Fundamentals Level – Skills Module

Financial Reporting (International)

Wednesday 4 June 2014

Paper F7 (INT)

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

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1 On 1 October 2013, Penketh acquired 90 million of Sphere's 150 million $1 equity shares. The acquisition was achieved through a share exchange of one share in Penketh for every three shares in Sphere. At that date the stock market prices of Penketh's and Sphere's shares were $4 and $2·50 per share respectively. Additionally, Penketh will pay $1·54 cash on 30 September 2014 for each share acquired. Penketh's finance cost is 10% per annum.

The retained earnings of Sphere **brought forward** at 1 April 2013 were $120 million.

The summarised statements of profit or loss and other comprehensive income for the companies for the year ended 31 March 2014 are:

	Penketh	Sphere
	$'000	$'000
Revenue	620,000	310,000
Cost of sales	(400,000)	(150,000)
Gross profit	220,000	160,000
Distribution costs	(40,000)	(20,000)
Administrative expenses	(36,000)	(25,000)
Investment income (note (iii))	5,000	1,600
Finance costs	(2,000)	(5,600)
Profit before tax	147,000	111,000
Income tax expense	(45,000)	(31,000)
Profit for the year	102,000	80,000
Other comprehensive income		
Gain/(loss) on revaluation of land (notes (i) and (ii))	(2,200)	3,000
Total comprehensive income for the year	99,800	83,000

The following information is relevant:

(i) A fair value exercise conducted on 1 October 2013 concluded that the carrying amounts of Sphere's net assets were equal to their fair values with the following exceptions:

– the fair value of Sphere's land was $2 million in excess of its carrying amount

– an item of plant had a fair value of $6 million in excess of its carrying amount. The plant had a remaining life of two years at the date of acquisition. Plant depreciation is charged to cost of sales.

– Penketh placed a value of $5 million on Sphere's good trading relationships with its customers. Penketh expected, on average, a customer relationship to last for a further five years. Amortisation of intangible assets is charged to administrative expenses.

(ii) Penketh's group policy is to revalue land to market value at the end of each accounting period. Prior to its acquisition, Sphere's land had been valued at historical cost, but it has adopted the group policy since its acquisition. In addition to the fair value increase in Sphere's land of $2 million (see note (i)), it had increased by a further $1 million since the acquisition.

(iii) On 1 October 2013, Penketh also acquired 30% of Ventor's equity shares. Ventor's profit after tax for the year ended 31 March 2014 was $10 million and during March 2014 Ventor paid a dividend of $6 million. Penketh uses equity accounting in its consolidated financial statements for its investment in Ventor.

Sphere did not pay any dividends in the year ended 31 March 2014.

(iv) After the acquisition Penketh sold goods to Sphere for $20 million. Sphere had one fifth of these goods still in inventory at 31 March 2014. In March 2014 Penketh sold goods to Ventor for $15 million, all of which were still in inventory at 31 March 2014. All sales to Sphere and Ventor had a mark-up on cost of 25%.

(v) Penketh's policy is to value the non-controlling interest at the date of acquisition at its fair value. For this purpose, the share price of Sphere at that date (1 October 2013) is representative of the fair value of the shares held by the non-controlling interest.

(vi) All items in the above statements of profit or loss and other comprehensive income are deemed to accrue evenly over the year unless otherwise indicated.

Required:

(a) Calculate the consolidated goodwill as at 1 October 2013.

(b) Prepare the consolidated statement of profit or loss and other comprehensive income of Penketh for the year ended 31 March 2014.

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

(a) 6 marks
(b) 19 marks

(25 marks)

2 The following trial balance relates to Xtol at 31 March 2014:

	$'000	$'000
Revenue (note (i))		490,000
Cost of sales	290,600	
Distribution costs	33,500	
Administrative expenses	36,800	
Loan note interest and dividends paid (notes (iv) and (v))	13,380	
Bank interest	900	
20-year leased property at cost (note (ii))	100,000	
Plant and equipment at cost (note (ii))	155,500	
Accumulated amortisation/depreciation at 1 April 2013:		
leased property		25,000
plant and equipment		43,500
Inventory at 31 March 2014	61,000	
Trade receivables	63,000	
Trade payables		32,200
Bank		5,500
Equity shares of 25 cents each (note (iii))		56,000
Share premium		25,000
Retained earnings at 1 April 2013		26,080
5% convertible loan note (note (iv))		50,000
Current tax (note (vi))	3,200	
Deferred tax (note (vi))		4,600
	757,880	757,880

The following notes are relevant:

(i) Revenue includes an amount of $20 million for cash sales made through Xtol's retail outlets during the year on behalf of Francais. Xtol, acting as agent, is entitled to a commission of 10% of the selling price of these goods. By 31 March 2014, Xtol had remitted to Francais $15 million (of the $20 million sales) and recorded this amount in cost of sales.

(ii) Plant and equipment is depreciated at 12½% per annum on the reducing balance basis.

All amortisation/depreciation of non-current assets is charged to cost of sales.

(iii) On 1 August 2013, Xtol made a fully subscribed rights issue of equity share capital based on two new shares at 60 cents each for every five shares held. The market price of Xtol's shares before the issue was $1·02 each. The issue has been fully recorded in the trial balance figures.

(iv) On 1 April 2013, Xtol issued a 5% $50 million convertible loan note at par. Interest is payable annually in arrears on 31 March each year. The loan note is redeemable at par or convertible into equity shares at the option of the loan note holders on 31 March 2016. The interest on an equivalent loan note without the conversion rights would be 8% per annum.

The present values of $1 receivable at the end of each year, based on discount rates of 5% and 8%, are:

	5%	8%
End of year 1	0·95	0·93
2	0·91	0·86
3	0·86	0·79

(v) An equity dividend of 4 cents per share was paid on 30 May 2013 and, after the rights issue, a further dividend of 2 cents per share was paid on 30 November 2013.

(vi) The balance on current tax represents the under/over provision of the tax liability for the year ended 31 March 2013. A provision of $28 million is required for current tax for the year ended 31 March 2014 and at this date the deferred tax liability was assessed at $8·3 million.

Required:

(a) Prepare the statement of profit or loss for Xtol for the year ended 31 March 2014.

(b) Prepare the statement of changes in equity for Xtol for the year ended 31 March 2014.

(c) Prepare the statement of financial position for Xtol as at 31 March 2014.

(d) Calculate the basic earnings per share (EPS) for Xtol for the year ended 31 March 2014.

Note: Answers and workings (for parts (a) to (c)) should be presented to the nearest $1,000; notes to the financial statements are not required.

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

(a) 8 marks
(b) 6 marks
(c) 8 marks
(d) 3 marks

(25 marks)

3 Shown below are the financial statements of Woodbank for its most recent two years:

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

	2014	2013
	$'000	$'000
Revenue	150,000	110,000
Cost of sales	(117,000)	(85,800)
Gross profit	33,000	24,200
Distribution costs	(6,000)	(5,000)
Administrative expenses	(9,000)	(9,200)
Finance costs – loan note interest	(1,750)	(500)
Profit before tax	16,250	9,500
Income tax expense	(5,750)	(3,000)
Profit for the year	10,500	6,500

Statements of financial position as at 31 March:

	2014	2013
	$'000	$'000
Assets		
Non-current assets		
Property, plant and equipment	118,000	85,000
Goodwill	30,000	nil
	148,000	85,000
Current assets		
Inventory	15,500	12,000
Trade receivables	11,000	8,000
Bank	500	5,000
	27,000	25,000
Total assets	175,000	110,000
Equity and liabilities		
Equity		
Equity shares of $1 each	80,000	80,000
Retained earnings	15,000	10,000
	95,000	90,000
Non-current liabilities		
10% loan notes	55,000	5,000
Current liabilities		
Trade payables	21,000	13,000
Current tax payable	4,000	2,000
	25,000	15,000
Total equity and liabilities	175,000	110,000

The following information is available:

(i) On 1 January 2014, Woodbank purchased the trading assets and operations of Shaw for $50 million and, on the same date, issued additional 10% loan notes to finance the purchase. Shaw was an unincorporated entity and its results (for three months from 1 January 2014 to 31 March 2014) and net assets (including goodwill not subject to any impairment) are included in Woodbank's financial statements for the year ended 31 March 2014 .There were no other purchases or sales of non-current assets during the year ended 31 March 2014.

(ii) Extracts of the results (for three months) of the previously separate business of Shaw, which are included in Woodbank's statement of profit or loss for the year ended 31 March 2014, are:

	$'000
Revenue	30,000
Cost of sales	(21,000)
Gross profit	9,000
Distribution costs	(2,000)
Administrative expenses	(2,000)

(iii) The following six ratios have been correctly calculated for Woodbank for the year ended 31 March 2013:

Return on capital employed (ROCE) (profit before interest and tax/year-end total assets less current liabilities)	10·5%
Net asset (equal to capital employed) turnover	1·16 times
Gross profit margin	22·0%
Profit before interest and tax margin	9·1%
Current ratio	1·7:1
Gearing (debt/(debt + equity))	5·3%

Required:

(a) Calculate for the year ended 31 March 2014:

(i) equivalent ratios (all six) to the above for Woodbank based on its reported figures; and

(ii) equivalent ratios to the first FOUR only for Woodbank excluding the effects of the purchase of Shaw.

Note: Assume the capital employed for Shaw is equal to its purchase price of $50 million. (10 marks)

(b) Assess the comparative financial performance and position of Woodbank for the year ended 31 March 2014. Your answer should refer to the effects of the purchase of Shaw. (15 marks)

(25 marks)

4 **(a)** A director of Enca, a public listed company, has expressed concerns about the accounting treatment of some of the company's items of property, plant and equipment which have increased in value. His main concern is that the statement of financial position does not show the true value of assets which have increased in value and that this 'undervaluation' is compounded by having to charge depreciation on these assets, which also reduces reported profit. He argues that this does not make economic sense.

Required:

Respond to the director's concerns by summarising the principal requirements of IAS 16 *Property, Plant and Equipment* in relation to the revaluation of property, plant and equipment, including its subsequent treatment. (5 marks)

(b) The following details relate to two items of property, plant and equipment (A and B) owned by Delta which are depreciated on a straight-line basis with no estimated residual value:

	Item A	Item B
Estimated useful life at acquisition	8 years	6 years
	$'000	$'000
Cost on 1 April 2010	240,000	120,000
Accumulated depreciation (two years)	(60,000)	(40,000)
Carrying amount at 31 March 2012	180,000	80,000
Revaluation on 1 April 2012:		
Revalued amount	160,000	112,000
Revised estimated remaining useful life	5 years	5 years
Subsequent expenditure capitalised on 1 April 2013	nil	14,400

At 31 March 2014 item A was still in use, but item B was sold (on that date) for $70 million.

Note: Delta makes an annual transfer from its revaluation surplus to retained earnings in respect of excess depreciation.

Required:

Prepare extracts from:

(i) Delta's statements of profit or loss for the years ended 31 March 2013 and 2014 in respect of charges (expenses) related to property, plant and equipment;

(ii) Delta's statements of financial position as at 31 March 2013 and 2014 for the carrying amount of property, plant and equipment and the revaluation surplus.

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

(i) 5 marks
(ii) 5 marks (10 marks)

(15 marks)

5 The following issues have arisen during the preparation of Skeptic's draft financial statements for the year ended 31 March 2014:

(i) From 1 April 2013, the directors have decided to reclassify research and amortised development costs as administrative expenses rather than its previous classification as cost of sales. They believe that the previous treatment unfairly distorted the company's gross profit margin.

(ii) Skeptic has two potential liabilities to assess. The first is an outstanding court case concerning a customer claiming damages for losses due to faulty components supplied by Skeptic. The second is the provision required for product warranty claims against 200,000 units of retail goods supplied with a one-year warranty.

The estimated outcomes of the two liabilities are:

Court case	Product warranty claims
10% chance of no damages awarded	70% of sales will have no claim
65% chance of damages of $4 million	20% of sales will require a $25 repair
25% chance of damages of $6 million	10% of sales will require a $120 repair

(iii) On 1 April 2013, Skeptic received a government grant of $8 million towards the purchase of new plant with a gross cost of $64 million. The plant has an estimated life of 10 years and is depreciated on a straight-line basis. One of the terms of the grant is that the sale of the plant before 31 March 2017 would trigger a repayment on a sliding scale as follows:

Sale in the year ended:	Amount of repayment
31 March 2014	100%
31 March 2015	75%
31 March 2016	50%
31 March 2017	25%

Accordingly, the directors propose to credit to the statement of profit or loss $2 million ($8 million x 25%) being the amount of the grant they believe has been earned in the year to 31 March 2014. Skeptic accounts for government grants as a separate item of deferred credit in its statement of financial position. Skeptic has no intention of selling the plant before the end of its economic life.

Required:

Advise, and quantify where possible, how the above items (i) to (iii) should be treated in Skeptic's financial statements for the year ended 31 March 2014.

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

(i) 3 marks
(ii) 4 marks
(iii) 3 marks

(10 marks)

End of Question Paper