UK STANDARDS UK STANDARDS UK STANDARDS UK STANDARDS UK STANDARDS

Intermediate Level

Financial Accounting – UK Accounting Standards

6a

IFNA

19 November 2003

Wednesday morning

INSTRUCTIONS TO CANDIDATES

Read this page before you look at the questions

You are allowed three hours to answer this question paper.
This question paper is based on UK ACCOUNTING STANDARDS. If you require the paper based on International Accounting Standards, please speak immediately to the invigilator.
Answer the ONE question in section A (this has 10 sub-questions). Answer the ONE question in section B. Answer TWO questions ONLY from section C.
Write your examination number, your contact ID and your name on a double-sided card, which must be attached to your answer book. Write IFNA on the line marked "Subject" on the front of the answer book. Write your examination number on the special answer sheet for section A, which is included with this question paper booklet. Detach the sheet from the booklet and insert it into your answer book before you hand this in.
Do NOT write your name or your contact ID anywhere on your answer book.
Tick the appropriate boxes on the front of the answer book to indicate which questions you have answered.

SECTION A – 20 MARKS

ANSWER *ALL* TEN SUB-QUESTIONS – 2 MARKS EACH

Each of the sub-questions numbered from **1.1** to **1.10** inclusive, given below, has only ONE correct answer.

REQUIRED:

On the SPECIAL ANSWER SHEET opposite, place a circle "O" around the letter that gives the correct answer to each sub-question.

If you wish to change your mind about an answer, block out your first answer completely and then circle another letter. You will not receive marks if more than one letter is circled.

Please note that you will not receive marks for any workings to these sub-questions.

You must detach the special answer sheet from the question paper and attach it to the inside front cover of your answer book before you hand it to the invigilators at the end of the examination.

Question One

1.1 A sub-committee of the Accounting Standards Board (ASB) is known as the UITF.

What does UITF stand for?

A Urgent International Task Force

B Undecided Issues Task Forum

C Urgent Issues Task Force

D Urgent Issues Task Forum

1.2 The ASB's *Statement of Principles for Financial Reporting* (SoP) lists the qualitative characteristics of financial statements.

Which THREE of the following are NOT included in the main qualitative characteristics listed by the SoP?

(i) Comparability
(ii) Relevance
(iii) Prudence
(iv) Reliability
(v) Understandability
(vi) Matching
(vii) Consistency

A (i), (iii) and (vii)

B (i), (ii) and (v)

C (iii), (vi) and (vii)

D (iii), (iv) and (vi)

Financial Accounting – UK Standards

NOVEMBER 2003 EXAMINATION

SPECIAL ANSWER SHEET FOR SECTION A

Write here your full examination number:				
Centre Code				
Hall Code				
Desk Number				

1.1	**A**	**B**	**C**	**D**
1.2	**A**	**B**	**C**	**D**
1.3	**A**	**B**	**C**	**D**
1.4	**A**	**B**	**C**	**D**
1.5	**A**	**B**	**C**	**D**
1.6	**A**	**B**	**C**	**D**
1.7	**A**	**B**	**C**	**D**
1.8	**A**	**B**	**C**	**D**
1.9	**A**	**B**	**C**	**D**
1.10	**A**	**B**	**C**	**D**

You must detach the special answer sheet from the question paper and attach it to the inside front cover of your answer book before you hand it in to the invigilators at the end of the examination.

1.3 Which of the following is NOT regarded as a related party of a company by FRS 8 – *Related party disclosures*?

A Directors of the company.

B A bank providing a loan to the company.

C The company's employee pension fund.

D A close relative of a director of the company.

1.4 SSAP 17 – *Post balance sheet events* classifies post balance sheet events as adjusting and non-adjusting.

Which of the following is an adjusting event?

A One month after the year end, a customer lodged a claim for £1,000,000 compensation. The customer claimed to have suffered permanent mental damage as a result of the fright she had when one of the company's products malfunctioned and exploded. The outcome of the court case cannot be predicted at this stage.

B There was a dispute with the workers and all production ceased one week after the year end.

C A fire destroyed all of the company's stock in its finished goods warehouse two weeks after the year end.

D Stock valued at the year end at £20,000 was sold one month later for £15,000.

1.5 B plc, a listed company, has 5,000,000 issued ordinary shares with a par value of 20 pence each. There were no movements of issued share capital during the year. B plc had the following results for the year ended 30 April 2003:

	£000
Profit before taxation	400
Taxation	100
Profit after taxation	300
Dividends paid	200
Retained profit	100

The quoted price of B plc shares on 30 April 2003 was £1·50.

B plc's P/E ratio on this date was

A 5

B 15

C 18·75

D 25

1.6 X Ltd signed a finance lease agreement on 1 October 2002. The lease provided for five annual payments, in arrears, of £20,000. The fair value of the asset was agreed at £80,000.

Using the sum of digits method, how much should be charged to the profit and loss account for the finance cost in the year to 30 September 2003?

A £4,000

B £6,667

C £8,000

D £20,000

1.7 D Ltd purchased a fixed asset on 1 April 2000 for £200,000. The asset attracted writing down allowances at 25% on the reducing balance. Depreciation was 10% on the straight-line basis. Assume corporation tax is at 30%.

The deferred tax balance for this asset at 31 March 2003 is

A £9,000

B £16,688

C £27,000

D £55,625

1.8 C Ltd started work on a contract to build a dam for a hydro-electric scheme. The work commenced on 24 August 2001 and is scheduled to take four years to complete. C Ltd recognises profit on the basis of the certified percentage of work completed. The contract price is £10 million.

An analysis of C Ltd's records provided the following information:

Year to 30 September	*2002*	*2003*
Percentage of work completed and certified in year	30%	25%
	£000	*£000*
Total cost incurred during the year	2,900	1,700
Estimated cost of remaining work to complete contract	6,000	3,900
Total payments made for the cost incurred during the year	2,500	2,000

How much profit should C Ltd recognise in its profit and loss account for the years ended

	30 September 2002 *£000*	*30 September 2003* *£000*
A	100	375
B	330	375
C	330	495
D	500	825

1.9 F Ltd's year end is 30 June. F Ltd purchased an asset for £50,000 on 1 July 2000.

Depreciation was provided at the rate of 20% per annum on the straight-line basis. There was no forecast residual value.

On 1 July 2002, the asset was revalued to £60,000 and then depreciated on a straight-line basis over its remaining useful economic life which was unchanged. On 1 July 2003, the asset was sold for £35,000.

In addition to the entries in the fixed asset account and provision for depreciation account, which TWO of the following statements correctly record the entries required on disposal of the asset?

(i) Debit profit and loss account with a loss on disposal of £5,000.

(ii) Credit profit and loss account with a gain on disposal of £25,000.

(iii) Transfer £60,000 from revaluation reserve to profit and loss reserve as a movement on reserves.

(iv) Transfer £30,000 from revaluation reserve to profit and loss reserve as a movement on reserves.

(v) Transfer £30,000 from revaluation reserve to profit and loss account.

(vi) Transfer £60,000 from revaluation reserve to profit and loss account.

A (i) and (iv)

B (ii) and (iii)

C (i) and (v)

D (ii) and (vi)

1.10 S plc announced a rights issue of 1 for every 5 shares currently held, at a price of £2 each. S plc currently has 2,000,000 £1 ordinary shares with a quoted market price of £2·50 each. Directly attributable issue costs amounted to £25,000.

Assuming all rights are taken up and all money paid in full, how much will be credited to the share premium account for the rights issue?

A £200,000

B £308,333

C £375,000

D £400,000

(Total = 20 marks)

End of section A

SECTION B – 30 MARKS

ANSWER THIS QUESTION

Question Two

Hi plc, listed on its local stock exchange, is a retail organisation operating several retail outlets countrywide. A reorganisation of the company was started in 2002 because of a significant reduction in profits. This reorganisation was completed during the current financial year.

The trial balance for Hi plc at 30 September 2003 was as follows:

	£000	£000
10% debentures 2010		1,000
Administrative expenses	615	
Bank and cash	959	
Buildings	11,200	
Cash received on disposal of equipment		11
Cost of goods sold	3,591	
Debenture interest paid – half year to 31 March 2003	50	
Debtors	852	
Distribution costs	314	
Equipment and fixtures	2,625	
Fixed asset investments at market value 30 September 2002	492	
Interim dividend paid	800	
Investment income received		37
Ordinary shares of £1 each, fully paid		4,000
Profit and loss account at 30 September 2002		1,390
Provision for deferred tax		256
Provision for reorganisation expenses at 30 September 2002		1,010
Provisions for depreciation at 30 September 2002:		
Buildings		1,404
Equipment and fixtures		1,741
Reorganisation expenses	900	
Revaluation reserve		172
Sales		9,415
Share premium		2,388
Stock at 30 September 2003	822	
Trade creditors		396
	23,220	23,220

Additional information provided:

(i) The reorganisation expenses relate to a comprehensive restructuring and reorganisation of the company that began in 2002. Hi plc's financial statements for 2002 included a provision for reorganisation expenses of £1,010,000. All costs had been incurred by the year end, but an invoice for £65,000, received on 2 October 2003, remained unpaid and is not included in the trial balance figures. No further restructuring and reorganisation costs are expected to occur and the provision is no longer required.

(ii) Fixed asset investments are carried in the financial statements at market value. The market value of the fixed asset investments at 30 September 2003 was £522,000. There were no movements in the investments held during the year.

(iii) On 1 November 2003, Hi plc was informed that one of its debtors, X Ltd, had ceased trading. The liquidators advised Hi plc that it was very unlikely to receive payment of any of the £45,000 due from X Ltd at 30 September 2003.

(iv) One of Hi plc's customers is suing the company for damages as a consequence of a faulty product. Legal advisers are currently advising that the probability of Hi plc being found liable is 75%. The amount payable is estimated to be the full amount claimed of £100,000.

(v) The corporation tax for the year ended 30 September 2003 is estimated at £1,180,000 and the deferred tax provision needs to be increased to £281,000.

(vi) A final dividend of 20p per share is being proposed by the directors.

(vii) During the year, Hi plc disposed of old equipment for £11,000. The original cost of this equipment was £210,000 and accumulated depreciation at 30 September 2002 was £205,000. Hi plc's accounting policy is to charge no depreciation in the year of disposal.

(viii) Depreciation is charged using the straight-line basis on fixed assets as follows:

Buildings	3%
Equipment and fixtures	20%

Depreciation is regarded as a cost of sales.

(ix) On 1 April 2003, Hi plc made a rights issue of 1 new share for 4 existing shares, at a price of £3. The fair value immediately before the rights issue was £4·25 per share. All the rights were taken up and all money paid by 30 September 2003.

Required:

(a) Prepare the profit and loss account for Hi plc for the year to 30 September 2003 and a balance sheet at that date, in a form suitable for publication and in accordance with all current regulations.

Notes to the financial statements are NOT required, but all workings must be clearly shown. DO NOT prepare a statement of accounting policies or a statement of total recognised gains and losses.

(20 marks)

(b) Prepare a reconciliation of movements in shareholders' funds for Hi plc for the year ended 30 September 2003.

(5 marks)

(c) Calculate Hi plc's earnings per share for the year ended 30 September 2003.

(5 marks)

(Total = 30 marks)

End of section B

SECTION C – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

(a) A Ltd purchased a site on the edge of a city and built a large new retail outlet there. A Ltd has now transferred its retail business from the city centre site to the new site. The former retail unit, on the city centre site, is surplus to requirements and A Ltd is trying to sell it. At 31 October 2003, a buyer had not been found. A Ltd's accounting policy is to carry property in its financial statements at current value.

At 31 October 2003, the property values were:

New retail outlet:	*£000*
Cost of land plus construction cost	900
Existing use valuation at 31 October 2003	1,000
Open market valuation at 31 October 2003	1,200
Former retail unit:	
Valuation at 31 October 2003	400
Existing use valuation at 31 October 2003	600
Open market valuation at 31 October 2003	1,200

Required:

State, with reasons, the valuations that A Ltd should use in its financial statements at 31 October 2003 in respect of each of these properties.

(5 marks)

(b) C plc owns a number of buildings, factories, offices and warehouses. C plc's accounting policy is not to revalue any fixed assets; all fixed assets are carried at depreciated historical cost.

A firm of independent valuers carried out a valuation of all the buildings on 30 June 2003. The results for three properties are given in the table below; all other properties were broadly similar in value to their net book values.

	Net book value	*Open market value*	*Existing use value*
	£000	*£000*	*£000*
Factory	2,300	1,400	1,600
Office	1,000	1,500	1,800
Warehouse	1,500	2,000	1,750
Totals	4,800	4,900	5,150

C plc's directors do not intend changing the carrying values of any of the buildings as their total open market value and existing use value are both greater than total net book value.

C plc's external auditors have indicated that they are unhappy with the directors' proposed treatment of the buildings.

Required:

(i) Explain why C plc's external auditors may be unhappy with the proposal to leave the value of the three buildings at £4,800,000 at 30 June 2003. Your explanation should refer to relevant Accounting Standards.

(7 marks)

(ii) Calculate the figures that should appear in respect of the three buildings in C plc's financial statements for the year ended 30 June 2003. Ignore depreciation.

(3 marks)

(iii) Explain the action that the external auditors could take if the directors pursue their view and use the current net book value of the three buildings (£4,800,000) in the financial statements at 30 June 2003.

(3 marks)

(iv) After the external auditors have done everything they can to dissuade them, the directors still intend to publish the company's financial statements using the current net book value of the three buildings (£4,800,000).

Explain the role of the Financial Reporting Review Panel (FRRP) and how it might relate to this situation.

(7 marks)

(Total = 25 marks)

Question Four

The following are the financial statements of B Ltd for the period 1 October 2001 to 30 September 2003:

Balance sheets at 30 September	*2003*		*2002*	
	£000	*£000*	*£000*	*£000*
Fixed assets:				
Intangible assets		550		470
Tangible assets		3,260		1,630
Investments		400		260
		4,210		2,360
Current assets:				
Stock	515		360	
Debtors	1,000		950	
Investments	315		100	
Bank	650		370	
	2,480		1,780	
Creditors amounts falling due within one year:				
Trade creditors	784		773	
Taxation	140		74	
Proposed dividend	320		200	
Bank loans and overdrafts	950		528	
	2,194		1,575	
Net current assets:		286		205
Total assets less current liabilities:		4,496		2,565
Creditors amounts falling due after more than one year:				
10% debentures 2003/2006		251		979
		4,245		1,586
Capital and reserves				
Ordinary shares of £1 each		325		150
Share premium		2,300		900
Revaluation reserve		1,339		350
Profit and loss account		281		186
		4,245		1,586

Profit and loss accounts for the year to 30 September

	2003		*2002*	
	£000	*£000*	*£000*	*£000*
Turnover		3,920		3,730
Cost of sales		(2,743)		(2,703)
Gross profit		1,177		1,027
Administrative expenses	(308)		(290)	
Distribution costs	(184)	(492)	(157)	(447)
Operating profit		685		580
Interest receivable	31		24	
Interest payable	(191)	(160)	(170)	(146)
Profit before tax		525		434
Taxation		(110)		(71)
Profit after tax		415		363
Proposed dividend		(320)		(200)
Retained profit		95		163

On 1 October 2002, the company made a new issue of ordinary shares at £9 per share. Part of the issue proceeds was used to purchase new equipment which became operational from 1 June 2003.

As the trainee management accountant, you have been asked to draft a briefing paper for the company Chairman to use to respond to possible questions from the shareholders regarding the performance of B Ltd between 2002 and 2003.

Required:

Prepare the briefing paper specified above.

Your paper should cover the following aspects of performance:

(i) Profitability

(13 marks)

(ii) Liquidity and efficiency

(5 marks)

(iii) Financial structure

(7 marks)

(Total = 25 marks)

Question Five

(a) Z plc acquired the business and assets of Q, a sole trader, on 31 October 2002.

The fair value of the assets acquired from Q were:

	£000
Intangible fixed assets	
Brand X – brand name	220
Tangible fixed assets	
Plant and equipment	268
Stock	5
	493
Cash paid to Q	523

Z plc spent the following amounts creating and promoting the Brand Z brand name:

Year to 31 October 2000	£100,000
Year to 31 October 2001	£90,000
Year to 31 October 2002	£80,000

Z plc's accounting policy on recognised intangible fixed assets is that goodwill and brand names are amortised over 10 years.

On 31 October 2003, Z plc's brand names were valued by an independent valuer as follows:

Brand X at £250,000

Brand Z at £300,000

The directors of Z plc have been very impressed with the increase in profits from Q's former business. They are certain that the goodwill has increased since they acquired Q's business. Z plc's directors have estimated that the goodwill is worth £45,000 at 31 October 2003.

Required:

Explain how Z plc should treat:

(i) the brand names;

(9 marks)

(ii) goodwill;

(6 marks)

in its financial statements for the years ended 31 October 2002 and 2003. Your explanation should include reference to relevant Accounting Standards.

(b)

Y Ltd provides packaging products to mail order and internet retailers. Y Ltd is the market leader in its sector and is trying to keep ahead of the competition by researching new packaging products. Y Ltd is about to launch a new type of packaging on to the market. The new product is expected to be commercially viable and Y Ltd has sufficient resources for the foreseeable future.

Y Ltd has developed this product from original research started three years ago. The research and development had three phases:

- Phase 1 – July 2000 to May 2001 – pure research into possible new types of material. Carried out by a local university department at a cost of £75,000.

- Phase 2 – June 2001 to April 2002 – consultancy fees incurred for the investigation of the commercial possibilities of the newly discovered material. Fees incurred £192,000.

- Phase 3 – June 2002 to May 2003 – costs of developing the product and preparing for product launch, £223,000.

The second phase, investigating the commercial possibilities of the newly discovered material, attracted a 50% government grant. All conditions attached to the grant were fully complied with during the year ended 30 May 2002.

Required:

Explain how Y Ltd should treat the research and development costs and government grant in its financial statements for the years ended 31 May 2001, 2002 and 2003. Your explanation should include reference to relevant Accounting Standards.

(10 marks)

(Total = 25 marks)

Question Six

The financial statements of YZ Ltd are given below.

Balance sheets at	*30 September 2003*		*30 September 2002*	
	£000	*£000*	*£000*	*£000*
Tangible fixed assets:		634		510
Current assets:				
Stock	420		460	
Debtors	390		320	
Interest receivable	4		9	
Investments	50		0	
Bank	75		0	
Cash	7		5	
	946		794	
Creditors: amounts falling due within one year:				
Bank overdraft	0		70	
Trade creditors	550		400	
Corporation tax	100		90	
Dividends	30		0	
Interest payable	6		33	
	686		593	
Net current assets		260		201
Total assets less current liabilities		894		711
Creditors: amounts falling due after more than one year:				
10% debentures		0		40
5% debentures		329		349
		565		322
Capital and reserves:				
Ordinary shares £0·50 each		363		300
Share premium account		89		92
Revaluation reserve		50		0
Profit and loss account		63		(70)
		565		322

Profit and loss account for the year to 30 September 2003

	£000	£000
Turnover		2,900
Cost of sales		(1,734)
Gross profit		1,166
Administrative expenses	(342)	
Distribution costs	(520)	(862)
Operating profit		304
Interest receivable	5	
Interest payable	(19)	(14)
Profit before tax		290
Taxation		(104)
Profit after tax		186
Dividends		(53)
Retained profit		133

Additional information:

1. On 1 October 2002, YZ Ltd issued 60,000 £0·50 ordinary shares at a premium of 100%. The proceeds were used to finance the purchase and cancellation of all its 10% debentures and some of its 5% debentures, both at par. A bonus issue of one for ten shares held was made on 1 November 2002; all shares in issue qualified for the bonus.
2. The current asset investment was a 30-day government bond.
3. Tangible fixed assets include certain properties which were revalued in the year.
4. Tangible fixed assets disposed of in the year had a net book value of £75,000; cash received on disposal was £98,000.
5. Depreciation charged for the year was £87,000.

Required:

(a) Prepare the following for YZ Ltd for the year ended 30 September 2003, in accordance with FRS 1 – *Cash flow statements*:

(i) a reconciliation of operating profit to net cash inflow from operating activities;

(4 marks)

(ii) a cash flow statement;

(14 marks)

(iii) an analysis of changes in net debt.

(3 marks)

(b) Briefly explain the usefulness of cash flow information to shareholders.

(4 marks)

(Total = 25 marks)

End of paper