

Instructor's Manual

Financial Accounting and Reporting

Nineteenth edition

**Barry Elliott
Jamie Elliott**

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Brief contents

Chapters	Pages
Part 1 Introduction to accounting on a cash flow and accrual accounting basis	5
1. Accounting and reporting on a cash flow basis	6
2. Accounting and reporting on an accrual accounting basis	11
Part 2 Preparation of internal and published financial statements	17
3. Preparation of financial statements of comprehensive income, changes in equity and financial position	18
4. Annual report: additional financial disclosures	42
5. Statements of cash flows	62
Part 3 Regulatory framework – an attempt to achieve uniformity	73
6. Financial reporting – evolution of global standards	74
7. Concepts – evolution of an international conceptual framework	76
8. Ethical behaviour and implications for accountants	80
Part 4 Income and asset value measurement systems	84
9. Income and asset value measurement: an economist's approach	85
10. Accounting for price-level changes	98
11. Revenue recognition	117
Part 5 Statement of financial position – equity, liability and asset measurement and disclosure	137
12. Share capital, distributable profits and reduction of capital	138
13. Liabilities	149
14. Financial instruments	158
15. Employee benefits	178
16. Taxation in company accounts	189
17. Property, plant and equipment (PPE)	198
18. Leasing	217
19. Intangible assets	227
20. Inventories	240
21. Construction contracts	255

Part 6	Consolidated accounts	274
22.	Accounting for groups at the date of acquisition	275
23.	Preparation of consolidated statements of financial position after the date of acquisition	294
24.	Preparation of consolidated statements of income, changes in equity and cash flows	303
25.	Accounting for associates and joint arrangements	321
26.	Introduction to accounting for exchange differences	342
Part 7	Interpretation	358
27.	Earnings per share	359
28.	Review of financial ratio analysis	376
29.	Analysis of published financial statements	400
30.	An introduction to digital financial reporting	429
Part 8	Accountability	431
31.	Corporate governance	432
32.	Integrated reporting: sustainability, environmental and social	437
Weblinks for Financial Accounting and Reporting		449

PART 1

Introduction to accounting on a cash flow and accrual accounting basis

CHAPTER 1

Accounting and reporting on a cash flow basis

Question 1 – Sasha Parker

(a) Cash budget (£000)

	<i>Jan</i>	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>June</i>	<i>Total</i>
Initial capital	150.00			82.50			232.50
Customers					60.00	75.00	135.00
Total receipts	150.00			82.50	60.00	75.00	367.50
Machinery	30.00						30.00
Motor vehicles	24.00						24.00
Premises	75.00						75.00
Drawings	1.20	1.20	1.20	1.20	1.20	1.20	7.20
Suppliers		30.00	48.00	60.00	60.00	60.00	258.00
Rates		1.20					1.20
Wages	2.25	2.25	2.25	2.25	2.25	2.25	13.50
General expenses		0.75	0.75	0.75	0.75	0.75	3.75
Insurance						2.10	2.10
Total payments	132.45	35.40	52.20	64.20	64.20	66.30	414.75
Net cash flow	17.55	(35.40)	(52.20)	18.30	(4.20)	8.70	
Balance b/f		17.55	(17.85)	(70.05)	(51.75)	(55.95)	
Balance c/f	17.55	(17.85)	(70.05)	(51.75)	(55.95)	(47.25)	(47.25)

(b) Statement of cash flows (£000)

Realised operating cash flows for the period ended 30 June 20X1

Receipts from customers	135.00
Payments:	
Suppliers	258.00
Rates	1.20
Wages	13.50
General expenses	3.75
Insurance	2.10
	<u>278.55</u>
	<u>(143.55)</u>

For information only

Statement of financial position as at 30 June 20X1

		£000
Capital – introduced		232.50
– withdrawn		(7.20)
Net operating cash flows:	Realised	(143.55)
	Unrealised	<u>(7.80)</u>
		<u>73.95</u>
Premises (NRV)		75.00
Vehicles (NRV)		19.20
Machinery (NRV)		27.00
Net cash balance		<u>(47.25)</u>
		<u>73.95</u>

(c) Further information regarding Sasha Parker

Nature of business linked to Parker's business background, technical ability, special skills, know-how, existing/terminated business involvement, contacts, associates and related parties.

Type of business unit to be used and rationale for its selection.

Sources of long- and short-term capital.

Products' life cycle and cash flow projections over product life cycle.

Initial investment in fixed assets and their terminal value at the end of the life cycle.

Parker's attitude to risk, and how this affects the choice of discount rate and payback period.

Question 2 – Mr Norman

(a) *Purchases budget (€000)*

	<i>Jan</i>	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>June</i>
Sales	15.00	20.00	35.00	40.00	40.00	45.00
Gross profit	3.00	4.00	7.00	8.00	8.00	9.00
Purchases	12.00	16.00	28.00	32.00	32.00	36.00
Payments	12.00	16.00	28.00	32.00	32.00	32.00

Notes:

This is a start-up situation.

Purchases equal projected sales less a gross margin on sales at 20%.

Goods are bought in the month of sale; assume stocks remain constant.

(b) *Statement of cash flows (£000)*

	<i>Jan</i>	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>June</i>	<i>Total</i>
Initial capital	50.00						50.00
Cash sales	7.50	10.00	17.50	20.00	20.00	22.50	97.50
Credit sales	–	7.50	10.00	17.50	20.00	20.00	75.00
	57.50	17.50	27.50	37.50	40.00	42.50	222.50
Premises	80.00						80.00
Rent and rates	2.20	2.20	2.20	2.20	2.20	2.20	13.20
Suppliers		12.00	16.00	28.00	32.00	32.00	120.00
Commission		0.30	0.40	0.70	0.80	0.80	3.00
Wages	0.60	0.60	0.60	0.60	0.60	0.60	3.60
Insurance	3.50	–	–	–	–	–	3.50
	86.30	15.10	19.20	31.50	35.60	35.60	223.30
Net cash flow	(28.80)	2.40	8.30	6.00	4.40	6.90	
Balance b/f	–	(28.80)	(26.40)	(18.10)	(12.10)	(7.70)	
Balance c/f	(28.80)	(26.40)	(18.10)	(12.10)	(7.70)	(0.80)	(0.80)

(c) Statements of operating cash flows and financial position

Realised operating cash flows for the period ended 30 June 20X8

	£000
Receipts from customers	172.50
Payments:	
Suppliers	120.00
Rates	13.20
Wages	3.60
Commission	3.00
Insurance	3.50
	<u>143.30</u>
	<u>29.20</u>

Notes:

The cash flow statement with summary attached is effectively a six-month cash budget showing the cash received, cash paid each month and the resulting month-end balances.

It is necessary to separate sales and purchase transactions into cash and on-credit, and to identify clearly the month of receipt and payment.

Commission is paid in the month after the sale is made, and all other cash flows are clearly indicated and allocated to specific months.

Note that the format of the cash flow statement brings out key figures – for management decision and control. For example:

- month-end balances – assist in the control of liquidity;
- cash deficiencies – identify how much must be financed;
- early warning – allows management to approach appropriate sources;
- cash surpluses – identify amounts to be invested on the best terms.

Statement of financial position as at 30 June 20X8

	£000
Capital – introduction	50.00
Net operating cash flows: Realised	29.20
: Unrealised	(4.00)
	<u>75.20</u>
Premises (NRV)	76.00
Net cash balance	(0.80)
	<u>75.20</u>

Notes:

This statement shows net assets of £75,200.

Make up: premises £76,000 less the negative cash balance £800.

The negative cash balance indicates the need for overdraft arrangements.

The statement is based on cash flow concept: It ignores accrual-based figures (£36,900 less £25,250).

Accruals are not regarded as real assets and liabilities.

Critics of the cash flow concept would maintain that its utility has, therefore, been seriously diminished.

(d) Letter to the bank requesting an overdraft facility

The maximum overdraft facility of £28,800:

will be required at the end of January;

will be eliminated by July.

Overdraft will fall progressively as per the cash budget.

It might be practical to request a limit of £30,000:

for the full six-month period;

reducing it to £15,000 thereafter to allow for contingencies. The facility is only to be called on as required.

Refer to the cash budget to support the request:

confirm that it is based on the most likely scenario;

agree to a repayment schedule.

Specify that collateral security is available in the form of premises if it should be required.

If not an existing customer:

give outline details of business background;

explain future plans;

market.

CHAPTER 2

Accounting and reporting on an accrual accounting basis

Question 1 – Sasha Parker

(a) Cash budget (€000)

	<i>Jan</i>	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>June</i>	<i>Total</i>
Initial capital	150.00					75.00	225.00
Customers				60.00	75.00	75.00	210.00
Total receipts	150.00			60.00	75.00	150.00	435.00
Machinery	30.00						30.00
Motor vehicles	24.00						24.00
Premises	75.00						75.00
Drawings	1.50	1.50	1.50	1.50	1.50	1.50	9.00
Suppliers		30.00	48.00	60.00	60.00	60.00	258.00
Rates							
Wages	2.25	2.25	2.25	2.25	2.25	2.25	13.50
General expenses		0.75	0.75	0.75	0.75	0.75	3.75
	132.75	34.50	52.50	64.50	64.50	64.50	413.25
Net cash flow	17.25	(34.50)	(52.50)	(4.50)	10.50	85.50	
Balance b/f	–	17.25	(17.25)	(69.75)	(74.25)	(63.75)	
Balance c/f	17.25	(17.25)	(69.75)	(74.25)	(63.75)	(21.75)	(21.75)

All balances are overdrawn except for January 20X1

	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>June</i>
o/d	17.25	69.75	74.25	63.75	4.65

Note:

No entries will be made for the 20X0/X1 local taxes that are paid in Feb 20X2 – this situation arose because Sasha Parker had assumed that the business would only pay the taxes from the start of the tax year, i.e. 1 April 20X1.

However, there will be an entry in the profit and loss account and the statement of financial position.

(b) Sasha Parker – profit and loss account for six months ended 30 June 20X1

	€000	€000
Sales [60.00 + (5 × 75.00)]		435.00
Purchases	378.00	
Closing inventory	<u>(30.00)</u>	
Cost of sales		<u>348.00</u>
Gross profit		87.00
Wages	13.50	
General expenses	4.50	
Local taxes (1.1.X1–30.6.X1)	4.00	
Insurance	13.20	
Depreciation:		
– Vehicles	2.40	
– Machinery	<u>1.50</u>	<u>39.10</u>
Net profit		<u>47.90</u>

Budgeted statement of financial position as at 30 June 20X1

Capital		225.00
Net profit		47.90
Less: drawings		<u>(9.00)</u>
		<u>263.90</u>
Non-current assets		
Premises		75.00
Vehicles	24.00	
Less: depreciation	<u>2.40</u>	21.60
Machinery	30.00	
Less: depreciation	<u>1.50</u>	28.50
Current assets		
Inventory	30.00	
Trade receivables (3 × 75.00)	225.00	
Insurance	<u>13.20</u>	268.20

Current liabilities

Trade payables	120.00	
Local taxes (1.1.X1–30.6.X1)	4.00	
Bank overdraft	4.65	
General expenses	<u>0.75</u>	<u>(129.40)</u>
Net current assets		<u>138.80</u>
		<u>263.90</u>

(c) Possible action to deal with exceeding agreed overdraft limit

Approach the bank to re-negotiate the overdraft or arrange a loan facility for an agreed term.

The amount and the period for which additional facilities are required depend on preparing a projected cash flow statement for a longer period taking into account future plans, e.g. owner's drawings requirement and any additional capital expenditure.

In particular, consider alternatives such as the following:

Leasing vehicles and/or machinery

Mortgaging the property

Getting debts in quicker manner

Introducing more capital

Obtaining or providing loan capital.

Question 2 – Mr Norman

(a) Purchases budget (\$000)

	<i>Jan</i>	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>Jun</i>
Sales units	1.65	2.20	3.85	4.40	4.40	4.95
– Closing inventory		0.55	0.96	1.10	1.10	1.24
+ Closing inventory	0.55	0.96	1.10	1.10	1.24	1.38
Purchases units	2.20	2.61	3.99	4.40	4.54	5.09

		<i>Purchases</i>	<i>Sales</i>
		<i>\$000</i>	<i>\$000</i>
Jan	(2,200 × 40)	88.00	82.50 (1,650 × 50)
Feb	(2,610 × 40)	104.40	110.00 (2,200 × 50)

Mar	(3,990 × 40)	159.60	192.50	(3,850 × 50)
Apr	(4,400 × 40)	176.00	220.00	(4,400 × 50)
May	(4,540 × 40)	181.60	220.00	(4,400 × 50)
Jun	(5,090 × 40)	<u>203.60</u>	<u>247.50</u>	(4,950 × 50)
		913.20	1,072.50	

(b) Cash flow forecast (\$000)

	Jan	Feb	Mar	Apr	May	June	Total
Initial capital	150.00						150.00
Cash sales	41.25	55.00	96.25	110.00	110.00	123.75	536.25
Credit sales		<u>41.25</u>	<u>55.00</u>	<u>96.25</u>	<u>110.00</u>	<u>110.00</u>	<u>412.50</u>
	191.25	96.25	151.25	206.25	220.00	233.75	1,098.75
Premises	80.00						80.00
Commission		1.65	2.20	3.85	4.40	4.40	16.50
Suppliers		88.00	104.40	159.60	176.00	181.60	709.60
Administration	8.00	8.00	8.00	8.00	8.00	8.00	48.00
Wages	17.00	17.00	17.00	17.00	17.00	17.00	102.00
Insurance	0.35						0.35
Total payments	105.35	114.65	131.60	188.45	205.40	211.00	956.45
Net cash flow	85.90	(18.40)	19.65	17.80	14.60	22.75	
Balance b/f	—	85.90	67.50	87.15	104.95	119.55	
Balance c/f	85.90	67.50	87.15	104.95	119.55	142.30	

(c) Budgeted statement of income for six months ended 30 June 20X8

	\$000	\$000
Sales		1,072.50
Purchases	913.20	
Closing inventory (1,380 units × £40)	<u>(55.20)</u>	
Cost of sales	<u>858.00</u>	
Gross profit		214.50
Wages		102.00
Administration		48.00
Commission (2% of 1,072.50)		21.45
Insurance		0.18
Amortisation of lease		<u>8.00</u>

	<u>179.63</u>
Net profit	<u><u>34.87</u></u>

Budgeted statement of financial position as at 30 June 20X8

	\$000	\$000
Capital		150.00
Net profit		<u>34.87</u>
		<u>184.87</u>
Non-current assets		
Leasehold premises	80.00	
Less: amortisation	<u>(8.00)</u>	
		72.00
Current assets		
Inventory	55.20	
Trade receivables	123.75	
Pre-payments – insurance	0.17	
Cash	<u>142.30</u>	
	<u>321.42</u>	
Current liabilities		
Trade payables	203.60	
Commission	<u>4.95</u>	
	<u>208.55</u>	
Net current assets		<u>112.87</u>
		<u>184.87</u>

(d) *Investment of surplus funds*

Acid test ratio

At the end of the first six-month trading, Norman's statement of financial position shows that the acid test ratio is 1.28:1 (266.22/208.55) – this is higher than the basic 1:1 ratio but it should be compared with the ratio of similar businesses in the same industry in order to establish a norm. It would appear, however, that the business has surplus funds to invest.

Amount to invest

A projected cash flow statement is required, taking into account future plans regarding the owner's drawing requirements, future capital commitments and working capital criteria, e.g. debtor collection and creditor payment terms.

Period to invest

The projected cash flow will give an indication of the period of the investment, e.g. it could range from overnight on the money market to term investments.

The important aspect is that the owner should be aware of the projected cash flows, so that return on surplus funds can be maximised.

PART 2

Preparation of internal and published financial statements

CHAPTER 3

Preparation of financial statements of comprehensive income, changes in equity and financial position

Question 1 – Old NV

(a) *Statement of income (internal) for the year ended 31 December 20X1*

		€000
Sales		12,050
Less: returns		<u>350</u>
		11,700
Inventory at 1.1. 20X1	825	
Purchases	6,263	
Carriage on purchases	13	
Less: returns	<u>(313)</u>	
	6,788	
Inventory at 31.12.20X1	<u>1,125</u>	
	5,663	
Depreciation of plant	<u>313</u>	
		<u>5,976</u>
Gross profit		5,724
Administration:		
Wages		738
Administration expenses (286 – 12)		274
Directors' remuneration		375
Selling:		
Salesmen's salaries		800
Distribution:		
Distribution expenses		290
Depreciation of vehicles		187
Carriage		125

Financial:

Goodwill impairment	177
Audit fee	38
Debenture interest	25
Rent receivable	(100)
	<u>2,929</u>
	2,795
Tax	<u>562</u>
Profit for year	<u>2,233</u>

(b) Statement of comprehensive income for publication

**Statement of comprehensive income of Old NV for the year ended
31 December 20X1**

	€000	€000
Sales		11,700
Cost of sales		<u>5,976</u>
Gross profit		5,724
Distribution costs W1	1,402	
Administrative expenses W2	1,602	
Other operating income	(100)	
		<u>2,904</u>
Trading profit		2,820
Interest payable		<u>25</u>
Profit on ordinary activities before tax		2,795
Income tax		<u>562</u>
Profit for the period		2,233
Other comprehensive income:		
Land revaluation		<u>50</u>
		<u>2,283</u>

W1

Salesmen's salaries	800
Distribution expenses	290
Depreciation of vehicles	187
Carriage	<u>125</u>
	<u>1,402</u>

W2

Wages	738
Administrative expenses	274
Directors' remuneration	375
Goodwill impairment	177
Audit fee	<u>38</u>
	<u>1,602</u>

There will be a disclosure note as follows:

Profit on ordinary activities after tax is after charging	
Goodwill impairment	177
Audit fee	38
Depreciation	500
Directors' remuneration	375

Statement of financial position of Old NV as at 31 December 20X1

	€000	€000
Non-current assets		
Intangible assets (1,062 – 177)		885
Property, plant and equipment Note 1		1,074
Land		150
Current assets		
Inventories	1,125	
Receivables	3,875	
Cash at bank and in hand	1,750	
Pre-payments	<u>12</u>	
	<u>6,762</u>	
Current liabilities		
Payables	738	
Provision for income tax	562	
Accrued charges	<u>63</u>	
	<u>1,363</u>	
Net current assets		<u>5,399</u>
Total assets less current liabilities		7,508
Non-current liabilities		
Debentures		<u>250</u>
		<u>7,258</u>

Equity

Ordinary shares of €1 each		3,125
Preference shares of €1 each		625
Share premium		350
Retained earnings	Note 2	<u>3,158</u>
		<u>7,258</u>

Disclosure notes to show make-up of statement of financial position balances

Note 1: Property, plant and equipment

Property, plant and equipment	Plant	Motor vehicles	Total
	€000	€000	€000
Cost			
At 1.1.20X1	1,200	1,125	2,325
Additions	362		362
Disposals			
At 31.12.20X1	<u>1,562</u>	<u>1,125</u>	<u>2,687</u>
Accumulated depreciation			
At 1.1.20X1	738	375	1,113
Charge for year	<u>313</u>	<u>187</u>	<u>500</u>
At 31.12.20X1	<u>1,051</u>	<u>562</u>	<u>1,613</u>
Net book value			
At 31.12.20X1	511	563	1,074
At 31.12.20X0	462	750	1,212

Working: accrued expenses

Working: accrued expenses	€000
Audit fee	38
Debenture interest	25

Note 2: Movements on reserves

	€000
Retained earnings at 1.1.20X1	875
Amount transferred from statement of comprehensive income	<u>2,283</u>
Balance at 31.12.20X1	<u>3,158</u>

Question 2 – Formatone plc

(i) *Statement of income*

Statement of income for the year ended 30 June 20X6

		£000
Sales		9480.6
Cost of sales (N1)		<u>(6,625.8)</u>
Gross profit		2,854.8
Distribution cost		<u>(529.2)</u>
Administrative expenses		<u>(946.8)</u>
Operating profit		1,378.8
Taxation (N2)		<u>(181.8)</u>
Profit after taxation		<u>1,197.0</u>
N1 cost of sales		
N1 cost of sales		£000
As per trial balance		5,909.4
Depreciation of buildings	(1,620/30)	54.0
Depreciation of plant	(1,728 – 504) @ 10%	122.4
Write-down of intangible assets		<u>540.0</u>
		<u>6,625.8</u>
N2 taxation		
Over provision		(14.4)
Current tax		169.2
Deferred tax		<u>27.0</u>
		<u>181.8</u>

(ii) Statement of financial position

Statement of financial position as at 30 June 20X6

			£000
Non-current assets			
Land at valuation			5,400.0
Buildings at valuation	1,620.0	(54.0)	1,566.0
Plant and equipment	1,728.0	(626.4)	1,101.6
Intangible assets			270.0
Current assets			
Inventory	586.8		
Trade receivables	585.0		
Cash	<u>41.4</u>		<u>1,213.2</u>
			<u>9,550.8</u>
			£000
Equity and reserves			
Ordinary shares of 50p	2,160.0		
Share premium account	432.0		
Revaluation reserve	4,179.6		
Retained earnings	<u>1,796.4</u>		8,568.0
Non-current liability			
Deferred tax			64.8
Current liabilities			
Trade payables	532.8		
Taxation	169.2		
Dividend declared	<u>216.0</u>		<u>918.0</u>
			<u>9,550.8</u>

(iii) Statement of changes in equity

<i>Statement of changes in equity</i>	<i>Share capital</i>	<i>Share premium</i>	<i>Revaluation reserve</i>	<i>Retained earnings</i>	<i>Total</i>
Balance b/f	2,085.0	387.0	–	891.0	3,363.0
New issue of shares	75.0	45.0	–	–	120.0
Land and buildings	–	–	4,212.0	–	4,212.0
Transfer N3	–	–	(32.4)	32.4	–
Retained profit for the year	–	–	–	1,197.0	1,197.0
Interim dividend paid	–	–	–	(108.0)	(108.0)
Interim dividend declared	–	–	–	(216.0)	(216.0)
Balance c/f	2,160.0	432.0	4,179.6	1,796.4	8,568.0

N3 Transfer from revaluation reserve

Revaluation surplus £972,000

Transfer 1/30 £ 32,400

Question 3 – Basalt plc

(i) Statement of income for the year ended 31 December 20X0

		£000
Turnover (962 – 27 returns)		935
Cost of sales	Note 1	<u>460</u>
Gross profit		475
Distribution costs	Note 2	218
Administrative expenses	Note 3	<u>118</u>
		139
Other operating income (i.e. rent receivable)		<u>7</u>
Profit on ordinary activities before tax		146
Tax on profit of ordinary activities		<u>58</u>
Profit for the year		88
Other comprehensive income:		
Revaluation of land		<u>55</u>
		<u>143</u>

	£000
Note 1: Opening inventory	66
Purchases	500
Carriage inwards	9
Returns out	(25)
Closing inventory	<u>(90)</u>
	<u>460</u>
Note 2: Warehouse wages	101
Salesmen's salaries	64
Distribution expenses	6
Hire of vehicles	19
Depreciation	<u>28</u> (7/11 of 20% of £220,000)
	<u>218</u>
Note 3: Administrative wages	60
Administrative expenses	10
Directors' remuneration	30
Auditors' remuneration	2
Depreciation (4/11)	<u>16</u>
	<u>118</u>

(ii) Statement of financial position as at 31 December 20X0

	£000
Non-current assets	
Tangible assets	
Plant and machinery	
(cost 220 – Depreciation b/f 49 – depreciation for year 44)	127
Current assets	
Inventory	90
Trade receivables	326
Cash at bank	<u>62</u>
	<u>478</u>
Liabilities	
Amounts falling due within one year:	
Trade payables	66
Other payables (Audit 2 + corporation tax 58)	<u>60</u>
	<u>126</u>

Net current assets	<u>352</u>
Total assets <i>less</i> current liabilities	<u>479</u>
Equity	
Called-up share capital	300
Share premium a/c	20
General reserve	16
Retained earnings	<u>143</u>
	<u>479</u>

(a) Directors' report must deal with certain matters by law, e.g.:

Proposed dividends.

Likely future developments in the company's business.

Principal activities of the company.

Political and charitable contributions.

Consistency with other statements – reviewed by auditors.

(b) Chairman's report

May be a highly personalised review of the business, its developments and the environment in which it operates.

Not subject to audit.

(c) Auditors' report expresses an opinion as to whether the financial statements give a 'true and fair view'.

Question 4 – HK Ltd

(a) Statement of comprehensive income for the year ended 30 June 20X1

	\$000	\$000
Turnover		381,600
Cost of sales		
Per trial balance		318,979
+ Hire 2,400 + depreciation 799*		
– Insurance 150*** + inventory loss 250		<u>3,299</u>
		<u>322,278</u>
Gross profit		59,322

Administration expenses	
Per trial balance 9,000 + directors 562 +	
Bad debt 157 + auditor remuneration 112	9,831
Distribution costs	<u>35,100</u>
	<u>44,931</u>
	14,391
Profit on disposal of non-current assets	<u>536</u>
Profit before tax and interest	14,927
Interest payable (454 + 151 tax on interest)	<u>605</u>
	14,322
Other operating income**	<u>17</u>
Profit before tax	14,339
Income tax	<u>5,348</u>
Profit for the year	8,991
Other comprehensive income	
Revaluation gain	<u>400</u>
Total comprehensive income for the year	<u>9,391</u>
<i>Note: *Depreciation consists of Buildings 94 + Plant 619 + Fixtures 86</i>	
**Development grant	85
Transfer versus income statement	
(20% of 85)	<u>(17)</u>
To statement of financial position	<u>68</u>

***Insurance is treated as an adjusting event.

Statement of financial position as at 30 June 20X1

Intangible non-current assets	
Goodwill	480
Tangible non-current assets	
Freehold land	2,500
Freehold buildings	4,680
Aggregate depreciation	<u>648</u>
Plant and machinery	3,096
Aggregate depreciation	<u>1,857</u>
Fixtures and fittings	864
Aggregate depreciation	<u>259</u>
	<u>605</u>
	<u>8,376</u>
	8,856

Current assets

Inventory to read (11,794 – 250 obsolescence)	11,544
Receivables (7,263 + 150 insurance)	7,413
Cash and cash equivalents	<u>11,561</u>
	<u>30,518</u>

Current liabilities

Payables	2,591
Dividends (Preference 162 + Ordinary 324)	486
Tax	<u>5,348</u>
	<u>8,425</u>

Net current assets 22,093

Non-current liabilities

9% loan	<u>7,200</u>
	23,749
Deferred income – government grant (see Note)	<u>68</u>
	<u>23,681</u>

Equity

Ordinary shares 50c each	3,600
9% preference shares of \$1 each	5,400
Revaluation reserve	400
Retained earnings (6,364 + 8,991 – 1,074 dividends)	<u>14,281</u>
	<u>23,681</u>

Note: The grant could be deducted from the cost of the plant under IAS 20.

(b) The usefulness of the non-current asset schedule

- (i) The column headings allow the user to see the type of non-current assets owned by the business. This can give helpful initial indications, e.g.

Realisability – intangible assets might be more difficult to sell than property.

Appreciation – land is more likely to appreciate than office equipment.

Depreciation – licences are subject to amortisation and possible fall in value due to competition.

Security – land and buildings are more likely to be accepted as security for loans and overdrafts than intangible assets.

- (ii) The carrying values may be at cost or revaluation.

If at cost, it may be that the statement of financial position gives too low an indication of current market values – this is often an important consideration if existing shareholders are assessing a takeover offer.

- (iii) The accumulated depreciation figure when related to the cost gives an indication of the age of the assets and possible need for capital outlays to replace with cash flow implications.
- (iv) Disposals may be an indication of the occurrence of replacement, which could indicate growth or maintenance of existing capacity. If there is no replacement, then consider implications for future capacity or other reasons, e.g. change of direction and disposal of non-profit-making parts of the business.

Question 5 – Phoenix plc

(a) *Statement of comprehensive income for the year ended 30 June 20X7*

	£000
Revenue	6,465
Cost of sales (4,165 + 196 depreciation)	<u>(4,361)</u>
Gross profit	2,104
Distribution cost	(669)
Administration expense (1,126 + 31 depreciation + 415)	<u>(1,572)</u>
Operating loss	(137)
Exceptional item:	
Gain on disposal of warehouse	75
Dividend received	<u>80</u>
Profit before taxation	18
Taxation	<u>(96)</u>
<i>Loss for the year</i>	<i>(78)</i>
Other comprehensive income	
Revaluation gain	<u>700</u>
Total comprehensive income for the year	<u>622</u>

(b) Statement of financial position as at 30 June 20X7

Property, plant and equipment	4,243
Investment	365
Current assets	
Inventory	1,468
Trade receivables	947
Cash at bank	175
Current liabilities	(868)
Net current assets	<u>1,722</u>
	<u>6,330</u>
Share capital and reserves	
Share capital	4,500
Share premium	500
Revaluation reserve	1,270
Retained earnings	<u>60</u>
	<u>6,330</u>

(c) Statement of movement of property, plant and equipment

	<i>L&B</i>	<i>P&M</i>	<i>F&F</i>	<i>Total</i>
Balance b/f	2,400	1,800	620	4,820
Disposal	(150)			(150)
Revaluation reserve		160		160
Balance c/f	<u>2,250</u>	<u>1,960</u>	<u>620</u>	<u>4,830</u>
Accumulated depreciation				
Balance b/f		540	360	900
Revaluation reserve		(540)		(540)
P&L charge		<u>196</u>	<u>31</u>	<u>227</u>
Balance c/f		196	391	587
WDV at 30.6.20X7	<u>2,250</u>	<u>1,764</u>	<u>229</u>	<u>4,243</u>

Current assets

Trade receivables	947
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Creditors

Trade payables	566
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Taxation	122
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Dividend proposed	<u>180</u>
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	<u>868</u>
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Balances in revaluation reserve and retained earnings are made up as follows:

	<i>Revaluation reserve</i>	<i>Retained earnings</i>
Balance b/f	600	488
Plant and machinery revaluation	700	
Transfer on disposal	(30)	30
Loss for year		(78)
Dividends		<u>(380)</u>
Balance c/f	<u>1,270</u>	<u>60</u>

Question 6 – Olive A/S

(a) Statement of comprehensive income for the year ended 30 September 20X4

Revenue		3,460
Cost of sales	W1	<u>(1,557.1)</u>
Gross profit		1,902.9
Distribution cost	W2	(362)
Administration expenses	W3	<u>(917.9)</u>
Operating profit		623
Exceptional items: gain – disposal of non-current assets		6
Investment income		45
Interest and similar charges		<u>(30)</u>
		644
Taxation (Sch 1)		<u>(197)</u>
Profit for the year		447

Other comprehensive income

Revaluation gain on property 380

Total comprehensive income for the year **827**

(b) Statement of financial position as at 30 September 20X4

Non-current assets

Intangible assets – development costs 425

Tangible assets (Sch 2) 1,480

Investments 248

Current assets

Inventory (364 + 40) 404

Receivables (Sch 3) 599

Cash and bank 38

Current liabilities (Sch 4) (636)

Net current assets **405**

2,558

Non-current liabilities

12% debentures 500

Net capital employed **2,058**

Share capital: ordinary shares of £1 each 600

Share premium account 30

Retained earnings (Sch 5) 1,055

Revaluation reserve 373

2,058

Schedule 1: Taxation charge

Income tax 185

Under-provision 20X3 (140 – 128) 12

197

Schedule 2: Statement of movement of non-current assets

	<i>Land and buildings</i>	<i>Plant and machinery</i>	<i>Fixtures and fittings</i>	<i>Pre- payments</i>	<i>Total</i>
Balance b/f	600	520	80	–	1,200
Revaluation	300	–	–	–	300
Acquisitions	–	320	40	60	420
Disposal	–	(240)	–	–	(240)
Balance c/f	<u>900</u>	<u>600</u>	<u>120</u>	<u>60</u>	<u>1,680</u>
Balance b/f	80	160	26	–	266
Revaluation	(80)	–	–	–	(80)
Income charge	15 (W4)	54	11	–	80

Disposal	=	(66)	=	=	(66)
Balance c/f	<u>15</u>	<u>148</u>	<u>37</u>	=	<u>200</u>
WDV 30.9.X4	885	452	83	60	1,480
WDV 30.9.X3	520	360	54	–	934

Schedule 3: Receivables

Trade receivables	584
Prepaid rent	<u>15</u>
	<u>599</u>

Schedule 4: Current liabilities

Trade payables	296
Debenture interest (three months)	15
20X3 Income tax	140
20X4 Income tax	<u>185</u>
	<u>636</u>

(c) Schedule 5: Statement of changes in equity

	<i>Share premium</i>	<i>Revaluation reserve</i>	<i>Retained earnings</i>
Balance b/f	150	–	661
Formation expenses w/off	(120)	–	–
Profit for the year	–	–	447
Dividend paid	–	–	(60)
Revaluation gain	–	380	–
Transfer – extra depreciation	<u>–</u>	<u>(7)</u>	<u>7</u>
Balance c/f	<u>30</u>	<u>373</u>	<u>1,055</u>

Notes

Expenses charged in the year include the following:

Depreciation written off	€80,000
Directors' emoluments	€180,000
Directors' pension	<u>€18,000</u>
Audit fees and expenses	€65,000

Company employs 646 persons, of whom 428 work at the factory and the rest work at the head office.

Land and Buildings were revalued during the year by Messrs XYZ, Chartered Valuers at open market value on existing use basis, and the surplus was recorded in a revaluation reserve.

Administration expenses include an exceptional item of €60,000 which is the under-provision for a claim that arose in a previous year and the balance of retained earnings b/f has been restated as 661,000.

Workings

W1 – Cost of Sales

Inventory on 1.10.20X3	211
Purchases	925
Carriage inwards	162
Depreciation – Building	9
Depreciation – Machinery (18 + 28 + 8)	54
Salaries (55% of 820)	451
Pension cost (10% of 451)	45.1
Heat and light (80% of 80)	64
Inventory 30.9.20X4	(364)
	<u>1,557.1</u>

W2 – Distribution cost

Advertising	112
Sales commission	92
Bad debts	<u>158</u>
	<u>362</u>

W3 – Administration expenses

Depreciation – Buildings	6
Depreciation – Fixtures and equipment (8 + 3)	11
Under-provision for litigation	60
Salaries	369
Directors' emoluments	<u>180</u>
Pension costs (10% of 549)	54.9
Heat and light	16
Audit fees and expenses	65
Stationery	28
Other administrative expenses	<u>128</u>

	<u>917.9</u>
W4 – Depreciation of buildings	
Original cost	400
Revaluation increase	<u>380</u>
	<u>780</u>
2% of 780 = approximately	<u>15</u>

Question 7 – Imecet

(a) *Statement of income for Imecet for the year ended 31 October 2005*

	\$000	\$000
Sales		10,300.0
Less:		
Opening inventory	1,100.0	
Purchases	6,350.0	
Factory wages	575.0	
Factory depreciation	<u>135.0</u>	
	8,160.0	
Closing inventory	<u>1,150.0</u>	
Cost of sales		<u>7,010.0</u>
Gross profit		3,290.0
Distribution costs	492.5	
Administrative expenses	<u>176.0</u>	<u>668.5</u>
Operating profit		2,621.5
Interest		<u>200.0</u>
Profit before tax		2,421.5
Taxation		
Income tax	350.0	
Deferred tax	<u>75.0</u>	<u>425.0</u>
Profit after tax		<u>1,996.5</u>

**(b) Statement of changes in equity for the year ended 31 October 2005
(\$000)**

	<i>Share capital</i>	<i>Share premium</i>	<i>Accumulated profit</i>	<i>Revaluation reserve N1</i>	<i>Total</i>
1.11.2004	3,000.0	750.0	3,701.0	2,500.0	9,951.0
Change	<u>1,000.0</u>	<u>750.0</u>	<u>1,996.5</u>	<u>1,200.0</u>	<u>4,946.5</u>
31.10.2005	<u>4,000.0</u>	<u>1,500.0</u>	<u>5,697.5</u>	<u>3,700.0</u>	<u>14,897.5</u>

N1 – Revaluation change would be reported as other comprehensive income.

Question 8 – Scott Ross discussion points

Nathan Davison is obviously still in the family business mentality, where the affairs of the business are kept secret as far as possible. He has not taken on board the idea that now it is a public company; it is no longer his business and he has a moral obligation to keep external investors fully informed on the nature of the business and of events affecting the business and its profitability and financial stability.

Under the law, he has a legal obligation to provide accounts that show a true and fair view which means he has to review the standards compliant accounts and ask what additional information is needed for readers of the annual report in order to understand the major elements of the business.

The suggestion of a footnote should be vague or that you should do the minimum that is necessary to protect yourself from prosecution is contrary to the spirit of open markets. If you cannot keep external shareholders informed, then perhaps you were immoral to take their money in the first place. It is interesting to note that the famous US investor Warren Buffett has stated that if a footnote was unclear, then he would assume that it was unclear by deliberate design. Then he would not invest in the company.

Just think of what impact that could have on a share price if a number of sophisticated investors take that view.

Then the suggestion that there be a deliberate attempt to mislead investors regarding the profitability of a segment is clearly both legally and morally wrong. Further, the admission that the company has been smoothing income is an interesting moral issue. If smoothing income was just an attempt to counter the fact that during booms the company is likely to view allowances for bad debts and outstanding through rose-coloured glasses and during busts they are likely to be too pessimistic in their accruals, then perhaps it could be justified. But if the motivation is to make life easier for executives or to report rosy steady upward trends to investors that contradict the reality of the business cycle, then the objective is immoral and the results are fraudulent misrepresentation. In the famous Royal Mail case, where profits were manipulated through transfers to and from reserves, the managing director went to jail and the auditor avoided the same fate on a technicality that he had

included a footnote mentioning the transfers. However, it is unlikely that the auditor would be able to make the same claims today by giving differences in accounting regulations and laws.

Question 9 – TYV

TYV – Statement of profit or loss for the year ended 30 September 2014 (in accordance with the requirements of IFSS)

	\$000	\$000
Revenue		19,460
Cost of sales (W2)		(11,119)
Gross profit		8,341
Administrative expenses (W2)	(1,954)	
Distribution costs	(1,110)	
		(3,064)
Profit from operations		5,277
Finance cost (W4)		(378)
Profit before tax		4,899
Income tax expense (W5)		(971)
Profit for the period		<u>3,928</u>

TYV – Statement of changes in equity for the year ended 30 September 2014 (in accordance with the requirements of IFSS)

	<i>Equity shares</i>	<i>Share premium</i>	<i>Retained earnings</i>	<i>Total</i>
	\$000	\$000	\$000	\$000
Balance as at 30 September 2013	6,000	850	491	7,341
Profit for period			3,928	3,928
<u>Dividend paid</u>			(350)	(350)
<u>Balance at end</u>	<u>6,000</u>	<u>850</u>	<u>4,069</u>	<u>10,919</u>

TYV – Statement of financial position as at 30 September 2014
(in accordance with the requirements of IFSS)

	\$000	\$000
Non-current Assets		
Property, plant and equipment (W1)		16,415
Current Assets		
Inventory	575	
Trade receivables	2,250	
Cash and cash equivalents	<u>272</u>	
Non-current assets held for sale		3,097
		<u>1,420</u>
Total Assets		<u>20,932</u>
Equity and Liabilities		
Equity		
Share capital	6,000	
Share premium	850	
Retained earnings	<u>4,069</u>	
Total equity		10,919
Non-current Liabilities		
7% Loan	5,000	
Deferred tax (W5)	<u>576</u>	
Total non-current liabilities		5,576
Current Liabilities		
Trade payables	1,880	
Tax payable	940	
Short-term loan	1,500	
Interest	<u>117</u>	
Total current liabilities		<u>4,437</u>
Total equity and liabilities		

Workings – All figures in \$000

W1 – Tangible Non-current Assets

	<u>Land</u>	<u>Buildings</u>	<u>Plant and equipment</u>	<u>Total</u>
Cost/Valuation				
Balance 30/9/13	11,000	6,386	7,750	
Disposal factory B	(1,120)	(325)		
Transfer factory A – held for sale	(1,375)	(455)		
Plant and equipment scrapped			(175)	
New factory building		<u>1,099</u>		
	<u>8,505</u>	<u>6,705</u>	<u>7,575</u>	
Depreciation				
Balance 30/9/13		1,700	4,510	
Disposal factory B		(286)		
Transfer factory A – held for sale		(384)		
Plant and equipment scrapped			(120)	
Charge for year		<u>134</u>	<u>796</u>	
		<u>1,164</u>	<u>5,186</u>	
<u>Net book value at 30/9/14</u>	<u>8,505</u>	<u>5,541</u>	<u>2,369</u>	<u>16,415</u>

Depreciation buildings

$$6,705 \times 2\% = 134$$

$$\text{Plant and equipment reducing balance} = 7,575 - (4,510 - 120) = 3,185 \times 25\% = 796$$

W2

	<i>Cost of sales</i>	<i>Administrative expenses</i>
	<i>\$000</i>	<i>\$000</i>
Balance per trial balance	10,200	1,820
Depreciation buildings (W1)		134
Loss on factory closures Factory A (W3)	46	
Loss on factory closures Factory B (W3)	29	
Loss on plant and equipment (W3)	48	
Depreciation plant and equipment (W1)	<u>796</u>	
	<u>11,119</u>	<u>1,954</u>

W3 – Loss on factory closures

Factory A

Carrying value:

Land	1,375	
Buildings	<u>455</u>	1,830
Less depreciation	(<u>364</u>)	
	1,466	
Fair value 30/9/2014	<u>1,420</u>	
Write-down	(46)	

Factory B

Carrying value:

Land	1,120	
Buildings	<u>325</u>	1,445
Less depreciation	(<u>286</u>)	
	1,159	
Cash received	<u>1,130</u>	
Loss on disposal	(29)	