Fundamentals Level – Skills Module

Financial Reporting

Wednesday 3 June 2015

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

This paper is divided into two sections:

Section A – ALL 20 questions are compulsory and MUST be attempted

Section B – ALL THREE 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.

Do NOT record any of your answers on the exam paper.

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

The Association of Chartered Certified Accountants

Paper F7

ACCA

Section B – ALL THREE questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

1 On 1 July 2014 Bycomb acquired 80% of Cyclip's equity shares on the following terms:

– a share exchange of two shares in Bycomb for every three shares acquired in Cyclip; and
– a cash payment due on 30 June 2015 of $1·54 per share acquired (Bycomb's cost of capital is 10% per annum).

At the date of acquisition, shares in Bycomb and Cyclip had a stock market value of $3·00 and $2·50 each respectively.

Statements of profit or loss for the year ended 31 March 2015:

	Bycomb $'000	Cyclip $'000
Revenue	24,200	10,800
Cost of sales	(17,800)	(6,800)
Gross profit	6,400	4,000
Distribution costs	(500)	(340)
Administrative expenses	(800)	(360)
Finance costs	(400)	(300)
Profit before tax	4,700	3,000
Income tax expense	(1,700)	(600)
Profit for the year	3,000	2,400

Equity in the separate financial statements of Cyclip as at **1 April 2014**:

	$'000
Equity	
Equity shares of $1 each	12,000
Retained earnings	13,500

The following information is also relevant:

(i) At the date of acquisition, the fair values of Cyclip's assets were equal to their carrying amounts with the exception of an item of plant which had a fair value of $720,000 above its carrying amount. The remaining life of the plant at the date of acquisition was 18 months. Depreciation is charged to cost of sales.

(ii) On 1 April 2014, Cyclip commenced the construction of a new production facility, financing this by a bank loan. Cyclip has followed the local GAAP in the country where it operates which prohibits the capitalisation of interest. Bycomb has calculated that, in accordance with IAS 23 *Borrowing Costs*, interest of $100,000 (which accrued evenly throughout the year) would have been capitalised at 31 March 2015. The production facility is still under construction as at 31 March 2015.

(iii) Sales from Bycomb to Cyclip in the post-acquisition period were $3 million at a mark-up on cost of 20%. Cyclip had $420,000 of these goods in inventory as at 31 March 2015.

(iv) Bycomb's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Cyclip'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.

(v) On 31 March 2015, Bycomb carried out an impairment review which identified that the goodwill on the acquisition of Cyclip was impaired by $500,000. Impaired goodwill is charged to cost of sales.

Required:

(a) Calculate the consolidated goodwill at the date of acquisition of Cyclip. (6 marks)

(b) Prepare extracts from Bycomb's consolidated statement of profit or loss for the year ended 31 March 2015, for:

(i) revenue;
(ii) cost of sales;
(iii) finance costs;
(iv) profit or loss attributable to the non-controlling interest.

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

(i) 1 mark
(ii) 3 marks
(iii) 2½ marks
(iv) 2½ marks

(9 marks)

(15 marks)

2 Yogi is a public company and extracts from its most recent financial statements are provided below:

Statements of profit or loss for the year ended 31 March

	2015	2014
	$'000	$'000
Revenue	36,000	50,000
Cost of sales	(24,000)	(30,000)
Gross profit	12,000	20,000
Profit from sale of division (see note (i))	1,000	nil
Distribution costs	(3,500)	(5,300)
Administrative expenses	(4,800)	(2,900)
Finance costs	(400)	(800)
Profit before taxation	4,300	11,000
Income tax expense	(1,300)	(3,300)
Profit for the year	3,000	7,700

Statements of financial position as at 31 March

	2015		2014	
	$'000	$'000	$'000	$'000
Non-current assets				
Property, plant and equipment		16,300		19,000
Intangible – goodwill		nil		2,000
		16,300		21,000
Current assets				
Inventory	3,400		5,800	
Trade receivables	1,300		2,400	
Bank	1,500	6,200	nil	8,200
Total assets		22,500		29,200
Equity and liabilities				
Equity				
Equity shares of $1 each		10,000		10,000
Retained earnings		3,000		4,000
		13,000		14,000
Non-current liabilities				
10% loan notes		4,000		8,000
Current liabilities				
Bank overdraft	nil		1,400	
Trade payables	4,300		3,100	
Current tax payable	1,200	5,500	2,700	7,200
Total equity and liabilities		22,500		29,200

Notes

(i) On 1 April 2014, Yogi sold the net assets (including goodwill) of a separately operated division of its business for $8 million cash on which it made a profit of $1 million. This transaction required shareholder approval and, in order to secure this, the management of Yogi offered shareholders a dividend of 40 cents for each share in issue out of the proceeds of the sale. The trading results of the division which are included in the statement of profit or loss for the year ended 31 March 2014 above are:

	$'000
Revenue	18,000
Cost of sales	(10,000)
Gross profit	8,000
Distribution costs	(1,000)
Administrative expenses	(1,200)
Profit before interest and tax	5,800

(ii) The following selected ratios for Yogi have been calculated for the year ended 31 March 2014 (as reported above):

Gross profit margin	40·0%
Operating profit margin	23·6%
Return on capital employed (profit before interest and tax/(total assets – current liabilities))	53·6%
Net asset turnover	2·27 times

Required:

(a) Calculate the equivalent ratios for Yogi:

(i) for the year ended 31 March 2014, after excluding the contribution made by the division that has been sold; and

(ii) for the year ended 31 March 2015, excluding the profit on the sale of the division. (5 marks)

(b) Comment on the comparative financial performance and position of Yogi for the year ended 31 March 2015. (10 marks)

(15 marks)

3 The following trial balance relates to Clarion as at 31 March 2015:

	$'000	$'000
Equity shares of $1 each (note (i))		30,000
Retained earnings – 1 April 2014		8,600
Other component of equity – share premium (note (i))		5,000
8% loan notes (note (ii))		20,000
Plant and equipment at cost (note (iii))	85,000	
Accumulated depreciation plant and equipment – 1 April 2014		19,000
Investments through profit or loss – value at 1 April 2014 (note (iv))	6,000	
Inventory at 31 March 2015	11,700	
Trade receivables	18,500	
Bank		1,900
Deferred tax (note (vi))		2,700
Trade payables		9,400
Environmental provision (note (iii))		4,000
Finance lease obligation (note (iii))		4,200
Revenue		132,000
Cost of sales	88,300	
Operating lease payments (note (v))	2,000	
Administrative expenses	8,000	
Distribution costs	7,400	
Loan note interest paid	800	
Suspense account (note (ii))	5,800	
Bank interest	300	
Dividends paid	3,900	
Investment income (note (iv))		500
Current tax (note (vi))		400
	237,700	237,700

The following notes are also relevant:

(i) The equity shares and share premium balances in the trial balance above include a fully subscribed 1 for 5 rights issue at $1·60 per share which was made by Clarion on 1 October 2014. The market value of Clarion's shares was $2·50 on 1 October 2014.

(ii) On 31 March 2015, one quarter of the 8% loan notes were redeemed at par and six months' outstanding loan interest was paid. The suspense account represents the double entry corresponding to the cash payment for the capital redemption and the outstanding interest.

(iii) Property, plant and equipment:

Included in property, plant and equipment are two major items of plant acquired on 1 April 2014:

Item 1 had a cash cost $14 million, however, the plant will cause environmental damage which will have to be rectified when it is dismantled at the end of its five year life. The present value (discounting at 8%) on 1 April 2014 of the rectification is $4 million. The environmental provision has been correctly accounted for, however, no finance cost has yet been charged on the provision.

Item 2 was plant acquired with a fair value of $8 million under a five-year finance lease. This required an initial deposit of $2·3 million and annual payments of $1·5 million on 31 March each year. The finance lease obligation in the trial balance above represents the fair value of the plant less both the deposit and the first annual payment. The lease has an implicit interest rate of 10% and the asset has been correctly capitalised in plant and equipment.

No depreciation has yet been charged on plant and equipment which should be charged to cost of sales on a straight-line basis over a five-year life (including leased plant). No plant is more than four years old.

(iv) The investments through profit or loss are those held at 31 March 2015 (after the sale below). They are carried at their fair value as at 1 April 2014, however, they had a fair value of $6·5 million on 31 March 2015. During the year an investment which had a carrying amount of $1·4 million was sold for $1·6 million. Investment income in the trial balance above includes the profit on the sale of the investment and dividends received during the year.

(v) Clarion renewed an operating lease on a property on 1 April 2014. The operating lease payments represent an annual payment (in advance) of $1 million and a lease premium of $1 million. The lease is for four years and operating lease expenses should be included in cost of sales.

(vi) A provision for current tax for the year ended 31 March 2015 of $3·5 million is required. The balance on current tax in the trial balance above represents the under/over provision of the tax liability for the year ended 31 March 2014. At 31 March 2015, the tax base of Clarion's net assets was $12 million less than their carrying amounts. The income tax rate of Clarion is 25%.

Required:

(a) Prepare the statement of profit or loss for Clarion for the year ended 31 March 2015.

(b) Prepare the statement of changes in equity for Clarion for the year ended 31 March 2015.

(c) Prepare the statement of financial position for Clarion as at 31 March 2015.

Notes to the financial statements are not required.

The following mark allocation is provided as guidance for these requirements:

(a) 10 marks
(b) 3 marks
(c) 10 marks

(23 marks)

(d) Calculate the basic earnings per share of Clarion for the year ended 31 March 2015. (3 marks)

(e) Prepare extracts from the statement of cash flows for Clarion for the year ended 31 March 2015 in respect of cash flows from investing (ignore investment income) and financing activities. (4 marks)

(30 marks)

End of Question Paper