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UNIVERSITY OF BOLTON

INSTITUTE OF MANAGEMENT

BSc (HONS) BUSINESS MANAGEMENT

SEMESTER 1 EXAMINATIONS 2021/22

FINANCIAL ACCOUNTING AND THE REGULATORY FRAMEWORK

MODULE NO: BMP6018

Date: Monday 10 January 2022 **Time: 10.00am – 1.00pm**

INSTRUCTIONS TO CANDIDATES:

There are four compulsory questions on this paper.

Answer **all four** questions.

All questions carry equal marks.

Calculators may be used but full workings must be shown.

Appendices: Financial statements template and ratio analysis formulae sheet.

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Question 1

Threads Limited manufactures nuts and bolts, which are sold to industrial users. The abbreviated financial statements for 2017 and 2018 are as follows:

Income statements for the year ended 30 June

	2017 £000	**2018 £000**
Revenue	1180	1200
Cost of sales	(680)	(750)
Gross profit	**500**	**450**
Operating expenses	(200)	(208)
Depreciation	(66)	(75)
Operating profit	**234**	**167**
Interest	-	(8)
Profit before taxation	**234**	**159**
Taxation	(80)	(48)
Profit for the year	**154**	**111**

Question 1 continues over the page

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Question 1 continued

Statements of financial position as at 30 June

	2017 £000	**2018 £000**
ASSETS		
Non-current assets		
Property, plant and equipment	702	687
Current assets		
Inventories	148	236
Trade receivables	102	156
Cash	3	4
	253	396
Total assets	955	1083
EQUITY AND LIABILITIES		
Equity Ordinary share capital (£1 shares, fully paid)	500	500
Retained earnings	256	295
	756	**795**
Non-current liabilities		
Borrowings – bank loan	**-**	**50**
Current liabilities		
Trade payables	**60**	**76**
Other payables and accruals	**18**	**16**
Taxation	**40**	**24**
Short-term borrowings (all bank overdraft)	**81**	**122**
	199	238
Total equity and liabilities	955	1083

Dividends were paid on ordinary shares of £70,000 and £72,000 in respect of 2017 and 2018, respectively.

Question 1 continues over the page

Question 1 continued

Required:

(a) Calculate the following financial ratios for both 2017 and 2018 (using year-end figures for statement of financial position items):

1 return on capital employed (3 marks)
2 operating profit margin (2 marks)
3 gross profit margin (2 marks)
4 current ratio (2 mark)
5 acid test ratio (2 marks)
6 settlement period for trade receivables (2 marks)
7 settlement period for trade payables (2 marks)

(15 marks)

b) Comment on the performance of Threads Limited from the viewpoint of a business considering supplying a substantial amount of goods to Threads Limited on usual trade credit terms.

(5 marks)

c) What potential problems arise particularly for the external analyst from the use of statement of financial position figures in the calculation of financial ratios?

(5 marks)

Total 25 marks

Question 2

Silver and Fox have just completed their first year in business as a partnership. When the partnership was formed they drew up the following agreement relating to financial matters.

- Silver would contribute £200,000 and Fox would contribute £120,000 as capital for the business.

Question 2 continues over the page

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Question 2 continued

- Interest on drawings to be charged at 5% per year on a monthly basis.
- They would each receive interest on capital at 10% per year.
- Each would receive a salary of £40,000 per year.
- Any loans made by the partners over and above their agreed capital contribution would attract interest at 7½ % per year.
- Profits or losses would be shared equally.

The partners also decided to keep separate Capital and Current Accounts.

The summarised Trial Balance of the partnership at the end of the first year of trading was as follows:

Trial Balance as at 31st December 2019

			DR £000	CR £000
Sales				400
Purchases			200	
Expenses			40	
Non-Current Assets			320	
Current Assets			120	
Current Liabilities				40
Long-term loan (Silver)				40
Capital:	Silver			200
	Fox			120
Drawings:	Silver	80		
	Fox	40		
			800	800

Notes:

1. There was no closing inventory.
2. The drawings were all made on 1st July 2019.
3. The loan was made by Silver to the business on 1st January 2019.

Required:

Calculate the net profit for the year. **(5 marks)**

Show the appropriation account and the partners' current and capital accounts. **(10 marks)**

Question 2 continued over the page

Question 2 continued

Prepare the Statement of financial position as at 31 December 2019.

(10 marks)

Total 25 marks

Question 3

a) Define the following accounting conventions using relevant examples. Each definition is worth 2 marks.

I. Historic cost;
II. Dual aspect;
III. Prudence;
IV. Materiality;
V. Matching.

(10 marks)

b) Plumber and Company has a fleet of motor vans that are used for making deliveries to customers. The owners want to show these vans on the statement of financial position at their current values rather than at their historic cost. They would like to use either current replacement cost (based on how much would have to be paid to buy vans of a similar type, age and condition) or current realisable value (based on how much a motor van dealer would pay for the vans, if the business sold them).

Why is the choice between the two current valuation methods important? Why would both current valuation methods present problems in establishing reliable values?

(5 marks)

c) ‘Depreciation is a process of allocation and not valuation.’ What do you think is meant by this statement? Discuss.

(5 marks)

Question 3 continued over the page

Question 3 contined

d) What is the convention of consistency? Does this convention help users in making a more valid comparison between businesses?

(5 marks)

Total 25 marks

Question 4

TT and Co. is a new business that started trading on 1 January 2020. The following is a summary of transactions that occurred during the first year of trading:

1. The owners introduced £50,000 of equity, which was paid into a bank account opened in the name of the business.
2. Premises were rented from 1 January 2020 at an annual rental of £20,000. During the year, rent of £25,000 was paid to the owner of the premises.
3. Rates (a tax on business premises) were paid during the year as follows:

   a. For the period 1 January 2020 to 31 March 2020 £500
   b. For the period 1 April 2020 to 31 March 2021 £1,200

4. A delivery van was bought on 1 January 2020 for £12,000. This is expected to be used in the business for four years and then to be sold for £2,000.
5. Wages totalling £33,500 were paid during the year. At the end of the year, the business owed £630 of wages for the last week of the year.
6. Electricity bills for the first three quarters of the year were paid totalling £1,650. After 31 December 2020, but before the financial statements had been finalised for the year, the bill for the last quarter arrived showing a charge of £620.
7. Inventories totalling £143,000 were bought on credit.
8. Inventories totalling £12,000 were bought for cash.
9. Sales revenue on credit totalled £152,000 (cost of sales £74,000).
10. Cash sales revenue totalled £35,000 (cost of sales £16,000).
11. Receipts from trade receivables totalled £132,000.
12. Payments of trade payables totalled £121,000.
13. Van running expenses paid totalled £9,400.

Question 4 continued over the page

Question 4 continued

At the end of the year it was clear that a credit customer who owed £400 would not be able to pay any part of the debt. All the other trade receivables were expected to be settled in full.

The business uses the straight-line method for depreciating non-current assets.

Required:

Prepare a statement of financial position as at 31 December 2020 and an income statement for the year to that date.

Total 25 marks

END OF QUESTIONS

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Appendices:

1) Financial Statements Template

Note: These are suggested templates with example items listed under specific sections such as expenses and current assets. Please check with question information to make correct entries and calculations.

1.1) Statement of Comprehensive Income

	£	£
Revenue/Sales		
Less: Sales returns		
Net Sales		
Less : Cost of Sales		
Opening inventory		
Purchases		
Less: Purchase returns		
Add: Carriage in		
Less: Closing inventory		
= Cost of sales		
Gross Profit		
Add: Discount received		
Add: Reductions in provision for doubtful debts		
Less Expenses		
Discount allowed		
Carriage outwards		
Rent, rates & Insurance		
Heating & lighting		
Postage & stationery		
Advertising		
Salaries and wages		
Bad debts		
Increase in provision for bad debts		
Depreciation charge		
Net Profit		

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1.2) Statement of Financial Position

	£	£	£
	Cost	**Accumulated Depreciation**	**NBV**
Non-Current assets			
Fixtures and fittings			
Current Assets			
Inventory			
Receivables			
Cash at bank			
Cash in hand			
Prepayments			
Non - Current Liabilities			
Long term loan			
Current liabilities			
Less: Payables			
Less: Accruals			
Net Assets			
Capital			
Add: Profit for year			
Less: Drawings			
Net Capital			

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2) Ratio analysis – Formulae

Profitability ratios

Gross profit Margin	Revenue – Cost of goods sold x 100 Revenue
Return on Capital Employed (ROCE)	Profit before interest and tax x 100 capital employed
Operating Profit Margin	Operating profit x 100 Total revenue
Net Profit Margin	Net profit x 100 Revenue

Liquidity ratios

Current ratio	Current asset Current liabilities
Quick or acid test ratio	Current assets – inventory Current liabilities
Inventory days	Average inventory x 365 Cost of sales
Receivable or debtor days	Receivables x 365 Sales
Payable or creditor days	Payables x 365 Cost of sales

Investor ratios

Dividend yield	Dividends per share market price
P/E ratio	Market price Earnings per share
Earnings Per Share ratio	Earnings available for distribution to equity Number of shares in issue and ranking for dividends