# UNIVERSITY OF BOLTON

# INSTITUTE OF MANAGEMENT

# BA (HONS) ACCOUNTANCY

# SEMESTER 1 EXAMINATIONS 2019/20

# FINANCIAL ACCOUNTING AND REPORTING AND FINANCIAL ACCOUNTING AND THE REGULATORY FRAMEWORK

# MODULE NO: ACC5001/BMP6018

**Date: Monday 13 January 2020 Time: 10.00 – 1.00**

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**INSTRUCTIONS TO CANDIDATES:**

**There are 5 questions in this examination; answer ALL 3 questions from section A and ONE question from section B:**

**This is a closed book examination.**

**You must hand in this exam paper with your answer booklet.**

## Section A answer all 3 questions

**Question 1**

You are the financial accountant for Bilbo Limited, a company that manufactures student festival clothing and sells to both retail and wholesale companies. The financial year ended 31 December 2019 has just passed and you have been provided with the draft financial statements (below) by the Director of Finance. They have not had time to complete the statement of cashflows and have tasked you to do this whilst they are away on a business trip.

Statement of profit or loss for the year ended 31 December 2019

| | £000 |
|---|---|
| Revenue | 53,600 |
| Cost of sales | (36,420) |
| Gross profit | 17,180 |
| Dividends received | 45 |
| Loss on disposal of non-current assets | (110) |
| Distribution costs | (11,163) |
| Administration expenses | (4,032) |
| Profit from operations | 1,920 |
| Finance costs | (109) |
| Profit before taxation | 1,811 |
| Taxation | (347) |
| Profit for the year | 1,464 |



**Question 1 continues over the page**

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**Question 1 continued**

Statement of financial position as at 31 December 2019

| | 2019 | 2018 |
|---|---|---|
| **ASSETS** | £000 | £000 |
| **Non-current assets** | | |
| Property plant and equipment | 12,832 | 9,911 |
| **Current assets** | | |
| Inventory | 5,057 | 5,168 |
| Trade receivables | 5,341 | 4,730 |
| Cash and cash equivalents | 0 | 1,360 |
| | 10,398 | 11,258 |
| **Total Assets** | 123,230 | 21,169 |
| **EQUITY AND LIABILITIES** | | |
| Share capital | 8,000 | 6,000 |
| Share premium | 2,000 | 1,000 |
| Retained earnings | 6,052 | 5,183 |
| **Total equity** | 16,052 | 12,183 |
| **Non-current liabilities** | | |
| Bank loan | 0 | 2,280 |
| **Current liabilities** | | |
| Trade payables | 6,721 | 6,410 |
| Tax payable | 347 | 296 |
| Bank overdraft | 110 | 0 |
| | 7,178 | 6,706 |
| **Total liabilities** | 7,178 | 8,986 |
| **Total equity and liabilities** | 23,230 | 21,169 |



**Additional information:**

- Depreciation in the year amounted to £1,520,000.
- PPE originally costing £450,000 with associated depreciation of £210,000 was sold in the year.
- All sales and purchases were on credit, all other expenses were paid for in cash.
- A dividend of £595,000 was paid to the shareholders during the year.

**Required:**

In accordance with IAS7, prepare the statement of cashflows for Bilbo Limited for the year ended 31 December 2019 suitable for publication. Please keep all workings on a separate page to the statement of cash flows.

**(Total 25 Marks)**

**End of question 1 - Questions continue over the page**

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**Question 2**

You are the financial accountant for BrillHolidays.com, an online holiday provider direct to the public. The directors are looking to grow by acquisition and have identified a potential target company. The financial statements of that target company are provided below along with BrillHolidays.com for the year ended 31 December 2019:

**Statements of profit or loss for the year ended 31 December 2019**

| | Brillholidays.com | Target company |
|---|---|---|
| | £000 | £000 |
| Revenue | 4,600 | 4,300 |
| Cost of sales | (2,245) | (2,135) |
| Gross profit | 2,355 | 2,165 |
| Other expenses | (1,582) | (1,491) |
| Profit for the year | 773 | 674 |

**Statements of financial position as at 31 December 2019**

| | | |
|---|---|---|
| **ASSETS** | | |
| **Non-current assets** | | |
| Property plant and equipment | 5,534 | 6,347 |
| **Current assets** | | |
| Inventory | 566 | 544 |
| Trade receivables | 655 | 597 |
| Cash and cash equivalents | 228 | 104 |
| | 1,449 | 1,245 |
| **Total Assets** | 6,983 | 7,592 |
| **EQUITY AND LIABILITIES** | | |
| Share capital | 2,300 | 2,000 |
| Share premium | 670 | 450 |
| Retained earnings | 1,375 | 1,140 |
| **Total equity** | 4,345 | 3,590 |
| **Non-current liabilities** | | |
| Bank loan | 1,824 | 3,210 |
| **Current liabilities** | | |
| Trade payables | 572 | 504 |
| Tax payable | 242 | 288 |
| | 814 | 792 |
| **Total liabilities** | 2,638 | 4,002 |
| **Total equity and liabilities** | 6,983 | 7,592 |

**Question 2 continues over the page – please turn the page**

**Question 2 continued**

**Additional information:**
The industry average ratios have been extracted form the financial press as follows:

ROCE: 11.3%
Operating profit percentage: 16.4%
Acid test ratio: 1.0:1
Gearing: 31%

**Required:**

Prepare a report for the directors that includes a comparison of the target company with that of your own and also the industry average ratios. Additionally you must compute trade receivable/payable days, inventory turnover and GP% for both companies. Your conclusion should include a recommendation as to whether or not an investment in the Target company should be made (workings should be on a separate page to your report and to one decimal place).

**(25 marks)**

**End of question 2**

**Questions continue over the page**

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**Question 3**

Debro manufactures high-quality tinned soups and other food products. The company spends a great deal of money advertising its products on television and in newspapers and magazines. The company sells its products to major retailing organisations.

Debro trial balance at 30 September 2019 is as follows:

| | £000 | £000 |
|---|---|---|
| Administration costs | 170 | |
| Advertising costs | 1,100 | |
| Bank | 17 | |
| Income tax | | 24 |
| Cost of new brand name | 1,600 | |
| Other manufacturing creditors | | 330 |
| Distribution costs | 240 | |
| Dividend (declared 1 December 2018) | 500 | |
| Plant and machinery – cost at 30 September 2018 | 1,200 | |
| Plant and machinery – depreciation at 30 September 2018 | | 520 |
| Premises – cost at 30 September 2018 | 3,300 | |
| Premises – depreciation at 30 September 2018 | | 794 |
| Retained earnings | | 461 |
| Purchases and other manufacturing costs | 1,900 | |
| Revenue | | 9,700 |
| Share capital | | 1,000 |
| Inventories at 30 September 2018 | 32 | |
| Trade payables | | 230 |
| Trade receivables | 850 | |
| Salaries – administration | 980 | |
| Salaries – distribution | 470 | |
| Salaries – manufacturing | 700 | |
| | 13,059 | 13,059 |

**Question 3 continues over the page**

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**Question 3 continued**

Additional information:

- Inventories were physically counted at 30 September 2019 and were valued at £39,000.
- Premises are to be depreciated at 2% of cost, and plant and machinery at 25% on the reducing balance basis. All depreciation is to be treated as part of the cost of goods sold. The company did not purchase or sell any tangible non-current assets during the year.
- The balance on the income tax account represents the amount remaining after the settlement of all tax liabilities up to and including those for the year ended 30 September 2018.
- The balance on the other manufacturing creditors account is to be increased to £390,000.
- The tax charge on the profits for the year ended 30 September 2019 is estimated at £940,000.
- During the year the company purchased an established brand name from and other manufacturing company which was selling its food business. The Directors of Debro have decided that the cost of this acquisition should be capitalised as a non-current intangible asset. A full year's amortisation is to be charged for the year ended 30 September 2019. Amortisation of the brand name is to be treated as part of the cost of goods sold. The useful life of the brand is estimated to be 10 years.
- A customer is suing the company for compensation of £200,000 for a serious injury caused in June 2019 by a sharp object which was accidentally packed in a can of soup. Debro's lawyers have warned the directors that that the court is likely to award damages of approximately the amount claimed and that payment will probably be due in December 2020.
- A final dividend of £700,000 is proposed by the directors.

**Required:**

Prepare for Debro:

(a) A statement of profit or loss and other comprehensive income for the year ended 30 September 2019; and (10 marks)

(b) A statement of financial position as at 30 September 2019. (20 marks)

Note**:** A statement of changes in equity is not required. Disclosure notes are not required.

**(Total: 30 marks)**

**End of question 3 - End of Section A – Questions continue over the page**

**Section B answer ONE question only from this section**

**Question 4**

IAS 38 Intangible Assets defines the difference between research expenditure and development expenditure. IAS 38 also lays down rules which must be applied to the capitalisation of research and development expenditure.

**Required:**

**a)** Explain the meaning of the terms research expenditure and development expenditure. **(6 marks)**

**b)** Explain the criteria applied to research and development expenditure, according to IAS 38, to determine whether the cost should be capitalised. **(11 marks)**

**c)** Discuss briefly why there was a need for an accounting standard relating to research and development expenditure. **(8 marks)**

**(Total: 25 marks)**

**End of question 4**

**Questions continue over the page**

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**Question 5**

The timing of revenue (income) recognition has long been an area of debate and inconsistency in accounting. The operating cycle of enterprises may involve the following stages:

- obtaining an order for goods prior to manufacture
- acquisition of goods or raw materials (including extraction)
- production of goods
- obtaining an order for goods in inventory
- delivery of goods
- collection of cash (re: credit sales)
- provision of after sales service or warranties.

In many countries the 'critical event' approach has traditionally been used to determine the timing of income recognition. The International Accounting Standards Board in its Conceptual Framework for Financial Reporting (Framework) identifies 'elements' of financial statements and uses these to determine when income or expenses occur. These principles also form the basis of revenue recognition in IFRS15 Revenue from Contracts with Customers.

**Required:**

(a) In relation to each of the above stages in the operating cycle discuss, giving practical examples where possible, the circumstances in which the critical event may be deemed to have occurred at that stage. (10 marks)

(b) Discuss the criteria used in the Framework to determine when income and expenses arise, and how they should be reported. (5 marks)

(c) Discuss the how IAS 2 (Accounting for inventories) requires inventory to be valued in the year end financial statements (your answers should include discussion on various valuation techniques including the IAS treatment on LIFO, FIFO, weighted average, absorption costing etc and also damaged/unsaleable inventory). (10 marks)

**(Total: 25 marks)**

**End of question 5**

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**END OF QUESTIONS**