Institute of Incorporated Public Accountants

Final Admitting Examination

Module 11:

Advanced Financial Accounting

Monday 26th May 2014

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	20 Marks
Question 2	50 marks

Question 3 30 marks

Total 100 marks

Question 1

Horton Ltd is an electronics company which has been listed on the Irish stock exchange for the last two years since it was first established. Set out below are the Equity and Long term funds at the end of its first year of trading for year ended 30/04/13. Also set out are the Income statements and movements in reserves for the year end 30/04/13 and 30/04/14 respectively.

Equity and Long term funds as at 30/04/13

Ordinary Share Capital with N.V. of €0.80 each		€ 1,920,000
Share Premium		€ 480,000
6% Preference shares		€ 50,000
Retained Profits		€ 324,000
Total Equity	30/04/13	€ 2,774,000
8% Convertible Loan stock		€ 100,000
Total equity plus Non-Current Liabilities as at	30/04/13	**€ 2,874,000**

Income statements of Horton L td for the years ended 30th April

	30/04/14	**30/04/13**
Revenue	€ 2,510,000	€ 2,172,000
Cost of sales	(€ 2,008,000)	(€ 1,629,000)
Gross Profit	**€ 502,000**	**€ 543,000**
Operating Expenses	(€ 122,000)	(€ 120,000)
Profit before interest and tax	**€ 380,000**	**€ 423,000**
Loan interest	(€ 8,000)	(€ 8,000)
Profit before tax	€ 372,000	€ 415,000
Taxation	(€ 53,500)	(€ 52,000)
Profit for the year	**€ 318,500**	**€ 363,000**

This question continues on the next page

Question1 Horton Ltd continued

Statement of movement in reserves

	30/04/14	30/04/13
Retained reserves at start of period	€ 324,000	€ -
Profit for the year	€ 318,500	€ 363,000
Preference Dividend	(€ 3,000)	(€ 3,000)
Ordinary Dividend	(€ 48,000)	(€ 36,000)
Retained profits at end of year	**€ 591,500**	**€ 324,000**

Notes

(i) On the 01/11/13 the company made a bonus issue of shares on the basis of one ordinary share for every 6 ordinary shares held.

(ii) On the 01/03/14 the company made a rights issue of one ordinary share for every seven ordinary shares held. The rights issue price was €0.85 per share. The market value of one ordinary share on the date of the rights issue was €1.25 per share.

(iii) The convertible loan stock can be converted at the option of the holders from the year 2020 at the rate of 125 ordinary shares for every €100 of stock held.

(iv) The rate of corporation tax is 12.50%

(v) There were no issues of Preference share capital in 2014

(vi) There were no issues of loan stock in 2014.

Required

(a) Calculate the basic earnings per share- EPS- for the year 30/04/13 that would have been shown in the 2013 financial statements. **[2 marks]**

(b) Calculate the basic earning per share for the year 30/04/14. **[7 marks]**

(c) Calculate the adjusted earnings per share for 2013 that would be shown in the 2014 financial statements as a comparative for the 2014 computed in (b) **[3 marks]**

(d) Calculate the diluted earnings per share. **[3 marks]**

(e) Explain briefly the following terms

(i) Anti-dilution

(ii) Contingently issuable ordinary shares.

[5 marks]

[20 marks]

Note the computation of the number of shares may be rounded to the nearest whole share. The computation of the EPS and where relevant the share price must be rounded to two decimal places.

Question 2

Oak Furnishing Ltd sells wood based products. Set out below is the Trial Balance as at 30/04/14

	Notes	€	€
Buildings		3,200,000	
Accumulated depreciation	**Note 3**		640,000
Ordinary share capital **Note 1**	N.V. €0.50 p/share		1,000,000
Share Premium			500,000
Retained Profits			500,000
Administration expense		750,000	
Purchase		2,420,000	
Royalties	**Note 7**	80,000	
6% Debentures			100,000
Machinery		2,400,000	
Accumulated depreciation	**Note 3**		1,171,200
Bank overdrawn			52,938
Internally generated goodwill	**Note 9**	50,000	
Sundry receipt	**Note 4**		800,000
Inventory	**Note 2**	242,000	
Payables			625,000
Deferred Tax	**Note 7**		223,600
Acorns			
Taxation on profits y/e30/04/14		30,738	
Selling and distribution		1,000,000	
Debenture interest paid		3,000	
Trade receivables	**Note 8**	417,000	
Revenue/Sales	**Note 5 & Note 6**		5,000,000
Dividends paid		20,000	
Totals		**10,612,738**	**10,612,738**

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Note 1

On the 01/05/13 the Oak Furnishing Ltd purchased 80% of the shares of Acorn Ltd. by issuing 312,500 of its own Ordinary shares at a value of €0.80 each. No adjustment has been made to reflect the issue of those shares.

The assets and liabilities of Acorn Ltd were stated at their fair value at the date of acquisition.

The Trial Balance of Acorn Ltd is set out on the next page.

Question 2 note 1-continued-Trial Balance of Acorns Ltd as at 30/04/14

		€	€
Sales			180,000
Cost of sales		90,000	
Inventory	30/04/14	8,000	
Share Capital			250,000
Land		300,000	
Distribution expenses		36,000	
Administration		3,600	
Taxation on profits		6,300	
Taxation owing			3,150
Payables			7,397
Receivables		15,000	
Profits brought forward	30/04/13		70,000
Cash in Bank		51,647	
Totals		**510,547**	**510,547**

The accountant of Acorn has ensured that all transactions were accounted for using similar accounting policies to the Group. Where relevant it may be assumed that the profits accrued evenly through-out the year.

The remaining notes [Note 2 to Note 10] refer entirely to the Trial Balance of Oak Furnishing Ltd

Note 2
The closing inventory of Oak Furnishings at 30/04/14 was €266,200. Included in the closing inventory was an amount of inventory costing €55,000 which can be sold for €57,000 after further modification and delivery costs of €3,600.

Note 3
The depreciation of the non-current assets of Oak Furnishings Ltd have not yet been accounted for in respect of the year ended 30/04/14. The rates are;
Buildings 2% straight line
Machinery 20% reducing balance

The allocation of the depreciation expenses are as follows;

	Production	**Distribution**	**Administration**
Buildings	50%	20%	30%
Machinery	100%	0%	0%

Question 2-continued-notes to Oak Furnishings Trial Balance

Note 4 **–**sundry receipt €800,000**.** This refers to an interest free bond received on the 01/05/12 which is convertible into Ordinary shares in 2016. The interest rate implicit in the terms of the bond is 5%. Apart from the recording of the bond as a sundry receipt no other postings have been made since its receipt.

Note 5

Sales include a receipt of a training grant for €50,000 in respect of an agreed target recruitment of 50 employees who have been out of work for over a year. So far the company has recruited 20 employees of this type.

Note 6- Warranty

The company offers warranties in respect of the products sold. Based on previous experience a minor defect in all of the company's products would cost it a total of €250,000 for rectification. But if there was a major defect in all of the company's products then the total cost of rectification would be €800,000.

The following historical data has been obtained;

There is a 75% chance that there will be no defects and thus no warranty claims.

There is a 20% chance that there will be minor defects in all its products.

There is a 5% change that there will be a major defect in all its products.

Note 7 Deferred taxation

The file on deferred tax has been prepared by tax consultants.

The net book value of the relevant assets as at 30/04/14 was €3,479,040
The tax written down values of those assets as at 30/04/14 was €1,500,000

Losses forward for tax purposes and unused were €70,000.

The company pays royalties for the right to produce certain products. The €80,000 royalties for year ended 30/04/14 was correctly accounted for under normal accounting rules.

However the amount of royalties actually paid during the period and deductible for tax purposes was €90,000

The corporation tax rate applicable is 12.50%

Question 2-continued-notes to Oak Furnishings Trial Balance

Note 8
Receivables includes an amount owing in respect of sale on credit to a UK customer on the last day the previous year ended 30/04/13 and properly accounted for.
The sale was for £100,000 when the exchange rate was £0.80 to the euro.
At 30/04/14 £50,000 was still owing by that customer and the exchange rate was £0.70 to the €euro.

Note 9
Shortly before retiring the company's accountant had estimated that the value of It's internally generated goodwill to be €50,000 but the accompanying working notes indicated that the value of such goodwill could be as low as €35,000

Note 10
The board members, who constitute a majority of the shareholders, proposed and authorised a dividend payment of €0.01 per ordinary share.

Required

(a) Prepare the Group Income Statement of Oak Furnishing Ltd for the year ended 30/04/14. **[18 marks**]

(b) Prepare the Group Statement of Changes in Equity of Oak Furnishing Ltd for the year ended 30/04/14. **[7 marks]**

(c) Prepare the Group Balance Sheet of Oak Furnishings as at 30/04/14 **[25 marks]**

Total [50 marks]

Question 3 is on the next page

Question 3

Set out below are the Income statements, Balance Sheets and Movement in Reserves of Canteen Equipment Ltd in its first two years of trading. The company manufactures equipment units for the various canteens around the country.

Income statement for the year ended 31st March

	31/03/14	31/03/13
Sales volume in units	**23,000 u**	**20,000 u**
	€	€
Sales/ Revenue	563,500	500,000
Cost of Goods Sold	(439,530)	(400,000)
Gross Profit	123,970	100,000
Operating Expenses	(73,255)	(50,000)
Operating Profit	50,715	50,000
Finance charges	(4,800)	(3,600)
Profit before tax	45,915	46,400
Taxation	(5,739)	(5,800)
Profit for the year	**40,176**	**40,600**

Movement in Reserves for years end 31st March

	31/03/14	31/03/13
	€	€
Profit brought forward	36,600	0
Profit for the year	40,176	40,600
Ordinary Dividends	(5,000)	(4,000)
	71,776	**36,600**

Question 3-continued

Balance Sheets [SOFP] of Canteen Equipment Ltd as at

	31/03/14	**31/03/13**
Non Current Assets	€	€
Property Plant & Equipment N 1	115,500	126,000
Current Assets		
Inventory	48,168	27,397
Receivables	77,192	41,096
Total Assets	**240,860**	**194,493**
Equity and Liabilities		
Equity		
Ordinary Share Capital of €1 each	50,000	50,000
Retained Earnings	71,776	36,600
Total Equity	**121,776**	**86,600**
Non Current Liabilities		
12% Debentures	40,000	30,000
Current Liabilities		
Payables	30,105	38,356
Bank	48,979	39,537
Total Equity plus Liabilities	**240,860**	**194,493**

Note 1
Additional machinery for €30,000 was purchased on the 1st of October 2013. There were no other acquisition or disposals of machinery in year end 2014.

Question 3-continued

The managing director has just received a letter from the bank demanding that the company reduce its overdraft to the agreed limit of €25,000.

Further the bank manager- Mr Gray- has also demanded a cash flow statement in addition to the above financial statements which had been forwarded to him.

Required

(a) Starting with the amount of Profit for the year, set out- in so far as the information permits-, a statement showing the relevant cash flows.

It is NOT required to comply with the format as set out in IAS 7 though candidates may use all or part of that format if s/he so wishes.

[8 marks]

(b) Compute any two ratios for each year under each of the heading set out below

(i) Liquidity
(ii) Profitability
(iii) Efficiency
(iv) Investor satisfaction

A suggested layout is set out below but is not prescribed.

Name of formula	Formula	2014	2013
??	??	$\frac{?? \times ??}{??} = ??$	$\frac{?? \times ??}{??} = ??$

[12 marks]

(c) Comment on your findings in (a) and (b) above **[10 marks]**

[30 marks]

END OF EXAMINATION PAPER