Institute of Incorporated Public Accountants

Final Admitting Examination

Module 11:

Advanced Financial Accounting

Monday 26th August 2013

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

Hotels Ireland Ltd is an Irish company with a number of hotels around the country. During its current accounting year ended 31/12/12 it acquired an 80% control of an English hotel group called Family Inns UK Ltd.

Set out below are the financial statements of the Hotels Ireland Ltd and the Family Inns UK Ltd.

Statement of Financial Position as 31/12/12

	Hotels Ireland Ltd	Family Inns UK Ltd
Non Current Assets		
Hotel buildings	€ 13,400,000	£ 5,200,000
Investment in Family Inns UK [**note 1**]	€ 4,784,000	
Current Assets		
Inventories	€ 4,900,000	£ 900,000
Receivables	€ 6,100,000	£ 150,000
Cash in bank	€ 47,675	£ 22,000
Total Assets	**€ 29,231,675**	**£ 6,272,000**
Ordinary Share Capital [nominal value €1/£1 per share	€ 1,000,000	£ 1,500,000
Share premium	€ 500,000	
Retained earnings	€ 17,222,675	£ 3,500,000
Revaluation [as at 31/12/11 & 31/12/12]	€ 1,150,000	
Total equity	€ 19,872,675	£ 5,000,000
Non Current Liabilities		
Bank Loans	€ 1,200,000	
5% UK Loan **[note 1**]	€ 4,784,000	
Deferred Tax	€ 425,000	£ 262,000
Current Liabilities		
Trade and other payables	€ 2,800,000	£ 870,000
Tax Liabilities	€ 150,000	£ 140,000
Total equity plus Liabilities	**€ 29,231,675**	**£ 6,272,000**

Question 1 continued

There were **no** issues of Ordinary Share Capital during the year ended 31/12/12 by Hotels Ireland Ltd or by Family Inns UK Ltd.

The nominal value [N.V.] of one Hotel Ireland Ltd Ordinary Share Capital is €1.00

The nominal value [N.V.] of one Family Inns UK Ltd Ordinary Share Capital is £1.00

Statement of retained profits for year ended 31/12/12

	Hotel Ireland Ltd		Family Inns UK Ltd
Retained profits 31/12/11	€ 16,525,000		£ 1,400,000
Profit /(Loss) for year ended 31/12/12	€ 997,675		£ 2,100,000
Dividends	(€ 300,000)		`
Retained Profits year ended 31/12/12	€ 17,222,675		£ 3,500,000

Income statements for the year ended 31/12/12

	Hotel Ireland Ltd	Family Inns UK Ltd
Revenue/ Sales	€ 18,000,000	£ 8,000,000
Cost of sales	(€ 10,800,000)	(£ 2,000,000)
Gross Profit	€ 7,200,000	£ 6,000,000
Operating expenses	(€ 6,000,000)	(£ 3,000,000)
Operating Profit	€ 1,200,000	£ 3,000,000
Finance costs	(€ 59,800)	(£ 500,000)
Profit before tax	€ 1,140,200	£ 2,500,000
Taxation	(€ 142,525)	(£ 400,000)
Profit for the year	€ 997,675	£ 2,100,000

Question 1-continued

Note 1

Hotel Ireland Ltd acquired 80% of the Ordinary Share Capital of Family Inns UK Ltd on the 30/09/12 when the total equity of Family Inns at that date was £4,475,000 consisting of:

Ordinary Share Capital	£1,500,000
Retained Profits	£2,975,000

The assets and liabilities of Family Inns UK ltd were stated at fair value at 30/09/12.

The consideration, which was paid in UK sterling, amounted to £3,588,000.

Hotels Ireland Ltd negotiated a 5% UK loan with a UK bank to pay the consideration. At the time of the loan i.e. 30/09/12 the exchange rate was £0.75 to €1.00.

Hotels Ireland Ltd translated the UK Loan at the above exchange rate and made the following double entry in its own accounts.

Investment-Family Inns UK Ltd	€4,784,000	
UK Loan-Non Current Liabilities		€4,784,000

All interest due on the UK loan for year ended 31/12/12 has been paid, correctly translated, recorded and accounted for in Hotel Ireland Ltd own financial statements.

No other adjustments in relation to the loan have since been made by Hotel Ireland Ltd.

Note 2

Profits are assumed to accrue evenly through out the year.

Note 3

The exchange rates between UK sterling and the euro were as follows

Exchange rate at the 30/09/12 was £0.75 to €1.00
Average Exchange rate during 3 months ended 31/12/12 was £0.80 to €1.00
Exchange rate at the 31/12/12 was £0.85 to €1.00

Requirements

(a) Prepare the Group Statement of Comprehensive Income for year ended 31/12/12 in accordance with IAS 27 and IAS 21

14 marks

(b) Present an analysis of any foreign exchange gains or losses arising out of the inclusion of Family Inns UK Ltd in the Group accounts of Hotel Ireland Ltd for year ended 31/12/12.

Where relevant the analysis should apportion exchange gains or losses between Controlling Interests and Non Controlling Interests.

8 marks

(c) Prepare the Group Statement of Changes in Equity for year ended 31/12/12 in accordance with IAS 27 and IAS 21

5 marks

(d) Show the amounts that would appear on the Group Balance sheet for

(i) Goodwill
(ii) The UK loan used to purchase the subsidiary

3 marks

Total **30 marks**

Question 2

Set out below is the Trial Balance of Industrial Energy Ltd as at 30/06/13 together with notes thereto. The company manufactures and sells its own brand of equipment-EcoSaver- that monitors and maintains energy efficiencies within factories.It also engages in some long term contract work to design, build and install custom made equipment for customers who have unique energy monitoring requirements.

Premises		€ 2,500,000	
Accumulated depreciation at 30/06/12	**note 2**		€ 500,000
5% Debenture Loan			€ 100,000
Machinery		€ 1,500,000	
Accumulated depreciation at 30/06/12	**note 2**		€ 732,000
Bank overdrawn		€ -	€ 24,400
Development costs	**note 3**	€ 600,000	
Inventory	**note 1**	€ 260,000	
Trade receivables		€ 35,000	
Defined benefits	**note 4**	€ Nil	€ Nil
Payables			€ 40,000
Ordinary share capital[N.V.€0.50 p/share]	**note 5**		€ 1,000,000
Share Premium			€ 200,000
Revenue			€ 9,250,000
Purchases		€ 4,200,000	
Long term contracts	**note 6**	€ 39,000	
Taxation	**note 7**	€ 3,600	
Selling and distribution expenses		€ 1,850,000	
Administration expense		€ 1,387,500	
Debenture interest paid		€ 2,500	
Retained Profits			€ 600,000
Investment in Vacuous Ltd	**note 8**	€ 50,000	
Dividend received	**note 8**		€ 1,200
Dividends paid	**note 9**	€ 20,000	
Totals		**€ 12,447,600**	**€ 12,447,600**

<u>Note 1</u>

Closing inventory was €286,000 on the 30/06/13.

Question 2-continued

Note 2

The depreciation rates for non current assets and its allocation under the functional headings is as follows;

	Production	Distribution	Admin
Premises 2% straight line	50%	30%	20%
Machine 20% reducing balance	100%		

Premises

Due to surplus needs the board met on the 29/06/13 and made a definite commitment to sell one of its premises and pursuant to that objective it has hired auctioneers Bailey & Sons to expedite its disposal.

The building cost €500,000 when it was purchased ten years ago on the 01/07/03.

The building has been valued by the auctioneers at €900,000 whilst disposal and legal costs are estimated at €80,000.

Machinery

In light of the current economic climate a review was undertaken on the 29/06/13 of the machinery values all of which are part of one cash generating unit.

The total net realisable values were estimated at €330,000 whilst the projected net Cash flows were estimated to be €145,000 per annum for the next five years from the 01/07/13. It is considered that a discount rate of 10% would be appropriate in any calculation.

The discount factors for 10% are as follows

Year 1	Year 2	Year 3	Year 4	Year 5
.909	.826	.753	.683	.621

Question 2-continued
Note 3-Development costs-€600,000

Internally generated goodwill (a)	€	200,000
Professional fees arising from bringing asset to its working condition	€	80,000
Cost of testing whether asset is performing functionally	€	120,000
Cost of introducing new product through promotion and advertising	€	90,000
Purchases of materials including import duties of €15,000	€	110,000
Total per Trial Balance	€	600,000

(a) The internally generated goodwill represents the net present value applying a 10% discount rate to the estimated incremental premium cash flows enjoyed by the company over its competitors.

Note 4-Defined benefits. - Net balance at 30/06/12 €Nil

The company contributes to a defined benefit scheme for its employees. The scheme is operated and managed independently by a professional Pension fund trust.The total contribution paid to the scheme for year ended 30/06/13 was €240,000. This consisted of €180,000 paid by the board of Industrial Energy Ltd to the pension fund trust. The €180,000 was recorded under Administration costs in Industrial Energy's Financial Accounts. The balance of €60,000 represents the contribution by the employees of Industrial Energy Ltd by way of deduction from their wages and which amount was forwarded to the pension fund.Apart from the above no other entries were made in accounts of Industry Energy Ltd.
Details of the scheme are as follows

	Fair value of Plan of Assets	Present value of Obligations
as at 30/06/12	€ 900,000	€ 900,000
as at 30/06/13	€1,200,000	€1,290,000

For the year ended 30/06/13

The return on the Plan of Assets was	€100,000.
The present value of the service costs for same period was	€170,000.
Interest cost for the accounting year. was	10%
Benefits paid out during year were	€120,000

Question 2-continued

Note 5- Share Capital [nominal value per share €0.50]

During the year the company issued 500,000 ordinary shares at €0.75 each to the general public. The issue was correctly recorded and accounted for.

Employee Share Option

On the 01/07/12 the company initiated a share option for its 400 highly skilled employees as an inducement to prevent them being poached by rivals. On that date the company granted a total of 150 options to each employee. These options would vest at the end of the four year period i.e. 30/06/16The company estimated the fair value of each option on grant date at €0.60.
It is estimated that 20% of the employees will have left before four years service is completed. No entries have been made in respect of the above.

Note 6 Long term contracts €39,000

This amount is analysed as follows;

Cumulative total costs to date on all three contracts	€162,000
Cumulative monies received to date from all three contracts	€123,000)
	€ 39,000

Analysis of the three separate contracts

Totals	**Contract 1**	**Contract 2**	**Contract 3**
Dates contracts commenced	30/12/11	01/07/12	01/05/13
Contract Price	€ 120,000	€ 90,000	€ 80,000
Total cumulate costs to date €162,000	€ 90,000	€ 60,000	€ 12,000
Estimated costs to complete contract	€ 8,000	€ 16,000	€ 50,000
Completion stage of each contract	**90%**	**70%**	**15%**
Total cumulative payments received to date €123,000	€ 72,000	€ 35,000	€ 16,000

The only entries made during the current year, and in the case of **Contract 1** in the previous year to 30/06/12, was to record the total costs incurred and the total monies received. Apart from the above no other entries were made in either accounting year for any of the above contracts.

Contract 1 was 60% complete in the year ended 30/06/12.

It is company policy not to recognise a profit on an individual contract if it is less than 20% complete.

Note 7-Taxation

The €3,600 represents an underestimation of the tax liability for year ended 30/06/12.

A provision for tax for the year ended 30/06/13 of €22,000 is to be made.

Note 8 -Acquisition of share in Vacuos Ltd

On the 31/12/12 Industry Energy Ltd bought a 30% share of Vacuous Ltd a company specialising in the domestic home cleaning market.

The analysis of the equity of that company as at 31/12/12 was as follows;

Ordinary share capital with nominal value of €1.00 per share	€80,000
Retained profits as at 31/12/12	€70,000

All the assets and liabilities were stated at their fair value at that date

Question 2-continued

Note 8 continued

The Statement of Comprehensive Income of Vacuous Ltd for year end 30/06/13 was

Revenue for the year	€ 120,000
Cost of goods sold	(€ 48,000)
Gross Profit	€ 72,000
Operating expenses	(€ 24,000)
Profit before tax	€ 48,000
Taxation	(€ 6,000)
Profit for the year	€ 42,000

Profits accrued evenly through out the year

Statement of retained Profits

Profit brought forward	30/06/12		€ 70,000
Profit for the year ended	30/06/13		€ 42,000
Dividend paid	€0.05	per share (a)	(€ 4,000)
Retained profits as at	30/06/2013		€ 108,000

(a) The dividend was paid out of post acquisition profits

A review of Goodwill, arising on acquisition, at the year end determined that it had been impaired by €1,500

Note 9

The government has passed legislation with effect from the 01/01/13 requiring all factories to install carbon reduction emission filters by that date. Failure to do so will result in fines ranging from €60,000 to €100,000.

The cost to Industry Energy Ltd of installing such filters is estimated at €200,000.On the 20/07/13 it invited tenders for the installation of such filters.

Note 10

It was proposed to pay a dividend of €0.02 per ordinary share

Required

In relation to Industry Energy Ltd prepare;

(a) **The Statement of Comprehensive Income** for the year end 30/06/13 in accordance with all relevant standards.

(23 marks)

(b) The **Balance Sheet [Statement of Financial Position]** as at 30/06/13 in accordance with all relevant standards.

(21 marks)

(c) The **Statement of Changes in Equity** for year ended 30/06/13 in accordance with all relevant standards.

(6 marks)

Total (50 marks)

Question 3

Set out below are the Financial Statements for the last two years of Failte Products Ltd a private family owned company which manufactures and sells tourist mementos to the various tourist shops around the country. The company is currently seeking to retain existing overdraft facilities or similar funding from its Bank Hiberno Ltd. The bank have notified the company that they cannot continue the present funding arrangement and have sought an urgent meeting

Statement of Comprehensive Income Failte Products Ltd for year's ended

	31/12/2012		31/12/2011
Sales volume in units	990,000 u		900,000 u
Sales Revenue	**€ 4,851,000**		**€ 4,500,000**
Cost of Goods Sold	(€ 3,977,820)		(€ 3,600,000)
Gross Profit	**€ 873,180**		**€ 900,000**
Operating Expenses	(€ 485,100)		(€ 540,000)
Operating Profit	**€ 388,080**		**€ 360,000**
Profit on disposal of machinery **note 2**	€ 80,000		
Finance charges	(€ 5,400)		(€ 4,200)
Profit before tax	**€ 462,680**		**€ 355,800**
Taxation	(€ 57,835)		(€ 44,475)
Profit for the year	**€ 404,845**		**€ 311,325**

Statement of retained Profits for Failte Products Ltd for year's ended

	31/12/12	31/12/11
Retained Profits at start of year	€ 111,325	€ -
Profit for the year	€ 404,845	€ 311,325
Ordinary Dividends	(€ 300,000)	(€ 200,000)
Balance at 31st December	€ 216,170	€ 111,325

Statements of Financial Position of Failte Products Ltd as at

	31/12/12	31/12/11
Non Current Assets		
Premises at cost or value	€ 2,000,000	€ 2,000,000
Accumulated Depreciation-Premises	(€ 200,000)	(€ 160,000)
Premise at net book value **note 1**	€ 1,800,000	€ 1,840,000
Machinery at cost **note 2**		€ 200,000
Accum.Depreciation -Machinery **note 2**		(€ 72,000)
Total Non Current Assets	**€ 1,800,000**	**€ 1,968,000**
Current Assets		
Inventory	€ 490,416	€ 295,890
Trade Receivables	€ 465,164	€ 406,849
Total Assets	**€ 2,755,581**	**€ 2,670,740**
Equity and Liabilities		
Equity		
Ordinary Share Capital of €0.50 each	€ 1,000,000	€ 1,000,000
Retained Earnings	€ 216,170	€ 111,325
Revaluation -note 1	€ 800,000	€ 800,000
Total Equity	**€ 2,016,170**	**€ 1,911,325**
	-	-
Non Current Liabilities		
12% Debentures	€ 45,000	€ 35,000
Current Liabilities		
Trade Payables	€ 326,944	€ 345,205
Bank	€ 367,466	€ 379,209

Total Equity plus Liabilities	**€ 2,755,581**	**€ 2,670,740**

Note 1
The revaluation relates entirely to the premises which were undertaken some years ago. A current valuation of the premises at the 31/12/12 is estimated to be €1,100,000 but since it is only a "paper" movement the managing director saw no need for making any adjustment.

Note 2
In order to improve its cash flow the company sold its machinery on the 01/01/12 to an overseas buyer for a profit of €80,000. The net book value of the machine at the date of sale was €128,000 [€200,000 less depreciation of €72,000 as B/S 31/12/11]
The company had acquired replacement machinery on the 01/01/12 with a fair value of €300,000 under a five year finance lease. The repayments were €79,139 a year. The residual value of the machine will zero at end of the lease term. The cost of finance is 10%. The lease repayment of €79,139 is included in "Cost of Sales" for 31/12/12

Required.
(a) Select and calculate two ratios for each of the headings set out below in respect of each year of the financial statements.

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

Ignore the information given in Note (1) and (2) when calculating ratios.

(b) Had the information under notes 1 & 2 been incorporated into the financial statements would any of the ratios selected and calculated in (a) be any different?

(c) You have been contracted part time to write a brief memo to the board incorporating the above results of your findings in (a) and (b) and suggest how the funding requirements of the company might be resolved.

(20 marks)

Note

In setting out the computation for a ratio the following format is required or any other format that gives the same full information required

Name of Formula	**Formula**	**2011**	**2010**
??	??	$\frac{??}{??}$ x 100 =??%	$\frac{??}{??}$ x 100 =??%

Ratios must be given to two decimal places.

Failure to set out ratios in the proper format or not to compute to two decimal places may result in loss of marks.

END OF EXAMINATION PAPER .