

**LAW SOCIETY OF SCOTLAND  
EXAMINATIONS**

**ACCOUNTING**

**Tuesday 13 February 2024**

**0830 - 1230  
(Four Hours)**

**Candidates should answer ALL Questions.**

**The questions do not carry equal marks.**

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### Question 1

#### Required:

- (a) Identify and explain the circumstances which would cause the Law Society of Scotland (LSS) to make a site visit to a legal practice. (3 marks)
- (b) On arrival at a legal practice, who will the LSS representative(s) speak with and why? What information will be requested for the LSS review? (5 marks)
- (c) An inspection/review of the accounting records highlighted the following –
- i. There were multiple withdrawals from a client's bank account initiated by one of the partners who it is assumed has Power of Attorney. How would the withdrawals be identified and how should the authority to withdraw client funds be verified?
  - ii. Due to illness, there was a 4-week period when key accounting staff were absent. The absences resulted in a delay to maintaining the accounting records and the month-end reconciliation process. Which monthly reconciliations are required to be performed? What do the Accounts Rules say about the accounting record keeping?
  - iii. During the period being reviewed, the firm arranged the settlement of a house purchase for a client. Some of the funds for the house purchase were to come from the sale of the client's current home. Unfortunately, there was a delay in the settlement of that sale. A cheque for the purchase price was drawn on the client's' account on the date of settlement as the firm was confident that funds from the sale would be lodged in the clients' account on the following day. However, checking of the banking records confirmed that the sale proceeds were not received until 4 days later.

What are the Accounts Rules stipulations with regard to the 3 events above? (8 marks)

You should make detailed reference as appropriate to 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).

(Question 1 -Total Marks 16)

## Question 2

### Required:

Suggest and explain the financial reporting and financial analysis which would be appropriate for a multi-partner firm, which is a multi-location practice offering a wide range of client services and generating income in excess of £4millions per annum.

How would your response be revised if a legal firm was a smaller single location practice with say, 3 partners, generating income of circa £0.5million per annum?

(Question 2 - 8 marks)

## Question 3

The Accounting profession uses its own terminology.

### Required:

Explain what is meant by each of the following terms and discuss its significance to a third party reading financial statements:

- (a) Goodwill and other intangible assets
- (b) Non-current liabilities
- (c) Retained earnings
- (d) Gross profit
- (e) Deferred taxation

(Question 3 - 10 marks)

#### Question 4

Prior to the possible integration/amalgamation of two competing businesses, you have been asked to review the financial status of one of these businesses. You have been provided with interim (unaudited) financial reports, i.e. Income Statement and the Statement of Financial Position of the business showing data for two years.

The two financial statements are appended below to enable you to review the financial health of the business.

The business started operations in 2015, manufacturing and selling premium accessories for mobile phones.

The products produced by the firm are well received in the marketplace but over time, there has been an increase in competition as new sellers entered the market and took market share from the business you are to review.

As part of management's business strategy, in early 2023, they hired personnel to improve the operational effectiveness of the business. The recruitment added a new sales manager with a remit to grow market share and increase the gross margin of products. Additionally, a purchasing specialist was recruited to source the required quality of materials but at a lower cost. The accounts team was increased with the addition of a credit controller whose objectives included the minimising of bad debt and the collection of accounts receivable within the standard sales terms.

#### Required:

(a) Calculate for each accounting period the following 6 ratios which aim to measure business profitability, liquidity and working capital management.

- 1) Return on shareholders' capital employed (ROSF) %
- 2) Return on capital employed (ROCE) %
- 3) Current assets to current liabilities
- 4) Stock days (stock turnover ratio)
- 5) Accounts Receivable days (debtors turnover ratio)
- 6) Accounts Payable days (creditors turnover ratio)

Show the formula for each ratio calculated.

Calculations should be made to 2 decimal places.

(12 marks)

(b) Provide an interpretation of the ratios calculated above.  
Suggest reason(s) for the year-on-year change in the ratios.  
How might the business improve upon the latest financial indicators?

(24 marks)

(c) Are there other financial ratios, not listed above, which would be useful when evaluating the financial performance of the business? Also, is there another financial statement which would be helpful when assessing the business performance?

(5 marks)

- (d) Calculate the 'gearing ratio' of the business being reviewed and comment on the resultant answer.

(5 marks)

- (e) Discuss the advantages and disadvantages of debt financing.

(10 marks)

- (f) Explain any limitations of your ratio analysis.

(5 marks)

- (g) Management have also asked your opinion on whether the staff recruitment has improved financial performance with reasons for your opinion.

(5 marks)

(Question 4 - 66 marks)

## APPENDIX – Extracts of financial statements

### Income Statement

For the year ended 31 March 2024

	<b>2024</b> <b>£'000</b>	<b>2023</b> <b>£'000</b>
Sales Income	84,240	92,880
Cost of Sales	<u>57,283</u>	<u>60,372</u>
<b>Gross profit</b>	<b>26,957</b>	<b>32,508</b>
Distribution costs	7,603	10,368
Administrative expenses	<u>3,046</u>	<u>3,456</u>
<b>Operating profit</b>	<b>16,308</b>	<b>18,684</b>
Interest paid	<u>223</u>	<u>162</u>
<b>Profit before tax</b>	<b>16,085</b>	<b>18,522</b>
Taxation	<u>6,264</u>	<u>7,182</u>
<b>Profit after tax</b>	<b><u>9,821</u></b>	<b><u>11,340</u></b>
<b>Additional information:</b>		
Purchases	<u>54,185</u>	<u>59,012</u>

Statement of Financial Position/



APPENDIX (cont'd) –

**Statement of Financial Position**

As at 31 March 2024

	<b>2024</b>	<b>2023</b>
	<b>£'000</b>	<b>£'000</b>
<b><u>Assets</u></b>		
<b>Non-Current Assets</b>	<b>67,568</b>	<b>63,416</b>
<b>Current Assets</b>		
Inventory (Stock)	8,640	7,344
Accounts Receivable (Trade Debtors)	10,368	7,776
Cash + Bank	432	864
<b>Total Current Assets</b>	<b>19,440</b>	<b>15,984</b>
<b>Total Assets</b>	<b>87,008</b>	<b>79,400</b>
<b><u>Liabilities &amp; Shareholder Funds</u></b>		
<b>Current Liabilities</b>		
Accounts Payable (Trade Creditors)	6,480	9,504
Deferred Taxation	6,264	6,156
<b>Total Current Liabilities</b>	<b>12,744</b>	<b>15,660</b>
<b>Non-current Liabilities</b>		
Bank loan	3,943	3,240
<b>Total Non-Current Liabilities</b>	<b>3,943</b>	<b>3,240</b>
<b>Capital and Reserves</b>		
Share Capital (Ordinary shares of £1)	29,160	29,160
Retained Earnings	41,161	31,340
<b>Shareholders' Funds</b>	<b>70,321</b>	<b>60,500</b>
<b>Total Liabilities &amp; Shareholder Funds</b>	<b>87,008</b>	<b>79,400</b>

(Question Paper – Total 100 marks)

**END OF QUESTION PAPER**