PROFESSIONAL LEVEL EXAMINATION

MONDAY 16 MARCH 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.

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1. You are the financial controller at Coghlan Ltd and an ICAEW Chartered Accountant. You are finalising the financial statements for the year ended 30 September 2014. Your colleague, a part-qualified ICAEW Chartered Accountant, has produced the following draft financial statements with some additional information. He was assisted by the managing director's son, who was on work experience at Coghlan Ltd.

You are under pressure from the managing director to finalise the financial statements as quickly as possible as he is about to go on holiday. The managing director has reminded you that your performance appraisal is due and has hinted that if you finalise the financial statements quickly he will make sure this is reflected in your appraisal which is linked to your salary.

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

	£
Revenue (Note 1)	3,359,200
Cost of sales	(2,198,050)
Gross profit	1,161,150
Administrative expenses (Note 2)	(1,039,700)
Operating profit	121,450
Other costs (Note 3)	(500,000)
Finance costs (Note 4)	(38,000)
Loss before tax	(416,550)
Income tax (Note 5)	–
Loss for the year	(416,550)

Draft statement of financial position as at 30 September 2014

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (Note 6)		1,110,325
Current assets		
Inventories (Note 7)	142,100	
Trade and other receivables	125,400	
Cash and cash equivalents	1,200	
		268,700
Total assets		**1,379,025**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares) (Note 4)		294,500
Share premium		94,000
Retained earnings		425,825
		814,325
Current liabilities		
Trade and other payables	31,900	
Provision (Note 3)	500,000	
Income tax (Note 5)	32,800	
		564,700
Total equity and liabilities		**1,379,025**

Additional information:

(1) Coghlan Ltd has launched a new monthly technical magazine to its customers on a subscription basis, based on a calendar year. £36,000 was received in annual subscriptions in December 2013 for the year commencing 1 January 2014. This was recognised immediately as revenue as the amount could be measured reliably and the economic benefit had flowed to Coghlan Ltd.

(2) On 1 October 2013 Coghlan Ltd entered into a new six-year lease for a regional office. Lease payments are £1,200 per month payable at the beginning of each month. The building is estimated to have a useful life of 30 years. Coghlan Ltd negotiated a rent holiday for the first six months. As a consequence, the rent for the final six months of the lease will be double. The first payment of £1,200 was made on 1 April 2014. The lease payments were recognised in administrative expenses as they were paid.

(3) The provision of £500,000 shown in the financial statements above relates to outstanding lawsuits for the supply, prior to the year end, of faulty products by Coghlan Ltd to a number of customers. This amount has been recognised as a provision based on advice from Coghlan Ltd's lawyers that the claims are very likely to succeed within the next six months, which has led to some adverse publicity. The product was withdrawn in August 2014.

Since recognising the above provision, Coghlan Ltd discovered that there are an additional 50 faulty products still in circulation. Coghlan Ltd's lawyers estimated for each product £350 would need to be paid.

During the year Coghlan Ltd started offering a one-year repair warranty with its luxury products. If minor repairs were required for all the relevant goods sold the cost would be £65,000, compared to £157,000 if major repairs were required. Coghlan Ltd estimates that 20% of the goods sold will require minor repairs and 5% will require major repairs. No provision was recognised in respect of the warranties for the year ended 30 September 2014 as no goods had been returned by this date.

(4) An interim ordinary dividend of 10p per share was paid on 11 May 2014 and recognised as a finance cost. Shortly after this, Coghlan Ltd entered into a share buyback scheme to reacquire 45,000 £1 ordinary shares for £1.90 cash per share. The total cash paid was debited to share capital.

(5) The income tax figure shown in the statement of financial position is the balance remaining on the nominal ledger after paying the liability for the previous year. As a loss was made for the year ended 30 September 2014 a tax refund of £65,000 has been appropriately estimated but has not yet been recognised.

(6) Depreciation on property, plant and equipment for the year ended 30 September 2014 has not yet been charged. The following information is available:

	Land and buildings	**Fixtures and fittings**
Cost (land £250,000)	£1,125,000	£236,000
Accumulated depreciation at 1 October 2013	£187,500	£63,175
Depreciation rate and method (buildings)	5% pa straight-line	20% pa reducing balance
Recoverable amount (land £225,000) at 30 September 2014	£600,000	£170,000

Land and buildings consist of Coghlan Ltd's head office and main warehouse which are located together on one piece of land. Local market values decreased following an announcement that a wind farm is to be built in the area.

All expenses in respect of property, plant and equipment should be recognised in administrative expenses.

(7) Inventories at 30 September 2013 and 2014 were valued at net realisable value, as this was higher than cost. The following inventory valuations are relevant.

	30 September 2014	**30 September 2013**
	£	**£**
Cost	98,000	79,000
Net realisable value	142,100	114,550

Requirements

(a) Prepare a revised statement of profit or loss for Coghlan Ltd for the year ended 30 September 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.
(19 marks)

(b) IAS 1, Presentation of Financial Statements, requires financial statements to be prepared using the accruals basis of accounting and the IASB's Conceptual Framework refers to going concern as the underlying assumption in the preparation of financial statements. Explain these two concepts, illustrating their application with reference to Coghlan Ltd. **(6 marks)**

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

Total: 30 marks

2. The draft financial statements of Porcaro plc, which has a number of wholly-owned subsidiaries, are being prepared by your trainee, Carmine. A number of outstanding issues are set out below which require your attention, as financial controller, as Carmine was unsure of the correct accounting treatment.

The draft consolidated profit for the year ended 30 September 2014 is £483,150.

(1) On 1 October 2013 Porcaro plc borrowed £600,000 at 6% pa, repayable in three years' time, to help fund the construction of an office block. Porcaro plc immediately paid £200,000 to acquire land and gained planning permission on this date but construction did not start until 31 December 2013. The remaining amount was put into a deposit account earning interest at 3% pa and was used to make payments to the construction company of £100,000 on 1 March 2014 and £200,000 on 1 September 2014. The building was not complete at the year end and a further payment of £100,000 was due to the construction company after 30 September 2014. All relevant interest was received and paid on 30 September 2014.

Carmine recognised the net interest paid in the statement of profit or loss and capitalised all other costs incurred as an asset in the course of construction.

(2) On 1 October 2013 Porcaro plc issued 6,000 5% £100 convertible bonds. Each bond is redeemable in four years' time at par or can be converted into 100 £1 ordinary shares. Interest is payable annually in arrears and the market rate of interest for similar bonds without the conversion option is 7% pa. Carmine has credited the cash proceeds from the bond issue to non-current liabilities. The annual interest of £30,000 was paid at the year end and was recognised as a finance cost.

(3) On 1 April 2014 Porcaro plc paid £72,000 for a licence for the production of a state of the art microchip. At the end of six years it is thought that the licence will be worthless due to advances in technology. Carmine has recognised the licence in the draft financial statements as an intangible asset of £90,000 as this is the amount that a competitor offered to Porcaro plc for the licence on 30 June 2014 due to its unique nature. Carmine showed the increase in value as a revaluation surplus in equity.

(4) On 1 May 2014 Porcaro plc and three other unrelated trading companies each purchased one quarter of the 100,000 £1 ordinary shares, at par, of a newly incorporated company, Barbarossa Ltd. Under a contractual agreement each investor is entitled to an equal share of the profits and losses and unanimous consent is required for all key operating decisions. For the period ended 30 September 2014 Barbarossa Ltd reported a profit after tax of £130,000, no dividends have yet been paid. On acquisition, Carmine recognised the cost of the 25,000 shares in Barbarossa Ltd as a current asset. No other accounting entries have been made in respect of Barbarossa Ltd.

On 1 October 2013 Porcaro plc had in issue 270,000 £1 ordinary shares. On 1 February 2014 Porcaro plc made a 1 for 3 rights issue for £1.70 per share. The market price of one Porcaro plc ordinary share immediately before the rights issue was £2.10.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 30 September 2014, preparing all relevant calculations and setting out the required adjustments in the form of journal entries.
(27 marks)

(b) Using your results from Part (a) calculate a revised figure for consolidated profit for the year. **(2 marks)**

(c) (i) Calculate basic earnings per share for the Porcaro plc group.

(ii) Briefly explain the treatment of the rights issue in the above calculation. **(6 marks)**

(d) Describe the difference between IFRS and UK GAAP in relation to issue (1) above.
(1 mark)

Total: 36 marks

3. Henrit plc has two subsidiary companies, one of which was acquired during the year ended 30 September 2014. Set out below is an extract from all three companies' draft statements of financial position.

Draft statements of financial position at 30 September 2014 (extracts)

ASSETS	**Henrit plc (single company)** £	**Bonham Ltd** £	**Crago Ltd** £
Non-current assets			
Property, plant and equipment	963,200	469,400	623,150
Investments	475,000	–	–
Current assets			
Inventories	46,980	18,900	31,300

Additional information:

(1) At 1 October 2013 Henrit plc held property, plant and equipment with a carrying amount of £729,400, none of which had been acquired under finance leases. During the year ended 30 September 2014 Henrit plc sold equipment with a carrying amount of £124,000, recognising a profit on disposal of £9,500. Depreciation of £113,000 was recognised.

Henrit plc acquired new plant during the year; some additions were made under a finance lease with the remainder for cash. The draft financial statements show a total finance lease liability of £97,725 at 30 September 2014 and a lease payment of £15,000 was made during the year.

(2) The statement of profit or loss shows finance costs of £25,875 which relate to the interest due on a bank loan and interest on the finance lease. Interest at 5% pa is payable on the bank loan. At 1 October 2013 Henrit plc had a bank loan of £290,000, with additional funding of £160,000 obtained on 1 April 2014.

(3) At 1 October 2013 Henrit plc had an investment in a wholly owned subsidiary, Bonham Ltd. This investment cost £200,000 and gave rise to goodwill at acquisition of £73,400.

On 1 April 2014 Henrit plc acquired 60% of the ordinary share capital of Crago Ltd for consideration comprising cash of £230,000 and 45,000 £1 ordinary shares in Henrit plc, with a market value of £3.15 each. The investment in Crago Ltd was recognised in non-current assets at £275,000 being the cash consideration and the share issue at £1 nominal value. The fair value of the assets and liabilities acquired were £615,000 at the date of acquisition which was the same as their carrying amount. The non-controlling interest and goodwill on the acquisition of Crago Ltd were calculated using the fair value method. The fair value of the non-controlling interest at 1 April 2014 was £261,000.

(4) Immediately after its acquisition by Henrit plc, Crago Ltd sold a machine to Henrit plc for £53,000. The machine had originally been acquired by Crago Ltd for £95,000 on 1 October 2011 and had an estimated five year useful life, which has never changed.

(5) In August 2014 Bonham Ltd sold goods to Crago Ltd for £11,500 at a mark-up of 15%. All of these goods were still in Crago Ltd's inventories at the year end.

Requirements

(a) Using the draft financial statements for Henrit plc and the additional information set out in (1) and (2) above, prepare extracts from Henrit plc's single company statement of cash flows for the year ended 30 September 2014 showing figures under the headings:

(i) Cash flows from investing activities

(ii) Cash flows from financing activities **(6 marks)**

(b) Using the draft financial statements of all three companies and the additional information set out in (3) to (5) above prepare extracts from the consolidated statement of financial position of Henrit plc as at 30 September 2014 showing:

(i) Non-current assets

(ii) Current assets **(5 marks)**

Total: 11 marks

PLEASE TURN OVER

4. At 1 October 2013 Mantia plc had investments in two companies: an 80% holding in Appice Ltd and a 65% holding in Starkey Ltd.

On 1 April 2014 Mantia plc sold all of its 91,000 £1 ordinary shares in Starkey Ltd, for £427,000. The disposal proceeds were credited to a suspense account. Starkey Ltd's retained earnings at 1 October 2013 were £243,000. Mantia plc measures all non-controlling interest and goodwill on acquisition using the proportionate method.

The draft individual statements of profit or loss of the three companies are shown below:

Draft statements of profit or loss for the year ended 30 September 2014

	Mantia plc £	Appice Ltd £	Starkey Ltd £
Revenue	2,986,000	768,000	1,672,000
Cost of sales	(1,343,700)	(345,600)	(585,200)
Gross profit	1,642,300	422,400	1,086,800
Operating expenses	(419,575)	(84,480)	(334,100)
Profit from operations	1,222,725	337,920	752,700
Investment income	42,600	–	–
Profit before tax	1,265,325	337,920	752,700
Income tax expense	(259,000)	(68,000)	(152,500)
Profit for the year	1,006,325	269,920	600,200

The draft individual statements of financial position at 30 September 2014 for Mantia plc and Appice Ltd show:

	Mantia plc £	Appice Ltd £
Equity		
Ordinary share capital (£1)	500,000	80,000
Retained earnings	596,300	384,200

Additional information:

(1) Mantia plc acquired its holding in Appice Ltd on 1 October 2012 when Appice Ltd's retained earnings were £136,000. The fair values of all Appice Ltd's assets and liabilities at the date of acquisition were the same as their carrying amounts, with the exception of a machine which was estimated to have a fair value of £70,000 in excess of its carrying amount. The machine was assessed as having a remaining useful life of ten years at 1 October 2012. Depreciation of plant and machinery is recognised in operating expenses.

(2) Mantia plc acquired its holding in Starkey Ltd several years ago for £230,000 when Starkey Ltd's retained earnings were £162,000. The fair values of all Starkey Ltd's assets and liabilities at the date of acquisition were the same as their carrying amounts. Starkey Ltd's revenue and costs accrued evenly over the current year.

(3) During the year Appice Ltd sold goods to Mantia plc for £32,000 earning a gross margin of 15%. At the year-end Mantia plc still held a quarter of these goods.

(4) Mantia plc and Appice Ltd paid a dividend of £1.20 and 40p per share respectively during the year ended 30 September 2014.

(5) Mantia plc has undertaken its annual impairment review of goodwill and identified that an impairment of £25,000 has arisen in relation to Appice Ltd and should be recognised. No impairment of goodwill arose in the year in respect of the acquisition of Starkey Ltd, however, cumulative impairments of £18,000 had been recognised at 1 October 2013.

Requirements

(a) Prepare, for Mantia plc for the year ended 30 September 2014:

(i) a consolidated statement of profit or loss;

(ii) the retained earnings column from the consolidated statement of changes in equity.

You should assume that the disposal of Starkey Ltd constitutes a discontinued activity in accordance with IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. **(20 marks)**

(b) Describe the differences between IFRS and UK GAAP in relation to the acquisition and disposal of Starkey Ltd. **(3 marks)**

Total: 23 marks