

Fundamentals Level – Skills Module

Financial Reporting (Malaysia)

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 (MYS)

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black square.

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- 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 RM100 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 RM5 each and the shares of Sanford had a stock market price of RM3.50 each. Below are the summarised draft financial statements of both companies.

Statements of comprehensive income for the year ended 30 September 2010

	Premier	Sanford
	RM'000	RM'000
Revenue	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
Income tax expense	(3,900)	(1,500)
Profit for the year	10,000	3,900
Other comprehensive income:		
Gain on revaluation of land (note (i))	500	nil
Total comprehensive income	10,500	3,900

Statements of financial position as at 30 September 2010

Assets		
Non-current assets		
Property, plant and equipment	25,500	13,900
Investments	1,800	nil
	27,300	13,900
Current assets	12,500	2,400
Total assets	39,800	16,300
Equity and liabilities		
Equity		
Equity shares of RM1 each	12,000	5,000
Land revaluation reserve – 30 September 2010 (note (i))	2,000	nil
Other equity reserve – 30 September 2009 (note (iv))	500	nil
Retained earnings	12,300	4,500
	26,800	9,500
Non-current liabilities		
6% loan notes	3,000	nil
Current liabilities	10,000	6,800
Total equity and liabilities	39,800	16,300

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 RM1.2 million **below** its carrying amount. This would lead to a **reduction** of the depreciation charge (in cost of sales) of RM50,000 in the post-acquisition period. Sanford has not incorporated this value change into its entity 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 RM500,000 as shown in other comprehensive income.

- (ii) Sales from Sanford to Premier throughout the year ended 30 September 2010 had consistently been RM1 million per month. Sanford made a mark-up on cost of 25% on these sales. Premier had RM2 million (at cost to Premier) of inventory that had been supplied in the post-acquisition period by Sanford as at 30 September 2010.
- (iii) Premier had a trade payable balance owing to Sanford of RM350,000 as at 30 September 2010. This agreed with the corresponding receivable in Sanford's books.
- (iv) Premier's investments include some available-for-sale investments that have increased in value by RM300,000 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) Premier's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Sanford's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.
- (vi) There has been no impairment of consolidated goodwill.

Required:

- (a) Prepare the consolidated statement of comprehensive income for Premier for the year ended 30 September 2010.**
- (b) Prepare the consolidated statement of financial position for Premier as at 30 September 2010.**

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

- (a) 9 marks
- (b) 16 marks

(25 marks)

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

	RM'000	RM'000
Equity shares of 20 sen each (note (i))		50,000
8% loan note (note (ii))		30,600
Retained earnings – 30 September 2009		12,100
Other equity reserve		3,000
Revaluation reserve		7,000
Share premium		11,000
Land and buildings at valuation – 30 September 2009:		
Land (RM7 million) and building (RM36 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	
Inventory at 30 September 2010	19,800	
Trade receivables	29,000	
Bank		4,600
Deferred tax (note (v))		4,000
Trade payables		21,700
Revenue		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 sen each. The company paid ordinary dividends of 3 sen per share on 30 November 2009 and 5 sen 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 RM30 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) Non-current 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 RM41.8 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 retained earnings in respect of the realisation of the revaluation surplus. Ignore deferred tax on the revaluation surplus.
- Plant and equipment includes an item of plant bought for RM10 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 RM4 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 non-current asset 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 RM13.5 million. There were no acquisitions or disposals of these investments during the year ended 30 September 2010.

- (v) A provision for income tax for the year ended 30 September 2010 of RM5.6 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 base of Cavern's net assets was RM15 million less than their carrying amounts. The movement on deferred tax should be taken to the income statement. The income tax rate of Cavern is 25%.

Required:

- (a) **Prepare the statement of comprehensive income for Cavern for the year ended 30 September 2010.**
- (b) **Prepare the statement of changes in equity for Cavern for the year ended 30 September 2010.**
- (c) **Prepare the statement of financial position 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) 11 marks
(b) 5 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:

Income statements for the year ended 30 September:

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

Statements of financial position as at 30 September:

	2010	2009
	RM'000	RM'000
Assets		
Non-current assets		
Property, plant and equipment	17,600	24,500
Investments at fair value through profit or loss	2,400	4,000
	<u>20,000</u>	<u>28,500</u>
Current assets		
Inventory and work-in-progress	2,200	1,900
Trade receivables	2,200	2,800
Tax asset	600	nil
Bank	1,200	100
	<u>6,200</u>	<u>4,800</u>
Total assets	<u>26,200</u>	<u>33,300</u>
Equity and liabilities		
Equity		
Equity shares of RM1 each	13,000	12,000
Share premium	1,000	nil
Revaluation reserve	nil	4,500
Retained earnings	3,600	6,500
	<u>17,600</u>	<u>23,000</u>
Non-current liabilities		
Bank loan	4,000	5,000
Deferred tax	1,200	700
Current liabilities		
Trade payables	3,400	2,800
Current tax payable	nil	1,800
	<u>3,400</u>	<u>4,600</u>
Total equity and liabilities	<u>26,200</u>	<u>33,300</u>

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 RM6 million in the year.'

The excess of these losses over previous surpluses has led to a charge to cost of sales of RM1.5 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 RM1.6 million (included in administrative expenses).'

There were no additions to or disposals of non-current 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 RM1.3 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 108 *Accounting Policies, Changes in Accounting Estimates and Errors* contains guidance on the use of accounting policies and accounting estimates.

Required:

Explain the basis on which the management of an entity 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 RM20 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 RM7.5 million (RM20 million/8 years x 3). In the financial statements for the year ended 30 September 2009, the accumulated depreciation was RM8 million (RM20 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 RM0.5 million (RM8 million – RM7.5 million) to the income statement in the current year to improve the reported profit. (5 marks)

(ii) Most of Tunshill's competitors value their inventory using the average cost (AVCO) basis, whereas Tunshill uses the first in first out (FIFO) basis. The value of Tunshill's inventory at 30 September 2010 (on the FIFO basis) is RM20 million, however on the AVCO basis it would be valued at RM18 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 RM2 million. Tunshill's inventory at 30 September 2009 was reported as RM15 million, however on the AVCO basis it would have been reported as RM13.4 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 FRS. Ignore taxation.

(15 marks)

- 5 Manco has been experiencing substantial losses at its furniture making operation which is treated as a separate operating 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 non-current 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 RM3.6 million and is expected to be sold for net proceeds of RM5 million. On the same date the plant had a carrying amount of RM2.8 million, but it is anticipated that it will only realise net proceeds of RM500,000.
 - (ii) Of the employees affected by the closure, the majority will be made redundant at cost of RM750,000, the remainder will be retrained at a cost of RM200,000 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 RM600,000 and from this date to the closure on 31 January 2011 a further RM1 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