PROFESSIONAL LEVEL EXAMINATION

MONDAY 7 DECEMBER 2015

(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 following trial balance was extracted from the nominal ledger of Darwin plc, an engineering company, at 30 June 2015.

	Note	£	£
Sales			6,558,550
Purchases		5,106,100	
Administrative expenses		1,008,300	
Distribution costs		262,800	
Construction costs	(1)	163,500	
Finance costs	(1)	15,250	
Bank loan	(1)		100,000
Land and buildings	(2)		
Cost (land £50,000)		400,000	
Accumulated depreciation at 30 June 2014			160,000
Plant and equipment	(3)		
Cost		382,000	
Accumulated depreciation at 30 June 2014			159,100
Retained earnings at 30 June 2014	(4)		148,100
Ordinary share capital (£1 shares)			500,000
Bank account			40,500
Trade and other receivables		403,375	
Trade and other payables			342,750
Inventories at 30 June 2014	(5)	266,175	
Income tax	(6)	1,500	
		8,009,000	8,009,000

The following additional information is available:

(1) Construction costs relate to the building of a specialised machine, the Baler, which is a qualifying asset. Construction commenced on 1 October 2014 and was still in progress on 30 June 2015. To help fund this, borrowings of £100,000 were arranged. £30,000 was drawn down on 1 October 2014 at an interest rate of 5% pa and the remaining £70,000 on 1 April 2015 at an interest rate of 4% pa. All interest was paid on 30 June 2015 and charged to finance costs. The loan is repayable on 31 December 2015.

(2) Darwin plc has previously measured property, plant and equipment under the cost model. However, with effect from 1 July 2014, the directors decided to adopt the revaluation model for land and buildings. A valuation of all land and buildings on 1 July 2014 gave a total of £600,000 (including land of £200,000). This valuation has not been reflected in the trial balance above. Darwin plc wishes to make an annual transfer between the revaluation surplus and retained earnings.

The remaining useful life of buildings was reassessed on 1 July 2014 at 40 years. There were no additions to, or disposals of, land and buildings in the year ended 30 June 2015. Depreciation on buildings should be presented in administrative expenses.

(3) A review of machinery on 31 December 2014 identified that one machine, the Molder, was not operating efficiently. The Molder was purchased on 1 July 2012 for £38,400.

The review on 31 December 2014 showed that if the Molder were to be retained it would generate future cash flows with a present value of £10,000. If the Molder were to be sold it would realise £11,000, with selling costs of £1,500. An equivalent new Molder could be purchased for £56,000.

No adjustments in respect of this review were recognised.

Plant and equipment is depreciated on a reducing balance basis, at a rate of 25% pa. Depreciation on plant and equipment should be presented in cost of sales.

(4) 150,000 4% £1 redeemable preference shares were issued at par on 1 July 2014. The cash received in respect of these shares was credited to retained earnings. The shares are redeemable on 30 June 2018 at a premium. The effective interest rate is 4.75% pa. The preference dividend was paid on 30 June 2015 and debited to retained earnings.

(5) Inventories at 30 June 2015 were correctly valued at £175,400. During the inventory valuation it was discovered that inventories at 30 June 2014 had, in error, been overvalued by £100,000. This error was not adjusted for in the trial balance above.

(6) The income tax figure in the trial balance represents the excess of the liability provided for at 30 June 2014 over the amount paid in February 2015. The liability for the current year was appropriately estimated at £18,600.

Requirements

(a) Prepare a statement of profit or loss for Darwin plc for the year ended 30 June 2015, and a statement of financial position as at that date, in a form suitable for publication. **(23 marks)**

Notes to the financial statements are not required.
Expenses should be analysed by function.

(b) Explain the IFRS financial reporting treatment of the error in respect of opening inventories (Note (5) above) in the published financial statements of Darwin plc for the year ended 30 June 2015. **(3 marks)**

(c) The IASB Conceptual Framework refers to four different measurement bases. Explain these four bases with reference to the figures in Note (3) above. **(5 marks)**

Total: 31 marks

2. Alan is the finance director of Girton plc and an ICAEW Chartered Accountant. He has prepared draft individual and consolidated financial statements for the year ended 30 June 2015 for Girton plc. The consolidated financial statements include the following figures:

	£
Profit for the year attributable to the shareholders of Girton plc	574,500
Earnings per share	127.7p
Equity	£
Ordinary share capital (£1 shares)	450,000
Share premium	90,000
Retained earnings	890,200

You are the financial controller at Girton plc and an ICAEW Chartered Accountant. The managing director is concerned about Alan's treatment of certain matters within the draft financial statements, particularly given that the directors' bonus is linked to earnings per share.

The managing director has asked you to review the following issues and correct the financial statements.

(1) On 1 January 2015 Girton plc acquired 150,000 of Downing Ltd's 200,000 £1 ordinary shares. The consideration was comprised of 100,000 £1 ordinary shares in Girton plc issued on 1 January 2015, cash of £375,000 paid on 1 January 2015 and additional cash due on 1 January 2016 of £147,000.

Alan has calculated goodwill on the business combination with Downing Ltd as £49,575 and has recognised this amount as an intangible asset in the consolidated financial statements. However, Alan only included the cash consideration of £375,000 in his calculation and has not accounted for the remaining consideration. When you queried this Alan said that this was because cash was the only part of the consideration which involved a transfer of funds in the current year. The market price of Girton plc's shares on 1 January 2015 was £1.20 per share.

You reviewed the board minutes and established that goodwill and the non-controlling interest were to be calculated using the fair value method. Alan has used the proportionate method. The fair value of the non-controlling interest on 1 January 2015 was £115,000.

Downing Ltd's financial statements for the year ended 30 June 2015 show profit for the year of £245,600 and retained earnings of £356,700. These financial statements include a note concerning a contingent liability in respect of ongoing legal proceedings against Downing Ltd. The proceedings had commenced on 15 December 2014. The contingent liability had a fair value of £75,000 on 1 January 2015. Alan made no adjustment for this liability when he calculated goodwill arguing that it did not form part of Downing Ltd's net assets on 1 January 2015.

The consolidated statement of profit or loss for the year ended 30 June 2015 correctly reflects the results of Downing Ltd.

(2) On 1 February 2015 Girton plc made a one for five bonus issue of ordinary shares. Alan has not accounted for the bonus issue, although the issue was based on the correct number of ordinary shares. On 30 June 2015 Girton plc acquired 100,000 of its own £1 ordinary shares for £2 cash per share. Alan debited the consideration to ordinary share capital.

(3) During the year Girton plc sold goods totalling £216,700 on credit to Selwyn Ltd, a company wholly-owned by Alan's son. At 30 June 2015 there was a trade receivable of £54,400 in respect of these sales. No disclosures were made in the individual or consolidated financial statements of Girton plc for this transaction. When you queried this Alan said that this was because the sales were made at an arm's length price. The managing director was unaware of these sales until the credit controller asked him to review the year-end allowance for doubtful debts, which includes £20,000 in respect of this debt, as Selwyn Ltd is known to be in financial difficulties.

(4) On 1 April 2015 Girton plc sold a package of products for £191,250 cash. The package was made up of equipment and 12 months of helpdesk support. The equipment normally retails at £175,000 and the support at £50,000. Alan recognised revenue of £191,250 in the financial statements for the year ended 30 June 2015, on the grounds that the equipment sale had been made in that year and the provision of helpdesk support was part of that sale.

The published financial statements for the year ended 30 June 2014 show that Girton plc had an earnings per share of 118.6p.

Requirements

(a) Explain the required IFRS financial reporting treatment of issues (1) to (4) above in the financial statements for the year ended 30 June 2015, preparing all relevant calculations. Unless stated otherwise, an applicable discount rate is 5% pa. **(22 marks)**

(b) Using your results from Part (a) calculate the following for Girton plc's consolidated financial statements for the year ended 30 June 2015:

(i) Revised profit for the year attributable to the shareholders of Girton plc

(ii) Revised number of ordinary shares

(iii) Basic earnings per share and comparative figure. **(4 marks)**

(c) Discuss the ethical issues arising from the scenario for yourself and Alan and the steps that you should take to address them. **(5 marks)**

Total: 31 marks

3. The financial controller of Peterhouse Ltd has prepared draft financial statements for the year ended 30 June 2015, including the following:

Draft statement of cash flows for the year ended 30 June 2015

	£	£
Cash flows from operating activities		
Cash generated from operations	978,700	
Interest paid	(2,100)	
Income tax paid	(195,500)	
Net cash from operating activities		781,100
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,041,200)	
Net cash used in investing activities		(1,041,200)
Cash flows from financing activities		
Proceeds from issue of ordinary share capital	150,000	
Ordinary dividend paid	(23,900)	
Increase in bank overdraft	85,000	
Net cash from financing activities		211,100
Net decrease in cash and cash equivalents		(49,000)
Cash and cash equivalents at 1 July 2014		49,150
Cash and cash equivalents at 30 June 2015		150

The financial controller has failed to deal correctly with the following matters:

(1) The draft statement of financial position as at 30 June 2015 includes inventories of £135,800. However, the financial controller had valued 2,000 units of one product, the Perro, in work in progress and 1,000 units in finished goods at their costs per unit of £15 and £18 respectively. Finished units usually sell for £25 per unit. However, difficult trading conditions meant that Peterhouse Ltd had to discount the finished units by 30% and incurred selling costs of £1 per unit. Work in progress was all at the same stage of production and a further £3 per unit was still to be incurred to finish off these items.

(2) On 1 July 2014 Peterhouse Ltd entered into a three-year finance lease for a machine with a list price of £31,000. Lease payments comprise an initial payment of £8,000 on 1 July 2014, followed by three annual instalments of £8,000 each, in arrears, the first of which was paid on 30 June 2015. Both payments made in the year ended 30 June 2015 were debited to cost of sales. The machine has a useful life of four years. The interest rate implicit in the agreement is 5% pa.

(3) At 30 June 2015, there was interest due but not paid of £1,500. This accrual was included in trade and other payables. The figure for interest paid in the draft statement of cash flows is that from the statement of profit or loss.

(4) On 1 July 2014 a machine with a carrying amount of £15,600 was sold for cash of £17,200. The sale was correctly recognised in the statement of profit or loss and statement of financial position but no adjustment was made for it in the draft statement of cash flows. The figure for purchase of property, plant and equipment in the draft statement of cash flows is the movement between the opening and closing figures from the statements of financial position adjusted by the depreciation charge for the year.

(5) 150,000 £1 ordinary shares were issued during the year at a price of £1.50 per share. The financial controller credited ordinary share capital with the par value and credited retained earnings with the premium.

(6) The figure for the ordinary dividend paid in the draft statement of cash flows is the movement between the opening and closing retained earnings figures from the statements of financial position adjusted by the profit for the year. This figure does not agree to the actual dividend paid per the statement of changes in equity.

(7) A bank overdraft was arranged during the year. The increase in bank overdraft shown in the draft statement of cash flows is the overdraft as at 30 June 2015.

Requirements

(a) Using the information in Note (1) above, calculate the carrying amount of inventories at 30 June 2015. **(3 marks)**

(b) Using the information in Note (2) above, prepare extracts from the statement of profit or loss of Peterhouse Ltd for the year ended 30 June 2015 and statement of financial position as at that date reflecting the finance lease. **(6 marks)**

(c) Using **all** of the information above, prepare a revised statement of cash flows for Peterhouse Ltd for the year ended 30 June 2015. A note showing the reconciliation of profit before tax to cash generated from operations is **not** required. **(8 marks)**

Total: 17 marks

PLEASE TURN OVER

4. At 1 July 2014 Pembroke Ltd held 80% and 40% respectively of the ordinary share capital of Newnham Ltd and Wolfson Ltd. On 1 November 2014 Pembroke Ltd acquired 70% of the ordinary share capital of Trinity Ltd. Pembroke Ltd measures non-controlling interest and goodwill using the proportionate method.

Extracts from the draft individual financial statements of the four companies for the year ended 30 June 2015 are shown below:

Draft statements of profit or loss

	Pembroke Ltd £	Newnham Ltd £	Trinity Ltd £	Wolfson Ltd £
Revenue	945,200	754,800	705,000	161,700
Cost of sales	(583,700)	(573,600)	(418,500)	(66,300)
Gross profit	361,500	181,200	286,500	95,400
Operating expenses	(128,900)	(116,400)	(122,550)	(109,900)
Profit/(loss) before tax	232,600	64,800	163,950	(14,500)
Income tax expense	(60,000)	(13,000)	(31,950)	–
Profit/(loss) for the year	172,600	51,800	132,000	(14,500)

Draft statements of financial position (extracts)

	Pembroke Ltd £	Newnham Ltd £	Trinity Ltd £	Wolfson Ltd £
Equity				
Ordinary share capital (£1 shares)	600,000	500,000	400,000	200,000
Retained earnings	1,025,400	363,600	271,000	(120,600)
	1,625,400	863,600	671,000	79,400

Additional information:

(1) Details of the three investments were as follows.

	Newnham Ltd £	Trinity Ltd £	Wolfson Ltd £
Cost of investment	844,000	360,000	118,200
Retained earnings at date of investment	301,000	175,000	181,900

The fair values of the assets and liabilities of all three companies at the date of the investments were the same as their carrying amounts with the exception of a property owned by Newnham Ltd which was estimated to have a fair value of £120,000 above its carrying amount. This property was assessed as having a remaining useful life of 25 years on 1 July 2012, the date of Newnham Ltd's acquisition by Pembroke Ltd. Depreciation on properties is presented in operating expenses.

(2) During the current year, Pembroke Ltd charged management fees of £24,000 to Trinity Ltd. These fees were included in revenue and operating expenses respectively.

(3) On 1 January 2015 Trinity Ltd sold a machine to Pembroke Ltd for £51,000. At this date, the machine had a carrying amount in Trinity Ltd's books of £39,000. The estimated remaining useful life of the machine was reassessed on the date of sale at five years. Depreciation on this machine is presented in cost of sales.

(4) Pembroke Ltd undertakes annual impairment reviews in respect of all its investments. At 30 June 2014 cumulative impairment losses of £50,000 had been recognised in respect of goodwill arising on the acquisition of Newnham Ltd.

(5) Revenues and costs accrued evenly over the year, with the exception of consultancy fees of £12,000 paid by Trinity Ltd to an unrelated company for the period to 30 October 2014. These fees were recognised in operating expenses.

Requirements

(a) Prepare for Pembroke Ltd for the year ended 30 June 2015:

(i) a consolidated statement of profit or loss

(ii) the non-controlling interest column from the consolidated statement of changes in equity.

(17 marks)

(b) Describe any differences between IFRS and UK GAAP in respect of the preparation of consolidated financial statements. Answers may be presented in a bullet point format.

(4 marks)

Total: 21 marks