Fundamentals Level – Skills Module

Financial Reporting (Irish)

Tuesday 14 December 2010

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F7 (IRL)

ACCA

ALL FIVE questions are compulsory and MUST be attempted

1 On 1 June 2010, Premier acquired 80% of the equity share capital of Sanford. The consideration consisted of two elements: a share exchange of three shares in Premier for every five acquired shares in Sanford and the issue of a €100 6% loan note for every 500 shares acquired in Sanford. The share issue has not yet been recorded by Premier, but the issue of the loan notes has been recorded. At the date of acquisition shares in Premier had a market value of €5 each. The summarised draft financial statements of both companies are:

Profit and loss accounts for the year ended 30 September 2010

	Premier €'000	Sanford €'000
Turnover	92,500	45,000
Cost of sales	(70,500)	(36,000)
Gross profit	22,000	9,000
Distribution costs	(2,500)	(1,200)
Administrative expenses	(5,500)	(2,400)
Finance costs	(100)	nil
Profit before tax	13,900	5,400
Corporation tax	(3,900)	(1,500)
Profit for the year	10,000	3,900

Balance sheets as at 30 September 2010

Fixed assets		
Tangible fixed assets	25,000	13,900
Investments	1,800	nil
	26,800	13,900
Current assets	12,500	2,400
Creditors: amounts falling due within one year:	(10,000)	(6,800)
Creditors: amounts falling due after more than one year:		
6% loan notes	(3,000)	nil
	26,300	9,500
Capital and reserves		
Equity shares of €1 each	12,000	5,000
Land revaluation reserve – 30 September 2009 (note (i))	1,500	nil
Other equity reserve – 30 September 2009 (note (iv))	500	nil
Profit and loss account	12,300	4,500
	26,300	9,500

The following information is relevant:

(i) At the date of acquisition, the fair values of Sanford's assets were equal to their carrying amounts with the exception of its property. This had a fair value of €1·2 million **below** its carrying amount. This would lead to a **reduction** of the depreciation charge (in cost of sales) of €50,000 in the post-acquisition period. Sanford has not incorporated this value change into its own financial statements.

Premier's group policy is to revalue all properties to current value at each year end. On 30 September 2010, the value of Sanford's property was unchanged from its value at acquisition, but the land element of Premier's property had increased in value by €500,000, although this has not yet been recorded by Premier.

(ii) Sales from Sanford to Premier throughout the year ended 30 September 2010 had consistently been €1 million per month. Sanford made a mark-up on cost of 25% on these sales. Premier had €2 million of stock (at cost to Premier) that had been supplied in the post-acquisition period by Sanford as at 30 September 2010.

(iii) Premier had a trade creditor balance owing to Sanford of €350,000 as at 30 September 2010. This agreed with the corresponding trade debtor in Sanford's books.

(iv) Premier's investments include some available-for-sale investments that have increased in value by €300,000 during the year. The other equity reserve relates to these investments and is based on their value as at 30 September 2009. There were no acquisitions or disposals of any of these investments during the year ended 30 September 2010.

(v) Consolidated goodwill is amortised over a five-year life. Goodwill has not been impaired as at 30 September 2010.

Required:

(a) Prepare the consolidated profit and loss account for Premier for the year ended 30 September 2010.

(b) Prepare the consolidated balance sheet for Premier as at 30 September 2010.

The following mark allocation is provided as guidance for this question:

(a) 7½ marks
(b) 17½ marks

(25 marks)

2 The following trial balance relates to Cavern as at 30 September 2010:

	€'000	€'000
Equity shares of 20 cent each (note (i))		50,000
8% loan note (note (ii))		30,600
Profit and loss account – 30 September 2009		12,100
Other equity reserve		3,000
Revaluation reserve		7,000
Share premium		11,000
Land and building at valuation – 30 September 2009:		
Land (€7 million) and building (€36 million) (note (iii))	43,000	
Plant and equipment at cost (note (iii))	67,400	
Accumulated depreciation plant and equipment – 30 September 2009		13,400
Available-for-sale investments (note (iv))	15,800	
Stock at 30 September 2010	19,800	
Trade debtors	29,000	
Bank		4,600
Deferred tax (note (v))		4,000
Trade creditors		21,700
Turnover		182,500
Cost of sales	128,500	
Administrative expenses (note (i))	25,000	
Distribution costs	8,500	
Loan note interest paid	2,400	
Bank interest	300	
Investment income		700
Current tax (note (v))	900	
	340,600	340,600

The following notes are relevant:

(i) Cavern has accounted for a fully subscribed rights issue of equity shares made on 1 April 2010 of one new share for every four in issue at 42 cent each. The company paid ordinary dividends of 3 cent per share on 30 November 2009 and 5 cent per share on 31 May 2010. The dividend payments are included in administrative expenses in the trial balance.

(ii) The 8% loan note was issued on 1 October 2008 at its nominal (face) value of €30 million. The loan note will be redeemed on 30 September 2012 at a premium which gives the loan note an effective finance cost of 10% per annum.

(iii) Fixed assets:
Cavern revalues its land and building at the end of each accounting year. At 30 September 2010 the relevant value to be incorporated into the financial statements is €41·8 million. The building's remaining life at the beginning of the current year (1 October 2009) was 18 years. Cavern does not make an annual transfer from the revaluation reserve to the profit and loss account in respect of the realisation of the revaluation surplus.

Plant and equipment includes an item of plant bought for €10 million on 1 October 2009 that will have a 10-year life (using straight-line depreciation with no residual value). Production using this plant involves toxic chemicals which will cause decontamination costs to be incurred at the end of its life. The present value of these costs using a discount rate of 10% at 1 October 2009 was €4 million. Cavern has not provided any amount for this future decontamination cost. All other plant and equipment is depreciated at 12·5% per annum using the reducing balance method.

No depreciation has yet been charged on any fixed assets for the year ended 30 September 2010. All depreciation is charged to cost of sales.

(iv) The available-for-sale investments held at 30 September 2010 had a fair value of €13·5 million. There were no acquisitions or disposals of these investments during the year ended 30 September 2010.

(v) A provision for corporation tax for the year ended 30 September 2010 of €5·6 million is required. The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September 2009. At 30 September 2010 the tax written down value of Cavern's net assets was €15 million less than their carrying amounts. The corporation tax rate of Cavern is 25%.

Required:

(a) Prepare the profit and loss account for Cavern for the year ended 30 September 2010.

(b) Prepare the statement of the movement on shareholders' funds for Cavern for the year ended 30 September 2010.

(c) Prepare the balance sheet of Cavern as at 30 September 2010.

Notes to the financial statements are not required.

The following mark allocation is provided as guidance for this question:

(a) 10 marks
(b) 6 marks
(c) 9 marks

(25 marks)

3 Hardy is a public listed manufacturing company. Its summarised financial statements for the year ended 30 September 2010 (and 2009 comparatives) are:

Profit and loss accounts for the year ended 30 September:

	2010 €'000	2009 €'000
Turnover	29,500	36,000
Cost of sales	(25,500)	(26,000)
Gross profit	4,000	10,000
Distribution costs	(1,050)	(800)
Administrative expenses	(4,900)	(3,900)
Investment income	50	200
Finance costs	(600)	(500)
Profit (loss) before taxation	(2,500)	5,000
Corporation tax (expense) relief	400	(1,500)
Profit (loss) for the year	(2,100)	3,500

Balance sheets as at 30 September:

	€'000	2010 €'000	€'000	2009 €'000
Fixed assets				
Tangible fixed assets		17,600		24,500
Investments at fair value through profit or loss		2,400		4,000
		20,000		28,500
Current assets				
Stock and work-in-progress	2,200		1,900	
Trade debtors	2,200		2,800	
Tax asset	600		nil	
Bank	1,200		100	
	6,200		4,800	
Creditors: amounts falling due within one year:				
Trade creditors	3,400		2,800	
Corporation tax payable	nil		1,800	
	(3,400)		(4,600)	
Net current assets		2,800		200
Total assets less current liabilities		22,800		28,700
Creditors: amounts falling due after more than one year:				
Bank loan		(4,000)		(5,000)
Provisions for liabilities				
Deferred tax		(1,200)		(700)
		17,600		23,000
Capital and reserves				
Equity shares of €1 each		13,000		12,000
Share premium		1,000		nil
Revaluation reserve		nil		4,500
Profit and loss account		3,600		6,500
		17,600		23,000

The following information has been obtained from the Chairman's Statement and the notes to the financial statements:

'Market conditions during the year ended 30 September 2010 proved very challenging due largely to difficulties in the global economy as a result of a sharp recession which has led to steep falls in share prices and property values. Hardy has not been immune from these effects and our properties have suffered impairment losses of €6 million in the year.'

The excess of these losses over previous surpluses has led to a charge to cost of sales of €1·5 million in addition to the normal depreciation charge.

'Our portfolio of investments at fair value through profit or loss has been 'marked to market' (fair valued) resulting in a loss of €1·6 million (included in administrative expenses).'

There were no additions to or disposals of fixed assets during the year.

'In response to the downturn the company has unfortunately had to make a number of employees redundant incurring severance costs of €1·3 million (included in cost of sales) and undertaken cost savings in advertising and other administrative expenses.'

'The difficulty in the credit markets has meant that the finance cost of our variable rate bank loan has increased from 4·5% to 8%. In order to help cash flows, the company made a rights issue during the year and reduced the dividend per share by 50%.'

'Despite the above events and associated costs, the Board believes the company's underlying performance has been quite resilient in these difficult times.'

Required:

Analyse and discuss the financial performance and position of Hardy as portrayed by the above financial statements and the additional information provided.

Your analysis should be supported by profitability, liquidity and gearing and other appropriate ratios (up to 10 marks available).

(25 marks)

4 **(a)** FRS 18 *Accounting Policies* contains guidance on the use of accounting policies and accounting estimates.

Required:

Explain the basis on which the management of a company must select its accounting policies and distinguish, with an example, between changes in accounting policies and changes in accounting estimates. (5 marks)

(b) The directors of Tunshill are disappointed by the draft profit for the year ended 30 September 2010. The company's assistant accountant has suggested two areas where she believes the reported profit may be improved:

(i) A major item of plant that cost €20 million to purchase and install on 1 October 2007 is being depreciated on a straight-line basis over a five-year period (assuming no residual value). The plant is wearing well and at the beginning of the current year (1 October 2009) the production manager believed that the plant was likely to last eight years in total (i.e. from the date of its purchase). The assistant accountant has calculated that, based on an eight-year life (and no residual value) the accumulated depreciation of the plant at 30 September 2010 would be €7·5 million (€20 million/8 years x 3). In the financial statements for the year ended 30 September 2009, the accumulated depreciation was €8 million (€20 million/5 years x 2). Therefore, by adopting an eight-year life, Tunshill can avoid a depreciation charge in the current year and instead credit €0·5 million (€8 million – €7·5 million) to the profit and loss account in the current year to improve the reported profit. (5 marks)

(ii) Most of Tunshill's competitors value their stock using the average cost (AVCO) basis, whereas Tunshill uses the first in first out (FIFO) basis. The value of Tunshill's stock at 30 September 2010 (on the FIFO basis) is €20 million, however on the AVCO basis it would be valued at €18 million. By adopting the same method (AVCO) as its competitors, the assistant accountant says the company would improve its profit for the year ended 30 September 2010 by €2 million. Tunshill's stock at 30 September 2009 was reported as €15 million, however on the AVCO basis it would have been reported as €13·4 million. (5 marks)

Required:

Comment on the acceptability of the assistant accountant's suggestions and quantify how they would affect the financial statements if they were implemented under RoI GAAP. Ignore taxation. (10 marks as indicated)

(15 marks)

5 Manco has been experiencing substantial losses at its furniture making operation which is treated as a separate reporting segment. The company's year end is 30 September. At a meeting on 1 July 2010 the directors decided to close down the furniture making operation on 31 January 2011 and then dispose of its fixed assets on a piecemeal basis. Affected employees and customers were informed of the decision and a press announcement was made immediately after the meeting. The directors have obtained the following information in relation to the closure of the operation:

(i) On 1 July 2010, the factory had a carrying amount of €3·6 million and is expected to be sold for net proceeds of €5 million. On the same date the plant had a carrying amount of €2·8 million, but it is anticipated that it will only realise net proceeds of €500,000.

(ii) Of the employees affected by the closure, the majority will be made redundant at cost of €750,000, the remainder will be retrained at a cost of €200,000 and given work in one of the company's other operations.

(iii) Trading losses from 1 July to 30 September 2010 are expected to be €600,000 and from this date to the closure on 31 January 2011 a further €1 million of trading losses are expected.

Required:

Explain how the decision to close the furniture making operation should be treated in Manco's financial statements for the years ending 30 September 2010 and 2011. Your answer should quantify the amounts involved.

(10 marks)

End of Question Paper