



**THE LAW SOCIETY OF SCOTLAND
EXAMINATIONS**

**ACCOUNTING
PAPER TWO**

Tuesday 6 February 2018

**1330 – 1630
(Three Hours)**

Candidates should;

Answer **BOTH** Questions in Section A

And

Three of the **Four** Questions in Section B

**LAW SOCIETY OF SCOTLAND
EXAMINATIONS**

**ACCOUNTING – PAPER TWO
6 February 2018
(Three hours)**

Candidates must answer BOTH questions in Section A and THREE of the four questions in Section B.

SECTION A

Answer **both** questions in Section A

Question 1

Malcolm Canmore died on 31 October 2016 domiciled in Scotland. He bequeathed £4,000 to his literary agent and his library to the National Library of Scotland. His widow is to receive the life rent of the balance of his estate and after her death the fee is to be divided equally between his three children. A Swiss bank account of £40,000 was discovered on 20 October 2017.

The estate at date of death was as follows:-

	£
Dwelling house	304,000
Furniture, including books in his library (£30,000)	70,000
Cash in house	600
Bank Current Account	13,000
Investment in Novels plc	60,000
Investment in Paperbacks plc	<u>100,000</u>
	<u>547,600</u>

The Trustees bank transactions were as follows:

	Debit £	Credit £
<u>2016</u>		
1 Nov		
Cash in house uplifted	600	
Balance from deceased's bank transferred	13,000	
<u>2017</u>		
1 Feb		
Received final dividend net on shares in Novels plc for the year to 31 December 2016		4,200
15 Feb		4,000
15 Mar		2,000
11 Apr		2,000
16 June		
Received dividend net for year to 31 May 2017 on shares in Paperbacks plc	8,400	
31 Aug		3,000
15 Oct		1,500
20 Oct		
Swiss bank account transfer	40,000	
31 Oct		53,700
	<u>66,200</u>	<u>66,200</u>

Notes

- 1) The books forming his library were delivered to the beneficiary on 16 September 2017
- 2) Ignore Income Tax and Inheritance Tax
- 3) The Apportionment Act 1870 **was** excluded by the Trust Deed

Required:

Prepare Capital and Revenue Trust Accounts for the year to 31 October 2017 to reflect the above transactions and information.

(20 marks)

Question 2

Your firm provides business advisory services to Shoemarket Ltd (“Shoemarket”), a shoe retailer which operates in Scotland and the North of England. Shoemarket began trading in 2010 and the business has grown steadily. The owner of Shoemarket now wishes to expand the business further by acquiring a competitor. Two potential acquisition targets have been identified – Brogues Ltd and Casuals Ltd. You have been asked by the owner to analyse the performance of both prospects and comment thereon. You have been provided with summaries of the latest financial statements for Brogues Ltd and Casuals Ltd and these are attached.

Required:

(a) Calculate for each company the following select ratios:

- (i) Gross profit %
- (ii) Operating profit (Net profit before interest) %
- (iii) Return on all capital employed (ROCE) %
- (iv) Current ratio
- (v) Stock turnover days
- (vi) Trade debtors collection days

Show the definition of each ratio used.

Calculations should be made to two decimal places.

(12 marks)

(b) Based on the above ratios, and any other(s) you consider appropriate, comment on the differences in the businesses’ profitability, liquidity and working capital management.

Suggest ways in which these areas could be improved following acquisition.

(24 marks)

(c) Calculate and compare the gearing ratio for each company.

(2 marks)

(d) Advise your client on the suitability of each company as a potential acquisition. Your answer should include comments on the limitations of your analysis and what further information you would require to support the advice given.

(6 marks)

(Question total 44 marks)

[Please turn over]

**Profit and loss accounts for the year ended
30 November**

	Brogues 2017 £000	Casuals 2017 £000
Sales	3,460	9,210
Cost of sales	<u>2,595</u>	<u>7,644</u>
Gross profit	865	1,566
Selling and distribution	415	645
Administration	<u>173</u>	<u>461</u>
Operating profit	277	460
Interest payable	<u>30</u>	<u>84</u>
Profit before taxation	247	376
Taxation	<u>74</u>	<u>113</u>
Profit after taxation	<u>173</u>	<u>263</u>

Balance sheets at 30 November

Fixed assets	2,100	1,435
Current assets		
Stock	411	520
Trade debtors	280	1,400
Bank	<u>20</u>	<u>5</u>
	<u>711</u>	<u>1,925</u>
Creditors due within one year:		
Trade creditors	220	1,250
Other creditors (including taxation)	<u>240</u>	<u>600</u>
	<u>460</u>	<u>1,850</u>
Net current assets	251	75
Creditors due after one year:		
Bank Loan	(330)	(600)
	<u>2,021</u>	<u>910</u>
Represented by:		
Share Capital – Ordinary shares of £1 each	500	550
Profit and loss account	<u>1,521</u>	<u>360</u>
	<u>2,021</u>	<u>910</u>

END OF SECTION A

SECTION B

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

Question 3

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 4

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 5

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)

Question 6

Accounting as a profession often uses its own terminology.

Required:

Explain what is meant by each of the following terms and discuss its significance:

- a) Net current assets
- b) Revaluation reserve
- c) Deferred taxation
- d) Gross profit

(12 marks)

END OF SECTION B

END OF QUESTION PAPER