CIPFA

FINANCIAL REPORTING

Certificate stage examination

8 June 2007

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

Instructions to candidates

*There are **five** questions on this question paper*

*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 – answer both question)

1 The following list of balances was taken from the accounts of Mestoplan plc as at 31 May 2007, the end of its most recent financial year:

	Notes	Dr	Cr
		£000	£000
Revenue			33,600
Cost of sales		24,050	
Inventory, as at 31 May 2007	*6*	1,350	
Administrative expenses		4,530	
Distribution costs		1,880	
Dividends paid		950	
Other operating income			640
Over-provision for corporation tax for 2005/2006			56
Non-current investments	*4*	1,250	
Investment income			130
Interest paid		300	
Properties at valuation:			
Land		800	
Buildings		8,000	
Plant and machinery	*2*	4,200	
Accumulated depreciation:			
Buildings	*3*		640
Plant and machinery	*2, 3*		2,140
Proceeds from sale of non-current assets			80
Trade receivables and payables		4,500	1,840
Allowance for doubtful debts, as at 31 May 2006	*5*		85
Cash at bank and in hand		98	
Bank loans:			
Due for repayment on 1 October 2007			300
Due for repayment in 2011			1,500
10% Loan notes			1,250
Issued share capital (£1 shares)	*1*		5,000
Share premium account			1,000
Revaluation reserve			600
Retained earnings, 31 May 2006			3,047
		51,908	51,908

The following additional information is available:

(1) Mestoplan plc's issued share capital as at 1 June 2006 was £4,000,000 in ordinary shares of £1 each. During November 2006 the company made a 1 for 8 bonus issue. In March 2007 the company made a rights issue of 1 for 9 ordinary shares at £1.50 a share which was fully subscribed and fully paid. These transactions have been correctly recorded in the accounts.

(2) During the year ended 31 May 2007 plant and machinery costing £200,000 was sold. The plant had been depreciated by £140,000 and was sold for £80,000. The proceeds of £80,000 have been recorded in the accounts but no other entries have yet been made in respect of this disposal.

(3) Depreciation for the year ended 31 May 2007 has yet to be provided for. The company's depreciation policies are:

Land	0%
Buildings	2% straight line method
Plant and machinery	20% reducing balance method

Depreciation is provided for on a full year basis.

(4) Non-current investments which cost £410,000 and which had been previously revalued at £500,000 are to be written down to £350,000 to reflect a permanent diminution in value.

(5) The allowance for doubtful debts is to be increased to £180,000.

(6) Certain items valued in the figure for inventory as at 31 May 2007 at £15,000 should have been written down to their net realisable value of £4,000.

(7) Corporation tax on the profit for the year ended 31 May 2007 has been estimated at £960,000.

(8) Shortly after 31 May 2007 Mestoplan plc discovered fundamental errors in its accounts which meant that operating expenses of £627,000 have been incorrectly included in the figures for the year ended 31 May 2007. Mestoplan plc has calculated that £450,000 of these expenses relate to the year ended 31 May 2006 and £177,000 to the year ended 31 May 2005.

- **Requirement for question 1**

(a) Prepare Mestoplan plc's balance sheet as at 31 May 2007 in accordance with IAS 1 *Presentation of Financial Statements*. *16*

Note:

- Supportive disclosure notes are not required.
- Retained earnings should be entered as a balancing figure.

(b) Prepare a statement of changes in equity for Mestoplan plc for the year ended 31 May 2007 in accordance with IAS 1 *Presentation of Financial Statements*. *14*

(30)

2

The following performance indicators have been taken from the financial statements of Kelpdon plc:

Financial ratios	**2002**	**2003**	**2004**	**2005**	**2006**
Operating margin (%)	44	30	27	33	20
Debt/equity ratio (%)	7	3	9	7	7
Return on equity (%)	18	10	7	10	7
Ratios relating to shares					
Earnings per share (£)	1.1	0.7	0.5	0.6	0.4
Diluted earnings per share (£)	1.1	0.7	0.5	0.6	0.4
Net asset value per share (£)	6.7	7.4	7.2	5.5	5.4
Cash flow per share (£)	1.0	0.7	0.6	0.8	0.5
Number of shares at year-end (1,000s, 50 pence each)	3,840	3,840	3,850	3,850	3,850
Average number of shares (1,000s, 50 pence each)	3,446	3,840	3,844	3,850	3,850
Market price per share, year-end (£)	17.2	12.0	10.1	10.3	12.0
Dividend per share (£)	0	0.5	2.5	0.5	0
Price earnings ratio	16	17	20	17	30
Ratios relating to staff					
Average number of employees	32	43	50	52	55

A shareholder in Kelpdon plc has asked you for help in understanding this data.

- **Requirement for question 2**

Prepare a report for the shareholder in which you:

(a) Explain the difference between 'earnings per share' and 'diluted earnings per share'. *4*

(b) Calculate the market capitalisation of Kelpdon plc as at the end of its 2006 financial year and explain what the term 'market capitalisation' means. *3*

(c) Use the data to explain how the price earnings ratio of 30 for 2006 has been calculated. *3*

(d) Use the data to estimate, in so far as you can, the revenue of the company for its 2006 financial year. *4*

(e) Use the data to report on the performance of the company over the five year period. *16*

(30)

SECTION B (Answer two from three questions)

3

Floothair plc is a large international airline company with three business segments:

- International airline business
- Domestic airline business
- Non-airline business

The company reports segment information in accordance with IAS 14 *Segment Reporting* and the following information is available for the financial year ended on 31 May 2007:

	£m
Total revenue:	
International airline business	8,207
Domestic airline business	402
Non-airline business	267
Unallocated income	22
Profit/(loss) before tax and finance costs:	
International airline business	803
Domestic airline business	(30)
Non-airline business	16
Profit on sale of assets:	
Non-airline business	32
Unallocated	4
Net finance costs	149
Income tax expense	170
Assets:	
International airline business	12,050
Domestic airline business	240
Non-airline business	140
Liabilities:	
International airline business	4,566
Domestic airline business	84
Non-airline business	350
Unallocated	5,420
Total revenue includes the following inter-segment sales:	
International airline business	103
Domestic airline business	14
Non-airline business	7

- **Requirement for question 3**

(a) Distinguish between business segments and geographical segments. *3*

(b) Distinguish between primary and secondary segments for reporting purposes. *3*

(c) Prepare, in so far as the above information permits, a primary segment report for Floothair plc's business segments. *11*

(d) Use the segment report to identify three significant aspects of the performance of Floothair plc which would not be evident from its income statement. *3*

(20)

4

Sparkling Pictures plc is a company which specialises in video production. The company is preparing its financial statements for the financial year ended 30 April 2007 and a number of issues have arisen.

(a) During the financial year ended 30 April 2006 Sparkling Pictures plc was responsible for videoing an important prize awards ceremony for subsequent broadcast on television. Shortly after the ceremony twenty-two people who had been there became seriously ill. They claimed that Sparkling Pictures plc was responsible because a poisonous chemical used in the manufacture of digital video tapes had been found in a soup tureen which had been used during the ceremony.

Legal proceedings seeking damages from Sparkling Pictures plc were started during the financial year ended 30 April 2006 plc. Sparkling Pictures plc denied liability and up to the date of authorisation of the financial statements for the year ended 30 April 2006 the company's lawyers were confident that the evidence against the company was weak and circumstantial, and that it was probable that Sparkling Pictures plc would not be found liable.

However, additional evidence emerged during the year ended 30 April 2007 which has caused Sparkling Pictures plc's lawyers to change their advice. They are now of the opinion that it is probable that Sparkling Pictures plc will be found liable.

- **Requirement for question 4 (a)**

(i) Explain, with reasons, how this matter would have been reported in the financial statements for the year ended 30 April 2006. *3*

(ii) Explain, with reasons, how this matter should be reported in the financial statements for the year ended 30 April 2007. *3*

(b) Sparkling Pictures plc replaced all its video cameras on 1 May 2004 for £96,000. The expected economic life of each video camera was 6 years from 1 May 2004 with a 10% residual value. Sparkling Pictures plc has been depreciating the video cameras using the straight line method.

It now appears that the estimated life of the video cameras was optimistic and, because of the rapid adoption of high definition video, the economic life of the cameras has been revised to 2 years as from 1 May 2007. It is also now expected that the video cameras will have a residual value of £10,950.

- **Requirement for question 4 (b)**

Explain how this asset should be reported in Sparkling Pictures plc's financial statements for the years ended 30 April 2007 illustrating your answer with appropriate figures. *6*

(c) Sparkling Pictures plc has a policy of making refunds to customers who are unhappy with the service delivered by the company. Sparkling Pictures plc is under no legal obligation to make refunds but its policy of making refunds is stated prominently in the company's advertising literature.

- **Requirement for question 4 (c)**

State, with reasons, how this item should be reported in the financial statements of Sparkling Pictures plc for the year ended 30 April 2007. *3*

(d) Sparkling Pictures plc acquired some non-current investments during the year ended 30 April 2007. The investments had maintained their value during the year ended 30 April 2007 but shortly after the end of the financial year, market conditions changed and there was a significant decline in the value of the investments. The investments had not recovered their value by the date on which the financial statements were authorised for issue.

- **Requirement for question 4 (d)**

State with reasons how this item should be dealt with in the financial statements of Sparkling Pictures plc for the year ended 30 April 2007. *2*

(e) Included in Sparkling Pictures plc's inventory as at 30 April 2007 were 1,000 digital video tapes which had cost £5 each. Shortly after 30 April 2007 it was discovered that these tapes were leaking a poisonous chemical which meant that the tapes could not be used and had to be scrapped. It was agreed that the tapes had probably started leaking some time before 30 April. Because of the leak it was necessary to clean and redecorate the store room. This cost £3,172. The work was started shortly before the financial statements were authorised for issue but was not paid for until after that date.

- **Requirement for question 4 (e)**

State with reasons how this should be dealt with in the financial statements of Sparkling Pictures plc for the year ended 30 April 2007. *3*

(20)

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5 The most recent financial year of Argentox plc ended on 31 May 2007 and the following draft financial statements are available:

Argentox plc
Income Statement
for the year ended 31 May 2007

			£
Revenue			24,796,000
Cost of goods sold			14,877,600
Gross profit			9,918,400
add	Other income		
	Discounts received		34,800
			9,953,200
less	Operating expenses		
	Wages and salaries	4,276,400	
	Rent, rates and insurance	546,870	
	Selling expenses	601,800	
	Discounts allowed	22,500	
	Interest paid	299,000	
	Depreciation and losses on sale of non-current assets	2,172,630	
	Accountancy	99,000	
	Sundries	254,300	
			8,272,500
Profit before tax			1,680,700
Income tax expense			(334,490)
Profit for the year			1,346,210

Argentox plc

Balance Sheets as at 31 May

		2007		2006
ASSETS				
Non-current assets		£		£
Property, planet and equipment				
- at cost		26,196,900		*18,264,800*
- accumulated depreciation		(3,757,610)		*(1,819,880)*
		22,439,290		*16,444,920*
Current assets	£		£	
Inventory	464,500		*424,400*	
Trade receivables	880,500		*814,200*	
Other receivables	1,050		*2,450*	
Cash and cash equivalents	260,000		*100,800*	
		1,606,050		*1,341,850*
Total assets		*24,045,340*		*17,786,770*
EQUITY AND LIABILITIES				
Equity				
Issued share capital		10,400,000		*7,500,000*
Share premium		800,000		*500,000*
Revaluation reserve		220,000		*220,000*
Retained earnings		7,906,760		*6,910,550*
Total equity		19,326,760		*15,130,550*
Non-current liabilities				
Loan notes		3,400,000		*1,200,000*
Deferred tax		300,000		*200,000*
Total non-current liabilities		3,700,000		*1,400,000*
Current Liabilities				
Trade payables		517,740		*408,400*
Other payables		5,700		*4,320*
Bank loan		159,000		*0*
Current tax payable		336,140		*843,500*
Total current liabilities		1,018,580		*1,256,220*
Total liabilities		4,718,580		*2,656,220*
Total equity and liabilities		*24,045,340*		*17,786,770*

The following additional information for the year ended 31 May 2007 is available:

(1) Property, plant and equipment which had cost £344,900 and which had a carrying value of £109,900 was sold for £110,000. Other movements in non-current assets are due to purchases of new assets.

(2) Dividends paid during the year were £350,000.

(3) 'Other receivables' consists of prepaid insurance. 'Other payables', in current liabilities, consists of accrued wages and salaries.

- **Requirement for question 5**

Prepare a cash flow statement for Argentox plc for the year ended 31 May 2007 in accordance with IAS 7 using the direct method.

(20)