INTERNATIONAL STANDARDS INTERNATIONAL STANDARDS INTERNATIONAL

Intermediate Level

Financial Accounting – International Accounting Standards

6b IFAI

19 November 2003
Wednesday morning

INSTRUCTIONS TO CANDIDATES

Read this page before you look at the questions

You are allowed three hours to answer this question paper.
This question paper is based on INTERNATIONAL ACCOUNTING STANDARDS. If you require the paper based on UK Accounting Standards, please speak immediately to the invigilator.
Answer the ONE question in section A (this has 10 sub-questions). Answer the ONE question in section B. Answer TWO questions ONLY from section C.
Write your examination number, your contact ID and your name on a double-sided card, which must be attached to your answer book. Write IFAI on the line marked "Subject" on the front of the answer book. Write your examination number on the special answer sheet for section A, which is included with this question paper booklet. Detach the sheet from the booklet and insert it into your answer book before you hand this in.
Do NOT write your name or your contact ID anywhere on your answer book.
Tick the appropriate boxes on the front of the answer book to indicate which questions you have answered.

SECTION A – 20 MARKS

ANSWER *ALL* TEN SUB-QUESTIONS – 2 MARKS EACH

Each of the sub-questions numbered from **1.1** to **1.10** inclusive, given below, has only ONE correct answer.

REQUIRED:

On the SPECIAL ANSWER SHEET opposite, place a circle "O" around the letter that gives the correct answer to each sub-question.

If you wish to change your mind about an answer, block out your first answer completely and then circle another letter. You will not receive marks if more than one letter is circled.

Please note that you will not receive marks for any workings to these sub-questions.

You must detach the special answer sheet from the question paper and attach it to the inside front cover of your answer book before you hand it to the invigilators at the end of the examination.

Question One

1.1 A committee of the International Accounting Standards Board (IASB) is known as the IFRIC.

What does IFRIC stand for?

A International Financial Reporting Issues Committee

B International Financial Recommendations and Interpretations Committee

C International Financial Reporting Interpretations Committee

D International Financial Reporting Issues Council

1.2 The IASB's *Framework for the preparation and presentation of financial statements* (Framework) lists the qualitative characteristics of financial statements.

Which THREE of the following are NOT included in the principal qualitative characteristics listed by the Framework?

(i) Comparability
(ii) Relevance
(iii) Prudence
(iv) Reliability
(v) Understandability
(vi) Matching
(vii) Consistency

A (i), (iii) and (vii)

B (i), (ii) and (v)

C (iii), (vi) and (vii)

D (iii), (iv) and (vi)

Financial Accounting – International Standards

NOVEMBER 2003 EXAMINATION

SPECIAL ANSWER SHEET FOR SECTION A

Write here your full examination number:				
Centre Code				
Hall Code				
Desk Number				

1.1	**A**	**B**	**C**	**D**
1.2	**A**	**B**	**C**	**D**
1.3	**A**	**B**	**C**	**D**
1.4	**A**	**B**	**C**	**D**
1.5	**A**	**B**	**C**	**D**
1.6	**A**	**B**	**C**	**D**
1.7	**A**	**B**	**C**	**D**
1.8	**A**	**B**	**C**	**D**
1.9	**A**	**B**	**C**	**D**
1.10	**A**	**B**	**C**	**D**

You must detach the special answer sheet from the question paper and attach it to the inside front cover of your answer book before you hand it in to the invigilators at the end of the examination.

1.3 Which of the following is NOT regarded as a related party of an enterprise by IAS 24 – *Related party disclosures*?

A Directors of the enterprise.

B A bank providing a loan to the enterprise.

C The enterprise's employee pension fund.

D A close relative of a director of the enterprise.

1.4 IAS 10 – *Events after the balance sheet date,* distinguishes between adjusting and non-adjusting events.

Which of the following is an adjusting event?

A One month after the year end, a customer lodged a claim for $1,000,000 compensation. The customer claimed to have suffered permanent mental damage as a result of the fright she had when one of the enterprise's products malfunctioned and exploded. The outcome of the court case cannot be predicted at this stage.

B There was a dispute with the workers and all production ceased one week after the year end.

C A fire destroyed all of the enterprise's inventory in its finished goods warehouse two weeks after the year end.

D Inventory valued at the year end at $20,000 was sold one month later for $15,000.

1.5 B, a listed enterprise, has 5,000,000 issued ordinary shares with a par value of 20 cents each. There were no movements of issued share capital during the year. B had the following results for the year ended 30 April 2003:

	$000
Profit before tax	400
Income tax expense	100
Profit for the year	300
Dividends paid	200
Retained profit for the year	100

The quoted price of B shares on 30 April 2003 was $1·50.

The P/E ratio of B on this date was

A 5

B 15

C 18·75

D 25

1.6 X signed a finance lease agreement on 1 October 2002. The lease provided for five annual payments, in arrears, of $20,000. The fair value of the asset was agreed at $80,000.

Using the sum of digits method, how much should be charged to the income statement for the finance cost in the year to 30 September 2003?

A $4,000

B $6,667

C $8,000

D $20,000

1.7 D purchased a non-current asset on 1 April 2000 for $200,000. The asset attracted writing down tax allowances at 25% on the reducing balance. Depreciation was 10% on the straight-line basis. Assume income tax is at 30%.

The deferred tax balance for this asset at 31 March 2003 is

A $9,000

B $16,688

C $27,000

D $55,625

1.8 C started work on a contract to build a dam for a hydro-electric scheme. The work commenced on 24 August 2001 and is scheduled to take four years to complete. C recognises profit on the basis of the certified percentage of work completed. The contract price is $10 million.

An analysis of C's records provided the following information:

Year to 30 September	*2002*	*2003*
Percentage of work completed and certified in year	30%	25%
	$000	*$000*
Total cost incurred during the year	2,900	1,700
Estimated cost of remaining work to complete contract	6,000	3,900
Total payments made for the cost incurred during the year	2,500	2,000

How much profit should C recognise in its income statement for the years ended

	30 September 2002 *$000*	*30 September 2003* *$000*
A	100	375
B	330	375
C	330	495
D	500	825

1.9 F's year end is 30 June. F purchased a non-current asset for $50,000 on 1 July 2000.

Depreciation was provided at the rate of 20% per annum on the straight-line basis. There was no forecast residual value.

On 1 July 2002, the asset was revalued to $60,000 and then depreciated on a straight-line basis over its remaining useful economic life which was unchanged. On 1 July 2003, the asset was sold for $35,000.

In addition to the entries in the non-current asset account and provision for depreciation account, which TWO of the following statements correctly record the entries required on disposal of the non-current asset?

(i) Debit income statement with a loss on disposal of $5,000.

(ii) Credit income statement with a gain on disposal of $25,000.

(iii) Transfer $60,000 from revaluation reserve to accumulated profits as a movement on reserves.

(iv) Transfer $30,000 from revaluation reserve to accumulated profits as a movement on reserves.

(v) Transfer $30,000 from revaluation reserve to income statement.

(vi) Transfer $60,000 from revaluation reserve to income statement.

A (i) and (iv)

B (ii) and (iii)

C (i) and (v)

D (ii) and (vi)

1.10 S announced a rights issue of 1 for every 5 shares currently held, at a price of $2 each. S currently has 2,000,000 $1 ordinary shares with a quoted market price of $2·50 each. Directly attributable issue costs amounted to $25,000.

Assuming all rights are taken up and all money paid in full, how much will be credited to the share premium account for the rights issue?

A $200,000

B $308,333

C $375,000

D $400,000

(Total = 20 marks)

End of section A

SECTION B – 30 MARKS

ANSWER THIS QUESTION

Question Two

Hi, listed on its local stock exchange, is a retail organisation operating several retail outlets. A reorganisation of the enterprise was started in 2002 because of a significant reduction in profits. This reorganisation was completed during the current financial year.

The trial balance for Hi at 30 September 2003 was as follows:

	$000	$000
10% loan notes (redeemable 2010)		1,000
Accumulated profits at 30 September 2002		1,390
Administrative expenses	615	
Bank and cash	959	
Buildings	11,200	
Cash received on disposal of equipment		11
Cost of goods sold	3,591	
Distribution costs	314	
Equipment and fixtures	2,625	
Interest paid on loan notes – half year to 31 March 2003	50	
Interim dividend paid	800	
Inventory at 30 September 2003	822	
Investment income received		37
Non-current asset investments at market value 30 September 2002	492	
Ordinary shares of $1 each, fully paid		4,000
Provision for deferred tax		256
Provision for reorganisation expenses at 30 September 2002		1,010
Provisions for depreciation at 30 September 2002:		
Buildings		1,404
Equipment and fixtures		1,741
Reorganisation expenses	900	
Revaluation reserve		172
Sales revenue		9,415
Share premium		2,388
Trade payables		396
Trade receivables	852	
	23,220	23,220

Additional information provided:

(i) The reorganisation expenses relate to a comprehensive restructuring and reorganisation of the enterprise that began in 2002. Hi's financial statements for 2002 included a provision for reorganisation expenses of $1,010,000. All costs had been incurred by the year end, but an invoice for $65,000, received on 2 October 2003, remained unpaid and is not included in the trial balance figures. No further restructuring and reorganisation costs are expected to occur and the provision is no longer required.

(ii) Non-current asset investments are carried in the financial statements at market value. The market value of the non-current asset investments at 30 September 2003 was $522,000. There were no movements in the investments held during the year.

(iii) On 1 November 2003, Hi was informed that one of its customers, X, had ceased trading. The liquidators advised Hi that it was very unlikely to receive payment of any of the $45,000 due from X at 30 September 2003.

(iv) Another customer is suing for damages as a consequence of a faulty product. Legal advisers are currently advising that the probability of Hi being found liable is 75%. The amount payable is estimated to be the full amount claimed of $100,000.

(v) The income tax due for the year ended 30 September 2003 is estimated at $1,180,000 and the deferred tax provision needs to be increased to $281,000.

(vi) During the year, Hi disposed of old equipment for $11,000. The original cost of this equipment was $210,000 and accumulated depreciation at 30 September 2002 was $205,000. Hi's accounting policy is to charge no depreciation in the year of the disposal.

(vii) Depreciation is charged using the straight-line basis on non-current assets as follows:

Buildings	3%
Equipment and fixtures	20%

Depreciation is regarded as a cost of sales.

(viii) On 1 April 2003, Hi made a rights issue of 1 new share for 4 existing shares, at a price of $3. The fair value of one share prior to the rights issue was $4·25 per share. All the rights were taken up and all money paid by 30 September 2003.

Required:

(a) Prepare the income statement for Hi for the year to 30 September 2003 and a balance sheet at that date, in a form suitable for presentation to the shareholders, in accordance with the requirements of International Accounting Standards.

Notes to the financial statements are NOT required, but all workings must be clearly shown. DO NOT prepare a statement of accounting policies or a statement of recognised gains and losses.

(20 marks)

(b) Prepare a statement of changes in equity for Hi for the year ended 30 September 2003.

(5 marks)

(c) Calculate Hi's earnings per share for the year ended 30 September 2003.

(5 marks)

(Total = 30 marks)

End of section B

SECTION C – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

(a) A purchased a site on the edge of a city and built a large new retail outlet there. A has now transferred its retail business from the city centre site to the new site. The former retail unit, on the city centre site, is surplus to requirements and A is trying to sell it. At 31 October 2003, a buyer had not been found. A's accounting policy is to carry property in its financial statements at current value.

At 31 October 2003, the property values were:

New retail outlet:	*$000*
Cost of land plus construction cost	900
Existing use valuation at 31 October 2003	1,000
Market value at 31 October 2003	1,200
Former retail unit:	
Valuation at 31 October 2003	400
Existing use valuation at 31 October 2003	600
Market value at 31 October 2003	1,100

Required:

State, with reasons, the valuations that A should use in its financial statements at 31 October 2003 in respect of each of the properties.

(5 marks)

(b) C owns a number of buildings, factories, offices and warehouses. C's accounting policy is not to revalue any non-current assets; all non-current assets are carried at depreciated historical cost.

A firm of independent valuers carried out a valuation of all the buildings on 30 June 2003. The results for three properties are given in the table below; all other properties were broadly similar in value to their net book values.

	Net book value	*Market value*	*Existing use value*
	$000	*$000*	*$000*
Factory	2,300	1,400	1,600
Office	1,000	1,500	1,800
Warehouse	1,500	2,000	1,750
Totals	4,800	4,900	5,150

C's directors do not intend changing the carrying values of any of the buildings as their total market value and existing use value are both greater than total net book value.

C's external auditors have indicated that they are unhappy with the directors' proposed treatment of the buildings.

Required:

(i) Explain why C's external auditors may be unhappy with the proposal to leave the value of the three buildings at $4,800,000 at 30 June 2003. Your explanation should refer to relevant International Accounting Standards.

(7 marks)

(ii) Calculate the figures that should appear in respect of the three buildings in C's financial statements for the year ended 30 June 2003. Ignore depreciation.

(3 marks)

(iii) Explain the action that the external auditors could take if the directors pursue their view and use the current net book value of the three buildings ($4,800,000) in the financial statements at 30 June 2003.

(3 marks)

(c) IAS 1 – *Presentation of financial statements* – requires directors to present fairly the financial position of an enterprise.

Required:

Explain why this requirement can be difficult to fulfil and how the IASB's *Framework for the preparation and presentation of financial statements* can help overcome these difficulties.

(7 marks)

(Total = 25 marks)

Question Four

The following are the financial statements of B for the period 1 October 2001 to 30 September 2003:

Balance sheets at 30 September	*2003*		*2002*	
	$000	*$000*	*$000*	*$000*
Non-current assets:				
Intangible assets		550		470
Tangible assets		3,260		1,630
Investments		400		260
		4,210		2,360
Current assets:				
Inventory	515		360	
Trade receivables	1,000		950	
Investments	315		100	
Bank	650		370	
		2,480		1,780
Total assets		6,690		4,140
Capital and reserves:				
Ordinary shares of $1 each	325		150	
Share premium	2,300		900	
Revaluation reserve	1,339		350	
Accumulated profits	281		186	
		4,245		1,586
Non-current liabilities:				
10% loan notes 2003/2006		251		979
Current liabilities:				
Trade payables	784		773	
Other payables including taxation	460		274	
Bank loans and overdrafts	950		528	
		2,194		1,575
Total equity and liabilities		6,690		4,140

Summary statement of changes in equity for the years to 30 September

	2003	*2002*
	$000	*$000*
Equity at start of year	1,586	1,423
Revaluation	989	
Net profit for the period	415	363
Dividends paid	(320)	(200)
Share issue	1,575	
Equity at end of year	4,245	1,586

Income statements for the years to 30 September

	2003		2002	
	$000	*$000*	*$000*	*$000*
Revenue		3,920		3,730
Cost of sales		(2,743)		(2,703)
Gross profit		1,177		1,027
Administrative expenses	(308)		(290)	
Distribution costs	(184)	(492)	(157)	(447)
Profit from operations		685		580
Income from investments	31		24	
Finance cost	(191)	(160)	(170)	(146)
Profit before tax		525		434
Income tax expense		(110)		(71)
Net profit for the period		415		363

On 1 October 2002, the enterprise made a new issue of ordinary shares at $9 per share. Part of the issue proceeds was used to purchase new equipment which became operational from 1 June 2003.

As the trainee management accountant, you have been asked to draft a briefing paper for the enterprise President to use to respond to possible questions from the shareholders regarding the performance of B between 2002 and 2003.

Required:

Prepare the briefing paper specified above.

Your paper should cover the following aspects of performance:

(i) Profitability

(13 marks)

(ii) Liquidity and efficiency

(5 marks)

(iii) Financial structure

(7 marks)

(Total = 25 marks)

Question Five

(a) Z acquired the business and assets of Q, a sole trader, on 31 October 2002.

The fair value of the assets acquired from Q were:

	$000
Non-current intangible assets	
Brand X – brand name	220
Non-current tangible assets	
Plant and equipment	268
Inventory	5
	493
Cash paid to Q	523

Z spent the following amounts creating and promoting the Brand Z brand name:

Year to 31 October 2000	$100,000
Year to 31 October 2001	$90,000
Year to 31 October 2002	$80,000

Z's accounting policy on recognised non-current intangible assets is that goodwill and brand names are amortised over 10 years.

On 31 October 2003, Z's brand names were valued by an independent valuer as follows:

Brand X at $250,000

Brand Z at $300,000

The directors of Z have been very impressed with the increase in profits from Q's former business. They are certain that the goodwill has increased since they acquired Q's business. Z's directors have estimated that the goodwill is worth $45,000 at 31 October 2003.

Required:

Explain how Z should treat:

(i) the brand names;

(9 marks)

(ii) goodwill;

(6 marks)

in its financial statements for the years ended 31 October 2002 and 2003. Your explanation should include reference to relevant International Accounting Standards.

(b)

Y provides packaging products to mail order and internet retailers. Y is the market leader in its sector and is trying to keep ahead of the competition by researching new packaging products. Y is about to launch a new type of packaging on to the market. The new product is expected to be commercially viable and Y has sufficient resources for the foreseeable future.

Y has developed this product from original research started three years ago. The research and development had three phases:

- Phase 1 – July 2000 to May 2001 – pure research into possible new types of material. Carried out by a local university department at a cost of $75,000.
- Phase 2 – June 2001 to April 2002 – consultancy fees incurred for the investigation of the commercial possibilities of the newly discovered material. Fees incurred $192,000.
- Phase 3 – June 2002 to May 2003 – costs of developing the product and preparing for product launch, $223,000.

The second phase, investigating the commercial possibilities of the newly discovered material, attracted a 50% government grant. All conditions attached to the grant were fully complied with during the year ended 30 May 2002.

Required:

Explain how Y should treat the research and development costs and government grant in its financial statements for the years ended 31 May 2001, 2002 and 2003. Your explanation should include reference to relevant International Accounting Standards.

(10 marks)

(Total = 25 marks)

Question Six

The financial statements of YZ are given below.

Balance sheets at	*30 September 2003*		*30 September 2002*	
	$000	*$000*	*$000*	*$000*
Non-current tangible assets:		634		510
Current assets:				
Inventory	420		460	
Trade receivables	390		320	
Interest receivable	4		9	
Investments	50		0	
Cash in bank	75		0	
Cash in hand	7		5	
		946		794
Total assets		1,580		1,304
Capital and reserves:				
Ordinary shares $0·50 each	363		300	
Share premium account	89		92	
Revaluation reserve	50		0	
Accumulated profit/loss	63		(70)	
		565		322
Non-current liabilities:				
10% loan notes	0		40	
5% loan notes	329		349	
		329		389
Current liabilities:				
Bank overdraft	0		70	
Trade payables	550		400	
Income tax	100		90	
Accruals	36		33	
		686		593
		1,580		1,304

Income statement for the year to 30 September 2003

	$000	$000
Revenue		2,900
Cost of sales		(1,734)
Gross profit		1,166
Administrative expenses	(342)	
Distribution costs	(520)	(862)
Profit from operations		304
Income from investments	5	
Finance cost	(19)	(14)
Profit before tax		290
Income tax expense		(104)
Net profit for the period		186

Additional information:

1. On 1 October 2002, YZ issued 60,000 $0·50 ordinary shares at a premium of 100%. The proceeds were used to finance the purchase and cancellation of all its 10% loan notes and some of its 5% loan notes, both at par. A bonus issue of one for ten shares held was made on 1 November 2002; all shares in issue qualified for the bonus.
2. The current asset investment was a 30-day government bond.
3. Non-current tangible assets include certain properties which were revalued in the year.
4. Non-current tangible assets disposed of in the year had a net book value of $75,000; cash received on disposal was $98,000.
5. Depreciation charged for the year was $87,000.
6. The accruals balance includes interest payable of $33,000 at 30 September 2002 and $6,000 at 30 September 2003.
7. Interim dividends paid during the year were $53,000.

Required:

(a) Prepare the following for YZ for the year ended 30 September 2003, in accordance with IAS 7 – *Cash flow statements*:

(i) a cash flow statement, using the indirect method;

(18 marks)

(ii) an analysis of cash and cash equivalents.

(3 marks)

(b) Briefly explain the usefulness of cash flow information to shareholders.

(4 marks)

(Total = 25 marks)

End of paper