

UNIVERSITY OF BOLTON

**SCHOOL OF BUSINESS AND CREATIVE
TECHNOLOGIES**

ACCOUNTANCY PATHWAY

SEMESTER 1 EXAMINATIONS 2009/2010

**FINANCIAL REPORTING AND THE REGULATORY
FRAMEWORK**

MODULE NO: ACC3003

Date: Friday 22nd January 2010

Time: 10:00 – 13:00

INSTRUCTIONS TO CANDIDATES:

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

Answer **FOUR** questions.

Section A question is **COMPULSORY**.

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

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Section A – Compulsory Question

Q1 The information below relates to two companies, Duncan plc, and Beatty Ltd., for the year 2009.

Balance sheets for Duncan plc. and Beatty Ltd. as at 31st December 2009.

	<u>Duncan plc</u>	<u>Beatty Ltd.</u>
	<u>£m</u>	<u>£m</u>
Non-current Assets	400	186
Investment	----- <u>400</u>	----- <u>186</u>
Current assets:		
Inventories	286	84
Receivables	234	56
Bank	<u>88</u>	<u>30</u>
	<u>608</u>	<u>170</u>
Current liabilities	<u>456</u>	<u>80</u>
Net current assets	<u>152</u>	<u>90</u>
	<u>552</u>	<u>276</u>
Equity and reserves:		
£1 Ordinary shares	500	160
Reserves	<u>52</u>	<u>116</u>
	<u>552</u>	<u>276</u>

Additional information:

- (i) Duncan plc purchased 120m shares in Beatty Ltd on Jan 1st 2009. On that date the reserves of Beatty Ltd were £40m. The purchase consideration was £150m and was in the form of a one for one share exchange, with the shares of Beatty Ltd being valued at £1.25 per share. This transaction has not been entered on the balance sheet of Duncan plc above.
- (ii) The assets of Beatty 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 Beatty Ltd which were considered to have a fair value of £6m in excess of their book value.
- (iii) At the balance sheet date Beatty Ltd owed Duncan plc £6m. This amount is included in the respective figures for Receivables and Payables in the above balance sheets.
- (iv) The above note (c) relates to sale of goods by Duncan plc to Beatty Ltd for £6m. All of these goods were still in Beatty Ltd's stock at the year end. The goods were sold by Duncan plc at a profit margin of 25%.

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Required:

- (a) Prepare the consolidated balance sheet of Duncan plc and Beatty Ltd on 31st December 2009.
(17 marks)
- (b) Discuss and critically evaluate the need to have accounting standards to cover the treatment of situations where one company acquires a financial interest in another company.
(8 marks)

TOTAL 25 MARKS

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Section B – Answer ANY THREE questions

Q2

You are in the process of preparing the financial statements of Hardy plc for the year to 31st December 2009, and have received the following information:

1. In January 2009, Hardy acquired all the shares in Beatty Ltd. The goodwill figure for the acquisition amounted to £20m. This included the cost of several licences with a market value of £8m, but which will need renewing in 4 years time.
2. During the year the company received a government grant of £6m towards the cost (£58m) of new plant and equipment, which is expected to have a useful life of 10 years.
3. In November 2009, an employee was seriously injured whilst working on the company premises. He is suing the company for damages of £250,000. The company's legal advisers will argue that the employee did not follow the health and safety guidelines in full, but they are still unsure as to what the outcome will be. They are, however, reasonably sure that the damages will not exceed £100,000.
4. In January 2010 the company issued £2m Convertible Debentures which are redeemable in 2020. The debentures are convertible into £1 ordinary shares on a one for one basis. The directors also announced that they are proposing to pay a dividend for the year of 2p per share.
5. Before the above had been considered, the pre-tax profit for the year had been calculated at £3.6m. Taxation was estimated at £1.2m. The company had 6m £1 ordinary shares in issue at the start of the year, and issued a further 2m £1 ordinary shares on July 1st 2009.

Required:

- (a)** Discuss and critically evaluate the recommended accounting treatment for each of the above items 1 – 4.

(20 marks)

- (b)** Discuss and evaluate how the company would report the relevant earnings per share figures at the year end.

(5 marks)

In all cases the relevant international accounting standard should be referred to.

TOTAL 25 MARKS

**Section B continued over
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Q3

Gordon Construction entered into two leases for earthmoving equipment on January 1st 2009.

The first was for a crane to be leased over a three year period.

The crane was new and has an expected life of 8 years.

Its current market value is £478,000.

The terms of the lease were that Gordon would pay the lessor quarterly payments of £10,000 commencing January 1st 2009 for the use of the digger.

The second lease was for a new tractor costing £162,000, to be leased over a four year period.

The expected life of the tractor is 4 years, and it is expected to have a scrap value of £10,000 in 4 years time.

Gordon agreed to pay an initial deposit of £20,000 on January 1st 2009, followed by two further instalments of £65,000 on December 31st 2009 and 2010, and a final payment of £45,164 on 31st December 2011.

The rate of interest implicit in the lease is 12%.

Required:

(a) Critically assess how each of the leases should be treated in accordance with the relevant international financial reporting standards.

(13 marks)

(b) Show the entries in the profit statement and balance sheet of Gordon Construction for each year of the respective leases.

(12 marks)

TOTAL 25 MARKS

Q4

(A) Napier plc produces, amongst other items, a range of electric lawn mowers. These are produced on an assembly line which is treated as a separate income generating unit.

The carrying value of the assets making up this assembly line at the 31st December 2009 was £450,000. The assets are expected to have a further four years useful life, at the end of which it is estimated they will have a scrap value of £50,000.

There is reason to believe, however, that due to increased competition in this particular market, that the assets have been impaired. As a result of this the company is considering closing down this line.

An estimate of the current net realisable value of the assets has been made at £350,000, but an assessment of their value in use has valued the assets at £340,000.

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Question 4(A) continued

Required:

- a) Make an assessment as to whether or not the assets have been impaired, and explain how the assets should be valued for balance sheet purposes.

(6 marks)

- b) Discuss and assess the meaning of impairment and how this differs from depreciation.

(6 marks)

Q4

- (B)** Nelson Construction plc is currently building a new school for a local authority. The contract commenced in February 2009 and is expected to be completed by January 2011.

Nelson Construction plc's year end is 31st December.

The contract price is £200m on completion, and the local authority has agreed to pay Nelson four equal payments of £50m at intervals throughout the period of construction. The first of these progress payments was received in December 2009.

The construction company is to invoice the local authority the value of work completed at various stages.

At 31st December 2009, costs incurred on the contract amounted to £70m.

Further costs to completion were estimated at £100m.

At the end of 2009 completed work was professionally assessed as being 50% complete and an amount of £80m was invoiced to the local authority.

Required:

Show how Nelson Construction plc should account for the above contract for the year ending 31st December 2009 in accordance with the relevant international accounting standard.

(13 marks)

TOTAL 25 MARKS

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Q5 (A)

The forecast balance sheet of Trafalgar plc as at 31st December 2009 is as follows:
 Forecast balance sheet as at 31st December 2009:

	<u>£m</u>
Non-current assets	16.2
Net current assets	<u>4.2</u>
	<u>20.4</u>
Equity and Reserves:	
Ordinary Shares (£1 each)	8.0
Redeemable shares (£1 each)	2.0
Share premium account	0.7
Revaluation Reserve	3.5
Retained profit	<u>6.2</u>
	<u>20.4</u>

The company is planning to redeem all of the redeemable shares on 1st March 2010. The shares were originally issued at par but will be redeemed at £1.25 per share. All of the retained profit is distributable.

Required:

(a) Discuss and evaluate the concept of 'permanent capital, and calculate the amount that would be regarded as being permanent capital in the above balance sheet.

(3 marks)

(b) Starting from the above balance sheet, prepare revised balance sheet assuming that in order to help fund the planned share redemption, the company will be making an issue of 1m ordinary shares at £1.50 each.

(9 marks)

**Question 5 continued over
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Question 5 continued

Q5 (B)

Codrington plc purchased some equipment on 1st January 2009 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 equipment is depreciated at 25% per annum on a straight line basis.

The current rate of taxation is 30%, and the taxable profit for the year ended 31st December 2009 was £50,000.

Required:

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

(6 marks)

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

(7 marks)

TOTAL 25 MARKS

END OF QUESTIONS