Advanced Financial Accounting
Module 11
November 2009

<u>Instructions</u>

Candidates must answer all three questions.

The information supplied in Question 1 is to be used to answer Question 3. The answer in Question 3 is not dependent on the answer in Question 1.

Question 1 and Question 3 can thus be answered in any order.

Candidates should begin each question on a new page.

<u>Marking Scheme</u>

Question 1	25 marks
Question 2	60 marks
Question 3	15 marks

Total	<u>100 marks</u>

Question 1

Garden Specialist Ltd have recently expanded their operations in the production of Garden furniture and glass houses. Set out below are the Statements of Financial Positions and the Income Statements for the past two years.

Statements of Financial Position	31/10/09 €000's	31/10/08 €000's
Non Current Assets		
Tangible Assets	791	450
Intangible Assets	12	17
Total Non Current Assets	803	467
Current Assets		
Inventories	62	44
Trade receivables	118	86
Interest receivables	7	4
Investments	25	12
Cash	8	10
Bank		10
Total Assets	1,023	633
Shareholders equity		
Ordinary share capital 80cents shares	232	200
Share premium	86	70
Revaluation surplus	66	16
Retained earnings	189	152
Total equity	573	438
Non Current Liabilities		
Long term borrowings		
10% Debentures [payable 2010]	160	70
	0	0
Finance Leases	30	40
Deferred Tax	10	14
Current Liabilities [Note 1]	250	71
Total Equity and Liabilities	1,023	633

Income statements for the past two years

	31/10/09 €000's	31/10/08 €000's
Revenues	1,080	900
Cost of Sales	(756)	(540)
Gross Profit	324	360
Operating costs	(259)	(270)
Operating profit before interest	65	90
Investment income	14	
Finance charges		
Interest expense	(19)	(13)
Profit before taxation	60	77
Income tax	(8)	(10)
Profit for the year	52	67

Extracts from Statement of Changes in Equity in relation to Retained Profits.

	31/10/09 €000's	31/10/08 €000's
Profit brought forward to start of year	152	95
Profit for the year	52	67
Dividends paid	(15)	(10)
Total retained profits at year end	189	152

Note 1 analysis of Current Liabilities

Analysis of Current Liabilities	31/10/09 €000's	31/10/08 €000's
Trade payables	124	44
Income taxes	13	8
Interest payable	10	7
Finance leases	14	12
Bank overdraft	89	
Total Current Liabilities	250	71

Note 2

During the year the company issued a total of 40,000 €0.80 Ordinary shares at an issue price of €1.20 . The legal and accountancy fees incurred were €1,800 and these were written off as part of operating expenses

Note 3

Tangible non current assets include properties which were re-valued during year give a surplus of €50,000

Note 4

The depreciation charge for the year was €19,000

Note 5

Assets capitalised under Finance Leases amounted to €41,000.

Note 6

An asset with a net book value of €31,000 realised a sale of €18,000

Note 7

The investments were acquired using temporary surplus cash which can be sold at near their stated value as cash needs arise

Required

(a) Prepare the statement of cash flow of Garden Specialists Ltd for the year ended 31/10/08 in accordance with IAS 7 **[20 Marks]**

(b) Subsequent to the preparation of the Cash Flow statement a number of issues came to light for which no accounting adjustment had been made

- (i) A bonus issue of one share for every four shares held was made immediately after the right issue but no entry had been put through the books to reflect this
- (ii) A bad debt of €18,000 had been identified earlier but no adjustment had been made
- (iii) Depreciation had been revised from straight line to reducing balance resulting in an increase charge of €25,000
- (iv) The estimate for Income tax computed on the profits for the year ended 31/10/09 was wrongly computed and should have been €12,000

Required

In relation to each of the above, indicate briefly what affect, if any, each of the above would have on the following year end balances : (1) Cash flow (2) Net Profit (3) Equity

[5 Marks]

Total Marks 25

Question 2

Stellar Productions Ltd is engaged in the production of high tech office equipment using blue tooth technologies. Set out below is its Trial Balance as at 31/10/09

	Notes	Debits	Credits
Revenue	[1]		1,450,000
Production Costs	[2]	900,000	
Distribution		110,000	
Administration		70,000	
Inventory	31/10/09	125,000	
Interest chargeable		20,000	
Income tax expense on Profit for year ended 31/10/08	[note 9]	2,000	
Ordinary Dividend paid		37,500	
Preference Dividend		2,500	
Land		1,550,000	
Premises		1,420,000	
Machinery	[note 3]	700,000	
Fixtures and Fittings		100,000	
<u>Accumulated. Depreciation</u>			
Premises	31/10/09		710,000
Machinery	31/10/09		341,600
Fixtures and Fittings	31/10/09		41,382
Investment in Chemico Ltd	[note 6]	100,000	
VAT			45,000
Revaluation			120,000
Development Costs	[note 5]	600,000	
Provisions for customer warranties	[note8]		30,000
Trade receivables		119,178	
Bank balances			13,566
Trade payables			98,630
10% Debentures			200,000
Lease rentals	[note 4]	14,000	
Sundry receipt	[note 7		500,000
Ordinary Share Capital of nominal value of €0.80 each			1,200,000
Share Premium			120,000
Accumulated Profits 31/10/08			900,000
5% Redeemable €1.00 Preference Share Capital			100,000
	Totals	5,870,178	5,870,178

Notes to Trial Balance

1) Included in its Revenue is a contract for the amount of €362,500 which was entered into with a customer on the 01/09/09. The contract includes a three year service contract to provided support services which will cost the company €90,000 to provide. The company makes a profit margin of 20% on such work

2) Opening inventory was discovered to have include marketing expenses of €75,000 in error

3) Machinery at cost of €700,000 per Trial Balance was purchased on the 01/11/06. At the start of the current year the engineer in consultation with the financial accountant revised the estimated useful life from 12.50% straight line to 20% reducing balance. The accountant recalculated the depreciation from the date of purchase applying the 20% reducing balance. S/he then calculated the depreciation charge for the current year by applying new rate to the revised opening net book value at the 01/11/08. Adjustments were also made to the opening retained profits to effect the change to the revised opening net book value of the machine.

4) The rental refers to a machine which was acquired under a five year finance lease on the 01/11/08 . The machine is to be used in a development project in which the company is engaged. The fair value of the asset at the date of the contract was s €55,902 and the cost of finance is 8%. Its useful life is six years and it is the company's intention to formally acquire legal ownership at the end of the lease period.

5) The plant acquired above [note 4] is part of the total expenditure on the development of a new "pocket size" office computer. The other costs [excluding the machine above] are

Feasibility studies	€120,000
Market research	€ 80,000
Development expenditure on new product	<u>€400,000</u>
Amount per Trial Balance	€600,000

On investigation it was found that the project satisfied the criteria for capitalisation in accordance with IAS 38

6) Stellar Production Ltd, as part of its long term strategy acquired a 20% stake in a USA company called Chemico Ltd, a leading developer of wireless office systems. It has had a director appointed to the board of Chemico Ltd The 20% share in the USA company was acquired by Stellar on the 01/11/08 for $145,000 when the Net Assets of Chemico were $600,000 Chemico summary results for the year ended 31/10/09 were;

Profit before tax of	$160,000
Taxation	<u>($16,000)</u>
Profit for the year	$144,000

The exchange rates were as follows:

At 01/11/08	$1.45 to €1.00 euro
Average during year end 31/10/09	$1.48 to €1.00 euro
At 31/10/09	$1.50 to €1.00 euro

7) Sundry receipts relate to the issue of 400,000 Ordinary shares at €1.25 each

8) The provision of €30,000 per the Trial Balance is in relation to warranties given by the company to some "special" customers for up to two years after the date of sale to them.

The provision in the Trial Balance is analysed as follows:

Warranties in respect of sales for period ended 31/10/07	€ 7,000
Warranties in respect of sales for period ended 31/10/08	€23,000
	€30,000

The warranty provides for either a refund or a free repair. Where the product sold to a customer is not repairable then a refund equal to the selling price is made by the company. Alternatively where the product is repairable, then this will be done entirely at the expense of the company

(i) The warranty of €7,000 in respect of sales to the 31/10/07 has expired during the current year ended 31/10/09

(ii) Repair costs of €6,900 in respect of sales for the year ended 31/10/08 were incurred in the current year ended 31/10/09

(iii) €435,000 of the sales for the current year ended 31/10/09 are subject to warranty. It is estimated that 10% of sales subject to this warranty will result in a full refund to the customers. The remaining 90% of such sales will incur costs equal to 25% of the original sales price. At the current year end of 31/10/09 €12,500 has actually been incurred in repair costs to goods sold under warranty during the current period

9) A provision for €9,000 should be made for tax on profits for the year ended 31/10/09. The amount included in the Trial Balance is in respect of an under provision of €1,800 of tax on profits for the year ended 31/10/08

10) A final ordinary dividend of €0.025 per share was proposed

Requirements

(a) Prepare in accordance with the relevant standards the statement of Comprehensive Income of Stellar productions Ltd for year ended 31/10/09

[28 Marks]

(b) Prepare the Statement of Changes in Equity for Stellar for the year ended 31/10/09

[10 Marks]

(c) Prepare the Statement of Financial Position of Stellar Productions Ltd as at 31/10/09

[22 Marks]

Total Marks 60

In relation to IAS 1 candidates may answer using either the existing standard or the amended one effective for accounting periods after 01/01/09

(i) Marks will be awarded for presentation and, where necessary, for clear working notes. Candidates need only present a working note if it is felt necessary to explain either the computation or the composition of particular amounts or to justify such computations or calculations by reference to an accounting standard.

(ii) If working notes are presented then these should be indicated as follows W/N1, W/N2 etc. accompanied by a suitable heading indicating the purpose of the working note.

Question 3

The Managing Director of Garden Specialists Ltd has received a letter from the bank informing them that they are in breach of their covenant to keep the overdraft at a maximum limit of €30,000.

They have asked for its immediate reduction or they will be forced to issue legal proceedings against Garden Specialist limited.

Required

Draft a brief report to the board in which there should be included

(i) Five relevant ratios to assess the company's performance and current statement of financial position. Indicate briefly the purpose of the ratios selected

[10 Marks]

(ii) Advise the board as to how the company might reduce its overdraft

[5 Marks]

Total Marks 15

Candidates should ignore the information given in the requirement to Question 1 (b) concerning any possible adjustments to the financial statements.