PROFESSIONAL LEVEL EXAMINATION

MONDAY 7 SEPTEMBER 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. The financial controller at Gamow Ltd has prepared draft financial statements for the year ended 31 March 2015. However, there are some issues which need to be finalised before the financial statements can be presented to the board. You are the financial controller's assistant, and you have been provided with the following information and asked to complete the financial statements.

Draft statement of profit or loss for the year ended 31 March 2015

	£
Revenue (Notes 1 to 3)	1,896,200
Cost of sales	(567,430)
Gross profit	1,328,770
Administrative expenses	(283,600)
Other operating costs	(189,720)
Operating profit	855,450
Finance costs	(1,560)
Profit before tax	853,890
Income tax	(74,000)
Profit for the year	779,890

Draft statement of financial position as at 31 March 2015

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment		1,260,780
Intangible assets (Note 2)		275,000
		1,535,780
Current assets		
Inventories	47,300	
Trade and other receivables	121,240	
Cash and cash equivalents	3,800	
		172,340
Total assets		**1,708,120**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)		580,000
Retained earnings		541,720
		1,121,720
Non-current liabilities		
6% convertible bonds (Note 4)		300,000
Current liabilities		
Trade and other payables	92,400	
Provisions (Note 5)	120,000	
Income tax	74,000	
		286,400
Total equity and liabilities		**1,708,120**

Additional information:

(1) On 1 July 2014 Gamow Ltd introduced a discount loyalty card scheme for select customers, issuing 200 cards for £1,250 each in return for a 25% discount on all purchases over the next two years. The financial controller included the total cash received of £250,000 as part of revenue for the year ended 31 March 2015.

An analysis of purchases over the last five years for these customers shows that purchases are evenly spread throughout each year.

(2) During the year ended 31 March 2015 Gamow Ltd incurred £275,000 of research and development expenditure on a new product, the Mendel. All of this expenditure was capitalised as an intangible asset. The following costs have been incurred:

	£
Background investigation work (1 April – 31 May 2014)	25,000
Initial development work (1 June – 15 July 2014)	42,800
Second phase development work (16 July – 30 November 2014)	160,000
Product launch costs (December 2014)	31,600
Staff training (February 2015)	15,600
	275,000

The Mendel was assessed as being commercially viable on 16 July 2014 and product development was completed by the end of November 2014. The product was launched in December 2014, although the first products were not delivered until April 2015.

2,000 advance orders were taken during the product launch events, with customers paying deposits of £50 per Mendel. The only accounting entries made in respect of the advance orders were to recognise the cash deposits and credit revenue.

(3) On 1 January 2015 Gamow Ltd made a one-off sale to a customer in mainland Europe. The sale was for €22,000 and a 120 day credit period was given to the customer. The sale was recognised in revenue and receivables using the 1 January 2015 spot exchange rate. No other accounting entries have been made. The cash from the customer was received on 1 May 2015. The spot exchange rates are as follows:

1 January 2015	€1:£0.83
31 March 2015	€1:£0.79
1 May 2015	€1:£0.80

(4) On 1 April 2014 Gamow Ltd issued 30,000 6% £10 convertible bonds at par. On 31 March 2017 each bond can be redeemed for cash at par or converted into three ordinary shares. The interest due on the bonds was paid on 1 April 2015. The equivalent effective interest rate on similar bonds without the conversion rights is 9% pa. The only accounting entries made at 31 March 2015 were to recognise the £300,000 cash received as a non-current liability.

(5) During the period a legal claim was made against Gamow Ltd in relation to a delivery of goods made on 1 April 2014 which were of a poor quality. This was an isolated incident with a fault with one of the production machines and the goods should not have been delivered to the customer. Gamow Ltd's legal department believe that the claim is likely to succeed and an out of court settlement is estimated at £120,000. A provision was recognised at 31 March 2015 for £120,000 and the costs were debited to other operating costs. Due to a number of complications with the claim it is estimated that it is not likely to be settled until April 2016. The appropriate discount rate is 7%.

(6) Depreciation on property, plant and equipment for the year ended 31 March 2015 has not yet been charged. All depreciation is charged on a straight-line basis. Buildings were assessed as having a 40 year useful life, and plant and machinery a 15 year useful life.

The cost of property, plant and equipment at 1 April 2014 included:

	£
Land	350,000
Buildings	1,080,000
Plant and machinery	384,900

No new items of property, plant and equipment were acquired in the year, although a machine was sold on 1 April 2014 for £9,300. This machine had originally been purchased on 1 April 2008 for £19,500. The only accounting entries made in respect of this disposal were to credit the cash proceeds to non-current assets.

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

Requirements

(a) Prepare the following for Gamow Ltd, in a form suitable for publication:

(i) a revised statement of profit or loss for the year ended 31 March 2015;

(ii) a revised statement of financial position as at 31 March 2015; and

(iii) a provisions note to the financial statements, including both the movements table and accompanying narrative. **(27 marks)**

(b) Describe any differences between IFRS and UK GAAP in respect of the presentation of financial statements. **(4 marks)**

(c) (i) Explain the concept of 'substance over form' using Gamow Ltd to illustrate your explanation.

(ii) Explain the concepts of 'present fairly' and 'true and fair view'. **(6 marks)**

Total: 37 marks

2. Meitner plc is a UK company operating in the global healthcare market. The draft financial statements for the year ended 31 March 2015 have been prepared by the financial controller and include:

	£
Profit before tax	1,460,000
Equity	2,600,180

The following information is required to finalise the financial statements:

(1) On 1 April 2014 Meitner plc received a government grant of £375,000 and credited it to other income. The grant is to help fund local employment within Meitner plc's research facilities.

A condition of the grant is that the "local workforce" must make up at least one third of the total number of Meitner plc's employees for the three years from the date of receipt of the grant. "Local workforce" is defined in the grant's terms and conditions as "living within a 10 mile radius of the research facility". At 31 March 2015 the local workforce made up 35% of Meitner plc's total number of employees. This percentage is expected to rise over the next two years and Meitner plc is confident that it will not have to repay the grant.

(2) Meitner plc is planning to centralise its operations in a few years' time which will release some additional finance. However, funding is needed now to finance the initial research stage of a new drug so Meitner plc sold its head office building for £8 million on 1 July 2014 and then immediately leased it back. The lease is for five years, with payments set at a market rate and has been correctly accounted for. The carrying amount of the property at 1 July 2014 was £6.5 million, with a 30 year remaining useful life, and the property's fair value was estimated at £7.3 million at that date. Meitner plc derecognised the property on 1 July 2014 and recognised a profit on disposal of £1.5 million as part of other income.

(3) On 1 December 2014 Meitner plc made the decision to close two smaller manufacturing operations in Ostwald and Dirac and to move to a single central location. The following information is relevant for the properties at the two operations at 1 December 2014:

	Ostwald	**Dirac**
Cost	£1,372,500	£1,890,000
Date of acquisition	1 April 2006	1 December 2005
Carrying amount	£976,000	£1,323,000
Fair value (independent professional valuations)	£1,300,000	£1,169,700
Selling costs (as a percentage of fair value)	1.5%	1%

On 1 December 2014 both properties were offered for sale at their fair value and advertised in the relevant trade press. The company's commercial property agent has advised that properties in Ostwald are generally selling within four to eight months. Properties within Dirac have dropped in value recently due to speculation that a major road restructure could affect the area. Meitner plc has decided not to sell the property yet and instead wait for the outcome of the road planning decision which is expected to take at least a year.

Although there had been some interest in Ostwald, both properties remained unsold at 31 March 2015. Meitner plc continued to depreciate both properties during the year on a straight-line basis over their 30 year useful life. Meitner plc measures all property, plant and equipment on a cost basis.

(4) On 1 February 2015 Meitner plc repurchased 150,000 of its £1 ordinary shares for £1.40 each. The only accounting entries made were to credit cash and debit investments.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 31 March 2015, preparing all relevant calculations. **(23 marks)**

(b) Calculate revised figures for Meitner plc for both profit before tax and equity for inclusion in the financial statements for the year ended 31 March 2015. **(3 marks)**

Total: 26 marks

3. For several years Fermi plc has owned a number of subsidiary companies and a 35% investment in an associate, Boas Ltd.

On 1 September 2014 Fermi plc acquired 70% of the ordinary share capital of Selye Ltd. The consideration consisted of 70,000 £1 ordinary shares with a fair value of £1.90 per share, and £135,000 in cash.

The junior accountant at Fermi plc, Elion, is preparing the draft consolidated financial statements and has asked for your help, as his senior and an ICAEW Chartered Accountant.

(a) The following information is needed to complete missing figures from the consolidated statement of cash flows.

Consolidated statement of financial position as at 31 March 2015 (extracts)

	2015 £	2014 £
Non-current assets		
Investment in associate	239,420	176,300
Current assets		
Trade and other receivables	112,400	83,100
Equity		
Share capital (£1 ordinary)	575,000	460,000
Share premium account	425,750	320,000
Non-controlling interest	471,400	246,700
Current liabilities		
Trade and other payables	96,700	53,840

Consolidated statement of profit or loss for the year ended 31 March 2015 (extracts)

	£
Share of profits of associate	83,200
Non-controlling interest	139,600

Additional information:

(i) Cash flows from operating activities had been calculated as £386,480 although the movement in trade receivables and payables was excluded from this calculation.

(ii) On 1 September 2014 Selye Ltd's net assets totaled £420,550 and included:

	£
Trade and other receivables	61,400
Cash and cash equivalents	3,150
Trade and other payables	36,700

(iii) The consolidated statement of changes in equity shows that Fermi plc made a share issue for cash on 1 January 2015.

Requirement

Prepare, for inclusion in Fermi plc's consolidated statement of cash flows for the year ended 31 March 2015, a revised figure for cash flows from operating activities and extracts from the investing activities and financing activities sections in so far as the information above allows.

(7 marks)

(b) Elion is having difficulties trying to calculate Fermi plc's consolidated gross profit for the year ended 31 March 2015. A number of transactions between group companies arose during the year, as detailed below.

In addition, Selye Ltd's results have not been included in the draft consolidated results for the Fermi plc group as Elion was unsure what should be included as the acquisition occurred part way through the year.

The following information is available to complete the consolidated gross profit figure.

(i) Draft extracts from the Fermi plc group and the individual financial statements of Selye Ltd are:

	Fermi plc group	**Selye Ltd**
	£	**£**
Revenue	2,345,800	963,000
Cost of sales	(1,290,200)	(537,000)
Gross profit	1,055,600	426,000

Selye Ltd's revenue and costs accrued evenly over the year ended 31 March 2015.

(ii) In January 2015 Fermi plc sold goods to one of its other subsidiary companies for £27,600 and to Boas Ltd, its associate, for £24,000. All goods were sold at a mark-up on cost of 20%. At 31 March 2015 both companies still held half of these goods in their inventories.

Requirement

Prepare a revised extract for gross profit, showing the breakdown of revenue and cost of sales, as part of Fermi plc's consolidated statement of profit or loss for the year ended 31 March 2015. **(5 marks)**

(c) The finance director has asked Elion to prepare a paper for consideration by the board on different forms of financing including possible takeover and merger opportunities. Elion is concerned that he lacks the right level of expertise, as he is still a trainee ICAEW Chartered Accountant.

Requirement

Set out which of the key fundamental principles from the ICAEW Code of Ethics might be relevant to the above scenario and explain any action that Elion should take. **(4 marks)**

Total: 16 marks

4. At 31 March 2015 Huygens plc has one subsidiary company, Planck Ltd. It also has a 25% investment in Quimby Ltd, along with three other equal investors.

The draft, summarised statements of financial position of the three companies at 31 March 2015 are shown below:

	Huygens plc £	Planck Ltd £	Quimby Ltd £
ASSETS			
Non-current assets			
Property, plant and equipment	911,700	89,400	85,000
Investments	116,250	–	–
	1,027,950	89,400	85,000
Current assets			
Inventories	43,700	32,000	24,400
Trade and other receivables	71,000	17,900	10,300
Cash and cash equivalents	5,600	3,100	2,940
	120,300	53,000	37,640
Total assets	1,148,250	142,400	122,640
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital (£1 shares)	300,000	50,000	100,000
Share premium account	105,000	–	–
Retained earnings	579,650	57,200	15,240
	984,650	107,200	115,240
Current liabilities			
Trade and other payables	98,600	21,400	4,600
Income tax	65,000	13,800	2,800
	163,600	35,200	7,400
Total equity and liabilities	1,148,250	142,400	122,640

Additional information:

(1) On 1 October 2014, Huygens plc acquired 80% of the ordinary shares of Planck Ltd when the retained earnings of Planck Ltd were £39,000. The consideration consisted of cash of £85,000 paid on 1 October 2014 and a further cash payment of £42,000, deferred until 1 October 2015. No accounting entries have been made in respect of the deferred cash payment. An appropriate discount rate is 5% pa. Huygens plc recognises goodwill and non-controlling interests using the fair value method.

The fair values of Planck Ltd's other assets, liabilities and contingent liabilities at 1 October 2014 were equal to their carrying amounts with the exception of a specialised piece of plant which had a fair value £15,000 in excess of its carrying amount. This plant had a ten year remaining useful life on 1 October 2014.

The fair value of the non-controlling interest in Planck Ltd on 1 October 2014 was estimated at £26,000.

(2) In December 2014 Planck Ltd sold goods to Huygens plc for £12,800, earning a gross margin of 15% on the sale. Huygens plc still held £9,600 of these goods in its inventories at 31 March 2015.

Planck Ltd still had the full invoice value of £12,800 in its trade receivables at 31 March 2015, however Huygens plc only showed half of the invoice value in its trade payables as it made a payment of £6,400 on 31 March 2015.

(3) Quimby Ltd is a joint venture, set up by Huygens plc and its fellow venturers on 1 April 2014. Each venturer paid £25,000 for a 25% share of Quimby Ltd. On 1 November 2014 Quimby Ltd paid a total dividend of £15,000. Huygens plc credited the dividend received to investments within non-current assets.

Requirements

(a) Prepare the consolidated statement of financial position of Huygens plc as at 31 March 2015. **(18 marks)**

(b) Calculate Huygens plc's distributable profits at 31 March 2015, explaining your calculation. **(3 marks)**

Total: 21 marks