Fundamentals Level – Skills Module

Financial Reporting (International)

Wednesday 5 June 2013

Time allowed

Reading and planning:	15 minutes
Writing:	3 hours

ALL FIVE questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper F7 (INT)

The Association of Chartered Certified Accountants

ACCA

ALL FIVE questions are compulsory and MUST be attempted

1 (a) On 1 October 2012, Paradigm acquired 75% of Strata's equity shares by means of a share exchange of two new shares in Paradigm for every five acquired shares in Strata. In addition, Paradigm issued to the shareholders of Strata a $100 10% loan note for every 1,000 shares it acquired in Strata. Paradigm has not recorded any of the purchase consideration, although it does have other 10% loan notes already in issue.

The market value of Paradigm's shares at 1 October 2012 was $2 each.

The summarised statements of financial position of the two companies as at 31 March 2013 are:

	Paradigm	Strata
Assets	**$'000**	**$'000**
Non-current assets		
Property, plant and equipment	47,400	25,500
Financial asset: equity investments (notes (i) and (iv))	7,500	3,200
	54,900	28,700
Current assets		
Inventory (note (ii))	20,400	8,400
Trade receivables (note (iii))	14,800	9,000
Bank	2,100	nil
Total assets	92,200	46,100
Equity and liabilities		
Equity		
Equity shares of $1 each	40,000	20,000
Retained earnings/(losses) – at 1 April 2012	19,200	(4,000)
– for year ended 31 March 2013	7,400	8,000
	66,600	24,000
Non-current liabilities		
10% loan notes	8,000	nil
Current liabilities		
Trade payables (note (iii))	17,600	13,000
Bank overdraft	nil	9,100
Total equity and liabilities	92,200	46,100

The following information is relevant:

(i) At the date of acquisition, Strata produced a draft statement of profit or loss which showed it had made a net **loss** after tax of $2 million at that date. Paradigm accepted this figure as the basis for calculating the pre- and post-acquisition split of Strata's profit for the year ended 31 March 2013.

Also at the date of acquisition, Paradigm conducted a fair value exercise on Strata's net assets which were equal to their carrying amounts (including Strata's financial asset equity investments) with the exception of an item of plant which had a fair value of $3 million **below** its carrying amount. The plant had a remaining economic life of three years at 1 October 2012.

Paradigm's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, a share price for Strata of $1·20 each is representative of the fair value of the shares held by the non-controlling interest.

(ii) Each month since acquisition, Paradigm's sales to Strata were consistently $4·6 million. Paradigm had marked these up by 15% on cost. Strata had one month's supply ($4·6 million) of these goods in inventory at 31 March 2013. Paradigm's normal mark-up (to third party customers) is 40%.

(iii) Strata's current account balance with Paradigm at 31 March 2013 was $2·8 million, which did not agree with Paradigm's equivalent receivable due to a payment of $900,000 made by Strata on 28 March 2013, which was not received by Paradigm until 3 April 2013.

(iv) The financial asset equity investments of Paradigm and Strata are carried at their fair values as at 1 April 2012. As at 31 March 2013, these had fair values of $7·1 million and $3·9 million respectively.

(v) There were no impairment losses within the group during the year ended 31 March 2013.

Required:

Prepare the consolidated statement of financial position for Paradigm as at 31 March 2013. (20 marks)

(b) Paradigm has a strategy of buying struggling businesses, reversing their decline and then selling them on at a profit within a short period of time. Paradigm is hoping to do this with Strata.

Required:

As an adviser to a prospective purchaser of Strata, explain any concerns you would raise about basing an investment decision on the information available in Paradigm's consolidated financial statements and Strata's entity financial statements. (5 marks)

(25 marks)

2 The following trial balance relates to Atlas at 31 March 2013:

	$'000	$'000
Equity shares of 50 cents each (note (v))		50,000
Share premium		20,000
Retained earnings at 1 April 2012		11,200
Land and buildings – at cost (land $10 million) (note (ii))	60,000	
Plant and equipment – at cost (note (ii))	94,500	
Accumulated depreciation at 1 April 2012: – buildings		20,000
– plant and equipment		24,500
Inventory at 31 March 2013	43,700	
Trade receivables	42,200	
Bank		6,800
Deferred tax (note (iv))		6,200
Trade payables		35,100
Revenue (note (i))		550,000
Cost of sales	411,500	
Distribution costs	21,500	
Administrative expenses	30,900	
Dividends paid	20,000	
Bank interest	700	
Current tax (note (iv))		1,200
	725,000	725,000

The following notes are relevant:

(i) Revenue includes the sale of $10 million of maturing inventory made to Xpede on 1 October 2012. The cost of the goods at the date of sale was $7 million and Atlas has an option to repurchase these goods at any time within three years of the sale at a price of $10 million plus accrued interest from the date of sale at 10% per annum. At 31 March 2013 the option had not been exercised, but it is highly likely that it will be before the date it lapses.

(ii) Non-current assets:
On 1 October 2012, Atlas terminated the production of one of its product lines. From this date, the plant used to manufacture the product has been actively marketed at an advertised price of $4·2 million which is considered realistic. It is included in the trial balance at a cost of $9 million with accumulated depreciation (at 1 April 2012) of $5 million.

On 1 April 2012, the directors of Atlas decided that the financial statements would show an improved position if the land and buildings were revalued to market value. At that date, an independent valuer valued the land at $12 million and the buildings at $35 million and these valuations were accepted by the directors. The remaining life of the buildings at that date was 14 years. Atlas does **not** make a transfer to retained earnings for excess depreciation. Ignore deferred tax on the revaluation surplus.

Plant and equipment is depreciated at 20% per annum using the reducing balance method and time apportioned as appropriate.

All depreciation is charged to cost of sales, but none has yet been charged on any non-current asset for the year ended 31 March 2013.

(iii) At 31 March 2013, a provision is required for directors' bonuses equal to 1% of revenue for the year.

(iv) Atlas estimates that an income tax provision of $27·2 million is required for the year ended 31 March 2013 and at that date the liability to deferred tax is $9·4 million. The movement on deferred tax should be taken to profit or loss. The balance on current tax in the trial balance represents the under/over provision of the tax liability for the year ended 31 March 2012.

(v) On 1 July 2012, Atlas made and recorded a fully subscribed rights issue of 1 for 4 at $1·20 each. Immediately before this issue, the stock market value of Atlas's shares was $2 each.

Required:

(a) (i) Prepare the statement of profit or loss and other comprehensive income for Atlas for the year ended 31 March 2013;

(ii) Prepare the statement of changes in equity for Atlas for the year ended 31 March 2013;

(iii) Prepare the statement of financial position of Atlas as at 31 March 2013.

Note: Notes to the financial statements are not required.

The following mark allocation is provided as guidance for this requirement:

(i) 9 marks
(ii) 4 marks
(iii) 9 marks

(22 marks)

(b) Calculate the basic earnings per share for Atlas for the year ended 31 March 2013. (3 marks)

(25 marks)

3 Monty is a publicly listed company. Its financial statements for the year ended 31 March 2013 including comparatives are shown below:

Statements of profit or loss and other comprehensive income for the year ended:

	31 March 2013	31 March 2012
	$'000	$'000
Revenue	31,000	25,000
Cost of sales	(21,800)	(18,600)
Gross profit	9,200	6,400
Distribution costs	(3,600)	(2,400)
Administrative expenses	(2,200)	(1,600)
Finance costs – loan interest	(150)	(250)
– lease interest	(250)	(100)
Profit before tax	3,000	2,050
Income tax expense	(1,000)	(750)
Profit for the year	2,000	1,300
Other comprehensive income (note (i))	1,350	nil
	3,350	1,300

Statements of financial position as at:

	31 March 2013		31 March 2012	
	$'000	$'000	$'000	$'000
Assets				
Non-current assets				
Property, plant and equipment		14,000		10,700
Deferred development expenditure		1,000		nil
		15,000		10,700
Current assets				
Inventory	3,300		3,800	
Trade receivables	2,950		2,200	
Bank	50	6,300	1,300	7,300
Total assets		21,300		18,000
Equity and liabilities				
Equity				
Equity shares of $1 each		8,000		8,000
Revaluation reserve		1,350		nil
Retained earnings		3,200		1,750
		12,550		9,750
Non-current liabilities				
8% loan notes	1,400		3,125	
Deferred tax	1,500		800	
Finance lease obligation	1,200	4,100	900	4,825
Current liabilities				
Finance lease obligation	750		600	
Trade payables	2,650		2,100	
Current tax payable	1,250	4,650	725	3,425
Total equity and liabilities		21,300		18,000

Notes:

(i) On 1 July 2012, Monty acquired additional plant under a finance lease that had a fair value of $1·5 million. On this date it also revalued its property upwards by $2 million and transferred $650,000 of the resulting revaluation reserve this created to deferred tax. There were no disposals of non-current assets during the period.

(ii) Depreciation of property, plant and equipment was $900,000 and amortisation of the deferred development expenditure was $200,000 for the year ended 31 March 2013.

Required:

(a) Prepare a statement of cash flows for Monty for the year ended 31 March 2013, in accordance with IAS 7 *Statement of Cash Flows*, using the indirect method. (15 marks)

(b) Comment on the comparative performance of Monty in terms of its return on capital employed, profit margins, asset utilisation and gearing.

Note: Up to 4 marks are available for the calculation of the ratios. (10 marks)

(25 marks)

4 **(a)** The objective of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* specifies, amongst other things, accounting for and presentation and disclosure of discontinued operations.

Required:

Define a discontinued operation and explain why the disclosure of such information is important to users of financial statements. (5 marks)

(b) Radar's sole activity is the operation of hotels all over the world. After a period of declining profitability, Radar's directors made the following decisions during the year ended 31 March 2013:

– it disposed of all of its hotels in country A;
– it refurbished all of its hotels in country B in order to target the holiday and tourism market. The previous target market in country B had been aimed at business clients.

Required:

Treating the two decisions separately, explain whether they meet the criteria for being classified as discontinued operations in the financial statements for the year ended 31 March 2013. (4 marks)

(c) At a board meeting on 1 July 2012, Pulsar's directors made the decision to close down one of its factories on 31 March 2013. The factory and its related plant would then be sold.

A formal plan was formulated and the factory's 250 employees were given three months' notice of redundancy on 1 January 2013. Customers and suppliers were also informed of the closure at this date.

The directors of Pulsar have provided the following information:

Fifty of the employees would be retrained and deployed to other subsidiaries within the group at a cost of $125,000; the remainder will accept redundancy and be paid an average of $5,000 each.

Factory plant has a carrying amount of $2·2 million, but is only expected to sell for $500,000 incurring $50,000 of selling costs; however, the factory itself is expected to sell for a profit of $1·2 million.

The company rents a number of machines under operating leases which have an average of three years to run after 31 March 2013. The present value of these future lease payments (rentals) at 31 March 2013 was $1 million; however, the lessor has said they will accept $850,000 which would be due for payment on 30 April 2013 for their cancellation as at 31 March 2013.

Penalty payments due to non-completion of supply contracts are estimated at $200,000.

Required:

Explain and quantify how the closure of the factory should be treated in Pulsar's financial statements for the year ended 31 March 2013.

Note: The closure of the factory does not meet the criteria of a discontinued operation. (6 marks)

(15 marks)

5 **(a)** The accounting treatment of investment properties is prescribed by IAS 40 *Investment Property*.

Required:

(i) Define investment property under IAS 40 and explain why its accounting treatment is different from that of owner-occupied property;

(ii) Explain how the treatment of an investment property carried under the fair value model differs from an owner-occupied property carried under the revaluation model.

The following mark allocation is provided as guidance for this requirement:

(i) 3 marks
(ii) 2 marks

(5 marks)

(b) Speculate owns the following properties at 1 April 2012:

Property A: An office building used by Speculate for administrative purposes with a depreciated historical cost of \$2 million. At 1 April 2012 it had a remaining life of 20 years. After a reorganisation on 1 October 2012, the property was let to a third party and reclassified as an investment property applying Speculate's policy of the fair value model. An independent valuer assessed the property to have a fair value of \$2·3 million at 1 October 2012, which had risen to \$2·34 million at 31 March 2013.

Property B: Another office building sub-let to a subsidiary of Speculate. At 1 April 2012, it had a fair value of \$1·5 million which had risen to \$1·65 million at 31 March 2013.

Required:

Prepare extracts from Speculate's entity statement of profit or loss and other comprehensive income and statement of financial position for the year ended 31 March 2013 in respect of the above properties. In the case of property B only, state how it would be classified in Speculate's consolidated statement of financial position.

Note: Ignore deferred tax. (5 marks)

(10 marks)

End of Question Paper