show the definition of each ratio used.

Calculations should be made to similar precision as the trade association.

(7 marks)

- (b) Suggest what the most significant differences are between the ratios for Libri Ltd and those produced by the trade association.

(7 marks)

- (c) Comment on the profitability, liquidity and efficiency of Libri Ltd and suggest ways in which these areas could be improved following acquisition.

(21 marks)

- (d) Calculate Libri Ltd's gearing ratio in two separate ways and briefly discuss the advantages and disadvantages of debt finance to a company.

(8 marks)

- (e) Could you recommend Libri Ltd as a potential acquisition to your client? What limitations might your current analysis have and what further information would you require to support your advice given?

(6 marks)

(Question Total 49 marks)

**Libri Ltd**  
**Profit and Loss account for the year ended 30 April 2018**

	<b>£000</b>
<b>Turnover</b>	1,590
Cost of sales	<u>1,245</u>
<b>Gross profit</b>	345
Selling and distribution expenses	156
Administration expenses	<u>69</u>
<b>Operating profit</b>	120
Debenture interest	<u>36</u>
<b>Profit on ordinary activities before taxation</b>	84
Taxation	<u>24</u>
<b>Profit on ordinary activities after taxation</b>	<u>60</u>
Dividend paid	<u>39</u>

**Libri Ltd**  
**Balance sheet as at 30 April 2018**

	<b>£000</b>	<b>£000</b>
<b>Fixed assets</b>		1,230
<b>Current assets</b>		
Stock	660	
Trade debtors	315	
Bank	<u>312</u>	
	<u>1,287</u>	
<b>Creditors: due within one year</b>		
Trade creditors	150	
Accrued expenses	36	
Taxation	<u>24</u>	
	<u>210</u>	
<b>Net current assets</b>		<u>1,077</u>
<b>Total assets less current liabilities</b>		2,307
<b>Creditors: due after one year</b>		
Debentures		<u>450</u>
<b>Net assets</b>		<u>1,857</u>
Share capital (Ordinary shares of £1)		780
Retained profits		<u>1,077</u>
<b>Shareholders' funds</b>		<u>1,857</u>

**END OF SECTION A**

## **SECTION B**

Answer any **three** questions of the **four** in Section B

### **QUESTION 3**

You have been given the following information relating to Ossian plc for the year to 31 May 2018:

- (a) The company has an issued and fully paid share capital of 500,000 ordinary shares of £1 each. There are no preference shares.
- (b) The market price of each share at 31 May 2018 was £3.50.
- (c) The net profit after taxation for the year to 31 May 2018 was £70,000.
- (d) The directors of Ossian plc are proposing a dividend of 7p per share for the year to 31 May 2018.

#### **Required:**

Calculate the following accounting ratios and discuss their relevance to a small investor who has come to you for advice.

- (i) Dividend Yield
- (ii) Earnings per Share
- (iii) Price/Earnings Ratio

(12 marks)

### **QUESTION 4**

Very few new businesses are able to commence operations without recourse to borrowing to some extent.

#### **Required:**

What information would you expect a clearing bank to demand of a solicitor requesting a loan for purposes of establishing his or her new legal practice?

(12 marks)

*[Please turn over]*

## **QUESTION 5**

A limited liability company can traditionally obtain long term funding from Shareholders or Lenders (including Debenture holders).

### **Required:**

Compare and contrast the various rights held by Shareholders and Lenders (including Debenture holders) in a limited liability company and how these are respectively represented in company accounts.

(12 marks)

## **QUESTION 6**

Ratio analysis is a useful tool in analysing company accounts but it does have its limitations, which need to be borne in mind.

### **Required:**

Discuss the limitations of using accounting ratios when comparing the liquidity, profitability and working capital management positions of two similar companies.

(12 marks)

**END OF SECTION B**

**END OF QUESTION PAPER**