



# *ROLE SIMULATION EXAMINATION*

## *ADVANCE INFORMATION*

This material is issued prior to the examination session.

Candidates **must** bring this material with them  
to the Examination Hall.  
No copies will be provided.

## ADVANCE INFORMATION

This Advance Information is issued prior to the examination session to allow you to familiarise yourself with the information provided and to undertake any other appropriate research and analysis. The Advance Information is also published on the website: [www.icaew.com/students](http://www.icaew.com/students).

**You must bring this Advance Information with you to the Examination Hall**, annotated if you wish, together with any other notes of your preparatory work. You must carry out sufficient and appropriate analysis work **of your own** in order to have a detailed understanding of the Advance Information. You should also undertake any additional research and analysis you feel necessary to enhance your awareness of the industry and market context and to enable you to clarify any technical terms or other issues of vocabulary. You will need to be able to refer back quickly to the Advance Information and your notes during the examination; you are therefore unlikely to benefit from taking large quantities of additional material with you into the Examination Hall.

At the start of the examination you will receive some additional material which will complete the description of the role simulation scenario and state the role simulation requirements. Your answer must be submitted on the paper provided by ICAEW in the Examination Hall. Any pre-prepared papers, or papers comprising annotated exhibits from this Advance Information, included in your answer will not be marked.

The examination is based on the 2019 Learning Materials.

### Assessment of the Role Simulation Examination

The marks in the Role Simulation Examination are awarded for demonstration of competence in the knowledge, skills and behaviours set out in the Level 4 Accounting Technician assessment plan. The marks are allocated broadly as follows:

- Knowledge 30% - 40%
- Skills 30% - 40%
- Behaviours 30% - 40%

The knowledge, skills and behaviours will be assessed through a series of requirements in the Role Simulation Examination. Marks available for each requirement will be shown next to each requirement.

### Presentation of Answers

Answer each task in black ballpoint pen only.

Answers to each task must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

For multiple choice questions, you should clearly record the response you wish to select in your answer booklet. If the examiner is in any doubt as to which option you consider to be correct, you will receive no marks for that question.

The examiner will take account of the way in which answers are presented.

## Horace and Doris plc

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This document reflects information available as at 16 January 2020.

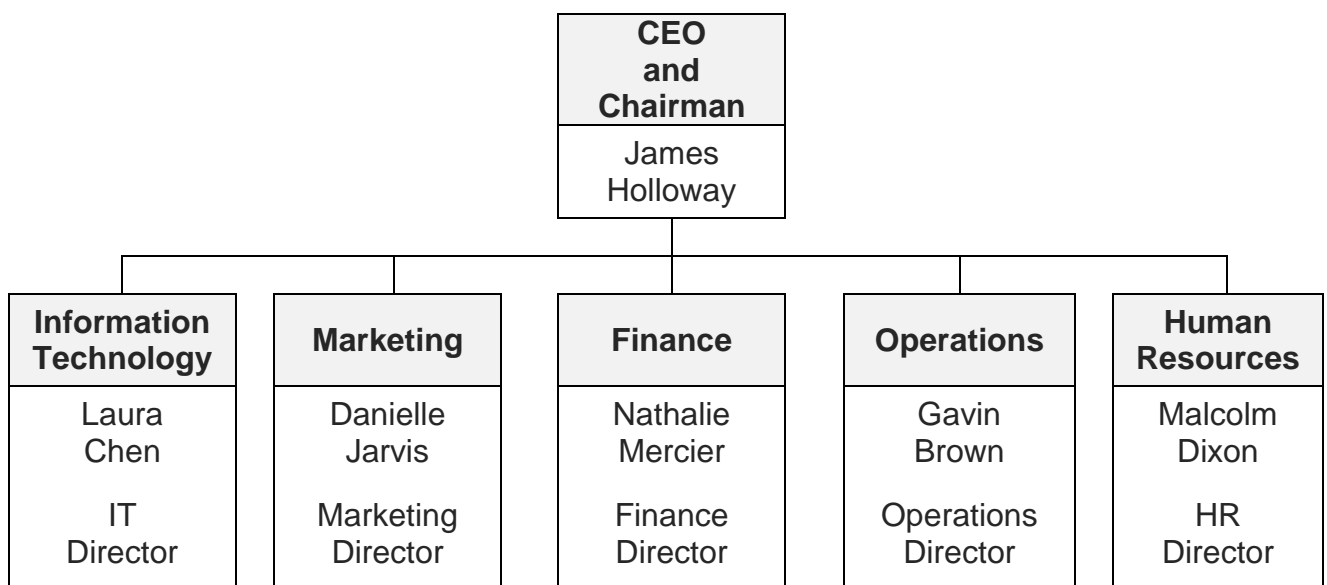
## Introduction: Horace and Doris plc (HD)

Horace and Doris plc is a UK manufacturer of premium pet food. The company sells to pet food retailers and also sells some products online directly to consumers. HD was founded in 2005 by two university friends, James Holloway and Danielle Jarvis. They named the company after the pets which they owned at the time – James’s dog Horace (a Doberman) and Danielle’s cat Doris (a Bengal). James is the Chief Executive Officer (CEO) and Chairman; Danielle is the Marketing Director. The company was listed on the Alternative Investment Market (AIM) in 2015. HD has not made any significant changes to its structure since it was founded.

Extracts from the audited financial statements for the year ended 31 December 2018 are in **Appendix A**.

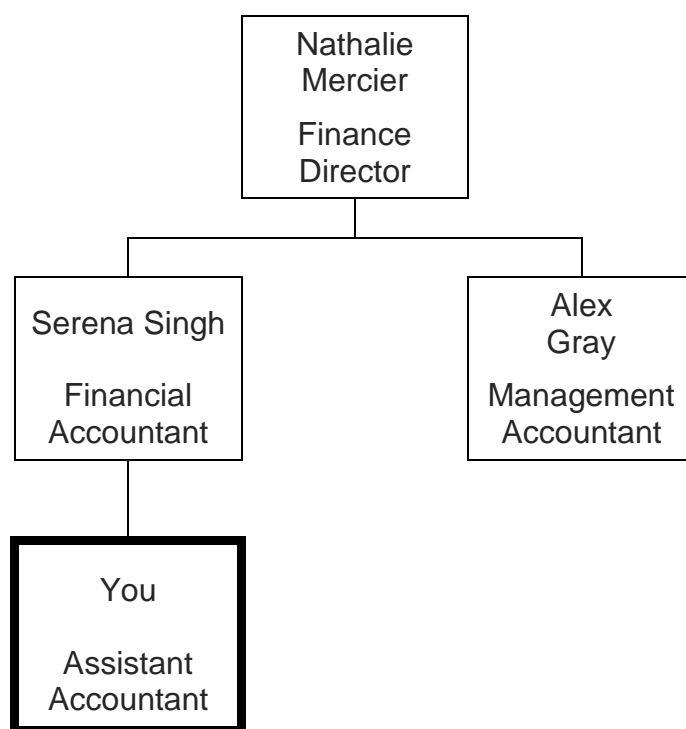
## Current organisational structure

Extract from HD’s organisation chart showing the current functional structure



The CEO and the five directors on the chart are all executive directors on HD’s board of directors.

Extract from HD's organisation chart showing the Finance function



You are an Assistant Accountant in HD's Finance function and you are training to become an ICAEW Chartered Accountant.

Alex, Serena and Nathalie are all ICAEW Chartered Accountants. You and all other staff in the Finance function are required to act in accordance with the company's Accounting Handbook (**Appendix B**), Mission and Values Statement and the Finance function Code of Conduct (**Appendix C**).

## Shareholders and directors

### Shareholders

The following individuals hold significant proportions of ordinary shares in HD:

James Holloway (CEO and Chairman)	15%
Danielle Jarvis (Marketing Director)	15%
Peter Holloway (James Holloway's father)	8%
Jana Serowska (an entrepreneur)	4%

Neither Peter Holloway nor Jana Serowska are employed by HD. Both take an interest in HD's activities and Jana has expressed her preference for higher dividends (see **Appendix G**).

## Chairman

Until December 2019 the roles of Chairman and CEO were performed by two different people. Robert Jarvis, Danielle's uncle, was a non-executive director and Chairman of HD's board of directors until December 2019 when he retired unexpectedly due to ill health. James Holloway has taken on the role of Chairman as an interim measure until a new person can be appointed.

## Executive and non-executive directors

In addition to its six executive directors, HD has two non-executive directors who have been in post for several years:

- Sandip Devdas is an ICAEW Chartered Accountant and a director of a company which manufactures and sells children's toys and games. Sandip is a friend of Peter Holloway.
- Rebecca Magellan is an experienced human resources manager and non-executive director. Rebecca was not known to anyone on the HD Board before she was introduced to James by a friend.

## **Industry information**

The UK pet food market was estimated to have a value of £4 billion in 2019. Over the five years to 2019, the total value of pet food sales grew by an average of 2.5% pa. Growth reflects the increasing preference for more expensive, high quality products (premiumisation).

Pet ownership in the UK is stable with very little growth expected in the pet population or the volume of pet food sold. Industry growth in the five years from 2020 to 2024 is expected to come almost exclusively from ongoing premiumisation.

Some pet owners increasingly prefer to buy pet food products which are natural or organic, high quality, free from artificial additives, and which have particular health benefits. There is an industry trend towards using sustainable and transparent production methods.

The pet food market is commonly segmented in a number of ways, including by product type, quality and animal type. Segmentation by product type recognises the following categories:

- dry food (pellets sold in boxes or sacks)
- wet food (sold in cans or pouches)
- raw food (sold by specialist retailers and often in frozen form)
- specialist veterinary-approved food (eg for pets requiring special diets, often sold by vets)
- treats

The treats segment has the highest growth rate, estimated at 3% pa in 2019.

Pet food manufacturing is fragmented: despite some consolidation, the top ten manufacturers accounted for only half of sales in 2019. HD is within the top ten.

Most pet food is sold by supermarkets, specialist pet product stores or small independent shops. There are also a small number of online-only specialist pet product retailers.

## Operations

HD produces and sells an extensive range of pet food products for dogs and cats, currently comprising three product types:

- dry food
- wet food
- treats.

HD purchases raw materials from a number of suppliers, most of which are in the UK. Products are manufactured at the company's factory in northern England. A relatively small volume of items, such as treats, are purchased as finished products from carefully selected suppliers and are then packaged at HD's factory.

All of HD's products are mid-range or premium, with an emphasis on quality ingredients. HD also manufactures a range of products suitable for pets with food intolerances or on special diets.

HD sells directly to specialist pet product stores and small independent shops; it does not sell to large supermarkets. All delivery and distribution activities are outsourced. In 2017, HD started selling directly to individual consumers via its website (online direct sales). HD had no previous experience of online sales.

HD has a strong social media presence with popular Twitter and Instagram accounts. The brand is especially popular with young people. HD is vocal in advocating ethical business practices – including fair treatment of employees, prompt payment of suppliers and care for the environment. HD has also campaigned in favour of laws mandating improved treatment of animals and against unregulated pet breeding.

James Holloway is charismatic and outspoken and has his own personal social media accounts with a large following. He has occasionally attracted controversy for his frank and uncompromising opinions on animal welfare issues.

## External audit

Frome LLP (Frome) has been HD's external auditor for four years. Lian Chang is the Audit Manager at Frome and she has already been in contact with Nathalie Mercier to discuss details of the audit of the 2019 financial statements. The final audit is expected to start on 17 February 2020. More information about the issues that arose during the 2018 external audit and the planning for the 2019 external audit is in **Appendix D**.

## Current challenges and developments

HD is currently analysing its strategic position and exploring opportunities for further business development and growth. It is considering restructuring from a functional to a divisional structure and outsourcing some or all of its IT function. HD is also planning to launch a new product type (branded accessories) to be sold online (see **Appendix F**). These issues were discussed at the most recent board meeting held on 10 January 2020. Extracts from the minutes of the meeting are in **Appendix E**.

**Appendix A - Horace and Doris plc financial statements for the year ended 31 December 2018 (extracts)**

**Statement of profit or loss for the year ended 31 December 2018**

	<b>£'000</b>
Revenue	37,080
Cost of sales	<u>(23,153)</u>
Gross profit	13,927
Administrative expenses	<u>(10,751)</u>
Profit from operations	3,176
Finance income	106
Finance costs	<u>(307)</u>
Profit before tax	2,975
Income tax	<u>(495)</u>
Profit for the year	<u>2,480</u>

**Statement of financial position as at 31 December 2018**

	<b>£'000</b>	<b>£'000</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment		11,135
Investments		<u>3,542</u>
		14,677
<b>Current assets</b>		
Inventories	3,028	
Trade and other receivables	5,146	
Cash and cash equivalents	<u>2,381</u>	
		<u>10,555</u>
<b>Total assets</b>		<b><u>25,232</u></b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Ordinary share capital (£1 shares)		4,500
Share premium		1,555
Revaluation reserve		1,100
Retained earnings		<u>7,603</u>
<b>Total equity</b>		14,758
<b>Non-current liabilities</b>		
Borrowings		5,000
<b>Current liabilities</b>		
Trade and other payables	5,224	
Income tax payable	<u>250</u>	
		<u>5,474</u>
<b>Total equity and liabilities</b>		<b><u>25,232</u></b>



## Property, plant and equipment

Details of property, plant and equipment as at 31 December 2018 are shown in the table below:

	<b>Land £'000</b>	<b>Buildings £'000</b>	<b>Equipment £'000</b>	<b>Total £'000</b>
Cost / revalued amount *	4,900	4,220	7,156	16,276
Accumulated depreciation		(2,195)	(2,946)	(5,141)
Carrying amount	<u>4,900</u>	<u>2,025</u>	<u>4,210</u>	<u>11,135</u>

\* Land was most recently revalued during the year ended 31 December 2017. Buildings and Equipment are shown at cost.

## Dividends

HD pays a dividend once a year in September. Following approval of the 2018 financial statements, HD paid a dividend of 10p per ordinary share on 1 September 2019.

## **Appendix B - Accounting Handbook (extracts)**

### Capital and revenue expenditure

Expenditure is capitalised when it results in the acquisition of assets or an improvement or enhancement of the earning capacity of assets.

All other expenditure is treated as revenue expenditure and is charged to the statement of profit or loss, provided that it relates to the trading activities of that period.

### Depreciation

Depreciation is recognised in respect of property, plant and equipment (PPE) with a finite useful life. All land is freehold and is not depreciated.

Buildings are depreciated on a straight-line basis over 40 years with a residual value of 20% of cost.

Equipment is depreciated on a straight-line basis over 10 years with no residual value.

Depreciation on buildings and equipment is calculated to the nearest whole month and is apportioned equally between cost of sales and administrative expenses.

### Revaluations

Land is revalued at least every five years. No other assets within property, plant and equipment are revalued.

### Trade discounts

Some established customers receive a trade discount of between 5% and 10% of list price. Sales are recorded net of trade discounts. HD does not offer any early settlement discounts to credit customers.

### Irrecoverable receivables and allowance for receivables

All receivables over six months old are treated as irrecoverable.

The allowance for receivables is reviewed each year and is determined as an appropriate percentage of receivables after writing off any irrecoverable debts. Increases in the allowance for receivables are debited to the irrecoverable debts expense account and reductions in the allowance for receivables are credited to the irrecoverable debts expense account.

### Inventories

All inventories are measured on a FIFO basis at the lower of cost and net realisable value.

## **Appendix C - Mission and Values Statement and Finance function Code of Conduct (extracts)**

### Extract from HD's Mission and Values Statement

Our mission is to nourish and delight all those who walk on four legs.

We will provide high quality, delicious pet food which is manufactured in an ethical and sustainable way. We will treat our suppliers, employees and customers with courtesy and respect. We will engage with all our business partners to achieve long-term shared success and we will put principles before profit.

We will campaign for the safety and welfare of all animals and we will use our voices to speak for animals, who cannot speak for themselves.

All directors and employees of the company will act with integrity, professionalism and courtesy in dealing with all internal and external stakeholders.

### Extract from the Finance function Code of Conduct

This Code forms part of your contract of employment.

You must act in accordance with the principles in the Mission and Values Statement.

You must also comply with the policies and procedures set out in the Accounting Handbook.

You should raise any questions or concerns you have about applying these policies and procedures with your direct line manager in the first instance. If that does not resolve the issue, you should raise your concern with a manager at a higher level. In the event of not being able to resolve the problem you should consult the Staff Helpline.

If you are a member of a professional body (either qualified or in training) you must act in accordance with both this Code and the ethical and professional requirements of your professional body. In the event of a conflict between the two, the latter should prevail, and you should alert your line manager to the conflict.

## **Appendix D - External audit**

### Issues arising during the 2018 audit

When the 2018 financial statements were in draft form, sales revenue and trade receivables were overstated by £700,000. This arose because a sales manager had inflated sales to two existing customers in order to meet his sales target and trigger a bonus payment. Danielle Jarvis discovered the fraud when contacting the customers and alerted both Nathalie Mercier and the external auditor, Frome. The manager was summarily dismissed and the overstatement was corrected in the accounting records and the financial statements.

Frome analysed the collection of amounts outstanding as at 31 December 2018 and discovered the probability of non-payment had been underestimated. As a result, HD increased the allowance for receivables in 2019.

### Recommendations and changes arising from the 2018 audit

Frome recommended to the directors of HD, as a result of the 2018 audit findings, that they should introduce additional controls over accepting credit customers, setting credit limits and making credit sales. HD implemented these changes with effect from 1 May 2019. The Finance function now undertakes a credit check on all new credit customers and either Danielle or Nathalie approve all new credit customers. The Finance function keeps details of the credit checks and other information on each credit customer in a file which is accessible to all staff.

### Preparation for the 2019 audit

In its engagement letter for the 2019 audit Frome informed HD that trade receivables were an area of high audit risk, partly because of the previous year's issues with fraudulent sales invoices and irrecoverable debts. Frome's engagement letter included statements regarding the responsibilities of both HD's directors and the auditor, including their responsibilities with respect to fraud and error. In addition, Frome has requested details of the start dates, experience and qualifications of all employees in the HD Finance function as well as details of the training and supervision of new and temporary staff.

James Holloway objected to Frome's suggestion that trade receivables are an area of high audit risk, stating that "there was one problem last year and that problem was solved, by us, not by the auditors". He asked why Frome wants details of the experience and qualifications of the employees in the Finance function, saying that this has nothing to do with the audit.

James has also objected to Frome's reference to 'fraud and error' in the engagement letter and asked if HD's directors were being accused of fraudulent activity as a result of the overstatement of sales invoices.

## Appendix E - Board meeting minutes (extracts)

The following items were discussed at the most recent board meeting on 10 January 2020.

### 1. Corporate appraisal

James wants HD to increase sales and the Board agreed that they would discuss business growth opportunities at the next board meeting in March. Danielle explained that some business development activities were already underway (see sections 2, 3 and 4 below). She agreed to prepare a corporate appraisal of HD in advance of the March board meeting to give the directors a basis for discussion.

### 2. New customers

HD recently increased its efforts to find new retailers for its products. Nathalie is concerned that many of HD's new credit customers are small independent shops with higher credit risk. She pointed out that such shops are facing a particularly difficult trading environment and may be at a higher than usual risk of insolvency. However, both Danielle and James wish to prioritise increasing sales and argue that a slightly higher level of credit risk is acceptable, since they are now carrying out credit checks on new customers.

### 3. Online sales of pet food and treats

Online sales have steadily increased since HD started selling directly to consumers, via its website, in 2017. In 2019, total online sales were £2.4 million. Laura Chen, IT Director, told the Board that in 2020 the website needs to be updated to handle increasing traffic and to comply with the latest security standards.

### 4. New product type – branded accessories

Alex Gray, Management Accountant, and Danielle had undertaken some research on possible sales of a new product type for HD, branded accessories. Danielle suggested starting with sales of collars and name tags (see **Appendix F**). James added that, because HD has a strong brand, existing consumers would be likely to buy these accessories which would only be sold online.

HD would purchase the accessories in bulk then brand and package them in HD's factory. There would be no additional overheads and no investment in property, plant and equipment. Gavin Brown, Operations Director stated that some of HD's salaried factory staff are currently underutilised and could work on these new products. However, only one existing machine would be capable of branding the items so machine hours are likely to be a limiting factor in determining the maximum profit that HD will be able to make on the accessories.

Danielle agreed to ask Alex to prepare a production budget once a decision had been made on available machine hours and forecast production and sales quantities.

## 5. Proposed restructuring

Danielle suggested that the Board should consider a formal restructuring of the company from a functional to a divisional structure. Each division would be led by a director who would be responsible for decision making within the division. Danielle explained that establishing separate divisions would help increase sales by allowing each division's director to concentrate on developing their own area of the business with the aim of launching new product types. Malcolm Dixon, HR Director, and Danielle agreed to work together to produce a draft new organisation chart in advance of the March board meeting.

## 6. IT

James suggested that, as part of the restructuring, some of the IT function could be outsourced. Laura explained that there may be some risks associated with outsourcing but that other areas of the business could benefit: the Finance function could make extensive use of cloud accounting, and the operation and maintenance of the website could be outsourced to a third party. HD could also move its email and document storage to a cloud-based provider.

## 7. Role of chairman and non-executive directors

James confirmed that he was willing to be Chairman for a short period of time, although he recognised it was not ideal for one person to be both Chairman and CEO. James thought HD needed two new additional independent non-executive directors. Nathalie agreed to identify suitable candidates and make a presentation to the March board meeting. The suitability of any potential candidates would need to be confirmed with respect to their independence under the provisions in the Corporate Governance Code 2016. Natalie agreed to ask one of the assistant accountants to help her to research this area. James stated that, as HD has no nomination committee, the Board as a whole must agree on a recruitment and appointment process for the new non-executive directors.

## Appendix F - Information on new product type

Alex has prepared a table with some preliminary calculations for the estimated average costs and selling price of collars and name tags. Machine cost includes the costs of branding and packaging the items.

A share of HD's existing fixed overhead costs are absorbed based on machine hours.

	<b>Collars</b>	<b>Name tags</b>
	<b>units</b>	<b>units</b>
Maximum demand forecast	12,000	8,000
	<b>£</b>	<b>£</b>
	<b>per unit</b>	<b>per unit</b>
Selling price	15.50	9.50
Purchase cost	(10.40)	(3.10)
Machine cost	(0.90)	(1.50)
Fixed overhead cost	(0.40)	(0.80)
Profit	<u>3.80</u>	<u>4.10</u>

## Appendix G - Email from shareholder

The following email was sent by Jana Serowska, a shareholder, to James Holloway and Nathalie Mercier.

From: Jana Serowska  
To: James Holloway, Nathalie Mercier  
Sent: 3 January 2020 at 10:15:23 GMT  
Subject: Sales growth

Hi James and Nathalie,

Following our meeting just before Christmas, I wanted to find out if sales have increased. Based on brand awareness I think HD could achieve 10% annual growth in sales revenue. I really think that this should be the company's priority for at least the next two years.

This could help to support a higher level of dividend payment, which, as you know, is one of my concerns. Last year the dividend was only 10p per share which was less than 20% of the profit for the year. Could the company make a higher dividend payment this year? This will make the shares more attractive to new investors and keep the share price up.

I know you need to keep some profits for reinvestment and I don't want to be unreasonable but I simply can't support this low level of dividend and I won't vote in favour of it at the AGM. Could HD use other reserves to pay a dividend? Or would the company repurchase shares as an alternative to a dividend? I am reluctant to keep all my shares if there is no possibility of a higher return.

Best wishes

Jana