FINANCIAL REPORTING

Certificate stage examination

6 June 2008

From 10.00am to 1.00pm
plus ten minutes reading time from 9.50am to 10.00am

Instructions to candidates

*There are **five** questions on this question paper*

*Answer **four** questions in total*

Both compulsory** questions from **Section A
Two** of the three questions from **Section B

*The questions in Section A carry, in total, **60** marks*
*The questions in Section B carry, in total, **40** marks*

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

Proforma income statement, balance sheet, cash flow statement and statement of changes in equity are appended to this paper and may be submitted as part of an answer.

AT THE HEART OF
YOUR CAREER

SECTION A (Compulsory – answer both questions)

1

The following list of balances was taken from the accounts of Troklanz plc as at 31 May 2008, the end of its most recent financial year:

Troklanz plc

List of balances as at 31 May 2008

	Notes	£000
Ordinary share capital (50 pence shares)	*1*	132,000
Share premium account		104,000
Revaluation reserve		11,400
Retained earnings, at 1 June 2007 (debit balance)		78,945
Sales		644,500
Cost of sales		522,000
Inventory, 31 May 2008	*2*	65,300
Administrative expenses		45,100
Distribution costs		51,600
Dividends paid		20,600
Other operating income		2,280
Corporation tax	*3*	155
Non-current investments	*4*	15,460
Properties at cost:		
Land		12,000
Buildings		48,000
Plant and machinery, at cost	*5*	135,980
Accumulated depreciation, at 1 June 2007:	*6*	
Buildings		10,800
Plant and machinery	*5*	73,400
Franchises and licences, at valuation	*7*	14,300
Investment income		1,700
Interest paid		3,700
Proceeds of sale of non-current assets	*5*	3,750
Trade receivables		64,500
Trade payables		74,600
Allowance for doubtful debts, 1 June 2007	*8*	1,300
Bank loan due for repayment on 1 May 2009		4,000
Bank loan due for repayment on 31 May 2010		14,500
11% Debentures		12,500
Bank and cash		13,400

The following additional information is available:

1) In June 2007 Troklanz plc made a bonus issue of 1 ordinary share for every 2 held. In April 2008 Troklanz plc made a rights issue of 1 ordinary share for every 10 in issue. The issue price was £1.60 a share and the issue was fully subscribed and paid by 31 May 2008. These share issues have been correctly recorded in the accounts.

2) Inventory as at 31 May 2008 includes items which were included at their cost of £2,455,000. These items should have been written down to their scrap value of £135,000.

3) The balance on the corporation tax account represents an overprovision for corporation tax for the financial year ended 31 May 2007. Corporation tax for the year ended 31 May 2008 has been estimated at £960,000.

4) Non-current asset investments are reported at their market value. They include investments which were purchased for £1,240,000 and valued at £1,620,000 at 31 May 2007. These are now to be written down to £910,000 to recognise a permanent diminution in value.

5) During the year ended 31 May 2008 machinery was sold for £3,750,000. This machinery cost £19,850,000 and had been depreciated by £15,430,000. The proceeds have been recorded in the accounts, but no other entries have been made.

6) Depreciation for the year ended 31 May 2008 has not yet been charged. Troklanz plc's depreciation rates are:

   Property: 2.5% per year using the straight line method
   Plant and equipment: 25% per year using the diminishing balance method.

   Depreciation is charged on a full year basis.

7) Troklanz plc uses the revaluation model as permitted by IAS 38 *Intangible Assets* for the reporting of franchises and licences. The fair value of franchises and licences was £14,300,000 as at 1 June 2007 and £16,000,000 as at 31 May 2008. The cost of franchises and licences as at 1 June 2007 was £15,000,000 and there were no purchases or acquisitions or disposals of franchises and licences during the year ended 31 May 2008.

8) Based on past experience, the allowance for doubtful debts is to be adjusted to 3% of trade receivables at 31 May 2008.

- **Requirement for question 1**

(a) Prepare Troklanz plc's balance sheet as at 31 May 2008 in accordance with IAS 1 *Presentation of Financial Statements*.

Note:
- Supportive disclosure notes are not required.
- Retained earnings should be entered as a balancing figure. *16*

(b) Prepare a statement of changes in equity for Troklanz plc for the year ended 31 May 2008 in accordance with IAS 1 *Presentation of Financial Statements*. *14*

(30)

2

(a) In question 1, franchises and licences were reported using the revaluation model as permitted by IAS 38 *Intangible Assets*. However, in practice it is unusual for companies to use the revaluation model to report intangible assets.

- **Requirement for question 2 (a)**

Explain why it is unusual for companies to use the revaluation model to report intangible assets. *5*

(b) The following key performance indicators and financial ratios have been extracted from the most recent financial statements of a UK retail company.

	Financial years ended 31 December				
Key performance indicators:	**2003**	**2004**	**2005**	**2006**	**2007**
Total sales growth	11.40%	7.80%	10.60%	6.10%	3.40%
Like for like sales growth (*)	6.50%	6.40%	5.10%	4.20%	0.45%
Total number of stores	559	617	646	661	670
Capital expenditure	£40.5m	£30.8m	£26.2m	£39.8m	£31.0m
Earnings before interest and tax	£35.7m	£38.6m	£45.1m	£46.6m	£40.4m
Earnings per share (basic)	212.2p	241.2p	276.3p	280.5p	257.0p

Financial ratios:	**2006**	**2007**
Gross margin	61.9%	62.0%
Distribution costs to sales	46.3%	48.3%
Administration costs to sales	6.7%	6.7%
Operating profit to sales	8.8%	7.0%
Finance income to sales	0.58%	0.29%
Finance expense to sales	0.02%	0.02%
Net profit after tax to sales	6.4%	4.9%
Return on equity	18.8%	18.7%
Equity to total assets	67.2%	63.4%
Current ratio (to 1)	1.3	0.7
Quick ratio (acid test ratio) (to 1)	1.2	0.5
Cash and cash equivalents at 31 December (£000)	65,602	19,585

* 'Like for like sales growth' is calculated for key stores which are regarded as representative of the company's core business and which were all owned and operated by the company throughout the five year period.

- **Requirement for question 2 (b)**

Write a report for a current investor in the company reviewing the progress of the company as evidenced by the information on the previous page. *25*

(30)

SECTION B (Answer two from three questions)

3

The following are the summarised income statements of two companies, Marie plc and Blanche plc, for the financial year ended 31 May 2008:

Income Statements
for the year ended 31 May 2008

	Marie plc	**Blanche plc**
	£m	**£m**
Revenue	355.0	300.0
Cost of sales	(195.3)	(165.0)
Gross Profit	159.7	135.0
Distribution costs	(35.5)	(15.0)
Administrative expenses	(53.3)	(30.0)
Operating profit	70.9	90.0
Income from investments	39.0	0.0
Net profit	109.9	90.0
Income tax expense	(33.0)	(27.0)
Net profit after taxation	76.9	63.0

The following additional information is available:

1) Marie plc has owned 70% of the ordinary share capital in Blanche plc since 2004. Each ordinary share in Blanche plc carries one vote and there are no other voting rights in, or shares issued by, Blanche plc.

2) During the year ended 31 May 2008 Marie plc paid dividends of £30m and Blanche plc paid dividends of £40m.

3) During the year ended 31 May 2008 Marie plc made sales to Blanche plc of £120m. These goods cost Marie plc £68m. Blanche plc had resold 75% of these goods by 31 May 2008.

4) There has been no impairment of goodwill arising on consolidation during the year ended 31 May 2008.

- **Requirement for question 3**

(a) Prepare the consolidated income statement of Marie plc for the year ended 31 May 2008. *17*

(b) Show how the group profit for the year and dividends would be reported in Marie plc's consolidated statement of changes in equity for the year ended 31 May 2008. *3*

(20)

4

(a) The capital structure of Noyce plc as at 1 June 2007 consisted of 20,000,000 ordinary shares of 40 pence each, fully paid. On 30 September 2007 Noyce plc made a 1 for 5 rights issue at £3.50 per ordinary share. These shares qualified for all dividends paid by Noyce plc after 31 May 2007. The fair value of Noyce plc's ordinary shares immediately before the rights issue was £4.05 per share, and the average share price for the year ended 31 May 2008 was £4.42.

In addition, some of Noyce plc's directors have been granted options to purchase 2,000,000 ordinary shares at £3 per share on 31 May 2009.

Noyce plc's profit on ordinary activities before taxation was £13,397,000 for the year ended 31 May 2008 and the taxation charge in the income statement was £5,320,000. Dividends paid during the year ended 31 May 2008 totalled £3,600,000.

- **Requirement for question 4 (a)**

Calculate the following earnings per share figures for Noyce plc for the financial year ended 31 May 2008:

(i) basic earnings per share; *12*

(ii) diluted earnings per share. *4*

(b) Noyce plc makes the following disclosure in its statement of accounting policies in its financial statements:

Employee benefits:

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement when they arise.

(ii) Defined benefit plans

The company's obligation in respect of defined benefit pension plans is calculated by estimating the amount of the future benefit that employees have earned in return for their service in the current and prior years. That benefit is discounted to determine its present value and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AA credit rated bonds that have maturity dates approximating to the terms of the company's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

The company recognises actuarial gains and losses in full in the year in which they occur in the statement of recognised income and expense.

- **Requirement for question 4 (b)**

(i) Distinguish between a defined contribution scheme and a defined benefit scheme. *2*

(ii) Describe what is meant by the 'projected unit credit method'. *2*

(20)

5

The following draft financial statements are available for Sipfalor plc for the year ended 31 May 2008:

Sipfalor plc
Balance sheets as at 31 May

		2008		***2007***
ASSETS				
Non-current assets	**£**	**£**	**£**	**£**
At cost		81,535,730		57,754,170
less Accumulated depreciation		16,677,788		12,687,297
		64,857,942		45,066,873
Current assets				
Inventory	412,350		389,500	
Trade receivables	558,400		467,800	
Other current assets	2,560		1,540	
Cash and cash equivalents	2,702,204		64,640	
		3,675,514		923,480
Total assets		68,533,456		45,990,353
EQUITY AND LIABILITIES				
Equity				
Issued share capital		35,000,000		20,000,000
Share premium		5,500,000		1,500,000
Revaluation reserve		1,000,000		800,000
Retained earnings		18,421,923		17,696,753
Total equity		59,921,923		39,996,753
Non-current liabilities				
Debentures		7,500,000		5,000,000
Deferred tax		359,800		289,500
Total non-current liabilities		7,859,800		5,289,500
Current Liabilities				
Trade payables		409,800		309,800
Other payables		5,140		4,560
Current tax payable		336,793		389,740
Total current liabilities		751,733		704,100
Total liabilities		8,611,533		5,993,600
Total equity and liabilities		68,533,456		45,990,353

Sipfalor plc
Income Statement for the year ended 31 May 2008

	£
Revenue	43,380,756
Cost of sales	(25,050,812)
Gross profit	18,329,944
Operating expenses	(15,833,481)
Operating profit	2,496,463
Interest paid	(812,500)
Profit before tax	1,683,963
Taxation	(278,793)
Profit for the year	1,405,170

The following additional information for the year ended 31 May 2008 is available:

1) Dividends paid during the year were £680,000.

2) Non-current assets which had cost £332,100 and which had a carrying value of £55,940 was sold for £45,000. Any surpluses or deficits on the disposal of non-current assets have been included in the depreciation charge for the year. Other movements in non-current assets are due to purchases of new assets and revaluations.

3) 'Other current assets' consists of prepaid insurance. 'Other payables', in current liabilities, consists of accrued wages and salaries.

- **Requirement for question 5**

Prepare a cash flow statement for Sipfalor plc for the year ended 31 May 2008 in accordance with IAS 7 *Cash flow statements* using the direct method. Additional notes are not required. Ignore VAT.

(20)