

UNIVERSITY OF BOLTON

BOLTON BUSINESS SCHOOL

BA (HONS) ACCOUNTANCY PATHWAY BY
DISTANCE LEARNING

KUALA LUMPUR INTAKE 18

SEMESTER 2 EXAMINATIONS 2008/2009

FINANCIAL REPORTING AND THE REGULATORY
FRAMEWORK

MODULE NO: ACC3003DL

Date: 13th June 2009

Time: 3 hours

INSTRUCTIONS TO CANDIDATES:

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

You are required to answer **FOUR** questions.

Section A is compulsory - answer **ONE** question.

Section B - answer **ANY THREE** questions.

All questions carry equal marks.

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SECTION A – COMPULSORY question

Q1

The information below relates to two companies, Diamond plc, and Jubilee plc, for the year 2008.

Diamond plc acquired 45 million ordinary shares of Jubilee plc on 1st January 2008 for an agreed price of £81 million. The purchase consideration was in the form of a share exchange consisting of three new shares in Diamond plc for every two shares held in Jubilee plc.

This transaction has not yet been entered in the books of Diamond plc.

Balance sheets for Diamond plc and Jubilee plc as at 31st Dec 2008

| | Diamond plc | Jubilee plc |
|------------------------------|----------------|---------------|
| | \$m | \$m |
| Non-current Assets | <u>220.8</u> | <u>58.2</u> |
| Current assets: | | |
| Inventories | 55.5 | 37.2 |
| Trade receivables | 48.9 | 22.2 |
| Cash and Bank | <u>22.2</u> | <u>5.4</u> |
| | <u>126.6</u> | <u>64.8</u> |
| Current liabilities: | | |
| Trade payables | 83.4 | 33.6 |
| Taxation | <u>26.4</u> | <u>10.2</u> |
| | <u>(109.8)</u> | <u>(43.8)</u> |
| Net current assets | <u>16.8</u> | <u>21.0</u> |
| Net assets | <u>237.6</u> | <u>79.2</u> |
| Equity and reserves | | |
| Ordinary shares of \$1 each | 150.0 | 60.0 |
| Share Premium | 30.0 | --- |
| Retained profit: | | |
| At 31st December 2007 | 42.9 | 7.2 |
| For year to 31 December 2008 | <u>14.7</u> | <u>12.0</u> |
| | <u>237.6</u> | <u>79.2</u> |

Additional information:

- The fixed assets of Jubilee plc are stated at cost less relevant depreciation, and include property shown at book value of \$24.0m but which were considered to have a market value of \$36.0m at the date of acquisition. All other fixed assets are considered to be stated at 'fair value' at the date on which the investment was made.

**Question 1 continued over
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Question 1 continued

2. At the balance sheet date Jubilee plc owed Diamond plc \$24.0m. This amount is included in the respective figures for trade receivables and trade payables in the above balance sheets.
3. At the date of acquisition, Diamond plc sold some goods to Jubilee plc for \$54.0m (mark-up of 25%). All of these goods were still in the stock of Jubilee plc at the year end and are included in Jubilee plc's stock figure.

Required:

- (a) Prepare the consolidated balance sheet of Diamond and Jubilee as at 31st December 2008.

(18 marks)
- (b) Discuss and assess the treatment of 'associate' companies and joint ventures in relation to the treatment of subsidiary companies.

(7 marks)

TOTAL 25 MARKS

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SECTION B – Answer ANY THREE questions

Q2

Below is a list of items to be dealt with in the preparation of the financial statements of Centenary plc. for the year ending 30th April 2009:

- (i) A government grant for \$40m received in respect of the development of new environmentally friendly processing system which will come into effect next year, and is expected to be in operation for at least five years.
- (ii) Goodwill and intangible assets costing \$118m as a result of the acquisition of small rival company at the start of the year. The intangible assets were valued at \$38m and the goodwill at \$50m. Also the treatment of internally generated trademarks, which the directors consider to be worth \$30m.
- (iii) The discovery in May 2009 that a debtor owing \$9m had gone into liquidation, and that Centenary would only receive 30c in the \$ owed at the most.
- (iv) A customer is suing Centenary for damages of \$16m as a result of injuries caused to him whilst on a visit to one of Centenary's factories in February 2009. Lawyers advising Centenary are uncertain as to whether the customer will be successful or not, but are very confident that, if any damages are awarded, they will not exceed \$5m.
- (v) The estimated after tax profit before the above items have been dealt with is \$365m. The company had 800m \$1 Ordinary shares in issue at the start of the year and issued a further 400m \$1 Ordinary shares on 1st November 2008. Calculate the earnings per share to be reported for the year.

Required:

For each of the above items;

Discuss and critically evaluate the recommended accounting treatment in accordance with current international accounting standards.

(5 marks each)

TOTAL 25 MARKS

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Section B continued

Q3

(A)

Bangor plc is a company manufacturing a range of high quality metal models of local landmarks. One of these is a model of Blackpool Tower.

The present production line employs assets which had a book value (carrying amount) at the end of the year 2008 of £78m and which have an estimated scrap value of \$6.8m at the end of 2012.

Towards the end of the year 2008, the price of one of the essential production materials increased due to a shortage in supply, and this is expected to continue for the foreseeable future. The revised cost per model has therefore increased, and as a result of this, the selling price per model has had to be raised which has 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 \$76m.

A calculation of the value in use of these assets resulted in a valuation of \$80.2m.

Required:

- (a) Discuss and assess what is meant by the 'impairment' of assets. **(4 marks)**
- (b) State how the above should be dealt with in accordance with the requirements of the relevant international accounting standard. **(8 marks)**

(B)

The following information relates to the purchase and installation of new plant for a company, required for carrying out a contract.

| | |
|------------------------------------|--------------|
| | <u>\$000</u> |
| Cost of plant | 24,000 |
| Installation charges | 4,000 |
| Annual maintenance contract charge | 500 |
| Cost of site clearance | 200 |
| Legal charges | 80 |

**Question 3 continued over
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Question 3 continued

At the end of the contract, which is expected to last for four years, the plant will be dismantled and sold for scrap (expected scrap value is approx. \$1m)
The company is obliged to return the site to the condition it was in prior to the instalment of the plant. This is expected to cost approximately \$400,000.

Required:

- (a) Discuss and evaluate the requirements of the relevant international accounting standard with regard to the valuation of fixed assets for depreciation purposes.

(7 marks)

- (b) Calculate the figure to be used for the cost of the plant for depreciation purposes.

(6 marks)

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Section B continued

Q4

(A)

Below is the summarised balance sheet of Willbrook plc at 31st December 2008.

| | |
|------------------------------|------------|
| Balance sheet extract | |
| | <u>\$m</u> |
| Net assets | <u>440</u> |
| Ordinary shares (\$1 each) | 200 |
| Redeemable Ord. Shares (\$1) | 50 |
| Share premium account | 40 |
| Retained profit | <u>150</u> |
| | <u>440</u> |

The redeemable shares are due to be redeemed in the near future.

Required:

- (a) Explain what is meant by, 'permanent capital'. (2 marks)
- (b) Discuss the options open to the company in order to maintain the capital when the shares are redeemed. (4 marks)
- (c) Revise the above balance sheet to take account of the following situation:
 The shares were initially issued at par and are to be redeemed at \$1.40 per share. To help finance the redemption, a new issue of 25m shares is to be made at a premium of 20c per share. (6 marks)

(B)

Sceptre Contractors Ltd commenced work on building a new telephone Exchange in August 2008. The work is expected to be completed by May 2010. The company's year-end is 30th June.

Details relating to work on the contract so far are given below:

| | |
|---|---------|
| Costs incurred up to 30 th June 2009 | \$32.0m |
| Estimated further costs to end of contract | \$36.4m |
| Contract price | \$76.0m |
| Progress payments received from customer | \$28.0m |

**Question 4 continued over
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Question 4 continued

The work was inspected towards the end of June 2009 and certified to be 40% complete. The customer was invoiced for \$36.0m at the end of May 2009.

Required:

- a) Discuss and assess how Sceptre should account for this contract for the year to 30th June 2009 in accordance with the relevant international accounting standard.
(4 marks)
- b) Show the relevant extracts from the income statement and balance sheet for the year.
(7 marks)
- c) Explain what would happen if the contract had commenced in January 2008.
(2 marks)

TOTAL 25 MARKS

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Section B continued

Q5

(A)

IAS 17 'Leases' requires different accounting treatment in the books of the Lessee for 'operating' leases and 'finance' leases.

Required:

Discuss the difference between the two types of lease and critically assess the reasons for their different treatment.

(8 marks)

(B)

The directors of Isinglass plc have decided to lease a computer system for sales ledger control purposes, from 1st January 2008 until Dec 31st 2011.

At the end of this period it is assumed that the system will have no value and will need replacing. The cost to purchase the system would be \$76m.

The lease terms are four equal annual instalments of \$25m payable on the 1st January each year.

The first lease payment will be made on 1st January 2008.

Required:

(a) Explain how this lease should be treated in accordance with the requirements of IAS 17.

(2 marks)

(b) Show the relevant extracts from the financial statements of Isinglass plc for the year ended 31st December 2008.

(8 marks)

(c) Explain how the above lease would be dealt with if the system had an expected useful life of 6 years and Isinglass plc only leased the system for 4 years.

(3 marks)

(d) Discuss and critically evaluate the meaning of - 'accounting for the substance of transactions'.

(4 marks)

TOTAL 25 MARKS

END OF QUESTIONS