PROFESSIONAL LEVEL EXAMINATION

MONDAY 8 DECEMBER 2014

(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.
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.

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1. Trakehner Ltd operates a chain of garden centres in the UK. Jamie, the financial controller of Trakehner Ltd, has prepared draft financial statements for the year ended 30 June 2014. These draft financial statements are set out below, along with some outstanding issues.

Draft statement of profit or loss for the year ended 30 June 2014

	£
Revenue	3,879,600
Cost of sales	(2,015,300)
Gross profit	1,864,300
Administrative expenses (Note 3)	(987,600)
Distribution costs	(398,400)
Profit from operations	478,300
Investment income (Note 1)	3,000
Profit before tax	481,300
Income tax (Note 5)	(120,000)
Profit for the year	361,300

Draft statement of financial position as at 30 June 2014

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (Notes 1 and 2)		1,982,500
Current assets		
Inventories	453,700	
Trade and other receivables	241,200	
Cash and cash equivalents	14,800	
		709,700
Total assets		**2,692,200**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares) (Note 3)		800,000
5% Preference share capital (Note 4)		200,000
Share premium		125,000
Retained earnings		871,600
		1,996,600
Non-current liabilities		
Loan (Note 1)		250,000
Current liabilities		
Trade and other payables	302,600	
Income tax (Note 5)	143,000	
		445,600
Total equity and liabilities		**2,692,200**

The following matters are outstanding:

(1) On 1 October 2013 construction commenced on a new garden centre. On that date Trakehner Ltd took out a loan of £250,000 specifically to finance this project. Construction costs to date of £176,000 have been included in property, plant and equipment. The interest rate on the loan is 4% pa, payable on 1 July annually, and the loan is repayable on 30 September 2015. The only accounting entries made in respect of the loan were to recognise its receipt. Interest received on the temporary investment of surplus funds was £3,000, which Jamie recognised as investment income. Construction of the garden centre was still in progress at 30 June 2014.

(2) Depreciation on property, plant and equipment has not yet been charged as Jamie was unsure how to treat the construction costs above. The carrying amount of £1,982,500 in the draft statement of financial position can be analysed as follows:

	£
New garden centre construction costs (Note 1)	176,000
Land	600,000
Other buildings (cost £950,000)	779,600
Plant and equipment	426,900
	1,982,500

Buildings are depreciated on a straight-line basis over 50 years, with the charge being included in administrative expenses. Plant and equipment is depreciated on a reducing balance basis using a rate of 25%, with the charge being included in cost of sales.

(3) On 1 January 2014 Trakehner Ltd made a 1 for 4 bonus issue of ordinary shares. No accounting entries have been made for these shares, although the correct number of shares was issued. The intention was to use the share premium account as far as possible.

An interim ordinary dividend of 10p per share, based on the correct number of shares in issue, was paid on 15 February 2014 and posted to administrative expenses.

(4) On 1 July 2013 Trakehner Ltd issued 200,000 5% redeemable preference shares at their par value of £1 per share. These shares are redeemable on 30 September 2018 at a premium. The preference dividend is paid annually in arrears on 1 July and no accrual has been made for this dividend. The effective interest rate of the preference shares is 5.6% pa.

(5) Income tax of £120,000 in the draft statement of profit or loss is the amount that Jamie has appropriately estimated will be payable for the current year. The figure of £143,000 in the draft statement of financial position includes the over provision of income tax of £23,000 from the year ended 30 June 2013.

(6) Adjustment needs to be made at 30 June 2014 for prepaid distribution costs of £10,500 and accrued administrative expenses of £12,600.

Requirements

(a) Prepare a revised statement of profit or loss for Trakehner Ltd for the year ended 30 June 2014 and a revised statement of financial position as at that date, in a form suitable for publication. Notes to the financial statements are **not** required. **(22 marks)**

(b) Explain the nature and required IFRS financial reporting treatment of redeemable preference shares. **(3 marks)**

(c) Describe the differences between IFRS and UK GAAP in respect of the treatment of borrowing costs. **(2 marks)**

Total: 27 marks

2. Ryan, an ICAEW Chartered Accountant, is the finance director of Holstein Ltd and also owns 20% of the company's ordinary shares. Ryan has just finished preparing the draft financial statements for the year ended 30 June 2014, which show a profit before tax of £135,400, total assets of £1,456,000 and total liabilities of £874,300. You are the financial controller of Holstein Ltd, and a recently qualified ICAEW Chartered Accountant.

You are aware that the financial statements will come under close scrutiny by Holstein Ltd's bank, as it will be looking to ensure that the conditions of a loan covenant are still met. This covenant requires Holstein Ltd to maintain total assets at a minimum of 150% of total liabilities. If this condition is not met the bank is likely to call in its loan and the company's future would be in jeopardy.

Whilst assisting Ryan with the drafting of the financial statements you discovered the following matters of concern:

(1) Holstein Ltd's stated accounting policy has been to depreciate all general machines on a straight-line basis over four years. However, during the current year, the board of directors decided that, with effect from 1 July 2013, all general machines should be depreciated using a reducing balance basis at a rate of 25%, as this better reflects their economic usage.

Ryan has restated the opening balance of general machines and retained earnings as if the new policy had always been in existence, on the grounds that this is a change of accounting policy in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors. As a result, Ryan increased the carrying amount of property, plant and equipment and retained earnings at 1 July 2013 by £352,100. Ryan then charged depreciation at 25% on the revised carrying amount of property, plant and equipment.

(2) On 1 December 2013 Holstein Ltd received a government grant of £200,000, representing 50% of the cost of a specialised asset that was acquired on 1 October 2013. The asset has a four-year life with no residual value and has been correctly depreciated in the draft financial statements on a straight-line basis. Holstein Ltd's stated accounting policy is to account for government grants using the netting-off method. Ryan has shown the full grant of £200,000 within other income in the draft financial statements as he does not expect the grant to be repaid and the asset has already been paid for.

(3) On 1 July 2013 Holstein Ltd signed a four-year lease for a machine with a fair value of £350,000. The lessor remains responsible for maintenance and insurance of the machine. Ryan negotiated a payment "holiday" so an annual payment of £60,000 is due on 1 July 2014, 2015 and 2016. Because no payment was made in the year ended 30 June 2014 Ryan has not included any amounts in respect of this lease in the draft financial statements.

(4) A machine which became surplus to requirements in May 2014 was sold for £170,000 on 15 August 2014, incurring selling expenses of £11,600. On 1 August 2014 Holstein Ltd incurred reconditioning expenses of £63,500. These expenses were required to bring the machine into a saleable and usable condition but Holstein Ltd had had to wait for a suitable specialist to be available to carry out this work.

The board of directors had agreed to sell the machine on 1 June 2014 and had duly advertised it at a price of £300,000. In view of this on 30 June 2014 Ryan revalued the machine from its carrying amount of £155,000 on 30 June 2014 to its advertised selling price, posting the difference to the revaluation surplus, disregarding Holstein Ltd's published accounting policy which is to use the cost model.

When you queried this with Ryan he quoted the requirement of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations to revalue an asset to its fair value immediately before classification as held for sale. The asset is shown in the draft statement of financial position as at 30 June 2014 as an asset held for sale at £300,000. Ryan intends to account for the actual disposal in the financial statements for the year ended 30 June 2015.

You have discussed these matters with Ryan, who does not accept that any adjustments are needed to the financial statements.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 30 June 2014, preparing all relevant calculations. **(21 marks)**

(b) Using your results from Part (a) calculate revised figures for profit before tax, total assets and total liabilities. **(4 marks)**

(c) Discuss the ethical issues arising from the scenario for you, as financial controller of Holstein Ltd, and list the steps that you should take to address them. **(5 marks)**

Total: 30 marks

3. On 1 July 2013 Appaloosa plc had a number of subsidiary companies, all acquired several years ago. Extracts from the group's consolidated financial statements for the year ended 30 June 2014 are set out below.

Consolidated statement of profit or loss for the year ended 30 June 2014 (extract)

Continuing operations	**£**
Profit from operations	1,589,600
Finance costs	(51,300)
Profit before tax	1,538,300
Income tax expense	(385,000)
Profit for the year from continuing operations	1,153,300
Discontinued operations	
Profit for the year from discontinued operations	77,500
Profit for the year	1,230,800
Attributable to:	
Owners of Appaloosa plc	1,015,300
Non-controlling interest	215,500
	1,230,800

Consolidated statement of financial position as at 30 June

	2014	2013
ASSETS	**£**	**£**
Non-current assets	3,214,500	2,478,000
Current assets		
Inventories	1,785,900	1,025,100
Trade and other receivables	725,200	699,800
Cash and cash equivalents	101,500	53,500
	2,612,600	1,778,400
Total assets	**5,827,100**	**4,256,400**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	500,000	400,000
Share premium account	100,000	40,000
Revaluation surplus	779,500	423,000
Retained earnings	2,279,800	1,364,800
Attributable to the equity holders of Appaloosa plc	3,659,300	2,227,800
Non-controlling interest	664,900	742,600
	4,324,200	2,970,400
Non-current liabilities		
Finance lease liabilities	350,200	270,000
Current liabilities		
Trade and other payables	582,500	489,800
Finance lease liabilities	150,200	148,200
Income tax payable	420,000	378,000
	1,152,700	1,016,000
Total equity and liabilities	**5,827,100**	**4,256,400**

Additional information:

(1) On 1 January 2014 Appaloosa plc sold all of its 70% holding in Connemara Ltd's 100,000 £1 ordinary shares, for cash of £590,000. Appaloosa plc had paid £350,000 for the shares in Connemara Ltd when the retained earnings of Connemara Ltd were £226,000. Goodwill was calculated using the proportionate method, although £50,000 of this amount had been written off by 30 June 2013. The profit from discontinued operations in the consolidated statement of profit or loss above relates wholly to the sale of the shares in Connemara Ltd and includes an income tax expense of £19,600.

The net assets of Connemara Ltd at the date of disposal were as follows:

	£
Property, plant and equipment	705,200
Trade and other receivables	57,900
Cash and cash equivalents	13,800
Trade and other payables	(42,700)
	734,200

(2) All finance costs in the consolidated statement of profit or loss relate to finance leases. In the year ended 30 June 2014 Appaloosa plc entered into finance leases for assets with a cash price of £550,000.

(3) Non-current assets comprise property, plant and equipment and goodwill which had arisen on business combinations. The only movement on goodwill during the year ended 30 June 2014 was with regard to Connemara Ltd. Depreciation of £561,500 was recognised during the year ended 30 June 2014. No property, plant and equipment was disposed of during the year other than through the disposal of Connemara Ltd.

(4) The consolidated statement of changes in equity shows the following:

- ordinary dividends were paid during the year to both the shareholders of Appaloosa plc and to the non-controlling interest;
- there was a revaluation of property, plant and equipment;
- Appaloosa plc made an issue of ordinary shares.

Requirements

(a) Calculate the profit on disposal of Connemara Ltd. **(2 marks)**

(b) Prepare a consolidated statement of cash flows for Appaloosa plc for the year ended 30 June 2014, including a note reconciling profit before tax to cash generated from operations, using the indirect method. A note showing the effects of the disposal of Connemara Ltd is **not** required. **(14 marks)**

(c) The IASB's Conceptual Framework identifies a wide range of users who use financial statements to make economic decisions. Identify **five** possible user groups and, for each user group, list the type(s) of decisions they regularly make from information contained within the financial statements. **(5 marks)**

Total: 21 marks

PLEASE TURN OVER

4. On 1 July 2013 Oldenburg plc had one subsidiary company, Zangersheide Ltd, and one associated company, Hanoverian Ltd, holding 90% and 30% respectively of their ordinary shares.

On 1 October 2013 Oldenburg plc acquired 80% of the ordinary shares of Westphalian Ltd. Initial calculations showed that a gain on bargain purchase ("negative goodwill") of £35,000 arose on the acquisition. In accordance with best practice, a reassessment of Westphalian Ltd's assets, liabilities and contingent liabilities and consideration transferred took place following acquisition and the following discoveries were made:

- The consideration transferred used in the goodwill calculation was £500,000, which included professional fees of £8,000 relating to the acquisition.
- A building which had been purchased by Westphalian Ltd for £300,000 on 1 October 1999 was assessed as having a fair value on the date of Westphalian Ltd's acquisition by Oldenburg plc of £154,000. This fair value had not been reflected in the goodwill calculation. The building has always had a total estimated useful life of 25 years. Depreciation on buildings is presented in operating expenses.
- Westphalian Ltd's financial statements for the year ended 30 June 2013 included a disclosure note showing a contingent liability of £42,000. This contingent liability had a fair value of £36,500 on 1 October 2013. This fair value was unchanged at 30 June 2014. No allowance was made for this contingent liability in the goodwill calculation.
- Oldenburg plc had decided to use the fair value method to measure goodwill and the non-controlling interest for Westphalian Ltd. However, the original calculation had incorrectly used the proportionate method. The fair value of the non-controlling interest at 1 October 2013 was £140,000.

Extracts from the individual statements of profit or loss of the four companies for the year ended 30 June 2014 are set out below:

Statements of profit or loss for the year ended 30 June 2014

	Oldenburg plc	**Zangersheide Ltd**	**Westphalian Ltd**	**Hanoverian Ltd**
	£	**£**	**£**	**£**
Revenue	2,978,500	1,759,500	1,310,400	713,000
Cost of sales	(2,100,600)	(1,198,500)	(874,600)	(471,400)
Gross profit	877,900	561,000	435,800	241,600
Operating expenses	(701,600)	(203,500)	(300,000)	(156,300)
Profit before taxation	176,300	357,500	135,800	85,300
Income tax expense	(53,000)	(107,200)	(40,000)	(24,200)
Profit for the year	123,300	250,300	95,800	61,100

Additional information:

(1) During the current year Oldenburg plc purchased goods to the value of £286,800 and £101,040 from Zangersheide Ltd and Hanoverian Ltd respectively. All sales between group companies are at a 20% mark up. Half of the goods purchased were still in Oldenburg plc's inventories at 30 June 2014.

(2) During the previous year, on 31 December 2012, Zangersheide Ltd sold a machine to Oldenburg plc for £567,000. At that date, the machine had a carrying amount in Zangersheide Ltd's books of £465,500 and the estimated remaining useful life was reassessed at five years. Depreciation on this machine is presented in cost of sales.

(3) At 30 June 2014 impairment losses of £18,000 in respect of goodwill arising on the business combination with Zangersheide Ltd and £6,000 in respect of the carrying amount of Hanoverian Ltd need to be recognised in the consolidated financial statements. Oldenburg plc used the proportionate method to measure goodwill and the non-controlling interest for Zangersheide Ltd.

Requirements

(a) Calculate a revised figure for the gain on bargain purchase arising on the business combination with Westphalian Ltd. **(5 marks)**

(b) Prepare the consolidated statement of profit or loss for Oldenburg plc for the year ended 30 June 2014. **(14 marks)**

(c) Describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of the issues in Parts (a) and (b) above. **(3 marks)**

Total: 22 marks