PROFESSIONAL LEVEL EXAMINATION

TUESDAY 5 DECEMBER 2017

(3 HOURS)

FINANCIAL ACCOUNTING AND REPORTING – IFRS

This exam consists of **four** questions (100 marks).

1. Please read the instructions on this page carefully before you begin your exam. If you have any questions, raise your hand and speak with the invigilator before you begin. The invigilator cannot advise you on how to use the software.

2. Click on the **Start Exam** button to begin the exam. The exam timer will begin to count down. A warning is given five minutes before the exam ends. When the exam timer reaches zero, the exam will end. To end the exam early, press the **Finish** button.

3. You may use a pen and paper for draft workings. Any information you write on paper will not be read or marked.

4. The examiner will take account of the way in which answers are structured. Do not write anything which is not in direct response to the exam questions.

5. Ensure that all of your responses are visible on screen and are not hidden within cells. Your answers will be presented to the examiner exactly as they appear on screen.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

1. Set out below are the draft financial statements of Guava Ltd for the year ended 30 June 2017 together with accompanying notes.

Draft statement of profit or loss for the year ended 30 June 2017

	£
Revenue	6,256,500
Cost of sales	(4,005,210)
Gross profit	2,251,290
Administrative expenses	(1,057,350)
Operating profit	1,193,940
Finance costs (Note 1)	(2,100)
Profit before tax	1,191,840
Income tax expense (Note 2)	(36,000)
Profit for the year	1,155,840

Draft statement of financial position as at 30 June 2017

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (Notes 3 and 4)		5,499,600
Intangible assets (Note 5)		556,400
		6,056,000
Current assets		
Inventories	2,561,200	
Trade and other receivables (Note 2)	1,005,450	
Cash and cash equivalents	120,550	
		3,687,200
Total assets		**9,743,200**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares) (Note 6)		5,000,000
Retained earnings		3,831,670
		8,831,670
Current liabilities		
Trade and other payables (Note 6)	875,530	
Income tax (Note 2)	36,000	
		911,530
Total equity and liabilities		**9,743,200**

Notes

(1) On 1 January 2017 Guava Ltd entered into a two year operating lease for a photocopier to be used in the administrative department. A non-returnable deposit of £1,000 was paid on signing the lease, debited to finance costs and credited to cash. These were the only entries made. There is nothing further to pay until 1 January 2018 when the first of four quarterly payments of £1,000 is due.

(2) The income tax expense of £36,000 in the draft statement of profit or loss is the appropriate estimate of the amount payable for the year ended 30 June 2017. Included in trade and other receivables in the draft statement of financial position as at 30 June 2017 is a debit balance of £2,000, being the difference between the income tax liability at 30 June 2016 and the sum eventually agreed with and paid to HMRC.

(3) The carrying amount for property, plant and equipment in the draft financial statements is made up as follows:

	Cost	**Accumulated depreciation**	**Carrying amount**
	£	**£**	**£**
Land and buildings (land £500,000)	4,300,000	1,198,000	3,102,000
Plant and equipment	3,996,000	1,598,400	2,397,600
	8,296,000	2,796,400	5,499,600

There were no additions to or disposals of property, plant and equipment during the year.

Guava Ltd measures property, plant and equipment using the cost model. Depreciation on property, plant and equipment for the year ended 30 June 2017 has yet to be charged. Depreciation on buildings is calculated on a straight-line basis over an estimated useful life of 40 years and is recognised in administrative expenses.

Depreciation on plant and equipment has previously also been calculated on a straight-line basis. However, the directors decided to change to the reducing balance basis at 20% pa from 1 July 2016 on the grounds that this better reflects the usage of these assets. Depreciation on plant and equipment is recognised in cost of sales.

(4) On 1 April 2017 Guava Ltd stopped using a machine because it was surplus to requirements. The machine was immediately advertised for sale and subsequently sold for £60,100 on 1 August 2017, incurring selling costs of £750. The machine met the definition of a held for sale asset per IFRS 5, Non-current Assets Held for Sale and Discontinued Operations on 1 April 2017.

The machine cost £150,400 on 1 July 2012. In the draft financial statements for the year ended 30 June 2017 the machine remains in plant and equipment at its 30 June 2016 carrying amount, with accumulated depreciation based on a straight-line basis over an estimated useful life of 10 years.

(5) During the year ended 30 June 2017 Guava Ltd spent £556,400 on research and development of two new products. This expenditure comprises:

	£
Research expenditure	32,500
Development expenditure	
Product A	313,000
Product B	143,100
Staff training – Product A	52,600
Pre-launch testing costs – Product A	15,200
	556,400

On 1 July 2016 Product A was considered to be commercially viable. It was launched on 1 January 2017 and is selling well. It is anticipated that Product A will have a useful life of three years from the launch date. Product B is still in development and as at 30 June 2017 Guava Ltd was unable to demonstrate that it would generate probable future economic benefits.

(6) On 1 October 2016 Guava Ltd issued 500,000 ordinary £1 shares at a price of £1.80 per share, crediting the amount received to ordinary share capital. Trade and other payables include an interim ordinary dividend of 5 pence per share. This dividend was declared on 15 May 2017 (based on the correct number of shares in issue on that date) and debited to retained earnings.

Requirements

1.1 Prepare a revised statement of profit or loss for Guava Ltd for the year ended 30 June 2017 and a revised statement of financial position as at that date, in a form suitable for publication. **(24 marks)**

1.2 Describe the differences between IFRS and UK GAAP in respect of the financial reporting treatment of intangible assets (other than goodwill) and assets held for sale. Supporting calculations are not required. **(4 marks)**

1.3 Explain how the qualitative characteristics of relevance, faithful representation, comparability, understandability and verifiability set out in the IASB's Conceptual Framework are applied in IAS 38, Intangible Assets. **(5 marks)**

Total: 33 marks

2. You are Hilary, an ICAEW Chartered Accountant employed by Goji LLP, a firm of ICAEW Chartered Accountants. You have recently been seconded to Kumquat Ltd to assist it in finalising its financial statements for the year ended 30 June 2017. Kumquat Ltd operates a number of garages, from which it sells and services cars.

2.1 The following issues are still outstanding.

(1) Historically Kumquat Ltd purchased cars from a single UK manufacturer. However, in June 2017, Kumquat Ltd began to sell cars which had been purchased from a different manufacturer, based in Europe. The first shipment of European cars was ordered on 5 May 2017, arrived on 10 June 2017, and the purchase invoice, for €160,000, was correctly translated and processed. No adjustments have subsequently been made to this figure.

At the year end the invoice was unpaid and all the cars were unsold. The cars have been included in inventories in the draft financial statements using the spot rate at 30 June 2017.

The spot exchange rates were as follows:

5 May 2017 – €1:£0.85
10 June 2017 – €1:£0.90
30 June 2017 – €1:£0.95

(2) On 1 July 2016 Kumquat Ltd purchased plant for processing used oil. The plant is expected to operate for five years. The plant cost £150,000 and the draft financial statements include a depreciation charge based on that figure. However, it was a condition of the purchase that Kumquat Ltd must dismantle the plant at the end of the five years. The cost of dismantling is estimated to be £20,000 but Kumquat Ltd made no accounting entries in respect of this cost. An applicable discount rate is 5% pa.

(3) On 1 July 2016 Kumquat Ltd purchased a zero coupon bond for £45,360 which the company expects to hold to redemption. The bond had a nominal value of £49,000. Kumquat Ltd also paid broker's fees of £1,250 in relation to the bond which it recognised in other operating expenses. The bond is redeemable on 30 June 2019 at a premium of 7% and has an effective interest rate of 4% pa. In the draft financial statements the bond was included in cash and cash equivalents at its cost of £45,360.

Requirement

Explain the required IFRS financial reporting treatment of Issues (1) to (3) above in the financial statements of Kumquat Ltd for the year ended 30 June 2017. Prepare all relevant calculations and set out the required adjustments in the form of journal entries.

(21 marks)

2.2 Max, another ICAEW Chartered Accountant with Goji LLP, who is due to leave the firm shortly, has been assisting you (Hilary) with your work at Kumquat Ltd.

Yesterday, whilst working at Kumquat Ltd, you overheard Max talking to a friend on his mobile phone. Max was telling his friend about the work he is doing at Kumquat Ltd, and made the following remarks:

> "I'm not really enjoying this assignment. I'm working on financial reporting issues where new IFRS have been introduced since I qualified, and I am struggling to understand how to apply these new rules.
>
> I know you are about to buy a new car. This has not yet been publicly announced, but I've heard that Kumquat Ltd will be launching a massive sale at the start of next month so it might be to your advantage to wait until then.
>
> The finance director has also offered me a significant discount on a new car if I can persuade Hilary, my senior on this job, not to make too many changes to the draft financial statements. If I manage to do this I could buy a car on your behalf and pass some of the discount on to you, in which case we'd both gain."

Requirement

Set out and describe the five fundamental principles of the ICAEW Code of Ethics. Identify, with reasons, which of these principles may be breached by Max in the above scenario.

(5 marks)

Total: 26 marks

3. On 1 July 2016 Pawpaw plc had a number of subsidiary companies. Extracts from the group's consolidated financial statements for the year ended 30 June 2017 are set out below.

Consolidated statement of profit or loss for the year ended 30 June 2017 (extract)

Continuing operations	**£**
Profit from operations	1,201,560
Finance costs	(12,500)
Profit before tax	1,189,060
Income tax expense	(238,000)
Profit for the year from continuing operations	951,060
Discontinued operations	
Profit for the year from discontinued operations	45,350
Profit for the year	996,410
Attributable to:	
Owners of Pawpaw plc	805,200
Non-controlling interest	191,210
	996,410

Consolidated statement of financial position as at 30 June

	2017	**2016**
ASSETS	**£**	**£**
Non-current assets	2,235,300	1,965,600
Current assets		
Inventories	1,052,300	903,200
Trade and other receivables	603,800	562,200
Cash and cash equivalents	83,600	62,200
	1,739,700	1,527,600
Total assets	**3,975,000**	**3,493,200**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	600,000	500,000
Share premium account	40,000	100,000
Revaluation surplus	850,600	509,200
Retained earnings	957,800	934,900
Attributable to the equity holders of Pawpaw plc	2,448,400	2,044,100
Non-controlling interest	506,200	615,900
	2,954,600	2,660,000
Non-current liabilities		
Finance lease liabilities	250,600	190,500
Current liabilities		
Trade and other payables	499,500	405,200
Finance lease liabilities	40,300	39,500
Income tax payable	230,000	198,000
	769,800	642,700
Total equity and liabilities	**3,975,000**	**3,493,200**

Additional information:

(1) On 1 January 2017 Pawpaw plc sold all of its 80% holding in Avocado Ltd for cash of £619,900. Goodwill arising on this acquisition was calculated correctly at £79,800, using the proportionate method, although impairments of £30,000 had been recognised by 30 June 2016. The profit from discontinued operations in the consolidated statement of profit or loss relates wholly to the sale of the shares in Avocado Ltd and can be analysed as follows:

	£
Profit before tax	52,350
Income tax expense	(10,500)
Profit on disposal	3,500
	45,350

The net assets of Avocado Ltd at the date of disposal were as follows:

	£
Property, plant and equipment	692,200
Trade and other receivables	48,300
Cash and cash equivalents	650
Trade and other payables	(32,900)
	708,250

(2) Non-current assets comprise property, plant and equipment and goodwill which had arisen on business combinations. The following is relevant to the movements on non-current assets for the year ended 30 June 2017:

- The only movement on goodwill was with regard to the disposal of Avocado Ltd.
- A depreciation charge of £495,300 was recognised during the year.
- There were no disposals of property, plant and equipment other than through the disposal of Avocado Ltd.
- The group entered into finance leases for assets with a cash price of £342,000. All finance costs relate to finance leases.
- On 1 July 2016 Pawpaw plc revalued a plot of land. On the same date a building in a different location, which cost Pawpaw plc £750,000 on 1 July 2000, was also revalued to £816,000. The building was being depreciated over a useful life of 50 years. A transfer was made between the revaluation surplus and retained earnings in accordance with best practice.

(3) During the year ended 30 June 2017 ordinary dividends were paid to both the shareholders of Pawpaw plc and to the non-controlling interest. Pawpaw plc also made an issue of shares for cash and a bonus issue of ordinary shares out of share premium.

Requirement

Prepare a consolidated statement of cash flows for Pawpaw plc for the year ended 30 June 2017, including a note reconciling profit before tax to cash generated from operations, using the indirect method. A note showing the effects of the disposal of Avocado Ltd is **not** required.

Total: 16 marks

4. On 1 July 2016 Greengage plc purchased a subsidiary, Papaya Ltd. The draft, summarised statements of financial position of the two companies at 30 June 2017 are shown below:

	Greengage plc	**Papaya Ltd**
	£	**£**
ASSETS		
Non-current assets		
Property, plant and equipment	3,156,800	1,589,500
Investments	2,150,000	–
Goodwill	–	30,000
	5,306,800	1,619,500
Current assets		
Inventories	1,156,200	505,200
Trade and other receivables	708,500	491,600
Cash and cash equivalents	10,800	2,600
	1,875,500	999,400
Total assets	7,182,300	2,618,900
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	2,000,000	800,000
Retained earnings	4,142,600	1,301,800
	6,142,600	2,101,800
Current liabilities		
Trade and other payables	689,700	397,100
Taxation	350,000	120,000
	1,039,700	517,100
Total equity and liabilities	7,182,300	2,618,900

Additional information:

(1) Greengage plc acquired 70% of Papaya Ltd's ordinary shares for cash of £2,000,000 on 1 July 2016, when the fair value of the non-controlling interest in Papaya Ltd was £535,000. In the year ended 30 June 2017 Papaya Ltd made a profit after tax of £578,600. Greengage plc recognises goodwill and non-controlling interest using the fair value method.

The fair values of the assets and liabilities of Papaya Ltd at the date of the acquisition were equal to their carrying amounts, with the exception of a building which had a fair value of £210,000 in excess of its carrying amount. The building had a remaining useful life of 30 years on the date Greengage plc acquired its shares in Papaya Ltd.

On the date of acquisition, Papaya Ltd's statement of financial position included goodwill of £40,000 which arose on the acquisition of a sole trader. In the current year an impairment of £10,000 was recognised by Papaya Ltd in relation to this goodwill.

(2) On 1 July 2016 Greengage plc sold a machine to Papaya Ltd for £60,000. The machine had a carrying amount in Greengage plc's accounting records at this date of £45,000. The estimated remaining useful life of the machine was reassessed on the date of sale at six years.

(3) At 30 June 2017 Greengage plc's trade and other payables included £83,000 due to Papaya Ltd. Papaya Ltd's trade and other receivables included £103,000 due from Greengage plc. The difference was due to a cheque for £20,000 which Greengage plc sent to Papaya Ltd on 28 June 2017. Papaya Ltd did not receive this cheque until 5 July 2017.

(4) On 1 January 2017 Greengage plc purchased 40% of Coconut Ltd's ordinary shares for cash of £150,000. This gave Greengage plc significant influence over Coconut Ltd. On this date a property owned by Coconut Ltd had a fair value £50,000 in excess of its carrying amount and a remaining useful life of 20 years. The remaining assets and liabilities at the date of acquisition were equal to their carrying amounts.

In the year ended 30 June 2017 Coconut Ltd made a profit after tax of £225,800 which accrued evenly over the year. On 15 June 2017 Greengage plc sold goods to Coconut Ltd for £12,000, at a mark-up of 20%. These goods remained in Coconut Ltd's inventories on 30 June 2017.

Requirements

4.1 Explain the required IFRS financial reporting treatment of Issue (4) above in the consolidated financial statements of Greengage plc for the year ended 30 June 2017. Provide supporting calculations. **(10 marks)**

4.2 Prepare the consolidated statement of financial positon of Greengage plc as at 30 June 2017. **(15 marks)**

Total: 25 marks