PROFESSIONAL LEVEL EXAMINATION

TUESDAY 6 JUNE 2017

(3 hours)

# FINANCIAL ACCOUNTING AND REPORTING IFRS

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.**

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|---|---|
| **IMPORTANT**<br><br>Question papers contain confidential information and must NOT be removed from the examination hall.<br><br>**DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK** | You MUST enter your candidate number in this box.<br><br>| | | | | |

1. The following trial balance has been extracted from the nominal ledger of Ballabriggs plc at 31 December 2016.

| | Note(s) | £ | £ |
|---|---|---|---|
| Purchases | | 741,800 | |
| Administrative expenses | | 211,500 | |
| Other operating costs | (1), (2), (3) | 98,700 | |
| Trade and other receivables | (4) | 208,850 | |
| Trade and other payables | | | 95,240 |
| 5% Irredeemable preference share capital (£1 shares) | (3) | | 200,000 |
| Retained earnings | (5) | | 101,210 |
| Ordinary share capital (£1 shares) | (5) | | 600,000 |
| Plant and machinery | (6) | | |
| Cost | | 1,212,920 | |
| Accumulated depreciation at 31 December 2015 | | | 305,600 |
| Share premium account | | | 60,000 |
| Cash at bank | | | 6,230 |
| Finance costs | | 560 | |
| Inventories at 31 December 2015 | | 85,600 | |
| Sales | | | 1,012,400 |
| Provision at 31 December 2015 | (7) | | 175,000 |
| Income tax | (8) | | 4,250 |
| | | 2,559,930 | 2,559,930 |

**Notes:**

(1) Ballabriggs plc rents all its properties under operating leases, with rental costs presented in other operating costs. On 1 July 2016 Ballabriggs plc moved into a new property (Valentine's Brook). The rent on Valentine's Brook is £1,000 per month, payable in advance on the first day of each month, for a ten year lease. The managing director negotiated zero payments for the first six months of the lease such that no rent was paid in 2016. As a result, rent for the last six months of the lease will be £2,000 per month. No rent has been charged in the trial balance above in respect of this property.

(2) On 31 December 2016 the company vacated its Canal Turn property. The lease on Canal Turn expires on 31 December 2019 and the rent is £20,000 annually, paid in arrears on 31 December. The conditions of the lease do not allow Ballabriggs plc to sublet the property. The rent paid on 31 December 2016 was debited to other operating costs and credited to cash.

(3) On 1 July 2016 Ballabriggs plc issued 200,000 5% £1 irredeemable preference shares at par. The payment of the dividend is at the discretion of Ballabriggs plc. The appropriate dividend of £5,000 was paid on 31 December 2016 and was debited to other operating costs and credited to cash.

(4) During 2016 a material error made in the previous year was identified, which has not yet been corrected. An invoice for £22,500 had been entered twice into the sales day book on 10 December 2015, and was duly posted twice to the relevant accounts. Due to a dispute over the amount owed by the customer neither the original invoice nor its duplicate had been paid by 31 December 2016 but the customer has now agreed to pay the outstanding £22,500.

(5) On 1 March 2016 Ballabriggs plc made a 1 for 5 bonus issue, debiting retained earnings and crediting ordinary share capital. The directors now wish to amend their original treatment and utilise the share premium account for this bonus issue as far as possible. An interim ordinary dividend of 5 pence per share was paid on 31 October 2016, debited to retained earnings and credited to cash.

(6) Plant and machinery is measured using the cost model and is depreciated using the reducing balance method at 10% pa. No depreciation charge has yet been recognised for the year ended 31 December 2016. Depreciation charges should be presented in cost of sales.

(7) The £175,000 provision in the trial balance relates to a legal case brought by an employee who had been injured at work. The amount of the provision at 31 December 2015 was based on the facts available at the time and had been expected to be settled within the next year. On 15 October 2016 the claim was settled out of court for cash of £100,000 and the payment was debited to administrative expenses and credited to cash.

(8) The income tax figure in the trial balance represents an overprovision for the year ended 31 December 2015. Ballabriggs plc's income tax liability for the year ended 31 December 2016 has been correctly estimated at £5,600 but is not included in the above trial balance.

(9) Inventories at 31 December 2016 cost £118,600.

**Requirements**

1.1 Prepare the following for the financial statements of Ballabriggs plc for the year ended 31 December 2016, in a form suitable for publication:

(a) a statement of profit or loss
(b) a statement of financial position
(c) a statement of changes in equity (a total column is **not** required).

**Note:** An appropriate discount rate is 7% pa.

**(22 marks)**

1.2 The IASB's Conceptual Framework refers to four enhancing qualitative characteristics: comparability, verifiability, timeliness and understandability. Explain how these enhancing qualitative characteristics help ensure that financial statements are useful to users. **(5 marks)**

**Total: 27 marks**

2. You are an ICAEW Chartered Accountant working as a temporary employee at Papillon Ltd. The managing director has asked you to check and redraft the following disclosure note as he is concerned that it may contain errors. The note was prepared by Anthony, the finance director of Papillon Ltd, who is also an ICAEW Chartered Accountant. All the directors of Papillon Ltd are entitled to a bonus based on a percentage of the profit for the year.

| | **Land and buildings £** | **Plant and equipment £** |
|---|---|---|
| **Cost/valuation** | | |
| At 1 January 2016 | 1,250,600 | 526,800 |
| Additions | – | 75,600 |
| Revaluation | 100,000 | – |
| At 31 December 2016 | 1,350,600 | 602,400 |
| | | |
| **Accumulated depreciation** | | |
| At 1 January 2016 | 345,600 | 316,000 |
| Charge for the year | 25,100 | 60,240 |
| At 31 December 2016 | 370,700 | 376,240 |
| | | |
| **Carrying amount** | | |
| At 31 December 2016 | 979,900 | 226,160 |
| At 31 December 2015 | 905,000 | 210,800 |

**Notes:**

(1) Land and buildings are carried under the revaluation model and plant and equipment is carried under the cost model. The depreciation charges in the table above were calculated using the depreciation methods in place at 31 December 2015.

(2) The revaluation during the year related to a piece of land which had previously been valued in 2014 at £350,000. The land had cost £332,600 in 2012. The land was revalued for the first time in 2014 when the excess of valuation over carrying amount was credited to the revaluation surplus.

The revaluation during the year was based on a report commissioned by Anthony from Bobbyjo LLP, a firm of chartered surveyors wholly-owned by Anthony's wife. The other directors are unaware that Bobbyjo LLP is owned by Anthony's wife. The report showed the value for land at £450,000 on 31 December 2016. Bobbyjo LLP invoiced Papillon Ltd £1,000 for the report in January 2017 and Papillon Ltd accrued for this invoice at 31 December 2016. Anthony recognised the revaluation increase as income in the statement of profit or loss for the year ended 31 December 2016 on the grounds that in early 2017 the directors decided to sell this property.

The land was sold in February 2017 for only £325,500, following the discovery in early January 2017 that the land had been contaminated in the previous year and needed remedial work to restore it to a useable condition. The land did not meet the definition of a held for sale asset at 31 December 2016.

(3) On 1 January 2016 Papillon Ltd entered into a three-year finance lease for equipment with a fair value of £62,000. An initial lease payment of £16,000 was made on 1 January 2016. Three further annual instalments of £16,000 each are due in arrears, the first of which was paid on 31 December 2016. The machine has a useful life of four years. The present value of the minimum lease payments at 1 January 2016, based on an annual interest rate of 5%, is £59,571. Anthony debited the actual lease payments made in the year to plant and equipment, and they are included in additions in the table above.

(4) The only other figure included in additions to plant and equipment was a machine purchased on 1 September 2016.

(5) The following have not been reflected in the table above:

- A machine was sold for scrap on 1 January 2016. The machine had cost £15,000 on 1 January 2009 and was sold for cash of £800. Anthony credited the cash received to revenue.

- On 1 January 2016 the directors decided to change the depreciation method for plant and equipment from a straight-line basis over a ten year useful life to 20% reducing balance as this is considered to be a better reflection of the consumption of economic benefits.

Anthony discovered that you have been asked to redraft the property, plant and equipment note. He said that if you can overlook any errors made he will recommend you for a permanent job with Papillon Ltd.

**Requirements**

2.1 Explain how the matters described in Note (2) above should have been dealt with in Papillon Ltd's financial statements for the year ended 31 December 2016. **(8 marks)**

2.2 Redraft the disclosure note showing the movements on property, plant and equipment for inclusion in Papillon Ltd's financial statements for the year ended 31 December 2016. A total column is **not** required, nor are you required to provide any additional narrative disclosures. **(8 marks)**

2.3 In so far as the information is available, prepare extracts from Papillon Ltd's statement of cash flows for the year ended 31 December 2016 showing:

- cash flows from investing activities;
- cash flows from financing activities; and
- the reconciliation of profit before tax to net cash from operating activities.

**(4 marks)**

2.4 Discuss the ethical issues arising for you and Anthony from the above scenario and the actions that you should take. **(5 marks)**

**Total: 25 marks**

3. On 1 January 2016 Corbiere plc held a number of insignificant investments in equity instruments that do not have a quoted price and are therefore carried at cost. During the year ended 31 December 2016 Corbiere plc acquired a subsidiary company, Seagram Ltd, and an associate, Minnehoma Ltd. The draft, summarised statements of financial position of Corbiere plc and its subsidiary company at 31 December 2016 are shown below:

| | **Corbiere plc £** | **Seagram Ltd £** |
|---|---|---|
| **ASSETS** | | |
| **Non-current assets** | | |
| Property, plant and equipment | 1,162,800 | 321,390 |
| Investments | 774,500 | – |
| | 1,937,300 | 321,390 |
| **Current assets** | | |
| Inventories | 523,600 | 398,500 |
| Trade and other receivables | 401,860 | 203,650 |
| Cash and cash equivalents | 52,600 | 1,100 |
| | 978,060 | 603,250 |
| **Total assets** | 2,915,360 | 924,640 |
| **EQUITY AND LIABILITIES** | | |
| **Equity** | | |
| Ordinary share capital (£1 shares) | 600,000 | 200,000 |
| Share premium account | 100,000 | 50,000 |
| Retained earnings | 1,776,260 | 502,540 |
| | 2,476,260 | 752,540 |
| **Current liabilities** | | |
| Trade and other payables | 385,200 | 148,500 |
| Income tax | 53,900 | 23,600 |
| | 439,100 | 172,100 |
| **Total equity and liabilities** | 2,915,360 | 924,640 |

**Additional information:**

(1) Corbiere plc acquired 80% of the ordinary shares of Seagram Ltd on 1 July 2016 when the retained earnings of Seagram Ltd were £404,000. The consideration was made up of cash of £650,000 paid on 1 July 2016 and a further cash payment of £147,000, deferred until 1 July 2017. No accounting entries have been made in respect of the deferred cash payment. An appropriate discount rate is 5% pa. Corbiere plc recognises goodwill and non-controlling interests using the fair value method.

The fair values of the assets, liabilities and contingent liabilities at 1 July 2016 were equal to their carrying amounts with the exception of a machine which had a fair value £60,000 in excess of its carrying amount. This machine had a six year remaining useful life on 1 July 2016.

The fair value of the non-controlling interest in Seagram Ltd on 1 July 2016 was estimated at £150,000.

(2) In December 2016 Seagram Ltd sold goods to Corbiere plc for £16,000. Corbiere plc still held half of these goods in its inventories on 31 December 2016. Seagram Ltd marks up all goods by 25%.

On 31 December 2016 Seagram Ltd's trade receivables still included the £16,000 due from Corbiere plc. However, Corbiere plc's trade payables only included £11,000 in respect of this transaction, as it had made a payment of £5,000 to Seagram Ltd on 31 December 2016.

(3) On 1 January 2016 Corbiere plc acquired 30% of the ordinary shares in Minnehoma Ltd for cash of £120,500, which gave Corbiere plc significant influence over Minnehoma Ltd. At that date a property owned by Minnehoma Ltd had a fair value £50,000 in excess of its carrying amount. This property had a remaining useful life of 20 years on 1 January 2016.

In the year ended 31 December 2016 Minnehoma Ltd made a profit of £56,800, out of which it paid a dividend of £20,000 on 30 October 2016. Corbiere plc debited the dividend received to cash and credited it to investments.

**Requirements**

3.1 Prepare the consolidated statement of financial position of Corbiere plc as at 31 December 2016. **(19 marks)**

3.2 Calculate Corbiere plc's distributable profit at 31 December 2016, explaining your calculation. **(3 marks)**

3.3 Describe any differences between IFRS and UK GAAP in respect of the calculation and subsequent treatment of goodwill arising on consolidation. **(4 marks)**

**Total: 26 marks**

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4. The following matters need to be dealt with to finalise the financial statements of Bindaree Ltd for the year ended 31 December 2016.

(1) On 1 January 2016 Bindaree Ltd borrowed £500,000 at 4% pa, repayable in two years' time, to help fund the construction of a new factory. The funds were immediately placed on deposit at interest of 3% pa. On 1 February 2016 the company purchased land for £200,000 but construction did not start until 1 July 2016, when Bindaree Ltd paid the construction company £100,000. Work on the factory was still in progress on 31 December 2016 when Bindaree Ltd paid a further £100,000 to the construction company. All relevant interest was received and paid on 31 December 2016.

(2) On 1 January 2016 Bindaree Ltd issued 2,000 4% £100 convertible bonds. Each bond is redeemable in three years' time at par or can be converted into 100 £1 ordinary shares. Interest is payable annually in arrears. The market rate of interest for similar bonds without the conversion option is 5% pa. The annual interest on the bonds was paid on 31 December 2016.

(3) Bindaree Ltd also prepares consolidated financial statements. On 1 January 2016 Bindaree Ltd purchased 70% of the ordinary shares of Kilmore Ltd. The fair value of the consideration has been correctly calculated at £252,000. Kilmore Ltd's statement of financial position as at 31 December 2015 included net assets of £679,800. Bindaree Ltd recognises goodwill and non-controlling interests using the proportionate method. The following information may be relevant to calculating goodwill on acquisition:

- Kilmore Ltd is expected to make losses for the next few years. The directors of Bindaree Ltd have estimated that losses of £750,000 will be made before Kilmore Ltd returns to profit. In order to improve the performance of Kilmore Ltd the directors of Bindaree Ltd intend to reorganise Kilmore Ltd. The implementation of this reorganisation plan is expected to cost £100,000, an amount which is not included in the losses above.

- The notes to Kilmore Ltd's financial statements for the year ended 31 December 2015 include reference to a contingent liability disclosed in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets. This relates to a legal claim brought against the company in October 2015, the outcome of which is dependent on a future court case. The note states that it is estimated that an amount of £500,000 may become payable. The fair value of this contingent liability as at 1 January 2016 was £200,000 and this is considered to be a reliable estimate.

- Kilmore Ltd's non-current assets at 31 December 2016 do not include any amount for the company's customer list. An independent valuation attributed a value of £50,000 to this list at 1 January 2016.

**Requirement**

Explain the required IFRS financial reporting treatment of matters (1) to (3) in the consolidated financial statements for the year ended 31 December 2016, preparing all relevant calculations.

**Total: 22 marks**