

Applied Skills

Financial Reporting (FR)

March/June 2019 – Sample Questions



FR

Time allowed: 3 hours 15 minutes

This question paper is divided into three sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL 15 questions are compulsory and MUST be attempted

Section C – BOTH questions are compulsory and MUST be attempted

Do NOT open this question paper 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.

Think Ahead

ACCA

The Association of
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Accountants

Section B – ALL 15 questions are compulsory and MUST be attempted

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write out the answers to the MCQs on the lined pages of the answer booklet.

Each question is worth 2 marks.

The following scenario relates to questions 16–20.

During the year ended 31 December 20X8, Linetti Co built an extension to its head office. The costs associated with the construction of the head office extension are as follows:

	\$m
Land acquisition	10·0
Fees for environmental certifications and building permits	0·5
Architect and engineer fees	1·0
Construction material and labour costs (including unused materials)	6·6

At 30 September 20X8, the date when the head office extension became available for use, the cost of unused materials on site amounted to \$0·5m. At that date, the total borrowing costs incurred on a loan which was used to specifically finance the head office extension amounted to \$0·8m.

Linetti Co also acquired 100% of a subsidiary, Scully Co, on 1 January 20X8. The carrying amount of the assets of Scully Co in the consolidated financial statements of the Linetti group at 31 December 20X8, immediately before an impairment review, were as follows:

	\$m
Goodwill	1·4
Brand name	2·0
Property, plant and equipment	6·0
Current assets (at recoverable amount)	2·4
	<hr/>
	11·8

The recoverable amount of Scully Co was estimated at \$9·6m at 31 December 20X8 and the impairment of the investment in Scully Co was deemed to be \$2·2m.

16 For the year ended 31 December 20X8, how much should be capitalised in respect of the construction of the extension to the head office building?

- A \$18·4m
- B \$17·6m
- C \$18·9m
- D \$18·1m

17 Linetti Co incurred further expenditure on the head office extension after it had been completed.

Which of the following would qualify as capital expenditure?

- A Property insurance premiums incurred
- B Installation of new office fixtures and fittings
- C Marketing costs telling the public that the head office extension is operational
- D Maintenance and relocation of computers and related office equipment

18 At 31 December 20X9, the directors of Linetti Co decide to adopt the revaluation model of IAS® 16 *Property, Plant and Equipment* for Linetti Co's property.

In accordance with IAS 16, which of the following statements is FALSE?

- A** In subsequent years, the depreciation will be based on the revalued amount of the head office building as opposed to its cost
- B** Any revaluation gain on the head office building is recognised in other comprehensive income and any revaluation loss is recognised in profit or loss
- C** Each component part of the head office building is revalued separately
- D** The residual value and the useful life of the head office building must be reviewed each year

19 Assuming Scully Co represents a cash generating unit, what is the carrying amount of the brand at 31 December 20X8 following the impairment review?

- A** \$1.2m
- B** \$1.45m
- C** \$1.73m
- D** \$1.8m

20 Which, if any, of the following statements regarding impairment reviews is/are correct?

- (1) At the end of each reporting period, an entity should assess if there is any indication that assets have been impaired
- (2) Annual impairment reviews are required on all intangible assets with indefinite lives

- A** 1 only
- B** 2 only
- C** Both 1 and 2
- D** Neither 1 nor 2

The following scenario relates to questions 21–25.

The following is an extract from Diaz Co's trial balance as at 31 December 20X8:

	Debit \$m	Credit \$m
Inventory at 31 December 20X8	8.6	
Trade receivables	6.2	
5% loan notes		9.0

The inventory count was completed on 31 December 20X8, but two issues have been noted. First, products with a sales value of \$0.6m had been incorrectly excluded from the count. Second, items costing \$0.2m which had been included in the count were damaged and could only be sold for 50% of the normal selling price. Diaz Co makes a mark-up of 50% on both of these items.

Diaz Co entered into a factoring agreement with Finaid Co on 31 December 20X8. In accordance with the agreement, Diaz Co sold trade receivables with a carrying amount of \$6.2m to Finaid Co for \$6m. Under the terms of the factoring agreement, after six months Finaid Co will return any unpaid receivables to Diaz Co for collection. Finaid Co will also charge Diaz Co a fee of 5% of any uncollected balances at the end of each month.

The 5% loan notes were issued for \$9m on 1 July 20X8. Diaz Co incurred issue costs of \$0.5m associated with this, which have been expensed within finance costs. The loan note interest is payable each 30 June and the loan note is repayable at a premium, giving them an effective interest rate of 8%.

21 In accordance with IAS 32 *Financial Instruments: Presentation*, which of the items in the trial balance would be classified as financial instruments?

- A Closing inventory and trade receivables only
- B 5% loan notes only
- C Trade receivables and 5% loan notes only
- D Closing inventory, trade receivables and 5% loan notes

22 What is the correct carrying amount of inventory to be recognised in Diaz Co's financial statements as at 31 December 20X8?

- A \$8.95m
- B \$9.0m
- C \$8.9m
- D \$9.15m

23 In an attempt to improve reported profit, the directors of Diaz Co want to change the valuation method of inventory from first in first out (FIFO) to an average cost method.

Which, if any, of the following statements regarding the potential change in inventory valuation is/are correct?

- (1) The change will represent a change in accounting estimate
- (2) The financial statements will be adjusted prospectively

- A 1 only
- B 2 only
- C Both 1 and 2
- D Neither 1 nor 2

24 Which of the following statements regarding the factoring arrangement is NOT true?

- A** \$6m received should be recorded in the liabilities of Diaz Co at 31 December 20X8
- B** \$0.2m should be expensed in Diaz Co's statement of profit or loss for the year ended 31 December 20X8
- C** A total of the 5% monthly fee should be expensed in Diaz Co's statement of profit or loss for the year ended 31 December 20X9
- D** The receivables will remain as an asset in the financial statements of Diaz Co at 31 December 20X8

25 In respect of the 5% loan notes, how much should be expensed within Diaz Co's statement of profit or loss for the year ended 31 December 20X8?

- A** \$0.68m
- B** \$0.45m
- C** \$0.72m
- D** \$0.34m

The following scenario relates to questions 26–30.

Jeffers Co prepares financial statements for the year ended 31 December 20X8. The financial statements are expected to be authorised for issue on 15 March 20X9.

The following three events have occurred in January 20X9:

(1) **Health and safety fine**

A health and safety investigation of an incident which occurred in 20X8 was concluded in January 20X9, resulting in a \$1.5m fine for Jeffers Co. A provision for \$1m had been recognised in Jeffers Co's financial statements for the year ended 31 December 20X8.

(2) **Customer ceased trading**

Notice was received on 10 January 20X9 that a customer owing \$1.2m at 31 December 20X8 had ceased trading. It is unlikely that the debt will be recovered in full.

(3) **Acquisition of a competitor**

The acquisition of a competitor was finalised on 10 January 20X9, being the date Jeffers Co obtained control over the competitor. Negotiations in respect of the acquisition commenced in May 20X8.

In addition to this, there is an outstanding court case at 31 December 20X8 relating to faulty goods supplied by Jeffers Co. Legal advice states that there is a small chance that they will have to pay out \$6m, but the most likely outcome is believed to be a payout of \$5m. Either way, Jeffers Co will have to pay legal fees of \$0.2m. All payments are expected to be made on 31 December 20X9. Jeffers Co has a cost of capital of 10% (discount factor 0.909).

Jeffers Co believes the fault lies with the supplier, and is pursuing a counter-claim. Legal advice states that it is possible, but not likely, that this action will succeed.

26 Which, if any, of the following statements regarding IAS Events after the Reporting Period 10 is/are correct?

- (1) 'Events after the reporting period' are deemed to be all events from the date the financial statements are authorised for issue up until the date of the annual meeting with the shareholders
- (2) Non-adjusting events do not need to be reflected in any part of an entity's financial statements or annual report

- A 1 only
- B 2 only
- C Both 1 and 2
- D Neither 1 nor 2

27 Which of the three events which occurred in January 20X9 would be classified as adjusting events in accordance with IAS 10?

- (1) Health and safety fine
- (2) Customer ceased trading
- (3) Acquisition of a competitor

- A 1 and 2 only
- B 1 and 3 only
- C 2 and 3 only
- D 1, 2 and 3

28 What amount should be recorded as a provision in respect of the outstanding court case against Jeffers Co as at 31 December 20X8 (to the nearest hundred thousand)?

- A \$5.6m
- B \$5.5m
- C \$4.7m
- D \$4.5m

29 At 31 December 20X8, which of the following represents the correct accounting treatment of the counter-claim made by Jeffers Co against the supplier?

- A** Nothing is recognised or disclosed in the financial statements
- B** Disclose as a contingent asset
- C** Recognise a receivable from the supplier
- D** Net the possible counter-claim proceeds from the supplier against the provision for legal claim

30 In February 20X9, a major fire broke out in Jeffers Co's property and warehouse. Jeffers Co has no insurance, and now the management of the company believes it is unable to continue trading.

How should this be reflected in Jeffers Co's financial statements for the year ended 31 December 20X8?

- A** No adjustment should be made to the figures in the financial statements, however, this event must be disclosed in the notes
- B** The financial statements can no longer be prepared on a going concern basis
- C** No disclosure is required in the financial statements, however, this event must be reflected in the financial statements for the year ended 31 December 20X9
- D** The financial statements should continue to be prepared using the going concern basis, with an impairment loss recognised against the non-current assets

(30 marks)

Section C – BOTH 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.

- 31** The consolidated statements of profit or loss for the Pirlo group for the years ended 31 December 20X9 and 20X8 are shown below.

	20X9 \$'000	20X8 \$'000
Revenue	213,480	216,820
Cost of sales	(115,620)	(119,510)
Gross profit	<u>97,860</u>	<u>97,310</u>
Operating expenses	(72,360)	(68,140)
Profit from operations	25,500	29,170
Finance costs	(17,800)	(16,200)
Investment income	<u>2,200</u>	<u>2,450</u>
Profit before tax	9,900	15,420
Share of profit of associate	4,620	3,160
Tax expense	<u>(2,730)</u>	<u>(3,940)</u>
Profit for the year	<u>11,790</u>	<u>14,640</u>
Attributable to:		
Shareholders of Pirlo Co	8,930	12,810
Non-controlling interest	2,860	1,830

The following information is relevant:

- (i) On 31 December 20X9, the Pirlo group disposed of its entire 80% holding in Samba Co, a software development company, for \$300m. The Samba Co results have been fully consolidated into the consolidated financial statements above. Samba Co does not represent a discontinued operation.
- (ii) The proceeds from the disposal of Samba Co have been credited to a suspense account and no gain/loss has been recorded in the financial statements above.
- (iii) Pirlo Co originally acquired the shares in Samba Co for \$210m. At this date, goodwill was calculated at \$70m. Goodwill has not been impaired since acquisition, and external advisers estimate that the goodwill arising in Samba Co has a value of \$110m at 31 December 20X9.
- (iv) On 31 December 20X9, Samba Co had net assets with a carrying amount of \$260m. In addition to this, Samba Co's brand name was valued at \$50m at acquisition in the consolidated financial statements. This is not reflected in Samba Co's individual financial statements, and the value is assessed to be the same at 31 December 20X9.
- (v) Samba Co is the only subsidiary in which the Pirlo group owned less than 100% of the equity. The Pirlo group uses the fair value method to value the non-controlling interest. At 31 December 20X9, the non-controlling interest in Samba Co is deemed to be \$66m.
- (vi) Until December 20X8, Pirlo Co rented space in its property to a third party. This arrangement ended and, on 1 January 20X9, Samba Co's administrative department moved into Pirlo Co's property. Pirlo Co charged Samba Co a reduced rent. Samba Co's properties were sold in April 20X9 at a profit of \$2m which is included in administrative expenses.
- (vii) On 31 December 20X9, the employment of the two founding directors of Samba Co was transferred to Pirlo Co. From the date of disposal, Pirlo Co will go into direct competition with Samba Co. As part of this move, the directors did not take their annual bonus of \$1m each from Samba Co. Instead, they received a similar 'joining fee' from Pirlo Co, which was paid to them on 31 December 20X9. These individuals have excellent relationships with the largest customers of Samba Co, and are central to Pirlo Co's future plans.
- (viii) Samba Co's revenue remained consistent at \$26m in both 20X9 and 20X8 and Samba Co has high levels of debt. Key ratios from the Samba Co financial statements are shown below:

	20X9	20X8
Gross profit margin	81%	80%
Operating profit margin	66%	41%
Interest cover	1.2 times	1.1 times

Required:

(a) Calculate the gain/loss on the disposal of Samba Co which will be recorded in:

- The individual financial statements of Pirlo Co; and
- The consolidated financial statements of the Pirlo group. (5 marks)

(b) Calculate ratios equivalent to those provided in note (viii) for the Pirlo group for the years ended 31 December 20X9 and 20X8. No adjustment is required for the gain/loss on disposal from (a). (3 marks)

(c) Comment on the performance and interest cover of the Pirlo group for the years ended 31 December 20X9 and 20X8. Your answer should comment on:

- The overall performance of the Pirlo group;
- How, once accounted for, the disposal of Samba Co will impact on your analysis; and
- The implications of the disposal of Samba Co for the future results of the Pirlo group. (12 marks)

(20 marks)

32 The following extract is from the trial balance of Vernon Co at 31 December 20X8:

	\$'000	\$'000
Cost of sales	46,410	
Finance costs	4,050	
Investment income (note (iii))		1,520
Operating expenses (note (iii))	20,640	
Revenue (notes (i) and (ii))		75,350
Tax (note vi))	130	

The following notes are relevant:

(i) Vernon Co made a large sale of goods on 1 July 20X8, which was also the date of delivery. Under the terms of the agreement, Vernon Co will receive payment of \$8m on 30 June 20X9. Currently, Vernon Co has recorded \$4m in revenue and trade receivables. The directors intend to record the remaining \$4m revenue in the year ended 31 December 20X9. The costs of this sale have been accounted for correctly in the financial statements for the year ended 31 December 20X8. Vernon Co has a cost of capital of 8% at which an appropriate discount factor would be 0.9259.

(ii) Vernon Co also sold goods to an overseas customer on 1 December 20X8 for 12m Kromits (Kr). They agreed a 60-day payment term. No entries have yet been made to record this sale, although the goods were correctly removed from inventory and expensed in cost of sales. The amount remains unpaid at 31 December 20X8.

Relevant exchange rates are:

1 December 20X8: 6.4 Kr/\$

31 December 20X8: 6.0 Kr/\$

(iii) Vernon Co acquired \$9m 5% bonds at par value on 1 January 20X8. The interest is receivable on 31 December each year. Vernon Co incurred \$0.4m broker fees when acquiring the bonds, which has been expensed to operating expenses. These bonds are repayable at a premium so have an effective rate of 8%. Vernon Co has recorded the interest received on 31 December 20X8 in investment income.

(iv) During the year, Vernon Co revalued its head office for the first time, resulting in an increase in value of \$12m at 31 December 20X8. Deferred tax is applicable to this gain at 25%.

(v) Vernon Co values its investment properties using the fair value model. The investment properties increased in value by \$4m at 31 December 20X8.

(vi) The tax figure in the trial balance represents the under/over provision from the previous year. The current tax liability for the year ended 31 December 20X8 is estimated to be \$3.2m.

(vii) At 1 January 20X8, Vernon Co had 30 million \$1 equity shares in issue. On 1 April 20X8, Vernon Co issued an additional 5 million \$1 equity shares at full market value. On 1 July 20X8, Vernon Co performed a 2 for 5 rights issue, at \$2.40 per share. The market value of a Vernon Co share at 1 July 20X8 was \$3.10 per share.

Required:

(a) Produce a statement of profit or loss and other comprehensive income for Vernon Co for the year ended 31 December 20X8. (15 marks)

(b) Calculate the earnings per share for Vernon Co for the year ended 31 December 20X8. (5 marks)

(20 marks)

End of Question Paper