

FINANCIAL REPORTING

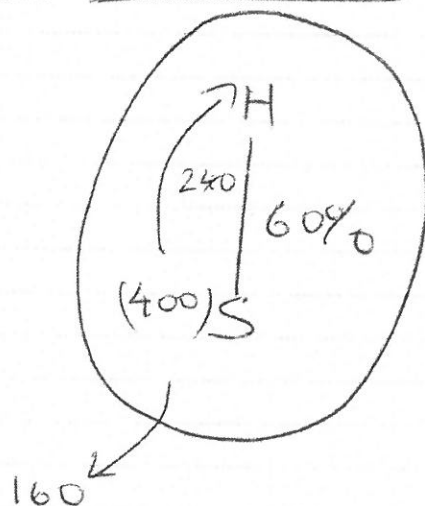
M5X00847

MAY 18 EXAM

MODEL ANSWERS

QUESTION ONE

(W1) GROUP STRUCTURE



$$\frac{3m}{5m} = \underline{60\%}$$

(W2) NET ASSETS OF SHE LTD

	(1-4-15) At Acct £1000	(31-3-17) At Y/S Date £1000
Share capital	5000	5000
Share premium	1000	1000
PLC A/C Reserve	2800	12460
Fair Value Adds:		
Land - surplus	2000	4100
Plant - surplus	3600	3600
- addnl dep- (3600 x 1/8 x 2)	-	(900)
	<u>14400</u>	<u>25260</u>

(W3) UNREALISED PROFIT ON STOCK (S → H)

$$UNP = \text{DIVIDEND} \frac{20}{120} \times 600000 = \frac{£1000}{100}$$

Dr p+l acc (group)
 minority interest 60
 40

Cr stock (S/S) 100

(W4) CURRENT ACCOUNTS

Dr Creditors 220

Cr Debtors 220

CONSOLIDATION SCHEDULES

1/ Goodwill

	£1000
Cost of investment	9900
less: share of net assets acquired (60% x 14400)	(8640)
Goodwill	
	1260
less: amortised to date (2/4 x 1260)	(630)
Intangible Asset	
	630

2/ Minority Interest

	£1000
= 40% x 25260 =	10104
	~~10104~~
less: minority interest	(40)
	10064

3. CONSOLIDATED P&L A/C RESERVE

HE (60500 + 240)

f1000

60740

Share

Share of post acquisition profits
 $60\% \times (12460 - 2800)$

5796

less: UNP on stock

(60)

less: goodwill amortised to date

(630)

less: group share of add'l dep-
 $(60\% \times 900)$

(540)

65306

CONSOLIDATED BALANCE SHEET AT 31-12-17

	£'000	£'000
Intangible Fixed Assets: goodwill		630
Tangible Fixed Assets: L+S (45000 + 10000 + 4100)	59100	
P+M (16920 + 8330 + 2700)	27950	
		<u>87680</u>

Current Assets:		
Stock (8250 + 4350 - 100)	12500	
Debtors (9660 + 2650 - 220)	12090	
Cash at Bank	<u>540</u>	
	<u>25130</u>	

Creditors < 1 year:		
Creditors (4600 + 2440 - 220)	6820	
Bank overdraft	650	
Tax (2330 + 890)	3220	
Dividends (600 + 160)	<u>760</u>	
	<u>11450</u>	

Net Current Assets	<u>13680</u>
Total Assets less Current Liabilities	101360

Creditors > 1 year:		
10% Debentures (7240 + 2490)	(9730)	
	<u>91630</u>	

	£1000
Ordinary share capital	15000
Profit + Loss Account	65306
Revaluation Reserve ($60\% \times [4100 - 2000]$)	1260
	81566
Minority Interest	10064
	91630

QUESTION 2

(W1) BONDS

YEAR	START	FINANCE COST AT 12%	CASH FLOW	END
	£1000	£1000	£1000	£1000
1	1000	<u>120</u>	(60)	<u>1060</u>
2	1060	127	(60)	1127
3	1127	133	(60 + 1200)	—

(W2) PROVISION

$$\text{Provision AT } 1-1-17 = 6200 \times \frac{1}{(1.04)^5} = \frac{5096}{\text{£1000}}$$

DR Fixed Assets 5096 CR Provision 5096

$$\text{Provision AT } 31-12-17 = 6200 \times \frac{1}{(1.04)^4} = \frac{5300}{\text{£1000}}$$

DR Interest Payable 204

CR Provision 204

(W3)

DEPRECIATION

$$\text{Depn (Property)} = 2\% \times (138100 - 30000) = \text{£}1000$$

$$\text{Depn (plant)} = 15\% \times (46850 + 5096) = 7792$$

$$\underline{\underline{10548}}$$

Fixed Assets At 31-12-17

	Cost £1000	Depn £1000	NBV £1000
Property	138100	(9296)	128804
Plant	51946	(23692)	28254
			<u><u>157058</u></u>

(W4)

TAX

$$\text{Increase in deferred tax} = 7700 - 6300 = \text{£}1400$$

(W5)

LOAN

$$\text{Interest due} = 10\% \times 60000 = \text{£}6000$$

$$\text{Interest paid} = \text{£}4500$$

$$\therefore \text{Interest Accrual} = \text{£}1500$$

(2)

Profit + Loss Account For Y/E 31-12-17

	£1000
Turnover	453310
Cost of sales	<u>(284000)</u>
Gross Profit	169310
Distribution costs	(36500)
Admin expenses (13500 + 10548)	<u>(29048)</u>
~~Profit before tax~~ Operating Profit	103762
~~then~~ Interest Payable (4500 + 1500 + 120 + 204)	<u>(6324)</u>
Profit Before Tax	97438
Tax (21650 + 1400)	(23050)
Retained Profit for the Period	<u><u>74388</u></u>

$$\text{EPS}(2017) = \frac{74388}{60000} = \underline{\underline{1.24}}$$

BALANCE SHEET AT 31-12-17

£'000

£'000

TANGIBLE FIXED ASSETS

157058

CURRENT ASSETS:

STOCK

22900

DEBTORS

44900

CASH (150 + 1000)

1150

68950

CREATORS < 1 YEAR:

TRADE CREDITORS

28600

ACCUMULATED

1850

LOAN INTEREST

1500

TAX

21650

53600

NET CURRENT ASSETS

15350

TOTAL ASSETS LESS CURRENT LIABILITIES 172408

CREATORS > 1 YEAR

BANK LOAN

(60000)

6% BONDS

(1060)

PROVISION FOR LIABILITIES + CHARGES

DEFERRED TAX

(7700)

ENVIRONMENTAL COSTS

(5300)

98348

ORDINARY SHARE CAPITAL

6000

PROFIT + LOSS ACCOUNT

92348

(17960 + 74388)

98348

QUESTION THREE

A provision should be recognised when and only when

1. An entity has a present legal or constructive obligation as a result of a past event.
 1. A legal obligation is one that derives from:
 1. A contract
 2. Legislation
 3. Other operation of law
 2. A Constructive obligation is one that derives from an entity's actions where:
 1. By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities.
 2. As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
2. It is probable that a transfer of economic benefits will be required to settle the obligation
3. A reliable estimate can be made of the amount of the obligation

QUESTION FOUR

The recognition of profit on uncompleted contracts is calculated in proportion to some measure of the percentage of completion applied to the estimated total contract profit. This is known as the attributable profit.

The percentage completion is calculated as either:

Value of work certified / contract price or costs to date / total contract costs

QUESTION FIVE

FRS 102 Section 20 follows the ***principle of substance over form*** and which states that transactions should be accounted for according to their commercial substance and not merely their legal form

To aid this treatment, 2 types of lease were defined:

Finance Lease a lease that transfers all the risks and rewards of ownership of an asset to the lessee

Operating Lease a lease other than a finance lease
e.g. video rental

ACCOUNTING TREATMENT

(a) ***Finance Lease***

- capitalise the asset in the balance sheet
- show the outstanding lease commitments in creditors
- p and l a / c is charged with depreciation and an appropriate share of the finance charge

(b) ***Operating Lease***

- the lessor records the asset as a fixed asset and depreciates it
- the lessee merely shows the rentals as an expense in the p and l a / c

QUESTION SIX

Post Balance Sheet Events are those events, both favourable and unfavourable, which occur between the balance sheet date and the date on which the financial statements are authorised for issue

There are two types of event:

Adjusting Events which require the accounts to be adjusted to reflect their impact

Non Adjusting Events which are merely noted in the accounts if material

ADJUSTING EVENTS

These are defined as PBSEs which provided additional evidence of conditions existing at the balance sheet date

e.g.

- The renegotiation of amounts owing by debtors or the insolvency of a debtor
- A valuation of property which provides evidence of a permanent diminution in value

NON ADJUSTING EVENTS

These are defined as PBSEs which concern conditions which did not exist at the balance sheet date. Such events will thus have no effect on the financial statements themselves but may be of such materiality that their disclosure is necessary to give a true and fair view

e.g.

- Mergers and acquisitions
- Issues of shares and debentures
- Proposed or actual reconstructions

QUESTION SEVEN

The objective of financial statements is to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of management and making economic decisions

FRS 3 (now section 5 of FRS 102) was introduced in order to provide users with information about the important components of financial performance and how they should be presented

The Format of the Profit and Loss Account

FRS 3 introduced a new "layered" format to the profit and loss account and requires businesses to analyse their results between continuing operations, acquisitions and discontinued operations. These additional disclosures were introduced in order to assist the user to assess more readily the current performance of the company and also to predict future maintainable profits

The analysis between the 3 layers needs to be made to the level of operating profit. Turnover and operating profit must be analysed on the face of the profit and loss account but the analysis of the other headings (cost of sales, distribution costs, admin expenses) can be shown as a note to the accounts.

Statement of Comprehensive Income

The profit and loss account for the year shows the effect of all realised gains and losses that have been recognised during the period under review. However, various unrealised gains and losses may also have been recognised during the year which would have been accounted for as a movement on reserves (e.g. a revaluation surplus)

The purpose of the statement is to bring together both unrealised and realised gains and losses into an overall performance statement for the year.

This is shown as an additional primary statement in order to give this additional performance statement added prominence in the accounts.

QUESTION EIGHT

The accruals basis requires transactions (or events) to be recognised when they occur (rather than on a cash flow basis). Revenue is recognised when it is earned (rather than when it is received) and expenses are recognised when they are incurred (i.e. when the entity has received the benefit from them), rather than when they are paid.

Recording the substance of transactions (and other events) requires them to be treated in accordance with economic reality or their commercial intent rather than in accordance with the way they may be legally constructed. This is an important element of faithful representation.

Prudence is used where there are elements of uncertainty surrounding transactions or events. Prudence requires the exercise of a degree of caution when making judgements or estimates under conditions of uncertainty. Thus when estimating the expected life of a newly acquired asset, if we have past experience of the use of similar assets and they had had lives of (say) between five and eight years, it would be prudent to use an estimated life of five years for the new asset.

Comparability is fundamental to assessing the performance of an entity by using its financial statements. Assessing the performance of an entity over time (trend analysis) requires that the financial statements used have been prepared on a comparable (consistent) basis. Generally this can be interpreted as using consistent accounting policies (unless a change is required to show a fairer presentation). A similar principle is relevant to comparing one entity with another; however it is more difficult to achieve consistent accounting policies across entities.