Fundamentals Level – Skills Module

Financial Reporting

September/December 2015

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This question paper is divided into two sections:

Section A – ALL 20 questions are compulsory and MUST be attempted

Section B – ALL THREE questions are compulsory and MUST be attempted

Do NOT open this question 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.

Do NOT record any of your answers on the question paper.

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

The Association of Chartered Certified Accountants

Paper F7

ACCA

Section B – ALL THREE questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

1 The following trial balance **extracts** (i.e. it is not a complete trial balance) relate to Moston as at 30 June 2015:

	$'000	$'000
Revenue (note (i))		113,500
Cost of sales	88,500	
Research and development costs (note (ii))	7,800	
Distribution costs	3,600	
Administrative expenses (note (iv))	6,800	
Loan note interest and dividends paid (notes (iv) and (vii))	5,000	
Investment income		300
Equity shares of $1 each (note (vii))		30,000
5% loan note (note (iv))		20,000
Retained earnings as at 1 July 2014		6,200
Revaluation surplus as at 1 July 2014		3,000
Other components of equity		9,300
Property at valuation 1 July 2014 (note (iii))	28,500	
Plant and equipment at cost (note (iii))	27,100	
Accumulated depreciation plant and equipment 1 July 2014		9,100
Financial asset equity investments at fair value 1 July 2014 (note (v))	8,800	

The following notes are relevant:

(i) Revenue includes a $3 million sale made on 1 January 2015 of maturing goods which are not biological assets. The carrying amount of these goods at the date of sale was $2 million. Moston is still in possession of the goods (but they have not been included in the inventory count) and has an unexercised option to repurchase them at any time in the next three years. In three years' time the goods are expected to be worth $5 million. The repurchase price will be the original selling price plus interest at 10% per annum from the date of sale to the date of repurchase.

(ii) Moston commenced a research and development project on 1 January 2015. It spent $1 million per month on research until 31 March 2015, at which date the project passed into the development stage. From this date it spent $1·6 million per month until the year end (30 June 2015), at which date development was completed. However, it was not until 1 May 2015 that the directors of Moston were confident that the new product would be a commercial success.

Expensed research and development costs should be charged to cost of sales.

(iii) Non-current assets:

Moston's property is carried at fair value which at 30 June 2015 was $29 million. The remaining life of the property at the beginning of the year (1 July 2014) was 15 years. Moston does not make an annual transfer to retained earnings in respect of the revaluation surplus. Ignore deferred tax on the revaluation.

Plant and equipment is depreciated at 15% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 June 2015. All depreciation is charged to cost of sales.

(iv) The 5% loan note was issued on 1 July 2014 at its nominal value of $20 million incurring direct issue costs of $500,000 which have been charged to administrative expenses. The loan note will be redeemed after three years at a premium which gives the loan note an effective finance cost of 8% per annum. Annual interest was paid on 30 June 2015.

(v) At 30 June 2015, the financial asset equity investments had a fair value of $9·6 million. There were no acquisitions or disposals of these investments during the year.

(vi) A provision for current tax for the year ended 30 June 2015 of $1·2 million is required, together with an increase to the deferred tax provision to be charged to profit or loss of $800,000.

(vii) Moston paid a dividend of 20 cents per share on 30 March 2015, which was followed the day after by an issue of 10 million equity shares at their full market value of $1·70. The share premium on the issue was recorded in other components of equity.

Required:

(a) Prepare the statement of profit or loss and other comprehensive income for Moston for the year ended 30 June 2015. (11 marks)

(b) Prepare the statement of changes in equity for Moston for the year ended 30 June 2015. (4 marks)

Note: The statement of financial position and notes to the financial statements are NOT required.

(15 marks)

2 Xpand is a public company which has grown in recent years by acquiring established businesses. The following financial statements for two potential target companies are shown below. They operate in the same industry sector and Xpand believes their shareholders would be receptive to a takeover. An indicative price for 100% acquisition of the companies is $12 million each.

Statements of profit or loss for the year ended 30 September 2015

	Kandid $'000	Kovert $'000
Revenue	25,000	40,000
Cost of sales	(19,000)	(32,800)
Gross profit	6,000	7,200
Distribution and administrative expenses	(1,250)	(2,300)
Finance costs	(250)	(900)
Profit before tax	4,500	4,000
Income tax expense	(900)	(1,000)
Profit for the year	3,600	3,000

Statements of financial position as at 30 September 2015

Non-current assets		
Property	nil	3,000
Owned plant	4,800	2,000
Leased plant	nil	5,300
	4,800	10,300
Current assets		
Inventory	1,600	3,400
Trade receivables	2,100	5,100
Bank	1,100	200
	4,800	8,700
Total assets	9,600	19,000
Equity and liabilities		
Equity		
Equity shares of $1 each	1,000	2,000
Property revaluation surplus	nil	900
Retained earnings	1,600	2,700
	2,600	5,600
Non-current liabilities		
Finance lease obligation	nil	4,200
5% loan notes (31 December 2016)	5,000	nil
10% loan notes (31 December 2016)	nil	5,000
	5,000	9,200
Current liabilities		
Trade payables	1,250	2,100
Finance lease obligation	nil	1,000
Taxation	750	1,100
	2,000	4,200
Total equity and liabilities	9,600	19,000

Notes

(i) Carrying value of plant:

	Kandid	Kovert
	$'000	$'000
Owned plant – cost	8,000	10,000
Less government grant	(2,000)	
	6,000	
Accumulated depreciation	(1,200)	(8,000)
	4,800	2,000
Leased plant – original fair value	nil	8,000

(ii) The following ratios have been calculated:

	Kandid	Kovert
Return on year-end capital employed (ROCE)	62·5%	31·0%
(finance lease obligations are treated as debt)		
Net asset (taken as same figure as capital employed) turnover	3·3 times	2·5 times
Gross profit margin	24·0%	18·0%
Profit margin (before interest and tax)	19·0%	12·3%
Current ratio	2·4:1	2·1:1
Closing inventory holding period	31 days	38 days
Trade receivables' collection period	31 days	47 days
Trade payables' payment period (using cost of sales)	24 days	23 days
Gearing (debt/(debt + equity))	65·8%	64·6%

Required:

(a) Using the above information, assess the relative performance and financial position of Kandid and Kovert for the year ended 30 September 2015 in order to assist the directors of Xpand to make an acquisition decision. (11 marks)

(b) Describe what further information may be useful to Xpand when making an acquisition decision. (4 marks)

(15 marks)

3 (a) On 1 January 2015, Palistar acquired 75% of Stretcher's equity shares by means of an immediate share exchange of two shares in Palistar for five shares in Stretcher. The fair value of Palistar and Stretcher's shares on 1 January 2015 were $4·00 and $3·00 respectively. In addition to the share exchange, Palistar will make a cash payment of $1·32 per acquired share, deferred until 1 January 2016. Palistar has not recorded any of the consideration for Stretcher in its financial statements. Palistar's cost of capital is 10% per annum.

The summarised statements of financial position of the two companies as at 30 June 2015 are:

	Palistar $'000	Stretcher $'000
Assets		
Non-current assets (note (ii))		
Property, plant and equipment	55,000	28,600
Financial asset equity investments (note (v))	11,500	6,000
	66,500	34,600
Current assets		
Inventory (note (iv))	17,000	15,400
Trade receivables (note (iv))	14,300	10,500
Bank	2,200	1,600
	33,500	27,500
Total assets	100,000	62,100
Equity and liabilities		
Equity		
Equity shares of $1 each	20,000	20,000
Other component of equity	4,000	nil
Retained earnings – at 1 July 2014	26,200	14,000
– for year ended 30 June 2015	24,000	10,000
	74,200	44,000
Current liabilities (note (iv))	25,800	18,100
Total equity and liabilities	100,000	62,100

The following information is relevant:

(i) Stretcher's business is seasonal and 60% of its annual profit is made in the period 1 January to 30 June each year.

(ii) At the date of acquisition, the fair value of Stretcher's net assets was equal to their carrying amounts with the following exceptions:

An item of plant had a fair value of $2 million below its carrying value. At the date of acquisition it had a remaining life of two years.

The fair value of Stretcher's investments was $7 million (see also note (v)).

Stretcher owned the rights to a popular mobile (cell) phone game. At the date of acquisition, a specialist valuer estimated that the rights were worth $12 million and had an estimated remaining life of five years.

(iii) Following an impairment review, consolidated goodwill is to be written down by $3 million as at 30 June 2015.

(iv) Palistar sells goods to Stretcher at cost plus 30%. Stretcher had $1·8 million of goods in its inventory at 30 June 2015 which had been supplied by Palistar. In addition, on 28 June 2015, Palistar processed the sale of $800,000 of goods to Stretcher, which Stretcher did not account for until their receipt on 2 July 2015. The in-transit reconciliation should be achieved by assuming the transaction had been recorded in the books of Stretcher before the year end. At 30 June 2015, Palistar had a trade receivable balance of $2·4 million due from Stretcher which differed to the equivalent balance in Stretcher's books due to the sale made on 28 June 2015.

(v) At 30 June 2015, the fair values of the financial asset equity investments of Palistar and Stretcher were \$13·2 million and \$7·9 million respectively.

(vi) Palistar's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Stretcher's share price at that date is representative of the fair value of the shares held by the non-controlling interest.

Required:

Prepare the consolidated statement of financial position for Palistar as at 30 June 2015. (25 marks)

(b) For many years, Dilemma has owned 35% of the voting shares and held a seat on the board of Myno which has given Dilemma significant influence over Myno. The other shares (65%) in Myno were held by many other shareholders who all owned less than 10% of the share capital. On this basis, Dilemma considered Myno to be an associate and has used equity accounting to account for its investment.

In March 2015, Agresso made an offer to buy all of the shares of Myno. The offer was supported by the majority of Myno's directors. Dilemma did not accept the offer and held on to its shares in Myno.

On 1 April 2015, Agresso announced that it had acquired the other 65% of the share capital of Myno and immediately convened a board meeting at which three of the previous directors of Myno were replaced, including the seat held by Dilemma.

Required:

Explain how the investment in Myno should be treated in the consolidated statement of profit or loss of Dilemma for the year ended 30 June 2015 and the consolidated statement of financial position at 30 June 2015. (5 marks)

(30 marks)

End of Question Paper