Final Admitting Examination

Module 11

Advanced Financial Accounting

May 2012

SOLUTIONS

Question 1-solution

(a) Cash and Cash equivalents as defined in IAS 7
(b)

Operating cash flow-working note 1				
Profit before tax		€53,000		
Investment income		(€18,000)		
Legal fees of share issue		€3,600		
Interest Charges		€14,000		
Adjustments for "non cash" movements				
Depreciation		€19,000		
Impairment of goodwill **W/N 1**		€10,000		
Profit on sale of asset **W/N 2**		€4,500		
Operating Profit before W/C adjustments		€86,100		
<u>Working capital</u>				
Stock		(€2,500)		
Debtors		€2,000		
Creditors		(€25,000)		
Cash from ongoing operations--->		€60,600		
Interest paid	**W/N 3**	(€11,000)		
Taxation paid	**W/N 4**	(€3,000)		
Dividend paid	**W/N 5**	(€15,000)		
Net Cash from operating activities			€31,600	
Cash flows from Investing activities				
Sale of plant		€19,500		
Purchase of tangible asset		(€69,000)		
Interest received	**W/N 7**	€21,000		
			(€28,500)	
Cash flows from financing activities				
Share capital		€56,400		
Repayment long term borrowings		(€25,000)		
Lease capital repayments **W/N 8**		(€34,000)		
			(€2,600)	
Net increases in cash and cash equivalents				€500

Question 1 (c)

	31/03/12		31/03/11
Cash on hand balance with banks	(€43,000)	€17,500	(€25,500)
Short term investments	€18,000	(€18,000)	€0
	(€25,000)	(€500)	(€25,500)

Major Non Cash transactions [not asked]
The company acquired an asset for €35,000 financed by a lease.

Working Notes.

W/N 1

Impairment of goodwill : Question note 5 stated that there no acquisition or disposals of intangible assets and thus difference must be write down due to impairment

W/N 2

Asset with book value of €24,000 sold for €19,500 represents a book loss of €4,500

W/N 3

Interest payable 31/03/11 €8,000 plus I/S charge €14,000 equals	€22,000
Less interest payable 31/03/12	(€11,000)
Interest paid	€17,000

W/N 4

Deferred Tax NCL per B/S 31/03/12	€10,000
Tax CL oer B/S 31/03/12	€12,000
Taxation in I/S	€6,500
Less closing Deferred Tax NCL	(€12,000)
Less closing Tax CL	(€13,500)
Taxation Paid------>	**€3,000**

W/N 5

Dividend owing at start	€nil
Charge to S.O.C.E.	€15,000
Closing balance should be --->	€15,000
Actual closing balance	(€nil)
Thus dividends paid---------->	(€15,000)

Question 1 solution
W/N 6

Non current assets at NBV at 31/03/11	€385,000
Capitalised lease assets **Question Note 4(iii)**	€35,000
Revaluation increase **Question Note 4(iv)**	€18,000
Depreciation charge **Question Note 4 (i)**	(€19,000)
Disposal at Net Book value-**Question Note 4(ii)**	(€24,000)
Thus balance at 31/03/12 should be-->	€395,000
But balance at 31/03/12 was	€464,000
Thus asset purchased	**(€69,000)**

W/N 7

Interest receivable 31/03/11 €11,000 plus I/S income €18,000 equals	€29,000
Less interest receivable per B/S at 31/03/12	(€ 8,000)
Equals interest income received	€21,000

W/N 8

Current Lease payments owing 31/03/11	€15,000
Non current lease payments owing 31/03/11	€25,000
Financing of asset acquired	€35,000
Balance at 31/03/12 should be	**€75,000**
Balance at 31/03/12 stated as	
Current lease payments owing 31/03/12	€6,000
Non current lease payments owing 31/03/12	€35,000
Total lease amounts owing 31/03/12	**€41,000**
Thus capital repayments during year were	€34,000

Question 2-solution

Statement of Comprehensive Income of Machine Parts for year ended 30/04/04

Revenue			1,500,000
Cost of sales	**W/N 1**		(847,410)
Gross Profit			652,590
Other expenses			
Distribution expenses		96,000	
Revaluation write down	**W/N 2**	25,000	
Administration expenses	**W/N 3**	64,500	
			(185,500)
Operating Profit			467,090
Profit on Disposal of subsidiary		**See SOCE note**	61,000
Profit before finance costs			528,090
Finance Costs			
Financial interest charges		**W/N 4**	(10,808)
Red. Preference share dividend		**W/N 5**	(2,400)
Profit before tax			514,883
Taxation		**W/N 6**	(4,990)
Profit after tax			509,893
Other comprehensive income			
Revaluation of land		**W/N 2**	(125,000)
Profit for the year			384,893

<u>Question 2-solution continued</u>

Statement of Financial Position of Machine Parts as at 30/04/12

Non Current Assets W/N 2		1,977,049
Development Costs W/N 1		70,000
Current Assets		
Inventory **W/N 1**	124,700	
Trade receivables	123,288	
Cash in Bank	62,954	
		310,941
Total Assets		2,357,990
Ordinary Share Capital N.V*. €0.50	350,000	
Other equity **W/N 4**	14,905	
Share Premium **see SOCE**	416,500	
Revaluation **W/N 2**	0	
Retained Profits **see SOCE**	1,248,893	
Total Equity		2,030,297
Non Current Liabilities		
5% Loan stock **W/N 4**	138,403	
3% Preference share capital **W/N 5**	80,000	
Deferred Income **W/N 1**	24,000	
Deferred tax **W/N 6**	7,440	
		249,843
Current Liabilities		
Trade payables	55,890	
VAT see W/N 2 re Qn Note (3)	18,110	
Corporation tax **W/N 6**	3,850	
		77,850
Total equity plus Liabilities		2,357,990

Question 2-solution continued

Statement of changes in Equity of Machine Parts for 30/04/12

	Ordinary Share Capital	Other Equity	Share Premium	Revaluation	Retained Profit	Total	Non Controlling Interest
Balances as at 30/04/11	250,000		280,000	125,000	(ii) 746,000	1,401,000	(i)196,000
Disposal of subsidiary						0	(196,000)
Issue of shares	100,000		140,000			240,000	
Legal Costs			(3,500)			(3,500)	
Equity element of loan stock		€14,905				14,905	
Profit for the year				(125,000)	509,893	384,893	
Ordinary dividends paid					(7,000)	(7,000)	
Balances as at 30/4/12	**350,000**	**14,905**	**416,500**	**0**	**1,248,893**	**2,030,297**	**0**

The company proposes to pay an ordinary dividend of €0.01 per share totalling €7,000

'--

Computation of profits brought forward from subsidiary and profit on disposal

(i) Note it is assumed that the fair value of the net assets of the subsidiary of €980,000 on the 01/05/11 i.e. date of sale were not materially different from their value one day earlier ie. 30/04/11. Thus minority interest or non controlling interest at 30/04/11 would be €980,000 x 20% equals €196,000

(ii) The fair value of the net assets of subsidiary at acquisition date were	€900,000
The fair value of the net assets of subsidiary at date of sale were	€980,000
Thus profits accumulated from date of acquisition to date of sale were	€ 80,000
Machine Parts Ltd has 80% share of accumulated profits i.e	€ 64,000
Thus opening retained profits are €682,000 per T/B plus €64,000	€746,000

(III) Note the total profit recorded on disposal of subsidiary by comparing Purchase price of €800,000 with sales price of €925,000 equals €125,000

This will now be split between attributable to opening reserves	€64,000
Balance ie. €125,000 minus €64,000 equals profit on sale	€61,000

Note alternatively to compute profit on sale of subsidiary Oils Ltd

Goodwill on acquisition is €800,000-[80% x €900,000] equals	€ 80,000
Fair value of assets of subsidiary at date of sale €980,000 x 80% i.e.	€784,000
Total value of subsidiary in Machine Parts Ltd Group Accounts	€864,000
Consideration received	€925,000
Thus profit at date of sale	**€ 61,000**

For opening Share Capital and Share Premium balances see working note 3

<u>Question 2-solution continued</u>

W/N 1

<u>Cost of production</u>

Production costs per Trial Balance	€680,000
Question note 1 IAS 2 Write down of inventory to NRV	€ 300

Balance Sheet -Inventory

€125,000 minus €300 equals €124,700

<u>Question note (3) -VAT</u>

Note question did not specify a VAT rate
This solution assumes 23% standard rate
Other assumed rates, if correctly applied would be equally valid
Purchases VAT is
€1,350,000 x 0.23 divided by 1.23 equals €252,439

25% disallowed thus €242,439 x 25% equals	€63,110
Ie. Dr Production and Credit VAT account	

Balance sheet amount- V.A.T.

Note since VAT in T/B is €45,000 debit it will mean
A credit balance of €63,110 minus €45,000 =€18,110

<u>Question note (7)-Development costs-</u>

Promotional activities and general overheads disallowed*		
€50,000	plus €30,0000*	€80,000
*Assuming not directly attributable to the development		

Balance Sheet amount-Development costs

€150,000 minus €80,000 equals €70,000

<u>Question note (5) -Training Grant €42,000</u>

Only six employees have been trained out of 14 employees	
Thus not yet earned is €42,000 x 8/14 equals	€24,000

Balance Sheet- amount Training costs

Dr Production costs €24,000 Cr Deferred Income €24,000

Total to I/S	€847,410

Question 2 solution continued

W/N 2 Non current Asset and revaluation-downwards of land

	Land	**Revaluation of land**	**S.O.C.I**
Balance at 30/04/11	€1000,000 Dr	€125,000 Cr	
Revaluation downwards	(€ 150,000) Cr	(€125,000) Dr	25,000 Dr
Balance at 30/04/12	€ 850,000	€0000	

Balance Sheet Non Current Assets at 30/04/12

Land per above		€ 850,000
Premises	€1,200,000 minus €480,000 equals	€ 720,000
Trucks	€ 580,000 minus €232,000 equals	€ 348,000
Equipment	€ 90,000 minus € 30,951 equals	€ 59,049
Total		**€1,977,049**

W/N 3 Legal and accountancy fee in relation to Share Issue

The €3,500 should be written off against the share premium as it is not a day to day expense.

200,000 shares x [€1.20-€0.50]=€140,000 minus €3,500=€136,500

Opening share premium €280,000[see below] plus€136,500=€416,500

Share Issue Question note (10) Issue of 200,000 €0.50 Ordinary Shares at €1.20

The shares were issued during the year In the absence of other information- for example a sundry receipt in the Trial Balance to balance any cash received- it can be assumed that the issue has already been properly accounted for.

The only significance therefore of the note, apart from the issue costs, is that the amounts for Share Capital and Share Premium in the Trial balance of €350,000 and €420,000 respectively represent closing balances before adjustment for issue costs.

Thus opening balances in the Statement of changes in Equity are

Share Capital	€350,000 i.e.	[€450,000 minus 200,000 shares x €0.50]
Share Premium	€280,000 i.e.	[€420,000 minus 200,000 shares x €0.70]

Question 2 solution continued

W/N 4 with reference to Question note (8)-issue of 5% Loan stock

	Year 1	Year 2	Year 3		Yr 4	Total
8% discount rate-->	0.926	0.857	0.794		0.735	3.312
PV of four interest payments	3.312	x	€7,500		equals	€24,841
PV of capital repayment	0.735	x	€150,000		equals	€110,254
Total P.V. of Loan stock->					Total	€135,095
Balance equals "other equity"					Equity	€14,905
						€150,000
						-
Computation of yearly amounts						
	8%	Paid	Balance	B/S as at		
€135,095	**€10,808**	(€7,500)	**€138,403**	30/04/12		
€138,403	€11,072	(€7,500)	€141,975	30/04/13		
€141,975	€11,358	(€7,500)	€145,833	30/04/14		
€145,833	€11,667	(€157,500)	€0			

	Debit	**Credit**
Cash	€150,000	
Loan stock		€135,095
Other equity		€ 14,905
[Effective]Interest charges	€10,808	
Loan stock		€10,800
Bank/cash interest paid		€7,500
Loan stock	€7,500	

W/N 5 Question note (6)

Redeemable Preference Shares are within the definition of a liability and should not be treated as part of equity. Any divided paid should be part of finance charges

Question 2 solution continued

W/N 6 with reference to Question note (9) Deferred Tax and Corporation tax

		I/S	**B/S**	**B/S**
Closing deferred tax balance	30/04/12	€7,440	€7,440	N.C.L.
Opening Deferred tax balance	30/04/11	€5,200		
Increased in deferred tax charge		€2,240		
Provision for corporation tax	30/04/12	€3,850	€3,850	C.L.
Over Provision of Tax prior yr		(1,100)		
Charge to Income statement	30/04/12	€4,990		

(I) Cumulative timing difference of €62,000 x CT rate of 12% equals €7,440

Question 3-solution continued

(a) Substance over Form.   Reference the Framework

(b) Five conditions before recognising the sale of good. Reference IAS 18

(c)

(I) “Barton sells to Murphy -a Dublin Shopkeeper on “Sale or return”……..”

Barton should recognise the sale when Murphy sells those goods on to his/her own customers or the three month option period for Murphy to return the goods has expired.

Any stock held by Murphy at Barton Ltd financial year end should be included In Barton Ltd Balance Sheet if the three month return option on those stocks has not yet expired

Note where sales are made on a regular basis by Barton Ltd to Murphy then computing historical percentages of goods not returned by Murphy to Barton Ltd may enable Barton Ltd to compute the amount of such sales to include in the current financial period. Otherwise Barton Ltd may be required to conduct regular “stock audits” of Murphy

(II) “Sold to Joe Doherty-Donegal shopkeeper for €125,000 ……”

€125,000 minus cash received immediately €50,000 =€75,000

50% of €75,000 i.e. €37,500 to received in year end 28/02/13
50% of €75,000 i.e. €37,500 to received in year end 28/02/13

Accounts	**Cash Received**		**Present Value**
28/02/13	€ 37,505	x discount factor 10% ie. .909 equals	€ 34,088
28/02/14	<u>€ 37,505</u>	x discount factor 10% ie. .826 equals	<u>€ 30,975</u>
	€ 75,000		€ 65,063
28/02/12	<u>€ 50,000</u>		<u>€ 50,000</u>
	€125,000		€115,063

Thus amount of sales to be included 28/02/12 is €115,023

Computation of interest income for the two following financial years.

	10%	cash	balance	
€65,063	€6,506	(€37,500)	€34,069	28/02/2013
€34,069	€3,407	(€37,500)	(€24)	28/02/2014

Re (€24) should be zero. Allow for rounding

Question 3 (c) (ii) solution continued

Double entry -not asked for

		Debit	Credit
Cash	29/02/12	€50,000	
Sales/Revenue	29/02/12		€50,000
Receivables	29/02/12	€65,063	
Sales Revenue	29/02/12		€65,063
Interest income	28/02/13		€6,506
Receivables	28/02/13	€ 6,506	
Cash	28/02/13	€37,500	
Receivables	28/02/13		€37,500
Interest income	28/02/14		€3,407
Receivables	28/02/14	€ 3,407	
Cash	28/02/14	€37,500	
Receivables			€37,500
Sundry w/off			
Receivables	28/02/14	€ 24	
Sundry expenses	28/02/14		€ 24

"Sold goods for €250,000 on 01/03/11 to Lowlay Ltd…….."

(III) The substance of the transaction is that of a loan and should be recorded as such with interest and other loan costs being shown under finance charges. The stock will remain an asset of Barton Ltd and no sale will be recorded.

END OF SOLUTIONS