

Fundamentals Level – Skills Module

# Financial Reporting (Singapore)

Tuesday 11 December 2007

**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

The Institute of Certified Public Accountants of Singapore

# Paper F7 (SGP)



**ALL FIVE questions are compulsory and MUST be attempted**

- 1 On 1 October 2006 Plateau acquired the following non-current investments:
- 3 million equity shares in Savannah by an exchange of one share in Plateau for every two shares in Savannah plus \$1 per acquired Savannah share in cash. The market price of each Plateau share at the date of acquisition was \$6.
  - 30% of the equity shares of Axle at a cost of \$7.50 per share in cash.

Only the cash consideration of the above investments has been recorded by Plateau.

The summarised draft balance sheets of the three companies at 30 September 2007 are:

	Plateau \$'000	Savannah \$'000	Axle \$'000
<b>Assets</b>			
Non-current assets			
Property, plant and equipment	18,400	10,400	18,000
Investments in Savannah and Axle	12,000	nil	nil
Available-for-sale investments	6,500	nil	nil
	<u>36,900</u>	<u>10,400</u>	<u>18,000</u>
Current assets			
Inventory	6,900	6,200	3,600
Trade receivables	3,200	1,500	2,400
Total assets	<u>47,000</u>	<u>18,100</u>	<u>24,000</u>
<b>Equity and liabilities</b>			
Equity shares			
Retained earnings – at 30 September 2006	10,000	4,000	4,000
– for year ended 30 September 2007	16,000	6,500	11,000
	<u>8,000</u>	<u>2,400</u>	<u>5,000</u>
	34,000	12,900	20,000
Non-current liabilities			
7% Loan notes	5,000	1,000	1,000
Current liabilities			
	<u>8,000</u>	<u>4,200</u>	<u>3,000</u>
Total equity and liabilities	<u>47,000</u>	<u>18,100</u>	<u>24,000</u>

The following information is relevant:

- (i) At the date of acquisition the fair values of Savannah's assets were equal to their carrying amounts with the exception of Savannah's land which had a fair value of \$500,000 **below** its carrying amount; it was written down by this amount shortly after acquisition and has not changed in value since then.
- (ii) On 1 October 2006, Plateau sold an item of plant to Savannah at its agreed fair value of \$2.5 million. Its carrying amount prior to the sale was \$2 million. The estimated remaining life of the plant at the date of sale was five years (straight-line depreciation).
- (iii) During the year ended 30 September 2007 Savannah sold goods to Plateau for \$2.7 million. Savannah had marked up these goods by 50% on cost. Plateau had a third of the goods still in its inventory at 30 September 2007. There were no intra-group payables/receivables at 30 September 2007.
- (iv) Impairment tests on 30 September 2007 concluded that the value of the investment in Axle was not impaired, but consolidated goodwill was impaired by \$900,000.
- (v) The available-for-sale investments are included in Plateau's balance sheet (above) at their fair value on 1 October 2006, but they have a fair value of \$9 million at 30 September 2007
- (vi) No dividends were paid during the year by any of the companies.
- (vii) The equity share capital of Plateau at 30 September 2007 consists of 10 million shares. The equity share capital of Savannah and Axle consist of 4 million shares each.

**Required:**

**(a) Prepare the consolidated balance sheet for Plateau as at 30 September 2007.** (20 marks)

**(b)** A financial assistant has observed that the fair value exercise means that a subsidiary's net assets are included at acquisition at their fair (current) values in the consolidated balance sheet. The assistant believes that it is inconsistent to aggregate the subsidiary's net assets with those of the parent because most of the parent's assets are carried at historical cost.

**Required:**

**Comment on the assistant's observation and explain why the net assets of acquired subsidiaries are consolidated at acquisition at their fair values.** (5 marks)

**(25 marks)**

2 The following trial balance relates to Llama, a listed company, at 30 September 2007:

	\$'000	\$'000
Land and buildings – at valuation 1 October 2006 (note (i))	130,000	
Plant – at cost (note (i))	128,000	
Accumulated depreciation of plant at 1 October 2006		32,000
Investments – at fair value through profit and loss (note (i))	26,500	
Investment income		2,200
Cost of sales (note (i))	89,200	
Distribution costs	11,000	
Administrative expenses	12,500	
Loan interest paid	800	
Inventory at 30 September 2007	37,900	
Income tax (note (ii))		400
Trade receivables	35,100	
Revenue		180,400
Equity shares		60,000
Retained earnings at 1 October 2006		25,500
2% loan note 2009 (note (iii))		80,000
Trade payables		34,700
Revaluation reserve (re land and buildings)		14,000
Deferred tax		11,200
Suspense account (note (iv))		24,000
Bank		6,600
	471,000	471,000

The following notes are relevant:

- (i) Llama has a policy of revaluing its land and buildings at each year end. The valuation in the trial balance includes a land element of \$30 million. The estimated remaining life of the buildings at that date (1 October 2006) was 20 years. On 30 September 2007, a professional valuer valued the buildings at \$92 million with no change in the value of the land. Depreciation of buildings is charged 60% to cost of sales and 20% each to distribution costs and administrative expenses.

During the year Llama manufactured an item of plant that it is using as part of its own operating capacity. The details of its cost, which is included in cost of sales in the trial balance, are:

	\$'000
Materials cost	6,000
Direct labour cost	4,000
Machine time cost	8,000
Directly attributable overheads	6,000

The manufacture of the plant was completed on 31 March 2007 and the plant was brought into immediate use, but its cost has not yet been capitalised.

All plant is depreciated at 12½% per annum (time apportioned where relevant) using the reducing balance method and charged to cost of sales. No non-current assets were sold during the year.

The fair value of the investments held at fair value through profit and loss at 30 September 2007 was \$27.1 million.

- (ii) The balance of income tax in the trial balance represents the under/over provision of the previous year's estimate. The estimated income tax liability for the year ended 30 September 2007 is \$18.7 million. At 30 September 2007 there were \$40 million of taxable temporary differences. The income tax rate is 25%. Note: you may assume that the movement in deferred tax should be taken to the income statement.
- (iii) The 2% loan note was issued on 1 April 2007 under terms that provide for a large premium on redemption in 2009. The finance department has calculated that the effect of this is that the loan note has an effective interest rate of 6% per annum.

- (iv) The suspense account contains the corresponding credit entry for the proceeds of a rights issue of shares made on 1 July 2007. The terms of the issue were one share for every four held at 80 cents per share. Llama's share price immediately before the issue was \$1. The issue was fully subscribed.
- (v) The equity share capital of Llama prior to the rights issue consisted of 120 million shares.

**Required:**

**Prepare for Llama:**

- (a) **An income statement for the year ended 30 September 2007.** (9 marks)
- (b) **A balance sheet as at 30 September 2007.** (13 marks)
- (c) **A calculation of the earnings per share for the year ended 30 September 2007.** (3 marks)

Note: a statement of changes in equity is not required.

**(25 marks)**

- 3 Shown below are the recently issued (summarised) financial statements of Harbin, a listed company, for the year ended 30 September 2007, together with comparatives for 2006 and extracts from the Chief Executive's report that accompanied their issue.

<b>Income statement</b>	<b>2007</b>	<b>2006</b>
	<b>\$'000</b>	<b>\$'000</b>
Revenue	250,000	180,000
Cost of sales	(200,000)	(150,000)
Gross profit	50,000	30,000
Operating expenses	(26,000)	(22,000)
Finance costs	(8,000)	(nil)
Profit before tax	16,000	8,000
Income tax expense (at 25%)	(4,000)	(2,000)
Profit for the period	12,000	6,000
<b>Balance sheet</b>		
Non-current assets		
Property, plant and equipment	210,000	90,000
Goodwill	10,000	nil
	220,000	90,000
Current assets		
Inventory	25,000	15,000
Trade receivables	13,000	8,000
Bank	nil	14,000
	38,000	37,000
Total assets	258,000	127,000
Equity and liabilities		
Equity shares (comprising 100 million shares)	100,000	100,000
Retained earnings	14,000	12,000
	114,000	112,000
Non-current liabilities		
8% loan notes	100,000	nil
Current liabilities		
Bank overdraft	17,000	nil
Trade payables	23,000	13,000
Current tax payable	4,000	2,000
	44,000	15,000
Total equity and liabilities	258,000	127,000

Extracts from the Chief Executive's report:

'Highlights of Harbin's performance for the year ended 30 September 2007:

- an increase in sales revenue of 39%
- gross profit margin up from 16.7% to 20%
- a doubling of the profit for the period.

In response to the improved position the Board paid a dividend of 10 cents per share in September 2007, an increase of 25% on the previous year.'

You have also been provided with the following further information.

On 1 October 2006 Harbin purchased the whole of the net assets of Fatima (previously a privately owned entity) for \$100 million. The contribution of the purchase to Harbin's results for the year ended 30 September 2007 was:

	\$'000
Revenue	70,000
Cost of sales	(40,000)
Gross profit	<u>30,000</u>
Operating expenses	(8,000)
Profit before tax	<u>22,000</u>

There were no disposals of non-current assets during the year.

The following ratios have been calculated for Harbin for the year ended 30 September 2006:

Return on year-end capital employed (profit before interest and tax over total assets less current liabilities)	7.1%
Net asset (equal to capital employed) turnover	1.6
Net profit (before tax) margin	4.4%
Current ratio	2.5
Closing inventory holding period (in days)	37
Trade receivables' collection period (in days)	16
Trade payables' payment period (based on cost of sales) (in days)	32
Gearing (debt over debt plus equity)	nil

**Required:**

- (a) Calculate ratios for Harbin for the year ended 30 September 2007 equivalent to those calculated for the year ended 30 September 2006 (showing your workings). (8 marks)
- (b) Assess the financial performance and position of Harbin for the year ended 30 September 2007 compared to the previous year. Your answer should refer to the information in the Chief Executive's report and the impact of the purchase of the net assets of Fatima. (17 marks)

**(25 marks)**

- 4 (a) An important requirement of the CCDG's *Framework for the Preparation and Presentation of Financial Statements* (Framework) is that in order to be reliable, an entity's financial statements should represent faithfully the transactions and events that it has undertaken.

**Required:**

**Explain what is meant by faithful representation and how it enhances reliability.** (5 marks)

- (b) On 1 April 2007, Fino increased the operating capacity of its plant. Due to a lack of liquid funds it was unable to buy the required plant which had a cost of \$350,000. On the recommendation of the finance director, Fino entered into an agreement to lease the plant from the manufacturer. The lease required four annual payments in advance of \$100,000 each commencing on 1 April 2007. The plant would have a useful life of four years and would be scrapped at the end of this period. The finance director, believing the lease to be an operating lease, commented that the agreement would improve the company's return on capital employed (compared to outright purchase of the plant).

**Required:**

- (i) **Discuss the validity of the finance director's comment and describe how FRS 17 Leases ensures that leases such as the above are faithfully represented in an entity's financial statements.** (4 marks)
- (ii) **Prepare extracts of Fino's income statement and balance sheet for the year ended 30 September 2007 in respect of the rental agreement assuming:**
- (1) **It is an operating lease** (2 marks)
- (2) **It is a finance lease (use an implicit interest rate of 10% per annum).** (4 marks)

**(15 marks)**



- 5 Product development costs are a material cost for many companies. They are either written off as an expense or capitalised as an asset.

**Required:**

- (a) **Discuss the conceptual issues involved and the definition of an asset that may be applied in determining whether development expenditure should be treated as an expense or an asset.** (4 marks)
- (b) Emerald has had a policy of writing off development expenditure to the income statement as it was incurred. In preparing its financial statements for the year ended 30 September 2007 it has become aware that, under FRS rules, qualifying development expenditure should be treated as an intangible asset. Below is the qualifying development expenditure for Emerald:

	\$'000
Year ended 30 September 2004	300
Year ended 30 September 2005	240
Year ended 30 September 2006	800
Year ended 30 September 2007	400

All capitalised development expenditure is deemed to have a four year life. Assume amortisation commences at the beginning of the accounting period **following** capitalisation. Emerald had no development expenditure before that for the year ended 30 September 2004.

**Required:**

**Treating the above as the correction of an error in applying an accounting policy, calculate the amounts which should appear in the income statement and balance sheet (including comparative figures), and statement of changes in equity of Emerald in respect of the development expenditure for the year ended 30 September 2007.**

Note: ignore taxation.

(6 marks)

**(10 marks)**

**End of Question Paper**