

Applied Skills

# Financial Reporting (FR)

September/December 2018 – Sample Questions



FR

**Time allowed:** 3 hours 15 minutes

This question paper is divided into three sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL 15 questions are compulsory and MUST be attempted

Section C – BOTH questions are compulsory and MUST be attempted

**Do NOT open this question paper until instructed by the supervisor.**

**Do NOT record any of your answers on the question paper.**

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

Think Ahead

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**Section C – BOTH 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.

- 31** Duke Co is a retailer with stores in numerous city centres. On 1 January 20X8, Duke Co acquired 80% of the equity share capital of Smooth Co, a service company specialising in training and recruitment. This was the first time Duke Co had acquired a subsidiary.

The consideration for Smooth Co consisted of a cash element and the issue of some shares in Duke Co to the previous owners of Smooth Co.

Duke Co has begun to consolidate Smooth Co into its financial statements, but has yet to calculate the non-controlling interest and retained earnings. Details of the relevant information is provided in notes (i) and (ii).

Extracts from the financial statements for the Duke group for the year ended 30 June 20X8 and Duke Co for the year ended 30 June 20X7 are provided below:

	Duke Group 30 June 20X8 \$'000	Duke Co 30 June 20X7 \$'000
Profit from operations	14,500	12,700
Current assets	30,400	28,750
Share capital	11,000	8,000
Share premium	6,000	2,000
Retained earnings	Note (i) and (ii)	9,400
Non-controlling interest	Note (i) and (ii)	Nil
Long-term loans	11,500	7,000
Current liabilities	21,300	15,600

The following notes are relevant:

- (i) The fair value of the non-controlling interest in Smooth Co at 1 January 20X8 was deemed to be \$3.4m. The retained earnings of Duke Co in its individual financial statements at 30 June 20X8 are \$13.2m.

Smooth Co made a profit for the year ended 30 June 20X8 of \$7m. Duke Co incurred professional fees of \$0.5m during the acquisition, which have been capitalised as an asset in the consolidated financial statements.

- (ii) The following issues are also relevant to the calculation of non-controlling interest and retained earnings:
- At acquisition, Smooth Co's net assets were equal to their carrying amount with the exception of a brand name which had a fair value of \$3m but was not recognised in Smooth Co's individual financial statements. It is estimated that the brand had a five-year life at 1 January 20X8.
  - On 30 June 20X8, Smooth Co sold land to Duke Co for \$4m when it had a carrying amount of \$2.5m.
- (iii) Smooth Co is based in the service industry and a significant part of its business comes from three large, profitable contracts with entities which are both well-established and financially stable.
- (iv) Duke Co did not borrow additional funds during the current year and has never used a bank overdraft facility.
- (v) The following ratios have been correctly calculated based on the above financial statements:

	20X8	20X7
Receivables collection period	52 days	34 days
Inventory holding period	41 days	67 days

Other than the recognition of the non-controlling interest and retained earnings, no adjustment is required to any of the other figures in the draft financial statements. All items are deemed to accrue evenly across the year.

**Required:**

(a) Calculate the non-controlling interest and retained earnings to be included in the consolidated financial statements at 30 June 20X8. (6 marks)

(b) Based on your answer to part (a) and the financial statements provided, calculate the following ratios for the years ending 30 June 20X7 and 30 June 20X8:

Current ratio;

Return on capital employed;

Gearing (debt/equity).

(4 marks)

(c) Using the information provided and the ratios calculated above, comment on the comparative performance and position for the two years ended 30 June 20X7 and 20X8.

Note: Your answer should specifically comment on the impact of the acquisition of Smooth Co on your analysis. (10 marks)

**(20 marks)**

**32** The following **extracts** from the trial balance have been taken from the accounting records of Duggan Co as at 30 June 20X8:

	\$'000	\$'000
Convertible loan notes (note (iv))		5,000
Cost of sales	21,700	
Finance costs (note (iv))	1,240	
Investment income		120
Operating expenses (notes (ii) and (v))	13,520	
Retained earnings at 1 July 20X7		35,400
Revenue (note (i))		43,200
Equity share capital (\$1 shares) at 1 July 20X7		12,200
Tax (note (iii))		130

The following notes are relevant:

- (i) Duggan Co entered into a contract where the performance obligation is satisfied over time. The total price on the contract is \$9m, with total expected costs of \$5m.

Progress towards completion was measured at 50% at 30 June 20X7 and 80% on 30 June 20X8.

The correct entries were made in the year ended 30 June 20X7, but no entries have been made for the year ended 30 June 20X8.

- (ii) On 1 January 20X8, Duggan Co was notified that an ex-employee had started court proceedings against them for unfair dismissal. Legal advice was that there was an 80% chance that Duggan Co would lose the case and would need to pay an estimated \$1.012m on 1 January 20X9.

Based on this advice, Duggan Co recorded a provision of \$800k on 1 January 20X8, and has made no further adjustments. The provision was recorded in operating expenses.

Duggan Co has a cost of capital of 10% per annum and the discount factor at 10% for one year is 0.9091.

- (iii) The balance relating to tax in the trial balance relates to the under/over provision from the prior period. The tax estimate for the year ended 30 June 20X8 is \$2.1m.

In addition to this, there has been a decrease in taxable temporary differences of \$2m in the year. Duggan Co pays tax at 25% and movements in deferred tax are to be taken to the statement of profit or loss.

- (iv) Duggan Co issued \$5m 6% convertible loan notes on 1 July 20X7. Interest is payable annually in arrears. These bonds can be converted into one share for every \$2 on 30 June 20X9. Similar loan notes, without conversion rights, incur interest at 8%. Duggan Co recorded the full amount in liabilities and has recorded the annual payment made on 30 June 20X8 of \$0.3m in finance costs.

Relevant discount rates are as follows:

<b>Present value of \$1 in:</b>	<b>6%</b>	<b>8%</b>
1 year	0.943	0.926
2 years	0.890	0.857

- (v) Duggan Co began the construction of an item of property on 1 July 20X7 which was completed on 31 March 20X8. A cost of \$32m was capitalised. This included \$2.56m, being a full 12 months' interest on a \$25.6m 10% loan taken out specifically for this construction. On completion, the property has a useful life of 20 years.

Duggan Co also recorded \$0.4m in operating expenses, representing depreciation on the asset for the period from 31 March 20X8 to 30 June 20X8.

- (vi) It has been discovered that the previous financial controller of Duggan Co engaged in fraudulent financial reporting. Currently, \$2.5m of trade receivables has been deemed to not exist and requires to be written off. Of this, \$0.9m relates to the year ended 30 June 20X8, with \$1.6m relating to earlier periods.

- (vii) On 1 November 20X7, Duggan Co issued 1.5 million shares at their full market price of \$2.20. The proceeds were credited to a suspense account.

**Required:**

- (a) Prepare a statement of profit or loss for Duggan Co for the year ended 30 June 20X8. (12 marks)
- (b) Prepare a statement of changes in equity for Duggan Co for the year ended 30 June 20X8. (5 marks)
- (c) Calculate the basic earnings per share for Duggan Co for the year ended 30 June 20X8. (3 marks)

Note: All workings should be done to the nearest \$'000.

**(20 marks)**

**End of Question Paper**