Fundamentals Level – Skills Module

Financial Reporting

Wednesday 3 December 2014

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.

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

Paper F7

ACCA

The Association of Chartered Certified Accountants

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

Please use the space provided on the inside cover of the Candidate Answer Booklet to indicate your chosen answer to each multiple choice question.
Each question is worth 2 marks.

1 **Which of the following is a change of accounting policy under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*?**

A Classifying commission earned as revenue in the statement of profit or loss, having previously classified it as other operating income
B Switching to purchasing plant using finance leases from a previous policy of purchasing plant for cash
C Changing the value of a subsidiary's inventory in line with the group policy for inventory valuation when preparing the consolidated financial statements
D Revising the remaining useful life of a depreciable asset

2 Aqua has correctly calculated its basic earnings per share (EPS) for the current year.

Which of the following items need to be additionally considered when calculating Aqua's diluted EPS for the year?

(i) A 1 for 5 rights issue of equity shares during the year at $1·20 when the market price of the equity shares was $2·00
(ii) The issue during the year of a convertible (to equity shares) loan note
(iii) The granting during the year of directors' share options exercisable in three years' time
(iv) Equity shares issued during the year as the purchase consideration for the acquisition of a new subsidiary company

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

3 Although most items in financial statements are shown at their historical cost, increasingly the IASB is requiring or allowing current cost to be used in many areas of financial reporting.

Drexler acquired an item of plant on 1 October 2012 at a cost of $500,000. It has an expected life of five years (straight-line depreciation) and an estimated residual value of 10% of its historical cost or current cost as appropriate. As at 30 September 2014, the manufacturer of the plant still makes the same item of plant and its current price is $600,000.

What is the correct carrying amount to be shown in the statement of financial position of Drexler as at 30 September 2014 under historical cost and current cost?

	historical cost	current cost
	$	$
A	320,000	600,000
B	320,000	384,000
C	300,000	600,000
D	300,000	384,000

4 Repro, a company which sells photocopying equipment, has prepared its draft financial statements for the year ended 30 September 2014. It has included the following transactions in revenue at the stated amounts below.

Which of these has been correctly included in revenue according to IAS 18 *Revenue*?

A Agency sales of $250,000 on which Repro is entitled to a commission
B Sale proceeds of $20,000 for motor vehicles which were no longer required by Repro
C Sales of $150,000 on 30 September 2014. The amount invoiced to and received from the customer was $180,000, which includes $30,000 for ongoing servicing work to be done by Repro over the next two years
D Sales of $200,000 on 1 October 2013 to an established customer which (with the agreement of Repro) will be paid in full on 30 September 2015. Repro has a cost of capital of 10%

5 Tynan's year end is 30 September 2014 and the following potential liabilities have been identified:

(i) The signing of a non-cancellable contract in September 2014 to supply goods in the following year on which, due to a pricing error, a loss will be made
(ii) The cost of a reorganisation which was approved by the board in August 2014 but has not yet been implemented, communicated to interested parties or announced publicly
(iii) An amount of deferred tax relating to the gain on the revaluation of a property during the current year. Tynan has no intention of selling the property in the foreseeable future
(iv) The balance on the warranty provision which relates to products for which there are no outstanding claims and whose warranties had expired by 30 September 2014

Which of the above should Tynan recognise as liabilities as at 30 September 2014?

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

6 Yling entered into a construction contract on 1 January 2014 which is expected to last 24 months. The agreed price for the contract is $5 million. At 30 September 2014, the costs incurred on the contract were $1·6 million and the estimated remaining costs to complete were $2·4 million. On 20 September 2014, Yling received a payment from the customer of $1·8 million which was equal to the full amount of the progress billings. Yling calculates the stage of completion of its construction contracts on the basis of progress billings to the contract price.

What amount would be reported in Yling's statement of financial position as at 30 September 2014 for the amount due from the customer for the above contract?

A Nil
B $160,000
C $800,000
D $200,000

7 Recognition is the process of including within the financial statements items which meet the definition of an element according to the IASB's *Conceptual Framework for Financial Reporting*.

Which of the following items should be recognised as an asset in the statement of financial position of a company?

A A skilled and efficient workforce which has been very expensive to train. Some of these staff are still in the employment of the company
B A highly lucrative contract signed during the year which is due to commence shortly after the year end
C A government grant relating to the purchase of an item of plant several years ago which has a remaining life of four years
D A receivable from a customer which has been sold (factored) to a finance company. The finance company has full recourse to the company for any losses

8 On 30 September 2014, Razor's closing inventory was counted and valued at its cost of $1 million. Some items of inventory which had cost $210,000 had been damaged in a flood (on 15 September 2014) and are not expected to achieve their normal selling price which is calculated to achieve a gross profit margin of 30%. The sale of these goods will be handled by an agent who sells them at 80% of the normal selling price and charges Razor a commission of 25%.

At what value will the closing inventory of Razor be reported in its statement of financial position as at 30 September 2014?

A $1 million
B $790,000
C $180,000
D $970,000

9 The following information is available for the property, plant and equipment of Fry as at 30 September:

	2014	2013
	$'000	$'000
Carrying amounts	23,400	14,400

The following items were recorded during the year ended 30 September 2014:

(i) Depreciation charge of $2·5 million
(ii) An item of plant, with a carrying amount of $3 million, was sold for $1·8 million
(iii) A property was revalued upwards by $2 million
(iv) Environmental provisions of $4 million relating to property, plant and equipment were capitalised during the year

What amount would be shown in Fry's statement of cash flows for purchase of property, plant and equipment for the year ended 30 September 2014?

A $8·5 million
B $12·5 million
C $7·3 million
D $10·5 million

10 Petre owns 100% of the share capital of the following companies. The directors are unsure of whether the investments should be consolidated.

In which of the following circumstances would the investment NOT be consolidated?

A Petre has decided to sell its investment in Alpha as it is loss-making; the directors believe its exclusion from consolidation would assist users in predicting the group's future profits

B Beta is a bank and its activity is so different from the engineering activities of the rest of the group that it would be meaningless to consolidate it

C Delta is located in a country where local accounting standards are compulsory and these are not compatible with IFRS used by the rest of the group

D Gamma is located in a country where a military coup has taken place and Petre has lost control of the investment for the foreseeable future

11 On 1 October 2013, Bertrand issued $10 million convertible loan notes which carry a nominal interest (coupon) rate of 5% per annum. The loan notes are redeemable on 30 September 2016 at par for cash or can be exchanged for equity shares. A similar loan note, without the conversion option, would have required Bertrand to pay an interest rate of 8%.

The present value of $1 receivable at the end of each year, based on discount rates of 5% and 8%, can be taken as:

	5%	8%
End of year 1	0·95	0·93
2	0·91	0·86
3	0·86	0·79

How would the convertible loan appear in Bertrand's statement of financial position on initial recognition (1 October 2013)?

	Equity $'000	Non-current liability $'000
A	810	9,190
B	nil	10,000
C	10,000	nil
D	40	9,960

12 The net assets of Fyngle, a cash generating unit (CGU), are:

	$
Property, plant and equipment	200,000
Allocated goodwill	50,000
Product patent	20,000
Net current assets (at net realisable value)	30,000
	300,000

As a result of adverse publicity, Fyngle has a recoverable amount of only $200,000.

What would be the value of Fyngle's property, plant and equipment after the allocation of the impairment loss?

A $154,545
B $170,000
C $160,000
D $133,333

13 Many commentators believe that the trend of earnings per share (EPS) is a more reliable indicator of underlying performance than the trend of the net profit for the year.

Which of the following statements supports this view?

A Net profit can be manipulated by the choice of accounting policies but EPS cannot be manipulated in this way
B EPS takes into account the additional resources made available to earn profit when new shares are issued for cash, whereas net profit does not
C The disclosure of a diluted EPS figure is a forecast of the future trend of profit
D The comparative EPS is restated where a change in accounting policy affects the previous year's profits

14 As at 30 September 2013 Dune's property in its statement of financial position was:

Property at cost (useful life 15 years)	$45 million
Accumulated depreciation	$6 million

On 1 April 2014, Dune decided to sell the property. The property is being marketed by a property agent at a price of $42 million, which was considered a reasonably achievable price at that date. The expected costs to sell have been agreed at $1 million. Recent market transactions suggest that actual selling prices achieved for this type of property in the current market conditions are 10% less than the price at which they are marketed.

At 30 September 2014 the property has not been sold.

At what amount should the property be reported in Dune's statement of financial position as at 30 September 2014?

A $36 million
B $37·5 million
C $36·8 million
D $42 million

15 **Which of the following statements about a not-for-profit entity is valid?**

A There is no requirement to calculate an earnings per share figure as it is not likely to have shareholders who need to assess its earnings performance
B The current value of its property, plant and equipment is not relevant as it is not a commercial entity
C Interpretation of its financial performance using ratio analysis is meaningless
D Its financial statements will not be closely scrutinised as it does not have any investors

16 Tazer, a parent company, acquired Lowdown, an unincorporated entity, for $2·8 million. A fair value exercise performed on Lowdown's net assets at the date of purchase showed:

	$'000
Property, plant and equipment	3,000
Identifiable intangible asset	500
Inventory	300
Trade receivables less payables	200
	4,000

How should the purchase of Lowdown be reflected in Tazer's consolidated statement of financial position?

A Record the net assets at their values shown above and credit profit or loss with $1·2 million
B Record the net assets at their values shown above and credit Tazer's consolidated goodwill with $1·2 million
C Write off the intangible asset ($500,000), record the remaining net assets at their values shown above and credit profit or loss with $700,000
D Record the purchase as a financial asset investment at $2·8 million

17 On 1 October 2013, Xplorer commenced drilling for oil from an undersea oilfield. The extraction of oil causes damage to the seabed which has a restorative cost (ignore discounting) of $10,000 per million barrels of oil extracted. Xplorer extracted 250 million barrels of oil in the year ended 30 September 2014.

Xplorer is also required to dismantle the drilling equipment at the end of its five-year licence. This has an estimated cost of $30 million on 30 September 2018. Xplorer's cost of capital is 8% per annum and $1 has a present value of 68 cents in five years' time.

What is the total provision (extraction plus dismantling) which Xplorer would report in its statement of financial position as at 30 September 2014 in respect of its oil operations?

A $34,900,000
B $24,532,000
C $22,900,000
D $4,132,000

18 **Which of the following is NOT an indicator of impairment?**

A Advances in the technological environment in which an asset is employed have an adverse impact on its future use
B An increase in interest rates which increases the discount rate an entity uses
C The carrying amount of an entity's net assets is higher than the entity's number of shares in issue multiplied by its share price
D The estimated net realisable value of inventory has been reduced due to fire damage although this value is greater than its carrying amount

19 During the year ended 30 September 2014 Hyper entered into two lease transactions:

On 1 October 2013, a payment $90,000 being the first of five equal annual payments of a finance lease for an item of plant. The lease has an implicit interest rate of 10% and the fair value (cost to purchase) of the leased equipment on 1 October 2013 was $340,000.

On 1 January 2014, a payment of $18,000 for a one-year lease of an item of excavation equipment.

What amount in total would be charged to Hyper's statement of profit or loss for the year ended 30 September 2014 in respect of the above transactions?

A $108,000
B $111,000
C $106,500
D $115,500

20 Comparability is identified as an enhancing qualitative characteristic in the IASB's *Conceptual framework for financial reporting*.

Which of the following does NOT improve comparability?

A Restating the financial statements of previous years when there has been a change of accounting policy
B Prohibiting changes of accounting policy unless required by an IFRS or to give more relevant and reliable information
C Disclosing discontinued operations in financial statements
D Applying an entity's current accounting policy to a transaction which an entity has not engaged in before

(40 marks)

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

1 Xpand is a publicly listed company which has experienced rapid growth in recent years through the acquisition and integration of other companies. Xpand is interested in acquiring Hydan, a retailing company, which is one of several companies owned and managed by the same family.

The summarised financial statements of Hydan for the year ended 30 September 2014 are:

Statement of profit or loss

	$'000
Revenue	70,000
Cost of sales	(45,000)
Gross profit	25,000
Operating costs	(7,000)
Directors' salaries	(1,000)
Profit before tax	17,000
Income tax expense	(3,000)
Profit for the year	14,000

Statement of financial position

	$'000	$'000
Assets		
Non-current assets		
Property, plant and equipment		32,400
Current assets		
Inventory	7,500	
Bank	100	7,600
Total assets		40,000
Equity and liabilities		
Equity		
Equity shares of $1 each		1,000
Retained earnings		18,700
		19,700
Non-current liabilities		
Directors' loan accounts (interest free)		10,000
Current liabilities		
Trade payables	7,500	
Current tax payable	2,800	10,300
Total equity and liabilities		40,000

From the above financial statements, Xpand has calculated for Hydan the ratios below for the year ended 30 September 2014. It has also obtained the equivalent ratios for the retail sector average which can be taken to represent Hydan's sector.

	Hydan	Sector average
Return on equity (ROE) (including directors' loan accounts)	47·1%	22·0%
Net asset turnover	2·36 times	1·67 times
Gross profit margin	35·7%	30·0%
Net profit margin	20·0%	12·0%

From enquiries made, Xpand has learned the following information:

(i) Hydan buys all of its trading inventory from another of the family companies at a price which is 10% less than the market price for such goods.
(ii) After the acquisition, Xpand would replace the existing board of directors and need to pay remuneration of \$2·5 million per annum.
(iii) The directors' loan accounts would be repaid by obtaining a loan of the same amount with interest at 10% per annum.
(iv) Xpand expects the purchase price of Hydan to be \$30 million.

Required:

(a) Recalculate the ratios for Hydan after making appropriate adjustments to the financial statements for notes (i) to (iv) above. For this purpose, the expected purchase price of \$30 million should be taken as Hydan's equity and net assets are equal to this equity plus the loan. You may assume the changes will have no effect on taxation. (6 marks)

(b) In relation to the ratios calculated in (a) above, and the ratios for Hydan given in the question, comment on the performance of Hydan compared to its retail sector average. (9 marks)

(15 marks)

2 After preparing a draft statement of profit or loss for the year ended 30 September 2014 and adding the year's profit (before any adjustments required by notes (i) to (iii) below) to retained earnings, the summarised trial balance of Kandy as at 30 September 2014 is:

	$'000	$'000
Equity shares of $1 each		40,000
Retained earnings as at 30 September 2014		17,500
Proceeds of 6% loan (note (i))		30,000
Land ($5 million) and buildings – at cost (note (ii))	55,000	
Plant and equipment – at cost (note (ii))	58,500	
Accumulated depreciation at 1 October 2013: buildings		20,000
plant and equipment		34,500
Current assets	68,700	
Current liabilities		38,400
Deferred tax (note (iii))		2,500
Interest payment (note (i))	1,800	
Current tax (note (iii))		1,100
	184,000	184,000

The following notes are relevant:

(i) The loan note was issued on 1 October 2013 and incurred issue costs of $1 million which were charged to profit or loss. Interest of $1·8 million ($30 million at 6%) was paid on 30 September 2014. The loan is redeemable on 30 September 2018 at a substantial premium which gives an effective interest rate of 9% per annum. No other repayments are due until 30 September 2018.

(ii) Non-current assets:
The price of property has increased significantly in recent years and on 1 October 2013, the directors decided to revalue the land and buildings. The directors accepted the report of an independent surveyor who valued the land at $8 million and the buildings at $39 million on that date. The remaining life of the buildings at 1 October 2013 was 15 years. Kandy does **not** make an annual transfer to retained profits to reflect the realisation of the revaluation gain; however, the revaluation will give rise to a deferred tax liability. The income tax rate of Kandy is 20%.

Plant and equipment is depreciated at 12½% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 September 2014.

(iii) A provision of $2·4 million is required for current income tax on the profit of the year to 30 September 2014. The balance on current tax in the trial balance is the under/over provision of tax for the previous year. In addition to the temporary differences relating to the information in note (ii), Kandy has further taxable temporary differences of $10 million as at 30 September 2014.

Required:

(a) Prepare a schedule of adjustments required to the retained earnings of Kandy as at 30 September 2014 as a result of the information in notes (i) to (iii) above.

(b) Prepare the statement of financial position of Kandy as at 30 September 2014.

Note: The notes to the statement of financial position are not required.

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

(a) 6 marks
(b) 9 marks

(15 marks)

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Question 3 begins on page 12.

3 On 1 January 2014, Plastik acquired 80% of the equity share capital of Subtrak. The consideration was satisfied by a share exchange of two shares in Plastik for every three acquired shares in Subtrak. At the date of acquisition, shares in Plastik and Subtrak had a market value of $3 and $2·50 each respectively. Plastik will also pay cash consideration of 27·5 cents on 1 January 2015 for each acquired share in Subtrak. Plastik has a cost of capital of 10% per annum. None of the consideration has been recorded by Plastik.

Below are the summarised draft financial statements of both companies.

Statements of profit or loss and other comprehensive income for the year ended 30 September 2014

	Plastik	Subtrak
	$'000	$'000
Revenue	62,600	30,000
Cost of sales	(45,800)	(24,000)
Gross profit	16,800	6,000
Distribution costs	(2,000)	(1,200)
Administrative expenses	(3,500)	(1,800)
Finance costs	(200)	(nil)
Profit before tax	11,100	3,000
Income tax expense	(3,100)	(1,000)
Profit for the year	8,000	2,000
Other comprehensive income:		
Gain on revaluation of property (note (i))	1,500	nil
Total comprehensive income	9,500	2,000

Statements of financial position as at 30 September 2014

	Plastik	Subtrak
Assets		
Non-current assets		
Property, plant and equipment	18,700	13,900
Investments: 10% loan note from Subtrak (note (ii))	1,000	nil
	19,700	13,900
Current assets		
Inventory (note (iii))	4,300	1,200
Trade receivables (note (iv))	4,700	2,500
Bank	nil	300
	9,000	4,000
Total assets	28,700	17,900
Equity and liabilities		
Equity		
Equity shares of $1 each	10,000	9,000
Revaluation surplus (note (i))	2,000	nil
Retained earnings	6,300	3,500
	18,300	12,500
Non-current liabilities		
10% loan notes (note (ii))	2,500	1,000
Current liabilities		
Trade payables (note (iv))	3,400	3,600
Bank	1,700	nil
Current tax payable	2,800	800
	7,900	4,400
Total equity and liabilities	28,700	17,900

The following information is relevant:

(i) At the date of acquisition, the fair values of Subtrak's assets and liabilities were equal to their carrying amounts with the exception of Subtrak's property which had a fair value of $4 million above its carrying amount. For consolidation purposes, this led to an increase in depreciation charges (in cost of sales) of $100,000 in the post-acquisition period to 30 September 2014. Subtrak has not incorporated the fair value property increase into its entity financial statements.

The policy of the Plastik group is to revalue all properties to fair value at each year end. On 30 September 2014, the increase in Plastik's property has already been recorded, however, a further increase of $600,000 in the value of Subtrak's property since its value at acquisition and 30 September 2014 has not been recorded.

(ii) On 30 September 2014, Plastik accepted a $1 million 10% loan note from Subtrak.

(iii) Sales from Plastik to Subtrak throughout the year ended 30 September 2014 had consistently been $300,000 per month. Plastik made a mark-up on cost of 25% on all these sales. $600,000 (at cost to Subtrak) of Subtrak's inventory at 30 September 2014 had been supplied by Plastik in the post-acquisition period.

(iv) Plastik had a trade receivable balance owing from Subtrak of $1·2 million as at 30 September 2014. This differed to the equivalent trade payable of Subtrak due to a payment by Subtrak of $400,000 made in September 2014 which did not clear Plastik's bank account until 4 October 2014. Plastik's policy for cash timing differences is to adjust the parent's financial statements.

(v) Plastik's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Subtrak'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.

(vi) Due to recent adverse publicity concerning one of Subtrak's major product lines, the goodwill which arose on the acquisition of Subtrak has been impaired by $500,000 as at 30 September 2014. Goodwill impairment should be treated as an administrative expense.

(vii) Assume, except where indicated otherwise, that all items of income and expenditure accrue evenly throughout the year.

Required:

(a) Prepare the consolidated statement of profit or loss and other comprehensive income for Plastik for the year ended 30 September 2014.

(b) Prepare the consolidated statement of financial position for Plastik as at 30 September 2014.

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

(a) 10 marks
(b) 17 marks

(c) Plastik is in the process of recording the acquisition of another subsidiary, Dilemma, and has identified two items when reviewing the fair values of Dilemma's assets.

The first item relates to $1 million spent on a new research project. This amount has been correctly charged to profit or loss by Dilemma, but the directors of Plastik have reliably assessed the fair value of this research to be $1·2 million.

The second item relates to the customers of Dilemma. The directors of Plastik believe Dilemma has a particularly strong list of reputable customers which could be 'sold' to other companies and have assessed the fair value of the customer list at $3 million.

Required:

State whether (and if so, at what value) the two items should be recognised in the consolidated statement of financial position of Plastik on the acquisition of Dilemma. (3 marks)

(30 marks)

End of Question Paper

Answers

Section A

1 A

A change of classification in presentation in financial statements is a change of accounting policy (CAP) under IAS 8.

2 C

3 B

Historical cost annual depreciation = $90,000 ((500,000 x 90%)/5 years).
After two years carrying amount would be $320,000 (500,000 – (2 x 90,000)).
Current cost annual depreciation = $108,000 ((600,000 x 90%)/5 years).
After two years carrying amount would be $384,000 (600,000 – (2 x 108,000)).

4 C

Although the invoiced amount is $180,000, $30,000 of this has not yet been earned and must be deferred until the servicing work has been completed.

5 C

(i) is an onerous contract and (iii) the provision is still required if there is no intention to sell

6 B

The total profit on the contract is expected to be $1 million (5,000 – (1,600 + 2,400)).
At 30 September 2014 the profit recognised would be $360,000 (1,000 x 1,800/5,000).

Therefore the amount due from the customer would be:

	$'000
Cost to date	1,600
Profit recognised	360
Progress billings	(1,800)
Amount due from the customer	160

7 D

As the receivable is 'sold' with recourse it must remain as an asset on the statement of financial position; it is not derecognised.

8 D

The normal selling price of damaged inventory is $300,000 (210/70%).

This will now sell for $240,000 (300,000 x 80%), and have a NRV of $180,000 (240 – (240 x 25%)). The expected loss on the inventory is $30,000 (210 cost – 180 NRV) and therefore the inventory should be valued at $970,000 (1,000 – 30).

9 A

Cash flow is (in $ million):
23·4 – 14·4 b/f + 2·5 dep + 3 disposal – 2 revaluation – 4 non-cash acquisition = 8·5

10 D

The investment no longer meets the definition of a subsidiary (ability to control) and therefore would not be consolidated.

11 A

Year ended 30 September	Cash flow $'000	Discount rate at 8%	Discounted cash flows $'000
2014	500	0·93	465
2015	500	0·86	430
2016	10,500	0·79	8,295
Value of debt component			9,190
Difference – value of equity option component			810
Proceeds			10,000

12 A

Goodwill should be written off in full and the remaining loss is allocated pro rata to property plant and equipment and the product patent.

	B/f $	Loss $	Post loss $
Property, plant and equipment	200,000	(45,455)	154,545
Goodwill	50,000	(50,000)	nil
Product patent	20,000	(4,545)	15,455
Net current assets (at NRV)	30,000	nil	30,000
	300,000	(100,000)	200,000

13 B

Correct for the reason given in the question.

14 C

At 30 September 2014:
Carrying amount = $37·5 million (45,000 – 6,000 b/f – 1,500 for 6 months; no further depreciation when classified as held for sale).
Recoverable amount = $36·8 million ((42,000 x 90%) – 1,000).
Therefore included at $36·8 million (lower of carrying amount and fair value less cost to sell).

15 A

A not-for-profit entity is not likely to have shareholders or 'earnings'.

16 A

Is the correct treatment for a bargain purchase (negative goodwill).

17 B

Extraction provision at 30 September 2014 is $2·5 million (250 x 10).
Dismantling provision at 1 October 2013 is $20·4 million (30,000 x 0·68).
This will increase by an 8% finance cost by 30 September 2014 = $22,032,000.
Total provision is $24,532,000.

18 D

Although the estimated NRV is lower than it was (due to fire damage), the entity will still make a profit on the inventory and thus it is not an indicator of impairment.

19 C

Rental of excavation equipment \$13,500 (18 x 9/12)
Depreciation of finance leased plant \$68,000 (340/5 years)
Finance cost \$25,000 ((340 – 90) x 10%)
Total \$106,500

20 D

As it is a new type of transaction, comparability with existing treatments is not relevant.

Section B

1 (a) For comparison

	Hydan adjusted	Hydan as reported	Sector average
Return on equity (ROE)	21·7%	47·1%	22·0%
Net asset turnover	1·75 times	2·36 times	1·67 times
Gross profit margin	28·6%	35·7%	30·0%
Net profit margin	9·3%	20·0%	12·0%

Hydan's adjusted ratios:
On the assumption that after the purchase of Hydan, the favourable effects of the transactions with other companies owned by the family would not occur, the following adjustments to the statement of profit or loss should be made:

	\$'000
Cost of sales (45,000/0·9)	50,000
Directors' remuneration	2,500
Loan interest (10% x 10,000)	1,000

These adjustments would give a revised statement of profit or loss:

Revenue	70,000
Cost of sales	(50,000)
Gross profit	20,000
Operating costs	(7,000)
Directors' remuneration	(2,500)
Loan interest	(1,000)
Profit before tax	9,500
Income tax expense	(3,000)
Profit for the year	6,500

In the statement of financial position:

Equity would be the purchase price of Hydan (per question)	30,000
The commercial loan (replacing the directors' loan) would now be debt	10,000

From these figures the adjusted ratios above are calculated as:

Return on equity	((6,500 /30,000) x 100)	21·7%
Net asset turnover	(70,000/(30,000 + 10,000))	1·75 times
Gross profit margin	((20,000)/70,000) x 100)	28·6%
Net profit margin	((6,500/70,000) x 100)	9·30%

(b) An analysis of Hydan's ratios based on the financial statements provided reveals a strong position, particularly in relation to profitability when compared to other businesses in this retail sector. Hydan has a very high ROE which is a product of higher-than-average profit margins (at both the gross and net profit level) and a significantly higher net asset turnover. Thus, on the face of it, Hydan is managing to achieve higher prices (or reduced cost of sales), has better control of overheads and is using its net assets more efficiently in terms of generating revenue.

However, when adjustments are made for the effects of its favourable transactions with other companies owned by the family, the position changes somewhat. The effect of purchasing its inventory from another family owned supplier at favourable market prices means that its reported gross profit percentage of 35·7% is flattered; had these purchases been made at market prices, it would fall to 28·6% which is below the sector average of 30·0%. The effects of the favourable inventory purchases carry through to net profit. Based on Xpand's estimate of future directors' remuneration, it would seem the existing directors of Hydan are not charging commercial rates for their remuneration. When Xpand replaces the board of Hydan, it will have to increase directors' remuneration by \$1·5 million. Additionally, when the interest free directors' loans are replaced with a commercial loan, with interest at 10% per annum, this would reduce net profit by a further \$1 million. The accumulation of these adjustments means that the ROE which Xpand should expect would be 21·7% (rather than the reported 47·1%) which is almost exactly in line with the sector average of 22·0%.

In a similar vein, when the asset turnover is calculated based on the equity purchase price and the commercial loan (equating to net assets), it falls from 2·36 times to 1·75 times which is above, but much closer to, the sector average of 1·67 times.

In summary, Hydan's adjusted results would still be slightly ahead of the sector averages in most areas and may well justify the anticipated purchase price of $30 million; however, Hydan will be nowhere near the excellently performing company suggested by the reported figures and Xpand needs to exercise a degree of caution in its negotiations.

2 (a) Kandy – Schedule of retained earnings of Kandy as at 30 September 2014

	$'000
Retained earnings per trial balance	17,500
Adjustments re:	
Note (i)	
Add back issue costs of loan note (w (i))	1,000
Loan finance costs (29,000 x 9% (w (i)))	(2,610)
Note (ii)	
Depreciation of buildings (w (ii))	(2,600)
Depreciation of plant and equipment (w (ii))	(3,000)
Note (iii)	
Income tax expense (w (iii))	(800)
Adjusted retained earnings	9,490

(b) Kandy – Statement of financial position as at 30 September 2014

Assets	**$'000**	**$'000**
Non-current assets		
Property, plant and equipment (44,400 + 21,000 (w (ii)))		65,400
Current assets (per trial balance)		68,700
Total assets		134,100
Equity and liabilities		
Equity		
Equity shares of $1 each		40,000
Revaluation surplus (12,000 – 2,400 (w (ii) and (iii)))	9,600	
Retained earnings (from (a))	9,490	19,090
		59,090
Non-current liabilities		
Deferred tax (w (iii))	4,400	
6% loan note (w (i))	29,810	34,210
Current liabilities		
Per trial balance	38,400	
Current tax payable	2,400	40,800
Total equity and liabilities		134,100

Workings (monetary figures in brackets in $'000)

(i) Loan note

The issue costs should be deducted from the proceeds of the loan note and not charged as an expense. The finance cost of the loan note, at the effective rate of 9% applied to the carrying amount of the loan note of $29 million (30,000 – 1,000), is $2,610,000. The interest actually paid is $1·8 million. The difference between these amounts of $810,000 (2,610 – 1,800) is added to the carrying amount of the loan note to give $29,810,000 (29,000 + 810) for inclusion as a non-current liability in the statement of financial position.

(ii) Non-current assets

Land and buildings
The gain on revaluation and carrying amount of the land and buildings will be:

	$'000
Carrying amount at 1 October 2013 (55,000 – 20,000)	35,000
Revaluation at that date (8,000 + 39,000)	47,000
Gain on revaluation	12,000
Buildings depreciation for the year ended 30 September 2014 (39,000/15 years)	(2,600)
Carrying amount at 30 September 2014 (47,000 – 2,600)	44,400

	$'000
Plant and equipment	
Carrying amount at 1 October 2013 (58,500 – 34,500)	24,000
Depreciation for year ended 30 September 2014 (12½% reducing balance)	(3,000)
Carrying amount at 30 September 2014	21,000

(iii) Taxation

Income tax expense	
Provision for year ended 30 September 2014	2,400
Less over-provision in previous year	(1,100)
Deferred tax (see below)	(500)
	800
Deferred tax	
Provision required at 30 September 2014 ((10,000 + 12,000) x 20%)	4,400
Provision at 1 October 2013	(2,500)
Movement in provision	1,900
Charge to revaluation of land and buildings (12,000 x 20%)	(2,400)
Balance – credit to profit or loss	(500)

3 (a) Plastik

Consolidated statement of profit or loss and other comprehensive income for the year ended 30 September 2014

	$'000
Revenue (62,600 + (30,000 x 9/12) – (300 x 9 months intra-group sales))	82,400
Cost of sales (w (i))	(61,320)
Gross profit	21,080
Distribution costs (2,000 + (1,200 x 9/12))	(2,900)
Administrative expenses (3,500 + (1,800 x 9/12) + 500 goodwill impairment)	(5,350)
Finance costs (200 + 135 (w (v)))	(335)
Profit before tax	12,495
Income tax expense (3,100 + (1,000 x 9/12))	(3,850)
Profit for the year	8,645
Other comprehensive income	
Gain on revaluation of property (1,500 + 600)	2,100
Total comprehensive income	10,745
Profit for year attributable to:	
Equity holders of the parent (balance)	8,465
Non-controlling interest (w (ii))	180
	8,645
Total comprehensive income attributable to:	
Equity holders of the parent (balance)	10,445
Non-controlling interest (180 above + (600 x 20%))	300
	10,745

(b) **Plastik – Consolidated statement of financial position as at 30 September 2014**

	$'000
Assets	
Non-current assets	
Property, plant and equipment (w (iii))	37,100
Intangible asset: goodwill (w (iv))	5,200
	42,300
Current assets	
Inventory (4,300 + 1,200 – 120 URP (w (i)))	5,380
Trade receivables (4,700 + 2,500 – 1,200 intra-group)	6,000
Bank	300
	11,680
Total assets	53,980
Equity and liabilities	
Equity attributable to owners of the parent	
Equity shares of $1 each ((10, 000 + 4,800) w (iv))	14,800
Other component of equity (share premium) (w (iv))	9,600
Revaluation surplus (2,000 + (600 x 80%))	2,480
Retained earnings (w (v))	6,765
	33,645
Non-controlling interest (w (vi))	4,800
Total equity	38,445
Non-current liabilities	
10% loan notes (2,500 + 1,000 – 1,000 intra-group)	2,500
Current liabilities	
Trade payables (3,400 + 3,600 – 800 intra-group)	6,200
Current tax payable (2,800 + 800)	3,600
Deferred consideration (1,800 + 135 w (v))	1,935
Bank (1,700 – 400 cash in transit)	1,300
	13,035
Total equity and liabilities	53,980

(c) IFRS 3 *Business Combinations* addresses the recognition of separable intangibles assets. Both of the items which the directors of Plastik have identified in the acquisition of Dilemma should be recognised as separate intangible assets on the acquisition of Dilemma. Both IFRS 3 *Business Combinations* and IAS 38 *Intangible Assets* require in-process research in a business combination to be separately recognised at its fair value provided this can be reliably measured ($1·2 million in this case). The recognition of customer list as an intangible asset is a specific illustrative example given in IFRS 3 (IE 24) and should also be recognised at its fair value of $3 million.

Workings (note figure in brackets are in $'000)

		$'000	$'000
(i)	**Cost of sales**		
	Plastik		45,800
	Subtrak (24,000 x 9/12)		18,000
	Intra-group purchases (300 x 9 months)		(2,700)
	URP in inventory (600 x 25/125)		120
	Additional depreciation on property		100
			61,320
(ii)	**Non-controlling interests in Subtrak's profit or loss**		
	Subtrak's profit as reported		2,000
	9/12 post-acquisition =		1,500
	Deduct: Additional depreciation on property		(100)
	Goodwill impairment		(500)
	Adjusted post-acquisition profit		900
	x 20% non-controlling interest		180

		$'000	$'000
(iii)	**Non-current assets**		
	Plastik		18,700
	Subtrak		13,900
	Fair value increase at acquisition		4,000
	Additional depreciation on property		(100)
	Fair value increase since acquisition		600
			37,100
(iv)	**Goodwill in Subtrak**		
	Investment at cost		
	Shares (9,000 x 80% x 2/3 x $3)		14,400
	Deferred consideration (9,000 x 80% x 27·5 cents x 1/1·1)		1,800
	Non-controlling interest (9,000 x 20% x $2·50)		4,500
			20,700
	Net assets (equity) of Subtrak at 30 September 2014	(12,500)	
	Less post-acquisition profits (2,000 x 9/12)	1,500	
	Fair value adjustment: property	(4,000)	
	Net assets at date of acquisition		(15,000)
	Goodwill on consolidation		5,700
	Impairment as at 30 September 2014		(500)
			5,200

Note: *The 4·8 million (9,000 x 80% x 2/3) shares issued by Plastik at $3 each would be recorded as share capital of $4·8 million (4,800 x $1) and share premium of $9·6 million (4,800 x $2).*

		$'000
(v)	**Retained earnings**	
	Plastik	6,300
	Subtrak's post-acquisition adjusted profit (900 (w (ii)) x 80%)	720
	Finance costs on deferred consideration (1,800 x 10% x 9/12)	(135)
	Unrealised profit in inventory (w (i))	(120)
		6,765
	Alternative calculation	
	Plastik's retained earnings at 30 September 2014	6,300
	Less Plastik's profit for the year	(8,000)
	Consolidated profit for the year from part (a)	8,465
		6,765
(vi)	**Non-controlling interest in statement of financial position**	
	At date of acquisition (w (iv))	4,500
	Post-acquisition from statement of profit or loss and other comprehensive income	300
		4,800

This marking scheme is given as a guide in the context of the suggested answers. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned conclusions are provided. This is particularly the case for written answers where there may be more than one acceptable solution.

				Marks
Section A				
2 marks per question				**40**
Section B				
1	**(a)**	1½ marks per ratio		6
	(b)	1 mark per valid point. A good answer must emphasise the different interpretation when using adjusted figures		9
			Total for question	**15**
2	**(a)**	Schedule of retained earnings as at 30 September 2014		
		retained earnings per trial balance		½
		issue costs		1
		loan finance costs		1
		depreciation charges		2
		income tax expense		1½
				6
	(b)	Statement of financial position		
		property, plant and equipment		2
		current assets		½
		equity shares		½
		revaluation surplus		2
		deferred tax		1
		6% loan note		1½
		current liabilities (per trial balance)		½
		current tax payable		1
				9
			Total for question	**15**

			Marks
3	(a)	Consolidated statement of profit or loss and other comprehensive income:	
		revenue	1½
		cost of sales	2½
		distribution costs	½
		administrative expenses (including goodwill impairment)	1
		finance costs	1
		income tax expense	½
		gain on revaluation of properties	1
		non-controlling interest: profit for the year	1
		total comprehensive income	1
			10
	(b)	Consolidated statement of financial position:	
		property, plant and equipment	2
		goodwill	2½
		inventory	1
		trade receivables	1
		bank	½
		equity shares	1
		other component of equity (share premium)	1
		revaluation surplus	1
		retained earnings	1½
		non-controlling interest	1
		10% loan notes	1
		trade payables	1
		taxation	½
		deferred consideration	1
		bank overdraft	1
			17
	(c)	Recognition of: research	2
		customer list	1
			3
		Total for question	**30**

Fundamentals Level – Skills Module

Financial Reporting

Wednesday 3 December 2014

Paper F7

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

This paper is divided into two sections:

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

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The Association of Chartered Certified Accountants

The Institute of Chartered Accountants of Barbados

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Paper F7

The Association of Chartered Certified Accountants

The Botswana Institute of Chartered Accountants

Fundamentals Level – Skills Module

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The Institute of Certified Public Accountants of Cyprus

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The Association of Chartered Certified Accountants

Σωμα Ορκωτων Ελεγκτων Λογιστων (ΣΟΕΛ)

Fundamentals Level – Skills Module

Financial Reporting

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Paper F7

The Association of Chartered Certified Accountants

The Institute of Chartered Accountants of Guyana

Fundamentals Level – Skills Module

Financial Reporting

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The Association of Chartered Certified Accountants

The Institute of Chartered Accountants of Jamaica

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Paper F7

The Association of Chartered Certified Accountants

Kampuchea Institute of Certified Public Accountants and Auditors

Fundamentals Level – Skills Module

Financial Reporting

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The Association of Chartered Certified Accountants

The Lesotho Institute of Accountants

Fundamentals Level – Skills Module

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Paper F7

The Association of Chartered Certified Accountants

The Public Accountants Examination Council of Malawi

Fundamentals Level – Skills Module

Financial Reporting

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The Association of Chartered Certified Accountants

The Malta Institute of Accountants

Fundamentals Level – Skills Module

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The Association of Chartered Certified Accountants

The Institute of Chartered Accountants of Sierra Leone

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Paper F7

The Association of Chartered Certified Accountants

The Swaziland Institute of Accountants

ACCA

Fundamentals Level – Skills Module

Financial Reporting

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The Association of Chartered Certified Accountants

The Institute of Chartered Accountants of Trinidad and Tobago

Fundamentals Level – Skills Module

Financial Reporting

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The Association of Chartered Certified Accountants

The Ministry of Finance of the Socialist Republic of Vietnam

Paper F7

ACCA

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Financial Reporting

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Paper F7

The Association of Chartered Certified Accountants

جمعية المحاسبين ومدققي الحسابات
Accountants & Auditors Association

ACCA