GX2175

**OLLSCOIL NA hEIREANN, GAILLIMH**

**NATIONAL UNIVERSITY OF IRELAND, GALWAY**

**Summer Examinations 2000**

**MASTER OF BUSINESS ADMINISTRATION**

**HIGHER DIPLOMA IN MANAGEMENT**

Accountancy (AY 510)

Professor R. W. Scapens
Professor S. Collins
Mr K. Warnock

Time allowed: THREE HOURS

Candidates are required to attempt TWO questions from Section A and TWO questions from Section B

Separate answer books are not required

All questions carry equal marks

## SECTION A - FINANCIAL ACCOUNTING AND ANALYSIS
## (Two questions to be attempted from this section)

### Question 1:

The profit and loss account of Dove Ltd. for the year ended 30 April 2000 is set out below:

| | | £000s |
|---|---|---|
| Sales | | 3,800 |
| Cost of sales | | 1,712 |
| Gross profit | | 2,088 |
| Distribution costs | 844 | |
| Administrative expenses | 676 | |
| | | 1,520 |
| Operating profit | | 568 |
| Interest payable | | 96 |
| Profit before taxation (note 1) | | 472 |
| Corporation tax | | 200 |
| Profit after taxation | | 272 |
| Dividends | | 160 |
| Retained profit for the year | | 112 |
| Profit brought forward at the beginning of the year | | 376 |
| Profit carried forward at the end of the year | | 488 |

The balance sheet for the company at 30 April 2000, together with the comparative figures for the previous year, was as follows:

| 30 April 1999 | | | 30 April 2000 | |
|---|---|---|---|---|
| £000s | £000s | | £000s | £000s |
| | 1,660 | Fixed assets, at cost (notes 2 and 3) | 1,920 | |
| | 428 | Accumulated depreciation | 624 | |
| 1,232 | | | | 1,296 |
| | | Current assets | | |
| | 792 | Stocks | 744 | |
| | 616 | Debtors | 704 | |
| | 36 | Cash at bank | 424 | |
| | 1,444 | | 1,872 | |
| | | Creditors due within one year | | |
| | 472 | Trade creditors | 408 | |
| | - | Other creditors (note 3) | 72 | |
| | 348 | Corporation tax | 380 | |
| | 80 | Proposed dividends | 120 | |
| | 900 | | 980 | |
| 544 | | Net current assets | | 892 |
| 1,776 | | | | 2,188 |
| 400 | | Long-term loan | | 520 |
| 1,376 | | | | 1,668 |

| | | |
|---|---|---|
| 1,000 | Called up share capital | 1,100 |
| - | Share premium account | 80 |
| 376 | Profit and loss account | 488 |
| 1,376 | | 1,668 |

Note 1: Profit is stated after charging depreciation of £240,000.

Note 2: During the year ended 30 April 2000, fixed assets with a cost of £80,000 were sold at net book value.

Note 3: Fixed assets with a total cost of £340,000 were purchased; the amount shown as "other creditors" consists of a balance still owed in relation to these purchases.

**You are required to:**

(a) prepare a cash flow statement for Dove Ltd. for the year ended 30 April 2000, in accordance with the requirements of *FRS 1 Cash flow statements*;

**(18 marks)**

(b) outline briefly why the requirement for a cash flow statement has been added to the statutory requirement for a profit and loss account.

**(7 marks)**

**Total: 25 marks**

## Question 2:

The balance sheet of Rita Ltd. on 31 March 1999 was as follows:

| | £ | £ |
|---|---|---|
| Tangible fixed assets, at cost | | 596,000 |
| Accumulated depreciation | | 124,000 |
| | | 472,000 |
| Financial fixed assets | | 300,000 |
| | | 772,000 |
| Current assets | | |
| Stocks | 750,000 | |
| Trade debtors | 410,000 | |
| Interest receivable | 6,000 | |
| Bank | 4,000 | |
| | 1,170,000 | |
| Creditors due within one year | | |
| Trade creditors | 378,000 | |
| Accruals | 60,000 | |
| Dividends payable | 40,000 | |
| | 478,000 | |
| Net current assets | | 692,000 |
| | | 1,464,000 |

**Cont'd...**

| | |
|---|---|
| Share capital | 800,000 |
| Share premium account | 100,000 |
| Profit and loss account | 564,000 |
| | 1,464,000 |

The following summarises the transactions and other relevant data in relation to the year ended 31 March 2000:

(1) Sales were £4,162,000; after £160,000 had been written off for bad debts, there was an increase of £40,000 in the amount of trade debtors over the course of the year.

(2) Stocks costing £2,816,000 were purchased during the year. The level of stocks at 31 March 2000 was £764,000. Payments to trade creditors were £2,840,000

(3) Financial fixed assets consist of a loan to another company and shares in that company. The loan of £200,000 earns interest at 12% per annum, payable annually on 31 December. The shares, which cost £100,000 and have a value of £150,000, earned dividends of £8,000 paid in January 2000.

(4) Expenses amounting to £364,000 (distribution expenses) and £598,000 (administrative expenses) were paid through the bank account. Accrued expenses, which all related to administration, were £60,000 at 31 March 1999 and £96,000 a year later.

(5) New tangible fixed assets of £64,000 were purchased in March 2000, but not paid for until April 2000. Depreciation on fixed assets was £102,000; all tangible fixed assets are used in the distribution process.

(6) A dividend of £40,000 was paid in May 1999 in respect of the year ended 31 March 1999; a dividend of £60,000 is proposed in respect of the year ended 31 March 2000.

(7) On 1 March 2000, the company bought Government securities, maturing on 30 September 2000, at a cost of £70,000.

**You are required to:**

(a) prepare a profit and loss account and balance sheet for Rita Ltd. for the year ended 31 March 2000;

**(18 marks)**

(b) explain why a profit and loss account is generally considered to provide a better measure of performance for an entity than a cash flow statement.

**(7 marks)**

**Total: 25 marks**

## Question 3:

Explain, with illustrations, how the exercise of judgment and the choice of accounting policies by directors may influence the reported results and financial position of a company.

**(25 marks)**

## SECTION B - COST AND MANAGEMENT ACCOUNTING
### (Two questions to be attempted from this section)

### Question 4:

Under the system used by Hall Ltd., estimated job costs are used as a basis for pricing. The company estimates manufacturing costs, including an allocation of fixed overheads calculated on a factory-wide basis. To this is added a mark-up which the sales staff vary according to certain criteria such as customer, job type, etc. Recently business has been difficult to obtain, and in the climate of newly increased competition the directors have asked the accountant to improve the accuracy of the costing system to ensure that unprofitable jobs are avoided in the remaining months of the financial year ending September 2000.

The following estimates have been made for that financial year:

| Department | Machining A | Machining B | Assembly |
|---|---|---|---|
| Fixed overheads | £960,000 | £1,056,000 | £1,328,000 |
| Direct labour hours | 64,000 | 80,000 | 96,000 |
| Machine hours | 80,000 | 96,000 | 24,000 |

The wage rate was forecast at £10 per hour and it seems likely that this will prevail throughout the financial year.

The accountant suggests allocating fixed overheads on the basis of machine hours in the two machining departments and on the basis of labour hours in the assembly Department. He has looked at two jobs in order to consider the impact which the new system might have. Details of these are as follows:

| | Machining A | Machining B | Assembly |
|---|---|---|---|
| Job 1 | | | |
| Material costs | £4,800 | £3,600 | £15,000 |
| Direct labour hours | 270 | 330 | 375 |
| Machine hours | 270 | 300 | 75 |
| Job 2 | | | |
| Material costs | £7,200 | £6,300 | £9,000 |
| Direct labour hours | 300 | 360 | 270 |
| Machine hours | 240 | 240 | 120 |

**You are required to:**

(a) calculate the total manufacturing costs of Jobs 1 and 2, using
(i) a factory-wide basis, with overheads allocated on the basis of machine hours;
(ii) a factory-wide basis, with overheads allocated on the basis of labour hours;
(iii) the departmental basis suggested by the accountant;

**(15 marks)**

(b) discuss briefly the usefulness of cost figures using such overhead allocations as a basis for management decisions, assessing in particular the directors' plea for more accurate figures to avoid the possibility of accepting unprofitable jobs

**(10 marks)**

**Total: 25 marks**

## Question 5:

Donald Ltd. is examining alternative approaches to the manufacture of a new product in its range. Method A involves a labour-intensive approach which is currently expected by management to prove more favourable as the necessary labour, at a cost of £15 per hour, is considered highly competitive by international standards. Method B, which involves a greater outlay on the purchase and maintenance of machinery, might be more favourable if wage rates increase significantly. Management's current estimate of the likely cost of the two methods is as follows:

Method A

| | |
|---|---|
| Material Type X | 10 kilos at £3 per kilo |
| Material Type Z | 6 kilos at £5 per kilo |
| Labour | 6 hours at £15 per hour |
| Annual fixed overheads | £600,000 |

Method B

| | |
|---|---|
| Material Type X | 8 kilos at £3 per kilo |
| Material Type Z | 6 kilos at £5 per kilo |
| Labour | 4 hours at £15 per hour |
| Annual fixed overheads | £1,140,000 |

The selling price has been fixed at £210 per unit.

Management considers that the maximum wage rate in the foreseeable future would be £18 per hour.

**You are required to:**

(a) calculate, for each method and for the currently estimated *and* maximum wage rate foreseeable, the number of units required to break even and the number of units required to earn a profit of £75,000 per annum;

**(15 marks)**

(b) calculate, in respect of the currently estimated wage rate only, the number of units at which both production methods would give the same profit;

**(5 marks)**

(c) outline briefly the main limitations of cost-volume-profit analysis.

**(5 marks)**

**Total: 25 marks**

## Question 6:

The managing director of a small manufacturing business has called you in as a consultant. She presently relies on quarterly accounts prepared by the auditors, sometimes as much as six weeks after the end of the quarter. Write her a letter explaining whether you think the introduction of a budgeting system would be useful for her business, and what problems she might expect to encounter on introducing such a system.

**(25 marks)**