Answers

1 Consolidated statement of financial position of Pacemaker as at 31 March 2009:

	$million	$million
Non-current assets		
Tangible		
Property, plant and equipment (w (i))		818
Intangible		
Goodwill (w (ii))		23
Brand (25 – 5 (25/10 x 2 years post acq amortisation))		20
Investments		
Investment in associate (w (iii))		144
Other available for sale investments (82 + 37)		119
		1,124
Current assets		
Inventory (142 + 160 – 16 URP (w (iv)))	286	
Trade receivables (95 + 88)	183	
Cash and bank (8 + 22)	30	499
Total assets		1,623
Equity and liabilities		
Equity attributable to the parent		
Equity shares (500 + 75 (w (iii)))		575
Share premium (100 + 45 (w (iii))	145	
Retained earnings (w (iv))	247	392
		967
Non-controlling interest (w (v))		91
Total equity		1,058
Non-current liabilities		
10% loan notes (180 + 20)		200
Current liabilities (200 + 165)		365
Total equity and liabilities		1,623

Workings (all figures in $ million)
The investment in Syclop represents 80% (116/145) of its equity and is likely to give Pacemaker control thus Syclop should be consolidated as a subsidiary. The investment in Vardine represents 30% (30/100) of its equity and is normally treated as an associate that should be equity accounted.

(i)	Property, plant and equipment		
	Pacemaker		520
	Syclop		280
	Fair value property (82 – 62)		20
	Post-acquisition depreciation (2 years) (20 x 2/20 years)		(2)
			818
(ii)	Goodwill in Syclop:		
	Investment at cost – cash		210
	– loan note (116/200 x $100)		58
	Cost of the controlling interest		268
	Fair value of non-controlling interest (from question)		65
	Equity shares	145	
	Pre-acquisition profit	120	
	Fair value adjustments – property (w (i))	20	
	– brand	25	
	Fair value of net assets at acquisition		(310)
	Goodwill		23

(iii) Investment in associate:

	$million
Investment at cost (75 x $1·60)	120
Share of post-acquisition profit ((100 – 20) x 30%)	24
	144

The purchase consideration by way of a share exchange (75 million shares in Pacemaker for 30 million shares in Vardine) would be recorded as an increase in share capital of $75 million ($1 nominal value) and an increase in share premium of $45 million (75 million x $0·60).

(iv) Consolidated retained earnings:

Pacemaker's retained earnings	130
Syclop's post-acquisition profits (130 x 80% see below)	104
Gain on investments – Pacemaker (see below)	5
Vardine's post-acquisition profits (w (iii))	24
URP in Inventories (56 x 40/140)	(16)
	247

Syclop's retained earnings:	
Post-acquisition (260 – 120)	140
Additional depreciation/amortisation (2 + 5)	(7)
Loss on available for sale investments (40 – 37)	(3)
Adjusted post-acquisition profits	130

Gain on the value of Pacemaker's available for sale investments:	
Carrying amount at 31 March 2008 (345 – 210 cash – 58 loan note)	77
Carrying amount at 31 March 2009	82
Gain to retained earnings (or other components of equity)	5

(v) Non-controlling interest

Fair value on acquisition (from question)	65
Share of adjusted post acquisition profit (130 x 20% (w (iv)))	26
	91

2 (a) Pricewell – Statement of comprehensive income for the year ended 31 March 2009:

	$'000
Revenue (310,000 + 22,000 (w (i)) – 6,400 (w (ii)))	325,600
Cost of sales (w (iii))	(255,100)
Gross profit	70,500
Distribution costs	(19,500)
Administrative expenses	(27,500)
Finance costs (4,160 (w (v)) + 1,248 (w (vi)))	(5,408)
Profit before tax	18,092
Income tax expense (4,500 +700 – (8,400 – 5,600 deferred tax))	(2,400)
Profit for the year	15,692

(b) Pricewell – Statement of financial position as at 31 March 2009:

Assets	$'000	$'000
Non-current assets		
Property, plant and equipment (24,900 + 41,500 w (iv))		66,400
Current assets		
Inventory	28,200	
Amount due from customer (w (i))	17,100	
Trade receivables	33,100	
Bank	5,500	83,900
Total assets		150,300
Equity and liabilities:		
Equity shares of 50 cents each		40,000
Retained earnings (w (vii))		12,592
		52,592
Non-current liabilities		
Deferred tax	5,600	
Finance lease obligation (w (vi))	5,716	
6% Redeemable preference shares (41,600 + 1,760 (w (v)))	43,360	54,676
Current liabilities		
Trade payables	33,400	
Finance lease obligation (10,848 – 5,716) (w (vi)))	5,132	
Current tax payable	4,500	43,032
Total equity and liabilities		150,300

Workings (figures in brackets in $'000)

		$'000
(i)	Construction contract:	
	Selling price	50,000
	Estimated cost	
	To date	(12,000)
	To complete	(10,000)
	Plant	(8,000)
	Estimated profit	20,000
	Work done is agreed at $22 million so the contract is 44% complete (22,000/50,000).	
	Revenue	22,000
	Cost of sales (= balance)	(13,200)
	Profit to date (44% x 20,000)	8,800
	Cost incurred to date materials and labour	12,000
	Plant depreciation (8,000 x 6/24 months)	2,000
	Profit to date	8,800
		22,800
	Cash received	(5,700)
	Amount due from customer	17,100

(ii) Pricewell is acting as an agent (not the principal) for the sales on behalf of Trilby. Therefore the income statement should only include $1·6 million (20% of the sales of $8 million). Therefore $6·4 million (8,000 – 1,600) should be deducted from revenue and cost of sales. It would also be acceptable to show agency sales (of $1·6 million) separately as other income.

(iii)	Cost of sales	
	Per question	234,500
	Contract (w (i))	13,200
	Agency cost of sales (w (ii))	(6,400)
	Depreciation (w (iv)) – leasehold property	1,800
	– owned plant ((46,800 – 12,800) x 25%)	8,500
	– leased plant (20,000 x 25%)	5,000
	Surplus on revaluation of leasehold property (w (iv))	(1,500)
		255,100

		$'000
(iv)	Non-current assets	
	Leasehold property	
	valuation at 31 March 2008	25,200
	depreciation for year (14 year life remaining)	(1,800)
	carrying amount at date of revaluation	23,400
	valuation at 31 March 2009	(24,900)
	revaluation surplus (to income statement – see below)	1,500

The $1·5 million revaluation surplus is credited to the income statement as this is the partial reversal of the $2·8 million impairment loss recognised in the income statement in the previous period (i.e. year ended 31 March 2008).

Plant and equipment	
– owned (46,800 – 12,800 – 8,500)	25,500
– leased (20,000 – 5,000 – 5,000)	10,000
– contract (8,000 – 2,000 (w (i)))	6,000
Carrying amount at 31 March 2009	41,500

(v) The finance cost of $4,160,000 for the preference shares is based on the effective rate of 10% applied to $41·6 million balance at 1 April 2008. The accrual of $1,760,000 (4,160 – 2,400 dividend paid) is added to the carrying amount of the preference shares in the statement of financial position. As these shares are redeemable they are treated as debt and their dividend is treated as a finance cost.

(vi)	Finance lease liability	
	balance at 31 March 2008	15,600
	interest for year at 8%	1,248
	lease rental paid 31 March 2009	(6,000)
	total liability at 31 March 2009	10,848
	interest next year at 8%	868
	lease rental due 31 March 2010	(6,000)
	total liability at 31 March 2010	5,716
(vii)	Retained earnings	
	balance at 1 April 2008	4,900
	profit for year	15,692
	equity dividend paid	(8,000)
	balance at 31 March 2009	12,592

3 (a) Coaltown – Statement of cash flows for the year ended 31 March 2009:

Note: figures in brackets in $'000

	$'000	$'000
Cash flows from operating activities		
Profit before tax		10,200
Adjustments for:		
depreciation of non-current assets (w (i))	6,000	
loss on disposal of displays (w (i))	1,500	7,500
interest expense		600
increase in warranty provision (1,000 – 300)		700
increase in inventory (5,200 – 4,400)		(800)
increase in receivables (7,800 – 2,800)		(5,000)
decrease in payables (4,500 – 4,200)		(300)
Cash generated from operations		12,900
Interest paid		(600)
Income tax paid (w (ii))		(5,500)
Net cash from operating activities		6,800
Cash flows from investing activities (w (i))		
Purchase of non-current assets	(20,500)	
Disposal cost of non-current assets	(500)	
Net cash used in investing activities		(21,000)
		(14,200)
Cash flows from financing activities:		
Issue of equity shares (8,600 capital + 4,300 premium)	12,900	
Issue of 10% loan notes	1,000	
Equity dividends paid	(4,000)	
Net cash from financing activities		9,900
Net decrease in cash and cash equivalents		(4,300)
Cash and cash equivalents at beginning of period		700
Cash and cash equivalents at end of period		(3,600)

Workings	$'000
(i) Non-current assets	
Cost	
Balance b/f	80,000
Revaluation (5,000 – 2,000 depreciation)	3,000
Disposal	(10,000)
Balance c/f	(93,500)
Cash flow for acquisitions	20,500
Depreciation	
Balance b/f	48,000
Revaluation	(2,000)
Disposal	(9,000)
Balance c/f	(43,000)
Difference – charge for year	6,000
Disposal of displays	
Cost	10,000
Depreciation	(9,000)
Cost of disposal	500
Loss on disposal	1,500
(ii) Income tax paid:	$'000
Provision b/f	(5,300)
Income statement tax charge	(3,200)
Provision c/f	3,000
Difference cash paid	(5,500)

(b) (i) **Workings** – all monetary figures in $'000

(note: references to 2008 and 2009 should be taken as to the years ended 31 March 2008 and 2009)

The effect of a reduction in purchase costs of 10% combined with a reduction in selling prices of 5%, based on the figures from 2008, would be:

Sales (55,000 x 95%)	52,250
Cost of sales (33,000 x 90%)	(29,700)
Expected gross profit	22,550

This represents an expected gross profit margin of 43·2% (22,550/52,250 x 100)

The actual gross profit margin for 2009 is 33·4% (22,000/65,800 x 100)

(ii) The directors' expression of surprise that the gross profit in 2009 has not increased seems misconceived.

A change in the gross profit margin does not necessarily mean there will be an equivalent change in the absolute gross profit. This is because the gross profit figure is the product of the gross profit margin and the volume of sales and these may vary independently of each other. That said, in this case the expected gross profit margin in 2009 shows an increase over that earned in 2008 (to 43·2% from 40·0% (22,000/55,000 x100)) and the sales have also increased, so it is understandable that the directors expected a higher gross profit. As the actual gross profit margin in 2009 is only 33·4%, something other than the changes described by the directors must have occurred. Possible reasons for the reduction are:

The opening inventory being at old (higher) cost and the closing inventory is at the new (lower) cost will have caused slight distortion.

Inventory write downs due to damage/obsolescence.

A change in the sales mix (i.e. from higher margin sales to lower margin sales).

New (lower margin) products may have been introduced from other new suppliers.

Some selling prices may have been discounted because of sales promotions.

Import duties (perhaps not allowed for by the directors) or exchange rate fluctuations may have caused the actual purchase cost to be higher than the trade prices quoted by the new supplier.

Change in cost classification: some costs included as operating expenses in 2008 may have been classified as cost of sales in 2009 (if intentional and material this should be treated as a change in accounting policy) – for example it may be worth checking that depreciation has been properly charged to operating expenses in 2009.

The new supplier may have put his prices up during the year due to market conditions. Coaltown may have felt it could not pass these increases on to its customers.

(iii) Note – all monetary figures in $'000

Trade receivables collection period in 2008:

2,800/28,500 x 365 = 35·9 days

Applying the 35·9 days collection period to the credit sales made in 2009:

53,000 x 35·9/365 = 5,213, the actual receivables are 7,800 thus potentially increasing the bank balance by 2,587.

A similar exercise with the trade payables period in 2008:

4,500/33,000 x 365 = 49·8 days

Note the 33,000 above is the cost of sales for 2008. This was the same as the credit purchases as there was no change in the value of inventory. However, in 2009 the credit purchases will be 44,600 (43,800 + 5,200 closing inventory – 4,400 opening inventory).

Applying the 49·8 days payment period to purchases made in 2009 gives:

44,600 x 49·8/365 = 6,085, the actual payables are 4,200 thus potentially increasing the bank balance by 1,885.

Inevitably a shortening of the period of credit offered by suppliers and lengthening the credit offered to customers will put a strain on cash resources. For Coaltown the combination of maintaining the same credit periods for both trade receivables and payables would have led to a reduction in cash outflows of 4,472 (2,587 + 1,885), which would have eliminated the overdraft of 3,600 leaving a balance in hand of 872.

4 **(a)** Events after the reporting period are defined by HKAS 10 *Events after the Reporting Period* as those events, both favourable and unfavourable, that occur between the end of the reporting period and the date that the financial statements are authorised for issue (normally by the Board of directors).

An adjusting event is one that provides further evidence of conditions that existed at the end of the reporting period, including an event that indicates that the going concern assumption in relation to the whole or part of the entity is not appropriate. Normally trading results occurring after the end of the reporting period are a matter for the next reporting period, however, if there is an event which would normally be treated as non-adjusting that causes a dramatic downturn in trading (and profitability) such that it is likely that the entity will no longer be a going concern, this should be treated as an adjusting event.

A non-adjusting event is an event after the end of the reporting period that is indicative of a condition that arose after the end of the reporting period and, subject to the exception noted above, the financial statements would not be adjusted to reflect such events.

The outcome (and values) of many items in the financial statements have a degree of uncertainty at the end of the reporting period. HKAS 10 effectively says that where events occurring after the end of the reporting period help to determine what those values were at the end of the reporting period, they should be taken into account (i.e. adjusted for) in preparing the financial statements.

If non-adjusting events, whilst not affecting the financial statements of the current year, are of such importance (i.e. material) that without disclosure of their nature and estimated financial effect, users' ability to make proper evaluations and decisions about the future of the entity would be affected, then they should be disclosed in the notes to the financial statements.

(b) **(i)** This is normally classified as a non-adjusting event as there was no reason to doubt that the value of warehouse and the inventory it contained was worth less than its carrying amount at 31 March 2009 (the last day of the reporting period). The total loss suffered as a result of the fire is $16 million. The company expects that $9 million of this loss will be recovered from an insurance policy. Recoveries from third parties should be assessed separately from the related loss. As this event has caused serious disruption to trading, HKAS 10 would require the details of this non-adjusting event to be disclosed as a note to the financial statements for the year ended 31 March 2009 as a total loss of $16 million and the effect of the insurance recovery to be disclosed separately.

The severe disruption in Waxwork's trading operations since the fire, together with the expectation of large trading losses for some time to come, may call in to question the going concern status of the company. If it is judged that Waxwork is no longer a going concern, then the fire and its consequences become an adjusting event requiring the financial statements for the year ended 31 March 2009 to be redrafted on the basis that the company is no longer a going concern (i.e. they would be prepared on a liquidation basis).

(ii) 70% of the inventory amounts to $322,000 (460,000 x 70%) and this was sold for a net amount of $238,000 (280,000 x 85%). Thus a large proportion of a class of inventory was sold at a loss after the reporting period. This would appear to give evidence of conditions that existed at 31 March 2009 i.e. that the net realisable value of that class of inventory was below its cost. Inventory is required to be valued at the lower of cost and net realisable value, thus this is an adjusting event. If it is assumed that the remaining inventory will be sold at similar prices and terms as that already sold, the net realisable value of the whole of the class of inventory would be calculated as:

$280,000/70% = $400,000, less commission of 15% = $340,000.

Thus the carrying amount of the inventory of $460,000 should be written down by $120,000 to its net realisable value of $340,000.

In the unlikely event that the fall in the value of the inventory could be attributed to a specific event that occurred after the date of the statement of financial position then this would be a non-adjusting event.

(iii) The date of the government announcement of the tax change is beyond the period of consideration in HKAS 10. Thus this would be neither an adjusting nor a non-adjusting event. The increase in the deferred tax liability will be provided for in the year to 31 March 2010. Had the announcement been before 6 May 2009, it would have been treated as a non-adjusting event requiring disclosure of the nature of the event and an estimate of its financial effect in the notes to the financial statements.

5 Flightline – Income statement for the year ended 31 March 2009:

	$'000
Depreciation (w (i))	13,800
Loss on write off of engine (w (iii))	6,000
Repairs – engine	3,000
– exterior painting	2,000

Statement of financial position as at 31 March 2009

Non-current asset – Aircraft	cost	accumulated depreciation	carrying amount
	$'000	$'000	$'000
Exterior (w (i))	120,000	84,000	36,000
Cabin fittings (w (ii))	29,500	21,500	8,000
Engines (w (iii))	19,800	3,700	16,100
	169,300	109,200	60,100

Workings (figures in brackets in $'000)

(i) The exterior of the aircraft is depreciated at $6 million per annum (120,000/20 years). The cabin is depreciated at $5 million per annum (25,000/5 years). The engines would be depreciated by $500 ($18 million/36,000 hours) i.e. $250 each, per flying hour.

The carrying amount of the aircraft at 1 April 2008 is:

	Cost	accumulated depreciation	carrying amount
	$'000	$'000	$'000
Exterior (13 years old)	120,000	78,000	42,000
Cabin (3 years old)	25,000	15,000	10,000
Engines (used 10,800 hours)	18,000	5,400	12,600
	163,000	98,400	64,600

Depreciation for year to 31 March 2009:		$'000
Exterior (no change)		6,000
Cabin fittings	– six months to 30 September 2008 (5,000 x 6/12)	2,500
	– six months to 31 March 2009 (w (ii))	4,000
Engines	– six months to 30 September 2008 (500 x 1,200 hours)	600
	– six months to 31 March 2009 ((400 + 300) w (iii))	700
		13,800

(ii) Cabin fittings – at 1 October 2008 the carrying amount of the cabin fittings is $7·5 million (10,000 – 2,500). The cost of improving the cabin facilities of $4·5 million should be capitalised as it led to enhanced future economic benefits in the form of substantially higher fares. The cabin fittings would then have a carrying amount of $12 million (7,500 + 4,500) and an unchanged remaining life of 18 months. Thus depreciation for the six months to 31 March 2009 is $4 million (12,000 x 6/18).

(iii) Engines – before the accident the engines (in combination) were being depreciated at a rate of $500 per flying hour. At the date of the accident each engine had a carrying amount of $6 million ((12,600 – 600)/2). This represents the loss on disposal of the written off engine. The repaired engine's remaining life was reduced to 15,000 hours. Thus future depreciation on the repaired engine will be $400 per flying hour, resulting in a depreciation charge of $400,000 for the six months to 31 March 2009. The new engine with a cost of $10·8 million and a life of 36,000 hours will be depreciated by $300 per flying hour, resulting in a depreciation charge of $300,000 for the six months to 31 March 2009. Summarising both engines:

	cost	accumulated depreciation	carrying amount
	$'000	$'000	$'000
Old engine	9,000	3,400	5,600
New engine	10,800	300	10,500
	19,800	3,700	16,100

Note: marks are awarded for clear calculations rather than for detailed explanations. Full explanations are given for tutorial purposes.

This marking scheme is given as a guide in the context of the suggested answers. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned conclusions are provided. This is particularly the case for written answers where there may be more than one acceptable solution.

		Marks
1	property, plant and equipment	2
	brand	1
	goodwill	$4\frac{1}{2}$
	investment in associate	2
	other investments	1
	inventories	2
	trade receivables, cash and bank	1
	equity shares	1
	share premium	1
	retained earnings	$6\frac{1}{2}$
	non-controlling interest	2
	loan notes	$\frac{1}{2}$
	current liabilities	$\frac{1}{2}$
	Total for question	**25**

2	**(a)**	Statement of comprehensive income	
		revenue	2
		cost of sales	5
		distribution costs	$\frac{1}{2}$
		administrative expenses	$\frac{1}{2}$
		finance costs	2
		income tax expense	2
			12
	(b)	Statement of financial position	
		property, plant and equipment	$2\frac{1}{2}$
		inventory	$\frac{1}{2}$
		due on construction contract	2
		trade receivables	$\frac{1}{2}$
		bank	$\frac{1}{2}$
		equity shares	$\frac{1}{2}$
		retained earnings (1 for dividend)	$1\frac{1}{2}$
		deferred tax	1
		finance lease – non-current liability	$\frac{1}{2}$
		preference shares	1
		trade payables	$\frac{1}{2}$
		finance lease – current liability	1
		current tax payable	1
			13
		Total for question	**25**

			Marks
3	**(a)**	operating activities	
		profit before tax	$^1/_2$
		add back interest	$^1/_2$
		depreciation charge	2
		loss on disposal	1
		warranty adjustment	$^1/_2$
		working capital items	$1^1/_2$
		finance costs	1
		income tax paid	1
		purchase of non-current assets	2
		disposal cost of non-current assets	1
		issue of equity shares	1
		issue of 10% loan notes	1
		dividend paid	1
		cash and cash equivalents b/f and c/f	1
			15
	(b) **(i)**	calculation of expected gross profit margin for 2009	**2**
	(ii)	comments on directors' surprise and other factors	**4**
	(iii)	calculate credit periods (receivables and payables) in 2008	2
		apply to 2009 credit sales/purchases	1
		calculate 'savings' and effect on closing bank balance	1
			4
		Total for question	**25**
4	**(a)**	definition	1
		discussion of adjusting events	2
		reference to going concern	1
		discussion of non-adjusting events	1
			5
	(b)	**(i)** to **(iv)** 1 mark per valid point as indicated	10
		Total for question	**15**
5		Income statement	
		depreciation – exterior	1
		– cabin fittings	2
		– engines	2
		loss on write off of engine	1
		repairs	1
		Statement of financial position	
		carrying amount at 31 March 2009	3
		Total for question	**10**