F7 Financial Reporting

This exam is divided into three sections:

Section A

- 15 objective (OT) questions: each worth 2 marks.
- 30 marks in total.

Section B

- Three OT cases, each containing a scenario which relates to five OT questions; each worth 2 marks.
- 30 marks in total,

Section C

- Two constructed response questions, each containing a scenario which relates to one or more requirements.
- Each constructed response question is worth 20 marks in total.
- 40 marks in total

Section A

This section of the exam contains 15 objective test (OT) questions.
Each question is worth 2 marks and is compulsory.
This exam section is worth 30 marks in total.

1. Which of the following could be classified as development expenditure in M's statement of financial position as at 31 March 20Y0 according to IAS 38 Intangible Assets?

A. $120,000 spent on developing a prototype and testing a new type of propulsion system. The project needs further work on it as the system is currently not viable.
B. A payment of $50,000 to a local university's engineering faculty to research new environmentally friendly building techniques.
C. $35,000 developing an electric bicycle. This is near completion and the product will be launched soon. As this project is first of its kind it is expected to make a loss.
D. $65,000 developing a special type of new packaging for a new energy-efficient light bulb. The packaging is expected to reduce M's distribution costs by $35,000 a year.

2. According to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations which of the following represent criteria for an asset to be classified as held for sale?

(i). Available for immediate sale in its present condition.
(ii). Sale is highly probable.
(iii). The sale is expected to be completed within the next month.
(iv). The asset is being marketed at a reasonable price.

A All of the above
B (i), (ii) and (iii)
C (i), (ii) and (iv)
D (ii), (iii) and (iv)

3. Which description is most representative of the accounting framework used under IFRS Standards?

	True	False
It is a principles-based framework		
It is a legal obligation		

4. Which of these changes would be classified as 'a change in accounting policy' as determined by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors?

A. Increased the allowance for irrecoverable receivables from 5% to 10% of outstanding debts
B. Changed the method of valuing inventory from FIFO to average cost
C. Changed the depreciation of plant and equipment from straight line depreciation to reducing balance depreciation
D. Changed the useful life of motor vehicles from six years to four years

5. During the year ended 30 September 20X4 Hyper entered into two lease transactions. On 1 October 20X3, Hyper made a payment of $90,000 being the first of five equal annual payments under a lease for an item of plant. The lease has an implicit interest rate of 10% and the present value of the total lease payments on 1 October 20X3 was $340,000.

On 1 January 20X4, Hyper made a payment of $18,000 for a one-year lease of an item of equipment.

What amount in total would be charged to Hyper's statement of profit or loss for the year ended 30 September 20X4 in respect of the above transactions?

A. $108,000
B. $111,000
C. $106,500
D. $115,500

6. ABC purchased 10,000 shares on 1 September 20X4, making the election to use the alternative treatment under IFRS 9 Financial Instruments. The shares cost $3.50 each. Transaction costs associated with the purchase were $500.

At 31 December 20X4, the shares are trading at $4.50 each.

What is the gain to be recognised on these shares for the year ended 31 December 20X4?

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7. Locke sells machines, and also offers installation and technical support services. The individual selling prices of each product are shown below.

Sale price of goods	$75
Installation	$30
One year service	$45

Locke sold a machine on 1 May 20X1, charging a reduced price of $100, including installation and one year's service.

Locke only offers discounts when customers purchase a package of products together.

According to IFRS 15 Revenue from Contracts with Customers, how much should Locke record in revenue for the year ended 31 December 20X1? Workings should be rounded to the nearest $.
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8. On 1 January 20X4, Sam Co had 3 million ordinary shares in issue. On 1 June 20X4, Sam Co made a 1 for 3 bonus issue. On 30 September 20X4, Sam Co issued a further 1 million shares at full market price. Sam Co had profits attributable to ordinary equity holders of $2 million for the year ended 31 December 20X4.

What is the basic earnings per share figure for the year ended 31 December 20X4, according to IAS 33 Earnings Per Share?

A. 47.1 $
B. 52.2 $
C. 56.8 $
D. 50.0 $

9. **Which TWO of the following events which occur after the reporting date of an entity but before the financial statements are authorised for issue are classified as ADJUSTING events in accordance with IAS 10 Events after the Reporting Period?**

A. A change in tax rate announced after the reporting date, but affecting the current tax liability
B. The discovery of a fraud which had occurred during the year
C. The determination of the sale proceeds of an item of plant sold before the year end
D. The destruction of a factory by fire

10. **Identify if the following will be recognised as part of the cost of an investment in a subsidiary.**

	Include in cost of investment	**Do not include in the cost of investment**
An agreement to pay a further $30,000 if the subsidiary achieves an operating profit of over $100,000 in the first 3 years after acquisition		
Professional fees of $10,000 in connection		

with the investment		

11. Identify the correct treatments for the following investments in the consolidated financial statements of the Nicol group.

30% of the share capital of Hansen. The other 70% is owned by Lawro, another listed entity, whose directors make up Hansen's board.	Subsidiary
80% of the share capital of Kennedy, whose activities are significantly different from the rest of the Nicol group.	Associate
30% of the share capital of Bruce. The Nicol group have appointed 2 of the 5 board members of Bruce, with the other board members coming from three other entities.	Investment

12. Johnson paid $1.2 million for a 30% investment in Treem's equity shares on 1 August 20X4.

Treem's profit after tax for the year ended 31 March 20X5 was $750,000. On 31 March 20X5, Treem had $300,000 goods in its inventory which it had bought from Johnson in March 20X5 These had been sold by Johnson at a mark-up on cost of 20%.

Treem has not paid any dividends.

On the assumption that Treem is an associate of Johnson, what would be the carrying mount of the investment in Treem in the consolidated statement of financial position of Johnson as at 31 March 20X5?

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13. Which of the following items is unlikely to be considered a 'one-off' item which would impact the comparability of ratios?

- **A.** A new website selling direct to the public has meant that deliveries are now made to more diverse geographical areas, increasing delivery costs
- **B.** A closure of a department has led to redundancies
- **C.** Sale of surplus property leading to a profit on disposal
- **D.** A storm in the year led to significant damage to the warehouse

14. Trent uses the formula (year-end trade receivables/credit sales for the year) × 365 to calculate how many days on average its customers take to pay.

Which TWO of the following would NOT affect the correctness of the above calculation of the average number of days a customer takes to pay?

- **A.** Trent experiences considerable seasonal trading
- **B.** Trent makes a number of cash sales through retail outlets
- **C.** Revenue does not include a 15% sales tax whereas the receivables do include the tax
- **D.** Trent factors with recourse the receivable of its largest customer

15. At 1 January 20X0 Casey had property, plant and equipment with a carrying amount of \$180,000. In the year ended 31 December 20X0 Casey disposed of assets with a carrying amount of \$60,000 for \$50,000. Casey revalued a building from \$75,000 to \$100,000 and charged depreciation for the year of \$20,000. At the end of the year, the carrying amount of property, plant and equipment was \$250,000.

How much will be reported in the statement of cash flows for the year ended 31 December
20X0 under the heading 'cash flows from investing activities'?

- **A.** \$75,000 outflow
- **B.** \$125,000 outflow
- **C.** \$135,000 outflow
- **D.** \$50,000 inflow

Section B

This section of the exam contains three OT cases.
Each OT case contains a scenario which relates to five OT questions.
Each question is worth 2 marks and is compulsory.
This exam section is worth 30 marks in total.

Wilrob Co

Wilrob Co has the following research projects at 31 March 20X7:

Project 324

The project commenced on 1 April 20X6 and incurred total costs of $15m during the period to 31 December 20X6 on a pro-rata basis. On 30 June 20X6, the directors were confident that the project met the capitalisation criteria of IAS 38 Intangible Assets. The project was completed and began to generate revenue from 1 January 20X7. It is estimated that the project will generate revenue for five years.

Project 325

The project commenced on 1 September 20X6. Costs of $20,000 per month were incurred until 31 January 20X7 when the project was abandoned.

The specialist equipment that had been purchased for Project 325 was transferred for use in another of Wilrob Co's research projects.

Project 326

The project commenced on 1 January 20X7. Costs of $40,000 per month were incurred until 31 August 20X7 when the directors increased the spend to $60,000 to complete the project quickly as a potential buyer had been identified on 20 July 20X7. The directors had not been confident of the success of the project until this point.

1. **Which TWO of the following are required by IAS 38 Intangible Assets in relation to the amortisation of intangible assets (excluding goodwill)?**
   A. Intangible assets should be amortised over the expected useful life or not at all if the useful life is deemed to be indefinite
   B. Intangible assets should not be amortised but instead reviewed for impairment losses only
   C. Intangible assets should be amortised on the basis of the expected pattern of consumption of the expected future economic benefits
   D. Intangible assets should not be amortised or impaired and instead simply carried forward at their original cost until sold or scrapped

2. **Which TWO of the following statements are true in relation to IAS 38 Intangible Assets?**
   A. IAS 38 requires the revaluation of intangible assets where an entity has chosen to revalue its tangible non-current asset
   B. IAS 38 does not permit the revaluation of any intangible assets in any circumstances
   C. IAS 38 permits the revaluation of intangible assets only if there is an active market for such assets.
   D. IAS 38 requires that the initial recognition of intangibles must be at cost.

3. **In accordance with IAS 38 Intangible assets, what is charged to the statement of profit or loss for the year ended 31 March 20X7 in respect of project 324?**
   A. $5.5m
   B. $6.5m
   C. $7m
   D. $10m
4. **In accordance with IAS 38 Intangible Assets, which of the following is/are true or false in respect of the accounting treatment of projects 325 and 326?**

	True	False
The cost for project 325 should be expensed in the statement of profit or loss for the year ended 31 March 20X7		
The specialist equipment which was purchased for project 325 should not be depreciated as it has been used in abandoned or research projects		
The costs for project 326 should be included as an asset in the statement of financial position as at 31 March 20X7		

5. During the year ended 31 March 20X8, Wilrob Co incurred the following costs:
(1) $400,000 in staff costs incurred in updating a computerised record of potential customers
(2) $800,000 for the purchase of a domain name for the website of an entity making substantial online sales
(3) $4m for a patent purchased to improve the production process, with an expected useful life of three years
Which of the above costs would be capitalised as intangible assets in accordance with IAS 38 Intangible Assets?
   A. 1 only
   B. 3 only
   C. 2 and 3 only
   D. 1, 2 and 3

Fino Co

On 1 October 20X6 Fino entered into an agreement to lease twenty telephones for its team of sales staff. The telephones are to be leased for a period of 24 months at a cost of $240 per telephone per annum, payable annually in advance. The present value of the lease payments at 1 October 20X6 is $ 9,164.

On 1 April 20X7, Fino entered into an agreement to lease an item of plant from the manufacturer.

The lease required four annual payments in advance of $100,000 each commencing on 1 April 20X7. The plant would have a useful life of four years and would be scrapped at the end of this period. The present value of the total lease payments is $350,000.

Fino has a cost of capital of 10%.

1- Which of the following applies the principle of faithful representation to the above plant lease agreement?

A. Recording an annual rent expense in Fino's statement of profit or loss
B. Expensing any interest on a straight-line basis over 4 years
C. Recording an asset in Fino's statement of financial position to reflect control
D. Record the $100,000 paid as a prepayment to be released over 4 years

2- How much would be charged to Fino's statement of profit or loss for the year ended 30 September 20X7 in respect of the telephones if Fino applied the exemption permitted under IFRS 16 Leases?

A. $4,800
B. $4,582
C. $4,364
D. $5,498

3- What would be the carrying amount of the right-of-use plant asset as at 30 September 20X7?

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4- What interest would be charged to Fino's statement of profit or loss for the year ended 30 September 20X7 in respect of the plant lease.

A. $12,500
B. $25,000
C. $17,500
D. $35,000

5- Applying the principles of IFRS 16 Leases to capitalise the plant and recognise the lease liability would have what impact upon the following ratios?

	Increase	Decrease
Return on Capital Employed		

Gearing		
Interest cover		

Manda Co.

Manda Co prepares its financial statements to 30 September each year. Manda Co's draft financial statements were finalised on 20 October 20X3. They were authorised for issue on 15 December 20X3 and the annual general meeting of shareholders took place on 23 December 20X3.

On 30 September 20X3, Manda Co moved out of one of its properties and put it up for sale. The property met the criteria as held for sale on 30 September 20X3. On 1 October 20X2, the property had a carrying amount of $2.6m and a remaining life of 20 years. The property is held under the revaluation model. The property was expected to sell for a gross amount of $2.5m with selling costs estimated at $50,000.

Manda Co decided to sell an item of plant during the year ended 30 September 20X3. On 1 October 20X2, the plant had a carrying amount of $490,000 and a remaining useful life of seven years. The plant met the held for sale criteria on 1 April 20X3. At 1 April 20X3, the plant had a fair value less costs to sell of $470,000, which had fallen to $465,000 at 30 September 20X3.

1- In accordance with IAS 10 Events after the Reporting Period, which of the following statements is/are CORRECT for Manda Co?

(1) All events which occur between 30 September 20X3 and 15 December 20X3 should be considered as events occurring after the reporting period

(2) An event which occurs between 30 September 20X3 and 15 December 20X3 and which provides evidence of a condition which existed at 30 September 20X3 should be considered as an adjusting event

A. 1 only
B. Both 1 and 2
C. 2 only
D. Neither 1 nor 2

2- In accordance with IAS 10, which of the following events would be classed as a non-adjusting event in Manda Co's financial statements for the year ended 30 September 20X3

A. During October 20X3, there was evidence of a permanent diminution in the carrying amount of a property held at 30 September 20X3
B. On 1 December 20X3 the acquisition of a subsidiary was completed following lengthy negotiations which began in September 20X3
C. The sale of inventory during October 20X3 at a value less than its cost. This inventory was included in the financial statements at a cost on 30 September 20X3.
D. The insolvency of a major customer during October 20X3 , whose balance was included within receivables at 30 September 20X3.

3- What is the total amount charged to Manda Co's profit or loss in respect of the property for the year ended 30 September 20X3

A. $130,000
B. $180,000
C. $150,000
D. $100,000

4- In accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, what is the carrying amount of the plant in Manda Co's statement of financial position as at 30 September 20X3?

A. $420,000
B. $470,000
C. $455,000
D. $465,000

5- Which of the following items should be classed as an asset held for sale under IFRS 5?

A. Manda Co's head office building is to be demolished, at which point the land will be put up for sale. A number of prospective bidders have declared an interest and the land is expected to sell within a few months of the demolition.
B. An item of plant was put up for sale at the start of the year for $500,000. Six parties have made a bid to Manda Co for the plant but none of these bids has been above $200,000.
C. A chain of retail outlets are currently advertised for sale. Manda Co has provisionally accepted a bid, subject to surveys being completed. The surveys are not expected to highlight any problems. The outlets are currently empty.
D. A brand name which Manda Co purchased in 20X2 is associated with the sale of potentially harmful products. Manda Co has decided to stop producing products under this brand, which is currently held within intangible assets.

Section c

This section of the exam contains two constructed response questions.
Each question contains a scenario which relates to one or more requirement(s) which may be split over multiple question screens.
Each question is worth 20 marks and is compulsory.
This exam section is worth 40 marks in total.

Palistar Co

On 1 January 20X5, Palistar acquired 75% of Stretcher's equity shares by means of an immediate share exchange of two shares in Palistar for five shares in Stretcher. The fair value of Palistar and Stretcher's shares on 1 January 20X5 were $4 and $3 respectively. In addition to the share exchange, Palistar will make a cash payment of $1.32 per acquired share, deferred until 1 January 20X6. Palistar has not recorded any of the consideration for Stretcher in its financial statements. Palistar's cost of capital is 10% per annum.

The summarised statements of financial position of the two entities as at 30 June 20X5 are:

Assets	Palistar $000	Stretcher $000
Non-current assets		
Property, plant and equipment	55,000	28,600
Financial asset equity investments	11,500	6,000
Total non-current assets	**66,500**	**34,600**
Current assets		
Inventory	17,000	15,400
Trade receivables	14,300	10,500
Bank	2,200	1,600
Total current assets	**33,500**	**27,500**
Total assets	**100,000**	**62,100**
Equity and Liabilities		
Equity		
Equity shares ($1 each)	20,000	20,000
Other components of equity	4,000	nil
Retained earnings – at 1 July 20X4	26,200	14,000
Profit for year ended 30 June 20X5	24,000	10,000
Total equity	**74,200**	**44,000**
Current liabilities	25,800	18,100
Total equity and liabilities	**100,000**	**62,100**

The following information is relevant:

1- Stretcher's business is seasonal and 60% of its annual profit is made in the period 1 January to 30 June each year.

2- At the date of the acquisition, the value of Stretcher's net assets was equal to their carrying amounts with the following exceptions:

The fair value of Stretcher's financial asset equity investments, carried at a value of $6 million, was $7 million (see also note (5)).

Stretcher owned the rights to a popular mobile (cell) phone game. At the date of acquisition, a specialist valuer estimated that the rights were worth $12 million and had an estimated remaining life of five years.

3- Following an impairment review, consolidated goodwill is to be written down by $3 million as at 30 June 20X5.
4- Palistar sells goods to Stretcher at cost plus 30%. Stretcher had $1.8 million of goods in its inventory at 30 June 20X5 which had been supplied by Palistar. In addition, on 28 June 20X5, Palistar processed the sale of $800,000 of goods to Stretcher, which Stretcher did not account for until their receipt on 2 July 20X5. The in-transit reconciliation should be achieved by assuming the transaction had been recorded in the books of Stretcher before the year end. At 30 June 20X5, Palistar had a trade receivable balance of $2.4 million due from Stretcher which differed to the equivalent balance in Stretcher's books due to the sale made on 28 June 20X5.
5- At 30 June 20X5, the fair values of the financial asset equity investments of Palistar and Stretcher were $13.2 million and $7.9 million respectively.
6- Palistar's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose the value given for Stretcher's shares may be used.

Required:
Prepare the consolidated statement of financial position for Palistar as at 30 June 20X5.
(Total: 20 marks)

Fit Co and Sporty Co

Fit Co and Sporty Co both operate in the sportswear sector. Extracts from the draft financial statements for the companies for the year end 31 December 20X0 are as follows:

Draft statement of profit or loss for the year ended 31 December 20X0:

	Fit Co **$000**	**Sporty Co** **$000**
Revenue	250,000	220,000
Cost of sales	(190,000)	(150,000)
Gross profit	**60,000**	**70,000**
Profit on disposal	5,000	–
Operating expenses	(40,000)	(38,000)
Profit from operations	**25,000**	**32,000**
Finance costs	(7,500)	(1,000)
Profit before tax	**17,500**	**31,000**

Draft statement of financial position as at 31 December 20X0:

	Fit Co **$000**	**Sporty Co** **$000**
Cash	5,000	10,000
Total equity	**90,000**	**60,000**
Non-current liabilities	45,000	15,000
Trade payables	35,000	12,000

The following information is also relevant:

(i). Fit Co is a manufacturer and retailer of premium branded sportswear, which it sells online and in its own international chain of branded stores.

(ii). Sporty Co sells mid-market sportswear in department stores and online. It sources its goods directly from the manufacturer and does not make international sales. Sporty Co plans to expand into the international market during the next financial year.

(iii). On 31 December 20X0, Fit Co disposed of its investment in the Active division for consideration of $10m. The cash proceeds have been recorded as a receivable at the date the financial statements were prepared and the gain on disposal is included in the statement of profit or loss above. The Active division had the following ratios for the year ended 31 December 20X0:

Gross profit margin is 40%
Operating profit margin is 5%

(iv). Fit Co also charged $100,000 per month to the Active division for central services, which was deducted from operating expenses in the financial statements.

Required:

(a) Using the financial statement extracts provided, calculate the following ratios for both Fit Co and Sporty Co:

a. Gross profit margin
b. Operating profit margin
c. Trade payables days
d. Return on capital employed
e. Gearing (debt/equity)

(6 marks)

(b) Comment on the performance and position of both companies for the year ended 31 December 20X0.

(14 marks)

(Total: 20 marks)