PROFESSIONAL LEVEL EXAMINATION

MONDAY 7 MARCH 2016

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.

2. Answer each question in black ballpoint pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which answers are presented.

5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK

You MUST enter your candidate number in this box.

1. The financial controller of Laderas plc is on long-term sick leave. Parry Dagwood, who has spent two years taking a career break, was appointed as temporary financial controller at the beginning of the financial year. This is Parry's first job on returning to work and he is responsible for preparing the financial statements for the year ended 30 September 2015. The finance director told Parry the board is hoping for high profits and a strong financial position as the company may seek additional funding. Parry is hoping to be offered a permanent position.

You are the assistant accountant at Laderas plc working for Parry. There are a number of outstanding issues which you were asked to help finalise before the financial statements can be presented to the board. Both you and Parry are ICAEW Chartered Accountants.

On 30 September 2015 Laderas plc's nominal ledger showed the following balances.

	Note(s)	**£**
Sales	(1)	1,323,700
Purchases		721,400
Administrative expenses		237,400
Other operating costs		113,000
Intangibles – brands	(2)	133,000
Plant and machinery	(3)	
Cost		290,600
Accumulated depreciation at 30 September 2014		78,000
Land and buildings	(3)	
Cost (land £300,000)		992,600
Accumulated depreciation at 30 September 2014		176,000
Retained earnings at 30 September 2014		70,690
Ordinary share capital (£1 shares)	(4)	520,000
Share premium account	(4)	307,500
Revaluation surplus	(2)	55,000
Cash at bank		15,600
Inventories at 30 September 2014		52,690
Trade and other receivables		47,800
Trade and other payables		61,200
Lease liability	(5)	12,000

Outstanding issues:

(1) On 1 December 2014 Laderas plc received a government grant of £75,000 to assist with the purchase of a specialised machine which has an estimated useful life of five years. As there were no conditions attached to the grant it was credited in full to sales, although Laderas plc's policy is to use the 'netting-off' method. The machine cost £125,000 and was ready for use on 1 January 2015. The total cost of the machine has been included in the plant and machinery balance above.

(2) On 1 March 2015 Laderas plc recognised two new unique brands as intangible assets. The first brand was acquired for £78,000 on 1 March 2015 and on the same date an internally generated brand was also recognised. An external expert valued the internally generated brand at £55,000 on 1 March 2015 and this was recognised in the revaluation surplus. The total of £133,000 was debited to intangible assets. Both brands are estimated to have a four-year useful life, although no amortisation was recognised in the current year. All expenses relating to intangible assets should be recognised in other operating costs.

(3) Depreciation on property, plant and equipment for the year ended 30 September 2015 has yet to be charged. All depreciation is charged on a straight-line basis. Buildings were estimated as having a 40 year useful life, and plant and machinery an 8 year useful life, unless stated otherwise.

A new building was acquired on 1 April 2015 for £350,000 and was recognised in property, plant and equipment.

All expenses related to property, plant and equipment should be recognised in cost of sales.

(4) On 1 July 2015 Laderas plc made a 1 for 4 rights issue at £1.20 per share. The market price of one Laderas plc ordinary share immediately before the rights issue was £1.85. The entire proceeds were credited to the share premium account.

(5) On 1 October 2014 Laderas plc entered into a three-year lease for a piece of equipment. Laderas plc negotiated the lease so that there was nothing to pay in the first year followed by two payments of £6,000 each on 1 October 2016 and 1 October 2017. The equipment has a useful life of eight years but will be returned to the lessor at the end of the three-year lease term. The full amount payable under the lease of £12,000 was debited to cost of sales and credited to lease liability.

(6) An inventory count was carried out at the main warehouse on 30 September 2015 and inventory held there was correctly valued at £42,600. However it was subsequently discovered that 1,200 units of one product, Eros, had not been included in this amount. This was an isolated incident. The unit selling price of the Eros is £8.25 and the total associated costs are:

	£
Materials and direct labour	14,800
Variable overheads	4,200
Fixed overheads	2,000

Due to an industrial dispute production of the Eros in the year ended 30 September 2015 was slightly lower than planned, at 3,800 rather than 4,000 units.

(7) The income tax liability for the current year has been estimated at £21,600.

Requirements

1.1 Prepare the statement of profit or loss for Laderas plc for the year ended 30 September 2015 and a statement of financial position as at that date, in a form suitable for publication. **(19 marks)**

1.2 Calculate basic earnings per share for the year ended 30 September 2015. **(4 marks)**

1.3 Prepare extracts from the statement of financial position as at 30 September 2015 for the transactions described in Issue (1) applying UK GAAP. **(3 marks)**

1.4 Identify and explain the inherent limitations of financial statements that may reduce their usefulness to users. **(4 marks)**

1.5 Discuss the ethical issues arising from the scenario and list the steps that the assistant accountant should take to address them. **(5 marks)**

Total: 35 marks

2. The following issues need to be resolved to finalise the financial statements of Chayofa Ltd for the year ended 30 September 2015:

(1) On 1 October 2014 Chayofa Ltd began constructing a specialised piece of plant. The plant underwent a final safety inspection on 30 June 2015 and was ready for use the following day. The plant has a useful life of 15 years, although replacement blades, which cost £14,000, will be needed every five years. No depreciation was recognised for the year ended 30 September 2015 as the plant was not working at its full capacity because staff were still being trained.

The following amounts were incurred between 1 October 2014 and 30 June 2015 and capitalised as part of property, plant and equipment:

	£
Materials cost (including the blades)	124,000
Labour costs	41,500
Sale of by-products produced as part of testing process	(450)
Staff training	1,800
Consultancy fees re installation and assembly	1,150
Professional fees	1,300
Safety inspection	1,500
Allocated overheads (50% general administration: 50% directly attributable)	14,200
	185,000

The labour costs consist of £31,500 in respect of the plant's installation and assembly and a £10,000 allocated share of the sales director's salary. The sales director was responsible for discussing the new plant's capabilities with existing customers.

(2) Prior to the year end Chayofa Ltd decided to acquire three new pieces of equipment. The total cost of £101,000 for all the equipment was accrued for at 30 September 2015 and capitalised as part of property, plant and equipment. The following information is relevant:

	Equipment A	**Equipment B**	**Equipment C**
Decision made to acquire asset	28 Aug 2015	30 Sept 2015	18 Sept 2015
Payment date	28 Oct 2015	1 Dec 2015	30 Nov 2015
Delivery date	28 Sept 2015	1 Nov 2015	25 Sept 2015
Cost (note)	£34,000	£27,000	£40,000

Note: The cost of Equipment C was an estimated figure at 30 September 2015. The actual cost was finalised on 31 October 2015 at £38,000.

The orders can be cancelled at no cost.

(3) On 1 October 2014 Chayofa Ltd acquired a recycling centre with an estimated useful life of 15 years. A condition of the purchase is that Chayofa Ltd will need to restore any environmental damage caused by its activities. On 1 October 2014 the estimated cost in 15 years' time of restoring the land to its original state was £450,000. However, it is possible that new technology over the 15 years will reduce these costs by 10%. The relevant annual discount rate was assessed as 6%. The cost of the recycling centre has been capitalised and depreciation was calculated based on this cost. The only other accounting entries made at 30 September 2015 were to recognise a provision and an expense of £450,000.

(4) On 31 August 2015 a machine was identified as requiring maintenance work. The machine originally cost £60,000 on 1 October 2009 and had an estimated useful life of eight years at that date. Depreciation was charged on a straight-line basis. The machine was revalued on 30 September 2012 to £42,000, with no change in its total useful life. Annual transfers between retained earnings and the revaluation surplus are not made.

An impairment review was carried out on 30 September 2015 and the machine was assessed as working at an acceptable level with a revised remaining useful life of five years. On that date the machine's fair value was assessed as being £10,500 with selling costs of £500 and its value in use as £11,000.

Requirement

Explain the required IFRS financial reporting treatment of Issues (1) to (4) above in the financial statements for the year ended 30 September 2015, preparing all relevant calculations and setting out the required adjustments in the form of journal entries.

Total: 28 marks

3. Hiedras plc has a number of subsidiary companies and an investment in an associate, Amparo Ltd. The draft consolidated financial statements for the year ended 30 September 2015 are being prepared and there are a number of outstanding issues.

3.1 Hiedras plc acquired 75% of the ordinary share capital in Isora Ltd several years ago for total consideration of £495,000. The fair values of Isora Ltd's assets, liabilities and contingent liabilities at acquisition were equal to their carrying amounts. On 1 July 2015 Hiedras plc sold all of its shares in Isora Ltd for £765,000. Hiedras plc measured the goodwill and non-controlling interest using the proportionate method.

Isora Ltd's financial statements showed equity of:

	At acquisition	**At 30 September 2014**
	£	**£**
Ordinary share capital (£1 shares)	200,000	200,000
Retained earnings	234,800	461,700
Revaluation surplus	175,000	237,000
	609,800	898,700

Isora Ltd made a profit for the year ended 30 September 2015 of £108,000, which accrued evenly over the year. There was no impairment loss in respect of the goodwill acquired in the business combination with Hiedras plc for the nine month period to the date of disposal although cumulative impairment losses of £35,000 had been recognised up to 30 September 2014.

Requirements

(a) Calculate the profit or loss from discontinued operations for inclusion in the consolidated statement of profit or loss for Hiedras plc in relation to the disposal of Isora Ltd for the year ended 30 September 2015. **(4 marks)**

(b) Describe any differences between IFRS and UK GAAP in respect of the presentation of discontinued operations. **(2 marks)**

3.2 On 1 April 2015 Hiedras plc acquired its 30% investment in Amparo Ltd for consideration of £263,000.

Amparo Ltd made a profit for the year ended 30 September 2015 of £51,300, accruing evenly over the year, and has paid no dividends since the acquisition.

The fair values of the assets and liabilities of Amparo Ltd at the date of acquisition were equal to their carrying amounts with the exception of some land and a building with a remaining useful life of 15 years as at 1 April 2015. The following values are relevant at 1 April 2015:

	Carrying amount	**Fair value**
	£	**£**
Land	150,000	375,000
Building	285,000	450,000
	435,000	825,000

Requirement

Prepare extracts from Hiedras plc's consolidated statement of financial position and consolidated statement of profit or loss in respect of its investment in Amparo Ltd for the year ended 30 September 2015. **(4 marks)**

3.3 On 1 October 2014 Hiedras plc sold a piece of land to an unconnected company, Eras Ltd, for £500,000, to raise some short-term finance. Hiedras plc will continue to have access to the land and has the right to buy it back on 30 September 2016 for £575,000, giving Eras Ltd a return of 15% over the two year period. On 1 October 2014 the land had a fair value of £1,250,000 and a carrying amount of £350,000. Hiedras plc derecognised the land and recognised a profit on disposal of £150,000. An annual rate for 15% over two years is 7.25%.

Requirement

Briefly explain with supporting calculations, the financial reporting treatment for the land in the financial statements of Hiedras plc for the year ended 30 September 2015. **(5 marks)**

3.4 The financing activities section of the consolidated statement of cash flows was not completed. The following extract is from the draft consolidated statement of financial position at 30 September 2015:

	2015	**2014**
	£	**£**
Equity		
Ordinary share capital (£1 shares)	570,000	320,000
Share premium account	275,000	120,000
Retained earnings	594,200	375,600
	1,439,200	815,600

In November 2014 Hiedras plc made a bonus issue out of retained earnings. This was followed in February 2015 by an issue of 155,000 ordinary shares for cash at £2.00 per share. Profit attributable to the owners of Hiedras plc for the year ended 30 September 2015 was £441,100 and the only dividend paid in the year was an interim dividend paid by Hiedras plc.

Requirement

Prepare an extract from Hiedras plc's consolidated statement of cash flows, showing 'Cash flows from financing activities' for the year ended 30 September 2015. Use the information in part 3.4 only. **(3 marks)**

Total: 18 marks

4. At 30 September 2015 Gordo plc has two subsidiary companies: Orotava Ltd, which was acquired during the year, and Tixera Ltd.

The draft consolidated statement of financial position for the Gordo group and the individual statement of financial position of Orotava Ltd, at 30 September 2015 are shown below.

Investments include the cost of the two subsidiaries and a number of shareholdings of below 5% each. Figures for the Gordo group were prepared by adding across the two statements of financial position of Gordo plc and Tixera Ltd.

	Gordo group (draft consolidated)	**Orotava Ltd**
	£	**£**
ASSETS		
Non-current assets		
Property, plant and equipment	936,400	389,500
Investments	667,800	–
	1,604,200	389,500
Current assets		
Inventories	46,170	21,500
Trade and other receivables	53,900	36,950
Cash and cash equivalents	4,700	1,400
	104,770	59,850
Total assets	1,708,970	449,350
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	600,000	150,000
Share premium account	250,000	75,000
Retained earnings	679,270	147,150
	1,529,270	372,150
Current liabilities		
Trade and other payables	67,400	37,800
Income tax	112,300	39,400
	179,700	77,200
Total equity and liabilities	1,708,970	449,350

Additional information:

(1) Equity from the individual statements of financial position of Gordo plc and Tixera Ltd at 30 September 2015 are shown below:

	Gordo plc	**Tixera Ltd**
	£	**£**
Ordinary share capital (£1 shares)	400,000	200,000
Share premium account	200,000	50,000
Retained earnings	580,870	98,400
	1,180,870	348,400

(2) The fair values of Tixera Ltd's assets, liabilities and contingent liabilities at the date of acquisition by Gordo plc were equal to their carrying amounts. Tixera Ltd's retained earnings at the date of acquisition were £61,200 and the consideration for the acquisition of 75% of the ordinary shares of Tixera Ltd was £220,000. A reassessment of Tixera Ltd's assets, liabilities, contingent liabilities and consideration transferred took place following the acquisition and no adjustments were necessary.

Gordo plc chose to recognise the goodwill and non-controlling interest using the proportionate method.

(3) On 1 January 2015, Gordo plc acquired 85% of the ordinary shares of Orotava Ltd when the retained earnings of Orotava Ltd were £89,650. The consideration consisted of cash of £340,000 and 85,000 £1 ordinary shares in Gordo plc. The market value of Gordo plc's shares on 1 January 2015 was £1.20 per share.

The fair values of Orotava Ltd's assets, liabilities and contingent liabilities at 1 January 2015 were equal to their carrying amounts with the exception of a building which had a fair value £150,000 in excess of its carrying amount. This building had a 25 year remaining useful life on 1 January 2015.

Gordo plc chose to recognise the goodwill and non-controlling interest using the fair value method. The fair value of the non-controlling interest in Orotava Ltd on 1 January 2015 was estimated at £52,000.

(4) In July 2015 Tixera Ltd sold goods to Orotava Ltd for £14,000, at cost plus a mark-up of 25%. At 30 September 2015 Orotava Ltd still held half of these goods in its inventories. Payment for the full invoice value of £14,000 was outstanding at the year end.

(5) On 1 October 2014 Tixera Ltd sold a machine to Gordo plc for £45,000. Tixera Ltd had originally bought the machine for £60,000 on 1 October 2011. The machine had a total useful life of eight years which has never changed.

Requirement

Prepare the revised consolidated statement of financial position of Gordo plc as at 30 September 2015.

Total: 19 marks