Paper F7 Financial Reporting

Worksheet Online Class

8^{th} September 2016

London School of Accountancy and Finance

1 Multiple choice questions – conceptual framework

1 How does the *Conceptual Framework* define an asset?

A A resource owned by an entity as a result of past events and from which future economic benefits are expected to flow to the entity

B A resource over which an entity has legal rights as a result of past events and from which economic benefits are expected to flow to the entity

C 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

D A resource to which an entity has a future commitment as a result of past events and from which future economic benefits are expected to flow from the entity **(2 marks)**

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2 Which one of the following would be classified as a liability?

A Dexter's business manufactures a product under licence. In 12 months' time the licence expires and Dexter will have to pay $50,000 for it to be renewed.

B Reckless purchased an investment 9 months ago for $120,000. The market for these investments has now fallen and Reckless's investment is valued at $90,000.

C Carter has estimated the tax charge on its profits for the year just ended as $165,000.

D Expansion is planning to invest in new machinery and has been quoted a price of $570,000.

(2 marks)

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3 Which one of the following would correctly describe the net realisable value of a two year old asset?

A The original cost of the asset less two years' depreciation
B The amount that could be obtained from selling the asset, less any costs of disposal
C The cost of an equivalent new asset less two years' depreciation
D The present value of the future cash flows obtainable from continuing to use the asset **(2 marks)**

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4 The *Conceptual Framework* identifies an **underlying assumption** in preparing financial statements. This is:

A Going concern
B Materiality
C Substance over form
D Accruals **(2 marks)**

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5 The *Conceptual Framework* identifies four enhancing qualitative characteristics of financial information. For which of these characteristics is **disclosure of accounting policies** particularly important?

A Verifiability
B Timeliness
C Comparability
D Understandability **(2 marks)**

2 Lisbon (pilot paper amended) 27 mins

(a) The qualitative characteristics of relevance, faithful representation, comparability and understandability identified in the IASB's *Conceptual Framework for Financial Reporting* are some of the attributes that make financial information useful to the various users of financial statements.

Required

Explain what is meant by relevance, faithful representation, comparability and understandability and how they make financial information useful. **(11 marks)**

(b) During the year ended 31 March 20X6, Lisbon experienced the following transactions or events.

(i) Sold an asset to a finance company and leased it back for the remainder of its useful life.

(ii) The company's statement of profit or loss prepared using historical costs showed a loss from operating its shops, but the company is aware that the increase in the value of its properties during the period far outweighed the operating loss.

Required

Explain how you would treat the items above in Lisbon's financial statements and indicate on which of the *Conceptual Framework's* qualitative characteristics your treatment is based. **(4 marks)**

(Total = 15 marks)

12 Fresco (6/12 amended) 54 mins

The following trial balance relates to Fresco at 31 March 20X2:

	$'000	$'000
Equity shares of 50 cents each (Note 1)		45,000
Share premium (Note 1)		5,000
Retained earnings at 1 April 20X1		5,100
Leased property (12 years) – at cost (Note 2)	48,000	
Plant and equipment – at cost (Note 2)	47,500	
Accumulated amortisation of leased property at 1 April 20X1		16,000
Accumulated depreciation of plant and equipment at 1 April 20X1		33,500
Inventory at 31 March 20X2	25,200	
Trade receivables (Note 3)	28,500	
Bank		1,400
Deferred tax (Note 4)		3,200
Trade payables		27,300
Revenue		350,000
Cost of sales	298,700	
Lease payments (Note 2)	8,000	
Distribution costs	16,100	
Administrative expenses	26,900	
Bank interest	300	
Current tax (Note 4)	800	
Suspense account (Note 1)		13,500
	500,000	500,000

Notes

The following notes are relevant:

1 The suspense account represents the corresponding credit for cash received for a fully subscribed rights issue of equity shares made on 1 January 20X2. The terms of the share issue were one new share for every five held at a price of 75 cents each. The price of the company's equity shares immediately before the issue was $1.20 each.

2 Non-current assets:

To reflect a marked increase in property prices, Fresco decided to revalue its leased property on 1 April 20X1. The directors accepted the report of an independent surveyor who valued the leased property at $36 million on that date. Fresco has not yet recorded the revaluation. The remaining life of the leased property is eight years at the date of the revaluation. Fresco makes an annual transfer to retained profits to reflect the realisation of the revaluation surplus. In Fresco's tax jurisdiction the revaluation does not give rise to a deferred tax liability.

On 1 April 20X1, Fresco acquired an item of plant under a finance lease agreement that had an implicit finance cost of 10% per annum. The lease payments in the trial balance represent an initial deposit of $2 million paid on 1 April 20X1 and the first annual rental of $6 million paid on 31 March 20X2. The lease agreement requires further annual payments of $6 million on 31 March each year for the next four years. Had the plant not been leased it would have cost $25 million to purchase for cash.

Plant and equipment (other than the leased plant) is depreciated at 20% per annum using the reducing balance method.

No depreciation/amortisation has yet been charged on any non-current asset for the year ended 31 March 20X2. Depreciation and amortisation are charged to cost of sales.

3 In March 20X2, Fresco's internal audit department discovered a fraud committed by the company's credit controller who did not return from a foreign business trip. The outcome of the fraud is that $4 million of the company's trade receivables have been stolen by the credit controller and are not recoverable. Of this amount, $1 million relates to the year ended 31 March 20X1 and the remainder to the current year. Fresco is not insured against this fraud.

4 Fresco's income tax calculation for the year ended 31 March 20X2 shows a tax refund of $2.4 million. The balance on current tax in the trial balance represents the under/over provision of the tax liability for the year ended 31 March 20X1. At 31 March 20X2, Fresco had taxable temporary differences of $12 million (requiring a deferred tax liability). The income tax rate of Fresco is 25%.

Required:

(a) (i) Prepare the statement of profit or loss and other comprehensive income for Fresco for the year ended 31 March 20X2. **(9 marks)**

(ii) Prepare the statement of changes in equity for Fresco for the year ended 31 March 20X2. **(5 marks)**

(iii) Prepare the statement of financial position of Fresco as at 31 March 20X2. **(8 marks)**

(b) Calculate the basic earnings per share for Fresco for the year ended 31 March 20X2. **(3 marks)**

Notes to the financial statements are not required.

(c) Explain why a company such as Fresco may decide to revalue non-current assets and what the requirements are for revaluations as set out in IAS 16 *Property, Plant and Equipment*. **(5 marks)**

(Total = 30 marks)

16 Flightline (6/09 amended) 27 mins

(a) Explain what is meant by a 'complex' non-current asset and explain briefly how IAS 16 requires expenditure on complex non-current assets to be accounted for. **(5 marks)**

(b) Flightline is an airline which treats its aircraft as complex non-current assets. The cost and other details of one of its aircraft are:

	$'000	*Estimated life*
Exterior structure – purchase date 1 April 20W5*	120,000	20 years
Interior cabin fittings – replaced 1 April 20X5	25,000	5 years
Engines (2 at $9 million each) – replaced 1 April 20X5	18,000	36,000 flying hours

*Ten years before 20X5

No residual values are attributed to any of the component parts.

At 1 April 20X8 the aircraft log showed it had flown 10,800 hours since 1 April 20X5. In the year ended 31 March 20X9, the aircraft flew for 1,200 hours for the six months to 30 September 20X8 and a further 1,000 hours in the six months to 31 March 20X9.

On 1 October 20X8 the aircraft suffered a 'bird strike' accident which damaged one of the engines beyond repair. This was replaced by a new engine with a life of 36,000 hours at cost of $10.8 million. The other engine was also damaged, but was repaired at a cost of $3 million; however, its remaining estimated life was shortened to 15,000 hours. The accident also caused cosmetic damage to the exterior of the aircraft which required repainting at a cost of $2 million. As the aircraft was out of service for some weeks due to the accident, Flightline took the opportunity to upgrade its cabin facilities at a cost of $4.5 million. This did not increase the estimated remaining life of the cabin fittings, but the improved facilities enabled Flightline to substantially increase the air fares on this aircraft

Required

Calculate the charges to profit or loss in respect of the aircraft for the year ended 31 March 20X9 and its carrying amount in the statement of financial position as at that date.

Note. The post accident changes are deemed effective from 1 October 20X8. **(10 marks)**

(Total = 15 marks)

23 Multiple choice questions – reporting financial performance

1 Which one of the following would be treated under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* as a change of accounting policy?

A A change in valuation of inventory from a weighted average to a FIFO basis
B A change of depreciation method from straight line to reducing balance
C Adoption of the revaluation model for non-current assets previously held at cost
D Capitalisation of borrowing costs which have arisen for the first time **(2 marks)**

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2 For an asset to be classified as 'held for sale' under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* its sale must be 'highly probable'. Which one of the following is **not** a requirement if the sale is to be regarded as highly probable?

A Management must be committed to a plan to sell the asset.
B A buyer must have been located for the asset.
C The asset must be marketed at a reasonable price.
D The sale should be expected to take place within one year from the date of classification. **(2 marks)**

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3 At what amount should an asset classified as 'held for sale' be measured?

A Lower of carrying amount and fair value less costs of disposal
B Lower of carrying amount and value in use
C Higher of value in use and fair value less costs of disposal
D Higher of carrying amount and recoverable amount **(2 marks)**

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4 Which one of the following events taking place after the year end but before the financial statements were authorised for issue would require adjustment in accordance with IAS 10 *Events after the Reporting Period*?

A Three lines of inventory held at the year end were destroyed by flooding in the warehouse.
B The directors announced a major restructuring.
C Two lines of inventory held at the year end were discovered to have faults rendering them unsaleable.
D The value of the company's investments fell sharply. **(2 marks)**

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70 Waxwork (6/09) **27 mins**

(a) The objective of IAS 10 *Events After the Reporting Period* is to prescribe the treatment of events that occur after an entity's reporting period has ended.

Required

Define the period to which IAS 10 relates and distinguish between adjusting and non-adjusting events.

(5 marks)

(b) Waxwork's current year end is 31 March 20X9. Its financial statements were authorised for issue by its directors on 6 May 20X9 and the AGM (annual general meeting) will be held on 3 June 20X9. The following matters have been brought to your attention.

(i) On 12 April 20X9 a fire completely destroyed the company's largest warehouse and the inventory it contained. The carrying amounts of the warehouse and the inventory were $10 million and $6 million respectively. It appears that the company has not updated the value of its insurance cover and only expects to be able to recover a maximum of $9 million from its insurers. Waxwork's trading operations have been severely disrupted since the fire and it expects large trading losses for some time to come. **(4 marks)**

(ii) A single class of inventory held at another warehouse was valued at its cost of $460,000 at 31 March 20X9. In April 20X9 70% of this inventory was sold for $280,000 on which Waxworks' sales staff earned a commission of 15% of the selling price. **(3 marks)**

(iii) On 18 May 20X9 the government announced tax changes which have the effect of increasing Waxwork's deferred tax liability by $650,000 as at 31 March 20X9. **(3 marks)**

Required

Explain the required treatment of the items (i) to (iii) by Waxwork in its financial statements for the year ended 31 March 20X9.

Note. Assume all items are material and are independent of each other. **(10 marks as indicated)**

(Total =15 marks)