Accounting Technicians Ireland

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Advanced Financial Accounting

2nd Year Examination

May 2013

Exam Paper, Solutions & Examiner's Report

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Accounting Technicians Ireland

2nd Year Examination: Summer 2013

Paper : Advanced Financial Accounting

Monday 13th May 2013 - 2.30 p.m. to 5.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

Candidates must indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

In this examination paper the €/£ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and the €/£ symbol may be understood by candidates in the Republic of Ireland to indicate the Euro.

Answer ALL THREE questions in Section A and TWO of the THREE questions in Section B. If more than TWO questions are answered in Section B, then only the first TWO questions, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All workings should be shown.

All figures should be labelled, as appropriate, e.g. €'s, £'s, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

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SECTION A

Answer ALL THREE Questions in this Section

QUESTION 1 *(Compulsory)*

(a) Chapter three of the *Conceptual Framework* states that 'financial information is useful if it is relevant and faithfully represents what it purports to represent'. Discuss 'faithful representation' stating how it is achieved.

5 Marks

(b) Chapter Four of the *Conceptual Framework* identifies five elements of financial statements as listed below. Define any three of the five elements listed:

i. Asset
ii. Liability
iii. Equity
iv. Income
v. Expenses

6 Marks

(c) IAS 8 examines and prescribes the treatment of changes in accounting policies, changes in accounting estimates and the correction of prior period errors.

Discuss the three provisions examined in the standard, each of which are listed below, and in each case state the impact, if any, on the prior and current year financial statements.

i. Change in accounting policies.
ii. Change in accounting estimates.
iii. Prior period error.

9 Marks
Total 20 Marks

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QUESTION 2 *(Compulsory)*

The following multiple choice question consists of TEN parts, each of which is followed by FOUR possible answers. There is ONLY ONE right answer in each part.

Each part carries 1 ½ marks.

Requirement

Indicate the right answer to each of the following ten parts.

Total 15 Marks

Candidates should answer this question by ticking the appropriate boxes on the special answer sheet which is contained within the answer booklet.

[1] IAS 1 requires that financial statements are prepared on a going concern basis which assumes that an entity will continue in business for a period of at least:

[a] twelve months from the end of the financial year.
[b] twelve months from the date the financial statements are signed.
[c] six months from the date the financial statements are signed.
[d] six months from the end of the financial year.

[2] An unqualified audit report as issued by an external auditor is:

[a] saying with certainty that the financial statements are accurate.
[b] saying that the financial statements do not show a true and fair view of the company's financial affairs.
[c] saying that the financial statements reflect a true and fair view of the company's financial affairs.
[d] saying with certainty that the financial statements are not accurate.

[3] Interest paid to a partner for a loan extended to the business must be accounted for:

[a] in the partner's current account.
[b] in the appropriation account.
[c] in the partner's capital account.
[d] in the Statement of Profit and Loss as an expense.

[4] In accordance with IAS 10 *Events after the Reporting Period* the determination after the reporting period of the proceeds from assets sold before the end of the reporting period is an example of:

[a] an adjusting event.
[b] a non-adjusting event.
[c] an immaterial event.
[d] a material event.

[5] Which of the following formulae calculates an entity's gearing ratio:

[a] [Non-current liabilities / (share capital + reserves)] x 100 / 1.
[b] [Non-current liabilities / (share capital + reserves + non-current liabilities)] x 100 / 1.
[c] Current assets / Current liabilities.
[d] [Current liabilities / (share capital + reserves + non-current liabilities)] x 100 / 1.

QUESTION 2 CONTINUED OVERLEAF

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QUESTION 2 *(Cont'd)*

[6] Which of the following ratios measures a company's profitability per share?

[a] Dividend yield ratio.
[b] Price earnings ratio.
[c] Earnings per share.
[d] Dividend cover.

[7] Which of the following best describes a provision?

[a] A possible obligation that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
[b] A probable obligation that arises from past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
[c] A present obligation arising from past events the settlement of which is expected to result in an outflow of economic benefits.
[d] A liability of uncertain timing or amount.

[8] The journal entries for a decrease in provision for bad debts are:

[a] debit Statement of Profit and Loss, credit bad debt provision (Statement of Financial Position).
[b] debit bad debt provision (Statement of Financial Position), credit Statement of Profit and Loss.
[c] debit receivables (Statement of Financial Position), credit sales (Statement of Profit and Loss).
[d] debit receivables (Statement of Financial Position), credit current liabilities (Statement of Financial Position).

[9] X prepares his financial statements to 31 December each year. He has prepaid insurance at 1 January 2012 of €/£3,680. On 15 July 2012 he paid €/£12,300 for insurance for the year ended 31 May 2013. What amount will appear in the Statement of Profit and Loss for the year ended 31 December 2012?

[a] a debit amount of €/£ 10,855
[b] a credit amount of €/£ 3,680
[c] a debit amount of €/£ 8,620
[d] a credit amount of €/£ 15,980

[10] In the year ended 31 December 2012 Company X received €/£ 72,000 in the form of a grant towards the purchase of new manufacturing equipment which will be depreciated evenly over a 6 year period. The company also received a grant of €/£ 12,000 towards the cost of training staff to use the new equipment.

What closing balances should appear in the Statement of Financial Position for the year ended 31 December 2012 in respect of the grant income?

[a] a debit of €/£ 84,000 and a credit of €/£ 60,000
[b] a debit of €/£ 24,000 and a credit of €/£ 60,000
[c] a debit of €/£ 60,000 and a credit of €/£ 84,000
[d] a debit of €/£ 72,000 and a credit of €/£ 72,000

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QUESTION 3 *(Compulsory)*

The Statement of Financial Position, Statement of Changes in Equity and other relevant information of FRANCHISE Limited, for the year ended 31 December 2012, are as follows:

Statement of Financial Position as at 31 December 2012

	2012		**2011**	
	€/£	**€/£**	**€/£**	**€/£**
ASSETS				
Non-current assets		332,550		180,800
Investments at cost		130,000		130,000
		462,550		310,800
Current assets				
Inventories	132,420		156,780	
Trade receivables	142,560		92,360	
Prepayments	21,800	296,780	6,300	255,440
Total assets		**759,330**		**566,240**
EQUITY AND LIABILITIES				
Capital and reserves				
Ordinary shares		220,000		160,000
Share premium		15,000		0
Retained earnings		155,380		133,190
		390,380		293,190
Non-current liabilities				
Debentures		135,000		86,500
Current liabilities				
Trade payables	95,340		83,260	
Accrued expenses	19,360		12,440	
Bank overdraft	56,500		42,600	
Corporation tax	62,750	233,950	48,250	186,550
		759,330		**566,240**

Statement of Changes in Equity

	Ordinary share capital €/£	**Share premium €/£**	**Retained profits €/£**	**Total equity €/£**
As at 1 January 2012	160,000	0	133,190	293,190
Net profit for year ended 31 Dec 2012			49,190	49,190
Share issue	60,000	15,000		75,000
Ordinary dividends			(27,000)	(27,000)
As at 31 December 2012	220,000	15,000	155,380	390,380

QUESTION 3 CONTINUED OVERLEAF

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Question 3 *(Cont'd)*

Additional information:

1. The Statement of Profit and Loss includes the following charges for the year:

	2012	**2011**
	€/£	**€/£**
Interest	18,500	9,400
Taxation	23,000	18,450
Depreciation	30,000	26,700

   There was no interest owing at year end.

2. On 1 July 2012 Franchise Limited issued €/£1 ordinary shares at €/£1.25 per share.

3. The company disposed of plant and equipment during the year with a net book value of €/£35,000. Proceeds from the sale amounted to €/£50,000.

4. The company purchased new plant and equipment during the year which is depreciated evenly over a five year period.

5. Following a review of the books and records it was noted that the financial statements contained the following errors:

   i. Prepaid expenses of €/£6,000 were incorrectly included in administration expenses at year end.

   ii. The company received a capital grant of €/£25,000 towards the cost of the plant and equipment purchased. This grant was incorrectly treated as a revenue grant.

   The above errors should be rectified before preparing the Statement of Cash Flows.

Requirement

(a) Prepare a Statement of Cash Flows for Franchise Limited for the year to 31 December 2012 in accordance with IAS 7 *Statement of Cash Flows*.

N.B. *You are NOT required to prepare notes to the Statement of Cash Flows. You are required to submit your workings.*

19 Marks

(b) Prepare the journal entries showing how the capital grant received should have been recorded in accordance with IAS 20 *Accounting for Government Grants*.

4 Marks
Presentation 2 Marks
Total 25 marks

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SECTION B

Answer TWO of the THREE questions in this Section

QUESTION 4

(a)

FINANCE Limited prepares its financial statements up to 31 December 2012. During a year end review of the books and records the following issues were identified:

1. Goods that cost €/£60,000 were sold on credit, at a mark-up of 10%, on the last day of the financial year. The sale of these goods was recorded however they were deducted from closing inventory twice in error.

2. Closing inventory includes obsolete goods that cost €/£46,800. These goods were sold at auction on 3rd January 2013 for €/£26,000. Auctioneer's fees were 4% of sales proceeds.

3. Goods for resale that were ordered on 15th December 2012 and were due to arrive prior to year end did not arrive until 12th January 2013. These goods were valued at €/£21,300.

4. There was a fire in one part of the factory at year end and goods that cost €/£42,000 were destroyed. The inventory was under-insured by 50%. These goods were included in inventory at year end.

Requirement

Prepare the journal entries to show how the above items should be dealt with in the financial statements of Finance Limited for the year ended 31 December 2012. You should use your understanding of the relevant IAS's in dealing with each item.

9 Marks

QUESTION 4 CONTINUED OVERLEAF

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QUESTION 4 *(Cont'd)*

(b)

FRANKFURT Limited
Trial balance as at 31 December 2012

	DR	CR
	€/£	**€/£**
Inventory at 1 January 2012		
- Raw materials	27,460	
- Work in progress	23,410	
- Finished goods	31,880	
Factory direct wages	159,870	
Factory indirect wages	103,450	
Factory supervisors salary	39,800	
Employers PAYE/PRSI (all factory related)	19,890	
Carriage inwards	6,200	
Returns inwards	12,400	
Returns outwards		9,340
Purchases of raw materials	437,600	
General factory expenses	38,600	
Light & heat	19,110	
Factory power	17,650	
Administration expenses	72,400	
Sales		1,140,600
Rent	22,350	
Selling expenses	19,600	
Bank charges	3,340	
Production equipment	155,800	
Production equipment accum depreciation		44,330
Office equipment	62,300	
Office equipment accumulated depreciation		33,870
Receivables	216,780	
Payables		185,450
Bank	43,700	
Ordinary shares		120,000
	1,533,590	**1,533,590**

QUESTION 4 CONTINUED OVERLEAF

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QUESTION 4 *(Cont'd)*

Additional information:

1 Inventories at 31 December 2012 are as follows:

	€/£
Raw materials	28,700
Work in progress	21,340
Finished goods	32,880

2 Light, heat and rent are to be apportioned: Factory (1/3) Administration (2/3)

3 Depreciation of production machinery is to be charged as follows:

Production equipment	15% straight line
Office equipment	10% reducing balance

4 Employer's PAYE/PRSI to be allocated between factory direct wages and factory Supervisor's salary.

Requirement

Prepare the manufacturing account for Frankfurt Limited for the year ended 31 December 2012.

9 Marks
Presentation 2 Marks

Total 20 Marks

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QUESTION 5

FREDERIK Limited has produced the following trial balance for the year ended 31 December 2012:

Frederik Limited
Trial balance as at 31 December 2012

	DR	**CR**
	€/£	**€/£**
Ordinary shares (of €/£0.50 ea)		260,000
10% debentures		112,000
Share premium		29,500
Retained earnings at 1 January 2012		208,610
Leasehold premises at cost	350,000	
Leasehold premises accumulated depreciation		113,500
Plant and equipment	432,100	
Plant and equipment accumulated depreciation		193,400
Motor vehicles	152,500	
Motor vehicles accumulated depreciation		48,700
Inventory at 1 January 2012	123,780	
Trade receivables	125,890	
Trade payables		98,760
Deferred income		42,600
Sales revenue		563,240
Sales returns	29,670	
Purchases	245,780	
Purchase returns		11,260
Administration expenses	87,450	
Distribution expenses	67,450	
Debenture interest	5,600	
Taxation	9,160	
Short term investments	26,300	
Cash at bank	43,280	
Accrued expenses		42,990
Prepayments	3,600	
Ordinary dividend	22,000	
	1,724,560	**1,724,560**

QUESTION 5 CONTINUED OVERLEAF

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QUESTION 5 *(Cont'd)*

The following additional information has also been provided:

1. The above trial balance has been arrived at after the calculation of depreciation. The following depreciation rates were applied:

Leasehold premises	2% per year on cost
Plant and equipment	10% per year on cost
Motor vehicles	15% reducing balance

2. The company entered into a four year lease for new machinery on 1 January 2012. The company has to make four annual payments of €/£12,000, payable in arrears, on the last day of the year. The present value of the minimum lease payments is €/£38,038. The interest rate implicit in the lease is 10%. No part of this transaction has been included in the trial balance.

3. Inventory at year end was valued at €/£132,550 and includes 80 identical units at a cost of €/£120 per unit. However market research undertaken at year end has shown that these goods will only achieve a sales price of €/£98 per unit.

4. A half year's debenture interest must be provided for.

5. The deferred income recorded in the trial balance relates to a capital grant which was received during the year towards the cost of plant and equipment purchased. The grant has not been amortised in line with the requirements of IAS 20 *Accounting for Government Grants*.

6. Included in administration costs is €/£12,000 relating to insurance for the year ended 31 March 2013.

Requirement

(a) Prepare Frederik Limited's Statement of Profit or Loss for the year ended 31 December 2012 in a form suitable for publication.

N.B. *You must show your workings to show how you arrived at figures in the Statement of Profit or Loss.*

12 Marks

(b) Prepare an extract from the Statement of Financial Position of Frederik Limited showing the Non-current assets and Current assets as at 31 December 2012.

6 Marks
Presentation 2 Marks
Total 20 Marks

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QUESTION 6

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

(a) Define two of the following in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets:*

i. Contingent asset.

ii. Contingent liability.

iii. Provision.

6 Marks

(b) You are working as a junior auditor for a large accountancy firm and the audit manager is keen to test your knowledge of IAS 37. He has provided you with the following scenarios. State how each of the scenarios listed below should be treated in the year end financial statements of each entity.

i. A television manufacturer provides warranties to all its customers on the sale of its products. Under the conditions of the warranty, the manufacturer undertakes to make good, by repair or replacement, any manufacturing defects that become apparent within 3 years from the date of sale. Based on past experience, it is probable that there will be some claims under the warranties.

ii. Ten employees of a large pharmaceutical company have been made redundant by the company. They are in the process of taking legal proceedings against the company for unfair dismissal. The company disputes liability. Up to the date of approval of the financial statements, the company's lawyers advise that it is probable that the entity will not be found liable.

iii. A high street shop has a policy of refunding purchases made by dissatisfied customers, even though it is under no legal obligation to do so. Customers are well aware of its policy

iv. A company has recently relocated to a new factory. The lease on the old factory has 3 years to run and it cannot be cancelled, it can however be sublet to another business. The old factory was substantially modified to suit the business and will not, therefore, suit many other businesses. The company is prepared to sublet the factory at 75% of the rental cost and hopes to have the factory sublet by the middle of the next financial year.

v. A customer is suing a company for €/£50,000 damages due to a fall in one of their retail outlets that resulted in the customer being badly injured. The company's lawyers are unsure as to the company liability. The court case will not be heard by year end or by the time the financial statements are approved by the directors.

10 Marks

(c) What are the necessary journal entries required to record a provision in line with the requirements of IAS 37?

2 Marks

Presentation 2 Marks

Total 20 Marks

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2nd Year Examination: May 2013

Advanced Financial Accounting

Suggested Solutions

Students please note: These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

Solution 1

(a)

Faithful representation

Financial reports reflect the economic transactions of an entity in terms of its financial position, performance and financial adaptability. To be useful financial reports should faithfully represent the underlying economic situation of the entity.
Faithful representation is achieved when the financial information that is provided is:

i. Complete
ii. Neutral, and
iii. Free from error

Complete:
Financial information is complete when it includes all the information necessary for a user to fully understand the transaction/event. The information may not just be financial in nature, but may include descriptions and explanations eg non-current assets may include value, description of asset, depreciation policy.
Neutral:
When information is neutral it is free from bias in the selection of policy or estimate that is used to measure it and in the way it is being presented (disclosed) in the financial statements. Neutrality in presentation means not presenting information in such a way that it will influence users and their decisions.
Free from error:
Faithful representation does not mean 100% accuracy. It does however mean that there are no errors or omissions in the description of the transaction/event and there has been no error in the process used to select and report on the transaction/event eg determining the value of shares held in an unlisted company.

Marks Allocated
Quality of Discussion: 5 Marks
5 Marks

(b)

Asset
An asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.
Liability
A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
Equity
The residual interest in the asset of the entity after deducting all its liabilities.

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Income
The increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from equity participants.
Expenses
The decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Marks Allocated
2 marks per definition (Max 3 definitions)
6 Marks

(c)

Change in accounting policies
Accounting policies are specific principles, bases, conventions, rules and practices applied by an entity when preparing and presenting financial statements.
In the interest of consistency and comparability accounting policies usually remain the same each year. Accounting policies can only be changed in the following circumstances:

1. It is required by a new standard or guidance.
2. If the change were to result in the information in the financial statements being more fairly represented and relevant.

When accounting policies are changed this is done retrospectively. Retrospective application means that all opening balances and prior year figures for the elements of financial statements that are affected by the change in policy must be restated as if the change in accounting policy had always been applied. If it is not possible to determine the effect on prior periods then the change can simply be applied to the current accounting period but this fact would need to be disclosed in the financial statements.

Change in accounting estimates
Financial statements are not prepared under conditions of certainty. Instead significant uncertainties exist and these result in some figures in the financial statements being estimated. A good example is depreciation and the expected useful life of an asset. While this can be estimated events can occur that result in these estimates changing and perhaps reduce the estimated useful life and consequently the annual depreciation will need to be adjusted. Changes in estimates are required when, the circumstances on which the estimate was based change, new information is received or the experience of management increases and refines the estimate. A change in estimate will affect the period in which the change occurred and if applicable, future accounting periods. Changes in estimates do not affect prior periods and therefore they are not applied retrospectively. Where the effect of the change on the financial statements is material, its nature and the monetary effect of the change on the financial statements must be disclosed.

Prior period error
Regardless of the reason for the prior period error, be it fraud or otherwise, IAS 8 states that an entity must correct all *material* prior period errors retrospectively in the first set of financial statements issued to users of financial information after the discovery of the error. The correction of a prior period error will involve restating the opening balances in all of the elements of financial statements affected by the error as if the error had never occurred, restating comparative figures as if the error had never occurred and showing the change in the opening balance of accumulated profit in the statement of changes in equity.
Non-material errors do not meet the definition of a prior period adjustment as prescribed by IAS 8. The normal procedure when an error from a prior period is discovered that is non-material in nature is to adjust for that error as if it had occurred in the current year. Accordingly the effect of the error is in the current year's financial statements and the comparative figures are not restated. The rationale for this treatment relates to the non-material nature of the item.

Marks Allocated
Quality of Discussion – Change in Accounting Policies : 3 Marks
Quality of Discussion – Change in Accounting Estimates: 3 Marks
Quality of Discussion – Prior Period Error: 3 Marks
9 Marks

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Solution 2
MCQ S2013

1.	b
2.	c
3.	d
4.	a
5.	b
6.	c
7.	d
8.	b
9.	a
10.	a

Marks Allocated	
Each Part: 1.5 Marks	
	15 Marks

MCQ Workings

9. 3680 + (7/12 x 12300) = 10,855 debit **Solution(a)**

10. Capital grant €/£ 72,000 to be credited to the Income Statement evenly over 6 yrs
72,000 / 6 = 12,000

Entries in Statement of Financial Position:

Bank
debit 72,000 capital grant + 12,000 revenue grant = 84,000 DR

Deferred income
credit 72,000 – 12,000 credited to Statement of P&L = 60,000 CR

Solution (a)

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Solution 3

Franchise Limited
Statement of Cash Flows for the year to 31 December 2012

	€/£	€/£	Ma… Alloca…
Cash flows from operating activities			
Net profit before interest (W1)		76,690	
Adjustments for:			
Depreciation	30,000		
Profit on disposal (W7)	(15,000)		
Capital grant amortisation (W9)	(5,000)		
Changes in working capital			
Decrease in inventory (W2)	24,360		
Increase in prepayments (W2)	(21,500)		
Increase in receivables (W2)	(50,200)		
Increase in payables (W2)	12,080		
Increase in accruals (W2)	6,920		
		(18,340)	
Cash generated from operations		**58,350**	
Interest paid (W3)	(18,500)		
Tax paid (W4)	(8,500)		
		(27,000)	
Net cash from operating activities		**31,350**	
Cash flows from investing activities			
Payment to acquire non-current assets (W6)	(216,750)		
Capital grants received	25,000		**¾ Mark**
Receipt from sale of non-current assets (W7)	50,000		**¾ Mark**
		(141,750)	
Cash flows from financing			
Proceeds from share issue (incl share prem) (W10)	75,000		
New bank loans (W11)	48,500		
Dividends paid(W12)	(27,000)		
		96,500	
Decrease in cash and cash equivalents		**(13,900)**	**1 ¼ Mark**
Cash and cash equivalents at start of year		(42,600)	**¼ Mark**
Cash and cash equivalents at end of year		**(56,500)**	**¼ Mark**

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Workings

					Marks Allocated
1	**Net profit before interest**				
			€/£		
	Operating profit		49,190		¼ Mark
	Add prepaid expenses recorded in error		6,000		½ Mark
	Revenue grant recorded in error		(25,000)		½ Mark
	Capital grant amortisation omitted in error (W9)		5,000		½ Mark
	Revised net profit		35,190		
	Add: interest charge for the year		18,500		¼ Mark
	Add: tax charge for the year		23,000		¼ Mark
			76,690		¾ Mark
2	**Changes in working capital**				
	Inventory	(132,420 - 156,780)	24,360	decrease	¾ Mark
	Receivables	(142,560 - 92,360)	(50,200)	increase	¾ Mark
	Prepayments	(27,800 - 6,300) (W8)	(21,500)	increase	1 Mark
	Payables	(95,340 - 83,260)	12,080	increase	¾ Mark
	Accrued expenses	(19,360 - 12,440)	6,920	increase	1 Mark
3	**Interest paid**				
	Opening balance		0		
	Annual charge		18,500		
	Closing balance		0		
	Amount paid		18,500		½ Mark
4	**Tax paid**				
	Opening balance		48,250		¼ Mark
	Annual charge		23,000		¼ Mark
	Closing balance		(62,750)		¼ Mark
	Amount paid		8,500		
5	**Depreciation**				
	Charge for year		30,000		¼ Mark
6	**Non-current asset acquisition**				
	Opening balance		180,800		¼ Mark
	Less disposals		(35,000)		½ Mark
	Less depreciation		(30,000)		½ Mark
			115,800		
	Closing balance		332,550		¼ Mark
	Acquisitions		216,750		½ Mark
7	**Non-current asset disposal**				

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	NBV	35,000	**¼ Mark**
	Sale proceeds	50,000	**¼ Mark**
	Profit on sale	15,000	**¼ Mark**
8	**Prepaid expenses**		
	Closing balance	21,800	**¼ Mark**
	Expenses omitted in error	6,000	**½ Mark**
	Revised accrued expenses	27,800	
9	**Grant income**		
	Capital grant received	25,000	
	To be amortised over 5 years		
	Annual amortisation	5,000	**1 Mark**
10	**Ordinary shares issued (incl share premium)**		
	Closing balance (incl share prem)	235,000	**½ Mark**
	Opening balance	(160,000)	**¼ Mark**
	Receipt from shares issued	75,000	
11	**Debentures issued**		
	Closing balance	135,000	
	Opening balance	(86,500)	
	Receipt from debentures issued	48,500	**1 ¼ Marks**
12	**Dividends paid**		
	As per SOCIE	27,000	**½ Mark**

(b) Journal entries

			€/£	**€/£**	
1.	Dr	Bank (SOFP)	25,000		**2 Marks**
	Cr	Deferred income (SOFP)		25,000	

[Being receipt of capital grant]

2.	DR	Deferred income (SOFP)	5,000		**2 Marks**
	CR	Other income (SOP&L)		5,000	

[Being first year amortisation of capital grant received]

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Solution 4

(a)

			€/£	**€/£**	
1.	Dr	Inventory (SOFP)	60,000		
	Cr	Inventory (SOP&L)		60,000	**2 Marks**
[Being correction of closing inventory]					
2.	DR	Inventory (SOP&L)	21,840		
	CR	Inventory (SOFP)		21,840	
[Being write down of inventory to NRV] (See working)					**2 Marks**
3.	Non-adjusting event as per IAS 10 therefore no journal entries required.				**1 Mark**
4.	DR	Inventory (SOP&L)	42,000		
	CR	Inventory (SOFP)		42,000	
[Being correction of closing inventory to allow for goods destroyed by fire]					**2 Marks**
	DR	Other receivable (SOFP)	21,000		
	CR	COGS Insurance on inventory (SOP&L)		21,000	
[being amounts receivable from insurance company for inventory destroyed in fire]					**2 Marks**
					Presentation: 1 Mark

Working:
26,000 – 1,040 (4%) = 24,960
46,800 - 24,960 = 21,840

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(b)

FRANKFURT Limited

Manufacturing Account for the year ended 31 December 2012

	€/£	**€/£**	**€/£**	
<u>Cost of raw materials consumed</u>				
Opening inventory of raw materials		27,460		**¼ Mark**
Add purchases of raw materials	437,600			**¼ Mark**
Carriage inwards	6,200			**½ Mark**
Returns of raw materials	(9,340)			**½ Mark**
		434,460		
		461,920		
Less closing inventory of raw materials		(28,700)		**¼ Mark**
Total cost of raw materials consumed			433,220	**½ Mark**
<u>Direct expenses</u>				
Direct (production wages)		159,870		**¼ Mark**
Employer's PAYE/PRSI (w3)		15,925		
			175,795	
Prime cost			609,015	**½ Mark**
<u>Overheads</u>				
Factory indirect wages		103,450		**¼ Mark**
Factory supervisor's salary		39,800		**¼ Mark**
Employer's PAYE/PRSI (w3)		3,965		
General factory expenses		38,600		**¼ Mark**
Factory power		17,650		**¼ Mark**
Depreciation of production equipment (w2)		23,370		
Light and heat (w1)		6,370		
Rent (w1)		7,450		
			<u>240,655</u>	
			849,670	
Add: Opening work in progress			23,410	**¼ Mark**
Less: Closing work in progress			(21,340)	**¼ Mark**
Factory cost of goods produced			**851,740**	**1 Mark**

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Workings

							Ar
1	**Cost of sales**			**€/£**	**€/£**	**€/£**	
					Factory	**Admin**	
					1/3	**2/3**	
	Light & heat			19,110	6,370	12,740	¾ **Marks**
	Rent			22,350	7,450	14,900	¾ **Marks**

2 Depreciation

Production equipment	15%	straight line	
Office equipment	10%	reducing bal	
		€/£	
<u>Production equip</u>			
Cost		155,800	
Depreciation		23,370	½ **Mark**
<u>Office equipment</u>			
NBV		28,430	
Depreciation		2,843	

3 Employers PAYE/PRSI

	€/£		**€/£**	
Total PAYE/PRSI			19,890	
Factory direct wages	159,870	80%	15,925	¾ **Mark**
Factory supervisors salary	39,800	20%	3,965	¾ **Mark**
	199,670		19,890	

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Solution 5

FREDRIK Limited

Statement of Profit or Loss for the year ended 31 December 2012

	€/£	Ma Alloc
Sales revenue (w8)	533,570	
Cost of sales (w1)	(227,510)	
Gross profit	306,060	
Other income (w6)	4,260	
Administration costs (w.7)	(93,960)	
Distribution costs	(67,450)	**¼ Mark**
	148,910	
Interest (w5)	(15,004)	
Profit on ordinary activities before tax	133,906	
Taxation	(9,160)	**¼ Mark**
Profits on ordinary activities after taxation	124,746	**1 Mark**

Statement of Financial Position as at 31 December 2012 (Extract)

	€/£	€/£	
Non-current assets			
premises (w9)		236,500	**½ Mark**
plant and equipment (w9)		238,700	**½ Mark**
motor vehicles (w9)		103,800	**½ Mark**
leased assets (w10)		28,528	**1 Mark**
		607,528	
Current assets			
short term investments	26,300		**¼ Mark**
inventory (w3)	130,790		**½ Mark**
receivables	125,890		**¼ Mark**
prepayments (w11)	6,600		**1 ¼ Marks**
cash at bank (w12)	31,280		**1 ¼ Marks**
		320,860	
			Presentation: 2 Marks
Total assets		**928,388**	

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*****The Statement of Financial Position and Statement of Changes in Equity are shown for illust... purposes only*****

Statement of Financial Position as at 31 December 2012

	€/£	€/£
Non-current assets		
Premises		236,500
Plant and equipment		238,700
Motor vehicles		103,800
Leased assets (w10)		28,528
		607,528
Current assets		
Short term investments	26,300	
Inventory (w3)	130,790	
Receivables	125,890	
Prepayments (w7)	6,600	
Cash at bank (w12)	31,280	
		320,860
Total assets		**928,388**
Equity and liabilities		
Capital and reserves		
Ordinary share capital		260,000
Share premium		29,500
Retained profit		311,356
		600,856
Non-current liabilities		
Debentures	112,000	
Finance lease liability	29,842	
Deferred income (w6)	38,340	180,182
Current liabilities		
Payables	98,760	
Debenture interest	5,600	
Accruals	42,990	147,350
Total equity and liabilities		**928,388**

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Statement of Changes in Equity

	Ordinary share capital €/£	Share premium €/£	Retained earnings €/£	Total equity €/£
As at 1 January 2012	260,000	29,500	208,610	498,110
Profit for the year			124,746	124,746
Ordinary dividends			(22,000)	(22,000)
Balance as at 31 Dec 2012	260,000	29,500	311,356	600,856

Workings

		€/£	€/£	Marks Allocated
1	**Cost of sales**			
	Opening inventory	123780		**¼ Mark**
	Purchases	245,780		**¼ Mark**
	Less: purchase returns	(11,260)	358,300	**¼ Mark**
	Closing inventory (w3)		(130,790)	**¼ Mark**
			227,510	**½ Mark**
2	**Leased asset**			
	PV of lease		38,038	
	No. Yrs in lease		4	
	Annual depreciation charge		**9,510**	**1 Mark**
	First year interest charge			
	PV of lease		38,038	
	Interest rate		10%	
	1st years interest		**3,804**	**1 Mark**

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3	**Closing inventory**				
	Inventory at year end			132,550	
	Units at cost	No units		80	
		€/£ per unit		120	
		Cost		9,600	
		NRV per unit		98	
		NRV		7,840	**¼ Mark**
	Reduction in value of closing inventory			1,760	**1 Mark**
	Revised value of closing inventory (132,550 - 1,760)			**130,790**	**¾ Mark**
4	**Debenture interest**				
	10% debenture			112,000	
	Annual interest		10%	11,200	
	6 mths interest			5,600	
	Interest as per trial balance			5,600	**½ Mark**
	Total interest			**11,200**	**¼ Mark**
5	**Finance costs**				
	Debenture interest (w4)			11,200	**¼ Mark**
	Lease interest (w2)			3,804	**¼ Mark**
	Total finance charge			**15,004**	
6	**Capital grant**				
	As per trial balance			42,600	
	Annual amortisation		10%	4,260	**1 Mark**
	(as per plant & equip depreciation policy)				
	Other income			**4,260**	
7	**Insurance/administration**				
	Annual insurance charge			12,000	
	No. Mths prepaid			3	
	Amount prepaid			3,000	**1 Mark**
	Administration as per trial balance			87,450	**¼ Mark**
	less prepayment			(3,000)	**½ Mark**
	add finance lease depreciation			9,510	**½ Mark**
	Revised administration costs			**93,960**	

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8 Sales

Sales per trial balance	563,240	¼ Ma
Sales returns	(29,670)	¼ Mark
Net sales	533,570	

9 Non-current assets

	Cost	Accdepr	NBV
Leasehold premises at cost	350,000	(113,500)	236,500
Plant and equipment	432,100	(193,400)	238,700
Motor vehicles	152,500	(48,700)	103,800

10 Leased assets

	Cost	Accdepr	NBV
Leased assets	38,038	(9,510)	28,528

11 Prepayments

As per trial balance	3,600
Prepaid insurance (w7)	3,000
Revised prepayments	6,600

12 Cash at bank

As per trial balance	43,280
Finance lease payment	(12,000)
Revised cash at bank	31,280

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Solution 6

(a) Definitions:

Contingent asset
A contingent asset is a possible asset that arises from past events, the existence of which will be confirmed only by the occurrence of one or more uncertain future events not wholly within the business's control. A contingent asset should not be recognised. It should only be recognised when the realisation of the related economic benefit is virtually certain. At that point the asset is no longer a contingent asset.

Contingent liability
A contingent liability can be thought of as an item that has failed one of the recognition criteria of a provision. As such IAS 37 provides the following definition of a contingent liability:

1. 'A present obligation that arises from past events but is not recognised because:

    a. It is not probable that a transfer of economic benefits will be required to settle the obligation or

    b. The amount of the obligation cannot be measured with sufficient reliability.

2. A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control.'

Contingent liabilities should not be recognised in financial statements but they should be disclosed by way of a note.

Provision
IAS 37 defines a provision as a 'liability of uncertain timing or amount'. Defining a provision as a liability is important as it means that a provision can only be recognised in the financial statements when all three of the following conditions are met:

i. A business has a present obligation (legal or constructive) as a result of a past event (the obligating event).

ii. It is probable that a transfer of economic benefits will be required to settle the obligation.

iii. A reliable estimate can be made of the amount of the obligation.

Unless these conditions are met, no provision should be recognised.

Marks Allocated
3 marks per definition (Max of 2 definitions)   ***6 Marks***

(b)

i. A provision should be recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date. The sale of a product with a warranty is an obligating event which gives rise to a legal obligation. It is probable that an outflow will be required for the warranties as a whole.

ii. No provision is recognised in the financial statements. The matter should be disclosed as a contingent liability unless the probability of any outflows is regarded as remote. On the basis of the evidence available when the financial statements were approved there was no obligation as a result of past events.

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iii. A provision should be recognised for the best estimate of the costs of refunds. The sale of a pr an obligating event which gives rise to a constructive obligation because the shop has created a expectation on the part of the customer that the shop will refund purchases. It is probable that an outflow w be required for purchases returned for refund.

iv. There is an obligation to see out the lease without gaining any benefit from the use of the factory. In accordance with IAS 37 the contract should be classified as onerous. On this basis, the full cost of the lease for the remaining three years should be provided for in the Statement of Financial Position. As there is no certainty about timing or amount of any sublet income no offsetting should be recognised.

v. No provision is recognised in the financial statements. The matter should be disclosed as a contingent liability by way of note as it is possible but not probable. At the date the financial statements are approved there is no obligation as a result of past events.

Marks Allocated
2 marks for each part (i) – (v)
10 Marks

(c)

Debit	Expense in the Statement of Profit and Loss	XXXX	
Credit	Provision account in Statement of Financial Position		XXXX

Marks Allocated
2 marks for Journal entries ***2 marks for presentation***
4 Marks

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2nd Year Examination: May 2013

Advanced Financial Accounting

Examiner's Report

Statistical Analysis – By Question						
Question No.	1	2	3	4	5	6
Average Mark (%)	31%	60%	62%	51%	61%	57%
Nos. Attempting	779	789	780	527	688	356

Statistical Analysis - Overall	
Pass Rate	66%
Average Mark	54%
Range of Marks	**Nos. of Students**
0-39	130
40-49	141
50-59	253
60-69	146
70 and over	119
Total No. Sitting Exam	**789**
Total Absent	108
Total Approved Absent	44
Total No. Applied for Exam	941

General comment

The overall performance in this exam was good with the result that once again the pass rate increased. The average mark recorded in this session was similar to that achieved in the Summer 2012 sitting, and the pass rate increased from 65% in 2012 to 66% in 2013. In terms of individual questions, other than question 1, there was a strong performance in all questions each of which achieved an average mark in excess of 50%.

Question 1

It is disappointing to have to note that there was, once again, a very poor performance in this question, which tests the students understanding of the theory elements of the syllabus. The average mark achieved for this question was 31%, lower than the average mark achieved in the previous two years highlighting a continuing downward trend. Students must gain a better understanding of the theory elements of the syllabus and appreciate the impact it will have on their overall exam result.

This question contained three separate individual requirements which and designed to help students pick up marks by having a wider scope with an element of choice. However it failed to achieve the desired stronger performance with the majority of students presenting very poor attempts and accordingly being awarded very low marks. Where students were familiar with the topics they scored very high marks relatively quickly and easily.

The common answer presented for part (a) was a discussion on compliance with the regulatory framework and the importance of a true and fair view. If students did mention one of the three components of faithful representation it was by accident rather than design. Part (b) asked students to define three elements of financial

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statements and rather than providing definitions the majority of students provided examples. This same and therefore cannot be rewarded with substantial marks. In relation to part (c) a significant perce solutions presented discussed each element of IAS8 but failed to discuss the impact on financial statements.

Question 2
Students continue to deliver a strong performance in the multiple choice question. Whilst the average mark decreased from 64% in 2012 to 60% it still showed a consistently solid performance. Part (10) appears to have caused the most confusion, although not enough to identify it as a problem area.

Question 3
This question was very well answered and accordingly delivered the highest average mark of 62%. Students were quite comfortable with the statement of cash flow and there were no obvious black spots. Students did struggle to determine the figures for interest paid and non-current asset acquisition but they did not lose significant marks for these and therefore were still able to score well. The add-on journal requirement was very well attempted and helped students gain an overall high score for this question.

Question 4
This question was the second most popular optional question however it delivered the second lowest score on the overall paper of 51%. The question was made up of two distinct requirements, part (a) examined the student's knowledge of inventory and journals and part (b) required students to prepare a manufacturing account.
Students appear to have been confused by the scenarios presented in part (a) and hence there were a very wide variety of solutions presented. The under-insured goods appears to have caused the most confusion and therefore very few students presented correct journals with a significant number declaring that the fire was a non-adjusting event.

Part (b) was met with a surprisingly positive response with many students scoring very highly. However despite getting the calculations right many students fell down on presentation which was often quite sloppy and confusing.

Question 5
This question delivered the best result in the optional questions, with students gaining an overall average mark of 61%. This question required students to prepare a Statement of Profit and Loss and an extract from the Statement of Financial Position. It was not surprising to see that this was by far the most popular optional question.

The most surprising trend noted in the solutions presented was in relation to depreciation. The question stated that the trial balance had been arrived at after the calculation of depreciation yet the majority of students went to great lengths to calculate depreciation and include this in both financial statements. The requirements in relation to the leased asset confused most students, many of whom ignored it altogether. For those who attempted to adjust for it they appeared to be unfamiliar with this scenario and as a result were very unsure of the correct treatment. It was surprising to note that most students calculated revised closing inventory correctly yet they were unable to correctly provide for debenture interest which was a far less complex requirement.

Question 6
This question tested the student's knowledge of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and was mainly attempted by the stronger students. Despite the fact that this was one of the less demanding questions on the paper it was clearly the least popular optional question. However, the students who attempted this question delivered a good performance and achieved an average mark of 57%. Part (a) asked students to provide two definitions however the definitions provided were relatively poor and hence this part of the question was certainly the weakest. In relation to part (b) a lot of students addressed each scenario by providing a one word answer with no supporting discussion. Whilst their recommended treatment may have been correct it would be unfair to award the same marks to those students as to those who supported their answer by reference to the IAS. Students should be mindful of the marks attributed to each requirement and consequently provide an appropriate level of detail.