Final Admitting Examination

PAPER 1 – FAE CORE COMPREHENSIVE

SUMMER 2016 (Tuesday 16th August 2016: 10.00 a.m. – 2.30 p.m.)

INSTRUCTIONS TO CANDIDATES

1. The first 30 minutes of this examination is dedicated to reading time.

During this time, candidates may make notes on this examination paper or on their own paper and refer to their materials.

Candidates are **NOT** permitted to open their answer books until instructed to do so.

2. Candidates should indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

3. Taxation:

Candidates answering the paper in accordance with the law and practice of the Republic of Ireland should answer in accordance with the appropriate provisions up to and including the Finance Act 2014.

Candidates answering the paper in accordance with the law and practice of Northern Ireland should answer in accordance with the appropriate provisions up to and including the Finance Act 2015.

4. Candidates should deem each monetary amount shown with the €/£ symbol to be stated in their relevant currency.

5. All workings should be shown.

6. The Case Study begins overleaf.

Appendices are provided in a separate insert

GUSTO RYAN LIMITED
(Suggested time: 240 minutes)

Introduction
You are Rory Byrne and on a bright morning in August 2016 you are on your way to Gusto Ryan Limited ("GUSTO") as the new company accountant, having recently completed your training contract with a reputable medium sized audit firm.

Gusto is 100% owned and controlled by 58 year old hands-on business man, Paul Ryan. Paul has run bars and restaurants as a sole trader for many years, and having reported revenue growth in each of the past 5 years, his operation grew to the point where he deemed it wise to incorporate just over two years ago (1 January 2014). You know Paul through your patronage of his business and ad hoc discussions over coffee regarding possible ways to develop his business, such as exploiting the well-known company name, product placements, deliveries and even possible franchising opportunities. You recently agreed to join the company as there was clearly a need for someone to take over the financial function and provide strategic input to the business. Until recently, Paul's daughter Emily, a business student in her final year, had been the 'caretaker accountant' on a part time basis, and although Emily will continue to contribute to the business, Paul admits that she simply doesn't have the time or knowledge to finish a lot of what was started. The company prepares accounts under IFRS.

Today is your first day on the job, and Paul has called you to his office for your induction.

Paul greets you as you arrive. 'Rory, welcome on board; I'm delighted that you joined the team, and it's great that we know each other already. There are a lot of things in the air that I would like you to prepare a report on, so you will need to hit the ground running.'

The bank
Paul reaches into the top drawer of his desk and hands you the bank file. He explains that following GUSTO's incorporation, the debt associated with the various restaurants was consolidated and assigned to the company. Inside the folder you see the Facility Agreement, and Paul directs you to the section documenting the financial covenants (see **Appendix I**). 'The bank has become somewhat more demanding since we incorporated, probably because the loans are guaranteed by the business now, and not me. In any case, there are a number of financial tests that need to be performed on the accounts, and I need you to determine how we measure up at the end of last year. While you are at it, calculate how it looks for this year also.'

Paul hands you the year end management accounts (see **Appendix II**), and conveys that he believes there won't be an issue. 'On the face of it we fall short, but I have a plan to make it all work - we can get into that later. For now, just work off these year end management accounts and calculate how we stand up against each covenant. Use the 2015 actual figures for last year's covenant testing, and the 2016 forecast figures for the current year's testing.'

A further requirement is that GUSTO submits a medium term business plan to the bank. Paul explains that Emily is keen to prepare this as she will get additional credit at college for making a contribution to a live business. However, Paul feels that Emily needs a starting point and some guidance, and asks you to prepare a one page summary highlighting just the strengths and opportunities that can become the focus of the business plan. Paul instructs you not to reference weaknesses and threats, as he wants Emily to draft a positive document.

Outbreak
Slightly frustrated, Paul changes the subject to an incident last year that was all over the media. There was an outbreak of E.coli at one of the restaurants that proved at the time to be a significant threat to the business. However, being hands on and upfront with the people affected, Paul managed the crisis well and settled complaints in most cases, with the exception of 5 former customers who claimed to have become seriously ill and brought legal action against GUSTO.

‘We incurred significant expense dealing with the incident as you can see from our accounts. The incident actually cost €/£ 700,000 in total. Half of this was spent dealing with the majority of cases without going down the legal route. The other half is the amount that we agreed to pay to the ‘firesome five’ as I call them, rather than prolonging the whole ordeal over the holidays. Thankfully, we didn’t pay out until January this year, and as our year end is 31 December, we have kept that part off last year’s management accounts. No choice really - we would be in trouble with the covenants otherwise for sure.’

The bank requires that an external audit is conducted each year going forward and the 2015 accounts are the first to be audited. Paul has had limited experience with external auditors and lets you know that he has some concerns, as the auditors have already made contact and are aware of the E.coli incident. They have written to GUSTO and advised that they will need to be satisfied that the whole affair was properly dealt with. ‘Let me know how far they are likely to dig, and how we can best avoid taking the hit for everything in last year’s accounts.’ You agree to advise Paul how the auditors will approach this and what they are likely to ask for, and you will recommend the best action for GUSTO to take, including details of any adjusting journals that may be required.

Financing

Now that the worst is over, Paul and the Board want some security moving forward. While your appointment goes some way to that end, one of their concerns is the servicing of a considerable amount of debt drawn from the bank on an interest only basis, with a variable interest rate. Paul asks you to advise on a hedging strategy, specifically interest rate swaps. ‘This is another one of Emily’s projects that was started, but not finished,’ Paul comments as he shows you an email from Emily (see **Appendix III**). ‘The proposal is from a reputable company and seems plausible, but I need you to explain how it all works – Emily promised to do this as you will read in the email but never got around to it, so it’s up to you now.’

Planning

‘I also want you to give me some advice on a personal matter’ continues Paul. ‘I have built up this company through dedication and hard work. All the company activities and profits are generated through the trade – there is no investment income. In the process I neglected to provide for myself. Although there is currently no occupational pension scheme in place, I did start a pension recently and have about €/£ 50,000 in the fund, which isn’t going to do too much!’ Paul tells you that his wife Patricia, a full time solicitor who has worked at the same firm for the past 28 years, will retire soon on a good pension, but he doesn’t want to rely on his spouse’s income in retirement. ‘I won’t be working forever, and want to provide for myself and my family for the future. I was thinking of transferring shares to my wife so that she can receive a dividend, as this won’t impact the EBITDA and therefore won’t be of any concern to the bank. I could simply increase my salary, but will lose a lot through taxes. Perhaps I could take a loan from the company with no fixed repayment date. Any thoughts?’ You agree that you will give it some consideration and advise accordingly.

‘By the way, it’s not just me that I look after,’ Paul informs you as he sits back in his chair. He explains that 7 of the store managers were offered share options at the beginning of last year, giving each the option to purchase 10,000 shares each at €/£ 1.20 per share, on condition that each manager completes 3 years’ service until the vesting date of 31 December 2017. Paul advised that 1 of the managers will most likely resign on her own accord later this year due to her embarrassment over the E.coli incident, while the other 6 are long serving and are expected to remain with the company well beyond the 3 year vesting period. The nominal value of the shares of GUSTO is €/£ 1.00 each and the fair value of each of the shares when the option was offered on 1 January 2015 was €/£ 2.20. The management accounts do not reflect this transaction as Emily was under the impression that as the vesting date was not until the end of 2017, no adjustment would be needed until then. Paul now knows this to be incorrect, and asks that you advise of the adjustments required to both the 2015 accounts and the future accounts, assuming that 1 manager does indeed resign and the remaining 6 exercise their options in due course. For the purpose of providing the indicative journals, you can assume the fair value of the share option to remain constant and ignore any tax implications.

As your meeting is wrapping up, Paul comments that he continuously monitors the performance of his employees, and this comes as no surprise to you given your previous exposure to entities operating in the hospitality sector during your auditing days. However, GUSTO has grown to the point where a formal method of staff appraisal that focuses on industry specific performance indicators is required, and Paul asks you to recommend an appropriate method to use. You have experience of the Balanced Scorecard approach, and promise Paul that you will explain the principles and provide a template suitable for GUSTO.

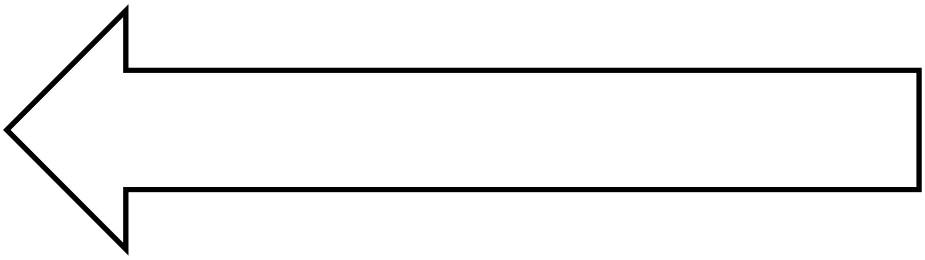
Rates

As you are about to leave, Paul looks up from his desk and motions you to sit back down. 'Just one last thing before you go; I mentioned that I had a plan to help us meet our covenants. We pay our rates in two equal instalments, usually in January and October. However, last year with all going on, the 2nd payment wasn't paid and is sitting as an accrual in the balance sheet. If you reverse this accrual back out of the accounts, discretely of course, we should be in the clear. Take a look and let me know your thoughts….Remember, it is important not to miss our commitments to the bank. This is crucial.'

'I think we're on the same page Rory. Give consideration to what we have discussed and we'll meet again later in the week for a follow up.'

You finally leave the office and after composing your thoughts you set about preparing a report that addressed the issues raised, to present at your next meeting.

END OF PAPER



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