



INSTITUTE OF ACTUARIAL
& QUANTITATIVE STUDIES

Subject: Business finance 2

Chapter: Unit 2

Category: Practice question 2

1. CT2 April 2010 Question 7

Which of the following is responsible for ensuring that the financial statements published by a company give a true and fair view?

- A. the board of directors
- B. the chief accountant
- C. the external auditor
- D. the finance director

2. CT2 October 2011 Question 9 (updated)

A company purchased some inventory towards the end of the financial year which remained unsold at the year end. Which of the following statements describes the manner in which this will be reflected in the financial statements?

- A. an expense in the statement of profit or loss and a cash outflow in the cashflow statement
- B. an expense in the statement of profit or loss and no effect on the cashflow statement
- C. no effect on the statement of profit or loss and a cash outflow in the cashflow statement
- D. no effect on either the statement of profit or loss or the cashflow statement

3. CT2 April 2012 Question 6

A company's external auditor included an emphasis of matter in the audit report. Which of the following statements best describes the meaning of an emphasis of matter?

- A. The auditor wishes to draw attention to an important matter that has been disclosed in the notes to the financial statements.
- B. The auditor wishes to draw attention to the limitations of the work undertaken during the audit.
- C. The audit report is being qualified.
- D. The auditor disagrees with the information in the financial statements.

4. CT2 October 2012 Question 6

An actuary started a consultancy in 2005 by investing his life savings of £40,000 in the business and borrowing £20,000 from a bank. Since then, the consultancy has grown to the point where it owns an office worth £100,000 and equipment worth £7,000. Trade receivables in the form of work that has been invoiced but not yet paid for total £8,000. The business now has bank loans totalling £82,000 and owes £500 for unpaid bills. What is the value of the actuary's equity?

- A. £25,000
- B. £32,500
- C. £40,000
- D. £52,500

5. CT2 October 2012 Question 7

Which of the following best describes the statement of changes in equity?

- A. a summary of revenues and expenses for the period
- B. a summary of the assets, liabilities and equity as at the end of the period
- C. a summary of changes in capital and reserves attributable to the equity holders
- D. a summary of movements in cash and cash equivalents for the period

6. CT2 April 2013 Question 6

- C. The company should use the policy that yields the strongest statement of financial position.
- D. The company should apply the logic in any accounting standard that deals with broadly

7. CT2 September 2013 Question 8

An external auditor cannot conduct an adequate audit because the directors have withheld a significant amount of vital audit evidence. What form of external audit report would be appropriate in these circumstances?

- A. adverse opinion
- B. disclaimer of opinion
- C. emphasis of matter
- D. except for opinion

8. CT2 September 2013 Question 7

What is the difference between profit and comprehensive income?

- A. Profit is calculated in accordance with International Financial Reporting Standards (IFRS) and comprehensive income is not.
- B. Comprehensive income covers a longer period than profit.
- C. Profit must be disclosed but comprehensive income need not.
- D. Comprehensive income includes unrealised gains that are excluded from profit.

9. CT2 April 2014 Question 10

To whom is the external auditor's report normally addressed?

- A. the directors
- B. the lenders
- C. the shareholders
- D. the Stock Exchange

10. CT2 September 2015 Question 10

Which of the following best explains what it means when the external auditor issues a disclaimer of opinion?

- A. The auditor disagrees with the figures prepared by the directors.
- B. The auditor is satisfied that the financial statements give a true and fair view.
- C. The auditor is unable to express an opinion on the truth and fairness of the financial statements.
- D. The auditor wishes to withdraw an opinion that has previously been reported.

11. CT2 September 2017 Question 10

Which of the following best describes the circumstances in which an emphasis of matter paragraph will be included in the external auditor's report?

- A. The auditor wishes to draw attention to a specific statement elsewhere in the audit report.
- B. The financial statements contain a material uncertainty.
- C. The financial statements do not give a true and fair view.
- D. There is an immaterial irregularity in the financial statements

12. CT2 April 2018 Question 7

Which of the following best reflects the significance of a company receiving an unmodified audit opinion?

- A. The company is a good investment.

13. CT2 September 2018 Question 10

A company owns an item of equipment that cost £10,000 on 1 July 2010. The equipment's estimated useful life was 10 years, at which time its estimated scrap value was £3,000. What is the depreciation charge on this equipment for the year ended 30 June 2018, assuming the straight line method of depreciation?

- A. £700
- B. £1,000
- C. £1,300
- D. £4,400

14. CB1 April 2019 Question 8

A newly formed company was funded by an equity injection, in which the shareholders purchased a total of 10,000 £1 fully-paid shares for £2.50 each. Which of the following figures will appear in the company's statement of financial position?

	<i>Share capital (£)</i>	<i>Share premium (£)</i>
A	10,000	15,000
B	10,000	25,000
C	25,000	0
D	25,000	15,000

15. CB1 April 2021 Question 9

A company's factory cost \$50 million. Depreciation to date on the building is \$12 million. The factory was recently valued at \$55 million. What amount will appear in the company's revaluation reserve in respect of this revaluation?

- A. \$5 million
- B. \$17 million
- C. \$38 million
- D. \$55 million

Short Answers**1. CT2 April 2010 Question 16**

Describe the purpose of a cashflow statement.

2. CT2 April 2010 Question 18

The directors of a limited company receive an annual bonus that is linked to reported profit. Explain how unscrupulous directors could go about overstating the reported profit without risking the legal and other penalties that would be imposed if they falsified the financial statements.

3. CT2 October 2010 Question 20 (part)

Koolclean plc was founded several years ago by the inventor of an innovative consumer product. The product has been very successful in the UK and the inventor has decided to seek a quote on the Alternative Investment Market (AIM)

Koolclean plc has published audited financial statements every year since it was incorporated. The inventor has decided to replace the company's audit firm with one that is larger and more experienced in auditing the financial statements of quoted companies.

Explain the likely implications that will arise from a company preparing financial statements which do not comply with relevant accounting standards and the external auditor reporting that failure to comply in the audit report.

5. Subject CT2 April 2011 Question 17

The external auditor's report for company Z Ltd consists of a disclaimer of opinion.

- (a) Explain what is meant by such an audit report.
- (b) Describe the circumstances for which it might be appropriate

6. CT2 April 2012 Question 18

Discuss the usefulness and limitations of a company's annual report to the company's lenders.

7. Subject CT2 September 2013 Question 16

Discuss the assertion that the cashflow statement is unnecessary because it is easy to see whether the closing bank balance is higher or lower than the opening bank balance

8. Subject CT2 September 2014 Question 17

Discuss the ways in which the external auditor adds credibility to a company's published financial statements.

9. Subject CT2 April 2016 Question 17

Describe the importance of the cashflow statement.

10. Subject CT2 April 2016 Question 19 (part)

The directors of Gryffe have been approached by Subb, a potential customer who wishes to seek a substantial trade credit facility. Subb is a small company, but it is a member of the Parrent Group, a major corporation.

Gryffe's accountant has ascertained the following:

- Subb was founded seven years ago. It has grown slowly but steadily ever since.
- Parrent purchased its 40% holding of Subb's equity two years ago. The terms of the agreement reached with Subb's existing shareholders are that Parrent will have the right to appoint a number of directors to Subb's board. Subb's chief buyer has submitted the latest financial statements of both Subb and the Parrent Group. Subb's financial position appears to be rather weak, but the Parrent Group is large, profitable and liquid. The chief buyer's covering letter indicates that Gryffe should evaluate the application for trade credit on the basis of Parrent's consolidated financial statements. Subb's chief buyer also asks that attention be paid to the external auditor's report in both sets of financial statements because the auditor has issued an unmodified report in both cases.

Gryffe's directors have asked for an explanation as to why Subb can claim to be part of the Parrent Group when Parrent is a minority shareholder.

- i. Explain the relevance of the external auditor's report to Gryffe in deciding whether to grant trade credit to Subb.
- ii. Recommend, with reasons, safeguards that Gryffe could put in place to manage the security of the receivable due from Subb in the event that it grants Subb's request

11. Subject CT2 April 2017 Question 17

Describe the problems faced by the external auditor in reporting on the fair presentation of financial statements

13. CT2 September 2017 Question 13

An actuarial consultancy has purchased a new computer system. Explain the difficulties associated with determining the useful life of that asset for depreciation purposes.

14. CT2 April 2018 Question 19

The information provided below was obtained from the bookkeeping records of Barlo plc on 30 June 2017.

- (i) Prepare Barlo plc's financial statements in a form suitable for publication:
- statement of profit or loss
 - statement of changes in equity
 - statement of financial position
- (ii) Describe the steps by which the estimated tax charge would have been determined

Barlo plc

Trial Balance as at 30 June 2017

	£000	£000
Administrative expenses	2,600	
Cash at Bank	428	
Directors' salaries	3,780	
Dividends paid	280	
Loan interest	123	
Loans		1,000
Marketing costs	2,457	
Opening inventory	1,700	
Plant and equipment – accumulated depreciation		2,600
Plant and equipment – cost	19,600	
Production expenses	4,800	
Production materials	11,080	
Property – accumulated depreciation		4,270
Property – cost	9,000	
Retained earnings		3,418
Revenue		47,896
Sales salaries	2,463	
Share capital		4,500
Share premium		1,200
Trade payables		509
Trade receivables	3,982	
Wages paid to production staff	3,100	
	<u>65,393</u>	<u>65,393</u>

Further information:

- (1) Inventory was counted at 30 June 2017 and was valued at £1,950,000.
- (2) Property is to be depreciated at 2% of cost and plant and equipment is to be depreciated at 25% on the reducing balance basis.
- (3) Corporation tax of £2,600,000 is to be provided for the year.

16. CT2 September 2018 Question 18

Describe the purpose of the external audit of financial statements.

17. CT2 September 2018 Question 19

The following information was obtained from the accounting records of Nolton plc, as at 30 June 2018.

(i) Prepare Nolton plc's financial statements in a form suitable for publication:

- statement of comprehensive income for the year ended 30 June 2018
- statement of changes in equity for the year ended 30 June 2018
- statement of financial position as at 30 June 2018

(ii) Discuss the proposition that the gain on the revaluation of property should be taxed

Nolton plc
Trial balance as at 30 June 2018

	\$000	\$000
Administrative expenses	7,514	
Cash at bank	1,238	
Dividends paid	809	
Loan interest	355	
Loans		2,890
Management salaries	10,924	
Manufacturing costs	13,872	
Manufacturing materials – opening inventory	4,913	
Manufacturing purchases	32,021	
Manufacturing wages	8,959	
Plant and equipment – accumulated depreciation		7,514
Plant and equipment – cost	56,644	
Property – accumulated depreciation		12,340
Property – cost	26,010	
Retained earnings		9,879
Revaluation reserve		3,000
Revenue		135,418
Sales commissions	7,118	
Selling expenses	7,101	
Share capital		13,005
Share premium		3,468
Trade payables		1,471
Trade receivables	11,507	
	<u>188,985</u>	<u>188,985</u>

Further information

- (1) All depreciation has been charged for the year and recorded in the relevant accounts.
- (2) Property was revalued at \$16 million on 30 June 2018. This revaluation has not yet been recorded in the accounting records.
- (3) The closing inventory of manufacturing materials was counted and valued at \$5,274,000.
- (4) The corporation tax charge has been estimated at \$5,700,000.

18. CB1 April 2019 Question 16

Discuss the proposition that the cash flow statement is a more suitable basis for understanding a business' performance than the statement of profit or loss.

20. CB1 September 2019 Question 15

Explain the purpose of integrated reporting as an alternative to traditional financial reporting.

21. CB1 April 2019 Question 18

Explain the relevance of a qualified audit opinion in which the external audit report stated that the financial statements gave a true and fair view, except for a specified disagreement over an accounting choice made by the company's board.

22. CB1 April 2019 Question 19

The information provided below was obtained from Dosco plc's bookkeeping records on 31 March 2020.

- (i) Prepare Dosco plc's financial statements in a form suitable for publication:
- statement of profit or loss
 - statement of changes in equity
 - statement of financial position.
- (ii) Discuss the implications of the loss on revaluation of property for Dosco's shareholders.

Dosco plc**List of balances as at 31 March 2020**

	<i>\$000</i>
Administrative expenses	939
Cash at bank	155
Borrowings (long term)	361
Directors' remuneration	1,366
Dividends paid	101
Interest on borrowings	44
Manufacturing costs	1,734
Manufacturing materials – inventory at start of year	614
Manufacturing purchases	4,003
Manufacturing wages	1,120
Plant and equipment – accumulated depreciation	939
Plant and equipment – cost	7,081
Property – accumulated depreciation	1,543
Property – cost	3,251
Retained earnings	1,610
Revenue	16,927
Sales salaries	890
Selling expenses	888
Share capital	1,626
Share premium	434
Trade payables	184
Trade receivables	1,438

Further information:

- (1) Inventory was counted at 31 March 2020 and was valued at \$740,000.
- (2) Manufacturing costs exclude \$50,000 of compensation that will be paid in June 2020 to employees who were injured in an industrial accident.
- (3) Property was valued at \$1,500,000 on 31 March 2020. That valuation is to be incorporated into the financial statements.
- (4) Corporation tax of \$1,337,000 is to be provided for the year.

T employs 50 staff in addition to the directors.

The company owns a large office building in the business district of Capital City. This cost \$2 million when it was acquired 11 months ago, but the building has recently been valued at \$2.4 million by a local property expert.

T's directors have engaged an accounting firm to conduct the external audit of the company's first set of financial statements. These will cover the company's first full year of operation and so they have not yet been prepared. However, T's Chief Accountant has been gathering information and has been briefing the directors on some of the accounting issues that have to be decided.

T's directors have instructed the Chief Accountant NOT to depreciate the company's buildings because they wish the first year's reported profits to be as high as possible. The Chief Accountant has refused to agree to this, arguing that the building must be depreciated if the financial statements are to comply with International Financial Reporting Standards and pointing out that the external auditor will also refuse to agree to this treatment.

T's Chief Executive has asked for an explanation of the logic behind charging depreciation on an asset that is increasing in value. They have also asked whether recognising the building at its valuation would enhance the company's reported performance.

- (i) Give an appropriate response, with reasons, to the Chief Executive's request for an explanation of the logic behind charging depreciation on T's office building even though it is increasing in value.
- (ii) Describe, with reasons, possible actions that T's external auditor will take in response to any refusal to depreciate the building.
- (iii) Describe the likely impact that revaluation of the property will have on T's reported performance.

24. CB1 April 2022 Question 19

A quoted manufacturing company has recently appointed a new Chief Executive Officer (CEO). It is close to the year end and the newly appointed CEO is working with the Finance Director on plans for the preparation of the company's annual financial statements.

The CEO has noted that the company's land and buildings have always been shown at cost less depreciation. The company owns a large plot of land that holds a factory that was built 15 years ago and an office block that was built 12 years ago. The land is shown in the financial statements at cost and the buildings are shown at cost less depreciation, with depreciation charged at 2% of cost each year.

The CEO believes that the land and buildings are worth far more than their depreciated cost and that the financial statements should use a revalued figure. They have asked the Finance Director to make the necessary arrangements with a professional valuer and also with the company's external auditor.

- (i) Describe the effects of the revaluation on the relevance and reliability of the company's financial statements.
- (ii) Outline the effect of the revaluation on the company's return on capital employed ratio and its likely impact on the share price.
- (iii) Explain why the external auditor should be consulted on the revaluation.

25. CB1 September 2022 Question 15

Discuss the usefulness of a company's cash flow statement to the shareholders.

26. CB1 September 2022 Question 18

A quoted company's external auditors disagree with a material accounting treatment that the company's board insists on. The external auditor has warned that this disagreement is so serious that it will be necessary to state an adverse opinion in the audit report, in which case the auditor's opinion will be that the financial statements do not present fairly.

(i) Prepare the following financial statements for Q, in a form suitable for publication:

- Statement of profit or loss
- Statement of changes in equity
- Statement of financial position.

(ii) Discuss:

- (a) the difficulties associated with determining the estimated useful life of the patent rights.
- (b) the implications of any error in the assumed life of 20 years.

Q

Trial balance as at 30 June 2022

	\$000	\$000
Advertising costs	2,300	
Bank	450	
Clerical staff salaries	4,200	
Cost of goods sold	8,200	
Directors' remuneration	2,700	
Dividends paid	300	
Interest on long-term loans	120	
Inventory	1,890	
Long-term loans		1,030
Manufacturing wages	1,120	
Patent rights – accumulated amortisation		356
Patent rights – cost	7,120	
Property, plant and equipment – accumulated depreciation		5,144
Property, plant and equipment – cost	21,230	
Retained earnings		4,950
Revenue		45,628
Sales staff salaries	8,300	
Selling expenses	1,778	
Share capital		5,000
Share premium		2,200
Trade payables		600
Trade receivables	5,200	
	64,908	64,908

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The tax bill for the year has been estimated at \$4,100,000.

The patent rights were purchased at the start of the financial year. Q manufactures electronics and the company paid \$7,120,000 for the right to use a patented manufacturing process for 20 years. The cost of that investment is being written off (or amortised) on the assumption that the intangible asset will have a useful life of 20 years.

28. CB1 April 2023 Question 14

Explain why it is necessary for the Global Reporting Initiative to set standards for sustainability reporting.

29. CB1 April 2023 Question 16

Describe the importance to the shareholders of the notes to the financial statements in a quoted company's annual report.