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# ACCA – Paper F7
# Financial Reporting
# September 2015 to June 2016
# Interim Assessment

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# Marking Report

**Notice to Markers**

1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

| | | | |
|---|---|---|---|
| • Time management | • Handwriting | • Presentation and layout | • Use of English |
| • Points clearly and concisely made | • Relevance of answers to question | • Coverage and depth of answer | • Accuracy of calculations |
| • Calculations cross-referenced to workings | • All parts of the requirement attempted | • Length of answers equates to marks available | • Read the question carefully |

2 For each question, please provide suitable constructive comments

| Question Number | General Comments | Exam Technique Comments |
|---|---|---|
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**ACCA INTERIM ASSESSMENT**

# Financial Reporting

## September 2015 to June 2016

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – ALL TWENTY questions are compulsory and MUST be attempted.

Section B – ALL THREE questions are compulsory and MUST be attempted.

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

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Paper F7

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# SECTION A

**All 20 questions are compulsory and must be attempted**

**1 Which ONE of the following items would CM recognise as subsequent expenditure on a non-current asset and capitalise it as required by IAS 16 Property, Plant and Equipment?**

A CM purchased a furnace five years ago, when the furnace lining was separately identified in the accounting records. The furnace now requires relining at a cost of $200,000. When the furnace is relined it will be able to be used in CM's business for a further five years.

B CM's office building has been badly damaged by a fire. CM intends to restore the building to its original condition at a cost of $250,000.

C CM's delivery vehicle broke down. When it was inspected by the repairers it was discovered that it needed a new engine. The engine and associated labour costs are estimated to be $5,000.

D CM closes its factory for two weeks every year. During this time, all plant and equipment has its routine annual maintenance check and any necessary repairs are carried out. The cost of the current year's maintenance check and repairs was $75,000.

**2** GK purchased a piece of development land on 31 October 20X0 for $500,000. GK revalued the land on 31 October 20X4 to $700,000. The latest valuation report, dated 31 October 20X8, values the land at $450,000.

GK has adjusted the land balance shown in non-current assets at 31 October 20X8.

**Which ONE of the following shows the correct debit entry in GK's financial statements for the year ended 31 October 20X8?**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| A | DR | Revaluation reserve | $50,000 | and | DR | Statement of profit or loss | $200,000 |
| B | DR | Revaluation reserve | $250,000 | | | | |
| C | DR | Revaluation reserve | $200,000 | and | DR | Statement of profit or loss | $50,000 |
| D | DR | Statement of profit or loss | $250,000 | | | | |

**3** DH has the following two legal claims outstanding:

- A legal action against DH claiming compensation of $700,000, filed in February 20X7. DH has been advised that it is probable that the liability will materialise.
- A legal action taken by DH against another entity, claiming damages of $300,000, started in March 20X4. DH has been advised that it is probable that it will win the case.

**How should DH report these legal actions in its financial statements for the year ended 30 April 20X7?**

| | *Legal action against DH* | *Legal action taken by DH* |
|---|---|---|
| A | Disclose by a note to the accounts | No disclosure |
| B | Make a provision | No disclosure |
| C | Make a provision | Disclose as a note |
| D | Make a provision | Accrue the income |

**4** On 28 September 20X1, GY received an order from a new customer, ZZ, for products with a sales value of $750,000. ZZ enclosed a deposit with the order of $75,000.

On 30 September 20X1, GY had not completed the credit referencing of ZZ and had not despatched any goods.

**Which ONE of the following will correctly record this transaction in GY's financial statements for the year ended 30 September 20X1 according to IFRS 15 *Revenue from contracts with customers*?**

A Debit Cash $75,000; Credit Revenue $75,000

B Debit Cash $75,000; Debit Trade Receivables $675,000; Credit Revenue $750,000

C Debit Cash $75,000; Credit Deferred Revenue $75,000

D Debit Trade Receivables $750,000; Credit Revenue $750,000

**5** **Using the requirements set out in IAS 10 *Events after the Reporting Period*, which of the following would be classified as an adjusting event after the reporting period in financial statements ended 31 March 20X4 that were approved by the directors on 31 August 20X4?**

A A reorganisation of the enterprise, proposed by a director on 31 January 20X4 and agreed by the Board on 10 July 20X4.

B A strike by the workforce which started on 1 May 20X4 and stopped all production for 10 weeks before being settled.

C A claim on an insurance policy for damage caused by a fire in a warehouse on 1 January 20X4. No provision had been made for the receipt of insurance money at 31 March 20X4 as it was uncertain that any money would be paid. The insurance enterprise settled with a payment of $1.5 million on 1 June 20X4.

D The enterprise had made large export sales to the USA during the year. The year end receivables included $2 million for amounts outstanding that were due to be paid in US dollars between 1 April 20X4 and 1 July 20X4. By the time these amounts were received, the exchange rate had moved in favour of the enterprise and the equivalent of $2.5 million was actually received.

**6 Which ONE of the following would be regarded as a change of accounting estimate according to IAS *8 Accounting Policies, Changes in Accounting Estimates and Errors*?**

A An entity decided to change where it charges depreciation in the year. Previously depreciation was charged to administrative expenses but will now be charged to cost of sales.

B An entity started revaluing its properties, as allowed by IAS 16 *Property, Plant and Equipment*. Previously all property, plant and equipment had been carried at cost less accumulated depreciation.

C A material error in the inventory valuation methods caused the closing inventory at 31 March 20X8 to be overstated by $900,000.

D An entity created a provision for claims under its warranty of products sold during the year. 5% of sales revenue had previously been set as the required provision amount. After an analysis of three years sales and warranty claims the calculation of the provision amount has been changed to a more realistic 2% of sales.

**7 Under the IASB's *The Conceptual Framework for Financial Reporting* the 'threshold quality' of useful financial information is:**

A relevance

B reliability

C materiality

D understandability

**8 The International Accounting Standards Board's (IASB) *The Conceptual Framework for Financial Reporting* is the IASB's conceptual framework. Which ONE of the following does the *Framework* NOT cover?**

A The format of financial statements

B The objective of financial statements

C Concepts of capital maintenance

D The elements of financial statements

**9 In the organisation structure for the regulation and supervision of International Accounting Standards, which of the bodies listed below acts as the overall supervisory body?**

A IFRS Foundation

B International Accounting Standards Board

C IFRS Advisory Council

D IFRS Interpretations Committee

**10** Pearson began constructing an asset for a customer during the year. The performance obligation will be satisfied over time, and Pearson measures progress based on the costs incurred as a proportion of total costs.

The following information relates to one of its contracts as at 31 May 20X4, Pearson's year-end.

Contract price $600,000

Costs incurred to date $440,000

Estimated cost to complete $220,000

Invoiced to customer $320,000

**What profit or loss should appear in Pearson's Statement of Profit or Loss as at 31 May 20X4 in respect of this contract?**

A Profit $60,000

B Loss $60,000

C Loss $40,000

D Profit $160,000

**11** Watson has the following balances included on its trial balance at 31 December 20X4:

| | |
|---|---|
| Taxation | $3,400 Debit |
| Deferred taxation | $23,000 Credit |

The balance on Taxation relates to an underprovision from 31 December 20X3.

At 31 December 20X4, the directors estimate that the provision necessary for taxation on current year profits is $17,000. The balance on the deferred tax account needs to be increased to $27,000.

**What is the charge for taxation that will appear in the Statement of Profit or Loss for the year to 31 December 20X4?**

A $16,400

B $24,400

C $17,600

D $9,600

**12** Toad plc enters into a 5 year finance lease agreement to lease a motor vehicle on 1st July 20X2. The asset has a fair value of $166,800 and a useful life of 6 years. The lease payments are $40,000 per annum to be made in advance. The interest rate implicit in the lease is 10%.

**What will the statement of profit or loss expenses be regarding this asset and lease for the year ended 31st December 20X2?**

| | *Depreciation* | *Finance costs* |
|---|---|---|
| A | $27,800 | $12,680 |
| B | $33,360 | $12,680 |
| C | $13,900 | $6,340 |
| D | $16,680 | $6,340 |

**13** Malik Ltd has an item in inventory which cost $15,000.

The usual selling price of this item is $20,500. However, this item has been found to be damaged, and needs to be repaired at a price of $3,750.

**At what value should the item of inventory be shown in Malik's financial statements?**

A $16,250

B $15,000

C $18,750

D $20,500

**14** Melba has commenced a contract to build an asset for a customer during the year ended 30 June 20X6. The performance obligation relating to the contract will be satisfied over time.

The contract price was agreed at $3.5m, and the following additional information is available in relation to the contract:

| | $000 |
|---|---|
| Costs incurred to date | 405 |
| Future expected costs | 2,295 |
| Amounts invoiced to customer | 175 |
| Amounts received from customer | 125 |

Melba measures progress towards completion by reference to the costs incurred as a percentage of total costs.

**What profit should Melba recognise in their Financial Statements for the year ended 30 June 20X6 in relation to this contract?**

A $405,000

B $114,706

C $175,000

D $120,000

**15** **When being impaired as part of a cash generating unit, which of the following assets would usually already be held at recoverable amount, and therefore not usually have any impairment allocated to it?**

A Goodwill

B Property

C Trade Receivables

D Patents

**16** Happy Co have decided to sell their head office, and meet the held for sale criteria per IFRS5

They purchased the head office 15 years ago, at a cost of $400,000

They estimated that the head office would have a useful life of 25 years

Happy Co believe that they can sell their head office for $300,000, but costs to sell will total $80,000

**At what value should the asset be valued when it is classified as held for sale?**

A $160,000

B $220,000

C $300,000

D $400,000

**17** XR Ltd has issued 6% loan notes with a nominal value of $45,000 at 1 January 20X8.

Issue costs associated with the issue totalled $750

The effective interest rate for the loan notes is 8.5%

**What is the finance charge in the profit or loss account for the year ended 31 December 20X8 (to the nearest whole dollar)?**

A $3,825

B $2,700

C $3,761

D $2,673

**18** Apollo Ltd has applied for a government grant. In order to receive the grant, Apollo have to create 50 local jobs, and these must be maintained for 3 years.

Apollo will receive $50,000 up front. Apollo believe they will create 30 jobs in year 1, 10 in year 2 and 10 in year 3, and that all of these jobs will be maintained for at least 3 years.

**How should Apollo recognise the government grant income?**

A Recognise all of the $50,000 upfront

B Recognise all of the $50,000 once all 50 jobs have been created

C Recognise $30,000 in year 1 and $20,000 in year 2

D Recognise $30,000 in year 1, $10,000 in year 2 and $10,000 in year 3

**19** **Which of the following would NOT meet the definition of an Investment Property per IAS 40?**

A An ex head office which is now being rented out to a third party company

B An ex head office now being held for capital appreciation due to rising property prices

C An ex head office that is currently being advertised for rental, but currently empty

D An ex head office currently being advertised for sale in the ordinary course of business

**20** Tresco Ltd has decided to construct a new retail outlet. They have purchased a new site at a cost of $5m, financed using a loan of $5m which carries an annual interest rate of 7.5%.

The construction of the outlet started on 1 March 20X6, and was completed on 31 August 20X6. The outlet was opened on 1 October 20X6.

Tresco invested some of the loan proceeds whilst they were unused and from 1 January 20X6 until 30 June 20X6 earned income from this of $20,000 per month.

**What is the value of borrowing costs to be capitalised by Tresco for the year ended 31 December 20X6?**

A $67,500

B $107,500

C $138,750

D $255,000

# SECTION B

**All 3 questions are compulsory and must be attempted**

**1** (a) Rablen decided to build a new head office at the start of the year. The total cost of the project was $20 million, and to fund this Rablen received a $20 million 6% loan on 1 April 20X3. As well as the interest payments, Rablen agreed to repay the loan by making five annual payments of $4 million on 31 March each year. Rablen paid the interest of $1,200,000 and the first $4 million repayment on 31 March 20X4.

Construction work on the office began on 1 May, and was completed on 30 November. Rablen decided to wait until the new year to move premises so began to use the building in January 20X4. Rablen expect to use the building for the next 25 years. As not all the funds were required immediately, Rablen invested $6 million of the loan in 5% bonds from 1 May until 1 August.

**Required:**

**Prepare extracts of Rablen's statement of profit or loss and statement of financial position in respect of the building for the year ended 31 March 20X4.**

**Note: All calculations should be made to the nearest thousand. (5 marks)**

(b) Pingway issued a $10 million 3% convertible loan note at par on 1 April 20X7 with interest payable annually in arrears. Three years later, on 31 March 20Y0, the loan note is convertible into equity shares on the basis of $100 of loan note for 25 equity shares or it may be redeemed at par in cash at the option of the loan note holder. Similar loan notes without the conversion option carry interest at 8%.

The present value of $1 receivable at the end of the year, based on discount rates of 3% and 8% can be taken as:

| | 3% | 8% |
|---|---|---|
| | $ | $ |
| End of year | 0.97 | 0.93 |
| | 0.94 | 0.86 |
| | 0.92 | 0.79 |

**Required:**

**Show the convertible loan note should be accounted for in Pingway's statement of profit or loss and other comprehensive income for the year ended 31 March 20X8 and statement of financial position as at that date. (5 marks)**

(c) *The Conceptual Framework for Financial Reporting* contains the definitions and recognition criteria for assets and liabilities.

**Required:**

**Define assets and liabilities. Explain why these definitions are of particular importance to the preparation of an entity's financial statements. (5 marks)**

**(Total: 15 marks)**

**2** The financial statements of Armstrong plc, a retailer of electronic products, are given below:

| **Statement of financial position** | *20X9* | | *20X8* | |
|---|---|---|---|---|
| | $000 | $000 | $000 | $000 |
| **Non-current assets** | | | | |
| Property, plant & equipment | 16,104 | | 13,918 | |
| Intangible assets | 1,439 | | 1,765 | |
| | | 17,543 | | 15,683 |
| **Current assets** | | | | |
| Inventories | 10,931 | | 9,480 | |
| Receivables | 4,429 | | 3,892 | |
| Cash at bank and in hand | 3,658 | | 7,518 | |
| | | 19,018 | | 20,890 |
| | | **36,561** | | **36,573** |
| **Equity** | | | | |
| Equity shares of $1 each | 450 | | 400 | |
| Share premium | 1,600 | | 1,500 | |
| Retained earnings | 8,951 | | 8,824 | |
| | | 11,001 | | 10,724 |
| **Non-current liabilities** | | | | |
| 7% Loan notes | 6,950 | | 1,500 | |
| Obligations under finance leases | 993 | | 356 | |
| Deferred taxation | 234 | | 108 | |
| | | 8,177 | | 1,964 |
| **Current liabilities** | | | | |
| Trade payables | 14,299 | | 23,162 | |
| Overdraft | 2,123 | | – | |
| Taxation | 300 | | 250 | |
| Warranty provision | 511 | | 428 | |
| Obligations under finance leases | 150 | | 45 | |
| | | 17,383 | | 23,885 |
| | | **36,561** | | **36,573** |

**Statement of profit or loss for the year ended 31 October 20X9**

| | $000 |
|---|---|
| Revenue | 83,430 |
| Cost of sales | (70,876) |
| Gross profit | 12,554 |
| Operating expenses | (10,446) |
| Profit from operations | 2,108 |
| Finance costs | (809) |
| Profit before tax | 1,299 |
| Taxation | (672) |
| Profit for the year | 627 |

**Statement of changes in equity for the year ended 31 October 20X9**

| | *Share capital* | *Share premium* | *Retained earnings* | *Total* |
|---|---|---|---|---|
| | $000 | $000 | $000 | $000 |
| Opening balance | 400 | 1,500 | 8,824 | 10,724 |
| Profit for the year | | | 627 | 627 |
| Dividends paid | | | (500) | (500) |
| Issue of shares | 50 | 100 | | 150 |
| Closing balance | 450 | 1,600 | 8,951 | 11,001 |

**Additional information:**

(i) An item of plant with a carrying amount of $965,000 was sold at a loss of $50,000 during the year. Depreciation of $2,395,000 was charged (to operating expenses) for property, plant and equipment in the year ended 31 October 20X9.

(ii) New assets were acquired under finance leases in the year. The fair value of these assets at acquisition was $960,000.

(iii) There were no acquisitions or disposals of intangible assets during the year.

(iv) The company issued new shares at full market value.

(v) Armstrong gives a 12 month warranty on the products it sells. The amounts shown in current liabilities as warranty provision are the amount of claims likely to be made in respect of warranties outstanding. Warranty costs are included in cost of sales.

**Required:**

**Prepare a statement of cash flows for Armstrong plc for the year ended 31 October 20X9 in accordance with IAS 7 *Statement of Cash-flows* by the indirect method.**

**(Total: 15 marks)**

**3** Nemesis is a well-known company manufacturing thrill rides. During the current economic climate, Nemesis has experienced some difficulties and unfortunately has had to close down its Merry Go Round division.

The company's trial balance at 31 October 20X8 is as follows:

| | $000 | $000 |
|---|---|---|
| Revenue | | 216,000 |
| Cost of sales | 91,080 | |
| Distribution costs | 21,180 | |
| Administrative expenses | 23,760 | |
| Investment income | | 4,680 |
| Investment property | 45,000 | |
| Interest paid | 2,880 | |
| Income tax | | 1,800 |
| Carrying value of PPE at 1 November 20X7 | 270,000 | |
| Inventories – 31 October 20X8 | 18,000 | |
| Trade receivables | 22,500 | |
| Bank | 10,800 | |
| Payables | | 7,200 |
| Deferred tax – 1 November 20X7 | | 12,600 |
| 8% Loan note – issued 1 November 20X7, repayable 20Y2 | | 72,000 |
| Ordinary $1 share capital | | 90,000 |
| Retained earnings – 1 November 20X7 | | 100,920 |
| | 505,200 | 505,200 |

**Note 1**

Revenue includes cash sales of $12 million for goods sold in August 20X8 to Abbeyfax plc, a bank. The goods are marked up at 25% on cost. Abbeyfax has the option to require Nemesis to repurchase these goods on 1 November 20X8 at their original selling price plus a one-off fee of $360,000. Abbeyfax has not taken delivery of the goods, and has always made Nemesis repurchase goods in the past under similar agreements.

**Note 2**

Included within property, plant and equipment is a building with a carrying value of $9 million. On 1 November 20X7 it was revalued at $12 million. The building had an estimated life of twenty five years when it was purchased ten years prior to the revaluation date. This has not changed as a result of the revaluation. The directors of Nemesis wish to incorporate this value in the financial statements for the year ended 31 October 20X8.

All other property, plant and equipment is depreciated at 20% per annum on the reducing balance basis. All depreciation is to be charged to cost of sales.

**Note 3**

On 1 October 20X8, Nemesis closed down its Merry Go Round division. The results of the division from 1 November 20X7 to the date of closure are included in the above trial balance figures. These results are as follows:

| | $000 |
|---|---|
| Revenue | 9,800 |
| Cost of sales | 6,450 |
| Distribution costs | 2,040 |
| Admin expenses | 1,980 |

The net assets of the division were sold at a loss of $3.2 million and are currently included within cost of sales. The Merry Go Round division qualifies as a discontinued operation.

**Note 4**

The investment property owned by Nemesis has risen in value during the year by 3%. This rise is to be incorporated into the financial statements. Nemesis uses the fair value model to value investment property, as allowed by IAS 40.

**Note 5**

The provision for income tax for the year ended 31 October 20X8 has been estimated at $23,400,000. For the deferred tax provision, the only temporary differences are accelerated capital allowances. At 31 October, these were $21,600,000. Income tax is charged at 30%.

**Required:**

**(a)** **Prepare a statement of profit or loss and other comprehensive income for the year ended 31 October 20X8 for Nemesis along with a statement of financial position and a statement of changes in equity at that date. (25 marks)**

(b) One of your assistants has queried why the treatments of the properties in notes 2 and 4 are treated differently.

**Required:**

**Explain the difference between investment properties and property, plant and equipment, outlining the different alternatives to account for each. (5 marks)**

**(Total: 30 marks)**