Fundamentals Level – Skills Module

Financial Reporting (International)

Tuesday 9 June 2009

Paper F7 (INT)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

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1 Below are the summarised statements of financial position for three companies as at 31 March 2009:

	Pacemaker		**Syclop**		**Vardine**	
Assets	$ million	$ million	$ million	$ million	$ million	$ million
Non-current assets						
Property, plant and equipment		520		280		240
Investments		345		40		nil
		865		320		240
Current assets						
Inventory	142		160		120	
Trade receivables	95		88		50	
Cash and bank	8	245	22	270	10	180
Total assets		1,110		590		420
Equity and liabilities						
Equity shares of $1each		500		145		100
Share premium	100		nil		nil	
Retained earnings	130	230	260	260	240	240
		730		405		340
Non-current liabilities						
10% loan notes		180		20		nil
Current liabilities		200		165		80
Total equity and liabilities		1,110		590		420

Notes:

Pacemaker is a public listed company that acquired the following investments:

(i) Investment in Syclop
On 1 April 2007 Pacemaker acquired 116 million shares in Syclop for an immediate cash payment of $210 million and issued at par one 10% $100 loan note for every 200 shares acquired. Syclop's retained earnings at the date of acquisition were $120 million.

(ii) Investment in Vardine
On 1 October 2008 Pacemaker acquired 30 million shares in Vardine in exchange for 75 million of its own shares. The stock market value of Pacemaker's shares at the date of this share exchange was $1·60 each. Pacemaker has not yet recorded the investment in Vardine.

(iii) Pacemaker's other investments, and those of Syclop, are available-for-sale investments which are carried at their fair values as at 31 March 2008. The fair value of these investments at 31 March 2009 is $82 million and $37 million respectively.

Other relevant information:

(iv) Pacemaker's policy is to value non-controlling interests at their fair values. The directors of Pacemaker assessed the fair value of the non-controlling interest in Syclop at the date of acquisition to be $65 million.

There has been no impairment to goodwill or the value of the investment in Vardine.

(v) At the date of acquisition of Syclop owned a recently built property that was carried at its (depreciated) construction cost of $62 million. The fair value of this property at the date of acquisition was $82 million and it had an estimated remaining life of 20 years.

For many years Syclop has been selling some of its products under the brand name of 'Kyklop'. At the date of acquisition the directors of Pacemaker valued this brand at $25 million with a remaining life of 10 years. The brand is not included in Syclop's statement of financial position.

The fair value of all other identifiable assets and liabilities of Syclop were equal to their carrying values at the date of its acquisition.

(vi) The inventory of Syclop at 31 March 2009 includes goods supplied by Pacemaker for $56 million (at selling price from Pacemaker). Pacemaker adds a mark-up of 40% on cost when selling goods to Syclop. There are no intra-group receivables or payables at 31 March 2009.

(vii) Vardine's profit is subject to seasonal variation. Its profit for the year ended 31 March 2009 was $100 million. $20 million of this profit was made from 1 April 2008 to 30 September 2008.

(viii) None of the companies have paid any dividends for many years.

Required:

Prepare the consolidated statement of financial position of Pacemaker as at 31 March 2009.

(25 marks)

2 The following trial balance relates to Pricewell at 31 March 2009:

	$'000	$'000
Leasehold property – at valuation 31 March 2008 (note (i))	25,200	
Plant and equipment (owned) – at cost (note (i))	46,800	
Plant and equipment (leased) – at cost (note (i))	20,000	
Accumulated depreciation at 31 March 2008		
Owned plant and equipment		12,800
Leased plant and equipment		5,000
Finance lease payment (paid on 31 March 2009) (note (i))	6,000	
Obligations under finance lease at 1 April 2008 (note (i))		15,600
Construction contract (note (ii))	14,300	
Inventory at 31 March 2009	28,200	
Trade receivables	33,100	
Bank	5,500	
Trade payables		33,400
Revenue (note (iii))		310,000
Cost of sales (note (iii))	234,500	
Distribution costs	19,500	
Administrative expenses	27,500	
Preference dividend paid (note (iv))	2,400	
Equity dividend paid	8,000	
Equity shares of 50 cents each		40,000
6% redeemable preference shares at 31 March 2008 (note (iv))		41,600
Retained earnings at 31 March 2008		4,900
Current tax (note (v))	700	
Deferred tax (note (v))		8,400
	471,700	471,700

The following notes are relevant:

(i) Non-current assets:

The 15 year leasehold property was acquired on 1 April 2007 at cost $30 million. The company policy is to revalue the property at market value at each year end. The valuation in the trial balance of $25·2 million as at 31 March 2008 led to an impairment charge of $2·8 million which was reported in the income statement of the previous year (i.e. year ended 31 March 2008). At 31 March 2009 the property was valued at $24·9 million.

Owned plant is depreciated at 25% per annum using the reducing balance method.

The leased plant was acquired on 1 April 2007. The rentals are $6 million per annum for four years payable in arrears on 31 March each year. The interest rate implicit in the lease is 8% per annum. Leased plant is depreciated at 25% per annum using the straight-line method.

No depreciation has yet been charged on any non-current assets for the year ended 31 March 2009. All depreciation is charged to cost of sales.

(ii) On 1 October 2008 Pricewell entered into a contract to construct a bridge over a river. The agreed price of the bridge is $50 million and construction was expected to be completed on 30 September 2010. The $14·3 million in the trial balance is:

	$'000
materials, labour and overheads	12,000
specialist plant acquired 1 October 2008	8,000
payment from customer	(5,700)
	14,300

The sales value of the work done at 31 March 2009 has been agreed at $22 million and the estimated cost to complete (excluding plant depreciation) is $10 million. The specialist plant will have no residual value at the end of the contract and should be depreciated on a monthly basis. Pricewell recognises profits on uncompleted contracts on the percentage of completion basis as determined by the agreed work to date compared to the total contract price.

(iii) Pricewell's revenue includes $8 million for goods it sold acting as an agent for Trilby. Pricewell earned a commission of 20% on these sales and remitted the difference of $6·4 million (included in cost of sales) to Trilby.

(iv) The 6% preference shares were issued on 1 April 2007 at par for $40 million. They have an effective finance cost of 10% per annum due to a premium payable on their redemption.

(v) The directors have estimated the provision for income tax for the year ended 31 March 2009 at $4·5 million. The required deferred tax provision at 31 March 2009 is $5·6 million; all adjustments to deferred tax should be taken to the income statement. The balance of current tax in the trial balance represents the under/over provision of the income tax liability for the year ended 31 March 2008.

Required:

(a) Prepare the statement of comprehensive income for the year ended 31 March 2009. (12 marks)

(b) Prepare the statement of financial position as at 31 March 2009. (13 marks)

Note: a statement of changes in equity and notes to the financial statements are not required.

(25 marks)

3 Coaltown is a wholesaler and retailer of office furniture. Extracts from the company's financial statements are set out below:

Statements of comprehensive income for the year ended:

		31 March 2009		31 March 2008	
		$'000	$'000	$'000	$'000
Revenue	– cash	12,800		26,500	
	– credit	53,000	65,800	28,500	55,000
Cost of sales			(43,800)		(33,000)
Gross profit			22,000		22,000
Operating expenses			(11,200)		(6,920)
Finance costs	– loan notes	(380)		(180)	
	– overdraft	(220)	(600)	nil	(180)
Profit before tax			10,200		14,900
Income tax expense			(3,200)		(4,400)
Profit for period			7,000		10,500
Other comprehensive income					
Gain on property revaluation			5,000		1,200
Total comprehensive income for the year			12,000		11,700

Statement of changes in equity for the year ended 31 March 2009:

	$'000 Equity shares	$'000 Share premium	$'000 Revaluation reserve	$'000 Retained earnings	$'000 Total
Balances b/f	8,000	500	2,500	15,800	26,800
Share issue	8,600	4,300			12,900
Comprehensive income			5,000	7,000	12,000
Dividends paid				(4,000)	(4,000)
Balances c/f	16,600	4,800	7,500	18,800	47,700

Statements of financial position as at 31 March:

	2009		2008	
	$'000	$'000	$'000	$'000
Assets				
Non-current assets (see note)				
Cost		93,500		80,000
Accumulated depreciation		(43,000)		(48,000)
		50,500		32,000
Current assets				
Inventory	5,200		4,400	
Trade receivables	7,800		2,800	
Bank	nil	13,000	700	7,900
Total assets		63,500		39,900
Equity and liabilities				
Equity shares of $1 each		16,600		8,000
Share premium		4,800		500
Revaluation reserve		7,500		2,500
Retained earnings		18,800		15,800
		47,700		26,800

	2009		2008	
	$'000	$'000	$'000	$'000
Non-current liabilities				
10% loan notes		4,000		3,000
Current liabilities				
Bank overdraft	3,600		nil	
Trade payables	4,200		4,500	
Taxation	3,000		5,300	
Warranty provision	1,000	11,800	300	10,100
Total equity and liabilities		63,500		39,900

Note

Non-current assets

During the year the company redesigned its display areas in all of its outlets. The previous displays had cost $10 million and had been written down by $9 million. There was an unexpected cost of $500,000 for the removal and disposal of the old display areas. Also during the year the company revalued the carrying amount of its property upwards by $5 million, the accumulated depreciation on these properties of $2 million was reset to zero.

All depreciation is charged to operating expenses.

Required:

(a) Prepare a statement of cash flows for Coaltown for the year ended 31 March 2009 in accordance with IAS 7 *Statement of Cash Flows* by the indirect method. (15 marks)

(b) The directors of Coaltown are concerned at the deterioration in its bank balance and are surprised that the amount of gross profit has not increased for the year ended 31 March 2009. At the beginning of the current accounting period (i.e. on 1 April 2008), the company changed to importing its purchases from a foreign supplier because the trade prices quoted by the new supplier were consistently 10% below those of its previous supplier. However, the new supplier offered a shorter period of credit than the previous supplier (all purchases are on credit). In order to encourage higher sales, Coaltown increased its credit period to its customers, and some of the cost savings (on trade purchases) were passed on to customers by reducing selling prices on both cash and credit sales by 5% across all products.

Required:

(i) Calculate the gross profit margin that you would have expected Coaltown to achieve for the year ended 31 March 2009 based on the selling and purchase price changes described by the directors; (2 marks)

(ii) Comment on the directors' surprise at the unchanged gross profit and suggest what other factors may have affected gross profit for the year ended 31 March 2009; (4 marks)

(iii) Applying the trade receivables and payables credit periods for the year ended 31 March 2008 to the credit sales and purchases of the year ended 31 March 2009, calculate the effect this would have had on the company's bank balance at 31 March 2009 assuming sales and purchases would have remained unchanged. (4 marks)

Note: the inventory at 31 March 2008 was unchanged from that at 31 March 2007; assume 365 trading days.

(25 marks)

4 **(a)** The objective of IAS 10 *Events after the Reporting Period* is to prescribe the treatment of events that occur after an entity's reporting period has ended.

Required:

Define the period to which IAS 10 relates and distinguish between adjusting and non-adjusting events. (5 marks)

(b) Waxwork's current year end is 31 March 2009. Its financial statements were authorised for issue by its directors on 6 May 2009 and the AGM (annual general meeting) will be held on 3 June 2009. The following matters have been brought to your attention:

(i) On 12 April 2009 a fire completely destroyed the company's largest warehouse and the inventory it contained. The carrying amounts of the warehouse and the inventory were $10 million and $6 million respectively. It appears that the company has not updated the value of its insurance cover and only expects to be able to recover a maximum of $9 million from its insurers. Waxwork's trading operations have been severely disrupted since the fire and it expects large trading losses for some time to come. (4 marks)

(ii) A single class of inventory held at another warehouse was valued at its cost of $460,000 at 31 March 2009. In April 2009 70% of this inventory was sold for $280,000 on which Waxworks' sales staff earned a commission of 15% of the selling price. (3 marks)

(iii) On 18 May 2009 the government announced tax changes which have the effect of increasing Waxwork's deferred tax liability by $650,000 as at 31 March 2009. (3 marks)

Required:

Explain the required treatment of the items (i) to (iii) by Waxwork in its financial statements for the year ended 31 March 2009.

Note: assume all items are material and are independent of each other. (10 marks as indicated)

(15 marks)

5 Flightline is an airline which treats its aircraft as complex non-current assets. The cost and other details of one of its aircraft are:

	$'000	estimated life
Exterior structure – purchase date 1 April 1995	120,000	20 years
Interior cabin fittings – replaced 1 April 2005	25,000	5 years
Engines (2 at $9 million each) – replaced 1 April 2005	18,000	36,000 flying hours

No residual values are attributed to any of the component parts.

At 1 April 2008 the aircraft log showed it had flown 10,800 hours since 1 April 2005. In the year ended 31 March 2009, the aircraft flew for 1,200 hours for the six months to 30 September 2008 and a further 1,000 hours in the six months to 31 March 2009.

On 1 October 2008 the aircraft suffered a 'bird strike' accident which damaged one of the engines beyond repair. This was replaced by a new engine with a life of 36,000 hours at cost of $10·8 million. The other engine was also damaged, but was repaired at a cost of $3 million; however, its remaining estimated life was shortened to 15,000 hours. The accident also caused cosmetic damage to the exterior of the aircraft which required repainting at a cost of $2 million. As the aircraft was out of service for some weeks due to the accident, Flightline took the opportunity to upgrade its cabin facilities at a cost of $4·5 million. This did not increase the estimated remaining life of the cabin fittings, but the improved facilities enabled Flightline to substantially increase the air fares on this aircraft

Required:

Calculate the charges to the income statement in respect of the aircraft for the year ended 31 March 2009 and its carrying amount in the statement of financial position as at that date.

Note: the post accident changes are deemed effective from 1 October 2008.

(10 marks)

End of Question Paper