

UNIVERSITY OF BRADFORD

ACCOUNTING

MAN4275M

Monday 13<sup>th</sup> January 2014

13:00 – 14:30 hours

*Main*

This is an **OPEN BOOK** examination

**SECTION A**

Multiple choice questions  
(Answer **ALL** questions)  
*MCQ Answer Sheet provided*

**Section B**

Answer **ONE** question only from this section

## SECTION A

Multiple choice questions

Answer ALL multiple choice questions on the answer grid provided

Worth 20% weighting for the examination. No negative marking.

### Question 1

Which of the following is **not** one of the accounting concepts/conventions?

- A Going concern
- B Materiality
- C Prudence
- D Accuracy

### Question 2

In the cash flow statement using the indirect method, depreciation is usually shown as:

- A Straight line
- B An addition
- C A deduction
- D Reducing balance

### Question 3

Goodwill will be usually be shown under:

- A Tangible non-current assets
- B Intangible non-current assets
- C Intangible non-current liabilities
- D Tangible current assets

#### Question 4

Bolt uses the straight line method of depreciation and charges a full year's depreciation in the year of purchase and none in the year of disposal. His year end is 30 June. On July 27 2010 he bought a machine that cost £200,000 that was expected to last 5 years with a resale value of £40,000. On 16 August 2012 he sold the machine for £116,000 cash. What entry was made in the profit and loss account for the loss on disposal for the year ended 30 June 2013?

- A £20,000
- B £44,000
- C £32,000
- D £64,000

#### Question 5

The traditional view of gearing suggests that in theory the firm should:

- A Issue only equity, so that the WACC=cost of equity
- B Issue mainly debt as WACC will always be low
- C Aim for an optimal balance where WACC is minimised
- D Assume the market is efficient

#### Question 6

The cost of debt is generally perceived as cheaper than the cost of equity because debt:

- A is often secured on an asset
- B interest is payable before dividends
- C is ranked higher than equity for repayment if a firm fails
- D has all the advantages given above

### Question 7

Recent reforms proposed by the Competition Commission mean that the audit of major UK listed companies will have to be put out to tender at least every:

- A Year
- B 5 years
- C 10 years
- D 20 years

### Question 8

If a company has total assets of £90m and total liabilities of £40m with 5m shares in issue with a current market value of £20 per share, the net asset value per share will be

- A £50m
- B £2.50
- C £10
- D £15

### Question 9

The enterprise value of a firm is:

- A The nominal value of equity in the balance sheet
- B Assets less liabilities
- C Market value of equity
- D The combined value of both debt and equity

### Question 10

Which of the following is not used as a reliable indicator of potential corporate failure?

- A Increase in advertising during a recession
- B Seeing whether the company has spent substantial sums on new Headquarters
- C Analysis of the use of the word "I" in presentations by the CEO
- D Ratio analysis

## Section B

Answer **ONE** question only from this section  
All questions carry equal weighting.

### Question 1

Given below is the draft Income statement for the 12 months ending 30 September 2013 for Kipsang plc.

	€'000	€'000
Turnover		425
Less: Cost of goods sold		<u>(225)</u>
Gross Profit		200
Sale of asset - profit		40
Wages	80	
Electricity	34	
Insurance	6	
Depreciation	20	
Rent	<u>18</u>	<u>(158)</u>
Net Profit		82

Further information has come to light which you have been asked to consider as the person who prepared the draft statement is unsure as to how to deal with each item:

- 1) The turnover figure includes €45,000 for a credit sale on 15 September 2013 that has not yet been paid for. As usual, two months credit was given.
- 2) Some inventory that cost €40,000 is now expected to be sold for only €10,000.
- 3) The asset (sale shown above) was sold for €40,000. Originally it cost €95,000 and accumulated depreciation as at 30 September 2012 was €45,000.
- 4) The figure in the income statement for electricity shows the cash paid during the last 12 months. There is one bill that has not been received and so not included in the accounts, expected to be for €6,000.
- 5) The depreciation figure has been calculated on the straight line method as this has produced a lower figure than the reducing balance method which the company normally uses - otherwise it would have been €35,000 - and the "change has been made for one year only to protect this year's profit figure".

### **REQUIRED:**

- a) Show the amended Income statement, explaining clearly how you have dealt with each of the points 1-5. Refer to accounting concepts/conventions in your answer.  
*(50% of Marks)*
- b) Your friend has told you that "investing in a company which has been audited means that the figures in the financial accounts are right and that it therefore guarantees that profits will increase next year." Explain to your friend why this statement is not correct.

*(30% of marks)*

*(Total: 80% of marks)*

## Question 2

The most recent balance sheet for Farah plc is given below.

### Balance Sheet as at 31 December 2013

	£m	£m	£m
<b><u>Assets Employed</u></b>			
<u>Non-current Assets:</u>			
Tangible	100		
Intangible	<u>60</u>		160
<u>Current Assets:</u>			
Stocks and Work in Progress	40		
Debtors	15		
Cash	<u>5</u>	60	
<u>Current Liabilities:</u>			
Trade Creditors	(5)		
Bank Overdraft	<u>(10)</u>	<u>(15)</u>	
Net Current Assets			45
10% Loan Stock			<u>(60)</u>
Net Assets			<u>145</u>
<b><u>Financed by:</u></b>			
Issued Share Capital (par value 25p)			50
Revenue Reserves			<u>95</u>
Shareholders' Funds			<u>145</u>

#### Further Information

- 1) During 2013 Farah plc made sales of £200m, with a net operating margin (i.e. after depreciation but before tax and interest) of 25%.
- 2) The rate of corporation tax is 25%.
- 3) Farah's sales are volatile, having ranged between £100m and £200m over the previous three years.
- 4) The tangible fixed assets have recently been revalued (by the directors) at £250m.
- 5) The intangible assets represent Research and Development for a major project. A competitor has recently made significant progress in a similar area which undermines the projected profitability figures, making the project only just viable.

- 6) Farah plc's current P:E ratio is 15:1
- 7) Farah plc depreciates tangible fixed assets at the rate of £5m per annum.
- 8) The interest charge on the overdraft is 10%.
- 9) Annual fixed investment is £5m. Ignore capital allowances. It is assumed that due to strong competition Farah plc will be able to operate independently before being sold to a competitor at the end of 2018 for £200m.

Discount rate with discount factors:

	10%
Period 1	0.909
2	0.826
3	0.751
4	0.683
5	<u>0.621</u>
	3.790

**REQUIRED:**

- a) Determine the value of Farah plc using each of the following methods and making adjustments where necessary (state your assumptions):
  - Net Asset Value
  - Price: Earnings ratio
  - Discounted Cash Flow (using a discount rate of 10%)

*(50% of marks)*
  
- b) In your opinion which of the valuation methods used in (a) above gives the correct valuation for Farah plc. Support your answer by discussing some of the problems encountered when valuing a company using these methods.
 

*(30% of marks)*

*(Total: 80% of marks)*

**Question 3**

Discuss how the published financial report and accounts are used to determine whether a company might fail. In your answer discuss some of the advantages and disadvantages to each approach.

Total: 80% of marks