

Fundamentals Level – Skills Module

Financial Reporting (United Kingdom)

Tuesday 14 June 2011

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

Paper F7 (UK)

ACCA

ALL FIVE questions are compulsory and MUST be attempted

- 1 (a) The UK Companies Act has required certain companies to produce group accounts for over 60 years.

Required:

Describe the circumstances where a company is required to produce group accounts and the circumstances where an exemption to this requirement is permitted. (4 marks)

- (b) On 1 October 2010 Produgal purchased 75% of the equity shares in Sentinel. The acquisition was through a share exchange of two shares in Produgal for every three shares in Sentinel. The stock market price of Produgal's shares at 1 October 2010 was \$4 per share.

The summarised statements of comprehensive income for the two companies for the year ended 31 March 2011 are:

	Produgal \$'000	Sentinel \$'000
Revenue	450,000	240,000
Cost of sales	(260,000)	(110,000)
Gross profit	190,000	130,000
Distribution costs	(23,600)	(12,000)
Administrative expenses	(27,000)	(23,000)
Finance costs	(1,500)	(1,200)
Profit before tax	137,900	93,800
Income tax expense	(48,000)	(27,800)
Profit for the year	89,900	66,000
Other comprehensive income		
Gain on revaluation of land (note (i))	2,500	1,000
Loss on fair value of equity financial asset investment	(700)	(400)
	1,800	600
Total comprehensive income	91,700	66,600

The following information for the equity of the companies at **1 April 2010** (i.e. before the share exchange took place) is available:

	\$'000	\$'000
Equity shares of \$1 each	250,000	160,000
Share premium	100,000	nil
Revaluation reserve (land)	8,400	nil
Other equity reserve (re equity financial asset investment)	3,200	2,200
Retained earnings	90,000	125,000

The following information is relevant:

- Produgal's policy is to revalue the group's land to market value at the end of each accounting period. Prior to its acquisition Sentinel's land had been valued at historical cost. During the post acquisition period Sentinel's land had increased in value over its value at the date of acquisition by \$1 million. Sentinel has recognised the revaluation within its own financial statements.
- Immediately after the acquisition of Sentinel on 1 October 2010, Produgal transferred an item of plant with a carrying amount of \$4 million to Sentinel at an agreed value of \$5 million. At this date the plant had a remaining life of two and half years. Produgal had included the profit on this transfer as a reduction in its depreciation costs. All depreciation is charged to cost of sales.

- (iii) After the acquisition Sentinel sold goods to Produgal for \$40 million. These goods had cost Sentinel \$30 million. \$12 million of the goods sold remained in Produgal's closing inventory.
- (iv) Produgal's policy is to value the non-controlling interest of Sentinel at the date of acquisition at its fair value which the directors determined to be \$100 million.
- (v) The goodwill of Sentinel has not suffered any impairment.
- (vi) All items in the above statements of comprehensive income are deemed to accrue evenly over the year unless otherwise indicated.

Required:

- (i) Prepare the consolidated statement of comprehensive income of Produgal for the year ended 31 March 2011;**
- (ii) Prepare the equity section (including the non-controlling interest) of the consolidated statement of financial position of Produgal as at 31 March 2011.**

Note: you are NOT required to calculate consolidated goodwill or produce the statement of changes in equity.

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

- (i) 14 marks
- (ii) 7 marks

(21 marks)

(25 marks)

2 The following trial balance relates to Highwood at 31 March 2011:

	\$'000	\$'000
Equity shares of 50 cents each		56,000
Retained earnings (note (i))		1,400
8% convertible loan note (note (ii))		30,000
Freehold property – at cost 1 April 2005 (land element \$25 million (note (iii)))	75,000	
Plant and equipment – at cost	74,500	
Accumulated depreciation – 1 April 2010 – building		10,000
– plant and equipment		24,500
Current tax (note (iv))		800
Deferred tax (note (iv))		2,600
Inventory – 4 April 2011 (note (v))	36,000	
Trade receivables	47,100	
Bank		11,500
Trade payables		24,500
Revenue		339,650
Cost of sales	207,750	
Distribution costs	27,500	
Administrative expenses (note (vi))	30,700	
Loan interest paid (note (ii))	2,400	
	<u>500,950</u>	<u>500,950</u>

The following notes are relevant:

- (i) An equity dividend of 5 cents per share was paid in November 2010 and charged to retained earnings.
- (ii) The 8% \$30 million convertible loan note was issued on 1 April 2010 at par. Interest is payable annually in arrears on 31 March each year. The loan note is redeemable at par on 31 March 2013 or convertible into equity shares at the option of the loan note holders on the basis of 30 equity shares for each \$100 of loan note. Highwood's finance director has calculated that to issue an equivalent loan note without the conversion rights it would have to pay an interest rate of 10% per annum to attract investors.

The present value of \$1 receivable at the end of each year, based on discount rates of 8% and 10% are:

	8%	10%
End of year 1	0.93	0.91
2	0.86	0.83
3	0.79	0.75

- (iii) Non-current assets:

On 1 April 2010 Highwood decided for the first time to value its freehold property at its current value. A qualified property valuer reported that the market value of the freehold property on this date was \$80 million, of which \$30 million related to the land. At this date the remaining estimated life of the property was 20 years. Highwood does not make a transfer to retained earnings in respect of excess depreciation on the revaluation of its assets.

Plant is depreciated at 20% per annum using the reducing balance method.

All depreciation of non-current assets is charged to cost of sales.

- (iv) The balance on current tax represents the under/over provision of the tax liability for the year ended 31 March 2010. The required provision for income tax for the year ended 31 March 2011 is \$19.4 million. The difference between the carrying amounts of the net assets of Highwood (including the revaluation of the property in note (iii) above) and their (lower) tax base at 31 March 2011 is \$27 million. Highwood's rate of income tax is 25%.

- (v) The inventory of Highwood was not counted until 4 April 2011 due to operational reasons. At this date its value at cost was \$36 million and this figure has been used in the cost of sales calculation above. Between the year end of 31 March 2011 and 4 April 2011, Highwood received a delivery of goods at a cost of \$2.7 million and made sales of \$7.8 million at a mark-up on cost of 30%. Neither the goods delivered nor the sales made in this period were included in Highwood's purchases (as part of cost of sales) or revenue in the above trial balance.
- (vi) On 31 March 2011 Highwood factored (sold) trade receivables with a book value of \$10 million to Easyfinance. Highwood received an immediate payment of \$8.7 million and will pay Easyfinance 2% per month on any uncollected balances. Any of the factored receivables outstanding after six months will be refunded to Easyfinance. Highwood has derecognised the receivables and charged \$1.3 million to administrative expenses. If Highwood had not factored these receivables it would have made an allowance of \$600,000 against them.

Required:

- (i) Prepare the statement of comprehensive income for Highwood for the year ended 31 March 2011;**
- (ii) Prepare the statement of changes in equity for Highwood for the year ended 31 March 2011;**
- (iii) Prepare the statement of financial position of Highwood as at 31 March 2011.**

Note: your answers and workings should be presented to the nearest \$1,000; notes to the financial statements are not required.

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

- (i) 11 marks
(ii) 4 marks
(iii) 10 marks

(25 marks)

- 3 Bengal is a public company. Its most recent financial statements are shown below:

Income statements for the year ended 31 March

	2011 \$'000	2010 \$'000
Revenue	25,500	17,250
Cost of sales	(14,800)	(10,350)
Gross profit	10,700	6,900
Distribution costs	(2,700)	(1,850)
Administrative expenses	(2,100)	(1,450)
Finance costs	(650)	(100)
Profit before taxation	5,250	3,500
Income tax expense	(2,250)	(1,000)
Profit for the year	3,000	2,500

Statements of financial position as at 31 March

	2011 \$'000		2010 \$'000	
Non-current assets				
Property, plant and equipment		9,500		5,400
Intangibles		6,200		nil
		15,700		5,400
Current assets				
Inventory	3,600		1,800	
Trade receivables	2,400		1,400	
Bank	nil		4,000	
Non-current assets held for sale	2,000	8,000	nil	7,200
Total assets		23,700		12,600
Equity and liabilities				
Equity				
Equity shares of \$1 each		5,000		5,000
Retained earnings		4,500		2,250
		9,500		7,250
Non-current liabilities				
5% loan notes		2,000		2,000
8% loan notes		7,000		nil
Current liabilities				
Bank overdraft	200		nil	
Trade payables	2,800		2,150	
Current tax payable	2,200	5,200	1,200	3,350
Total equity and liabilities		23,700		12,600

Notes

- (i) There were no disposals of non-current assets during the period; however Bengal does have some non-current assets classified as 'held for sale' at 31 March 2011.
- (ii) Depreciation of property, plant and equipment for the year ended 31 March 2011 was \$640,000.

A disappointed shareholder has observed that although revenue during the year has increased by 48% ($8,250/17,250 \times 100$), profit for the year has only increased by 20% ($500/2,500 \times 100$).

Required:

- (a) Prepare a statement of cash flows for Bengal for the year ended 31 March 2011, in accordance with IAS 7 *Statement of cash flows*, using the indirect method. (9 marks)
- (b) Using the information in the question and your answer to (a) above, comment on the performance (including addressing the shareholder's observation) and financial position of Bengal for the year ended 31 March 2011.

Note: up to 5 marks are available for the calculation of appropriate ratios.

(16 marks)

(25 marks)

- 4 (a) Your assistant has been reading the IASB's Framework for the preparation and presentation of financial statements (Framework) and as part of the qualitative characteristics of financial statements under the heading of 'relevance' he notes that the predictive value of information is considered important. He is aware that financial statements are prepared historically (i.e. after transactions have occurred) and offers the view that the predictive value of financial statements would be enhanced if forward-looking information (e.g. forecasts) were published rather than backward-looking historical statements.

Required:

By the use of specific examples, provide an explanation to your assistant of how IFRS presentation and disclosure requirements can assist the predictive role of historically prepared financial statements.

(6 marks)

- (b) The following summarised information is available in relation to Rebound, a publicly listed company:

Income statement extracts years ended 31 March:

	2011		2010	
	Continuing \$'000	Discontinued \$'000	Continuing \$'000	Discontinued \$'000
Profit after tax				
Existing operations	2,000	(750)	1,750	600
Operations acquired on 1 August 2010	450		nil	

Analysts expect profits from the market sector in which Rebound's existing operations are based to increase by 6% in the year to 31 March 2012 and by 8% in the sector of its newly acquired operations.

On 1 April 2009 Rebound had:

\$3 million of 25 cents equity shares in issue.

\$5 million 8% convertible loan stock 2016; the terms of conversion are 40 equity shares in exchange for each \$100 of loan stock. Assume an income tax rate of 30%.

On 1 October 2010 the directors of Rebound were granted options to buy 2 million shares in the company for \$1 each. The average market price of Rebound's shares for the year ending 31 March 2011 was \$2.50 each.

Required:

- (i) **Calculate Rebound's estimated profit after tax for the year ending 31 March 2012 assuming the analysts' expectations prove correct;** (3 marks)
- (ii) **Calculate the diluted earnings per share (EPS) on the continuing operations of Rebound for the year ended 31 March 2011 and the comparatives for 2010.** (6 marks)

(15 marks)

- 5 On 1 October 2009 Mocca entered into a construction contract that was expected to take 27 months and therefore be completed on 31 December 2011. Details of the contract are:

	\$'000
Agreed contract price	12,500
Estimated total cost of contract (excluding plant)	5,500

Plant for use on the contract was purchased on 1 January 2010 (three months into the contract as it was not required at the start) at a cost of \$8 million. The plant has a four-year life and after two years, when the contract is complete, it will be transferred to another contract at its carrying amount. Annual depreciation is calculated using the straight-line method (assuming a nil residual value) and charged to the contract on a monthly basis at 1/12 of the annual charge.

The correctly reported income statement results for the contract for the year ended 31 March 2010 were:

	\$'000
Revenue recognised	3,500
Contract expenses recognised	(2,660)
Profit recognised	840

Details of the progress of the contract at 31 March 2011 are:

	\$'000
Contract costs incurred to date (excluding depreciation)	4,800
Agreed value of work completed and billed to date	8,125
Total cash received to date (payments on account)	7,725

The percentage of completion is calculated as the agreed value of work completed as a percentage of the agreed contract price.

Required:

- (a) Calculate the amounts which would appear in the income statement and the statement of financial position of Mocca for the year ended 31 March 2011 in respect of the above contract in accordance with IAS 11 *Construction contracts*. (8 marks)

- (b) Show how the amounts due from/to customers would be disclosed in the statement of financial position in accordance with SSAP 9 *Stocks and long-term contracts*. (2 marks)

(10 marks)

End of Question Paper