PROFESSIONAL LEVEL EXAMINATION

MONDAY 8 SEPTEMBER 2014

(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.
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.

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 list of balances has been extracted from the nominal ledger of Barchetta Ltd at 31 March 2014.

	Note(s)	£
Sales		4,521,000
Purchases		3,379,100
Administrative expenses		804,700
Finance costs		83,060
Plant and machinery	(1), (2)	
Cost		60,500
Accumulated depreciation at 31 March 2013		21,780
Land and buildings	(1), (3)	
Cost (land £250,000)		2,230,000
Accumulated depreciation at 31 March 2013		144,950
Retained earnings at 31 March 2013		321,370
Ordinary share capital (£1 shares)	(5)	400,000
Share premium account at 31 March 2013		75,000
Bank loan (repayable 31 March 2016)		1,100,000
Cash at bank		6,800
Inventories at 31 March 2013		27,640
Trade and other receivables		85,400
Trade and other payables		93,100

The following additional information is available:

(1) Property, plant and equipment is measured under the cost model and depreciation is charged on a straight-line basis over the following estimated useful lives:

- Buildings – 50 years
- Plant and machinery – 5 years (unless otherwise specified)

Following a review of useful lives, plant acquired on 1 April 2012 for £22,000 was estimated to have a remaining useful life of eight years at 1 April 2013. Depreciation on property, plant and equipment should be presented in cost of sales.

(2) On 1 April 2013 a machine was acquired on a six-year lease, being its estimated useful life. Six annual amounts of £3,210 are payable, commencing on 31 March 2014. The machine could have been purchased on 1 April 2013 for £15,300, equivalent at that date to the present value of the minimum lease payments. By 31 March 2014 the only accounting entry made had been to credit cash with £3,210 and recognise an equal expense in cost of sales. The interest rate implicit in the lease is 7%.

(3) On 1 April 2013 Barchetta Ltd began construction on its new head office building, which was assessed as being a qualifying asset. Barchetta Ltd already had significant borrowings in place at 1 April 2013 which funded the construction. £300,000 was paid in advance to the contractor on 1 April 2013 and a second payment of £400,000 was paid on 1 January 2014. Barchetta Ltd had the following bank loans at 31 March 2013:

- £600,000 at an interest rate of 6.4% pa
- £500,000 at an interest rate of 7.5% pa

Accounting entries made were to recognise payments to the contractor as part of buildings costs and to charge interest on the loans to finance costs. Construction of the head office building was completed on 31 May 2014.

(4) Inventories at 31 March 2014 have been valued at cost of £35,850. However, in April 2014 a review was carried out to assess customer demand. The review identified that sales of one inventory line, the Camry, were extremely low because a competitor product had been launched in February 2014 and had been selling very well at a lower price than the Camry.

At 31 March 2014 Barchetta Ltd had 200 units of the Camry in its inventory. The unit cost of the Camry was £315 and its sales price was £550. Barchetta Ltd incurs selling costs of £25 per unit. It is now thought that the Camry will need to be considerably discounted and that a realistic selling price is £320 with the same selling costs.

(5) On 1 January 2014 Barchetta Ltd made a 1 for 5 bonus issue of ordinary shares. No accounting entries have been made to reflect this bonus issue. The share premium account should be utilised for such issues wherever possible.

(6) The income tax liability for the current year has been estimated at £84,500.

Requirement

Prepare the statement of profit or loss for Barchetta Ltd for the year ended 31 March 2014 and a statement of financial position as at that date, in a form suitable for publication.

Total: 20 marks

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

2. Impreza plc is a UK company operating in the automotive industry. The financial statements for the year ended 31 March 2014 have been drafted by your assistant, although there are a number of outstanding issues which need finalising. Extracts from the draft financial statements are:

	£
Profit before tax	5,349,000
Equity	6,547,000
Liabilities (current and non-current)	2,986,000

The finance director wishes to review the completed draft financial statements and has asked you, as financial controller, for assistance with the following outstanding issues:

(1) On 1 June 2013 Impreza plc issued 450,000 5% £1 irredeemable preference shares at par. When the cash was received the issue proceeds were credited to equity. No dividend had been paid on the preference shares by 31 March 2014 and no entries had been made in the accounting records in respect of dividends. The full annual dividend for the year was subsequently paid on 31 May 2014. It transpires that the dividend payment on the irredeemable preference shares is mandatory and if it is not paid it becomes cumulative.

(2) During the year Impreza plc spent £3,570,000 developing a new automotive control system. The full amount has been recognised as part of non-current assets as it is thought that the new technology will sell well and that, at present, Impreza plc has a competitive advantage in the market due to this new technology.

The first £350,000 of this expenditure was incurred investigating alternative processes and designs. The next £700,000 was used on early development of the control system. On 1 August 2013 the development was considered to be at a stage where funding was secured for its completion and it was assessed as being commercially viable.

The remaining expenditure was incurred between 1 August 2013 and the date when the new control system was ready for sale, being 31 March 2014. On 1 February 2014 an advertising campaign was launched to market the control system and customers could place advance orders from that date. £200,000 was spent on launch activities and is included in the total development expenditure above. By 31 March 2014 £320,000 of cash deposits had been received as advance orders from customers and the cash receipts have been recognised as part of revenue for the year ended 31 March 2014.

(3) Impreza plc has a number of supplier contracts. One supplier, Murano Ltd, attracted some adverse publicity. Impreza plc therefore decided to terminate its contract with Murano Ltd on 1 March 2014 when the contract still had 18 months to run. The contract has a termination clause which states that a one-off payment of £20,000 is payable to Murano Ltd if more than six months of the contract term remains on termination. No additional amounts had been paid to Murano Ltd under the contract by the year end.

(4) During the year ended 31 March 2014 Impreza plc sold parts to a customer, Samuri Ltd, for £50,000, after giving Samuri Ltd a 20% discount. Impreza plc gives discounts to many customers varying between 5% and 25%. Rio Yukon is the managing director of Impreza plc and his daughter Aerio owns 80% of the ordinary share capital of Samuri Ltd. At 31 March 2014 £30,000 was outstanding from Samuri Ltd as part of trade receivables.

(5) On 1 October 2013 Impreza plc sold 500 units of a combined software module and a two year technical support package to a new customer for £440,000. This sum was recognised as revenue because the cash had been received before the year end. The normal selling price of a module is £1,000 and the two year technical support package is sold for 10% of the module's unit selling price.

Requirements

(a) Explain the required IFRS financial reporting treatment of the five issues above in the financial statements for the year ended 31 March 2014, preparing all relevant calculations. **(24 marks)**

(b) Calculate revised figures for Impreza plc's profit before tax, equity and liabilities for inclusion in the financial statements for the year ended 31 March 2014. **(6 marks)**

(c) Explain how the requirements of IAS 18, Revenue, apply the accrual basis and the IASB's Conceptual Framework's recognition criteria. **(4 marks)**

Total: 34 marks

3. The following information has been extracted from Vitara plc's draft consolidated financial statements for the year ended 31 March 2014.

Consolidated statement of profit or loss (extracts)

	£
Depreciation charge	127,200
Profit after tax	496,500

Consolidated statement of financial position (extracts)

	£
Property, plant and equipment	1,156,300
Total assets	1,673,500

Consolidated statement of cash flows (extract)

	£
Net cash from investing activities	316,700

The draft consolidated financial statements of Vitara plc were incomplete due to the following outstanding issues:

(1) On 1 April 2013 Vitara plc stopped using equipment which had a carrying amount of £20,000 at that date and the equipment was advertised for sale. The equipment had originally cost £56,000 and had a useful life of seven years. The fair value of the equipment was estimated at £17,000 on 1 April 2013 and costs to sell were estimated at £500. The equipment is included in the property, plant and equipment figure above and depreciation was charged at the year end as the equipment had not been sold at this time.

(2) On 1 January 2014 a piece of plant was no longer used by Vitara plc due to obsolescence. The plant had been acquired on 1 April 2006 for £15,000 and was being depreciated at 10% pa on a straight-line basis. The plant is included in the property, plant and equipment figure above and a full year's depreciation was charged at the year end.

(3) Property, plant and equipment had been acquired during the year and was correctly included in the property, plant and equipment figure above. The amount included in the statement of cash flows was £280,000 being the increase in property, plant and equipment during the period (ie the carrying amount at 31 March 2014 less the carrying amount at 31 March 2013). There have been no disposals of property, plant and equipment during the period. All additions were acquired for cash except for the following:

- Early in 2014 Vitara plc acquired a subsidiary which had property, plant and equipment with a carrying amount of £151,200 at the date of its acquisition by Vitara plc. There was no difference between the carrying amount and fair value of these assets.

- On 1 April 2013 Vitara plc acquired a piece of plant with a fair value of £72,000 on two years' interest free credit. The plant was correctly included in the property, plant and equipment figure above and the correct finance cost was recognised in the statement of profit or loss.

(4) On 1 April 2013 equipment with a carrying amount of £24,500 was damaged in one of Vitara plc's warehouses, although the equipment is still being used and had an estimated value in use of £18,000 at that date. The equipment's fair value at 1 April 2013 was estimated at £18,500 with costs to sell of £800. At 1 April 2013 the equipment had an estimated remaining useful life of three years. No accounting entries have been made for the year ended 31 March 2014 in respect of this equipment.

(5) On 1 October 2013 Vitara plc purchased 90% of the ordinary share capital of Tredia Ltd. Extracts from the draft consolidated statement of profit or loss, excluding the acquisition of Tredia Ltd, for the year ended 31 March 2014 and the individual statement of profit or loss of Tredia Ltd for the same period are shown below:

	Vitara plc group (draft consolidated)	**Tredia Ltd**
	£	**£**
Revenue	1,395,600	356,000
Cost of sales	(793,200)	(193,500)
Gross profit	602,400	162,500

During the period from 1 October 2013 to 31 March 2014, Vitara plc sold goods to Tredia Ltd for £46,000, at a mark-up of 15% on cost. Half of these goods were still in Tredia Ltd's inventory at the year end.

Requirements

(a) Using the information in (1) to (4) above:

(i) prepare revised extracts from Vitara plc's consolidated statement of financial position as at 31 March 2014 and consolidated statement of cash flows for the year then ended showing property, plant and equipment, total assets and net cash from investing activities.

(ii) calculate the revised consolidated profit after tax and depreciation charge for the year ended 31 March 2014. **(12 marks)**

(b) Using the information in (5) above:

(i) prepare a revised extract from Vitara plc's consolidated statement of profit or loss for the year ended 31 March 2014, showing revenue and cost of sales; and

(ii) explain the required IFRS financial reporting treatment of the goods sold by Vitara plc to Tredia Ltd in the consolidated financial statements of Vitara plc for the year ended 31 March 2014. Make reference to the IASB's Conceptual Framework's qualitative characteristic of faithful representation, where relevant. **(7 marks)**

Total: 19 marks

PLEASE TURN OVER

4. Altima plc has investments in three companies, Fuego Ltd, Previa Ltd and Tacoma Ltd. A draft consolidated statement of financial position as at 31 March 2014 has been prepared by an interim manager, an ICAEW Chartered Accountant, who has little recent experience of consolidation.

Goodwill was not calculated for any acquisitions and 'Investments' consists of the purchase consideration for all three acquisitions. Figures for Tacoma Ltd were not available at the date the interim manager prepared the financial statements, therefore Tacoma Ltd was excluded from the draft consolidation (Fuego Ltd's figures were included). The only figure included for Previa Ltd in the draft consolidation is the acquisition cost.

Ciera Durango, the financial controller, who is also an ICAEW Chartered Accountant, is concerned that impairments in relation to all three investments have been identified. Ciera was involved in the investment decisions and is worried about the impact that showing these impairments might have on her current position at Altima plc.

An extract from the draft consolidated statement of financial position as prepared by the interim manager is shown below, together with the individual statement of financial position of Tacoma Ltd:

	Altima plc group (draft consolidated)	**Tacoma Ltd**
Non-current assets	**£**	**£**
Property, plant and equipment	2,140,050	496,000
Investments	1,583,750	–
	3,723,800	496,000
Current assets		
Inventories	191,300	49,700
Trade and other receivables	86,600	56,600
Cash and cash equivalents	55,000	5,450
	332,900	111,750
Total assets	4,056,700	607,750
Total liabilities	556,050	54,150

Additional information:

(1) Details of Altima plc's three investments are set out below:

	Fuego Ltd	**Previa Ltd**	**Tacoma Ltd**
Date of acquisition	1 April 2010	1 July 2011	1 April 2013
Percentage holding acquired	80%	40%	75%
Consideration	£820,000	£283,500	£480,250
Retained earnings at the date of acquisition	£236,700	£67,000	£126,800
Goodwill and non-controlling interest method	Proportionate basis	N/A	Fair value basis
Impairment of goodwill for year ended 31 March 2014	£15,000	–	£21,000
Impairment of investment for year ended 31 March 2014	–	£24,000	–

(2) The fair value of the non-controlling interest at the date of acquisition of Tacoma Ltd was £150,000. There had been no impairments of goodwill or investments prior to 1 April 2013.

(3) An extract from the equity section of the individual financial statements of the four companies at 31 March 2014 is shown below. No shares have been issued during the year by any of the four companies.

	Altima plc £	**Fuego Ltd £**	**Previa Ltd £**	**Tacoma Ltd £**
Ordinary share capital	1,500,000	420,000	300,000	400,000
Share premium account	500,000	160,000	–	50,000
Retained earnings	548,900	371,750	96,900	103,600
Total equity	2,548,900	951,750	396,900	553,600

(4) At the date of acquisition the fair values of the assets, liabilities and contingent liabilities of Fuego Ltd, Previa Ltd and Tacoma Ltd were equal to their carrying amounts, with the following exceptions:

(i) Previa Ltd had an item of plant which had a fair value £30,000 in excess of its carrying amount. The plant had a remaining useful life of six years at 1 July 2011, the date that Altima plc acquired its shares in Previa Ltd.

(ii) Fuego Ltd has internally generated brands which were not recognised in Fuego Ltd's own financial statements and the interim manager did not include them in the draft consolidated financial statements. An independent expert valued the brands at £150,000, with a useful life of five years, at 1 April 2010, the date of acquisition of Fuego Ltd by Altima plc.

(5) During the year ended 31 March 2014 Altima plc sold goods to Previa Ltd for £24,000 with a gross profit margin of 15%. At the year end Previa Ltd still held these goods in its inventories.

Requirements

(a) Prepare the consolidated statement of financial position of Altima plc as at 31 March 2014. **(18 marks)**

(b) Describe the UK GAAP financial reporting treatment of the goodwill recognised on the acquisition of Tacoma Ltd and calculate the impact of applying this UK GAAP treatment on the consolidated financial statements of Altima plc for the year ended 31 March 2014. **(5 marks)**

(c) Identify and explain any ethical issues arising for Ciera and the interim manager and explain any action Ciera should take. **(4 marks)**

Total: 27 marks