CIPFA

FINANCIAL REPORTING

Certificate stage examination

7 December 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 examinations room.

Proforma booklets, graph paper and cash analysis paper are available from the invigilator, where applicable.

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 questions)

1 The following trial balance was taken from the accounts of Masfin plc as at 31 October 2007, the end of its most recent financial year:

Masfin plc
Trial balance as at 31 October 2007

	Note	**£000**	**£000**
Turnover			1,795
Investment income			47
Proceeds from sale of equipment	*1*		50
Cost of sales		1,364	
Administrative expenses		72	
Distribution costs		40	
Environmental costs	*3*	60	
Provision for environmental costs	*3*		90
Corporation tax	*4*		13
Preference share dividends paid		3	
Ordinary dividends paid		80	
Property, plant and equipment			
- at cost	*2*	525	
- accumulated depreciation	*2*		155
Bank and cash		266	
Inventory	*5*	98	
Non-current asset investments	*6*	80	
Trade receivables	*7*	224	
Trade payables			45
8% Preference Shares, redeemable 2012	*9*		40
Ordinary shares of £1			200
Deferred taxation	*4*		99
Revaluation reserve			69
Share premium			80
Retained earnings			129
		2,812	2,812

The following additional information is available:

1) During the year ended 31 October 2007 production equipment which cost £125,000 and which had been depreciated by £96,000 was sold for £50,000. The proceeds have been recorded in the accounts, but no other entries have been made.

2) Property, plant and equipment includes property costing £100,000 with accumulated depreciation of £20,000.

   Depreciation for the year ended 31 October 2007 has not yet been charged. Masfin plc's depreciation rates are:

Property	2% per year
Plant and equipment	20% per year

   The straight line method is used with a full year's depreciation being charged in the year of purchase and no depreciation charged in the year of sale.

   Depreciation charges are to be allocated as follows:

Cost of sales	50%
Administration	30%
Distribution	20%

3) During the financial year ended 31 October 2006 Masfin plc made a provision for £90,000 for environmental costs. The provision was to make good contamination caused by the company's operations. All the necessary work was completed during the year ended 31 October 2007, but there are accrued costs of £26,000 which have not yet been recognised.

4) The balance on the corporation tax account represents an over-provision for corporation tax for the financial year ended 31 October 2006. Corporation tax for the year ended 31 October 2007 has been estimated at £52,000 and deferred taxation is to be decreased by £22,000.

5) Inventory as at 31 October 2007 does not include items which were with a customer on a sale or return basis. The customer was invoiced £6,000 for these items but returned the goods on 5 November 2007. These items cost Masfin plc £4,000.

6) Non-current asset investments are reported at market value. The figure in the trial balance represents market value as at 31 October 2006. The market value of the investments as at 31 October 2007 was £92,000.

7) Masfin plc does not make a general allowance for receivables. However, a review of trade receivables as at 31 October 2007 has revealed a debt of £33,000 which is to be written off as irrecoverable.

8) A customer is suing Masfin plc for compensation for an injury sustained in July 2007. Masfin plc's lawyers feel that the customer will probably win the case and have estimated the compensation payable as £190,000.

9) Masfin plc's directors have been advised by the company's auditors that the redeemable preference shares cannot be treated as part of equity.

- **Requirement for question 1**

Prepare, for publication, Masfin plc's income statement for the year ended 31 October 2007 and its balance sheet as at 31 October 2007. Show full supportive workings.

Earnings per share, comparative figures and additional disclosure notes are not required.

(30)

2 A friend of yours is a professional footballer. He has an interest in the financial affairs of his club and has asked you for help in interpreting the club's cash flow statement. The most up to date information your friend has comes from the club's interim financial report. The cash flow statement is as follows:

Cash flow statement
For the six months ended 31 July 2007

	6 months ended 31 July 2007	**6 months ended 31 July 2006**	**12 months ended 31 Jan 2007**
	Unaudited	***Unaudited***	***Audited***
	£000	**£000**	**£000**
Cash flow from operating activities			
(Loss)/profit for the period	(6,330)	7,246	609
Adjustments for:			
Finance expenses	3,487	2,660	5,613
Finance income	(250)	(341)	(486)
Income tax expense	—	2,513	—
Amortisation of intangible non-current assets	9,711	5,084	10,344
Impairment of intangible assets	1,455	—	3,760
Profit on disposal of players' registrations	(4,213)	(8,388)	(13,380)
Profit on sale of property, plant and equipment	(51)	—	(6)
Depreciation of property, plant and equipment	1,950	1,817	3,839
Decrease/(increase) in trade and other receivables	1,720	180	(869)
(Increase)/decrease in inventories	(360)	82	(289)
(Decrease)/increase in trade and other payables	(5,820)	(3,321)	2,239
Increase/(decrease) in deferred income	470	(10,284)	(365)
Cash flow from operations	1,769	(2,752)	11,009
Interest paid	(4,120)	(4,344)	(4,888)
Interest received	170	369	520
Net cash flow from operating activities	(2,181)	(6,727)	6,641
Cash flows from investing activities			
Acquisitions of property, plant and equipment	(542)	(2,191)	(2,653)
Proceeds from sale of property, plant and equipment	91	—	17
Acquisition of players' registrations	(34,664)	(15,130)	(18,773)
Proceeds from sale of players' registrations	9,080	15,496	19,311
Net cash flow from investing activities	(26,035)	(1,825)	(2,098)
Cash flows from financing activities			
Dividends paid	(443)	(2,640)	(3,940)
Payment of share issue expenses	(192)	—	—
Proceeds from borrowings	—	1,500	2,750
Repayments of borrowings	(3,840)	(8,500)	(11,300)
Net cash flow from financing activities	(4,475)	(9,640)	(12,490)

Net decrease in cash and cash equivalents	(32,691)	(18,192)	(7,947)
Cash and cash equivalents at start of period	18,164	26,111	26,111
Cash and cash equivalents at end of period	(14,527)	7,919	18,164
Analysed as:			
Cash and cash equivalents	3,355	7,919	18,164
Bank overdraft	(17,882)	—	—
	(14,527)	7,919	18,164

- **Requirement for question 2**

Referring to the above statements, prepare notes in preparation for a meeting with your friend in which you:

(a) Explain the difference between *audited* and *unaudited* figures. *3*

(b) Explain the difference between *profit/(loss) for the period* and *net cash flow from operating activities*. *6*

(c) Explain where the wages paid to players are included in the cash flow statement. *1*

(d) List and explain *ten* significant aspects of the club's activities over the period as evidenced by its cash flow statements. *20*

(30)

SECTION B (Answer two from three questions)

3

The following is the equity and liabilities section of Castrani plc's balance sheet as at 31 October 2006:

	£m
Non-current liabilities	200
Current liabilities	85
Share capital	100
Share premium	25
Revaluation reserve	32
Retained earnings	153
Total equity and liabilities	595

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

- Castrani plc's share capital on 1 November 2006 consisted of 100 million £1 ordinary shares issued and fully paid. On 1 January 2007 Castrani plc issued 10 million £1 ordinary shares for a price of £2.50 per ordinary share. The issue was fully subscribed and paid.
- Following the adoption of IAS39 *Financial Instruments: Recognition and Measurement* during the year ended 31 October 2007 the company restated its 2006 balance sheet figure for available for sale investments. This resulted in an increase of £18m in the carrying value of the investments as at 31 October 2006.
- During the year ended 31 October 2007 available for sale investments were sold and realised a gain of £11m which has been included in profit for the year. £10m of the £18m increase in the carrying value of the investments as at 31 October 2006 related to these investments. The fair value of the remaining available for sale investments had increased by £4m at 31 October 2007.
- At 1 November 2006 property was carried in the balance sheet at its fair value of £287m. At 31 October 2007 the value of the property was updated to its market value of £302m.
- Profit before tax for the year ended 31 October 2007 was £110m and the charge for taxation was £22m.
- Dividends paid during the year ended 31 October 2007 were £50m.

- **Requirement for question 3**

(a) Prepare Castrani plc's statement of changes in equity for the year ended 31 October 2007. *15*

(b) Assess the usefulness of the statement of changes in equity to the users of financial statements. *5*

(20)

4

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

(i) Explain what a related party is and why transactions with related parties should be disclosed in the financial statements. *3*

(ii) State, with reasons, whether or not each of the following would be regarded as a related party of Prebnez plc.

(1) one of Prebnez plc's employees

(2) a shareholder holding 30% of the equity shares in Prebnez plc

(3) a director of Prebnez plc

(4) the brother of a director of Prebnez plc

(5) Orter plc which supplies 90% of its output to Prebnez plc and which is economically dependent on its transactions with Prebnez plc.

5

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

(i) Distinguish between *research* and *development* within the context of IAS38 *Intangible Assets*. *3*

(ii) State, with reasons, how the following expenditure would be dealt with in the financial statements of Prebnez plc to conform with IAS38:

(1) Money spent on a joint project with a university investigating the potential use of carbon nanotubes for the storage of digital data.

(2) Expenditure on developing a new high speed hard disk which, in the opinion of Prebnez plc, has an assured and profitable market. Work has been suspended pending the development of a new glue suitable for the construction of the disk drives.

4

Prebnez plc has entered into an agreement with Fidget Factoring Finance to factor its trade receivables. Under the agreement:

- Fidget Factoring Finance would pay Prebnez plc a monthly advance equivalent to 80% of the value of the invoices issued to customers in the previous month.
- A fee of 1.75% of sales revenue plus a monthly charge of 0.22% will be charged by Fidget Factoring Finance.
- The remaining 20% of invoices issued, less fees and charges, would be paid to Prebnez plc after the debts are collected by Fidget Factoring Finance.
- Any advances relating to debts which remain uncollected after 140 days have to be repaid by Prebnez plc to Fidget Factoring Finance.

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

How would the factoring agreement be reported in the financial statements of Prebnez plc? *5*

(20)

5

The following information relates to two companies, Ruslan plc and Lyudmila plc. The financial year of each company ends on 31 October each year.

Ruslan plc

Ruslan had 18 million ordinary shares in issue on 1 November 2006. Earnings attributable to the ordinary shares for Ruslan for the year ended 31 October 2007 were £6,900,000.

On 1 February 2007 Ruslan made a bonus issue of one share for every six shares held. On 1 August 2007 the company made an issue of 9 million shares at the full market price of £2.20 per share. The issue was fully subscribed and paid.

Ruslan's reported earnings per share for the year ended 30 November 2006 were 25 pence.

Lyudmila plc

On 1 November 2006 Lyudmila had 18 ordinary million shares in issue. Earnings attributable to the ordinary shares for the year ended 31 October 2007 were £6,900,000.

Lyudmila's reported earnings per share for the year ended 31 October 2006 were 25 pence.

On 1 February 2007 Lyudmila made a rights issue of one share for every six shares held. The price of this rights issue was £2.10. The market price of the shares prior to the rights issue was £2.36. The rights issue was fully subscribed and paid.

- **Requirement for question 5**

(a) Calculate the earnings per share figures for the year ended 31 October 2007 *and* 31 October 2006 that should be disclosed in the financial statements for the year ended 31 October 2007 calculated in accordance with IAS33 *Earnings per share* for:

(i) Ruslan plc *6*
(ii) Lyudmila plc. *9*

(b) Prepare a disclosure note for earnings per share for Ruslan plc for inclusion in the financial statements for the year ended 31 October 2007 which conforms with the disclosure requirements of IAS33 in so far as the above information permits. *3*

(c) Describe the impact the above transactions would have on each company's cash flow statement for the year ended 31 October 2007. *2*

(20)