

UNIVERSITY OF BOLTON
BOLTON BUSINESS SCHOOL
ACCOUNTANCY PATHWAY
SEMESTER I EXAMINATION 2008/2009
FINANCIAL REPORTING AND THE REGULATORY
FRAMEWORK
MODULE NO: ACC3003

Date: Friday 23rd January 2009

Time: 10:00 – 13:00

INSTRUCTIONS TO CANDIDATES:

There are **FIVE** questions on this paper.

Answer **FOUR** questions.

Section A is **COMPULSORY**.

Section B - There are **FOUR** questions.

Answer **THREE** questions only.

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Section A – COMPULSORY question

Q1 (a)

The information below relates to two companies, Thomas plc, and Hardy Ltd., for the year 2004.

Balance sheets for Thomas plc. and Hardy Ltd. as at 31st Dec.2008.

	<u>Thomas plc</u>	<u>Hardy Ltd.</u>
	<u>£m</u>	<u>£m</u>
Non-current Assets	2,080	640
Investment	-----	-----
	<u>2,080</u>	<u>640</u>
Current assets:		
Inventories	740	440
Receivables	760	326
Bank	<u>280</u>	<u>86</u>
	<u>1,780</u>	<u>432</u>
Current Liabilities	<u>896</u>	<u>852</u>
Net current assets	<u>240</u>	<u>312</u>
	<u>2,320</u>	<u>952</u>
Equity and reserves:		
£1 Ordinary shares	1,600	800
Reserves	<u>720</u>	<u>152</u>
	<u>2,320</u>	<u>952</u>

Additional information:

(i) Thomas plc purchased 640m shares in Hardy Ltd on Jan 1st 2008.

On that date the reserves of Hardy Ltd were £80m.

The purchase consideration was £800m and was in the form of a one for one share exchange, with the shares of Hardy Ltd being valued at £1.25 per share.

This transaction has not been entered on the balance sheet of Thomas plc above.

(ii) The assets of Hardy Ltd were considered to be stated at 'fair value' at the date on which the investment was made, with the exception of the premises of Hardy Ltd which were considered to have a fair value of £16m in excess of their book value.

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Q1 (a) continued

- (iii) At the balance sheet date Hardy Ltd owed Thomas plc £12m.
This amount is included in the respective figures for Receivables and Payables (current liabilities) in the above balance sheets.
- (iv) The above note (c) relates to sale of goods by Thomas plc to Hardy Ltd for £12m. Half of these goods were still in Hardy Ltd's stock at the year end.
The goods were sold by Thomas plc at a profit margin of 20%.

Required:

Prepare the consolidated balance sheet of Thomas plc and Hardy Ltd on 31st December 2008.

(20 marks)

- (b)** Thomas plc has also recently acquired 30% of the ordinary share capital of Cromwell Ltd.

The share capital of Cromwell Ltd was made up as below:

	<u>£m</u>
Ordinary shares of £0.50 each	30.0
Share premium	2.4
Retained profit	<u>3.6</u>
	<u>36.0</u>

The non-current assets of Cromwell Ltd included goodwill of £6.2m

Required:

Explain how Thomas plc would account for this share acquisition, giving reasons for your explanation.

(5 marks)

Total 25 marks

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SECTION B

Answer **THREE** questions only

Q2 The following trial balance has been extracted from the books of Pommern plc at 31st December 2008.

Trial Balance as at 31st December 2008:

	<u>£m</u>	<u>£m</u>
Ordinary shares of £1 each		600
Share Premium		50
10% Debentures		150
Freehold properties (at cost)	160	
Plant and machinery (at cost)	720	
Provision for depreciation of plant and machinery (at 31.12.08)		320
Inventories	160	
Receivables	240	
Revenue		1,560
Cost of sales	1,220	
Administrative expenses	150	
Distribution costs	56	
Goodwill	300	
Payables		134
Bank balance	25	
Debenture interest	15	
Sale of freehold property		56
Retained profit (1.1.08)		176
	<u>3,046</u>	<u>3,046</u>

Additional information:

- (i) The company's year end is 31st December.
- (ii) The share capital is comprised of £1 Ordinary shares. The company issued 100 million ordinary shares on 1st July 2008 at a premium of 20p per share.
- (iii) During December 2008 the company sold one of its properties, which was surplus to requirements, for £56m. This had cost £24m several years ago. A firm of surveyors have valued the remaining properties at £236m and the directors would like this value to be reflected in the balance sheet. The company has not charged any depreciation on its properties, as, in the opinion of the directors, the properties are maintained to such a high standard that depreciation is not relevant

**Q2 continued over
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Q2 continued

(iv) In January 2009, it was discovered that a major customer had gone into liquidation. This customer owed the company £6.8m and it was estimated that creditors would receive a maximum of 50p in the £.

(v) A customer is suing Pommern plc for damages of £2.4m. This is the result of an injury incurred in November 2008 whilst the customer was on a tour of the company premises. Lawyers for Pommern have indicated the company could have been negligent, but that damages, if awarded, would probably amount to £1.2m at the most.

(vi) Taxation for the year is estimated at £54m.

Required:

(a) Discuss and assess how you would deal with items (iii), (iv) and (v) above in accordance with internal accounting standards. **(9 marks)**

(b) Prepare an Income Statement and a Balance Sheet for the year to December 31st 2006 **(13 marks)**

(c) Calculate the Earnings Per Share for the year **(3 marks)**

Total 25 marks

Q3

Duncan plc entered into the following leases on January 1st 2006:

The lease of specialised excavation equipment over a two year period. Duncan paid an initial deposit of £20,000 on January 1st 2006, to be followed by two further payments of £12,000 on the 1st January 2007 and 2008.

The equipment is not new, and is expected to have a further useful life of 3 years. If purchased outright, the equipment would have cost £68,000.

The lease of two mechanical diggers. Each digger would have cost £48,000 if purchased outright. Duncan paid an initial deposit of £16,000 on January 1st 2006, to be followed by four annual rental payments of £36,000 payable on 31st December 2006, 2007, 2008, and 2009 respectively.

The lease agreement contains a clause giving Duncan plc an option to purchase the two diggers at the end of the lease for a nominal sum.

The diggers have an expected useful working life of five years.

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Q3 continued

Required:

(a) Explain how you would treat each of the two leases in the accounts of Duncan plc, and show the relevant entries in the financial statements at the 31st December 2006.

(18 marks)

(b) Keyes plc has made an arrangement to sell part of its freehold land to Madden Bank plc for £20m. Keyes plc has an option to repurchase the land after three years for £26m. During the three year period, the land will remain under the control of Keyes plc.

Required:

Discuss what is meant by 'substance over form' in relation to reporting transactions and explain how the above transaction should be treated in the books of Keyes plc.

(7 marks)

Total 25 marks

Q4

(A) Galatea plc purchased some equipment on 1st January 2008 at a cost of £240,000.

The equipment is expected to have a useful life of 5 years and it is company policy to depreciate such assets using the straight-line method. The equipment is not expected to have any value at the end of its working life.

For tax purposes the company gets a writing down allowance of 25% per annum on a reducing balance basis.

The current rate of taxation is to be taken as 30%, and the profit for the year ended 31st December 2006 before depreciation was £180,000.

Required:

a) Calculate the amount of deferred tax liability that should be recognised at the year-end.

(7marks)

b) Discuss and critically assess the requirements of IAS 12 'Income Taxes' with regard to the accounting treatment of deferred taxation.

(6 marks)

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Q4 continued

(B) Arethusa plc has in issue 5m £1 redeemable ordinary shares. The company intends to redeem all of these shares at a premium of 25p per share at the end of June 2008.

Required:

- a) Discuss the options open to Arethusa when the shares are redeemed, and the effect this would have on the balance sheet. **(8 marks)**
- b) Critically assess the reasons for companies having to maintain a certain level of 'permanent' capital. **(4 marks)**

Total 25 marks

Q5(A)

Prestatyn plc is a company manufacturing a range of high quality models of steam locomotives.

The present production line employs assets which had a book value (carrying amount) at the end of the year 2008 of £520,000 and which have an estimated scrap value of £112,000 at the end of 2012.

Each model currently sells for £80 and the cost per model is £46.

However, towards the end of the year 2008, the price of one of the essential production materials increased due to a shortage in supply, which is expected to continue for the foreseeable future. The revised cost per model increased to £66 per unit.

As a result of this, the selling price per model had to be raised to £100, which had a big impact on the budgeted sales.

There was an indication, therefore, at the end of 2008, that the net assets employed to produce this model may have been impaired.

The financial manager estimated that the net realisable value of these net assets at the 31st December 2008 would now only be £400,000.

A calculation of the value in use of these assets resulted in a valuation of £426,000.

Required:

- a) Explain what is meant by the following terms:
 - (i) net assets being 'impaired'
 - (ii) 'value in use' of assets, and, **(4 marks)**
- b) Critically evaluate the requirements of the international accounting standard which covers the treatment of such assets. **(4 marks)**

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Q5 continued

- c) Calculate the amount at which these assets should be reported on the balance sheet of Prestatyn plc at the end of December 2008.

(4 marks)**Q5 (B)**

Holyhead Ltd. commenced trading on 1st January 2007 as building contractors. The following details relate to a contract which was still incomplete at the year end 31st December 2008.

<u>Contract No. A210</u>	<u>£000</u>
Agreed final contract price	840
Total cost incurred to date	300
Estimated further costs to completion	340
Progress billings	140
Payments received in advance	120

The contract was 25% complete the end of the previous financial year (2007) at which time revenue of £210,000 and costs of £160,000 were recognised in the income statement.

The contract was assessed as being 60% complete at the end of 2008.

Required:

- a) Critically assess the recommended treatment for construction contracts under international accounting standards. **(4 marks)**
- b) Prepare the relevant extracts from the company's financial statements for the year ended 31st December 2008 in respect of the above contract. **(9 marks)**

Total 25 marks**END OF QUESTIONS**