Institute of Incorporated Public Accountants

Final Admitting Examination

Module 11: Advanced Financial Accounting

Monday 25 May 2015

2pm – 5:30pm

Time Allowed: Three and a half hours

Instructions

Candidates must answer all three questions**.** Candidates should clearly indicate the number of the question and the part of that question (a),(b),(c) etc. on every page on which the answer to that part of the question is written.

Where working notes are supplied by candidates as part of their answer to a particular question then these should be numbered W/N1, W/N2 etc. accompanied by a heading that will clearly indicate the purpose of that note. If a candidate chooses to use a separate answer book for working notes then s/he must indicate the question to which the working note refers, the working note number together with a suitable description on each and every page on which that working note is written.

Example

Qn? W/N?? "Composition of amount for €???" shown under- say Cost of Sales- in the Statement of Comprehensive Income?

Candidates should begin each question on a new page

Marking Scheme

Question 1	30 marks
Question 2	50 marks
Question 3	20 marks
Total	**100 marks**

Question 1
Set out below are the separate Financial Statements of Titanic Ltd and Bigster Ltd

Income statements for the twelve months ended 30th April 2015

		Titanic Ltd		**Bigster Ltd**
		€		**€**
Revenue		290,945		56,194
Cost of sales		(218,209)		(39,336)
Gross Profit		72,736		16,858
Operating expense		(15,000)		(7,040)
Operating Profit		57,736		9,818
Interest		(7,200)		(3,000)
investment income		600		
Profit before tax		51,136		6,818
Taxation		(6,136)		(818)
Profit for the year		45,000		6,000

Profits accrued evenly throughout the year.

<u>Movement in Reserves for year ended 30/04/15</u>

		Titanic Ltd		**Bigster Ltd**
		€		**€**
Profit brought forward	30/04/14	40,000		15,000
Profit for the year to	30/04/15	45,000		6,000
Dividends charged		(3,100)		**(a)**(1,000)
Retained Profits	30/04/15	81,900		20,000

(a) The dividend declared and paid by Bigster Ltd was made on the 30/04/15

Question 1 Continued

Statements of Financial Position as at 30th April 15

			30/04/15		30/04/15
			Titanic Ltd		**Bigster Ltd**
			€		€
Non-current Assets					
Land			250,000		80,000
Buildings			350,000		90,000
Investment in					
Bigster Ltd see note 1					
Current Assets					
Inventory			8,000		7,800
Receivables			6,300		5,600
Bank			18,600		
Total Assets			**632,900**		**183,400**
Equity					
Share Capital	N.V. €1.00		350,000	N.V. €1.00	70,000
Share Premium			70,000		
Retained Profits			81,900		20,000
Total equity			**501,900**		**90,000**
Non-Current Liabilities					
Loans			120,000		50,000
Current Liabilities					
Payables			11,000		28,000
Bank					15,400
Total Equity & Liabilities			**632,900**		**183,400**

Question 1-continued

Note 1

Titanic Ltd acquired 56,000 shares in Bigster Ltd on the 01/05/14. The assets and liabilities of Bigster Ltd were stated at their fair value at the date of acquisition. The consideration paid was in the form of an issue to Bigster Ltd of 36,500 ordinary shares in Titanic Ltd at an agreed valuation of €2.00 per share.

No adjustments have been made in the accounts of Titanic Ltd to reflect this share issue

On the 01/11/14 Titanic Ltd asked its brokers, Snodgrass & Co., to find a buyer for 14,000 of its shares in Bigster Ltd. The brokers managed to sell the 14,000 shares for a total of €23,000 to a private investor.

Due to an oversight by Snodgrass & Co., the €23,000, received from the sale of the shares was not forwarded to Titanic Ltd until May 1st 2015.

For that reason the sale was not recorded by Titanic Ltd in the period ended 30/04/15

Requirements

(a) Prepare, in respect of Titanic Ltd , for the year ended 30/04/15

- (i) Group Income Statement. [10 marks]
- (ii) Statement of Changes in Equity. [7 marks]

(b) Show the amounts that would appear on the Group Statement of Financial Position of Titanic Ltd as at 30/04/15 in respect

- (i) Goodwill [including working note] [5 marks]
- (ii) Non-Controlling Interest [including working note]

[8 marks]

Total [30 marks]

Question 2

Set out below is the Trial Balance of P & P products Ltd for the year ended 31/03/15

	Notes		**€ Debit**	**€Credit**
Premises			2,000,000	
Accumulated depreciation	**note 2**	31/03/14		324,000
Machinery	**note 3**		1,200,000	
Accumulated depreciation	**note 2**	31/03/14		240,000
Payables				416,667
Revenue	**note 4**			5,000,000
Administration expense			600,000	
Production expenses	**note 10**		2,900,000	
3 % €400,000 Loan stock	**note 5**			380,000
Ordinary share capital		€0.75 per share		1,350,000
Share Premium				450,000
Retained Profits		31/03/14		520,000
Development costs	**note 6**		320,000	
Loan stock interest			6,000	
Bank overdrawn				59,833
Ordinary Dividends paid	**note 12**		18,000	
Inventory	**note 1**	31/03/14	348,000	
4% Redeemable Preference shares	**note 7**			200,000
London Products Ltd	**note 8**		432,000	
Revaluation account		31/03/14		50,000
Taxation	**note 9**			4,500
Preference dividend			4,000	
Selling and distribution			750,000	
Trade receivables	**note 11**		417,000	
Totals			**8,995,000**	**8,995,000**

Question 2 continued - notes to Trial Balance

Note 1 The inventory at the 31/03/15 was €382,800

Note 2

The depreciation rates are as follows

Premises 2% straight line

Machinery 20% straight line

The allocation of the depreciation costs are as follows

Non-Current Asset	Production	Administration	Distribution
Premises	50%	30%	20%
Machinery	100%	0%	0%

No provision has been made for the depreciation charge for the current year.

Note 3

A review of the machine was undertaken on the 31st March 2015. It was estimated that it could be sold for €730,000 if modification costs of €12,000 were carried out.

The estimated net cash flows over the remainder of its useful life were as follows

	31/03/16	31/03/17	31/03/18
Projected net Cash flows	€263,000	€263,000	€263,000

A required return on this asset was estimated at 5%. The Present value factors are set out hereunder.

	31/03/16	31/03/17	31/03/18	Total
P.V. factor for 5%	0.952	0.907	0.864	2.723

Question 2-continued - notes to Trial Balance

Note 4 –Sales with warranties

In February and March 2015, for the first time, the company sold a number of their products/units with warranties. The total revenue from these sales is €1,500,000 and the amount is included in the total for sales revenue in the Trial Balance. Details are set out on the next page. The warranties are for a twelve month period and are deemed to come into effect on the 1st day of the month after the month of sale.

Note 4 –Sales with warranties-continued

.	**Actual Sales Revenue**	**Estimated sales**	**Estimated Sales**
Month	**from units sold**	**value if same units**	**value of Warranties**
	with warranties	**sold without**	**for same units if**
		warranties	**sold separately**
February	€900,000	€810,000	€145,800
March	€600,000	€540,000	€97,200
Total	**€1,500,000**	**€1,350,000**	**€243,000**

Note 5

On the 1st April 2014 the company issued a 3% €400,000 bond at a discount of 5%. The costs involved in its issue were €13,607 and is included in administration expenses. The bond is redeemable on the 31st March 2018 at a premium of 10%. The interest rate implicit in the bond is estimated at 7.75%

Question 2-continued - notes to Trial Balance

Note 6 Development costs per Trial Balance
Set out below are the movements in cost in relation to two projects, project W and project Z

	Project W	**Project Z**	**Total**
Balance at 31/03/2014	€120,000	€80,000	€200,000
Training costs		€40,000	€40,000
Marketing costs	€20,000		€20,000
Materials		€25,000	€25,000
Salaries and wages		€35,000	€35,000
Balance at 31/03/2015	**€140,000**	**€180,000**	**€320,000**

The opening balances at 31/03/14 were properly classified as development cost in last year's financial statements. Further details are set out on the next page.

Project W has been completed and the marketing costs of €20,000 were expended in promoting its sales during the year ended 31/03/15.

The sales from product W were, according to the marketing director, a bit sluggish for year end 31/03/15. However s/he estimates that they will take off over the forthcoming years. The revenue from the actual units sold is included the total revenue amount in the Trial Balance. Set out below are the actual and projected sales units over the life of product W.

31/03/15	Actual sales units	10,000 u
30/03/16	Projected sales units	35,000 u
30/03/17	Project sales units	50,000 u
30/03/18	Project sales units	60,000 u
30/03/19	Project sales units	45,000 u
		200,000 u

Project Z will not be fully developed until 2017.

Question 2-continued-notes to Trial Balance

Note 7

The 4% redeemable preference shares are repayable in full in 2018

Note 8

On the 1st April 2014 the P& P Ltd bought 40% of the shares in London Products Ltd for €432,000. The shareholding enables it to exercise significant influence over the financial and operating policies of that company. The total share capital and retained profits of London Products Ltd at date of acquisition were:

London Products Ltd			
Share Capital		£600,000	sterling
Retained Profits		£240,000	sterling
Total	01/04/14	**£840,000**	sterling

The asset and liabilities at acquisition date were stated at their fair values.

The profit for the year ended 31st March 2014 was £258,000 [sterling] before tax with a tax on those profits of £3,000 [sterling]

Exchange rates		
Exchange rate 01/04/14	£0.80	to € 1 euro
Average rate during year ended 31/03/15	£0.85	to € 1 euro
Exchange rate at 31/03/15	£0.75	to € 1 euro

Question 2 continued-notes to Trial Balance

Note 9

The balance of €4,500 represents an overestimation of the tax liability on profits for the year ended 31/03/14. The estimate of tax on profits for year ended 31/03/15 is €12,000 and has not yet been provided for.

Note 10 Equity based share option scheme for production employees

On the 1st of April 2013 the company set up equity based share option scheme for certain key production employees as an incentive to stay with the company for three years.

Under the scheme each employee is to have the option of taking 100 shares provided s/he remained with the company for following 3 years. The total number of production employees involved at the time the scheme was set up was 500 persons.

The estimated value of each option was €14.00 per share and it was further estimated that 30% of the employees would not complete the three year service condition.

At the 31/03/14, the estimate of the number of employees who would leave before completion the three year service was revised to 25% in light of the number who had actually left during that period.
At the end of the current year end 31/03/15 the estimate, of the total number of employees who would leave, was revised again to 20%, in light of the total number of employees who had left to date.

On enquiry it was discovered that no entries had been put through for the previous year to 31/03/14 nor for the current year to the 31/03/15 because management felt it was only a “paper” movement involving no cash.

Question 2 continued-notes to Trial Balance

Note 11

An ongoing regular customer of P& P Ltd. went bankrupt on the 30th of April 2015 owing the company €50,000. Preliminary estimates suggest s/he will only be able to pay €0.30 for each euro owed. An analysis of the unpaid amount owing was as follows:

January	Sales	2015	€12,000
February	Sales	2015	€10,000
March	Sales	2015	€ 8,000
April	Sales	2015	€20,000
Total debt			€50,000

Note 12

An ordinary dividend of €0.15 was proposed for year ended 31/03/15

Required

From the above Trial Balance and the notes in relation to it prepare:

(a) Statement of Comprehensive Income of P & P Ltd for year ended 31/03/15 **[21 marks]**

(b) Statement of Changes in Equity of P& P Ltd for year ended 31/03/15 **[7 marks]**

(c) Statement of Financial Position of P& P Ltd as at 31/03/15

[22 marks]

Total [50 marks]

End of Question 2

Question 3

(a) Define what is meant by investment property as set out in IAS 40

[2 marks]

(b) PMS Group Ltd engages in a wide range of activities from manufacture, to property services. The following two issues have been raised with by the board of the PMS Group Ltd for its financial statements year ended 30/04/15.

Issue 1

The PMS Group currently rents one of its properties in Cork to a tenant ABC Ltd.

On the Statement of Financial Position as at 30/04/14, of the PMS group, the value of the property was classified as an investment property in accordance with IAS 40 at a fair value of €3,000,000.

During a strategic review of its future requirements, PMS Ltd decided that the Cork property would be better suited as a head office for their operations than the current building which they rent from Acto properties, for use as their headquarters. Accordingly on the 1st July 2014 they notified the tenant of their Cork property-ABC Ltd- that they would not be renewing the rental agreement and that the tenant should vacate the property. The tenant vacated the property on the 1st of July. However the property required renovation work before it could be made suitable as their new headquarters. The company finally moved to their new Cork headquarters on the 01/11/14.

The valuation of the property on the 01/07/14 was €2,785,000
The valuation of the property on the 01/11/14 was €2,500,000

The property has a 35 year remaining useful life. It is company policy, where relevant, to depreciate, pro rata, in the year of acquisition, any depreciable non-current asset. No adjustments have been made to reflect the above events and the Cork property continues to be presented as an investment property at fair value of €3,000,000 on the draft Statement of Financial Position as at 30/04/15.

Required

(i) Set out the journal entries, if any, required.
(ii) Give reasons for reclassifying as a non-investment property.

[8 marks]

Question 3 - continued

Issue 2

As stated earlier, PMS Ltd rents premises in Dublin, from ACTO properties and which PMS Ltd had formerly used as their headquarters. The property is rented under a 24 year operating lease, at annual rent of €770,000. The rent is payable in advance in two equal instalments of €385,000 on the 1st of May and the 1st of November respectively.
The full €770,000 was charged to its draft Statement of Comprehensive Income for year ended 30/04/15
PMS Ltd has now managed to sub-let the Dublin premises to a tenant from the 01/11/14 for an annual rent of €790,000, payable in advance in two equal instalments of €395,000 on the 1st of November and the 1st of May. There are 18 years remaining on the lease.

The Interest rate implicit in the lease is 4% semi-annually and the present value of the semi-annual payments, to be made by PMS Ltd to ACTO properties over the remainder of the lease, has been estimated at €7,570,876

PMS Ltd has recorded its rental payments to ACTO properties in accordance with the requirements for Operating Leases. It has also recorded the first instalment of rent received from sub-letting that premises. Management would like however to have the property reclassified as an investment property.

Required

(i) Advise the board as to whether the property could be treated as an Investment property under IAS 40.

(ii) Set out the schedule of payments under a Finance lease arrangement up to the year 2016 in relation to the rentals paid by PMS Ltd.

(iii) Set out the journal entries to incorporate the amendments necessary to give effect to including the Dublin premises as an investment property.

[10 marks]

Total marks [20 marks]

End of examination paper