Fundamentals Level – Skills Module

Financial Reporting (United Kingdom)

Tuesday 15 December 2009

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

Paper F7 (UK)

ALL FIVE questions are compulsory and MUST be attempted

1 On 1 April 2009 Pandar purchased 80% of the equity shares in Salva. The acquisition was through a share exchange of three shares in Pandar for every five shares in Salva. The market prices of Pandar's and Salva's shares at 1 April 2009 were £6 per share and £3·20 respectively.

On the same date Pandar acquired 40% of the equity shares in Ambra paying £2 per share.

The summarised profit and loss accounts for the three companies for the year ended 30 September 2009 are:

	Pandar	Salva	Ambra
	£'000	£'000	£'000
Turnover	210,000	150,000	50,000
Cost of sales	(126,000)	(100,000)	(40,000)
Gross profit	84,000	50,000	10,000
Distribution costs	(11,200)	(7,000)	(5,000)
Administrative expenses	(18,300)	(9,000)	(11,000)
Investment income (interest and dividends)	9,500		
Finance costs	(1,800)	(3,000)	nil
Profit (loss) before tax	62,200	31,000	(6,000)
Corporation tax (expense) relief	(15,000)	(10,000)	1,000
Profit (loss) for the year	47,200	21,000	(5,000)

The following information for the equity of the companies at 30 September 2009 is available:

Equity shares of £1 each	200,000	120,000	40,000
Share premium	300,000	nil	nil
Profit and loss account – 1 October 2008	40,000	152,000	15,000
Profit (loss) for the year ended 30 September 2009	47,200	21,000	(5,000)
Dividends paid (26 September 2009)	nil	(8,000)	nil

The following information is relevant:

(i) The fair values of the net assets of Salva at the date of acquisition were equal to their carrying amounts with the exception of an item of plant which had a carrying amount of £12 million and a fair value of £17 million. This plant had a remaining life of five years (straight-line depreciation) at the date of acquisition of Salva.

In addition Salva owns the registration of a popular internet domain name. The registration, which had a negligible cost, has a five year remaining life (at the date of acquisition); however, it is renewable indefinitely at a nominal cost. At the date of acquisition the domain name was valued by a specialist company at £20 million.

The fair values of the plant and the domain name have not been reflected in Salva's financial statements.

No fair value adjustments were required on the acquisition of the investment in Ambra.

(ii) Immediately after its acquisition of Salva, Pandar invested £50 million in an 8% loan note from Salva. All interest accruing to 30 September 2009 had been accounted for by both companies. Salva also has other loans in issue at 30 September 2009.

(iii) Pandar has credited the whole of the dividend it received from Salva to investment income.

(iv) After the acquisition, Pandar sold goods to Salva for £15 million on which Pandar made a gross profit of 20%. Salva had one third of these goods still in its stock at 30 September 2009. There are no intra-group current account balances at 30 September 2009.

(v) The goodwill of Salva has an indefinite life; the goodwill of Ambra has a five year life. There have been no impairment losses to goodwill at 30 September 2009. All depreciation/amortisation is charged to cost of sales.

(vii) All items in the above profit and loss accounts are deemed to accrue evenly over the year unless otherwise indicated.

Required:

(a) (i) Calculate the goodwill arising on the acquisition of Salva at 1 April 2009. (5 marks)

(ii) Calculate the carrying amount of the investment in Ambra to be included within the consolidated balance sheet as at 30 September 2009. (4 marks)

(b) Prepare the consolidated profit and loss account for the Pandar Group for the year ended 30 September 2009. (16 marks)

(25 marks)

2 The following trial balance relates to Sandown at 30 September 2009:

	£'000	£'000
Turnover (note (i))		380,000
Cost of sales	246,800	
Distribution costs	17,400	
Administrative expenses (note (ii))	50,500	
Loan interest paid (note (iii))	1,000	
Investment income		1,300
Profit on sale of investments (note (iv))		2,200
Taxation (note (v))	2,100	
Freehold property – at cost 1 October 2000 (note (vi))	63,000	
Plant and equipment – at cost (note (vi))	42,200	
Brand – at cost 1 October 2005 (note (vi))	30,000	
Accumulated depreciation – 1 October 2008 – building		8,000
– plant and equipment		19,700
Accumulated amortisation – 1 October 2008 – brand		9,000
Available-for-sale investments (note (iv))	26,500	
Stock at 30 September 2009	38,000	
Trade debtors	44,500	
Bank	8,000	
Trade creditors		42,900
Equity shares of 20 pence each		50,000
Equity option		2,000
Other reserve (note (iv))		5,000
5% convertible loan note 2012 (note (iii))		18,440
Profit and loss account at 1 October 2008		26,060
Deferred tax (note (v))		5,400
	570,000	570,000

The following notes are relevant:

(i) Sandown's turnover includes £16 million for goods sold to Pending on 1 October 2008. The terms of the sale are that Sandown will incur ongoing service and support costs of £1·2 million per annum for three years after the sale. Sandown normally makes a gross profit of 40% on such servicing and support work. Ignore the time value of money.

(ii) Administrative expenses include an equity dividend of 4·8 pence per share paid during the year.

(iii) The 5% convertible loan note was issued for proceeds of £20 million on 1 October 2007. It has an effective interest rate of 8% due to the value of its conversion option.

(iv) During the year Sandown sold an available-for-sale investment for £11 million. At the date of sale it had a carrying amount of £8·8 million and had originally cost £7 million. Sandown has recorded the disposal of the investment. The remaining available-for-sale investments (the £26·5 million in the trial balance) have a fair value of £29 million at 30 September 2009. The other reserve in the trial balance represent the net increase in the value of the available-for-sale investments as at 1 October 2008. Ignore deferred tax on these transactions.

(v) The balance on taxation represents the under/over provision of the corporation tax liability for the year ended 30 September 2008. The directors have estimated the provision for corporation tax for the year ended 30 September 2009 at £16·2 million. At 30 September 2009 the carrying amounts of Sandown's net assets were £13 million in excess of their tax written down values. The corporation tax rate of Sandown is 30%.

(vi) Fixed assets:

The freehold property has a land element of £13 million. The building element is being depreciated on a straight-line basis.

Plant and equipment is depreciated at 40% per annum using the reducing balance method.

Sandown's brand in the trial balance relates to a product line that received bad publicity during the year which led to falling sales revenues. An impairment review was conducted on 1 April 2009 which concluded that, based on estimated future sales, the brand had a value in use of £12 million and a remaining life of only three years. However, on the same date as the impairment review, Sandown received an offer to purchase the brand for £15 million. Prior to the impairment review, it was being depreciated using the straight-line method over a 10-year life.

No depreciation/amortisation has yet been charged on any fixed asset for the year ended 30 September 2009. Depreciation, amortisation and impairment charges are all charged to cost of sales.

Required:

(a) Prepare the profit and loss account for Sandown for the year ended 30 September 2009. (11 marks)

(b) Prepare the balance sheet of Sandown as at 30 September 2009. (14 marks)

Notes to the financial statements are not required.

(25 marks)

3 **(a)** The following information relates to Crosswire a publicly listed company.

Summarised balance sheets as at:

	30 September 2009		30 September 2008	
	£'000	£'000	£'000	£'000
Fixed assets				
Intangible – development costs (note (ii))		1,000		2,500
Tangible (note (i))		32,500		13,100
		33,500		15,600
Current assets	8,200		6,800	
Creditors: amounts falling due within one year				
Finance lease obligations	1,760		nil	
Trade creditors	8,040		6,500	
	(9,800)		(6,500)	
Net current assets/(liabilities)		(1,600)		300
Total assets less current liabilities		31,900		15,900
Creditors: amounts falling due after more than one year				
10% convertible loan notes (note (iii))	1,000		5,000	
Environmental provision	3,300		nil	
Finance lease obligations	5,040		nil	
Deferred tax	3,360	(12,700)	1,200	(6,200)
Total assets		19,200		9,700
Capital and reserves				
Equity shares of £1 each		5,000		4,000
Share premium	6,000		2,000	
Other capital reserves	500		500	
Revaluation reserve	2,000		nil	
Profit and loss account	5,700	14,200	3,200	5,700
		19,200		9,700

Information from the profit and loss accounts for the year ended:

	30 September 2009	30 September 2008
	£'000	£'000
Turnover	52,000	42,000
Finance costs (note (iv))	1,050	500
Taxation	1,000	800
Profit for the year after tax	4,000	3,000

The following information is available:

(i) During the year to 30 September 2009, Crosswire embarked on a replacement and expansion programme for its fixed assets. The details of this programme are:

On 1 October 2008 Crosswire acquired a platinum mine at a cost of £5 million. A condition of mining the platinum is a requirement to landscape the mining site at the end of its estimated life of 10 years. The present value of this cost at the date of the purchase was calculated at £3 million (in addition to the purchase price of the mine of £5 million).

Also on 1 October 2008 Crosswire revalued its freehold land for the first time. The credit in the revaluation reserve is the net amount of the revaluation after a transfer to deferred tax on the gain as Crosswire has a firm commitment to sell the asset shortly after the year end. The tax rate applicable to Crosswire for deferred tax is 20% per annum.

On 1 April 2009 Crosswire took out a finance lease for some new plant. The fair value of the plant was £10 million. The lease agreement provided for an initial payment on 1 April 2009 of £2·4 million followed by eight six-monthly payments of £1·2 million commencing 30 September 2009.

Plant disposed of during the year had a carrying amount of £500,000 and was sold for £1·2 million. The remaining movement on the tangible fixed assets, after charging depreciation of £3 million, was the cost of replacing plant.

(ii) From 1 October 2008 to 31 March 2009 a further £500,000 was spent completing the development project at which date marketing and production started. The sales of the new product proved disappointing and on 30 September 2009 the development costs were written down to £1 million via an impairment charge.

(iii) During the year ended 30 September 2009, £4 million of the 10% convertible loan notes matured. The loan note holders had the option of redemption at par in cash or to exchange them for equity shares on the basis of 20 new shares for each £100 of loan notes. 75% of the loan note holders chose the equity option. Ignore any effect of this on the other capital reserves.

All the above items have been treated correctly according to current Accounting Standards.

(iv) The finance costs are made up of:

For year ended:	30 September 2009 £'000	30 September 2008 £'000
finance lease charges	400	nil
unwinding of environmental provision	300	nil
loan note interest	350	500
	1,050	500

Required:

(i) Prepare a statement of the movements in the carrying amount of Crosswire's fixed assets for the year ended 30 September 2009; (9 marks)

(ii) Calculate the amounts that would appear as finance costs paid, capital expenditure and financing in the cash flow statement for Crosswire for the year ended 30 September 2009. (8 marks)

(b) A substantial shareholder has written to the directors of Crosswire expressing particular concern over the deterioration of the company's return on capital employed (ROCE).

Required:

Calculate Crosswire's ROCE for the two years ended 30 September 2008 and 2009 and comment on the apparent cause of its deterioration.

Note: ROCE should be taken as profit before interest on long-term borrowings and tax as a percentage of equity plus loan notes and finance lease obligations (at the year end). (8 marks)

(25 marks)

4 (a) An assistant of yours has been criticised over a piece of assessed work that he produced for his study course for giving the definition of a fixed asset as 'a physical asset of substantial cost, owned by the company, which will last longer than one year'.

Required:

Provide an explanation to your assistant of the weaknesses in his definition of fixed assets when compared to the Accounting Standards Board's (ASB) view of assets. (4 marks)

(b) The same assistant has encountered the following matters during the preparation of the draft financial statements of Darby for the year ending 30 September 2009. He has given an explanation of his treatment of them.

(i) Darby spent £200,000 sending its staff on training courses during the year. This has already led to an improvement in the company's efficiency and resulted in cost savings. The organiser of the course has stated that the benefits from the training should last for a minimum of four years. The assistant has therefore treated the cost of the training as an intangible asset and charged six months' amortisation based on the average date during the year on which the training courses were completed. (3 marks)

(ii) During the year the company started research work with a view to the eventual development of a new processor chip. By 30 September 2009 it had spent £1·6 million on this project. Darby has a past history of being particularly successful in bringing similar projects to a profitable conclusion. As a consequence the assistant has treated the expenditure to date on this project as an asset in the balance sheet.

Darby was also commissioned by a customer to research and, if feasible, produce a computer system to install in motor vehicles that can automatically stop the vehicle if it is about to be involved in a collision. At 30 September 2009, Darby had spent £2·4 million on this project, but at this date it was uncertain as to whether the project would be successful. As a consequence the assistant has treated the £2·4 million as an expense in the profit and loss account. (4 marks)

(iii) Darby signed a contract (for an initial three years) in August 2009 with a company called Media Today to install a satellite dish and cabling system to a newly built group of residential apartments. Media Today will provide telephone and television services to the residents of the apartments via the satellite system and pay Darby £50,000 per annum commencing in December 2009. Work on the installation commenced on 1 September 2009 and the expenditure to 30 September 2009 was £58,000. The installation is expected to be completed by 31 October 2009. Previous experience with similar contracts indicates that Darby will make a total profit of £40,000 over the three years on this initial contract. The assistant correctly recorded the costs to 30 September 2009 of £58,000 as a fixed asset, but then wrote this amount down to £40,000 (the expected total profit) because he believed the asset to be impaired.

The contract is not a finance lease. Ignore discounting. (4 marks)

Required:

For each of the above items (i) to (iii) comment on the assistant's treatment of them in the financial statements for the year ended 30 September 2009 and advise him how they should be treated under United Kingdom Accounting Standards.

Note: the mark allocation is shown against each of the three items above.

(15 marks)

5 **(a)** The following figures have been calculated from the financial statements (including comparatives) of Barstead for the year ended 30 September 2009:

increase in profit after taxation	80%
increase in (basic) earnings per share	5%
increase in diluted earnings per share	2%

Required:

Explain why the three measures of earnings (profit) growth for the same company over the same period can give apparently differing impressions. (4 marks)

(b) The profit after tax for Barstead for the year ended 30 September 2009 was £15 million. At 1 October 2008 the company had in issue 36 million equity shares and a £10 million 8% convertible loan note. The loan note will mature in 2010 and will be redeemed at par or converted to equity shares on the basis of 25 shares for each £100 of loan note at the loan note holders' option. On 1 January 2009 Barstead made a fully subscribed rights issue of one new share for every four shares held at a price of £2·80 each. The market price of the equity shares of Barstead immediately before the issue was £3·80. The earnings per share (EPS) reported for the year ended 30 September 2008 was 35 pence.

Barstead's corporation tax rate is 25%.

Required:

Calculate the (basic) EPS figure for Barstead (including comparatives) and the diluted EPS (comparatives not required) that would be disclosed for the year ended 30 September 2009. (6 marks)

(10 marks)

End of Question Paper