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CIMA

Intermediate Level

Financial Reporting – UK Accounting Standards

7a

IFRP

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 UK ACCOUNTING STANDARDS. If you require the paper based upon International 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.
Maths Tables and Formulae were provided with the printed question paper and are available elsewhere on the website.
Write your examination number, your contact ID and your name on a double-sided card, which must be attached to your answer book. Write IFRP 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 in your answer book before you hand this in.
Do NOT write your name or your contact ID anywhere on this booklet.
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

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 Parent plc owns 80% of the equity share capital of Child Ltd, its only subsidiary. The following information is extracted from the individual balance sheets of the two companies on 30 September 2003:

	Parent plc	*Child Ltd*
	£	£
Current assets	600,000	450,000
Current liabilities	350,000	300,000

The current liabilities of Child Ltd include £80,000 in respect of a dividend that was declared before 30 September 2003 and paid on 31 October 2003. Parent plc recognises investment income on a cash basis.

If there are no other intra-group balances, what is the value of the net current assets in the consolidated balance sheet of Parent plc at 30 September 2003?

A £320,000

B £400,000

C £464,000

D £480,000

Financial Reporting – UK 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.

1.2 Foot plc owns 150,000 of the issued ordinary shares and 60,000 of the issued preference shares of Step Ltd (its only subsidiary). The balance sheets of the two companies at 31 August 2003 showed the following:

	Foot plc	*Step Ltd*
	£000	*£000*
Ordinary shares of £1	500	250
Preference shares of £1	100	150
Profit and loss reserve	250	170
	850	570

What is the minority interest that will appear in the consolidated balance sheet of Foot plc at 31 August 2003?

A £228,000

B £258,000

C £292,000

D £342,000

1.3 On 30 June 2003, Sugar plc entered into an agreement with two other investors to establish a new company, Spice Ltd. All three investors subscribed for $^1/_3$ of the equity shares in Spice Ltd and each share carries one vote. All three investors appointed two representatives to the six-member board of directors of Spice Ltd. All key policy decisions require the agreement of five of the six board members.

The following statements refer to the treatment of the investment in Spice Ltd in the consolidated financial statements of Sugar plc for the year ended 30 September 2003:

(i) Spice Ltd will be treated as a joint venture simply because the three investors hold $^1/_3$ of the shares each.

(ii) Spice Ltd will be treated as a joint venture in this case, but only because of the requirement that key policy decisions require the consent of at least five of the directors.

(iii) If Spice Ltd carries on a business that is distinct from that of its investors, then it will be consolidated using the equity method of consolidation.

(iv) If Spice Ltd is a vehicle through which the businesses of the investors is carried out, but it has no separate business of its own, then it will be consolidated using a form of proportional consolidation.

Which of the above statements are true?

A (i) and (iii) only.

B (i), (ii) and (iv) only.

C (ii) and (iii) only.

D (ii), (iii) and (iv) only.

1.4 On 1 July 1994, Super plc acquired 75% of the ordinary shares in Man Ltd for £6 million. Goodwill on consolidation of £1 million was amortised on a monthly basis over 20 years (or 240 months).

On 31 December 2002 (102 months after acquisition), Super plc disposed of part of its shareholding in Man Ltd for £4 million, retaining a 40% interest. The net assets of Man Ltd on 1 July 2002 were £8·5 million and Man Ltd made a profit of £800,000 in the year ended 30 June 2003 (no dividends were paid or declared by Man Ltd in that year).

What is the profit on disposal that will be included in the consolidated profit and loss account of Super plc for the year ended 30 June 2003?

A £616,667

B £683,750

C £885,000

D £1,200,000

1.5 Near plc has a subsidiary, Faraway, that prepares its financial statements in florins. Near plc owns 80% of the ordinary shares of Faraway.

On 1 October 2002, the net assets of Faraway that were included in the consolidated balance sheet of Near plc had a carrying value of 40 million florins. The profit of Faraway for the year ended 30 September 2003 was 4·5 million florins. Near plc translates the financial statements of Faraway for consolidation purposes using the closing rate method, using the average rate to translate the profit and loss account.

Relevant exchange rates are as follows:

Date	*Exchange rate [florins to £1]*
1 October 2002	2·5
30 September 2003	2·0
Average for the year ended 30 September 2003	2·25

Ignoring goodwill on consolidation, what is the exchange gain relating to Faraway that will be taken to the consolidated statement of total recognised gains and losses of Near plc for the year ended 30 September 2003?

A £3,200,000

B £3,400,000

C £4,000,000

D £4,250,000

1.6 An income-generating unit was reviewed for impairment at 31 May 2003 as required by FRS 11 – *Impairment of fixed assets and goodwill*. The impairment review revealed that the income-generating unit had a value in use of £25 million and a net realisable value of £23 million.

The carrying values of the net assets of the income-generating unit immediately prior to the impairment review were as follows:

	£000
Goodwill	5,000
Tangible fixed assets	18,000
Net current assets	4,000
	27,000

The review indicated that a tangible fixed asset (included in the above figure of £18 million) with a carrying value of £1 million had been severely damaged and was virtually worthless. There was no other evidence of obvious impairment to specific assets.

What is the carrying value of the goodwill relating to the unit immediately after the results of the impairment review have been reflected in accordance with FRS 11?

A £1 million

B £2 million

C £3 million

D £4 million

1.7 Spencer plc has produced draft consolidated financial statements for the year ended 30 June 2003. These financial statements include a deferred tax liability of £8 million. However, no account has been taken of the potential deferred tax implications of the following:

(i) On 30 June 2003, the group revalued all its properties and a surplus of £7 million was taken to the statement of total recognised gains and losses. The group has no intention of disposing of any of these properties in the foreseeable future.

(ii) One of the subsidiaries of Spencer plc made a loss adjusted for tax purposes of £2 million in the year ended 30 June 2003. This loss can only be relieved against future trading profits made by the subsidiary. The directors of Spencer plc believe the loss made by the subsidiary to be attributable to non-recurring factors.

What is the deferred tax liability of Spencer plc at 30 June 2003 under the provisions of FRS 19 – *Deferred Tax* after taking account of both the above events? [Use a rate of tax of 30% where required.]

A £7·4 million

B £8 million

C £9·5 million

D £10·1 million

1.8 B plc issued new loan stock to finance a construction project on the following terms:

- The new stock had a nominal value of £50 million.
- The stock carried an annual interest rate of 4%.
- The costs of issuing the stock totalled £600,000. This comprised underwriting fees relating to the issue of £500,000 and fees of £100,000 payable for general advice on which of a number of sources of finance should be pursued.
- The stock was theoretically repayable at £60 million after five years. However, the stock contained an option to convert into ordinary shares after five years as an alternative to repayment. At the date of issue, the directors of B plc were virtually certain that the investors would choose the conversion option.

What is the total finance cost relating to this loan stock?

A £10·5 million

B £10·6 million

C £20·5 million

D £20·6 million

1.9 The following statements relate to accounting for retirement benefits under the provisions of FRS 17 – *Retirement benefits*:

(i) Other things being equal the net pension asset increases when interest rates increase.

(ii) Other things being equal the net pension asset decreases when share prices fall.

(iii) Where the terms of retirement benefits are altered so as to provide immediate additional benefits to retired members, then the cost of the additional benefits should be recognised in the profit and loss account over a period equal to the average life expectancy of the retired members.

Which of the statements are true?

A (i) and (ii) only.

B (i) and (iii) only.

C (ii) and (iii) only.

D All of them.

1.10 Experimenter plc appraises projects using a cost of capital of 12%. All fixed assets of Experimenter plc are depreciated on a straight-line basis over their useful economic lives.

On 1 July 2002, Experimenter plc opened a chemical reprocessing plant. The plant was due to be active for 5 years until 30 June 2007, when it would be decommissioned. At 1 July 2002, the costs of decommissioning the plant were estimated to be £4 million.

What is the total charge to the profit and loss account in respect of the decommissioning for the year ended 30 June 2003?

A £453,600

B £725,760

C £800,000

D £2,268,000

(Total = 20 marks)

End of section A

SECTION B – 30 MARKS

ANSWER THIS QUESTION

Question Two

The balance sheets of George plc and its subsidiary companies Zippy Ltd and Bungle Ltd at 30 June 2003 (the accounting date for all three companies) are given below:

	George plc		*Zippy Ltd*		*Bungle Ltd*	
	£000	*£000*	*£000*	*£000*	*£000*	*£000*
Fixed assets:						
Tangible assets (*Note 3*)	45,000		25,000		20,000	
Investments (*Notes 1* and *2*)	20,000		Nil		Nil	
		65,000		25,000		20,000
Current assets:						
Stocks (*Notes 3* and *4*)	18,000		12,000		11,000	
Debtors (*Notes 3* and *4*)	15,000		10,000		9,000	
	33,000		22,000		20,000	
Creditors: amounts falling due within one year:						
Trade creditors (*Note 4*)	10,000		6,500		6,000	
Tax payable	2,000		1,500		1,000	
Proposed dividend (*Note 5*)	Nil		1,000		Nil	
Bank overdraft	5,000		4,000		3,000	
	17,000		13,000		10,000	
Net current assets		16,000		9,000		10,000
Total assets less current liabilities		81,000		34,000		30,000
Creditors: amounts falling due after more than one year:						
Long-term loan (*Note 3*)		(20,000)		Nil		(4,000)
Provisions for liabilities and charges:						
Deferred tax	(2,000)		(1,000)		(1,500)	
Other (*Note 3*)	Nil		Nil		(1,200)	
		(2,000)		(1,000)		(2,700)
		59,000		33,000		23,300
Capital and reserves:						
Ordinary share capital (£1 shares)		25,000		15,000		10,000
10% £1 preference shares		Nil		10,000		Nil
Share premium account		10,000		Nil		4,000
Profit and loss account		24,000		8,000		9,300
		59,000		33,000		23,300

Notes to the balance sheets

1 On 1 July 1990, the date of incorporation of Zippy Ltd, George plc subscribed for all the ordinary shares of Zippy Ltd at par. Then, on 1 July 1995, when its profit and loss account balance was £3 million, Zippy Ltd issued 10 million £1 preference shares at par. George plc subscribed for 50% of these shares.

2 On 30 June 2003, George plc purchased 8 million £1 shares in Bungle Ltd. The terms of the purchase consideration were as follows:

2.1 On 30 June 2003, George plc issued 3 £1 ordinary shares for every 4 shares purchased in Bungle Ltd. The market value of the George plc ordinary shares at 30 June 2003 was £4 per share.

2.2 On 30 June 2005, George plc will pay the former shareholders of Bungle Ltd £1 in cash for every share in Bungle Ltd they have purchased. This payment is contingent on the cumulative profits after tax of Bungle Ltd for the two years ending 30 June 2005 being at least £3 million. At the date of carrying out the fair value exercise (see *Note 3* below), the directors of George plc considered it probable that this cash payment would be made.

2.3 No entries in respect of the purchase of shares in Bungle Ltd have been made in the balance sheet of George plc that appears on page 10.

3 Following the acquisition of Bungle Ltd, the directors of George plc carried out a fair value exercise as required by FRS 7 – *Fair values in acquisition accounting*. The following matters are relevant and all potential fair value adjustments are material:

3.1 Tangible fixed assets comprise land and buildings and plant and machinery. At 30 June 2003, the land and buildings had a carrying value of £12 million and a market value of £15 million. The plant and machinery had a carrying value of £8 million. All the plant and machinery was purchased on 30 June 2000 and was being depreciated on a straight-line basis over 8 years. No reliable estimate was available of the current market value of the plant and machinery, but, at 30 June 2003, the plant would have cost £22 million to replace with new plant.

3.2 The stock in hand at 30 June 2003 would have cost £12 million to replace. This included a consignment of stock with an estimated replacement cost of £500,000 that had been damaged and could only be sold for scrap (estimated proceeds £100,000).

3.3 Debtors include an amount of £400,000 that the directors of George plc consider doubtful.

3.4 The long-term loan of Bungle Ltd is repayable at par on 30 June 2006. Interest at 10% per annum is payable annually in arrears and the payment due on 30 June 2003 has already been made. The relevant discount rate is 7%.

3.5 The other provisions of Bungle Ltd comprise:

- £400,000 in respect of the closure of various retail outlets to which the directors of Bungle Ltd became committed prior to entering into acquisition negotiations with the directors of George plc.
- £800,000 in respect of the estimated cost of integrating Bungle Ltd into the George plc group. No detailed integration plans had been formulated by 30 June 2003.

4 George plc supplies a component to Zippy Ltd at cost plus a mark up of 20%. At 30 June 2003, the stocks of Zippy Ltd included £1·5 million in respect of this component. At 30 June 2003, the debtors of George plc showed an amount receivable from Zippy Ltd of £1·2 million, while the trade creditors of Zippy Ltd showed an amount payable to George plc of £600,000. On 29 June 2003, George plc sent a consignment of components to Zippy Ltd at an invoiced price of £600,000. The consignment was received and recorded by Zippy Ltd on 2 July 2003.

5 On 15 July 2003, Zippy Ltd paid its preference dividend for the year ended 30 June 2003. George plc made no entries in its financial statements in respect of this dividend until it was received in cash.

6 Goodwill on consolidation is amortised over its estimated useful economic life of 20 years. The amortisation of goodwill on consolidation of Bungle Ltd commences on 1 July 2003.

Required:

(a) Compute the goodwill on consolidation of Bungle Ltd that will be shown in the consolidated balance sheet of George plc at 30 June 2003. Provide justification for your figures where you consider this is needed.

(14 marks)

(b) Prepare the consolidated balance sheet of George plc at 30 June 2003.

(16 marks)

(Total = 30 marks)

SECTION C – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

You are the accountant of Acquirer plc. Your company has the strategy of growth by acquisition and your directors have identified a company, Target Ltd, which they wish to investigate with a view to launching a takeover bid. Your directors consider that the directors of Target Ltd will contest any bid and will not be very co-operative in providing background information on the company. Therefore, relevant financial information is likely to be restricted to the publicly available financial statements.

Your directors have asked you to compute key financial ratios from the latest financial statements of Target Ltd [for the year ended 30 November 2002] and compare the ratios with those for other companies in a similar sector. Accordingly, you have selected ten broadly similar companies and have presented the directors with the following calculations:

Ratio	*Basis of calculation*	*Ratio for Target Ltd*	*Spread of ratios for comparative companies*		
			Highest	*Average*	*Lowest*
Gross profit margin	$\frac{\text{Gross profit}}{\text{Sales}}$	42%	44%	38%	33%
Operating profit margin	$\frac{\text{Operating profit}}{\text{Sales}}$	29%	37%	30%	26%
Return on total capital	$\frac{\text{Operating profit}}{\text{Total capital}}$	73%	92·5%	69%	52%
Interest cover	$\frac{\text{Operating profit}}{\text{Finance cost}}$	1·8 times	3·2 times	2·5 times	1·6 times
Gearing	$\frac{\text{Debt capital}}{\text{Total capital}}$	52%	56%	40%	28%
Dividend cover	$\frac{\text{Profit after tax}}{\text{Dividend}}$	5·2 times	5 times	4 times	3 times
Stock turnover	$\frac{\text{Cost of sales}}{\text{Closing stock}}$	4·4 times	4·5 times	4 times	3·2 times
Debtor days	$\frac{\text{Trade debtors}}{\text{1 day's sales}}$	51 days	81 days	62 days	49 days

Required:

(a) Using the ratios provided, write a report that compares the financial performance and position of Target Ltd to the other companies in the survey. Where an issue arises that reflects particularly favourably or unfavourably on Target Ltd you should assess its relevance to a potential acquirer.

(16 marks)

(b) Identify any reservations you have regarding the extent to which the ratios provided can contribute to an acquisition decision by the directors of Acquirer plc. You should highlight the extent to which the financial statements themselves might help you to overcome the reservations you have identified.

(9 marks)

(Total = 25 marks)

Question Four

You are the chief accountant of Ant plc, a company that prepares financial statements in accordance with UK Accounting Standards. Your assistant has prepared the first draft of the consolidated financial statements for the year ended 31 October 2003 and these show a profit after tax of £66 million, while the balance sheet shows ownership interests [total assets less total liabilities, including minority interests] of £450 million.

Your assistant has identified the following issues that require your review:

Issue (a)

An overseas subsidiary has incurred a loss (adjusted for tax purposes and appropriately translated into £s) of £15 million for the year ended 31 October 2003. Local tax legislation allows this loss to be relieved for tax purposes only against future profits of the same trade. Ant plc has no other subsidiaries in the same tax jurisdiction as this subsidiary. The loss is primarily due to a reduction in turnover caused by a reduction in demand for the product that the subsidiary produces. There is little indication that demand will be restored to its former levels in the foreseeable future.

Your assistant has recognised a deferred tax asset of £6 million in the draft financial statements, being the future tax consequences of the timing difference of £15 million, measured at the local tax rate of 40%. This deferred tax asset has been offset against deferred tax liabilities arising on timing differences originating in other tax jurisdictions.

Issue (b)

On 1 November 2002, Ant plc established a new French subsidiary by investing 40 million Euros (€) (the initial net assets of the subsidiary). The investment was financed by a loan of 40 million € from a German bank. No capital repayments of the loan are due until 31 October 2022.

The exchange rate at 1 November 2002 was 1·6€ to £1. On 31 October 2003, the exchange rate was 1·5€ to £1. Due to large start up costs, the subsidiary did not make a profit in the early months of trading and the net assets of the subsidiary at 31 October 2003 remained at 40 million €.

In preparing the draft consolidated financial statements, your assistant has translated both the loan and the financial statements of the French subsidiary at 1·6€ to £1 on the basis that the financing of the subsidiary was obtained when the exchange rate was 1·6€ to £1. The French subsidiary has its own distinct market presence and manufactures its products in France.

Issue (c)

On 1 November 2002, Ant plc issued two million £100 loan notes at £90 per note. A merchant bank received £4 million to underwrite the issue and Ant plc incurred other costs of £500,000 relating to the issue of the notes. The notes pay no interest and are redeemable at £135 per note on 31 October 2007. As an alternative to redemption, the notes can be converted into 50 equity shares per £100 note on 31 October 2007.

Your assistant has written off the issue costs of £4·5 million to the profit and loss account for the year ended 31 October 2003 as an administrative expense and credited the proceeds of issue [£180 million] to a convertible loan notes account. Your assistant proposes to show this in the ownership interests section of the balance sheet on the basis that the share price on 31 October 2007 is likely to be at least £4, so conversion, rather than repayment, is likely to be a near certainty.

Required:
For each of the three issues, evaluate the treatment adopted by your assistant with reference to currently published Accounting Standards. Where you consider the treatment adopted to be incorrect, you should state the journal adjustment required to correct the error.

In all cases, you should give any supporting explanations you consider appropriate to justify your conclusions.

The allocation of marks to the three issues is as follows:

Issue (a)	*(6 marks)*
Issue (b)	*(9 marks)*
Issue (c)	*(10 marks)*

(Total = 25 marks)

Question Five

You are the accountant responsible for training at Develop plc, a company with a number of investments throughout the world. A key financial reporting task is to prepare consolidated financial statements and this forms an important aspect of the training of new accountants.

A recently-employed trainee has sent you this memorandum:

> I have just attended my first training course and have learned the mechanics of how to treat subsidiaries, associates, and trade investments in the consolidated accounts. I'm reasonably comfortable with the numbers, but the concepts baffle me. Why does the exercise of adding together the balance sheets of our company with those of our subsidiaries give our shareholders useful financial information? Why do we treat associates differently – I find the concept of adding together all the net assets and showing our share as one amount particularly confusing? I'm happier with the treatment of trade investments, at least I can see that the figure is what we paid to buy the shares. Why not do this for all our investments? I don't need a detailed explanation of the mechanics, which I'm already reasonably happy with.

Required:

(a) Draft a reply to your trainee that explains the principles underpinning the preparation of consolidated financial statements. You should clearly explain why subsidiaries, associates and trade investments are treated differently and why the information is of benefit to the shareholders of the investor.

(15 marks)

You also receive a memorandum from a slightly more experienced trainee:

> I've just attended my second training course and a couple of things confused me. First of all, we were told that the net assets of newly-acquired subsidiaries need to be revalued to fair value at the date of acquisition. I don't see how this can produce sensible results unless the net assets of other group members are revalued at the same time. Then we were told about another method of consolidation, the merger method. This seemed a lot easier than the normal one. It seems that we don't need to worry about fair value adjustments under this method and we don't even have to distinguish between pre- and post-acquisition profits. What's more, it seems to produce higher reported profits! Why don't we use it all the time?

Required:

(b) Draft a reply to this second trainee that explains the rationale behind fair value adjustments and identifies the type of business combinations which might lead to the use of the merger method of consolidation. You do NOT need to explain the detailed mechanics of fair value adjustments or the merger method. However, you should refer to any relevant current developments.

(10 marks)

(Total = 25 marks)

Question Six

Global plc is a company incorporated in the United Kingdom [UK] and preparing financial statements in accordance with UK Accounting Standards. Global plc has a subsidiary, Local Inc, located in a jurisdiction that prepares financial statements in £ sterling in a format that is consistent with UK company law, but in accordance with local accounting standards.

The draft financial statements of Local Inc for the year ended 30 September 2003 [the group accounting date] are given below:

Profit and loss account – year ended 30 September 2003

	£000
Turnover	40,000
Cost of sales	(25,000)
Gross profit	15,000
Other operating expenses	(10,000)
Operating profit	5,000
Profit on sale of land	2,000
Interest payable	(1,500)
Profit before tax	5,500
Tax	(500)
Profit after tax	5,000

Balance sheet at 30 September 2003

	£000	*£000*
Fixed assets:		
Intangible assets	3,000	
Tangible assets	21,000	
		24,000
Net current assets		4,000
Creditors falling due after more than one year:		
Long-term loans		(9,000)
Provisions for liabilities and charges:		
Deferred tax		(1,000)
		18,000
Capital and reserves:		
Called-up share capital		8,000
Revaluation reserve		2,000
Profit and loss account		8,000
		18,000

The accountant of Local Inc has informed you of the following transactions that have occurred during the year.

1 The directors of Local Inc decided to make the balance sheet stronger by including their estimate of the value of key employees as an intangible fixed asset. They placed a value of £3 million on the asset and justified its inclusion on the basis that the expertise of key employees gave Local Inc a clear competitive edge. No amortisation was charged on the basis that the asset was unlikely to lose value. The asset was incorporated into the financial statements by debiting fixed assets and crediting other operating expenses.

2 On 1 October 2002, Local Inc sold a piece of land for £16 million, when the carrying value of the land was £14 million and its market value £20 million. The profit on sale of £2 million is separately disclosed in the profit and loss account.

At the time of the sale, Local Inc was given an option to repurchase the land on 30 September 2003, 2004 or 2005 on the following terms:

- 30 September 2003 £17·6 million
- 30 September 2004 £19·36 million
- 30 September 2005 £21·296 million

The option was not exercised on 30 September 2003 and is unlikely to be exercised on 30 September 2004 due to anticipated cash shortages in that year. However, the cash shortages are expected to be temporary and Local Inc expects substantial accumulations of cash in 2005. The directors of Local Inc expect the price of land to rise at around 12% per annum for the foreseeable future.

3 Local Inc has a policy of periodically revaluing all its properties. All properties were revalued in the current period. One of the properties that was revalued during the year was a factory that had a carrying value prior to revaluation of £8 million. The current value of the property was estimated at £7 million. The deficit was caused by the fact that the product manufactured in the factory was no longer popular with customers. The deficit has been offset against the revaluation reserve on the basis that the factory had been revalued upwards by an amount in excess of £1 million in a previous period. Properties and land are regarded as separate classes of tangible fixed assets and land is not subject to periodic revaluations.

In other respects, the accounting practices followed by Local Inc are in accordance with UK Accounting Standards.

Required:

(a) Redraft the profit and loss account and balance sheet of Local Inc to reflect any adjustments that are necessary to ensure that they are prepared in accordance with UK Accounting Standards. You should fully explain any adjustments you make by referring to necessary UK Accounting Standards.

Ignore any potential adjustments to deferred tax.

(20 marks)

(b) Discuss the suggestion that it would be easier for consolidation purposes if all group companies followed UK Accounting Standards when preparing their individual financial statements.

(5 marks)

(Total = 25 marks)

End of paper