Mock Exam One

AAT Level 4
Drafting and Interpreting Financial Statements

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This practice assessment is one of a set of five AAT mock practice assessments which have been published for this subject. They are produced by our expert AAT tutors, giving real AAT exam style and standard tasks, which ensure the very best for exam success. All practice assessments are relevant for the current syllabus.

Our AAT tutors work extensively to produce study material that is first class and absolutely focused on passing your exam. We hope very much that you enjoy this product and wish you the very best for exam success! For feedback please contact our team aatlivelearning@gmail.com or safina@acornlive.com

Mock Exam One

AAT L4 Drafting and Interpreting Financial Statements for Businesses

Assessment information:

You have **2 hours and 30 minutes** to complete this practice assessment.

This assessment contains **7 tasks** and you should attempt to complete **every** task.
Read every task carefully to make sure you understand what is required.

In tasks 1, 2 and 5 you may be presented with tables that can be used for your workings. You don't have to use the workings tables to achieve full marks in these tasks, but any data entered into the workings tables will be taken into consideration if you make errors in the proforma.

Tasks 3, 4 and 7 require extended writing as part of your response to the questions. You should make sure you allow adequate time to complete these tasks.

Where the date is relevant, it is given in the task data.

Both minus signs and brackets can be used to indicate negative numbers **unless** task instructions say otherwise.

You must use a full stop to indicate a decimal point. For example, write 100.57 not 100,57 or 100 57

You may use a comma to indicate a number in the thousands, but you don't have to. For example, 10000 and 10,000 are both acceptable.

Task 1 (32 marks)

You have been asked to prepare the statement of cash flows and statement of changes in equity for XYZ Ltd for the year ended 31 August 20X9.

The most recent statement of profit or loss and statement of financial position (with comparatives for the previous year) for XYZ Ltd is shown below.

XYZ Ltd - Statement of financial position as at 31 August 20X9

	£000 20X9	**£000 20X8**
Assets		
Non-current assets		
Property, plant and equipment	11,380	9,800
Current assets		
Inventories	278	340
Trade receivables	255	430
Cash and cash equivalents	31	670
	564	1,440
Total assets	11,944	11,240
EQUITY AND LIABILITIES		
Equity		
Share capital (£1 ordinary shares)	6,000	5,000
Share premium account	1,000	2,000
Revaluation reserve	2,000	0
Retained earnings	2,091	2,189
Total equity	11,091	9,189
Non-current liabilities		
Loan certificates	500	1,500
Current liabilities		
Trade payables	250	452
Tax liability	103	99
	353	551
Total liabilities	853	2,051
Total equity and liabilities	11,944	11,240

XYZ Ltd - Statement of profit or loss for the year ended 31 August 20X9

	£000
Continuing operations	
Revenue	2,450
Cost of sales	-845
Gross profit	1,605
Loss on disposal of PPE	-300
	1,305
Distribution costs	-420
Administrative expenses	-230
Profit from operations	655
Finance costs	-150
Profit before tax	505
Tax	-103
Profit for the period from continuing operations	402
Other comprehensive income	2,000
Total comprehensive income	2,402

Further information

- Total depreciation charged for the year was £180,000 and is included within administration and distribution expenses.
- There were no prepaid expenses or accrued expenses at the beginning or end of the year.
- A 1 for 5 bonus issue occurred for shareholders during the year out of the share premium account.
- Property, plant and equipment with a carrying value of £700,000 was sold in the year.
- A property was revalued upwards during the year by £2.0 million.
- A dividend was paid in the year of £500,000.

(a) Draft a reconciliation of profit before tax to net cash from operating activities for XYZ Ltd for the year ended 31 August 20X9.

(13 marks)

(b) Draft the statement of cash flows for XYZ Ltd for the year ended 31 August 20X9.

(19 marks)

Note the following:

- **Show any items that need to be deducted as negative figures.**
- You don't have to use the workings tables to achieve full marks on this task. However, any data that you enter into the workings tables will be taken into consideration if you make errors in the main proforma.
- You must enter a figure into the main proforma in order for your workings to be taken into account.

(You will be asked to draft a statement of changes in equity in Task 2 using the same data. You will be able to view this data again in Task 2).

Reconciliation of profit before tax to net cash from operating activities

	£000
Adjustments for:	
Cash generated by operations	
Net cash from operating activities	

Statement of cash flows for the year ended 31 August 20X9

	£000
Net cash from operating activities	
Investing activities	
Net cash from investing activities	
Financing activities	
Net cash used in financing activities	
Net increase / (decrease) in cash and cash equivalents	
Cash and cash equivalents at the beginning of the year	
Cash and cash equivalents at the end of the year	

Picklist for completion of the two statements above: Adjustment in respect of inventories, Adjustment in respect of trade payables, Adjustment in respect of trade receivables, Loan certificates, Depreciation, Finance costs, Interest paid, Proceeds on disposal of PPE, Profit after tax, Profit before tax, Loss on disposal of PPE, Purchases of PPE, Revaluation, Proceeds of share issue, Tax paid, Dividends paid.

Workings:

Proceeds on disposal of PPE	£000
Total disposal proceeds	

Purchases of PPE	£000
PPE at start of the year	
Total PPE additions	

Picklist for completion of workings tables (optional): Carrying amount of PPE sold, Depreciation charges, PPE at end of the year, Loss on disposal of PPE, Revaluation.

End of Task

Task 2 (8 marks)

This task is a continuation of the scenario from Task 1 and uses the same data.

The statement of profit or loss and statement of financial position (with comparatives for the previous year) of XYZ Ltd are shown below.

XYZ Ltd - Statement of financial position as at 31 August 20X9

	£000 20X9	**£000 20X8**
Assets		
Non-current assets		
Property, plant and equipment	11,380	9,800
Current assets		
Inventories	278	340
Trade receivables	255	430
Cash and cash equivalents	31	670
	564	1,440
Total assets	11,944	11,240
EQUITY AND LIABILITIES		
Equity		
Share capital (£1 ordinary shares)	6,000	5,000
Share premium account	1,000	2,000
Revaluation reserve	2,000	0
Retained earnings	2,091	2,189
Total equity	11,091	9,189
Non-current liabilities		
Loan certificates	500	1,500
Current liabilities		
Trade payables	250	452
Tax liability	103	99
	353	551
Total liabilities	853	2,051
Total equity and liabilities	11,944	11,240

XYZ Ltd - Statement of profit or loss for the year ended 31 August 20X9

	£000
Continuing operations	
Revenue	2,450
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	1,305
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Profit for the period from continuing operations	402
Other comprehensive income	2,000
Total comprehensive income	2,402

Further information

- Total depreciation charged for the year was £180,000 and is included within administration and distribution expenses.
- There were no prepaid expenses or accrued expenses at the beginning or end of the year.
- A 1 for 5 bonus issue occurred for shareholders during the year out of the share premium account.
- Property, plant and equipment with a carrying value of £700,000 was sold in the year.
- A property was revalued upwards during the year by £2.0 million.
- A dividend was paid in the year of £500,000.

Draft the statement of changes in equity for XYZ Ltd for the year ended 31 August 20X9.

(8 marks)

Note: Show any items that need to be deducted as negative figures (using minus signs or brackets).

Statement of changes in equity for the year ended 31 August 20X9

	Share capital £000	Share Premium £000	Revaluation Surplus £000	Retained Earnings £000	Total Equity £000
Balance at 1 September 20X8					
Changes in equity					
Total comprehensive income					
Dividends					
Issue of share capital					
Balance at 31 August 20X9					

End of Task

Task 3 (8 marks)

You are preparing the financial statements of KLM Ltd for the year ended 31 August 20X9. KLM Ltd is a manufacturer of cakes and biscuits. On 12 March 20X9 KLM Ltd purchased a new bakery oven for use in its factory, the purchase cost was £280,000 and it was financed wholly by a bank loan. The new bakery oven could be sold today for a second hand value of £150,000.

(a) (i) Explain the definitions of assets and liabilities as elements within the financial statements, according to the IASBs Conceptual Framework for Financial Reporting.

(2 marks)

(a) (ii) Explain why the new bakery oven and bank loan should be recognised as an asset and liability respectively, according to the IASBs Conceptual Framework for Financial Reporting.

(4 marks)

(a) (iii) Identify TWO measurement bases which could be used to determine how the bakery oven is recognised in the financial statements as at 31 August 20X9.

(2 marks)

End of Task

Task 4 (12 marks)

The following measures relate to a non-current asset owned by AWD Limited.

- Net book value £20,000
- Net realisable value £18,000
- Value in use £22,000
- Replacement cost £50,000

(a) The recoverable amount of the asset is

(3 marks)

£18,000	☐
£20,000	☐
£22,000	☐
£50,000	☐

(b) Which ONE of the following would be classified by WDC Limited as a non-adjusting event according to IAS 10 *Events After The Reporting Period.*

(3 marks)

WDC was notified on 5 November 20X1 that one of its customers was insolvent and was unlikely to repay any of its debts. The balance outstanding at 30 September 20X1 was £42,000.	☐
On 30 September WDC had an outstanding court action against it. WDC had made a provision in its financial statements for the year ended 30 September 20X1 for damages awarded against it of £22,000. On 29 October 20X1 the court awarded damages of £18,000.	☐
On 5 October 20X1 a serious fire occurred in WDC's main production centre and severely damaged the production facility.	☐
The year end inventory balance included £50,000 of goods from a discontinued product line. On 1 November 20X1 these goods were sold for a net total of £20,000.	☐

PQR Limited publishes newspapers and has a contract with a large supermarket chain for the supply of several newspaper titles.

PQR has agreed the following terms:

- The same quantities of each newspaper will be supplied each month.
- Payment is made six months in advance.

PQR is preparing its financial statements for the year ended 31 October 20X7. The supermarket paid £150,000 to PQR on 1 September 20X7 for six months' supply of newspapers for the period 1 September 20X7 to 28 February 20X8.

(c) How much sales revenue should be recognised as income in PQR's financial statements for the year ended 31 October 20X7. (3 marks)

£25,000	☐
£50,000	☐
£100,000	☐
£150,000	☐

XYZ Limited owns a building. The original cost of the building was £1,000,000; it has not been depreciated. The building was recently revalued on 31 October 20X6 at £1,800,000. The economic climate had then deteriorated, causing XYZ to carry out an impairment review of its assets on 31 October 20X7. XYZ's building was valued at a market value of £1,500,000 on 31 October 20X7 by a professional valuation.

(d) Identify whether the following statements are true or false for XYZ for its year ended 31 October 20X7. (3 marks)

	TRUE	FALSE
The building must be impaired by £300,000 and this loss of value charged as an expense in the statement of profit or loss.	☐	☐
The building must be impaired by £300,000 and this loss of value posted to the revaluation reserve in the statement of financial position.	☐	☐
The building must be revalued by £500,000 and this unrealised gain posted to the revaluation reserve in the statement of financial position.	☐	☐

End of Task

Task 5 (30 marks)

The summarised statement of financial position of ABC Ltd and XYZ Ltd at 31 August 20X9 and further information, is shown below.

Statement of financial position as at 31 August 20X9

	ABC Ltd £000	**XYZ Ltd £000**
Assets		
Non-current assets		
Property, plant and equipment	10,000	1,500
Investment in XYZ Ltd	4,000	
	14,000	1,500
Current assets		
Inventories	3,400	670
Trade and other receivables	1,600	900
Cash and cash equivalents	1,800	780
	6,800	2,350
Total assets	20,800	3,850
EQUITY AND LIABILITIES		
Equity		
Share capital	5,000	1,000
Retained earnings	9,500	2,400
Total equity	14,500	3,400
Non-current liabilities	5,000	0
Current liabilities		
Trade and other payables	1,180	400
Taxation	120	50
	1,300	450
Total liabilities	6,300	450
Total equity and liabilities	20,800	3,850

Additional notes

- ABC Ltd had acquired 60% of the share capital of XYZ Ltd on the 1 June 20X1. On the acquisition date the retained earnings of XYZ Ltd were £2,000,000 and its share capital was £1,000,000.
- ABC Ltd has decided that non-controlling interest will be valued at their proportionate share of net assets.
- There was cash in transit of £300,000 from XYZ Ltd to ABC Ltd at the year ended 31 August 20X9.
- Included in ABC's trade and other receivables is £650,000 owed from XYZ.
- Included in XYZ's trade and other payables is £350,000 owed to ABC.
- ABC Ltd sold inventory to XYZ Ltd for £1,000,000 during the year, these goods had cost ABC Ltd £400,000. One quarter of these goods still remain unsold for the year ended 31 August 20X9.

Draft the consolidated financial position of ABC Ltd and its subsidiary undertaking as at 31 August 20X9.

(30 marks)

Note the following:

- **Do not use negative figures (minus signs or brackets).**
- You don't have to use the workings tables to achieve full marks for this task. However, any data that you do enter into the workings tables will be taken into consideration if you make errors in the main proforma.

ABC Ltd - Consolidated statement of financial position as at 31 August 20X9

	£000
Assets	
Non-current assets	
Goodwill	
Property, plant and equipment	
Current assets	
Inventories	
Trade and other receivables	
Cash and cash equivalents	
Total assets	
EQUITY AND LIABILITIES	
Equity	
Share capital	
Retained earnings	
Non-controlling interest	
Total equity	
Non-current liabilities	
Current liabilities	
Trade and other payables	
Taxation	
Total liabilities	
Total equity and liabilities	

Workings boxes

Goodwill	£000

Picklist for goodwill: Consideration, Non-controlling interest at acquisition, Net assets acquired.

Retained earnings	£000

Picklist for retained earnings: ABC Ltd, Provision for unrealised profit for inventory sold, XYZ Ltd - attributable to ABC Ltd.

Inventory	£000

Picklist for inventory: ABC Ltd, Provision for unrealised profit for inventory sold, XYZ Ltd.

Trade and other receivables	£000

Picklist for trade and other receivables: ABC Ltd, XYZ Ltd, Inter-company adjustment, Cash in transit.

Cash and cash equivalents	£000

Picklist for cash and cash equivalents: ABC Ltd, XYZ Ltd, Cash in transit.

Trade and other payables	£000

Picklist for trade and other payables: ABC Ltd, XYZ Ltd, Inter-company adjustment.

End of Task

Task 6 (8 marks)

You have been provided with the financial statements of PQR Ltd for the year ended 30 June 20X6. You are required to prepare financial ratios to assist your manager in the analysis of this company. PQR's statement of profit or loss and statement of financial position are shown below.

PQR Ltd - Statement of financial position as at 30 June 20X6	
	£000
	20X6
Assets	
Non-current assets	
Property, plant and equipment	1,300
Current assets	
Inventories	150
Trade receivables	250
Cash and cash equivalents	530
	930
Total assets	2,230
EQUITY AND LIABILITIES	
Equity	
Share capital (£1 ordinary shares)	600
Share premium account	150
Retained reserves	245
Total equity	995
Non-current liabilities	
Bank loans	900
Current liabilities	
Trade and other payables	250
Tax liability	85
	335
Total liabilities	1,235
Total equity and liabilities	2,230

PQR Ltd - Statement of profit or loss for the year ended	
	£000
Revenue	4,500
Cost of sales	-3,845
Gross profit	655
Distribution costs	-142
Administrative expenses	-155
Profit from operations	358
Finance costs	-150
Profit before tax	208
Tax	-85
Profit for the period	123

Calculate each of the following ratios to ONE decimal place.

(8 marks)

Asset turnover (non-current assets)		times
Inventory holding period		days
Current ratio		: 1
Return on shareholders' funds		%

End of Task

Task 7 (22 marks)

Susan has been approached by Adrian who is a personal friend. Adrian has asked Susan to invest £30,000 of her personal savings to buy equity shares in Adrian's company, VUW Ltd.

You have calculated the following ratios in respect of VUW Ltd's most recent financial statements and have obtained last year's figures for comparative purposes.

	20X8	**20X7**
Gearing	145%	85%
Interest cover	1.7 times	3.1 times
Trade payables	54 days	31 days
Operating profit percentage	13.6%	12.4%

(a) Identify whether each ratio is better or worse compared to the previous year. Explain what each ratio may tell you about the company.

(20 marks)

Gearing

	Better	**Worse**
Gearing	☐	☐

Interest cover

	Better	Worse
Interest cover	☐	☐

Trade payables

	Better	Worse
Trade payables	☐	☐

Operating profit percentage

	Better	Worse
Operating profit percentage	☐	☐

(b) Recommend with reasons, whether or not Susan should buy shares in VUW Ltd, based solely on your analysis of the ratios in part (a) above.

(2 marks)

End of Task

1

Mock Exam One - Solutions

AAT L4 Drafting and Interpreting Financial Statements for Businesses

Task 1 (32 marks)

(a) Draft a reconciliation of profit before tax to net cash from operating activities for XYZ Ltd for the year ended 31 August 20X9.

(13 marks)

You don't have to use the workings tables to achieve full marks on this exam task. However, any data that you do enter into the workings tables will be taken into consideration by the exam marker. You must enter a figure into the main proforma in order for your workings to be taken into account. This exam task also stated to show any items that need to be deducted as negative figures. The exam will normally have auto sum as a function to automatically calculate 'cash generated from operations', so it is important to ensure you enter figures correctly as either positive or negative.

You need to make sure that you adopt a methodical approach to completing financial statements and use the picklists and workings tables provided in your exam task (also rough workings on paper, pen and T accounts for greater understanding).

Reconciliation of profit before tax to net cash from operating activities

	£000
Profit before tax	505
Adjustments for:	
Depreciation	180
Loss on disposal of PPE	300
Finance costs	150
Adjustment in respect of inventories	62
Adjustment in respect of trade receivables	175
Adjustment in respect of trade payables	-202
Cash generated by operations	1170
Interest paid	-150
Tax paid	-99
Net cash from operating activities	921

The statement above converts profits that have been prepared using an accruals basis into 'real actual cash-flows' received or paid. The net profit before tax for the period needs to be adjusted for the following items:

- **Non-cash items** e.g. depreciation (of tangible non-current assets), amortisation (of intangible non-current assets), changes for inventory, changes for trade receivables, changes for trade payables and gains/losses on disposal. PPE means 'property, plant and equipment'. Adjusting for non-cash items converts the profit before tax figure to actual cash-flows generated by business operations.

- **Items related to investing or financing activities** (these items are independent from business operations and appear instead in the statement of cash-flows) e.g. purchase or sale of PPE, dividends paid, proceeds from share issues (equity), repayment of or proceeds from borrowing (debt) such as bank loans, preference shares, debentures, loan certificates or loan stock.

Adjustments for inventories, trade receivables and trade payables

Changes in the balances for inventories, trade receivables and trade payables from one year to another, will cause a difference between accrued sales and purchases recognised in the profit or loss account and the actual cash-flows received from customers or paid to suppliers in a cash-flow statement.

An acronym which may help you to recall whether you add or deduct changes in the balances for inventories, trade receivables and trade payables in a cash-flow statement is **A Police Constable in a London Car Park (APC** in an **LPC).**

- The **A** is for **A**ssets such as inventories and trade receivables.
- The **L** is for **L**iabilities such as trade payables.
- The **P** is the **P**revious year's figure in the statement of financial position.
- The **C** is the **C**urrent year's figure in the statement of financial position.

The above acronym indicates the order in which you deduct the current or previous year's figures for an asset or liability, to get the right answer in your calculator as a positive or negative value. If the answer is positive it indicates that you add the difference calculated to profits before tax and if negative it indicates that you deduct the difference calculated from profits before tax.

- Inventory is an Asset (**APC**) so deduct the Previous year's figure (340) from the Current year's figure (278) and the difference is +62. So, add back £62,000 to profits before tax.

Purchases in the profit or loss account have been adjusted by the valuation of opening and closing inventories in order to calculate cost of sales. Inventory adjustments in the profit or loss account are non-cash items. Given inventory levels have fallen from the previous year, then £62,000 more has been charged to cost of sales in the profit or loss account, compared with the real purchases figure. This would have reduced profits before tax by £62,000 as a 'non-cash' adjustment and so must be added back to profits before tax.

- Trade receivables is an Asset (**APC**) so deduct the Previous year's figure (430) from the Current year's figure (255) and the difference is +175. So, add back £175,000 to profits before tax.

Sales in the profit or loss account have been accrued (included as earned for the period, whether or not the cash was actually received by customers). Given trade receivables have fallen from the previous year, more money was collected compared with sales earned in the statement of profit or loss. £175,000 more cash was collected compared with sales earned in the profit or loss account, therefore £175,000 is added to profits before tax.

- Trade payables is a Liability (**LCP**) so deduct the Current year's figure (250) from the Previous year's figure (452) and the difference is -202 (negative). So, deduct £202,000 from profits before tax.

Purchases in the profit or loss account have been accrued (included as expenses for the period, whether or not the cash was actually paid to suppliers). Given trade payables have fallen from the previous year, more money was paid to suppliers compared with purchases (expenses) recognised in the statement of profit or loss. £202,000 more cash was paid to suppliers compared with purchases (expenses) in the profit or loss account, therefore £202,000 is deducted from profits before tax.

Adjustments for depreciation and loss on disposal of PPE

Depreciation and the loss on disposal of PPE have been deducted from profits before tax (both expenses) but these are not cash-flows. Both items would be added back to profits before tax to move closer to the actual cash position of the business.

Interest and tax paid

Finance costs of £150,000 were initially added back and then later deducted as interest paid. In some cases the interest paid figure may not be the same as the finance cost (expense) recognised in the profit or loss account (hence the adjustment). In this case there was no mention of any accrued interest at the beginning or end of the year, so both figures are the same.

The cash flow statement started with profits before tax. So a tax paid figure needs to be included as a cash outflow for the year. The payment of tax based on the previous year's figure (£99,000) in the statement of financial position, was paid during the year. The current year's tax charge of £103,000 in the statement of profit or loss is represented as a liability (unpaid) in the statement of financial position. So this has not been paid during the year. Watch out also for tax under or over paid from the previous tax year as this may further complicate the calculation of tax paid.

(b) Draft the statement of cash flows for XYZ Ltd for the year ended 31 August 20X9.

(19 marks)

Statement of cash flows for the year ended 31 August 20X9

	£000
Net cash from operating activities	921
Investing activities	
Proceeds on disposal of PPE	400
Purchases of PPE	-460
Net cash from investing activities	-60
Financing activities	
Loan certificates	-1000
Dividends paid	-500
Net cash used in financing activities	-1500
Net increase / (decrease) in cash and cash equivalents	-639
Cash and cash equivalents at the beginning of the year	670
Cash and cash equivalents at the end of the year	31

Workings:

Proceeds on disposal of PPE	**£000**
Carrying amount of PPE sold	700
Loss on disposal of PPE	-300
Total disposal proceeds	400

Purchases of PPE	**£000**
PPE at start of the year	9,800
Depreciation charge	-180
Carrying amount of PPE sold	-700
Revaluation	2000
PPE at end of the year	-11,380
Total PPE additions	-460

Preparing the cash-flow statement

Exam note: AAT will not examine dividends received or interest received (returns from investments made). Interest received and dividends received can be classified as either operating activities, or investing activities. Some accountants prefer to classify these items under operating activities, because they contribute to the operating profits before tax of the business. Either method is acceptable by regulations.

Exam note: AAT expect interest paid to be included under 'operating activities' and dividends paid to be included under 'financing activities'. Interest paid and dividends paid can be classified as either operating activities, or financing activities. Some accountants prefer to classify these items as operating activities, because funds (equity and debt) are used to facilitate the trading of the company. Either method is acceptable by regulations.

Net cash from operating activities

Take the 'net cash from operating activities' (from the 'statement of profit before tax to net cash from operating activities' (+£921,000) and include this amount in the 'statement of cashflows for the year ended 31 August 20X9 (see above).

Investing activities

AAT will not examine dividends received or interest received. Therefore the only other cash inflows or outflows examinable within this section would be proceeds from the sale of PPE or purchases of PPE made during the year. PPE means 'property, plant and equipment' which are non-current assets (long-term investments beyond one year) working for the business. Workings boxes would be included in the exam task for the purchase of PPE and for the sale proceeds received from the sale of PPE during the year. You can use positive or negative figures in any order with a workings box, as these workings are human marked.

Proceeds received from the sale of PPE

You are not given any figure for proceeds received (cash) from the sale of PPE. A disposal account (included in the statement of profit or loss) could be prepared (see T account workings below) which records the carrying value of the asset (its original cost less accumulated depreciation) and bank proceeds received to work out any profit or loss for the year.

The carrying value (£700,000) would be a debit entry overall to the disposal account. Sale (cash) proceeds are a debit to the bank and a credit to the disposal account. There is a loss of £300,000 on the sale of PPE (see statement of profit or loss account) and this is a debit to the statement of profit and loss (an expense) and a credit of £300,000 as an entry to the disposal account to close the account. If we include all of the above information in the right place, by double entry logic we can prove the missing cash figure received which was the bank (cash) proceeds received of £400,000 (see the below T account).

Disposal account for PPE

Details	Amount £	Details	Amount £
(Cost - Accum Dep'n)	700	Loss on disposal (P&L)	300
		Bank (balance)	400
Total	700	**Total**	700

A quicker way of looking at the above is that if a £300,000 loss was made from the sale of PPE, then sale proceeds received must have been £300,000 less than the carrying value of £700,000. Sale proceeds must be £400,000.

Purchase of PPE

You are not given any figure for the purchase of PPE. The task did include a workings box for the amount to be calculated. All figures relevant in the task have been entered in a PPE (asset) ledger account below including the revaluation of property during the year, the missing figure of £460,000 on the debit side is the amount of PPE purchased during the year.

PPE account (Cost - Accumulated depreciation)

Details	Amount £	Details	Amount £
Balance b/d	9800	Depreciation	180
Revaluation	2000	Disposed PPE	700
Acquired PPE (balance)	460	Balance c/d	11380
Total	12260	**Total**	12260

Financing activities

Financing activities include all transactions to do with long-term debt (borrowings) or equity (ordinary shares). It shows how the business is financed in the long-term. Debt maybe repaid or more borrowed, so compare the previous and current years non-current liabilities to find out what happened. Loan certificates (non-current liabilities) have reduced from £1.5 million in the previous year to £0.5 million in the current year. Overall a reduction (cash outflow) of £1.0 million.

The AAT exam assumption is that interest paid is included under 'operating activities' and dividends paid are included under 'financing activities'. Dividends paid were £500,000 during the year.

Equity may include cash received from the issue of new ordinary shares during the year. A bonus issue (free shares) was mentioned in the task, however no cash is received from a bonus issue (the double entry would be Debit the Share Premium account and Credit the Share capital account.

You should now have three headings (with subtotals) in the statement of cash flows indicating where money was received and paid during the year. The auto sum function in the real exam may already add up figures automatically to work out the subtotals. Add together all three subtotals to work out the net increase / (or decrease) in cash and cash equivalents. The figure calculated is -£639,000, this shows the net amount spent through the bank account during the year.

As a final check, if we added -£639,000 net cash outflow to the opening bank balance of £670,000 we would have a closing bank balance left of £31,000. The opening and closing bank balance can be found in the statement of financial position. So, you should be able to check the answer is 100% correct.

Task 2 (8 marks)

Draft the statement of changes in equity for XYZ Ltd for the year ended 31 August 20X9.

Statement of changes in equity for the year ended 31 August 20X9

	Share capital £000	Share premium £000	Revaluation surplus £000	Retained earnings £000	Total equity £000
Balance at 1 September 20X8	5,000	2,000		2,189	9,189
Changes in equity					
Total comprehensive income			2,000	402	2,402
Dividends				-500	-500
Issue of share capital	1000	-1000			
Balance at 31 August 20X9	6000	1000	2,000	2,091	11,091

Equity represents the value attributable to the owners (ordinary shareholders) of the company. The book value of equity is calculated as the difference between total assets and total liabilities. The statement of changes in equity show what changes occurred for ordinary shareholders during the financial year. Start by including the opening year balances from the previous year and the closing year balances for the current year (see the statement of financial position).

Included in total comprehensive income (see the statement of profit or loss) is profits for the period from continuing operations (£402,000) and 'other comprehensive income' which is the revaluation surplus (£2,000,000) for the property revalued during the year. The purpose of other comprehensive income (OCI) is to show 'unrealised gains and losses' meaning the revaluation surplus reflects an increase in the value of the property but since it has not actually been sold then the gain has not actually been 'realised'.

Include any payment of dividends to ordinary shareholders, this amount of £500,000 is paid out of retained earnings (accumulated profits) and deducted from this reserve account to work out the retained earnings left that potentially could be paid out as dividends to ordinary shareholders in the future.

A bonus issue (free shares) was mentioned in the task. You were not required to work out the effects of the bonus issue as these were already included in the statement of financial position. A bonus issue is the issue of free shares to existing shareholders based on the number of shares currently held. It is normally used as an alternative to paying a dividend when a company is cash starved. Given there is no cash proceeds, the double entry would be DR Share Premium (reducing this reserve) and CR Share Capital (increasing this reserve). There was £5m ordinary shares in issue before the bonus issue and it was a 1 for 5 bonus issue (one share given free for every 5 shares held), so £5m ÷ 5 x 1 = £1m extra shares issued.

If all the above has been applied correctly the closing balances for reserves in the statement of changes in equity should agree to the closing balances for reserves within the statement of financial position for the year ended.

Task 3 (8 marks)

The IASB's Conceptual Framework for financial reporting specifically addresses:

- The objective of financial reporting.
- Qualitative characteristics of useful financial information.
- Financial statements and the reporting entity.
- The elements of financial statements.
- Recognition and derecognition.
- Measurement.
- Presentation and disclosure (not examined).
- Concepts of capital and capital maintenance (not examined).

(a) (i) Explain the definitions of assets and liabilities as elements within the financial statements, according to the IASBs Conceptual Framework for Financial Reporting. (2 marks)

Asset

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity e.g. the new bakery oven.
1 mark maximum for the definition of an asset.

Liability

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits e.g. the bank loan to finance the new bakery oven.
1 mark maximum for the definition of a liability

(a) (ii) Explain why the new bakery oven and bank loan should be recognised as an asset and liability respectively, according to the IASBs Conceptual Framework for Financial Reporting.

(4 marks)

In the case of the new bakery oven, it is probable that future economic benefits will flow to the entity by way of sales or profits that the machine will generate over its lifetime, from making cakes and biscuits. The asset also has a cost or value that can be measured reliably, the purchase cost was £280,000.
2 marks maximum for the new bakery oven.

In the case of the bank loan, a liability is recognised when it is probable that an outflow of economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In this case it is likely a legal contract exists with the bank, so the liability must be settled or repaid in the future and repayment can be measured reliably.
2 marks maximum for the bank loan.

(a) (iii) Identify TWO measurement bases which could be used to determine how the bakery oven is recognised in the financial statements as at 31 August 20X9.

(2 marks)

- £150,000 net realisable value (or market/second-hand value after disposal costs).
- £280,000 historical cost.

1 mark maximum for identifying each method.

You were only expected to identify (not explain) two methods. However, for further revision net realisable value (NRV) is the £150,000 price the oven could be sold for today, minus any estimated costs of selling or disposing of the asset. Historical cost is the amount of money originally spent to acquire the asset which was £280,000. Historical cost means the original cost and maybe very different to NRV especially when an asset has been owned for several years.

Task 4 (12 marks)

(a) The recoverable amount of the asset is

(3 marks)

£18,000	☐
£20,000	☐
£22,000	✓
£50,000	☐

The recoverable amount of an asset is always the higher of its net realisable value (£18,000) or value in use (£22,000). Net realisable value (NRV) is the sale proceeds (less any selling costs) the company could receive if the asset was sold today. The value in use (also called economic value) is the present value of the assets future cash flows from profits generated over its lifetime. According to IAS 36 Impairment of Assets, whenever an assets recoverable amount falls below its net book value (carrying value in the statement of financial position) it is prudent to write down the value of the asset to its recoverable amount. Impairments are 'recognised' as an expense in the profit or loss account.

(b) Which ONE of the following would be classified by WDC Limited as a non-adjusting event according to IAS 10 *Events After The Reporting Period.*

(3 marks)

WDC was notified on 5 November 20X1 that one of its customers was insolvent and was unlikely to repay any of its debts. The balance outstanding at 30 September 20X1 was £42,000.	☐
On 30 September WDC had an outstanding court action against it. WDC had made a provision in its financial statements for the year ended 30 September 20X1 for damages awarded against it of £22,000. On 29 October 20X1 the court awarded damages of £18,000.	☐
On 5 October 20X1 a serious fire occurred in WDC's main production centre and severely damaged the production facility.	✓
The year end inventory balance included £50,000 of goods from a discontinued product line. On 1 November 20X1 these goods were sold for a net total of £20,000.	☐

Events after the reporting period (year ended) that are favourable or unfavourable, that occur between the end of the reporting period and the date that the financial statements are authorised (signed and approved by the board of directors). IAS 10 Events after the Reporting Period provides guidance as to which events should lead to adjustments to the financial statements, or instead disclosed as a note in the financial statements.

- Adjusting events provide evidence about conditions that existed at the year end 30 September 20X1 (adjust the financial statements, if the adjustment has a material effect).
- Non-adjusting events provide evidence about conditions that existed after the year end 30 September 20X1 (disclose as a note in the financial statements, if material to a user).

WDC was notified on 5 November 2011 that one of its customers was insolvent and was unlikely to repay any of its debts. The balance outstanding at 30 September 2011 was £42,000. **This is an adjusting event as it provides evidence about trade receivables that existed at the year-end date.**

On 30 September WDC had an outstanding court action against it. WDC had made a provision in its financial statements for the year ended 30 September 2011 for damages awarded against it of £22,000. On 29 October 2011, the court awarded damages of £18,000. **This is an adjusting event as it provides evidence about the amount of provision that existed at the year-end date.**

On 5 October 2011, a serious fire occurred in WDC's main production centre and severely damaged the production facility. **The fire occurred after the year end so doesn't affect the year end statement of financial position, it a non-adjusting event.**

The year-end inventory balance included £50,000 of goods from a discontinued product line. On 1 November 2011, these goods were sold for a net total of £20,000. **This is an adjusting event as it provides evidence about the impairment of inventory that existed at the year-end date.**

(c) How much sales revenue should be recognised as income in PQR's financial statements for the year ended 31 October 20X7.

(3 marks)

£25,000 ☐

£50,000 ☑

£100,000 ☐

£150,000 ☐

International Accounting Standard (IAS) 18 and International Financial Reporting Standard IFRS 15 both guide revenue recognition. The basic foundation of these accounting principles is how to recognise revenue and other forms of income in the financial statements. Revenues are recognised when they are realised or realisable, and are earned (usually when goods are transferred or services rendered), no matter when the actual cash was received.

Workings

- £150,000 was received from the supermarket on 1 September 20X7 for 6 months' supply of newspapers (the same quantity and therefore value supplied each month).
- This equates to £25,000 per month (£150,000 ÷ 6 months), so for the year ended 31 October 20X7 PQR has earned 2 months of revenue (2 x £25,000) = £50,000 which should be recognised as income for the year ended 31 October 20X7.
- The remaining £100,000 received would be shown as deferred income in the statement of financial position at the year end and is not recognised as income in the statement of profit or loss for the year ended 31 October 20X7.

(d) Identify whether the following statements are true or false for XYZ for its year ended 31 October 20X7.

(3 marks)

	TRUE	FALSE
The building must be impaired by £300,000 and this loss of value charged as an expense in the statement of profit or loss.	☐	☑
The building must be impaired by £300,000 and this loss of value posted to the revaluation reserve in the statement of financial position.	☑	☐
The building must be revalued by £500,000 and this unrealised gain posted to the revaluation reserve in the statement of financial position.	☐	☑

The original revaluation gain of £800,000 (£1.8m - £1.0m) on 31 October 20X6 would have been posted to a revaluation reserve and presented as equity reserves in the statement of financial position. The gain is unrealised and would have been reported as other comprehensive income in the statement of profit or loss.

The subsequent revaluation loss of £300,000 (£1.8m - £1.5m) on 31 October 20X7 can be offset against the revaluation reserve (gain) held previously for this building within the statement of financial position. This amount should also be included under other comprehensive income (as a loss) within the statement of profit or loss.

Task 5 (30 marks)

Draft the consolidated financial position of ABC Ltd and its subsidiary undertaking as at 31 August 20X9.

(30 marks)

ABC Ltd - Consolidated statement of financial position as at 31 August 20X9

	£000
Assets	
Non-current assets	
Goodwill	2200
Property, plant and equipment	11500
	13700
Current assets	
Inventories	3920
Trade and other receivables	1850
Cash and cash equivalents	2880
	8650
Total assets	22350
EQUITY AND LIABILITIES	
Equity	
Share capital	5000
Retained earnings	9590
Non-controlling interest	1360
Total equity	15950
Non-current liabilities	5000
Current liabilities	
Trade and other payables	1230
Taxation	170
	1400
Total liabilities	6400
Total equity and liabilities	22350

Investment in XYZ Ltd
The basic idea of a consolidated financial position is to remove the investment cost of £4,000,000 that ABC holds in XYZ (held under non-current assets in ABCs financial position) and replace this figure with the net assets of XYZ and any goodwill figure to acquire the net assets of XYZ.

This gives shareholders of the parent company (ABC) a better understanding of the net assets of both companies as a single entity (consolidated). If we are to represent the financial statements as a 'single entity', then the single entity cannot hold 'an investment in itself', so the £4 million investment cost in XYZ must be removed on consolidation.

Goodwill
ABC acquired 60% of the share capital of XYZ Ltd on the 1 June 20X1 for £4,000,000 (this figure included in ABC's financial position as an investment in XYZ Ltd). On the acquisition date the retained earnings of XYZ Ltd were £2,000,000 and its share capital was £1,000,000 (a total of £3,000,000 preacquisition reserves). If the equity of XYZ was £3,000,000 then it also means the net assets (total assets less total liabilities) of XYZ were also £3,000,000, since assets less liabilities equals capital or 'equity'.

ABC paid £4,000,000 to acquire a 60% share of the equity (or net assets) of XYZ. Therefore goodwill paid to acquire XYZ would be the price paid less 60% of the fair value of the net assets acquired.

Price paid (investment by ABC)	£4,000,000
60% of equity (net assets of XYZ) 60% x £3,000,000 =	£1,800,000
Goodwill (a non-current asset)	£2,200,000

Goodwill is capitalised as a non-current asset in the consolidated financial position.

The task stated that ABC Ltd has decided that non-controlling interest will be valued at their proportionate share of net assets. This refers to the goodwill note (see workings box below). The workings box provided in your exam task will use the accounting standard as terminology and would include 100% of XYZ's net assets (£3,000,000) in the goodwill calculation.

Since ABC only purchased 60% (not 100%) of the net assets (equity) of XYZ, then the other 40% (non-controlling interest) is included in the goodwill calculation to represent consideration to acquire the other 40% of XYZ's net assets (equity). As stated in the task, consideration by the non-controlling interest to acquire XYZ's equity should be 'valued at their proportionate share of net assets' (40% x £3,000,000 = £1,200,000 consideration paid by non-controlling interest).

Goodwill	£000
Consideration	4000
Non-controlling interest at acquisition	1200
Net assets acquired	-3000
	2200

Property, plant and equipment (PPE)
No change needs to be made for PPE. The consolidated financial position would include the total of PPE for both companies (ABC £10 million + XYZ £1.5 million = Total PPE £11.5 million).

Inventories and the provision for unrealised profit (PUP)
ABC has sold goods (inventory) to XYZ (intercompany sales). If goods are sold internally but then sold on to other third parties (buyers outside the group), then no adjustment is required since all profits have been 'realised' by selling the goods on to a third party.

If goods sold internally still remain unsold at the financial year end then 'unrealised' profits are being reported by the seller. Given we are consolidating the assets and liabilities of both companies as 'one single entity' it would be wise to remove any reported profits that are unrealised. Otherwise profits reported would be overstated as we now represent the financial statements as a single entity making profits by 'selling goods to itself'. The value of closing inventory (an asset) would also be overstated.

ABC made sales to XYZ. (Sales £1,000,000 - Cost of sales £400,000 = Profit £600,000). 25% (one quarter) of these goods were unsold by XYZ at the financial year end. Therefore unrealised profits would be 25% x Profit £600,000 = £150,000.

The rule is always to adjust the sellers (ABC's) books on consolidation.

Adjustment in the accounting system of ABC:

- Debit Increase Cost of Sales (profit or loss account) £150,000.
- Credit Decrease Inventories (financial position) £150,000.

Inventories in the financial position will be reduced by £150,000 and Cost of Sales in the profit or loss account will be increased by £150,000 (closing inventories have fallen so cost of sales will increase). ABC (the seller) will report £150,000 less profit because Cost of Sales have increased, remember this point later when calculating ABC's retained earnings in the financial position, if profits are lower, then ABC's retained earnings will be lower.

The workings box provided in the exam task would include the total of inventories for both companies less the provision for unrealised profit (PUP). ABC £3.4 million + XYZ £0.67 million less PUP £0.15 million = Total inventories £3.92 million.

Inventory	£000
ABC Ltd	3400
Provision for unrealised profit for inventory sold	-150
XYZ Ltd	670
	3920

Trade and other receivables
Given we are consolidating the assets and liabilities of both companies as 'one single entity' then intercompany balances owing (due to the sale of goods) should be eliminated as a single entity cannot owe money to itself. Intra-group trade receivables and trade payables at the year-end must be eliminated in the consolidated financial position. At present ABC has trade receivables (an asset from selling goods to XYZ) of £650,000 and XYZ has trade payables (a liability from buying goods from ABC) of £350,000. We cannot eliminate intercompany balances unless they reconcile.

There was cash in transit of £300,000 paid from XYZ to ABC. XYZ has already adjusted its books for the cash it sent to ABC (reducing or debiting its trade payables and reducing crediting its bank by £300,000). The rule with cash in transit is to follow the money to its ultimate destination, which is to ABC and adjust their accounting system (reducing or crediting its trade receivables and increasing debiting its bank by £300,000).

When ABC has adjusted its books its trades receivables now owing from XYZ will now fall to £350,000 (£650,000 owing less cash in transit £300,000). Intercompany balances owing would now reconcile and can be eliminated in the consolidated financial position.

The workings box provided in the exam task would include the total of all trade and other receivables for both companies less the £300,000 cash in transit received by ABC and the remaining £350,000 trade receivables eliminated (as an intercompany balance).

Trade and other receivables	£000
ABC Ltd	1600
XYZ Ltd	900
Inter-company adjustment	-350
Cash in transit	-300
	1850

Cash and cash equivalents
The workings box provided in the exam task would include the total of all cash and cash equivalents for both companies and increased for the £300,000 cash in transit received by ABC.

Cash and cash equivalents	£000
ABC Ltd	1800
XYZ Ltd	780
Cash in transit	300
	2880

Trade and other payables
The workings box provided in the exam task would include the total of all trade and other payables for both companies less £350,000 trade payables eliminated (as an intercompany balance).

Trade and other payables	£000
ABC Ltd	1180
XYZ Ltd	400
Inter-company adjustment	-350
	1230

Taxation
No adjustment needs to be made for taxation. The consolidated financial position would include the total for both companies (ABC £120,000 + XYZ £50,000 = Total £170,000).

Non-current liabilities
No adjustment needs to be made for non-current liabilities. The consolidated financial position would include the total for both companies (ABC £5 million + XYZ £0 million = Total £5 million).

Share capital
Only the parent company's (ABC's) share capital of £5 million would be included in the consolidated financial position. The share capital of XYZ (the subsidiary) represents preacquisition reserves and would not be included in the consolidated financial position. XYZ's preacquisition reserves would be included in the goodwill calculation.

Retained earnings
ABC's retained earnings of £9.5 million would be included in the consolidated financial position. However, a provision for unrealised profit (PUP) of £150,000 has reduced ABC's profits for the accounting period. The workings box provided in the exam task (see below) must reduce ABC's retained earnings, since it is always the sellers books that would be adjusted for a PUP.

XYZ has retained earnings of £2.4 million, however £2.0 million of retained earnings represents preacquisition reserves and would not be included in the consolidated financial position. XYZ's preacquisition reserves would be included in the goodwill calculation. You need to include a 60% share of the post-acquisition retained earnings of XYZ. 60% x (£2.4 million retained earnings less £2.0 million pre-acquisition retained earnings) = £240,000 post acquisition retained earnings included in the consolidated financial position.

Retained earnings	£000
ABC Ltd	9500
Provision for unrealised profit for inventory sold	-150
XYZ Ltd - attributable to ABC Ltd	240
	9590

Non-controlling interest (NCI)
There is no workings box provided in your AAT exam for the calculation of non-controlling interest. ABC owns 60% of the equity reserves (net assets) of XYZ. You need to show the equity reserves (net assets) of XYZ owned by the other 40% of minority shareholders.

The equity (net assets) of XYZ is £3.4 million (share capital £1.0 million + retained earnings £2.4 million) and this value has not changed due to any consolidated adjustments made. 40% non-controlling interest (NCI) x £3.4 million = £1.36 million NCI included in the consolidated financial position.

Task 6 (8 marks)

Calculate the above ratios to ONE decimal place.

(8 marks)

Asset turnover (non-current assets)	3.5	times
Inventory holding period	14.2	days
Current ratio	2.8	: 1
Return on shareholders' funds	12.4	%

Workings (all calculations rounded to one decimal place)

Asset turnover (non-current assets) = revenue / non-current assets = X times.
Asset turnover (non-current assets) = 4500 / 1300 = 3.5 times.
Shows how efficient and productive non-current (long-term) assets are at generating sales (revenue).

Inventory holding period (days) = inventories / cost of sales x 365 (days).
Inventory holding period (days) = 150 / 3845 x 365 = 14.2 days.
Shows the length of time (days) that inventories are held before sale to customers.

Current ratio = current assets / current liabilities = X:1.
Current ratio = 930 / 335 = 2.8 : 1.
Shows the liquidity (or solvency) position of the business to cover its short-term liabilities (current liabilities) from its current assets held.

Return on shareholders' funds = profit after tax / total equity x 100%.
Return on shareholders' funds = 123 / 995 x 100% = 12.4%.
Shows the returns to equity (ordinary) shareholders of the business from the profits after tax the business has generated.

Task 8 (22 marks)

(a) Identify whether each ratio is better or worse compared to the previous year. Explain what each ratio may tell you about the company. (20 marks)

Exam note: 1 mark to identify whether the ratio is better or worse. 1-2 marks for each relevant point about what this may tell you about the company. Maximum 5 marks awarded for each ratio.

	20X8	**20X7**
Gearing	145%	85%
Interest cover	1.7 times	3.1 times
Trade payables	54 days	31 days
Operating profit percentage	13.6%	12.4%

Gearing

	Better	**Worse**
Gearing	☐	☑

Gearing = total debt / total debt + total equity x 100%. Where total debt is non-current liabilities and total equity is ordinary shareholders equity reserves. The rise in gearing suggests the company is carrying too much long-term debt. This increases the financial risk of the company as more cash generated from operations is required to meet debt and interest payments. This may affect Susan's ability to receive future dividends in the company, if she buys shares. A rise in gearing could also mean it is more difficult for the company to obtain more loans in the future. Gearing is inter-related strongly with interest cover, because when debt (gearing) rises, then interest cover tends to worsen as interest payments will normally rise.

Interest cover

	Better	**Worse**
Interest cover	☐	☑

Interest cover = profit from operations / finance costs (i.e. interest) = X times. Lower interest cover indicates less operating profits will be available after interest payments from borrowing (debt). This makes the company higher financial risk to investors (equity) and lenders (debt). The worsening position is either caused by less profits available to meet interest payments, or higher interest payments. More debt (higher gearing) tends to make this ratio worse because interest payments tend to rise as the company takes on more debt. This could make it more difficult for the company to obtain more finance in the future.

Trade payables

	Better	Worse
Trade payables	☑	☐

Trade payables payment period = trade payables / cost of sales x 365 (days). This ratio indicates VUW Ltd is taking longer to pay its suppliers. This is generally better for cash-flows, since taking longer to pay suppliers holds money in the bank for longer (or avoids a poorer overdraft position). Taking longer to pay suppliers can be viewed by some businesses as a free source of short-term finance.

The reasons for a longer period to pay suppliers, could be either renegotiated payment terms with suppliers, or that the company is cash starved and cannot pay its suppliers on time. The latter may indicate the company has solvency problems.

Operating profit percentage

	Better	Worse
Operating profit percentage	☑	☐

Operating profit percentage = profit from operations / revenue x 100%. Operating profit percentage has got slightly better compared with the previous year. The reasons could be anything from higher prices from sales achieved, higher volume of sales achieved, or lower cost of sales (or expenses) compared with the previous year.

This ratio tends to improve with the size and efficiency of a company e.g. larger companies can share overheads over a greater volume of sales, or obtain bigger discounts for their cost of sales, due to a higher volume of orders made. Cost savings as a result of size are referred to as economies of scale, which help improve profits by reducing the cost of goods or services sold by the business. This may suggest that VUW has either become more efficient or has scaled up the size of its business.

(b) Recommend with reasons, whether or not Susan should buy shares in VUW Ltd, based solely on your analysis of the ratios in part (a) above.

(2 marks)

Exam note: 1 mark for a relevant point made. 1 mark maximum for advice (buy or not to buy the shares). Maximum 2 marks awarded.

My advice to Susan is not to buy the shares. The gearing and interest cover have worsened drastically. Generally, gearing (debt) should not exceed more than 50% of total debt + total equity (currently it is 145%) and interest cover should be ideally 3 times or more that profits cover interest payments (currently it is 1.7 times).

The company is also taking much longer to pay its suppliers. All these ratios indicate the company may have cash-flow problems, which may cause going concern problems for the business.