Fundamentals Level – Skills Module

Financial Reporting (Irish)

Wednesday 4 December 2013

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.

Paper F7 (IRL)

ACCA

The Association of Chartered Certified Accountants

ALL FIVE questions are compulsory and MUST be attempted

1 On 1 April 2013, Polestar acquired 75% of the equity share capital of Southstar. Southstar had been experiencing difficult trading conditions and making significant losses. In allowing for Southstar's difficulties, Polestar paid only $1·70 per share which the directors of Polestar expect to lead to a bargain purchase and negative goodwill.

At the date of acquisition shares in Southstar had a listed market price of $1·20 each.

Below are the summarised draft financial statements of both companies.

Statements of profit or loss for the year ended 30 September 2013

	Polestar	**Southstar**
	$'000	**$'000**
Revenue	110,000	66,000
Cost of sales	(88,000)	(67,200)
Gross profit (loss)	22,000	(1,200)
Distribution costs	(3,000)	(2,000)
Administrative expenses	(5,250)	(2,400)
Finance costs	(250)	nil
Profit (loss) before tax	13,500	(5,600)
Income tax (expense)/relief	(3,500)	1,000
Profit (loss) for the year	10,000	(4,600)

Statements of financial position as at 30 September 2013

Assets		
Non-current assets		
Property, plant and equipment	41,700	21,000
Investment in Southstar	15,300	nil
	57,000	21,000
Current assets	16,500	4,800
Total assets	73,500	25,800
Equity and liabilities		
Equity		
Equity shares of 50 cents each	30,000	6,000
Retained earnings	28,500	12,000
	58,500	18,000
Current liabilities	15,000	7,800
Total equity and liabilities	73,500	25,800

The following information is relevant:

(i) At the date of acquisition, the fair values of Southstar's assets were equal to their carrying amounts with the exception of a leased property. This had a fair value of $2 million above its carrying amount and a remaining lease term of 10 years at that date. All depreciation is included in cost of sales.

(ii) Polestar transferred raw materials at their cost of $4 million to Southstar in June 2013. Southstar processed all of these materials incurring additional direct costs of $1·4 million and sold them back to Polestar in August 2013 for $9 million. At 30 September 2013 Polestar had $1·5 million of these goods still in inventory. There were no other intra-group sales.

(iii) Polestar's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, Southstar'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.

(iv) All items in the above statements of profit or loss are deemed to accrue evenly over the year unless otherwise indicated.

Required:

(a) (i) Prepare the consolidated statement of profit or loss for Polestar for the year ended 30 September 2013.

(ii) Prepare the consolidated statement of financial position for Polestar as at 30 September 2013.

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

(i) 12 marks
(ii) 9 marks

(21 marks)

(b) Describe how the treatment of the negative goodwill under RoI GAAP differs to that under International Financial Reporting Standards. (4 marks)

(25 marks)

2 The following trial balance relates to Moby as at 30 September 2013:

	$'000	$'000
Revenue		227,800
Cost of sales	164,500	
Construction contract (note (i))	4,000	
Distribution costs	13,500	
Administrative expenses (note (iii)	16,500	
Bank interest	900	
Lease rental paid on 30 September 2013 (note (ii))	9,200	
Land ($12 million) and building ($48 million) at cost (note (ii))	60,000	
Owned plant and equipment at cost (note (ii))	65,700	
Leased plant at initial carrying amount (note (ii))	35,000	
Accumulated depreciation at 1 October 2012:		
building		10,000
owned plant and equipment		17,700
leased plant		7,000
Inventory at 30 September 2013	26,600	
Trade receivables	38,500	
Bank		7,300
Insurance provision (note (iii))		150
Deferred tax (note (iv))		8,000
Finance lease obligation at 1 October 2012 (note (ii))		29,300
Trade payables		21,300
Current tax (note (iv))		1,050
Equity shares of 20 cents each		45,000
Loan note (note (v))		40,000
Retained earnings at 1 October 2012		19,800
	434,400	434,400

The following notes are relevant:

(i) The balance on the construction contract is made up of the following items:

Cost incurred to date	$14 million
Value of contract billed (work certified)	$10 million

The contract commenced on 1 October 2012 and is for a fixed price of $25 million. The costs to complete the contract at 30 September 2013 are estimated at $6 million. Moby's policy is to accrue profits on construction contracts based on a stage of completion given by the work certified as a percentage of the contract price.

(ii) Non-current assets:

Moby decided to revalue its land and building, for the first time, on 1 October 2012. A qualified valuer determined the relevant revalued amounts to be $16 million for the land and $38·4 million for the buildings. The building's remaining life at the date of the revaluation was 16 years. This revaluation has not yet been reflected in the trial balance figures. Moby does not make a transfer from the revaluation reserve to retained earnings in respect of the realisation of the revaluation surplus. Deferred tax is applicable to the revaluation surplus at 25%.

The leased plant was acquired on 1 October 2011 under a five-year finance lease which has an implicit interest rate of 10% per annum. The rentals are $9·2 million per annum payable on 30 September each year.

Owned 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 2013. All depreciation is charged to cost of sales.

(iii) On 1 October 2012, Moby received a renewal quote of $400,000 from the company's property insurer. The directors were surprised at how much it had increased and believed it would be less expensive for the company to 'self-insure'. Accordingly, they charged $400,000 to administrative expenses and credited the same amount to the insurance provision. During the year, the company incurred $250,000 of expenses relating to previously insured property damage which it has debited to the provision.

(iv) A provision for income tax for the year ended 30 September 2013 of $3·4 million is required. The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September 2012. At 30 September 2013, the tax base of Moby's net assets was $24 million less than their carrying amounts. This does not include the effect of the revaluation in note (ii) above. The income tax rate of Moby is 25%.

(v) The $40 million loan note was issued at par on 1 October 2012. No interest will be paid on the loan; however, it will be redeemed on 30 September 2015 for $53,240,000 which gives an effective finance cost of 10% per annum.

Required:

(a) Prepare the statement of profit or loss and other comprehensive income for Moby for the year ended 30 September 2013.

(b) Prepare the statement of financial position for Moby as at 30 September 2013.

Note: A statement of changes in equity and notes to the financial statements are not required.

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

(a) 12 marks
(b) 13 marks

(25 marks)

3 Kingdom is a public listed manufacturing company. Its draft summarised financial statements for the year ended 30 September 2013 (and 2012 comparatives) are:

Statements of profit or loss and other comprehensive income for the year ended 30 September:

	2013	2012
	$'000	$'000
Revenue	44,900	44,000
Cost of sales	(31,300)	(29,000)
Gross profit	13,600	15,000
Distribution costs	(2,400)	(2,100)
Administrative expenses	(7,850)	(5,900)
Investment properties – rentals received	350	400
– fair value changes	(700)	500
Finance costs	(600)	(600)
Profit before taxation	2,400	7,300
Income tax expense	(600)	(1,700)
Profit for the year	1,800	5,600
Other comprehensive income	(1,300)	1,000
Total comprehensive income	500	6,600

Statements of financial position as at 30 September:

	2013		2012	
	$'000	$'000	$'000	$'000
Assets				
Non-current assets				
Property, plant and equipment		26,700		25,200
Investment properties		4,100		5,000
		30,800		30,200
Current assets				
Inventory	2,300		3,100	
Trade receivables	3,000		3,400	
Bank	nil	5,300	300	6,800
Total assets		36,100		37,000
Equity and liabilities				
Equity				
Equity shares of $1 each		17,200		15,000
Revaluation reserve		1,200		2,500
Retained earnings		7,700		8,700
		26,100		26,200
Non-current liabilities				
12% loan notes		5,000		5,000
Current liabilities				
Trade payables	4,200		3,900	
Accrued finance costs	100		50	
Bank	200		nil	
Current tax payable	500	5,000	1,850	5,800
Total equity and liabilities		36,100		37,000

The following information is relevant:

On 1 July 2013, Kingdom acquired a new investment property at a cost of $1·4 million. On this date, it also transferred one of its other investment properties to property, plant and equipment at its fair value of $1·6 million as it became owner-occupied on that date. Kingdom adopts the fair value model for its investment properties.

Kingdom also has a policy of revaluing its other properties (included as property, plant and equipment) to market value at the end of each year. Other comprehensive income and the revaluation reserve both relate to these properties.

Depreciation of property, plant and equipment during the year was $1·5 million. An item of plant with a carrying amount of $2·3 million was sold for $1·8 million during September 2013.

Required:

(a) **Prepare the statement of cash flows for Kingdom for the year ended 30 September 2013 in accordance with IAS 7 *Statement of Cash Flows* using the indirect method.** (14 marks)

(b) At a board meeting to consider the results shown by the draft financial statements, concern was expressed that, although there had been a slight increase in revenue during the current year, the profit before tax had fallen dramatically. The purchasing director commented that he was concerned about the impact of rising prices. During the year to 30 September 2013, most of Kingdom's manufacturing and operating costs have risen by an estimated 8% per annum.

Required:

(i) **Explain the causes of the fall in Kingdom's profit before tax.** (6 marks)

(ii) **Describe the main effects which the rising prices may have on the interpretation of Kingdom's financial statements. You are not required to quantify these effects.** (5 marks)

(25 marks)

4 **(a)** The *Conceptual Framework for Financial Reporting* identifies faithful representation as a fundamental qualitative characteristic of useful financial information.

Required:

Distinguish between fundamental and enhancing qualitative characteristics and explain why faithful representation is important. (5 marks)

(b) Laidlaw has produced its draft financial statements for the year ended 30 September 2013 and two issues have arisen:

(i) On 1 September 2013, Laidlaw factored (sold) $2 million of trade receivables to Finease. Laidlaw received an immediate payment of $1·8 million and credited this amount to receivables and charged $200,000 to administrative expenses. Laidlaw will receive further amounts from Finease depending on how quickly Finease collects the receivables.

Finease will charge a monthly administration fee of $10,000 and 2% per month on its outstanding balance with Laidlaw. Any receivables not collected after four months would be sold back to Laidlaw; however, Laidlaw expects all customers to settle in full within this period. None of the receivables were due or had been collected by 30 September 2013. (5 marks)

(ii) On 1 October 2012, Laidlaw sold a property which had a carrying amount of $3·5 million to a property company for $5 million and recorded a profit of $1·5 million on the disposal. Part of the terms of the sale are that Laidlaw will rent the property for a period of five years at an annual rental of $400,000. At the end of this period, the property company will sell the property through a real estate company/property agent at its fair value which is expected to be approximately $6·5 million. Laidlaw will be given the opportunity to repurchase the property (at its fair value) before it is put on the open market.

All of the above amounts are deemed to be at commercial values. (5 marks)

Required:

Explain, and quantify where appropriate, how Laidlaw should account for the above two issues in its financial statements for the year ended 30 September 2013.

Note: The mark allocation is shown against each of the two issues above.

(15 marks)

5 Fundo entered into a 20-year **operating** lease for a property on 1 October 2000 which has a remaining life of eight years at 1 October 2012. The rental payments are $2·3 million per annum.

Prior to 1 October 2012, Fundo obtained permission from the owner of the property to make some internal alterations to the property so that it can be used for a new manufacturing process which Fundo is undertaking. The cost of these alterations was $7 million and they were completed on 1 October 2012 (the time taken to complete the alterations can be taken as being negligible). A condition of being granted permission was that Fundo would have to restore the property to its original condition before handing back the property at the end of the lease. The estimated restoration cost on 1 October 2012, discounted at 8% per annum to its present value, is $5 million.

Required:

(a) Explain how the lease, the alterations to the leased property and the restoration costs should be treated in the financial statements of Fundo for the year ended 30 September 2013. (4 marks)

(b) Prepare extracts from the financial statements of Fundo for the year ended 30 September 2013 reflecting your answer to (a) above. (6 marks)

(10 marks)

End of Question Paper