Dublin Business School

QQI

BA (HONS) ACCOUNTING & FINANCE

SUMMER 2020 EXAMINATIONS

Module Code: **B8AF102**

Module Description: **Financial Reporting**

Examiner: **James Browne**

Internal Moderator: **Diana Ghazale**

External Examiner: **Eoin Langan**

Date: Monday, 15th June 2020
Time: 15:00 – 18:00

INSTRUCTIONS TO CANDIDATES

Time allowed is 3 hours
Section A: Compulsory question, 25 marks.
Section B: Answer ANY THREE questions, all carry 25 marks.
Total: 100 marks.

Section A: COMPULSORY

Question 1

The summarised statements of financial position of three companies as at 31 March 2020 are as follows:

	Priya Co €'000	Sriya Co €'000	Ariya Co €'000
ASSETS			
Non-current assets			
Property, plant and equipment	65,000	33,000	30,000
Intangible assets (Licence)	5,000	-	-
Investments:		-	-
Sriya Co (7 million shares at €5 each)	35,000	-	-
Ariya Co Ltd	12,000	-	-
	117,000	33,000	30,000
Current assets			
Inventory	5,000	3,000	2,000
Trade receivables	7,500	3,500	3,000
Bank	2,000	1,000	1,500
Total assets	131,500	40,500	36,500
EQUITY AND LIABILITIES			
Ordinary shares of €1 each	70,000	10,000	15,000
Retained earnings -			
- Opening as at 1 April 2019	46,200	20,500	16,100
- For current y/e 31 March 2020	6,500	5,000	1,400
	122,700	35,500	32,500
Non-current liabilities			
Deferred tax	3,000	2,000	1,500
Current liabilities	5,800	3,000	2,500
Total equity and liabilities	131,500	40,500	36,500

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The following additional information also applies:

1. On 1 April 2019, Priya Co obtained a majority equity shareholding in Sriya Co on the following terms: an immediate cash payment of €5 per share on 1 April 2019; and a further amount deferred until 1 April 2020 of €5 million. The immediate payment has been recorded in Priya Co's financial statements, but the deferred payment has not been recorded. Priya Co's cost of capital is 8% per annum.

2. On 1 October 2019, Priya Co acquired 30% of the equity shares of Ariya Co, paying €12 million in cash.

3. Priya Co's policy is to value the non-controlling interest at fair value at the date of acquisition. To calculate the fair value of non-controlling interest the directors of Priya Co have agreed to use a share price for Sriya Co of €2 per share.

4. At the date of acquisition, the fair values of Sriya Co's property, plant and equipment was equal to its carrying amount with the exception of machinery which had a fair value €200,000 above its carrying amount. At that date the plant had a remaining life of four years. Sriya Co uses straight-line depreciation for machinery assuming a nil residual value.

5. At 31 March 2020, Priya Co's inventory included goods bought from Sriya Co for €1 million. Sriya Co had marked up these goods by 25% on cost. The agreed intercompany current account balance between the two entities at 31 March 2020 was €500,000.

6. Impairment tests carried out on 31 March 2020 concluded that consolidated goodwill was not impaired, but, due to disappointing performance, the value of the investment in Ariya Co was impaired by €250,000.

7. Assume all profits accrue evenly through the year.

Required:

(a) Prepare a consolidated statement of financial position for Priya Co as at 31 March 2020.

(20 marks)

(b) Discuss the term **"Equity Accounting"** clearly explaining when and how it should be utilised in relation to consolidated financial statements.

(5 marks)

(Total: 25 Marks)

Section B: Answer ANY THREE questions

Question 2

Financial Instruments play an important part in financial reporting for many entities and the recognition, measurement and presentation, although governed by a number of accounting standards, are areas of constant attention for standard setters.

(a) Discuss **four** reasons the International Accounting Standards Board consider it of critical importance to provide formal regulatory standards in the area of Financial Instruments.

(8 marks)

(b) Explain the concepts of **"Substance Over Form"** and **"Off Balance Sheet Finance"** in terms of their use and application to modern accounting practice. Clearly state whether in your opinion these principles encourage or protect against creative accounting practices by reporting entities.

(8 marks)

IAS 36 sets out the basis for the recognition and measurement of asset impairments in published financial statements. Application of the standard helps ensure that the asset values presented remain consistent with the principles identified in the Conceptual Framework.

(c) Critically discuss the purpose of an impairment review, the steps involved in conducting the process and how the process links to the Conceptual Framework.

(9 marks)

(Total 25 marks)

Question 3

The following extracts are from the financial statements of Impy Co. for the year ended 31 March 2020:

Income Statement for the year ended 31 March 2020

	€m
Sales revenue	860
Cost of Sales	(370)
Gross profit	490
Distribution costs	(56)
Administrative expenses	(95)
Profit from operations	339
Interest receivable	4
Interest payable	(23)
Profit before tax	320
Income tax expense	(129)
Profit after tax	191

Statement of Financial Position as at:

	31 Mar 2020		*31 Mar 2019*	
	€m	€m	€m	€m
Non-current assets				
Property, plant and equipment	720		575	
Intangible assets	110		100	
Investments	15		19	
		845		694
Current Assets				
Inventories	170		182	
Trade receivables	160		145	
Cash	10		61	
		340		388
Total Assets		**1,185**		**1,082**
Equity				
Issued share capital (50 cent nominal value)	240		200	
Share premium	155		135	
Revaluation reserve	15		10	
Retained earnings	266		201	
		676		546
Non-current liabilities				
Long term loans		310		300
Current liabilities				
Trade payables	125		131	
Bank overdraft	15		60	
Taxation	59		45	
		199		236
Total equity and liabilities		**1,185**		**1,082**

Additional information:

(i) Profit from operations is after charging depreciation on the property, plant and equipment of €46 million and amortisation on the intangible non-current assets of €11 million.

(ii) The revaluation reserve relates wholly to property, plant and equipment.

(iii) On 1 April 2019, plant and machinery costing €700 million, and with accumulated depreciation of €500 million at 31 March 2019, was sold for €220 million.

(iv) On 1 October 2019, investments were disposed of at their carrying amount of €4 million therefore not incurring any profit / loss on disposal. No other investments were purchased during the year.

(v) During the year a 1 for 5 rights issue took place at a premium of 25 cent per share.

(vi) Ordinary Dividends were paid during the year and the amount is disclosed in the Statement of Changes in Equity.

Required:

(a) Prepare a Statement of Cash Flow for Impy Co for the year ended 31 March 2020 using the indirect method in compliance with IAS 7.

Ensure you clearly display the reconciliation of opening and closing cash balances for the year.

(20 marks)

(b) Explain the difference between the direct and indirect methods of preparing a Statement of Cash Flow identifying **<u>ONE</u>** advantage for each method.

(5 marks)

(Total 25 marks)

Question 4

Harvey is a company operating in the Pet care industry and has decided that a policy of growth through acquisition is the fastest way to achieve the directors' long term strategy. In recent years they have acquired shares in two other companies as follows:

Company	*Date acquired*	*Ownership*	*Total Equity at acquisition*	*Purchase Consideration*
Plonk	1st April 2015	75%	€300m	€285m
Nitro	1st July 2018	40%	€180m	€102m

The results for the three companies for the year ended 31st March 2019 are as follows:

	Harvey €m	**Plonk €m**	**Nitro €m**
Revenue	750	340	110
Cost of Sales	(600)	(283)	(88)
Gross profit	150	57	22
Operating expenses	(65)	(14)	(7)
Operating profit	85	43	15
Investment income			
- dividends from Plonk	6		
- dividends from Nitro	1		
Interest payable	(5)	(4)	(2)
Profit before tax	87	39	13
Tax	(27)	(11)	(4)
Profit after tax	60	28	9

The following information is available:

1. Harvey has a policy of measuring NCI using the proportionate share method. Goodwill impairment to date since acquisition amounts to a total of €20m. Goodwill impairments recognised as expenses up to 31st March 2018 were €16m.

2. During the year Harvey made sales to Plonk of €80m. All of these goods had been sold on by Plonk at the year-end. Since the acquisition of Nitro, Harvey has made sales to Nitro of €10m. Only one quarter of these goods had been sold on to third parties by Nitro by the year end.

3. Harvey charges a mark-up of 25% on cost when setting its sales price.

Required:

(a) Explain the difference between Acquisition Accounting and Equity Accounting in terms of group accounting.

(5 marks)

(b) Prepare the Consolidated Income Statement for the year ended 31st March 2019 in so far as the information above allows.

(20 marks)
(Total 25 marks)

Question 5

The following trial balance has been extracted from the financial records of Pippa Co for the accounting year end 31 March 2020.

	DR €000	CR €000
Ordinary Share Capital (€1Nominal Value)		40,000
Share Premium		8,000
Retained Earnings at 1 April 2019		78,740
7% Debentures (2030)		10,000
Deferred Tax		2,100
Current Tax		80
Bank		180
Trade Payables and Receivables	33,500	25,500
Inventory at 1 April 2019	29,500	
Land & Buildings at Cost (Land €15 million)	95,000	
Investment Property at Cost	25,000	
Plant at Cost	8,000	
Equipment at Cost	11,000	
Accumulated Depreciation 1 Apr 2019 – Buildings		10,000
Accumulated Depreciation 1 Apr 2019 – Plant		1,600
Accumulated Depreciation 1 Apr 2019 – Equipment		2,000
Revenue		353,500
Purchases	195,500	
Administration Costs	78,500	
Distribution Costs	53,750	
Debenture Interest Paid	200	
Other Finance Costs	1,500	
Equity Dividend Paid	12,000	
Suspense Account (see note 6)		11,750
	543,450	**543,450**

The following **additional** information has been provided to help finalise the financial statements:

1. Depreciation policy for the company is that Plant is depreciated at 20% using the reducing balance method; Buildings have a remaining useful life of 35 years and Equipment is depreciated at 10% on cost using the straight line method and assuming a residual value of €1 million. All depreciation should be charged to Cost of Sales.

2. The investment property was bought on 1 October 2019 and is held for its rental income with an expected useful life of 30 years. Sunshine Co does not occupy any part of the property and their policy is to use the fair value model as permitted in IAS 40 (Investment Property). The valuation at 31 March 2020 was €28 million. (Ignore deferred tax.)

3. Closing inventory at 31 March 2020 was valued at €33 million. This figure includes the following items which require further consideration:

- An amount of €1.4 million relating to inventory ordered from a supplier on 20 March 2020. Due to a strike at the supplier's factory, these goods were not delivered or invoiced until 1 April 2020.

- A batch of products recorded at original cost of €1 million. Due to flood damage in the warehouse during March, it was only possible to sell this entire batch of products for an amount of €0.7 million during May 2020.

4. The current tax in the trial balance relates to last year's over/under provision. The charge for the current year is estimated at €13 million. Deferred tax provision should be increased by €500,000.

5. The 7% Debentures were issued on 1 July 2019 at par value and are due for repayment in July 2030 at par value.

6. The Suspense Account balance represents two events for which the directors do not know the correct accounting treatment:

    - During the year, a 1 for 8 Rights Issue took place at an issue price which included a 50% premium on the share's nominal value. Only the cash received and lodged to the bank has been recorded.

    - Pippa Co issued a long term bond on 1 April 2019. The nominal value is €5 million but it was issued at a discount of 5% and will be redeemed at a small premium on maturity. As a result of the discount and premium, the effective finance cost is 12% although the quoted coupon rate is 10% (payable in arrears). Only the items going through the bank account have been recorded (cash received and the coupon paid for the year) in the suspense account.

Required:

a) Prepare the Statement of Comprehensive Income for the year ended 31 March 2020.

(10 marks)

b) Prepare the Statement of Changes in Equity for the year ended 31 March 2020.

(5 marks)

c) Prepare the Statement of Financial Position as at 31 March 2020.

(10 marks)

(Total: 25 Marks)

END OF EXAMINATION