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Chapter 6
International Accounting Standard

Regulatory system

Limited companies must prepare their financial statements within a regulatory framework. This framework consists of:

- the UK Companies Act 1985 as amended by the UK Companies Act 1989
- international accounting standards (International Accounting Standards and International Financial Reporting Standards)

Why is there a need to have standards?

The standards seek to:

- resolve areas of difference in the preparation and presentation of accounting information
- recommend disclosure of accounting bases
- identify any departure from the standards
- improve existing disclosure requirements.

International Accounting Standards (IAS) are gradually being replaced with

International Financial Reporting Standards (IFRS)

Although it is not, as yet, mandatory for the financial statements of private limited companies to be prepared in accordance with the IASs, it seems inevitable that, in time, the standards will apply to all limited companies. Consequently, in this book appropriate standards have been applied to the preparation of the financial statements of all limited companies.

IAS Topic

IAS 1	Presentation of financial statements
IAS 2	Inventories (not long-term contracts)
IAS 7	Statement of cash flows
IAS 8	Accounting policies
IAS 10	Events after the reporting period
IAS 16	Property, plant and equipment
IAS 36	Impairment of assets
IAS 37	Provisions, contingent liabilities and contingent assets
IAS 38	Intangible assets

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IAS 1 – Presentation of Financial Statements

Components of Financial Statements

Financial Statement comprise

- Income Statement
- Statement of Financial Position
- Cash Flow Statement
- Statement of Changes in Equity
- Notes to Accounts

General Terms and Discussions:

Accounting Policies

Accounting policies are the bases (methods, accounting treatments) developed for applying fundamental accounting concepts.
The reliability of financial statement is achieved if the information provides for: faithful representation, substance over form, prudence and completeness.

Fundamental Accounting Concepts

Fundamental Accounting concepts are going concern, accruals, consistency of presentation and prudence.

Materiality and Aggregation

All material items should be **disclosed** in the financial statements.
Amounts which are immaterial can be aggregated with amounts of a similar nature or function and need not be presented separately
Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements

Offsetting

IAS 1 does not allow assets and liabilities to be offset against each other unless such a treatment is required or permitted by another IFRS.
Income and expenses can be offset only when one of the following applies.
(a) An IFRS requires/permits it.
(b) Gains, losses and related expenses arising from the same/similar transactions are not material

IAS 2 -Inventory

Marginal Costing is not an acceptable method for inventory valuation.

IAS 2 Inventories are defined as:

- Goods or other assets purchased for resale
- Consumables stores

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- Raw material and components purchased for incorporation into products for sale
- Products and services in intermediate stage of completion
- Finished goods

Cost of purchase comprises the purchase price including import taxes, transport and handling **costs** and any other costs that are directly attributable to the goods
Cost of conversion comprises:

- Costs that can be specifically attributed to units of production, for example direct labour, other direct expenses and subcontracted work
- Production overheads
- Any other overheads

The standard states that inventory should be valued at the lower of cost and net realizable value of separate items of inventory or of groups of similar items

IAS 7 – Cash Flow Statement

A cash flow statement has three sections.

- Cash flow from operating activities
- Cash flow from investing activities
- Cash flow from financing activities

IAS 8 – Accounting Policies

Accounting policies once adopted should be applied consistently from year to year. The consistently use of accounting information enhances the usefulness of the financial statements.
Change in accounting policy, will include, for example change in the method of inventory valuation from FIFO to average cost.
A change in accounting policy is permitted only if the change:

- is required by a new IAS
- results in more and true and fair view of financial statements

IAS 10 – Events after Reporting Period

Events after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date on which the financial statements are authorised for issue. Two types of events can be identified:

- ❖ those that provide further evidence of conditions that existed at the reporting date; and
- ❖ those that are indicative of conditions that arose subsequent to the reporting date

The date when financial statements are authorised for issue is the date when board of directors reviews the year end draft financial statements and authorises them for issue.

Events after balance sheet date are categorised into

- Adjusting Events

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- Non adjusting Events

Adjusting event is one which requires the accounts of the year to be adjusted as a result of the conditions of the event existing at the statement of financial position date

Examples could include:

- A valuation of property indicating permanent diminution in value as at the balance sheet date
- The insolvency of debtor included in the year end figure for debtors
- The announcement of a tax rate applicable to the year ended on the balance sheet date
- The discovery of an error in the accounts
- Decision taken by the board of directors relating to the year concerned, e.g, amount of proposed dividend or of transfer to reserve

A non-adjusting event is an event that occurs after the period end where the conditions did not exist at the period end. It is usually shown by a note to the final financial statements.
A non-adjusting event does not require the statements to be adjusted but a note is added as the conditions leading to the event were not present at the statement of financial position date

Examples might include:

- A major restructuring of the business;
- Significant business commitments entered into after the balance sheet date.
- Proposed dividend

IAS 16 – Property, Plant and Equipment

This standard sets out how property, plant and equipment is dealt with. Plant, property and equipment is measured at cost. Cost includes the purchase price, plus any import duties, plus any costs attributable to make the asset fit for use at the intended location, plus any estimated costs of dismantling and removing the asset at the end of its life.

After acquisition the company must chose to value its assets using:
Cost – the asset is shown at cost less accumulated depreciation and impairment losses.
Revaluation– the asset is shown at a revalued amount (that is an amount at which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction) less subsequent depreciation and impairment losses.
Depreciation is to be charged on all non-current assets with the exception of freehold land.

The two methods examined are:

- The straight-line method
- The diminishing (reducing) balance method.

The company chooses the method in a manner that reflects the way in which the assets' economic benefits are consumed. The method used should be reviewed at least annually in order to consider whether the method used is still the most appropriate method.

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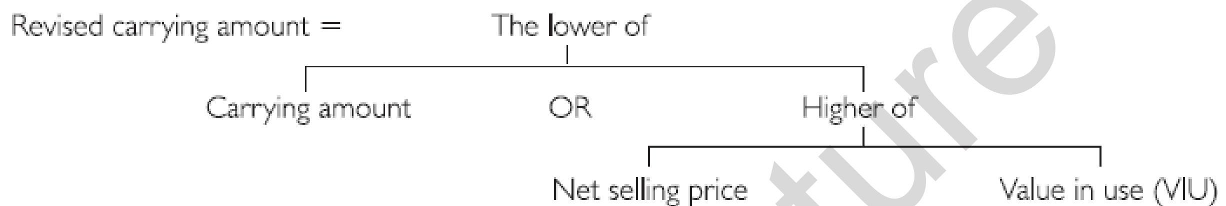
IAS 36 – Impairment of Assets

Impairment: A fall in the value of an asset, so that its recoverable amount is now less than its carrying value in the balance sheet.

This standard sets out the accounting treatment to ensure that assets are shown in the balance sheet at no more than their value or recoverable amount.
The recoverable amount is the higher of a fair value less any costs that would be incurred were it to be sold and its present value in use.
The standard applies to non-current assets. Assets need to be reviewed at each balance sheet date to judge whether there is evidence of any impairment.
If there is an impairment loss, the asset should be shown on the balance sheet at its recoverable amount and the impairment loss should be shown on the income statement as an expense.



IAS 37 – Provisions, Contingent Liabilities and Contingent assets

Provisions

Provision can be defined as a liability of uncertain timings or amounts
For example: a business is facing legal action for breaching health and safety law. The likely repercussion is that they will be fined. The timing and severity of the fine will be decided by the criminal court at some point in future. The key question is should the business attempt to reflect this cost in the financial statements?
As the amount would be settle in the future a corresponding liability is recorded as follows

Dr Expenses
Cr Provision Liability

Criteria for recording provision

- There must be present obligation (legal or constructive) that exists as a result of past event
- There must be a probable transfer of economic benefits
- There must be a reliable estimate of the potential cost

Worked example

A business has been told by its lawyers that it is likely to have to pay $10,000 damages for a product that failed. The business duly set up a provision at 31 December 20X7. However, the following year, the lawyers found that damages were more likely to be $50,000. How is the provision treated in the accounts at:
(a) 31 December 20X7?
(b) 31 December 20X8?

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Solution

(a) The business needs to set up a provision as follows:

DEBIT	Damages (I/S)	$10,000	
CREDIT	Provision (SOFP)		$10,000

EXTRACT FROM INCOME STATEMENT

	$
Expenses:	
:	
:	
Provision for damages	10,000

EXTRACT FROM STATEMENT OF FINANCIAL POSITION

	$
Non-current liabilities	
Provision for damages	10,000

(b) The business needs to increase the provision.

DEBIT	Damages (I/S)	$40,000	
CREDIT	Provision (SOFP)		$40,000

Do not forget that the provision account has already got a balance brought forward of $10,000, so that we only need to account for the **increase** in the provision.

EXTRACT FROM INCOME STATEMENT

	$
Expenses:	
:	
:	
Provision for damages	40,000

EXTRACT FROM STATEMENT OF FINANCIAL POSITION

	$
Non-current liabilities	
Provision for damages (10,000 + 40,000)	50,000

<u>**Contingent liabilities**</u>

Contingent liabilities are made with regard to liabilities of uncertain timing or amount. However , unlike provisions no accounting entries are made with regard to contingent liabilities (no expense or liability is recognized). When a contingent liability is required the business will include a note in the financial statements describing the potential liability to the users.
A contingent liability is recognized when there is:

- A possible obligation that arises from past events; or
- A probable obligation that arise from past events but the amount of the obligation cannot be measured with sufficient reliability

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Examples of contingent liabilities include outstanding litigation where the potential costs cannot be estimated with any degree of reliability or when the likelihood of losing the litigation is only deemed possible

Contingent assets

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

An example of a contingent asset is when a business is claiming compensation off either an individual or another business and the outcome of the claim is uncertain at the reporting date.

Accounting for contingent liabilities and assets

The requirements as regards to contingent liabilities and assets are summarized in the following table.

Probability of occurrence	Contingent liabilities	Contingent assets
Virtually certain	Provide	Recognize
Probable	Provide	Disclose in note
Possible	Disclose in note	Ignore
Remote	Ignore	Ignore

Note that the standard gives no guidance as the meaning of the terms in the left handed column. One possible interpretation is as follows

Virtually certain greater than 95%
Probable between 51% - 95%
Possible between 5% - 50%
Remote less than 5%

IAS 38 – Intangible Assets

Intangible Asset

An intangible asset is an identifiable non-monetary asset without physical substance. The asset must be:
– Controlled by the entity as a result of events in the past; and
– Something from which the entity expects future economic benefits to flow

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

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Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life. Amortisation period and amortisation method should be reviewed at each financial year end.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Useful life is:

(a) The period over which an asset is expected to be available for use by an entity; or

(b) The number of production or similar units expected to be obtained from the asset by an entity.

The standard gives examples of activities which might be included in either research or development or which are neither but may be closely associated with both.

Research

– Activities aimed at obtaining new knowledge
– The search for applications of research findings or other knowledge
– The search for product or process alternatives
– The formulation and design of possible new or improved product or process alternatives

Development

– The design, construction and testing of pre-production prototypes and models
– The design of tools, jigs, moulds and dies involving new technology
– The design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production
– The design construction and testing of a chosen alternative for new/improved materials

Worked example

XY Co has development expenditure of $500,000. Its policy is to amortise development expenditure at 2% per annum. Accumulated amortisation brought forward is $20,000.
(a) What is the charge in the income statement for the year's amortisation?
(b) What is the amount shown in the statement of financial position for development expenditure?

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Past Paper Questions

Q # 1 The draft statement of financial position at 30 April 2007 for O'Really Ltd, an electrical goods retailer, is shown below. Unfortunately it did not balance, and a suspense account was created.

Statement of financial position as at 30 April 2007

	$	$
Fixed assets		
Premises		500 000
Other tangible fixed assets		710 000
		1 210 000
Current assets		
Stock	60 000	
Debtors	8 000	
Bank	14 000	
	82 000	
Creditors: amounts falling due in less than one year	42 000	40 000
Suspense account		180 000
		1 430 000
Share capital and reserves		
Ordinary shares of $1 each fully paid		750 000
7% redeemable preference shares fully paid		250 000
Share premium		62 500
Profit and loss account		367 500
		1 430 000

After the preparation of the draft final accounts for O'Really Ltd for the year ended 30 April 2007 the following items were revealed, all of which need to be included in the final accounts.

1. On 1 May 2006 O'Really Ltd purchased the business of a rival retailer. As part of the purchase price O'Really paid $180000 for goodwill. The directors were unsure how to treat the goodwill. It had been entered in a suspense account. It is estimated that the economic life of the goodwill will be 4 years.

2. O'Really's sales have doubled over the past few years and the directors believe that they have a very good business reputation. As a result they propose to introduce a further $120000 as additional goodwill.

3. The directors of O'Really Ltd valued stock at cost. The closing stock at 30 April 2007 has been valued at $60000. Included in the closing stock were 6 air conditioning units that had been damaged in a recent flood. The units cost $220 each and normally sell for $350 each.
The 6 damaged units could be sold for $250 each after undertaking total repair costs of $400. The 6 units could be replaced for $200 each.

4. On 1 May 2006 the business premises were re-valued from a net book value of $500000 to $750000. Premises are depreciated at 2% per annum. The revaluation had not been included in the books of account.

5. No provision has been made for doubtful debts. The directors feel that 5 % would be appropriate.

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REQUIRED

(a) Identify the appropriate accounting standard for each of the items 1-5. [5]

b) Calculate the profit and loss account balance at 30 April 2007 showing clearly the effect of each of the items 1-5. [11]

(c) Prepare a balance sheet at 30 April 2007 taking into account items 1-5. [12]

November 2007

Q # 2

- There was a flood at the company's premises on 29 July 2011 resulting in a material uninsured loss of $215 000.
- On 14 August 2011 the company declared its final dividend for the year ended 30 June 2011 of $0.03 per share.

IAS 10 (events after the statement of financial position date) identifies two types of event as adjusting events and non-adjusting events.

REQUIRED

1. State the difference between adjusting and non-adjusting events. Explain their treatment in the financial statements. [4]
2. State if the items in points 4 and 5 in the additional information are adjusting or non-adjusting events. Justify your answer. [4]

November 2011

Q # 3 IAS 36 sets out the accounting procedures to ensure that assets are carried on the statement of financial position at no more than their recoverable amount.

REQUIRED

Explain the accounting treatment to ensure that this is achieved. [3]

June 2012

Q # 4 The following balances were extracted from the draft financial statements of Flott plc on 31 January 2012:

	$
Revenue	2 120 600
Purchases	1 180 800
Non-current assets	420 800
Trade receivables	205 400
Trade payables	91 100

REQUIRED

(a) Calculate:
(i) Non-current asset turnover; [2]
(ii) Trade receivables turnover (in days); [2]
(iii) Trade payables turnover (in days). [2]

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(b) Comment on the relationship between the trade receivables turnover and the trade payables turnover. What is the probable effect of this relationship? [2]

The non-current asset figure includes the net book value of an item of equipment which was bought on 1 February 2010 at a cost of $50 000. This equipment had been subject to depreciation at the rate of 20% a year on the reducing balance basis.
This equipment could now be sold on the open market for $26 000 although the company would incur transport costs of $200.
If the company continued to use the equipment it could be used for four more years.
The associated revenues and costs (excluding depreciation) would be as follows:

Year	Revenue	Costs
	$	$
1	42 292	32 611
2	34 444	25 364
3	30 622	22 500
4	24 810	18 221

The discount factors used by the company are as follows

Year	Discount factor
1	0.909
2	0.826
3	0.751
4	0.683

REQUIRED

(c) Calculate at 31 January 2012:
(i) The equipment's carrying amount; [3]
(ii) Its fair value less costs to sell; [2]
(iii) Its value in use. [9]

(d) State:
(i) The equipment's recoverable amount at 31 January 2012; [2]
(ii) The value at which the equipment should be included in the statement of financial position at 31 January 2012. [2]

(e) Calculate:
(i) The impairment loss; [2]
(ii) The correct value for total non-current assets in the statement of financial position at 31 January 2012; [2]
(iii) The cost of capital used by the company. [2]
(f) (i) Suggest two possible reasons for impairment loss. [4]
(ii) Name the IAS which deals with impairment losses. [2]

Additional information:
The equipment operates in a factory which the company recently built. The figure for non-current assets includes the amounts paid to the seller of the land, the supplier of the building materials, and the building contractor who supplied the labour.

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REQUIRED

(g) Name one additional cost involved in building the factory which is included in non-current assets.[2]

November 2012

Q # 5 Explain the following terms in accordance with IAS 37:

(i) Provision
(ii) Contingent liability
(iii) Contingent asset [6]

Nov 2014

Q # 6 In July 2014, the directors carried out impairment review of their plant and equipment. The data for this review is shown below:

Asset	Carrying value	Net selling price	Value in use
	$	$	$
1	1870	1560	1362
2	2423	2514	2625
3	1368	1287	1313

REQUIRED

(i) Explain what is meant by impairment. [2]

(ii) Calculate the total impairment loss that would be recognised in the income statement for the year ending 31 May 2015 in accordance with IAS 36, Impairment of assets. [4]

Nov 2014

Q # 7 Jamal prepared his own financial statements for the year ended 31 August 2015. After the financial statements were prepared his accountant made the following discoveries.

1 An impairment review of three delivery vans was as follows:

Van	Carrying amount	Net selling price	Value in use
	$	$	$
1	16000	15000	17000
2	18000	14000	16000
3	24000	20000	16750

Jamal entered the carrying amount in his statement of financial position.

2 When preparing his income statement Jamal treated the opening inventory of $6000 as closing inventory and closing inventory of $4000 as opening inventory.
Jamal's income statement for the year ended 31 August 2015 showed a draft profit for the year of $40000

REQUIRED

Calculate the revised profit for the year. [5]

Nov 2015

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Q # 8 After the financial statements had been prepared it was discovered that an item of fixtures and fittings should have been impaired. The item was bought two years ago for $6000. It could now be sold for $4000 and has a value in use of $3000.

REQUIRED

(c) Explain the term impairment and the treatment of impairment in the financial statements. [4]

(d) Advise the directors as to whether or not the item of fixture and fittings is impaired. Show your workings. [4]

(e) Explain how your advice would differ if the value in use had been $5000. [2]

Nov 2015

Q # 9 Before the financial statements for 30 September 2016 were approved, the directors were made aware that another trade receivable owing $10 000 at 30 September 2016 had been made bankrupt.

REQUIRED

(i) Explain the difference between an adjusting event and a non-adjusting event. [4]

(ii) Explain, with reference to IAS 10, how this event should be dealt with in the financial statements. [2]

An impairment review was carried out and revealed that an item of plant with a carrying value of $100 000 could be sold for $65 000. Its value in use was $70 000. The directors are uncertain how this should be treated in the financial statements.

REQUIRED

Calculate the effect on the profit for the year of the impairment review. [4]

Nov 2016

Q # 10 Euan was the external auditor of Z Limited.

REQUIRED

(a) Explain the difference between the role of an external auditor and the role of an internal auditor of a limited company. [4]

Additional information

For the purpose of carrying out the audit, Euan was presented with the following draft financial statements which were prepared by the directors of Z Limited.

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Draft Income Statement for year ended 31 December 2016

	$
Revenue	848 000
Cost of sales	494 000
Gross profit	354 000
Administrative and distribution expenses	254 200
Profit for the year	99 800
Dividend paid	20 000
Dividend proposed	30 000
Retained earnings for the year	49 800
Retained earnings 1 January 2016	94 600
Retained earnings 31 December 2016	144 400

Draft Statement of Financial Position at 31 December 2016

	$
Assets	
Non-current assets	
Freehold property	700 000
Machinery and equipment	457 400
Goodwill	200 000
	1 357 400
Current assets	
Inventories	44 500
Trade receivables	74 800
Cash and cash equivalents	36 000
	155 300
Total assets	1 512 700
Equity and liabilities	
Equity	
Ordinary shares	1 000 000
Revaluation reserve	300 000
Retained earnings	144 400
Total equity	1 444 400
Current liabilities	
Trade payables	38 300
Dividend payable	30 000
	68 300
Total equity and liabilities	1 512 700

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The directors of Z Limited provided Euan with the following information.

1 At 31 December 2016 the directors proposed a final dividend of $30000. This had been included in the draft financial statements.
2 The company purchased a machine in 2016 for $150 000 to print graphics on the products requested by the customers. The machine had been depreciated by 20% using the straight-line method.
3 The demand for printing services is expected to decrease in the future. The directors suggest that the new machine should be depreciated at 30% by using the reducing balance method.
This has not yet been actioned.
4 Z Limited's share capital and revaluation reserve (from freehold property) at 1 January 2016 amounted to $1000000 and $100000 respectively.
5 A professional valuer suggested that the goodwill of the company would be $200 000. This amount had been included in the non-current assets and the revaluation reserve.
6 Inventory valued at cost, $44 500, had been included in the draft financial statements.
Further information was available.

	Purchase Price	Estimated Selling Price
	$	$
Inventory		
Category A	24 200	33 800
Category B	15 100	24 000
Category C	5 200	4 100

REQUIRED

(b) Recommend how information 1, 3, 5 and 6 should be treated in the financial statements. [8]

(c) Calculate the revised profit for the year ended 31 December 2016 after taking into account your recommendations in (b). [3]

(d) Prepare the statement of changes in equity for the year ended 31 December 2016. [4]

(e) Prepare the redrafted statement of financial position at 31 December 2016. [3]

(f) Discuss what actions Euan should take if the directors do not adjust the financial statements.[3]

March 2017

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Q # 11 The directors of G Limited prepared the following draft statement of financial position at 31 December 2016:

G Limited
Statement of Financial Position at 31 December 2016

	$
Non-current assets	642 000
Current assets	
Inventory	78 000
Trade receivables	189 000
Other receivables	3 000
Cash and cash equivalents	54 000
	324 000
Total assets	966 000
Equity and liabilities	
Equity	
Ordinary shares of $1 each	550 000
Retained earnings	235 000
	785 000
Current liabilities	
Trade payables	171 000
Other payables	10 000
	181 000
Total equity and liabilities	966 000

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The auditor brings the following items to the attention of the directors:

1 G Limited entered into an 18-month rental agreement for a warehouse on 1 May 2016. The following payments totalling $220 000 were made and charged as an expense in the draft income statement:
$20 000 rental deposit which is refundable at the end of the lease period; and
$200 000 total rent covering the period from 1 May 2016 to 28 February 2017.

2 After an inspection of G Limited's office premises by the local authority in December 2016, it was found that the fire exits did not meet the safety specifications. A penalty of $27 000 is probable and G Limited will incur a cost of $47 000 to rebuild the fire exits. No accounting entries had been made for this.

3 A customer who owed $12 000 at 31 December 2016 was declared bankrupt on 12 January 2017. It is probable that only 20% of the debt is recoverable. No accounting entries had been made for this.

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REQUIRED

(a) Prepare the **revised** statement of financial position at 31 December 2016. [10]

(b) Explain how **each** of items 1 and 2 should be treated in the financial statements. [5]

(c) Explain the role of an external auditor. [4]

(d) Explain why the audit report of a limited company is addressed to the company's shareholders and not its directors [2[

Additional information

G Limited adopted the Weighted Average Cost (AVCO) method to ascertain the value of inventories in 2016. The purchase price has been increasing over recent years. The directors are now considering changing to First in, First out (FIFO) method to value inventory in 2017.

REQUIRED

(e) Advise the directors whether or not the method of valuing inventory should be changed. Justify your answer [4]

June 2017

Q # 12 Lushan and Samson are the directors of Z Limited which was newly formed on 1 January 2016.

They understand that they are legally obliged to prepare financial statements in accordance with International Accounting Standards

REQUIRED

(a) State four reasons why the business should comply with International Accounting Standards when financial statements are being prepared. [4]

(b) Explain what is meant by stewardship with regard to the role of the directors. [2]

Additional information

The directors prepared the following draft statement of financial position at 31 December 2016:

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Z Limited
Statement of financial position at 31 December 2016

	$
Non-current assets	
Property, plant and equipment	478 000
	478 000
Current assets	
Inventories	124 000
Trade receivables	217 000
Cash and cash equivalents	132 000
	473 000
Total assets	951 000
Equity and liabilities	
Equity	
Ordinary shares of $1 each	500 000
Retained earnings	210 000
Total equity	710 000
Current liabilities	
Trade payables	188 000
Taxation	53 000
	241 000
Total equity and liabilities	951 000

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Julia is the auditor of Z Limited. During the course of conducting her audit she was provided with the following information.

1 On 31 December 2016, Z Limited had been sued for an amount of $29 000. Legal advice indicated that Z Limited had a 90% chance of losing the case.

2 Included in the trade receivables was a debt of $30 000 owed by P Limited which was in financial difficulty. The directors of Z Limited had accepted office equipment from P Limited on 31 December 2016 to settle 70% of P Limited's debt. They were of the opinion that the recovery of the remaining debt was highly improbable.

3 A piece of machinery had been purchased on 1 January 2016 for $50 000. The machinery had been depreciated at an annual rate of 20% by using the straight-line method. At 31 December 2016, it had an estimated fair value of $32 500 and the estimated value in use was $19 500.

REQUIRED

(c) Prepare a revised draft statement of financial position at 31 December 2016 after considering the information provided to Julia. [8]

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(d) Explain the adjustments you have made to the statement of financial position in (c). [6]

Additional information

Jack, Julia's brother, is the sole trader of a small business. He has asked his sister if his accounts should be audited.

REQUIRED

(e) Discuss the advantages and disadvantages to Jack of having his accounts audited. [5]

June 2017

Q # 13 LS Limited has completed its first year of trading. The company has four directors, of whom two are not shareholders. The auditors are currently carrying out the end of year audit.

REQUIRED

(a) (i) Explain the term 'stewardship'. [2]
(ii) Explain how directors carry out their role of stewardship within a limited company. [2]
(iii) Explain the purpose of an end of year audit. [2]

Additional information

The draft financial statements for the year showed the following:

	$
Sales	182 000
Sales returns	8 000
Purchases	154 000
Purchases returns	12 000

All sales were at a mark-up of 150%.

During the audit the auditors discovered that included in the sales records was a sales invoice for $6000 which had been prepared for a customer but not yet been sent. The customer had received the inventory on a sale or return basis, but had yet to decide whether or not to keep the inventory.

REQUIRED

(b) (i) Calculate what should have been the value of the closing inventory. [5]

(ii) Calculate the gross profit for the year. [1]

Additional information

During the year the warehouse manager had been absent from work for a long period of time. There had been little control over the movement of inventory. Staff had valued the inventory actually in the warehouse at the end of the year at $24 000.

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REQUIRED

(c) Calculate the percentage change in gross profit if the inventory valuation from the warehouse had been used. [3]

(d) Discuss three possible reasons for the difference between the warehouse inventory valuation and the calculated value of inventory. [6]

(e) Discuss whether the directors should use the warehouse inventory valuation or the amount from the accounting records as the inventory figure in the financial statements. Justify your answer. [4]

Nov 2017

Q # 14 DG Limited has been trading for several years. The external auditors are about to commence work on the financial statements for the year ended 31 December 2017.
The following draft financial information for the year ended 31 December 2017 has been provided by the directors before the audit work is started.

	$
Ordinary shares of $1 each	500 000
Share premium	80 000
Retained earnings at 1 January 2017	94 000
Profit for the year	78 000

The directors also provided the following information:

1 The value of inventory at 31 December 2017 was $120 000. As the purchasing cost had decreased, the company had changed its valuation method from First in, First out (FIFO) to Weighted Average Cost (AVCO). The inventory value would have been $104 000 if FIFO had been used.

2 The profit for the year ended 31 December 2017 was arrived at after charging the following dividends:

	$
Interim dividend paid during the year	75 000
Proposed dividend for the year	82 500

3 A bonus issue of 1 ordinary share for every 10 ordinary shares held was made during the year. No entries had been made in the books of account for this issue. The directors wished to keep the reserves in their most flexible form.
This was the only change to share capital during the year.

4 On 1 July 2017 the company had entered into a 3-year tenancy agreement for a new office.
The monthly rent was $21 000. A total of $105 000 was paid during the year ended 31 December 2017 and this amount had been charged in the income statement.
Required

(a) Distinguish between the roles of the shareholders and the directors of a limited company. [4]
(b) State one reason why a sole trader does not require an audit of their financial statements. [1]
(c) Calculate the adjusted profit for the year ended 31 December 2017. [6]
(d) Explain the accounting treatment of information items 1 and 2. [6]
(e) Prepare the statement of changes in equity for the year ended 31 December 2017. [4]

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Additional information

The directors are trying to obtain a bank loan for expanding the business. The bank has requested the audited financial statements for the last three years.

(f) Advise the directors whether or not the audited financial statements provide all the information required in order for the bank to make its decision. Justify your answer. [4]

March 2018

Q # 15 The directors of K Limited provided information on the following balances at 31 December 2017:

	$
Plant and machinery at net book value	654 000
Human asset (see note 1)	116 000
Inventory	146 000
Trade receivables	182 000
Cash and cash equivalents	56 000
$1 Ordinary shares	600 000
Retained earnings at 1 January 2017	215 000
Profit for the year	98 000
Trade payables	166 000
Other payables	75 000

During the course of the year-end audit, the external auditor obtained the following information from the directors (notes 1 to 3).

1 During the year, K Limited paid a deposit of $70 000 for a 6-month training programme commencing on 1 November 2017. The balance of $50 000 will be paid on completion of the programme. This had been included in 'other payables'.
The directors believed that the training would benefit the company for 5 years. The total payments were regarded as an intangible asset and recorded as a 'human asset'. Amortisation of $4000 had been provided.

2 Inventory at 31 December 2017 included some obsolete goods. These had been included in the inventory at their original cost of $12 000. They could only be sold at half of the normal selling price which was 25% above cost.

3 On 1 July 2017, K Limited paid $60 000 for acquiring the right to use computer software for three years. The full amount had been charged as an expense in the income statement.

Required

(a) Explain the role of an external auditor. [2]
(b) Explain the correct accounting treatment of the items in notes 1 and 2. [5]
(c) Calculate the revised profit for the year ended 31 December 2017 after taking into account notes 1, 2 and 3. [8]
(d) State the values at which the following should be included in the statement of financial position at 31 December 2017.
(i) Software licence [2]

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(ii) Inventory [1]
(iii) Retained earnings [1]
(iv) Other payables [1]

Additional information

K Limited needs additional computer software. The directors are considering whether to buy the computer software or acquire the right to use the new software for three years.

(e) Evaluate whether the directors should buy the computer software or acquire the right to use it for three years. Justify your answer. [5]

June 2018

Q # 16 There was a water leak in the company's printing room in January 2018. This destroyed the new photocopier which was not insured.
(c) State how this should be treated in both 2017 financial statements and 2018 financial statements. [3]
(d) State what is meant by impairment loss in respect of non-current assets. [2]

June 2018

Q # 17 The company purchased two plots of land in August 2017: Plot X for $400 000 and Plot Y for $320 000. Plot X has planning permission to build on and is expected to increase in value. Plot Y, however, has been found to have toxic chemicals and is expected to have a lower value.
The directors only want to record the increase in value of Plot X but not the decrease in value of Plot Y.

(d) Advise the directors whether they can only revalue Plot X but not Plot Y. Support your answer by referring to relevant accounting standard(s). [4]

Nov 2018

Q # 18 The financial statements of W Limited for the year ended 31 December 2018 are ready to be audited.
The directors have provided the following assets balances from the statement of financial position

	$
Property, plant and equipment	682 000
Inventory	94 200
Trade receivables	87 400
Other receivables	9 430
Cash and cash equivalents	21 170

The following information is available.

1 Included in property, plant and equipment was equipment with a carrying value of $140 000. The fair value of the equipment was $132000 and the value in use was $136 000.
2 The retained earnings for the year ended 31 December 2018 were $184 000. This is after deducting a proposed final dividend of $12 000.
3 The directors had budgeted to incur $25 000 advertising in 2019. A provision was made for this expenditure

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(a) Explain one benefit of auditing. [2]

(b) Explain to the directors the appropriate accounting treatments for item 1, 2 and 3, making reference to the relevant International Accounting Standards (IAS). [7]

Additional information

The following information is also available.

1 A deposit of $3000 had been paid to a supplier for goods to be delivered in April 2019. This amount had been recorded as purchases.

2 Goods costing $5400 and with a sales value of $7000 were sent to a customer on sale or return basis. The directors had recorded $7000 as a sale. At 31 December 2018 the customer had not decided whether to buy the goods.

(c) Calculate the revised retained earnings at 31 December 2018 using all the information available. [6]

(d) Calculate the corrected figure for the following items for inclusion in the revised statement of financial position at 31 December 2018.
(i) Property, plant and equipment
(ii) Inventory
(iii) Trade receivables
(iv) Other receivables
(v) Total assets [5]

Additional information

At the annual general meeting, some of the shareholders queried that the final dividend proposed by the directors was too low

(e) Advise the directors whether or not they should increase the proposed dividend. Justify your answer by discussing benefits and drawbacks of your advice for both the company and the shareholders. [5]

May 2019

Q # 19 A new director of R Limited has raised some concerns about their role in the company. He has also questioned the role of the company's auditors

(a) (i) Explain what is meant by the term 'stewardship'. [2]

(ii) State two duties of the auditor of a limited company. [2]

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Additional information

The directors of R Limited have provided the following information at 31 December 2018

	$
Ordinary shares of $1 each	200 000
Share premium	20 000
8% Debenture (2025)	150 000
General reserve	54 000
Retained earnings at 1 January 2018	96 000
Debenture interest paid	4 000
Interim dividend paid	6 250
Land and buildings	
cost	450 000
accumulated depreciation	25 000
Plant and machinery	
cost	40 000
accumulated depreciation	15 000
Vehicles	
cost	24 000
accumulated depreciation	8 000
Inventory at 31 December 2018	65 000
Trade receivables	42 000
Cash and cash equivalents	37 000
Trade payables	35 000
Profit from operations	65 250

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The 8% debenture (2025) was issued on 1 January 2017.

A bonus issue of shares of 1 ordinary share for every 20 shares held was made on 31 December 2018 This had not yet been recorded in the books of account. The directors wish to keep the reserves in their most flexible form.

A provision for tax of $14 700 is to be made.
The directors have proposed a final dividend of $0.15 per share on all shares in issue at the year end.

(b) Prepare an extract from the income statement for the year ended 31 December 2018, to show the profit for the year, starting with the profit from operations. [2]

(c) Prepare the statement of changes in equity for the year ended 31 December 2018. A total column is not required. [4]

(d) Prepare the statement of financial position at 31 December 2018. [6]

Additional information

In February 2019 it was discovered that plant and machinery with a net book value of $15 000 had become obsolete. It could be sold for $8000 with a selling cost of $1200.

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The cash flows from the machinery's continued use showed:

	future cash flows	10% discount factor
year 1	$4000	0.909
year 2	$5000	0.826
year 3	$3000	0.751

(e) Calculate the impairment loss. [4]

Additional information

The financial statements will be presented to the shareholders for their approval at the annual general meeting on 31 March 2019. The directors have decided that it is too late to include the impairment loss in the financial statements.

(f) Discuss the decision of the directors making reference to any relevant International Accounting Standards (IAS). [5]

Nov 2019

Q # 20 During the year ended 31 December 2019, J plc was sued by a customer for the breach of a sales contract. The case will be heard in court in May 2020. The lawyer of J plc advises the directors that it is highly probable that the company will be found liable and the compensation is likely to be $20000. No accounting entries have been made to record this

(a) Define the following terms:

(i) Liability [2]

(ii) Provision [2]

(iii) Contingent liability. [2]

(b) Explain the accounting treatment of the expected compensation of $20000 in the financial statements by making reference to the relevant International Accounting Standard (IAS). [6]

March 2020

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