Fundamentals Level – Skills Module

Financial Reporting (Irish)

Tuesday 10 June 2008

Paper F7 (IRL)

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 August 2007 Patronic purchased 18 million of a total of 24 million equity shares in Sardonic. The acquisition was through a share exchange of two shares in Patronic for every three shares in Sardonic. Both companies have shares with a par value of €1 each. The market price of Patronic's shares at 1 August 2007 was €5·75 per share. Patronic will also pay in cash on 31 July 2009 (two years after acquisition) €2·42 per acquired share of Sardonic. Patronic's cost of capital is 10% per annum. The reserves of Sardonic on 1 April 2007 were €69 million.

Patronic has held an investment of 30% of the equity shares in Acerbic for many years.

The summarised profit and loss accounts for the three companies for the year ended 31 March 2008 are:

	Patronic	Sardonic	Acerbic
	€'000	€'000	€'000
Turnover	150,000	78,000	80,000
Cost of sales	(94,000)	(51,000)	(60,000)
Gross profit	56,000	27,000	20,000
Distribution costs	(7,400)	(3,000)	(3,500)
Administrative expenses	(12,500)	(6,000)	(6,500)
Operating profit	36,100	18,000	10,000
Finance costs (note (ii))	(2,000)	(900)	nil
Profit before tax	34,100	17,100	10,000
Tax	(10,400)	(3,600)	(4,000)
Profit for the year	23,700	13,500	6,000

The following information is relevant:

(i) The fair values of the net assets of Sardonic at the date of acquisition were equal to their carrying amounts with the exception of property and plant. Property and plant had fair values of €4·1 million and €2·4 million respectively in excess of their carrying amounts. The increase in the fair value of the property would create additional depreciation of €200,000 in the consolidated financial statements in the post acquisition period to 31 March 2008 and the plant had a remaining life of four years (straight-line depreciation) at the date of acquisition of Sardonic. All depreciation is treated as part of cost of sales.

The fair values have not been reflected in Sardonic's financial statements.

No fair value adjustments were required on the acquisition of Acerbic.

(ii) The finance costs of Patronic do not include the finance cost on the deferred consideration.

(iii) Prior to its acquisition, Sardonic had been a good customer of Patronic. In the year to 31 March 2008, Patronic sold goods at a selling price of €1·25 million per month to Sardonic both before and after its acquisition. Patronic made a profit of 20% on the cost of these sales. At 31 March 2008 Sardonic still held stock of €3 million (at cost to Sardonic) of goods purchased in the post acquisition period from Patronic.

(iv) The goodwill of Sardonic should be amortised over a nine-year life with time apportionment in the year of acquisition. The goodwill in Acerbic was deemed to have an indefinite life and was not impaired at 31 March 2008.

(v) All items in the above profit and loss accounts are deemed to accrue evenly over the year.

(vi) Ignore deferred tax.

Required:

(a) Calculate the goodwill arising on the acquisition of Sardonic at 1 August 2007. (6 marks)

(b) Prepare the consolidated profit and loss account for the Patronic Group for the year ended 31 March 2008.

Note: assume that the investment in Acerbic has been accounted for using the equity method since its acquisition. (15 marks)

(c) At 31 March 2008 the other equity shares (70%) in Acerbic were owned by many separate investors. Shortly after this date Spekulate (a company unrelated to Patronic) accumulated a 60% interest in Acerbic by buying shares from the other shareholders. In May 2008 a meeting of the board of directors of Acerbic was held at which Patronic lost its seat on Acerbic's board.

Required:

Explain, with reasons, the accounting treatment Patronic should adopt for its investment in Acerbic when it prepares its financial statements for the year ending 31 March 2009. (4 marks)

(25 marks)

2 Below is the summarised draft balance sheet of Dexon, a publicly listed company, as at 31 March 2008.

	€'000	€'000	€'000
Fixed assets			
Property at valuation (land €20,000; buildings €165,000 (note (ii))			185,000
Plant (note (ii))			180,500
Investments at fair value through profit and loss at 1 April 2007 (note (iii))			12,500
			378,000
Current assets			
Stock		84,000	
Debtors (note (iv))		52,200	
Bank		3,800	
		140,000	
Creditors: amounts falling due within one year		(81,800)	
Net current assets			58,200
Provisions for liabilities			
Deferred tax – at 1 April 2007 (note (v))			(19,200)
Net assets			417,000
Share capital and reserves			
Ordinary shares of €1 each			250,000
Share premium		40,000	
Revaluation reserve		18,000	
Profit and loss account – at 1 April 2007	12,300		
– for the year ended 31 March 2008	96,700	109,000	167,000
			417,000

The following information is relevant:

(i) Dexon's profit and loss account for the year includes €8 million in turnover from credit sales made on a 'sale or return' basis. At 31 March 2008, customers who had not paid for the goods, had the right to return €2·6 million of them. Dexon applied a mark up on cost of 30% on all these sales. In the past, Dexon's customers have sometimes returned goods under this type of agreement.

(ii) The fixed assets have not been depreciated for the year ended 31 March 2008.

Dexon has a policy of revaluing its land and buildings at the end of each accounting year. The values in the above balance sheet are as at 1 April 2007 when the buildings had a remaining life of fifteen years. A qualified surveyor has valued the land and buildings at 31 March 2008 at €180 million.

Plant is depreciated at 20% on the reducing balance basis.

(iii) The investments at fair value through profit and loss are held in a fund whose value changes directly in proportion to a specified market index. At 1 April 2007 the relevant index was 1,200 and at 31 March 2008 it was 1,296.

(iv) In late March 2008 the directors of Dexon discovered a material fraud perpetrated by the company's credit controller that had been continuing for some time. Investigations revealed that a total of €4 million of the debtors as shown in the balance sheet at 31 March 2008 had in fact been paid and the money had been stolen by the credit controller. An analysis revealed that €1·5 million had been stolen in the year to 31 March 2007 with the rest being stolen in the current year. Dexon is not insured for this loss and it cannot be recovered from the credit controller, nor is it deductible for tax purposes.

(v) During the year the company's timing differences increased by €10 million (capital allowances in excess of carrying values) of which €6 million related to the revaluation of the property. Dexon has a firm commitment to sell this property in the near future and has therefore been advised that a tax liability will arise on its sale. The applicable corporation tax rate is 20%.

(vi) The above figures do not include the estimated provision for corporation tax on the profits for the year ended 31 March 2008. After allowing for any adjustments required in items (i) to (iv), the directors have estimated the provision at €11·4 million (this is in addition to the deferred tax effects of item (v)).

(vii) On 1 September 2007 there was a fully subscribed rights issue of one new share for every four held at a price of €1·20 each. The proceeds of the issue have been received and the issue of the shares has been correctly accounted for in the above balance sheet.

(viii) In May 2007 a dividend of 4 cent per share was paid. In November 2007 (after the rights issue in item (vii) above) a further dividend of 3 cent per share was paid. Both dividends have been correctly accounted for in the above balance sheet.

Required:

Taking into account any adjustments required by items (i) to (viii) above

(a) Prepare a statement showing the recalculation of Dexon's profit for the year ended 31 March 2008. (8 marks)

(b) Prepare a statement of the movements in the share capital and reserves of Dexon for the year ended 31 March 2008. (8 marks)

(c) Redraft the balance sheet of Dexon as at 31 March 2008. (9 marks)

Note: notes to the financial statements are NOT required.

(25 marks)

3 Pinto is a publicly listed company. The following financial statements of Pinto are available:

Profit and loss account for the year ended 31 March 2008	**€'000**
Turnover	5,740
Cost of sales	(4,840)
Gross profit	900
Distribution costs	(120)
Administrative expenses (note (ii))	(350)
Operating profit	430
Income from and gains on investment property	60
Finance costs	(50)
Profit before tax	440
Tax	(160)
Profit for the year	280

Balance sheets as at	**31 March 2008**		**31 March 2007**	
	€'000	**€'000**	**€'000**	**€'000**
Fixed assets				
Tangible assets (note (i))		2,880		1,860
Investment property		420		400
		3,300		2,260
Current assets				
Stock	1,210		810	
Debtors	480		540	
Tax asset	nil		50	
Bank	10		nil	
	1,700		1,400	
Creditors: amounts falling due within one year				
Bank overdraft	nil		120	
Creditors	1,410		1,050	
Warranty provision (note (iv))	200		100	
Taxation	150		nil	
	(1,760)		(1,270)	
Net current assets (liabilities)		(60)		130
Creditors: amounts falling due after more than one year				
6% loan notes (note (ii))		nil		(400)
Provisions for liabilities				
Deferred tax		(50)		(30)
		3,190		1,960
Capital and reserves				
Equity shares of 20 cent each (note (iii))		1,000		600
Share premium	600		nil	
Revaluation reserve (note (i))	150		50	
Profit and loss account	1,440	2,190	1,310	1,360
		3,190		1,960

The following supporting information is available:

(i) The increase in the revaluation reserve is attributable to a revaluation of Pinto's property during the year.

An item of plant with a carrying amount of €240,000 was sold at a loss of €90,000 during the year. Depreciation of €280,000 was charged (to cost of sales) for tangible fixed assets the year ended 31 March 2008.

There were no purchases or sales of investment property during the year.

(ii) The 6% loan notes were redeemed early incurring a penalty payment of €20,000 which has been charged as an administrative expense in the profit and loss account.

(iii) There was an issue of shares for cash on 1 October 2007. There were no bonus issues of shares during the year.

(iv) Pinto gives a 12 month warranty on some of the products it sells. The amounts shown as warranty provision are an accurate assessment, based on past experience, of the amount of claims likely to be made in respect of warranties outstanding at each year end. Warranty costs are included in cost of sales.

(v) A dividend of 3 cent per share was paid on 1 January 2008.

Required:

(a) Prepare a cash flow statement for Pinto for the year to 31 March 2008 in accordance with FRS 1 *Cash Flow Statements*. (15 marks)

(b) Comment on the cash flow management of Pinto as revealed by the cash flow statement and the information provided by the above financial statements.

Note: ratio analysis is not required, and will not be awarded any marks. (10 marks)

(25 marks)

4 **(a)** The ASB's *Statement of Principles for Financial Reporting* requires financial statements to be prepared on the basis that they comply with certain accounting concepts, underlying assumptions and (qualitative) characteristics. Five of these are:

Matching/accruals
Substance over form
Prudence
Comparability
Materiality

Required:

Briefly explain the meaning of each of the above principles/concepts. (5 marks)

(b) For most entities, applying the appropriate concepts/assumptions in accounting for stock is an important element in preparing their financial statements.

Required:

Illustrate with examples how each of the principles/concepts in (a) may be applied to accounting for stock. (10 marks)

(15 marks)

5 Pingway issued a €10 million 3% convertible loan note at par on 1 April 2007 with interest payable annually in arrears. Three years later, on 31 March 2010, the loan note is convertible into equity shares on the basis of €100 of loan note for 25 equity shares or it may be redeemed at par in cash at the option of the loan note holder. One of the company's financial assistants observed that the use of a convertible loan note was preferable to a non-convertible loan note as the latter would have required an interest rate of 8% in order to make it attractive to investors. The assistant has also commented that the use of a convertible loan note will improve the profit as a result of lower interest costs and, as it is likely that the loan note holders will choose the equity option, the loan note can be classified as equity which will improve the company's high gearing position.

The present value of €1 receivable at the end of the year, based on discount rates of 3% and 8% can be taken as:

	3%	8%
	€	€
End of year 1	0·97	0·93
2	0·94	0·86
3	0·92	0·79

Required:

Comment on the financial assistant's observations and show how the convertible loan note should be accounted for in Pingway's profit and loss account for the year ended 31 March 2008 and balance sheet as at that date.

(10 marks)

End of Question Paper