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OLLSCOIL NA hÉIREANN, GAILLIMH
NATIONAL UNIVERSITY OF IRELAND, GALWAY

SUMMER EXAMINATION, 2002

BACHELOR OF COMMERCE – FIRST YEAR
BACHELOR OF COMMERCE WITH LANGUAGE – FIRST YEAR
BACHELOR OF INFORMATION TECHNOLOGY – FIRST YEAR
BACHELOR OF COPORATE LAW – FIRST YEAR

ACCOUNTING (AY102)

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INSTRUCTIONS TO CANDIDATES:

Answer TWO questions from Section A and Two questions from Section B

Use a separate answer book for each section

All questions carry equal marks

Time allowed: THREE HOURS

SECTION A
(Answer TWO questions from this Section)

Question 1

Set out below are the balance sheets of Tetuan Limited as at 31st December 2000 and 2001, and the profit and loss account for the year ended 31st December 2001.

Balance Sheets as at 31st December	**2001**		**2000**	
	€000	€000	€000	€000
Tangible Fixed Assets:				
Land and buildings (Note 1)		195		220
Plant and machinery (Note 1)		590		230
Motor vehicles (Note 1)		46		22
		831		472
Current Assets:				
Stock	222		196	
Debtors	416		380	
Cash and bank	20		266	
	658		842	
Current Liabilities				
Creditors	172		160	
Taxation	82		70	
Proposed dividend	20		14	
	274		244	
Net Current Assets		384		598
Creditors Due After More Than One Year				
9% Long term debt		155		140
		1,060		930
Share Capital And Reserves				
Ordinary shares of €2 each		630		600
Share premium account		110		100
Profit and loss account		320		230
		1,060		930

/... Question 1 continues on the next page ...

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Profit and Loss Account for the Year Ended 31st December 2001

			€000
Operating profit	....	Note 1.	216
Interest payable net	....	Note 2.	9
Profit on ordinary activities before taxation	....		207
Taxation	....		95
Profit for the year	....		112
Ordinary Dividend for the year	....		22
Profit retained for the year			90

Notes:

1. In arriving at Operating Profit the following items were charged or credited:

		€000
Depreciation:	Buildings....................	15
	Plant & Machinery	38
	Motor Vehicles	10

   Profit on sale of Buildings..............................35
   Loss on sale of Plant & Machinery.....................20

   During the year no new Land or Buildings were acquired. The Company purchased new plant at a cost of £430,000 and new Motor Vehicles for €34,000.

2. Interest payable net is made up of interest payable of €13,000 and interest receivable of €4,000

Required:

a) Prepare the Cash Flow Statement for Tetuan Ltd for the year ended 31st March 2001 in accordance with the requirements of FRS1;

(18 Marks)

b) Using your answer to part a) of this question, identify what additional information is provided by a cash flow statement to users of financial statements that is not provided by the profit and loss account and balance sheet and comment on the significance of this information.

(7 Marks)
Total: 25 Marks

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Question 2

Shine On Limited a company wholly owned by Fidel Novac has been running a successful ethnic jewellery store for the past three years. The trial balance for the company as at 31 March 2002 was extracted as follows:

	Dr.	Cr.
	€	€
Advertising & promotion	4,620	
Bank balances		1,440
Creditors		18,900
Debtors	4,900	
Depreciation - Safe and storage units accumulated to 1 April 2001		6,200
Depreciation - Shop fittings and equipment accumulated to 1 April 2001		16,000
Discount received		1,100
Insurance	4,800	
Light & heat	5,200	
Long term financial investment	45,000	
Opening stock - 1 April 2001	38,200	
Ordinary Share Capital (€3 shares)		60,000
Other general expenses	10,040	
Profit & loss account - 1 April 2001		23,350
Purchases	172,400	
Rent & rates	16,400	
Repairs & maintenance	1,400	
Safe and storage units	38,900	
Sales		346,400
Security	13,200	
Shop fittings and equipment	71,290	
Telecommunications charges	4,300	
Wages	41,300	
Web site maintenance charges	1,440	
	473,390	473,390

/... *Question 2 continues on the next page ...*

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Notes:

1. Closing stock at 31 March 2002 amounted to €41,300.
2. Security expenses of €600 were due but unpaid as at 31 March 2002 and €280 was owing for light and heat.
3. Included in the website maintenance charges is an amount of €600 covering the six month period from 1 November 2001 to 30 April 2002.
4. Depreciation, which has not been charged for the current year as yet, is to be provided for on Shop Fittings & Equipment at a rate of 20% on a reducing balance basis and on the Safe and Storage Units at a rate of 12% straight line.
5. The board have resolved to pay a dividend for the year of €0.50 per ordinary share. The dividend has not yet been provided for.
6. Finally it has been determined that €1,900 of the debtors will not be in a position to pay the company and that that amount should be written off in full. In light of this experience the company has decided to instigate a policy of maintaining a provision for bad debts of 10% of debtors outstanding.

Required:

a) Prepare the Profit and Loss Account of Shine On Limited. for the year ended 31 March 2002 and its Balance Sheet for the year then ended.

(20 Marks)

b) The Accounting Standards Board ('ASB') set out in the Statement of Principles the desired qualitative characteristics of financial information. 'Comparability' was one of those characteristics. Briefly explain in your view why the ASB included 'Comparability' as a desirable characteristic and how might such comparability be achieved when preparing financial statements?

(5 Marks)
Total: 25 Marks

Question 3

Your company is considering acquiring one of two competitors in the same industry as its own. The board will be considering the acquisition at a forthcoming meeting and the financial director has asked you to put together a preliminary analysis for them on the relative profitability, liquidity and gearing of the two target companies. You have been given the following information on the two companies, Alpha Limited and Beta Limited, for the financial year just ended, 31 December 2001:

/ ... *Question 3 continues on the next page ...*

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/ ... *Question 3, continued from the previous page* ...

BALANCE SHEETS

			Alpha		**Beta**
			€000		€000
Fixed assets	at cost		4,125		4,104
	depreciation		1,470		3,028
			2,655		1,076
Current assets	Stock	630		408	
	Debtors	1,350		816	
	Cash	60		0	
		2,040		1,224	
Current Liabilities	Creditors	540		480	
	Dividends	300		96	
	Overdraft	295		672	
		1,135		1,248	
Net Current Assets/(Liabilities)			905		(24)
			3,560		1,052
Debentures (Alpha 10%, Beta 8%)			315		720
			3,245		332
Capital and Reserves					
	Ordinary share capital		1,800		240
	Profit and loss account		1,445		92
			3,245		332

PROFIT AND LOSS ACCOUNTS	**Alpha**	**Beta**
For the year ended 31st December 2001	€000	€000
Sales	3,225	1,871
Cost of Sales	2,145	1,421
Gross Profit	1,080	450
Other expenses	375	234
Operating profit	705	216
Interest on debentures	32	58
Net profit before tax	673	158
Taxation	150	37
Net profit after tax	523	121
Dividends	300	95
Retained profit	223	26

/ ... *Question 3 continues on the next page* ...

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You are further informed that the Stock, Debtors and Creditors figures represent typical average levels for both companies.

Required:

a) Prepare a summary analysis for the board with commentary on profitability, liquidity and gearing. Your commentary and analysis should be supported by relevant ratios where appropriate;

(18 Marks)

b) Annual reports contain sections other than the financial statements that are useful in providing information to users of financial information. Identify two such sections and summarise what useful information that they might typically contain.

(7 Marks)

Total: 25 Marks

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SECTION B
(Answer TWO questions from this Section)

Question 4

Furey Ltd. has been involved in the development of several new products.

For Product ABC, development costs to date have been €150,000. The product will have a short life, and after sales of 10,000 units in the coming year, the company will cease manufacturing. The selling price will be €180 per unit, materials will cost €54 per unit, labour will cost €60 per unit, variable overheads are estimated at €27 per unit and fixed overheads will be allocated to the product at the rate of €33 per unit from the company's general pool of fixed overheads (there are no fixed overheads specific to Product ABC).

For Product XYZ, the development phase has been completed for some months and the product has already reached production. The directors have decided to upgrade the product by sourcing better quality materials. They estimate that in the coming year, materials will cost €64 per unit, labour will cost €44 per unit, there will be variable overheads of €36 per unit, and the fixed overheads specific to this product will be €400,000. Several of the directors have stated that they think that the volume of sales the company should aim for is 10,000 units per annum; some of the other directors have focused on the selling price and recommend that this should be fixed at €200.

Required:

a) State, with supporting calculations, whether or not the company should proceed with Product ABC.

(6 marks)

b) Write a short note for a director who asked for an explanation as to why, in the case of a similar product to ABC, the accountant's advice was to proceed with manufacturing even though, when the overall figures were considered, the product appeared to be loss-making.

(6 marks)

c) Calculate (i) the sales price required for the company to break even on Product XYZ if the volume of sales is fixed at 10,000 units, (ii) the volume of units required to break even if the sales price is fixed at €200 per unit, and (iii) the margin of safety if the selling price is fixed at €200 per unit and the expected volume of sales is 10,000 units.

(7 marks)

d) Explain briefly the concept of "the relevant range" and its importance on cost-volume profit analysis.

(6 marks)
Total: 25 marks

Question 5

Cosgrave Ltd. is an engineering company that manufactures products to customer order using three departments, casting, finishing and assembly. It has recently been losing many contracts to competitors, and fears that the costing policy which it uses to estimate and charge prices to potential customers may be at fault. The company currently allocates manufacturing overheads to the cost of jobs on the basis of the budgeted percentage of direct labour costs for the whole factory; it then adds 40% to total manufacturing cost to determine price. Budget estimates for the year ended 31 March 2002 had been as follows:

	Casting	Finishing	Assembly
Direct materials	€1,500,000	-	€500,000
Direct labour costs	€250,000	€750,000	€750,000
Direct labour hours	12,500	25,000	37,500
Manufacturing overheads	€875,000	€1,000,000	€225,000
Machine hours	12,500	25,000	2,500

The directors are anxious to see how a departmental approach to overhead allocation, using machine hours for casting and finishing and labour hours for assembly, would alter measurements of price. They have asked for the calculations to be made for two jobs, one with a large amount of casting and finishing, and one with a large element of assembly work. Details of these are given below:

Job 62	Casting	Finishing	Assembly
Direct materials	€30,000	-	€5,000
Direct labour hours	260	480	375
Machine hours	270	460	25

Job 94	Casting	Finishing	Assembly
Direct materials	€14,500	-	€10,000
Direct labour hours	140	240	780
Machine hours	150	230	50

Required:

a) Calculate the prices quoted for Jobs 62 and 94 under the existing system of pricing.

(9 marks)

b) Calculate the prices that would have been quoted for Jobs 62 and 94 if the new system had been in operation.

(9 marks)

c) Job costing produces figures suitable for stock valuation purposes. What other uses may such figures have, and for what decisions or judgements would the figures be unsuitable?

(7 marks)
Total: 25 marks

Question 6

Mulvey Ltd. plans to complete the development of a tourist venture in Galway shortly. Of the current cash balance in the company of €250,000, a final payment of €205,000 is due to the contractors on 1 June 2002, the day the venture is due to open. The following details have been assembled about the operation of the venture, which includes a renovated castle, a restaurant and a shop:

(1) Admission to the castle costs €8; all admission fees will be received in cash immediately. The anticipated number of admissions before the six-month winter closure of the venture on 1 October are:

June	4,000	August	9,000
July	9,000	September	6,000

(2) Sales of food and drink in the restaurant are expected to average €5 per visitor. Sixty per cent of the sales will be for cash, and the remainder will be on credit card and received in the month following sale, after deduction of a fee of 2.5% by the credit card company. Cost of food and drink will be 50% of sales value. Since everything will be sourced locally and the venture is well supported by local businesses, payment need not be made until two months after the sales take place.

(3) Sales of gifts in the shop are expected to average €10 per visitor; half will be for immediate cash and half on credit card (received a month later after deduction of 2.5%). The cost of gifts will be 50% of sales value and must be paid in the month after purchase. The company will maintain a constant stock balance of €25,000 after an initial purchase of that amount at the end of May 2002.

(4) Basic wages and salaries will be €8,000 per month, and there will be further wages of €2,000 to additional staff for the months of July and August. Basic staff are also expected to earn overtime of €1,000 for July and August, which will be payable in the month after it is earned.

(5) An initial insurance premium of €4,000 was paid on 1 March 2002; a further €16,000 is due on 1 June 2002, to cover the increased risks when the venture is open to the customers, for the balance of the year ended 28 February 2003.

(6) Other costs of €100,000 (including depreciation of €40,000) will be incurred in the period from 1 June 2002 to 31 March 2003. Apart from depreciation, it is expected that 80% of these costs will relate to the four months when the venture is open (during which the costs will be incurred evenly and paid in cash as they are incurred) and the balance to the period after 30 September 2002.

/ ... ***Question 6 continues on the next page ...***

(7) Total loans of €1,250,000 to finance the operation were raised on 1 March 2002. Interest at 8% per annum is payable quarterly on 1 June, 1 September, 1 December and 1 March, and a first repayment of principal amounting to €62,500 is due on 1 September 2002. Interest is not included in the figure of "other costs" in (6) above.

Required:

a) Prepare a cash budget for each of the four months from June to September 2002.

(18 marks)

b) Discuss what you consider to be the major benefit which an organisation such as Mulvey Ltd. would derive from the process of budgeting.

(7 marks)
Total: 25 marks