CIPFA

FINANCIAL REPORTING

Certificate stage examination

8 December 2006

From 10.00am to 1.00pm
plus ten minutes reading time from 9.50am to 10.00am

Instructions to candidates

*Answer **four** questions in total:*
Both** compulsory questions from **Section A
Two** of the three questions from **Section B

The questions in Section A carry, in total, 60 marks
The questions in Section B each carry a total of 20 marks

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examination room.

A Proforma booklet, graph paper and cash analysis paper are available from the invigilator.

Candidates may use the Proforma sheets provided and submit them as part of their answer.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

AT THE HEART OF YOUR CAREER

SECTION A (Compulsory)

1 The following trial balance has been extracted from the accounts of DeVoux plc as at 31 October 2006, the end of its most recent financial year.

	Notes	Dr	Cr
		£m	£m
Sales			1,840
Purchases		1,240	
Stock, as at 1 November 2005		84	
Administrative expenses		363	
Dividends paid		40	
Other operating income			41
Corporation tax	*7*		9
Fixed asset investments	*5*	108	
Investment income			22
Interest payable		14	
Property, plant and equipment, at cost	*2, 3*	490	
Investment property, at valuation	*2*	68	
Accumulated depreciation, as at 1 November 2005			
Property, plant and equipment	*4*		126
Assets disposals	*3*		36
Trade debtors and creditors		230	103
Allowance for doubtful debts, as at 1 November 2005	*6*		16
Cash at bank and in hand		37	
Bank loan, repayable 1 March 2012			70
8% Debenture, repayable 1 March 2012			60
Issued ordinary shares of £1	*3*		200
Share premium account			35
Revaluation reserve			50
Profit and loss account, as at 1 November 2005			66
		2,674	2,674

The following additional information is available:

1 It was not possible to value closing stock on 31 October 2006. However, stock was valued at £92,000,000 on 5 November. The following transactions involving stock took place between 31 October and 5 November:

	£
Sales	38,000,000
Returns inwards	2,000,000
Purchases	19,000,000

The sales were made at an average mark-up of 33⅓ percent.

2 The following were the balances on the fixed asset accounts as at 1 November 2005:

	£
Property, plant and equipment	386,000,000
Investment property, at valuation	60,000,000

3 During the year ended 31 October 2006 DeVoux plc raised additional capital as follows:

	£
Issue of shares	70,000,000
Sale of surplus fixed assets	36,000,000

The fixed assets sold comprised plant and equipment with a net book value of £30,000,000 (cost of £64,000,000). The proceeds from the sale have been credited to the assets disposals account and debited to bank. No other entries have been made.

The issue of shares was a 1 for 3 rights issue which was fully subscribed and paid. The issue has been correctly recorded in the accounts.

4 Depreciation of £48,000,000 for the year ended 31 October 2006 is to be charged on property, plant and equipment. 50% of the depreciation is to be allocated to cost of sales, and 50% to administration.

5 Fixed asset investments include equity investments which cost £17,000,000. It has been decided to adjust the carrying value of these investments to £21,000,000. During the year ended 31 October 2004 these investments had been revalued upwards to £27,000,000 but the directors believe that there was a permanent diminution in the recoverable amount of these investments during the year ended 31 October 2006. None of the holdings of equity shares gives rise to a participating interest.

6 Based on past experience the allowance for doubtful debts is to be adjusted to 3% of trade debtors.

7 The balance on the corporation tax account represents an overprovision for corporation tax for the year ended 31 October 2005. The liability for corporation tax on the profits for the year ended 31 October 2006 is estimated at £50,000,000.

- **Requirement for question 1**

(a) Prepare a calculation of the value of stock as at 31 October 2006. *3*

(b) Prepare the disclosure note showing movements in tangible fixed assets for the year ended 31 October 2006 in so far as the above information permits. *5*

(c) Prepare DeVoux plc's profit and loss account for the year ended 31 October 2006 in so far as the above information permits.

Note:
- You need not provide the additional disclosures of expenses required by the Companies Acts or a statement of accounting policies.
- Disclosure of earnings per share is not required.
- All figures should be rounded to the nearest £m. *14*

(d) Prepare a suitable disclosure note for movements in share capital and reserves for the year ended 31 October 2006. *8*

(30)

2 The following statistics for the past five financial years have been taken from the Annual Report of Electra, a company which generates and supplies electricity to customers in the UK.

	2006	**2005**	**2004**	**2003**	**2002**
Profit and Loss Account extracts (£m)					
Turnover	54.8	56.4	58.8	60.5	61.2
Operating profit	7.6	8.3	7.6	5.4	5.2
Profit before tax	7.6	7.3	6.5	4.4	3.3
Profit after tax	5.5	5.3	4.7	3.2	2.4
Dividends paid	1.7	1.5	1.2	1.1	0.8
Balance sheet extracts (£m)					
Fixed assets	118.9	125.3	128.7	119.4	122.0
Net current assets/(liabilities)	25.8	10.7	3.3	0.8	(8.1)
Creditors: amounts due after one year	(26.9)	(24.1)	(21.5)	(13.4)	(13.2)
Net assets	117.8	111.9	110.5	106.8	100.7
Financial Ratios and Statistics					
Dividend paid per ordinary share	51.0p	46.0p	36.4p	33.0p	30.0p
Dividend cover (times)	3.2	3.5	3.9	2.9	2.9
Earnings per share	£1.83	£1.71	£1.33	£1.07	£0.79
Cash at bank/(net debt) (£m)	11.2	3.1	(5.1)	(2.2)	(11.3)
Capital expenditure (£m)	5.0	5.2	9.8	4.1	15.5
Electricity Statistics					
Number of customers	44,886	44,750	43,600	43,090	43,015
Units sold (millions)	608	588	578	561	560
% of units generated locally	2%	6%	10%	20%	30%
% of units imported	98%	94%	90%	80%	70%
Average price per kilowatt hour sold	7.3p	7.3p	7.3p	7.2p	7.2p
Maximum demand (megawatts)	144	133	152	133	131
Numbers of employees					
Energy	176	186	195	220	230
Trainees	5	8	15	28	34
Other	101	110	124	153	160
Total employees	282	304	334	401	424
Units sold per energy employee (000's)	3,455	3,161	2,964	2,550	2,435
Customers per energy employee	255	241	224	196	187

The most recent financial year of Electra ended on 31 October 2006. In September 2006 the company announced that it would be raising the price of electricity to all its customers by 7% as from 1 November 2006 because of increasing energy costs on the world markets.

- **Requirement for question 2**

(a) The following two ratios appear in the table:

(i) Dividend cover, and
(ii) Earnings per share

Explain how these ratios are calculated and what they mean. *6*

(b) Imagine that you are to have meetings to discuss what the above statistics mean for each of the following stakeholders:

(i) an ordinary shareholder in Electra, *12*
(ii) an Electra employee, and *6*
(iii) an Electra customer. *6*

Identify the particular interests of each of the above and interpret the information supplied in the table from the particular perspective of each stakeholder.

(30)

SECTION B (Answer two questions from this section)

3 The following are the balance sheets of GlenKogan plc as at 31 October 2006 and 31 October 2005:

GlenKogan plc
Balance Sheets as at 31 October

	2006		*2005*	
FIXED ASSETS	£	£	*£*	*£*
Freehold property, at cost	4,767,000		*4,550,000*	
Accumulated depreciation	(801,675)		*(682,500)*	
		3,965,325		*3,867,500*
Plant and equipment, at cost	1,834,000		*1,860,000*	
Accumulated depreciation	(894,400)		*(660,280)*	
		939,600		*1,199,720*
		4,904,925		*5,067,220*
CURRENT ASSETS				
Stock	66,500		*103,500*	
Trade Debtors	244,850		*344,700*	
Prepaid expenses	3,000		*5,000*	
Cash at bank	1,315,038		*31,300*	
	1,629,388		*484,500*	
CREDITORS: amounts falling due within one year				
Trade Creditors	315,000		*306,100*	
Accrued expenses	16,500		*11,100*	
Bank overdraft	0		*75,600*	
Corporation tax payable	199,500		*133,000*	
	531,000		*525,800*	
NET CURRENT ASSETS		1,098,388		*(41,300)*
NET ASSETS		6,003,313		*5,025,920*
CREDITORS: amounts falling due after more than one year				
Debentures		140,000		*200,000*
PROVISIONS FOR LIABILITIES				
Deferred taxation		200,000		*100,000*
		5,663,313		*4,725,920*

SHARE CAPITAL and RESERVES		
Issued share capital (ordinary shares of £1)	3,500,000	*3,000,000*
Share premium	1,150,000	*850,000*
Revaluation reserve	100,000	*100,000*
Profit and loss account	913,313	*775,920*
	5,663,313	*4,725,920*

The following is GlenKogan plc's internal profit and loss account for the year ended 31 October 2006:

GlenKogan plc

Profit and Loss Account for the year ended 31 October 2006

			£
Sales			16,750,000
Less	Cost of goods sold		13,400,000
Gross profit			3,350,000
Add	Other income		
	Discounts received		14,500
			3,364,500
Less	Operating expenses		
	Selling expenses	385,600	
	Wages and salaries	955,000	
	Rent, rates and insurance	210,400	
	Accountancy	74,200	
	Interest paid	18,512	
	Discounts allowed	20,400	
	Depreciation and profits on sale of fixed assets	653,395	
	Other expenses	30,500	
			2,348,007
Net profit			1,016,493
Less	Taxation		354,100
Net profit after taxation			662,393

The following additional information is available for the year ended 31 October 2006:

1 GlenKogan plc paid dividends totalling 17.5 pence per share based on the number of shares in issue as at the start of the year.

2 Plant and equipment which cost £345,600 and had a carrying value of £39,100 was sold for £45,500.

3 Accrued expenses relate to wages and salaries. Prepaid expenses relate to insurance.

- **Requirement for question 3**

(a) Prepare, using the direct method, GlenKogan plc's cash flow statement for the year ended 31 October 2006. Ignore VAT. *16*

(b) Prepare the reconciliation of operating profit to net cash flow from operating activities for the year ended 31 October 2006. *4*

(20)

4

Stenberg plc's financial year ended on 30 November 2006 and there are a number of accounting issues.

Issue 1 – Legal claims

1 An employee is claiming damages of £15,000 against Stenberg plc because of injuries received while driving one of the company's delivery vans in September 2006. The employee is claiming that Stenberg plc was negligent in its maintenance of the van and that the van crashed because of poor maintenance. Stenberg plc's lawyer is of the opinion that the probability of the employee winning the case is 80%.

2 Stenberg plc is making a claim for damages of £25,000 against a contractor to cover the additional costs of making good faulty work on a contract. The contactor had refused to make good the work because they were too busy with work on other contracts. Stenberg plc's lawyer is of the opinion that the probability of winning this claim is 85%.

- **Requirement for Issue 1**

(a) According to FRS 12 what are the conditions necessary for making a provision for a liability in the financial statements? *3*

(b) For each of the two legal claims Stenberg plc is involved in discuss whether or not a provision should be made in the financial statements for the year ended 30 November 2006. *4*

Issue 2 – Possible impairment

Stenberg plc purchased a factory for the manufacture of optical disks on 1 May 2006 paying £24,000,000. The factory will be depreciated over its estimated life of 10 years using the straight line method on a full year basis with no residual value.

The asking price for the factory had been £30,000,000. However, Stenberg plc estimated the net present value of the factory's future expected net cash flows at £28,500,000 and the price eventually agreed with the vendor was £24,000,000.

During October a rival company announced that it had patented a new technology which has been enthusiastically greeted by the major players in the industry. Stenberg plc now feels that it may be necessary to revise downwards its expectations for the factory. It now believes that the net present value of the expected net cash flows from the factory as at 30 November was £20,500,000. The net realisable value of the factory was estimated at £14,000,000 as at 30 November 2006.

- **Requirement for Issue 2**

Discuss whether or not there is evidence of impairment and describe how the factory should be treated in the financial statements for the year ended 30 November 2006. *4*

Issue 3 – Treatment of debentures

Stenberg plc will be issuing a 10% debenture with a nominal value of £750,000 at par on 1 December 2006. The company has the option of redeeming the debenture at a premium of 14% in 4 years or at a premium of 11% in 5 years. The costs of issuing the debenture will be £87,987 and the rate of interest implicit in the debenture is 17%. The interest on the debenture will be payable annually in arrears.

- **Requirement for Issue 3**

(a) Explain how the debenture should be treated in the financial statements to comply with the requirements of FRS 4 Capital Instruments. In particular:

(i) How the debenture should be initially recognised in the financial statements.
(ii) How the finance charge should be calculated.
(iii) How the finance charge should be charged to profit and loss account.
(iv) How the carrying value of the debenture should be calculated as at the end of the financial year. *4*

(b) Calculate the figures which would be reported in the financial statements for:

(i) The amount initially recognised in the balance sheet as at 1 December 2006.
(ii) The charges to the company's profit and loss accounts
  (a) for the year ended 30 November 2007, and
  (b) for the year ended 30 November 2008.
(iii) The carrying value of the debenture in the company's balance sheets as at
  (a) 30 November 2007, and
  (b) 30 November 2008. *5*

(20)

5

Klinibild plc has three contracts to build new clinics for NHS trusts. The three projects are the Tyne, the Tees and the Wear.

The following information as at 31 October 2006 is available for each of the three contracts:

	Tyne	Tees	Wear
	£m	£m	£m
Contract value	19.80	24.83	15.50
Certified value of work completed	10.30	1.25	10.00
Value of work invoiced	8.30	1.00	10.00
Payments received	6.50	1.00	9.00
Costs to date	7.52	1.33	12.93
Estimated future costs to complete	6.56	9.45	5.27
Recognised in previous financial year			
Turnover	5.25		
Profit	1.40		

Work on the Tees and Wear contracts commenced during the financial year ended 31 October 2006. The Tyne contract commenced during the financial year ended 31 October 2005.

Klinibild plc uses a revenue approach to calculate the percentage of work completed to date. Revenue is to be based on independent surveyors' certificates.

Cost of sales is to be calculated as the difference between turnover recognised and attributable profit. All the amounts invoiced to the contractees are expected to be collected and no provision is to be made for doubtful debts. Klinibild plc does not recognise profit on contracts until the contract is at least 10% complete.

- **Requirement for question 5**

(a) Calculate the estimated total profit or loss on each of the three contracts. *4*

(b) Calculate the attributable profit or loss on each of the three contracts *3*

(c) Calculate the figures which will be reported in Klinibild plc's profit and loss account for the year ended 31 October 2006 for
- turnover,
- cost of sales, and
- profit or loss

for each of the three contracts. *4*

(d) Calculate the figures which will be reported in Klinibild plc's balance sheet as at 31 October 2006 for:
- work in progress,
- amounts recoverable on contracts, and
- trade debtors

for each of the three contracts. *9*

(20)