Fundamentals Level – Skills Module

Financial Reporting (Singapore)

Wednesday 5 December 2012

Paper F7 (SGP)

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

ACCA

ALL FIVE questions are compulsory and MUST be attempted

1 On 1 January 2012, Viagem acquired 90% of the equity share capital of Greca in a share exchange in which Viagem issued two new shares for every three shares it acquired in Greca. Additionally, on 31 December 2012, Viagem will pay the former shareholders of Greca $1·76 per share acquired. Viagem's cost of capital is 10% per annum.

At the date of acquisition, shares in Viagem and Greca had a stock market value of $6·50 and $2·50 each, respectively.

Income statements for the year ended 30 September 2012

	Viagem $'000	Greca $'000
Revenue	64,600	38,000
Cost of sales	(51,200)	(26,000)
Gross profit	13,400	12,000
Distribution costs	(1,600)	(1,800)
Administrative expenses	(3,800)	(2,400)
Investment income	500	nil
Finance costs	(420)	nil
Profit before tax	8,080	7,800
Income tax expense	(2,800)	(1,600)
Profit for the year	5,280	6,200
Equity as at **1 October 2011**		
Equity shares of $1 each	30,000	10,000
Retained earnings	54,000	35,000

The following information is relevant:

(i) At the date of acquisition, the fair values of Greca's assets were equal to their carrying amounts with the exception of two items:

– An item of plant had a fair value of $1·8 million above its carrying amount. The remaining life of the plant at the date of acquisition was three years. Depreciation is charged to cost of sales.
– Greca had a contingent liability which Viagem estimated to have a fair value of $450,000. This has not changed as at 30 September 2012.

Greca has not incorporated these fair value changes into its financial statements.

(ii) Viagem's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, Greca'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.

(iii) Sales from Viagem to Greca throughout the year ended 30 September 2012 had consistently been $800,000 per month. Viagem made a mark-up on cost of 25% on these sales. Greca had $1·5 million of these goods in inventory as at 30 September 2012.

(iv) Viagem's investment income is a dividend received from its investment in a 40% owned associate which it has held for several years. The underlying earnings for the associate for the year ended 30 September 2012 were $2 million.

(v) Although Greca has been profitable since its acquisition by Viagem, the market for Greca's products has been badly hit in recent months and Viagem has calculated that the goodwill has been impaired by $2 million as at 30 September 2012.

Required:

(a) (i) Calculate the consolidated goodwill at the date of acquisition of Greca.

(ii) Prepare the consolidated income statement for Viagem for the year ended 30 September 2012.

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

(i) 7 marks
(ii) 14 marks

(21 marks)

(b) The carrying amount of a subsidiary's leased property will be subject to review as part of the fair value exercise on acquisition and may be subject to review in subsequent periods.

Required:

Explain how a fair value increase of a subsidiary's leased property on acquisition should be treated in the consolidated financial statements; and how any subsequent increase in the carrying amount of the leased property might be treated in the consolidated financial statements.

Note: Ignore taxation. (4 marks)

(25 marks)

2 The following trial balance relates to Quincy as at 30 September 2012:

		$'000	$'000
Revenue (note (i))			213,500
Cost of sales		136,800	
Distribution costs		12,500	
Administrative expenses (note (ii))		19,000	
Loan note interest and dividend paid (notes (ii) and (iii))		20,700	
Investment income			400
Equity shares of 25 cents each			60,000
6% loan note (note (ii))			25,000
Retained earnings at 1 October 2011			18,500
Land and buildings at cost (land element $10 million) (note (iv))		50,000	
Plant and equipment at cost (note (iv))		83,700	
Accumulated depreciation at 1 October 2011:	buildings		8,000
	plant and equipment		33,700
Equity financial asset investments (note (v))		17,000	
Inventory at 30 September 2012		24,800	
Trade receivables		28,500	
Bank		2,900	
Current tax (note (vi))		1,100	
Deferred tax (note (vi))			1,200
Trade payables			36,700
		397,000	397,000

The following notes are relevant:

(i) On 1 October 2011, Quincy sold one of its products for $10 million (included in revenue in the trial balance). As part of the sale agreement, Quincy is committed to the ongoing servicing of this product until 30 September 2014 (i.e. three years from the date of sale). The value of this service has been included in the selling price of $10 million. The estimated cost to Quincy of the servicing is $600,000 per annum and Quincy's normal gross profit margin on this type of servicing is 25%. Ignore discounting.

(ii) Quincy issued a $25 million 6% loan note on 1 October 2011. Issue costs were $1 million and these have been charged to administrative expenses. The loan will be redeemed on 30 September 2014 at a premium which gives an effective interest rate on the loan of 8%.

(iii) Quincy paid an equity dividend of 8 cents per share during the year ended 30 September 2012.

(iv) Non-current assets:

Quincy had been carrying land and buildings at depreciated cost, but due to a recent rise in property prices, it decided to revalue its property on 1 October 2011 to market value. An independent valuer confirmed the value of the property at $60 million (land element $12 million) as at that date and the directors accepted this valuation. The property had a remaining life of 16 years at the date of its revaluation. Quincy will make a transfer from the revaluation reserve to retained earnings in respect of the realisation of the revaluation reserve. Ignore deferred tax on the revaluation.

Plant and equipment is depreciated at 15% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 September 2012. All depreciation is charged to cost of sales.

(v) The investments had a fair value of $15·7 million as at 30 September 2012. There were no acquisitions or disposals of these investments during the year ended 30 September 2012.

(vi) The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September 2011. A provision for income tax for the year ended 30 September 2012 of $7·4 million is required. At 30 September 2012, Quincy had taxable temporary differences of $5 million, requiring a provision for deferred tax. Any deferred tax adjustment should be reported in the income statement. The income tax rate of Quincy is 20%.

Required:

(a) Prepare the statement of comprehensive income for Quincy for the year ended 30 September 2012.

(b) Prepare the statement of changes in equity for Quincy for the year ended 30 September 2012.

(c) Prepare the statement of financial position for Quincy as at 30 September 2012.

Note: notes to the financial statements are not required.

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

(a) 11 marks
(b) 4 marks
(c) 10 marks

(25 marks)

3 Quartile sells jewellery through stores in retail shopping centres throughout the country. Over the last two years it has experienced declining profitability and is wondering if this is related to the sector as whole. It has recently subscribed to an agency that produces average ratios across many businesses. Below are the ratios that have been provided by the agency for Quartile's business sector based on a year end of 30 June 2012.

Return on year-end capital employed (ROCE)	16·8%
Net asset (total assets less current liabilities) turnover	1·4 times
Gross profit margin	35%
Operating profit margin	12%
Current ratio	1·25:1
Average inventory turnover	3 times
Trade payables' payment period	64 days
Debt to equity	38%

The financial statements of Quartile for the year ended 30 September 2012 are:

Income statement

	$'000	$'000
Revenue		56,000
Opening inventory	8,300	
Purchases	43,900	
	52,200	
Closing inventory	(10,200)	(42,000)
Gross profit		14,000
Operating costs		(9,800)
Finance costs		(800)
Profit before tax		3,400
Income tax expense		(1,000)
Profit for the year		2,400

Statement of financial position

	$'000	$'000
Assets		
Non-current assets		
Property and shop fittings		25,600
Deferred development expenditure		5,000
		30,600
Current assets		
Inventory	10,200	
Bank	1,000	11,200
Total assets		41,800
Equity and liabilities		
Equity		
Equity shares of $1 each		15,000
Property revaluation reserve		3,000
Retained earnings		8,600
		26,600
Non-current liabilities		
10% loan notes		8,000
Current liabilities		
Trade payables	5,400	
Current tax payable	1,800	7,200
Total equity and liabilities		41,800

Note: The deferred development expenditure relates to an investment in a process to manufacture artificial precious gems for future sale by Quartile in the retail jewellery market.

Required:

(a) Prepare for Quartile the equivalent ratios that have been provided by the agency. (9 marks)

(b) Assess the financial and operating performance of Quartile in comparison to its sector averages. (12 marks)

(c) Explain four possible limitations of the usefulness of the above comparison. (4 marks)

(25 marks)

4 **(a)** Two of the qualitative characteristics of information contained in the ASC's *Conceptual Framework for Financial Reporting* are understandability and comparability.

Required:

Explain the meaning and purpose of the above characteristics in the context of financial reporting and discuss the role of consistency within the characteristic of comparability in relation to changes in accounting policy. (6 marks)

(b) Lobden is a construction contract company involved in building commercial properties. Its current policy for determining the percentage of completion of its contracts is based on the proportion of cost incurred to date compared to the total expected cost of the contract.

One of Lobden's contracts has an agreed price of $250 million and estimated total costs of $200 million.

The cumulative progress of this contract is:

Year ended:	30 September 2011	30 September 2012
	$million	$million
Costs incurred	80	145
Work certified and billed	75	160
Billings received	70	150

Based on the above, Lobden prepared and published its financial statements for the year ended 30 September 2011. Relevant extracts are:

Income statement

	$million
Revenue (balance)	100
Cost of sales	(80)
Profit (50 x 80/200)	20

Statement of financial position

	$million
Current assets	
Amounts due from customers	
Contract costs to date	80
Profit recognised	20
	100
Progress billings	(75)
	25
Contract receivables (75 – 70)	5

Lobden has received some adverse publicity in the financial press for taking its profit too early in the contract process, leading to disappointing profits in the later stages of contracts. Most of Lobden's competitors take profit based on the percentage of completion as determined by the work certified compared to the contract price.

Required:

(i) **Assuming Lobden changes its method of determining the percentage of completion of contracts to that used by its competitors, and that this would represent a change in an accounting estimate, calculate equivalent extracts to the above for the year ended 30 September 2012;** (7 marks)

(ii) **Explain why the above represents a change in accounting estimate rather than a change in accounting policy.** (2 marks)

(15 marks)

5 (a) Shawler is a small manufacturing company specialising in making alloy castings. Its main item of plant is a furnace which was purchased on 1 October 2009. The furnace has two components: the main body (cost \$60,000 including the environmental provision – see below) which has a ten-year life, and a replaceable liner (cost \$10,000) with a five-year life.

The manufacturing process produces toxic chemicals which pollute the nearby environment. Legislation requires that a clean-up operation must be undertaken by Shawler on 30 September 2019 at the latest. Shawler received a government grant of \$12,000 relating to the cost of the main body of the furnace only.

The following are extracts from Shawler's statement of financial position as at 30 September 2011 (two years after the acquisition of the furnace):

	Carrying amount $	
Non-current assets		
Furnace: main body	48,000	
replaceable liner	6,000	
Current liabilities		
Government grant	1,200	
Non-current liabilities		
Government grant	8,400	
Environmental provision	18,000	(present value discounted at 8% per annum)

Required:

(i) Prepare equivalent extracts from Shawler's statement of financial position as at 30 September 2012; (3 marks)

(ii) Prepare extracts from Shawler's income statement for the year ended 30 September 2012 relating to the items in the statement of financial position. (3 marks)

(b) On 1 April 2012, the government introduced further environmental legislation which had the effect of requiring Shawler to fit anti-pollution filters to its furnace within two years. An environmental consultant has calculated that fitting the filters will reduce Shawler's required environmental costs (and therefore its provision) by 33%. At 30 September 2012 Shawler had not yet fitted the filters.

Required:

Advise Shawler as to whether they need to provide for the cost of the filters as at 30 September 2012 and whether they should reduce the environmental provision at this date. (4 marks)

(10 marks)

End of Question Paper