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ACCA – Paper F7 (INT and UK)
Financial Reporting
June 2015
Final assessment

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Notice to Markers

1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

• Time management	• Handwriting	• Presentation and layout	• Use of English
• Points clearly and concisely made	• Relevance of answers to question	• Coverage and depth of answer	• Accuracy of calculations
• Calculations cross-referenced to workings	• All parts of the requirement attempted	• Length of answers equates to marks available	• Read the question carefully

2 For each question, please provide suitable constructive comments

Question Number	**General Comments**	**Exam Technique Comments**

ACCA FINAL ASSESSMENT

Financial Reporting

June 2015

Paper F7

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

This paper is divided into two sections:
Section A – ALL TWENTY questions are compulsory and MUST be attempted.
Section B – ALL THREE 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.

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SECTION A

ALL 20 QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED

1 Turrett Ltd has adopted the cost model for their investment properties. They purchase land and buildings for investment purposes for $2.5m on 1 January 20X7. The land element of cost is valued at $750,000. The estimated useful life of the asset is 25 years. The fair value of the property has increased by $100,000 at the end of the year

What is the carrying value of the asset at 31 December 20X7?

A $2,400,000

B $2,430,000

C $2,530,000

D $2,600,000

2 Which of the following is an example of a revenue grant?

A A grant received to subsidise the cost of implementing solar panels

B A grant received to subsidise the cost of investing in electric cars

C A grant received to subsidise the cost of insulation for an office building

D A grant received to subsidise the cost of a training course on energy efficiency

3 Harvey Plc has 5 million 50c shares in issue. In its current year financial statements, for the year ended 30 September 20X6, Harvey has made a net profit of $4,500,000.

Harvey has 2 million share options currently in issue. These options are exercisable at price of $2.25 each. The average market value of the shares during the year ended 30 September 20X6 was $3.00

What is the Diluted Earnings per Share calculation for Harvey for the year ended 30 September 20X6?

A 79c

B 82c

C 90c

D 180c

4 HA acquired 120,000 of SB's equity shares on 1 April 20X0 for $185,000, when the value of a share in SB was $2. The values of SB's equity at 1 April 20X0 was:

	$
$1 equity shares	150,000
Share premium	15,000
Retained earnings	(22,000)

NCI is valued using the proportion of net assets method.

What is the value of the NCI at acquisition?

A $28,600

B $37,400

C $60,000

D $70,600

5 AB owns 40% of CD. During the year the investment in CD suffered impairment of $1,000.

How should the impairment be treated in the consolidated statement of profit or loss?

A Increase the operating expenses by $1,000

B Reduce the share of the associates profit by $1,000

C Increase the operating expenses by $400

D Reduce the share of the associates profit by $400

6 During the year Fluff sold $168,000 worth of goods to its 90% owned subsidiary Ball. These goods were sold at a mark-up of 50% on cost. On 31 December Ball still had $36,000 worth of these goods in inventory.

Which of the statements below are correct?

(i) PURP is $56,000

(ii) PURP is $12,000

(iii) Adjustment should reduce inventory, reduce retained earnings, and increase cost of sales

(iv) Adjustment should reduce inventory, reduce retained earnings and reduce cost of sales

A (ii) and (iv)

B (i) and (iii)

C (ii) and (iii)

D (i) and (iv)

7 The HC group acquired 30% of the equity share capital of AF on 1 April 20X8 paying $25,000.

At 1 April 20X8 the equity of AF comprised:

	$
$1 equity shares	50,000
Share premium	12,500
Retained earnings	10,000

AF made a profit for the year to 31 March 20X9 (prior to dividend distribution) of $6,500 and paid a dividend of $3,500 to its equity shareholders.

What is the value of the investment in AF to be included in HC's consolidated statement of financial position as at 31 March 20X9?

A $25,900

B $21,750

C $26,950

D $24,100

8 Which one of the following statements is INCORRECT in respect of the recognition of goodwill in consolidated financial statements?

A If goodwill at acquisition is negative, it should be credited to profit or loss immediately.

B Changes in the fair value of the subsidiary's net assets arising after acquisition are dealt with as post-acquisition adjustments in line with group accounting policies.

C Contingent consideration should only be recognised in the goodwill calculation if it is considered probable that it will be paid.

D The various elements of consideration paid should be measured at their fair value at the date of acquisition.

9 YG acquired 75% of the ordinary share capital of VB, its only subsidiary, on 1 July 20X6. In the year ended 31 December 20X6 VB made total profit of $180,000. A fair value adjustment at acquisition resulted in additional depreciation of $15,000 being charged to profit or loss in the post-acquisition period.

The directors carried out an impairment review on the goodwill arising on the acquisition of VB at 31 December 20X6 and charged $25,000 to consolidated profit or loss as a result.

It is group policy to measure non-controlling interest at the proportionate share of net assets at the date of acquisition. Profit is assumed to accrue evenly throughout the year.

What is the profit attributable to the non-controlling interest for the year ended 31 December 20X6?

A $20,625

B $12,500

C $18,750

D $35,000

10 Smooth's year end is 31 December. Previously Smooth sold luxury chocolates into retailers aimed at the Christmas market. Smooth has now moved into the health food market and has opened up shops to the public, aiming to make sales on a consistent level throughout the year.

What impact would you expect to see on inventory and receivables at 31 December in the year following this change?

A Higher inventory turnover period (days), higher receivable collection period

B Higher inventory turnover period (days), lower receivable collection period

C Lower inventory turnover period (days), higher receivable collection period

D Lower inventory turnover period (days), lower receivable collection period

11 The following information is available for 2 potential acquisition targets. The entities are situated in the same country and both operate in the same industry.

	A	*B*
Revenue	$375m	$380m
Gross profit margin	28%	19%
Profit for the year/revenue margin	11%	11%

Which one of the following statements is NOT a valid conclusion that could be drawn from comparing the above information for A and B?

A A's gross profit margin is better than B's as it is able to benefit from economies of scale.

B The difference between the gross profit margin of A and B may be due to how they classify their expenses between cost of sales and operating costs.

C A may have improved their gross profit margin by significant investment in new and efficient machinery, but could be suffering from high finance costs as a result of financing the investment with long-term borrowings.

D B may be selling a significantly higher volume of products than A but at a lower price.

12 A has purchased its head office building using debt finance, whereas B leases its head office under an operating lease agreement. Both entities use their head office for administrative purposes.

Which THREE of the following ratios would be considered incomparable between the two entities based on the way the entities have financed their head offices?

(i) Gross profit margin

(ii) Non-current asset turnover

(iii) Return on capital employed

(iv) Current ratio

(v) Gearing

A Statements (ii), (iii), (iv)

B Statements (i), (iii), (iv)

C Statements (ii), (iii), (v)

D Statements (ii), (iv), (v)

13 Which one of the following statements correctly identifies the effect that an upwards revaluation of non-current assets would have on return on capital employed (ROCE) and gearing?

A Increase in both ROCE and gearing

B Decrease in both ROCE and gearing

C Increase in ROCE and decrease in gearing

D Decrease in ROCE and increase in gearing

14 In the statement of cash flow of BKS for the year to 31 December 20X5 the net cash flow from operating activities is to be arrived at by the indirect method.

The following information is relevant:

Profit before tax	12,044
Depreciation	1,796
Loss on sale of tangible non-current assets	12
Increase in inventories	398
Increase in receivables	144
Increase in payables	468

What is the cash generated from operations for the year ended 31 December 20X5?

A $12,818

B $12,842

C $13,754

D $13,778

15 Extracts from SF's statement of financial position at 31 March 20X3, with comparatives, are shown below:

	20X3	*20X2*
Equity	$000	$000
Ordinary $0.50 shares	460	400
Share premium	82	70
Retained earnings	273	246

During the year ended 31 March 20X3 SF's transactions included the following:

Issued some ordinary shares at a 20% premium.

What amount will be shown as the proceeds of the share issue in the financing section of SP's statement of cash flow?

A $12,000

B $60,000

C $72,000

D $99,000

16 Which of the following is NOT listed as an element of financial statements by the IASB Conceptual Framework for Financial Reporting?

A Asset

B Equity

C Profit

D Expenses

17 Which of the following criteria need to be satisfied in order for an item to be recognised in the financial statements?

(i) It meets the definition of an element of the financial statements

(ii) It is probable that future economic benefits will flow to or from the enterprise

(iii) It is certain that future economic benefits will flow to or from the enterprise

(iv) The item has a cost or value

(v) The item has a cost or value that can be reliably measured

A (i), (ii) and (v)

B (i), (iii) and (v)

C (i), (ii) and (iv)

D (i), (iii) and (iv)

18 Which ONE of the following statements regarding IFRS 13 is not true?

A Level 1 inputs are likely to be used without adjustment

B Level 3 inputs are based on the best information available to market participants and are therefore regarded as providing the most reliable evidence of fair value

C Level 2 inputs may include quoted prices for similar (but not identical) assets and liabilities in active markets

D Level 1 inputs comprise quoted prices in active markets for identical assets and liabilities at the reporting date

19 Brass is a construction company, recognising contract profits earned based on the costs incurred as a proportion of total costs. The following information relates to one of its contracts as at 31 August 2014, Brass's year-end.

Contract price $450,000

Costs incurred to date $220,000

Estimated cost to complete $110,000

Invoiced to customer $180,000

What profit should appear in Brass's Statement of Profit or Loss as at 31 August 2014 in respect of this contract?

A $120,000

B $153,333

C $80,000

D $40,000

20 JK is a motor dealership and has motor vehicles on its premises that were supplied by a car manufacturer, SB. Trading between JK and SB was subject to a contractual arrangement.

Which one of the following would be an indicator that SB should continue to recognise the motor vehicles in its inventory?

A When JK makes a sale, SB raises an invoice to JK at the price agreed when the vehicle is delivered to JK.

B JK has the right to return any vehicle at any time without incurring a penalty.

C JK is responsible for insuring all the vehicles on its premises.

D JK is entitled to use any of the vehicles supplied to it for demonstration purposes and road testing.

SECTION B

ALL 3 QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED

1 You are an assistant to the Finance Director of Shop Top, a large fashion retailer. Shop Top's merchandise is obtained from many different suppliers around the world. Shop Top's senior management has a business policy of building lasting relationships with suppliers either by investing in their shares, or by making loans to them at favourable rates of interest.

A request has recently been received from a supplier, Clothes Inc, for a loan of $25 million to allow it to invest in up to date machinery. The directors of Clothes Inc claim that the investment will result in efficiency improvements which, in the short to medium term, will allow it to reduce prices to its customers. Shop Top is a major customer of Clothes Inc, buying approximately 10% of Clothes Inc's annual output of cotton clothing.

Clothes Inc has not paid a dividend in the last five years.

In support of the application, Clothes Inc's Finance Director has supplied financial statements for the year ended 30 September 2012. These financial statements are unaudited. The financial statements supplied by Clothes Inc are as follows:

Statement of profit of loss for the year ended 31 March:

	2015	*2014*
	$000	$000
Revenue	256,300	281,700
Cost of sales	(226,600)	(243,100)
Gross profit	29,700	38,600
Distribution costs	(9,200)	(8,900)
Administrative expenses	(20,000)	(22,400)
Finance costs	(5,400)	(6,200)
(Loss)/profit before tax	(4,900)	1,100
Income tax	1,500	(400)
Profit for the year	(3,400)	700

Statement of financial position for Clothes Inc as at 31 March

	2015		*2014*	
	$000	$000	$000	$000
Non-current assets				
Property, plant and equipment		221,400		227,300
Investments at FVTOCI		16,400		19,900
		237,800		247,200

Current assets				
Inventories	132,400		125,600	
Trade and other receivables	51,700		58,200	
Bank	nil		4,800	
		184,100		188,600
		421,900		435,800
Equity				
Share capital		25,000		25,000
Retained earnings		116,900		120,100
		141,900		145,100
Non-current liabilities				
Loan notes	83,200		91,300	
Deferred tax	18,000		25,800	
		101,200		117,100
Current liabilities				
Trade and other payables	150,100		161,200	
Bank overdraft	28,700		12,400	
		178,800		173,600
		421,900		435,800

The following ratios have been calculated for Clothes Inc from the financial statements for the year ended 31 March 2014 and 2015:

	2015	*2014*
Return on capital employed	0.22%	3.1%
Gross profit margin		13.7%
Operating profit margin	0.20%	2.6%
Net asset turnover		1.2 times
Current ratio	1.0:1	1.1 : 1
Quick ratio		0.36 : 1
Inventory turnover period	213	189 days
Payables payment period		242 days
Gearing (debt to equity)		63%
Interest cover	0.09	1.2 times

Required:

(a) **Calculate the missing ratios for the year ended 31 March 2015.** **(5 marks)**

(b) **Analyse and interpret the information given above from the point of view of Shop Top as a potential lender.** **(10 marks)**

(Total: 15 marks)

2 The following trial balance relates to Cole Ltd at 31 March 2015:

	$000	$000
Administrative expenses	43,000	
Bank	6,430	
Cost of sales	174,420	
Deferred tax – 1 April 2014 (note (iv))		12,600
Distribution costs	23,210	
Inventories – 31 March 2015	56,430	
Lease payments made (note (iii))	25,000	
Ordinary $1 share capital		100,000
Plant and Machinery accumulated depreciation 1 Apr 2014		43,700
Plant and Machinery cost 1 April 2014	230,000	
Retained earnings – 1 April 2014		84,050
Revenue (note (i))		318,000
Suspense (note (ii))		10,000
Trade payables		34,450
Trade receivables	44,310	
	602,800	602,800

The following notes are relevant:

(i) The figures in the trial balance include $5 million of goods made on a sale or return basis, where customers still have the right to return the goods. Cole makes a margin of 40% on these sales.

(ii) The suspense account relates to the proceeds of plant and machinery disposed of at the start of the year, which have been recorded correctly in the bank. The machinery cost $14 million when it was purchased on 1 April 2013.

All plant and machinery is depreciated on a 10% reducing balance basis and is charged to cost of sales.

(iii) The lease payments relate to two leases entered into on 1 April 2014. The first of these is an operating lease relating to a new administrative office which carries an annual rental of $8 million.

The second lease is a 6 year finance lease for specialised equipment, requiring annual payments of $17 million, payable annually on 31 March. The equipment would have cost $88 million to purchase outright and carries a useful life of 7 years.

The lease carries an effective interest rate of 4.41%

Note: Do all workings to the nearest thousand.

(iv) The estimated tax charge for the year is $5.4 million, and the deferred tax liability at 31 March is estimated at $11.9 million.

Required:

Prepare a statement of profit or loss for the year to 31 March 2015 and a statement of financial position as at that date. **(Total: 15 marks)**

Note: A statement of changes in equity is not required.

3 On 1 October 2014, Heidi purchased 75% of Keisha by way of a share exchange of two new shares in Heidi for every three purchased in Keisha plus an immediate cash payment of $11,160,000. Heidi's share price at the acquisition date was $4.70. Only the cash element of the consideration has been recorded. On the same date, Heidi purchased $5,000,000 of Keisha's 10% loan notes at par.

The summarised financial statements of both companies are as follows:

Statement of profit or loss and other comprehensive income for the year ended 31 March 2015

	Heidi	*Keisha*
	$000	$000
Revenue	120,000	48,000
Cost of sales	(84,000)	(40,000)
Gross profit	36,000	8,000
Operating expenses	(11,900)	(400)
Profit from operations	24,100	7,600
Other income	300	–
Finance costs	–	(1,200)
Profit before tax	24,400	6,400
Income tax expense	(6,000)	(1,200)
Profit for the year	18,400	5,200
Other comprehensive income:		
Gain on revaluation of land	500	–
Total comprehensive income	18,900	5,200

Statements of Financial Position at 31 March 2015

	Heidi	*Keisha*
	$000	$000
Non-current assets:		
Property, plant and equipment	38,640	16,000
Investments	16,280	–
	54,920	16,000
Current assets		
Inventory	11,240	6,450
Receivables	13,600	7,355
Bank	5,160	2,195
	30,000	16,000
	84,920	32,000

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Equity and liabilities		
Ordinary shares of $1 each	40,000	4,000
Retained earnings	17,720	8,800
Revaluation reserve	7,200	–
	64,920	12,800
Non-current liabilities		
10% loan notes	–	10,000
Current Liabilities	20,000	9,200
	84,920	32,000

The following information is relevant:

(i) The fair value of Keisha's net assets differed from its carrying values at 1 October 2014. Plant was $8 million in excess of its carrying value. The plant had a remaining useful economic life of four years at the date of acquisition. The depreciation should be charged to cost of sales. No adjustment has been made for this in Keisha's financial statements.

(ii) On 1 October 2014, Heidi transferred an item of machinery to Keisha. The machine had originally cost $1.2 million on 1 October 2009, and it was transferred to Keisha for $1 million. Machines have a useful life of ten years. The useful economic life has not changed as a result of the transfer.

(iii) During the year Heidi sold goods to Keisha at a transfer price of $250,000. All of these goods had been sold outside the group at the year end. The current accounts of Heidi and Keisha were reconciled at the year end with Keisha owing $50,000.

(iv) Heidi's policy is to value the non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interests at the date of acquisition is $7.3 million.

(v) An impairment test carried out on 31 March 2015 concluded that consolidated goodwill was impaired by $780,000.

Required:

(a) Prepare a consolidated statement of profit or loss and comprehensive income for the year to 31 March 2015 and a statement of financial position as at that date.
(25 marks)

(b) **You have recently been speaking to one of the directors about a proposed investment in another company, Mutya. The directors are negotiating a deal to purchase 30% of the share capital of Mutya. Discussions are currently ongoing as to the level of representation Heidi would have on the board. At the moment, there are 3 directors, all representing different companies who have a stake in Mutya.**

Explain the likely accounting treatment for Mutya in Heidi's group accounts if:

(i) Heidi is able to appoint a director to Mutya's board

(ii) Heidi is unable to appoint a director. **(5 marks)**

(Total: 30 marks)