The following trial balance relates to Clarion as at 31 March 2015:

	$'000	$'000
Equity shares of $1 each (note (i))		30,000
Retained earnings — 1 April 2014		8,600
Other component of equity — share premium (note (i))		5,000
8% loan notes (note (ii))		20,000
Plant and equipment at cost (note (iii))	85,000	
Accumulated depreciation plant and equipment — 1 April 2014		19,000
Investments through profit or loss — value at 1 April 2014 (note (iv))	6,000	
Inventory at 31 March 2015	11,700	
Trade receivables	18,500	
Bank		1,900
Deferred tax (note (vi))		2,700
Trade payables		9,400
Environmental provision (note (iii))		4,000
Finance lease obligation (note (iii))		4,200
Revenue		132,000
Cost of sales	88,300	
Operating lease payments (note (v))	2,000	
Administrative expenses	8,000	
Distribution costs	7,400	
Loan note interest paid	800	
Suspense account (note (ii))	5,800	
Bank interest	300	
Dividends paid	3,900	
Investment income (note (iv))		500
Current tax (note (vi))		400
	237,700	237,700

The following notes are also relevant:

(i) The equity shares and share premium balances in the trial balance above include a fully subscribed 1 for 5 rights issue at $1.60 per share which was made by Clarion on 1 October 2014. The market value of Clarion's shares was $2.50 on 1 October 2014.

(ii) On 31 March 2015, one quarter of the 8% loan notes were redeemed at par and six months' outstanding loan interest was paid. The suspense account represents the double entry corresponding to the cash payment for the capital redemption and the outstanding interest.

(iii) Property, plant and equipment:

Included in property, plant and equipment are two major items of plant acquired on 1 April 2014:

Item 1 had a cash cost $14 million, however, the plant will cause environmental damage which will have to be rectified when it is dismantled at the end of its five year life. The present value (discounting at 8%) on 1 April 2014 of the rectification is $4 million. The environmental provision has been correctly accounted for, however, no finance cost has yet been charged on the provision.

Item 2 was plant acquired with a fair value of $8 million under a five-year finance lease. This required an initial deposit of $2.3 million and annual payments of $1.5 million on 31 March each year. The finance lease obligation in the trial balance above represents the fair value of the plant less both the deposit and the first annual payment. The lease has an implicit interest rate of 10% and the asset has been correctly capitalised in plant and equipment.

No depreciation has yet been charged on plant and equipment which should be charged to cost of sales on a straight-line basis over a five-year life (including leased plant). No plant is more than four years old.

(iv) The investments through profit or loss are those held at 31 March 2015 (after the sale below). They are carried at their fair value as at 1 April 2014, however, they had a fair value of $6.5 million on 31 March 2015. During the year an investment which had a carrying amount of $1.4 million was sold for $1.6 million. Investment income in the trial balance above includes the profit on the sale of the investment and dividends received during the year.

(v) Clarion renewed an operating lease on a property on 1 April 2014. The operating lease payments represent an annual payment (in advance) of $1 million and a lease premium of $1 million. The lease is for four years and operating lease expenses should be included in cost of sales.

(vi) A provision for current tax for the year ended 31 March 2015 of $3.5 million is required. The balance on current tax in the trial balance above represents the under/over provision of the tax liability for the year ended 31 March 2014. At 31 March 2015, the tax base of Clarion's net assets was $12 million less than their carrying amounts.

The income tax rate of Clarion is 25%.

Required:

(a) Prepare the statement of profit or loss for Clarion for the year ended 31 March 2015.

(b) Prepare the statement of changes in equity for Clarion for the year ended 31 March 2015.

(c) Prepare the statement of financial position for Clarion as at 31 March 2015.

Notes to the financial statements are not required.

The following mark allocation is provided as guidance for these requirements:

(a) 10 marks

(b) 3 marks

(c) 10 marks

Examiners Report

This was a traditional preparation of the financial statements for a single entity. The three main parts (a) to (c) were the usual preparation of statements of profit or loss, changes in equity and financial position.

Part (d) was a 3 mark section on the calculation of basic earnings per share, involving the effects of a share issue at below market price and part (e) was short extracts from the statement of cash flows.

The question included notes requiring accounting for a rights issue of shares, redemption of loan notes, capitalisation of environmental costs, plant on both finance and operating leases, fair valuing and disposal of investments and the usual tax adjustments including deferred tax.

Most well-prepared candidates were expecting this type of question and scored very well on it, even if they weren't able to complete it. However, a significant number of candidates did not attempt the earnings per share and cash flow extracts of parts (d) and (e).

Both of these topics have been examined many times, were not difficult, and thus represented a lost opportunity to gain some relatively easy marks.
The more common errors are detailed below:

Part (a) statement of profit or loss:
* Depreciation as part of cost of sales should have been straightforward (85 million × 20%), however many candidates separated two new acquisitions of plant (one under a finance lease) when the question clearly stated that these items were already included in property plant and equipment. A significant number of candidates applied reducing balance depreciation although the question clearly stated the straight line basis should be used. The other problem area within cost of sales was the incorrect treatment of the operating lease premium. Such premiums, payable at the beginning of the lease, should be spread over the lease term, in this case for four years. The deferred element of the premium is treated as an asset.

* Finance costs often excluded the second-half of the loan note interest (which was part of the suspense account), showed incorrect finance lease interest (some marks were given for incorrect figures here), and omitted the finance cost on the unwinding of the environmental provision.

* In the calculation of the investment income, candidates sometimes incorrectly deducted sales of $1.4 million from the investment's carrying amount before calculating the fair value gain at $1.9 million instead of the correct figure of $500,000 (the sale proceeds had already been deducted from the investment's carrying amount in the trial balance). A minority of candidates showed the gain (of $1.9 million or $500,000) as other comprehensive income when the question clearly stated the investments were at fair value through profit or loss.

* The most common mistake on taxation was to get either the adjustment for the previous year's overprovision or the movement on deferred tax the wrong way around although overall there was a marked improvement in the treatment of taxation items compared to recent diets.

Part (b) statement of changes in equity:
The only significant error in this section was that several candidates did not realise that the figures for share capital and share premium in the trial balance already included the 1 for 5 rights issue; thus they showed opening share capital of $30 million and calculated the rights issue at $6 million, whereas the correct answer was to work back from the closing share capital of $30 million to calculate the rights issue had been for 5 million $1 shares (with an equivalent effect on the share premium).

'Own figures' were marked as correct for the profit for the year but some candidates forgot to deduct the dividends paid. Some candidates showed the dividends received from the investments in this statement rather than in the statement of profit or loss and many candidates either showed the dividends paid as a deduction from profit after tax or (worse still) as a finance cost in the statement of profit or loss.
Part (c) statement of financial position:

As with questions of this type, many errors in the statement of financial position were the knock-on effects from previous calculations. Again under the 'own figure rule' such errors were marked as being correct assuming the correct principles had been followed.

This point particularly applied to non-current assets as nearly all errors here related to previous errors made in the calculation of profit or loss account items, the most common being depreciation charges and not correctly deferring the operating lease premium. Some candidates accrued six months interest on the loan notes whereas it had already been paid, but included in the suspense account.

Some candidates included the trial balance figure for deferred tax rather than the closing balance, this was usually because they had not calculated the movement on deferred tax.

Where candidates had not calculated a finance cost for the environmental provision, it was also omitted from the liability and often the environmental provision itself was completely omitted.

Most candidates had a good attempt at dealing with the finance lease, the most common error was to treat the annual payment as occurring at the beginning rather than the end of the year.

This is relatively minor error, and as long as the principles were still followed, such an answer attracted most of the marks available. Worryingly, some candidates treated the overdraft as cash in hand whilst some forgot to include the current tax payable in current liabilities.