



# ***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 60 marks.

### Task 1.1

Kelly Littler, CEO, and Aysha Patel, finance director, have been concerned for some time about PackUp's cash flow, especially in light of the covenants attached to the loan from Franchay Bank plc (**Advance Information: Loan covenants**). They will be attending a meeting at the bank later this week.

In preparation for the meeting Will Henderson, financial controller, has produced draft financial statements for the year ended 31 August 2020 as follows:

#### **PackUp Ltd: Draft statement of profit or loss for the year ended 31 August 2020**

	<b>£'000</b>
Revenue	33,217
Cost of sales	<u>(27,118)</u>
Gross profit	6,099
Distribution costs and administrative expenses	<u>(4,051)</u>
Profit from operations	2,048
Finance costs	<u>(190)</u>
Profit before tax	1,858
Income tax expense	<u>(372)</u>
Profit for the period	<u>1,486</u>

#### **PackUp Ltd: Draft statement of financial position as at 31 August 2020**

	<b>£'000</b>	<b>£'000</b>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment		8,639
Intangible assets		<u>352</u>
		8,991
<b>Current assets</b>		
Inventories	6,754	
Trade receivables	<u>8,684</u>	
		<u>15,438</u>
<b>Total assets</b>		<u>24,429</u>

	£'000	£'000
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Ordinary share capital (£1 shares)		2,000
Retained earnings		<u>8,877</u>
<b>Total equity</b>		<u>10,877</u>
<b>Non-current liabilities</b>		
Borrowings		3,600
<b>Current liabilities</b>		
Trade payables	8,797	
Borrowings	200	
Income tax payable	388	
Bank overdraft	<u>567</u>	
		<u>9,952</u>
<b>Total equity and liabilities</b>		<u>24,429</u>

Will asks you to prepare the draft statement of cash flows for the year ended 31 August 2020 and to perform some ratio calculations. He tells you that, during the year to 31 August 2020:

- Dividends of £500,000 were paid in December 2019.
- Depreciation and amortisation of £1,825,000 in total was charged.
- Machinery was purchased for £3,150,000 in September 2019. No further additions were made to non-current assets.
- Plant costing £1,000,000 was disposed of for £140,000. Accumulated depreciation of £850,000 had been charged on the plant.

### Requirements

1.1(a) To help Kelly and Aysha discuss the loan covenants at the meeting with the bank:

- Calculate the quick (liquidity) ratio, inventory turnover period and trade receivables collection period based on the draft financial statements for the year ended 31 August 2020.

Round your answers to one decimal place and one whole day. Show your workings.

- Compare your figures with those in **Advance Information: Loan covenants** and **Working capital management** and comment briefly on what they indicate about PackUp's compliance with the loan covenants.

**(6 marks)**

1.1(b) Prepare a draft statement of cash flows for PackUp Ltd for the year ended 31 August 2020 using the information above and following the layout in **Advance Information: Appendix A**. Comparatives are **not** required. Show your workings.

**(14 marks)**

**Total: 20 marks**

## Task 1.2

In a recent phone call, Aysha and Kelly discussed the difference between PackUp's forecast performance (**Advance Information: PackUp's financial performance**) for the year ended 31 August 2020 and its actual performance as shown in the draft financial statements (**Task 1.1**). They concluded that PackUp's financial statements will once again be prepared using the going concern assumption. Mario Patini recently started work for PackUp as an assistant accountant. Mario overheard their conversation and asks you to explain the importance of this assumption.

Will tells you about two further adjustments that need to be made to the draft financial statements for the year ended 31 August 2020.

- A major fast-food chain client entered insolvency proceedings on 31 July 2020. PackUp expects to receive only 15% of the £300,000 that the client still owes at 31 August 2020.
- The inventory figure had already been adjusted for writing off the full cost of £120,000 of faulty inventory that was received from one of PackUp's outsourcing suppliers. Will received confirmation on 30 August 2020 that the supplier agreed to refund PackUp 60% of the cost of the faulty inventory.

### Requirements

1.2(a) Write an email to Mario that explains:

- the assumption of going concern and
- how the preparation of PackUp's financial statements for the year ended 31 August 2020 would be affected if PackUp was **no longer** a going concern.

(4 marks)

1.2(b) State the debits and credits required to make the two further adjustments to the draft figures for the financial statements for the year ended 31 August 2020. Refer to **Advance Information: Appendix B**.

(4 marks)

1.2(c) Using the information from **Task 1.1**, together with your answer to **1.2(b)**, for the year ended 31 August 2020:

- Calculate PackUp's gross profit margin.
- Calculate PackUp's operating profit margin.
- Comment briefly on what your calculations indicate about PackUp's performance compared with the forecast and with the year ended 31 August 2019 (**Advance Information: PackUp's financial performance**).

Express the margins as percentages to one decimal place.

(6 marks)

**Total: 14 marks**

### Task 1.3

Following the meeting with Strinder LLP (Strinder), the external auditor, on 15 June 2020 (**Advance Information: Appendix C**) PackUp was approached by HC LLP (HC) which hoped to act as PackUp's new external auditor (**Advance Information: External audit**). PackUp has had no further discussions with HC since HC's offer was discussed at the board meeting on 26 June 2020 (**Advance Information: Appendix E**).

Last week Aysha was off sick, so Kelly met Frank Marple, the audit partner at Strinder, to discuss the external audit for the year ended 31 August 2020.

Frank commented that his staff had completed the interim audit and had attended the inventory count on 31 August 2020. The count had again been badly managed by Olga Vachkov, PackUp's operations director. Frank therefore insisted once again that, to obtain sufficient appropriate audit evidence, additional audit procedures were required during the final audit which would raise the fee well above last year's level.

Kelly responded that PackUp still had plenty of time to file its audited financial statements for the year ended 31 August 2020, so she was reviewing the company's arrangements for external audit. She told Frank that:

- as Strinder had not been reappointed for this year's audit, the Companies Act allows PackUp to appoint a new external auditor with immediate effect
- she believed losing the PackUp audit would be detrimental to Strinder because it represents an important part of the firm's fee income
- she had approached another potential external auditor, HC, which had offered her a lower fee
- PackUp would appoint HC unless Frank reduced Strinder's fee to below the 2019 fee level.

When Frank presented his quote for the environmental assurance report (**Advance Information: Appendix C**), Kelly stated that she would not appoint Strinder to produce the report unless Frank agreed to reduce the external audit fee below the 2019 level.

### Requirements

- 1.3(a) State the date by which PackUp must file its audited financial statements at Companies House. **(1 mark)**
- 1.3(b) Briefly explain whether Kelly is correct about the legal position with respect to the re-appointment of Strinder. **(2 marks)**
- 1.3(c) Identify and explain the threats to professional ethical principles that arise for Strinder as a result of Kelly's insistence that the firm must reduce its fee. **(4 marks)**
- 1.3(d) Discuss whether Kelly's behaviour in relation to Strinder is ethical and complies with PackUp's Corporate Code of Ethics (**Advance Information: Appendix B**). **(4 marks)**

**Total: 11 marks**

## Task 1.4

Following a discussion between Kelly and Aysha, and another meeting with Frank, it has been agreed that Strinder will complete the external audit of PackUp's financial statements for the year ended 31 August 2020.

At the meeting with Frank, Kelly and Aysha discussed PackUp's working capital position. They told him that KebabHut plc, which had switched from PackUp to a different supplier in March 2020 (**Advance Information: Appendix C**), had now placed a substantial order for one of PackUp's recyclable product lines. Although revenue was continuing to fall, they all agreed that PackUp remained a going concern.

Frank reported to Kelly and Aysha the following problems which occurred at the inventory count on 31 August 2020:

- Some items had been paid for by a client, FastMeals plc, but not yet collected by them. The items were located in the despatch area of the factory and were included on the inventory count sheets.
- One machine was operating to complete a late order for soup cartons while the count was taking place. The inputs into the machine and the output from it were not included on the inventory count sheets.
- During the day there was a flood which damaged some inventory. No record of the damage was noted on the inventory count sheets.

Kelly confirmed to Frank at the meeting that she wanted Strinder to prepare the environmental assurance report in relation to information PackUp gives to its clients about the impact of its production processes on the natural environment (**Advance Information: Appendix C**). She believed the report would be of benefit to PackUp and its clients but accepted that it would be a limited assurance engagement.

## Requirements

1.4(a) Explain the respective responsibilities of:

- the directors; and
- the external auditor

in relation to the preparation of PackUp's financial statements for the year ended 31 August 2020 **using the going concern assumption.** (4 marks)

1.4(b) In relation to PackUp's closing inventory balance in the financial statements for the year ended 31 August 2020:

- Describe **three** key assertions that should be tested by Strinder.
- List **two** substantive procedures, in addition to procedures undertaken during attendance at the inventory count, which should be undertaken as part of the audit of closing inventory. For each substantive procedure, state the assertion that is being tested. (8 marks)

1.4(c) What type of assurance is being sought by PackUp in relation to the environmental assurance report?

- A Limited assurance, expressed positively
- B Limited assurance, expressed negatively

**(1 mark)**

1.4(d) Briefly explain the key benefit to PackUp of the environmental assurance report.

**(2 marks)**

**Total: 15 marks**

## Task 2

This task consists of **three** parts worth a total of 40 marks.

### Task 2.1

PackUp's finished goods are costed using labour hours to absorb production overheads into batches (**Advance Information: Product costing** and **Appendix B**). Aysha is concerned that PackUp's product costing may be inaccurate, leading to incorrect selling prices.

The artificial intelligence (AI) incorporated into the new machinery means that production is much more automated, so Aysha believes a machine hour overhead absorption rate will now be more appropriate.

To demonstrate how the new method of overhead absorption will affect product costs and pricing, Will has asked you to calculate the cost of a recent batch of basic PackUp sandwich cartons produced on a single machine. He gives you the following information:

Materials      32 metric tons of coated paperboard

Labour          4 people each worked 21 hours at a cost of £12.50 per hour  
                  2 people each worked an additional 8 hours overtime at £25 per hour

The machine operated for a total of 29 hours.

Inventory card for coated paperboard:

Date		Metric tons	£
01/09/2020	Opening inventory	20	250.00
04/09/2020	Purchased	25	240.00

Will tells you that 84,000 labour hours and 21,000 machine hours are budgeted for in-house production of all PackUp's product lines for the 12 months to 31 August 2021. Budgeted overheads are £2,940,000. Will reminds you that inventories are measured on a FIFO basis.

### Requirements

- 2.1(a) Calculate the full absorption cost of the batch of basic PackUp sandwich cartons. Use a labour hour overhead absorption rate of £35 per hour in your calculations. **(7 marks)**
- 2.1(b) Calculate the machine hour overhead absorption rate that could be used instead of the labour hour rate. **(1 mark)**
- 2.1(c) Calculate the difference in the full absorption cost of the batch of basic sandwich cartons if PackUp uses the machine hour overhead absorption rate you calculated in **2.1(b)**, rather than the existing labour hour overhead absorption rate. **(2 marks)**
- 2.1(d) Briefly discuss the implications of your calculation in **2.1(c)** for the costing and pricing of PackUp's products. **(4 marks)**

**Total: 14 marks**



## Task 2.2

To comply with its debt covenants to the bank, PackUp has made adjustments to its working capital management (**Advance Information: Loan covenants** and **Working capital management**). It has extended its payment period to suppliers, but some suppliers are refusing to make deliveries without payment in advance. In addition, the insolvency of the fast-food chain client (**Task 1.2**) has alarmed PackUp's board, who are aware that another such event would place cash flow under very severe strain. At a meeting yesterday PackUp's board agreed that the company needed to start collecting cash much more quickly.

Having analysed sales, profit and cash collections for the PackWild product line (**Advance Information: Appendix D**), Will has now analysed the impact of offering clients a 4% settlement discount for settling invoices within 30 days of the month-end invoice date:

- Monthly sales will rise to £300,000 as a result, with no change in gross margin.
- 20% of invoices will be collected net of the discount within 30 days of the invoice date.
- 30% of invoices will be collected between 31 and 60 days of the invoice date.
- 47% of invoices will be collected between 61 and 90 days of the invoice date.
- There will be no change to the level of irrecoverable invoices.

The discount will be offered on all PackWild invoices issued from October 2020.

Aysha suggested that, as an alternative to offering settlement discounts to clients, PackUp could obtain finance against sales by approaching a debt factor.

### Requirements

- 2.2(a) Use the format in **Advance Information: Appendix D** to prepare the profit and cash collection schedules for the PackWild invoices issued in October 2020, assuming a 4% settlement discount is offered. **(7 marks)**
- 2.2(b) Discuss whether offering clients a settlement discount is a better strategy for PackUp than using the services of a debt factor. **(4 marks)**

**Total: 11 marks**

### Task 2.3

Yesterday the board met to follow up some of the issues discussed at its meeting on 26 June 2020 (**Advance Information: Appendix E**). A summary of the discussion is set out below.

Kelly has received details of the claim made by a consumer that a Warm&Safe cup cracked and split, scalding her hand. Because the retailer from which she purchased the cup has ceased trading, the consumer is suing PackUp under the tort of negligence. Kelly commented that the company's lawyers have warned of an increasing trend in consumers suing manufacturers for faulty products.

Kelly confirmed that LMP Ltd's sister company has been copying the Warm&Safe design for its own benefit. She stated that she would be taking action against them under patent law once she has established that the patent protection is still current.

Anton Mayer, the marketing director, explained that the PackWild product line was proving successful. PackWild comprises innovative, recyclable cartons. They are being bought by existing clients of PackUp in increasing numbers even though competition is fierce. Anton pointed out that the major reason competition is so tough for all PackUp's product lines is that demand for packaging is price elastic, so the company's ability to raise prices is limited. The directors noted that action by the public to combat the effect on climate change of single-use plastics has increased further recently, with protests taking place across the UK. In addition, many individuals now actively avoid eating fast food on public transport.

The directors agreed that PackUp is influenced by a range of factors that affected the fast-food packaging industry as a whole. Aysha offered to prepare an analysis of these factors using the economic, environmental and legal headings of the PESTEL framework.

Olga Vachkov, the operations director, wanted to investigate further the cyber risks that PackUp is facing now that it is more reliant on computer-controlled production technology, including the internet of things.

### Requirements

- 2.3(a) State the length of time for which a patent offers protection to PackUp from copying by others. **(1 mark)**
- 2.3(b) State the **three elements** that the injured consumer must prove in law to be successful in her negligence claim against PackUp. **(3 marks)**
- 2.3(c) Which of Ansoff's product/market strategies for growth has PackUp followed to date in relation to the PackWild product line? **(1 mark)**
- A Market development
  - B Market penetration
  - C Product development
  - D Diversification
- 2.3(d) Explain the factors that are affecting the fast-food packaging industry and PackUp under the **economic, environmental** and **legal** headings of the PESTEL framework. Include **two** factors under each heading.

At least **four** factors must relate to information in this exam paper. **(6 marks)**

- 2.3(e) Explain the nature of cyber risk and explain **two** types of cyber-attack to which PackUp is particularly exposed because its production technology uses the internet of things. **(4 marks)**

**Total: 15 marks**



