IAQS | INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Subject: Business finance

Chapter: Unit 3

Category: Practice question

Part 1(Accounting terminology & Regulatory overview)

1. **CT2 April 2008 Question 13**
   Explain the purpose of accounting standards.

2. **CT2 April 2012 Question 17**
   Explain why accounting information that is relevant may not be reliable and why accounting information that is reliable may not be relevant.

3. **CT2 October 2012 Question 18**
   Explain the difficulties faced by the International Accounting Standards Board (IASB) in setting credible accounting standards.

4. **CT2 September 2013 Question 17**
   A famous accounting scandal involved a company's decision to recognise the premiums from the sale of holiday insurance contracts when the contracts were sold, rather than waiting until after the customer's safe return from holiday (which was the normal practice followed by other companies). There were no specific accounting standards to deal with this matter.
   Discuss the issues associated with recognising the profit from the sale of travel insurance in this way in terms of accounting concepts

5. **CT2 April 2014 Question 17**
   Discuss the importance of the International Accounting Standards Board (IASB).

6. **CT2 April 2014 Question 18**
   Discuss the difficulties associated with deciding whether the going concern concept is appropriate

7. **CT2 April 2015 Question 18**
   Describe the importance of the standards set by the International Accounting Standards Board (IASB).

8. **CT2 September 2017 Question 14**
   Describe why it is necessary for the International Accounting Standards Board (IASB) to identify the users of financial statements.

9. **CB1 April 2019 Question 18**
   The development and implementation of International Financial Reporting Standards (IFRS) is sometimes a contentious and prolonged process.
   Describe the implications of this.

10. **CB1 April 2020 Question 14**
    International Accounting Standards identify relevance as a desirable characteristic for accounting information.
    Describe whether accounting for property, plant and equipment at historical cost less depreciation results in a valuation that lacks relevance.

11. **CB1 April 2020 Question 16**
Describe the relevance of International Financial Reporting Standards (IFRS) to external auditors.

12. **CB1 September 2020 Question 17**
Discuss the proposition that the needs of all users of financial statements can be satisfied by a single set of financial statements.

13. **CB1 September 2020 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.

14. **CB1 April 2021 Question 15**
A quoted company's directors have drafted their financial statements in a manner that they claim is realistic, despite the fact that it does not comply with International Financial Reporting Standards (IFRS). Changing the figures to comply with IFRS would lead to the recognition of a loss instead of the profit shown in the draft statements.
Explain how the company's external auditor would respond to this.

15. **CB1 September 2021 Question 16**
A major company exploited a loophole in an International Financial Reporting Standard (IFRS) that permitted it to publish financial statements that complied with the IFRS, but which were nonetheless misleading.
Describe the implications for the International Accounting Standards Board (IASB).

16. **State the key responsibilities of SEBI.**

17. **Why is there a need for competition laws?**

Part 2 (Introduction to financial reporting, Management accounting)

1. **CT2 April 2008 Question 12**
Explain why financial statements must be supplemented and supported by notes to the accounts.

2. **CT2 September 2008 Question 12 (updated)**
A company's statement of profit or loss shows that it has generated substantial profits but its cashflow statement indicates that it has suffered a large outflow of cash during the same period. The figures are reliable and free from distortion.
Explain whether this set of circumstances warrants any major concern.

3. **CT2 September 2008 Question 14**
Explain the implications to the reader of a qualified independent auditor's report.

4. **CT2 April 2009 Question 16**

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PRACTICE QUESTION

Describe the purpose of the standard setting system that regulates the preparation of published financial statements.

5. **CT2 April 2009 Question 17**
Explain, using examples, how the directors of a limited company could create a misleading impression of their company's profitability in the published financial statements.

6. **CT2 April 2009 Question 19**
The following information was extracted from the accounting records of Maker plc:

Maker plc Trial balance as at 31 March 2009

	£m
Administrative expenses	24
Bank overdraft	6
Delivery vehicles — cost	380
Delivery vehicles — depreciation	140
Factory — cost	600
Factory — depreciation	64
Interest paid	120
Inventory at end of year	16
Long term loan	600
Machinery — cost	580
Machinery — depreciation	160
Manufacturing costs	34
Raw materials consumed	440
Retained earnings as at start of year	166
Running costs for delivery vehicles	80
Sales	1,200
Share capital	220
Trade payables	52
Trade receivables	140
Wages — administrative staff	42
Wages — delivery drivers	28
Wages — manufacturing staff	124

The directors had the factory revalued on 1 April 2008. It was valued at £700m, although this valuation has not yet been incorporated into the company's bookkeeping records.

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PRACTICE QUESTION

Depreciation has yet to be charged on the non-current assets.
The following rates are to be used:

- Factory 2% of cost or more recent valuation
- Delivery vehicles 25% reducing balance
- Machinery 10% of cost

i. Prepare, using the above information, a statement of profit or loss for the year ended 31 March 2009 and a statement of financial position as at that date.
ii. Outline the advantages and disadvantages of revaluing the factory.
iii. At 1 April 2008 the company had a positive bank balance of £4m. Explain why the change in the balance from the opening figure to that shown in the above trial balance might differ from the profit or loss calculated in your statement of profit or loss.

7. **CT2 September 2009 Question 18**
Explain the role of the external auditor of a limited company.

8. **CT2 April 2010 Question 16**
Describe the purpose of a cashflow statement.

9. **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.

10. **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.

    (i) Describe the external auditor's role in protecting Koolclean plc's shareholders' interests after it obtains its quotation.

11. **CT2 October 2010 Question 17**
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.

12. **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

13. **CT2 April 2012 Question 18**

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PRACTICE QUESTION

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

14. **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

15. **CT2 September 2014 Question 17**
Discuss the ways in which the external auditor adds credibility to a company's published financial statements.

16. **CT2 April 2016 Question 17**
Describe the importance of the cashflow statement.

17. **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

18. **CT2 April 2017 Question 18**
Describe the problems faced by the external auditor in reporting on the fair presentation of financial statements

19. **CT2 April 2017 Question 17**
Explain the relative importance of liquidity and profitability to the shareholders of a quoted company who are analysing the company's financial statements.

20. **CT2, April 2018, Q.19**

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PRACTICE QUESTION

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

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	
	65,393	65,393

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.

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PRACTICE QUESTION

21. CT2, Sept 2018, Q.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

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 commisisons	7,118	
Selling expenses	7,101	
Share capital		13,005
Share premium		3,468
Trade payables		1,471
Trade receivables	11,507	
	188,985	188,985

Further information:

(1) All depreciation has been charged for the year and recorded in the relevant accounts.

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(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.

22. CB1 April 2019 Q16

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.

23. CB1, October 2020, Q.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.

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Dosco plc
List of balances as at 31 March 2020

	$000
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

24. **CB1 September 2020 Q15**
    Discuss the usefulness of a company's cash flow statement to the shareholders

25. **CB1 September 2020 Q19**
    The information provided below was obtained from Q's bookkeeping records on 30 June 2022.
    (i) Prepare the following financial statements for Q, in a form suitable for publication:

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- Statement of profit or loss [6]
- Statement of changes in equity [2]
- Statement of financial position. [6]

(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**

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.