PROFESSIONAL LEVEL EXAMINATION

MONDAY 8 JUNE 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 ball point 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 has been extracted from the nominal ledger of Antigua plc at 31 December 2014.

	Note(s)	£	£
Sales			8,417,010
Purchases		4,741,400	
Land and buildings	(1)		
Valuation (land £140,000)		1,490,000	
Accumulated depreciation at 31 December 2013			90,000
Plant and equipment	(1), (2)		
Cost		578,000	
Accumulated depreciation at 31 December 2013			231,200
Retained earnings at 31 December 2013		15,010	
Revaluation surplus at 31 December 2013			757,000
Ordinary share capital (£1 shares)			50,000
Bank account			101,300
Operating expenses	(3)	2,017,500	
Trade and other receivables		578,700	
Trade and other payables			325,100
Income tax	(4)		127,000
Inventories at 31 December 2013		678,000	
		10,098,610	10,098,610

The following additional information is available:

(1) Antigua plc originally measured its land and buildings under the cost model. All buildings were acquired on 1 January 2006 and had a zero residual value and a total estimated useful life of 50 years at that date. On 1 January 2011 Antigua plc adopted the revaluation model for its land and buildings and revalued all its land and buildings at that date, with no change to total estimated useful lives. No further revaluations have been necessary since this date.

On 31 December 2014 a building which was surplus to requirements met the “held for sale” criteria of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. The building is included in property, plant and equipment at its carrying amount on 31 December 2013. Details in respect of this building are as follows:

	£
Cost on 1 January 2006	76,000
Valuation on 1 January 2011	108,000
Estimated fair value on 31 December 2014	58,000
Estimated costs to sell	5,000

Depreciation for the year ended 31 December 2014 has not yet been charged on any of Antigua plc’s property, plant and equipment. Depreciation on buildings should be presented in operating expenses and depreciation on plant and equipment should be presented in cost of sales. Plant and equipment is depreciated on a reducing balance basis using a rate of 20% pa.

Antigua plc does not make annual transfers between the revaluation surplus and retained earnings.

(2) On 1 July 2014 Antigua plc paid £103,500 for a piece of high-tech equipment, which is included in the total for plant and equipment in the trial balance above. A government grant of 50% of the cost of the equipment was received to help finance the purchase of this equipment as part of the government's drive to encourage investment in new technology. There were no future performance-related conditions attached to the grant. The grant was debited to cash and credited to purchases, although Antigua plc's published accounting policy for government grants is to use the netting-off method.

(3) On 1 January 2014 Antigua plc entered into a six year finance lease for a machine with a fair value of £50,250, a zero residual value and a useful life of seven years. Lease payments of £9,250 are due annually on 1 January. The first payment of £9,250 was duly made on 1 January 2014 and included in operating expenses. No other accounting entries have been made in respect of this lease. Antigua plc allocates finance charges on a sum-of-the-digits basis.

(4) The income tax in the trial balance represents a refund in respect of prior years, which was made on 15 June 2014, following an appeal to HMRC. The income tax liability for the year ended 31 December 2014 has been estimated at £497,500.

(5) Inventories at 31 December 2014 were valued at their cost of £752,000. This included £118,000 for one product line which had a total list price of £142,000 on 31 December 2014. However, on 15 January 2015 the directors discovered that, since December 2014, a number of competitors had been selling an equivalent product for 30% less than Antigua plc's list price.

Requirements

(a) Prepare a statement of profit or loss for Antigua plc for the year ended 31 December 2014 and a statement of financial position as at that date, in a form suitable for publication.

(25 marks)

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

(b) Describe the differences between IFRS and UK GAAP in respect of the financial reporting treatment of the government grant. **(3 marks)**

(c) The IASB Conceptual Framework refers to five elements of the financial statements. Give one example of each of these elements from the financial statements of Antigua plc, explaining how each meets the definition of the relevant element. **(5 marks)**

Total: 33 marks

2. The finance director of the Cuba Ltd group, Philippe, who is due to retire very shortly, has prepared draft consolidated financial statements for the year ended 31 December 2014. Shortly after Philippe completed the draft consolidated financial statements, he was taken ill and has been on sick leave since then. The managing director of Cuba Ltd asked José, the financial controller, to make any adjustments necessary to complete the consolidated financial statements. Both José and Philippe are ICAEW Chartered Accountants.

On examining the draft financial statements prepared by Philippe, José has identified the following issues:

(1) On 1 January 2014 Cuba Ltd acquired a zero coupon bond with a nominal value of £100,000 for £94,500. The bond is quoted in an active market. Broker's fees of £2,500 were incurred in relation to the purchase and recognised in profit or loss. The bond is redeemable on 31 December 2015 at a premium of 10% of its nominal value and will be held to maturity. The effective interest rate on the bond is 6.49%. On purchase of the bond Philippe debited investments within non-current assets with £110,000, being the redemption value, credited cash with £94,500 and credited income with £15,500, and has made no subsequent accounting entries in respect of this bond.

(2) On 1 July 2014 Cuba Ltd disposed of its entire holding in Honduras Ltd for £256,600. Cuba Ltd had acquired 80% of the ordinary share capital of Honduras Ltd a number of years ago for £147,800, when the fair value of Honduras Ltd's net assets was £157,500. At acquisition, the non-controlling interest was measured at its fair value of £40,100. No impairment losses in respect of goodwill acquired in the business combination with Honduras Ltd have arisen.

At 31 December 2013, Honduras Ltd had net assets with a fair value of £301,000. In the year ended 31 December 2014 Honduras Ltd made a loss of £16,600, with revenue and costs accruing evenly over the year.

In the draft consolidated financial statements for the year ended 31 December 2014 Philippe has included a single figure for Honduras Ltd: a profit on disposal of £108,800, being the difference between the sale proceeds of £256,600 and the cost of the original investment of £147,800. The investment in Honduras Ltd represented a separate major line of business of the Cuba Ltd group.

(3) In previous years Cuba Ltd had traded only with UK suppliers. However, in November 2014, Cuba Ltd began importing goods from Germany. The goods were received on 23 November 2014, and the purchase invoice, for €158,000, was correctly processed by Philippe. No adjustments have subsequently been made to this figure.

At the year end the invoice was unpaid and the goods were still in inventory. Philippe has valued this inventory using the spot rate at 31 December 2014 and included it in closing inventory used to prepare the draft consolidated financial statements.

The spot exchange rates were as follows:

23 November 2014 – €1:£0.85
31 December 2014 – €1:£0.90

(4) During the year Cuba Ltd made a significant proportion of its purchases (£550,000) from Grenada Ltd, a company owned by Philippe's wife. At 31 December 2014 £75,000 was due to Grenada Ltd in respect of these purchases. No disclosure of this transaction has been made in Cuba Ltd's draft consolidated financial statements. When José queried this with the managing director of Cuba Ltd, the managing director told him that he had been assured by Philippe that no disclosure was necessary as the purchases had all been made at an arm's length price.

Philippe is due to return to work next week and has told José, in a brief telephone call, that he is expecting to present the draft consolidated financial statements to the board exactly as he prepared them as he has already accrued for his bonus based on the consolidated profit for the year per those draft financial statements.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the consolidated financial statements of Cuba Ltd for the year ended 31 December 2014. You should prepare all relevant calculations and quantify the effects on the draft financial statements where possible. **(21 marks)**

(b) Discuss the ethical issues arising for Philippe and José from the scenario and the steps that José should take to address them. **(5 marks)**

(c) Describe the differences between IFRS and UK GAAP in respect of the financial reporting treatment of Issue (2) above. **(2 marks)**

Total: 28 marks

3. Columbia plc operates in the manufacturing sector. The company's statement of financial position as at 31 December 2013 included the following balances:

	£
Property, plant and equipment	1,456,700
Ordinary share capital (£1 shares)	300,000
Share premium account	35,000
Retained earnings	145,800
	480,800

The following information is relevant to its financial statements for the year ended 31 December 2014:

(1) Columbia plc constructed a new manufacturing facility, capitalising the following costs, all of which were incurred between 1 January 2014 and 30 November 2014:

	£
Site preparation	100,000
Materials and labour	358,300
Professional fees	10,000
General overheads	32,500
Construction overheads	11,000
Costs of relocating staff to the new facility	45,600
Initial safety inspection	21,000

The facility was ready for use on 30 November 2014. However, due to delays in moving equipment into the facility, it was not in fact used until January 2015. As a result no depreciation on the facility has been calculated or recognised. The overall life of the facility is estimated to be 20 years. The next safety inspection is due in three years' time and thereafter every three years.

(2) The following transactions took place and were recognised in respect of other property, plant and equipment:

- Depreciation of £235,600 was charged.
- An asset with a carrying amount of £125,700 was disposed of at a loss of £14,300.
- Columbia plc acquired plant and equipment for cash of £432,500.

(3) The following share issues were made during the year ended 31 December 2014. All shares have a nominal value of £1 per share.

Date	Type of shares	Number of shares	Issue price
1 February 2014	Ordinary	75,000	£1.50 per share
1 July 2014	4% Irredeemable preference	50,000	Par
1 November 2014	Ordinary	1 for 4 bonus issue	-

The dividend on the irredeemable preference shares is mandatory and if it is unpaid at the end of the period it becomes cumulative in the following period. The dividend due on these shares was paid on 1 January 2015 but no entry was made in the financial statements for the year ended 31 December 2014. An interim ordinary dividend of 15p per share was paid on 30 June 2014.

(4) Columbia plc's draft statement of profit or loss for the year ended 31 December 2014 shows a profit for the year of £52,600. Columbia plc wishes to retain the maximum balance on retained earnings whilst still following IFRS.

Requirements

(a) Explain the required IFRS financial reporting treatment of the manufacturing facility described in (1) above, with supporting calculations. **(5 marks)**

(b) (i) Calculate a revised profit for Columbia plc for the year ended 31 December 2014.

(ii) Prepare extracts from Columbia plc's statement of financial position as at 31 December 2014, and the investing and financing sections of its statement of cash flows for the year then ended. **(14 marks)**

Total: 19 marks

4. Dominica plc has investments in two companies, a subsidiary, Tobago Ltd, and an associate, Anguilla Ltd. The unqualified assistant accountant has prepared a draft consolidated statement of financial position at 31 December 2014 by simply adding together each line of the individual statements of financial position of Dominica plc and Tobago Ltd. However, he was unsure how to deal with Anguilla Ltd so has not included any of that company's figures in the consolidation.

The draft consolidated statement of financial position as at 31 December 2014 is shown below, together with the individual statement of financial position of Anguilla Ltd at the same date:

	Dominica plc group (draft consolidated)	**Anguilla Ltd**
	£	**£**
ASSETS		
Non-current assets		
Property, plant and equipment	3,780,400	351,200
Investments	756,000	–
	4,536,400	351,200
Current assets		
Inventories	400,800	42,000
Trade and other receivables	182,400	35,600
Cash and cash equivalents	53,400	6,800
	636,600	84,400
Total assets	5,173,000	435,600
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	1,400,000	200,000
Share premium account	890,000	–
Revaluation surplus	1,061,600	–
Retained earnings	1,367,900	168,100
	4,719,500	368,100
Current liabilities		
Trade and other payables	320,000	61,900
Taxation	133,500	5,600
	453,500	67,500
Total equity and liabilities	5,173,000	435,600

Additional information:

(1) Dominica plc acquired 85% of Tobago Ltd on 1 January 2014 for £600,000 when Tobago Ltd's equity was as follows:

	£
Ordinary share capital (£1 shares)	160,000
Share premium account	80,000
Revaluation surplus	140,000
Retained earnings	63,200
Equity	443,200

On 31 December 2014 Tobago Ltd's retained earnings were £181,500 and its revaluation surplus was £240,000. All other components of equity were unchanged.

The consideration of £600,000 was made up of £400,000 cash payable immediately and a further £200,000 payable on 31 December 2015 if the post-acquisition profits of Tobago Ltd exceeded a certain amount by that date. At 1 January 2014 the probability of Tobago Ltd hitting the earnings target was such that the fair value of the possible cash payment was £100,000. At 31 December 2014 the probability had risen such that the fair value of the possible cash payment was judged to be £150,000. When preparing the draft consolidated statement of financial position the assistant accountant included the full £600,000 in investments and the full £200,000 in trade and other payables.

The fair values of the assets and liabilities of Tobago Ltd at the date of acquisition were equal to their carrying amounts, with the exception of inventory. On 1 January 2014 the fair value of Tobago Ltd's inventories was £124,000 but their carrying amount was £107,000. At 31 December 2014 half of these inventories were still held by Tobago Ltd.

Dominica plc has decided to measure goodwill and the non-controlling interest using the proportionate method.

(2) Dominica plc acquired 35% of Anguilla Ltd on 1 January 2005 for £156,000 when the retained earnings of Anguilla Ltd were £104,500. At this date a property owned by Anguilla Ltd had a fair value £100,000 in excess of its carrying amount and a remaining useful life of 20 years. The remaining assets and liabilities at the date of acquisition were equal to their carrying amounts.

(3) On 1 January 2014 Dominica plc sold a machine to Tobago Ltd for £180,000. The machine had a carrying amount in Dominica plc's books of £156,000. The estimated remaining useful life of the machine was reassessed on the date of sale at six years.

(4) During the year Dominica plc sold goods to Anguilla Ltd for £20,000, making a gross profit margin of 30%. At 31 December 2014 Anguilla Ltd held one-third of these goods in its inventories.

(5) Inventories in the statements of financial position of all three companies at 31 December 2014 were based on physical inventory counts carried out on 31 December 2014. However, on 10 January 2015 Tobago Ltd received a report from one of its customers, Trinidad Ltd, showing that on 31 December 2014 Trinidad Ltd held £23,600 (cost to Trinidad Ltd) of Tobago Ltd's inventories on a sale or return basis. Tobago Ltd makes a gross profit margin of 25% on all sales but has not yet raised any invoices for this transaction.

Requirement

Prepare the consolidated statement of financial position of Dominica plc as at 31 December 2014.

Total: 20 marks