Fundamentals Level – Skills Module

Financial Reporting

Wednesday 3 June 2015

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

This paper is divided into two sections:

Section A – ALL 20 questions are compulsory and MUST be attempted

Section B – ALL THREE 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.

Do NOT record any of your answers on the exam paper.

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

The Association of Chartered Certified Accountants

Paper F7

ACCA

Section A – ALL 20 questions are compulsory and MUST be attempted

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write out the answers to the MCQs on the lined pages of the answer booklet. Each question is worth 2 marks.

1 Faithful representation is a fundamental characteristic of useful information within the IASB's *Conceptual framework for financial reporting*.

Which of the following accounting treatments correctly applies the principle of faithful representation?

A Reporting a transaction based on its legal status rather than its economic substance
B Excluding a subsidiary from consolidation because its activities are not compatible with those of the rest of the group
C Recording the whole of the net proceeds from the issue of a loan note which is potentially convertible to equity shares as debt (liability)
D Allocating part of the sales proceeds of a motor vehicle to interest received even though it was sold with 0% (interest free) finance

2 **Which of the following statements relating to intangible assets is true?**

A All intangible assets must be carried at amortised cost or at an impaired amount; they cannot be revalued upwards
B The development of a new process which is **not** expected to increase sales revenues may still be recognised as an intangible asset
C Expenditure on the prototype of a new engine cannot be classified as an intangible asset because the prototype has been assembled and has physical substance
D Impairment losses for a cash generating unit are first applied to goodwill and then to other intangible assets before being applied to tangible assets

3 Each of the following events occurred after the reporting date of 31 March 2015, but before the financial statements were authorised for issue.

Which would be treated as a NON-adjusting event under IAS 10 *Events After the Reporting Period*?

A A public announcement in April 2015 of a formal plan to discontinue an operation which had been approved by the board in February 2015
B The settlement of an insurance claim for a loss sustained in December 2014
C Evidence that $20,000 of goods which were listed as part of the inventory in the statement of financial position as at 31 March 2015 had been stolen
D A sale of goods in April 2015 which had been held in inventory at 31 March 2015. The sale was made at a price below its carrying amount at 31 March 2015

4 Metric owns an item of plant which has a carrying amount of $248,000 as at 1 April 2014. It is being depreciated at 12½% per annum on a reducing balance basis.

The plant is used to manufacture a specific product which has been suffering a slow decline in sales. Metric has estimated that the plant will be retired from use on 31 March 2017. The estimated net cash flows from the use of the plant and their present values are:

	Net cash flows	Present values
	$	$
Year to 31 March 2015	120,000	109,200
Year to 31 March 2016	80,000	66,400
Year to 31 March 2017	52,000	39,000
	252,000	214,600

On 1 April 2015, Metric had an alternative offer from a rival to purchase the plant for $200,000.

At what value should the plant appear in Metric's statement of financial position as at 31 March 2015?

A $248,000
B $217,000
C $214,600
D $200,000

5 Pact acquired 80% of the equity shares of Sact on 1 July 2014, paying $3·00 for each share acquired. This represented a premium of 20% over the market price of Sact's shares at that date.

Sact's shareholders' funds (equity) as at 31 March 2015 were:

	$	$
Equity shares of $1 each		100,000
Retained earnings at 1 April 2014	80,000	
Profit for the year ended 31 March 2015	40,000	120,000
		220,000

The only fair value adjustment required to Sact's net assets on consolidation was a $20,000 increase in the value of its land.

Pact's policy is to value non-controlling interests at fair value at the date of acquisition. For this purpose the market price of Sact's shares at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

What would be the carrying amount of the non-controlling interest of Sact in the consolidated statement of financial position of Pact as at 31 March 2015?

A $54,000
B $50,000
C $56,000
D $58,000

6 The IASB's *Conceptual framework for financial reporting* defines recognition as the process of incorporating in the financial statements an item which meets the definition of an element and satisfies certain criteria.

Which of the following elements should be recognised in the financial statements of an entity in the manner described?

A As a non-current liability: a provision for possible hurricane damage to property for a company located in an area which experiences a high incidence of hurricanes
B In equity: irredeemable preference shares
C As a trade receivable: an amount of $10,000 due from a customer which has been sold (factored) to a finance company with no recourse to the seller
D In revenue: the whole of the proceeds from the sale of an item of manufactured plant which has to be maintained by the seller for three years as part of the sale agreement

7 At 31 March 2015, Jasim had shareholders' funds (equity) of $200,000 and debt of $100,000.

Which of the following transactions would increase Jasim's gearing compared to what it would have been had the transaction NOT taken place?

Gearing should be taken as debt/(debt + equity). Each transaction should be considered separately.

A During the year a property was revalued upwards by $20,000
B A bonus issue of equity shares of 1 for 4 was made during the year using other components of equity
C A provision for estimated damages was reduced during the year from $21,000 to $15,000 based on the most recent legal advice
D An asset with a fair value of $25,000 was acquired under a finance lease on 31 March 2015

8 Germane has a number of relationships with other companies.

In which of the following relationships is Germane necessarily the parent company?

(i) Foll has 50,000 non-voting and 100,000 voting equity shares in issue with each share receiving the same dividend. Germane owns all of Foll's non-voting shares and 40,000 of its voting shares
(ii) Kipp has 1 million equity shares in issue of which Germane owns 40%. Germane also owns $800,000 out of $1 million 8% convertible loan notes issued by Kipp. These loan notes may be converted on the basis of 40 equity shares for each $100 of loan note, or they may be redeemed in cash at the option of the holder
(iii) Germane owns 49% of the equity shares in Polly and 52% of its non-redeemable preference shares. As a result of these investments, Germane receives variable returns from Polly and has the ability to affect these returns through its power over Polly

A (i) only
B (i) and (ii) only
C (ii) and (iii) only
D All three

9 Tibet acquired a new office building on 1 October 2014. Its initial carrying amount consisted of:

	$'000
Land	2,000
Building structure	10,000
Air conditioning system	4,000
	16,000

The estimated lives of the building structure and air conditioning system are 25 years and 10 years respectively. When the air conditioning system is due for replacement, it is estimated that the old system will be dismantled and sold for $500,000. Depreciation is time apportioned where appropriate.

At what amount will the office building be shown in Tibet's statement of financial position as at 31 March 2015?

$'000
A 15,625
B 15,250
C 15,585
D 15,600

10 To which of the following items does IAS 41 *Agriculture* apply?

(i) A change in the fair value of a herd of farm animals relating to the unit price of the animals
(ii) Logs held in a wood yard
(iii) Farm land which is used for growing vegetables
(iv) The cost of developing a new type of crop seed which is resistant to tropical diseases

A All four
B (i) only
C (i) and (ii) only
D (ii) and (iii) only

11 Wilmslow acquired 80% of the equity shares of Zeta on 1 April 2014 when Zeta's retained earnings were $200,000. During the year ended 31 March 2015, Zeta purchased goods from Wilmslow totalling $320,000. At 31 March 2015, one quarter of these goods were still in the inventory of Zeta. Wilmslow applies a mark-up on cost of 25% to all of its sales.

At 31 March 2015, the retained earnings of Wilmslow and Zeta were $450,000 and $340,000 respectively.

What would be the amount of retained earnings in Wilmslow's consolidated statement of financial position as at 31 March 2015?

A $706,000
B $542,000
C $498,000
D $546,000

12 IFRS requires extensive use of fair values when recording the acquisition of a subsidiary.

Which of the following comments, regarding the use of fair values on the acquisition of a subsidiary, is correct?

A The use of fair value to record a subsidiary's acquired assets does not comply with the historical cost principle
B The use of fair values to record the acquisition of plant always increases consolidated post-acquisition depreciation charges compared to the corresponding charge in the subsidiary's own financial statements
C Cash consideration payable one year after the date of acquisition needs to be discounted to reflect its fair value
D Patents must be included as part of goodwill because it is impossible to determine the fair value of an acquired patent, as, by definition, patents are unique

13 The following trial balance extract relates to a property which is owned by Veeton as at 1 April 2014:

	Dr $'000	Cr $'000
Property at cost (20 year original life)	12,000	
Accumulated depreciation as at 1 April 2014		3,600

On 1 October 2014, following a sustained increase in property prices, Veeton revalued its property to $10·8 million.

What will be the depreciation charge in Veeton's statement of profit or loss for the year ended 31 March 2015?

A $540,000
B $570,000
C $700,000
D $800,000

14 Under certain circumstances, profits made on transactions between members of a group need to be eliminated from the consolidated financial statements under IFRS.

Which of the following statements about intra-group profits in consolidated financial statements is/are correct?

(i) The profit made by a parent on the sale of goods to a subsidiary is only realised when the subsidiary sells the goods to a third party
(ii) Eliminating intra-group unrealised profits never affects non-controlling interests
(iii) The profit element of goods supplied by the parent to an associate and held in year-end inventory must be eliminated in full

A (i) only
B (i) and (ii)
C (ii) and (iii)
D (iii) only

15 Which of the following statements about IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* are true?

(i) A government grant related to the purchase of an asset must be deducted from the carrying amount of the asset in the statement of financial position
(ii) A government grant related to the purchase of an asset should be recognised in profit or loss over the life of the asset
(iii) Free marketing advice provided by a government department is excluded from the definition of government grants
(iv) Any required repayment of a government grant received in an earlier reporting period is treated as prior period adjustment

A (i) and (ii)
B (ii) and (iii)
C (ii) and (iv)
D (iii) and (iv)

16 In a review of its provisions for the year ended 31 March 2015, Cumla's assistant accountant has suggested the following accounting treatments:

(i) Making a provision for a constructive obligation of $400,000; this being the sales value of goods expected to be returned by retail customers after the year end under the company's advertised 30-day returns policy
(ii) Based on past experience, a $200,000 provision for unforeseen liabilities arising after the year end
(iii) The partial reversal (as a credit to the statement of profit or loss) of the accumulated depreciation provision on an item of plant because the estimate of its remaining useful life has been increased by three years
(iv) Providing $1 million for deferred tax at 25% relating to a $4 million revaluation of property during March 2015 even though Cumla has no intention of selling the property in the near future

Which of the above suggested treatments of provisions is/are permitted by IFRS?

A (i) only
B (i) and (ii)
C (ii) and (iii)
D (iv)

17 At 1 April 2014, Tilly owned a property with a carrying amount of $800,000 which had a remaining estimated life of 16 years. The property had not been revalued. On 1 October 2014, Tilly decided to sell the property and correctly classified it as being 'held-for-sale'. A property agent reported that the property's fair value less costs to sell at 1 October 2014 was expected to be $790,500 which had not changed at 31 March 2015.

What should be the carrying amount of the property in Tilly's statement of financial position as at 31 March 2015?

A $775,000
B $790,500
C $765,000
D $750,000

18 Johnson paid $1·2 million for a 30% investment in Treem's equity shares on 1 August 2014.

Treem's profit after tax for the year ended 31 March 2015 was $750,000. On 31 March 2015, Treem had $300,000 goods in its inventory which it had bought from Johnson in March 2015. These had been sold by Johnson at a mark-up on cost of 20%. Treem has not paid any dividends.

On the assumption that Treem is an associate of Johnson, what would be the carrying amount of the investment in Treem in the consolidated statement of financial position of Johnson as at 31 March 2015?

A $1,335,000
B $1,332,000
C $1,300,000
D $1,410,000

19 Hindberg is a car retailer. On 1 April 2014, Hindberg sold a car to Latterly on the following terms:

The selling price of the car was $25,300. Latterly paid $12,650 (half of the cost) on 1 April 2014 and would pay the remaining $12,650 on 31 March 2016 (two years after the sale). Hindberg's cost of capital is 10% per annum.

What is the total amount which Hindberg should credit to profit or loss in respect of this transaction in the year ended 31 March 2015?

A $23,105
B $23,000
C $20,909
D $24,150

20 **Which of the following current year events would explain a fall in a company's operating profit margin compared to the previous year?**

A An increase in gearing leading to higher interest costs
B A reduction in the allowance for uncollectible receivables
C A decision to value inventory on the average cost basis from the first in first out (FIFO) basis. Unit prices of inventory had risen during the current year
D A change from the amortisation of development costs being included in cost of sales to being included in administrative expenses

(40 marks)

This is a blank page.
Section B begins on page 10.

Section B – ALL THREE questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

1 On 1 July 2014 Bycomb acquired 80% of Cyclip's equity shares on the following terms:

– a share exchange of two shares in Bycomb for every three shares acquired in Cyclip; and
– a cash payment due on 30 June 2015 of $1·54 per share acquired (Bycomb's cost of capital is 10% per annum).

At the date of acquisition, shares in Bycomb and Cyclip had a stock market value of $3·00 and $2·50 each respectively.

Statements of profit or loss for the year ended 31 March 2015:

	Bycomb	Cyclip
	$'000	$'000
Revenue	24,200	10,800
Cost of sales	(17,800)	(6,800)
Gross profit	6,400	4,000
Distribution costs	(500)	(340)
Administrative expenses	(800)	(360)
Finance costs	(400)	(300)
Profit before tax	4,700	3,000
Income tax expense	(1,700)	(600)
Profit for the year	3,000	2,400

Equity in the separate financial statements of Cyclip as at **1 April 2014**:

	$'000
Equity	
Equity shares of $1 each	12,000
Retained earnings	13,500

The following information is also relevant:

(i) At the date of acquisition, the fair values of Cyclip's assets were equal to their carrying amounts with the exception of an item of plant which had a fair value of $720,000 above its carrying amount. The remaining life of the plant at the date of acquisition was 18 months. Depreciation is charged to cost of sales.

(ii) On 1 April 2014, Cyclip commenced the construction of a new production facility, financing this by a bank loan. Cyclip has followed the local GAAP in the country where it operates which prohibits the capitalisation of interest. Bycomb has calculated that, in accordance with IAS 23 *Borrowing Costs*, interest of $100,000 (which accrued evenly throughout the year) would have been capitalised at 31 March 2015. The production facility is still under construction as at 31 March 2015.

(iii) Sales from Bycomb to Cyclip in the post-acquisition period were $3 million at a mark-up on cost of 20%. Cyclip had $420,000 of these goods in inventory as at 31 March 2015.

(iv) Bycomb's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Cyclip's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

(v) On 31 March 2015, Bycomb carried out an impairment review which identified that the goodwill on the acquisition of Cyclip was impaired by $500,000. Impaired goodwill is charged to cost of sales.

Required:

(a) Calculate the consolidated goodwill at the date of acquisition of Cyclip. (6 marks)

(b) Prepare extracts from Bycomb's consolidated statement of profit or loss for the year ended 31 March 2015, for:

(i) revenue;
(ii) cost of sales;
(iii) finance costs;
(iv) profit or loss attributable to the non-controlling interest.

The following mark allocation is provided as guidance for this requirement:

(i) 1 mark
(ii) 3 marks
(iii) 2½ marks
(iv) 2½ marks

(9 marks)

(15 marks)

2 Yogi is a public company and extracts from its most recent financial statements are provided below:

Statements of profit or loss for the year ended 31 March

	2015	2014
	$'000	$'000
Revenue	36,000	50,000
Cost of sales	(24,000)	(30,000)
Gross profit	12,000	20,000
Profit from sale of division (see note (i))	1,000	nil
Distribution costs	(3,500)	(5,300)
Administrative expenses	(4,800)	(2,900)
Finance costs	(400)	(800)
Profit before taxation	4,300	11,000
Income tax expense	(1,300)	(3,300)
Profit for the year	3,000	7,700

Statements of financial position as at 31 March

	2015		2014	
	$'000	$'000	$'000	$'000
Non-current assets				
Property, plant and equipment		16,300		19,000
Intangible – goodwill		nil		2,000
		16,300		21,000
Current assets				
Inventory	3,400		5,800	
Trade receivables	1,300		2,400	
Bank	1,500	6,200	nil	8,200
Total assets		22,500		29,200
Equity and liabilities				
Equity				
Equity shares of $1 each		10,000		10,000
Retained earnings		3,000		4,000
		13,000		14,000
Non-current liabilities				
10% loan notes		4,000		8,000
Current liabilities				
Bank overdraft	nil		1,400	
Trade payables	4,300		3,100	
Current tax payable	1,200	5,500	2,700	7,200
Total equity and liabilities		22,500		29,200

Notes

(i) On 1 April 2014, Yogi sold the net assets (including goodwill) of a separately operated division of its business for $8 million cash on which it made a profit of $1 million. This transaction required shareholder approval and, in order to secure this, the management of Yogi offered shareholders a dividend of 40 cents for each share in issue out of the proceeds of the sale. The trading results of the division which are included in the statement of profit or loss for the year ended 31 March 2014 above are:

	$'000
Revenue	18,000
Cost of sales	(10,000)
Gross profit	8,000
Distribution costs	(1,000)
Administrative expenses	(1,200)
Profit before interest and tax	5,800

(ii) The following selected ratios for Yogi have been calculated for the year ended 31 March 2014 (as reported above):

Gross profit margin	40·0%
Operating profit margin	23·6%
Return on capital employed (profit before interest and tax/(total assets – current liabilities))	53·6%
Net asset turnover	2·27 times

Required:

(a) Calculate the equivalent ratios for Yogi:

(i) for the year ended 31 March 2014, after excluding the contribution made by the division that has been sold; and

(ii) for the year ended 31 March 2015, excluding the profit on the sale of the division. (5 marks)

(b) Comment on the comparative financial performance and position of Yogi for the year ended 31 March 2015. (10 marks)

(15 marks)

3 The following trial balance relates to Clarion as at 31 March 2015:

	$'000	$'000
Equity shares of $1 each (note (i))		30,000
Retained earnings – 1 April 2014		8,600
Other component of equity – share premium (note (i))		5,000
8% loan notes (note (ii))		20,000
Plant and equipment at cost (note (iii))	85,000	
Accumulated depreciation plant and equipment – 1 April 2014		19,000
Investments through profit or loss – value at 1 April 2014 (note (iv))	6,000	
Inventory at 31 March 2015	11,700	
Trade receivables	18,500	
Bank		1,900
Deferred tax (note (vi))		2,700
Trade payables		9,400
Environmental provision (note (iii))		4,000
Finance lease obligation (note (iii))		4,200
Revenue		132,000
Cost of sales	88,300	
Operating lease payments (note (v))	2,000	
Administrative expenses	8,000	
Distribution costs	7,400	
Loan note interest paid	800	
Suspense account (note (ii))	5,800	
Bank interest	300	
Dividends paid	3,900	
Investment income (note (iv))		500
Current tax (note (vi))		400
	237,700	237,700

The following notes are also relevant:

(i) The equity shares and share premium balances in the trial balance above include a fully subscribed 1 for 5 rights issue at $1·60 per share which was made by Clarion on 1 October 2014. The market value of Clarion's shares was $2·50 on 1 October 2014.

(ii) On 31 March 2015, one quarter of the 8% loan notes were redeemed at par and six months' outstanding loan interest was paid. The suspense account represents the double entry corresponding to the cash payment for the capital redemption and the outstanding interest.

(iii) Property, plant and equipment:

Included in property, plant and equipment are two major items of plant acquired on 1 April 2014:

Item 1 had a cash cost $14 million, however, the plant will cause environmental damage which will have to be rectified when it is dismantled at the end of its five year life. The present value (discounting at 8%) on 1 April 2014 of the rectification is $4 million. The environmental provision has been correctly accounted for, however, no finance cost has yet been charged on the provision.

Item 2 was plant acquired with a fair value of $8 million under a five-year finance lease. This required an initial deposit of $2·3 million and annual payments of $1·5 million on 31 March each year. The finance lease obligation in the trial balance above represents the fair value of the plant less both the deposit and the first annual payment. The lease has an implicit interest rate of 10% and the asset has been correctly capitalised in plant and equipment.

No depreciation has yet been charged on plant and equipment which should be charged to cost of sales on a straight-line basis over a five-year life (including leased plant). No plant is more than four years old.

(iv) The investments through profit or loss are those held at 31 March 2015 (after the sale below). They are carried at their fair value as at 1 April 2014, however, they had a fair value of $6·5 million on 31 March 2015. During the year an investment which had a carrying amount of $1·4 million was sold for $1·6 million. Investment income in the trial balance above includes the profit on the sale of the investment and dividends received during the year.

(v) Clarion renewed an operating lease on a property on 1 April 2014. The operating lease payments represent an annual payment (in advance) of $1 million and a lease premium of $1 million. The lease is for four years and operating lease expenses should be included in cost of sales.

(vi) A provision for current tax for the year ended 31 March 2015 of $3·5 million is required. The balance on current tax in the trial balance above represents the under/over provision of the tax liability for the year ended 31 March 2014. At 31 March 2015, the tax base of Clarion's net assets was $12 million less than their carrying amounts. The income tax rate of Clarion is 25%.

Required:

(a) Prepare the statement of profit or loss for Clarion for the year ended 31 March 2015.

(b) Prepare the statement of changes in equity for Clarion for the year ended 31 March 2015.

(c) Prepare the statement of financial position for Clarion as at 31 March 2015.

Notes to the financial statements are not required.

The following mark allocation is provided as guidance for these requirements:

(a) 10 marks
(b) 3 marks
(c) 10 marks

(23 marks)

(d) Calculate the basic earnings per share of Clarion for the year ended 31 March 2015. (3 marks)

(e) Prepare extracts from the statement of cash flows for Clarion for the year ended 31 March 2015 in respect of cash flows from investing (ignore investment income) and financing activities. (4 marks)

(30 marks)

End of Question Paper