PROFESSIONAL LEVEL EXAMINATION

MONDAY 3 DECEMBER 2018

(3 HOURS)

FINANCIAL ACCOUNTING AND REPORTING - IFRS

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

Marks breakdown

Question 1	31 marks
Question 2	32 marks
Question 3	15 marks
Question 4	22 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.

2. Please alert the invigilator immediately if you encounter any issues during the delivery of the exam. The invigilator cannot advise you on how to use the software. If you believe that your performance has been affected by any issues which occurred, you must request and complete a candidate incident report form at the end of the exam; this form must be submitted as part of any subsequent special consideration application.

3. 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.

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

5. The examiner will take account of the way in which answers are structured. Respond directly to the exam question requirements. Do not include any content or opinion of a personal nature. A student survey is provided post-exam for feedback purposes.

6. 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.

Question 1

You are the financial controller of Penne Ltd and an ICAEW Chartered Accountant. You report to Giorgio, the Finance Director, who is also an ICAEW Chartered Accountant. Giorgio is not a shareholder in Penne Ltd.

Penne Ltd's shares are owned by three brothers, one of whom, Andreas, is planning to sell his shares and resign his seat on the board. Andreas has not yet tried to find a buyer. It is likely that the new shareholder would be appointed to the board. Giorgio told his friend Marco, who is looking for a suitable investment, about the sale:

> "I know the shares will be for sale soon, although Andreas hasn't looked for a buyer as yet. The share price will be based on a profit multiple for the year ended 30 June 2018. This would be a good investment opportunity for you, and I will see what I can do to keep the reported profit down which should make the shares cheaper. I know you will look on me favourably if you become a Penne Ltd shareholder."

Prior to preparing the financial statements for the year ended 30 June 2018 Giorgio extracted the following list of balances from the nominal ledger. These balances include initial year-end adjustments made by Giorgio.

	Note(s)	**£**
Revenue		6,256,800
Cost of sales	(1) to (4)	3,983,900
Operating expenses		2,005,500
Property, plant and equipment at 30 June 2018 – carrying amount	(1), (2)	1,150,700
Inventories at 30 June 2018	(3)	256,800
Trade and other receivables	(5)	586,250
Cash and cash equivalents		10,100
Ordinary share capital (£1 shares)		75,000
Revaluation surplus		305,200
Retained earnings at 1 July 2017		857,550
Trade and other payables	(3)	498,700

Giorgio told the brothers that the profit before tax for the year, based on the above list of balances, is £267,400. The brothers are disappointed by this figure, which is lower than expected. They have asked you to review the financial statements and make any amendments necessary. The brothers are also concerned that Giorgio has not been keeping his technical knowledge up to date, and are worried he may have made errors.

Giorgio knows that you are doing this work and said that he doesn't expect you to find any errors. He also said that if you support his figures he will recommend a significant salary increase for you.

Notes:

(1) Penne Ltd rents its administrative buildings and most of its plant and equipment under operating leases. Factory and warehouse buildings and related land are measured under the revaluation model. Depreciation is recognised in cost of sales. Penne Ltd makes annual transfers between the revaluation surplus and retained earnings.

The year-end review of the factory buildings showed that valuations were up to date. However, it was discovered that a fire at one of the warehouses on 29 June 2018 had caused significant damage. As a result, the warehouse has a recoverable amount of £11,600 at 30 June 2018. This warehouse was acquired on 1 July 2015 for £100,000 and was revalued to £120,000 on 1 July 2016. It is being depreciated over five years from 1 July 2015.

Giorgio recognised an impairment of £88,400 on this warehouse, calculated as cost less recoverable amount. He debited cost of sales and credited property, plant and equipment with this figure. He recognised the correct depreciation charge on this warehouse for the year in cost of sales and the correct transfer between the revaluation surplus and retained earnings.

(2) On 1 July 2017 Penne Ltd signed a five year finance lease for a machine, which had a cash price of £80,000 and a five year useful life. The lease requires payments of £9,685 on 1 July and 1 January each year. The interest rate implicit in the lease is 5% per half year. The first two payments were made on 1 July 2017 and 1 January 2018 and Giorgio debited these to cost of sales and credited them to cash. The present value of the minimum lease payments was equivalent to fair value. Giorgio made no other accounting entries in respect of this lease.

(3) Penne Ltd previously traded only within the UK. In May 2018 the production director visited Italy and placed orders for goods of €100,000. Giorgio debited purchases and credited trade payables using the exchange rate on 15 June 2018, the date when Penne Ltd received the goods. No further accounting entries were made in respect of this transaction.

On 30 June 2018 half of the goods remained in inventory but in error were excluded from the year-end physical inventory count. The invoice for these goods was unpaid at 30 June 2018.

The spot exchange rates were:

15 June 2018 – €1:£0.95
30 June 2018 – €1:£0.90

(4) During the year ended 30 June 2018 Penne Ltd incurred £315,000 on research and development expenditure for a new product. Giorgio recognised this sum in cost of sales. The £315,000 was made up as follows:

	£
Initial investigation work	59,200
Product development costs	240,000
Product launch costs	10,800
Staff training	5,000
	315,000

The development costs accrued evenly over the period from 1 August 2017 to 31 March 2018. The product was assessed as commercially viable on 1 November 2017. Sales commenced on 1 May 2018. The product is expected to be sold for four years before it is superseded.

(5) Giorgio has not yet made any adjustment for the income tax due for the year ended 30 June 2018. An appropriate estimate of this amount is £53,500. Income tax for the year ended 30 June 2017 was settled during the current year for £1,200 more than the amount recognised in the financial statements. Giorgio debited the £1,200 additional payment to trade and other receivables in the list of balances.

Requirements

1.1 Prepare, for Penne Ltd, a statement of profit or loss for the year ended 30 June 2018 and a statement of financial position as at that date, in a form suitable for publication.

(26 marks)

1.2 Discuss the ethical issues arising for yourself and Giorgio and the steps that you should take to address them.

(5 marks)

Total: 31 marks

Question 2

The following matters need to be dealt with to finalise the consolidated financial statements of Rigatoni Ltd for the year ended 30 June 2018. Before adjusting for these matters the consolidated profit for the year was £145,800.

(1) On 1 January 2018 Rigatoni Ltd and Tagliatelle Ltd, an unrelated company, each subscribed for half of Spaghetti Ltd’s 100,000 £1 ordinary shares on Spaghetti Ltd’s incorporation. A contract between Rigatoni Ltd and Tagliatelle Ltd gives them equal profit shares and states that unanimous consent is required for all key operating decisions.

Spaghetti Ltd made a profit for the six months ended 30 June 2018 of £15,600. In June 2018 Rigatoni Ltd made sales of £5,000 to Spaghetti Ltd, at a mark-up of 25%. Spaghetti Ltd still held all these goods in inventories at 30 June 2018. Rigatoni Ltd recognised its cost of investment in Spaghetti Ltd of £50,000 in current assets, but made no further accounting entries, other than to record the sale of the goods.

(2) On 1 July 2017 Rigatoni Ltd issued 75,000 £1 ordinary shares at a premium of 20 pence per share to Gemelli Ltd, an unconnected company. These shares amount to 10% of Rigatoni Ltd’s ordinary shares and carry the same rights as Rigatoni Ltd’s existing ordinary shares. The proceeds were debited to cash and credited to a suspense account.

(3) On 1 July 2017 Rigatoni Ltd borrowed £200,000 at 6% pa to fund the construction of a new warehouse, a qualifying asset. The cash received was immediately placed on deposit earning interest at 2% pa. Construction did not begin until 1 August 2017 due to delays in agreeing the plans with the architects.

A construction payment of £120,000 was made on 1 August 2017 and the remaining £80,000 paid on 1 May 2018. The warehouse was ready for use on 1 June 2018 but Rigatoni Ltd did not start to use it until 1 July 2018. The directors estimate that the warehouse has a useful life of 10 years.

Rigatoni Ltd recognised the net interest in the statement of profit or loss for the year ended 30 June 2018. The construction costs were included in assets in the course of construction in the statement of financial position as at 30 June 2018. No depreciation is charged on assets in the course of construction.

(4) On 1 March 2018 Rigatoni Ltd received a government grant of £72,000 which it credited to other income in accordance with its accounting policy. The grant is to help fund additional employees needed for the new warehouse. A condition of the grant is that for five years from its receipt 50% of these new employees must be “local”, ie must live within a 20 mile radius of Rigatoni Ltd’s premises. All the new employees started work on 1 June 2018, and had one month’s training before the warehouse became operational. 60% of the new employees are “local” and Rigatoni Ltd expects to be able to maintain this percentage for the five years.

Requirements

2.1 Explain the required IFRS financial reporting treatment of matters (1) to (4) in the consolidated financial statements of Rigatoni Ltd for the year ended 30 June 2018, preparing all relevant calculations. **(26 marks)**

2.2 Calculate a revised consolidated profit for the year.

(2 marks)

2.3 Describe any differences between IFRS and UK GAAP in respect of the above financial reporting treatments.

(4 marks)

Total: 32 marks

Question 3

Linguine plc is a listed company and is financed by both debt and equity. It manufactures medicines for the pharmaceutical industry and has a high turnover of staff.

Question 3.1

The following information is relevant to the statement of cash flows for the year ended 30 June 2018.

(1) Extracts from Linguine plc's statement of financial position as at 30 June 2018:

	2018	**2017**
	£	**£**
Property, plant and equipment	969,400	987,200
Ordinary share capital (£1 shares)	2,500,000	1,500,000
Share premium	400,000	600,000
Revaluation surplus	275,600	150,300
Retained earnings	3,560,800	2,968,500

(2) During the year ended 30 June 2018 Linguine plc:

- made a profit for the year of £1,035,600
- paid ordinary dividends
- paid £15,000 (including £1,000 interest) due on a finance lease taken out in the previous financial year
- purchased new machines for cash of £214,600
- sold a machine for cash, making a profit of £12,700
- charged depreciation of £314,000
- revalued its land.

(3) On 1 September 2017 Linguine plc made a 1 for 4 bonus issue out of share premium. On 1 February 2018 ordinary shares were issued for cash.

(4) Trade and other receivables included the amount due for the machine sold.

(5) Cash generated from operations was £256,200 before adjusting for relevant information above.

Requirement

Prepare an extract from Linguine plc's statement of cash flows for the year ended 30 June 2018, showing:

- Cash generated from operations;
- Cash flows from investing activities; and
- Cash flows from financing activities. **(10 marks)**

Question 3.2

The IASB's Conceptual Framework identifies a wide range of users who use financial information to make economic decisions.

Requirement

Identify five possible user groups for Linguine plc and, for each user group, list the type(s) of decisions they regularly make from information contained within financial statements.

(5 marks)

Total: 15 marks

Question 4

On 1 July 2017 Barbina plc had one subsidiary company, Fusilli Ltd. On 1 November 2017 Barbina plc acquired shares in a second subsidiary company, Macaroni Ltd.

The individual statements of profit or loss for the year ended 30 June 2018 for Barbina plc and its subsidiaries are set out below:

Statements of profit or loss for the year ended 30 June 2018

	Barbina plc £	**Fusilli Ltd £**	**Macaroni Ltd £**
Revenue	789,600	501,200	301,200
Cost of sales	(401,200)	(302,800)	(158,160)
Gross profit	388,400	198,400	143,040
Operating expenses	(201,100)	(111,200)	(98,280)
Profit from operations	187,300	87,200	44,760
Investment income	97,000	–	–
Profit before tax	284,300	87,200	44,760
Income tax expense	(56,000)	(17,400)	(9,000)
Profit for the year	228,300	69,800	35,760

Additional information:

(1) Extracts from the statements of financial position as at 30 June 2018:

	Barbina plc £	**Fusilli Ltd £**	**Macaroni Ltd £**
Ordinary share capital (£1 shares)	500,000	400,000	300,000
Retained earnings	1,250,600	524,800	161,900

(2) Barbina plc owns 70% of Fusilli Ltd's ordinary shares. At the date of acquisition:

- the fair values of Fusilli Ltd's assets and liabilities were the same as their carrying amounts
- the fair value of the non-controlling interest was £123,600
- retained earnings were £325,600.

Barbina plc chose to measure the non-controlling interest and goodwill on this acquisition using the fair value method.

(3) On 1 November 2017 Barbina plc acquired 60% of Macaroni Ltd's ordinary shares. Barbina plc chose to measure the non-controlling interest and goodwill on this acquisition using the proportionate method. Macaroni Ltd's profits for the year ended 30 June 2018 accrued evenly over the year.

The fair values of Macaroni Ltd's assets and liabilities at the date of acquisition were the same as their carrying amounts with the exception of a machine which had a fair value of £8,400 in excess of its carrying amount. The machine had a remaining estimated useful life of seven years at 1 November 2017. Depreciation on this machine is recognised in cost of sales.

(4) Cumulative impairments of £14,000 had been recognised by 30 June 2017 in respect of goodwill arising on the acquisition of Fusilli Ltd.

(5) In June 2018 Barbina plc sold goods to Fusilli Ltd for £16,000 at a gross margin of 20%. At 30 June 2018 half of these goods remained unsold by Fusilli Ltd.

(6) In March 2018 Barbina plc and Fusilli Ltd paid ordinary dividends of 20p and 30p per share respectively.

Requirement

Prepare for the year ended 30 June 2018 for Barbina plc:

- the consolidated statement of profit or loss; and
- an extract from the consolidated statement of changes in equity showing the retained earnings and non-controlling interest columns.

Total: 22 marks