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OLLSCOIL NA hÉIREANN, GAILLIMH

NATIONAL UNIVERSITY OF IRELAND, GALWAY

AUTUMN EXAMINATIONS, 1999

BACHELOR OF COMMERCE (EVENING) – FIRST YEAR

ACCOUNTING & FINANCIAL ANALYSIS (AY 103)

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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.

Graph Paper is available if required.

Time Allowed: THREE HOURS

SECTION A
(Answer TWO questions from this Section)

Question 1:
The financial statements of Euro Ltd. for the two years ended 31 October 1997 and 31 October 1998 were as follows:

Profit and Loss Accounts

	Year ended 31/10/97	Year ended 31/10/98
	£	£
Sales	500,000	600,000
Cost of sales	285,000	354,000
Gross profit	215,000	246,000
Wages and salaries	115,000	150,000
Depreciation	28,000	30,000
Advertising	5,000	15,000
Interest	12,000	12,000
	160,000	207,000
Net profit	55,000	39,000
Proposed dividends	15,000	15,000
Retained profit	40,000	24,000

Balance Sheets

	31/3/97	31/3/98
	£	£
Fixed assets, at cost	280,000	300,000
Accumulated depreciation	168,000	198,000
	112,000	102,000
Current assets		
Stocks	135,000	140,000
Debtors	100,000	110,000
Bank	10,000	39,000
	245,000	289,000
Creditors due within one year		
Trade creditors	90,000	100,000
Proposed dividends	15,000	15,000
	105,000	115,000
Net current assets	140,000	174,000
	252,000	276,000
Long-term bank loan at 15%	80,000	80,000
	172,000	196,000
Ordinary shares of £1 each	50,000	50,000
Profit and loss account	122,000	146,000
	172,000	196,000

The increase in advertising expenditure reflects the cost of a major newspaper and radio campaign undertaken during the last three months of the year ended 31 October 1998.

You are required to:

(a) discuss the changes in the profitability and liquidity situation of Euro Ltd. between the two years for which accounts are available, calculating appropriate ratios to support your arguments

(20 Marks)

and

(b) summarise briefly the difficulties that may arise in using ratios to help in a comparison of the performance of two different companies.

(5 Marks)
Total: 25 Marks

Question 2:

The profit and loss account of Zanzibar Ltd. for the year ended 31 March 1999 was as follows:

	£000's
Sales	2,944
Cost of goods sold (including depreciation of £76,000)	1,742
Gross profit	1,202
Administration expenses	480
Interest paid	44
Distribution costs	542
	1,066
Interest received	20
Net profit before taxation	156
Taxation	70
Net profit after taxation	86
Dividends	20
Retained profits	66

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Question 2 Cont'd...

The balance sheet of Zanzibar Ltd. at 31 March 1999, together with comparative figures for the previous year, was as follows:

31 March 1998 £000's	31 March 1998 £000's		31 March 1999 £000's	31 March 1999 £000's
		Tangible fixed assets		
500		Land & buildings at valuation		500
	642	Plant & machinery at cost	758	
	246	Accumulated depreciation	304	
396				454
896				954
200		Investments		80
		Current Assets		
	370	Stocks	458	
	312	Debtors	294	
	146	Investments	82	
	58	Bank	10	
	886		844	
		Creditors: amounts falling due within one year		
	240	Trade creditors	270	
	110	Taxation	70	
	80	Proposed dividend	-	
	430		340	
456		Net current assets		504
1,552		Total assets less current liabilities		1,538
		Creditors: amounts falling due after more than one year		
320		Long term loan		120
1,232				1,418
		Capital and reserves		
700		Called up share capital		750
100		Share premium account		170
200		Revaluation reserve		200
232		Profit and loss account		298
1,232				1,418

Note 1: Plant and machinery costing £30,000 was sold to another company at net book value during the year.

Note 2: 50,000 shares, with a nominal value of £1 each, were issued for cash during the year.

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Required:

a) Prepare a cash flow statement for Zanzibar Ltd. for the year ended 31 March 1999 in accordance with FRS1 Cash Flow Statements and include a note reconciling operating profit to net cashflow from operating activities.

(20 Marks)

b) Comment briefly on whether the cash flow statement can be of benefit to different users of the financial statements.

(5 Marks)

Total: 25 Marks

Question 3:

a) The annual final accounts of businesses are prepared in accordance with a number of fundamental accounting concepts – namely: Accruals/matching; prudence; consistency and the going concern assumption.

Required:

Briefly explain how each of the above four concepts may affect the figures in the accounts in relation to - Fixed Assets and Depreciation
- Trading Stocks/inventory

(10 Marks)

b) Sean is the proprietor of a newsagency shop and has provided you with the following information in respect of his business's sundry expenditure and income for the year ended 31 December 1998:

(1) Rent Payable
£15,000 was paid during the year to cover the 15 months ending 31 March 1999.

(2) Gas
£810 was paid during the year for gas charges from 1 January to 30 November 1998 together with the opening accrual of £40 for gas used in December 1997. Gas charges were last increased on 1.1.1998 and Sean estimates that the accrual for December 1998 can be assumed to be equal to the average monthly bill for the current year.

(3) Sean purchased an ice-cream cabinet in March 1998 and paid £1,800 being the balance payable on delivery. A supplier of ice-cream agreed to 'pick up' 40% of this cost provided Sean's ice-cream sales of their product exceeded an agreed target. Sean achieved the sales target in November 1998 but did not actually receive the cheque from the supplier until February 1999.
(Note: ignore any possible charge for depreciation)

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(4) The business's bank statements show that interest has been charged to the account as follows:

For period up to 30 April 1998	Nil (No overdraft)
For period 1 May – 31 July 1998	£56
For period 1 August – 30 November 1998	£90

In addition, the bank statement for March 1999 shows that £92 was charged for the four months to 31.3.1999.

(5) Rates
Towards the end of 1997, £3,600 was paid to cover the six months ended 31 March 1998. In May 1998, £4,800 was paid to cover the six months ended 30 September 1998. In early 1999, £5,400 was paid for the six months ending 31 March 1999.

(6) Rents receivable
During 1998 Sean received £400 rent from L. J. Silver for the use of a lock-up garage attached to the shop, in respect of the 6 months ended 30 April 1998. Sean increased the rent to £1,200 per year from 1 May 1998 and in July 1998 Mr. Silver paid Sean the rent for the full year ending 30 April 1999.

Required:
Write up a ledger account for each of the above six items showing
(1) The opening balance at 1 January 1998, if any
(2) Any cash paid or received during 1998
(3) The closing balance at 31 December 1998, if any
(4) The charge or credit for the year to the profit and loss account

(15 Marks)
Total: 25 Marks

SECTION B
(Answer TWO questions from this Section)

Question 4:

J. D. Sallinger and Co. Ltd. produces child safety gates. The firm has a maximum capacity of 200,000 units per year. Variable manufacturing costs are £24 per unit. Fixed factory overhead costs are £1,200,000 per year. Variable selling and administrative costs are £10 per unit whereas the fixed selling and administrative costs are £600,000 per year. The safety gate has a sales price of £46 per unit at present.

Required:

a) Calculate the firm's breakeven point in units and in £ sales.

(5 Marks)

b) Calculate how many units must be sold to earn a target profit of £250,000 per annum.

(2 Marks)

c) Draw a breakeven graph showing the above information (please use graph paper available)

(10 Marks)

d) Last year the firm sold 190,000 safety gates. During the current year a fire at its non-toxic plastic supplier has caused a material shortage, so that total production and sales for the current year will be restricted to a maximum output of only 155,000 units. To date the firm has already produced and sold 30,000 units this year at a sales price of £46 per safety gate and with the above unit variable costs. Management are urgently considering an emergency program to reduce total fixed costs for the year by £62,000. In addition, it is proposed to either increase the unit selling price and/or reduce the variable costs in order to earn a target profit equal to last year's actual profit.

What contribution margin per unit is needed on the remaining 125,000 units in order to reach the target profit?

(8 Marks)
Total: 25 Marks

Question 5:
Practice Ltd. produces a range of products. The company absorbs fixed production overhead using a rate of 120% of direct labour costs based on the following budgeted figures:

	£
Direct labour costs	160,000
Variable production overhead costs	128,000
Fixed production overhead costs	192,000

The company is currently considering two separate decision-making problems:

a) The normal selling price of product P is £44 and the production cost for one unit is:

	£
Raw materials	16.00
Direct labour	8.00
Variable overhead	6.40
Fixed overhead	9.60
	40.00

The company has received a request from a new customer to supply a special order of 2,000 units of product P at £32 each. There is sufficient capacity to produce the additional units.

Required:
State with reasons whether the company should accept the special order based on the above information and briefly indicate any qualitative factors which should also be considered.

(12 Marks)

b) Practice Ltd. currently make the Toggle – a component which forms part of Product Q; the cost of making one Toggle is as follows:

Raw materials	8.00
Direct Labour	16.00
Variable overhead	12.80
Fixed overhead	19.20
	56.00

The company has recently received an offer from an outside supplier to deliver Toggles at a unit price of £40 each.

Required:

State with reasons whether the company should make or buy-in the Toggle component based on the above information and briefly indicate any qualitative factors which should also be considered.

(13 Marks)
Total: 25 Marks

Question 6:

The Twildo company is currently planning its activities for the last four months of 1999, i.e. September to December 1999. The following forecast information was prepared for the business some months earlier:

	Production units	Sales units
June	700	700
July	800	800
August	1,000	800
September	1,200	1,000
October	1,200	1,200
November	1,400	1,300
December	1,500	1,400
January	1,500	1,600
February	1,500	1,500

The selling price per unit will be £10 throughout the period. All sales are on credit and receipts from Debtors are normally 40% in the month after sale and the balance in the second month following sale.

Raw materials costing £4 per unit of production are generally purchased one month before production, however, suppliers give one month's credit.

Labour costs are £3 per unit produced. The net wages usually average 70% of the total cost and are paid in the month concerned whereas the PAYE income tax and PRSI averages 30% of gross wages and is paid to the revenue commissioners in the following month.

In order to boost sales it is planned to spend £1,000 in October and £1,500 in December on extra advertising.

Production and other overheads are currently £1,300 per month but these are expected to rise to £1,600 per month in October and to rise to £2,000 in December. These overheads include a fixed monthly charge of £300 for depreciation. Approximately 75% of the overheads are paid in the month incurred and the remainder in the following month.

To help boost production the company intends to purchase a new machine for £8,000 for delivery in November, payment will be 10% on signing the contract in September with the balance payable on delivery.

It is estimated that the company will have cash at bank of £2,600 on 1 September 1999.

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Required:

a) For each of the four months September to December 1999 prepare
   (i) A raw materials budget
   (ii) A purchases/creditors budget
   (iii) A cash budget

(16 Marks)

b) Comment on the company's liquidity over this period.

(5 Marks)

c) Comment briefly on the options generally available to a company to overcome liquidity problems when a cash budget reveals a potential cash deficiency.

(4 Marks)
Total: 25 Marks