



**THE LAW SOCIETY OF SCOTLAND
EXAMINATIONS**

ACCOUNTING

Tuesday 25 July 2023

**0830 – 1230
(Four Hours)**

Candidates should answer ALL THREE Questions

The questions do not carry equal marks

LAW SOCIETY OF SCOTLAND
EXAMINATIONS

ACCOUNTING

25 July 2023

(Four hours)

Candidates should answer **ALL THREE** questions. The questions do not carry equal marks.

QUESTION 1

You have been approached by Alistair MacLean, the managing director of your client company Stellar Ltd ('Stellar').

Stellar has performed well in recent years in the competitive extractor fan market but Alistair is concerned by the company's bank overdraft which is steadily increasing. Yesterday he received a letter from the company's bankers asking that the overdraft be reduced in the short term and explaining that if the situation did not improve, then the overdraft would be recalled.

Alistair has approached you for help. He wants you to explain to him the factors that have led to the overdraft increase and to provide him with some suggestions for improving the situation.

Abbreviated financial statements for the company for the last two years are provided by way of Appendix.

Required:

(a) Calculate for both accounting years the following 9 ratios which will comprehensively measure Stellar's profitability, liquidity and working capital management. Show the formula for each ratio calculated. Calculations should be made to 2 decimal places.

1. Gross profit %
2. Operating profit % (net profit %)
3. Return on shareholders' funds employed (ROSF) %
4. Return on capital employed (ROCE) %
5. Current assets to current liabilities
6. Current assets less stock to current liabilities (quick or acid-test)
7. Stock days (stock turnover ratio)
8. Trade debtors days (debtors turnover ratio)

9. Trade creditors days (creditors turnover ratio)

(18 marks)

(b) Give an interpretation of your ratio analysis which includes explanations of the movements in the ratios and highlights strengths and areas of concern for Stellar and its various stakeholders. Equally importantly, please also include your recommendations for improvement, particularly in regard to the worsening bank overdraft situation.

(27 marks)

(c) Compare and contrast the various rights held by Shareholders and Debenture holders in a limited company and explain how these are respectively presented in company financial statements.

(12 marks)

(d) Calculate the 'gearing ratio' for Stellar from a Balance Sheet perspective and comment accordingly.

(3 marks)

(e) Briefly outline the various sources of loan finance available to a limited company.

(5 marks)

(Question Total 65 marks)

APPENDIX REFERRED TO – Extracts from Stellar Ltd financial statements

Profit and Loss Account For the year ended 31 March 2023

	£'000 2023	£'000 2022
Turnover	9,100	7,650
Cost of Sales	<u>6,370</u>	<u>5,126</u>
Gross profit	2,730	2,524
Distribution costs	1,090	900
Administrative expenses	<u>356</u>	<u>300</u>
Operating (net) profit	1,284	1,324
Interest paid	<u>280</u>	<u>160</u>
Profit before tax	1,004	1,164
Taxation	<u>200</u>	<u>232</u>
Profit after tax	<u>804</u>	<u>932</u>

Note 1: Additional Information

	£'000 2023	£'000 2022
Purchases	<u>6,028</u>	<u>5,000</u>

APPENDIX REFERRED TO – Extracts from Stellar Ltd financial statements (cont'd)

Balance Sheet

As at 31 March 2023

	£'000	£'000
	2023	2022
Fixed Assets	1,832	1,800
Current Assets		
Stock	2,200	1,400
Trade Debtors	2,210	1,480
Cash	<u>70</u>	<u>40</u>
Total Current Assets	<u>4,480</u>	<u>2,920</u>
Current Liabilities		
Trade Creditors	850	800
Bank overdraft	2,118	1,440
Taxation	<u>500</u>	<u>440</u>
Total Current Liabilities	<u>3,468</u>	<u>2,680</u>
Net Current Assets	<u>1,012</u>	<u>240</u>
Total Assets less Current Liabilities	2,844	2,040
Non-current Liabilities		
Bank loan	<u>220</u>	<u>220</u>
Net Assets	<u>2,624</u>	<u>1,820</u>
Represented by:		
Capital and Reserves		
Share Capital	600	600
Retained Earnings	<u>2,024</u>	<u>1,220</u>
Shareholders' Funds	<u>2,624</u>	<u>1,820</u>

QUESTION 2

You have recently been appointed Cashroom Manager for your firm.

Required

Briefly outline your understanding of the nature and extent of your new role and schedule those tasks you consider will require your ongoing attention on a daily basis, along with those specifically on a monthly, quarterly and six monthly basis.

You should quote from Rule B6 (Accounts, Accounts Certificates, Professional Practice & Guarantee Fund) and Rule B9 (Money Laundering and Terrorist Financing) of the Law Society of Scotland Practice Rules 2011 (as amended, including amendments from 4 January 2023).

(20 marks)

QUESTION 3

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) Operating profit
- b) Revaluation reserve
- c) Earnings per share
- d) Deferred taxation
- e) Intangible assets

(15 marks)

(Examination Total: 100 marks)

END OF EXAMINATION PAPER