PROFESSIONAL LEVEL EXAMINATION

MONDAY 9 JUNE 2014

(3 hours)

# FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** written test questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ball point pen only.
3. Answers to each written test 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.

**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 Tipperary plc at 31 December 2013.

| | **Note(s)** | **£** | **£** |
|---|---|---|---|
| Sales | (2), (3) | | 5,709,600 |
| Purchases | | 3,968,600 | |
| Administrative expenses | | 1,097,900 | |
| Distribution costs | | 562,700 | |
| Land and buildings | (1) | | |
| Valuation (on 1 January 2011) | | 500,000 | |
| Accumulated depreciation at 31 December 2012 | | | 80,000 |
| Plant and equipment | (1), (2) | | |
| Valuation (on 1 January 2011) | | 175,000 | |
| Accumulated depreciation at 31 December 2012 | | | 70,000 |
| Retained earnings at 31 December 2012 | | | 256,450 |
| Revaluation surplus at 31 December 2012 | (1) | | 209,000 |
| Ordinary share capital (£1 shares) | (3) | | 230,000 |
| Redeemable preference share capital 2015 (£1 shares) | (3) | | 100,000 |
| Bank account | | | 57,850 |
| Trade and other receivables | | 363,750 | |
| Trade and other payables | | | 233,050 |
| Inventories at 31 December 2012 | (4) | 278,000 | |
| | | 6,945,950 | 6,945,950 |

The following additional information is available:

(1) Tipperary plc measures its property, plant and equipment under the revaluation model. On 1 January 2013 the company's land and buildings were valued at £450,000 (land £100,000) and its plant and equipment at £85,000. This valuation has not been reflected in the trial balance above.

On 1 January 2013 the remaining useful lives of the buildings and plant and equipment were reassessed at 20 years and four years respectively. Depreciation on buildings should be presented in administrative expenses and depreciation on plant and equipment should be presented in cost of sales. Other than the equipment referred to in Note (2) below, there were no additions to or disposals of property, plant and equipment in the year ended 31 December 2013. The revaluation surplus at 31 December 2012 included £200,000 in respect of land and buildings, with the remainder attributable to plant and equipment.

Tipperary plc has a policy of making an annual transfer between the revaluation surplus and retained earnings wherever possible. Depreciation charges for the year ended 31 December 2013 on a historical cost basis would have been £15,000 for plant and equipment and £10,000 for buildings.

(2) On 1 January 2013 Tipperary plc acquired new equipment for £30,000, which is included in the £175,000 in the trial balance and in the valuation of £85,000 in Note (1) above. A government grant of £18,000 was received to help finance the purchase of this equipment as part of the government's drive to encourage investment in new technology, and was credited to sales. Tipperary plc has an accounting policy of using the deferred income approach.

 

(3) The redeemable preference shares were issued on 1 January 2013, and the coupon and effective interest rates are both 5%.

On 15 February 2013 Tipperary plc declared an ordinary dividend of 10p per share in respect of the year ended 31 December 2012. This was paid one month later and debited to administrative expenses.

On 30 June 2013 Tipperary plc made a 1 for 4 rights issue of ordinary shares at a price of £1.20 per share. The rights issue was fully taken up. The nominal value received was credited to ordinary share capital, but the premium was credited to sales.

No ordinary or preference dividends have been paid or accrued in respect of the current year.

(4) Inventories at 31 December 2013 have been valued at £192,300. During the inventory valuation it was discovered that inventories at 31 December 2012 had, in error, been overvalued by £100,000.

(5) On 15 November 2013 Tipperary plc purchased some inventories from an overseas supplier for €115,000, correctly recording the transaction at that date, but making no further adjustments. The invoice was unpaid at 31 December 2013. The spot exchange rates are as follows:

| | |
|---|---|
| 15 November 2013 | €1:£0.90 |
| 31 December 2013 | €1:£0.85 |

(6) The income tax liability for the current year has been estimated at £10,500.

**Requirements**

(a) Prepare the following for the financial statements of Tipperary plc for the year ended 31 December 2013, in a form suitable for publication:

(i) a statement of profit or loss
(ii) a statement of financial position
(iii) a statement of changes in equity (a total column is **not** required). **(22 marks)**

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

(b) Describe the alternative treatment of the government grant set out in Note (2) above, comparing this to the treatment adopted by Tipperary plc, and quantifying the effect on the financial statements of Tipperary plc for the year ended 31 December 2013. **(4 marks)**

(c) According to the IASB Conceptual Framework, users require information regarding financial position, financial performance and changes in financial position.

Explain how the information contained in financial statements in respect of property, plant and equipment meets those information needs. **(5 marks)**

**(31 marks)**

2. You are an ICAEW Chartered Accountant employed as the financial controller at Limerick plc, a UK listed company. You have recently returned from maternity leave to find that the finance director (another ICAEW Chartered Accountant) has resigned and left the company, following his concerns over accounting practices he was being asked to implement. In your absence, the managing director, who is not a qualified accountant, has drafted financial statements for the year ended 31 December 2013. The managing director summoned you to his office and explained the situation to you:

"As you know, Limerick plc has been in difficulties for some time and after disappointing results for the year ended 31 December 2012, the board of directors is keen to report as high a profit as possible for the year ended 31 December 2013. In particular, I want to show the board that the company's basic earnings per share has improved significantly on last year's figure of 70.3p.

Whilst you were away I have drafted the financial statements for the year ended 31 December 2013 and need you to confirm that they are suitable for publication. Can you also check that I have correctly calculated basic earnings per share at 500.5p? I based this on earnings of £500,500 and the 100,000 £1 ordinary shares in issue on 1 January 2013. If you can confirm my figures you could be our next finance director."

On examining the draft financial statements prepared by the managing director, you identify the following matters of concern:

(1) On 1 January 2013 Limerick plc entered into a 40 year lease for land and buildings. Ownership of both the land and the buildings passes to Limerick plc at the end of the lease term. The lease payments are £120,000 pa, paid annually in advance. The managing director has treated the entire lease as an operating lease on the grounds that the land has an indefinite economic life and so Limerick plc is not leasing the land over the majority of its economic life. The buildings have an estimated useful life of 42 years. Limerick plc depreciates buildings on a straight-line basis.

    Having made further enquiries you have established that the fair value of the leasehold interest is £1.3 million, of which £110,000 relates to land. The interest rate implicit in the lease is 10% pa. The present value of the minimum lease payments in relation to the buildings is £1,183,265, and in relation to the land is £107,570.

(2) On 1 January 2013 Limerick plc had purchased a recycling plant for £260,000, in order to process hazardous waste generated as a by-product of its other operations. The plant has an estimated useful life of five years after which it is expected to be superseded by new technology. The plant was capitalised at £260,000 and the managing director has correctly calculated depreciation based on that figure. However, he has not made any accounting entries in respect of the cost of decommissioning the plant at the end of the five year period of operation, which was a condition of the purchase, and which you have established is expected to cost £50,000.

(3) Limerick plc's building division buys land, and builds and fits out retail outlets which are then sold. On 1 January 2013 this division sold a plot of building land to an unconnected company for £750,000 when the market value of the land was £1 million. The plot had originally been acquired for £500,000. Limerick plc retains the right to build on this land until 31 December 2014 when it has the right to buy the plot back for £858,675. The managing director has recognised the profit on the sale of the land in the statement of profit or loss for the year ended 31 December 2013. You have seen emails between the directors of Limerick plc indicating that the company is likely to repurchase the land.

(4) The managing director included a note to the financial statements for the year ended 31 December 2013 regarding a contingent liability relating to a court case against Limerick plc which was in progress at the year end. On 15 February 2014 the judge in the case ruled against Limerick plc and the company was ordered to pay damages of £100,000 to the claimants and legal costs of £25,000. The managing director has not accrued for this amount in the financial statements for the year ended 31 December 2013 on the grounds that the judgment was not made until after the year end.

On 1 July 2013 Limerick plc made a 1 for 4 bonus issue of ordinary shares, and on 1 October 2013 issued a further 80,000 ordinary shares at full market price.

**Requirements**

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 31 December 2013, preparing all relevant calculations. Unless stated otherwise, an applicable discount rate is 7% pa. **(18 marks)**

(b) Using your results from Part (a) calculate revised earnings and basic earnings per share for the year ended 31 December 2013. Your answer should include an explanation of why the managing director was incorrect to base his calculation on the number of ordinary shares in issue at the beginning of the year. **(6 marks)**

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

**(29 marks)**

3. Laois plc has investments in two companies, Carlow Ltd and Kerry Ltd and recognises goodwill and non-controlling interest using the fair value method.

The draft, summarised statements of financial position of the three companies at 31 December 2013 are shown below:

| | **Laois plc** £ | **Carlow Ltd** £ | **Kerry Ltd** £ |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 2,687,000 | 2,196,000 | 591,800 |
| Investments | 1,760,000 | – | – |
| Goodwill | – | – | 24,000 |
| | 4,447,000 | 2,196,000 | 615,800 |
| **Current assets** | | | |
| Inventories | 193,200 | 53,700 | 159,000 |
| Trade and other receivables | 288,000 | 92,300 | 207,000 |
| Cash and cash equivalents | 15,800 | 12,400 | 1,100 |
| | 497,000 | 158,400 | 367,100 |
| **Total assets** | 4,944,000 | 2,354,400 | 982,900 |
| **EQUITY AND LIABILITIES** | | | |
| **Equity** | | | |
| Ordinary share capital (£1 shares) | 2,000,000 | 650,000 | 360,000 |
| Share premium account | 750,000 | 300,000 | – |
| Retained earnings | 1,645,400 | 1,078,600 | 176,000 |
| | 4,395,400 | 2,028,600 | 536,000 |
| **Current liabilities** | | | |
| Trade and other payables | 398,600 | 220,800 | 436,400 |
| Taxation | 150,000 | 105,000 | 10,500 |
| | 548,600 | 325,800 | 446,900 |
| **Total equity and liabilities** | 4,944,000 | 2,354,400 | 982,900 |

**Additional information:**

(1) Laois plc acquired 80% of the 650,000 ordinary shares of Carlow Ltd for cash of £1,560,000 on 1 January 2009 when the retained earnings of Carlow Ltd were £592,000. The fair values of the assets, liabilities and contingent liabilities of Carlow Ltd at this date were equal to their carrying amounts, with the exception of a property which had a fair value £200,000 in excess of its carrying amount. The property had a remaining useful life of 25 years on the date that Laois plc acquired its shares in Carlow Ltd. The fair value of the non-controlling interest in Carlow Ltd on 1 January 2009 was £350,000.

(2) On 1 January 2013, Laois plc acquired 60% of the 360,000 ordinary shares of Kerry Ltd. The consideration consisted of cash of £200,000 paid on 1 January 2013 and a further cash payment of £104,000, deferred until 1 January 2014. An appropriate discount rate is 4% pa.

On 1 January 2013 Kerry Ltd's retained earnings were £240,000 and its statement of financial position included goodwill of £30,000 which had arisen on the acquisition of a sole trader. In the year ended 31 December 2013 an impairment of £6,000 was recognised by Kerry Ltd in relation to this goodwill.

The fair values of the other assets, liabilities and contingent liabilities were equal to their carrying amounts. The fair value of the non-controlling interest in Kerry Ltd on 1 January 2013 was £235,000. A reassessment of Kerry Ltd's assets, liabilities and contingent liabilities and consideration transferred took place following acquisition and no adjustments were necessary.

(3) Early in December 2013 Kerry Ltd recorded goods purchased from Carlow Ltd for £50,000. At the year end Kerry Ltd held half of these goods in its inventories. Carlow Ltd makes all sales at cost plus a mark-up of 25%.

In addition, on 30 December 2013 Carlow Ltd had dispatched goods to Kerry Ltd and raised the relevant sales invoice. These goods were not received by Kerry Ltd until 3 January 2014 and the related purchase invoice was not accrued for as at the year end. These goods in transit had originally been purchased by Carlow Ltd at a cost of £12,000.

No intra-group balances had been settled by the year end.

**Requirement**

Prepare the consolidated statement of financial position of Laois plc as at 31 December 2013.

**(19 marks)**

PLEASE TURN OVER

4. Kildare plc is a UK listed company, and has a number of investments in other companies. The following information has been extracted from Kildare plc's draft consolidated financial statements for the year ended 31 December 2013:

**Consolidated statement of profit or loss (extract)**

| | **£** |
|---|---|
| Profit attributable to | |
| Owners of Kildare plc | 865,800 |
| Non-controlling interest | 256,700 |

**Consolidated statement of financial position (extract)**

| | **£** |
|---|---|
| Non-current assets | |
| Property, plant and equipment | 2,752,100 |
| Intangibles | 356,000 |

**Consolidated statement of cash flows (extract)**

| | **£** |
|---|---|
| Net cash used in investing activities | (50,600) |

Kildare plc's draft retained earnings (single entity) were £109,700 at 31 December 2013.

The following matters have not yet been accounted for in the draft consolidated financial statements:

(1) On 1 January 2007 Kildare plc had acquired 70% of the 100,000 ordinary 50p shares of Sligo Ltd for £225,000 when the retained earnings of Sligo Ltd were £158,900. The fair values of the assets, liabilities and contingent liabilities of Sligo Ltd at this date were equal to their carrying amounts, with the exception of inventory, which had a carrying amount of £29,000 but a fair value of £35,000. The inventory was sold in July 2007.

On 30 June 2013 Kildare plc sold its holding in Sligo Ltd for cash of £300,000, when Sligo Ltd had cash and cash equivalents of £1,500, crediting the sale proceeds to a suspense account. On 31 December 2013 the retained earnings of Sligo Ltd were £275,000, including a profit for 2013 of £75,000, which had accrued evenly over the year. As at 31 December 2012 Kildare plc had recognised cumulative impairment losses of £40,000 in respect of goodwill acquired in the business combination with Sligo Ltd.

Kildare plc has not consolidated any amounts in respect of Sligo Ltd for the year ended 31 December 2013. The group accounting policy is to recognise goodwill and non-controlling interest using the proportionate method.

(2) On 1 January 2012 Kildare plc had entered into a joint venture, purchasing 40% of the 200,000 ordinary £1 shares of Mayo Ltd at par. In the year ended 31 December 2013 Mayo Ltd made a profit of £48,400 (2012 £52,800) and made sales of £120,000 to Kildare plc, at a gross profit margin of 25%. Kildare plc held half of these goods in its inventory at 31 December 2013. On 31 December 2013 Kildare plc received a dividend of £10,000 from Mayo Ltd. The dividend was credited to a suspense account.

(3) During the year ended 31 December 2013, Kildare plc spent £275,000 on the research and development of a new product that is believed to be commercially viable, although it is still currently in its development stage. The £275,000 can be broken down as follows:

| | £ |
|---|---|
| Initial research costs | 50,000 |
| Evaluation of research findings | 20,000 |
| Patent registration costs | 5,000 |
| Specialised equipment needed for the development process | 90,000 |
| Qualifying development costs | 110,000 |
| | 275,000 |

Kildare plc has debited these amounts to a suspense account. The useful life of the specialised equipment is estimated to be three years. The equipment is to be depreciated on a straight-line basis over that period starting on 1 July 2013, when the equipment was first used in the development process.

**Requirements**

(a) Prepare revised extracts from Kildare plc's consolidated financial statements for the year ended 31 December 2013 showing profit attributable to the owners of Kildare plc and to the non-controlling interest, non-current assets, and net cash from investing activities. **(12 marks)**

(b) Describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of all of the above issues. **(4 marks)**

(c) Calculate the amount of Kildare plc's distributable profits at 31 December 2013, explaining your calculation. **(5 marks)**

**(21 marks)**

**NOTES: Ignore the impact of taxation on the above issues.**
**The preparation of disclosure notes is not required.**