



ROLE SIMULATION EXAMINATION

This paper consists of **two** tasks (100 marks).

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.
2. Ensure you have a copy of the Advance Information.
3. Answer each task in black ballpoint pen only.
4. 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.
5. 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.
6. The examiner will take account of the way in which answers are presented.
7. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

IMPORTANT

Question papers contain confidential information and must **not** be removed from the examination hall.

DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK

You **must** enter your candidate number in this box.

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Task 1

This task consists of **four** parts worth a total of 54 marks.

Task 1.1

Serena Singh, Financial Accountant, asks you to help in finalising the financial statements of HD for the year ended 31 December 2019.

Serena gives you the following draft statement of profit or loss:

Statement of profit or loss for the year ended 31 December 2019 (draft)

	£ '000
Revenue	38,695
Cost of sales	(23,192)
Gross profit	15,503
Administrative expenses	(11,850)
Profit from operations	3,653
Finance income	107
Finance costs	(276)
Profit before tax	3,484
Income tax	(568)
Profit for the year	2,916

She also tells you about some errors that have been made and transactions that have not yet been accounted for, which will require journals to be produced.

(1) Amount owed by Mammoth Pet Stores Ltd

One of HD's customers, Mammoth Pet Stores Ltd (Mammoth), owes £355,000 in respect of sales made by HD in May 2019. HD has made no further sales to Mammoth since then. Mammoth has stopped communicating with HD. Serena thinks that it is unlikely that HD will recover any of the amount owed, and Danielle Jarvis, Marketing Director, agrees. Danielle has suggested that the sale should be reversed so that it is excluded from revenue and trade receivables for the year ended 31 December 2019.

No accounting entries have been made since the sale was initially recorded in May 2019.

(2) Trade discount to Bravo Retail Ltd

On 15 December 2019 HD made a sale to a regular credit customer, Bravo Retail Ltd (Bravo). The list price of the items sold was £225,000. The agreement entitles Bravo to a trade discount of 8%. However, a temporary employee in the finance function recorded the sale at the full price in HD's accounting system.

(3) Insurance costs

HD recently changed one of its insurance providers. On 18 December 2019 HD paid the new provider £195,000 in respect of insurance for the quarter from 1 January 2020 to 31 March 2020. This payment was debited to administrative expenses and credited to cash in the year ended 31 December 2019.

Requirements

Refer to **Advance Information: Appendix B**.

- 1.1 (a) Explain, with reference to Danielle's suggestion, the correct accounting treatment of the amount owed by Mammoth. Set out the debit and credit entries required.

Ignore VAT.

(5 marks)

- 1.1 (b) Prepare journals, including narratives, for the adjustments required in the year ended 31 December 2019 in respect of:

- the trade discount to Bravo
- the insurance costs

Ignore VAT. Show your workings.

(6 marks)

- 1.1 (c) If HD increases the allowance for trade receivables, which of the following statements about the effect on the statement of financial position is correct?

- A Current assets will increase
- B Current assets will decrease
- C Current liabilities will increase
- D Current liabilities will decrease

(1 mark)

Total: 12 marks

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Task 1.2

Serena gives you the following information, in addition to the draft statement of profit or loss and the other information provided in **Task 1.1**.

- (1) On 1 July 2019 HD purchased new manufacturing equipment at a cost of £400,000. There were no other additions to property, plant and equipment and no disposals during the year ended 31 December 2019. No accounting entries have yet been made to property, plant and equipment in respect of the depreciation charge for the year.
- (2) A physical inventory count was undertaken on 31 December 2019. Staff discovered that some raw materials, with a total cost of £145,000, were rotten and had a realisable value of zero. Closing inventory is included in the draft financial statements at its cost of £3,509,000.

Serena asks you to adjust the draft statement of profit or loss to reflect the depreciation charge and the damage to inventory, and to make the necessary amendments arising from Task 1.1.

Requirements

Refer to relevant information from Task 1.1, including your answers, and **Advance Information: Appendices A and B**.

- 1.2 Prepare the statement of profit or loss for the year ended 31 December 2019, in a form suitable for publication.

Notes:

- Assume that the draft income tax expense is unchanged.
- Round your answers to the nearest £1,000. Show your workings.
- Comparative figures are not required.

Total: 14 marks

Task 1.3

During the planning of the audit, Frome identified trade receivables as an area of high audit risk partly because of issues in 2018 (see **Advance Information: Appendix D**). Frome was also concerned about the use of temporary finance staff in 2019.

During July and August 2019, a number of sales were incorrectly recorded. This arose because a temporary member of staff in the Finance function omitted to award some credit customers a trade discount that had previously been agreed. The error was discovered by Serena after several customers complained and the mistakes were corrected in September 2019.

Lian Chang is the audit manager at Frome. She knows that, with effect from 1 May 2019, new credit customers should have been subjected to a credit check and approval by either Danielle or Nathalie. Lian is concerned that the controls may be inconsistently enforced and has asked the Frome audit junior, Adrian Warner, to test these controls. Lian has also decided to request external confirmations of trade receivables so Adrian has selected a sample from HD's list of receivables at the reporting date.

James Holloway, CEO and Chairman, is concerned about the references to fraud in Frome's engagement letter. Nathalie asks you to prepare an email that she can send to James which explains the relevance of fraud and error in the context of HD's financial statements.

Requirements

Refer to **Advance Information: Appendix D**.

1.3 (a) Identify and explain the likely impact of HD's employing new or temporary members of staff in its Finance function on:

- Frome's assessment of the risk of material misstatement; and
- Frome's management of detection risk.

(5 marks)

1.3 (b) Which **two** of the following financial statement assertions are tested by external confirmation of trade receivables?

- A Existence
- B Rights and obligations
- C Completeness
- D Accuracy, valuation and allocation
- E Classification
- F Presentation

(2 marks)

1.3 (c) List **two** substantive procedures, in addition to external confirmation, that Frome could undertake as part of the audit of trade receivables. For each substantive procedure, state the objective of that procedure.

(4 marks)

1.3 (d) Prepare an email for Nathalie to send to James. Your email should:

- explain the difference between fraud and error in the context of financial statements, using examples from HD; and
- describe the respective responsibilities of HD's directors and Frome for preventing and detecting fraud.

(8 marks)

Total: 19 marks

Task 1.4

This morning, while you were working in the Finance function, Gavin Brown, Operations Director, came in. He said:

'I'll be glad when it's the weekend. Every day something else goes wrong. You might remember that on 1 January 2020 we started purchasing grain from a new supplier – EcoAgri. They are now in the news for using illegal workers without checking their right to work in the UK.

'We've already used their grain in production and we've got more of it in inventory. I've been on to them this morning and they have said that this was a one-off because they were short-staffed last month and used an agency for temporary staff. They've promised it won't happen again and they've agreed to give us a 50% discount off the current outstanding invoice from February if we keep buying from them. Of course James Holloway is out there on Twitter banging on about ethical business so I daren't tell him about all this. I'm just hoping that no one will find out that we are involved with EcoAgri.

'Please make sure that the original February invoice is cancelled and I'll get EcoAgri to send a new one under a different name. I don't want there to be any obvious sign that we've got a discount or that we are buying cheap stuff from an unethical supplier. Oh, and whatever you do, don't tell James!'

Requirements

Refer to **Advance Information: Operations and Appendix C**.

1.4 (a) Explain the ethical issues that arise as a result of the above events:

- for HD; and
- for you.

(6 marks)

1.4 (b) Identify the actions that you should take as a result of Gavin's request.

(3 marks)

Total: 9 marks

Task 2

This task consists of **three** parts worth a total of 46 marks.

Task 2.1

Alex Gray, Management Accountant, prepared some preliminary calculations of the costs and selling prices of HD's proposed new branded accessories (see **Advance Information: Appendices E and F**). Following some additional research, Alex revised some of her initial estimates. Alex now provides you with additional information on the forecast costs and selling prices, including an estimate of variable distribution cost for the new products. Alex asks you to help her determine the optimum production plan.

	Collars	Name tags
	units	units
Maximum demand forecast	12,000	8,000
	minutes per unit	minutes per unit
Machine time	6	15
	£	£
	per unit	per unit
Selling price	15.00	10.00
Purchase cost	(10.40)	(3.10)
Machine cost	(0.90)	(2.25)
Distribution cost	(0.80)	(0.80)
Fixed overhead cost	(0.40)	(1.00)

Gavin Brown, Operations Director, confirms that there are underutilised salaried factory staff who can work on these products so there will be no additional labour cost. However, only one of HD's current machines is capable of branding the items. Machine hours are therefore limited to the spare capacity of this machine, which is one shift per day and is equivalent to 1,800 hours per year.

Requirements

2.1 (a) Assuming that HD wants to maximise contribution, calculate, for the 12-month period from 1 July 2020 to 30 June 2021:

- the optimum production plan for the new products, based on the machine hours available; and
- the total contribution that will be generated by the production plan.

(11 marks)

2.1 (b) Calculate the number of additional machine hours that would be needed to produce enough of both products to meet forecast sales demand.

(2 marks)

Total: 13 marks

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Task 2.2

Serena is short of time and has asked you to help Natalie with some tasks in preparation for the next board meeting on 20 March 2020.

Non-executive directors

Nathalie has identified two individuals who are interested in becoming independent non-executive directors (NEDs) for HD (see **Advance Information: Appendix E**). Nathalie explains to you:

‘We hope to recruit two new NEDs and need to confirm if they would be considered independent:

Kevin – he’s very experienced in manufacturing and retail, though he doesn’t know much about online selling, and we were hoping to get someone who did. He is Danielle’s brother-in-law, but Danielle isn’t trying to influence the decision.

Raheem – he runs his own business in web advertising and his experience on that side of things would be useful. He did a lot of work for us three years ago when we were first setting up the website to do online sales.

If we manage to recruit both of them, then Rebecca Magellan (**Advance information: Shareholders and directors**) can take over as Chairman. We know it’s not ideal to have James as Chairman and CEO but I think we can get away with it on a temporary basis because we are only AIM listed.’

Dividends and share repurchase

Jana Serowska, a shareholder of HD, recently sent an email to Nathalie and James asking about dividends and a possible share repurchase (see **Advance Information: Appendix G**). Nathalie now needs to respond to Jana’s email.

Requirements

- 2.2 (a) Draft notes for Natalie to explain to the board whether, according to the UK Corporate Governance Code 2016:
- James can be both the Chairman and CEO of HD
 - each of Kevin and Raheem would be considered independent for the purposes of being a NED.
- (8 marks)**
- 2.2 (b) Discuss whether Jana, as a shareholder, can compel HD to:
- pay a higher dividend
 - repurchase shares.
- (5 marks)**
- 2.2 (c) State whether each of the following reserves of HD are distributable or non-distributable:
- share premium
 - revaluation reserve.
- (2 marks)**
- Total: 15 marks**

Task 2.3

Danielle asks you to help her and Malcolm Dixon, HR Director, prepare slides for a presentation on a new organisational structure and to help her to prepare a SWOT analysis for HD.

Change in organisational structure

HD's board has decided that as it expands its range of product types its current functional structure is no longer appropriate (see **Advance Information: Current organisational structure and Appendix E**). Danielle asks you to prepare a draft organisation chart showing a new divisional structure for HD, based on product types (**Advance Information: Industry information and Operations**).

Danielle also reminds you that HD is considering whether to outsource some or all of the IT function's activities (see **Advance Information: Appendix E**) and needs to evaluate the possible advantages and risks of doing so.

SWOT analysis

Danielle is preparing a SWOT analysis to help the board of directors to identify opportunities to grow the business (see **Advance Information: Appendix E**). She asks you to suggest some points that could be included.

Danielle tells you that a current market research report includes the following information:

- The HD brand was the third most recognised pet food brand in the UK
- Over 40% of those surveyed said that HD's products were expensive
- 55% of existing HD consumers said they would be likely or very likely to purchase HD branded pet accessories
- 40% of existing HD consumers said they would be likely or very likely to purchase animal medicine products online from HD
- only 5% of existing HD consumers had used HD's website and only 20% of those consumers thought that the website was easy to use.

Requirements

- 2.3 (a) Draw an organisation chart showing your suggested new divisional structure for HD. Your chart should show the new operating divisions and central support services. **(5 marks)**
- 2.3 (b) Identify **two** advantages and **two** disadvantages to HD of outsourcing some aspects of its IT function. **(4 marks)**

2.3 (c) Which **one** of the following is a disadvantage to HD of using cloud accounting?

- A Cloud accounting software is expensive
- B Only one person can access cloud accounting software at any one time
- C Accounting data will have to be moved manually from HD's software to the cloud accounting software
- D HD will be relying on the security and backup measures of the software provider

(1 mark)

2.3 (d) Prepare a SWOT analysis for HD. Explain **two** items under each heading. At least **one** item per heading must be taken from the new information provided in this exam paper.

(8 marks)

Total: 18 marks



