

SECTION A

Answer BOTH Questions

- 1 Sofa So Good plc produces sofas at its factory. The sofas are then delivered to customers' shops. At 31 March 2021, the following balances and information were available.

	Debit	Credit
	£	£
Allowance for irrecoverable debts		13 000
Auditors fees	12 300	
Bank current account	65 000	
Bank current account interest		400
Cash	27 000	
Commission on sales	62 340	
8.5% Debenture December 2021		500 000
Debenture interest	21 250	
Delivery costs	119 000	
Direct materials	1 670 000	
Discount allowed	61 000	
Discount received		28 000
Factory buildings (carrying value)	2 950 000	
General reserve		25 000
Goodwill	40 000	
Head office expenses	320 000	
Inventory at 1 April 2020	451 000	
Irrecoverable debts	18 000	
Marketing	203 000	
Motor lorries at cost	228 000	
Motor lorries provision for depreciation		121 000
Motor lorries running expenses	27 500	

	Debit	Credit
	£	£
Ordinary shares of £1.00 each		2 100 000
Other payables		11 700
Production machinery (carrying value)	266 000	
Rent on warehouse	148 000	
Retained earnings	160 710	
Revenue		6 840 000
Share premium		420 000
Trade payables		126 000
Trade receivables	595 000	
Wages	2 740 000	
	<u>10 185 100</u>	<u>10 185 100</u>

Additional information at 31 March 2021

- (1) Auditor's fees for £2 600 are outstanding.
- (2) A Corporation Tax bill of £188 000 has been calculated, which is to be paid by 31 December 2021, and a provision needs to be made.
- (3) The factory buildings are being depreciated over a 40-year life, using the straight-line method. Fifteen years depreciation has been calculated to date. Depreciation for the present year needs to be calculated and entered into the books.
- (4) The motor lorries are to be depreciated using the straight-line method over a six-year life assuming a residual value of £18 000
- (5) The production machinery is to be depreciated at 20% per year, using the reducing balance method.
- (6) The interest payments on the debenture are made in two equal instalments at the end of March and the end of September. The payment for March 2021 is outstanding.
- (7) Inventory £498 000
- (8) Marketing paid in advance is £22 000
- (9) The allowance for irrecoverable debts is to be 4% of trade receivables.
- (10) Wages are to be apportioned on the following basis:
Factory 65%; Warehouse 10%; Transport 5%; Sales 15%; Head office 5%

Required

(a) Prepare for Sofa So Good plc, in accordance with International Accounting Standard 1 (Revised), a:

(i) Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 March 2021

(27)

(ii) Statement of Financial Position at 31 March 2021.

(16)

A meeting was recently held between the Board of Directors and the auditors. The auditors expressed concern in the following areas of corporate governance.

- 1) Leadership – the Chairman is also the Chief Executive Officer.
- 2) Effectiveness – length of intervals between election of Board members.
- 3) Accountability – checks that are made when taking over another company.
- 4) Remuneration – one director sits on the Remuneration Committee and was involved in setting his own pay level.
- 5) Relations with shareholders – notice being given concerning the date of the Annual General Meeting.

(b) Evaluate the role of the auditor in the corporate governance of a limited company. You must include in your answer how the auditors' concerns above should be addressed.

(12)

(Total for Question 1 = 55 marks)

- 2 Digital Estates plc decided to merge with Homesales plc. A new company called Redbricks plc was formed on 1 October 2017 with ordinary shares of £1 each.

The Statements of financial position at 30 September 2017

	Digital Estates plc £ 000's	Homesales plc £ 000's
ASSETS		
Non-current assets		
Buildings	22 000	18 000
Computers	5 600	4 300
Fixtures and fittings	1 900	1 500
Motor vehicles	<u>1 200</u>	<u>875</u>
	30 700	24 675
Current assets		
Inventory	420	370
Trade receivables	2 950	2 210
Cash and cash equivalents	<u>870</u>	<u>565</u>
	4 240	3 145
Total assets	<u>34 940</u>	<u>27 820</u>
EQUITY AND LIABILITIES		
Equity		
Ordinary shares of £1	20 000	10 000
Share premium	4 000	10 000
Retained earnings	<u>4 140</u>	<u>3 840</u>
	28 140	23 840
Non-current liabilities		
Bank loans	<u>5 500</u>	<u>3 100</u>
	5 500	3 100
Current liabilities		
Trade payables	1 050	770
Other payables	<u>250</u>	<u>110</u>
	<u>1 300</u>	<u>880</u>
Total equity and liabilities	<u>34 940</u>	<u>27 820</u>

Redbricks plc took over **all** the assets and liabilities at book value, with the following exceptions.

- Non-current assets were revalued as follows:

	Digital Estates plc £ 000's	Homesales plc £ 000's
Buildings	25 000	20 000
Computers	5 000	4 000
Fixtures and fittings	1 700	1 400
Motor vehicles	1 100	700

- Inventory of Digital Estates plc was reduced by £20 000
- Inventory of Homesales plc was reduced by £30 000
- Trade receivables of £100 000 of Homesales plc were written off as bad debts.

Required

- (a) Calculate the value of Homesales plc **after** the revaluations.

(6)

The directors of Redbricks plc offered shareholders in Homesales plc one ordinary share of £1.00 in Redbricks plc, at a premium of £1.50 (making a total of £2.50), for every £1 ordinary share held.

The shareholders of Homesales plc rejected this offer.

- (b) Explain the financial reason why the shareholders of Homesales plc rejected this offer.

(4)

The directors of Redbricks plc made a new offer to shareholders in Homesales plc of one ordinary share of £1.00 in Redbricks plc, at a premium of £2.00 (making a total of £3.00), for every £1 ordinary share held. This offer was accepted by shareholders in Homesales plc.

- (c) Calculate the goodwill paid by Redbricks plc for Homesales plc.

(4)

The value of Digital Estates plc was agreed at £42 000 000 for the merger. Shareholders in Digital Estates plc received 14 000 000 ordinary shares of £1.00 each in Redbricks plc, at a premium of £2.00 per share.

The goodwill paid for Digital Estates plc was £11 780 000

(d) In the books of Digital Estates plc, prepare the:

(i) realisation account

(8)

(ii) sundry shareholders account.

(8)

(e) Prepare the statement of financial position of Redbricks plc at 1 October 2017 after the merger.

(13)

At the first board meeting of Redbricks plc, the Finance Director stated, "We must treat goodwill correctly in the accounts."

(f) Evaluate the accounting treatment of goodwill during and after the merger process.

(12)

(Total for Question 2 = 55 marks)