Accounting Technicians Ireland

Advanced Financial Accounting

2nd Year Examination

May 2014

Exam Paper, Solutions & Examiner's Comments

NOTES TO USERS ABOUT THESE SOLUTIONS

The solutions in this document are published by Accounting Technicians Ireland. They are intended to provide guidance to students and their teachers regarding possible answers to questions in our examinations.

Although they are published by us, we do not necessarily endorse these solutions or agree with the views expressed by their authors.

There are often many possible approaches to the solution of questions in professional examinations. It should not be assumed that the approach adopted in these solutions is the ideal or the one preferred by us. Alternative answers will be marked on their own merits.

This publication is intended to serve as an educational aid. For this reason, the published solutions will often be significantly longer than would be expected of a candidate in an examination. This will be particularly the case where discursive answers are involved.

Accounting Technicians Ireland

2nd Year Examination: Summer 2014

Paper: Advanced Financial Accounting

Monday 12th May 2014 - 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.

Note:
This paper uses the language of International Accounting Standards (I.A.S). Examinees are permitted to use either I.A.S or Financial Reporting Standards (F.R.S) terminology when preparing financial statements but the use of the language of the International Accounting Standards (e.g. Receivables rather than Debtors) is preferred.

SECTION A

Answer ALL THREE Questions in this Section

QUESTION 1

(a) The "Conceptual Framework" states that "financial information is useful if it is relevant and faithfully represents what it purports to represent". To this end, it identifies three fundamental qualitative characteristics of useful information. These are: Relevance, Materiality and Faithful Representation. Write a brief note on <u>two</u> of these three fundamental qualitative characteristics.

6 marks

(b) List <u>six</u> different users of financial reports and give examples of their likely information needs.

6 marks

(c) As per IAS 1, what is required to be included in a complete set of Financial Statements?

4 marks

(d) What are the requirements of IAS 1 with regard to the provision of comparative information and why?

4 marks
Total <u>20</u> marks

QUESTION 2

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 <u>15</u> marks

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

1. Under the terms of IAS 2, the net realisable value of an inventory item is the:

   (a) estimated selling price in the ordinary course of business, less the estimated costs of completion and estimated costs necessary to make the sale.
   (b) estimated selling price in the ordinary course of business.
   (c) actual selling price in the ordinary course of business less selling costs.
   (d) estimated selling price in the ordinary course of business less the estimated costs of completion.

2. If closing inventory is undervalued in the Financial Statements, this results in:

   (a) the understatement of Cost of Sales and overstatement of operating profit.
   (b) the overstatement of Cost of Sales and understatement of operating profit.
   (c) the understatement of Cost of Sales and understatement of operating profit.
   (d) the overstatement of Cost of Sales and overstatement of operating profit.

QUESTION 2 (*Cont'd*)

3. Under the terms of IAS 8, where the effect of a change in estimate is material to the financial statements;

   (a) the nature and monetary effect of the change on the financial statements must be disclosed.
   (b) the nature and monetary effect of the change on the financial statements must be disclosed. only where it is deemed necessary to provide more reliable information.
   (c) the change in estimate must be applied retrospectively.
   (d) the change in estimate should only be applied retrospectively where it is deemed necessary to provide more reliable information..

4. Healy Ltd's mark up on cost is 20%. The closing inventory at 31 December 2013 was counted and valued at cost at £/€102,000. This amount includes damaged items which cost €/£8,800. It is expected that once repaired, at a cost of €/£500, the goods will be sold at a discount of 25% on full price. At what value should the inventory be stated in the Financial Statements for the year ended 31 December 2013?

   (a) €/£101,500
   (b) €/£99,300
   (c) €/£100,620
   (d) €/£101,120

The following information relates to questions 5 to 7.

R, C and D are in partnership. At 1 January 2013, the following were the credit balances on their capital accounts;

R €/£20,000
C €/£12,000
D €/£8,000

On the same day, the credit balances on their current accounts were;

R €/£7,500
C €/£5,000
D €/£4,000

The partnership agreement provides that interest on capital is to be allowed at 10% per annum. The balance of profits is to be shared as follows – R to get 25%, C to get 35% and D to get 40%. The profits for the year ended 31 December 2013 were €/£28,000 before charging interest on capital. Drawings made by the partners during the year were;

R €/£5,000
C €/£4,000
D €/£3,000

5. The full share (including interest on capital) of the partnership profit of €/£28,000, to which R is entitled is;

   (a) €/£10,000
   (b) €/£2,000
   (c) €/£8,000
   (d) €/£6,000

QUESTION 2 (Cont'd)

6. The full share (including interest on capital) of the partnership profit of €/£28,000, to which C is entitled is;

   (a) €/£9,800
   (b) €/£1,200
   (c) €/£8,400
   (d) €/£9,600

7. The full share (including interest on capital) of the partnership profit of €/£28,000 to which D is entitled is;

   (a) €/£11,200
   (b) €/£800
   (c) €/£9,600
   (d) €/£10,400

8. If a partnership agreement provides for interest to be paid annually on partners' capital balances, how should the annual interest charge be treated?

   (a) Debited to the partners' capital account.
   (b) Credited to the partners' capital account.
   (c) Credited to the partners' current account.
   (d) Debited to the partners' current account.

9. Drawings made during the year by a partner in a partnership should be;

   (a) debited to the partner's capital account.
   (b) credited to the partner's capital account.
   (c) debited to the partner's current account.
   (d) credited to the partner's current account.

10. Where a partnership exists and there is no formal partnership agreement, the Partnership Act 1890 provides that;

   (a) the partners share profits in proportion to their capital balances.
   (b) the partners share profits equally.
   (c) the partners get 5% interest on capital and the remaining profit is shared equally.
   (d) the partners share profits in proportion to the combined balances of their capital and current accounts.

QUESTION 3 ***(Compulsory)***

GHI Ltd.

Statement of Comprehensive Income for the Year Ended 31 December 2013

Statement of Profit or Loss

	€/£ '000
Revenue	2,553
Cost of Sales	1,814
Gross Profit	739
Distribution costs	(125)
Administrative expenses	(264)
Operating profit	350
Interest received	25
Interest paid	(75)
Profit on ordinary activities before taxation	300
Taxation	(140)
Profit after taxation	160

GHI Ltd.
Statement of Financial Position as at 31 December 2013

	2013 €/£ '000	2012 €/£ '000
Assets		
Non Current Assets		
Tangible assets	280	214
Intangible assets	250	200
Investments	-	25
	530	**439**
Current Assets		
Inventories	150	102
Receivables	390	315
Short-term investments	50	-
Cash in hand	2	1
	592	**418**
Total Assets	**1,122**	**857**
Equity and Liabilities		
Equity and reserves		
Share capital (€/£1 ordinary shares)	200	150
Share premium account	160	150
Retained earnings	160	100
	520	**400**
Non-current Liabilities		
Long-term loan	**170**	**50**
Current Liabilities		
Trade payables	127	119
Bank overdraft	85	98
Taxation	120	110
Dividends due	100	80
	432	**407**
Total equity and liabilities	**1122**	**857**

QUESTION 3 *(Cont'd)*

The following additional information is available.

1. The proceeds of the sale of non-current asset investments amounted to €/£30,000.

2. Fixtures and fittings, with an original cost of €/£85,000 and a net book value of €/£45,000 were sold for €/£32,000 during the year. No depreciation is charged in year of disposal.

3. The following information relates to tangible non-current assets.

	31/12/13	**31/12/12**
	€/£'000	**€/£'000**
Cost	620	504
Accumulated Depreciation	(340)	(290)
NBV	280	214

4. 50,000 €/£1 ordinary shares were issued during the year at a premium of 20 cent per share.

5. The interim dividend for 2013 of €/£100,000 remains unpaid. No final dividend for 2013 has been proposed.

Requirement

(a) Prepare a cash flow statement for the year ended 31st December 2013 in accordance with IAS 7 *Statement of Cash Flow*.

19 marks

(b) "Profits do not always translate into a positive cash balance at year end". Briefly discuss two reasons why cash and profit are different.

4 marks
Presentation: 2 marks
Total: 25 marks

SECTION B

Answer TWO of the THREE questions in this Section

QUESTION 4

(a) Waverley Limited buys and sells two products: P and Q. The business incurs the following unit costs in relation to the products:

	P	**Q**
	€/£	**€/£**
Purchase cost	100	200
Delivery costs from supplier	20	30
Delivery costs to customers	25	25
Sales and marketing costs	15	18
Selling price	150	295
General administration expenses	11.50	16.50
Import duty	1.20	2.60

Requirement

(i) State the basis on which inventories should be valued in accordance with IAS 2.

3 marks

(ii) Calculate the figure to be included in closing inventory for a unit of each product, in accordance with IAS 2, *Inventories*.

6 marks

(iii) List three costs excluded by IAS 2, from inclusion as part of the cost of inventory items.

3 marks

(b) There was a fire at the warehouse of ABC Ltd on the last day of the reporting period and inventory with a cost of €/£300,000 was destroyed. The inventory in the warehouse was under-insured by 50%. Explain how the above event should be treated in the Financial Statements of ABC Ltd for the reporting period. Include in your explanation, the journal entries necessary to correctly reflect the loss.

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6 marks
Presentation: 2 marks
Total: 20 marks

QUESTION 5

The following trial balance has been extracted from the books of Holmes Ltd. as at 31st December 2013.

	€/£ '000	€/£ '000
Land at cost	120	
Buildings at cost	250	
Equipment at cost	196	
Vehicles at cost	284	
Goodwill at cost	300	
Accumulated depreciation at 1st January 2013:		
Buildings		90
Equipment		76
Vehicles		132
Inventory at 1st January 2013	107	
Trade receivables and payables	183	117
Allowance for receivables		8
Bank balance		63
Ordinary shares at €/£1 each		200
Retained earnings at 1st January 2013		503
Sales		1,432
Purchases	488	
Directors' fees	150	
Wages and salaries	276	
General distribution costs	101	
General administration expenses	186	
Dividend paid	20	
Rents received		30
Disposal of vehicle		10
	2,661	2,661

The following information is also available

1. The company's non-depreciable land was valued at €/£300,000 on 31st December 2013 and this valuation is to be incorporated into the accounts for the year to 31st December 2013.

2. The company's depreciation policy is as follows:

Buildings:	4% p.a. Straight-line
Equipment	40% p.a. Reducing balance
Vehicles	25% p.a. Straight-line

   In all cases, a full year's depreciation is charged in the year of acquisition and none in the year of disposal. None of the assets had been fully depreciated by 1st January 2013.
   On 1st November 2013, a vehicle used entirely for administrative purposes was sold for €/£10,000. The sale proceeds were debited to the bank account and credited to a disposal account but no other entries were made in relation to this disposal. The vehicle had cost €/£44,000 in August 2010. This was the only disposal of a non-current asset made during the year to 31st December 2013.

QUESTION 5 (*Cont'd*)

3. Depreciation is apportioned as follows:

	Distribution costs	Administrative expenses
Buildings	50%	50%
Equipment	25%	75%
Vehicles	70%	30%

4. The company's inventory at 31st December 2013 is valued at cost of €/£119,000.

5. Trade receivables include a debt of €/£8,000 that is to be written off. The allowance for receivables is to be adjusted to 4% of the receivables which remain after this debt is written off.

6. The corporation tax liability for the year to 31st December 2013 is estimated to be €/£30,000.

7. One-quarter of wages and salaries were paid to distribution staff and the remaining three-quarters were paid to administrative staff.

8. General administrative expenses include bank overdraft interest of €/£9,000.

9. A dividend of 10c per ordinary share was paid on 31st August 2013. No further dividends are proposed for the year to 31st December 2013.

Requirement:

Prepare the following for Holmes Ltd. in accordance with the requirements of international standards:

(a) A Statement of Comprehensive Income for the year to 31st December 2013

12 marks

(b) The relevant notes to the Financial Statements, relating to non-current assets.

6 marks

Presentation: 2 marks

Total: <u>20</u> marks

QUESTION 6

A meeting of the Directors of Johnston Ltd. is scheduled to discuss matters with a view to finalising the accounts for the year ended 31st December 2013 and the following issues need to be addressed:

1. On 1st January 2013, Johnston Ltd purchased a machine for €/£300,000. The machine is depreciated over five years using the straight line method, at the end of which it will have no scrap value. Johnston Ltd received a grant of €/£100,000 towards the purchase of this machine.

2. On the 17th January 2014 Walsh Ltd. who owed Johnston Ltd. €/£75,000 at 31 December 2013, went into liquidation and it is expected that nothing will be recovered.

Before the year end, an ex-employee of Johnston Ltd. commenced proceedings against Johnston Ltd for unfair dismissal. The legal advice available to Johnston Ltd. is that the claim is unlikely to succeed but if it does, the award is likely to be €/£150,000. The legal costs are expected to be €/£25,000 even if the claim is unsuccessful.

3. On January 15th 2014, a fire in the company's warehouse resulted in smoke damage to a number of items of stock. The stock that was included in the year end stock count at a cost of €/£75,000 is now not expected to be sold for more than €/£20,000.

Requirement:

(a) Prepare a report for the board of directors stating how each of the above items should be accounted for in the financial statements of Johnston Ltd. for the year ended 31st December 2013, in accordance with the applicable international accounting standards.

10 marks

(b) Prepare the journal entries necessary to give effect to the required treatment of each of the above.

8 marks

Presentation: 2 marks

Total: 20 marks

2nd Year Examination: May 2014

Advanced Financial Accounting

Suggested Solutions and Examiner's Comments

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.

Statistical Analysis – By Question						
Question No.	1	2	3	4	5	6
Average Mark (%)	61%	60%	55%	51%	49%	53%
Nos. Attempting	806	811	804	521	625	461

Statistical Analysis - Overall	
Pass Rate	67.45%
Average Mark	55%
Range of Marks	**Nos. of Students**
0-39	140
40-49	127
50-59	192
60-69	169
70 and over	183
Total No. Sitting Exam	**811**
Total Absent	132
Total Approved Absent	30
Total No. Applied for Exam	973

General Comments:

GENERAL COMMENTS ON THE PAPER AS A WHOLE

Overall, the paper was well answered with many students displaying a sound knowledge of the material and a sizeable minority achieving a grade of 70% and over.

Examiner's Comments on Question One

This question was well answered with many students achieving high marks especially in part (b).

In relation to part (c), many students forgot to include "Notes to the Financial Statements including accounting policies and other explanatory notes"

Solution One

Marks Allocated

a)

Notes on any 2 of the following is sufficient for full marks

Relevance

Information is relevant if it is important to decision making. It helps a user to evaluate the past, make decisions about the present or the future in relation to the entity or confirm or correct past evaluations which the user may have made. Relevant information has predictive value, confirmatory value or both.

3 marks each.

Materiality

Information is material to the financial statements if its omission or misstatement could influence the economic decisions of users about the reporting entity. Information can be material in terms of its size in relation to the financial statements as a whole or an item can be material by its nature.

Faithful Representation

To be useful, financial statements should faithfully represent the underlying economic situation of the entity. Faithful representation is achieved when the financial information that is provided is complete, neutral and free from error. Financial information is complete when it contains all the information necessary for a user to fully understand the transaction/event. Financial information is neutral when it is free from bias in how it is measured and presented or disclosed. Financial information is free from error when there are no errors or omissions in the description of the transaction/event and no error in the process used to select and report on the transaction/event. Faithful representation does not necessarily mean 100 per cent accuracy.

b)

1 mark for each user plus information needs

Possible potential users

Investors (existing and potential)
Lenders
Creditors
Government (including the tax authorities)
Employees
Suppliers
Customers
The Public generally

arks
ted

Solution One *(Cont'd)*

Likely information needs

Profit levels, profit trends, debt levels, capital structure, details of directors including remuneration, liquidity ratios, details of major loans or assets.

(c)

IAS 1 requires the following to be included in a complete set of Financial Statements;

Statement of Comprehensive Income **0.5mark**
Statement of Financial Position **0.5mark**
Statement of Changes in Equity **1 mark**
Statement of Cash Flow **1 mark**
Notes to the Financial Statements comprising a summary of the significant accounting policies and other explanatory information. **1 mark**

(d)

IAS 1 requires entities to provide comparative information in Financial Statements for the previous accounting period including accounting policies. Comparative figures must also be provided in the notes to the accounts. This is to aid users make informed decisions by being able to compare current years' results with the corresponding prior year numbers.

2 marks for the requirement And 2 marks for the reason

Examiner Comments on Question Two

Again this was a well answered question. Questions 5 to 10 incl. examined partnership principles and in general these were well answered.

Solution Two

			Marks Allocated
			1.5 marks each
1	(a)		
2	(b)		
3	(a)		
4	(c)	NRV of damaged stock =8800 *120%*75%-500=7420 Reduce closing stock by 8800-7420.Reduce 102000 by 1380. Ans = 100,620	
5	(c)	Interest on capital 2000 + 25% of 24000(28000-interest on capital balances of 4000). Ans = 2000 + 6000 = 8000	
6	(d)	Interest on capital 1200 + 35% of 24000(28000-interest on capital balances of 4000). Ans = 1200 + 8400 = 9600	
7	(d)	Interest on capital 800 +40% of 24000(28000-interest on capital balances of 4000). Ans = 800+9600 = 10400	
8	(c)		
9	(c)		
10	(b)		

Examiner Comments on Question Three

In general, students scored either very highly or very poorly in this question.

Students are encouraged to revise the principles and format of cash flows as this was an area of weakness for those who did not perform well.

Also, take care to answer the question that is asked. Some students gave a lengthy explanation of why cash is needed in a business, rather than why profit does not always equate to cash.

The presentation marks were awarded to the extent that the cash flow format followed the format required by IAS 7.

Solution Three

(a)

GHI Ltd.
Statement of Cash Flows for the year to 31st December 2013

Cash flows from operating activities	**€/£ '000**	**€/£ '000**	**Marks Allocated**
Profit before interest and income tax.	**350**		**1 mark**
As adjusted for:			
Depreciation charge	90		**1**
Loss on sale of non- current assets (Wkg 2)	13		**1**
Profit on sale of non- current asset investments (30-25)	(5)		**1**
Increase in inventories	(48)		**1**
Increase in receivables	(75)		**1**
Increase in payables	8		**1**
Operating cash flows before interest and tax		**333**	
Interest paid		(75)	1
Taxation paid		(130)	1
Net cash flows from operating activities after interest and tax		**128**	
Cash flows from investing activities			
Payments to acquire tangible non -current assets (Wkg.4)	(201)		**1mark**
Payments to acquire intangible non-current assets	(50)		**1**
Receipts from sales of tangible non-current assets	32		**1**
Receipts from sales of non-current assets investments	30		**1**
Interest received			
	25		**1**
Net cash flows from investing activities		**(164)**	
Cash flows from financing activities			
Issue of share capital	60		**1mark**
Long-term loan	120		**1**
Dividends paid	(80)		**1**
Net cash flows from financing		100	
Net movement in cash and cash equivalents		**64**	
Cash & Cash equivalents at 1/1/13 (Wkg.6)		(97)	1 mark
Cash & Cash equivalents at 31/12/13 (Wkg.6)		(33)	1

Solution Three *(Cont'd)*

Workings:

(Wkg. 1)

Depreciation a/c

Disposal	40	Bal b/d (3)	290
Balance c/d	340	CFS *	90
	380		380

(Wkg.2)

Disposal a/c

		Depreciation	40
Non current assets	85	Cash	32
	85	CFS *	13
			85

(Wkg.3)

Taxation a/c

Bank CFS *	130	Balance b/d	110
Balance c/d	120	Inc. Stat	140
	250		250

(Wkg.4)

Tangible Assets

Balance b/d (3)	504	Disposals(2)	85
Additions *	201	Bal c/d(3)	620
	705		705

(Wkg. 5)

Dividends a/c

Cash CFS *	**80**	Balance b/d	**80**
Balance c/d	100	Equity (6)	100
	180		180

(Wk g.6)

Cash and cash Equivalents

At 1/1/2013 Overdraft of 98-positive cash balance of 1 – net (97)
At 31/12/2013 Overdraft of 85 – positive cash balance of 2- short term investments of 50 = 33

Partial marks were awarded for a sound methodology, demonstrated in the workings, even if the resultant figure on the face of the cash flow was incorrect.

2 marks were awarded for presentation of the cash flow in accordance with IAS 7.

Solution Three *(Cont'd)*

(b)

"Profits do not always translate into a positive cash balance at year end" This is because certain items taken into account in computing profit do not involve the movement of cash. Two such examples are depreciation charges and profit on sale of non – current assets. Depreciation is a charge in the Profit and Loss Account to represent the wear and tear on fixed assets by virtue of being used in the business. However no cash leaves the business. When the asset is ultimately replaced cash will at that stage be absorbed by the purchase of the replacement asset. **2 marks for each reason**

A Profit on sale of fixed assets represents in effect a write back of excess depreciation charged in respect of the asset in previous years rather than cash received. Consequently, the profit figure calculated in respect of the disposal which ultimately feeds into the total profit figure will not necessarily be the same as the cash generated from the disposal.

Examiner Comments on Question Four

Part (b) of this question was a challenge to some students and revision of the journal entries required is to be advised.

Also note that some students did not give complete answers in relation to part a) i)

Solution Four

(a)

(i) IAS 2 provides that inventory should be valued at the lower of cost and net realizable value. **1 mark**

Net realizable value NRV is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs of marketing selling and distribution. **1 mark**

Cost includes all costs of purchase including taxes, import duties and transport and handling costs. It also includes all costs of conversion including fixed and variable overheads and other costs incurred in bringing the inventories to their present location and condition. **1 mark**

(ii) The cost of each product is as follows:

	P	Q
	£/€	€/£
Purchase cost	100	200
Delivery costs from supplier	20	30
Import duty	1.20	2.60
Total cost	121.20	232.60

1.5 marks for each calculation

...rks ...d

The NRV of each item is as follows:

	P	Q
	£/€	**€/£**
Selling price	150	295
Sales and marketing costs	(15)	(18)
Delivery costs to customers	(25)	(25)
	110	252

1.5 ma... for each calculation

2 marks for presentation of calculations and conclusion.

Each unit of product P should be valued at €/£110 and each unit of product Q should be valued at €/£232.60.

(iii) Costs specifically excluded:

Abnormal costs and spoilage
Marketing and selling costs
General administration expenses
Factory idle time

1 mark each. This list is not meant to be exhaustive.

(b)

The inventory should be written down to its net realizable value in accordance with IAS 2. Assuming receipt of the insurance claim is certain, provision should be made for the claim of €/£ 150,000 receivable from the insurance company, **2 marks**

Journal

Dr. Cost of Goods Sold: Closing Inventory (SOPL)	€/£300,000		**2 marks**
Cr. Closing Inventory (SOFP)		€/£300,000	
Dr. Sundry Receivable (SOFP)	€/£150,000		
Cr. Cost of Goods sold: Insurance on Inventory		€/£150,000	**2 marks**

Being write down of inventory that was destroyed in the fire and provision for amounts recoverable from the insurance company.

Examiner Comments on Question Five

While students were familiar with the basic IAS 1 format for the Statement of Comprehensive Income, the treatment of the revaluation gain posed some difficulty and students would do well to revise this topic.

In part (b), many students omitted to include the accounting policy note, although the fixed asset note was completed well in most cases.

Solution Five

(a)

Holmes Ltd

Statement of comprehensive income for year to 31st December 2013

Statement of Profit or Loss

	2013	2013	2012	2012	A...
	€/£ '000	€ /£'000			
Revenue		1,432			1 mark
Cost of sales		476			2 marks
Gross Profit		956			
Other operating income		30			1 mark
		986			
Distribution costs	229				2 marks
Admin expenses	601	830			2 marks
Profit from Operations		156			
Finance Costs		9			1 mark
Profit before tax		147			
Income Tax		30			1 mark
Profit for the year		117			
Statement of Other Comprehensive Income					
Other comprehensive income					
Gain on property revaluation		180			2 marks
Total Comprehensive income for the year		297			
					2 Presentation marks were awarded for IAS 1 format

Note 1: Land revaluation	**€/£ '000**
Land per trial balance	120
New valuation	300
Increase in valuation	180

Solution Five *(Cont'd)*

Marks Allocated

Partial marks were awarded for a sound methodology, demonstrated in the workings, even if the resultant figure on the face of the SOCI was incorrect.

Note 2: Depreciation

	€/£ '000	€/£ '000	€/£ '000
Non Current Assets			
Land at valuation			300
Buildings at cost		250	
Depreciation to 31/12/12	90		
Depreciation for year (4%x250)	10	100	150
Equipment at cost		196	
Depreciation to 31/12/12	76		
Depreciation for year (40%x120)	48	124	72
Motor vehicles at cost (284-44)		240	
Depreciation to 31/12/12 (132-33)	99		
Depreciation for year (25%x240)	60	159	81
			603

Disposal of vehicle

Cost	44
Less accumulated depreciation (3 year@25%)	33
Net book value at date of disposal	11
Proceeds received	10
Loss on disposal	1

Note 4: Bad debt & allowance for receivables

Receivables per trial balance	183
Less bad debt write off	8
	175
Allowance for receivables	8
New allowance (175 @ 4%)	7
Decrease in allowance	1

Note 6: Finance costs

Loan interest reduce admin exp and show separately as finance cost

Solution Five *(Cont'd)*

Note 7: Split of Expenses

	Dist	**Admin**
Per trial balance	101	186
Wages & salaries	69	207
Buildings depreciation	5	5
Equipment depreciation	12	36
Vehicles depreciation	42	18
Loss on disposal		1
Bank overdraft interest		-9
Director's fees		150
Bad debt		8
Reduction in allowance for rec.		-1
	229	601

(b)

Accounting Policies

Non Current Assets

Non current assets other than land are stated at cost less accumulated depreciation.

Depreciation is calculated so as to write off the cost of the assets over their useful lives as follows;

3 marks for accounting policy

Buildings	4% straight line
Equipment	40% Reducing Balance
Vehicles	25% Straight line

Land is stated at valuation. The company's valuers valued the land at 31 December 2013 and this valuation is incorporated in the financial statements

Solution Five *(Cont'd)*

Notes to the Financial Statements

	Land	Blds	Equipment	Vehicles	Total
Opening Cost or valuation	120000	250000	196000	284000	850000
Additions					
Disposals				-44000	-44000
Revaluation surplus	180000				180000
Closing cost or valuation	300000	250000	196000	240000	986000
Opening depreciation		90000	76000	132000	298000
Dep. On disposals				-33000	-33000
Charge for the year		10000	48000	60000	118000
		100000	124000	159000	383000
NBV 31 December 2013	300000	150000	72000	81000	603000
NBV 31 December 2012	120000	160000	120000	152000	552000

Al

3 marks for PPE note.

Students could have included an intangible assets note but no marks were lost if this was omitted.

Examiner Comments on Question Six

This was not a popular question, but those that did answer it generally scored well. The challenges were in sections 1 and 4. In section 1, students in general gave only one of the two possible treatments for the government grant. In section 4, students in the main, treated the fire as an adjusting rather than a non – adjusting event.

Presentation marks were awarded for the report format

Solution Six

(a)

Report format

Marks Allocated

2 marks for report format

Title: Report to the Board of Directors of Johnston Ltd on the financial accounting issues for the year ended 31st December 2013

Date: 31st January 2013

Introduction:

We have examined the accounting issues you raised with us in relation to the financial statements for the year ended 31 December 2013 and as requested, this report sets out the recommended accounting treatment of each of the matters raised, in line with international accounting standards.

Marks Allocated

(1): Treatment of grant received to purchase new machine
(2): Treatment of bad debt
(3): Treatment of employee law suit
(4): Treatment of the loss of stock due to a fire after the year end date.

Main Body:

(1)

IAS 20 provides guidance on the treatment of Government grants. It permits two alternate methods for accounting for grants received/ receivable on non – current assets.

Method 1: Reduce purchase price of asset by the amount of the grant received and depreciate the balance over the remaining useful life of the asset

Income Statement extract for year ended 31/12/13

Depreciation			40,000

Statement of financial position extract as at 31/12/13

	Cost	Dep	NBV
Non – current assets	200,000	40,000	160,000

2 marks

Method 2: Treat the grant as a deferred credit in the statement of financial position and transfer a portion to the income statement in each period over the expected useful life of the asset involved

Income Statement extract for year ended 31/12/13

Depreciation	60,000
Other operating income (grant)	20,000

2 marks

Statement of financial position extract as at 31/12/13:

	Cost	Dep	NBV
Non Current Assets	300,000	60,000	240,000
Non- current Liabilities			
Deferred income (Government grant)			80,000

Note:
Both methods have the same net effect in the financial statements. However, while IAS 20 permits either method, the Companies Acts recommend Method 2.

Solution Six *(Cont'd)*

(2)

This is "an event after the reporting period" as defined in IAS 10. It is an event, either favourable or unfavourable, which occurs between the statement of financial position date and the date on which the financial statements are authorised for issue. They may be either adjusting or non-adjusting in nature. The IAS states that: **2 ma**

- an enterprise should adjust its financial statements for events after the statement of financial position date that provide further evidence of conditions that existed at the end of the reporting period.
- an enterprise should not adjust its financial statements for events after the statement of financial position date that are indicative of conditions that arose after the statement of financial position date;

The insolvency of a debtor (trade account receivable)is an adjusting event, on the grounds that it provides additional evidence of a condition existing at the statement of financial position date. Hence a provision for this bad debt should be made in the financial statements.

(3)

2 marks

IAS 37 defines a contingent liability as:

- A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the enterprise's control
- If an obligation is probable it is not a contingent liability and a provision should be made.

An entity should never recognise a contingent liability. The IAS requires a contingent liability to be disclosed unless the possibility of any outflow of economic benefits to settle it is remote.
As the claim is unlikely to succeed, the potential settlement of €/£150,000 should be disclosed as a contingent liability. However, given that the legal costs of €/£25,000 must be paid whether the claim is successful or not, this amount should be provided for in the 2013 financial statements.

(4)

As in part B above, this is "an event after the reporting period" as defined in IAS 10. The fire in the company's warehouse is however a non adjusting event as it took place after the year end and the inventory was effectively undamaged at the year- end date. Accordingly the inventory should continue to be stated at cost of €/£75,000 in the year- end financial statements. However, a note to the financial statements should disclose the incidence of the fire and the effect of the damage (€/£55,000) caused to the inventory. **2 marks**

Conclusion:

I hope this report clarifies the appropriate accounting treatment of the issues identified, however if there are any queries please do not hesitate to contact me.

Signed: ______________
An Accountant

Solution Six *(cont'd)*
(b)

Journal Entries

Allo...

(1) Method 1

1 mark

Dr. Machinery	300,000
Cr. Bank	300,000
Dr. Bank	100,000
Cr. Machinery	100,000

Dr. Income Statement	40,000 (depreciation)
Cr. Prov for depreciation	40,000

Being grant received netted off against fixed asset cost. Depreciation calculated on net amount.

Or

Method 2

Dr. Machinery	300,000
Cr. Bank	300,000
Dr. Bank	100,000
Cr. Deferred Grant (SOFP)	100,000
Dr Deferred Grant (SOFP)	20,000
Cr Income Statement	20,000
Dr Income Statement	60,000 (depreciation)
Cr Prov. For Depreciation	60,000

2 marks

Being grant received credited to income over the useful life of the asset. Depreciation calculated of gross cost.

(2) Dr Bad Debts a/c 75,000
Cr. Receivable a/c 75,000

Being bad debt written off

2 marks

(3) Dr Legal costs 25,000
Cr Sundry Creditors 25,000

Being provision for legal costs in relation to employee legal case

2 marks

(4) No journal required.